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Recommended Citation
Victor Savikas & Fred Shandling, Credit Cards - A Survey of the Bank Card Revolution and Applicability of the Uniform Commercial Code, 16 DePaul L. Rev. 389 (1967) Available at: https://via.library.depaul.edu/law-review/vol16/iss2/7

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COMMENTS
CREDIT CARDS—A SURVEY OF THE BANK CARD REVOLUTION AND APPLICABILITY OF THE UNIFORM COMMERCIAL CODE

In the fall of 1966, several midwest banks launched a new credit card system. In order to enroll as many cardholders as possible, the banks not only invited applications for these cards, but also mailed the cards to persons who had not applied for them. This unsolicited mailing resulted in some unfavorable publicity and legislation was proposed to curb the distribution of these cards. The publicity was the result of the inevitable consequences of any blanket mailing, while the legislation was a kind of reflex action of an aroused public's representatives. All this sound and fury led to some basic questions being asked about the need for and operation of credit card systems. This comment will attempt to answer these questions.

It is the purpose of this comment to explore the unique structure of the Midwest Bank Card (MBC) system and its impact upon the meager existing law on this topic. This lack of jurisprudence was not detrimental to a determination of the rights and liabilities of the parties under a two party credit card system. But, it is not sufficient to meet the complexities of tripartite credit cards or the more intricate MBC system. The possible legal theories which might be applied to controversies arising under the MBC system will be explored with special emphasis upon the effects of the Uniform Commercial Code in this area.

It is important at the outset to distinguish the various credit card plans. The two party credit card is the simplest arrangement, whereby a retailer issues credit cards to a select group of customers and subsequently allows these cardholders to pay for merchandise at a later date or by installments. Such a system is governed by the ordinary rules of contract and is not discussed in any depth in this comment. The three party or tripartite credit card plan is more complex. Perhaps the best example of such a system is the credit card of any major oil company. The company provides credit cards for its customers and these cards enable them to charge purchases and services at any of the company's dealers. Of course, if the retail outlet is company owned, then this plan is really a two party credit system; if the outlet is independently owned, the plan is a tripartite system. The Midwest Bank Card (MBC) system is a variation of the tripartite credit card and has distinguishing characteristics. The tripartite credit card will only
be discussed in this comment when what is said of the MBC system is likewise applicable.

**UNIQUE STRUCTURE OF THE MIDWEST BANK CARD SYSTEM**¹

There are many bank credit card plans presently in operation in this country. Any bank may enroll into its plan as many merchants and retailers as it wishes who agree to honor the bank's credit card when presented by a purchaser and to also accept payment from the bank less a discount. This type of plan is not limited to banks and its branches, but is used on a national and international scale by American Express Co., Diners' Club, Inc. and many of the major oil companies. Under this plan, any one transaction for goods or services involves only three parties: the issuer, the merchant and the cardholder. The credit card system employed in the Midwest Bank Card (MBC) system is unique because (1) there are more than three parties involved in a single transaction, and (2) the various bank cards are compatible.

The MBC system was initially founded by five Chicago banks who became members of Midwest Bank Card System, Inc.² At the time of this writing, there were twelve banks (referred to as system banks) who were members of this corporation, banks from Illinois, Indiana, and Michigan. The corporation is the owner of the distinctive symbol that appears on every MBC card, regardless of which bank issued the card, and it has established and regulates a clearing house that processes the charge sales slips used by the merchants. The MBC system considers these charge slips to be "items" as that term is defined in Article 4 of the Uniform Commercial Code.³ These system banks are comembers of the corporation but are competitors in enrolling merchants and soliciting cardholders. If the MBC system involved only these twelve system banks, merchants and cardholders, it would still be unique because of the compatibility feature of the cards. Even if a merchant has been enrolled by one of the twelve system banks, he will honor a card that was issued by a different system bank.

However, the system banks are limited, not by the terms of the corporate regulations, but, strictly in terms of geography and practicality, as to the number of merchants they might enroll. The MBC system allows a system bank to contract with another bank (referred to as a participating bank)

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¹ The information in this section which pertains to the structure of the Midwest Bank Card system was obtained through an interview with Mr. Robert N. Hampton, Vice-President, FirstCard Department, The First National Bank of Chicago, in Chicago, February 15, 1967.


³ *Uniform Commercial Code*, § 4-104(g). "'Item' means any instrument for the payment of money even though it is not negotiable but does not include money."
whereby the latter agrees to conform to certain rules and procedures of the MBC system and either share in the discount or receive a fee directly from the merchant for charge slips purchased from the merchants depending upon the particular system bank involved. The participating bank may then enroll merchants and solicit cardholders. At the time of this writing, there were approximately eight hundred banks participating in the system. As a result of this expanded system, there may be as many as sixteen parties directly or indirectly involved in any one transaction. For example, Mr. Cardholder has a card given to him by B Bank, a participating bank, who has a contract with C Bank, a system bank. Mr. Cardholder buys merchandise from Mr. Merchant who was enrolled by E Bank, a participating bank in privity with F Bank, a system bank. The item is processed through a clearing house regulated by Midwest Bank Card System, Inc., in which C Bank and F Bank and ten other banks are members.

The MBC system is a complete innovation in credit card concepts and a substantial variation of tripartite credit cards. The relationship of the parties in a two party credit card system does not apply to the MBC system and much of what was said regarding the tripartite credit card system is likewise inapplicable. An examination of the relationship of the parties in the MBC system is the topic of the following section of this comment.

RELATIONSHIP OF THE PARTIES

The focal point of this section shall be an investigation of the legal relationships of the principal parties, issuer, cardholder and merchant, and, as a corollary thereto, the derivative rights and liabilities of each as determined by a direct and indirect application of the Uniform Commercial Code. Only two theories have been proposed thus far as to the relationship of these three parties. One court has likened the credit card transaction to the factoring of accounts receivable, and one writer has proposed that it is something closely akin to a commercial letter of credit. In this section, both theories and their correlation to the MBC agreements will be discussed. The procedure that will be followed is a comparative analysis of certain basic elements from which conclusions can be drawn as to the applicability of one theory or the other to the MBC system.

The initial discussion must be centered upon the ultimate purpose of each party in entering into any one of the relationships to be discussed. The essential premise shall be that all potential purchasers of goods would rather do business upon a credit rather than a cash basis. The conclusion then follows that all sellers who wish to stay competitive must of necessity

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engage in selling on credit. The purpose of each one of the relationships is to facilitate this demand for credit while at the same time alleviating the inherent risks of selling on open account. Thus, while each method of financing has the same initial purpose, it is the methodology that is the distinguishing feature. The factor of accounts receivable accomplishes this purpose by contracting with a seller of goods on open account whereby he effectuates an outright purchase of all the accounts receivable at a specified discount. In return he makes available to the seller a drawing account from which the seller has access to immediate cash. In this fashion, it is the factor who assumes the risk of bad debts and eliminates tedious and expensive bookkeeping problems for the seller. The legal result of such a transaction is an assignment of the accounts receivable.

The method used in letter of credit financing bears no resemblance to that of factoring. In this case, the seller, not wanting to rely on the buyer's personal credit, suggests to the buyer that he procure a letter of credit, which is defined as "an engagement by a bank or other person made at the request of a customer . . . that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit." In this way, the seller relies solely upon the credit of the issuer, and the buyer has an effective credit instrument at his disposal. In the MBC system, the procedure is somewhat similar to that outlined for a letter of credit. The buyer, desirous of purchasing goods on credit, but whose credit standing is not established with the particular merchant, obtains a credit card from one of the MBC system banks. By the presentation of this card, the cardholder is allowed to purchase goods without the necessity of producing ready cash. As in the letter of credit situation, the merchant is not relying upon the credit of his immediate customer, but upon the bank with whom he has contracted. Thus, the method used to insulate the merchant by the use of a letter of credit or the MBC system occurs before the underlying sales contract is formed, while in the factoring of accounts receivable, the sales contract is formed prior to the financing arrangement.

A second area to be considered is the separate undertaking of the parties when they enter into such an arrangement. Regardless of the type of agreement which is to be employed, the purchaser of the goods undertakes to pay for the products or services rendered, according to a specified arrangement, at some time in the future. Also essential to all three agreements is that the purchaser is ultimately going to pay someone other than

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7 Id. at 706.

8 Restatement, Contracts § 149 (1932).

9 Uniform Commercial Code § 5-103 (1) (a). Hereafter the Uniform Commercial Code, 1962 Official Text, with comments, will be cited as U.C.C.
the merchant. By an assignment of accounts receivable, the merchant (assignor) undertakes to sell bona fide accounts, and the factor (assignee) undertakes to purchase these accounts at an agreed discount.\textsuperscript{10}

This sale of accounts receivable is a transaction covered by Article 9 of the Uniform Commercial Code—Secured Transactions: "this Article applies so far as concerns any personal property and fixtures within the jurisdiction of this state . . . (b) to any sale of accounts, contract rights, or chattel paper."\textsuperscript{11} An account is defined as, "any right to payment for goods sold or leased or for services rendered which is not evidenced by an instrument or chattel paper . . ."\textsuperscript{12} and instrument is defined as a negotiable instrument, or a security or any other writing which evidences a right to payment of money and is not itself a security agreement or lease and is of a type which is in ordinary course of business transferred by delivery with any necessary indorsement or assignment.\textsuperscript{13} Thus, any future discussion of rights or duties of one engaged in a factoring agreement will be based upon Article 9.

The engagement of the issuer of a letter of credit varies materially from that of the factor. The issuer's obligation is defined as an engagement to honor drafts drawn upon it or, "that the bank has been . . . authorized to honor."\textsuperscript{14} Any future discussion of the rights of parties involved in a letter of credit agreement will be subject to Article 5 of the Uniform Commercial Code, which governs the operation of letters of credit.

The engagement of the issuer of an MBC credit card is more difficult to determine. The contract with the merchant, whether by the issuer or a participating bank, does not call for the purchase of any accounts receivable, and in fact there is doubt as to whether an account receivable is created at all since the transfer of the item might be considered payment, and the issuer does not promise to honor drafts drawn upon him. The terms of one contract specifies that the issuer is to:

grant final irrevocable credit in respect of sales slips (items) generated through the use of the Bank Card which are deposited with Bank.

While the specific operations are not the same, conceptually the issuer's engagement resembles that of an issuer of a letter of credit, in that there is provided an institution with a high credit rating who assumes a primary obligation to pay for the goods or services, predicated upon the presentation of certain documentation.

Perhaps the major distinction between factoring and a letter of credit is the aspect of the "privity concept" a term which may be defined as,

\textsuperscript{10} Moore, \textit{supra} note 6, at 706.  
\textsuperscript{11} U.C.C. § 9-102. See also U.C.C. § 9-502 and comments.  
\textsuperscript{12} U.C.C. § 9-106.  
\textsuperscript{13} U.C.C. § 9-105(g).  
\textsuperscript{14} Moore, \textit{supra} note 6, at 706.
“mutual or successive relationship to the same rights of property.”

This “privity concept” is the foundation of the assignment of accounts receivable agreement. The assignee acquires whatever rights the assignor had as regards the basic underlying contract of sale. In reality, the underlying sales contract is the sine qua non of the entire financial agreement. The “privity concept” is foreign to letter of credit financing. This point was aptly stated by one commentator: “A letter of credit is a contract. It is distinguished by the fact that it is inevitably linked to another understanding, usually also a contract, but is independent of that other understanding or contract.”

Thus, the basic distinction that must be made relates to this concept of privity. The factoring agreement is a contract dependent upon the underlying sales contract. On the other hand, the letter of credit is an independent contract which must, “be construed within its own four corners.”

Examined from this aspect of privity, the MBC system appears to involve independent sets of contracts closely resembling those of a letter of credit. The issuer enters into a contract with several customers and simultaneously enters into separate contracts with a number of merchants. Neither of these contracts is dependent upon the existence of an underlying sales contract for a determination of the rights and liabilities of the parties. Their respective rights and duties are determined by the particular agreement. Thus, in the area of privity, the letter of credit analogy again gains more credence.

Another significant area for comparison is the obligation of the ultimate party (assignee-issuer) to the purchaser of the goods or services. The general rule of law is that an assignee takes subject to all defenses and counterclaims good against his assignor until notification of the assignment has been given to the principal obligor. In order to avoid this consequence, the merchant-purchaser contract often contains a waiver of defenses by the purchaser against the assignee. This waiver is validated by the Uniform Commercial Code, subject to any state laws to the contrary. Since the underlying sales contract is the basis for the assignment, it is only reasonable that the assignee be subject to any defenses or counterclaims to it.

The issuer of a letter of credit, however, is invulnerable to defenses that arise under the sales contract: “An issuer’s obligation to its customer . . . unless otherwise agreed does not include liability or responsibility [a]

19 RESTATEMENT, CONTRACTS § 149 (1932).
17 N.Y. CONSOL. LAWS ANN. ch. 621 art. 5-101 (McKinney 1964). See also U.C.C. § 5-114, comment 1.
18 Ibid.
19 U.C.C. § 9-318.
20 U.C.C. § 9-206.
for performance of the underlying contract for sale or other transaction between the customer and the beneficiary. . .”\textsuperscript{21} The issuer's sole obligation to its customer is determined by the contract between them. The theoretical basis for the rule is that the issuer has no control over the making of the underlying contract or over the selection of the beneficiary.\textsuperscript{22} Each cardholder agreement used in the MBC system has a specific clause disclaiming all liability on the underlying sales contract by the issuer. If the analogy to a strict letter of credit is accepted, the presence of the clause is superfluous. However, an examination of the theory behind the issuer's immunity perhaps discloses the reasoning of the MBC banks in including such a provision. The proposition that the issuer of an MBC has no control over the underlying sales contract fails upon an examination of the merchant-bank contract which details the exact procedures to be followed by the merchant with regard to every credit card sale. The requirement that all merchants must lease the bank's imprinting machine, check circulated lists for stolen cards and obtain approval for all purchases over a certain amount, are indications of control. However, this control does not extend to the quality of the merchandise sold and the control theory is weak in this respect. Of greater force is the fact that the issuers have complete control over the selection of the beneficiaries (merchants) of these cards, since only those merchants in a contractual relationship with the MBC system can accumulate the "items" necessary for presentation and payment. Thus, an argument can be made that sufficient control of the underlying sales contract is present so as to make the bank liable for breaches of that contract, without an express disclaimer.

Therefore, a comparative examination of certain basic aspects of the relationships of the principal parties discloses almost no resemblance to a factoring of accounts receivable arrangement, although there is a marked resemblance to the letter of credit theory as applied to the financing of domestic rather than foreign sales transactions. The analogy is enhanced by an examination of specific requirements laid down in the Uniform Commercial Code for an instrument to become a letter of credit, in that the credit must require a documentary draft or demand for payment.\textsuperscript{23} A documentary draft is defined as, "one honor of which is conditioned upon the presentation of a document or documents. ‘Document’ means any paper including document of title, security, invoice, certificate, notice of default, and the like."\textsuperscript{24} In the MBC system the merchant, as mentioned previously, in order to secure a final credit, must present an "item" for deposit, an instrument that could fall within the ambit of this definition.

\textsuperscript{21} U.C.C. § 5-109.\textsuperscript{22} U.C.C. § 5-109, comment 1.\textsuperscript{23} U.C.C. §§ 5-102 (1) (a).\textsuperscript{24} U.C.C. § 5-103 (1) (b).
The major conclusion that can be drawn from the above examination is that a court in deciding litigation involving the MBC system, whether it finds that the cards create a de facto letter of credit relationship or not, cannot adequately determine the respective rights and liabilities of the parties without first examining the article on letters of credit within the Uniform Commercial Code and the basic principles which that article encompasses. A second conclusion that can be drawn is that there is no basis for finding that cards of this type create an assignment of accounts receivable relationship when compared with the concepts which are embodied in the basic agreements.

SELECTED CONTRACTUAL PROVISIONS

The following section shall be concerned with and limited to an examination of the contractual provisions which will most likely interest the legal profession in assessing any rights or liabilities of any of the parties. As it is the intention and purpose of this comment to present an overall picture of the MBC system, with special emphasis upon the relationship of the parties and the application of the Uniform Commercial Code thereto, the discussion that follows can only cover selected provisions of the typical contract and the law pertaining to these particular clauses. It must be noted that no one agreement contains all the provisions which will be discussed, however each individual agreement does contain a significant proportion of the following terms and conditions.

One provision which appears is:

By the retention or use of the [credit] card issued by the bank, the cardholder agrees to the terms and conditions hereinafter set forth.

Can one be subjected to the terms of a contract, and liable for the breach thereof, by merely retaining the card, without even using it? To make such a determination it is necessary to examine the rules pertaining to offer and acceptance.  

The general rule is that one need make no reply to an offer, and that mere silence or inaction will not amount to an acceptance. Nevertheless, under certain circumstances the law will imply an acceptance from the offeree's failure to reject the offer. According to Professor Williston, one such circumstance is: "Where the offeree takes or retains possession of property which has been offered to him." Under this doctrine, one who receives an unsolicited credit card and thereafter leaves

25 Williston, Contracts § 91 (Students ed. 1938).
26 1 Corbin, Contracts § 73 (1963); see also 1 Williston, Contracts § 91 (Jaeger 1957).
28 Williston, op. cit. supra note 25.
it on his desk, without anything more, would be subject to the terms of the contract since his retention constitutes an acceptance.

The Restatement of Contracts, however, has limited this theory to include only those offerees who have exerted dominion and control over the proffered property. To illustrate these concepts, the Restatement offers the following two examples:

A sends B a one volume edition of Shakespeare with a letter saying, 'If you wish to buy this book send me $6.50 within one week after receipt hereof, otherwise notify me and I will forward postage for return.' B examines the book and without replying makes a gift of it to his wife. B owes A $6.50.

The facts being otherwise as stated (above), B examines the book and without replying carefully lays it on a shelf to await A's messenger. There is no contract.

From the foregoing illustrations, it can be inferred that the mere possession of an unsolicited credit card will not be deemed an acceptance of the contract. However, if the offeree goes further and signs his name to the card, he should be said to have exerted the necessary dominion and control over the property so as to have accepted the contract.

Each issuer-cardholder agreement contains a specific clause denying liability on the part of the issuer for disputes between the merchant and the cardholder. A representative example is:

Issuer has no responsibility for merchandise or services purchased by the customer with (card) ... and customer agrees to pay issuer for all credit purchases even though a dispute may exist.

The question as to whether such a right of setoff or counterclaim exists has been discussed in the section on the relationship of the parties under the Uniform Commercial Code, since the existence or nonexistence of such a right is necessarily dependent upon the relationship that is created. This present discussion will center on the question of what effect the waiver of liability has, assuming such a right of setoff does exist.

Waiver has been defined as "the voluntary . . . relinquishment of a

29 Restatement, Contracts § 72 (1932). See also Restatement (Second), Contracts § 72 (Tent. Draft No. 1, 1964); U.C.C. § 2-607.

30 Restatement (Second), Contracts, supra note 29. at illus. 7-8.

31 See also Ill. Rev. Stat. ch. 121 1/2, § 351 (1965), wherein it is provided that "unless otherwise agreed . . . if . . . unsolicited goods are either addressed to or intended for the recipient, they shall be deemed a gift to the recipient, who may use them or dispose of them in any manner without any obligation to the sender." This statute does not in any way alter the conclusions stated in the text because: (1) without any indication of acceptance there is no obligation running from the recipient to the sender; and (2) if the recipient acts so as to accept the offer, he has agreed to be bound by the terms of the contract which provides that the card shall remain the property of the issuer, and has thereby nullified the effect of the statute.
known right, claim, or privilege.\textsuperscript{32} A person to be capable of a valid and effective waiver of his rights must be of legal age, and sui juris.\textsuperscript{38} The legal effect of such waiver is that the party so doing is henceforth precluded from asserting such a right.\textsuperscript{34} A right arising under a contract may be waived,\textsuperscript{35} including a right to assert any defenses.\textsuperscript{36} This view is continued, and even broadened, in the Uniform Commercial Code which provides for waiver of any claim or right even without consideration, if it is in writing and signed and delivered by the aggrieved party.\textsuperscript{37} The conclusion is that if the holder has a right of setoff or counterclaim, he may waive that right and by so doing cannot assert it in defense of any action by the issuer.

Another interesting aspect of these cards is the inclusion of a warrant of attorney to confess judgment. One agreement states:

Cardholder irrevocably empowers an attorney of any court of record to appear for the cardholder in any court, in term time or vacation at any time hereafter, and confess judgment without process against cardholder on this agreement in favor of the bank for the amount of said indebtedness, including interest and service charges costs and 15\% of the amount of such indebtedness as attorney's fees, and to waive and release all errors which may intervene in any such proceedings, waive any rights to appeal from such judgment and consent to immediate execution thereon, hereby ratifying and confirming all that said attorney or attorneys may lawfully do by virtue hereof. Cardholder waives personal service of such execution. . . . Void where prohibited by law.

A majority of the states uphold the validity of these clauses, although many invalidate them as a matter of public policy.\textsuperscript{38} Illinois is one state which upholds these clauses, with certain procedural restrictions, such as place of venue\textsuperscript{39} and additional requirements which must be met before a "Deduction Order summons" may issue.\textsuperscript{40}

This same clause however is void in Indiana, which declares any cognovit clause to be void if in a contract to pay money.\textsuperscript{41} This statute however, has no extraterritorial effect and applies only to the execution of

\textsuperscript{32} 28 AM. JUR. 2d 24 Estoppel and Waiver § 154 (1966).
\textsuperscript{33} Potter v. Fahs, 167 F.2d 641 (5th Cir. 1948).
\textsuperscript{35} Bellaire Sec. Corp. v. Brown, 124 Fla. 47, 168 So. 625 (1936); People v. Police Comm'rs, 174 N.Y. 450, 67 N.E. 78 (1903).
\textsuperscript{36} Supra note 32, at § 162.
\textsuperscript{37} U.C.C. § 1-107.
\textsuperscript{38} 6 WILLISTON, CONTRACTS, § 1724 (Rev. ed. 1938).
\textsuperscript{39} ILL. REV. STAT. ch. 110 § 50(4) (1965).
\textsuperscript{40} ILL. REV. STAT. ch. 62 § 82 (1965).
\textsuperscript{41} IND. STAT. ANN. ch. 29 § 2-2904 (Burns 1966).
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the instrument in Indiana. Michigan, another state in which these credit cards have been disseminated, treats these clauses as valid with one restriction, that the clause must be printed on a separate and distinct instrument from the contract to be confessed.

The issuers have also inserted a provision whereby in collection proceedings, they may offset the bank deposit of the cardholder against his indebtedness:

In any such event, any and all indebtedness due from the issuer to customer may be offset and applied in satisfaction of customer's indebtedness.

This right has always existed with regard to bankruptcy proceedings initiated against a bank's depositor. In interpreting the applicable section of the Bankruptcy Act, the court in Mayo v. Pioneer Bank & Trust held that "generally, a bank may apply the debtor's deposit on his debts to the bank as they mature."

Even outside the bankruptcy setting however, a bank has the right to setoff a general deposit to pay any debt due to the bank from the depositor. This view has been accepted in Illinois, where the appellate court has held that when a depositor of a bank is indebted to that bank, the bank may apply the funds to cover the indebtedness. As Mr. Tiffany points out in his treatise on banking, this right of setoff can only be used against matured debts; however, a recent case has allowed such setoff for an unmatured debt.

If this setoff can only be accomplished with respect to matured debts, then a cursory examination is required of the clause permitting the issuer to allow the total outstanding balance to become due and payable at once, if at any time the holder of the sales slips shall feel insecure.


44 Bankruptcy Act. 11 U.S.C. § 108(a) (1963). "In all cases of mutual debts or mutual credits between the estate of a bankrupt and a creditor the account shall be stated and one debt shall be set off against the other, and the balance only shall be allowed or paid."

45 270 F.2d 823 (5th Cir. 1959). See also Ribaudo v. Citizens' Nat'l Bank of Orlando, 261 F.2d 929 (5th Cir. 1959); First Nat'l Bank of Negaunee v. Fox, 111 F.2d 810 (6th Cir. 1940); Corbett v. Kleinsmith, 112 F.2d 511 (6th Cir. 1940).


47 Tiffany, Banks and Banking §§ 19-21 (1912).


49 Tiffany, op. cit. supra note 47.

According to Professor Corbin, these clauses are held to make the acceleration optional with the creditor, this meaning that he has the power to advance the due date by giving notice or upon the occurrence of some overt act, with the privilege of exercising this option or not at his will. The clause is phrased in terms of election, since most courts in interpreting them have imposed an election requirement regardless of the absoluteness of the provision. The unmatured debt can therefore become matured at the option of the issuer. A clause such as this inserted in a negotiable instrument can only be exercised in good faith, and it must be assumed that this requirement should be judicially integrated in this situation so as to avoid unconscionability.

A final clause which might lead to litigation is the clause authorizing termination at will, a clause most often found in exclusive dealership agreements. Such provisions are not illegal per se; however, in many instances they are unenforceable since the person in whose favor such a clause runs is not bound to do anything, and thus the contract fails for lack of mutuality and consideration. If, however, an independent consideration can be found, they will be upheld. Since many of these contracts allow either party to terminate at will, it can be said that each promise is sufficient consideration to support the other.

Thus, in conclusion it can be said that no one clause standing alone, with the possible exception of the cognovit clause, is unduly harsh or one-sided. However, taken as a whole, a court could not be criticized for finding the contract unconscionable. In view of this prospect, many of the issuers might use their unilateral right of modification of the terms of the contract to balance the obligations encompassed in such a contract.

UNAUTHORIZED USE OF CREDIT CARDS

Because of a fear of bad publicity, credit card issuers do not normally sue their cardholders whose cards have been lost or stolen and subsequently used by a thief to purchase merchandise. No matter what the reason,

51 1A CORBIN, CONTRACTS § 265 (1963) and cases cited.
52 6 WILLISTON, CONTRACTS § 2025 (Rev. ed. 1938) and cases cited.
53 U.C.C. § 1-208.
54 Ard Dr. Pepper Bottling Co. v. Dr. Pepper Co., 202 F.2d 372 (5th Cir. 1953).
56 1 WILLISTON, CONTRACTS, § 105 (Rev. ed. 1938).
57 There have been some startling accounts of spending sprees of credit card thieves. See for example Porter, HOW TO GUARD AGAINST THE CREDIT CARD THIEVES, Chicago Daily News, Dec. 21, 1966, p. 37, col. 1:

"Three Long Island housewives went on a shopping spree and billed $16,000 worth of merchandise to stolen credit cards.

"A Pittsburgh gambler had $10,000 in his pocket when arrested by police—most of it refunds from airline tickets he had bought with other people's credit cards.

"A credit card thief posing as a health-center operator ran up bills of more than
the fact is that there are few cases on the subject. Because of this dearth of case law, it is important to view the cases there are, and attempt to categorize these few in order to arrive at what, at most, is only a determination of the options available to a court hearing a case of first impression involving the unauthorized use of credit cards.

By the terms of the underlying contract between the cardholder and the issuer, the holder either agrees to assume the risk of any loss or theft up to the time when he notifies the issuer of loss or theft, or he does not. This general statement however is subject to further modification because a cardholder may agree to assume responsibility for loss or theft only to a certain limit. In determining liability for any unauthorized use, the cardholder-issuer contract must be examined first. If there is no agreement by the cardholder to assume this risk, he is not liable unless he is precluded from denying that the use was authorized. The first court deciding a case involving credit identification devices reached the opposite conclusion under a theory that the charge coin of a department store was similar to a negotiable instrument.\(^5\) This rather astounding theory was abandoned and completely rejected in subsequent litigation involving charge coins.\(^5\) In these cases the coin was looked upon simply as a means of identification. The presentation of the coin indicated that the customer had acceptable credit and that goods could be delivered to him without further credit investigation. Up to this point in the development of the law, a holder of any credit identification device was only liable for authorized uses of that coin or card. A Pennsylvania court later added that a holder might be liable even for an unauthorized use if he were precluded from denying that the use of the card was authorized.\(^6\)

At the present time most credit card agreements contain a clause expressly stating that the holder will pay for any use of the card, authorized or unauthorized.\(^6\) Just what effect this clause had was not agreed upon

\(\$10,000\) at gas stations by promising attendants health courses if they would make out phony bills against the credit card and give him the cash.”

\(^5\) Wanamaker v. Megary, 24 Pa. Dist. 778, 779 (1915). The court viewed the coin as being “in effect an order upon the plaintiff to deliver goods to the person presenting it, and to charge the said goods to the defendant’s account. It is similar to a check, a bill of exchange or other negotiable instrument payable to bearer.”


\(^6\) Gulf Refining Co. v. Plotnick, 24 Pa. D. & C. 147 (1935). In this case the cardholder was negligent in not notifying the issuer after he became aware that his card had been lost or stolen.

\(^6\) The card of a leading oil company states: “Customer agrees to pay for all purchases made by any person, whether authorized or not, using this card unless and until [issuer] has received written notice that it has been lost or stolen.”
by the courts which faced the problem. Four courts have interpreted these risk-shifting clauses and two clear cut variations have evolved. In *Magnolia Petroleum Co. v. McMillan* the credit card holder loaned his card to a third party who refused to return the card and subsequently purchased fuel with it. The holder did not notify the oil company of the theft of the card. While the court could have decided the case on the basis of the holder’s negligence, the court found for the card issuer on the basis of the contract saying that the holder had obligated himself to be responsible for all purchases made with his card and was therefore bound to pay. The fact that the holder was admittedly negligent clouds the issue somewhat and it is unfortunate that the court did not verbalize its opinion in terms of the negligence of the holder. The two diverse schools of thought relative to the interpretation of the agreement to pay for unauthorized use grew out of the facts in each situation. While the holder was negligent in the *McMillan* case, the merchant was negligent in *Gulf Ref. Co. v. Williams Roofing Co.* The Williams Roofing Co. applied for and received eight credit cards from the issuer. The holder typed the words “Good for Truck Only” on the front of each card. A service station attendant retained possession of one of these cards and left the state to begin a ninety day spending spree. Faced with a criminal act of a dealer of the issuer, the court was reluctant to apply the finding of the *McMillan* court that the holder was bound to pay, even when confronted with the expressed assumption of the holder to pay for all merchandise obtained by any person who presented the card. The court found that the dealers of the issuer assigned their rights to the issuer and once it made this determination it could have decided the case solely on the basis of assignment principles. The dealers were negligent in selling merchandise to the thief who presented a card marked “Good for Truck Only” but was driving a passenger automobile. The holder then could use the defenses against the assignee that were available against the assignor. Granted that the issuer might have argued that even if the dealers were negligent and the holder had defenses against them, the agreement to assume full responsibility for all purchases prevented the holder from

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62 168 S.W.2d 881 (Tex. Civ. App. 1943). The credit card in question contained the following clause: “The named holder shall be responsible for all purchases made by use of this card, prior to its surrender to the issuing company, whether or not such purchases are made by the named holder or into the card described.”

63 Ibid.


65 Id. at 369, 186 S.W.2d at 794. The reverse side of the cards provided that the holder “assumes full responsibility for all merchandise, deliveries or service obtained on credit by any person by its presentation.”

66 Supra note 64, at 367, 186 S.W.2d at 794.
asserting any defense, but the holder could have countered that the agreement did not encompass assuming responsibility for purchases that resulted from the negligence of the dealers. In any event, the court construed the contract as one of guaranty and determined that the person who extended the credit must do so in good faith "subject to any limitation appearing on the face on the card."\[67\] From these two cases developed two theories that evolved from the facts peculiar to each case. One theory held that the contract binds the holder to pay in all events, while the other held that the holder must pay only if the issuer and merchant act in good faith and are not negligent. The latter theory was enforced and amplified in *Union Oil Co. of Cal. v. Lull.*\[68\] Before any further discussion of this case, it must be pointed out that in *Lull*, like *Williams*, the dealer was negligent. In *Lull*, the card was issued in Oregon but the thief was driving a car licensed in Idaho. As the court in *Williams*, the *Lull* court found the contract of the holder to be one of guaranty but amplified the "good faith" of *Williams* by imposing upon the merchant and issuer the affirmative duty to exercise reasonable diligence to protect the guarantor. The most recent case, *Texaco, Inc. v. Goldstein,*\[69\] adopts the theory of strict compliance with the contract. However, once again the issue is muddied by the facts because in *Goldstein* the holder was negligent in not reporting the theft of his card. The *Goldstein* court expressly distinguished the contract before it from the one in the *Lull* case and refused to call such a contract one of guaranty. In effect the court refused to place any affirmative duty of diligence upon the issuer whom it felt was so totally removed from the actual confrontation of the customer and seller that any required diligence would have been impossible to exercise.\[70\]

It becomes impossible to extrapolate any isolated rule of law regarding liability of the holder for unauthorized use that is unfettered with any fact situation that does not limit its application. The most that can be said is that the courts up to this point have held the holder liable when he has been negligent and have refused to grant recovery to an issuer whose dealers were negligent, even though the recovery or denial of recovery have been couched in terms of the contract between the parties. But even this statement leads to the conclusion that when negligence is

\[67\] Supra note 64, at 368-69, 186 S.W.2d at 794. In other words, while the cardholder was bound by the terms of the agreement the issuer and the dealers were bound by the terms of the cardholder which he typed on the card.


\[69\] 34 Misc. 2d 751, 229 N.Y.S.2d 51 (1962). See Note, 12 De Paul L. Rev. 150 (1962), wherein the case is analyzed.

\[70\] *Union Oil Co. of Cal. v. Lull,* supra note 69, at 754-55, 229 N.Y.S.2d at 55.
not at issue the terms of the contract will govern.\textsuperscript{71} If the contract is at issue, the only difference in application of the two theories is that by following the theory in \textit{Lull}\textsuperscript{72} it would be incumbent upon the issuer to prove the exercise of reasonable diligence while the need for such proof is missing from the theory of the \textit{Goldstein}\textsuperscript{73} case.

The cardholder agreements used in the Midwest Bank Card system contain risk-shifting clauses\textsuperscript{74} and what has already been said about such clauses applies to these agreements. When the Chicago banks began this system, both system banks and participating banks mailed credit cards to their customers, and this unsolicited mailing can result in liability for unauthorized use. Once a contract is made and the card is lost or stolen, even if the holder had never used the card, the holder will be bound by the terms of the agreement.\textsuperscript{75}

As was indicated in the section on the unique structure of the MBC system, the banks view the sales slip as an "item" and as such it falls within the Uniform Commercial Code.\textsuperscript{76} If this "item" is the actual payment for the purchases, the thief of any MBC credit card actually gives a non-negotiable instrument to the merchant as the quid pro quo for the merchandise. This aspect of unauthorized use is discussed further in the following section.

\textbf{EFFECT OF ARTICLES 3 AND 4 OF THE U.C.C.}

The sales slip used by the MBC system has space for the entry of quantity, description and price of merchandise sold. This sale history takes up one half of the sales slip, but the other half is of importance for this discussion. There is space for the imprinting of the name and card number of the holder. Beneath this space appears the following:

\textsuperscript{71} What has been said about the risk-shifting clauses presupposes that they are valid and will be applied according to ordinary contract law. One writer suggests that since these clauses are not generally known to be in the contract, the provisions of liability must be specifically brought to the cardholder's attention. See Comment, 13 \textsc{Sta. L. Rev.} 150 (1960). Another commentator posits that credit card risk shifting clauses should be interpreted by analogy to those factors involved in interpreting exculpatory clauses. See Comment, 22 \textsc{La. L. Rev.} 640 (1962). See also Uni-Serv Corp. v. Fride, \textit{supra} note 4. In this case the court suggested that the extent of liability of the cardholder should be limited to the credit limit imposed by the issuer. If the issuer put a $250 limit on the credit available to the holder, the holder's liability for unauthorized purchases should not exceed that limit.

\textsuperscript{72} \textit{Supra} note 68.

\textsuperscript{73} \textit{Supra} note 69.

\textsuperscript{74} One such clause reads: "In addition, Cardholder agrees to pay for all purchases and Instant Cash advances made by or to any person presenting one of Cardholder's cards prior to its surrender to Issuer or Issuer's receipt of written notice that the Card has been lost or stolen."

\textsuperscript{75} See discussion in text pp. 391–95.

\textsuperscript{76} U.C.C. § 4-104(g). See definition \textit{supra} note 3.
I hereby authorize the Issuer of the Midwest Bank Card imprinted above to pay the amount shown as Total hereon upon presentation hereof to Issuer by a bank which is a member of the Midwest Bank Card system. I hereby promise to pay said Issuer the amount shown as Total hereon (together with other charges due thereon, if any) subject to and in accordance with the terms of the cardholder agreement governing the use of Issuer's Midwest Bank Cards.

Below this paragraph is a line for the customer's signature. The MBC system treats these sales slips as "items" under Article 4 of the Uniform Commercial Code and has established a clearing house for their processing. "Item" is defined in the Uniform Commercial Code as "any instrument for the payment of money even though it is not negotiable but does not include money."77

The item performs an important function and it must be examined in any discussion that purports to investigate the MBC system. It has already been mentioned in the section on the structure of the MBC system that the compatibility is a unique aspect. This compatibility is accomplished through the clearing house that processes the item and through the function of the item itself. It must be pointed out that the cardholder is obligated to the issuer by the terms of the contract existing between the parties. Keeping this in mind, the following interpretation of the legal status of the item and the corollary implications thereof is offered.

The main function of the item is to transfer money in terms of credits and debits. The merchant takes the item to the bank that is in privity with him and receives a credit. The item is then forwarded to the MBC system clearing house where it is paid by the issuing bank.

The first sentence of the two that appear on the item (sales slip) is an authorization given to the issuer by the cardholder to pay the MBC system or participating bank which presents the item. It is posited that this language makes the item a three party instrument in the nature of a draft and places it within the terms of Article 3 of the Uniform Commercial Code. The item is clearly nonnegotiable because it lacks words of negotiability; however, nonnegotiable instruments are encompassed by the Code if they are not payable to order or bearer but are otherwise negotiable.80 The "authorization to pay" sentence of the item conforms to this provision and it is contended that the "promise to pay" sentence is mere surplusage that does not preclude the item from being within the provisions of the Uniform Commercial Code. The cardholder, as has been pointed out, is already obligated to the issuer by the terms of a pre-existing contract and any promise of the cardholder to pay the issuer is of no legal significance since he is already legally obligated to do so.

77 Specific reference to these slips as "items" is also made in the contract between the bank and the merchant.
78 U.C.C. § 4-104(1)(g).
79 U.C.C. § 3-104(1)(d).
80 U.C.C. § 3-805.
Working on the basis of what has been hypothesized, several conclusions can be drawn. By the terms of the merchant-bank agreement, the bank agrees to:

grant [the] merchant final, irrevocable . . . credit in respect of sales slips ["items"].

The merchant, in effect, agrees to deliver merchandise to the cardholder and to accept a nonnegotiable instrument for which the bank agrees to give final credit. By granting such final credit to the merchant, the bank in which the merchant deposits these slips becomes a holder for value. Upon transferring the instrument to the bank the merchant makes warranties to the transferee bank both by the terms of the merchant-bank contract and by the terms of the Uniform Commercial Code. According to the merchant-bank agreement, one such warranty is that the merchant: has no knowledge that the signature on the item is unauthorized.

However, the warranty of the Code is much more positive in that the transferor warrants that "all signatures are genuine or authorized." The merchant-bank agreement does state that except as provided in the agreement:

the bank shall have no recourse against merchant on any item nor shall merchant have the liability of an endorser.

But the fact is that the merchant does not endorse the item and his warranties are given only to his immediate transferee. In addition, it can be questioned if "no recourse against merchant on any item" is sufficient language to constitute a waiver of an action on the warranty. Perhaps any action by a bank against a merchant or by a bank against a bank would be commercial suicide. Consequently a discussion of any litigation is somewhat moot; but such an action is possible, and indeed, when and if the MBC system is firmly established as an indispensable part of the midwest business world, the sensitivity of the banks to adverse publicity may not be so great.

When the cardholder presents the signed "item" in exchange for merchandise, the merchant by a pre-existing contract with an MBC bank has agreed to accept that item as payment, relying on the bank's engagement to pay him for all items deposited. The item then serves a dual purpose. It discharges the cardholder from his obligation to the merchant on the underlying sales contract. The Uniform Commercial Code provides that when an instrument is taken for an underlying obligation, the obligation

81 U.C.C. § 3-303.
82 U.C.C. § 3-417 (2).
83 U.C.C. § 3-417 (2) (b).
84 U.C.C. § 3-417 (2).
85 U.C.C. § 3-417 comment 1.
is not discharged but only suspended pro tanto until payment. But this does not appear to be the effect of payment by "item" in the MBC system. The merchant does take the instrument but the cardholder has not authorized the issuer to pay the merchant. The cardholder has authorized the issuer to pay the MBC bank which presents the item for payment. By a collateral agreement, the item is of value to the merchant because he can receive cash for it by depositing it with the appropriate bank. Relying on the executory promise of the MBC bank to honor all items deposited, it is posited that the merchant at the time of sale discharges the cardholder of his obligation under the sales contract.

In addition to operating as a discharge of the cardholder, the item is evidence of his pre-existing undertaking to pay the issuer the amount shown on the item. When an MBC credit card is used by an unauthorized person, he is the one who signs the name of the true cardholder to the item. According to the Uniform Commercial Code, an unauthorized signature "is wholly inoperative as that of the person whose name is signed unless he ratifies it or is precluded from denying it. . . ." The signature however operates as the signature of the unauthorized user. The fact that the "item" evidences a debt of the unauthorized user lends credence to the theory that these risk-shifting clauses are contracts of guaranty. However, viewing the item in its capacity as an authorization to pay, the risk-shifting clause becomes a contract of indemnity because the MBC bank by a collateral agreement is bound to honor the item rightfully presented for payment. In other words, by the unauthorized use, the issuer has become liable to the presenting bank: on the item and the holder agrees to make good the loss resulting from that liability. As indicated in the preceding section, if the contract is determined to be one of guaranty or indemnity, an affirmative duty of reasonable diligence is thereby imposed on the issuer.

CREDIT CARD LEGISLATION

Shortly after the initial promotion of the MBC system, the Illinois General Assembly convened. Several bills were introduced that affected the distribution or use of credit cards. One provides for a penalty of $500.00 for the unsolicited distribution of credit cards. Another bill limits the liability of cardholders. In the instance where the card is unsolicited:  

solicited, the cardholder is not liable for unauthorized use unless he has signed the card or otherwise indicated his acceptance. On the other hand, when application is made for the card or acceptance of an unsolicited card is indicated, the holder's liability for unauthorized use is limited to $150.00. A fourth bill completely prohibits the issuance of any card unless written application has been made for the card and provides that the issuer insure the cardholder or hold him harmless for the first $1,000.00 of charges made by an unauthorized user of the credit card. If a thief used a credit card to purchase $10,000.00 worth of merchandise, under one bill the holder would pay $150.00 and the bank $9,850.00. By the terms of another, the holder is insured for the first $1,000.00 but must pay $9,000.00. Ironically, in the absence of any statute, by the terms of the agreement, now in use by two of the MBC system banks, if a thief charged 10,000.00, the holder would pay $50.00 and the bank 9,950.00. If there were no credit cards and a person earned $10,000.00 in cash on a business trip, his out of pocket loss by the theft would be $10,000.00.

Credit and credit cards are an important and vital part of the present state of commerce. Statutes should not impose a penalty on a bank which, in the interest of convenience, issues a credit card to a customer rather than cash. The statutes should make it mandatory that card issuers make holders aware of the clauses in agreements that allocate the risk of loss. One cardholder agreement has this risk—shifting clause in type so small that there are thirteen lines to one inch. If in fact the risk of loss is to be shared, this term in any contract should be brought to the attention of the holder by being set out in bold print or in larger size type. Not only should these risk—shifting clauses be highlighted, but the extent of liability for unauthorized use should be limited to the credit limit imposed by the issuer, and such credit limits should appear on the card. Any proposed legislation should realistically evaluate the place of credit in this modern age and rather than attack the issuer, should lay ground rules whereby the public can appraise fairly the proposed contract without being surprised at some future date to learn of the true extent of contractual liability.

The legislative concern over unsolicited credit cards is not warranted. The issuer itself is willing to assume the risk that the card might be sent

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93 S.B. 190, 75th Ill. Gen. Ass. (1967). This is a statutory enactment of what liability would be limited to even in the absence of the statute.

94 Two of the system banks in recent advertisements have announced that no holder shall be liable in excess of $50 for any unauthorized use. The banks reacted to public opinion in a more positive way than the legislature. Of course, with a statute, the permanency of such self insurance plans is not guaranteed.


96 See N.Y. GEN. BUS. LAW § 512 (1961).