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ARTICLES

An Economic Rationale for Judicial Decisionmaking in Corporate Law
E. Norman Veasey

Continuity of Contracts After the Introduction of the Euro: The United States Response to European Economic and Monetary Union
James H. Freis, Jr.

The Line Item Veto and *Unocal*: Can a Bidder *Qua* Bidder Pursue *Unocal* Claims Against a Target Corporation's Board of Directors?
J. Travis Laster

An Introduction to Federal Income Tax Issues Relating to the Issuance of High-Yield Securities
Kenneth L. Hooker

REPORTS

Changes in the Model Business Corporation Act Pertaining to the Standards of Conduct and Standards of Liability for Directors—Final Adoption
Committee on Corporate Laws

Proposed Changes in the Model Business Corporation Act
Committee on Corporate Laws

Legal Opinion Principles
Committee on Legal Opinions

REVIEW

The Early History of the Law of Bills and Notes: A Study of the Origins of Anglo-American Commercial Law
By James Steven Rogers
Reviewed by Charles J. Reid, Jr.

continued on back cover

Can the Promise of Debit Cards Be Fulfilled?

*By David A. Balto**

During the past few years, there has been dramatic growth in the use of debit cards. With this growth, a host of competition and consumer protection issues have been raised, posing important consequences for the future of the debit card and whether it can fulfill its potential to provide a safe, secure, and efficient payment system for consumers. On the competition side, debit cards have developed slowly in the United States, in part because of a lack of competition between debit card networks. Because Visa and MasterCard are primarily credit card networks, they have been slow to embrace the opportunity to develop debit card networks. Perhaps even more importantly, debit cards pose new consumer protection risks and may result in a high rate of fraud. This Article addresses the combined competition and consumer protection challenges.

BACKGROUND

The three most prominent consumer payment systems in the United States for consumer-merchant transactions are cash, checks, and credit cards. Each of the systems has its strengths and weaknesses from the perspective of banks, consumers, and merchants. To oversimplify grossly, cash cannot be used for large transactions. Checks have a significant risk of loss (for the merchant) and relatively high handling costs because of the processing fees. In addition, the merchant is not compensated until the check clears, frequently a period of several days. Credit cards have a lower risk of loss and lower handling costs than checks, but the merchant still faces costs in terms of the float.

Another payment system—debit cards—was relatively uncommon in the United States until the mid-1990s. Under debit, a consumer pays for a transaction by giving the merchant a debit card, which directly and electronically debits the consumer's bank account. There are two types of debit cards: online and offline. Online debit cards, including automatic

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teller machine (ATM) cards and cards that can be used at online point-of-sale (POS) terminals,[1] require the use of a personal identification number (PIN) to initiate the transaction. All ATM cards have online debit capability, and online debit transactions are sent though ATM networks. Offline debit cards are much more similar to credit cards. Transactions flow over the credit card network (e.g., Visa or MasterCard), and access to the consumer's account is not immediate. These transactions require up to a few days to settle or for payment to transfer.

The relatively slow development of debit in the United States is striking for several reasons. Debit is very well-developed in Europe, Japan, and other industrialized countries where it accounts for a substantial portion of consumer transactions. Many of these foreign systems have existed since the early 1980s. In contrast, while scholars and banking analysts have predicted the emergence of large debit systems in the United States ever since the mid-1970s, these predictions failed to materialize.[2] The failure of debit to emerge is particularly puzzling because it has significant advantages over other payment systems. For the consumer who does not want to carry cash or checks, debit offers a convenient and safe way to make purchases. For the merchant, a debit system decreases the costs associated with bank deposits and check processing, earlier fund availability, and fewer bad checks. Financial institutions gain from debit a reduction in check volumes, lower transaction costs, and a wider range of services to offer their customers.

Technologically, there were no significant barriers to the creation of debit networks in the 1980s. Both ATM and credit card networks had the computer systems and access to consumer accounts necessary for a debit network. Many regional ATM networks entered into debit at that time. Yet debit development was slow. There were only a handful of online debit networks. Although many cards were issued, there were relatively few transactions due to a number of factors. First, although merchants may have desired debit, only the banks were in a position to form networks and issue cards. Second, the incentives of the banks were mixed; they feared in part that debit would cannibalize their lucrative credit card programs, which earned substantial annual fees and interest rates. Finally, there was much controversy as to who would bear the burden of the program costs associated with debit; merchants and banks each saw the other as the real beneficiary of debit, and tried to place the pricing burden accordingly.

1. Transactions using debit cards were initially limited to the bank that issued the card, typically an ATM card; later, banks and other institutions began providing merchants with card readers or other ways for consumers to use these cards to access their accounts. This latter development enabled consumers to use the card at various banks around the country and at merchants' online POS terminals to pay for purchases such as groceries, gasoline, movie tickets, and other retail goods or services.

2. *See* Peggy Lunt, *Is it First and Goal for Debt Cards?*, ABA BANKING JOURNAL (Sept. 1996).

COMPETITION ISSUES: THE ENTREE *ANTITRUST SUIT*

Financial institutions' indifference toward debit began to change in 1987, when Visa and MasterCard announced the creation of a joint-venture debit network, which they named Entree. Earlier, Visa had acquired the only significant regional debit network, Interlink, which was based in California. At about the same time, MasterCard and Visa gained controlling interests in the two national ATM networks, Cirrus and Plus, respectively. If the de facto merger of Visa and MasterCard in the debit field raised antitrust concerns anywhere, those concerns were not to be found in Washington, D.C. The U.S. Department of Justice reviewed the joint venture but declined to challenge it.

In 1989, however, fourteen state attorneys general brought suit against Visa and MasterCard, charging that in forming the Entree debit program and acquiring interests in Plus and Cirrus, the associations had violated antitrust law.[3] The states alleged that they had done so with an intent to retard the development of debit, based upon a fear that debit could compete favorably with and erode the profitability of credit cards. Debit cards, unlike credit cards, typically did not charge annual fees. If debit prospered, consumers might begin using it as an alternative to the relatively high-cost credit cards. Entree, the states alleged, was a combination of the five most likely entrants into the debit market (Visa, MasterCard, Plus, Cirrus and Interlink). The states further alleged that, as part of the joint venture, Visa and MasterCard had agreed not to introduce separate competing debit systems.

The states' theory was that such a large national network would inhibit entry and growth by the smaller regional ATM networks into debit. The states also challenged provisions in the agreement that limited Entree membership to banks that were members of both associations, and excluded nonbanks (e.g., Sears/Discover Card and American Express) from participation. The complaint sought an injunction against the implementation of Entree, as well as divestiture of Cirrus by MasterCard, and of Plus and Interlink by Visa. At the time of this suit, Entree had signed up relatively few merchants and had yet to clear a single debit transaction.

In 1990, Visa and MasterCard settled with the states.[4] Under the terms of the agreement, the associations agreed to abandon the Entree joint venture, although Visa retained ownership of Interlink, and both Visa and MasterCard were permitted to retain their interests in the national ATM networks. The most interesting aspect of the settlement decree was its nonduality provisions, which compelled Visa and MasterCard to keep

3. *See* New York v. Visa U.S.A., Inc., [1990-91 Transfer Binder] 1990-91 Trade Cas. (CCH) ¶ 69,016, at 63,566 (S.D.N.Y. 1990). In addition, the states charged that Visa's acquisition of Interlink violated antitrust law. *Id.*

4. New York v. Visa U.S.A., Inc., No. CV-89-5043, 1990 WL 75047 (S.D.N.Y. May 8, 1990) (settlement agreement and order).

bank memberships in any new debit networks separate. At the time, the states viewed duality as the source of much competitive mischief in the credit card arena, working to dampen incentives for the two card associations to compete, and facilitating the establishment of a united front to stifle or delay innovation from nonbanks, such as Discover, American Express, and AT&T.

THE RESULTS OF THE SETTLEMENT DECREE

Visa and MasterCard embarked on different courses under the decree. Visa used Interlink as its brand and attempted to build from its base in California. MasterCard created a new brand, Maestro, and established alliances with many regional ATM networks. In essence, Maestro attempted to build on the technological infrastructure and expertise of these networks. The fees charged by the networks, including interchange fees, are far less than those involving credit cards. Both national networks experienced moderate growth, and each has signed up hundreds of merchants and bank issuers.[5]

By the mid-1990s, it appeared the states' assessment that two exclusive networks could succeed (and that network competition was important) was correct. Without the specter of a single dominant national network, almost twenty-five regional debit networks—primarily an extension of ATM networks—have formed. Networks such as Pulse, Star, and NYCE are now leaders in debit development and have expanded substantially. Interlink and Maestro have been worthy competitors in the emerging field. The nonduality rules have led to vigorous competition between the networks, as measured by product promotion, product development, and pricing. The level of debit competition has been aggressive and far more significant than that in the credit card market, where duality is permitted.[6]

Because both Interlink and Maestro are exclusive, they compete vigorously to sign up banks and merchants. Both have adopted different switch and interchange fees[7] in order to offer more attractive packages to their consumers. Interlink charged additional "annual card service fees" and "merchant location fees." When Maestro entered, however, it did not charge such fees. Significantly, Interlink initially charged a "transaction service fee" of two cents per transaction by an Interlink cardholder at an

5. *See generally* Stephen Kleege, *Debit Card War Faces Tough Choices*, AM. BANKER, Feb. 7, 1994, at 17; Mickey Meece, *Bank of America is Going to Bat for Maestro*, AM. BANKER, Apr. 5, 1994, at 10; *More Issuers Get Debit Interchange, While Merchants Get Perturbed*, POS NEWS, Jan. 1, 1994.

6. *See* Jeffrey Kutler, *Bankers are Burying the Hatchet to Join Forces for Debit Push*, AM. BANKER, Feb. 8, 1994, at 20; *see also* David A. Balto, *Duality in Payment Systems: Antitrust Issues*, 11 REV. OF BANKING AND FIN. SERVS., May 31, 1995, at 105.

7. The "switch fee" is a fee charged by the network for moving a transaction over the network's switch. The "interchange fee" is a fee paid by the merchant bank to the cardholder's bank for processing a credit card or debit card transaction. Both fees are set by the bank card association.

Interlink terminal, even if the transaction was actually processed through a regional network (i.e., if the bank attempted to bypass the Interlink network). When Maestro entered without such a "bypass" fee, it forced Interlink to eliminate the fee.

In 1994, Maestro sought to eliminate its nonduality rule to permit issuer duality. After considering Maestro's proposal for more than three months, the states attorneys general which brought the *Entree* case rejected it in October 1994.[8] In doing so, state regulators observed that both networks were competing aggressively and appeared to be thriving, as measured by transaction volumes and merchant participation. Moreover (and a feature which distinguishes the debit card market from others), competition from nonbank participants, such as Discover Card and American Express, was unlikely in the debit card area because debit services are necessarily linked to a financial institution's demand deposit account. As such, the states expressed concern that elimination of Maestro's nonduality rule "would bring to an end the aggressive inter-system competition between the two bank card associations in the point-of-sale debit card market."[9] Thus, the states concluded they could not assure Maestro that deviation from its nonduality rule would not lead to an enforcement action.[10]

A PYRRHIC VICTORY? THE EMERGENCE OF OFFLINE DEBIT

By the mid-1990s, online debit seemed to be making a substantial competitive impact. The regional ATM networks experienced substantial growth each year and online debit became more popular with consumers. The competitive landscape of debit, however, has changed radically during the past two years. Starting in the mid-1990s, Visa and MasterCard began to focus their debit attention on an older form of debit—offline debit. In offline debit, transactions are handled in the same manner as credit card transactions and sent via the credit card system.

The offline debit networks are known as Visa check card and MasterMoney. Each of these networks, like Maestro and Interlink, is exclusive. They have existed for more than a decade, but have received little attention or promotion from the card associations. In the past three years, offline debit cards have experienced extraordinary growth. There are now approximately sixty million offline debit cards in circulation, up from twenty-five million only three years ago.[11] More than one million debit

8. *See* Jeffrey Kutler, *States Criticize MasterCard Stand on Debit Cards*, AM. BANKER, Dec. 13, 1994, at 1.

9. *State Attorneys General Give Opinion on Debit Card Duality*, AM. BANKER, Dec. 13, 1994, at 17.

10. *Id.*

11. *See* Saul Hansell, *Not All Plastic Is Created Equal When It Comes to Renting a Car*, N.Y.

cards are being issued each month, largely as replacements for ATM-only cards.[12] In 1996, businesses handled 1.4 billion transactions totaling $54.5 billion with offline debit cards.[13] Indeed, Visa reports that consumer use of its offline debit cards averages thirty-one transactions per second—an 800% increase since 1991.[14] The growth of offline debit has been so remarkable that some network executives and commentators have predicted the "extinction" of online debit.[15]

This is ironic since online debit cards offer several advantages over offline cards. Online debit cards offer greater security for the consumer and the bank than do offline debit cards. Online cards subtract funds from deposit accounts immediately, while offline cards are more like credit cards, debiting accounts several days after a transaction.[16] Online cards require the consumer to enter a PIN, while offline cards only require the consumer to sign a transaction receipt. Online cards permit the consumer to secure cash as part of the transaction, while offline cards do not. On the other hand offline cards are accepted at a much larger number of merchants. Both Visa and Mastercard require all merchants who accept their credit cards also to accept their offline debit cards—a tying arrangement that is currently the subject of an antitrust suit.[17]

The most divisive issue between online and offline cards is transaction pricing. For online transactions, the fees are comparable to the interchange fees in ATM networks. Offline debit transactions mimic the pricing structure of the Visa and MasterCard credit card programs, in which merchants must pay an interchange fee to the issuer. Generally, the online fee is about ten cents while the offline interchange fee is about two percent of the transaction. On a $100 transaction, the difference would be between

TIMES, Apr. 2, 1997, at A1; Margaret Mannix, *Debit Card Dangers*, U.S. NEWS AND WORLD REP., Apr. 7, 1997, at 73.

12. David J. Morrow, *Handy? Surely, But Debit Card Has Risks, Too*, N.Y. TIMES, July 13, 1997, at A1. As discussed below, under current federal law, card issuers can replace an online ATM debit card with an offline debit card (including online and offline features) without consumer assent, and many issuers are apparently doing just that.

13. *Id.* In 1996, "[offline] debit transactions displaced a quarter of a billion checks at supermarkets alone." Valerie Block, *Media Avalanche of Horror Stories Hits MasterCard, Visa Debit Cards*, AM. BANKER, Apr. 30, 1997, at 1 (according to Brittain & Associates, an Atlanta-based research firm).

14. *See* Christine Dugas, *Debit Card Convenience Comes with Caveat*, U.S.A. TODAY, May 30, 1997, at 5B.

15. *See generally Interlink Plans for a Bright Future Despite a Gloomy POS Forecast*, DEBIT CARD NEWS, Mar. 17, 1997; *Off-line Debit Markets Its Way to the Top*, BANK NETWORK NEWS, Mar. 26, 1997.

16. *See Online Debit: the Risk Manager's Dream? Wal-Mart to Implement Online Debit Throughout Its Chain of Stores*, CREDIT RISK MGMT. REP., Dec. 29, 1997 (discussing differences in costs and risks between online and offline debit); *see also* Joanna Kolor, *The Online-Offline Debit Card Debate*, BANK TECH. NEWS, Jan. 1997.

17. *See* Kolor, *supra* note 16 (referring to two suits filed in October 1997, against Visa and Mastercard: One by Wal-Mart Stores, Inc. and The Limited, Inc. against Visa, the other by New Jersey-based Bernie's ArmyNavy Store, Vineland, against both Visa and MasterCard). Similar restrictions were not imposed for Interlink and Maestro.

ten cents and $2.00. Considering that the aggregate amount of offline debit interchange fees is currently more than $250 million, the additional costs to merchants and consumers can be substantial.[18] If those transaction were sent online, the costs would be less than $33 million.[19]

If online debit is more technologically and productively efficient—less costly and quicker, with significantly less risk of loss—why is it not overtaking offline debit?[20] Typically, in technology markets, cost and efficiency govern; why not in payment systems? The answer is that the fee structure creates perverse incentives to favor the more costly system. Although banks face a higher risk of loss on offline transactions, they also have the opportunity to make substantially greater interchange revenues. When banks have a choice to invest or promote one system over another, they will almost invariably choose offline debit because of the higher interchange fees. Indeed, some bankers have gone so far as to threaten withdrawal from online debit networks as a way to force those networks to increase their interchange fees.[21]

Does the credit card interchange fee structure make sense in the debit environment? Interchange fees were first established in the credit card environment. They were set to compensate the card-issuer for its costs, the cost of the float, the risk of loss, and associated costs of card issuance. Interchange fees were set on a fully allocated basis for decades until competition from Discover Card forced the card associations to provide "incentive fees."[22] Assuming that some type of interchange fee is necessary in the debit environment, should the fee be the same amount as the credit card fee? Visa and MasterCard might argue that pricing should be identical because debit and credit transactions are both sent along the same system, but in reality the system fees are recovered through a separate switch fee. Debit transactions have a much smaller risk of loss than credit transactions, and practically no float. Thus, the costs that provide much of the basis of the interchange fee are absent, and the card-issuing bank requires less compensation to offset those costs.

Perhaps one could argue that an interchange fee that is significantly above cost is needed to provide adequate incentives to banks to issue and promote debit cards. This is a new product, and there is some risk it could fail. Debit, however, already provides substantial savings to banks. Debit transactions typically replace more costly check transactions. Processing

18. *See* Kolor, *supra* note 16.

19. *See* Kolor, *supra* note 16; *see also Building a Debit Bridge Over a Wide Price Gap*, DEBIT CARD NEWS, Apr. 14, 1998.

20. In Canada, where offline debit does not exist, the usage of online debit is far greater than in the United States. *See Canadians Give Credit to a Young Online Debit Card Network*, DEBIT CARD NEWS, Dec. 16, 1997; Charles Davis, *Canada's a Credit to Debit*, ELEC. PAYMENTS INT'L, June 1, 1997, at 13.

21. Valerie Block, *Norwest on Crusade for Profits on Debit*, AM. BANKER, Sept. 6, 1995, at 10A.

22. Basically, Discover signed up merchants such as grocery stores and discounters who could not afford Visa's rich interchange fees.

check transactions yields a significant cost to banks, and neither checks nor cash provide any revenue stream. Thus, debit already brings significant savings and new revenues to banks both in terms of replacing more costly check transactions and providing revenue from what were formerly cash transactions. Even before any interchange revenue is recovered, debit already provides substantial savings to the banks.

A larger problem is that the pricing structure for debit creates what economists call "moral hazard." A moral hazard occurs when the person who incurs a cost is insensitive to or unaware of the costs associated with that transaction. Consumers are unaware of the relative costs of different payment systems. The banks have incentives to increase the charges as much as possible and to choose the more costly form of transaction. Retailers who pay the fees have no ability to affect behavior so as to promote customers' usage of less costly payment methods. For example, Visa's rules prohibit merchants from surcharging offline debit to encourage customers to use online debit.[23]

What is the best solution to these problems? Some suggest that the regional ATM networks should increase their online interchange fees. (There are probably no consumers or merchants in this camp.) Such a result would benefit only the banks. Others call for eliminating the interchange fee. Although the credit card interchange fee survived an antitrust challenge in the mid-1980s, many prominent economists have questioned the rationale behind that decision.[24] They would argue that a system in which merchants charge consumers directly for debit would provide the most accurate "pricing signals." There is currently a debate in the ATM industry about whether interchange fees could be replaced by surcharges.[25] Elimination of the interchange fee might have some theoretical appeal, but it faces a painful real world truth: consumers do not like to pay for using any payment device. Making charges for debit transparent may deter the use of debit altogether.[26]

23. Although consumers ultimately pay the retailers' debit fees in the form of higher product and service prices, they may remain unaware of the costs attendant to the different payment options. In some respects, the situation is similar to the problems employers have in controlling health insurance costs. Employees were unaware of the costs of individual services and thus had little incentive to limit utilization of these. In order to control costs, employers implemented co-payments, requiring employees to pay for individual services. These co-payments conveyed pricing information to consumers, who responded by making choices that better controlled utilization and cost. As the debit environment is currently configured, merchants cannot send pricing signals to consumers.

24. Some commentators have suggested that the collective setting of interchange fees is a violation of the antitrust laws, although the practice has been upheld by the courts. *Compare* National Bankcard Corp. v. Visa USA, 596 F. Supp. 1231 (S.D. Fla. 1984), *aff'd*, 779 F.2d 592 (11th Cir.), *cert. denied*, 479 U.S. 923 (1986) (NaBanco) (upholding challenge to collectively set interchange fees), *with* Dennis Carlton & Alan Frankel, *The Economics of Credit Card Networks*, 63 ANTITRUST L.J. 643, 665-66 (1995) (describing why NaBanco was in error).

25. *See Is it the End of Interchange Fees?*, 17 EFT REP., Aug. 14, 1996, at 19.

26. *See POS Transactions Get on Surcharging Train*, 14 FIN. SERVS. REP., Jan. 15, 1997, at 2.

Others suggest permitting merchants to refuse to offer the offline debit payment option. In this way, merchants can force the networks to compete in the level of interchange fees much in the same way merchants do in the online debit area. In the past, merchants used this power to reject as a means of forcing American Express to lower its interchange fees. Similarly, merchant resistance forced Interlink to cap its interchange fee.[27] A group of merchants led by Wal-Mart, and several merchant associations— has filed an antitrust suit to permit merchants to reject the Visa and Mastercard offline product.[28] How that litigation is resolved will have a substantial impact on whether efficiency and competition will triumph in the debit environment.

A NET ASSESSMENT OF THE ENTREE *ENFORCEMENT ACTION*

The *Entree* enforcement action provided a number of important lessons for courts and antitrust enforcers.

Efficiencies

Networks seem more efficient as they grow. One issue confronting courts and regulators is whether this fact justifies the creation of a single, albeit monopoly, network.[29] Here, Entree could have argued that a single national debit network would have offered the opportunity for greater customer convenience, as it would link all debit terminals. Similarly, aggregating all of the cardholders in a single network could foster the use of the new debit network by merchants, who would not be divided by multiple choices. But these arguments were unavailing. The states recognized that even though a single network might present some efficiencies, these were outweighed by the potential loss of competition between separate and distinct debit networks.[30]

Relief

Often courts and regulators grapple with how to stop the exercise of monopoly power. In network settings, the answer is often behavioral relief,

27. *See Interlink Caps its Interchange Fees*, DEBIT CARD NEWS, Feb. 28, 1997.

28. The cases have been consolidated into one class action lawsuit against Visa U.S.A., Inc. and MasterCard International, Inc. *See In re* Visa Check/MasterMoney Antitrust Litigation, Master File No. CV-96-5238 (E.D.N.Y. 1996); Plaintiffs' First Amended Consolidated Class Action Complaint and Jury Demand, *In re* Visa Check/MasterMoney Antitrust Litigation, (on file with *The Business Lawyer*, University of Maryland School of Law); *see also* Lisa Fickenscher, *2 Retail Giants Sue Visa Over Having to Take Debit Cards*, AM. BANKER, Oct. 31, 1996; Kolor, *supra* note 16.

29. In approving the creation of regional ATM network monopolies, at least the Federal Reserve Board appears to have accepted this "bigger is better" argument.

30. *See* Kutler, *supra* note 6.

Consumers in general are not fully aware of the risks of the new offline debit feature that they receive unsolicited from their banks.[33] Because of the lack of a PIN requirement, there is a much greater chance of abuse if the card is stolen. Debit cards are tied to a checking account; if they are lost, a cardholder's liquid assets can be depleted overnight. Once informed that offline cards do not require the use of a PIN, a consumer will recognize that he or she is far less secure than if he or she had had an online card. Offline cards have been subject to much more fraud and theft than online debit cards (where these problems are almost nonexistent, due to the PIN requirement). Banks have provided information on the new range of services, but have failed to clearly informed consumers of the new risks. Moreover, banks have not tended to recredit consumers' accounts in a prompt fashion. The U.S. Public Interest Research Group has called offline debit a "sloppy bank product" and "completely unsafe," and there have been calls for greater regulatory protection.[34]

CURRENT REGULATORY PROTECTIONS

Although debit and credit cards may appear interchangeable, under federal law debit cards are vastly different from their credit counterparts in the level of consumer protection. Under the Truth in Lending Act (TILA),[35] consumers with credit cards are liable for no more than $50 for unauthorized use of the card or account.[36] This rule applies across the board, regardless of the type of credit card issued. As a result, consumers need not discern what form of credit card (e.g., charge card or revolving credit card) may have been issued to understand quickly the card's level of risk and ultimate liability. Further, when unauthorized credit card use does occur, the loss generally involves the bank's funds rather than funds withdrawn from the consumer's account.

Liability for debit cards, governed by the Electronic Fund Transfer Act (EFTA), is much different than liability for credit cards. Consumers may face a threatening scenario if their debit cards are lost or stolen, as liability is entirely contingent upon when the fraud is discovered and reported. Liability increases over time in sharp increments: (i) up to a maximum of $50 if the consumer notifies the card issuer within two business days of learning the card is lost, and (ii) up to a maximum of $500 if the consumer notifies the card issuer after two business days.[37] The consumer's liability

33. *See* Block, *supra* note 13, at 1.

34. *See, e.g.*, Richard E. Anderson, *The Costly Other Life of an A.T.M. Card*, N.Y. TIMES, Apr. 20, 1997, at C12.

35. 15 U.S.C. §§ 1601-1665b (1994 & Supp. I 1996).

36. *Id.* § 1643; *see* Regulation Z, 12 C.F.R. § 226.12(a) (1998).

37. Electronic Fund Transfer Act § 909, 15 U.S.C. § 1693g (1994). The first two liability limits do not apply if the debit card implicated in the unauthorized transaction was not itself lost or stolen. For example, if the thief obtains the debit card account number and uses that

will be equal to the amount of the unauthorized transfers, however, if he or she fails to report the unauthorized use within sixty days after receiving a statement showing the fraudulent charges.[38] Thus, consumers who suffer a fraudulent use of debit cards but fail to review their bank statements may lose their entire checking or savings account.[39] Even if the consumer timely reports the fraud, the bank or card issuer may take up to twenty days—and, under some circumstances, up to ninety days, if necessary—to complete its investigation.[40] During that time, the consumer may or may not have full use of his or her funds, depending upon whether a provisional credit is granted.[41] Indeed, some consumers have reported difficulty in obtaining credits due them under the law, and some have even returned their offline debit cards to the issuer to obtain ATM-only (online) replacements.[42]

SELF-REGULATORY EFFORTS

Recently, there has been an increasing outcry for consumer protection in relation to debit cards, in part because of the high degree of fraud. In response, Visa and MasterCard each announced voluntary, but not equivalent, changes in their guidelines for member institutions, capping consumer liability for unauthorized use of certain debit cards at a maximum of $50.[43] MasterCard limited consumer liability to $50 for unauthorized activity on its MasterMoney cards, but not on its other debit cards. Visa eliminated all consumer liability for those who report the problem within

to make a purchase, and the consumer notices the charges on the monthly bank statement and reports the fraud within 60 days after the statement's transmittal to the consumer, the consumer would not be liable for the charges. Regulation E, 12 C.F.R. pt. 205, Supp. I. cmt. to § 205.6(b)(3)-2.

38. Regulation E, 12 C.F.R. § 205.6.

39. Indeed, if the consumer's bank account has an overdraft feature linked to a savings or other account, the consumer's loss could involve thousands of dollars in a few hours or less.

40. *See* Electronic Funds Transfer Act § 908, 15 U.S.C. § 1693f; Regulation E, 12 C.F.R. § 205.11(b)-(c). The extended time frame for investigation is specifically applicable to POS debit card transactions. *See id.* § 205.11(c). Although financial institutions need sufficient time to investigate reports of potentially fraudulent activity, the consumer can face a dire situation in the interim without adequate funds to pay the rent or for mortgage, child care, food, utilities, medical/dental, and educational expenses. Prompt provisional credits, as well as quick but adequate investigations, are critical to consumers in this situation.

41. Although under federal law, the card issuer usually must give provisional credit to the consumer's account to invoke the extended investigation rules under federal law, that credit extends only to the amounts alleged to be in error. Amounts related to the fraud that are not discovered (or documented) initially are not necessarily subject to the provisional credit. *See* Regulation E, 12 C.F.R. § 205.11(c)(2)-(3).

42. *See* Anderson, *supra* note 34, at C12; Dugas, *supra* note 14, at 5B; Edgar A. Hatcher, *Banks Are Too Sly on Risks of Debit Cards; Try Sending It Back*, N.Y. TIMES, July 17, 1997, at 22.

43. *See* Lisa Fickenscher, *MasterCard to Cap Consumer Debit Card Liability*, AM. BANKER, July 31, 1997.

two business days and a set maximum liability of $50 thereafter, applicable to all of its transactions, whether online and offline.[44] Visa also pledged that its members would give customers a provisional credit for lost funds due to unauthorized transactions within five business days of notification, rather than the twenty days permitted under Regulation E.

Although these efforts are a good initial step, they are not be a satisfactory overall solution. The changes adopted are: (i) not uniform in regard to consumer liability; (ii) not uniform in regard to the time for provisional credits; and (iii) fail to focus on the unsolicited issuance of debit cards to consumers, many of whom do not fully understand the benefits and risks associated with the possession and use of these cards. Moreover, as indicated above, problems with debit card fraud remain; even with these refinements in approach, thieves still may obtain offline debit cards, quickly purchase merchandise or services, and drain consumers' accounts and backup credit lines completely.[45]

A LEGISLATIVE RESPONSE

In response to the growing concern over consumer protection issues, several bills were proposed in the current session of Congress. Two bills in particular, Senate Bill 1154, the Dual-Use Debit Cardholder Protection Act of 1997[46] (introduced by Senator Reed of the Committee on Banking, Housing, and Urban Affairs), and Senate Bill 1203, the Debit Card Consumer Protection Act of 1997[47] (introduced by Chairman D'Amato) would amend the EFTA in ways that address many of the problems discussed above.

Senate Bill 1154 would cap offline debit card liability at $50 and limit even that liability to only those transactions occurring before the cardholder gives notice to the issuer of possible unauthorized use of a card properly issued to him or her.[48] For all forms of electronic fund transfer (EFT), the measure would also require that, in order to incur any liability at all, the consumer must have received timely disclosures as required by the EFTA, and that these be supplemented by new disclosures pertaining to card liability and the card issuer's requirements for prompt reporting.[49] Senate Bill 1154 would also restrict the right to issue offline debit cards to those associations that limit liability consistent with the bill's terms.[50]

44. *Visa Announces New Protections for Cardholders*, PR NEWSWIRE, Aug. 13, 1997.

45. *See* Alexandra Alger, *Carte Blanche for Crooks: Banks Are Pushing New ATM Cards That Double as a Visa or a MasterCard. Avoid 'Em*, FORBES, Dec. 2, 1996, at 272; Anderson, *supra* note 34, at C12.

46. S. 1154, 105th Cong. (1997).

47. S. 1203, 105th Cong. (1997).

48. S. 1154, § 2(b), 105th Cong.

49. *Id.* § 2(c).

50. *Id.* § 3(c).

Senate Bill 1203 addresses similar issues, but appears to provide greater protections. It limits consumer liability for all unauthorized EFTs to the lesser of $50 or the amount of property or services obtained before the financial institution is notified (or otherwise becomes aware) of circumstances warranting a reasonable belief that an unauthorized EFT has occurred or may occur.[51] Moreover, the financial institution can invoke even this limited amount of liability only when: (i) there has been adequate notice to the consumer of potential liability; (ii) there has been notice to the consumer of the required means for apprising the institution of loss or theft of the card (or other access device); (iii) the unauthorized EFTs occurred prior to consumer notice to the financial institution; and (iv) the financial institution has provided a method for the consumer to whom the card (or other access device) was issued to be identified as the person authorized to use it.[52] The bill shortens the time period in which financial institutions may require consumers to provide written confirmation of the unauthorized use, and the period for provisionally recrediting the consumer's account from ten to five business days.[53]

Senate Bill 1203 limits issuance of offline debit cards to circumstances where a consumer requests or applies for that type of debit card, or as a renewal or substitution for an offline debit card.[54] In addition, the bill halts unsolicited issuance of EFT devices and requires that to be "issued" (not merely "distributed," as current law provides), all such devices must meet the following criteria: (i) they must be provided initially in an unvalidated form (so they cannot be used until consumers contact the issuer to validate them);[55] (ii) they must be accompanied by clear and conspicuous printed disclosure of their characteristics and liability;[56] (iii) there must be clear explanation that the device is unvalidated and how the consumer may dispose of the device if he or she does not want it;[57] and (iv) there must be validation of the card only upon request or application from the consumer with verification of the consumer's identity.[58] The bill would also establish a clear and conspicuous disclosure that the device does not require a PIN for use, and that loss or theft of the card could result in unauthorized access to the account.[59] Finally, the measure would require disclosure to consumers of the financial institution's restitution policy, including whether it will reimburse fees imposed by third parties for

51. S. 1203, § 2(a)(1), 105th Cong.

52. *Id.* These measures are similar to those limiting liability for credit cards under TILA. *See* 15 U.S.C. § 1643 (1994).

53. S. 1203, § 4, 105th Cong.

54. *Id.* § 5(a)(2).

55. *Id.* § 5(a).

56. *Id.* § 5(a)-(b).

57. *Id.* § 2.

58. *Id.*

59. *Id.* § 5(a).

unauthorized EFTs, e.g., dishonored check fees, late charges, and other fees.[60]

Although provisions in both Senate Bill 1154 and Senate Bill 1203 are beneficial to consumers, Senate Bill 1203 appears to provide more remedies for the wide-ranging issues faced by consumers using debit cards today. Senate Bill 1203 establishes considerable protections for consumers that are absent from the EFTA. Although Visa and MasterCard have limited the liability imposed on consumers by their member organizations—and Visa has revised its guidelines on provisional credit, as noted above—these rules are not federally mandated and do not apply to other debit card issuers.[61] Consumers should not be required to shoulder the burden of unauthorized use of any form of debit card, offline or online. Indeed, because new payment technologies are rapidly evolving, debit cards, credit cards, and other cards may soon merge into a unitary card with many options and features (multi-application "smart cards").[62] It is, therefore, appropriate that consumer liability rules for debit cards be consistent with those for credit cards, with which they may merge at some future point and which they already closely resemble to the consumers who use them. Consumers should not be penalized, and protections for their bank accounts (and possibly their overdraft credit lines as well) should not be contingent on the peculiarities of the particular card they were mailed (and may not even have requested or used due to intervening theft). Moreover, the loss of use of funds for even a few days can be devastating to those consumers who depend on their bank accounts to cover everyday expenses for themselves and their families. Thus, the time for crediting of consumers' accounts should also be shortened, as provided by Senate Bill 1203.

Because consumers' funds can be rapidly depleted by fraudulent activity following the theft of debit cards from the mail, federal rules pertaining to issuance of these devices must be addressed. Senate Bill 1203 focuses on this issue and brings debit card issuance rules closer to those for credit cards.[63] As such, it provides significant protection against fraud to consum-

60. *Id.* § 2.

61. That Visa and MasterCard have taken such actions, of course, does suggest that many of Senate Bill 1203's requirements are commercially reasonable and could be applied throughout the marketplace without incurring financial upheaval as a result.

62. Prototypes of these cards are already moving from the drawing board into operation. *See, e.g.*, Antoinette Coulton, *Smart Cards Graduating*, AM. BANKER, Sept. 16, 1997, at 15A; Jeffrey Kutler, *Wells to Issue Hundreds of Thousands of Smart Cards to On-line Customers*, AM. BANKER, June 11, 1997, at 1; Michael Moore, *Card Frontiers: 3 in New England to Test Smart Card Hybrid*, AM. BANKER, June 18, 1997, at 16; *Multi-App Cards Coming*, AM. BANKER, July 7, 1997, at 29; Ellen Stark, *What to Know Before You Spend Cyberdough*, MONEY, Jan. 1, 1997, at 33.

63. Credit cards may only be issued upon a consumer's request or application, or as a renewal or substitute for an existing credit card. *See* 15 U.S.C. § 1642 (1994); Regulation Z, 12 C.F.R. § 226.12(a) (1998). To adapt the Regulation Z "model" to debit cards requires

ers. Moreover, use of the "clear and conspicuous" format for EFT disclosures is critical to assure consumer awareness of the information.[64] Senate Bill 1203 wisely requires clear and conspicuous disclosure of offline debit cards' primary features, including the fact that they do not involve a PIN or other non-signature identifier. Finally, the bill also appropriately apprises consumers of the institution's policy regarding restitution of third-party fees in the event of unauthorized use.[65] These fees may be of many varying types—including late charges, overdraft charges, returned check fees, and others—but not insubstantial amounts. Because consumers may lose several hundreds of dollars in related fees, the proposed notice would clarify significantly the true extent of consumer risk for unauthorized debit card transactions.

OTHER SELF-REGULATORY INITIATIVES

If Congress does not act, MasterCard and Visa should consider additional self-regulatory initiatives. As noted above, limitations in consumer liability solve only part of the problem. The offline product is still very risky, and consumers are not fully informed of those risks (or their alternatives) when their ATM cards are converted into offline debit cards. What further action is necessary? The author suggests five proposals:

(i) *Better consumer disclosure.* The consumer should be informed in clear and simple language when his or her ATM card is being converted into an offline debit card. Consumers who receive new or converted cards should be told clearly and explicitly that these can be used without a PIN or signature.

establishing a general rule—as Senate Bill 1203 does—that all debit cards be issued only in response to an application or request, or as a renewal or substitute for the debit card. To apply the Regulation Z approach, however, requires consideration of the essentially different natures of offline and online debit cards. Because offline debit cards are akin to a new payment device to consumers who are primarily conversant with credit cards and ATM cards, it is not unreasonable to require—as Senate Bill 1203 does—that offline debit cards be issued in response to a request or application for an offline device, or as a renewal or substitution. Anything less may be insufficient to limit the potential for expansive fraud in this new payment technology. In addition, the consumer should not have to shoulder the burden of canceling an offline debit card he or she never requested.

64. The mandate for "clear and conspicuous" disclosure ensures that the information will be legible as well as understandable to consumers, based on a well-established body of federal disclosure requirements for consumer financial transactions. *See, e.g.*, 15 U.S.C. §§ 1632, 1667a; Regulation M, 12 C.F.R. § 213.3(a); Regulation M, 12 C.F.R. pt. 213, Supp. I. cmt. to § 213.3(a)-2 (lease disclosures); Regulation Z, 12 C.F.R. § 226.17; Regulation Z, 12 C.F.R. pt. 226, Supp. I. cmt. to § 226.17(a)(1)-1 (credit disclosures).

65. The $50 liability limitation under the bill would include overdraft or other fees imposed by the financial institution issuing the debit card. Other financial institutions or third parties also frequently impose fees in connection with the unauthorized use of a debit card, however, and the measure would require disclosure of the card issuer's policy regarding restitution of these fees.

(ii) *Informed consumer choice.* The consumer should be given the choice of accepting an offline debit card. Because these cards are more risky, a consumer should have to make an affirmative decision to accept the offline card after being informed of its risks.

(iii) *Online debit as an alternative.* Because online debit, which requires a PIN, has a much smaller rate of fraud, the consumer should be given the choice to designate his or her card for use with only online debit. Both Visa and MasterCard have online debit networks that are more efficient and less risky than their offline sister programs.

(iv) *Permit the consumer to tailor his or her debit program.* One approach to limiting the risk of loss is to permit consumers to set a personal daily spending limit for an offline card (e.g., $100 a day). Debit cards are most frequently used for small purchases, and a cardholder could set a daily limit accordingly. In addition to limiting risk of loss, this could provide an earlier warning of card theft.

(v) *Compress the dispute resolution process.* Brevity in the dispute resolution process is critical for consumers who have lost their funds. In contrast, in the credit card environment, a longer period may be acceptable because consumers do not have to pay the disputed charges until after the matter is resolved against them. Given that debit cardholders lose all access to the disputed assets, issuers should reduce the dispute period to ten days or fewer, and thereafter provisionally recredit funds until the dispute is resolved. Visa's new rule providing for provisional credit after five days is a good first step in resolving this problem.

Markets function best when consumers are fully informed of a particular product's strengths and weaknesses. It is in everyone's best interest to ensure that consumers are aware of the risks associated with debit cards, particularly offline debit cards, so as to exclude risks of unreasonable liability and ensure that consumers' acceptance of the cards is the result of their informed choice. For almost thirty years, this approach has characterized the credit card market. Indeed, federal regulations on the issuance of and liability for credit cards, coupled with clear disclosure of their risks and primary features, surely have played a major role in consumer acceptance of those cards and, hence, their tremendous growth and success in the economy. That approach—based on informed choices and decision-making—will be crucial to the success of debit cards, both in their current form and as multi-featured cards of the future.

CONCLUSION

The development of debit cards has reached a critical crossroads with regard to both antitrust and consumer protection concerns. Antitrust disputes are common in the payment systems arena because of the size of Visa and MasterCard and their joint venture character. For debit, the

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