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Beyond the Black Box, or, When Shrouded Clauses Are Pro-Consumer

Luke Herrine
University of Alabama School of Law, lherrine@law.ua.edu

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BEYOND THE BLACK BOX, OR, WHEN SHROUDED CLAUSES ARE PRO-CONSUMER

LUKE HERRINE[**]

This article compares two clauses in credit card contracts providing for alternative dispute resolution (ADR). Arbitration clauses use ADR to cut off consumer remedies, while reversal clauses use ADR to expand them. Holding constant the possibility of earning extra money by exploiting consumer biases, it is argued that the coexistence of these two clauses must be explained in terms of which aspects of a firm's institutional structure leads it to instantiate this possibility. Viewing a firm as a forum to mediate the interests of the constituencies that either own or contract with it, one can ask how the aggregate interests of a firm's constituencies (including consumers) affect its incentives to take advantage of consumer biases. Ownership can explain the low rate of arbitration clauses in credit union credit card contracts. Contracting patterns, specifically cross-elasticity of merchants and consumers, can explain the consumer friendliness of reversal clauses. Implications for analyzing credit card contracts and consumer regulation more broadly are discussed.

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[**] Legal Fellow, Furman Center for Real Estate and Urban Policy. J.D, N.Y.U. School of Law, 2015. In writing this paper I benefited most from the patient guidance of Ryan Bubb. Thanks also to Ronald Mann, Oren Bar-Gill, Zev Eigen, and Wei Zhang. Also central to its development was the Furman Academic Scholars community, led by David Kamin and Barry Friedman *in absentia* but also including Jo Langille, Sandy Mayson, Patrice Wylly, Thad Eagles, Nabil Ansari, Susan Smelcer, Kristin Loveland, Steven Marcus, Jack Millman, Wen Xue, Alex Schindler, and Alexandra Bursak. Another Furman-funded community, that of the Furman Center, provided very helpful feedback on a draft, especially Mark Willis, Michael Suher, Brian Karfunkel, and Gita Khun Jush. All mistakes and bad ideas that remain are my own.

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INTRODUCTION

Scholars and practitioners alike have become familiar with the idea that a credit card company (indeed, any consumer-facing firm) can avoid liability by squeezing an arbitration clause partway through its novella of a contract. Arbitration has recently been the subject of numerous law review articles, a three-part *New York Times* investigation, a thousand-page Consumer Financial Protection Bureau report, a proposed regulation by the CFPB, and an episode of "The Good Wife."[1] In the legal academic literature, credit card contracts are treated as prime examples of "behavioral market failure," whereby firms direct consumers' attention towards an attractively low upfront price term while loading costs onto "shrouded" back-end terms such as arbitration clauses.[2] A market full of such firms

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[1] CONSUMER FINANCIAL PROTECTION BUREAU, ARBITRATION STUDY: REPORT TO CONGRESS, PURSUANT TO DODD-FRANK WALL STREET REFORM AND CONSUMER PROTECTION ACT § 1028(a) (March 2015); *The Good Wife*: *Payback* (CBS, Nov. 1 2015). The New York Times released a three-part investigative series under the title "Beware the Fine Print" in addition to an editorial a few days later. Jessica Silver-Greenberg & Robert Gebeloff, *Arbitration Everywhere, Stacking the Deck of Justice*, N.Y. TIMES (Oct. 31, 2015), http://www.nytimes.com/2015/11/01/business/dealbook/arbitration-everywhere-stacking-the-deck-of-justice.html; Jessica Silver-Greenberg & Michael Corkery, *In Arbitration, a 'Privatization of the Justice System'*, N.Y. TIMES (Nov. 1, 2015), http://www.nytimes.com/2015/11/02/business/dealbook/in-arbitration-a-privatization-of-the-justice-system.html; Michael Corkery & Jessica Silver-Greenberg, *In Religious Arbitration, Scripture is the Rule of Law*, N.Y. TIMES (Nov. 2, 2015), http://www.nytimes.com/2015/11/03/business/dealbook/in-religious-arbitration-scripture-is-the-rule-of-law.html; Editorial, *Arbitrating Disputes, Denying Justice*, N.Y. TIMES (Nov. 7, 2015), http://www.nytimes.com/2015/11/08/opinion/sunday/arbitrating-disputes-denying-justice.html.

[2] *See* Xavier Gabaix & David Laibson, *Shrouded Attributes, Consumer Myopia, and Information Suppression in Competitive Markets*, QUARTERLY J. ECON. 505 (2006). They are also known as "invisible" or "non-salient" clauses, depending on the scholar. Todd D. Rakoff, *Contracts of*

equilibrates inefficiently: firms use shrouded arbitration clauses to maximize their welfare without doing the same for consumers.[3]

But credit card contracts also contain shrouded clauses providing for alternative dispute resolution that not only resist dealing sharply with consumers but also act as a form of affirmative consumer protection. Reversal clauses, as I will call these understudied provisions, allow a cardholding consumer to contest a payment for a transaction with which there has been a problem—from an unprocessed refund to an unsatisfactory product—and to get their money back in most cases.[4] Explaining these clauses provides an opportunity to think again about what drives firms to take advantage of consumer biases.

An obvious first place to look would be government regulation. And indeed Congress, via the Fair Credit Billing Act (FCBA), created the basic consumer right to refuse to pay for an item on a credit card bill when there is a legally cognizable dispute with the merchant about that item.[5] However, that statute has limited application and is challenging to enforce.[6] Given financial institutions' apparently endless creativity in dancing around regulations, it would not be difficult for credit card issuers to "work creatively around those rule changes" to make them effectively toothless.[7] Yet, even with abundant loopholes to jump through, credit card issuers have taken the FCBA as a jumping-off point. They have expanded consumers' reversal rights well beyond the restrictions in the bill and have even extended them to other jurisdictions without similar legal protections.[8] Something else must be going on.

Another candidate is firm ownership. Ryan Bubb and Alex Kaufman have found that that non-investor-owned firms (non-profits and mutuals) are much less likely to use teaser rates and other advantage-taking

Adhesion: An Essay in Reconstruction, 96 HARV. L. REV. 1174, 1176 (1983) (describing the terms as "invisible"); Russell Korobkin, *Bounded Rationality, Standard Form Contracts, and Unconscionability*, U. CHI. L. REV. 1203, 1206 (2003) (describing the terms as "non-salient").

[3] *E.g.* OREN BAR-GILL, SEDUCTION BY CONTRACT 23–26 (2012) (analyzing welfare implications).

[4] It is not the language of the clause *per se* that gives consumers this ability, but the clause read in conjunction with other contract clauses and internal policies that govern the dispute resolution process. *See infra* Section II.B.

[5] This was passed in 1974 as an amendment to the Truth in Lending Act (TILA). 15 U.S.C. §§ 1666(a), 1666i. 12 C.F.R. §§ 226.12(b), (c). Technically, it is only TILA 170 (15 U.S.C. § 1666i) that passes on liability to the issuer, but TILA 161 (15 U.S.C. § 1666(a)) operates in a parallel way by making the issuer liable for "billing errors," which are defined broadly enough to include non-delivery of a product or even, arguably, some fault in the product.

[6] *See infra* Section I.B.2.

[7] MICHAEL S. BARR, SENDHIL MULLAINATHAN & ELDAR SHAFIR, BEHAVIORALLY INFORMED FINANCIAL SERVICES REGULATION 3 (New America Foundation Whitepaper, 2008).

[8] *See infra* Section I.B.

pricing structures in their credit card contracts.[9] A recent CFPB analysis similarly found that for-profit credit card issuers are much more likely than (mutually owned) credit unions to deploy arbitration clauses.[10] Drawing from the work of Henry Hansmann, Bubb and Kaufman argue that firms without investor ownership have weaker incentives to take advantage of consumer biases because they are not as beholden to the bottom line.[11] The notion is that a firm's agents always have countervailing incentives (that icky feeling of bilking consumers of their money, the risks of toeing the boundary of legality, the dangers of going too far and having the firm's reputation impugned) and that these incentives have more pull when investors are not demanding full profit maximization.[12] Indeed, being owned by cardholders, as credit unions are, may even generate new countervailing incentives to look after long-term cardholder interests.

Reversal clauses can be found in credit card contracts regardless of ownership. But Bubb and Kaufman's approach of asking how an institutional analysis of firm structure can help predict how a firm will treat consumers is a step in the right direction. The behavioral law and economics (BLE) approach, which focuses on firms' incentives to take advantage of consumer biases, tends to treat firms as black boxes about which the only thing we can know is that they will maximize profits wherever possible.[13] But, as other work in several social sciences has emphasized, firms are complex institutions behavior of which cannot always be explained using a simple production function.[14] Even within the most neoclassical realms of economic analysis of law, it is familiar to think of a firm as an institution for collective action the behavior of which depends on the relative ability of each party that has ownership interests and/or contracts with the firm to assert its interests (so long as those parties are investors or executives).[15] It would be strange if none of the jockeying described in this literature affected how firms interact with their customers.

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[9] Ryan Bubb & Alex Kaufman, *Consumer Biases and Mutual Ownership*, 105 J. PUB. ECON. 39, 46 (2014) ("investor-owned issuers are far more likely than credit unions to offer introductory APRs").

[10] *See* CFPB Study, *supra* note 1, at Section 2, p. 10.

[11] Bubb & Kaufman, *supra* note 9.

[12] *Id.*

[13] *E.g.* BAR-GILL, *supra* note 3, at 14–16 (discussing how firms will design prices for biased consumers).

[14] For an overview of the economic literature, see Nicolai J. Foss, Henrik Lando, & Steen Thomsen, *The Theory of the Firm*, *in* ENCYCLOPEDIA OF LAW AND ECONOMICS VOLUME III. THE REGULATION OF CONTRACTS 631 (Boudewijn Bouckaert & Gerrit De Gees eds., 2000). For an overview of recent sociological literature, see Gerald F. Davis, *Firms and Environments*, *in* THE HANDBOOK OF ECONOMIC SOCIOLOGY (Neil J. Smelser & Richard Swedberg eds., 2d ed. 2005).

[15] The foundational works in the neoclassical vein are Armen Alchian & Harold Demsetz, *Production, Information Costs, and Economic Organization*, 62 AM. ECON. REV. 777 (1972); Michael Jensen & William Meckling, *Theory of the Firm: Managerial Behavior, Agency Costs and Ownership Structure*, 3 J. FIN. ECON. 305 (1976); Eugene Fama, *Agency Problems and the*

For Hansmann and other theorists of firm structure, ownership is one of two general ways to relate to a firm, the other being contract.[16] This goes for any of a firm's constituencies. Investors can issue debt or demand stock, workers can be employees/independent contractors or start a worker cooperative, consumers can end their relationship at checkout or commit to longer-term ownership, etc.[17] Hansmann's fundamental point is that there are advantages and disadvantages to channeling one's interests through a contract, with a roughly inverse balance of equities to ownership. Thus, one can predict which constituency will own a firm by inquiring into which constituency will have the lowest costs of ownership and/or the highest costs of contracting.[18] While Hansmann's model is likely only a starting point in predicting ownership structure, it is a useful framework for understanding how different constituencies of a firm can affect its incentives and behavior.[19]

Reversal clauses demonstrate how *contracting* constituencies can tilt a firm to favor their interests without becoming owners. Rather than governing a dispute between consumers and credit card issuers, as arbitration clauses do, reversal clauses govern disputes between merchants and consumers, two different constituencies that contract with credit card networks.[20] The way a credit card network determines how to mediate these relationships depends not only on contracts with consumers and relations to investors but also on contracts with merchants. Vis-à-vis payments between merchants and consumers, credit card networks serve as "two-sided platforms," meaning that they deal with two distinct types of contracting constituencies, each of whose willingness to contract with the platform (and on what terms) depends in part on the platform's ability to attract the other constituency.[21] In a world with positive transaction costs, attracting

Theory of the Firm, 88 J. POL. ECON. 288 (1980). The "nexus of contracts" model developed by Jensen and Meckling was dominant in the economically inclined legal academy for a long time, but much debate about the value of the model has ensued. *Cf.* Foss et al., *supra* note 14. Regardless of which approach one takes, however, common to all of them is an understanding of the firm as a forum where different parties compete to further their own interests.

[16] *Cf.* HENRY HANSMANN, THE OWNERSHIP OF ENTERPRISE 12 (1996); Ronald H. Coase, *The Nature of the Firm*, *in* THE FIRM, THE MARKET, AND THE LAW 33–56 (1988); OLIVER E. WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985).

[17] HANSMANN, *supra* note 16, at 11–23 (outlining the framework).

[18] *Id.*

[19] For instance, the sociological literature has discussed how networks of firms affect how firms structure their ownership and their employment practices, among other things. *See* Davis, *Firms and Environments*, *supra* note 14.

[20] The structure of the credit card market is explained below, *see infra* note 95. For present purposes, one can abstract away from these details and treat a credit card network as a unitary entity that deals with both consumers and merchants.

[21] *See* Jean-Charles Rochet & Jean Tirole, *Platform Competition in Two-Sided Markets*, 1 J. EURO. ECON. ASSOC. 990 (2003); Jean-Charles Rochet & Jean Tirole, *Two-Sided Markets: A Progress Report*, 37 RAND J. ECON. 645 (2006); Mark Armstrong, *Competition in Two-Sided Markets*, 37

distinct types of potential contracting parties (here merchants and consumers) with different elasticities of demand requires bundles of contracts that favor the more elastic user.[22] It creates cross-subsidy across the platform, in other words. In a credit card context, merchants tend to have lower elasticity of demand than consumers, which means that in conflicts between merchant and consumer interests, a credit card network will tend to tilt towards consumers.[23] One piece of evidence for this bias is the fact that interchange fees, which are charged on each payment processed through a credit card network, tend to fall on merchants rather than consumers.[24] Using similar logic, issuers should have generous reversal clauses, as they do in fact.

Opening the black box of the firm to explain the two dispute resolution systems in credit card contracts can advance at least two discussions, one in credit card scholarship and the other in scholarship on consumer contracts more broadly. Concerning the first, it is common practice among credit card scholars to divide the use of credit cards into vehicles for easily accessible (but expensive) consumer credit and a convenience-enhancing payment system.[25] Looking at institutional structure in the way outlined above provides a way to think through how credit card networks are likely to treat consumers in matters related to payments (when the two-sided platform is activated) versus matters related to lending (when it is not). Second, recent scholarship on how to regulate consumer markets in the presence of behavioral market failures has focused on how to alter firm incentives to internalize consumers' welfare losses, by "changing the scoring" rather than simply "changing the rules."[26] Zooming out from the consumer-firm relationship to the other relationships that shape firm behavior could open up space for creative thinking on how to alter firm incentives in more efficient and effective ways than by directly regulating contract terms.

To go through this analysis in more detail requires first going into more detail about arbitration and reversal clauses. Section I does so, situating each clause within a historical and regulatory context. Once the facts are laid out, Section II explains them by building up a theoretical model of firm-consumer interaction. Beginning with the standard neoclassical framework, it then adds behavioral elements, followed by a discussion of how institutional structure—in the form of ownership and contracting interests—complicates things. At each stage, the model is

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RAND J. ECON. 668 (2006); DAVID S. EVANS & RICHARD SCHMALENSEE, PAYING WITH PLASTIC: THE DIGITAL REVOLUTION IN BUYING AND BORROWING 133–159 (2d ed. 2005).

[22] *See infra* Section II.C.

[23] *Id.*

[24] *Id.*

[25] *See infra* Section III.A.

[26] *See infra* Section III.B.

applied to the relevant clauses. Section III contains a brief discussion of two potential implications of adopting a more institutionally sophisticated model of firms when analyzing consumer markets: one for the credit card context and one for regulating consumer markets more broadly. Section IV concludes.

I. THE CLAUSES AND THEIR HISTORIES

A. *ARBITRATION*

1. The Clause: What and Where

Most credit card transactions are governed by arbitration clauses. If counting by the *number of issuers* that include arbitration clauses in their contracts, they might seem insignificant: only 16% of issuers do.[27] However, this measurement is misleading, since a few enormous banks issue most credit cards, and big banks are considerably more likely to include arbitration clauses in their contracts. A more accurate measure is the *percentage of credit card loans* subject to an arbitration clause, which was 53% as of 2012.[28] Yet even that measure misleads. In 2009–2010, issuing banks accounting for 86.8% of outstanding loans temporarily excised the arbitration clauses from their contracts as part of a major settlement.[29] When the CFPB found that the number of credit cards loans subject to arbitration clauses was 50.2%, the settlement was still in effect. It has since expired. Most issuers subject to the settlement have not reinserted

[27] CFPB Study *supra* note 1 at Section 2, p. 9. In fact, this number does not take into account the changes that have occurred since the CFPB did this study (it would be higher), which are described later in this paragraph.

[28] *Id.* at Section 2, p. 10.

[29] *See id.* at Section 2, p. 10–11; Stipulation and Agreement of Settlement with Bank of America, N.A. (USA) (N/K/A/ FIA Card Services, N.A.) and Bank of America, N.A., ¶ 3(b), Ross v. Bank of America, N.A., (USA), No. 05-cv-7116 (S.D.N.Y. Feb. 23, 2010), http://www.arbitration.ccfsettlement.com/documents/files/2010-02-23-stip-and-agreement-withbank-of-america.pdf; Stipulation and Settlement Agreement with Capital One Bank (USA), N.A. and Capital One, N.A., ¶ 3(b), Ross v. Bank of America, N.A., (USA), No. 05-cv-7116 (S.D.N.Y. Feb. 23, 2010), http://www.arbitration.ccfsettlement.com/documents/files/2010-02-23-stip-and-agreement-with-capital-one.pdf; Stipulation and Agreement of Settlement with JPMorgan Chase & Co. and Chase Bank USA, N.A., ¶ 3(b), Ross v. Bank of America, N.A., (USA), No. 05-cv-7116 (S.D.N.Y. Feb. 23, 2010), http://www.arbitration.ccfsettlement.com/documents/files/2010-02-23-stip-and-agreement-with-chase.pdf; Stipulation and Agreement of Settlement with HSBC Finance Corp. and HSBC Bank Nevada, N.A., ¶ 3(b), Ross. v. Bank of America, N.A., (USA), No. 05-cv-7116 (S.D.N.Y. Feb. 24, 2010), http://www.arbitration.ccfsettlement.com/documents/files/2010-02-24-stip-and-agreement-with-hsbc.pdf.

arbitration clauses yet, but if they do, up to 94% of credit card loans will be governed by arbitration clauses.[30]

The rules these clauses tend to proclaim are nicely summarized in an all-caps disclaimer on page 15 of the UBS Visa Signature card agreement, a contract selected more or less at random from the CFPB's collection of such agreements.[31] Note that this is a *summary*—the clause itself runs one and one-half single-spaced pages in what seems to be 11-point font.

ARBITRATION WITH RESPECT TO A CLAIM IS BINDING AND NEITHER YOU [the cardholder] NOR WE [UBS] WILL HAVE THE RIGHT TO LITIGATE THAT CLAIM THROUGH A COURT. IN ARBITRATION YOU AND WE WILL NOT HAVE THE RIGHTS THAT ARE PROVIDED IN COURT INCLUDING THE RIGHT TO A TRIAL BY JUDGE OR JURY AND THE RIGHT TO PARTICIPATE OR BE REPRESENTED IN PROCEEDINGS BROUGHT BY OTHERS SUCH AS CLASS ACTIONS OR SIMILAR PROCEEDINGS. IN ADDITION, THE RIGHT TO DISCOVERY AND THE RIGHT TO APPEAL ARE ALSO LIMITED OR ELIMINATED BY ARBITRATION. ALL OF THESE RIGHTS ARE WAIVED AND ALL CLAIMS MUST BE RESOLVED THROUGH ARBITRATION."[32]

This clause, as with others like it, requires that any dispute a consumer has with the issuing bank (or vice versa) under any cause of action—federal, state, contract, tort, statutory, and even a claim that the contract itself is invalid[33]—take place in a private arbitration tribunal rather than a public court. If a consumer attempts to sue the issuer in court, the issuer need only move to dismiss the case so that it can be removed to an arbitration tribunal for further proceedings. Courts routinely grant these motions.[34]

By far the most well used arbitration tribunal is the American Arbitration Association (AAA), a non-profit organization that employs lawyers, ex-judges, and others to arbitrate a variety of disputes.[35] A contract can create custom rules for disputes with the particular issuer, but issuer contracts often defer to the AAA's rules.[36] According to these rules,

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[30] *Id.*

[31] *Credit Card Agreement Database*, Consumer Financial Protection Bureau (August 31, 2015), http://www.consumerfinance.gov/credit-cards/agreements/.

[32] UBS Visa Signature Credit Card Cardmember Agreement 15 (as of March 21, 2014), http://files.consumerfinance.gov/a/assets/credit-card-agreements/pdf/creditcardagreement_10517.pdf [hereinafter UBS Contract].

[33] *See* Buckeye Check Cashing v. Cardegna, 546 U.S. 440 (2006).

[34] Often under duress. This is due to the extremely favorable treatment the Supreme Court has provided such clauses. *See* notes 61–74 and accompanying text.

[35] *See* CFPB Study, *supra* note 1, at Section 2, p. 34.

[36] *Cf.* AMERICAN ARBITRATION ASSOCIATION, CONSUMER ARBITRATION RULES (Sep. 1, 2014), https://www.adr.org/aaa/ShowPDF?doc=ADRSTAGE2021424.

members of the public cannot attend the proceedings or access any of the documents related to them, including the decision (if the arbitrator(s) even produce a written decision).[37] Administrators at the AAA appoint the arbitrator from its national registry unless a particular arbitrator is provided for in a contract between issuers and cardholders.[38] The AAA also streamlines the process by eliminating many of the rules of evidence and civil procedure required in state and federal courts.[39] Arbitration does not follow precedent and only recently added a skeletal appeals process.[40] After heavy pressure from consumer advocates, the AAA also enacted "Consumer Due Process Protocol," which commits, at least rhetorically, to minimum standards for unincorporated persons.[41]

The UBS exemplar demonstrates another feature of arbitration clauses nearly ubiquitous in the credit card context.[42] Mentioned in the above summary, but also standing out from the long-form clause's wall of text in bold print, the contract includes the following: "No class actions or joinder or consolidation of any Claim with a Claim of any other person or entity shall be allowable in arbitration, without the written consent of both you and us."[43] The mutuality here is—to put this gently—more formal than substantive, since joinder and class action are unlikely to be all that useful to an issuing bank. In so many words, it requires all such actions to be filed only on behalf of the individual named on the complaint. Even if multiple parties have the exact same problem caused by the exact same action of the issuer and none has the time or resources to bring the action on their own behalf, they must each file their complaint separately (or, more likely, not at all) unless the issuer, temporarily overtaken by some masochistic impulse, consents to joinder or class action.

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[37] *Id.* at R-27, R-30 [note that can agree to have record of hearing, but unclear whether can be public or not]

[38] *Id.* at R-15–R-20.

[39] *Id.*

[40] *See Optional Appellate Arbitration Rules*, American Arbitration Association (Nov. 1, 2013), http://go.adr.org/AppellateRules.

[41] AMERICAN ARBITRATION ASSOCIATION, CONSUMER DUE PROCESS PROTOCOL (Apr. 17, 1998), https://adr.org/aaa/ShowPDF?doc=ADRSTG_005014. *See also* Richard C. Reuben, *Constitutional Gravity: A Unitary Theory of Alternative Dispute Resolution and Public Civil Justice*, 47 U.C.L.A. L. REV. 949, 988 (2000) (discussing the modification of AAA procedures to attempt to resolve the repeat player problem identified by academics and consumer advocates).

[42] CFPB Study, *supra* note 1, at Preliminary Results App'x, p. 13 ("Around 90% of the contracts with arbitration clauses—covering close to 100% of credit card loans outstanding…include such class arbitration provisions.").

[43] UBS Contract, *supra* note 32, at 14.

2. The Practical Effect of Arbitration Clauses

Among practitioners and academics, the dominant view is that arbitration clauses reduce consumers' ability to successfully sue issuers who have wronged them.[44] Doing so, they suggest, not only leaves individual harms unaddressed, it reduces the ability of the law to deter welfare-reducing behavior and undermines the legitimacy of the legal system more broadly.[45] A substantial amount of evidence, of which follows a summary, indicates that the dominant view is correct, and that any claims of countervailing benefits to consumers, such as passing along cost savings, are overstated.

Firms seem to primarily value arbitration as a way to cut off class action lawsuits. Class actions are expensive for defendant firms, win or lose, since the litigation process itself can be lengthy and complex.[46] They are all the more expensive for firms who lose and must pay judgments which, in the consumer finance space alone, average at least $540 million a year.[47] The words of boilerplate drafters themselves provide compelling support for this picture of how arbitration interacts with class actions. Firms have not hid their disdain for class actions nor their appreciation for the potential of arbitration clauses to prevent this costly procedure.[48] Direct

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[44] *See*, *e.g.*, Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L.Q. 637 (1996); Myriam Gilles & Gary Friedman, *After Class: Aggregate Litigation in the Wake of* AT&T Mobility v. Concepcion, 79 U. CHI. L. REV. 623 (2012). *But see* Stephen J. Ware, *The Case for Enforcing Adhesive Arbitration Agreement—with Particular Consideration of Class Actions and Arbitration Fees*, 5 J. AM. ARBITRATION 251 (2006).

[45] *Cf. e.g.*, MARGARET JANE RADIN, BOILERPLATE: THE FINE PRINT, VANISHING RIGHTS, AND THE RULE OF LAW 33–46 (2012) (discussing the "democratic degradation" brought about by boilerplate dispute resolution); Jaime Dodge, *The Limits of Procedural Private Ordering*, 97 VA. L. REV. 724, 743 (2011) ("The rise of procedural private ordering is thus likely to affect not only those parties who engage in procedural contracting but also to shape the rules of procedure available to all litigants."); Mark E. Budnitz, *The Federalization and Privatization of Public Consumer Protection Law in the United States: Their Effect on Litigation and Enforcement*, 24 GA. ST. U. L. REV. 663, 665 (2008) ("Arbitration privatizes the justice system, hiding litigation involving consumers from government review. Arbitration also stymies effective and efficient consumer enforcement by banning class actions."). [Include full citation—Radin is not previously cited.]

[46] *Compare* CFPB Study, *supra* note 1, at Section 8 p. 5 (noting that the median time to settlement for a consumer finance class action is 560 days) *with id.* at Section 5 p. 12 (noting that the median consumer finance arbitration settlement occurs in 155 days).

[47] *Id.* at Section 8 p. 4.

[48] *See* Nicole F. Munro & Peter L. Cockrell, *Drafting Arbitration Agreements: A Practitioner's Guide for Consumer Credit Contracts*, 8 J. BUS. & TECH. L. 363, 364 (2013) (a guide to drafting enforceable arbitration clauses draws its readers in by reminding them that "arbitration provisions are undoubtedly the most effective defense a creditor has against consumer class actions."); Silver-Greenberg & Gebeloff, *supra* note 1 (citing various corporate lawyers' complaints about class actions); Mayer Brown LLP, *Do Class Actions Benefit Class Members? An Empirical Analysis of Class Actions* (Dec. 2013), http://www.mayerbrown.com/files/uploads/Documents/PDFs/2013/December/DoClassActionsBe

evidence that arbitration clauses are used to cut off class action litigation that might have otherwise succeeded is also building.[49] To the extent that class actions have deterrent and remedial effects, as many believe, contracting out of them is a way to increase private welfare at the expense of social welfare.[50]

The claim-squelching potential of arbitration clauses goes beyond preventing claim aggregation. Even with the growing prevalence of arbitration clauses, many fewer individual cases are brought in arbitral forums than in state and federal courts, suggesting that "arbitration is not, in fact, an ideal forum for many consumer claims."[51] Further evidence for this conclusion comes from firms' almost comically lopsided success rate in arbitral tribunals.[52] Some declarations-against-interest type evidence can

nefitClassMembers.pdf (framing the arbitration issue as really an issue about the problems with class actions); Consumer Litigation and Class Actions, Mayer Brown, LLP, http://www.mayerbrown.com/experience/Consumer-Litigation-Class-Actions (the firm that authored that study, claiming class actions "pose a significant threat in today's business world"); CFPB Study, *supra* note 1, at Section 10 p. 2, fn. 2 (citing American Banking Association and the Chamber of Commerce letters encouraging the CFPB to focus on how arbitration reduces litigation costs in determining how it would regulate them).

[49] PUBLIC CITIZEN & NAT'L ASSOC. OF CONSUMER ADVOCATES, JUSTICE DENIED—ONE YEAR LATER: THE HARMS TO CONSUMERS FROM THE SUPREME COURT'S *CONCEPCION* DECISION ARE PLAINLY EVIDENT 4 (2012), http://www.citizen.org/documents/ concepcion-anniversary-justice-denied-report.pdf (a 2012 study of one year's worth of litigation finding 76 cases listed on Westlaw where an arbitration clause was used to dismiss a putative class action); Myriam Gilles, *Killing Them with Kindness: Examining Consumer-Friendly Arbitration Clauses After* AT&T Mobility v. Concepcion, 88 NOTRE DAME L. REV. 825, 855 (2012) (a 2012 study of 37 arbitration clauses in consumer-facing firms' contracts finding that drafters are adding class waivers more and more frequently and doing everything they can to make sure they are enforceable); CFPB Study, *supra* note 1; *Id.* at Section 6, p. 59 (finding that 65% of these issuers filed motions to compel arbitration in putative class actions and that most cases dismissed because of arbitration agreements are not re-filed in an arbitral forum); Silver-Greenberg & Gebeloff, *Arbitration Everywhere*, *supra* 48 ("Of 1,179 class actions that companies sought to push into arbitration [between 2010 and 2014], judges ruled in their favor in four out of every five cases. In 2014 alone, judges upheld class-action bans in 134 out of 162 cases.").

[50] *See* Gilles & Friedman, *supra* note 44, at 660 (discussing class actions as a way for "private actors to vindicate public rights"); George L. Rutherglen, *Wal-Mart, AT&T Mobility, and the Decline of the Deterrent Class Action*, 98 U. VA. L. REV. 24, 25 (2012) ("The justification for class actions rests on two main grounds: compensating victims whose claims are too small to be brought individually an deterring wrongdoing by aggregating claims to facilitate private enforcement.").

[51] Jean R. Sternlight, *Mandatory Binding Arbitration Clauses Prevent Consumers from Presenting Procedurally Difficult Claims*, 42 SOUTHWESTERN L. REV. 87, 100 (2012). *See also* CFPB Study, *supra* note 1 at, Section 6, p. 6 (finding, out of a sample of state and federal courts between 2010 and 2012, 3,462 individual cases filed and, during the same period of time, 1,847 cases concerning the same subject matter in the AAA); Silver-Greenberg & Corkery, *supra* note 1 (providing anecdotes as well as evidence from interviews with "hundreds of lawyers, arbitrators, plaintiffs and judges in 35 states").

[52] CFPB Study, *supra* note 1, at Section 5, pp. 11–14 (providing qualified evidence of firms' higher success rates, but summarized in the single statistic that consumers get about 12% of what they ask for when they bring arbitration cases while firms get about 91%).

be found in the fact that sectors with firms with high rates of arbitration clauses in their consumer-facing contracts have much lower rates of such clauses in their business-to-business contracts.[53] The two most compelling explanations for the firm-favoring dynamics of arbitration are (1) firms are repeat players, which confers manifold advantages[54] and (2) "procedurally difficult" claims—i.e. those where plaintiffs are likely to fail to realize that they have been injured or that their injuries are legally cognizable, where the claims would be complex and costly to pursue, and/or where the claims would most effectively involve group relief or an injunction—are difficult to bring in the limited-discovery individualistic context of arbitration.[55]

The small group of authors—and the majority of Supreme Court justices—who have portrayed arbitration as consumer-friendly have commonly argued that the cost savings it provides for firms are actually passed onto consumers, providing a net benefit that consumers would rationally contract for.[56] While it may be the case that arbitration does save firms money and in some markets they may pass on the cost savings, the current evidence—based on a natural experiment conducted by the CFPB—weighs against that proposition in the credit card context.[57] Under every statistical specification, the CFPB was unable to find any difference in price for consumers between issuers that included arbitration clauses and those that did not.[58]

3. How Arbitration Clauses Became Widespread

Despite their profit-saving qualities, most large credit card issuers only began inserting arbitration clauses into their contracts in the late 1990s.[59] The rapid *rate* of the growth of arbitration during the early 2000s seems to have been coordinated by a network of white shoe attorneys.[60] But the *timing* of the growth can be traced to changes in the legal environment.

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[53] *See* Theodore Eisenberg, Geoffrey P. Miller, & Emily Sherwin, *Arbitration's Summer Soldiers: An Empirical Study of Arbitration Clauses in Consumer and Nonconsumer Contracts*, 41 U. MICH. J. L. REFORM 871 (2008) (finding that over 75% of B2C contracts had arbitration clauses, but only 10% of the B2B contracts of the same firms had them).
[54] *See, e.g.*, Reuben, *supra* note 41, at 988 (discussing evidence that the AAA modified procedures to help reduce the repeat player problem commonly complained about in the literature).
[55] Sternlight, *supra* note 51, at 108.
[56] *See, e.g.*, Ware, *supra* note 44; *Concepcion*, 563 U.S. at 17 (finding that arbitration is a matter of mutual agreement, and arguing that to allow for class arbitration would lower the benefits for contracting parties by increasing the cost of dispute resolution); CFPB Study, *supra* note 1, at Section 10, p. 2, fn. 1 (citing comments arguing that firms pass on the cost savings to consumers).
[57] CFPB Study, *supra* note 1, at Section 10, p. 5.
[58] *Id.* at Section 10, p. 6.
[59] CFPB Study, *supra* note 1, at Preliminary Results App'x, 7 n.7.
[60] Silver-Greenberg & Gebeloff, *Arbitration Everywhere*, *supra* note 48 (discussing a 1999 meeting between top corporate lawyers, including lawyers from Bank of America, Chase, Citigroup, and Discover, about the advantages of arbitration clauses). On how social networks

Until the 1920s, even businesspersons of roughly equal bargaining power could not be certain that agreements to resolve their dispute out of court would be enforced in court were one party to renege.[61] And while unconscionability jurisprudence cannot but be described as inconsistent, courts have frequently found creative ways around higher court decisions to apply it to arbitration clauses.[62] As a means to overcome common law disfavor for arbitration, Congress enacted the Federal Arbitration Act (FAA) in 1926.[63] For decades arbitration clauses could be found only in contracts between sophisticated commercial parties, in part because courts limited the laws' scope in that way.[64]

With the growing population, the development of the class action, the liberalization of civil procedure, and the increasing amount of grounds for suit, courts began to swell.[65] Judicial and scholarly worry about unsustainable caseloads grew throughout the 1970s into the 1980s. Chief Justice Burger himself made damming the tide of lawsuits a pet project, frequently speaking with relish about alternative dispute resolution as a potential solution.[66] His Supreme Court and the increasingly pro-business Courts following his tenure began to reinterpret established doctrine to allow for contracts to modify a variety of procedural rules.[67] The FAA received this treatment starting with a series of opinions in the early 1980s,

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enable diffusion of ideas across businesses, see Davis, *Firms and Environments*, *supra* note 14, at 493–94.

[61] *See* IAN R. MACNEIL, AMERICAN ARBITRATION LAW: REFORMATION, NATIONALIZATION, INTERNATIONALIZATION 15–24 (1992) (summarizing the common law approach to arbitration clauses before the passage of the FAA).

[62] Even after the Supreme Court has narrowed to a sliver the opening for unconscionability claims concerning arbitration clauses, courts continue to find ways through. *See, e.g.*, Chavarria v. Ralphs Grocery, Co., 733 F.3d 916 (9th Cir. 2013).

[63] The statute was originally titled the United States Arbitration Act (USAA). The name never officially changed, but in 1947 the naming section was deleted and, for whatever reason, the naming convention today is FAA, not USAA. MACNEIL, *supra* note 61, at 231 n.48 (1992).

[64] *See* Jean R. Sternlight, *Panacea or Corporate Tool?: Debunking the Supreme Court's Preference for Binding Arbitration*, 74 WASH. U. L. REV. 637, 648–49 (1996) (discussing *Wilko v. Swan* and surrounding circumstances).

[65] According to the Federal Judicial Center's History of the Federal Judiciary, the number of private civil cases (those that would be governed by arbitration agreements) just about doubled between the 1940s and the early 1960s (around 25,000 to around 50,000) and then doubled again by the mid-1970s (to around 100,000) and then again by the end of the 1990s (to around 200,000). *See* Private Civil Cases, Federal Judicial Center (2014), http://www.fjc.gov/history/caseload.nsf/page/caseloads_private_civil.

[66] *See, e.g.*, Warren E. Burger, *Agenda for 2000 A.D.—A Need for Systematic Anticipation* 70 F.R.D. 83 (1976); Warren E. Burger, *Isn't There a Better Way?*, 68 A.B.A. J. 274 (1982); Warren E. Burger, *Using Arbitration to Achieve Justice*, 40 ARB. J. 3, (1985). *See also* Owen M. Fiss, *Against Settlement*, 93 YALE L.J. 1073, 1073 (1984) (putting these speeches in context).

[67] *E.g.*, The Bremen v. Zapata Off-Shore Co., 407 U.S. 1 (1972) (ruling that forum selection clauses are generally enforceable absent a showing of unreasonableness or injustice); Carnival Cruise Lines, Inc. v. Shute, 499 U.S. 585 (1991) (allowing forum selection clauses in contracts of adhesion).

the most important of which, *Southland Corp. v. Keating*, was written by Justice Burger himself.[68] Since then, the Court has interpreted the FAA more and more expansively—not only allowing arbitration clauses in more and more circumstances, but ultimately limiting the ability of any courts or state legislatures to restrict the use of arbitration clauses for nearly any reason, especially unconscionability.[69]

For companies considering including arbitration clauses in their contracts with consumers, the FAA as interpreted by the Supreme Court went from prohibitory to ambiguous to permissive to inviting.[70] It had become evident by the mid-1990s that the Court was loath to approve of a lower court or state legislature striking down an arbitration clause, so perhaps only excess caution or bankers' conservatism led credit card issuers to delay until the late 1990s.[71] Since adopting them, however, credit card networks have seemed to remain on the *avant garde* of drafting. The most recent controversial arbitration clause that the Supreme Court approved, for example, was authored by American Express.[72]

This revolution may soon give way to retrenchment, however. Congress still has the power to limit or eliminate the domain of arbitration clauses. Recent attempts to do so on a broad basis have gathered little momentum, although Dodd-Frank included a provision that requires the CFPB to conduct a study on arbitration and to determine how to regulate it in the consumer financial context.[73] The study has been completed (and

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[68] The cases I have in mind are Moses H. Cone Memorial Hospital v. Mercury Construction, 460 U.S. 1 (1983), Southland Corp. v. Keating, 465 U.S. 1 (1984), and Mistubishi Motors Corp. v. Soler Chrysler-Plymouth, Inc., 473 U.S. 614 (1985). A good account of the shift in FAA jurisprudence can be found in MACNEIL, *supra* note 61, at 134–155 and Sternlight, *Panacea or Corporate Tool?*, *supra* note 64, at 660–74. Both of these authors are strongly critical of the Supreme Court's decision in these cases. Their views reflect the majority scholarly position (as far as I can tell), but for a thorough dissent, *see* Christopher Drahozal, *In Defense of* Southland *Reexamining the Legislative History of the Federal Arbitration Act*, 78 NOTRE DAME L. REV. 101 (2002).

[69] Even a summary of the development of the case law is well beyond the scope of this paper. A good and relatively updated account is Hal Neth, The Federal Arbitration Act and How it Grew (May, 2011) (unpublished Masters thesis in Conflict and Dispute Resolution, University of Oregon).

[70] The famous line, expressed originally by Justice Brennan, is that there is a "federal policy favoring arbitration." This phrase has been repeated in almost every subsequent Supreme Court case on the subject and has taken on a more and more substantial meaning over time. *Moses. H. Cone*, 460 U.S. at 24

[71] *See* Sternlight, *Panacea or Corporate Tool?*, *supra* note 64, at *passim* (discussing the state of the jurisprudence as of 1995).

[72] American Express Co. v. Italian Colors Restaurant, 133 S. Ct. 2304 (2013). Actually, it is a bit misleading to cite this case as an example of issuer contracts: it concerned a contract between *acquiring*, not issuing banks, who contract with *merchants*, not consumers. That said, American Express serves as its own acquirer and issuer, so it is not as if focusing on this case is to highlight an irrelevant actor.

[73] On Congress's failure to act, see Amalia D. Kessler, *Stuck in Arbitration*, N.Y. TIMES (Mar. 6 2012), http://www.nytimes.com/2012/03/07/opinion/stuck-in-arbitration.html; Arbitration Fairness Act of 2013, H.R. 1844, 113th Cong. (2013); *see H.R. 1844*, GOVTRACK.US (last visited

liberally cited in the foregoing) and a draft regulation has been floated that would ban clauses that prevented class actions and create a system for transparency from arbitration tribunals.[74]

B. REVERSALS

1. What They Are

What I am calling "reversal clauses" are part of a larger bundle of rules governing how payments are processed via credit card networks. Every payment system has such a bundle of rules—some written by public lawmakers, but most decided among the banks that make up the different credit card networks.[75] One stick of the bundle—that which governs *reversals* of payments—concerns whether and when a payor can order a payment pulled back from the payee. With a check, a payor can order a reversal "for any reason it wishes or even, it seems, for no reason at all" long as they do so before their bank processes the payment.[76] With a wire transfer, a payor can order a reversal for any reason as long as they do so before the payee's bank processes the payment.[77] With cash, a payor can never cancel payment unless they can convince the payee to give the money back. Credit cards are a bit more complicated.

An amendment to the Truth in Lending Act called the Fair Credit Billing Act lays out cardholders' basic rights. The basic idea is that a consumer can refuse to pay an item on their monthly bill if that item derives from a transaction in which the merchant had acted wrongfully in some way.[78] In other words, the FCBA "grants cardholders that make purchases with a credit card the right to assert against their issuing banks any defense that they could have asserted against the merchant from whom the purchases were made," which are also any claims a consumer could

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Sept. 14, 2013), http://www.govtrack.us/congress/bills/113/hr1844. On the CFPB's authority, see 22 U.S.C. § 5518.

[74] CFPB Study, *supra* note 1; Small Business Advisory Review Panel for Potential Rulemaking on Arbitration Agreements: Outline of Proposals under Consideration and Alternatives Considered, Consumer Financial Protection Bureau (Oct. 7, 2015), http://files.consumerfinance.gov/f/201510_cfpb_small-business-review-panel-packet-explaining-the-proposal-under-consideration.pdf.

[75] For a valiant attempt to make these rules coherent, see L. Ali Khan, *A Theoretical Analysis of Payment Systems*, 60 S. CAROLINA L. REV. 1 (2008).

[76] Ronald J. Mann, *Making Sense of Payments Policy in the Information Age*, 93 GEO. L.J. 633, 643 (2005); U.C.C. § 4-403(a).

[77] U.C.C. § 4A-211.

[78] 15 U.S.C. § 1666i; 12 C.F.R. § 12(c).

affirmatively sue a merchant for.[79] The legislation places geographic restrictions on this right and includes a $50 deductible.[80] In addition, if the merchant does not complete their end of the transaction at all or does not complete it in accordance with a contract they executed with the cardholder, cardholders have the additional right to claim that the item on their bill representing the transaction is a "billing error" and to demand that their card issuing bank remove the charge while resolving the discrepancy in a timely fashion.[81] This right has neither geographic restrictions nor deductible, although it caps out at $50.[82]

In practice, credit card networks merged these two rights and expanded them to create a broad right for a consumer to complain about a particular transaction with their card-issuing bank and to have the bank remove the charge from their bill while resolving the grievance.[83] Grievance resolution procedures called "chargebacks" cost nothing in monetary terms for consumers, resolve the dispute within strict time frames, and do not cut off the possibility of public litigation should the complaint fail to be resolved satisfactorily.[84] Furthermore, the process has morphed into a proactive policing tool: too many problems from a single merchant can lead to an escalating series of penalties, culminating in expulsion for the worst actors.[85]

More details of the chargeback procedure will be divulged in a matter of paragraphs, but it must first be marveled at that, despite the fact

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[79] Mann, *Making Sense*, *supra* note 76, at 647. The one exception being tort claims. 15 U.S.C. § 1666i(a).

[80] 15 U.S.C. § 1666i.

[81] 15 U.S.C. §§ 1666(b)(3) (defining "billing error" in part as "a reflection on a statement of goods or services not accepted by the obligor or his designee [read: the cardholder] or not delivered…in accordance with the agreement made at the time of a transaction."). Ronald Mann argues that Section 161 (15 U.S.C. § 1666(e)) covers non-delivery and Section 170 (15 U.S.C. § 1666i) covers faulty delivery. Mann, *Making Sense*, *supra* note 76, at 648–49 (2005). I am not so sure that 161 is so narrow and, thus, that the two provisions are non-overlapping. It seems to me that because 161 requires the item to be delivered "in accordance with the agreement," a cardholder could assert a contract dispute under this provision, which would certainly be a claim against a merchant, as allowable under 170.

[82] 15 U.S.C. § 1666(e).

[83] *See infra* notes 104–114 and accompanying text.

[84] The right embodied in TILA 170 (15 U.S.C. § 1666i) is a right for a consumer to assert as a *defense* to a debt collection action by the card-issuing bank any legal problem with the underlying transaction. This right had to be created because the merchant has passed on the ability to collect the debt to the credit card bank. *See* Roland E. Brandel & Carl A. Leonard, *Bank Charge Cards: New Cash or New Credit*, 69 MICH. L. REV. 1033, 1041 (1971); Neil O. Littlefield, *The Continuing Demise of the Holder in Due Course Concept*, COMMERCIAL L.J. 41, 42–43 (Feb. 1974). This does not affect the right of the consumer to affirmatively sue the merchant for violation of the law.

[85] *See* Mann, *Making Sense*, *supra* note 76, at 661; Clayton P. Gillette, *Contractual Networks, Contract Design, and Contract Interpretation: The Case of Credit Cards in* THE ORGANIZATIONAL CONTRACT: FROM EXCHANGE TO LONG-TERM NETWORK COOPERATION IN EUROPEAN CONTRACT LAW 77, 85 (Stefan Grundmann, Fabrizio Cafaggi, and Giuseppe Vettori eds., 2013). Consumers who abuse the system can also face expulsion.

that consumer-facing credit card contracts contain only the boilerplate disclosures required by the FCBA and promulgating regulations,[86] issuers have in practice *expanded* reversal rights beyond the statutory minimum and into a full-blown dispute resolution system with the credit card network mediating between merchants and consumers. In addition to these ornate procedural protections, credit card networks expanded the range of consumer complaints they would accept well beyond the FCBA's minima. This goes well beyond ignoring the geographic and monetary limitations they bargained hard to have included in that statute.[87] For instance, the category of transactions that are reversible because goods or services were "defective/not as described" include not simply broken or otherwise non-functioning products, but also "goods or services [that] did not conform to the merchant's description, or…goods…of different quality, quantity, color, size, or health of plant or animal." [88] Perhaps more surprisingly, commodities are even considered defective if "terms and conditions of the original contract or agreement were changed without the cardholder's consent," a standard that many credit card companies would fail to live up to in their own contracts with consumers.[89] In a similar contract-policing vein, credit card networks allow reversals for canceled recurring transactions, including recurring payments "entered into without proper notification."[90] This requirement is especially strong in the MasterCard

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[86] The regulation is 12 C.F.R. § 226.13. The model disclosure is 12 C.F.R. § 226 App'x G-3(A) (2010). These disclosures are usually at the very end of credit card contracts. *E.g.*, UBS Contract, *supra* note 32, at 15–16.

[87] One can induce the strength of bank advocacy from the transcripts of backroom battles fought during the legislative history. Transcript of Mark-Up Session, S. Comm. On Banking, Housing, and Urban Affairs *passim* (Jun. 20, 1973) (bargaining over geographic and monetary limitations); S. REP. NO. 92-750, 28 (Senator Proxmire's dissent discussing the derivation of the limitations). Another strong piece of evidence is an article published during the negotiation by bank lobbyists proposing the precise limitations that made it into the final text, which were in fact cited in the committee report. Brandel & Leonard, supra note 84, at 1062–63 (discussing the "arbitrary dollar figure") and 1064–68 (discussing the geographic limitation, with slightly more justification).

[88] MasterCard, Chargeback Guide (Apr. 15, 2014), at Reason Code 4853, p. 3-133, http://www.mastercard.com/us/merchant/pdf/TB_CB_Manual.pdf [hereinafter MasterCard]; Visa International Operating Regulations (Oct. 15, 2013) at Reason Code 53, p. 727, http://www.merchantservice.com/university/resource/rules/rules_for_visa_merchants.pdf [hereinafter Visa].

[89] MasterCard, *supra* note 88, at 1-134. Visa does not explicitly provide for this contingency, but its rules could be interpreted to include it. For information about how issuers constantly change their terms with fictional notification of cardholders, see RONALD J. MANN, CHARGING AHEAD 138 (2006); Ronald J. Mann, *"Contracting" for Credit*, 104 MICH. L. REV. 899, 908 (2006).

[90] MasterCard, *supra* note 88, at 3-107. This reason code is not as broadly defined in the Visa Operating Regulations. The closest Visa seems to come is to allow chargebacks if "[t]he transaction amount was not within the range of amounts preauthorized by the Cardholder or the Merchant was to notify the Cardholder before processing each Recurring Transaction." p. 722. This could be interpreted to cover the situation explicitly provided for in the MasterCard agreement, since if the cardholder did not explicitly authorize *any* recurring transaction, it was not "within the range of amounts", it seems.

agreement, which requires, for notification to be "proper," that "terms and conditions for recurring transactions must be *clearly detailed* to the cardholder...[and] *separate and distinct* from general terms and conditions of sale."[91] In other words, the chargeback rules create affirmative standards for merchants that want to set up automatic payment with their customers—it must not only explicitly say so in its contract (rather than setting it up automatically and claim "reasonable expectations"), but the clause that says so must also be explicit and set apart from the rest of the contract. Thus, in defining whether a given recurring transaction is authorized, the credit card networks created consumer-protection-style disclosure requirements with standards higher than even those found in the U.S. Code.[92] I spare the reader a full guide of the hundreds of pages of rules, but suffice it to say that credit card networks' consumer friendliness goes beyond the legal requirements.[93]

2. How Reversal Clauses Got That Way

Such a (relatively) consumer-friendly dispute resolution system is especially striking since, before the passage of the FCBA, credit card issuers included in their consumer-facing boilerplate "whereby the customer agree[d] not to assert against the bank any defenses which rise out of any sales transaction with any merchant."[94] Before the FCBA defanged this clause, it served to cut through the tangle of common law and UCC doctrines applied to putative credit card reversals by cutting off any semblance of a reversal right.[95]

[91] MasterCard, *supra* note 88, at 3-107. Italics added.

[92] The Electronic Funds Transfer Act, which governs recurrent electronic payments requires "the terms and conditions of electronic fund transfers involving a consumer's account shall be disclosed at the time the consumer contracts for an electronic fund transfer service…in readily understandable language… " (15 U.S.C. § 1693c). The promulgating regulations include model disclosure clauses, which are impressively comprehensible given the general run of such clauses but do not require them to be separate and distinct. *See* 12 C.F.R. § 205.7(b), App'x A-2.

[93] This goes even beyond the rules themselves, since issuers will apparently often eat the cost of reversals without dealing with the chargeback system at all. Ronald Mann, one of the leading experts on credit cards, concluded after talking with insiders in the industry in 2006 that "the practical effect of the rule [in the FCBA] …allows consumers to retract payment from merchants essentially at will." Mann, *Making Sense*, *supra* note 76, at 647. Wei Zhang, a credit card expert at the CFPB with over a decade of experience in the industry, also suggested that issuers grant nearly every consumer request for a reversal. Telephone Interview with Wei Zhang, Adviser to Credit Card Program in the CFPB (Nov. 5, 2014). I have also heard and experienced anecdotal evidence suggesting reversals are widely available.

[94] Littlefield, *supra* note 84, at 43. For a detailed account of what consumer credit card contracts and the jurisprudence surrounding them looked like in this era, see generally Stewart Macaulay, *Private Legislation and the Duty to Read—Business Run by IBM Machine, the Law of Contracts and Credit Cards*, 19 VAND. L. REV. 1051 (1966).

[95] Sometimes it was argued that "the charge card transaction is in reality tantamount to an assignment for value to the [credit card issuing] bank of the consumer's obligation to the merchant." Brandel & Leonard, *supra* note 84, at 1042 (1971). This would have made any

Moreover, when Senators Proxmire and Brooke introduced the first version of the FCBA in February 1971, banks (the only issuers at the time) campaigned to quash the provisions governing reversals.[96] They nearly won outright, eliminating TILA § 170—the more expansive provision—partway through the committee process.[97] But Senator Proxmire, one of the leading consumer advocates in perhaps the strongest era of federal consumer protection legislation,[98] fought hard for the original version of his bill and the committee eventually arrived at a compromise that included the geographic and monetary limitations described above, which had been taken whole cloth from a law review article penned by two bank lawyers in response to the initial introduction of the TILA amendments that became the FCBA.[99]

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defense against repayment of the debt to the merchant assertable against the credit card issuer (with the assignee having a right to sue the assignor), which would have effectively required the card issuer to grant a refund as long as the consumer (as obligor) refused to pay for the item on their bill because of merchant breach. More common was to treat a credit card payment as analogous to a letter-of-credit or negotiable instrument transaction. *See, e.g.*, *id.* at 1046–47; Littlefield, *supra* note 84, at 41–42 (Feb. 1974). (Courts still occasionally appeal to the law of negotiable instruments in resolving FCBA cases. *E.g.*, Citibank v. Mincks, 135 S.W.3d 545 (2004).) Under a letter of credit arrangement, the card issuer has an agreement with a merchant to pay the merchant when the merchant presents documents indicating a consumer purchase with the issuer's card. U.C.C. § 5-108; Brandel & Leonard, *supra* note 84, at 1047. The issuer can then bill the consumer at regular intervals for all of the payments the issuer made on the consumer's behalf, regardless of whether the merchants performed their obligations or not. U.C.C. § 5-108(f)(a). A negotiable instrument analysis—the most commonly used—looks much like an assignment structure—the consumer's obligation to pay is transferred from the merchant to the issuer. In case of a problem with the transaction the question would be whether, if a bank were to sue for the amount on the bill, the consumer could assert that problem as a defense to repayment. Issuing banks argued that under this framework the "holder-in-due-course" doctrine should apply, which cuts off all such consumer defenses to "good faith purchasers" of negotiable instruments (here, the issuers). U.C.C. § 3-302 is the general holder-in-due-course provision. U.C.C. § 3-305(b) clarifies that this provision even applies to consumer transactions, which, under section 3-305(a)(2) are subject contract defenses against the original holder. *See also* Littlefield, *supra* note 84, at 42. Consumers argued for one exception or another to this doctrine. *See* Brandel & Leonard, *supra* note 84, at 1041–43 (describing various consumer arguments and citing cases). The clauses at issue would be merely surplusage for a letter-of-credit interpretation of the transaction—which precludes the transfer of liability in the first place—and provides the requisite performance of consent to get out of any creative interpretation of negotiable instruments or assignment law. On letters of credit *see* U.C.C. § 5-108(f)(a). On negotiable instruments, *see* U.C.C. § 3-117 ("...the obligation of a party to an instrument to pay the instrument may be modified, supplemented, or nullified by a separate agreement of the obligor [here the cardholder] and a person entitled to enforce the instrument [here the issuer]... ").

[96] On timeline, *see* S REP. NO. 92-750, *supra* note 87, at 2.

[97] *See id.* at 11–13 (summarizing the proposed clause and the committee's vote against it).

[98] *See* LOUIS HYMAN, DEBTOR NATION 182 (2011) (noting that Proxmire "led hearings that inaugurated a long series of influential credit reforms over the next decade.")

[99] Senator Proxmire discusses the derivation of the limitations in his dissent to the 1973 Committee Report, footnoting the Brandel & Leonard article. S REP. NO. 92-750, *supra* note 87, at 28.

After FCBA passed, card issuers had to act quickly to determine how to prevent the potential deluge of liability from "wreak[ing] havoc with credit cards as a payment system."[100] One natural way to deal with these costs would have been to comply as narrowly as possible with the FCBA—strictly enforcing its geographic restrictions, its deductibles, its deadlines, its liability limits. Perhaps issuers could even have gotten away with mostly ignoring the FCBA except in extreme cases, relying on the likelihood that few consumers would take the trouble to sue them or to complain to the FTC (or, in the contemporary world, the CFPB). In other words, issuers could have offloaded as many of the costs of the FCBA onto consumers as possible. Reported cases do provide some evidence that issuing banks attempt to offload some costs by insisting on the language of the statute and its regulations (especially in high cost situations),[101] but we have already seen that they largely *overcomply* with the FCBA.

What else could issuers do with the cost of consumer complaints about merchants? Well, why not pass them on to the merchants themselves? Issuers did not even have to devise an entirely new device to do so; card networks already had a skeletal chargeback process in place, apparently mostly to deal with fraud cases.[102] Perhaps it was also used to pass along the costs of providing refunds to especially valued white shoe customers.[103] In any case, expanding the chargeback process was the path that issuers took. What was once a bare bones system became an elaborate process for determining the relative liability of merchants and consumers.

3. How the Chargeback System Works

After decades of development, the basic chargeback procedure for Visa and MasterCard now works as follows.[104] Once the issuing bank

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[100] RONALD J. MANN, PAYMENT SYSTEMS AND OTHER FINANCIAL TRANSACTIONS: CASES, MATERIALS, AND PROBLEMS 159 (5th ed. 2011).

[101] A Westlaw search turns up 355 results for "fair credit billing act" (for all 40-some years of the statute's existence), many of which are not concerned with the portions of it at issue here (that is, many dispute, say, finance charges rather than the quality of merchant services). Apparently the FCBA is more litigated than this reported evidence would suggest, however, since most cases settle. Interview with Zev Eigen, Associate Professor, Northwestern University School of Law, in N.Y., N.Y. (Jan. 5, 2015).

[102] *See* S REP. NO. 92-750, *supra* note 87, at 26.

[103] Credit cards were, in the early days, much driven by the performance of wealth and largely reserved for wealthy bank customers. *See* HYMAN, *supra* note 98, at 240 ("But only the most creditworthy households (35 percent) had bank cards in 1977—double the number in 1970 but still not a majority of American households."). Later on, as the card market became more saturated, the class performance aspect of credit cards had to be explicitly marketed by credit card companies. *Id.* at 249 ("And as credit cards became more commonplace [in the 1980s], credit card companies used evermore exclusive cards—gold, black, platinum—to wrest market share from their competitors").

[104] Visa and MasterCard are "open-loop" networks. American Express and Discover are "closed-loop" networks. Open loops account for 75% or so of the market. MANN, PAYMENT SYSTEMS,

receives the complaint—nowadays usually through an online system—it must temporarily remove the charge for the transaction at issue from the cardholder's account, as long as the complaint fits within certain time limits and other restrictions, including "documentation requirements" (read: rules of evidence).[105] For smaller dollar complaints, the process may stop here—issuers may decide that the cost of investigating and sending the charge back through the system is not worth it.[106] If the complaint facially meets the requirements of a pleading under a particular "reason code" (read: cause of action) the issuer then has the right to "chargeback" the transaction through the network to the acquiring bank—the bank that does business with the merchant—within 120 days.[107] The chargeback simply reverses the original charge, automatically pulling the disputed portion of the payment (up to the full amount of the payment, but no more) through the system. Debited is the acquirer's account and credited the issuer's. Along with the chargeback comes a $25 handling fee, also debited from the acquirer.[108]

The acquirer then consults the merchant to ask for their side of the story. If the acquirer decides that the issuer's/cardholder's claim cannot be successfully contested, it can absorb the chargeback or pass it on to the merchant, depending on the nature of their contract and relationship with

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supra note 100, at 155 (5th ed. 2011). Open loops consist of overlapping networks of banks, some of which do business with merchants, some with cardholders, and some with both (via separate departments). *See* EVANS & SCHMALENSEE, *supra* note 21, at 162. For decades, these member banks owned Visa and MasterCard directly and governed themselves through a complicated committee process that allocated votes in proportion to the member bank's volume of transactions. *Id.* They spun off into publicly traded corporations in the mid-aughts to avoid antitrust and other regulatory threats, but both remain relatively small companies meant to facilitate self-governance of the larger member banks. CAROL COYLE BENSON & SCOTT LOFTESNESS, PAYMENT SYSTEMS IN THE U.S. 65–66 (2d ed. 2010). Closed loops, on the other hand, function as their own self-contained systems within a single corporate structure, contracting directly with both merchants and cardholders. EVANS & SCHMALENSEE, *supra* note 21, at 75. Despite their differences, closed- and open-loop networks operate according to similar rules, but only open-loops allow non-industry-insiders to view their "Operating Regulations." Visa, *supra* note 88; MasterCard, *supra* note 88; American Express, Resolve Disputes: User Guide (Feb. 2012), https://www.americanexpress.com/au/content/merchant/pdf/disputes-process/OMS_Disputes_AU.pdf?intlink:AU-Mer-omsdispute. Because open-loop networks account for more than a supermajority of the market, because they make their rules publicly available, because the separate ownership of acquirers and issuers dramatizes the internal dynamics at play, and because the relevant parts of their rules are apparently similar to those of the closed-loops, I will focus on Visa and MasterCard, i.e. the open-loop networks.

[105] *See* MasterCard, *supra* note 88, at Section 1.15; Visa, *supra* note 88, at p.720 (discussing documentation requirements for one particular reason code).

[106] Telephone Interview with Wei Zhang, *supra* note 93.

[107] *See* Visa Operation Regulations, *supra* note 88, at 716–867 (elaborating on each reason code and its requirements); MasterCard Chargeback Rules, *supra* note 88, at 3-27, 28 (a chart of all reason codes).

[108] MANN, CHARGING AHEAD, *supra* note 89, at 28 cites the $25 number. The Operating Regulations do not seem to list these amounts.

the merchant. Should the acquirer find something wrong with the issuer's chargeback or learn about conflicting facts from the merchant that seems to indicate the chargeback was actually invalid, it can "represent" the amount in controversy to the issuer along with a $50 handling fee.[109] This must occur within 45 days of the chargeback.[110] Some of the "representment conditions" are the equivalent of counterarguments, while others are more similar to defenses or evidentiary objections.[111] All of the foregoing steps take place without a neutral party supervising—issuers and acquirers are relied upon to follow the rules. If they do not and the dispute goes to arbitration (as described below), they can be penalized.

At this point, Visa's and MasterCard's processes differ slightly. In Visa's process, the issuer is allowed to immediately request that Visa intervene and arbitrate the dispute.[112] In MasterCard's process, an extra step is added: the issuer may send an "arbitration chargeback" through the system, which serves as a gantlet that the acquirer can pick up by appealing that chargeback to MasterCard for arbitration.[113] In both cases, the net effect is that network HQ (i.e. Visa/MasterCard) has the opportunity to rule on the dispute, assess penalties for process violations, and shift fees to the loser.[114] A single appeal to a higher level of employee is allowed, but then decisions are final.[115] After the dust has settled, both the issuer and the acquirer have their own internal policies to decide how and whether to pass on the win/loss to their respective customers.

II. THEORY AND ITS APPLICATION TO THESE CLAUSES

With arbitration clauses, card issuers have used alternative dispute resolution to eliminate the costs of dealing with disgruntled cardholders and regulation has become more and more permissive. With reversal clauses, these same issuers responded to weak consumer protection regulation by developing an elaborate alternative dispute resolution system

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[109] "Representment" is Visa's terminology. Visa Operating Regulations, *supra* note 88, at 713. MasterCard calls it a "second presentment." MasterCard Chargeback Rules, *supra* note 88, at 1-6. I will continue to use Visa's simply because I find it more mellifluous.

[110] MasterCard Chargeback Rules, *supra* note 88, at 1-12; Visa Operating Regulations, *supra* note 88, at 713.

[111] *See, e.g.*, MasterCard Chargeback Rules, *supra* note 88, at 3-316–3-317 (outlining second presentment conditions for "Defective/Not as Described," including the fact that deficiency was corrected, that the merchant did not receive any returned goods, and that the evidence fails to support the initial chargeback).

[112] Visa Operation Regulations, *supra* note 88, at 868.

[113] MasterCard Chargeback Rules, *supra* note 88, at 1-6 (outlining the whole process), 6-1 (outlining the arbitration process).

[114] MasterCard Chargeback Rules, *supra* note 88, at 6-1–6-7; Visa Operation Regulations, *supra* note 88, at 873–74.

[115] Visa Operation Regulations, *supra* note 88, at 874–75; MasterCard Chargeback Rules, *supra* note 88, at 6-5–6-6.

to take on the cost of disgruntled cardholders. Having described these divergent paths, it remains to explain them. Economic theory has for a while now been the dominant way of analyzing consumer contracts, so it is from its fount the following draws.

A. *BLACK BOX FIRMS, BIASED CONSUMERS, AND ARBITRATION CLAUSES*

1. Neoclassicism

The standard economic approach to mass-market consumer contracts treats them as attributes of the product or service with which they are associated.[116] When a consumer signs up for a credit card, she receives both the piece of plastic that she can use to pay for commodities and a modification of her legal rights and obligations towards the financial institution that issued her that piece of plastic.[117] Economists need not differentiate between these two things because they care only about the decisions made about the contract and/or the commodity as well as the incentives that drive decision-making, but not (necessarily) the metaphysical or moral differences between the objects of decision. Neoclassical models treat consumers as fully informed and fully economically rational and treat firms as black boxes about which the only thing we need know is that they will rationally maximize profit.[118] In other words, consumers and firms are both treated as abstracted economic agents that will respond to incentives in a way that rationally maximized their welfare (or profit) function. For consumers, this means that they will only decide whether to sign up for a particular credit card after considering all of the benefits they will receive from the credit card at their net present value based on their expected use patterns weighed against the costs that the credit card and its contract terms are likely to impose on them given the same likely set of use projections.[119] If the net benefits exceed those of other card issuers, the consumer will sign up for the card. Acknowledging the cumulative costs of reading many consumer contracts, more realistic versions of neoclassicism assume that consumers only read the terms likely to be most crucial to their decision and assume the rest of the terms will be

[116] The earliest and best formulation of this analytic frame comes from a non-economist. Arthur Allen Leff, *Contract as Thing*, 19 AM. U. L. REV. 131 (1970). For a framing by an economist, *see* Lewis A. Kornhauser, *Unconscionability in Standard Forms*, 64 CAL. L. REV. 1151, 1167–1170 (1976).

[117] Oren Bar-Gill and Elizabeth Warren compared contracts to toasters and lawnmowers in a well-known article. Oren Bar-Gill & Elizabeth Warren, *Making Credit Safer*, 157 U. PENN. L. REV. 1, 6 (2008).

[118] *See* Richard M. Hynes & Eric Posner, *The Law and Economics of Consumer Finance*, 4 AM. L. & ECON. REV. 168, 168–178 (2002).

[119] *Id.*; BAR-GILL, *supra* note 3, at 8–10.

either weighted in favor of the card issuer, pricing them accordingly, or policed by other consumers in the market with similar preferences.[120] Knowing that rational consumers will only acquire their card if its attributes, including the contract terms governing its use, are preferable to those of competing firms, card issuers will draft consumer-favorable terms to the extent their budget can bear it. The equilibrium market condition will maximally satisfy consumer preferences for contract terms to the extent firms can find the funds. That is, it will be efficient.

Variations on this model depend on factors like market segmentation, firms' market power, and the pervasiveness of information asymmetries.[121] However, so long as consumers comply with the assumptions of neoclassicism and no other market failure pervades, efficient equilibria will be reached.[122] Government intervention, usually in the form of disclosure, can solve collective action problems caused by the information costs of especially long contracts or the information asymmetry caused by indecipherable terms.

2. Behavioral Law and Economics

Drawing from a bevy of empirical work on human decision-making, an increasingly mainstream group of theorists under the aegis of behavioral law and economics (BLE) argue that consumers deviate in predictable ways from neoclassical projections.[123] Consumers have been found to ignore all but five or fewer aspects of a commodity and its associated contract, *including* price terms.[124] What is more, consumers do not take into account the fact that such unread terms are likely to be less than optimal, even to the point of making the purchase a net loss for them.[125] Not only do consumers fail to understand or even properly consider the terms themselves, they tend to systematically misperceive their own likely use patterns (and thus, the likely relevance of the term to their future

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[120] On the ability of consumers to rely on a small group of informed consumers to "police" markets, see Alan Schwartz & Louis Wilde, *Intervening in Markets on the Basis of Imperfect Information*, 127 U. PENN. L. REV. 631, 638–39 (1979).

[121] *See* Hynes & Posner, *supra* note 118.

[122] *See*, *e.g.*, Hynes & Posner, *supra* note 119; BAR-GILL, *supra* note 3, at 8–9; Kornhauser, *supra* note 116, at 1167–68.

[123] This literature is now too enormous to provide anything beyond a suggestive string cite. For excellent summaries, *see*, *e.g.*, BAR-GILL, *supra* note 3; Korobkin, *supra* note 2; Daniel Kahneman, *A Perspective on Judgment and Choice: Mapping Bounded Rationality*, 58 AM. PSYCH. 697 (2003); Christine Jolls, Cass R. Sunstein, & Richard Thaler, *A Behavioral Approach to Law and Economics*, 50 STANFORD L. REV. 1471 (1998); Bubb & Kaufman, *supra* note 9.

[124] Korobkin, *supra* note 2, at 1227–29 (summarizing this empirical research).

[125] BAR-GILL, *supra* note 3, at 9 ("Rational-choice decision-making provides tools for effectively coping with imperfect information. These tools are not used by the imperfectly rational consumer.")

selves).[126] With a late fee calculated through a complicated methodology, for instance, a consumer is unlikely to have the faintest idea both what the actual fee would be and what her likelihood of incurring it is. Armed with their own data indicating that consumers routinely commit these sins against neoclassicism, firms mete out penitence by jamming costs into the unread and mispriced boilerplate. They then compete only on the terms salient to consumers.[127] This process results in contracts that seem cheap at a glance but actually contain a minefield of potentially explosive costs for consumers in the boilerplate. Any "high road" firm that attempts transparency about its prices will be driven out of the market, since its advertised prices will not be able to compete with those artificially deflated prices advertised by advantage-taking firms.[128] Rather than efficiently equilibrating such a market, competition increases the perversely inefficient effects of consumer imperfections.

Some forms of market-driven "debiasing" may occur if, for instance, a firm makes a particular contract clause salient through advertising or if a firm gains a reputation for fair/unfair contract drafting.[129] Competing on consumer education would allow even imperfectly rational consumers to approximately price for clauses offloading costs, and to cleanse the market of such clauses. However, debiasing is not always possible. Firms may realize that if they attempt a debiasing campaign their competitors may free ride on their efforts, and then decide not to undertake the campaign in the first place.[130] Furthermore, debiasing frequently has the same chance of success as smoothing out a lumpy rug: it pushes cost offloading out of one contract clause only to find it reappear in another.[131]

Even if harsh boilerplate mostly means harsh consumer treatment, it need not always. Firms always have an *ex post* choice of whether and how to enforce their boilerplate.[132] Including strict rules in the contract provides flexibility: a firm can always choose to enforce them when it thinks the benefits of doing so would outweigh the reputational costs, while ignoring them when doing so would, say, ensure the continued business of a valued customer.[133] Whether or not such flexibility is close enough to a

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[126] *Id.* at 10–14 (describing the difference between use and attribute misperception).
[127] *Id.* at 10 ("When perceived benefit is different from actual benefit, a seller may be able to increase demand by raising the perceived benefit without incurring the added cost of raising the actual benefit."); Korobkin, *supra* note 2, at 1235–39.
[128] *See* BAR-GILL, *supra* note 3, at 16–17. However, market segmentation among sophisticated and unsophisticated consumers can occur.
[129] *See* Korobkin, *supra* note 2, at 1239–43; BAR-GILL, *supra* note 3, at 26–32.
[130] *See* Gabaix & Laibson, *supra* note 2.
[131] *See* BAR-GILL, *supra* note 3, at 19 ("[C]omplexity will increase over time as consumers learn to incorporate more price dimensions into their decision.").
[132] *See* Lucian A. Bebchuk & Richard A. Posner, *One-Sided Contracts in Competitive Consumer Markets*, MICH. L. REV. 827, 831–32 (2006).
[133] *Id.*

policy to provide a reason not to worry about seemingly unfair boilerplate can be set aside: the point is just that *ex post* firm behavior may matter in understanding the role of boilerplate.

3. Application: Arbitration Clauses Written by For-Profit Credit Card Issuers

Available evidence indicates that it is highly likely that the forces that behavioral economics describes have shaped multiple clauses in credit card contracts. Credit card contracts run more than ten pages, each containing single-spaced seven-point font.[134] Most of their clauses are nigh incomprehensible to a layperson, both in terms of the language in which they are written and in terms of the concepts that they employ.[135] Consumers are unlikely to read any of the contract or to understand it if they were to do so.[136] This is the basic recipe for shrouded clauses. Credit card agreements go over and above, however, since they usually come in the mail *after* a card is issued and can change at any point merely by notice of the issuer.[137] All of these factors should and do lead to contracts carefully engineered to exploit consumer biases.[138] Creatively designed interest rates and fees, encouragements to pay the minimum rather than the full balance each month, as well as sophisticated price-switching strategies, all suggest predatory behavior.[139]

Arbitration clauses exhibit many of the characteristics of other cost-cutting and welfare-reducing boilerplate. Too few consumers know about the clauses and attach any importance to them, let alone enough to exert sufficient bargaining power (through the aggregative mechanisms of the market) to change them.[140] Any individual issuer has little incentive to

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[134] In 2006, Ronald Mann stated that card agreements ran 8 pages. MANN, CHARGING AHEAD *supra* note 89, at 131. They must have grown since then, since a sampling of the card agreements on the CFPB's database includes agreements of up to 15 pages. *E.g.*, UBS Contract.

[135] CFPB Report, *supra* note 2, at Section 2.4 (finding that arbitration clauses tends to be written at a college reading level, with the rest of the contract at a 10th grade reading level); MANN, CHARGING AHEAD, *supra* note 89, at 131 (discussing the technicality of these agreements).

[136] *See* BAR-GILL, *supra* note 3, at 79–80 (citing studies indicating as much).

[137] MANN, CHARGING AHEAD, *supra* note 89, at 132 – 33; Mann, "*Contracting*", *supra* note 89, at 905–08.

[138] *See* BAR-GILL, *supra* note 3, at 80–96 (providing a detailed analysis of how credit card terms take advantage of consumer biases).

[139] *See*, *e.g*., BAR-GILL, *supra* note 3, at 65–75 (describing multiple aspects of the credit card contract).

[140] *See* CFPB Report, *supra* note 1, at Section 3, pp. 13–14, 18–24 (describing the results of a survey showing that consumers rarely if ever take into account arbitration agreements in deciding between credit cards and that most believe they still have the right to sue in court). *See also* Yannis Bakos, Florencia Marotta-Wurgler & David R. Trossen, *Does Anyone Read the Fine Print? Consumer Attention to Standard-Form Contracts*, 43 J. L. STUD. 1 (2014) (finding that very few consumers spend any time viewing online licensing agreements and that almost none spend any significant period of time doing so).

eliminate an arbitration clause and advertise the more consumer-friendly contract, since most consumers would hyperbolically discount the cost of not being able to sue their issuer, and the issue is probably too complex to advertise.[141] Furthermore, advertising might have the reverse of the effect intended, increasing the salience of potentially suing the issuer in question and making it a less desirable firm to do business with. Given the toppled legal obstacles to including arbitration clauses, even firms that would prefer not to include them in their contract for whatever reason might find themselves outcompeted by firms who do.[142] Litigation costs can be substantial, and issuers that can bring them closer to zero will simply make more money.[143] On the one hand, it is unclear whether an issuer that did not include an arbitration clause would truly be competed *out* of the credit card market—given the fact that most issuers are banks that have multiple other profit centers and credit cards are so unbelievably profitable anyway.[144] On the other, to preview the institutionalist perspective to be discussed below, in the contemporary activist shareholder culture an unwillingness to cut litigations costs might be viewed as a potentially fatal demerit against corporate leadership.[145] To tread even more closely towards sociology, it seems that the networks in which bank lawyers run have come to treat arbitration agreements as par for the course, so deviating from the norm would require some amount of cost at least in terms of effort of writing a different contract.[146] In other words, path dependence may now be at work.[147]

[141] Jolls et al., *supra* note 123, at 1539; David Laibson, *Golden Eggs and Hyperbolic Discounting*, 112 Q.J. ECON. 443 (1997).

[142] *Supra* Section I.A.3.

[143] *Cf. supra* note 48 (describing firm's concerns about the costs of litigation).

[144] Board of Governors of the Federal Reserve System, *Report to Congress on the Profitability of Credit Card Operations of Depository Institutions*, 7 (June 2012), http://www.federalreserve.gov/publications/other-reports/files/ccprofit2012.pdf ("Although profitability for the large credit card banks has risen and fallen over the years, credit card earnings have been almost always higher than returns on all commercial bank activities.")

[145] On the point that more demanding shareholders have dramatically shifted corporate culture in a form profound enough to have macroeconomic effects, *see, e.g.*, J.W. MASON, ROOSEVELT INSTITUTE, DISGORGE THE CASH (Feb. 25, 2015), http://rooseveltinstitute.org/sites/all/files/Mason_Disgorge_the_Cash.pdf.

[146] Silver-Greenberg & Gebeloff, *Arbitration Everywhere*, *supra* note 48 (describing the acceptance of these clauses among corporate lawyers).

[147] *Cf.* DOUGLASS C. NORTH, INSTITUTIONS, INSTITUTIONAL CHANGE AND ECONOMIC PERFORMANCE 92–106 (1992) (discussing path dependence as a way of explaining institutional structure, especially if it is inefficient).

B. *ADDING FIRM OWNERSHIP: CREDIT UNIONS' LACK OF ARBITRATION CLAUSES*

It does not require any conceptual innovation to point out that firms are not actually automata engineered solely to maximize profit based on the preferences of consumers within a well-defined segment of the market. They are complex organizations pulled in different directions by their various stakeholders and power players. For scholars that focus on the management of a firm, whether from a sociological, economic, or legal point of view, this point will be quite familiar. Regardless of the theoretical approach, all the action concerns the conflicts between different parties battling over the use of the firm's resources.[148]

So why treat firms as automata when analyzing consumer markets? One response is that this method works most of the time, and better to stick to parsimony if conceptual complexity does not add predictive power.[149] A more sophisticated point is that for-profit corporations in competitive markets do their best to mold themselves in the image of *homo oeconomicus* and, since firms who fail to do so tend to be outcompeted, they can be, for most intents and purposes, treated as if they succeed.[150] Deviation from the firm-as-a-production-function model is said to occur only in the short term: they are the noise, not the signal. For describing much of today's consumer markets, including credit card markets, this approach seems to work. The most impactful credit card issuers tend to have an institutional setup and exist in a regulatory and cultural context that produces fiercely profit-maximizing behavior.[151]

Yet even within the cutthroat credit card market some firms consistently comport themselves differently than others. Ryan Bubb and Alex Kaufman have presented empirical evidence that non-investor-owned firms (non-profits and mutuals) are significantly less likely to include clauses in their contracts that take advantage of consumer biases.[152] The authors posit that including such clauses in contracts imposes costs on firm management (that icky feeling of cheating somebody out of their money) regardless of the type of firm, but that managers who have to report to investors have "higher-powered financial incentives" that overwhelm the

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[148] *Cf. supra* note 14 for some references to the relevant literature.
[149] Gilles & Friedman, *supra* note 44.
[150] *Cf.* NORTH, *supra* note 147, at 80–82 (discussing institutional learning).
[151] Board of Governors of the Federal Reserve System, *supra* note 144.
[152] Bubb & Kaufman, *supra* note 9, at 46 ("investor-owned issuers are far more likely than credit unions to offer introductory APRs"). *See also* Christopher R. Drahozal & Peter B. Rutledge, *Arbitration Clauses in Credit Card Agreements: An Empirical Study*, 9 J. L. STUD. 536, 548–49 (2012).

discomfort.[153] Non-investor-owned firms, on the other hand, "have muted incentives to maximize penalty revenue" (that is, the revenue generated from shrouded clauses) because they do not face shareholders demanding maximal profit regardless of the human cost.[154] Furthermore, managers of non-investor-owned firms receive far less of their own income through incentives tied to firm profits, further attenuating their decisions from those of full profit maximization.[155] The combined muting of internalization of the profit motive allows qualms about bilking consumers to overwhelm the ceaseless striving to grow M to M'.[156]

Reasoning backward from what it is about the firms in this subsection of the credit card market that restrains their baser instincts to produce clauses that take advantage of consumer biases can help to think through which aspects of the structure of other credit card issuers eggs them on. Bubb and Kaufman draw from the work of Henry Hansmann, who argued that whether a firm is for-profit, non-profit, worker-owned, or consumer-owned (that is to say, which constituency owns a firm) depends in large part on which set of transactions that the firm enters into are least costly to govern via contract and which are least costly to govern via granting an ownership interest in the firm.[157] But rather than asking what incentives organizations have to adopt different ownership structures, Bubb and Kaufman ask how different ownership structures change the mix of incentives a firm's agents face when engaging in outward-facing contracting behavior, here with consumers. They provide good reason to believe that investor ownership will strengthen incentives to maximize profit (i.e. investors' claims on the firms' assets) *über alles* whereas customer ownership and non-ownership (i.e. non-profit) will weaken these incentives and perhaps even produce countervailing incentives.

Does this dynamic play out beyond the pricing (interest rate and fee) terms Bubb and Kaufman examine? In particular, does it extend to

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[153] Bubb & Kaufman, *supra* note 9, at 41. Drahozal and Rutledge argue that credit unions may have another reason not to include arbitration clauses in their credit card contracts. Because credit unions have a "common bond" requirement for their customer base, they may have more information about their customers, which would make them less worried about the risk of non-payment and/or suit. Drahozal & Rutledge, *supra* note 152, at 549.

[154] Bubb & Kaufman, *supra* note 9, at 41

[155] *Id.*

[156] May the reader forgive the slip into Marxist terminology. *See* KARL MARX, CAPITAL VOLUME 1 247 (Ben Fowkes trans. 1977).

[157] HANSMANN, *supra* note 16, at 18–22 (outlining the general framework). Hansmann's work can be read as one version of New Institutional Economics, which treats the structure of firms as determined by minimizing transaction costs. *See, e.g.*, Oliver E. Williamson, *The New Institutional Economics: Taking Stock, Looking Ahead*, 38 J. ECON. LIT. 595 (2000) (summarizing the state of the new institutional economics literature and placing it in relationship to related social sciences); RONALD H. COASE, THE FIRM, THE MARKET, AND THE LAW (1988) (the classic collection of essays that inspired the field of new institutional economics); NORTH, *supra* note 147 (1990) (providing a historically oriented framework similar to Williamson's).

arbitration clauses? The CFPB's research on arbitration clauses suggests that the answer is yes. Focusing on credit card contracts, it found that whereas 60% of the 50 largest bank issuers and 42% of the 57 small bank issuers had arbitration clauses, only 3% of credit unions did.[158] The difference between for-profits and credit unions is dramatic and consistent with Bubb and Kaufman's hypothesis. Perhaps the less dramatic difference between large and small issuers is as well. Smaller banks are more likely to have community ties and to offer credit cards for convenience rather than as a major profit center, so they may have countervailing incentives that occasionally overwhelm pure bottom-line-driven behavior.[159] Conversely, big banks now tend to be owned by clusters of institutional investors that push towards shareholder value at all costs (even, arguably, to the long-term health of the firm itself).[160]

C. *Adding Other Contracts: Reversal Clauses*

1. Cross-Subsidy across Contracts: Two-Sided Platforms

It is not only ownership that affects incentives. Constituencies that have not converted their contracting relationship with a firm into an ownership interest still limit firms' options and exert their interests through their contracts. A moment's thought reveals that this is trivially true: a contract itself creates restrictions on any of the contracting parties' behavior, creating costs for deviating from the terms of the contract, which removes some degrees of freedom from firm behavior. Once locked into a contract, costs of defection appear, which are just the same thing as costs of not honoring the interests of the other party. Indeed, as the literature on long-term contracting suggests, having an ownership interest in a firm may be different from contracting with a firm only in degree.[161]

But firms contract with multiple different constituencies, which means that they must mediate between their varying interests. From this perspective, consumers are just one among many interests a firm must take into account in determining its business strategies. One very influential way

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[158] CFPB Report, *supra* note 1, at Section 2, p. 10. Drahozal and Rutledge find similar results in their regression analysis. *Supra* note 152, at 560.

[159] *Cf.* MEHRSA BARADARAN, HOW THE OTHER HALF BANKS: EXCLUSION, EXPLOITATION, AND THE THREAT TO DEMOCRACY 64–101 (2015) (describing how different types of banks in U.S. history had different behavior depending on their understanding of their relationship to their customers).

[160] *Cf.* GERALD F. DAVIS, MANAGED BY THE MARKETS: HOW FINANCE RE-SHAPED AMERICA 59–101 (2009) (describing how the transition from managerialism to shareholder power changed firm behavior).

[161] *Cf.* OLIVER WILLIAMSON, THE ECONOMIC INSTITUTIONS OF CAPITALISM (1985); THE ORGANIZATIONAL CONTRACT: FROM EXCHANGE TO LONG-TERM NETWORK COOPERATION IN EUROPEAN CONTRACT LAW 77–95 (Stefan Grundmann, Fabrizio Cafaggi, and Giuseppe Vettori eds., 2013).

to model the firm's role as a mediator of multiple contracts is to view them as "platforms" with multiple sides, one for each constituency with which it contracts (or has an ownership interest).

The basic idea, as well as the mathematical models, of a two-sided platform (the most basic version of an n-sided platform), come from a widely cited 2003 paper by Jean-Charles Rochet and Jean Tirole.[162] They identify the essential property of a two-sided platform as its two distinct types of end-users of its product or service, each of whose willingness to come onto the platform depends in part on the platform's ability to attract the other type of user.[163] As Rochet and Tirole themselves put it, "economic value is created by 'interactions' or 'transactions' between pairs of end-users."[164] Examples include video game consoles (which must attract gamers and developers), newspapers (which must attract readers and advertisers), shopping malls (which must attract customers and businesses), and heterosexual dating sites or singles bars (which must attract men and women).[165]

While the users of each side create benefits for the users of the other side, they do not internalize the benefits their own use creates. The platform owner must take into account this lack of internalization to price strategically so as to attract the amount and quality of users on each side that the users on the other side prefer. In order to understand these dynamics, Rochet and Tirole proposed "a cross between network economics…and the literature on (monopoly or competitive) multi-product pricing."[166] The former helps model how additional users of a platform can add value to other users, and the latter provides insights on how different elasticities of demand can be bundled into a single pricing strategy such as loss-leading.

In a frictionless neoclassical world, any surplus created by an additional user's participation in the platform would be known by all and bargained over. The overall price level for use of the platform would matter, but the price structure (i.e. the way the price is allocated between different types of end users) would not, since end users could merely bargain around it.[167] If the platform raised the cost for one side (i.e. one of the types of users), that side could pass on the cost to the other side. But empirical observation of two-sided platforms indicates that the way price is allocated between different sides *does* matter.[168] Quite frequently, one side

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[162] Rochet & Tirole (2003), *supra* note 21.
[163] *Id.* at 990.
[164] *Id.* at 995.
[165] *Cf. id.* at 992.
[166] *Id.* at 991.
[167] *See* Rochet & Tirole (2005), *supra* note 21, at 6–7.
[168] *Id.*

of a platform is treated as a loss leader or a break-even investment while the other side provides all of the profit.[169] In the world of newspapers, advertisers subsidize readers; for gaming consoles, game developers subsidize gamers; and at singles bars, men frequently subsidize women during "ladies' nights."[170] In these and other situations, the subsidizing side of a platform faces insurmountable barriers, which can mostly be grouped into the category of call "transaction costs," in passing on costs to the subsidized side. Advertisers do not even come into direct contact with readers, game developers are prohibited from passing on costs by console operators, and social convention (and self-preservation) stands in the way of (most?) men asking the women they are courting from compensating them for the privilege.

The main determinant of which side subsidizes the other is the relative elasticity of demand on each side.[171] This might be most easily seen at the extremes. If the users on one side are "captive"—whether because there is no other such platform, switching costs are prohibitive, or some other reason—they will pay more. If the users on one side are "marquee"—that is, especially desirable to users on the other side—they will pay less.[172] In two-sided platform markets such elasticities tend to be linked: "a factor that is conducive to a high price on one side, to the extent it raises the platform's margin on that side, tends also to call for a low price on the other side as attracting members on that other side becomes more profitable."[173]

2. Application to Credit Cards and Reversal Clauses

It so happens that credit cards (and other payment cards) are one of the earliest examples of two-sided platforms to be studied.[174] In the preceding sections, we have seen the workings of the consumer side in some detail, but on the other side of payment transactions is another constituency: merchants. Industry insiders and observers agree that, overall, merchants subsidize cardholders via the interchange fee.[175] Extrapolating

[169] Indeed, in Rochet & Tirole's more developed theory this price structure is the defining characteristic of multi-sided platforms. *See* Rochet & Tirole (2005), *supra* note 21, at 2 ("We define a two-sided market as one in which the volume of transactions between end-users depends on the structure and not only the overall level of the fees charged by the platform.").
[170] *See* Rochet & Tirole (2003), *supra* note 21, at 922.
[171] Rochet & Tirole (2005), *supra* note 21, at 24.
[172] *See id.* at 25.
[173] *Id.*
[174] *E.g.*, Rochet & Tirole (2003), *supra* note 21, at 1013; EVANS & SCHMALENSEE, *supra* note 21, at 149.
[175] *See* Rochet & Tirole (2003), *supra* note 21, at 1013–14; EVANS & SCHMALENSEE, *supra* note 21, at 149–50; BENSON & LOFTESNESS, *supra* note 104, at 79, 87. There are various exceptions to the general rule that I keep out of the main discussion to prevent this already overlong article

from the general rule of cost-bearing's inverse relationship to elasticity, theorists agree that the cardholders' subsidization derives from their wider availability of substitutes.[176] Cardholders can have multiple credit cards at the same time, and they can change issuers within a network or across networks from transaction to transaction.[177] Accounts are relatively easy to open and close. Merchants, on the other hand, have medium-term deals with acquirers and certainly cannot change which they use with each transaction. They are also pressured into contracting with as many networks as possible, since not accommodating popular networks creates a risk of losing customers.[178] Consumers' relative power shows up in pricing patterns within the industry—with the issuing side often making three times the amount of money per transaction as the acquiring side.[179] The revenue differential means that merchants subsidize cardholders.[180] This subsidization has been hard enough on merchants that it has led to litigation and even recent Congressional action.[181]

The fact that credit card networks would favor cardholders over anybody may sound strange after having spent so much space reviewing the literature on how credit card companies' profits depend on creatively relieving cardholders of their money, but the two realities are perfectly consistent. Credit cards can be thought of as serving two purposes: a source of consumer loans and a convenient payment system.[182] Within the lending realm, massive cross-subsidies exist across consumers—with, to put things too simply, constantly indebted "revolvers" paying for the benefits of the "deadbeats" who pay off their bills every month and rack up the airline miles.[183] Credit card networks make the great majority of their ample profits

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from becoming unwieldy. To cite just one example, "marquee merchants" like Wal-Mart command so much business that they can bargain for special prices.

[176] *See* EVANS & SCHMALENSEE, *supra* note 21, at 156.

[177] *Id.*; BENSON & LOFTESNESS, *supra* note 104, at 79.

[178] Mann points out that merchants and issuers have been frenemies since the very beginning of credit cards. MANN, CHARGING AHEAD, *supra* note 89, at 82.

[179] *Id.* at 27 (noting that issuers tend to make 1.5% of a transaction, with acquirers making 0.5%).

[180] EVANS & SCHMALENSEE, *supra* note 21, at 156. As discussed infra, there is also cross-subsidization within groups.

[181] *See, e.g.*, Final Approval Order, *in re* Payment Card Interchange Fee and Merchant Discount Antitrust Litigation, 1:05-MD-1720, Dec. 13, 2013 (approval of a settlement between a class of merchants and Visa and MasterCard); American Express Co. v. Italian Colors Restaurant, 133 S. Ct. 2304 (2013) (rejecting a class of merchants' attempt to get around an anti-class arbitration clause to sue American Express for similar alleged antitrust violations); 156 CONG. REC. S5802 (daily ed., July 15, 2010) (statement of Sen. Durbin) (speaking in support of an amendment to Dodd-Frank limiting interchange fees in the debit card market: "It turns out that small businesses and merchants across America have literally no strength, no power, no voice in determining these interchange fees.")

[182] *Cf.* Mann, *Making Sense*, *supra* note 76, at 637 (discussing the "balkanization" of the academic fields that study these two functions).

[183] *See* HYMAN, *supra* note 98, at 240–41; Robin Stein, *The Ascendancy of the Credit Card Industry*, FRONTLINE (Nov. 23, 2004),

from interest and fees on consumers whom they can nudge into the sweet spot where they are behind on their bills but still paying them.[184] So lucrative is this strategy that the ability of networks to make money off of consumers is one of the prime reasons they compete so vigorously on that side of the platform. Still, money is generally made from consumers through the *lending* function of credit cards rather than through their *payment* function.[185] Merchants account for most of the latter's *payment-related* revenue, even if lending revenue from consumers dwarfs it in the bigger scheme of things.[186]

As with non-profit ownership, it is not that firms' incentives to hide costs in consumer contracts *disappear* when dealing with payment-related issues; it is that they are, in net, *outweighed* by their ability to pass along the costs to merchants. One can even see that balance tip historically: before the passage of the FCBA, consumer-facing contracts completely disclaimed issuer liability for reversals despite the fact that a (basic) chargeback process was already in effect.[187] As mentioned above, this coexistence could potentially be explained by issuers' desire to only spend time on especially valued consumer complaints.[188] It may also be explained in part by the fact that changing between credit cards was more difficult in those days, especially for non-wealthy cardholders. Market saturation was a ways away, so the pull of consumers on the two-sided platform was not as strong.[189]

As consumer elasticity of demand increased over time, incentives may have shifted enough to tilt the balance towards consumer-favorable reversal clauses. Perhaps so, perhaps not, but what seems certain is that the FCBA put a heavy enough thumb on the scales to move past the tipping point. Most obviously, it generated a set of legal risks for failing to grant a wide number of requested reversals. Issuers' ability to grant only those

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http://www.pbs.org/wgbh/pages/frontline/shows/credit/more/rise.html. On cross-subsidy *see*, *e.g.*, BAR-GILL, *supra* note 3, at 75 (discussing "inefficient cross-subsidization" among cardholders). On the terminology see *Deadbeat*, CREDITCARDS.COM, http://www.creditcards.com/glossary/term-deadbeat.php; *Revolver*, CREDITCARDS.COM, http://www.creditcards.com/glossary/term-revolver.php. For a history of how this strategy developed, see JOSEPH NOCERA, A PIECE OF THE ACTION 316–324 (1994).

[184] BENSON & LOFTESNESS, *supra* note 104, at 87 ("The economics of the credit card industry are dominated by interest earned on revolving loans to cardholders"); Stein, *The Ascendancy*, *supra* note 183 (describing several strategies for doing so); Ronald J. Mann, *Bankruptcy Reform and the 'Sweat Box' of Credit Card Debt*, 1 ILL. L. REV. 375 (2006) (arguing at length for the existence of this strategy).

[185] BENSON & LOFTESNESS, *supra* note 104, at 87. Credit card lending is of macroeconomic significance. *See* BAR-GILL, *supra* note 3, at 62.

[186] This is evidenced by the pricing of interchange costs. *See supra* notes 175, 181.

[187] *Supra* notes 94–95 and accompanying text.

[188] *Id.*

[189] *See* Evans & Schmalensee, *supra* note 21, at 88–90 (discussing the spread of credit cards from exclusive goods to mass use). Furthermore, credit card markets were much more segmented—with differences between travel cards, gas cards, etc. *See* Macaulay, *supra* note 94, at 1071.

requests that made short-term economic sense had been abruptly circumscribed, forcing them to take on either the cost of litigating failures to comply or that of reversing all of those charges. It also potentially added to the reputational cost of failing to grant a reversal: losing a lawsuit or having a government agency declare a firm in noncompliance is rarely good for business. Lastly, although most consumers do not know about the details of reversals or the FCBA, to the extent that a reversal right was written into law, forced into a credit card contract, and utilized by consumers, it began to seep into consumer culture—likely raising the number of consumers willing to demand reversals.[190]

Dealing with these costs in addition to the preexisting reputational costs of disgruntled consumers put a thumb on the scale in favor of granting more reversals. Doing so would make statutory compliance easier and cheaper: an ability to reverse more transactions than absolutely necessary would ensure that even if courts were to read the FCBA at its broadest or Congress were to broaden it, issuers would incur much lower litigation costs. This would have been all the easier to do, of course, if issuers did not have to take on the cost of steering clear of violating the law.

A two-sided platform creates a quasi-political dynamic in which the consumer-facing side of the credit card network (i.e. issuers) has more power to set rules than the merchant-facing side.[191] Although frequently interests of the network members converge on maximizing shared profit (with decisions reflecting that fact), they diverge when questions of dividing up the spoils arise.[192] Maximizing and dividing are easily separated

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[190] I have no truly reliable evidence for this, but I do have anecdotal evidence. While working on this project, I have had the opportunity to speak with many friends and relatives about these rights and whether they knew they existed—a surprisingly large number of people (certainly a sampling bias living among law students specifically and mostly middle to upper-middle class people more broadly) had some inkling that they could ask their credit card issuer to refund a problematic charge.

[191] For a discussion of how economic dynamics can create quasi-political power within for-profit networks, see TIM BÜTHE & WALTER MATTLI, THE NEW GLOBAL RULERS: THE PRIVATIZATION OF REGULATION IN THE WORLD ECONOMY (2011). In open-loop networks, these "sides" of the network are different companies: issuing banks and acquiring banks. All agree that issuing banks have outsize power in open-loop networks. BENSON & LOFTESNESS, *supra* note 104, at 63 ("on the critical operating committees and boards of the card associations, the voice of card issuers [has] frequently dominated discussions, a situation that continues even within the new ownership structure."); Mann, *Making Sense*, *supra* note 76, at 661 ("all the issuing banks are the ones who sit on the board with Visa and MasterCard."). In closed-loop networks, the divergent interests of acquiring and issuing sides of the two-sided platform might be represented by different departments within the same corporation or might play out in less formal ways.

[192] Gillette's transaction-cost analysis of open-loop credit card networks predicts that banks will cooperate on the network rules that maximize surplus and compete on rules that divide the surplus. This may be a good rule of thumb, but I doubt these two categories are always so easily distinguishable and I am more prone to believe that individual banks with outsize power would

in theory, but not always in practice. Issuers' outsize power in the decision-making mechanisms derives from the slant created by the two-sided platform, and to the extent their interests coincide with consumers' (as they do in most payment-related matters), issuers' power likely allows them to create rules even more favorable to consumers than simple shared profit maximization would account for.[193]

Making rules that allow issuers to pass more costs along to merchants does not ipso facto guarantee that issuers will grant more reversal requests. However, the ability to pass along reversals removes the costs of granting such requests, which makes the incentives (reputation, reduction of legal risk, etc.) to grant them more powerful. What is more, it may be less costly in terms of employee person-hours to spend less time reviewing relatively low-dollar consumer complaints in detail, instead granting reversals except in cases of clear consumer misconduct or more expensive purchases.

Obviously the magnitude of each of these costs and the incentives they give rise to cannot be determined from the armchair. Some insight can be gained by borrowing from the literature on who bears the economic cost of interchange fees (merchants, as we have seen), but this can only go so far.[194] More direct empirical investigation would be the only way to confirm the story told here and to elaborate on its details. Without proprietary credit card data,[195] it is hard to explain a generous reversals policy without incorporating two-sided platform dynamics. In any case, from the perspective of the theorist, the armchair will do just fine.

III. TWO IMPLICATIONS OF ADDING INSTITUTIONAL STRUCTURE TO ANALYSIS OF CONSUMER MARKETS

The previous section pasted together two literatures: one on how consumer biases affect contracting and the other on how a firm's relationships with different constituencies affect its incentives. In the first, it is taken for granted that a firm will do anything it can to maximize profit when dealing with consumers, which results in contracts creatively drafted to bilk consumers of their money and rights. However, examining which aspects of institutional structure motivate a firm's agents when dealing with consumers, requires subtler analysis. Who owns the firm and who else

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eat into shared surplus if they could gain an advantage for their own balance sheet. *Cf.* Gillette, *supra* note 85.

[193] Merchants do have an interest in keeping consumers happy, of course. To the extent they share this interest with issuers, there will be no conflict and the platform will reflect that shared interest.

[194] *See supra* note 175.

[195] In private communication, Ronald Mann told me that attempting to get such data would be a fruitless endeavor, at least in the short term. E-mail from Ronald Mann, Professor of Law, Columbia University, to author (Apr. 16, 2014, 17:54 EST) (on file with author).

contracts with the firm both matter. When investors own a firm, they tend to seek profit maximization above all else. Other owners have more mixed incentives and thus weaken firm's agents' incentives for predatory behavior. Comparing the pricing of fees and interest as well as the incidence of arbitration clauses in for-profit vs. mutually owned or non-profit credit card issuers provides evidence for this hypothesis. Moreover, a firm's contracts with one constituency cannot always be viewed in isolation. A given constituency may contract with a firm in large part because another constituency does so, creating cross-elasiticities that make analyzing either contract in isolation an incomplete or even an inaccurate analysis. The structure of interchange fees as well as the details of the reversal process buttress this claim.

Adding an institutional dimension to the analysis of consumer contracts can go beyond the two particular clauses that have been the subject of close examination so far. It can help provide a broader framework for understanding credit card markets, as we have seen in the passing examination of different fees. More broadly, an institutional perspective can ground more creative and comprehensive regulatory interventions. This section explores these two possibilities.

A. *FOR CREDIT CARD CONTRACTS*

As discussed above, it is commonplace to divide the functions of credit cards in two. One the one hand, credit cards are payment systems—like checks, wire transfers, or debit cards—on the other, they are lending vehicles—like store credit, mortgages, or payday loans.[196] For the most part, in fact, these two functions of credit cards are the subject of separate parallel literatures. Analysts of consumer credit and contracts of adhesion deal with credit cards almost exclusively as the predominant form of small-dollar loans in the United States, whereas scholars of payment systems and the UCC treat credit cards more or less as they treat debit cards.[197]

The payment and lending functions do overlap, though. A credit card loan is merely a delayed payment on a credit card bill, which is itself an invoice for use of the payment system.[198] The bill itself, then, serves as the threshold between the two functions. In a sense, the delayed billing structure makes each consumer purchase with a credit (or debit) card a loan, and the lack of interest charged unless the bill goes unpaid allows the

[196] *Supra* note 182 and accompanying text.
[197] *See id.*
[198] Cash advances are also possible with credit cards. It is debatable whether this is a use of a credit card or use of a line of credit from an account associated with a credit card. In any case, these are obviously not borderline cases, so it is a complication that need not be dealt with here.

consumer to benefit from thirty days' worth of interest rate "float."[199] One might draw the line at the moment that interest begins to be charged or perhaps by looking at how the terms of the contracts themselves define what counts as a loan, but these are both unsatisfactory. Not all loans charge interest and, to the extent that we want to predict how firms will treat different parts of the transaction, we want a framework for determining *when* they will define some part of the transaction as a loan.

The institutionalist perspective provides the basis for making sense of borderline cases. The way it draws the boundary may not reflect the different between "lending" and "payment," but it will provide a way to predict how any given part of the transaction will affect the contracting behavior of issuers. Other motives for drawing the boundary line might lead to the employment of different frameworks.[200]

In terms of institutional structure, the lending function of credit cards can be seen as not involving merchants at all. A credit card network's contracts with merchants might affect its overall revenue levels, ability to retain earnings, and the like, but these relatively diffuse effects can be abstracted away for most purposes. For open-loop credit card networks, where issuers (which do business with consumers) are separate firms from acquirers (which do business with merchants), each issuer sets its own terms for lending to consumers without consulting others in the network—Visa cards from different banks have different terms.[201] The ownership structure of an issuer (as well as other aspects of institutional structure not touched on here) may affect how it designs its consumer contracts, but its relationship to the merchant side of the network will generally not. Conversely, a credit card network intermediates a relationship between merchants and consumers through the payment function. A network's relationship with merchants will affect how its consumer-facing payment policy will work. We have seen this with reversals and, in passing, with interchange fee pricing.[202] An examination of two borderline cases will help illustrate how this framework can work.

When an issuer charges a consumer for the past month's payment activity, it may make mistakes (typos are wont to be less common now in the age of automation, but some other transcription error may occur) or it may make "mistakes" (issuers might creatively order line items such that a higher interest rate is triggered or display billing information in a way that

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[199] *See* CHARLES R. GEISST, COLLATERAL DAMAGED: THE MARKETING OF CONSUMER DEBT TO AMERICA 55–56 (2009).

[200] On how models depend on what one is looking for, *see* Leff, *supra* note 116, at 134 ("Once there is—stated, perceived, or felt—a purposive aim and a classificatory criterion (or more) associatable [sic] with it (empirical causation being one of the most common associations used), classification becomes 'useful' to that end.").

[201] *See* Gillette, *supra* note 85.

[202] Section II.C *supra*.

encourages consumers to borrow rather than to pay in full). All of these seem to be closer to payment-related aspects of the transaction than lending-related, although in the case of creative ordering to turn a payment into a loan we are on the border. From the institutional structure perspective, though, they clearly fall on the "lending" side (whether or not they govern loans!) to the extent they involve only the issuer and consumer, not the merchant. We should then expect the level of consumer friendliness to depend solely on bilateral factors such as ability to hide these charges and concerns about reputation.

From the other direction: a consumer may be behind on their bills while refusing to pay part of the principal and interest because it involves a disputed transaction. In this case, the payment at issue is clearly on a loan (with interest compounding!), but the relationship at issue is three-way: consumer, issuer merchant. Thus, we can add in issuers' ability to pass on costs to merchants into the analysis: if they can easily do it, we may expect more consumer friendliness in resolving the dispute.

B. *For Regulatory Approaches More Generally*

Examining how institutional structure can change firm incentives can also prove a useful tool for regulators and policymakers looking to encourage consumer-friendly firms. Usually regulatory action is conceived of as a direct intervention in the market: a set of rules for appropriate behavior within that market.[203] In other words, "there is an attempt to change the nature of the interactions between individuals and firms, as when the regulation attempts to affect what can be said, offered, or done."[204] But regulatory action can also indirectly alter the incentives for firms to behave in particular ways. In this way, a regulator can "change[] the payoffs a firm will receive for particular outcomes."[205] Michael Barr, Senhil Mullainathan and Eldar Shafir have deemed the former "changing the rules" and the latter "changing the scoring."[206]

In looking for ways that regulators and policymakers can alter firm incentives through "scoring" changes, it may be helpful to draw from the foregoing discussion on how institutional structure does just that. If credit unions and mutually owned financial institutions are less likely to offer sharp terms in their credit cards, then there is a reason to bias regulation in

[203] *See* Michael S. Barr, Sendhil Mullainathan, & Eldar Shafir, *The Case for Behaviorally Informed Regulation*, *in* NEW PERSPECTIVES ON REGULATION 25 (D. Moss & J. Cisternino eds., 2009); BARR ET AL., *supra* note 7.
[204] Barr et al., *The Case*, *supra* note 203, at 35.
[205] *Id.*
[206] Barr at al., *The Case*, *supra* note 203.

their favor through one channel or another.[207] Indeed, Mehrsa Baradaran has recently provided an extended argument in favor of having the U.S. Post Office re-open banking services (which would, of course, be government rather than mutually owned), relying in part on a similar argument about muted profit-making incentives.[208] *En route*, she provides an extended discussion about how different institutional structures in the banking industry do a better or worse job serving savers' and lenders' interests while advancing their own.[209] Her approach and recommendation has much to recommend it, but it should be viewed as only one part of a broader discussion about which ownership structures work best in banking and elsewhere.

The potential of two-sided firms to tilt firms towards consumers' interests might also be harnessed by regulators and policymakers. A quick example may help to illustrate that the point is not limited to the credit card market. Credit reporting agencies (CRAs) have come under fire recently for their high error rates and woefully inadequate procedures for resolution of consumer disputes.[210] The Fair Credit Reporting Act (FCRA) mandates that CRAs "reasonably" investigate consumer complaints about the accuracy of their credit reports.[211] CRAs have set up an online system and, at least on paper, an orderly process to resolve these disputes that involves requesting information from both parties.[212] Unlike credit card networks, however, CRAs do not qualify as two-sided platforms: they make nearly all of their money from businesses who purchase information on consumers and almost none from consumers themselves.[213] Consumer advocates, drawing

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[207] *See* Bubb & Kaufman, *supra* note 9, at 55 ("Our analysis suggests that a potential benefit of policies that expand the market share of mutual and nonprofit firms is a reduction in the costs that stem from consumer biases.").
[208] BARADARAN, *supra* note 159, at 183–209.
[209] *Id.* at 64–101.
[210] Consumer Financial Protection Bureau, Key Dimensions and Processes in the U.S. Credit Reporting System 34 (Dec. 2012) [hereinafter CFPB CRA Report] (discussing the lack of space for consumers to elaborate on their complaints and the inability of consumers to upload attachments); Federal Trade Commission, Report to Congress Under Section 319 of the Fair and Accurate Credit Transactions Act of 2003 28 (Jan. 2015) (summarizing the results of their recent studies, indicating that "While most of the disputing consumers (80%) in the main study received a modification in response to their dispute, only 37% received all requested modifications…[and t]he majority of follow-up participants (almost 70%) with unresolved disputes believe that the information is still inaccurate.").
[211] 15 U.S.C. § 1681i (2013).
[212] CFPB CRA Report, *supra* note 210, at 31–32 (describing the four-step process).
[213] *See, e.g.*, Highbeam Business, *Credit Reporting Services* (http://business.highbeam.com/industry-reports/business/credit-reporting-services) ("An annual or monthly fee is usually charged for credit reporting services … A per-report cost is also charged."); Board of Governors of the Federal Reserve System, Report to the Congress on Credit Scoring and Its Effects on the Availability and Affordability of Credit 29–32 (August 2007) (discussing who uses credit scores). CRAs do charge for certain services to consumers, such as credit scoring, but this does not make up much of their revenue. *See generally* TransUnion, Annual Report (Form 10-K) 43 (Feb. 15, 2017) (discussing sources of revenue).

from long experience with initiating disputes on behalf of consumers, have argued that because CRAs "earn the lion's share of their profits from creditors rather than consumers" they "have little legal or financial incentive to conduct meaningful investigations of disputes."[214] And the evidence indicates that they hardly, or just barely, meet their FCRA obligations—certainly not surpassing them.[215]

A firmer regulatory hand—as the CFPB has begun to wield—will certainly ameliorate the situation,[216] but perhaps changing the scoring to make CRAs' incentives more like credit card networks would be even more effective in a more sustainable way.[217] FCRA could, say, compel creditors that report to CRAs to pay CRAs a yearly fee indexed to the number of disputes associated with their accounts, charging additional fees for a bad ratio of resolved to unresolved disputes. This would simulate for CRAs the ability to pass along costs of dispute resolution, which might make them more consumer responsive without the need for undue regulatory expense.

These are only two examples of how taking into account institutional structure might help develop more effective and efficient regulation. It is often thought that a targeted direct regulation is the light-touch approach to intervention in the market, but it may at times be the case that a self-conscious shaping of which types of firms are likely to win or lose in any given market is in fact the cheaper and more effective approach to enhancing welfare and freedom.

CONCLUSION

This article began with two clauses found in consumer credit card contracts. Arbitration clauses use alternative dispute resolution to cut off consumer remedies, while reversal clauses use ADR to expand them. Holding constant the possibility of earning extra money by exploiting consumer biases, it was argued that the coexistence of these two clauses must be explained in terms of which aspects of a firm's institutional structure leads it to instantiate this possibility. Viewing a firm as a forum to mediate the interests of the constituencies that either own or contract with it, one can ask how the aggregate interests of a firm's constituencies

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[214] Shawn Fremstad and Amy Traub, Discrediting America: The Urgent Need to Reform the Nation's Credit Reporting Industry 11 (Demos 2011). *See also* CFPB CRA Report, *supra* note 210, at 35 (noting that consumer advocates claim that CRAs tend to accept information from businesses at face value).

[215] *Supra* note 210.

[216] *See, e.g.*, Kim Phan, *Credit Reporting Remains a Top CFPB Priority*, CFPB MONITOR (Mar. 4, 2014), http://www.cfpbmonitor.com/2014/03/04/credit-reporting-remains-a-cfpb-top-priority/.

[217] *See* Barr et al., *The Case*, *supra* note 203.

(including consumers) affect its incentives to take advantage of consumer biases.

All owners want some financial return from the firm, but some owners value other things as well. It was argued that investor ownership creates stronger incentives to maximize profit above all else. The fact that arbitration clauses are very rare in credit card contracts written by credit unions was adduced as evidence for this claim, building on the evidence from other authors that predatory pricing terms exhibit a similar cross-firm pattern.

For some terms in consumer contracts, a firm is not only mediating between its own (its owners) interests and those of consumers, but also those of other constituencies contracting with the firm. When laying out the rules for these portions of the consumer relationship, firms have to take into account how the rules will affect consumers *and* the other contracting parties, balancing the interests. Drawing from the literature on “two-sided platform” dynamics, it was argued that reversal clauses follow the pattern of interchange fees: mediating disputes between consumers and merchants mostly in favor of consumers.

Once the institutional framework was grounded in the reality of credit card contracts, it was suggested that there could be relevance beyond the two clauses that provided the impetus for the analysis. Most relevantly for policymakers, a more sophisticated understanding of how firms with different structures make decisions can lead to a regulatory approach oriented toward encouraging structures that are likely to generate the desired contract terms beyond prohibiting or encouraging certain terms directly.