

WHAT RESPONSIBILITIES DO CREDIT CARD ISSUERS HAVE IN CONSUMER FRAUD COMPLAINTS?

When a credit card company provides a merchant access to the credit card banking system by providing them with a merchant account, what responsibilities does the company have in making sure that the merchant is not engaged in fraudulent or deceptive business practices? When a consumer complains to a credit card company about being a victim of fraud or deceptive practices what responsibilities does the company have in investigating the complaint and providing remedies? Do these obligations change if the merchant in question files for bankruptcy? These are just a few of the questions that today's growing number of online consumers have in regards to using their credit cards for internet transactions.

Case Study

This brings us to a current situation arising from the bankruptcy of online retailer Cyberrebate.com. This company's business model entailed enticing consumers to buy products at highly inflated prices by the promise of a 100% rebate of the purchase price. For example, a DVD normally priced at \$30 would sell at Cyberrebate.com for \$150 representing five times suggested retail price.

All of the major credit card companies (MasterCard, Visa, Discover, & American Express) approved Cyberrebate.com into their merchant account programs thereby giving the company access to the banking system by allowing them to accept their respective credit cards for payment of goods and services.

On May 17, 2001 Cyberrebate.com filed for bankruptcy protection. In their petition the company stated they owed over \$82 million in unpaid rebates yet only had \$24 million in assets. Clearly many consumers will never see a dime of their rebates. Some of these consumers are owed tens of thousands of dollars each.

It is easy to say that the consumers are responsible for their own losses since they knowingly engaged in a transaction that seemed too good to be true. Yet, the consumers engaged in a perfectly legal transaction. The merchant made promises that it is legally

required to honor. Regardless of whether the promises seem outrageous, it is the merchant's responsibility to follow all respective laws which require honoring these promises. The merchant does not have a right to make deceptive claims in order to achieve a purchase contract and then break the terms of this contract

Many laws have been passed to protect consumers from just these types of deceptive acts. Yet, what is the role of the credit card company when merchants, whom they have approved into their system, violate these laws and engage in deceptive practices? Some of the reasons that the various credit card companies have used in denying cardholder's chargeback rights are:

- 1) Rebate was separate from the underlying purchase transaction and therefore is not subject to the Fair Credit Billing Act's (FCBA) chargeback rights
- 2) Rebates were an incentive and therefore neither a "good or service" and FCBA chargeback rights only apply to goods or services
- 3) Cardholder's complaint is against the merchant and thus the credit card issuer cannot be held responsible
- 4) The merchant is bankrupt and thus cardholder must make a claim in the bankruptcy proceedings and not against the card issuer
- 5) The merchant is bankrupt and therefore we cannot investigate your claim

The FTC has passed several laws to provide protection to consumers who use their credit cards in transactions. The Fair Credit Billing Act, a subsection of the Truth in Lending Act, regulates how credit card companies must handle disputes lodged by cardholders. This act requires that the credit card company do a proper investigation of any dispute raised by a cardholder if the dispute follows rules regarding time limitations for filing.

This leads to the question of "what is a proper investigation." The FTC has commented on this in a bulletin dated February 6, 1996 entitled "FTC Commends Federal Reserve's Plan to Clarify Creditors' Obligation to Investigate Credit Card Charges Disputed by Consumers." In this bulletin, the FTC states:

If card issuers can thwart cardholders' actual assertion of claims and defenses by causing cardholders to believe that their only recourse is with the merchant, the aims of [the provision] are frustrated not only with respect to individual cardholder's disputes, but also as to broader objectives of card issuers' incentives to bear some responsibility for the merchants with whom they deal.

From these statements it becomes clear that the FTC and the Federal Reserve both believe that credit card issuers have some responsibility for protecting consumers from merchants whom they have given access to the merchant banking system.

Similarly, in a lawsuit against Citicorp Credit Services, Inc. the FTC found that Citicorp had aided and abetted a fraudulent sales scheme by continuing to process credit card transactions from a merchant whom they were aware "had extremely high chargeback rates...and a high consumer complaint level, and that...did not meet Better Business Bureau standards and was subject to continuing investigation by government agencies."

Cyberrebate.com had a high level of charge backs, a high consumer complaint level, did not meet Better Business Bureau standards and was subject to a New York State Attorney General's investigation less than a year before their bankruptcy; yet, the credit card companies all continued to process credit card transactions for this company.

Also, Regulation Z of the Fair Credit Billing Act provides a mechanism by which the card issuer becomes subject to all claims and defenses that the consumer could assert against the merchant. This regulation goes even further and states that "if the merchant has filed for bankruptcy, the consumer need not file a claim." The credit card companies' assertions that they cannot be held liable for claims against Cyberrebate.com because the merchant is bankrupt and/or that the cardholder must file a claim in those bankruptcy proceedings are patently false.

In conclusion, the Federal Government has repeatedly come down on the side of consumers in events of fraudulent or deceptive business practices. The FTC's conclusions state it best: "Consumers who have been victimized by an unscrupulous seller should not

be placed in the position to bear the resulting losses instead of the bank or other financing entity which has regularly dealt with the seller and which has profited from the transaction.”