

USE OF CHARGE-BACKS AS A FORM OF
CONSUMER PROTECTION

Stakeholder Consultation Document

WHAT IS THE ISSUE?

On May 25, 2001, federal, provincial and territorial Ministers responsible for consumer affairs met in St. John's, Newfoundland to discuss consumer protection in light of a rapidly changing and more complex marketplace.

The Conference's key outcome was that the Ministers in attendance endorsed the Internet Sales Contract Harmonization Template (the Template) to aid provinces and territories to amend their consumer protection legislation.

The Template introduces a credit card charge-back provision to provide consumers redress if they lawfully cancel credit card purchases made on the Internet, but do not receive reimbursement from the vendor. In instances where, for example, a vendor fails to deliver within 30 days of the date promised and fails to provide a refund after the consumer lawfully cancelled the contract, a consumer could require the credit card issuer to reverse the credit and associated interest charges.

What is a charge-back?

It is a voluntary policy of most credit card issuers to look into a charge that is disputed by the cardholder.

If the credit card issuer finds the charge to be unsubstantiated, the issuer will refund the amount to the cardholder.

A credit card issuer may be under a legal obligation to process charge-back claims (e.g. under the *Fair Credit Billing Act* in the United States).

The charge-back, whether voluntary or required legally, is not an obligation to reverse charges. Rather it is an obligation to review disputed charges and to reverse the charge only where the charge is not substantiated.

The consultation comments of key stakeholders were considered in arriving at a final document. During consultation on the Template, some stakeholders raised the question of whether charge-back provisions should be applied to off-line sales in addition to e-commerce transactions.

In endorsing the Template, Ministers directed officials, through the Consumer Measures Committee (CMC), to examine options for extending charge-back rights to other forms of commerce.

As a result of this direction, the CMC, a committee of representatives from federal, provincial and territorial governments, is consulting with the public regarding how to implement the charge-back remedy in consumer protection law.

WHY IS THIS AN ISSUE?

Treating consumers differently simply because of the use of different sales channels, or treating sales channels differently, has the danger of inequity. It is also inconsistent with the developments of electronic commerce, in which businesses are increasingly moving to integrated customer service. Such integration provides the same level of customer service through a variety of different channels. Business generally has concluded that giving consumers substantially different treatment based on the communications medium they use is not viable. Similarly, Consumer Ministers have indicated that levels of consumer protection should be consistent on and off-line.

This was evident during consultation on the Template, where the question arose of why, if charge-backs are a fair tool to supplement a statutory cancellation right in e-commerce, they should be applied only to e-commerce. For example, should the senior citizen trying to cancel a door to door contract under a statutory cooling off period, and unable to get an answer from the telephone number left by the seller not also be able to charge back on their credit card?

As a result of the questions raised by stakeholders, the Ministers asked the CMC to consider the appropriate scope for a charge-back remedy. Do the arguments support limiting the use of a statutory charge-back remedy to electronic commerce; or should such a remedy apply in other circumstances? If so, in what circumstances?

Some provinces have already taken a policy direction on this issue. For example, Quebec will be extending charge-back remedies beyond e-commerce to all distance-selling transactions.

As part of its consideration of this issue, the CMC is seeking feedback from stakeholders. A preliminary analysis of the charge-back remedy indicates that it could be applied in a number of different ways. The following discussion sets out options for the appropriate scope of a charge-back remedy.

POSSIBLE COURSES OF ACTION

Questions in applying a current credit card charge-back remedy include whether it should apply to sales channels other than the Internet, to transactions where there is no statutory right of cancellation and to payment instruments other than credit cards.

Option 1: Maintain Current Scope

The current scope of the charge-back remedy has several limits. It only applies to on-line purchases, or, in Québec, to distance sales; the consumer must use a credit card; and, the consumer must have used a statutory right to cancel the contract and failed to receive redress from the seller before they can seek a charge-back remedy.

United States

- *Fair Credit Billing Act* (federal) sets out a statutory charge-back remedy
- applies to any sales channel (i.e. not limited to on-line purchases)
- applies to open end credit accounts (e.g. credit cards, revolving charge accounts and overdraft checking accounts)
- applies to "billing errors" which includes unauthorized charges, correcting the wrong amount charged and goods/services not delivered as agreed

Option 2: Extend Application to Other Sales Channels

One argument underlying the adoption of charge-backs as a complement to contract cancellation is that the legal effect of contract cancellation under consumer law is to return the consumer to the position they would be in if the contract never existed. All related obligations incurred by the consumer on entering such a contract are also cancelled. For example, if a financing contract arises through a consumer sale, it is cancelled by the sales' cancellation. Although credit card charges are incurred under an ongoing agreement, the same argument may apply. The cancellation of a transaction negates the basis for the charge. With no basis for the credit charge, how can the charge continue to exist and accrue interest?

The Organisation for Economic Co-operation and Development (OECD) 1999 *Guidelines for Consumer Protection in the Context of Electronic Commerce* included an endorsement of the use and development of charge-back mechanisms in the field of e-commerce, especially for unauthorized and fraudulent payments. The *Guidelines* are a technology neutral international consensus on core consumer protection in business-to-consumer e-commerce transactions (consumers should not be less protected when buying online than they are when buying in store or by catalogue).

Logically, the converse is appropriate. Consumers should not have different legal protection against the same problem (e.g. non-delivery) when buying on-line than when buying in a store or by catalogue.

Option 3: Extend to Situations of Error Correction

According to a March 15, 2001 OECD report, titled *Working Group Report on Consumer Protections for Payment Cardholders*, three of the primary types of problems encountered by consumers in using payment cards are "I didn't receive it", "I didn't do it" and "I don't want it".

“I didn’t receive it” means the cardholder has been charged for the purchase but has not received the goods after a reasonable time. It may also include receiving an item completely different from what was ordered and non-receipt where the merchant goes bankrupt before honouring their obligation to a consumer.

“I didn’t do it” means unauthorized transactions, where a transaction is charged to the cardholder’s account without him or her having authorized it. Such transactions may be the result of fraud or processing error.

In the first instance, a charge-back remedy would be available if the purchase was made on-line, by credit card, and the consumer lawfully cancelled the contract. And under Option 2 above, it would be available regardless of sales channel. However, in the second instance, there is no statutory requirement for the credit card issuer to correct the error. Should there be a difference in the remedy available to a consumer, when the charges are legally invalid in both instances?

A third type of problem consumers face is "I don't want it" meaning, the good received does not match the quality expected. It may also include situations where the good/service is not fit for the purpose such as, concert tickets that arrive after the performance date. This discussion of billing errors excludes disputes about the quality of goods and services that arise in this category of consumer problems.

The United State’s *Fair Credit Billing Act* provides statutory obligations to address errors on credit card charges. It gives a right to have the above invalid charges reversed and not just those made invalid for one reason.

There has been a national agreement by Canadian jurisdictions to harmonize limits on consumer liability for erroneous credit card charges to a maximum of \$50. However, unlike the United States, there is no corresponding positive obligation on a credit card issuer to correct errors in such charges. The United States provides both limits on liability and the responsibility to correct.

If a credit card issuer does not correct the error and the cardholder does not pay the charge, the issue will likely be forwarded to a consumer/credit-reporting agency. If the consumer complains to the agency that the charge was in error, the agency has a legal obligation (in most Canadian jurisdictions) to verify the information and correct or delete it if not substantiated. Would it be appropriate for the credit card issuers who originate the charge to have the same positive obligation to correct or delete information that is in error?

A 1999 study of charge-backs internationally by the Public Interest Advocacy Center found that, at that time, Canadian cardholder agreements did not mention the possibility of charge-backs. Since then, some companies have begun to use freedom from liability for unauthorized charges, and thus the ability to charge-back, as a marketing measure. However, the disclosure of this mechanism to Canadian consumers still trails the US.

Given consumers' fear that credit card use online will lead to false or fraudulent charges, statutory measures to provide clear redress for erroneous charges would likely increase consumer confidence.

What level of burden would broader charge-back rights impose on sellers or credit card issuers? Credit card issuers have mechanisms in place to reverse charges and correct errors. Sellers already have a responsibility to refund monies in the event of statutory cancellation.

Option 4: Extend to Other Payment Methods

The OECD lists four main types of payments cards available to consumers.

a) "Pay later" cards

- Chargecards/deferred debit cards – where the total amount incurred with the card in a billing period must be settled at once by a date agreed upon in the contract.
- Credit cards – where (part of) the amount due may be rescheduled at the end of the fixed period and paid by installments. The credit card gives access to a line of credit.

b) "Pay now" cards

- Debit cards – where the amount due is immediately deducted from the cardholder's account.

c) "Pay before" cards

- Stored value/pre-paid cards – a card on which value can be stored (electronically, on a microchip, etc.). The value diminishes as the card is used to make payments. Some of these cards can be reloaded.

A card's classification is not always apparent on its face and depends on the contract between the card issuer and the cardholder. If credit card companies are required to reverse charges that are fraudulent or erroneous, is it reasonable for other payment mechanisms to provide this remedy?

Financial intermediaries, such as credit card issuers, have a unique position as gatekeepers that track the flow of funds between consumer and seller on specific identified transactions. However, are credit cards issuers unique in their ability to provide charge-backs? Should this be a consideration for all payment systems?

There are some payment mechanisms that would not be appropriate for a charge-back framework. For example, a consumer paying cash cannot approach the Bank of Canada to refund their money if the vendor fails to do so.

However, are there other payment mechanisms that would be appropriate for a charge-back remedy? For example, payment for a timeshare by promissory note may be an instrument to address by a similar remedy. It is counter-intuitive, if a transaction is cancelled, for a related promissory note to remain in effect.

When consumers use a “pay now” card, such as a debit card, there is the possibility for erroneous or unauthorized transactions to occur, similar to when a credit card is used. Does the fact that payment is immediately deducted from a consumer’s account when using a debit card make a charge-back framework inappropriate or could financial institutions be an intermediary in such instances as in credit card transactions?

ADDITIONAL ISSUES

Regardless of the option selected, there are two additional issues that should be settled before implementation of a charge-back policy.

a) Time Limits

A common limitation on consumer redress is time. Limits are placed on the time in which a consumer may lodge a complaint and the time a credit card issuer may use to conduct an investigation and resolve a dispute. Time limits may vary based on the nature of the transaction or the nature of the complaint.

b) Disclosure of Rights

In Canada, charge-back provisions are usually stated in merchant agreements with a credit card company stating the conditions under which the company may refuse to credit the merchant's account or to charge back the amount of credit card sales. However, cardholder agreements make no mention of charge-backs although credit card companies are known to engage in the practice where there is satisfactory evidence to justify it.

c) Obligations between merchant and credit card company

Much of the discussion regarding charge-backs focuses on the obligations between the consumer and the merchant and between the credit card company and the consumer. However, the obligations between the merchant and the credit card company are often ignored, yet, they are essential to closing the charge-back loop. When a credit card company credits a consumer as a charge-back remedy, the company is owed money in the amount of the sales transaction. Credit card companies may be more likely to fulfill their obligations to cardholders if there were assurances of clear obligations in their relationship with merchants. Should any provisions guide the relationship between credit card companies and merchants in the charge-back determination process? What are the parameters of the demands that a credit card company should make on a merchant in establishing the validity of a charge-back claim?

YOUR VIEWS

The CMC has been tasked to examine options for extending charge-back rights to other forms of commerce. The CMC needs the input and advice of consumers and businesses to make fair, equitable and practical recommendations.

To assist us with this task, we ask for your responses to the following questions. Please provide an explanation for your answers.

Consultation Questions

1. Should the statutory charge-back remedy for contract cancellation rights be extended to apply to all sales channels in addition to Internet sales contracts, and, in the case of Québec, for distance sales?
2. Should the statutory charge-back remedy be extended to apply to situations of error correction?
3. Should the statutory charge-back remedy be extended to apply to payment mechanisms in addition to credit cards? If yes, to which payment mechanisms should it apply?
4. What sort of time limits should be included in a charge-back system?
5. Should there be a requirement for disclosure regarding charge-back rights?
6. Should the obligations between credit card companies and merchants be addressed in the charge-back remedy?

Please submit your written responses to the following address by March 22, 2002:

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