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Bank Credit Plans: Innovations in Consumer Financing

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"Nicest thing since money" proclaims a slogan on a Chicago bank's charge card,\(^1\) and in seeming agreement is a San Francisco church which posted a sign stating "Charge a tithe—Use your BankAmericard."\(^2\) Expressions of this kind are suggestive of the general posture of today's bankers and consumers regarding bank credit cards and related bank credit plans.

Although the public has been afforded a plentiful array of "consumer type credit cards"\(^3\) for a good many years, it is only recently that the banking industry has made such a substantial and significant bid for a share of the installment credit market. The past two and a half years have shown a pronounced increase in the number of bank sponsored credit vehicles, and this increase is enthusiastically predicted to continue. It is this phenomenon within the banking industry that has prompted this comment.

There are currently several varied customer credit plans offered by banks throughout the United States which, although identified by different merchandising labels, may be generally classified into the following three categories: (1) the credit card plan; (2) the overdraft plan; and (3) the check guarantee card plan.\(^4\) Both the physical operation and the legal relationships created differ significantly with respect to each plan.

Although both the overdraft plan and the check guarantee plan are relatively new banking procedures,\(^5\) the bank credit card has been used for several years.\(^6\) Because of the extent to which each of these plans is being implemented by an ever increasing number of banks throughout this country, each of the three plans is equally appropriate for analysis. As in previous analyses of legal problems arising out of "consumer type credit card" transactions, it must be stated at the outset that

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\(^1\)First National Bank of Chicago issued a credit card bearing this slogan in December, 1966. The slogan was used in a massive newspaper and television campaign costing over 2 million dollars. *Chicago's Credit Card Crisis*, BUSINESS WEEK, July 15, 1967, at 35; *Credit Cards: Nicest Thing Since Money*, 70 NEWSWEEK, July 17, 1967, at 73.

\(^2\)Easy Go, 89 TIME, April 21, 1967, at 91.

\(^3\)The "consumer type credit card" is to be distinguished from the "travel and entertainment credit card," such as Diners Club and Carte Blanche, which are aimed more at the needs of the expense-account oriented executive.

\(^4\)Although the bank plans can be classified into 3 or 4 general categories, each particular plan may vary in its interest application, mechanics, or contractual construction.

\(^5\)Security First National Bank was the first on the west coast, introducing their Ready ReservAccount in 1964 and adding their Check Guarantee Card in 1966. A similar program was launched in Boston early in 1966 and, by the end of that year, had been adopted by over 130 banks in the country. Pullen, *Bank Credit Card and Related Plans*, FEDERAL RESERVE BOSTON-NEW ENGLAND BUSINESS REVIEW, Dec. 1966, at 2.

\(^6\)The first bank credit card plan was inaugurated in 1951 by the Franklin National Bank of Mineola, N. Y.
there is a continuing paucity of judicial or statutory authority.\footnote{The Tripartite Credit Card Transaction: A Legal Infant, 48 CALIF. L. REV. 459 (1960).}

The function of this comment is to provide a detailed examination of the operational mechanics, commercial role, and economic impact relative to each of the participating parties, i.e., customer, merchant, and bank, involved in each of the three plans. Each of the first three sections examines a particular bank plan. Included in each is a brief historical review, an explanation of the basic mechanics, and a discussion of the factors motivating participation by the parties, the legal relationships which arise as a result of this participation, and the problems which arise as a result of these legal relationships.

Finally, section four consists of an analysis of current and pending legislation regarding fraudulent consumer use, usury, and interest disclosure, and the applicability thereof to each of the three bank plans.

I. BANK CREDIT CARD PLANS

The extension of credit is an important function of banking institutions. Traditionally, banks have participated in retail credit financing by lending money to consumers. Recently, several hundred banks throughout the country have instituted bank credit card programs. The use of such a vehicle permits more direct, and more profitable, participation in consumer financing; at the same time, it deviates from traditional bank lending principles.

In the past, caution has typified most banks' lending policies, yet, often, a "borrower" receives a bank credit card for which he has not applied. Such a card permits the holder to charge a wide variety of merchandise and services, including cash. Credit investigations of card recipients are less thorough than are those of applicants for standard bank loans. Issuing banks receive no collateral for credit extended to card holders. Recent predictions of a future "cashless-checkless" society\footnote{See, e.g., Easy Go, supra note 2; Reistad,... Banking 25 Years From Now, FINANCE, Nov. 1966, at 18. But see Agemian, Credit Card Avalanche: Risks High Enough as It Is, Let's Not Compound Them by Hiding the Real Issues, American Banker, Mar. 21, 1967, at 19, col. 1 [hereinafter cited as Credit Card Avalanche].} evolving from increased development, expansion, and use of bank credit card plans partially illustrate the significance of this relatively new credit instrument.

The holder of a credit card issued by a bank participating in the large-scale plans\footnote{Bank plans originated as local systems with only local recognition of a bank's credit card. BankAmericard, however, is recognized throughout California. Recently, a system of franchising was introduced to enable banks in other states to issue BankAmericards. In some areas in which there are competing bank plans, the issuing banks have entered into local interchange agreements. Under such plans, a participating merchant honors the credit card issued by any bank member. Inter-regional interchange agreements have developed to permit a bank's credit card to be used in a separate geographical area. See generally Abouchar and Magnis, Bank Credit Cards—Implications for the Future, BANKERS MONTHLY MAGAZINE, Jan. 15, 1967, at 22. Master Charge is representative of an interchange plan operating both locally and statewide.} may purchase many, if not all,\footnote{To prove the effectiveness of its credit card, the Bank of America hired a San Francisco secretary to use its card in place of money for one month; she encountered difficulties only} of the goods and services he requires with
credit extended on the basis of this card. The proliferation of bank credit cards, their wide acceptance by the consumer public, and their present and future significance in our society are of sufficient import to require an examination of this instrument and an analysis of some of the legal problems inherent in such systems. Although prior writers have treated the subject of credit cards, the recent intensified activity in the development of bank credit cards and the present and potential economic, social, and legal significance of this specialized credit device justify this further examination.

Two major bank credit card systems—BankAmericard and Master Charge—are operative in California. These two plans are conceptually similar; operational differences are noted and discussed.

A. History

Department stores were the first to issue small devices in order to identify certain credit customers to their sales personnel. Originally, a small coin was used; later, these were replaced by charge plates; now, most department stores issue the familiar credit card. This type of credit card plan involves only two parties, the card-holding purchaser and the card-issuing seller. In extending credit to the customer, the store seeks to increase its profit by promoting increased sales and greater customer loyalty. If the buyer is dissatisfied, his recourse is directly against the card-issuing seller.

During the 1920’s, many major oil companies began issuing courtesy cards to selected customers. Today, the familiar credit card has replaced the courtesy card. Oil company credit cards are the most numerous; there are approximately seventy...

1\textsuperscript{1}Some plans advertise that with their credit card the holder can charge everything from the cradle to the grave. Merchant members of these plans include, among others, hospitals, doctors (including obstetricians), undertakers, and cemeteries.

2\textsuperscript{2}It is estimated that at least 1500 banks now offer credit cards, while two years ago, only about 100 did. In addition to the BankAmericard and Master Charge plans, there are several other large operations. The Midwest Bank Card System, Inc., with headquarters in Chicago, by last spring had 13 card-issuing banks, 60,000 participating merchants, and over 6,000,000 cards outstanding. Michigan Bankcard, a statewide operation, as of last spring, had 60 participating banks, 15,000 merchants, and over 600,000 cards outstanding. 62 U. S. NEWS & WORLD REPORT, May 22, 1967, at 103.

3\textsuperscript{3}For example, during 1966, BankAmericard produced sales of more than $228 million; sales for the first quarter of 1967 were substantially above 1966 figures. Id. at 104.

The customer purchases gasoline or other products from the service station and receives credit on the basis of his card. The service station submits the signed sales ticket to the issuing oil company and receives a credit or cash in return. The oil company bills and collects from the customer. In those instances where the service station is not owned by or the agent of the oil company, there are three separate parties to the transaction. In this respect, the transaction differs conceptually from those in department store credit plans.

In 1950, Diners' Club, Inc., introduced a new concept in credit cards—the “travel and entertainment” card. In later years, the American Express Company and the Hilton Credit Corporation issued similar cards designed for use primarily by businessmen. These cards are honored internationally by most airlines, railroads, hotels, and other travel-oriented services. Unlike the department store and oil company plans, the issuers of these credit cards have no product to sell. They perform a service for the cardholder and for the participating businesses in return for compensation from both. The cardholder pays the issuer an annual fee in exchange for being a member. Participating service establishments submit sales tickets to the card issuer and receive the sales price, less a pre-negotiated discount. The sale of no one product or service is promoted. The card issuer performs all billing and collecting. In addition, each of the three major issuers of such cards has recently introduced a plan involving one or more banks to extend to its cardholders not only the usual services but also certain services formerly available only to bank credit card holders.

Bank credit cards were first introduced during the 1950's. By the end of that decade, several major banks had entered the credit card field; the most notable was Bank of America with its BankAmericard.

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17Some oil companies have arranged for certain chains of hotels and motels to honor their credit cards. To encourage cardholders to use their oil company cards, issuers often invite them to purchase merchandise unrelated to automobiles with their credit cards. For example, cameras, power tools, radios, and various forms of insurance have been offered in recent months.
18American Express Company issues the American Express Credit Card. In addition, the company has recently acquired at least one major eastern bank credit card system.
19The Hilton Credit Card is now the Carte Blanche Credit Card.
20Each plan currently charges an annual fee of $12.00.
21Discounts vary between two and eight percent.
22For example, American Express has joined with about 175 banks to offer the American Express Executive Credit Card. A cardholder, who must have a minimum annual income of $10,000, receives all the privileges of the regular American Express Card; further, he receives a line of credit from his own bank to enable him to purchase on credit American Express Travelers Cheques or to have funds transferred to his checking account.
23The first bank credit card plan was inaugurated in 1951 by the Franklin National Bank in Mineola, New York. During the early 1950's, several banks throughout the country commenced similar plans.
24After three years of testing, research, and pilot operations, BankAmericard became an operational statewide program in 1959. Not until 1962, when credit sales totaled $84.8 million, did BankAmericard have a profitable year. In 1966, Bank of America implemented a
During the last two years, several hundred banks have introduced credit card plans. In late 1966, five large banks commenced the Midwest Bank Card, a co-operative system in which each bank issues its own credit card and enrolls member merchants; any participating merchant will honor a card issued by any member bank. Four California banks\textsuperscript{24} founded the California Bankcard Association in 1966 and, together with about sixty-two member banks, introduced the Master Charge card in July, 1967. Plans to implement regional exchanges of credit cards are now being discussed by several issuing banks to permit wider geographic acceptance of each bank's card.\textsuperscript{25}

Bank credit cards are similar to travel and entertainment cards in that there are three entities involved in each credit transaction—the card-holding purchaser, the selling merchant, and the bank, or banks. The bank performs services similar to those of a travel and entertainment card issuer by billing and collecting money from the cardholder and by crediting the merchant with the discounted value of his credit sales slips. In those systems involving participation by several banks, these functions are divided between the bank issuing the card and the bank with which the merchant deals. A basic feature of the bank plans, however, is the option the cardholder has to pay his balance in full or to pay only part of it, in effect, borrowing the unpaid balance from the bank and paying a monthly interest or service charge.\textsuperscript{26} This feature affords the cardholder an added convenience and the card issuer an important source of interest income. Further, since merchants deposit the sales drafts in local banks rather than mailing them to a national headquarters, the merchant receives credit or cash within one banking day of the deposit.\textsuperscript{27} Finally, whereas the travel and entertainment card is expense-account oriented, the bank credit card is consumer oriented in that it focuses on local retail and service outlets.

B. Mechanics

An examination of the operation of a bank credit card system is necessary to illustrate the significant problems. Most bank credit card plans are similar in operation; the following description includes both of the major plans in California.

In a typical bank credit card transaction, the cardholder receives merchandise or services from a business participating in the plan. The purchaser presents his credit national licensing program to permit banks outside California to issue their own BankAmericards.\textsuperscript{28}

\textsuperscript{24}The four founding banks were Crocker-Citizens Bank, United California Bank, Wells Fargo Bank, and the Bank of California.

\textsuperscript{25}Bank of America, through its franchise program, is implementing this concept. The California Bankcard Association is a member of Interbankcard, Inc., an interchange group formulated by several major, area-wide bank plans. This group is investigating the possibility and practicability of adopting a common name and symbol to be used by each member bank plan. Interbankcard, Inc., anticipates that it will be able to affiliate with local and regional interchange groups and with independent plans throughout the country, thus making a credit card of any of its members a national credit card.

\textsuperscript{26}One and one-half percent per month of the unpaid balance is the most common rate.

\textsuperscript{27}Merchants participating in travel and entertainment plans submit sales drafts to national or regional offices. The time lapse between submission of the sales draft and receipt of credit or cash is often several weeks.
card to the vendor, who imprints the customer's name and account number on a
triplicate sales slip provided by the bank. The customer signs the sales slip and
retains a copy. The seller deposits one of the retained copies in his account at the
bank which enlisted him in the program and receives credit for the purchase price
less a pre-arranged discount. The bank bears the risk and expense of collection.
In addition to purchases, the cardholder may present his credit card to any partici-
pating bank and receive an immediate cash advance. A fee, usually four per cent,
is charged for this service. The customer receives a monthly statement reflecting
his credit card purchases for the preceding month. He may elect to pay the amount
of his bill in full within 25 days of receipt of the statement without incurring an
interest or service charge, or he may pay any lesser amount, provided it is not less
than five per cent or $10, whichever is greater. A fee of one and one-half per cent a
month is charged on the unpaid balance if the cardholder selects the latter payment
option. Computed on an annual basis, the charge for the use of credit is at least
eighteen per cent per year. It is doubtful that many cardholders realize the actual
cost of repaying the issuer in monthly installments.

The success of such a plan requires the simultaneous creation and development
of a substantial consumer and merchant membership. Because the bank credit card
is primarily a credit device for the consumer, the bank must affiliate a large number
and wide variety of merchants to encourage and facilitate frequent use of the credit
card by the holders. Three main difficulties have arisen in recruiting member mer-
chants: (1) reluctance by some merchants already offering credit to install a com-
peting credit plan; (2) hesitancy by merchants to pay the discount rate deducted

28 Both major bank plans in California have established a maximum dollar limitation on
individual transactions. Before completing a sale exceeding the established "floor limit," the
merchant is required to receive authorization from the issuer. BankAmericard maintains cen-
ters in Los Angeles and San Francisco to authorize transactions exceeding the designated
limits to ensure that the customer's credit line will not be exceeded; Master Charge main-
tains similar centers.

29 The discount rate usually varies between two and five percent.

30 The maximum cash advance varies, depending on the credit card plan, between $50.00
and $500.00.

31 A customer desiring a cash advance of $100.00 signs a draft for $104.00. Banks have dis-
favored small loans because of the relatively high administrative costs. Channeling these loans
through a bank credit card plan eliminates much of this expense because the borrower's credit
history is already known to the bank, the administrative work has already been done, and
the initial discount fee plus the monthly service charge generates more income.

32 The BankAmericard centers process all sales drafts, charge them to customers' accounts,
and perform billing and collecting. The California Bankcard Association's clearing house
collects all sales drafts generated by Master Charge the preceding month, totals them, and
performs the billing and collecting for the member banks.

33 Most credit card issuers describe the monthly charge as a service charge; one bank states
that it is an interest charge. It would appear that the latter is more advantageous insofar
as income tax deductions are concerned. See IN T. REV. CODE of 1954, § 163.

34 Methods of computing the service charge are discussed subsequently in the section
concerning truth-in-lending legislation.

35 Retailers who have issued their own credit cards are often reluctant to participate
in bank card systems. The holder of such a card is a captive customer in that he can use
by the bank from each credit sale; and (3) doubt by some prospective members that there will be a sufficient number of credit card users to warrant the affiliation with the plan and the discount expense.

The eventual profit of the issuing bank is greatly dependent on the number of businesses that participate in its credit card program. Income from discounting sales drafts provides a major source of revenue to the sponsoring institution. The other major source of income is the service charge imposed on cardholders who elect to pay their balance in monthly installments. It follows that success also requires a large number of consumers using bank credit cards. Because a certain percentage of the population is not considered credit-worthy, and because the wide acceptability of a bank credit card makes it especially susceptible to abuse, care must be exercised in selecting prospective credit cardholders. One method is to issue a card only after receipt of an application and a thorough check of credit; another is to select prospective cardholders exclusively from a bank's customers who have conducted their financial affairs responsibly or who have maintained a certain minimum balance in their demand deposit accounts. Some banks, anxious to enlist as large a body of cardholders as possible, have used less reliable methods for selecting credit card recipients and have acquired a relatively high percentage of irresponsible consumer members. Distribution of unsolicited credit cards has caused some legislators to condemn the bank credit card system and may cause problems in affixing the liability of the cardholder for the unauthorized use of such a card.

C. Legal Relationships

Two problem areas inherent in bank credit cards are of major significance. One involves the recourse and defenses that are available to each party as against either or both of the other two. The second concerns which party bears what

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38. The distinction between a cardholder and a card user is obvious but critical.

37. Credit card issuing banks anticipate realizing some profit from merchant members utilizing other bank services.

39. Distribution itself has caused problems for many banks; illustrative are the difficulties encountered by many Chicago banks last year. Cards were initially distributed during the 1966 holiday season; many were stolen while en route or from mailboxes. Losses from unauthorized use of these cards greatly exceeded the anticipated one or two percent. To ensure that credit cards reach the intended recipients, many of these banks are now sending the cards by registered mail at a cost of eighty cents a card. *Chicago's Credit Card Crisis*, *Business Week*, July 15, 1967, at 35; *Credit Cards: Nicest Thing Since Money*, 70 *NEWSWEEK*, July 17, 1967, at 73.

38. Congressman Wright Patman (D-Texas) has been especially critical of the distribution of unsolicited bank credit cards. In August, 1967, he introduced a bill (H. R. 12646, 90th Cong., 1st Sess. (1967)) designed to prohibit such distribution. Patman's primary objection to bank credit cards is that the mass extension of credit impairs or prevents a bank's being able to ascertain its liquidity or reserve position.
responsibility if a bank credit card is used without the authority of the person to whom it was issued.

Since each party to a credit card transaction has entered into two separate agreements, one with each of the other parties to the transaction, and since the legal relationships are governed primarily by these agreements, an analysis of each contract is necessary.

1. Cardholder-Bank Agreement

The agreements between the issuing bank and cardholder used by the two major plans in California are similar in many respects. The contract in one plan provides that use of the credit card constitutes an acceptance of the terms of the contract; under the other, either using the card or placing one's signature on the card purportedly operates as an acceptance. The agreements in both programs state that the issuee agrees to pay the issuer for purchases made by or for credit extended to anyone using the card. Further, the cardholder agrees to waive and release the bank from all defenses, rights, and claims the holder may have against any merchant honoring the card.

Differences in the agreements used by the two systems are significant. Although the cards issued by both bank plans contain certain terms to which the issuee purportedly agrees, only one issuer places the actual contract on the card. The terms on the reverse side of the other card provide that by signing or using the card, the cardholder agrees to be bound by the issuer's charge card agreement. This agreement is printed on the paper folder to which the bank affixes the credit card for mailing. This paper folder is probably discarded by the average recipient before having read the agreement. The terms on the reverse of the card do, however, advise the issuee that he is responsible for all purchases made or credit extended on the basis of the card. Because the agreements used by both plans are in small print, it is doubtful that the average cardholder realizes the duties which he purportedly accepts.

One agreement provides that receipt by the issuer of written notice of the loss of the customer's card terminates his liability for any future charges. Other proposed legislation to limit or regulate the distribution of bank credit cards is being considered in both federal and state legislatures.

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Other customers of both plans receive their credit cards after submitting an application which contains the printed agreement. Some of these applications provide that the signature of the applicant operates as his acceptance of the terms therein. But cf. Allied Stores of New York, Inc. v. Funderburke, 52 Misc. 2d 872, 277 N.Y.S.2d 8 (Civ. Ct. of City of N.Y., 1967), wherein it was held that a customer's signing an application for a two party department store credit card did not bind her to all the terms of the agreement.

Under one plan, the recipient is designated the holder; under the other, he is described in the second person, i.e., "you," on the back of the card and in the first person, i.e., "I," in the agreement.

The agreements in both plans also provide that the credit card is the property of the issuer, that it may be cancelled or revoked at any time, and that it must be surrendered upon the issuer's demand. Attorney's fees resulting from an action brought to collect any payment due are to be borne by the cardholder.

contains no liability-limiting clause, but does include a duty on the part of the card-
holder to inform the issuer of loss of the credit card.

2. Merchant-Bank Agreement

The relationship between a sponsoring bank and a merchant member is em-
body in a written agreement. The California Bankcard Association does not pre-
scribe a uniform contract for each of its member banks to use, but does require
certain provisions be included in each agreement. The provisions found in the
contracts used by both the Master Charge member banks and Bank of America
are similar. In each, the merchant agrees to honor any valid card issued by any bank
participating in the plan of which he is a member. Goods or services are to be sold
at the regular cash price with no service charge or additional fee. Credit card
transactions are to be reflected on sales drafts furnished by the bank; the merchant
must complete each sales draft to include the information on the credit card, a
description of the merchandise sold or the services rendered, and the total price.
A copy must be given to the purchaser.

Inclusion of the following provisions found in all BankAmericard merchant
agreements is not required by the California Bankcard Association; however, most
member banks issuing Master Charge cards do include these terms. Merchants
must agree to indemnify the bank and hold it harmless from any and all claims
imposed by way of a defense, set-off, or counterclaim by a purchaser arising out of
a sale. Delivery of a sales draft to the bank operates as a warranty that the mer-
chant has no knowledge that would impair the validity or the collectibility of the
sales draft. The merchant must establish a fair policy for the exchange and return of
merchandise. In the event that merchandise is returned or that the cardholder
disputes the sale or quality of such merchandise or services, the merchant agrees
to pay to the bank the net amount of any sales draft involved.

The California Bankcard Association requires inclusion of the following pro-
visions not present in the BankAmericard agreement. The merchant shall incur no
liability in respect to forged or unauthorized signatures on sales drafts or because
a counterfeit card was honored. This release is conditioned on the merchant having
exercised reasonable diligence in determining that the card was issued for use in
the Master Charge system; further, the signature on the sales draft must appear to
be the same as the one on the card, and the merchant must have complied with
the other provisions of the agreement.

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44One plan exempts supermarkets from this requirement because their profit margin is low.
45Each credit card customer is charged a small fee.
46It is interesting to note that the agreement of one plan fails to require that the merchant
obtain the signature of the card holder. However, written instructions, apart from the
contract, do direct the merchant to obtain the customer's signature.
47In the event that a customer returns merchandise, the merchant must prepare a credit
voucher and present a copy to the customer and to the bank. The bank credits the cardholder's
account with the amount of the return. This procedure eliminates the possibility that a
person with a bank credit card could bypass the four percent fee accompanying cash advances
by making purchases with the credit card and subsequently returning them for cash.
3. Cardholder-Merchant Agreement

In a two party credit sales transaction, a buyer receives goods or services and gives as consideration his promise to subsequently pay the seller. A bank credit card sale differs from such a transaction in that the purchaser, in exchange for merchandise or services, makes no express promise to pay the merchant. The purchaser signs a sales draft; his signature operates as an acceptance to a bill of exchange drawn by the merchant on the purchaser in favor of the issuing bank. The purchaser's promise is to pay the participating bank, or order, the amount reflected on the sales draft.

Determination of whether the purchaser's promise is only to pay the bank or whether the purchaser also promises the merchant that he will pay the bank is essential in ascertaining the nature of the rights of the merchant should the sales draft be returned by the bank for any reason. The underlying transaction is a sale of goods or services, the receipt of which is the consideration received by the purchaser. If the purchaser promises the seller to pay the bank, his promise would be the seller's consideration. If, however, the seller receives no direct promise from the purchaser, he parts with merchandise or performs services solely in reliance on the participating bank's promise to discount the sales draft. If the purchaser has made no promise to the seller, his subsequent refusal to pay the bank cannot operate as a breach of any duty owing to that seller. The merchant then would have to obtain an assignment of the draft from the bank in order to collect from the cardholder. If, however, the purchaser's signature also operates as a promise to the merchant to pay the bank, refusal to perform would be a failure of consideration and would afford the merchant a direct cause of action for breach of contract.

It is submitted that the cardholder's signature is an acceptance of the order drawn by the merchant and is therefore a promise to the bank, as well as a direct promise to the bank.

D. Rights and Duties of the Respective Parties

Each participant in a credit card transaction has certain rights and obligations which result from the agreements to which he is a party. The principal problems arise as to the rights of one party if another fails to perform and as to the ability of one party to raise defenses available against the second in an action brought by the third. These problems are considered below from the position of each party.

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47 The California Bankcard Association requires each sales draft be in such form that the merchant is the drawer, the purchaser is the drawee, and the bank is the payee. The positions of the parties in a check transaction are different. The purchaser is the drawer; the bank is the drawee; the merchant is the payee.

48 The sales drafts of the two plans use different language. One requires payment within a specified number of days from demand. The other requires payment in accordance with the agreement between the issuing bank and the card holder.


50 The merchant offers a bill of exchange to the cardholder for his acceptance. This signature operates as such an acceptance. It also clearly operates as a promise to the merchant—the drawer of the draft—as a promise to pay the bank. Cf. W. HAWKLAND, COMMERCIAL PAPER 36 (1959).
to the transaction.

In attempting to define the legal relationships, other writers have analogized to commercial letters of credit and to the assignment and factoring of accounts receivable.\(^1\) Conceptual differences, however, preclude the application of the law pertaining to either of these transactions.\(^2\) Although the sales draft used by both

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\(^2\)Both the commercial letter of credit and the bank credit card involve the substitution of the established credit reputation of a bank for that of a purchaser whose financial responsibility is not known to the seller. In a letter of credit transaction, the bank promises a seller to accept bills of exchange drawn on the bank with the seller as payee; in a credit card transaction, the bill of exchange is drawn on the cardholder with the bank as payee. In both transactions, the purchaser, the seller, and the bank are each parties to separate agreements with each other party. Because the participants in a letter of credit transaction are usually businessmen, they realize that compliance with one contract is not a condition precedent to the enforceability of another. Most bank credit cardholders are retail consumers—a large proportion are housewives—and it is doubtful that many realize signing a sales draft operates as a promise to pay the issuing bank irrespective of having received satisfactory performance from the merchant. The buyer in a letter of credit transaction has no duty to pay the bank unless the bank is in receipt of specified documents indicating the shipment of the purchased goods; the buyer in a credit card transaction has no such protection. The two transactions are similar in that the purchaser cannot assert a claim available against the seller in an action brought by the bank; the purchaser's obligation is to the bank.

To be a letter of credit within the scope of the California Commercial Code, an instrument must be:

- (a) . . . a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; [or]
- (b) . . . a credit issued by a person other than a bank; [or]
- (c) . . . a credit issued by a bank or other person if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled. CAL. COMM. CODE § 5102(1) (West 1964).

Section 5103 states:

- (1) In this division unless the context otherwise requires
  - (a) "Credit" or "letter of credit" means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this division (Section 5102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. . . . CAL. COMM. CODE § 5103(1) (West 1964).

The sales draft used in a credit card transaction appears to satisfy the requirement of the documentary draft. "Document" is defined as "any paper." CAL. COMM. CODE § 5103 (1) (b) (West 1964). The bank, however, is the payee, not the drawee; as such, the bank does not honor the draft "upon compliance with conditions specified within the credit" but in accordance with its pre-existing agreement with the merchant. Therefore, a bank credit card is not a letter of credit within the scope of the California Commercial Code.

Because the merchant presents the sales draft to the issuing bank and receives the discounted value, the transaction resembles the merchant's assigning an account receivable to a factor. The analogy fails because of conceptual and legal variations. Unlike a factor of accounts receivable, the card issuing bank has a pre-existing contractual right to receive payment from the buyer. Since the factor, an assignee, can receive no better right than the assignor, the buyer may assert any defense available against the seller in an action brought by the factor. A credit card transaction involves an unconditional promise by the cardholder to pay the bank. Because the bank receives this promise directly rather than by assignment, such defenses may not be available.
issuers resembles a negotiable instrument, the draft of neither plan meets the re-

quirements of division 3 of the California Commercial Code.53

1. The Bank

The enlisting bank has the right to receive from the seller each sales draft at a
previously negotiated discount. Failure of a merchant to deliver to the bank each
draft reflecting a credit card sale would constitute breach of one of the promises
made by the merchant to the bank in the agreement between the two, thus giving
the bank a cause of action against the merchant.

The purchaser's signature on the sales draft operates as a direct promise to pay
the bank. Further, the terms of the agreement between the cardholder and the
issuer provide that the cardholder will pay the bank for all credit extended, ir-
respectively of any defenses, rights, or claims the holder may have against the

merchant. It thus appears that the bank has an absolute right to receive payment
from the cardholder for all purchases made with the card.54 However, the bank
may elect to charge back against the merchant any sales draft the purchaser declines
to pay because of the existence of an alleged defense against the merchant. For
practical reasons, it is probable that the bank would choose the latter course.55

The bank has a duty to accept from member merchants all sales drafts which
comply with the agreement between the bank and such merchants. The contract
used by one bank does not include an express duty to accept all tendered drafts
that comply with the agreement between the bank and the merchant.56 However,
as the merchant is obliged to tender all drafts generated by credit card sales,

53 The California Commercial Code states that any writing to be a negotiable instrument
within division 3 (Commercial Paper) must be signed by the maker or the drawer. CAL. COMM. CODE § 3104 (1) (a) (West 1964). The sales drafts used by both plans require only the signature of the drawer-acceptor, thus not meeting this requisite. It can be argued that the merchant's imprinting his name on the sales draft is accomplished with the present intent of authenticating the instrument, thus falling within the definition of "signed." See CAL. COMM. CODE § 1201 (39) (West 1964). If such is the case, it would be signed by the drawer.

The sales draft used by one of the issuers in California states that the purchaser's duty
to pay is governed by the agreement between the cardholder and the bank. This provision
further prevents the draft from being negotiable. CAL. COMM. CODE § 3105 (2) (a)
(West 1964).

It has been suggested that there may be negotiable instruments not within division 3. See ABA UNIFORM COMMERCIAL CODE HANDBOOK 89 (1964).

If the sales drafts used in these bank credit card systems are negotiable instruments,
additional problems exist. It is arguable, for instance, that the bank, as the motivating force
in the credit card transaction, is not a holder in due course. Cf. Commercial Credit Corp. v.
Orange County Machine Works, 34 Cal. 2d 766, 214 P.2d 819 (1950).

54 The agreement between the issuing bank and the cardholder provides that the card-
holder agrees to pay the bank for all credit extended on the basis of the credit card; it does
not limit this responsibility to credit extended solely to the cardholder.

55 The expense that the bank would incur by proceeding against the cardholder and the
resulting unfavorable public image are avoided by returning the draft to the selling merchant.

56 The contract states, "Bank will pay Member . . . [s] percentage of the total face amount
of each sales draft accepted and purchased hereunder . . . ."
the bank would appear to have an implied duty of good faith to accept such drafts. Further, since the seller has parted with goods or performed services in reliance on the bank's receiving and discounting the drafts, the bank would be estopped from refusing to accept them. Finally, the implied promise of the bank to receive and discount the tendered sales drafts appears to be part of the consideration for the seller's participation in the credit card system. It follows that unjustified refusal to discount the drafts would be failure of consideration.

2. The Member Merchant

The seller parts with merchandise or renders services in return for the purchaser's signature on the sales draft and in reliance on the bank's promise to accept the draft at a prearranged discount. Refusal of the bank to accept any draft complying with the agreement between the bank and the merchant would enable the merchant to recover damages from the bank.

If the bank discounts the draft and the cardholder fails to pay the bank for reasons other than those permitting the bank to charge the draft back to the merchant, no loss is realized by the merchant. If, however, the cardholder's refusal to pay results from an alleged defense he has against the merchant, or if the merchant fails to comply with all provisions of his agreement with the bank, the bank may return the sales draft to the merchant.

As consideration for parting with goods or rendering services, the merchant receives a promise from the purchaser to pay the bank. Failure of the purchaser to perform this promise would operate as a failure of consideration, thus giving the merchant a right to rescind or to collect damages from the cardholder. Should the merchant bring an action against the buyer, the buyer would be able to use any defenses or counterclaims he might have against the merchant.

3. The Credit Card Purchaser

Since any sale of goods is governed by division 2 of the California Commercial Code, each sale includes the implied warranty of merchantability and possibly an additional warranty of suitability. If the purchaser has accepted goods and notified the merchant of any breach within a reasonable time, he may recover as damages the loss resulting in the ordinary course of events from the seller's breach. The cardholder, however, still purportedly owes the bank the duty of payment upon receipt of the monthly statement.

If the cardholder refuses to pay the bank because he has returned the merchandise or because the services or goods were in some way infirm, the bank may either return the sales draft to the seller or bring an action against the cardholder.

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67 See CAL. COMM. CODE §§ 1102(3), 1203 (West 1964).
69 See CAL. COMM. CODE § 2102(1) (West 1964).
70 See CAL. COMM. CODE § 2314 (West 1964).
71 See CAL. COMM. CODE § 2315 (West 1964).
72 See CAL. COMM. CODE § 2607(3) (West 1964).
73 See CAL. COMM. CODE §§ 2714(1)-(3) (West 1964).
Election of the former choice would operate as a waiver of the bank's rights to receive payment from the cardholder. The cardholder and the merchant would then settle their respective claims as if there were no third party involved. However, the possibility that a bank would elect to pursue the latter course of action requires consideration of the extent to which the cardholder’s duty to pay is unconditional. In the normal two party sales transaction, should the goods or services be so defective as to operate as a material breach of contract, the purchaser would be excused from performing his promise to pay and could bring an action for damages. In the three party transaction, however, the cardholder, in his agreement with the issuer, purportedly agrees to be liable to the bank for any credit extended on the basis of the credit card, irrespective of any defenses the cardholder might have against the merchant. Unless this provision is invalid, the cardholder is effectively prevented from raising these defenses.

Several arguments can be made that the provision should be inoperative or invalid. The agreement embodying this term is in fine print and is probably not read by the cardholder. Yet, it is generally accepted that if a party is capable of reading a contract and is not prevented from so doing, he shall be presumed to have read it and assented to the terms thereof. Since the recipient of a bank credit card is under no pressure to accept it, he should be presumed to have read the terms of the agreement and assented thereto.

An issuing bank is in a superior bargaining position and can dictate the terms of the agreement. Because an issuing bank anticipates realizing income from its outstanding credit cards, it is arguable that the bank should accept any loss resulting from customer dissatisfaction as a cost of doing business. The most persuasive argument concerning the unreasonableness of the provision is that the bank has a right to return a sales draft to the merchant if the purchaser claims a defense against the merchant. Since the bank has minimized its risk, it can be argued that the consumer cardholder should not be compelled to assume the expense and burden of paying the bank in addition to having to institute an action against the merchant. All the foregoing arguments fail, however, because a bank credit card is not a necessity but a convenience which a recipient is free to accept or reject.

It is submitted that the cardholder’s waiver of any defenses he has against the merchant as against the bank is not unreasonable. The cardholder, therefore, owes a duty to pay the bank for all credit transactions in which he uses his bank credit card.

64However, if, as suggested, the purchaser has made both a direct promise to pay the bank and a promise to the merchant that the bank would be paid, the promise made to the merchant would still be in effect, and an action could be brought upon it. If the suggested analysis is incorrect, and no promise has been made to the merchant, the bank could assign its rights against the cardholder at the time it charges the sales draft back to the merchant. In any event, it appears that the merchant can always bring an action against the purchaser on an underlying implied promise to pay for goods received.

65CAL. COMM. CODE § 2711 (West 1964).
E. Liability for Unauthorized Charges

The wide variety of goods and services available to the user of a bank credit card and its broad acceptability have combined to produce a significant incidence of unauthorized usage. To reduce and hopefully eliminate the losses suffered by banks, cardholders, and merchants from such abuse, card issuing banks have implemented procedures to detect the unauthorized use of their credit cards. Once a cardholder reports to the issuing bank that he has lost his credit card, the bank sets in motion certain procedures designed to notify merchants that the card has been stolen; often, the card is retrieved and the unauthorized user apprehended.

Determination of which party must pay for the unauthorized charges requires examination of the various contracts and of the trend of judicial opinion in this field. The contracts between the issuing bank and the cardholder in both bank card programs in California provide that the cardholder is liable for all charges made with the credit card. One of the agreements states that this liability shall continue until the issuer receives notice of the loss of the card; the other agreement has no liability limiting clause, but does include a duty on the part of the cardholder to notify the issuer if the card is lost or stolen.

Assuming that the cardholder has acted in such a way that his assent67 to the terms of the agreement may be implied,68 strict construction of the agreements would require him to bear the risk and expenses of the unauthorized use of his credit card, at least until the issuer received notice of the loss. Examination of the few cases dealing with lost or stolen credit cards indicates that courts have not been consistent in interpreting similar agreements.69 Several writers have concluded from the cases that if the cardholder has not been negligent, he probably will not be held liable for the charge.70 Courts in so deciding overlook the terms of the agreement and balance the negligence of the cardholder with that of the issuer and the merchant, apparently imputing nonfeasance of the merchant to the issuer.71

67Using the credit card, according to the terms of both issuers' agreements, operates as assent to all the terms. Should the cardholder act inconsistently with acceptance, i.e., by discarding it before using or signing it, there would be no contractual basis for liability. Arguably, there could exist liability on a tort theory since it was the negligent disposition of the credit card by the recipient which led to its unauthorized use. However, it is submitted that by distributing credit cards to those who have not applied for them, a bank assumes the risk that some will be unwelcome and discarded.

68In those instances where the cardholder has signed an application in which the agreement is included, he should be considered to have expressly assented to all of the terms. See Palmquist v. Mercer, 43 Cal. 2d 92, 272 P.2d 26 (1954); Smith v. Occidental & Oriental Steamship Co., 99 Cal. 462, 34 P. 84 (1893).

69No reported cases concerning bank credit cards have been found. The few cases dealing with other credit cards are collected in Annot., 15 A.L.R. 3d 1086 (1967).


Banks distribute credit cards intending to produce income. Since the cardholder is usually the first party to know his card has been lost or stolen, his duty to inform the bank appears to be not only reasonable but necessary to the success of the bank credit card system. Since a reading of the terms of the agreement would advise a cardholder that he has agreed to assume all liability, and since bank credit cards are a convenience rather than a necessity, it is submitted that a cardholder should bear the risk of unauthorized charges until he notifies the issuer of the loss. It is conceivable that a thief could make charges totaling several thousand dollars even after the loss of a credit card was reported to the issuer; since the issuee can do nothing to prevent such charges after he has notified the issuer, his liability should terminate upon the issuer's receipt of written notification of loss.7

Banks often settle with cardholders for less than the total amount of unauthorized charges, in effect dividing the liability. As a condition to settlement, the banks usually require the issuee to appear as a witness in the prosecution of the person using the card.73

Both merchants and consumers have accepted the bank credit card. Banks are realizing substantial income from their credit card operations. In order to promote the further success of these operations, they will continue to seek public favor and to avoid adverse publicity by declining to strictly enforce their rights.

II. OVERDRAFT PLANS

It should be stated at the outset that in the majority of cases the overdraft plan and the check guarantee plan are promoted and packaged as one program.74 The two are particularly suited for such a relationship and together provide an attractive consumer package. Notwithstanding this merchandising feature, the two plans are, in fact, separate and distinct credit producing vehicles which individually create unique legal and operational considerations. For this reason, the two are separately discussed.

A. History

The overdraft plan was first launched in California by Security First National Bank late in 1964; before the end of 1966, it had been adopted by over 130 banks

72The travel and entertainment card issuers limit a cardholder's loss after notification to no more than $50 or $100. The availability of insurance to protect against unauthorized charges makes placing the risk of loss on the cardholder more reasonable.

73If a cardholder receives a monthly statement reflecting charges not made by him, he should notify the bank immediately that he challenges the statement. His failure to object within a reasonable time may operate to cause the open account to be superseded by an account stated, thus preventing him from asserting the defense that he did not make the charges. See California Bean Growers Ass'n v. Williams, 82 Cal. App. 434, 255 P. 751 (1927); 1 B. WITKIN, SUMMARY OF CALIF. LAW CONTRACTS § 320 (7th ed. 1960).

74Although the overdraft plan is entirely capable of effective commercial operation without an appended check guarantee program (as evidenced by United California Bank's Balance-Plus Plan), whether a check guarantee program could properly operate without an association with some type of overdraft program is highly questionable.
throughout the country. Simply stated, the plan gives the depositor-customer a line of credit in the form of an overdraft privilege on his personal checking account. In the typical situation, after the prospective customer has submitted an application form provided by the bank and has been accepted as a suitable risk, he is provided with a standardized contract for his signature. When this is completed, the customer has at his fingertips, albeit abeyant, an unsecured loan in an amount equal to the determined line of credit. Hence, the overdraft plan is a form of facilitating consumer credit by the use of an established and natural bank mechanism, the checking account.

B. Mechanics

The process is conveniently and comfortably simple to the bank customer. When he issues a check in excess of the balance available in his checking account and it is presented by the payee to the bank, funds sufficient to pay the check are automatically transferred into the account in the form of a deposit, and the check is paid. There is no requirement of advance notice or the use of a special check. The transferred amount is actually a loan. As it is repaid, the amount available for future loans increases until it again reaches the maximum credit line.

One common method of administering this loan process is by establishing two separate customer accounts, one account being a typical personal checking account and the other a “loan holding account” which theoretically contains an available cash reserve. Upon execution of an overdraft, money is transferred from the “loan holding account” to the personal checking account. An interest charge is applied

76The overdraft plan is properly categorized as a type of revolving consumer credit which simply supports the customer’s checking account.
77Unlike a bank credit card program, which must evidence a high number of cardholders to attract sufficient merchant participation (generally resulting in more lenient credit standards during the early stages of operation), the overdraft plan is able to retain selective customer membership through more discriminating credit investigatory procedures. For an example of the turmoil which can result from lenient credit standards and distribution of millions of unsolicited bank credit cards, see Chicago’s Credit Card Crisis, BUSINESS WEEK, July 15, 1967, at 35.
78The agreement must be signed by all parties who sign as depositors on the checking account signature card. In addition, because of joint tenancy and California community property laws, a spouse must sign a guarantee agreeing to liability on the advanced credit where he or she does not sign as a party to the overdraft account.
79A special check is required where a “check credit” program is employed. The “check credit” program is promoted primarily in the east and midwest and is similar to a “traveler’s check” system. The customer is given a book of checks, specially numbered or otherwise uniquely identified. Use of one of these special checks constitutes a loan by the bank for which the customer pays a one to one and one-half percent interest charge on the unpaid balance each month. In addition, the customer may be required to pay a fixed amount for each check.
80All overdraft plans allow partial repayment of the outstanding loan with certain minimum amounts payable, computed on a percent of the amount outstanding.
on the interest bearing principal\textsuperscript{81} at the prevailing rate on overdraft loans of one and one-half percent per billing period, which is approximately one month.\textsuperscript{82}

The amount transferred from the “loan holding account” to the personal checking account varies according to the overdraft program of the particular bank. Some programs automatically transfer a pre-determined amount irrespective of the amount of the overdraft;\textsuperscript{83} others simply transfer an amount equal to the amount overdrawn. This variance can result in significantly dissimilar interest consequences, as is illustrated by the following example. Assume a customer overdraws his checking account by one dollar which shall be stipulated to be interest bearing principal. Under the program which transfers only an amount necessary to cover the deficit in the checking account, a loan of one dollar is transacted. This results in an interest charge of one and one-half cents for the billing period. However, where the program automatically transfers money in multiples of a designated amount, such as one hundred dollars, the customer will pay interest pursuant to that amount, here, a dollar and fifty cents. Thus, while only one dollar was required to satisfy the overdraft, interest is assessed on one hundred dollars; in effect, the customer pays one hundred and fifty percent interest per billing period on his one dollar overdraft.\textsuperscript{84}

The customer is apprised of his account activity through a monthly billing statement which includes a summary of the transactions in both accounts. Analogous to the usual procedure of most revolving consumer credit systems, the loan may be repaid either in designated minimum monthly installments or in one total payment. Normally, the repayment is due a stated number of days after the date of the billing.\textsuperscript{85} Also, where the dual account method is employed, deposits must be directed toward the desired account. That is, a deposit to a personal checking account does not restore the borrowed money to the “loan holding account.” A deposit must be entered specifically as a “loan holding account” deposit to effect a repayment of funds previously borrowed.

Usually, there is neither an initial charge to set up the overdraft account,\textsuperscript{86} nor a charge if the overdraft privilege is not used. Also, unlike conventional bank loans, the borrowed money is unrestricted in terms of consumer use.

\textsuperscript{81}Interest bearing principal is determined according to the program of the particular bank. In general, the customer may be required to pay an interest charge on the average overdraft balance during the period covered by the billing statement, or he may enjoy a short “grace period,” usually 25 days, before the interest rate is applied. The subject of interest application and interest bearing principal is discussed further in note \textsuperscript{87}, infra.

\textsuperscript{82}The billing period is dependent upon the particular bank program but usually does not exceed \textsuperscript{30} days.

\textsuperscript{83}Transfers are made in multiples of a designated amount, such as $100, which should leave the depositor with a balance in his checking account after the overdraft is paid.

\textsuperscript{84}One can produce an even more dramatic example by assuming an overdraft of one penny which is subjected to such interest computation. There, a depositor would still be required to pay $1.50 in interest each billing period, or an interest rate of 15,000 percent on a one cent loan.

\textsuperscript{85}This varies according to the particular plan but is usually a period of 10 days.

\textsuperscript{86}Unlike the typical “travel and entertainment credit card” sponsored by American Express, Carte Blanche, or Diners Club, neither the bank credit cards nor the related plans require monthly or annual customer fees or initial membership costs.
This program is doubtless attractive to many bank customers since it eliminates the not uncommon periodic apprehension of an overdrawn checking account and the embarrassment of a returned check stamped "insufficient funds." Yet, its most inviting aspect is the fact that the customer is provided with an available cash loan which entails no more effort or formality than is present when one executes a check in his local supermarket. In effect, the bank has deposited an interest free loan into his account which he may or may not ever choose to use and which begins to earn interest only after a given number of days following activation of the loan. This prospect of using bank funds for as many as 50 interest free days is no small inducement to the average consumer.

Hence, in these days of increased debt assumption by consumers, the bank customer is provided with a loan vehicle in the form of his checkbook which allows unrestricted, immediate cash transactions with a merchant, an individual, or an institution. In this respect, this credit form significantly differs from the bank card. While the bank card is restricted in use to only those places which honor the card, the use of the individual's check is restricted only to the extent to which it will not be accepted in place of money. This functional advantage is attractive when one considers the number of nonconsumer type transactions which occur in our everyday lives.

The sponsoring bank receives a number of desirable incidents from an overdraft program in addition to the obvious benefit accruing through interest earnings on

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87There are two general classifications regarding interest application which pertain to overdraft plans. The first is the "no grace period application," which provides for computation of the interest, one and one-half percent, on the average overdraft balance during the period covered by the statement. Of course, the depositor does receive interest free use from the date of the statement to the date of required payment, but, regardless of when the overdraft occurs, interest will be applied so as to produce an average minimum outstanding loan during the statement's period. The second type, "grace period application," computes interest at the rate of one and one-half percent for a billing period on the minimum amount of funds continuously in use from one statement date through the next statement date. As an example, imagine two consecutive statement dates—June 1 and July 1. On June 1, the depositor owed $500, and at sometime before the July 1 statement, the depositor repaid $50, leaving a balance of $450 that was continuously owing through the entire statement period. On July 1, the depositor's interest would be computed at the rate of one and one-half percent on the $450 for that monthly period. However, if at some time during June the depositor received a new credit advance of $300, the actual total owed would be $750 on July 1. But, this added $300 would not be taken into consideration when computing interest for that month, as it occurred between the two statement dates and was not continuously owing for the entire statement month.

It can be seen that if a depositor overdraw his total line of credit, say $500, on the second day of the billing period, June 2, it would not earn interest until August 1, as it would not be continuously owing for an entire statement month until it was outstanding for the period between July 1-August 1. In this case, the depositor would obtain just less than two months of interest free use of a bank's money.

88Individuals stand much more ready these days to commit their future income to debt repayment than they were a generation or two ago. Moreover, rising incomes and employment and increasing security of both jobs and incomes have encouraged borrowers to take on additional debt. Federal Reserve Bulletin, June, 1966.

89This is subject to the depositor's covenant not to exceed the established credit line.
continuing loan accounts. In comparison to a bank credit card plan, low operating and start-up costs and the absence of non-bank competition provide attractive inducements for a bank's adoption of such a plan. These factors are further explained in the discussion of the check guarantee card.

C. Legal Relationships

Unlike the tripartite bank card plan, the overdraft plan involves only the bank and the bank customer. Hence, there is no contractual or legal relationship arising between the merchant and either of these two parties other than that normally arising as a result of a check purchase transaction.

The overdraft plan, of course, necessarily assumes that the participating customer has opened, or will open, a checking account with the bank. The customer by depositing funds in the account creates a debtor-creditor legal relationship along with an implied contract on the part of the bank to discharge the indebtedness by honoring checks on the account. This relationship is merely reversed once the deposits are exceeded by charges to the account, and the overdraft loan is activated. In addition to this fundamental relationship, there exist rights and duties expressly contained in the standardized contract. The typical contract provides that the customer will not exceed the established credit line, will pay a certain minimum amount on the outstanding balance each billing period, and will provide the bank with periodic personal financial information at the bank's request. The bank normally reserves the right to terminate credit and cause the entire balance to be immediately due and payable if the customer fails to comply with the contract provisions.

Interest application and the incremental amount to be loaned produce the greatest variance in overdraft contracts. The cost of the loan, or interest, is uniformly set at one and one-half percent per billing period on the interest bearing principal. However, there is wide divergence between contracts as to when the loan becomes interest bearing principal. Under one type of contract, there is no free interest period as the interest is applied on the average overdraft balance during the period covered by the billing statement. Another type provides for an interest free period which can work out to be in excess of 50 days. Hence, a customer under the latter contract is entitled to an unlimited number of short unsecured loans at no cost if the loan is repaid within the grace period. This variance in the calculation of interest becomes more significant because of the substantially different methods employed by the banks in effectuating the loans. As discussed earlier, one method transfers only that amount necessary to cover the current deficit while

90CAL. CIV. CODE § 1878 (West 1957); Basch v. Bank of America, 22 Cal. 2d 316, 139 P.2d 1 (1943); Union Tool Co. v. Farmers' & Merchants' Nat'l Bank, 192 Cal. 40, 218 P. 424 (1923).

91All overdraft agreements are essentially the same, although they do vary from one bank to another in contractual structure and terminology. For the purpose of this comment, the agreements provided by five major banks were examined: Security First National Bank, United California Bank, Bank of America, Union Bank, and Chase Manhattan Bank.

92See note 87, supra.
another method transfers money in designated multiples irrespective of the overdraft amount. Thus, if a “no grace period” interest provision is combined with a “predetermined loan transfer method,” an overdraft would guarantee the bank an interest return of one and one-half percent of the automatically transferred amount. However, where the automatic transfer of a predetermined amount is joined with an interest free grace period, the likelihood of a small overdraft incurring the proportionately large interest assessment seems remote. The customer is given a period of time to make up the deficit and avoid the interest. Where a dual account method is used, however, the payment must be directed to the proper account or the deposit will not be applied to the loan, and if the grace period terminates, interest will be assessed.

The overdraft plan is probably the least legally complicated plan of the three under discussion. The legal designation of the two participating parties and the mechanism employed are settled and traditional legal concepts. Most important is the absence of a third contracting party, a characteristic of credit card systems which gives rise to legally undefined additional and competing rights and duties. Though the trend appears to be a proliferation of credit plans, it is only under the overdraft plan that the legal positions, rights, and duties of the bank and the customer can be defined and predicted with certainty.

### III. Check Guarantee Card Plans

The check guarantee card is a recent addition to the myriad types of bank sponsored cards. Its combination with the overdraft plan is being proclaimed by some to be the most natural and desirable of all the emerging bank credit programs. Such a statement, examined in detail below, must be considered a bold assertion in view of the apparent success of the increasing number of bank credit card systems.

#### A. History

The check guarantee card probably has as its conceptual predecessor the bank “courtesy card” which allowed the bank customer virtually unquestioned check negotiation at any branch of the issuing bank. The card served, however, only to identify the customer to the branch as a responsible depositor of the particular institution so that normal identification procedures could be eliminated.

Although the check guarantee card retains the concept of the courtesy card, it is essentially an ingenious hybrid of a bank credit card and the check credit system. The check guarantee plan retains the enviable aspects of each of these bank credit programs while eliminating the less attractive elements.

This bank mechanism is not a true credit vehicle. Its function is not to furnish a line of revolving credit, but rather to complement an existing credit producing

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93 See note 83, supra.
94 Credit Card Avalanche, supra note 8, at 21, col. 1.
95 The bank “courtesy card” imports no legal obligations or privileges but is simply a customer service engendering preferential bank treatment.
96 In 1966, the check guarantee card was introduced in California as a separate but complementary program to Security First National Bank's existing overdraft program.
program—the overdraft plan. The check guarantee card was conceived as a means of expediting the "check purchase transaction," a crucial process in that plan. Yet, as will be seen, because of the contractual nature of the check guarantee plan, it is capable of effecting consumer credit as readily as each of the other two bank programs.

B. Mechanics

The role of the check guarantee card is precisely as its label suggests. When the bank customer and an "eligible" merchant follow the conditions of the plan, the issuing bank guarantees that the customer's check will be honored.

The card is customarily issued pursuant to the same contract used to initiate an overdraft plan. The two features compose a complete customer package; once the customer is granted overdraft privileges, the check guarantee card is included. The customer, by presenting the guarantee card to the merchant when negotiating a personal check, replaces his undefined financial responsibility with that of the recognized solvency and reliability of the issuing bank. The merchant, with this bank guarantee, may accept the check with the assurance that it will be paid, thus expediting consummation of the "check purchase transaction."

The bank's guarantee is conditioned on compliance with provisions stated in the customer's contract and on the reverse side of the guarantee card. Because there is no pre-existing agreement between the issuing bank and the merchant, he may or may not have been apprised of the function of the guarantee card prior to its presentation. The rights and duties of the merchant flow directly from the terms and conditions expressed on the reverse side of the card; they are framed as simple procedural directions.

The typical check guarantee card states in its preamble that, provided the enumerated conditions are met, the issuing bank guarantees payment of checks drawn by the customer whose name appears on the face of the card. The conditions require that the check be endorsed in the payee's presence, on a personalized check of the issuing bank, pursuant to an unexpired guarantee card, and for an amount not in excess of the designated maximum. Further, the merchant is required to compare the signature on the check with the signature on the card and to present the check without further negotiation.

97All check guarantee contracts limit the guarantee to bona fide business establishments. Understandably, the bank is not willing to guarantee intra-family check transactions.

98The guarantee card is not offered to a depositor except as part of the overdraft plan. The overdraft contract includes the depositor's covenants, rights, and duties regarding the check guarantee card. Banks adding a check guarantee feature to an existing overdraft plan necessarily require an additional contract.

99As with the bank credit card, there is a maximum amount which will be guaranteed. The usual program guarantees checks only up to $100 but not the first $100 of a check in excess of that amount. That is, if a depositor negotiates a check for $150, no part of the check is guaranteed. There are a number of exceptions to this limit arising out of arrangements between banks and such businesses as airlines, rental car agencies, and hotels.

100This requirement seems to be unenforceable by the bank unless the two signatures are so dissimilar as to put a reasonable man on notice of the variance.
To activate the guarantee provision, the number and expiration date of the card must be noted on the back of the check. Also, the payee must be within the class to which the guarantee extends, generally defined as "an established business or firm." The card itself always remains the property of the issuer and is revocable at any time. The customer must promise not to negotiate checks in excess of his overdraft credit line; he waives his right to stop payment on all checks drawn pursuant to the guarantee card.

1. The Merchant

The merchant, being a vital party in the success of the bank program, is a providential beneficiary of the check guarantee plan. In the absence of a pre-existing agreement, there is no obligation to accept a check or participate in the plan. If a merchant chooses to accept a check on the basis of a guarantee card, he may still accept or reject later checks at his unrestricted option. Hence, he is completely free to enjoy the obvious benefits of a guaranteed check where it suits his needs and to discontinue the practice without notice or obligation.

Understandably, the merchant has a great deal to gain by participating in the program. The commercial dangers of forgery, fraud, and insufficient funds in a personal check transaction are a constant concern to the retail merchant. By guaranteeing customer checks, the sponsoring bank actually assumes these "bad check" risks. For the small retailer, the bank in a sense becomes his credit department with its greater credit investigatory resources. Yet, for all this, the merchant pays no fee or discount, nor does he obligate himself in any way.

2. The Customer

The customer acquires a number of consumer benefits through the use of the check guarantee card. Perhaps the most salient attraction is the ease with which his proffered personal check may be negotiated once the merchant can dispense with protracted identification procedures. Because the card guarantees personal checks for cash as readily as it guarantees checks for goods or services, it obviates the hesitancy of merchants to accept checks in excess of the sale. Thus, the merchant can be auspiciously indifferent as to whether there are existing funds in the offeror's checking account. Unlike the credit card plans, the acceptance of the guarantee card is not limited to merchants under prior contract to the bank, although its use is restricted by the contractual requirement of an "eligible merchant."

3. The Bank

The most obvious benefit realized by the issuing bank is that the check guarantee plan represents a way to expand business. The card is an attractive marketing

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1. This requirement provides the bank with its only indication that the check was negotiated pursuant to a check guarantee card.
2. This provides the issuing bank with a method of control over a depositor's abuse of a check guarantee card so that the card may be legally recovered from the depositor as quickly as he can be found.
3. Most plans require that the check be payable to and endorsed by an established business or firm.
tool enhancing the overdraft package. Through its use, the bank enjoys substantial community exposure, and the bank customer is provided with a means of prompt check encashment. However, its primary function is to assist and thereby facilitate use of the accompanying overdraft account. This overriding motive prompted the creation of the card and controls its contractual construction. Despite this seemingly narrow design, the guarantee card has incorporated the positive aspects of each of its predecessor plans while eliminating the less desirable features.

The check guarantee program has three attractive characteristics not present in the popular bank credit card system. These characteristics—low start-up costs, low operating costs, and reduced non-bank competition—are especially attractive to smaller banking institutions which may contemplate entrance into the revolving credit field but are less able to sustain long term losses than are the larger institutions.

Inherent in the credit card plan are the invariably high start-up costs of signing up merchants, enlisting cardholders, installing imprinters for merchants' slips, and acquiring computer facilities if they are not already available. The check guarantee program, together with an overdraft plan, incurs none of these initial costs. Merchants need not be signed up at all, and cardholders are selected from depositors of the sponsoring bank.

To persuade merchants to participate in a credit card program, the bank must evidence a large number of cardholders. However, indiscriminate issuance of cards on the basis of lenient credit standards may mean high credit losses. The check guarantee program can ordinarily be more cautious and selective in extending credit than a credit card program where pressures are great for a large distribution of the cards. In addition, a check guarantee plan eliminates the special and costly clearing arrangements required in the use of credit card sales drafts. In the check guarantee plan, only existing check clearing channels are utilized.

The check guarantee program enjoys low operating costs because the plan is readily integrated with the banks' existing demand deposit accounting process. This results in reduced costs by avoiding separate billing procedures, file maintenance, and mailing operations.

To effectuate the guarantee provisions of the check guarantee plan, the customer must have both the personalized check and the guarantee card. The requirement of these two instruments serves to reduce the incidence of fraudulent purchases which result when the finder of a lost credit card unlawfully purchases items before the card is "blocked."

The check guarantee program does not conflict with the substantial and profitable retail credit card operations of the larger department stores. Experience shows that such stores hesitate to participate in bank credit card programs for the obvious reason that they compete with their own credit card plans. As a result, a bank credit card plan must attract a large number of small and medium size merchants if it is to achieve the volume necessary for profitable operation. The check guarantee plan, on the other hand, is readily accepted by all retail merchants. Personal checks are constantly tendered for payment of purchases in the ordinary
course of business. The large department store, by accepting the check guarantee card in these transactions, receives bank protection without compromising its own credit program.

The check guarantee plan is, in principle, very similar to the check credit system but, in operation, significantly different. Under a check credit system, in place of a guarantee card the customer is given a book of checks, specially numbered or otherwise uniquely identified. Use of one of these special checks constitutes a loan by the bank for which the customer pays a one to one and one-half per cent interest rate on the unpaid balance each month. In addition, the customer may be required to pay a fixed amount for each check. The check guarantee plan avoids the use of a special check by utilizing the normal customer checks and only transacts a loan when the check amount exceeds existing deposits, thereby activating the accompanying overdraft plan. Hence, the guarantee card may be used for check transaction convenience without incurring loan liability.

C. Legal Relationships

A difficult problem concerning the check guarantee plan is ascertaining its legal designation. Until this is established, a meaningful definition of the rights and duties of the participating parties is impossible.

1. Contract of Guaranty

Practically, it has been described as a plan which guarantees payment of checks out of funds on deposit or funds which the bank has agreed to lend and which the customer has agreed to repay. Though the term "guarantee" normally imports that payment of the check is guaranteed, courts, nevertheless, have held that the use of the term does not always embrace such a legal consequence. However, a careful reading of the cases discloses that either a guarantee was impossible, or that the parties had expressed an intention to create something other than a contract of guaranty.\(^{104}\)

The California Civil Code defines a guarantor as a person who promises to answer for the debt, default, or miscarriage of another.\(^{105}\) The underlying essential of a contract of guaranty is the presence of a primary and a secondary liability.\(^{106}\) It is well established that where a promise designated a guarantee is in form or has as its leading purpose the primary responsibility for performance of

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\(^{105}\) CAL. CIV. CODE § 2787 (West 1957); the 1939 amendment to section 2787 abolished the distinction between sureties and guarantors and eliminated the rule in contracts of guaranty that the obligation of the principal debtor and that of the guarantor were entirely independent obligations. A continuing guarantee is now a form of suretyship obligation and is subject to all provisions of law relating to suretyship. American Guar. Corp. v. Stoody, 230 Cal. App. 2d 390, 41 Cal. Rptr. 69 (1964).

the promisor's obligation, it will be regarded as an original undertaking.\(^{107}\)
Hence, it is fundamental that the liability of the guarantor be secondary. To determine if this requisite is present in the check guarantee plan, an inquiry must be made as to the respective liabilities of the three participating parties.

(a). Drawee-Bank v. Drawer-Depositor

As between the issuing bank and the customer, California has long declared that a deposit in a general checking account establishes a debtor-creditor relationship.\(^{108}\) The bank, in receiving ordinary deposits, impliedly contracts with the depositor to discharge its indebtedness by honoring checks drawn by him against the account.\(^{109}\) Upon receipt of the deposit, the bank becomes the debtor of the depositor to care for and repay on demand the moneys deposited.\(^{110}\) If the bank fails to discharge its obligation to the depositor by dishonoring a duly presented check, a right of action accrues to the depositor, but the injury, although arising through a breach of contract, nevertheless, is viewed as a tortious breach of duty.\(^{111}\) Therefore, as between the bank and depositor, there exists a recognized contractual relationship with clearly defined respective rights and duties.

(b). Drawee-Bank v. Payee-Holder

The relationship of the bank and the holder or payee of the check is equally well established. California cases have long held that a depositor's check drawn to another does not operate as an assignment of funds held by the drawee bank; nor does it, in any way, obligate the bank to the payee until the check has been accepted or certified.\(^{112}\) Thus, the bank could refuse to pay the check without good reason and incur no liability to the payee. It was reasoned that the check was only a direction to pay the amount to the payee and that no contractual or legal obligation was created between the drawee-bank and the payee.\(^{118}\)

This rationale is clearly reiterated in section 3409 of the California Commercial Code, which provides that the bank is not liable on the instrument until it is accepted, and that a check, of itself, does not operate as an assignment of funds deposited by the customer.\(^{114}\) Therefore, absent an agreement to the contrary,


\(^{108}\) CAL. CIV. CODE § 1878 (West 1957); Union Tool Co. v. Farmers' & Merchants' Nat'l Bank, 192 Cal. 40, 218 P. 424 (1923); Glassell Dev. Co. v. Citizens' Nat'l Bank, 191 Cal. 375, 216 P. 1012 (1923).

\(^{109}\) Basch v. Bank of America, 22 Cal. 2d 316, 139 P.2d 1 (1943).


\(^{114}\) CAL. COMM. CODE § 3409(1) (West 1964). However, in one small respect, section 3409 is not as broad as its predecessor, California Civil Code section 3265(e). This results from the qualifying language of California Commercial Code section 4302 which imposes
there is no obligation owed to the payee on the part of the bank to honor a presented check. Since a bank has no primary obligation to the payee, it is possible for the bank to assume the secondary obligation of a guarantor.

(c). Payor-Depositor v. Payee-Holder

Thus, it is the relationship existing between the payor-depositor and the payee which is determinant of whether there can be a true guarantee. If the payor owes a primary obligation to the payee, it follows that a guarantor may secondarily assume the liability. Conversely, if the payor owes no primary obligation, there is nothing for the guarantor to guarantee. The question rests of the nature of payor's liability and is readily answered by either the general law of contracts or the California law of negotiable instruments.

An early California case\(^1\) expressed the rule that a person indebted to another who gives a check as payment does not, by the mere giving of the check, pay the indebtedness. The court recognized that the check is simply a request by the maker to pay the holder thereof the stated amount, and that if the drawee fails to comply with the request, the debtor still owes the money.\(^2\) In reaching this decision, the court concluded that the debtor is a principal and not a surety.\(^3\) This holding has been consistently affirmed and gives the payee, in the event of the check's dishonor, a cause of action either on the check or on the original consideration.\(^4\)

The California Commercial Code has endorsed these rules by the enactment of section 3413 and thereby affords the payee an alternative basis for remedy according to the law of negotiable instruments. Hence, by either of the two legal theories available to the payee the drawer of the check is determined to be primarily liable for its payment.

It seems apparent, in view of the terms of the typical check guarantee contract, that the issuing bank desires to preserve the customer's primary liability to the payee. The conditions of the agreement require that the depositor not issue checks in excess of the established line of credit and that the bank be irrevocably au-


\(^{111}\)Id.

\(^{112}\)Id. at 399, 112 P. at 466, where the court declared: "[T]he drawer of a check is regarded as the principal debtor, and the check purports to be made upon a fund deposited to meet it."


\(^{114}\)CAL. COMM. CODE § 3413 (West 1964). That section provides:

(1) The [drawer] ... engages that he will pay the instrument according to its tenor at the time of his engagement. ... (2) The drawer engages that upon dishonor ... he will pay the amount of the draft to the holder. ...
torized to charge to the account all guaranteed checks. The customer must agree that termination of the extended credit does not affect the obligation of the customer to pay the amounts owing. From this indication of the bank's intention, and from the fact that the bank becomes liable only in the event the depositor defaults because of insufficient funds and credit, it would appear the requisites of a contract of guaranty have been met.

2. Letter of Credit

In spite of the apparent propriety of designating the check guarantee plan as a contract of guaranty, it is frequently referred to as a letter of credit. The application of such a label is puzzling in view of the plan's questionable compliance with the statutory requirements of a letter of credit.

Traditionally, comparatively few banking institutions have engaged in the writing of commercial letters of credit, a device used primarily in international trade. Although the enactment of the Commercial Code has codified some of the principles of the letter of credit, it is recognized that the Code is merely intended to provide a framework for future development of the law in this field. The letter of credit is statutorily defined as "... an engagement by the bank... made at the request of a customer... that... [it] will honor drafts or other demands for payment upon compliance with the conditions specified in the [letter of] credit..."

Those instruments which qualify as a letter of credit under the California Commercial Code are described in subsection (1) of section 5102 as follows:

(a) . . . a credit issued by a bank if the credit requires a documentary draft or a documentary demand for payment; and

(b) . . . a credit issued by a person other than a bank...; and

(c) . . . a credit issued by a bank... if the credit is not within subparagraphs (a) or (b) but conspicuously states that it is a letter of credit or is conspicuously so entitled.

Because the check guarantee card is issued by a bank, subparagraph (b) is obviously inapplicable, leaving only subparagraphs (a) and (c) as possibly descriptive of the guarantee card. However, because none of the guarantee cards to date...

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120 One contract provides:

... I agree to maintain with you sufficient funds on deposit... or to have sufficient unused credit available... to pay all checks drawn by any of the undersigned which are guaranteed by means of the Card... You are irrevocably authorized to pay and charge to the above-numbered checking account all checks guaranteed by means of the Card and I hereby waive the right to stop payment of any and all such checks.

Another recent contract provides: "Applicant agrees not to issue checks in excess of the Credit... I waive all right to stop payment on checks guaranteed under the card."

121 Division 5 of the California Commercial Code contains seventeen sections relevant to letters of credit. Sections 5102 and 5103 concern the requirements necessary to qualify as a letter of credit. CAL. COMM. CODE §§ 5102, 5103 (West 1964).


124 Comments to CAL. COMM. CODE § 5102 (West 1964).

125 CAL. COMM. CODE § 5103 (1) (a) (West 1964).
have been "entitled" or "conspicuously state" that they are letters of credit, subparagraph (c) is also necessarily eliminated.

Subparagraph (a) requires that a documentary draft or a documentary demand be presented to the issuer or bank by the seller as a condition precedent to the bank's duty to pay. The definition of such documents, contained in subsection 5103(1)(b), precludes the check guarantee card from falling within subparagraph (a). "Document" as defined in subsection 5103(1)(b) refers to "documents of title, security, invoice . . . and the like." The check guarantee plan involves no such document and thereby fails to satisfy the requirements of subparagraph (a) of subsection 5102(1).

In addition, subsection (2) of section 5102 specifically provides that if the "engagement," here the check guarantee plan, does not meet the requirements of subsection (1), then division 5 of the Commercial Code, containing all of the sections applying to letters of credit, does not apply to guarantees.

Because of this technical noncompliance with the stated requirements of the Commercial Code, the policy expressed therein that the Code merely provides a framework for further development in the field becomes an important factor for proponents of the theory that the guarantee plan is a type of letter of credit. It is conceivable that, because the plan is so like a letter of credit in its function and operation, a court would consider it as such and determine the respective rights, duties, and liabilities accordingly. This result would appear to be contrary to the intention of the bank in view of the slight alteration necessary to conform the card to the requirements stated in subdivision (c) of section 5102. Further, because the card is issued by recognized and established banking institutions with presumed business acumen and legal sophistication, the possibility of ignorance or oversight in regard to such a simple remedy is unlikely at best.

Prior to the enactment of the Commercial Code in California, statutory definition and regulation of the letter of credit was contained in sections 2858 through 2866 of the California Civil Code. Section 2860 stated that the liability of the issuer of a letter of credit commenced upon the default of the debtor. This section suggested that the issuer was simply a guarantor as defined in the Civil Code. Such an interpretation is not supported by the California cases dealing with letters

128CAL. COMM. CODE § 5103(1)(b) (West 1964). This section provides:
A "documentary draft" or a "documentary demand for payment" is one [the] 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.
129CAL. COMM. CODE § 5102 (West 1964).
130CAL. CIV. CODE §§ 2858-66 (West 1957); these sections have since been repealed, Calif. Stats. 1963, ch. 819, § 2, at 1997 (effective Jan. 1, 1965).
131CAL. CIV. CODE § 2787 (West 1957).
of credit. These cases, in regard to the liability of the issuer, are in accord with section 5103 of the California Commercial Code, which holds the issuer primarily liable to the beneficiary in contrast to the secondary liability imposed on a guarantor.

D. Rights and Duties of the Respective Parties

1. Construed as a Contract of Guaranty

The distinction between a contract of guaranty, in which the guarantor's obligation is secondary, and a letter of credit, in which the issuer's obligation is primary, is important in regard to the effect it may have on the rights and duties of the participants in the check guarantee plan.

Where a contract of guaranty covers the payment of a money obligation, as in the check guarantee plan, the guarantor becomes the debtor to the party guaranteed in the event the obligation is not paid. However, inasmuch as a contract of guaranty is by definition secondary to another obligation, it is apparent that a guarantor cannot be held if the principal obligation is invalid. Thus, to hold one liable as a guarantor, it is essential that there be an obligation that is binding on the principal. It follows that a guarantor's obligation is unenforceable if the principal obligation is invalid due to some vitiating element such as illegality, fraud, or lack of consideration. If, however, the principal obligation is merely unenforceable against the debtor because of a defense which is available only to the principal, such as infancy or incompetency, the guarantor may not use this defense to defeat an action by the creditor seeking to hold him liable on the contract of guaranty.

Therefore, subject to the qualifications stated above, to enforce the obligation of a contract of guaranty, the creditor or obligee must show that the guaranteed debt is due him. If the debtor is not bound to make payment to the creditor, the creditor may not hold the guarantor liable. As a general rule, the guarantor

\[132\] Crocker First Nat'l Bank v. De Sousa, 27 F.2d 462 (9th Cir. 1928), cert. denied, 278 U.S. 650 (1928).

\[133\] CAL. COMM. CODE § 5103(1) (a) (West 1964). This section provides:

"Credit" or "letter of credit" means an engagement by a bank or other person made at the request of a customer and of a kind within the scope of this division (Section 5102) that the issuer will honor drafts or other demands for payment upon compliance with the conditions specified in the credit. A credit may be either revocable or irrevocable. The engagement may be either an agreement to honor or a statement that a bank or other person is authorized to honor.


\[136\] Wells v. Comstock, 46 Cal. 2d 528, 297 P.2d 961 (1956).


\[138\] Fisher v. Salmon, 1 Cal. 413 (1851).

\[139\] CAL. CIV. CODE § 2810 (West 1957).

may assert any non-personal defense that would be available to his principal, such as failure of consideration where there has been a breach of warranty. Moreover, the guarantor may require the creditor to proceed against the principal or to pursue any other remedy which would lessen the guarantor’s liability. If the creditor fails to discharge this condition, the guarantor is exonerated to the extent he is prejudiced.

It can be seen by the preceding discussion that, if the check guarantee plan is construed to be an “unqualified” contract of guaranty, the bank as guarantor would necessarily be involved in the legal or substantive details of each check guarantee transaction. Disputes arising between the merchant and the customer concerning their respective performances of a transaction would require the sponsoring bank to sift through the contentions of each party and evaluate its own duties and liabilities. In this respect, the bank would be ultimately forced to accept the position of one of the parties and place itself in the undesirable position of opposing a necessary participant of the check guarantee program.

However, because of the particular terms of the contract entered into between the bank and the customer, the above described consequences normally flowing from an “unqualified” contract of guaranty would not occur under this plan. In fact, whether the check guarantee plan is determined to be a contract of guaranty or not would appear relevant only insofar as the bank chooses to treat it as such. This results from two important provisions contained in the bank-customer contract which significantly qualify the usual obligations arising between these two parties.

The first provision is the customer’s express waiver of his right to stop payment on a check executed pursuant to the guarantee card. The second provision concerns the customer’s authorization to the bank allowing it to charge all guaranteed checks against his deposits or remaining credit. These concessions permit the bank to honor all guaranteed checks as they are presented by the merchant, debiting the customer’s account accordingly, irrespective of the customer’s dissatisfaction with the merchant’s performance. This has the desirable effect, in the bank’s view, of avoiding in each customer-merchant transaction the costly and damaging involvement inherent to a guarantor. The presence of these two contractual provisions obviates the difficulties which might be incurred by the bank if it were designated a guarantor.

By this interpretation, the customer has received all that he has bargained for from the bank and must rely on other consumer remedies available to a dissatisfied purchaser. The merchant, having received payment from the bank, has obtained the fruits of his participation, thus satisfying his interest in the transaction.

However, because the bank is only secondarily obligated on the customer-merchant transaction, assuming the plan to be a contract of guaranty, it may still disregard its contractual right and refuse to honor the check where the merchant has acted unconscionably. Thus, by assuming the role of the guarantor in order to

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141 CAL. CIV. CODE § 2845 (West 1957).
142 Id.
protect its customers from unfair practices of an unscrupulous merchant, the bank could, if it so chose, refuse to honor the check. Similarly, if the customer prevailed in a suit against the merchant, the guarantor-bank would also be excused from the merchant's claim. This results from the established rule that a guarantor cannot be held if the principal obligation is invalid.\footnote{Schwiesau v. Mahon, 110 Cal. 543, 42 P. 1065 (1895); Mill Valley v. National Sur. Co., 41 Cal. App. 540, 182 P. 459 (1919).}

It would appear that the bank could exercise the option of assuming the obligations of a guarantor where such a role served to protect its customers or remain aloof from the petty disagreements which often arise out of customer-merchant transactions where such a course appeared prudent. Whether a bank could or would provide such protection for the thousands of customers participating in the many check guarantee programs is not known. It would seem unlikely that the bank could effectively provide such protection, since the principal disadvantage of construing the plan as a contract of guaranty in the first place was the undesirable involvement in each check guarantee transaction.

If the customer's dissatisfaction with the merchant's performance occurs or is made known after the check is accepted and cleared by the sponsoring bank, his remedies are the same as those normally arising out of a personal check transaction. The relevance of the check guarantee card has passed, and the customer's situation is neither prejudiced nor enhanced by that passing.

2. Construed as a Letter of Credit

It is well established that the liability of the issuer of a letter of credit is entirely independent of the underlying sales contract made by the seller and the buyer.\footnote{CAL. COMM. CODE § 5103(1) (a) (West 1964). Continental Nat'l Bank v. National City Bank, 69 F.2d 312 (9th Cir. 1934); 2 W. HAWKLAND, A TRANSACTIONAL GUIDE TO THE UNIFORM COMMERCIAL CODE 800 (1964).} The issuer's liability is primary. There is no promise by the issuer that the buyer will perform the underlying contract, nor does the issuer guarantee its performance.

Normally, the issuer becomes liable on a letter of credit when the "documents" usually required in such a transaction comply with the conditions specified in the letter.\footnote{Crocker First Nat'l Bank v. De Sousa, 27 F.2d 462 (9th Cir. 1928), cert. denied, 278 U.S. 650 (1928); Banco Nacional De Credito Ejidal, S.A. v. Bank of America, 118 F. Supp. 308 (N.D. Cal. 1954).} The only condition which would appear to be required of the seller or merchant in the check guarantee plan would be to present a validly executed guaranteed check. Because the check guarantee plan involves no "documents," liability of the issuing bank would presumably arise upon presentation of the check by the merchant. This follows the contractual theme of the plan and most likely conforms to the expectations of the parties.

Under this interpretation of the check guarantee plan, the rights and duties of the participating parties are well defined. The bank would be obligated to pay all properly executed guaranteed checks irrespective of the underlying contract.
This would have the effect of avoiding any involvement in the individual transactions and reducing its costs and responsibility. The problems arising out of the underlying contract would be settled according to the prevailing law affecting such transactions and independent of the law applying to letters of credit. The merchant would be assured of payment of his goods or services once he received the customer's check, thereby foreclosing the customer's ability to stop payment.

These are the identical results bargained for by the parties. The customer has already expressly waived his right to stop payment and is no worse off as a participant to a letter of credit. The bank desires to be independent of the underlying contract, and the merchant simply expects his check to be paid without question.

Whether the plan is designated a contract of guaranty or a letter of credit, the position of each party is substantially the same. However, construing the check guarantee card as a letter of credit insures the sponsoring bank non-involvement in individual transactions.

E. Other Legal Problems

1. Power of Bank to Issue a Check Guarantee Card

Whether the check guarantee plan constitutes a valid exercise of banking power is probably of greater importance than whether it is construed as a contract of guaranty or a letter of credit.

As a general rule, a bank has no power to lend its credit to any person or corporation or to become a guarantor of the obligations of another unless it does so in the ordinary course of banking or has an interest in the obligation guaranteed. There is little doubt the bank's assumption of liability under either a contract of guaranty or a letter of credit would fall within this general prohibition if the transaction was not within the ordinary course of banking. A contract of guaranty presumes the guarantor is liable for the promisor's obligation should the promisor default, and a letter of credit is nothing more than a temporary loan of the bank's credit to a person or corporation.

Whether the plan is within the ordinary course of banking can be determined by examining the underlying purpose of the sponsoring bank. Its primary reason for issuing a check guarantee card in conjunction with an overdraft plan is to effect loans with its participating customers. Conceding lending to be a cornerstone of banking, it necessarily follows that the guarantee plan, in effecting such loans, is within the ordinary course of banking. The Comptroller of the Currency has rendered just such a ruling. He states:

An arrangement whereby a bank holds out to the public that it will honor checks drawn on it up to a certain amount by a depositor displaying a so-called "check guarantee card" is in essence an agreement by the bank with its depositor to extend credit to the depositor, if necessary, to honor his checks. Such an arrangement is essentially a commitment to lend and is within the power of a national bank. There is no apparent reason why such a construction should not apply to a state

1464 A. H. MITCHELL, BANKS AND BANKING 44, at 49 (1931).
bank as well. Thus, the question of a bank's power to engage in such a program appears settled.

2. Waiver of the Right to Stop a Check

A second possible problem arising from the check guarantee plan involves the contractual provision requiring the depositor to waive his right to stop payment on an executed check.

It is well established that an uncertified check is merely a direction by the creditor-depositor to the debtor-bank for disposition of the deposited funds and does not operate as an assignment thereof. Furthermore, as a mere order upon a bank to pay from the depositor's account the amount stipulated, it is subject to revocation or countermand by the drawer at anytime before it has been certified or accepted by the bank.\textsuperscript{148} If the bank, after receiving proper notice from the depositor not to pay a check which the depositor has drawn on his account, nevertheless, pays such a check, it does so at its own peril; the payment constitutes a disposition of the depositor's fund without authority.\textsuperscript{149}

The required waiver by the customer of his right to stop payment on a check executed pursuant to a guarantee card is a vital element of the check guarantee plan. Without it, the bank would be obligated to pay the merchant out of its own funds where the depositor, subsequent to the transaction, stopped payment of his check. Yet, it must be recognized that the waiver denies the customer one effective remedy normally available should he become immediately dissatisfied with his bargain.

It is clear that the consideration for the drawer's waiver of his right to stop payment is present at the time of the original contract in the consideration for the entire transaction. Therefore, assuming that the waiver was fully understood by the drawer,\textsuperscript{150} a question arises as to the legality of the agreement.

It has been held that a provision of a notice to stop payment of a check which provided that the drawer release the bank from all liability by reason of compliance or noncompliance therewith was void as contrary to public policy.\textsuperscript{151} The court relied on section 1668 of the California Civil Code, which provides:

All contracts which have for their object, directly, or indirectly, to exempt anyone from responsibility for his own fraud, or willful injury to the person or property of another, or violation of law, whether willful or negligent, are against the policy of the law.

The court viewed the agreement as a contract to relieve the bank from responsibility for its negligence and, as such, within section 1668.

The check guarantee agreement providing for the customer's waiver of the right to stop a guaranteed check does not exempt the bank from the violation of any law. The duty of the bank to stop payment at the order of the depositor is not

imposed by law but arises by contract. Because the waiver provision precludes the possibility of a wilful or negligent omission to stop a check, there is no attempt to release the bank from the wilful or negligent violation of any duty. Hence, the agreement of waiver would seem to fall clearly outside the scope of section 1668; it, therefore, constitutes a proper subject for an intelligent contractual waiver.

The check guarantee card, not unlike its predecessor, the bank courtesy card, is an identification card designed to assist customers of the issuing bank in negotiating personal checks. The enlarged ambit of its operation, together with the element of guaranteed payment, has transformed a simple customer service into a legally complex tripartite credit creating instrument.

IV. LEGISLATION

The three credit vehicles under discussion, being products of a severely regulated industry and involving subjects of traditional governmental concern, are, as might be expected, exposed to numerous legislative measures. This section is concerned with two areas of legislation which appear particularly relevant and appropriate to a discussion of these contemporary forms of bank credit.

The first area concerns the existing criminal statutes regarding unauthorized or unlawful use of credit cards. The second concerns existing and proposed legislation regarding consumer or borrower protection in dealings with lenders. California usury provisions will be briefly examined in conjunction with an analysis of the pending federal truth-in-lending bill.

A. Criminal Legislation

Credit cards, especially those issued by banks, are subject to great criminal abuse. Applying traditional criminal law to crimes committed with credit cards has proved impracticable. Although the user of a credit card could obtain goods exceeding $200 in value, theft of a credit card was arguably only petty theft. In 1961, to eliminate deficiencies in the existing law, the legislature enacted section 484a of the California Penal Code. This statute codified in one section the law pertaining to credit card abuses and eliminated the problem concerning the gravity of the theft. Taking, receiving, or possessing a credit card of another with the intent to use, deliver, circulate, or sell the card was defined as a misdemeanor. Using a card so obtained, or a revoked credit card, to obtain...
anything the value of which did not exceed $50 was a misdemeanor;\footnote{159} if the value exceeded $50, the offense was a felony.\footnote{160}

Although counterfeiting a credit card was defined as a felony, forging a sales draft while effecting a transaction with a stolen credit card was not expressly included within the statute. In \textit{People v. Swann},\footnote{161} the defendant had allegedly used a stolen oil company credit card to make purchases totaling less than $50. He was charged with forgery\footnote{162} in that he had signed the name of the issuee of the credit card to the sales draft. The District Court of Appeal\footnote{163} held that the defendant could be prosecuted only under section 484a of the California Penal Code; the court stated:

We believe the People do not have the power to prosecute under the general felony statute in a case such as this where the facts of the alleged offense parallel the acts proscribed by a specific statute.\footnote{164}

Since the dollar value of the goods obtained was less than $50, the defendant could be convicted of only a misdemeanor; if prosecution under the forgery statute had been permitted, a felony conviction could have been obtained. The \textit{Swann} case made section 484a of the Penal Code the only statute the state could proceed under if an offense fell within that section.

In 1967, section 484a was repealed,\footnote{165} and sections 484a through i were added.\footnote{166} The new act expressly states:

This act shall not be construed to preclude the applicability of any other provision of the criminal law of this state which presently applies or may in the future apply to any transaction which violates this act.\footnote{167}

Further, the act defines as forgery the conduct declared a misdemeanor in \textit{People v. Swann}.\footnote{168} The act includes all types of credit cards and check guarantee cards. Other conduct not included in the former act is defined as illegal.\footnote{169} The dis-
tinction between a misdemeanor and a felony is modified by the new legislation; if the value of the goods or other things taken or received exceeds $200 in a six-month period, the theft is grand theft.170

B. Borrower Protection

Almost 100 years ago, Congress enacted and President Grant signed the first consumer protection law, prohibiting the fraudulent use of the mails.171 Since that time, the American consumer has been the auspicious beneficiary of numerous federal measures affording him ever greater protection.172 Today, many believe the spectacular growth in consumer credit has created the need for additional safeguards and legal remedies.173

171 Act of June 8, 1872, ch. 335, 149, 17 Star. 302.
172 Current legislation regulating the lending industry had its inception in very early times. For example, over 37 centuries ago, the King of Babylonia decreed that all loans had to be accompanied by a written contract setting forth the terms of the loan. Moreover, if through subterfuge, a higher than legal rate of interest was actually collected, the principal of the loan was forfeited to the borrower. S. HOMER, A HISTORY OF INTEREST RATES 4 (1964). It is apparent such regulation was prompted then, as today, by deceptive and unconscionable practices of a small minority of unscrupulous lenders who preyed on unfortunate people desperately in need of funds. In ancient Athens, loan sharks were known to have charged interest at the rate of forty-eight percent a month, or five hundred and seventy-six percent a year. Id. at 6. In the 15th century, Italian bankers charged the King of France one hundred percent interest on a war loan while local merchants were borrowing at only five percent. Id.

During the Middle Ages, the Catholic Church instituted the “just price” doctrine, which declared an interest rate of more than six percent to be usurious. This rate has not always been feasible in respect to small consumer loans. Fixed processing and collection costs have been high, risks have been great, and responsible capital has been difficult to attract. Hence, the field has been open to the illegal loan shark, who frequently charged interest in excess of two hundred percent a year.

In an attempt to combat the flourishing loan shark practice, in 1916, the Russell Sage Foundation drafted a uniform small loan act as a guide for state action. The model act significantly provided for a monthly interest ceiling of three and one-half percent on the unpaid balance. This rate expressed on a yearly basis comes to forty-two percent which greatly exceeds the sanctified six percent interest limit. Today, 49 states have small loan laws, patterned after the recommendations of the Russell Sage Foundation.

173 In January 1967, the American consumer owed $93.5 billion in short and intermediate debt. Interest payments alone on this debt amounted to at least $12 billion. Long term mortgages accounted for an additional $225.2 billion in outstanding debt and at least $13 billion in interest. Thus, the total consumer or personal debt amounted to $318.7 billion, or only $11 billion less than the entire national debt, which then totaled approximately $330 billion, while interest payments on personal debt were at least double the interest payments on our national debt.

Since 1945, consumer credit has increased from $5.7 to $93.5 billion, or by 17 times. The rate of increase in consumer debt was four and one-half times greater than the growth rate of our gross national product. If, during the post war years, the government had increased the national debt at the same rate American families increased theirs, the size of the national debt today would be over $4 trillion. Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 43 (1967).
1. Usury

The California usury provisions provide little comfort for those concerned with exorbitant, deceptive, and confusing finance charges by lenders operating in this state. Indeed, California was without any usury restriction until 1918, when an initiative measure was adopted. This usury law provides for a maximum rate of interest of twelve percent per annum but limits the maximum rate to seven percent if a higher rate is not clearly stipulated. On November 6, 1934, an amendment to the California Constitution was adopted; it provided for a maximum rate of interest of seven percent per annum unless a written contract specifies a higher rate, not exceeding ten percent. The California Supreme Court has declared that the constitutional amendment of 1934 merely reduced the maximum rate of interest which a lender may receive for the loan or forbearance of money.

One of the effects of the constitutional amendment was to exempt several specific organizations and individuals from the usury law and from the purview of its own provisions. These exemptions include all banks created and operating under and pursuant to the laws of California or of the United States. Thus, the interest assessments of the credit programs discussed in this article are in no way affected or restricted by the usury laws of the State of California. The application of interest and finance charges would seem to be regulated only by the competitive considerations of the marketplace.

2. Truth-in-Lending Bill

Since 1960, proponents of a federal truth-in-lending law have persistently proposed legislation before the United States Senate. Since 1961, similar measures have been repeatedly introduced in the House of Representatives. These bills, designed to insure the American consumer meaningful information concerning the price he is asked to pay for credit, were "bottled up" in the respective Committees on Banking and Currency for six years. On January 11, 1967, the most recent Senate truth-in-lending bill was introduced; it was passed six months later. If enacted by the 90th Congress, this bill will become effective on July 1, 1969. On July 20, 1967, the most recent House truth-in-lending bill was introduced; it was passed February 1, 1968. If enacted by the 90th Congress, this bill will be-

174Usury has been defined as:

... the receiving, securing, or taking of a greater sum or value for the loan or forbearance of money, goods, or things in action than is allowed by law—the exaction of a greater sum for the use of money than the highest rate of interest allowed by law.

55 AM. JUR., Usury § 2 (1946).


176CAL. CONST. art. XX, § 22.


180CAL. CONST. art. XX, § 22. Other organizations or individuals exempted are building and loan associations, industrial loan companies, credit unions, and pawn brokers.


come effective nine months after the date of enactment.

The march of technology in the United States, which has brought unprecedented abundance and selection to the consumer, has exposed him to new complexities and hazards. Mass consumer credit has emerged as a major element of American business and economic activity. This widespread use of installment and revolving credit has led to confusion in the minds of consumers about the cost of credit.\(^{183}\)

In the case of a simple loan, in which principal is totally repaid at the end of the period, the finance charge is relatively easy to calculate. However, the installment repayment plan, whereby the borrower repays a portion of the loan at the end of each payment period, leads to increased difficulty in determining the true annual rate of interest. For example, where $1,000 is borrowed for a year at a finance charge of $60, or six percent of the principal, but is repaid in 12 equal monthly installments during that year, the actual rate of interest is slightly less than twelve percent. This difference in expressing the finance charge as an annual rate results because the borrower, by repaying money over the period of the loan, has had the use, on the average, of only one-half the amount borrowed over the course of the year. There is a bewildering variety of methods for stating finance charges so that an informed choice among different credit plans is all but impossible except for the trained mathematician.\(^{184}\)

(a). Senate Bill (S. 5)

The 1967 Senate truth-in-lending bill would not set interest ceilings or regulate interest charges in any way. Its effect and purpose is simply to require that people be told in a meaningful, accurate, and understandable manner what the finance charge is.

\(^{183}\)One recent study asked a sample of 800 families to estimate the rate of interest they were paying on their debts. The average estimate was 8.3 percent. The actual rate was nearly three times higher, or 23.2 percent. JUSTER & SHAM, CONSUMER SENSITIVITY TO FINANCE RATES 51 (1964).

\(^{184}\)Five major methods with seemingly unlimited variations available to a lender are listed herein:

First. Frequently, no rate of interest or finance charge is quoted to the consumer. This is the easiest method of obscuring the cost of credit. The price is simply stated as so much a month. Neither the total amount of the finance charge in dollars nor its computable rate is disclosed. In addition, it is not uncommon for the number of periodic payments to be left unstated, leading to an open-ended series of payments which are continued until the customer finally realizes his plight and protests.

Second. Another frequent method occurs when the customer is told the finance charge in "dollars per $100," with the debt repayable in equal monthly installments. Thus, if he is told that the charge on a $100 loan is $6, the loan may be represented as a "6 percent loan." But, of course, since he is repaying in installments, the actual rate is almost 12 percent, or nearly double the stated rate. Therefore, when the interest rate is quoted on the original amount of the debt, and not on the declining or unpaid balance, the true cost of the credit is concealed. This practice has been called the "add-on rate."

Third. The third method, a variation of the "add-on rate," is the "discount rate." Here, the borrower receives, instead of the full amount of the loan, that amount less the finance charge. Hence, on a $100 loan at a charge of $6, the borrower receives only $94. Again, the finance charge may be represented as "6 percent," but results in an actual rate of slightly more than 12 percent, or twice the quoted rate.

Fourth. Small loan companies and retailers frequently state only a simple monthly rate. The customer is told that the finance rate is, for example, 3 percent per month. The actual annual rate, of course, is 12 times the quoted figure, or 36 percent, assuming the interest is based on the unpaid balance at the end of each monthly period. This is an important assumption because, if the rate is based on the entire original amount which
charges are. The bill is designed to cover all forms of consumer credit transactions, including installment purchases, home mortgages, small loans, and revolving charge accounts. Lenders within the scope of the bill would be required to reveal the total finance charge, both in dollars and cents and as an annual percentage rate. In addition, all other charges incident to the transaction would have to be set forth. In the usual case, the lender would provide the required information on the contract or other evidence of indebtedness which the consumer might sign in order to complete the transaction.

The annual percentage rate would be determined on the declining balance of the obligation and would thereby eliminate any possible confusion, on the part of the consumer, inherent in installment contracts. By measuring the annual percentage rate against the amount of credit actually in use over the period instead of against the original amount of credit, a true interest assessment is revealed.

Both of the proposed bills provide that the Federal Reserve Board will be given the authority as the administering agency to provide for rate tables, charts, or other methods to assist creditors in compliance with the provisions. This agency is gradually being repaid, the approximate annual rate is about 24 times the quoted figure, or in the above example, 72 percent. This results because the borrower has the use, on the average, of only one-half the amount loaned.

Fifth. Lenders commonly confuse a customer's understanding of the actual cost of credit and, at the same time, frequently evade state laws regulating credit by adding on numerous extra charges. These may include wholly extraneous charges for services which may or may not actually be performed or for alleged expenses not actually incurred by the lender. Examples of such charges include credit investigation, processing and handling fees, finder's fees, and credit life insurance. See 113 Cong. Rec. 1204-5 (daily ed. Jan. 31, 1967). 185 See 113 Cong. Rec. 1204-5 (daily ed. Jan. 31, 1967). 186 S. 5, 90th Cong., 1st Sess. § 2 (1967). 187 Id. § 3(b).

This section specifically excepts:

(1) credit transactions involving extensions of credit for business or commercial purposes, or to governments or governmental agencies or instrumentalities, or to organizations; (2) transactions in securities or commodities in accounts by a broker-dealer registered with the Securities and Exchange Commission; (3) credit transactions, other than real property transactions, in which the total amount to be financed exceeds $25,000; or (4) transactions involving extensions of credit secured by first mortgages on real estate. 188 S. 5, 90th Cong., 1st Sess. § 3(f) (1967). This section defines "annual percentage rate" as the "nominal annual rate determined by the actuarial method (United States Rule)."

The "United States Rule" requires that each periodic payment is to be applied first to the interest for the period, with the remainder of the payment applied to reduce the principal outstanding. See Story v. Livingstone, 38 U.S. 359 (1839).

The term "annual percentage rate" is further explained in a commentary on the truth-in-lending bill contained in the Congressional Record. 113 Cong. Rec. 1202 (daily ed. Jan. 31, 1967).

... annual percentage rate is arrived at by multiplying the "percentage rate per period" times the number of periods in a year. The percentage rate is the rate to be applied to the unpaid balance of the total amount to be financed. ... Avoiding the use of the term "simple" or any other descriptive term avoids semantic disputes and possible difficulties in the administration of the law. ... Nevertheless, there is no change in concept and the "annual percentage rate" follows the two basic characteristics of the "simple annual rate": (1) use of the year as the common time unit denominator, and (2) expression as a percentage rate per period of the ratio that the finance charge bears to the money actually used during the period.
will have the authority to prescribe reasonable tolerances of accuracy regarding the disclosure provisions.\(^{190}\)

Also, both bills establish the basic policy that the proposed legislation does not pre-empt state consumer credit legislation unless the state provision is inconsistent with the federal law, and then only to the extent of the inconsistency.\(^{191}\) Language has also been included to make it clear that the annual percentage rate required to be disclosed is not an interest rate within the meaning of the various state usury laws.\(^{192}\) The definition of finance charge includes all costs incident to credit, including interest.\(^{193}\)

### Effect on Bank Credit Plans

The original Senate bill, introduced on January 11, 1967, would have required all revolving plans to disclose the annual percentage rate at the time the account was opened and again on the monthly statements.\(^{194}\) The annual percentage rate would be determined by multiplying the monthly rate by 12.\(^{195}\)

This provision of the original bill drew considerable criticism from representatives of various revolving credit sponsors and resulted in the compromise bill

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\(^{188}\) S. 5, 90th Cong., 1st Sess. § 5(a) (3) (1967); H. R. 11601, 90th Cong., 2d Sess. 204(a) (3) (1968).

\(^{189}\) Senator William Proxmire (D-Wis.) stated in his address to the Senate on Jan. 31, 1967, regarding the tolerance provision of the Senate bill, the following:

I also point out in this connection that this bill does not require an exact statement of the annual rate accurate to several decimal places. We changed the bill in this respect from the bill last year and the year before. We seek a statement of the approximate rate. The bill explicitly provides in section 5 that the administering agency may "prescribe reasonable tolerances of accuracy."


\(^{190}\) S. 5, 90th Cong., 1st Sess. § 6(a) (1967); H. R. 11601, 90th Cong., 2d Sess. § 205(a) (1968).

\(^{191}\) S. 5, 90th Cong., 1st Sess. § 6(a) (1967); H. R. 11601, 90th Cong., 2d Sess. § 205(a) (1968).

\(^{192}\) S. 5, 90th Cong., 1st Sess. § 3(d) (1) (1967); H. R. 11601, 90th Cong., 2d Sess. § 202(d) (1968).

\(^{193}\) Section 4(b) of the Jan. 11, 1967 draft provided:

Any creditor agreeing to extend credit to any person pursuant to a revolving or open-end credit plan shall, in accordance with rules and regulations prescribed by the board (1) furnish to such person, prior to agreeing to extend credit under such plan, a clear statement in writing setting forth the following information: (i) the periodic dates of the balances against which a finance charge will be imposed; (ii) the percentage rate per period of the finance charge to be imposed; and (iii) the periodic rate of finance charge expressed as an annual percentage rate. . . (emphasis supplied).


\(^{194}\) Section 3(5) of the Jan. 11, 1967 draft provided: "Annual percentage rate means the percentage rate per period expressed as a per centum per annum. It shall be computed by multiplying a percentage rate per period by the number of periods per year." S. 5, 90th Cong., 1st Sess. § 4(b) (Jan. 1967).

For example, if the monthly rate were one and one-half percent, the creditor, under the bill as introduced, would have to state the annual rate to be eighteen percent.

\(^{195}\) Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. (1967). See, e.g., statement of William Batten, Chairman of the Board, J. C. Penney Co., Inc., id. at 199; statement of J. O. Elmer and William G. Kirchner on behalf of the American Bankers Association, id. at 404; statement of
passed by the Senate. The modified bill provides that revolving credit plans which are similar to installment contract credit remain subject to the annual rate disclosure requirement, while "ordinary" revolving credit plans would be exempt.

Understandably, the definition of what constitutes an installment type credit plan as compared to an "ordinary" revolving credit plan is of critical concern to sponsors of the various bank credit programs. The current Senate bill contains in subsection 3 (g) a general definition of an open-end credit plan, and in the following subsection, 3 (h), separates out of open-end credit those plans described by the bill as installment open-end credit. Subsection 3 (h) defines an installment open-end credit plan as any plan which has one or more of the following characteristics:

1. The plan creates a security interest in or provides for a lien on, or retention of title to any property—(whether real or personal, tangible or intangible),
2. provides for a repayment schedule pursuant to which less than 60 per centum of the unpaid balance at anytime outstanding under the plan is required to be paid within twelve months, or
3. provides that amounts in excess of required payments under the repayment schedule are applied to future payments in the order of their respective due dates.

Hence, any revolving credit plan which includes one or more of these characteristics would, for the purposes of the 1967 truth-in-lending bill, be denominated as an installment open-end credit plan and thereby subject to the annual rate disclosure requirement.

Subsection 4 (d) outlines the dissimilar treatment accorded the two types of open-end credit. It provides that the creditor must disclose "... the percentage rate per period of the finance charge to be imposed if any, and in the case of an installment open-end credit plan the equivalent annual percentage rate. ..." (emphasis supplied). Thus, open-end credit plans are expressly exempted from the annual rate while installment open-end credit plans are included. Reasons prompting this dissimilar treatment of the two plans were explained in a report

Edgar Ray McAllister, American Retail Federation, id. at 452; statement of George H. Kimball, representing the National Retail Merchants Association, id. at 499; prepared statement of Henry C. Coleman, Vice President Chamber of Commerce of the United States, id. at 572.

The criticism rested on the proposition that any revolving credit plan contains a built in "free ride" during which a finance charge is not imposed. The critics contended that if the actual credit in use as measured from the time of each transaction to the time of each payment were computed, the monthly rate of one and one-half percent would vary considerably from eighteen percent. This argument was countered by proponents of the bill with the argument that the credit was to be measured from the time the credit would actually begin and not from the time of the purchase, and if the "free ride" period were deducted from the computation, the rate would always work out to eighteen percent.

197Hearings on S. 5 Before the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 21 (1967); S. REP. No. 392, 90th Cong., 1st Sess. 10 (1967).
198§ 3, 90th Cong., 1st Sess. § 3(g) (1967). This section provides:
"Open-end credit plan" means a plan prescribing the terms of credit transactions which may be made thereunder from time to time and under the terms of which a finance charge may be computed on the outstanding unpaid balance from time to time thereunder.
199§ 4, 90th Cong., 1st Sess. § 4(d) (2) (c) (1967).
by the Senate Committee on Banking and Currency, wherein it was stated:

Such [installment open-end] plans are ordinarily used to finance large purchases and are distinguished from ordinary revolving credit by the extended length of time permitted for repayment and the maintenance of a security interest in the merchandise. Such plans would be covered if less than 60 percent of any amount of credit was payable in one year, or if the seller maintained a security interest, or if accelerated payments are applied to future payments.

The purpose of this distinction is to eliminate any incentive to convert closed-end installment credit to revolving credit merely to escape annual rate disclosure. The amendment also provides greater comparability between installment open-end credit plans and installment closed-end credit plans. Smaller merchants who extend credit through installment contracts can compete on a comparable basis with the larger stores who use extended payment revolving credit.

An analysis of the three characteristics defining installment open-end credit indicates that many bank sponsored credit plans would be designated as installment open-end credit and required to comply with the annual disclosure provisions of subsection 4 (d). Most of the bank revolving credit plans are presently set up so as to require the borrower to make a minimum periodic repayment of not less than five percent of the unpaid balance which is outstanding at any time. A simple computation of five percent times 12 months would seem to result in sixty percent, and thus, outside the requirement set forth in subdivision 3 (h) (2). Assuming, therefore, that they were not within the remaining two subdivisions, such plans would appear to qualify as open-end credit plans and only be required to disclose the percentage rate of the finance charge per period. However, because the five percent minimum repayment requirement is applied against a declining balance and not a constant balance, a sixty percent repayment does not occur within a 12 month period. Therefore, because the balance is continuing to diminish as the five percent repayments are being made, the periodic payments, correspondingly, diminish in turn. Hence, on a balance of $1,000 where no other purchases are made during the 12 month period, a five percent workdown would result in approximately $460 being repaid by the end of the first year, or a forty-six percent repayment.

The following table illustrates this example. No finance charges are reflected.

<table>
<thead>
<tr>
<th></th>
<th>5% of Balance</th>
<th>Remaining Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>$1000.00</td>
<td>$50.00</td>
</tr>
<tr>
<td>2.</td>
<td>950.00</td>
<td>47.50</td>
</tr>
<tr>
<td>3.</td>
<td>902.50</td>
<td>45.12</td>
</tr>
<tr>
<td>4.</td>
<td>857.38</td>
<td>42.68</td>
</tr>
<tr>
<td>5.</td>
<td>814.52</td>
<td>40.72</td>
</tr>
<tr>
<td>6.</td>
<td>773.80</td>
<td>38.69</td>
</tr>
<tr>
<td>7.</td>
<td>735.11</td>
<td>36.75</td>
</tr>
</tbody>
</table>

(Chart continued on page 92)
In addition, testimony before the Senate Committee on Banking and Currency revealed that several of the banks' credit card programs either provide for the taking of a security interest or are working on a computerized adoption of such a plan. This is a logical extension of the bank credit card and is necessary to combat the rising costs of small household appliance financing. By switching this type of purchase to revolving credit and taking a security interest, the servicing costs are greatly reduced through the substitution of the established revolving credit plan procedures in place of the time consuming and expensive small loan financing procedures. The servicing would become one of several credit transactions easily included within the billing procedures on the credit card. However, the taking of a security interest would result in these bank revolving credit plans falling squarely within the definition of installment open-end credit as provided in subsection 3 (h).

The third characteristic defining installment open-end credit would appear to be inapplicable to present bank credit plans. There is presently no contractual provision for repayments in excess of the required minimum repayment being applied against the succeeding payment or payments falling due.

The direct effect of the 1967 Senate truth-in-lending bill on existing bank revolving credit plans appears to be that the annual percentage rate of the finance charge to be imposed would be required to be disclosed before the account is opened and again at the end of each billing period. The most significant effect of the present bill arises from the arbitrary distinction between installment open-end credit defined in subsection 3 (h) and open-end credit defined in subsection 3 (g). The effect of this distinction is to place those revolving credit plans which permit longer and more flexible repayment on goods or services at a real competitive disadvantage with so-called open-end credit plans. This result appears to be anomalous to the expressed objective of providing a uniform finance charge yardstick for comparison of various credit plans and the elimination of confusing and deceptive explanations of credit costs. The open-end credit plan is allowed to continue practices which apparently result in deceptively low finance charges, while a revolving credit plan falling within the definition of subsection 3 (h) must state the equivalent finance charges at a rate well in excess of monthly disclosures and thereby price itself out of the market. The irony of this situation is intensified by the notion that the creator of this artificial competitive imbalance is the very instrument proclaimed as necessary to provide universal marketplace

\[
\begin{align*}
8. \text{5\% of } 698.36 &= 34.91 & \text{leaving } 663.45 \\
9. \text{5\% of } 663.45 &= 33.17 & \text{leaving } 630.28 \\
10. \text{5\% of } 630.28 &= 31.51 & \text{leaving } 598.77 \\
11. \text{5\% of } 598.77 &= 29.93 & \text{leaving } 568.84 \\
12. \text{5\% of } 568.84 &= 28.44 & \text{leaving } 540.40 \\
\text{Amount repaid} &= \$459.42 & \text{balance } \$540.40 \\
\text{after 12 mos.}
\end{align*}
\]

204See 113 CONG. REC. 45 (daily ed. Mar. 21, 1967).
equality among lenders and retailers.\textsuperscript{205}

No doubt, bank sponsored revolving credit plans and those of large retail outlets could avoid the discriminating aspects of subsection 3 (h) by shortening their repayment schedules so that at least sixty percent of the loan would be repaid within 12 months. A minimum payment of ten percent per billing period would avoid the “60 percent provision,” and permit disclosure on a monthly basis. However, such a modification would in turn raise the installment payment amount to the consumer and result in a discriminatory competitive advantage over a creditor who permits smaller and more flexible repayment.

Furthermore, the bank revolving credit plans which provide for the taking of a security interest, thus falling within subsection 3 (h), are faced with the choice of continuing at a competitive disadvantage, reverting to the expensive small appliance loan and passing the higher costs on to the consumer, or withdrawing from this field entirely.

(b). House Bill (H.R. 11601)

While the House version of the 1967 truth-in-lending bill is in purpose entirely consistent with that of the Senate bill,\textsuperscript{206} its scope is considerably more ambitious. The inclusion of several provisions which significantly depart from the Senate-passed bill provides markedly broadened consumer protection. In addition, the House bill includes provisions which only indirectly relate to the use of credit by consumers, but which have an important effect on creditors.\textsuperscript{207}

\textsuperscript{205}Senator Proxmire (D-Wis.), sponsor of the present truth-in-lending bill, made the following statement concerning the bill's effect on American businessmen:

I point out also, that the present system penalizes the ethical businessman. If the unethical seller can advertise ridiculously low prices but make huge profits through hidden finance charges, then his ethical brother either must adopt his tactics or lose business. As I have often said, the truth-in-lending bill is intended to help the businessman as well as the consumer.


\textsuperscript{206}The “Declaration of Purpose” contained in section 2 of S. 5 provides:

The Congress finds and declares that economic stabilization would be enhanced and that competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit...

It is the purpose of this Act to assure a full disclosure of such costs with a view to promoting the informed use of consumer credit to the benefit of the national economy.

S. 5, 90th Cong., 1st Sess. § 2 (1967). The “Declaration of Purpose” contained in section 201 of H.R. 11601 provides:

The Congress finds that economic stabilization would be enhanced and that competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. It is the purpose of this title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit.


\textsuperscript{207}Title II of H. R. 11601 concerns the restriction of garnishment of wages and provides in section 202 (a) therein that not more than ten percent of the excess over $30 per week may be attached, garnished, or subjected to any similar legal or equitable process. Title II also prohibits the discharge of any employee by reason of the fact that on one occasion the employee has been subjected to such a process.

One cogent argument advanced for the proposal to restrict the availability of garnishment procedures to creditors concerns the extension of credit itself. That is, the availability of
As with the Senate bill, the most important feature of H.R. 11601 is the requirement that every business extending credit must furnish all consumers a clear, written statement of the amount of the finance charge to be paid; this disclosure must be both in dollars and cents and as an approximate "annual percentage rate." Similarly, the disclosure provisions of the House bill concern the annual rate of finance charges and not merely interest rates.

The major differences between S. 5 and H.R. 11601, insofar as disclosure is concerned, relate to real estate credit, insurance premiums, transactions involving small finance charges, credit advertising, and revolving credit. Although only the sections dealing specifically with revolving credit affect the bank credit plans discussed herein, a brief explanation of the remaining differences is relevant to an understanding of the chasm separating the two bills and for an appreciation of the effort which will be required to achieve congressional agreement.

Requiring full disclosure of the annual finance charges regarding first mortgages—the largest credit transaction most families ever experience—is indicative of the comprehensive theme pervading H.R. 11601. The exemption of first mortgages from the disclosure provisions of S. 5 was based on the finding of the Senate committee that adequate disclosure was already being made in this area of the garnishment process encourages the extension of spurious and ill-advised credit. A merchant who knows he can garnish may induce a wage earner to overextend himself. Secondly, it is argued that the rash of personal bankruptcies which are steadily increasing in this country are largely due to the abuse of garnishment. 114 CONG. REC. 689 (daily ed. Feb. 1, 1968).

As was stated by Mrs. Leonor K. Sullivan (D-Mo.), sponsor of H. R. 11601, during one of the debates concerning the garnishment provision:

We have hundreds of pages of testimony on the cruelties of the garnishment system in many states as a means not of satisfying just debts but of selling shoddy or defective goods at high prices to poor people who cannot afford them... and then using the device of garnishment to force the courts and the employers to do the bill collecting. . . . In California—the personal bankruptcy capital—our hearings show . . . that this tool is used almost exclusively by collection agencies, professional bill collectors. 114 CONG. REC. 688 (daily ed. Feb. 1, 1968).

It was pointed out during these debates that although garnishment is, and has been, in widespread use for several decades, some states do not allow it. Texas prohibited garnishment at the time of the adoption of its constitution in 1876. Pennsylvania has been without such procedures since 1945, Florida since 1875, and the District of Columbia since 1902. North Carolina, New York, and South Carolina have recently restricted garnishment. Three states have established prohibitions against firing an employee because of wage garnishment, and many states have established minimums by which a worker's wage is exempt from garnishment. 114 CONG. REC. 689 (daily ed. Feb. 1, 1968).

208 H. R. 11601, 90th Cong., 2d Sess. §§ 203(b)(6)-(7), (c)(4)-(5), (d)(2)(C) (1968); "annual percentage rate" is defined and applied just as provided in S. 5 as "the nominal annual rate determined by the actuarial method (United States Rule)." H. R. 11601, 90th Cong., 2d Sess. § 202(f)(1) (1968).


210 It has even been suggested that some of the provisions provided for in H. R. 11601 were included not with any real hope that they would be ultimately enacted, but instead as a strategic ploy to provide areas for concession in the inevitable compromise bill to be agreed
However, the Under Secretary of the Treasury stated during the hearings on H.R. 11601 that the confusion lies in the variety and diversity of charges which are added to first mortgages and not in the cost of the first mortgage itself.

The treatment of insurance premiums on policies taken out by borrowers as a condition of the credit contract has proved troublesome during consideration of disclosure legislation. If such insurance is required, the borrower bears a cost which probably would not have been incurred if no credit were obtained. The exclusion of insurance premiums from the finance charge creates a potential area of abuse, since some lenders may be encouraged to promote high-cost insurance to compensate for low finance charges. However, it should be recognized that the insurance coverage does provide a benefit to the borrower over and above the use of the credit, and in this sense, the inclusion of such premiums in the finance charge would overstate the actual charge for credit.

The third area of disclosure divergence between S. 5 and H.R. 11601 concerns the inclusion of closed-end installment credit transactions involving small finance charges. In the Senate, it was decided that this item should be excluded to simplify compliance by small retail businesses. It was recognized that many retailers impose a fixed minimum charge on installment contracts, regardless of the amount of credit. For credit of this type, a high effective rate may be justified to compensate the creditor for the relatively high costs of handling the transaction. However, he may be understandably reluctant to disclose a high annual percentage rate and decide instead to discontinue this type of credit. Nevertheless, the $10 exemption of S. 5 may conceal a very high interest rate even though the actual charge appears small. By its very nature, this will weigh most heavily on the poor, who must necessarily buy in small quantities at high prices and on exorbitant credit terms. A $10 finance charge may easily result from a $100 credit transaction. Carried further, a charge could reach twenty percent on a $45 purchase and result in an exempted $9 credit charge under the provisions of S. 5.

It would be upon by the House and Senate. Mr. Waggoner (D-La.) stated during a House debate concerning the garnishment provisions of H. R. 11601:

"This proposal additionally should not be part of this legislation today, because members of the committee say "We are going to drop it in conference. We want it for bargaining power with the Senate." When members stand up and make that sort of admission they should remember that the Members of the Senate read this debate also. They ... are not going to be hoodwinked or browbeaten in conference when we make statements such as that openly. (emphasis supplied)."


211S. REP. No. 392, 90th Cong., 1st Sess. 10 (1967).
213The Senate truth-in-lending bill exempts from annual percentage rate disclosure any purchase or credit transaction on which the credit charge is $9.99 or less. S. 5, 90th Cong., 1st Sess. §§4(b) (7), (c) (5) (1967).
215A cursory glance through most department store newspaper supplements will illustrate the effect of an exemption where the credit charges is less than $10. Most of the items are
appear that determination of the question of a small credit charge exemption will rest on whether to favor the consumer or the small retail merchant.

A unique feature of H.R. 11601 is the requirement that disclosure be included in the advertisement of credit terms instead of confining it to the provisions of the credit contract. Presumably, this would allow prospective buyers to begin shopping for credit in the privacy of their homes rather than during the pressures present at the time of a transaction. Advertising, today, is probably a more important factor in leading people to contract for credit than either the written terms of the agreement or the guarded statements of the salesman. The abuses in advertisement are well known and widespread. The emphasis is commonly placed on low down payments and monthly installments without a statement of the cash price, the actual interest rate, or the duration of payments.

However, these disclosure provisions could discourage advertisers from specifying rates or other credit terms on radio or television, as it would be impractical to make the detailed disclosures that are required. Such an effect might also operate to prevent creditors who offer lower rates or other advantages from advertising that fact and thus inhibit competition.

The most important departure from the provisions contained in S. 5 which bear on the bank credit plans discussed herein concern the treatment of revolving credit. Under the Senate bill, an annual percentage rate need not be disclosed for some types of revolving credit plans. To guard against the possibility that existing forms of ordinary installment credit might be converted to exempted forms of revolving credit in order to escape disclosure of the annual percentage rate, the exemption was limited to plans which meet three tests. The majority of bank sponsored plans do not meet these tests and are therefore subject to disclosure of the annual percentage rate.

In eliminating the revolving credit exemption so that all forms of revolving credit are subject to an annual percentage rate disclosure, the sponsors of H.R. 11601 have recognized the importance of providing consumers with a standardized method of comparing credit costs. More importantly, from the bank's view, the elimination of the dissimilar treatment under S. 5 avoids giving one type of creditor an unfair and discriminatory competitive advantage over another. The exemption under S. 5 would permit one segment of the credit community to continue to use statements which give misleading impressions of the cost of credit priced at less than $100 and are generally listed separately where they make up one item of a set. As an example, where a bedroom set is advertised, the bed, chest of drawers, night stand, and bachelor chest will generally all be listed separately. It would be a simple matter for many retail businesses to adopt this practice in order to circumvent the disclosure provisions of S. 5.

218S. 5, 90th Cong., 1st Sess. § 3(h) (1967).
and, at the same time, exaggerate this illusory low credit cost by requiring the annual percentage rate disclosure by a competitor. Not all will agree as to whether to impose disclosure of a periodic rate or an annual percentage rate on sponsors of revolving credit. Nevertheless, common fairness requires and legislative impartiality demands a uniform disclosure requirement rather than different methods of disclosure for different categories or types of consumer credit.

Although the House bill is presently a complete and comprehensive consumer protection proposal, the crucial question is whether it will be adopted intact. A comparison of S. 5 with H.R. 11601 produces striking dissimilarities. Yet, it is only with the support of the Senate that a truth-in-lending bill can be passed during the 90th Congress. This suggests that significant concessions will be required by both houses for successful passage this year. The pretentious scope of H.R. 11601 may operate to its detriment. Especially in politics must there be an awareness of the dangers of stirring up added and otherwise non-existent opposition to the main principles by loading a proposal with more burdens than it can legislatively carry. The inclusion of several ancillary provisions with the general credit cost disclosure sections may attract more unnecessary opposition than their compromise value warrants. The immediate concern is for passage of the basic truth-in-lending legislation. Despite the becoming enthusiasm of the sponsors of H.R. 11601 for the accompanying consumer protection provisions contained therein, prudence would seem to prescribe a realistic goal of a truth-in-lending act composed of the S. 5 provisions with an amendment eliminating the revolving credit exemption.

V. CONCLUSION

The bank credit card, the overdraft plan, and the check guarantee card are now established credit vehicles. Although all three are producing income for their sponsors, the credit card is the most widely used and publicized.

The consuming public has accepted the bank credit card as an important and convenient instrument. With these cards, businesses are enabled to permit credit purchases without having to maintain their own credit systems. However, too few cardholders understand the rights and duties inherent in their relationships with the bank and the merchant. Card issuing banks have the responsibility to educate the public as to these obligations. Although imposing liability for unauthorized charges on the cardholder is reasonable, including this provision in fine print in the cardholder’s agreement with the bank does not apprise him of his potential liability. Further, cardholders should be informed of the availability of insurance to protect against this risk.

Further developments in all three plans are inevitable. Deficiencies will be remedied as banks gain experience in administering these plans. Public awareness of the legal relationships created and the costs involved in using these plans should result in a more responsible consuming public.

Some banks are now modifying their credit card plans to permit cardholders to receive certain overdraft and check guarantee privileges. Development of this concept would result in the most commercially practical credit device. A con-
sumer with such a card could make credit purchases, have his personal check widely accepted, and "overdraw" his checking account. Merchants could extend credit and accept checks with no risk. Banks could serve a larger body of consumers.

Expansion of bank credit card systems has resulted in nationwide acceptance of some credit cards. Yet, no body of law clearly defines the relationships created by these instruments. The similarity in legal effect between bank credit cards and letters of credit has already been noted, as has the similarity between the operation of the check guarantee card and the letter of credit. The official comments to sections 5101 and 5102 of article 5 of the Uniform Commercial Code state that the law of letters of credit is still developing and that article 5 is intended within its limited scope as a basis for their further development. Check guarantee cards would be brought within the operation of that article if the words "Letter of Credit" were printed on them. Another chapter should be added to the article to include the law concerning bank credit cards which has already developed and the law as it continues to develop.