Louisiana Law Review

Volume 30 | Number 1
December 1969

Prescription of a Credit Card Purchase

Paul Spaht

against the desire and need for stability and efficiency with regard to transfers of commercial documents. The uniform laws were adopted to fulfill these needs with a minimum of formality. Nor should the absence of a notarial act arouse fear that the donor will not be protected against fraud and coercion. The Uniform Stock Transfer Act provides such protection by allowing rescission in the event an endorsement or delivery has been made under fraud, mistake, or duress.[57]

Fred Sutherland

PRESCRIPTION OF A CREDIT CARD PURCHASE

Suit was filed by a credit card corporation to recover a sum of money allegedly due for cardholder's purchases made seven years before from various business establishments. Defending cardholder answered, alleging that the credit card purchase was an open account and thus prescriptible in three years. No payments had been made between purchase and suit. *Held*, that the prescriptive period of three years was applicable, and that since the plaintiff was an assignee, the period had run. *Carte Blanche Corp. v. Pappas*, 216 So.2d 917 (La. App. 2d Cir. 1968).

Credit cards are a modern phenomenon,[1] and their increasing use has recently caused considerable debate as to the exact legal nature of the credit card transaction.[2] In the instant case, the main question confronting the court was the classification of the cause of action arising from a credit card purchase. It is settled that the prescriptive period for an obligation arising *ex contractu* is generally ten years,[3] and because there was a written contract between the plaintiff and the defendant it could be argued that a ten-year period would be applicable. On the other hand, the prescriptive period for an open account, which is also an obliga-

57. LA. R.S. 12:630 (1950).

1. The first case dealing with a credit card was Wanamaker v. Megary, 24 Pa. Dist. 778 (Phil. Mun. Ct. 1915). One of the best known credit card plans, Diners' Club, was founded in 1950. In 1964, there were approximately 70 consumer credit card plans in the United States. By 1967, the number of plans had increased to about 1,000. Wall Street Journal (Midwest Edition), Jan. 17, 1967, at 1, col. 8.

2. Bergsten, *Credit Cards—A Prelude to the Cashless Society*, 8 B.C. IND. & COM. L. REV. 485 (1967); Davenport, *Bank Credit Cards and the Uniform Commercial Code*, 1 VALPARAISO U.L. REV. 218 (1967); Comment, 48 CALIF. L. REV. 459 (1960); Note, 35 NOTRE DAME LAW. 225 (1960).

3. LA. CIV. CODE art. 3544: "In general, all personal actions, except those before enumerated, are prescribed by ten years."

tion arising *ex contractu*, is three years.[4] In view of this specific provision in the Civil Code that "accounts" are prescribed in three years, and numerous decisions holding likewise,[5] the court correctly decided this important issue.

It is less certain, however, that the credit card transaction should be treated as the "assignment" of an open account from the merchant to the credit card corporation. Although courts of other jurisdictions have used this theory to explain the three-party relationship,[6] there has been strong and well-reasoned criticism of these decisions.[7]

To analyze this criticism, it is first necessary to understand the credit card plan, which involves one card issuer, many cardholders, and many merchants. When a single purchase is made by means of the card, three contracts are involved. The agreement between the issuer and the cardholder provides that the latter will pay the former for purchases made by means of the card at approved stores, until notice of loss or theft of the card is received by the issuer. In exchange, the issuer promises to render monthly statements to the cardholder and to pay in his behalf all purchases made through the use of the card.[8] The second agreement—be-

4. *Id.* art. 3538: "The following actions are prescribed by three years:
". . . .
"That on the accounts of merchants, whether selling for wholesale or retail.
". . . .
"That on all other accounts.
"This prescription only ceases from the time there has been an account acknowledged in writing, a note or bond given, or an action commenced."

5. *E.g.*, United Carbon Co. v. Mississippi River Fuel Co., 230 La. 709, 89 So.2d 209 (1956); Frierson Co. v. Murray, 190 So. 132 (La. App. 2d Cir. 1939); Antoine v. Franichevich, 163 So. 784 (La. App. Orl. Cir. 1935), *aff'd*, 184 La. 612, 167 So. 98 (1936).

6. Gulf Ref. Co. v. Williams' Roofing Co., 208 Ark. 362, 186 S.W.2d 790 (1945); Union Oil Co. v. Lull, 220 Ore. 112, 349 P.2d 243 (1960); Diners' Club, Inc. v. Whited, Civ. No. A 10872, Los Angeles Super. Ct., Aug. 6, 1964, cited in Bergsten, *Credit Cards—A Prelude to the Cashless Society*, 8 B.C. IND. & COM. L. REV. 485 (1967).

7. Note, 35 NOTRE DAME LAW. 225 (1960); Note, 13 STAN. L. REV. 150 (1960). *See also* United States v. Golden, 166 F. Supp. 799 (S.D.N.Y. 1958); Texaco, Inc. v. Goldstein, 34 Misc.2d 751, 229 N.Y.S.2d 51 (1962), *aff'd*, 39 Misc.2d 552, 241 N.Y.S.2d 495 (1963). Both base their holdings, not on the assignment of an account, but on the fact that there is a contract between the issuer and the cardholder which imposes obligations upon each party.

8. A typical agreement may be seen on a Louisiana BankAmericard application: "The BankAmericard applied for herein is to be the property of the Bank. By retention or use of the card, holder named, and all users thereof, agree to be bound by the rules forwarded with the card and as follows: (1) to assume responsibility for credit extended by the Bank on the basis of the card; (2) to pay, at such place as this Bank designates, obligations evidencing such credit, and service charges where applicable, in accordance with billings and the current Customer Payment Schedule, including a rea-

tween the issuer and the merchant—obligates the latter to honor the card and to sell to the issuer all "charge slips" or "accounts" which evidence sales made to cardholders. In return, the issuer pays the merchant for the cardholder's purchases, less a discount of the gross amount of such "charges."[9] The third contract is the sale between the cardholder and the merchant.

The "assignment theory" attempts to explain the credit card plan by focusing attention on this last contract, that of sale between cardholder and merchant.[10] Once a sale has been made, the merchant is said to "assign" the account to the credit card corporation. The difficulty with this theory is that it ignores the two previous contracts entered into among the parties. When one looks at the tripartite relationship, it becomes apparent that the cardholder never expressly obligates himself to pay the merchant. A credit card sale is accomplished by the merchant's mere acceptance of the card, preparation of a cash sales slip, and then forwarding this slip to the issuer. In short, once there has been a sale, the cardholder is obligated to pay the issuer, not the merchant, so that no rights are acquired by the merchant which can be "assigned" by the merchant to the issuer.

A second explanation of the credit card transaction is the "direct obligation" theory, which recognizes that because of the three contracts there is a direct obligation existing between each of the three parties. The focal point in the cardholder-issuer relationship is their original contract and not the sale. By observing that the merchant parts with goods relying on the issuer's promise to pay rather than the buyer's, this second theory explains more completely the actual workings of a credit card purchase. In effect, the buyer's open account is not with the merchant, but with the issuer. Certainly, an account with the issuer was actually contemplated by the cardholder when he entered

sonable attorney's fee in the event of suit; (3) to notify Bank promptly in writing of loss of the card; (4) the card may be cancelled by the Bank at any time without notice; (5) to surrender the card upon demand; (6) to waive and release Bank from all defenses, rights and claims holder may have against any merchant or company honoring the card; (7) any claim of Bank against holder shall at Bank's option become immediately due and payable if holder fails to perform any terms hereunder or make any payments as otherwise agreed; (8) all transactions involving credit extended by Bank on basis of the card shall be controlled by the laws of Louisiana which are hereby expressly adopted to control all transactions hereunder."

9. The discount for bank credit card plans average under 3%. *See* Taylor, *On the Road to a Cashless Society*, CONTEMPORARY MAGAZINE (published by the Denver Post, Inc.), July 14, 1954, condensed in READER'S DIGEST, August, 1968, at 187.

10. The terms "assignment theory" and "direct obligation theory" were coined in Comment, 48 CALIF. L. REV. 459 (1966).

into the contract with it. Because there is still an open account, the three-year prescription period remains applicable.[11]

The "direct obligation" theory has the advantage of permitting a separate analysis of each of the three contracts in the credit card plan. The legal relationship existing between the cardholder and the issuer in many respects resembles that of mandate, with the issuer serving as mandatary for the cardholder. The issuer acts for the cardholder by paying the latter's charges at approved stores;[12] the issuer is bound to render a monthly accounting to the cardholder;[13] the cardholder is required to reimburse the charges made by the issuer incurred in the execution of the contract;[14] and the relationship can be terminated at the will of the credit card company or the card holder.[15] Nonetheless, one difficulty with this analogy is that Louisiana decisions require that the principal exercise control over the agent.[16] In actuality, the credit card company is the initiating and dominating party, and it might be questioned whether the cardholder controls the credit card company. On the other hand, it can be argued that the cardholder does exercise this control, in view of the fact that he can either make purchases or not, thus either obligating or not obligating the issuer to act.

With regard to the issue of prescription, the importance of using the direct obligation theory rather than the assignment theory lies in fixing a starting point for the running of time. If the credit card transaction is viewed as the assignment of the merchant's rights to the issuer, prescription starts at the moment the merchant could collect from the cardholder. Since an assignee obtains no better rights than the assignor,[17] prescription would

11. Reddick v. White, 46 La. Ann. 1198, 15 So. 487 (1894). Speaking of the application of the three-year prescriptive period to accounts for goods sold, the Court said "that prescription refers to accounts for goods sold, and merchants' accounts against their customers, and generally to those business or other relations in which accounts are usually rendered." *Id.* at 1207, 15 So. at 490.

12. *See* LA. CIV. CODE art. 2985: "A *mandate, procuration* or *letter of attorney* is an act by which one person gives power to another to transact for him and in his name, one or several affairs."

13. *Id.* art. 3004: "He is obliged to render an account of his management, unless this obligation has been expressly dispensed with in his favor."

14. *Id.* art. 3022: "The principal ought to reimburse the expenses and charges which the agent has incurred in the execution of the mandate, and pay his commission where one has been stipulated."

15. *Id.* art. 3027: "The procuration expires:
"By the revocation of the attorney . . . ."

16. White v. Hudspeth, 147 So.2d 874 (La. App. 3d Cir. 1962), *cert. denied*, 243 La. 1018, 149 So.2d 768 (1963); Donovan v. Standard Oil Co. of La., 197 So. 320 (La. App. 2d Cir. 1940); Graham v. American Employers' Ins. Co., 171 So. 471 (La. App. 2d Cir. 1937).

17. Harris v. Westwood Homes, Inc., 191 So.2d 702 (La. App. 4th Cir.

run against the credit card company even in the interim between the sale and the notification thereof to the issuer. This effect of the assignment theory seems unfair. After all, it is the issuer who will suffer from the merchant's delay. Using the assignment approach, it is theoretically possible that the issuer could lose his action against the cardholder without even knowing that a sale had been made. On the other hand, the insertion in most merchant-issuer contracts of a relatively short time period within which the merchant is required to notify the issuer of the sale lessens this possibility.[18]

The direct obligation theory allows the use of a more equitable starting point for the running of the prescriptive term. As mentioned earlier, this second approach recognizes that the cardholder has an open account with the issuer and that a three-year prescriptive period is applicable. As to the starting point for this period, it ideally should commence when both parties are certain of the exact amount of the indebtedness, for it is only at that moment that the creditor has the opportunity to collect or the debtor to pay. By Act 118 of 1852, the term for an open account commenced at the moment the articles charged were furnished to the purchaser.[19] However, this act is no longer incorporated in the Revised Statutes, and the three-year term for an open account now seems to begin as of the date of the entry of the debit in the creditor's account book.[20] The advantages of using this starting point for the running of prescription in the credit card plan, rather than the sale, would be many. The issuer

1966); Castille v. Glassell-Taylor Co., 18 So.2d 839 (La. App. 2d Cir. 1944); RESTATEMENT OF CONTRACTS § 167, Comment 1 (1932); 4 A. CORBIN, CONTRACTS § 892 (1951); S. WILLISTON, LAW OF CONTRACTS § 432 (1 vol. rev. ed. 1938).

18. In the Louisiana BankAmericard Member Agreement there is the following stipulation: "Each sales draft and each credit voucher shall be delivered to Bank not later than the third banking business day following the date of issuance." Carte Blanche Corporation and American Express each allow ten days for delivery. Diners' Club allows the submission of credits for a period of thirty days after their issuance.

19. La. Acts 1852, No. 118, § 1: "That the accounts of retailers of provisions and liquors, and the accounts of all merchants, whether selling for wholesale or retail, within this state, shall be prescribed by the lapse of three years, from the time the articles charged shall have been furnished to the purchaser . . . ."

20. Although no case could be found directly on point, the following cases use this starting point in their reasoning: Sleet v. Sleet, 109 La. 302, 33 So. 322 (1903); Frieburg v. Rembert, 213 So.2d 104 (La. App. 1st Cir. 1968); *In re* Succession of Magee, 79 So.2d 137 (La. App. 1st Cir. 1955); Deluxe Filling Station v. Mee, 152 So. 784 (La. App. 2d Cir. 1934); Holmes Co. v. Hiller, 7 La. App. 590 (1928); Harper v. Barton, 2 La. App. 317 (1925).

If credit or credits are entered subsequent to the last debit entry, then the three-year term begins as of the date of the last credit entry. Ritchie Grocer Co. v. Dean, 182 La. 518, 162 So. 62 (1935); Frieburg v. Rembert, 213 So.2d 104 (La. App. 1st Cir. 1968); Frierson Co. v. Murray, 190 So. 132 (La. App. 2d Cir. 1939).

would not be threatened with the loss of all or part of his action against the cardholder without even knowing that a sale had been made. Since the cardholder would not be forced to pay the issuer until the former received his monthly statement, the cardholder's rights would not be unduly prejudiced. At the same time, if the cardholder desired to make an earlier payment, he would at least know the amount of such payment, as evidenced by the receipt he is given for each of the purchases. If the relationship between the cardholder and the issuer were treated as one of mandate, the same three-year period and starting point would be applicable. The cardholder-principal would simply have an open account with the issuer-agent:[21] a relationship which appears to have been contemplated by the Civil Code.[22]

The selection of either the assignment theory or the direct obligation theory is important for a second reason. The appropriate classification of the credit card transaction determines the defenses and counterclaims available to the cardholder.[23] Under the assignment theory the principles of assignment would determine the cardholder's rights against the issuer. Since an assignee obtains no greater rights than the assignor,[24] the cardholder could assert any defense against the issuer which he could have asserted against the merchant. As to counterclaims available to the cardholder,[25] a distinction arises depending upon whether the contract was formed in Louisiana or elsewhere. If the contract were made in this state the obligor could assert those counterclaims against the assignees which arose prior to the obligor's receiving notice of the assignment.[26] If the contract were formed outside this state, which is quite likely due to the

21. The claim of an agent against his principal is generally treated as a contract for services prescribed in ten years. Masset v. Baldwin Piano Co., 186 La. 356, 172 So. 418 (1937); Millaudon v. Lessups, 17 La. Ann. 246 (1865); Cooper v. Harrelson, 12 La. Ann. 631 (1857). However, if the principal maintained an open account with the agent, then a three-year prescriptive period would seem to be applicable.

22. *See* LA. CIV. CODE art. 3004.

23. For an excellent discussion of the effect of the two suggested theories on available defenses and counterclaims, *see* Comment, 48 CALIF. L. REV. 459 (1960).

24. *See* cases cited note 17 *supra.*

25. 4 A. CORBIN, CONTRACTS § 896 (1951): "When we say that a defendant has a counterclaim, we mean that the plaintiff has committed a breach of duty to the defendant. Each party has done wrong; each is entitled to a remedy, although there must be an adjustment of remedies."

26. LA. CIV. CODE art. 2212: "The debtor, who has accepted purely and simply the transfer which a creditor has made of his right to a third person, can no longer oppose to the latter the compensation which, before the acceptance, he might have opposed to the former.

"As to the transfer which has not been accepted by the debtor, but

enormous size of many of the credit card plans, the cardholder could assert against the issuer all counterclaims, regardless of when notice was received, with one exception: the cardholder could not assert those counterclaims which matured after receipt of the notice, if the origin of the counterclaim was a collateral transaction.[27]

If the direct obligation theory were accepted, the defenses and counterclaims available to the cardholder are not clear. In regard to possible defenses, it has been suggested that the cardholder's promise to pay the issuer should be interpreted as conditional, the performance of which is dependent on satisfactory completion of the sales.[28] Thus, if defective goods were sold, the cardholder would be able to assert this defense against the issuer. This analysis of the cardholder's obligation is largely the result of policy considerations, which recognize the fact that the issuer, equipped with vast resources, would have a greater chance of recovering from the merchant than the cardholder.[29] However, it is questionable whether this analysis should be accepted. It would seem better to interpret the cardholder's promise to pay the issuer as unconditional. If defective goods were sold, the cardholder would still be able to seek relief from the merchant. Although this second interpretation could cause a loss to the cardholder—for example, if the merchant went bankrupt after selling defective goods—the cardholder would be in no worse position than if he had made his purchases without the card. If the issuer was viewed as a mandatary, he would be able to assert some defenses, but only those based upon the issuer's fault or neglect.[30] An example of this neglect would be the issuer's approval of a merchant whose reputation for the sale of faulty goods was notorious. In regard to counterclaims, the direct obligation theory has the advantage of disallowing the cardholder any counter-

---

which has been notified to him, it hinders only the compensation of credits posterior to that notification."

Thus, the cut-off for the assertion of counterclaims against the assignee is the receipt by the obligor of notice of the assignment. Falls, Howell & Co. v. Thoms & Powell, 22 La. Ann. 173 (1870); Gray v. Trafton, 12 Mart. (O.S.) 702 (1823); P. P. Williams & Co. v. Roach, 125 So. 465 (La. App. 2d Cir. 1929).

27. 4 A. CORBIN, CONTRACTS §§ 896, 897 (1951); Comment, 48 CALIF. L. REV. 459 (1960).

28. Comment, 48 CALIF. L. REV. 459 (1960).

29. Bergsten, *Credit Cards—A Prelude to the Cashless Society*, 8 B.C. IND. & COM. L. REV. 485 (1967).

30. LA. CIV. CODE art. 3003: "The attorney is responsible, not only for unfaithfulness in his management, but also for his fault or neglect.

"Nevertheless, the responsibility with respect to faults, is enforced less rigorously against the mandatary acting gratuitously, than against him who receives a reward."

claims against the issuer which he might have been able to assert against the merchant.[31] A counterclaim is based upon a breach of duty by both the plaintiff and the defendant. In such a situation, it would be more equitable to force the cardholder to seek relief by asserting this counterclaim against the merchant, rather than burdening the innocent issuer with troublesome litigation.

Although few credit card suits have arisen,[32] an increasing use of credit cards will certainly occur.[33] For this reason, an accurate understanding of the nature of the credit card transaction is essential. Unfortunately, most of the merchant-issuer contracts speak of the "assignment" of the "invoices" to the credit card company. Nevertheless, this language could be best understood by viewing this transfer, not as the assignment of a right which never existed, but merely as the "assignment" of the invoice itself, necessary for the workings of the plan.

In the instant case, regardless of whether the court had used the assignment or direct obligation theory, prescription would have run. For cases arising in the future, however, it would be more realistic to focus attention on all three contracts entered into in the credit card relationship, and not merely on the sale. As to the loss of the issuer's action against the cardholder because of liberative prescription, the credit card company will receive better protection at no substantial sacrifice of the cardholder's rights. In addition, recognition of the direct obligation between the cardholder and the credit card company has the advantage of allowing the cardholder to assert neither defenses nor counterclaims against the issuer, unless the issuer were to be considered the cardholder's mandatary. If this last relationship were to be accepted, then the cardholder would be able to assert those defenses based only upon the issuer's fault or neglect.

Paul Spaht

31. A. CORBIN, CONTRACTS § 896 (1951): "When we say that a defendant has a counterclaim, we mean that the *plaintiff* has committed a breach of duty to the defendant." (Emphasis added.) Comment, 48 CALIF. L. REV. 459, 472 (1960): "A counterclaim must be based upon a cause of action which could have been brought against the *plaintiff*." (Emphasis added.)

32. An explanation of this fact is the low percentage of defaults as well as the reluctance of issuers for reasons of public relations to sue. In fact, up to 1966, there had been only twenty reported cases involving credit cards. Bergsten, *Credit Cards—A Prelude to the Cashless Society*, 8 B.C. IND. & COMM. L. REV. 485 (1967).

33. *See generally* Murray, *A Legal-Empirical Study of the Unauthorized Use of Credit Cards*, 21 U. MIAMI L. REV. 811 (1967); *Toward a Cashless Society*, TIME MAGAZINE, Nov. 5, 1965, at 97.