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THE CASH DISCOUNT ACT: MORE THAN JUST A MATTER OF SEMANTICS?

I. INTRODUCTION

The rapid growth in availability and use of consumer credit during the past two decades, and particularly the omnipresence of "plastic money,"¹ has spawned considerable legislation governing consumer credit practices. This comment will examine the Cash Discount Act,² Congress' most recent decree in a series of legislative actions and amendments concerning consumer credit protection which began with passage of the Truth in Lending Act³ (TILA) in 1968.

A. Terminology

Before beginning any discussion about the Cash Discount Act, it is necessary to define several terms which will be used throughout this comment. Except where otherwise indicated, the definitions given below are those used by the Office of Consumer Affairs, U.S. Department of Commerce.⁴

Annual Percentage Rate (APR) - the charge for a loan or credit purchase stated as a percentage; that is, the finance charge per dollar per year.⁵

Bank Credit Card - a credit card issued by a bank to extend credit for interest. It allows the borrower to obtain a cash loan from the bank or to buy goods or services from the seller. (See *Third-party Credit Card*.)⁶

Cash Discount - a reduction from the regular price allowed for a cash

1. Garcia, *Credit Cards: An Interdisciplinary Survey*, 6 J. CONSUMER RESEARCH 327 (1980). During the past decade, credit card use has grown at an average rate of 12.2% annually; bank credit card growth has been even more rapid at 28.7% in part due to the advantage of universal acceptance. *Id.*

2. Pub. L. No. 97-25, 95 Stat. 144 (1981) (to be codified in scattered sections of 12, 15, and 42 U.S.C.). This comment will examine Titles I and II of the Act. Title III includes miscellaneous provisions which (1) clarify the effective date for civil liability provisions under the Truth in Lending Simplification and Reform Act, (2) allow a two year moratorium on real estate divestiture requirements imposed upon national banks having real estate on the books at a nominal value as of December 31, 1979, and (3) permit appointment of the Surgeon General without regard to the existing mandatory retirement age. Title III will not be discussed further.

3. Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. §§ 1601-14, 31-45, 61-67) (1976 & Supp. IV 1980).

4. OFFICE OF CONSUMER AFFAIRS, U.S. DEPARTMENT OF COMMERCE, CREDIT & FINANCIAL ISSUES - RESPONSIVE BUSINESS APPROACHES TO CONSUMER NEEDS, 18-19 (1981).

5. *Id.* See also *infra* note 28, explaining methods of calculation under TILA.

6. OFFICE OF CONSUMER AFFAIRS, *supra* note 4.

purchase.⁷

Closed-end Credit - Credit which involves scheduled payments made over a specific period of time. (See *Installment Credit*.)⁸

Credit - the right granted by a creditor to a consumer to defer payment for the purchase of goods or services.⁹

Debit Card - a bank card which substitutes for a check or cash, whereby the consumer's bank account is debited electronically for the amount of purchase.¹⁰

Finance Charge - the total dollar amount charged for a loan or credit purchase, including interest and other fees.¹¹

Installment Credit - credit which is repaid in a series of payments over time. (See *Closed-end Credit*.)¹²

Open-end Credit - credit which allows customers to make a series of purchases up to a set credit limit. Payment may be made in full each month or on only a portion of the balance. (Also called *Revolving Credit*.)¹³

Surcharge - any means of increasing the regular price to a credit cardholder which is not imposed on customers paying by cash, check, or other similar means.¹⁴

Third-party Credit Card - a credit card issued by a creditor other than the merchant. (Examples of Third-party Credit Cards are Visa, MasterCard, American Express, Diners' Club.)¹⁵

B. Characteristics of Credit Use

Much of the research on consumer credit has examined *who* uses credit and credit cards.¹⁶ Studies have shown that the most frequent users of all types of consumer credit are young married families with children.¹⁷ Credit card use tends to increase with income, education,

7. *Id.* See also 15 U.S.C. § 1603(p). For example, if a merchant offers a 10% cash discount on an item which normally sells for \$10.00, a cash paying customer could purchase the item for \$9.00.

8. OFFICE OF CONSUMER AFFAIRS, *supra* note 4.

9. *Id.*

10. *Id.*

11. *Id.*

12. *Id.*

13. *Id.*

14. See 15 U.S.C. § 1603(q). For example, if a merchant imposed a 10% surcharge on an item which normally sells for \$10.00, a credit card customer would pay \$11.00 for that item, while a cash paying customer could purchase that item for \$10.00.

15. OFFICE OF CONSUMER AFFAIRS, *supra* note 4.

16. Garcia, *supra* note 1, at 328.

17. REPORT OF NATIONAL COMM'N ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 12 (1972) [hereinafter cited as CONSUMER CREDIT REPORT].

and social class, but decreases significantly among retirees.¹⁸ The research on *causes* of credit use is essentially descriptive in nature.¹⁹ Reasons generally advanced for the use of credit cards include such things as convenience as a medium of exchange and simplicity as a source of short-term revolving credit which allows deferred payments.²⁰ Cardholders in the lower income or socioeconomic groups use credit cards to generate revolving credit; higher income groups use cards for convenience.²¹ The lower income consumers tend to substitute credit cards for cash more frequently and use credit for 'durable' and 'necessary' goods; higher income groups use credit for 'luxury' items.²² In general, increased urbanization of the population, age, attitude (willingness to incur debt), and increases in the purchase of durable consumer goods have contributed to the upsurge in reliance on consumer credit.²³

It has been estimated that forty percent of the residents of this country hold a bank credit card and more than half hold at least one major oil company credit card, although active use of these accounts varies regionally.²⁴ The value of goods and services purchased on bank credit cards in 1977 was \$37.6 billion, representing 3% of all consumer expenditures; purchases made on all types of consumer credit cards represented 8% of consumer expenditures.²⁵

In the Day-Brandt study of consumers who made major purchases, 43% used cash.²⁶ Of those who used credit, 28% had cash available for the purchase but chose to use credit instead of paying cash. Assuming all those who used cash also had a choice (i.e. could have obtained credit), almost 60% of the buyers in the study could choose between cash and credit.²⁷ The Cash Discount Act is aimed toward encouraging these consumers to use cash and rely less on consumer credit.

II. PRECEDING CONSUMER CREDIT LEGISLATION

As originally enacted, the Truth in Lending Act (TILA) required creditors to inform consumers of credit terms, including the finance

18. Garcia, *supra* note 1, at 328. See also CONSUMER CREDIT REPORT, *supra* note 17, at 12.

19. Garcia, *supra* note 1, at 328.

20. *Id.* at 329. See also Plummer, *Life Style Patterns and Commercial Bank Credit Card Usage*, J. MARKETING, Apr. 1971, at 35.

21. Garcia, *supra* note 1, at 329.

22. Plummer, *supra* note 20, at 35.

23. CONSUMER CREDIT REPORT, *supra* note 17, at 5-7.

24. *Melso v. Texaco, Inc.*, 532 F. Supp. 1280, 1288 (E.D. Pa. 1982).

25. Garcia, *supra* note 1, at 328.

26. CONSUMER CREDIT REPORT, *supra* note 17, at 182.

27. *Id.*

charge, annual percentage rate (APR),²⁸ and total transaction cost.²⁹ The underlying assumptions of TILA were that standardized disclosure of the APR and finance charge would improve consumer knowledge and understanding and lead to more informed, and cost-effective use of credit through comparison of terms,³⁰ and availability of a common denominator.³¹

TILA had three functions: descriptive, shopping, and economic stabilization.³² The descriptive function was intended to help consumers make more informed choices regarding the use of cash versus credit and versus postponement of the purchase.³³ The shopping function would enable consumers to seek credit under the most favorable terms.³⁴ It was also anticipated that TILA would contribute to economic stability by preventing overindebtedness leading to bankruptcy and by reducing credit use in general, thereby avoiding the inflationary effects of credit use.³⁵ TILA made a useful contribution to consumer credit protection by providing standardized information to compare credit costs.³⁶ This does not mean the consumer will always select the lower rate, but he will have the time-rate information available as a basis for his decision.³⁷

The Day-Brandt study revealed that as a result of TILA, between one and three percent of all buyers would not use credit in the future once they learned the true cost of credit.³⁸ However, the study concluded there was no evidence that overall credit use was significantly influenced by disclosure of the APR and finance charge.³⁹ Further-

28. TILA requires calculation of the APR according to the actuarial method. It is the true annual rate of the finance charge computed on the declining unpaid balance of the amount financed. An alternative to this, called the add-on method, is calculated on the initial amount financed. The add-on method is not permitted for TILA purposes because it is misleading. An APR computed on the declining balance is approximately twice the simple add-on rate. For example, 9.1% add-on interest over 12 months is equivalent to 18% APR under the actuarial method for 12 months. *Id.* at 169; Comment, *Legal Problems of Consumer Credit: Consumer Credit Sale Disclosure in California*, 4 U.C.D. L. REV. 123, 164 (1971).

29. 15 U.S.C. §§ 1601(a), 1605, 1606.

30. 1 NATIONAL COMM'N ON CONSUMER FINANCE, TECHNICAL STUDIES, A STUDY OF CONSUMER CREDIT DECISIONS: IMPLICATIONS FOR PRESENT AND PROSPECTIVE LEGISLATION, 2, 43 (Day & Brandt 1972) [hereinafter cited as Day & Brandt].

31. Mandell, *Consumer Perception of Incurred Interest Rates: An Empirical Test of the Efficacy of the Truth-In-Lending Law*, 26 J. FIN. 1143 (1971).

32. CONSUMER CREDIT REPORT, *supra* note 17, at 171-74.

33. *Id.* at 172.

34. *Id.*

35. *Id.* at 174.

36. Day & Brandt, *supra* note 30, at 61.

37. CONSUMER CREDIT REPORT, *supra* note 17, at 172.

38. Day & Brandt, *supra* note 30, at 71.

39. *Id.* at 73. See generally Mandell, *supra* note 31, at 1153; CONSUMER CREDIT REPORT, *supra* note 17, at 175-77, 182-84.

more, the decision to use credit was found to be highly sensitive to situational variables such as availability of cash, price of the goods or services, previous credit buying experience, and size of the monthly payment.⁴⁰

TILA created legal impediments for a merchant who wished to offer cash discounts to reduce the costs incident to extending consumer credit. Under the strict disclosure requirements, any difference between the price of a cash purchase and a credit transaction was considered a finance charge, and as such, inclusion in the calculation of the APR and disclosure to the consumer as a cost of credit were necessary.⁴¹ This requirement effectively precluded a cash discount because the required disclosure is generally made by an open-end creditor when an account is opened and on periodic (monthly) billing statements, rather than at the time of the purchase.⁴² Difficulties in compliance are further complicated in cases in which the finance charge and APR are calculated by a third-party creditor instead of by the merchant.⁴³ In addition, merchants or other creditors already charging the maximum finance rate in the state where the purchase was made would risk exceeding the state usury ceiling when a cash discount was reflected as an additional cost of credit.⁴⁴

Congress first eased the stringent requirements of TILA pertaining to cash discounts when it enacted the Fair Credit Billing Act of 1974.⁴⁵ This legislation modified TILA by declaring that a cash discount not exceeding 5% would not constitute a finance charge, providing such discount was offered to all prospective buyers and its availability was clearly and conspicuously disclosed.⁴⁶ This discount was limited to open-end or revolving credit plans that involved the issuance of a credit card; a discount would not be excluded from finance charge and APR calculations when offered in conjunction with installment credit terms.⁴⁷ The 5% ceiling was imposed to prevent merchants from passing along to the cash customer a savings greater than the amount a merchant would otherwise pay a third-party creditor if the purchase

40. Day & Brandt, *supra* note 30, at 73, 100.

41. S. REP. NO. 23, 97th Cong., 1st Sess. 1, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74.

42. Lobell & Gelb, *Consumer Credit*, 186 N.Y.L.J. 125 (1981).

43. *Id.*

44. *Id.*

45. Pub. L. No. 93-495, 88 Stat. 1511 (1974) (codified as amended as 15 U.S.C. §§ 1601, 1602, 1610, 1631, 1632, 1637, 1666-1666(j)) (1976 & Supp. III 1979).

46. S. REP. NO. 23, 97th Cong., 1st Sess. 2, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 75.

47. Lobell & Gelb, *supra* note 42.
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were made with a bank credit card.⁴⁸ The amount of the discount was set at approximately the same amount as the merchant processing or discount fee imposed by a third-party credit card issuer on participating member merchants. In practice, however, the merchant discount fee varies among merchants and banks and is established on a contractual basis between the member merchant and servicing bank.⁴⁹ Despite congressional approval for merchants to offer limited cash discounts, many merchants were reluctant to do so.⁵⁰ The Federal Reserve Board itself has acknowledged that the complicated regulatory requirements imposed under Regulation Z were probably a significant factor in discouraging widespread use of cash discounts.⁵¹ These regulations required extensive advertising and posting of the availability of cash discounts; merchants were unwilling to risk exposure to civil liability provisions for noncompliance.⁵²

In the Fair Credit Billing Act, Congress created an ambiguity which was discovered by the Federal Reserve Board as it was preparing the implementing regulations for the limited discount provision. The Federal Reserve Board found it unclear whether Congress intended to permit *any* type of two-tier pricing system resulting in a lower price for cash customers, or only a *discount* from the tagged price.⁵³ In other words, how was discount to be defined? Did Congress intend to permit surcharges to be imposed on credit transactions?⁵⁴ Congress resolved these questions on February 27, 1976, when it passed an amendment to

48. S. REP. NO. 23, 97th Cong., 1st Sess. 11, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 84.

49. Most explanations of bank credit card systems describe three contractual agreements: one between the bank and participating merchant whereby the merchant agrees to accept the credit card and bank agrees to process and make collection on all receipts at a negotiated discount rate; a second between the bank and the cardholder which covers terms of credit; and a third between the retail merchant and cardholder when payment for goods or services is made with the credit card. See *United States v. Maze*, 414 U.S. 395, 411 n.2 (1974); Davenport, *Bank Credit Cards and the Uniform Commercial Code*, 1 VAL. U. L. REV. 218, 224-25 (1967); Comment, *The Tripartite Credit Card Transaction: A Legal Infant*, 48 CALIF. L. REV. 459 (1960); Comment, *Bank Credit Cards — Contemporary Problems*, 41 FORDHAM L. REV. 373, 374 (1972). A Tenth Circuit case describes another contract between member banks in the interchange processing system, establishing the mechanism for clearing authorizations and processing receipts to the issuing bank to be charged against the cardholder's account. *Colorado Springs Nat'l Bank v. United States*, 505 F.2d 1185, 1187 (10th Cir. 1974).

50. S. REP. NO. 23, 97th Cong., 1st Sess. 3, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 76.

51. *Id.* See also Regulation Z, 12 C.F.R. § 226.4(i) (1980) (rescinded 1981).

52. Lobell & Gelb, *supra* note 42. The civil liabilities were set at \$100 minimum statutory damages, plus attorney's fees in an individual action; up to the lesser of \$500,000 or 1% of merchant's net worth, plus attorney's fees in a class action.

53. S. REP. NO. 23, 97th Cong., 1st Sess. 2, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 75.

54. *Id.*

TILA (including the Fair Credit Billing Act) specifically prohibiting the imposition of surcharges on credit customers.⁵⁵ This surcharge ban, which was due to expire in February 1979, was extended for an additional two years, through February 27, 1981, as part of the Financial Institutions Regulatory and Interest Rate Control Act of 1978.⁵⁶ In 1980, the 96th Congress considered, but did not enact, legislation which would have removed the ceiling on cash discounts and further extended the surcharge ban.⁵⁷ The 97th Congress House and Senate banking committees thus recognized the need to act promptly if the surcharge ban was to be retained beyond the February 1981 sunset date.

The Cash Discount Act was introduced in the House by Congressman Frank Annunzio (D-Ill.) as H.R. 31 and in the Senate by Senator John Chafee (R-R.I.) as S. 414.⁵⁸ Both bills contained a three-year extension on the surcharge ban and additionally contained provisions removing the ceiling on cash discounts.⁵⁹

III. THE CASH DISCOUNT ACT - PROVISIONS

A. Title I - Removing the Discount Ceiling

Title I of the Cash Discount Act removes several impediments to the offering of cash discounts. Section 101 provides that "*any discount from the regular price offered by a seller for the purpose of inducing payment by cash, check, or other means not involving the use of an open-end credit plan or credit card shall not constitute a finance charge. . . [providing] the discount is offered to all prospective buyers, and its availability is disclosed clearly and conspicuously.*"⁶⁰ The obvious impact of this section is to amend the portion of TILA limiting a cash discount to 5%. However, the comprehensive effect of this amendment is more clearly delineated in section 102, in which Congress defines the term "regular price."

[R]egular price means the tag or posted price charged for the property or service if a single price is tagged or posted, or the price charged . . .

55. Act of February 27, 1976, Pub. L. No. 94-222, 90 Stat. 197 (codified at 15 U.S.C. § 1666(f)) (Supp. III 1979).

56. Pub. L. No. 95-630, § 1501, 92 Stat. 3641, 3713 (codified at 15 U.S.C. § 1666(f)) (Supp. III 1979).

57. S. REP. NO. 23, 97th Cong., 1st Sess. 2, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 75. The House passed a bill, but provisions to permit unlimited cash discounts and prohibit surcharges were never considered by the Senate because they were part of a more comprehensive bill which was not enacted.

58. *Id.*

59. *Id.*

60. Cash Discount Act § 101 (emphasis added).

when payment is made by use of an open-end credit plan or charge card if either (1) no price is tagged or posted, or (2) two prices are tagged or posted, one of which is charged when payment is made by use of an open-end credit plan or credit card and the other when payment is made by cash, check, or similar means.⁶¹

This definition distinguishes clearly between cash discounts, which are permitted, and surcharges, which are not permitted.⁶² Section 103 further enhances the practical aspects of offering a cash discount by nullifying all Federal Reserve System rules and regulations pertaining to cash discounts which were in effect on July 27, 1981, the day prior to the effective date of this Act.⁶³

B. Title II - Extending the Surcharge Ban

The most compelling reason for passage of the Cash Discount Act is found in section 201. This section extends, until February 27, 1984, the earlier provisions of the public law which prohibited merchants from imposing a surcharge on customers who choose to use a credit card rather than pay cash.⁶⁴ This provision was the subject of considerable congressional debate and testimony before congressional subcommittees.⁶⁵

The paucity of conclusive evidence on the wisdom of prohibiting surcharges resulted in a legislative mandate for a two-year study by the Federal Reserve System to ascertain the effect of charge card transactions upon card issuers, merchants, and consumers.⁶⁶ The findings should address

(1) the effect of charge card transactions on retail sales; (2) the effect of credit card usage on consumers and on merchants, including the effects on merchant costs; and (3) the effect of charge card usage on the pricing of goods and services, with a comparison of the costs resulting from payment by (a) currency and coin, (b) by personal check or similar instrument, (c) by in-house credit plans, and (d) by charge card.⁶⁷

IV. ANALYSIS

A. A Closer Look at Title I - The Practical Effects

Despite its straightforward language and regulatory simplicity, the

61. *Id.* § 102(a).

62. See *supra* notes 7 & 14 and accompanying text.

63. Cash Discount Act § 103. See also *supra* note 51.

64. Cash Discount Act § 201.

65. See *infra* text accompanying notes 88-127.

66. Cash Discount Act § 202. See also S. REP. NO. 23, 97th Cong., 1st Sess. 4, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 74, 77.

67. Cash Discount Act § 202.

essence of Title I — removal of the 5% ceiling on cash discounts—has one apparent flaw. Because an unlimited discount (even a 5% discount) can have a substantial impact on the APR for a credit transaction, the credit consumer is now even more frustrated in his attempt to make meaningful cost comparisons, thus circumventing the original purpose of TILA: consumer protection through standardized disclosure of credit costs.⁶⁸ Nancy H. Teeters, a member of the Federal Reserve Board, called this the “loophole in the blanket embrace of TILA.”⁶⁹

At the same time, the removal of the 5% ceiling creates a greater incentive for customers to pay cash. James L. Kittle, a retail merchant representing the National Home Furnishings Association, testified before a Senate subcommittee that customers have little incentive to pay cash when credit is so readily available; the 5% discount was not a sufficient inducement for customers to pay cash, particularly when the prime lending rate was 17%.⁷⁰ The amount of a cash discount must be flexible and realistically reflect the current money market. Many of the consumers who can afford to pay cash are well informed about the time value of money and are thus inclined to take advantage of credit “float” by allowing their cash on deposit to draw interest and then paying off the full monthly balance on the charge account to avoid paying interest to the creditor.⁷¹ Float, the credit outstanding between the time the bank pays the merchant and the credit cardholder pays the bank without incurring interest on the balance due, can often be as long as 45-55 days.⁷² At the time of Senator Proxmire’s statement, float was running between \$4-5 billion at any given time.⁷³ To reduce float, some creditors now charge interest from the date the purchase is posted to the cardholders account, effectively eliminating what is essentially a short-term interest free loan.⁷⁴

The definition of regular price is the cornerstone of the Cash Discount Act because it establishes a benchmark. The definition requires a merchant to tag or post the highest price charged for all goods and/or

68. S. REP. NO. 23, 97th Cong., 1st Sess. 11, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 84.

69. *Cash Discount Act, 1981: Hearings on S. 414 Before the Subcomm. on Consumer Affairs of the Senate Comm. on Banking, Housing, and Urban Affairs*, 97th Cong., 1st Sess. 10 (1981) (statement of Nancy H. Teeters, Member, Federal Reserve Board) [hereinafter cited as *Senate Hearings*].

70. *Id.* at 25-26 (statement of James L. Kittle, representing National Home Furnishings Association).

71. 127 CONG. REC. S2097 (daily ed. Mar. 12, 1981) (statement of Sen. Proxmire).

72. *Melso v. Texaco, Inc.*, 532 F. Supp. 1280, 1289 (E.D. Pa. 1982).

73. 127 CONG. REC. S2097 (daily ed. Mar. 12, 1981).

74. *Melso*, 532 F. Supp. at 1290.

services.⁷⁵ A merchant is not prohibited from posting more than one price, but the language of the Act precludes the possibility of a merchant posting or tagging only the lower, or discount price. Thus, a consumer cannot be lured into a store on the basis of "low, rock-bottom prices" only to find at the cash register that the price will be higher if a credit card is used.⁷⁶ The consumer must see at least the highest possible price he will pay if he uses a credit card. The possibility of a merchant posting only the lower cash price is also effectively precluded by the surcharge ban.⁷⁷ The merchant may choose the manner or method for tagging or posting prices, providing it does not mislead the consumer.⁷⁸

The definition of regular price provides that payment by cash, check, draft, or other negotiable instrument, which may result in the debiting of a credit-type account, shall not be considered a credit transaction for purposes of the Cash Discount Act.⁷⁹ For example, the Official Commentary specifically allows merchants the flexibility to selectively offer a discount to customers who pay with currency, but not to those who pay by check or debit card.⁸⁰ The Official Commentary also sanctions a graduated discount plan where a merchant might offer a 10% discount for cash, a 5% discount for use of a third party credit card, and no discount for use of an in-house credit card in order to discourage the use of the in-house credit plan.⁸¹ Thus, a merchant also has flexibility in determining which method of payment will qualify for a discount and at what rate.

The significance of the language "all prospective buyers" must not be overlooked. When a discount is offered, the discount must be available to prospective buyers regardless of whether they are cardholders or members of the open-end credit plan.⁸² This phrase thus insures that customers who do not have credit cards can still reap the benefits of a cash discount even though they would have paid cash anyway. This does not, however, preclude offering discounts to members of special

75. See *supra* text accompanying notes 61-62.

76. S. REP. NO. 23, 97th Cong., 1st Sess. 4, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 77.

77. See *supra* text accompanying notes 14 & 64.

78. S. REP. NO. 23, 97th Cong., 1st Sess. 4, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 77.

79. Cash Discount Act § 102(a).

80. Federal Reserve Board, Official Staff Commentary 104 § 226.4, 4(b)(9)(2), Report No. 343 (Oct. 21, 1981) [hereinafter cited as Official Staff Commentary]. See also Lobell & Gelb, *supra* note 42.

81. Official Staff Commentary, *supra* note 80. See also Lobell & Gelb, *supra* note 42.

82. Lobell & Gelb, *supra* note 42.

groups such as senior citizens.⁸³

Section 103, which nullifies the Regulation Z provisions,⁸⁴ is also an extremely important part of the Cash Discount Act because each merchant is now "free to determine what [method] of disclosure best suits his or her purpose, so long as a good faith effort [is] made to clearly and conspicuously [advise the customer about] the availability of cash discounts."⁸⁵ This should substantially reduce merchant reluctance to participate caused by a fear of inadvertent violation.⁸⁶ It would not be unreasonable to expect the courts and regulatory agencies to enforce the requirement of clear and conspicuous notice with some latitude.⁸⁷

B. A Closer Look at Title II - The Irony and the Controversy

Title II is clearly the most controversial part of this legislation. A closer look at Title II reveals what Senator Proxmire terms the "delicious irony": at a time when the Administration has placed considerable emphasis on reducing government regulation, the Cash Discount Act calls for increased restriction of the free enterprise system.⁸⁸ TILA and its progeny were enacted ostensibly to promote consumer protection, but under Title II, the Cash Discount Act affords substantial continuing protection to the credit card industry by extending the ban on credit card surcharges. The result, according to Senator Proxmire, is inflationary because it ultimately encourages credit and discourages cash purchases.⁸⁹ Consumers should be able to make informed choices, however, this ban on surcharges "promotes costly economic inefficiencies by encouraging [consumers] to use credit cards without knowing the true cost of the credit card."⁹⁰

The advantages and disadvantages of the credit card surcharge have been discussed in Congress three times in the six years from 1976 to 1981. Senator Proxmire is not alone in his belief that the ban on surcharges should have been allowed to expire permanently. Prior to passage of the Act, the Senate Subcommittee on Consumer Affairs heard testimony from the Federal Reserve Board, Consumer Federa-

83. *Id.*

84. 12 C.F.R. § 226.4(i) (1980) (rescinded 1981). See *supra* text accompanying notes 50-52, 63.

85. S. REP. NO. 23, 97th Cong., 1st Sess. 3, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 74, 76.

86. See *supra* text accompanying notes 50-52.

87. S. REP. NO. 23, 97th Cong., 1st Sess. 3, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 74, 76.

88. *Id.* at 8, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 74, 80.

89. *Id.*

90. *Id.* at 9, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 74, 83.

tion of America, and Consumers Union calling for an end to the surcharge ban.⁹¹ The Federal Trade Commission,⁹² the Federal Home Loan Bank Board,⁹³ the Comptroller of the Currency, and the National Credit Union Administration also opposed the surcharge ban. In addition, Proxmire's position (and the proposed Proxmire-Glenn amendment to allow surcharges) found support from labor, farm, and senior citizen groups.⁹⁴

Senator Dodd, however, points out that the sum of special interest groups does not always equal the national interest.⁹⁵ Senator Inouye and others have spoken in favor of the ban on surcharges because a credit card surcharge would discriminate against middle income Americans, penalizing those who rely on credit. In addition to having a chilling effect on credit use, surcharges would also reduce the benefits to the cardholder.⁹⁶ Congressman Annunzio fears that if the consumer had to pay an added charge every time he or she used a credit card, the results would be "catastrophic."⁹⁷ Senator D'Amato called it "counter-

91. *Id.*

92. Then-Chairman Michael Pertschuk wrote:

We understand from our staff that many small merchants which adopt programs to ensure that cash customers do not pay the costs associated with accepting credit cards do so by imposing a surcharge rather than granting a discount. In instances in which the staff has notified these merchants that surcharges are illegal, the uniform response has been to abandon the surcharge, but not to institute cash discounts. Moreover, in at least one instance, the merchant orally expressed his dismay that the law allowed him to raise his cash price and then grant a discount but not to take the much simpler step of simply imposing a surcharge.

In theory, a discount and a surcharge are equivalent concepts, but one is hidden in the cash price and the other is not. From a practical standpoint the surcharge seems easier to implement and more likely to ensure that the price credit card users pay reflects the cost of accepting credit cards. If the goal of this legislation is to ensure that cash customers are not required to absorb the extra costs of accepting credit cards, and thereby subsidize credit card users, then elimination of the current prohibition on surcharges would seem to be one of the most effective methods of obtaining this goal.

Id. at 10-11, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 83.

93. John Dalton, writing for the Federal Home Loan Bank Board, stated that the actual difference between a discount and a surcharge is unclear[;] . . . it [is] anomalous to allow one and not the other. The practical consequence of imposing this artificial distinction undoubtedly would be to discourage the use of discounts, for merchants would be confused as to what is or what is not allowed, and thus would be reluctant to engage in any alteration of their pricing structure.

Id. at 15, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 87.

94. 127 CONG. REC. S2096 (daily ed. Mar. 12, 1981) (remarks of Sen. Proxmire).

95. *Id.* at S2098 (statement of Sen. Dodd). (Sen. Dodd is not clearly opposed to a surcharge, but supports the Federal Reserve Board study before a final decision can be made).

96. *Id.* at S2095 (remarks of Sen. Inouye).

97. *Cash Discount Act, 1981: Hearings on H.R. 31 Before the Subcomm. on Consumer Affairs and Coinage of the House Comm. on Banking, Finance, and Urban Affairs*, 97th Cong., 1st Sess. 1 (1981) (opening statement of Rep. Annunzio) [hereinafter cited as *House Hearings*].

productive."⁹⁸ Amy Topiel, testifying on behalf of MasterCard International, Inc., said that a surcharge would give merchants an opportunity to make windfall profits, while offering no additional benefit to cash or credit consumers.⁹⁹ Mr. Kittle, speaking as a merchant, said he personally would not use a surcharge even if it were allowed because it would be a disincentive for his credit customers who represent 40% of his business.¹⁰⁰ Curiously, as the debates and hearings were taking place, one astute merchant, a restaurateur in Vermont, did impose a surcharge during the interim between the February 27, 1981 expiration of the surcharge ban and the enactment of the Cash Discount Act. The reaction was a letter from a customer to the President of Visa calling this a questionably illegal, and definitely immoral, practice.¹⁰¹ In his letter, the customer stated that he was informed of the surcharge after he and his guests had finished their meals; the policy was not posted anywhere in the restaurant. He avoided an unpleasant confrontation, but was less generous than usual when he tipped the waitress.¹⁰² According to Hugh Smith, as his remarks were interpreted by Senator Chafee, the ban on surcharges is a consumer protection device—"protecting the consumer who has a card from being had."¹⁰³

At the heart of the surcharge debate is the question of whether, or to what extent, the cash customer subsidizes the credit card customer. In 1980, the three major credit card issuers, MasterCard, Visa, and American Express, collectively earned in excess of \$1.5 billion from domestic activities through the merchant discount fee.¹⁰⁴ The proponents of a surcharge believe that these fees are passed along to all customers in the form of higher prices because the merchant does not know who will pay cash or use credit, and therefore, bases his price on the assumed use of credit; the result is that both the cash and credit customers pay this "hidden fee."¹⁰⁵ Two commentators¹⁰⁶ have suggested that subsidization also occurs when credit consumers receive an implicit discount by taking advantage of credit float. The cost of credit

98. 127 CONG. REC. S2101 (daily ed. Mar. 12, 1981) (statement of Sen. D'Amato).

99. *Senate Hearings*, *supra* note 69, at 56 (statement of Amy Topiel).

100. *Id.* at 28 (statement of James L. Kittle).

101. 127 CONG. REC. S2089-90 (daily ed. Mar. 12, 1981) (Harrison letter of Mar. 2, 1981, introduced by Sen. Garn).

102. *Id.* at S2089.

103. *Senate Hearings*, *supra* note 69, at 58-59 (emphasis added) (dialogue between Hugh Smith and Sen. Chafee).

104. S. REP. NO. 23, 97th Cong., 1st Sess. 9, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 81.

105. *Id.* See generally *Melso*, 532 F. Supp. at 1288-89.

106. Murphy & Ott, *Retail Credit, Credit Cards and Price Discrimination*, 43 SO. ECON. J. 1303, 1311 (1977).

plans must include not only direct operating expenses, but also the lost interest.¹⁰⁷ This is a strong argument to show that price discrimination exists, but cash discounts would appear to be an equally effective method of overcoming this inequity. Subsidy has also been examined from the perspective that the lower income consumer who uses credit cards as a source of revolving credit subsidizes the higher income consumer who pays his bill in full and avoids interest, but this is disputed because the cost of providing credit (especially the probability of default) differs among income groups.¹⁰⁸

Senator Chafee, on the other hand, raises the question of how the \$1.5 billion in fees compares to the costs of doing business inherent in other forms of payment.¹⁰⁹ According to Richard D'Agostino, speaking on behalf of the American Bankers Association, credit cards may in fact be a more efficient and less expensive way of doing business.¹¹⁰ Peter Hood, also testifying for the American Bankers Association, echoes Mr. D'Agostino's sentiments: the basic premise, that the cost of doing business with a credit card is more expensive for the merchant than other forms of payment, is not the case in his experience.¹¹¹ Hugh Smith's testimony is even more decisive.

The central premise behind credit card surcharges—that the service fee paid to a card issuer is a direct, additional, and irrecoverable cost to merchants which is passed along to all customers in the form of higher prices—is superficial and fallacious. We know it is not supported by empirical data.¹¹²

107. *Id.* at 1303.

108. Garcia, *supra* note 1, at 329.

109. 127 CONG. REC. S2084 (daily ed. Mar. 12, 1981) (statement of Sen. Chafee). The other costs might include counterfeit currency, additional security requirements due to increased cash on hand, bad check losses and collection fees, fraud, and costs related to in-house credit plans such as credit applications, investigations, collection of accounts, bad debts. *See generally Senate Hearings, supra* note 69, at 32 (statement of Peter Hood, American Bankers Association).

110. *House Hearings, supra* note 97, at 15 (statement of Richard D'Agostino's American Bankers Association).

111. *Senate Hearings, supra* note 69, at 31 (statement of Peter Hood).

112. *Id.* at 43 (statement of Hugh Smith, American Express Co.). Mr. Smith asked to have relevant parts of the 1968 Federal Reserve Board study titled "Bank-Credit Card and Check-Credit Card Plans" reprinted in the subcommittee report. *Id.* at 65. In this study, the task group concluded that

bank credit cards are likely to have little or no direct effect on the prices of goods or services in stores where they are accepted. They would not necessarily result in any increase in operating expenses and would likely reduce them. What little evidence there is suggests that credit cards tended to reduce the costs to small merchants . . . and there is no evidence that they have pressed merchants in general to raise prices. All in all, credit cards should have little influence on retail prices and therefore on the cash customer.

Id. at 87-88.

Brandel and Leonard¹¹³ point out that a credit card system must be highly efficient (ie. low cost per transaction) in order to exist. Third-party credit card systems are economically advantageous for everyone because only one credit investigation is necessary, there is only one billing per cycle for purchases involving multiple merchants, and highly automated data systems are used in processing transactions.¹¹⁴

Ten years ago it was predicted that bank credit cards would lower retail costs to the benefit of everyone.¹¹⁵ Today it is argued that they have. The use of credit cards has been perpetuated as a way of life.¹¹⁶ In order to remain competitive, a merchant must offer credit. In doing so, the merchant may increase his volume of business, which in turn could result in lower unit costs.¹¹⁷ Garcia discusses the question of whether consumer credit stimulates consumption, concluding that this question remains a subject for future research.¹¹⁸ This conclusion is based on Russell's theoretical model of optimum allocation of lifetime income over time and Hirschman's empirical study which suggests that credit cards raise, rather than merely redistribute, customer expenditures over time. Both theories Garcia finds unconvincing.¹¹⁹ Hirschman's theory is that the use of credit cards may stimulate increased purchasing on the part of the cardholder thereby resulting in a higher level of dollar expenditures and sales volume. This occurs because credit card systems permit the individual to make purchases on the basis of anticipated future income. Since most people anticipate higher future incomes, credit card expenditures may exceed cash purchases.¹²⁰

It is not surprising in light of the controversy over the surcharge/subsidy issue that Congress should be skeptical. As Senator Dodd indicated, "[a] thorough, objective analysis by the Federal Reserve System [as required by section 202]. . . is essential if we are to eventually resolve the debate over whether or not credit surcharges are in our national interest."¹²¹ In fact, very little concrete information has been presented to refute or substantiate the theory that as a result of the

113. Brandel & Leonard, *Bank Charge Cards: New Cash or New Credit*, 69 MICH. L. REV. 1033, 1036 (1971).

114. *Id.* at 1037.

115. *Id.* at 1039-40.

116. See Garcia, *supra* note 1; *Senate Hearings, supra* note 69, at 60 (remarks of Hugh Smith).

117. *Senate Hearings, supra* note 69, at 42-43; *House Hearings, supra* note 97, at 23-25 (statements of Hugh Smith). See also Garcia, *supra* note 1, at 329.

118. Garcia, *supra* note 1, at 333.

119. *Id.*

120. Hirschman, *Differences in Consumer Purchase Behavior by Credit Card Payment System*, 6 J. CONSUMER RESEARCH 58, 60 (1979).

121. S. REP. NO. 23, 97th Cong., 1st Sess. 16, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 74, 88.

surcharge ban, cash customers subsidize credit customers.¹²² According to Senator Chafee, extension of the surcharge ban is not an avoidance of the issue, but rather constitutes a maintenance of the *status quo*.¹²³ In the interim, the effect of allowing unlimited cash discounts can be ascertained. To allow a surcharge now would presuppose the outcome of the Federal Reserve Board study.¹²⁴ Senator Hayakawa expressed a similar opinion that Congress should rely on facts, not conjecture.¹²⁵ Until the results of the Federal Reserve Board study are known, Congress cannot determine whether it has gone far enough by allowing unlimited discounts or should go further and allow a surcharge.¹²⁶ Congressman Annunzio believes retaining the surcharge ban in the interim will create greater economic stability by avoiding inconsistent policies.¹²⁷

C. Who Really Benefits?

Major portions of the Cash Discount Act, particularly Title I, are predominantly beneficial to the merchant. He may offer a cash discount in any amount, select the method of payment which will qualify for the discount, establish a graduated rate if he so chooses, and disclose the availability of a cash discount in good faith in the manner which is most suitable for his purpose or circumstances, all without the intimidating constraint of Regulation Z. Or he may choose not to offer a discount at all. If he offers a discount, he may, as a result, attract new customers, increase his sales volume while reducing his credit related expenses, and improve his cash flow. According to Mr. Kittle, for merchants with large amounts of money tied up in inventory, cash flow can be a constant problem. A reasonable incentive to increase cash sales will have an immediate beneficial effect on business and the economy as a whole.¹²⁸

The consumer will benefit through lower prices for cash customers, and he will benefit because a merchant is prohibited from conditioning the discount on possession of a credit card, posting deceptively low prices to entice unsuspecting buyers into his place of business, or imposing a surcharge on a customer who uses credit. The surcharge ban may not be a benefit *per se* for the *cash* customer, but neither is it a disincentive. Clearly, however, it is a benefit to the *credit* customer

122. *Id.* at 4, reprinted in 1981 U.S. CODE CONG. & AD. NEWS 74, 77.

123. 127 CONG. REC. S2084 (daily ed. Mar. 12, 1981) (statement of Sen. Chafee).

124. *Id.*

125. *Id.* at S2102 (remarks of Sen. Hayakawa).

126. *Id.*

127. *Id.* at H1729 (daily ed. May 4, 1981) (statement of Rep. Annunzio).

128. *Senate Hearings, supra* note 69, at 26 (statement of James L. Kittle).

since an additional charge will not be added on to the cost of his purchase. This is an admittedly simplified analysis in that it does not consider the argument that credit causes higher prices because of the hidden costs nor the argument that credit results in lower prices because it generates greater sales volume.¹²⁹

Under the Cash Discount Act, if credit customers start paying cash to take advantage of cash discounts, this will diminish the merchant discount fees collected by the third-party credit card issuers. While this was at one time a more prevalent concern,¹³⁰ in all probability, it is not a significant drawback today because the industry relies more heavily on interest income on outstanding debts as a primary source of revenue; discount fees tend to be a break-even activity.¹³¹ Presumably, many of the customers who will respond to the new incentive to pay cash are those who pay off their account in full each month and thus do not represent the primary source of revenue to the card issuer.¹³² The Title II surcharge prohibition is undoubtedly advantageous to the credit card industry by allowing it to retain a favorable market image.¹³³ Industry representatives claim that this governmental restriction is also in the public interest.¹³⁴ Many uninformed credit card users continue to presume third-party credit service, provided to and by merchants, is "free". If the credit customer had to pay a surcharge to reimburse the merchant for the amount of the discount fee, he might well be motivated to purchase less on credit. But he might well be motivated to purchase less, period. The negative statement about credit cards, which the surcharge would inflict, would result in a lower volume of sales and would destroy any "economies of scale" benefits.¹³⁵ Hirschman and others have found that in making a credit purchase, the consumer had to decide not only to use credit, but which type to use. Hirschman suggests the choice might be influenced by five factors: (1) characteristics of the individual, such as age, income; (2) characteristics of the credit card system, such as interest rates, prestige, line of credit available; (3) characteristics of the goods or services being purchased, such as price; (4) policies of the merchant regarding acceptable payment systems; and (5) characteristics of the

129. See generally *supra* text accompanying notes 105, 115-20.

130. See generally Murphy & Ott, *supra* note 106, at n.9-10 and accompanying text; O'Driscoll, *infra* note 146, at 166-68.

131. *Senate Hearings, supra* note 69, at 63-64.

132. See generally *supra* text accompanying notes 26-27.

133. See *Senate Hearings, supra* note 69, at 32 (statement of Peter Hood); *House Hearings, supra* note 97, at 27 (statement of Hugh Smith).

134. *Senate Hearings, supra* note 69, at 44 (statement of Hugh Smith). *Id.* at 56 (statement of Amy Topiel).

135. *Id.* at 32 (statement of Peter Hood).

situation, such as time, amount of debt outstanding, necessity of the purchase, or ability to postpone the purchase.¹³⁶ These five factors are consistent with the Day-Brandt situational variables.¹³⁷ Although correlation may be speculative, factor four, policies of the merchant, might, in the future, include whether the merchant imposes a surcharge, and might influence factor five, necessity of the purchase, leading to postponement of the purchase or no purchase at all.

Despite the fact that Congress has eased the restriction in an effort to encourage cash discounts, the bottom line still presents a curious dichotomy. The benefit to the cash customer is enjoyed only if the merchant is responsive. If the merchant offers the discount, the credit customer may not fully appreciate the consequential impact on his true cost of credit or may not be able to make an informed choice.¹³⁸ This raises two questions. What are the alternatives? How can this be reconciled with the Truth in Lending Act?

The alternatives to the provisions of the Cash Discount Act would be either to allow merchants to utilize both discounts and surcharges, or to allow a surcharge, but not a cash discount. Offering a cash discount and/or imposing a surcharge would permit the greatest degree of freedom in the free enterprise system. In the competitive marketplace, merchants could determine whether discounts or surcharges are best suited to their needs. It would also, however, be a kind of shell game for the consumer because comparison of price and terms would be impossible where the base price is constantly changing. Using Senator Chafee's example,¹³⁹ what customer without a calculator would be able to quickly determine whether an item offered by merchant *A* for \$340 less a 6% discount or the same item offered by merchant *B* at \$328 with a 4% surcharge would be the better bargain? Allowing both the surcharge and cash discount would, in this respect, further frustrate TILA purposes because there would be no common denominator. Imposing a surcharge in lieu of the cash discount would possibly be more detrimental to the credit customer in terms of higher prices and greater potential for abuses. If the consumer resists the surcharge, the merchant may suffer a loss of incremental sales leading to higher prices

136. Hirschman, *supra* note 120, at 64.

137. Day & Brandt, *supra* note 30, at 73.

138. See generally *supra* text accompanying notes 68 & 69, 90.

139. *Senate Hearings*, *supra* note 69, at 109-10 (remarks of Sen. Chafee directed to Jim Boyle, Consumer Federation of America). Boyle responded that consumers would want the cash discount, and he is quite correct. A less obvious example would be an item at \$138 with a 10% discount or the same item at \$118 with a 5% surcharge. In this case the surcharge is the better bargain. The point here is that with both discounts and surcharges, the rates of which are determined by the individual merchant and vary from one to another, it creates a great deal more confusion for the customer. Often the choice could be among several merchants.

for everyone; if the consumer submits to the surcharge, the merchant may enjoy a windfall.¹⁴⁰ Either way, there is no evidence that the cash paying customer would benefit. In fact, the surcharge may be viewed as a detriment to the economy in general, particularly in the socioeconomic sense, because it would burden those consumers who rely on credit for necessary as opposed to luxury goods. Nonetheless, a surcharge appears to be more consistent with the TILA purposes because it would clearly identify another cost of credit, and would do so in a manner designed to discourage consumer reliance on credit in general and credit cards in particular. However, in all likelihood, allowing surcharges would also require some degree of regulation, thus weakening the argument that permitting surcharges would lead to a reduction of governmental intervention.

Some commentators have compared the concepts of surcharge and discount to the glass of water which is half-full or half-empty depending on one's perspective.¹⁴¹ Despite this analogy, Congress chose to promulgate the cash discount in lieu of a surcharge. Title I protects the cash customer by allowing price reductions in his favor. Title II protects the credit customer by prohibiting price increases. Both titles work together to assure that a price differential will only be expressed in one context: discount. Thus, any apparent contradiction to the underlying purpose of TILA can be reconciled by a broad interpretation of that purpose: to enhance consumers' informed use of credit by calculating the APR and finance charge on a clearly defined regular price basis.¹⁴² This avoids the shell game effect to the customer, and even more important, avoids the complex problems that allowing both would generate with respect to calculating the APR and finance charges in the absence of a base price. This also acknowledges the broader functions of TILA described earlier, with perhaps a little greater emphasis on the economic stability function.

V. THE LITIGATION

As of this writing, there appears to be no reported case law deciding complaints or violations of the provisions of the Cash Discount Act. This is not altogether surprising for two reasons. First, the relatively short length of time that these provisions have been in effect, coupled with the apparent lack of knowledge on the part of the merchant and consumer and the potentially small individual dollar amounts involved, make litigation an unlikely alternative for most customers. One might

140. *Id.* at 56, 58 (statement of Amy Topiel).

141. *House Hearings, supra* note 97, at 6 (statement of Amy Topiel).

142. *Id.* at 15.

speculate that the position taken by consumer watchdog groups such as Consumers Union (favoring a surcharge) also contributes to the unlikelihood of litigation.¹⁴³ A second reason for the lack of adjudication may be that potential violations are decided on other provisions of TILA and antitrust legislation, specifically the Sherman Act.¹⁴⁴ This observation is based upon a brief review of cases decided prior to enactment of the Cash Discount Act which dealt with issues such as cash price disclosure in calculation of finance charges,¹⁴⁵ third-party creditor-merchant contracts,¹⁴⁶ and state usury laws.¹⁴⁷ In *Joseph v. Norman's Health Club, Inc.*,¹⁴⁸ the Club sold lifetime memberships primarily on an installment plan, but sold a few memberships for cash at a discount of 10%-15% off the total installment price prior to TILA. They also sold at least four memberships at a discount after the TILA effective date without disclosing this cash price differential as part of the finance charge. The promissory notes signed by customers who purchased memberships on the installment plan stated the finance charge and the APR as zero.¹⁴⁹ The Club had made agreements with several finance companies whereby a finance company would purchase such notes as it found to be acceptable, paying the Club the face amount of the note, less the amount of the negotiated discount provided in the agreement.¹⁵⁰ The district court held that the price reduction allowed to those members who paid cash after the effective date of TILA was an undisclosed finance charge imposed on installment customers, but did not discuss whether the amount discounted on the notes purchased by the finance companies required disclosure as a finance charge.¹⁵¹ The court of appeals, however, held that the discount paid by the Club on the notes assigned to the finance companies was required to be included

143. *Senate Hearings*, *supra* note 69, at 90-91, 99 (statement of Jim Boyle, Consumer Federation of American and Ellen Broadman, Consumers Union). The surcharge ban is anti-free enterprise. It puts merchants in a straight-jacket and narrows the marketing approach while affording special interest protection for credit card issuers who do not wish purchasers to know the true cost of buying on credit. *Id.* at 90-91.

144. Sherman Anti-Trust Act, 15 U.S.C. §§ 1-7 (1976).

145. *Joseph v. Norman's Health Club, Inc.*, 532 F.2d 86 (8th Cir. 1976), *rev'g*, 386 F. Supp. 780 (E.D. Mo. 1974).

146. O'Driscoll, *The American Express Case: Public Good or Monopoly?*, 19 J. LAW AND ECON. 163 (1976) (discussing *Blitz v. American Express Co.*, No. 74-314 (D.D.C. filed Feb. 27, 1974) (withdrawn). Consumers Union was also a plaintiff in this case.

147. *State v. J.C. Penney Co.*, 48 Wis. 125, 179 N.W.2d 641 (1970). For further discussion of this area, see Comment, *Legal Problems of Consumer Credit: Bank Credit Cards and the Usury Laws*, 4 U.C.D. L. REV. 335 (1971).

148. 532 F.2d 86 (8th Cir. 1976), *rev'g* 386 F. Supp. 780 (E.D. Mo. 1974).

149. *Id.* at 88 n.3.

150. *Id.* at 89. The discount was substantial, ranging from \$85 to \$165 on notes with a face value of \$360.

151. *Id.* at 89, 93.

in the finance charge to the extent this discount was passed on to the consumer.¹⁵² In the absence of regular or frequent cash sales, the cash price which should have been disclosed was the amount of cash the Club received from the finance company after the discounting of the customer's note.¹⁵³ In *State v. J. C. Penney Co.*,¹⁵⁴ the court found the 1-1/2% monthly charge on the unpaid balance of revolving charge accounts not to be a time price differential; the difference between the cash price and the credit price amounted to interest governed by the state's usury statutes. In a suit against the American Express Company, the plaintiffs sought declaratory and injunctive relief under the Sherman Act because American Express contracted with member merchants to the effect that the seller would agree the prices charged to cardholders would not be greater than those charged to other customers.¹⁵⁵ The suit against American Express had the makings of a landmark decision, but it was settled out of court with American Express agreeing to permit member merchants to grant cash discounts.¹⁵⁶ In his article discussing this case, Professor O'Driscoll observed that this contractual provision forbade the granting of discounts to customers willing to pay cash.¹⁵⁷ What he neglected to point out was that this contractual provision forbade the imposition of surcharges as well. At the time this suit was commenced, TILA required cash discounts to be disclosed as part of the finance charge. The Fair Credit Billing Act was also pending in Congress and would have nullified the clause.¹⁵⁸ The clause in question was purportedly a method to preclude merchants from benefiting from American Express advertising and market segregation and then avoiding payment for these services in the form of merchant discount fees by inducing the cardholder to pay cash.¹⁵⁹ The American Express practice was clearly contrary to public and congressional sentiment as evidenced by the subsequent enactment of the Fair Credit Billing Act. Also evident was a belief that cash discounts are desirable and might lead to lower prices at the retail level.¹⁶⁰

The absence of litigation is not evidence that there are no violations of the Cash Discount Act, nor does it mean there are no potential

152. *Id.* at 93. The finance company was also held liable for failing to make the required disclosure because the finance company was an integral part of the seller's financing program. *Id.* at 92.

153. *Id.* at 93 n.14.

154. 48 Wis. 125, 179 N.W.2d 641 (1970).

155. O'Driscoll, *supra* note 146, at 163-64.

156. *Id.* at 164.

157. *Id.* at 163.

158. *Id.* at 175 n.21.

159. *Id.* at 166-68. See also Murphy & Ott, *supra* note 106, at 1308-09.

160. O'Driscoll, *supra* note 146, at 164.

issues which might ripen and come before the courts. For example, a merchant in Xenia, Ohio, recently offered a 10% cash discount in conjunction with a promotional event. It appears that his methods were appropriate, but his motivation was entirely unrelated to the Cash Discount Act. "A merchant in Columbus tried it; it was a huge success. I thought I would try it too."¹⁶¹ This Xenia businessman admitted that he had never heard of the Cash Discount Act. Because this merchant also offers installment credit, a question might arise as to what price he discloses and what basis he uses for calculating the APR and finance charge on the installment credit contracts. The Cash Discount Act only excludes cash discounts from these calculations as applied to open-end credit.¹⁶² An even more disconcerting example was recently observed in Denver, Colorado. A restaurant participating in *Carriage Trade*, a coupon plan for discounts and "two-fers" at area eating establishments, had a sign posted near the cash register that advised customers of a 10% charge for credit cards used in conjunction with *Carriage Trade* coupons. Mr. Irvin Abrams, Chief Investigator, Division of Credit Practices, Federal Trade Commission, confirmed that this was a violation of the Cash Discount Act.¹⁶³ While it is permissible for a merchant to offer a *discount* in conjunction with a special promotional event, as our friend in Xenia did, it does not follow that a *surcharge* can also be imposed in conjunction with a promotional program.¹⁶⁴ The parties involved have been informed that their practices do not comply.

Another example of how merchants are imposing illegal surcharges involves a New York based mail order stereo equipment distributor. The brochure which this company mails to prospective customers states that "[Credit cards] are accepted. Please add 4% service charge."¹⁶⁵ Personal checks are also accepted, but require a fourteen-day clearing period.¹⁶⁶ The customer is required to pay shipping charges, but customers outside of New York are not required to pay sales tax.¹⁶⁷ Prices quoted in the brochure are approximately 20% less than the prices for identical merchandise purchased through local merchants. While the consumer may not object to paying the 4% ser-

161. Telephone Interview (Aug. 6, 1982)(memorandum on file at University of Dayton Law Review).

162. Cash Discount Act § 101.

163. Telephone Interview with Irvin Abrams, Chief Investigator, Division of Credit Practices, Federal Trade Commission (Aug. 31, 1982) (memorandum on file at University of Dayton Law Review).

164. *Id.*

165. The Audio Factory, Bayside, N.Y., Summer 1982 Catalog & Price List 5 (relevant portions on file at University of Dayton Law Review).

166. *Id.*

167. *Id.*

vice charge, and may still *net* a lower price, this does not make the surcharge legal. It is an abuse of the consumer who may use credit for convenience and to assure a more prompt shipment of his order than if he were to pay by check.

The Cash Discount Act was noted in *Melso v. Texaco, Inc.*¹⁶⁸ Although *Melso* did not directly involve the Cash Discount Act, it dealt with the policy questions of cash and credit purchases, the relative costs of consumer goods, alternative purchasing methods, and the government's role in regulating particular transactions and payment systems.¹⁶⁹ *Melso* was a class action brought by Texaco dealers against the parent company because Texaco implemented a 3% merchant discount fee on the processing of all Texaco credit card receipts.¹⁷⁰ The merchants were denied injunctive relief on their allegations of restraint of trade and illegal tie-in, unconscionability, improper contract modification, and lack of consideration in an adhesion contract.¹⁷¹ In *Melso*, the court discussed subsidy as a foregone conclusion:

Many credit card purchasers in the United States have long received a subsidy at the expense of those consumers who have been paying cash for the product. . . . [T]he cash customers, by paying a price made higher because of the cost of operating a credit program, have been subsidizing. . . . credit card purchasers.¹⁷²

The Texaco credit program was found to be consistent with the Cash Discount Act because it attempts to correct this flaw in the credit market.¹⁷³ Prior to November 1, 1981, Texaco dealers had no incentive to offer a cash discount because the processing fee was only \$36 annually. Since the implementation of the 3% processing or discount fee, Texaco dealers have become acutely aware of the costs related to extending credit and may, as a result, feel compelled to offer a cash discount in order to avoid imposing this cost of credit on all customers.¹⁷⁴ The fact that this case did not deal directly with the Cash Discount Act, and therefore discussion of the Act was unnecessary for the court to decide the issues, suggests that Judge Broderick's signaling treatment of the Act, and particularly the subsidy question, may reflect a degree of subjectivity inconsistent with the judicial function.

168. 532 F. Supp. 1280, 1288 (E.D. Pa. 1982).

169. *Id.* at 1288.

170. *Id.* at 1280.

171. *Id.* at 1298.

172. *Id.* at 1288.

173. *Id.* at 1289.

174. *Id.* at 1288.

VI. MORE LEGISLATION?

In February 1982, Congressman Frank Annunzio introduced a bill¹⁷⁵ that would amend the Cash Discount Act. The proposed legislation would add another section to the Act, prohibiting a credit card issuer who is also an oil company franchisor from requiring a seller who is a franchisee to pay a discount fee to the franchisor for processing credit card receipts when the franchisee honors a credit card issued by the franchisor.¹⁷⁶ Specifically, this would forbid major oil companies from imposing a processing or discount fee on dealers for processing credit card receipts.¹⁷⁷ This, of course, suggests that the Texaco procedure at issue in *Melso* may not be consistent with the Cash Discount Act after all.¹⁷⁸ The reason for this proposed amendment is that dealers pay for the services provided by the franchisor through the prices paid for the product. In addition, credit cards have been a marketing device for the major oil companies to build customer loyalty rather than a *per se* credit source.¹⁷⁹ When he introduced this legislation, Rep. Annunzio said, "[t]he company's credit card is part of that marketing power and the dealer has paid for it. Imposing a fee on the dealer for honoring the card would be charging twice for the service. . . . It is to prevent the double charge of this fee that I introduce this legislation."¹⁸⁰

VII. CONCLUSION

The Cash Discount Act deletes the 5% ceiling on cash discounts offered by a merchant to induce more customers to pay cash for their purchases and removes the burdensome Federal Reserve Board regulations concerning disclosure of availability of a cash discount. It also extends, pending a Federal Reserve Board study, the ban on imposing a surcharge when a customer uses a credit card. There are also other non-germane provisions which have not been discussed in this comment.¹⁸¹

The surcharge ban is the most controversial provision. Senator Proxmire found it ironic that at a time when politicians were promising to restrict governmental interference, Congress was busy legislating

175. H.R. 5362, 97th Cong., 2d Sess. (1982).

176. *Id.*

177. *Gasoline Dealers' Antisurcharge Bill: Hearings on H.R. 5362 Before the Subcomm. on Consumer Affairs and Coinage of the House Comm. on Banking, Finance, and Urban Affairs*, 97th Cong., 2d Sess. 3 (opening statement of Rep. Annunzio) [hereinafter cited as *Hearings on H.R. 5362*]. See also *Franchising*, 43 ANTITRUST & TRADE REG. REP. (BNA) No. 1080, at 410 (Sept. 2, 1982).

178. See *Melso*, 532 F. Supp. at 1289. See also *supra* text accompanying note 173.

179. See *Hearings on H.R. 5362*, *supra* note 177, at 3, 4.

180. *Id.*

181. See *supra* note 2.

controls on the free enterprise system.¹⁸² However, allowing surcharges may also necessitate some regulation. Although a surcharge may appear to be more consistent with TILA because the cost of credit is not "hidden" in the price of goods or services, the cash discount results in less confusion and less opportunity for real or perceived consumer abuses. The Cash Discount Act is by no means a panacea in today's sagging economy. It is, however, a viable step in the direction of encouraging consumers to rely less on credit. Congress can encourage Americans to kick the credit habit with either the proverbial carrot or stick. The cash discount is a carrot to entice consumers to voluntarily pay cash more often. A credit surcharge is the stick, inflicting an economic penalty upon those who continue to use credit. If experience shows in three years that discounts are still the exception to the rule in the marketplace, Congress may conclude that a surcharge is the only effective approach to two-tier pricing,¹⁸³ if two-tier pricing is even necessary. However, it seems clear today that the merits of allowing a discount and/or allowing a surcharge is not the end of the discussion.

Ultimately, the success of the Cash Discount Act depends on *awareness* and *willingness to participate*. The merchant must be aware that he can offer cash discounts and be willing to do so. The consumer must also be aware that discounts are legal, and must bring pressure on reluctant merchants through the competitive market forces to offer them. Similarly, consumers must be aware that surcharges are not legal, and must refuse to patronize merchants who engage in this practice. Without these necessary ingredients, the Cash Discount Act will have little or no effect in achieving the desired results.

As Congressman Annunzio has suggested, the Cash Discount Act may be most beneficial as a stabilizing influence in a fluctuating economy. The Cash Discount Act preserves the basic intent, if not the letter, of TILA, while at the same time encouraging more consumers to pay cash without creating turmoil or penalizing middle income America. This may be regulation at its best, seeking to accomplish a legitimate goal in the least burdensome manner.

Betsy Horkovich

182. S. REP. NO. 23, 97th Cong., 1st Sess. 8-9, *reprinted in* 1981 U.S. CODE CONG. & AD. NEWS 74, 80-81.

183. See 127 CONG. REC. S2085 (daily ed. Mar. 12, 1981) (statement of Sen. Chafee).
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