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UNSTACKING THE DECK? CONTRACT MANIPULATION AND CREDIT CARD ACCOUNTABILITY

*Eric A. Zacks**

This Article examines and critiques the revised legal framework for interpreting and enforcing consumer credit card agreements under the federal Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009. Credit card issuers have historically prepared credit card agreements in their favor in a “race to the bottom,” regardless of regulatory requirements or enforcement mechanisms. This Article argues that many reforms mandated by the CARD Act may be ineffective, or at best, incomplete, with respect to creating effective and informed contracts. Rather than addressing fundamental flaws in the credit card agreement negotiation context regarding asymmetries of information, incentives, and resources, the CARD Act generally attempts to solve problems by relying on passive disclosure processes that are based on unrealistic assumptions about individual debtors’ likely responses and existing enforcement regimes. Instead, this Article recommends establishing ex ante default rules and ex post presumptions of enforceability that align issuers’ profit incentives with the desire for meaningful and timely disclosure of material contract terms. The contractual regime’s flaws could be further remedied through mechanisms designed to demonstrate and ensure credit card holders’ knowing assent to the initial or amended terms of credit card agreements. Finally, the limits of the CARD Act could be addressed through other ex post mechanisms designed to address contractual issues after they arise, including permitting collective remedial actions with respect to similarly situated holders. These solutions are offered not as a perfect antidote to the asymmetries identified above, which may be structural, but instead as tools to assist in preventing, as well as providing redress for, outcomes that are predicated on the exploitation of those same asymmetries.

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I. INTRODUCTION

The public outcry over credit card agreements and disclosures has reached a feverish pitch in recent years.¹ Complaints about hidden fees, retroactive interest rate changes, and mandatory individual arbitration clauses have risen, especially in light of the economic struggles of the past few years.² These unfavorable contractual features suggest the need for additional reform to the legal framework governing credit card agreements.

Traditionally, form contracts such as credit card agreements have been used to simplify and streamline repeated and repeatable transactions.³ In the credit card context, financial institutions that issue credit cards (Issuers) may be entering into agreements with thousands of consumers seeking to obtain a credit card (Holders). From an Issuer's viewpoint, it is rational to expend time and resources to ensure that the credit card agreement meets the Issuer's desires and needs on a mass scale. From a Holder's viewpoint, however, there are factors and limitations that make it irrational, unlikely, or, even worse, impossible, for the Holder to negotiate effectively the credit card agreement. These factors and limitations, well-known to Issuers, create opportunities that are exploited to the benefit of Issuers without the knowledge or desire of Holders.⁴ This exploitation of asymmetrical information and (generally)

1. See, e.g., Steven Gray & Michael Peltier, *Exposing the Credit-Card Fine Print*, TIME, Feb. 21, 2008, available at <http://www.time.com/time/magazine/article/0,9171,1715293,00.html> ("There has never been such a spotlight on the [credit card] industry [with respect to issuer practices]" (quoting Curtis Arnold, founder of CardRatings.com, a website offering credit card guidance)). Gray and Peltier also find that "[t]he added interest and late fees . . . are feeding a consumer backlash that is gaining strength." *Id.*; Amy Schatz, *White House to Put Credit-Card Rates in Cross Hairs*, WALL ST. J., Apr. 20, 2009, at A3; David Lazarus, *It's Time To Hold Credit Card Issuers to Account*, L.A. TIMES, Mar. 4, 2009, at B1; Eileen Ambrose, *Card Issuers Become Wary, Leaving Consumers Pinched*, L.A. TIMES, Sept. 16, 2007, available at <http://www.latimes.com/sns-yourmoney-0916cards,0,4027435.story>; see also Julie L. Williams & Michael S. Bylsma, *A Renewed Federal Focus on Credit Card Disclosures*, 61 BUS. LAW. 867, 867 (2006) ("The perception that card issuers—and federally required disclosure statements—have failed to adequately inform consumers about certain material credit card terms and conditions has led to increased consumer complaints, criticism of card issuers, and criticism of federal disclosure rules.").

2. See, e.g., Editorial, *The Credit Card Squeeze*, N.Y. TIMES, May 10, 2009, at WK7 ("Many credit card holders are complaining about unexpected increases in fees or interest rates that double or triple for no reason."); Drew Griffin & Kathleen Johnston, *Credit Card Holders Livid About 'Rate-Jacking'*, Dec. 17, 2008, <http://www.cnn.com/2008/US/12/17/credit.card.rates/index.html>; Connie Prater, *Proposed credit card rule changes draw massive response*, CREDIT CARDS.COM, Aug. 8, 2008, <http://www.creditcards.com/credit-card-news/unfair-practices-credit-cards-1282.php> (noting that the Federal Reserve Board had received over 56,000 responses (a record response) from banks, credit unions, credit card users, and advocates to proposed credit card industry regulation).

3. Melvin Aron Eisenberg, *The Limits of Cognition and the Limits of Contract*, 47 STAN. L. REV. 211, 243 (1995).

4. See Oren Bar-Gill, *Seduction By Plastic*, 98 NW. U. L. REV. 1373, 1373 ("The contract, itself

resources and other situational factors often results in contracts that are neither knowingly made nor efficient from the Holder's perspective.

Against this backdrop, the federal Credit Card Accountability Responsibility and Disclosure (CARD) Act of 2009 was enacted.⁵ The CARD Act attempts to address certain flaws of the current contracting framework by mandating certain disclosures, prohibiting or limiting certain billing practices or fees, providing time periods during which consumers may terminate the contractual arrangement following unfavorable changes to the agreement's provisions, altering the format of certain disclosures, and restricting credit card agreements with individuals below a certain age.

This Article contends that many reforms mandated by the CARD Act may be ineffective, or at best, incomplete, with respect to creating voluntary knowing contracts. Rather than addressing fundamental flaws in the credit card agreement context regarding asymmetries of information, incentives, and resources, the CARD Act generally attempts to solve problems by relying on passive disclosure processes that are based on unrealistic assumptions about individual Holders' likely responses and existing enforcement regimes. Instead, the contractual regime's flaws could be addressed by establishing *ex ante* default rules and *ex post* presumptions of enforceability that align Issuers' profit incentives with the desire for meaningful and timely disclosure of material contract terms. These default rules would be strengthened further by introducing mechanisms designed to demonstrate and ensure Holders' knowing assent to the initial or amended terms of credit card agreements. The limits of the CARD Act also could be remedied through other *ex post* mechanisms designed to address contractual issues after they arise, including permitting collective remedial actions with respect to similarly situated Holders. These solutions are offered not as a perfect antidote to the asymmetries identified above, which may be structural in part, but instead as tools to assist in preventing, as well as providing redress for, outcomes that are predicated on the exploitation of those same asymmetries.

Part II of this Article describes generally the "situation" of credit card agreements prior to the enactment of the CARD Act. Part III then describes the CARD Act's various provisions and provides a critical analysis from behavioral, efficiency, and fairness perspectives. Next,

commonly designed by the [Issuer], will be shaped around consumers' systematic deviations from perfect rationality... [C]ompetitive forces compel sellers to take advantage of consumers' weaknesses.").

5. Credit Card Accountability, Responsibility and Disclosure Act of 2009, Pub. L. No. 111-24, 123 Stat. 1734 (codified in scattered sections of 15 U.S.C.) [hereinafter The CARD Act].

Part IV suggests various alternatives or complements to the credit card agreement regime as modified by the CARD Act to remedy existing asymmetries of information and control with Issuers' profit incentives. Consequently, these solutions will be designed to address shortcomings within both the existing regulatory regime as well as the common law and will address these issues on an ex ante and ex post basis. Lastly, Part V concludes this Article by suggesting that the CARD Act is flawed in several aspects and likely will not address the structural flaws within the credit card agreement regime. Absent additional reforms, such as those suggested in this Article, Issuers and Holders may continue to enter into credit card agreements that do not reflect the actual desires of both parties.

II. THE CREDIT CARD AGREEMENT CONTEXT

It has been suggested that the credit card market is the "perfect example of a democratized market" involving a "world of contracts of adhesion, with terms and conditions set by the seller with no realistic prospective of negotiation."⁶ Credit card agreements, similar to many consumer contracts, typically are standard form contracts offered on a "take it or leave it basis," where the Issuer provides the Holder with a contract containing all of the business terms with respect to the transaction with little or no opportunity for negotiation.⁷

Theoretically, standard form contracts can be beneficial for both parties by reducing transaction costs, because the time and expense for negotiation and bargaining will be reduced.⁸ For example, Issuers and Holders will not have to start "from scratch" with respect to every term contained in a credit card agreement, which may range from payment terms to choice of venue for disputes. In particular, standard form contracts that are not subject to negotiation permit sellers to "standardize their risks and reduce bargaining costs by offering one set of terms to all consumers."⁹ With respect to many Holders who do not carry a balance from month to month and therefore may not care about the agreement's terms (because they will never be paying interest or late fees), a preprinted agreement may reduce the hassle and cost of negotiating such

6. Samuel Issacharoff & Erin F. Delaney, *Credit Card Accountability*, 73 U. CHI. L. REV. 157, 166-67 (2006).

7. Michael I. Meyerson, *The Efficient Consumer Form Contract: Law and Economics in the Real World*, 24 GA. L. REV. 583, 594 (1990); see also Robert A. Hillman & Jeffrey J. Rachlinski, *Standard-Form Contracting in the Electronic Age*, 77 N.Y.U. L. REV. 429, 435 (2002).

8. See Meyerson, *supra* note 7, at 594.

9. Hillman & Rachlinski, *supra* note 7, at 439.

terms.

The lack of negotiation, however, may be problematic for those Holders who lack credit alternatives or do not negotiate as a result of certain behavioral biases.¹⁰ At least with respect to many subordinate contract terms (generally other than basic price and payment), locating alternative sources for the consumer good (such as consumer credit) “imposes significant additional transaction costs.”¹¹ For example, a Holder would have to seek out a different Issuer that uses a different standard form credit card agreement without losing the benefits of the current Issuer’s interest rate or other terms. Even if there were Holders whose credit card agreements did not contain a particular unfavorable contract term, such as a mandatory binding individual arbitration clause (as discussed in Part III.E, *infra*), the cost in terms of time and money to the Holder likely would be significant and definite, while the benefit may be uncertain (as the Holder would not know, or be able to estimate accurately, the likelihood of a dispute in the future).¹²

Moreover, certain behavioral biases suggest that Holders will not negotiate such terms even in the absence of such transaction costs. One such bias is the status quo bias, which is the general preference of individuals for the status quo even in the absence of an efficient allocation of rights (i.e., what the individuals would have bargained for absent the status quo).¹³ In this context, the status quo bias suggests that Holders, upon receipt of the credit card agreement, presumably through the mail, will believe that the credit card agreement represents the status quo and, consequently, are unlikely to challenge its provisions.¹⁴ In particular, it has been suggested that the agreement’s appearance as a formal legal contract will “induce deference.”¹⁵ The status quo bias is further reinforced to the extent that a Holder would likely encounter resistance to change with respect to any attempted negotiations with an Issuer’s agent. For example, if a Holder contacted an Issuer customer service representative over the telephone to negotiate a particular contractual term, the Issuer’s representative would likely inform the

10. See also Robert Prentice, *Contract-Based Defenses in Securities Fraud Litigation: A Behavioral Analysis*, 2003 U. ILL. L. REV. 337, 361–62 (2003) (noting that “[c]onsumers and investors not only think that adhesion contracts are generally nonnegotiable, they are correct (practically speaking) in so thinking.”).

11. Meyerson, *supra* note 7, at 600.

12. See *id.*

13. See Prentice, *supra* note 10, at 371.

14. *Id.* at 372.

15. *Id.* But see Meyerson, *supra* note 7, at 595 (suggesting that “consumers are well able to determine the subjective value of such purchases and can find a different seller, or forego a particular purchase altogether, if the deal is not perceived to be in their best interest.”).

Holder that the representative could not by herself change the term and that an exception was unlikely.¹⁶ Compounding the issue in this context is that, unlike in many consumer sales contexts, no sales representative typically is present when the Holder is considering the credit card agreement, because it is often received through the mail.

In addition to the status quo bias, social proof, or “the notion that people in a particular situation tend to take their cues for correct behavior from others they observe,” suggests that Holders will be reluctant to negotiate a credit card agreements’ provisions because they perceive very few people attempting to do so.¹⁷ The tendency to experience more regret from negative situations resulting from actions an individual takes rather than inaction also may explain Holders’ reluctance to negotiate credit card agreements.¹⁸ In other words, Holders may prefer to end up in a negative situation with respect to credit card debt as a result of having not acted, than attempting to negotiate the credit card agreement.¹⁹

Beyond the lack of negotiation or negotiability of standard form contracts, many consumers do not read such contracts at all.²⁰ For example, borrowers typically “do not know the range of collection remedies available to the creditor, the myriad events that could trigger foreclosure, or that they must pay the creditor’s legal fees for collection procedures, but cannot recover their own fees even if they are successful in litigation.”²¹

It also may be in Issuers’ best interest to prepare credit card agreements that obscure, rather than disclose, the material terms of the credit card agreement. Generally, it is rational for the party with the most knowledge to prepare contract terms that shift the risk to the party

16. Prentice, *supra* note 10, at 372. Prentice expects that most “form takers” would “likely give up after being told that the agent had no authority to alter [the form contracts], that the forms came from the lawyers and could not be changed, or that an exception could not be made just for this particular investor [consumer].” *Id.* at 372–73.

17. *Id.* at 372–73.

18. Colin Camerer et al., *Regulation for Conservatives: Behavioral Economics and the Case for “Asymmetric Paternalism”*, 151 U. PA. L. REV. 1211, 1224 (2003) (describing the “tendency [of individuals] to care much more about errors of commission than about errors of omission, even when there is no obvious normative reason to draw a distinction.”); *see also* Prentice, *supra* note 10, at 376.

19. Prentice, *supra* note 10, at 376–7 (citing Russell Korobkin, *The Status Quo Bias and Contract Default Rules*, 83 CORNELL L. REV. 608 (1998), where Professor Korobkin described experiments demonstrating that law students selected default or alternate contract terms based on whether an affirmative act or choice was required).

20. Prentice, *supra* note 10, at 358–62; *see also* Michael I. Meyerson, *The Reunification of Contract Law: The Objective Theory of Consumer Form Contracts*, 47 U. MIAMI L. REV. 1263, 1269 (1993) (asserting that “[i]t is no secret that consumers neither read nor understand standard form contracts.”).

21. Meyerson, *supra* note 7, at 595–96.

lacking the knowledge to evaluate the cost of the risk.²² In this instance, one would expect financial institutions, as profit-maximizing entities, to prepare or furnish contracts that preclude or hamper Holders' ability to evaluate the risks and costs of various agreement terms. If Holders are unable to evaluate the costs because of knowledge asymmetries created or exploited by Issuers (as well as behavioral biases), then they will over-borrow or otherwise enter into agreements containing higher interest rates or other unfavorable contractual provisions without properly evaluating the negative costs associated with such agreements.

In the credit card agreement context, Issuers have in fact prepared agreements that are heavily tilted in their favor.²³ For example, Issuers often include contractual provisions that permit them to charge penalty or increased interest rates with respect to purchases that have already been made or (sometimes) already discharged.²⁴ In addition, Issuers typically reserve the right to increase interest rates because of a Holder's credit issues (such as late payments with other lenders or creditors) or for no reason at all.²⁵ Certain Issuers also have used questionable billing practices such as "double-cycle billing," which is when Issuers consider the outstanding balance for two billing cycles in assessing interest for the current month, or applying Holder payments towards the lowest

22. Meyerson, *supra* note 7, at 605.

23. Bar-Gill, *supra* note 4, at 1373 ("Absent legal intervention, the sophisticated seller will often exploit the consumer's behavioral biases. The contract itself, commonly designed by the seller, will be shaped around consumers' systematic deviations from perfect rationality This broad theme is developed within a detailed case study of the credit card market and the credit card contract."); *see also* Meyerson, *supra* note 7, at 595.

24. See JOINT ECON. COMM., VICIOUS CYCLE: HOW UNFAIR CREDIT CARD PRACTICES ARE SQUEEZING CONSUMERS AND UNDERMINING THE RECOVERY 9 (2009) [hereinafter VICIOUS CYCLE], http://jec.senate.gov/public/?a=Files.Serve&File_id=42840b23-fed8-447b-a029-e977c0a25544 ("Credit card companies have the incentive to include provisions to increase interest rates on existing balances because the debt held by credit cardholders is not secured by any underlying assets."); *see also* H.R. 627, *The Credit Cardholders' Bill of Rights of 2009*; and H.R. 1456, *The Consumer Overdraft Protection Fair Practices Act of 2009: Hearing Before the Subcomm. on Fin. Insts. & Consumer Credit of the H. Comm. on Fin. Servs.*, 111th Cong. 161 (2009) (statement of Travis B. Plunkett, Legislative Dir., Consumer Fed'n of Am.) [hereinafter *Plunkett Statement*] (noting that "[t]he primary effect of a punitive retroactive rate increase appears to be to escalate the proportion of the consumer's debt owed to the card issuer").

25. See JOSHUA M. FRANK, CTR. FOR RESPONSIBLE LENDING, PRICELESS OR JUST EXPENSIVE? THE USE OF PENALTY RATES IN THE CREDIT CARD INDUSTRY 4 (2008) [hereinafter FRANK], <http://www.responsiblelending.org/credit-cards/research-analysis/priceless-or-just-expensive.pdf> (noting that critics have asserted that issuers "want their customers to turn into these higher risk borrowers with few options because they can charge higher rates, yet do not need to be concerned about the customer leaving for a competitor"); Carolyn Carter et al., *The Credit Card Market and Regulation: In Need of Repair*, 10 N.C. BANKING INST. 23, 39 (2006) (noting Issuer use of universal default provisions designed to leave "consumers stuck to pay often high balances at interest rates far higher than was originally agreed, with devastating consequences"); *see also* *Plunkett Statement*, *supra* note 24, at 162.

applicable interest rate debt.²⁶ Perhaps the most alarming feature of credit card agreements is the Issuer's ability to change the credit card agreement's provisions and terms for any (or no) reason and at any time.²⁷

Current weaknesses in the disclosures contained in or accompanying credit card agreements also suggest that Issuers prepare such agreements in their favor in an attempt to maximize profits.²⁸ These weaknesses include an unreasonable reading level required to understand the disclosures and contractual provisions, inadequate presentation of information, and excessive detail and length.²⁹ One report found that comprehending most credit card agreements would require a twelfth-grade education, while approximately half of the U.S. population reads at about the eighth-grade level.³⁰ In addition, important information for credit card disclosures is frequently placed at the end of sentences or otherwise is unorganized.³¹ Formatting weaknesses, such as using tiny font, footnotes, improper emphasis on certain words or terms, and confusing headings, also can encumber comprehension of many credit card agreements and disclosures.³² Finally, the complexity of credit card disclosure documents, such as the use of unfamiliar or complex terms to describe simple concepts and inclusion of irrelevant detail, make it difficult and labor-intensive for a Holder to understand what she is signing.³³

26. *Plunkett Statement*, *supra* note 24, at 163 ("A consumer who begins with no balance and pays off most but not all of the purchases he or she makes in the first month would still be charged interest for the entire amount of the balance in the second month." (emphasis omitted)); Carter et al., *supra* note 25, at 42 (describing Issuer practices to allocate payments to account balances with the lowest interest rates). Issuers also typically include "ridiculously early" payment cut-off times for crediting payments received on a particular day. *Id.* at 43.

27. Carter et al., *supra* note 25, at 42 (describing Issuer practices to raise interest rates "through change-in-terms notices and use penalty fees with punitive late payment and over-limit policies to subsequently entrap consumers."); *Plunkett Statement*, *supra* note 24, at 162.

28. Comptroller of the Currency, Administrator of National Banks, Credit Card Practices, OCC Advisory Letter No. AL 2004-10 (Sept. 14, 2004), available at <http://www.occ.treas.gov/ftp/advisory/2004-10.doc> (cautioning national banks regarding current misleading or poor disclosure practices in credit card marketing and agreements).

29. U.S. GOV'T ACCOUNTABILITY OFFICE, CREDIT CARDS: INCREASED COMPLEXITY IN RATES AND FEES HEIGHTENS NEED FOR MORE EFFECTIVE DISCLOSURES TO CONSUMERS 33 (2006) [hereinafter GAO REPORT], available at <http://www.gao.gov/new.items/d06929.pdf>.

30. *Id.* at 37 (consequently concluding that the "disclosure documents provided to many cardholders likely were written at a level too high for the average individual to understand").

31. See Carter et al., *supra* note 25, (noting weaknesses in disclosures regarding "universal default" credit card agreement provisions); GAO REPORT, *supra* note 29, at 39.

32. GAO REPORT, *supra* note 29, at 41, 42-45 (detailing how formatting weaknesses "likely reduce[] the usefulness of typical credit card disclosure documents.").

33. *Id.* at 46; see also Prentice, *supra* note 10, at 372 (discussing the effect of the legal appearance of consumer contracts on consumers).

It has been suggested that Issuers choose to prepare their agreements in the manner described above deliberately to minimize potential legal liability.³⁴ For example, using simple language may raise the risk that a Holder will misinterpret a particular provision.³⁵ The lengthier disclosures also may be responses to court decisions or current regulatory guidance.³⁶ The most compelling argument, however, is that Issuers, responding to their incentive to maximize profit, prepare credit card agreements and disclosures that are “loaded with booby traps designed to trip consumers, and written in intentionally impenetrable and confusing language.”³⁷

Despite the publicity of credit card agreement “abuses,” it should be noted that credit card debt is not dangerous for much of the population.³⁸ The group that is likely to suffer the most from abusive credit card practices, however, is comprised of individuals in a poor position to address or remedy them.³⁹ This suggests that any reforms should be specifically tailored to addressing the costs suffered by the subset of the population that suffers from the costs of over-borrowing without unreasonably interfering with the use of credit cards by the balance of the population who do not suffer similarly.⁴⁰

III. THE CARD ACT’S REFORMS

The CARD Act introduces many reforms into the credit card agreement legal framework, which range widely from reliance on substantial government enforcement of enhanced restrictions or new

34. GAO REPORT, *supra* note 29, at 51.

35. *Id.* at 51–52.

36. *Id.* at 52. Interestingly, the GAO report does not identify the likely primary reason for inadequate disclosure, namely, the profit incentive of Issuers in the context of standard form contracting.

37. *Id.* at 46 (quoting an unnamed consumer).

38. Sean Hannon Williams, *Sticky Expectations: Responses to Persistent Over-Optimism in Marriage, Employment Contracts, and Credit Card Use*, 84 NOTRE DAME L. REV. 733, 780, 786 (2009) (noting that “[m]uch but not all of this [credit card] debt is benign Only half of credit card users carry any balance on their credit cards. Among them, few get into deep trouble.” (footnote omitted)). *But see* FRANK, *supra* note 25, at 5 (reporting that, based on survey results, over 10% of all outstanding credit card balances are priced at a “penalty” rate, and that over 50% of Holders being charged penalty rates are unaware of it).

39. *Plunkett Statement*, *supra* note 24, at 161 (noting that individuals earning under \$50,000 annually were significantly more likely to be charged “penalty” interest rates than higher-income individuals with credit card debt). There also is evidence that certain Issuers have targeted subprime Holders with additional credit card solicitations, even as general economic conditions worsened. *Id.* at 157, 164.

40. Williams, *supra* note 38, at 741 (“Policymakers need to be especially cognizant of the collateral costs that regulations might impose on the bulk of consumers who do not experience high costs from credit card debt.”).

prohibitions (“hard” or “strong” paternalism) to mechanisms designed to encourage more efficient behavior without significant government involvement (“soft” or “weak” paternalism).⁴¹ As described below, the CARD Act prohibits or severely restricts certain practices while in other areas institutes mechanisms intended to permit and encourage individual Holders to become aware of material terms of the credit card agreements or Issuer practices.⁴² The effectiveness of each of these reforms is analyzed in light of market as well as behavioral and equitable insights.

A. Increased Disclosure

The CARD Act heavily relies on increased disclosure to Holders to address the information asymmetries detailed above. For example, Issuers are required to include in monthly credit statements warnings that making only the minimum payment will increase the amount of interest paid and the amount of time to repay the balance.⁴³ Statements must also include repayment information that sets forth the number of months it would take to pay off the current balance if only the minimum payment is made and the monthly payment amount that would be required to eliminate the current balance within three years.⁴⁴ Such disclosure, however, occurs after the debt already has been incurred and a contract already is in effect.

This subpart focuses on the CARD Act’s *ex ante* disclosure requirement with respect to “teaser rates,” which are low rates offered for a set period of time as an inducement to credit card holders to sign up for and use a particular credit card.⁴⁵ After the “teaser” period, however, the interest rate may be increased, including with respect to any existing balance at the end of such period. Under the CARD Act, “teaser rates” are not prohibited so long as certain requirements are met.

41. See Cass R. Sunstein, *Boundedly Rational Borrowing*, 73 U. CHI. L. REV. 249 (2006); see also Issacharoff & Delaney, *supra* note 6, at 167 (“In effect, soft paternalism searches for mechanisms to improve decisionmaking without having the state assume responsibility for all decisions, most typically on a one-size-fits-all basis.”)

42. It should be noted that this Article generally does not examine or compare the CARD Act to federal rules promulgated in December 2008 by the Board of Governors of the Federal Reserve System, the Office of Thrift Supervision, Treasury, and National Credit Union Administration. See *Unfair or Deceptive Acts or Practices*, 74 Fed Reg. 5,498 (Jan. 29, 2009) (to be codified at 12 C.F.R. §§ 227, 535, 706) [hereinafter *Federal Rules*].

43. The CARD Act, *supra* note 5, § 201(a).

44. *Id.* These statements assume that no further advances are made. The statements also must include the total cost to the consumer (interest and principal) if only minimum payments were made until the total balance was paid as well as a toll-free telephone number offering access to credit counseling and debt management services. *Id.*

45. *Id.* § 101(b).

First, prior to the commencement of the applicable borrowing period containing the teaser rate (which may be increased retroactively at the end of the teaser period), the Holder must be informed “in a clear and conspicuous manner” the length and the interest rate that would apply after expiration of the teaser period.⁴⁶ Any increases in the teaser rate also may not be increased with respect to transactions that occurred prior to the teaser period.⁴⁷ In addition, “promotional” rates may not be increased prior to the end of the six-month period after the promotional rate has taken effect.⁴⁸

The CARD Act does not introduce a separate mechanism providing for any separate volitional act demonstrating acknowledgment or agreement on the part of the Holder regarding the changes to the rate, other than the Holder’s general agreement to the terms and conditions of the credit card agreement (or by the Holder’s actual use of the card during the teaser period). In addition, the CARD Act relies on outside parties, namely, regulatory enforcement agencies, to ensure that the disclosure standards (e.g., the “clear and conspicuous” standard) are met.⁴⁹ The CARD Act’s teaser rate reform apparently is based on the premise that additional disclosure in these circumstances will result in contracts with terms that have been fully disclosed to, and comprehended by, Holders. Consequently, it must be determined whether disclosure alone, even if provided in a “clear and conspicuous” manner, will result in such comprehension.

At first blush, this provision appears to address concerns about ensuring that Holders understand and comprehend the terms of their credit card agreement before signing up for the card. Holders will be informed, prior to borrowing, that the initial rate may be increased at a later date, and the initial rate generally cannot be increased until the teaser rate has been in effect for at least six months, presumably to give Holders sufficient time to discharge any of their debts.⁵⁰ The context of credit card disclosures and standard form contracts, however, suggests that disclosure alone does not result in better comprehension or “agreements,” from the viewpoint of the Holder regarding the terms of the credit card agreement.⁵¹

46. *Id.*

47. *Id.*

48. *Id.* § 101(d).

49. See Part III.E *infra*.

50. Generally, the CARD Act restricts rate increases during the first year of an account being opened, but a “teaser rate” exception applies. The CARD Act, *supra* note 5, § 172(a).

51. See, e.g., Williams, *supra* note 38, at 782 (concluding, based on a recent study regarding the efficacy of providing additional credit card disclosures or warnings, that “most people either did not read, or did not understand, these warnings”); Issacharoff & Delaney, *supra* note 6, at 167 (concluding

First, individual Holders are subject to fundamental biases that may prevent them from accurately internalizing the risks associated with the teaser rate even when there is clear disclosure. In addition to the biases that may prevent negotiation, such as the status quo bias discussed in Part II, *supra*, Holders generally are overoptimistic and overconfident, which results in consumers underestimating risk.⁵² In the credit card context, this bias likely results in Holders borrowing too much at a given interest rate.⁵³ This bias is especially compounded when a teaser rate applies, because a Holder is being asked to assess the risk that she will have a balance at the end of the teaser rate period (in the future), which would then be subject to the default (non-teaser) rate.⁵⁴ The general inability of individuals to calculate probabilities and general tendency to discount the risk of negative events that may not happen for some period of time also suggest that Holders will be unable to determine accurately the likelihood of the default interest rate's application to a balance at the end of the teaser rate period.⁵⁵

As a result, there is little assurance at the outset that Holders will understand the new disclosures or even read them when provided. In

that disclosure is unlikely to be sufficient to address market manipulation).

52. Prentice, *supra* note 10, at 362; see also Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: The Problem of Market Manipulation*, 74 N.Y.U. L. REV. 630, 657–58 (1999) [hereinafter Hanson & Kysar, *Taking Behavioralism Seriously*] (concluding that “it seems that the optimistic bias is an indiscriminate and indefatigable cognitive feature, causing individuals to underestimate the extent to which a threat applies to them even when they can recognize the severity it poses to others”); Williams, *supra* note 38, at 783 (asserting that Holders’ “nominal control” over credit card use and debt repayment “fosters overconfidence and probably leads at least a subset of credit card consumers to accrue more debt than they originally intended”).

53. Williams, *supra* note 38, at 780 (“Most people who accrue credit card debt are not happy about it. In short, many people regret their choices to incur debt.” (footnote omitted)). Williams suggests that Holders may accrue too much credit card debt either because they cannot calculate accurately how quickly the debt will increase over time or because they are unable to accurately predict the amount they will borrow and be able to repay in the future. *Id.* at 781. Williams concludes that the former explanation suggests that better disclosure of the costs of borrowing will alleviate over-optimism and suggests such disclosures have been ineffective. *Id.* On the other hand, the explanation regarding the inability of individuals to predict their future borrowing and repayment behavior suggests the existence of “sticky expectations,” or an optimism bias that is strongly resistant to change. *Id.* at 734, 782. If the optimism bias is due to “sticky expectations,” then simply providing more factual information is unlikely to be effective since the over-borrowing is not a reaction to errors regarding objective facts. Others have focused on other reasons for over-borrowing. See, e.g., Sunstein, *supra* note 41, at 251–53 (listing cumulative cost neglect, procrastination, myopia, self-control problems, and “miswanting” as potential explanations for over-borrowing).

54. Bar-Gill, *supra* note 4, at 1392. (“Despite the fact that most borrowing is done at the high post-promotion rates, consumers appear to be extremely sensitive to teaser rates.”). Another manifestation of the optimism bias may be that Holders believe that their credit card agreement (including the teaser rate provisions) contain better terms from the Holders’ perspective than they actually do. See Prentice, *supra* note 10, at 363 (noting that consumers tend to believe “that the terms of their contracts are more favorable to them than they actually are”).

55. Prentice, *supra* note 10, at 363–64.

addition, the teaser rate provisions also do not require specific disclosure that the increased rate would apply to balances outstanding as of the end of the teaser period, which suggests that even more Holder confusion may result.⁵⁶ As discussed above, even to the extent that such disclosures are objectively clear and complete, Holder behavior suggests that disclosure alone will not reduce credit card over-borrowing or overuse.

It also is not clear that Issuers would provide meaningful disclosure in this context, despite the new requirements. As noted above, the CARD Act requires disclosure of the teaser rate and the teaser rate period in a “clear and conspicuous manner.” A “clear disclosure,” however, could be buried within or accompanied by several other lengthy and complex credit card disclosure documents.⁵⁷ Setting aside the concerns about enforcement of the disclosure requirements (discussed in Part III.E, *infra*), an important factor in determining whether the requirements will be met is the Issuers’ incentive in these circumstances.

Issuers generate significant revenue by charging interest and fees with respect to credit cards to Holders (as well as by charging merchants for accepting their credit cards at the merchants’ establishments).⁵⁸ For example, Issuers do not realize any interest from a Holder who does not carry a balance from month to month. As a result, Issuers logically seek Holders who will carry a balance, subject to concerns about the Holder’s ultimate ability to repay. Thus, in the context of teaser rates, it is in Issuers’ rational interest to seek Holders who will not pay off their balance by the time that the new increased rate is imposed.⁵⁹ In particular, one would expect Issuers to prepare credit card agreements that do not reveal to the Holder the risks associated with using the particular credit card, including making adequate disclosures regarding the teaser rate; as seen above, empirical data supports this thesis.

If credit card agreements do not sufficiently disclose rate information, Holders may spend (borrow) too much at a given teaser rate because they have not understood or evaluated properly the costs or risks

56. This problem is likely solved by federal rules enacted at the end of 2008 which requires financial institutions to disclose the interest rate that will apply to each category of transactions charged to a credit card account. See *Federal Rules*, *supra* note 42.

57. See discussion regarding the weaknesses of current credit card agreement disclosures in Part II, *supra*.

58. Robin Sidel, *Card Firms’ Loss Tally: Billions of Dollars in Fees*, WALL ST. J., May 25, 2009, at A21.

59. Gray & Peltier, *supra* note 1 (“The credit card industry doesn’t really want you to pay off your debt. . . . It’s like a sweat box. They want you in there as long as possible.” (quoting Adam J. Levitin, a law professor at Georgetown University)); see also Sidel, *supra* note 58 (reporting that subprime customers (typically borrowers with credit scores of less than 600) represent almost one third of the portfolios at Bank of America, CitiGroup and Capital One Finance Corp.).

involved. This has been labeled the “quantity effect.”⁶⁰ In the product liability context, the impact of the quantity effect, where the costs or risks of injury is a cost that ultimately will be borne by the consumer or the seller, there is no additional benefit to the seller of the injury actually occurring (besides the obvious and significant benefit of consumers purchasing too much of a given product and the seller not paying for the cost).⁶¹ In fact, the injury occurring may have adverse market consequences for a seller, as the seller’s reputation may be harmed. In the consumer credit card context, however, the Issuers receive all of the benefits of the “injury” of increases in interest rates. Thus, the product risks are the risks to the Holder of nonpayment and the resulting increased default interest rate on the balance of the debt. The inability of Holders to accurately assess the risks (because of contractual language or otherwise) results in additional income to Issuers. The “quantity effect,” or borrowing too much at the teaser rate prior to the expiration of the teaser rate, in this instance is a very desirable end for Issuers.⁶²

Compounding the quantity effect is the “quality effect.” The “quality effect” occurs in the contract context when the party with more bargaining power is not incentivized to improve the product because uninformed consumers will not compensate sellers for doing so.⁶³ In other contexts, it has been argued that sellers with superior bargaining power would actually be better off by preparing contracts that better address consumer demands at a slightly higher price charged to the

60. Meyerson, *supra* note 7, at 603.

61. See Hanson & Kysar, *Taking Behavioralism Seriously*, *supra* note 52, at 724 (suggesting that, in the product liability context, “it is in the manufacturer’s interest for consumers to have the lowest estimate of product risks possible: The lower the consumer’s risk estimate, the more consumers will be willing to pay for the product, leading to greater sales and increased profits for manufacturers”). It should be noted that, although others have examined the actions of sellers outside the contract context to determine whether buyer’s perceptions of risk are manipulated by sellers, this Article does not generally examine any noncontractual market actions taken by Issuers with respect to Holders and credit card agreements. See, e.g., Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: Some Evidence of Market Manipulation*, 112 HARV. L. REV. 1420 (1999) [hereinafter Hanson & Kysar, *Some Evidence of Market Manipulation*] (describing the manipulation of consumer cognitive biases by market sellers to lower consumer perceptions of product risk). One would expect, however, that many of the same concerns identified by Hanson and Kysar would be raised in this context, especially given that the risks of additional borrowing costs (such as higher interest rates or penalty fees) are beneficial to Issuers (as opposed to the product liability context, where the seller is merely able to externalize the cost of injury by shifting the risk to the consumer). Similarly, one would expect the advertising and marketing practices of credit card companies to manipulate consumer perceptions (e.g., the “No-Hassle Card”) to reinforce the “status quo” of credit card agreements.

62. Of course, there are other risks to be allocated, such as fee-shifting provisions in the event of dispute, and businesses are similarly incentivized in that situation to “impose hidden risks on consumers where possible.” Hillman & Rachlinski, *supra* note 7, at 440.

63. Meyerson, *supra* note 7, at 603.

consumer.⁶⁴ For example, one could imagine credit card issuers that provide simple, complete disclosure regarding teaser rates also charging a slightly higher teaser rate (or slightly higher rate at the end of the teaser period) for any cost of the better disclosure (such as less borrowing). If clear disclosure of the rate adjustment is viewed as a contract “term,” then one would expect an Issuer with an obscure adjustment rate mechanism to receive more business than an Issuer with a clear adjustment rate mechanism *and* a higher interest rate for the teaser or adjusted rate.⁶⁵ If credit card holders are not aware of the “term” to be disclosed, then they cannot have a preference for such “disclosure,” and one should expect Issuers to act accordingly.⁶⁶ In this context, then, if certain Issuers decided to disclose fully and effectively the increased rate being applied to the outstanding balance, it is doubtful that Holders would compensate those financial institutions for providing such disclosure (i.e., for improving their “level of care”) and the same Issuers actually would face the likelihood of Holders declining to sign up for that particular credit card (and choosing to sign credit card agreements with teaser rates that do not include this particular piece of information).⁶⁷ Again, in this area, the costs and risks of the contracting parties are inextricably tied in the sense that a cost to Holders is a corresponding benefit to Issuers.

These effects, in turn, suggest that Issuers will do the minimum required to meet the requirements of the CARD Act, which means that Issuers will likely omit any relevant information not specifically mandated by the CARD Act (such as the fact that any increases to the teaser rate will be applied to all outstanding balances). Correspondingly, Issuers will also likely minimize the “clear and conspicuous” requirement for disclosure of any increases to the teaser rate by continued presentation techniques that, although potentially permitted by

64. *Id.* at 607.

65. Similarly, it has been argued that competitive pressures force Issuers to interest rates and other “long-term, borrowing-contingent elements of the credit card price” above the marginal cost and price below marginal cost with respect to “short-term, non-contingent elements (such as teaser rates), because consumers underestimate the risk and costs of future borrowing.” Bar-Gill, *supra* note 4, at 1376 (“Issuers that do not take advantage of the underestimation bias, and offer lower interest rates instead of short-term perks, would not succeed in the marketplace.”).

66. Meyerson, *supra* note 7, at 608.

67. In a similar vein, the lack of compensation to Issuers to provide better “boilerplate” terms in credit card agreements may result in such Issuers reducing the “quality” of their agreements to avoid losing potential customers to other Issuers. See Eisenberg, *supra* note 3, at 244 (suggesting that “[i]f, as a result of imperfect information, the market price of a product is low because of the product’s perceived low quality, high-quality producers must lower quality to ensure that they will turn a profit at the low market price. As applied to form contracts, this means that competition may actually degrade preprinted terms that involve nonsalient risks.”).

the CARD Act, will ensure that many Holders will continue not to read or comprehend their credit card agreements and disclosures. If credit card agreements continue to be lengthy, complex, unnecessarily detailed, and poorly presented, then the effectiveness of even particularly clear disclosures will be reduced as well. In any event, the general ineffectiveness of disclosure alone in the credit card agreement context suggests that many credit card holders will not read or fully understand the teaser rate provisions.⁶⁸ The CARD Act's failure to address Issuers' fundamental incentives and Borrowers' disclosure disposition and comprehension is significant and may result in insufficient disclosure and inferior contracts. This obfuscation will be compounded, and the intent of the overall reform hampered, by the lack of sufficient ex post mechanisms to remedy any failure by Issuer to meet the "clear and conspicuous" disclosure requirements discussed in Part III.E, *infra*.

B. Increased Disclosure Plus a Termination Option

The CARD Act uses a similar approach with respect to prospective increases in interest rates on consumer credit cards as with teaser rates. The CARD Act requires forty-five days' advance written notice, in a "clear and conspicuous manner," of any increase in an interest rate or any other "significant change," as determined by the Board of Governors of the Federal Reserve System (Board).⁶⁹ The notice must also disclose the Holder's right to cancel the account before the date of the rate increase or significant change.⁷⁰ In addition, the choice by a Holder to terminate the account may not constitute a default, trigger a penalty or fee, including any obligation to repay immediately any outstanding balance, except that the Issuer may require the credit card holder to repay the outstanding balance using an "approved" repayment method.⁷¹

As with teaser rate reforms, where the Holder now theoretically will have available all pertinent information prior to contracting for the teaser rate, the CARD Act also requires that the Holder have all relevant information regarding a proposed agreement modification prior to the effective date of the new contract term. In other words, if the Issuer has

68. See Sunstein, *supra* note 41, at 260–61 (noting that "[i]f borrowers are both myopic and excessively optimistic, there is a serious risk that purely informational responses will do little or nothing").

69. The CARD Act, *supra* note 5, § 101(a)(1)(i)(1)–(2).

70. *Id.* § 101(a)(1)(i)(3).

71. *Id.* § 101(a)(1)(i)(4). See discussion of approved repayment methods in Part III.D, *infra*.

evidenced its desire to amend the agreement such that the new interest rate no longer is what was initially agreed to by the parties, then the Holder has been granted the right either to accept the proposed amendment or to terminate the current agreement.

Combined with the CARD Act's prohibition on retroactive rate increases on outstanding balances,⁷² the restriction above appears to address many concerns about the unilateral approach to consumer credit card agreements previously used by financial institutions. Under prior practice, Issuers could correct their underwriting "mistakes" by unilaterally increasing interest rates without notification and applying these rates retroactively; the rights to do so were included in the initial credit card agreements. These reservations of rights are premised on Holders' contracting *ex ante* bias towards over-optimism, as described above, whereby Holders underestimate the likelihood that any rates would ever be increased in the future or that any default would occur.⁷³

The CARD Act addresses the biases that Holders may have at the outset of a credit card arrangement by permitting borrowers to react (by terminating the credit card arrangement) *at the time* of the rate increase and determine whether the contract, as amended, is desirable at the new rate. This approach also addresses Issuers' concerns about changed risk profiles for credit card consumers. If a Holder's credit risk profile has changed and the Issuer determines that it needs additional compensation to extend credit (i.e., by charging a higher interest rate), then the Issuer may propose new terms at that time, subject to the Holder's desire to terminate.

This approach is premised on a number of troublesome assumptions. First, it assumes that the notice will be sufficient to inform Holders and that Holders, if they have not opted out, have actually provided assent to the pending rate increase. With respect to the former assumption, because of limited *ex post* mechanisms to enforce the standard of disclosure and the troublesome limitations of disclosure in the context, it is doubtful that the new disclosures will communicate effectively the increased rate and the Holders' rights to terminate the account.⁷⁴ In somewhat counterintuitive fashion, the CARD Act relies on Holders to respond to notice from the very Issuers who benefit from the Holders failing to act in response to such notice. With respect to the latter

72. See Part III.D, *infra*.

73. See FRANK, *supra* note 25, at 8; see also Hillman & Rachlinski, *supra* note 7, at 453 (providing evidence that people make "inferences consistent with what they want to believe" and therefore interpret a form contract as containing more favorable terms that may otherwise exist because the consumer's motivation to consummate the transaction).

74. For example, Holders may prefer not to act as a result of their preference for inaction rather than action.

assumption, it is at best questionable whether Holders' lack of action to terminate an account following notice of an interest rate increase signifies actual consent, and at worst indicates that the disclosure was not effectively communicated to Holders (if they read the notice at all) or that the Holders are not in a position to terminate the credit card account and obtain alternative lending at the time that the rate has been increased.⁷⁵

These faulty assumptions suggest that financial institutions' methods of disclosure with respect to pending rate increases will be incomplete and not as effective as they might of otherwise have been. As suggested in Part IV, *infra* and as included on a limited basis in the CARD Act with respect to certain penalty fees (discussed in Part III.C, *infra*), Holders would be better served by a regime that provides financial institutions with incentives to share the pending contract change information as effectively as possible.

C. Increased Disclosure Plus an Opt-In Requirement

The CARD Act uses an innovative approach with respect to "over-the-limit" transaction fees by combining increased disclosures with the additional requirement for the express assent of Holder.⁷⁶ These fees are charged when a Holder exceeds the Holder's credit limit for a particular account. Under the applicable provisions of the CARD Act, no over-the-limit fee may be charged unless the Holder "has expressly elected" to allow the applicable financial institution to complete over-the-limit transactions.⁷⁷ Any election must be preceded by disclosure from the Issuer of any over-the-limit fee, and the Board will determine the form, manner, and timing for delivery of such disclosure.⁷⁸ Any election will be effective until revoked, and revocation may be provided orally, electronically, or in writing, and the option to revoke must be disclosed to Holders in any periodic statement that includes notice of the fee being charged for that period.⁷⁹ The CARD Act also instructs the Board to regulate the form of election and revocation.⁸⁰

The effectiveness of this reform will likely hinge on the required form

75. FRANK, *supra* note 25, at 8 (Issuers' ability to modify interest rates to penalty rates "strategically raises the prices on consumers precisely when they are least able to switch to a lower rate competitor.").

76. The CARD Act, *supra* note 5, § 102(a). The CARD Act also restricts how often "over-the-limit" fees can be imposed. *Id.*

77. *Id.*

78. *Id.*

79. *Id.*

80. *Id.*

and timing of the election. If the Board permits one-time disclosure of any over-the-limit fees or the Holder's election to accept such fees to occur up front or months or years in advance, then the utility of these provisions will be substantially compromised because the Holder will often be unable to assess accurately the likelihood of incurring a fee in the future.⁸¹ More problematically, if the form of election may be manipulated or obfuscated to the detriment of the Holders, then Issuers will take advantage of the "one-time" requirement for disclosure and election to secure the Holders' elections.⁸²

If the Board requires disclosure of any over-the-limit fee contemporaneously with any over-the-limit transaction and required consent forms (that may not be disguisable or otherwise manipulated by financial institutions) or enforceable standards for a Holder's affirmative election for over-the-limit transactions, then these provisions may create an effective regime for agreements regarding these fees. The closer in time to the potential charge, the more effective the notice in ensuring that the Holder recognizes the reality of the pending charge. In addition, and more importantly, the requirement for Issuers to receive the affirmative unmanipulated election of the credit card customers means that the Issuers will be incentivized to make sure that the credit card customer has received effective notice of the charge and makes the election.

This provision is subject to criticism that, even if disclosure is made contemporaneously with a pending over-the-limit transaction, Holders forced to make such decisions may not actually have a "decision" to make. That is, if credit card holders are potentially over their credit limit and have no other way to pay for the necessities, then the decision will rationally be made to accept the fee. This concern is partially addressed by the CARD Act's requirement for such fees to be "reasonable and proportional" to the violation of the credit limit.⁸³ The definition of "reasonable and proportional" is unclear, but will be addressed by rules to be promulgated by the Board.⁸⁴

By requiring Holders to take a voluntary act to be charged a fee, the CARD Act addresses the asymmetrical information and differing incentives of the parties by aligning the Issuer's incentive to charge fees (and its information about what the fees are) with the Holder's lack of information regarding what the fees are and when they can be charged.⁸⁵

81. See discussion of optimism bias in Part III.A, *supra*.

82. See discussion of quantity effect in Part III.A, *supra*.

83. The CARD Act, *supra* note 5, § 102(b).

84. *Id.*

85. See Bar-Gill, *supra* note 4, at 1394 ("The high fees that issuers charge for late payments and

The effectiveness of this reform will be based on the Board requirements regarding the timing and form of disclosure and election, but the CARD Act takes an important step towards addressing this particular flaw in credit card agreements.

D. Prohibitions and Other Severe Restrictions

The CARD Act also has imposed stronger regulation that essentially mandates or restricts certain terms and conditions in credit card agreements. This heavy-handed approach is apparently tailored towards those issues where strict regulation is not likely to have a negative impact on the availability of credit and where Issuers generally have provided default contract provisions unfavorable to, and likely to be ignored by, Holders. This approach also reduces the need for dispute resolution regarding the validity or binding nature of such provisions or practices because the permitted practices are very narrowly defined.

A compelling segment of the CARD Act may be the general prohibition on interest rate adjustments on existing balances. Prior to the CARD Act, Issuers often included provisions in the credit card agreements that would permit them to increase the interest rate on existing balances.⁸⁶ In other words, if a Holder currently paid interest at an annual rate of twelve percent on existing balances that dated back three years, an Issuer could increase the interest rate on that balance. This is different from the teaser rate reforms discussed in Part III.A, *supra*, where the interest rate may be increased retroactively with respect to a given period so long as the borrower is fully informed prior to the date of borrowing that the rate may be increased to a certain amount if payments are not made within a given period. Under the CARD Act, Issuers may not change the interest rate on any card for an outstanding account balance unless certain conditions are met, including the teaser disclosure requirements described above or a sixty day delinquency on the account (which may be restored to the previous interest rate after six months of timely payments).⁸⁷

Issuers have argued that their ability to modify current rate structures is necessary to compensate Issuers for lending to riskier Holders.⁸⁸ This

for exceeding the credit limit have no basis in the extra cost to issuers . . . even accounting for the potentially heightened risk of accommodating a consumer who failed to pay on time or remain within the specified credit line. This disparity between price and cost is especially striking when the late and over-limit fees are set at fixed dollar amounts, irrespective of the tardiness of the payment or the magnitude of the deviation from the credit limit.”)

86. See discussion in Part II, *supra*.

87. The CARD Act, *supra* note 5, § 101(a).

88. VICIOUS CYCLE, *supra* note 24, at 2; see also *Plunkett Statement*, *supra* note 24, at 165. It

contention, however, is belied by the fact that any underwriting with respect to the credit risk of a particular borrower would have been completed by the Issuer when the charges were being incurred.⁸⁹ It is one issue to increase the interest rate going forward with respect to an uncreditworthy borrower for future transactions, but it is quite another to increase the interest rate on a Holder's existing balance where the Issuer has determined that, in retrospect, it made a poor underwriting assessment for purposes of determining the initially offered rate.⁹⁰

By prohibiting unilateral increases in rates for existing balances, the hope is that any negative impact associated with the inability of Issuers to engage in such practices, such as the potential for Issuers to reduce the amount of credit to extend, is outweighed substantially by the potential for unfortunate and unanticipated results when such practices are permitted. It is, in fact, unclear how much less credit will be made available to credit card holders or how much more expensive credit will be (in the form of higher interest rates) because of Issuers' inability to change unilaterally and retroactively the interest rate on existing balances. The CARD Act does attempt to address the collection concerns of financial institutions by permitting changes in the terms governing repayment of existing balances, but limits these changes to a repayment method that provides either a five year principal repayment period or a required minimum payment that is (on a percentage basis) not more than twice that required prior to increase in the interest rate.⁹¹ In other words, if, because of changed circumstances, an Issuer deems that a previously creditworthy Holder may not be able to pay, the Issuer may not increase the existing interest rate but may require accelerated principal payments.

In this situation, it may be that the "soft paternalism" approach used elsewhere in the CARD Act with respect to additional disclosure would not be suitable to address the systemic asymmetries documented in this context. In other words, there may not be a mechanism to permit or enable Holders to make better choices regarding credit card agreements

also has been suggested that changing to penalty rates is useful to motivate borrowers more responsibly. See FRANK, *supra* note 25, at 8 (citing American Bankers Association study).

89. This contention is also contradicted by empirical data. FRANK, *supra* note 25, at 11 (concluding that empirical data suggests that Issuer practices with respect to imposing penalty interest rates more resembles "excuse-based pricing" in that "issuers try to find excuses to increase rates as much as possible rather than making a legitimate attempt to correlate rate with risk.").

90. *Id.* at 12 ("Both the card holders and card issuers would benefit from responsible underwriting in the beginning, and the integrity of a competitive market would be enhanced by transparent, and real price information when consumers first choose a card.").

91. The CARD Act, *supra* note 5, § 101(a).

that permit rate increases for existing balances.⁹² For example, it would be impossible for a Holder to determine accurately the likelihood of an Issuer deciding in the future to increase the Holder's interest rate on existing balances, even if the Holder was aware of that possibility. In fact, it is likely that most Holders would be subject to the biases described above that would otherwise limit their ability to accurately assess that risk. In particular, as noted above, individuals tend to be irrationally optimistic in calculating the risks within the consumer context.⁹³ Moreover, it is probable that the Holders whose interest rate for existing balances will be increased are the same "[u]nrealistically optimistic people" who "borrow more than they otherwise would" in the first place.⁹⁴ As a result, such individuals may not be able to assess the risk of such a contractual provision.

The CARD Act also regulates other Issuer practices and credit card agreement terms.⁹⁵ It prohibits Issuers from imposing finance charges on payments made prior to 5:00 p.m. on the due date (as opposed to a contractually imposed earlier deadline) or changing the payment due date for different months.⁹⁶ The CARD Act also requires Issuers to apply credit card holder payments in excess of the minimum requirement towards the balance with the highest interest rate, as opposed to "cherry-picking" the most favorable rate for the benefit of

92. See Jeffrey J. Rachlinski, *The Uncertain Psychological Case for Paternalism*, 97 NW. U. L. REV. 1165, 1225 (2003) ("Paternalistic constraints on choice cannot be justified with psychology absent a showing that the costs of privately developing better ways to make choices are greater than the costs of restricting individual choice.").

93. See FRANK, *supra* note 25, at 7–8 (suggesting that current Issuer disclosure regarding the potential for penalty interest rates are designed based on Holders' inattention to such disclosures and "plays into known behavioral biases such as excessive optimism"); see also Prentice, *supra* note 10, at 362–63.

94. Williams, *supra* note 38, at 788.

95. The CARD Act also sets forth a number of restrictions with respect to issuances of credit cards to individuals under the age of twenty-one, including requiring either a co-signer on the account or submission of financial information evidencing ability to repay before issuing a card and also requiring institutions of higher education to publicly disclose any agreement with a financial institution for credit card marketing purposes. The CARD Act, *supra* note 5, §§ 301–305. A complete analysis of these restrictions is beyond the scope of this Article, but the author wonders whether any of the justifications for the protections for underage individuals would also justify additional protections for overage individuals. See, e.g., Meyerson, *supra* note 7, at 610 (arguing that the law should protect the consumer class interests because consumers are unable to evaluate accurately the standard form contract terms similar to the way in which the law differentiates between contracts with adults and contracts with minors); see also Williams, *supra* note 38, at 743 (finding that college students and Americans in general exist similar tendencies with respect to exhibiting an optimism bias). In addition, the use of credit cards does not necessarily result in more "risky" behavior by underage individuals. See Karen Blumenthal, *Teaching Kids About Money The Hard Way*, WALL ST. J., July 15, 2009, at D1.

96. The CARD Act, *supra* note 5, § 104. Similarly, if the payment due date falls on a weekend or holiday, then the Issuer may not treat a payment received on the next business day as late. *Id.* § 106(a).

Issuers.⁹⁷ Finally, the CARD Act generally prohibits the Issuer practice of “double-cycle billing,” where a finance charge could be assessed on prior balances for failure to pay during current billing periods.⁹⁸

As a result of these new default rules, the CARD Act likely meets the *ex ante* preferences of unknowing or uncomprehending Holders. In other words, if Holders actually bargained for the credit card agreement terms, Holders would choose terms that prevent payment deadlines prior to the close of business on the due date, setting inconsistent payment due dates, or double-cycle billing, and would require excess payments to be applied to the highest possible interest rate. Issuers now face a loss of revenue generated from the fees and interest charged under the formerly malleable default contract rules, and consequently, the calculus used by Issuers when extending credit and setting rates will likely be adjusted accordingly.

In the product liability context, it has been argued that an enterprise liability regime may be desirable to address market manipulation and ensure that risks are fully disclosed and that all costs are not surprisingly externalized onto consumers, especially when consumers are ill-equipped to internalize such risks.⁹⁹ Similarly, the (newly-restricted) credit card charges and fees described above may be seen as risks that no longer are borne unknowingly by the Holders. It is somewhat more problematic, of course, in this context to describe these charges and fees as risks because they are beneficial, on a dollar-for-dollar basis, to the Issuers. Nevertheless, the Issuers’ loss of anticipated revenue as a result of these new default rules either has to be internalized by the Issuers by accepting lower revenues without otherwise changing their behavior or expressly passing along as the “cost” to Holders through higher interest rates or other upfront fees. It has been predicted, for example, that the CARD Act will subtract \$10 billion from Issuers’ revenues, primarily as a result of the new restrictions on penalty fees and higher interest rates.¹⁰⁰

If the revenue associated with those practices is required by the Issuers to provide credit card services, then these costs or risks should be reflected in the price of the service (e.g., the interest rate).¹⁰¹ Following

97. *Id.* § 104.

98. *Id.* § 102(a).

99. See generally Hanson & Kysar, *Some Evidence of Market Manipulation*, *supra* note 61; Jon D. Hanson & Douglas A. Kysar, *Taking Behavioralism Seriously: A Response to Market Manipulation*, 6 ROGER WILLIAMS U. L. REV. 259 (2000).

100. Sidel, *supra* note 58.

101. Angela Littwin, *Testing the Substitution Hypothesis: Would Credit Card Regulations Force Low-Income Borrowers Into Less Desirable Lending Alternatives?*, 2009 U. ILL. L. REV. 403, 453 (2009) (“A regulation that increased the transparency of credit card practices and caused issuers to seek

this thesis to the end, if Holders borrow less because the “true” cost of borrowing has been revealed in the price, then Holders will have signaled that they previously were borrowing too much under the prior contractual agreements and now have been able to counteract the “quantity effect.” By providing contractual default rules that restrict Issuers’ ability to generate revenue through costs (risks) not currently well-understood by Holders, the “price” of credit card services will be more clearly disclosed.

E. Enforcement

In contrast to the broad changes to the requirements imposed on Issuers regarding credit card agreements, the CARD Act largely leaves the current enforcement regime unchanged. The CARD Act increases monetary penalties for violations of the requirements for consumer credit cards to a maximum of \$5,000, which may be increased in the instance of an established pattern or practice of violations.¹⁰² To aid the Board’s determination of violations (and detection by consumer advocacy groups), Issuers are also required to post their credit card agreements on an Internet site and submit copies electronically to the Board.¹⁰³

The Board also is required to conduct a review every two years of credit card agreements, including reviewing the terms of credit card agreements, the practices of credit card issuers, the effectiveness of current disclosure requirements and protections against deceptive credit card practices, and any impact of the CARD Act on the availability or cost of credit, especially with respect to “nonprime borrowers,” the stability of credit card issuers, risk-based pricing, and new credit card products or services.¹⁰⁴ These reviews are required to include solicitation of comments from Holders, Issuers, and other interested parties.¹⁰⁵ After conducting the review, the Board is required to publish a summary of the review and any proposed changes to current regulations, as well as report to Congress on its review.¹⁰⁶ Finally, certain enforcement agencies (such as the Federal Trade Commission)

the lost revenue elsewhere would still leave them considerable room to increase interest rates without triggering substitution away from their products.”).

102. The CARD Act, *supra* note 5, § 107.

103. *Id.* § 204(a). Individually negotiated changes to agreements are not required to be disclosed. *Id.*

104. *Id.* § 502(a).

105. *Id.* § 502(b).

106. *Id.* § 502(c)–(d). If the Board determines that no changes are needed, it must disclose the reason for its determination. *Id.* § 502(c).

are required to report annually to the Board regarding Issuer compliance with the Card Act and other consumer protection statutes and regulations.¹⁰⁷

Posting credit card agreements in public may be the most useful change in the CARD Act with respect to the current enforcement regime. Between government regulators and consumer watchdog groups, the review of credit card agreements for compliance with the CARD Act and other statutes and regulations should be more substantial and thorough.¹⁰⁸ The CARD Act does not, however, require public disclosure of the forms of notice used by Issuers to inform consumers of pending increases in interest rates or with respect to teaser rates.¹⁰⁹ Given the importance of the additional disclosure requirements, it is not clear why the publication requirement was not extended for such purposes as well.

More importantly, it is not clear that federal agencies are equipped or motivated to address adequately financial institutions' compliance with consumer credit card laws.¹¹⁰ In addition, relying on the Board to promulgate and enforce rules for effective disclosure under the CARD Act may actually result in worse consumer comprehension. For example, if Issuers are required to provide additional disclosure documents as a result of the Board's new rules, then this may lead to "information overload" and result in Holders disregarding the additional disclosures, together with all other disclosures.¹¹¹ Another problem with relying on regulatory enforcement is that it is focused on Issuer compliance rather than Holder comprehension. In other words, the Board will focus on whether the Issuer met the Board's standard rather than whether the standard properly protects Holder. The Board may consider such issues when promulgating the rules, but there is no

107. *Id.* § 502(e).

108. Although beyond the scope of this Article, it is possible that the posting requirement for credit card agreements could assist not only in enforcing credit card laws and rules (by both providing the public with relevant information) but also act as a "shaming sanction" where Issuers with agreements that violate the laws are identified or otherwise have their agreements corrected (publicly) on the same website. See, e.g., Joshua D. Blank, *What's Wrong With Shaming Corporate Tax Abuse*, 62 TAX L. REV. 539 (2009) (discussing the arguments for and against imposing "shaming sanctions" on corporations that violate tax laws).

109. Of course, to the extent that the exact structure of such notice is required by rules of the Board, then this concern may be alleviated. Regardless, it would be preferable for the public to be able to review and verify the form and presentation of such notices.

110. See, e.g., *Feds Take Overdue First Step To Curb Credit Card Business*, USA TODAY, May 6, 2008, at A10 (noting that "[o]ne major obstacle [to the promulgation of final rules] is the regulators' own tendency to debate and delay"); see also Keith N. Hylton, *When Should We Prefer Tort Law to Environmental Regulation?*, 41 WASHBURN L.J. 515, 520 (2002) (noting the general disconnect between regulatory agencies and protected citizens).

111. Cass R. Sunstein, *Paradoxes of the Regulatory State*, 57 U. CHI. L. REV. 407, 425 (1990).

assurance that this will occur or that the Board will be able to adapt promptly or at all if such rules ultimately are ineffective.¹¹²

It is also possible that the uproar over credit card practices has come to the forefront not because of increased detection by enforcement officials but because of negative economic conditions and publicity by public advocacy groups. Given federal agencies' inability to police Issuers effectively to date, the CARD Act may fail to provide credit card consumers any additional enforcement protection due to its unchanged and exclusive reliance on such agencies. Suggestions to address such shortcomings are detailed in Part IV.C, *infra*.

Another notable weakness of the CARD Act is its failure to address mandatory individual arbitration provisions within credit card agreements.¹¹³ These provisions require all disputes regarding the credit card agreement to be addressed through arbitration on an individual and not collective basis (e.g., through a class action lawsuit). Such provisions also typically permit Issuers to choose the arbitration firm. These provisions are problematic because they have prevented Holders from actively, collectively, and publicly seeking redress for Issuer misbehavior or breaches of a credit card agreement. As a result, some have concluded that "[e]very indication is that the imposed arbitration clauses are nothing but a shield against legal accountability by the credit card companies."¹¹⁴

As with credit card agreements in general, arbitration clauses typically are imposed in a more or less "take-it-or-leave-it" fashion and included in the fine print or ancillary portions of the credit card agreement.¹¹⁵ As a result, many Holders are not aware that they are agreeing to binding arbitration when entering in a credit card agreement.¹¹⁶ In addition, even if Holders read and comprehend that an

112. See Williams & Bylsma, *supra* note 1, at 874 (expressing concern about using fixed rules that do not have the flexibility "so that disclosure requirements will not be outpaced by rapidly evolving market practices."). Williams and Bylsma also raise the concern that the "piecemeal" process of promulgating rules in response to particular concerns will "lead to rules that over time highlight terms and conditions that are no longer most relevant to a consumer in shopping for credit, result in unwieldy disclosure statements, and impose unjustifiable costs on creditors relative to the consumer benefits." *Id.* Consequently, this Article proposed permitting the evolving common law to address concerns about the adequacy of disclosure. See Part IV.B, *infra*.

113. Carter et al., *supra* note 25, at 45 ("The use of arbitration provisions in credit card agreements has been a tremendous barrier for consumers seeking redress.")

114. Issacharoff & Delaney, *supra* note 6, at 173.

115. *Id.* at 176.

116. See Linda J. Demaine & Deborah R. Hensler, "Volunteering" to Arbitrate though Predispute Arbitration Clauses: The Average Consumer's Experience, 67 LAW & CONTEMP. PROBS. 55, 73 (2004) (indicating that "this study provides little basis for believing that consumers are making informed decisions when they 'agree' to arbitrate"); see also Issacharoff & Delaney, *supra* note 6, at 173 (noting that "there is every reason to believe" that Holders will not act upon disclosure of an arbitration clause).

arbitration clause exists, it has been argued that Holders' "predictable irrationality biases" will prevent them from properly assessing the costs and risks associated with accepting such a clause.¹¹⁷ These biases, such as the tendency for individuals to underestimate the likelihood of a particular unfavorable event occurring (such as needing to sue an Issuer), may result in Holders undervaluing the right to bring a private suit.¹¹⁸

Arbitrators and arbitration firms also are financially incentivized to favor Issuers over Holders because arbitrators are often compensated based on the amount of cases referred to them by Holders.¹¹⁹ If arbitration firms or individual arbitrators provide what is perceived to be anticorporate stances about arbitration policies (such as permitting class-wide arbitrations) or arbitration results (in favor of Holder), then such firms or providers can expect to see reduced "business" in the future from corporate clients.¹²⁰ As a result of the "repeat player effect"—where the neutrality of the arbitrator can be affected in favor of the entity that refers claims to the arbitrator or arbitration firm—Holders can expect poorer results than might otherwise be expected in the event of an arbitrated dispute.¹²¹

Finally, arbitration proceedings typically are confidential and leave a limited (if any) written record.¹²² The result of this lack of publicity and public record can restrict societal awareness of any wrongdoing by Issuers, which impacts both regulators and other similarly situated Holders. Contrary to an arbitration proceeding conducted in secret without records, "[a] public enforcement proceeding also alerts the

117. Jean R. Sternlight, *Creeping Mandatory Arbitration: Is it Just?*, 57 STAN. L. REV. 1631, 1649 (2005).

118. *Id.* (also noting that "psychologists have shown that people are risk-seeking with respect to certain prospective losses. Given the motivation for profit maximization, it seems inevitable that, absent regulation, companies will seek to take advantage of consumers' irrational behavior by manipulating arbitration clauses." (footnote omitted)); see also Michael I. Meyerson, *The Reunification of Contract Law: The Objective Theory of Consumer Form Contracts*, 47 U. MIAMI L. REV. 1263, 1301 (1993) (suggesting that "[c]ourts and sellers should realize that consumers do not knowingly assent to terms that effectively discard their legal rights," because they "rarely consider even the possibility of a subsequent legal action").

119. JOHN O'DONNELL, PUBLIC CITIZEN, THE ARBITRATION TRAP: HOW CREDIT CARD COMPANIES ENSNARE CONSUMERS 8 (2007) ("Unlike judges, arbitrators are paid only when they are assigned cases by arbitration companies."); Carter et al., *supra* note 25, at 46 (noting that arbitration proceedings are "often conducted by arbitration providers that are amazingly biased against consumers.").

120. Sternlight, *supra* note 117, at 1650 (noting how arbitration providers compete to provide dispute services for companies that require their customers to sign contracts with arbitration provisions).

121. See Paul D. Carrington, *Self-Deregulation, The "National Policy" of the Supreme Court*, 3 NEV. L. J. 259, 285 (2003) (noting that "many predispute arbitration agreements, as they are written, load the dice to the advantage of the repeat player" who is the drafter of the agreement).

122. See O'DONNELL, *supra* note 119, at 7.

general public to the need for regulation and enables them to measure the usefulness of their legal institutions.”¹²³ As a result of arbitration, individual Holders may not become aware that they are similarly situated with other wronged individuals and consequently be more reluctant to pursue their own remedies.¹²⁴

Most troubling, mandatory individual binding arbitration clauses prevent similarly situated Holders from seeking redress for Issuer breaches or wrongdoing that may not be sufficiently significant for each individual to proceed by herself, but is substantial in the aggregate.¹²⁵ Consequently, individual small claims generally will not be brought in individual arbitration proceedings, because the claim value will be insignificant (either generally or relative to the cost and effort of bringing such a claim), even if the claim value is material to a particular individual.¹²⁶

Not surprisingly, the empirical results suggest that Holders rarely, if ever, bring a claim in arbitration, and Holders rarely prevail in arbitration proceedings.¹²⁷ The inability of individuals to seek redress adequately through the courts is a significant flaw in the CARD Act reforms, and may very well undercut the significance of the additional required disclosures and protections. The future of binding individual arbitration clauses, however, is very much in flux as a result of the recent actions by certain arbitration firms to withdraw from resolving arbitration disputes.¹²⁸ These withdrawal actions are not a response to the CARD Act but instead follow litigation instituted by the Minnesota attorney general’s office regarding the National Arbitration Forum’s practices of resolving consumer debt disputes, including many of the problems noted above.¹²⁹

123. Carrington, *supra* note 121, at 283; *see also* Sternlight, *supra* note 117, at 1649.

124. *See* Carrington, *supra* note 121, at 283 (“It is clear that [arbitration’s secrecy] is one of its attractions to predatory business because it diminishes the likelihood that the success of one claim by a consumer or employee will encourage others like it.”).

125. *See generally* Issacharoff & Delaney, *supra* note 6 (examining the prohibition on collective actions as a result of mandatory individual arbitration clauses in various contexts).

126. Issacharoff & Delaney, *supra* note 6, at 158 (noting that in “all markets characterized by large sellers and relatively atomized consumers, there is the risk of improper practices that impose small, almost inconsequential costs on individuals but yield significant returns in the aggregate.”)

127. *See* Sternlight, *supra* note 117, at 1655 (noting that a particular Issuer filed over 50,000 arbitration claims against Holders during a two-year period as opposed to four claims made by Holders against the Issuer).

128. Robin Sidel & Amol Sharma, *Credit-Card Disputes Tossed into Disarray*, Wall St. J., July 22, 2009, at A1 (reporting that The American Arbitration Association and The National Arbitration Forum would cease resolving credit card debt disputes).

129. *Id.*

IV. ALTERNATIVES AND PROPOSED REFORMS

A more complete reform of credit card contracts would address the ex ante concerns regarding the weakness of passive disclosure as well as the ex post issues regarding enforcement of regulatory requirements and the underlying agreement for the benefit of Holders. By better addressing the information asymmetries as well as Issuers' underlying incentives, Issuers will prepare credit card agreements that, to the extent reasonably practicable, inform Holders of the true costs of borrowing when the Holders are best able to assess their likely ability to repay amounts borrowed (as well as paying all the other "costs" of the agreement). These reforms are based on an understanding that, although an "efficient scheme for interpreting and enforcing form contracts would encourage the seller, with substantially lower information costs, to share critical information with consumers," such a scheme, to be truly effective, would need to address any inability by certain Holders to process and use effectively such information.¹³⁰

A. Modifying Passive Disclosure

In several circumstances, the CARD Act relies solely on disclosure to Holders without also requiring Holders to evidence affirmatively (or separately) their assent to the particular provision being modified. For example, as noted in Part III.A, *supra*, the CARD Act generally requires Issuers to disclose to Holders pending interest rate increases in advance and permits Holders to terminate the account prior to the effective date of the rate increase. There is no separate mechanism, however, that signifies Holders' actual assent to the credit card agreement's modified term (the new interest rate). Instead, if a Holder does not read the particular notice (e.g., if a Holder fails to open the mail) or fails to take note of the notice or disclosures (because of the significant amount of other accompanying credit card disclosures or notices, or Issuer obfuscation of the notice), then the Holder nevertheless is deemed to have agreed to modify one of the most important terms of the borrowing agreement. It also is likely that many Holders will fail to take action because of the behavioral biases noted above, such as the status quo bias. This failure to take action should not be interpreted as voluntary assent.

130. Meyerson, *supra* note 7, at 610; see also Williams, *supra* note 38, at 789 ("If consumers systematically underestimate their borrowing and overestimate their ability to repay, and debiasing is not a realistic option, policymakers should explore insulation strategies that decrease the costs of these erroneous expectations" and "impose little or no burden on most credit card consumers.").

A mechanism that could be used in these circumstances is the presumption that any modification to an agreement to the Holder's detriment (such as an increased interest rate or increased penalty fees) would result in termination of the credit card agreement unless Holder affirmatively opted in and accepted the modification.¹³¹ For example, in the context of the interest rate increase, the credit card agreement would terminate on the effective date of the interest rate increase unless the Holder sent a signed notice to the Issuer affirmatively agreeing to the increase. Such a shift would address concerns about the effectiveness of the disclosure of the interest rate to Holders, as Issuers' incentive to "hide the ball" would disappear. Instead, Issuers would be incentivized to ensure that Holders understood that the agreement would be terminated unless Holders agreed to the rate increase. One can imagine the boldface notices to Holders warning them that their account is in danger of cancellation unless the Holder agrees to the pending rate increase. To the extent that cancellation of the account is undesirable to a particular Holder, then the Holder would be aware of the pending cancellation because of the enhanced disclosure and empowered to prevent the cancellation by taking an affirmative act signifying agreement to the modified term.

Moreover, by establishing a default rule that does not permit unilateral contractual modification by Issuers in the future, the future-looking biases of Holders are limited. Typically, Holders may execute a credit card agreement with an unfavorable term, such as reserving an Issuer's right to increase unilaterally interest rates, because Holders are by nature overly optimistic about the likelihood of that unfavorable event ever occurring.¹³² A mechanism that requires affirmative opting in, on the other hand, forces Holders to address the certainty, rather than the possibility of, an unfavorable event (the unfavorable contractual change) occurring. Once informed, Holders can either affirmatively accept or passively reject such a possibility.

The potential revenue loss to Issuers as a result of cancellation of agreements (following notice of increased interest rates) also would force Issuers to make underwriting decisions more carefully in advance (such as when setting initial interest rates), because Issuers would be faced with more (and a more accurate number of) Holders who, if

131. A default rule "is both libertarian and paternalistic if it retains freedom of choice while also leading people to make decisions that will improve their well-being." Sunstein, *supra* note 41, at 256; see also Bar-Gill, *supra* note 4, at 1421 ("Individuals tend to make fewer mistakes when a decision involves higher costs. It is rational to invest more (e.g., in improving one's understanding of the future implications of a contract), when there is a cost associated with signing the contract [such as reading the disclosure and affirmatively opting in].").

132. See Williams, *supra* note 38, at 783.

properly informed, actually would want to terminate their account if their interest rate was increased. In other words, Issuer underwriting mistakes cannot be corrected by shifting the cost to Holders without affirmative and actual Holder consent.¹³³ Of course, this incentive shift is partially developed through the CARD Act's provision for Holder termination of the agreement following notice of an interest rate increase, but Issuers could still, when assessing the potential effect of an interest rate increase, rely on faulty or missed disclosures as well as Holder behavioral biases that would lead to fewer Holders opting out.

It could be argued that less credit will be available, or at the very least, credit will be more expensive because of reforms that limit Issuers' unilateral ability to increase interest rates.¹³⁴ For example, if Issuers are unlikely to generate additional interest from increasing interest rates unilaterally, then Issuers may reduce the credit available to a particular Holder (to prevent the Holder from borrowing too much at a rate that is too low), increase the initial interest rate, or charge additional upfront fees (to compensate Issuers for the lost revenue). This argument assumes, however, that the amount of additional Issuer revenue currently generated from unilateral increases in interest rates is not a corresponding (and improper) cost to Holders.¹³⁵ If Issuers have been able to generate revenue from costs borne by Holders as a result of contractual terms modified without Holders' desire, knowledge, or assent, then the true cost of Holders' borrowings have not been internalized and assessed by Holders in advance. This means that Holders have not been borrowing at the appropriate rate (the "quantity effect"). If Issuers will not provide the service of a credit card without the compensation currently realized through unilateral rate increases, then Issuers can recoup such amounts through increased initial interest

133. See VICIOUS CYCLE, *supra* note 24, at 5 (noting how Issuers "share the risk" of Holder default by increasing the interest rates on other cardholders, including in situations (such as a recession) where it is difficult for credit cardholders to obtain an alternative lower interest rate credit card); see also Lazarus, *supra* note 1 (criticizing Issuers' "decidedly shortsighted approach to punish those customers who still pay their bills [by increasing their interest rates] and haven't shown themselves to represent any greater risk" during a downturn in the economy.).

134. Sidel, *supra* note 58, at A21 ("Industry executives say that credit is likely to become less available, particularly to risky borrowers, and more fees likely will be loaded into the front end of the account, rather than being assessed after a customer falls behind on payments."); see also Joseph William Singer, *Normative Methods for Lawyers*, 56 UCLA L. REV. 899, 974 (2009) (describing generally the argument that "adverse consequences of regulation could overwhelm any benefits sought by imposing minimum standards on the contractual relationship").

135. See also Meyerson, *supra* note 7, at 622-23 (suggesting that "enforcing all standard contract terms as drafted merely to lower sales prices for poor consumers falls into the category of paternalism: a nonefficient regimen whose sole justification is the protection of the welfare of certain individuals," as opposed to a regimen that "reduces information costs and decreases the likelihood of one party's unknowing assumption of risk, [which] is easily justified on nonpaternalistic, economic grounds.").

rates that disclose to the Holder the actual costs of borrowing under the particular credit card agreement. Of course, the market may constrain a particular Issuer from doing so because other Issuers will continue to lend at the old interest rates, but this is not a defect in the market and is, in fact, a correction.¹³⁶ There also is evidence that the fears of additional costs to be imposed on Holders as a result of such additional regulation are unfounded.¹³⁷

Holders may still borrow too much at a given rate because of certain behavioral biases, such as the optimism bias.¹³⁸ In particular, teaser rates are difficult because there may be little that can be done to counter the effect of the optimism bias and other biases that may prevent Holders from accurately assessing the risks involved with borrowing at a teaser rate, regardless of the quality of factual disclosure.¹³⁹ If, however, the standard of disclosure is adjusted to a subjective understanding standard, or at least investigated for general effectiveness, then it is possible that Issuers may develop standards of disclosure designed to temper the optimism bias itself.¹⁴⁰ In addition, altering the presumption of enforceability, as suggested in Part IV.B, *infra*, may also lead to disclosures designed to negate the optimism bias. Finally, in the absence of “harder” paternalistic policies (such as banning credit cards), which may not be cost-justified or have other risks,¹⁴¹ it may not be

136. In fact, it has been suggested that, rather than a required opt-in, Issuers would be required to permit other lenders to “bid” on the existing credit card account if the current Issuer desired to modify unilaterally a term of the provision. Holders could then either stick with the existing Issuer (with the modified contract term) or switch to a new Issuer. See Ian Ayres & Barry Nalebuff, *A Market Test for Credit Cards*, FORBES, July 13, 2009, available at <http://www.forbes.com/forbes/2009/0713/opinions-market-credit-cards-why-not.html>. Such a “market test” is not necessarily incompatible with an opt-in mechanism as an additional feature.

137. See Ryan Bubb & Alex Kaufman, *A Fairer Credit Card? Priceless*, N.Y. TIMES, June 23, 2009, at A25 (concluding, based on a comparison of credit cards issued by banks (owned by shareholders) to those issued by credit unions (owned by customers), that the lending model used by credit unions would be feasible for banks, even though credit card unions typically charged lower fees and were less likely to charge penalty or late fees).

138. Williams, *supra* note 38, at 790 (“The main pattern that emerges is that debiasing is unlikely to correct above-average effects and errors that people make when they are predicting their likelihood of suffering some future negative event,” such as being unable to pay accrued debt at the nonteaaser rate); see also Bar-Gill, *supra* note 4, at 1378, 1418 (“If a consumer believes that she will not borrow on her card, she will not mind the high interest rate, no matter how large the font Knowledge of credit terms is meaningless if the consumer mistakenly believes that she will not borrow.”).

139. See Sunstein, *supra* note 41, at 268 (suggesting that outright prohibitions may be appropriate with respect to certain credit card practices such as teaser rates).

140. Bar-Gill, *supra* note 4, at 1418 (suggesting that disclosure to Holders regarding their anticipated or predicted borrowing behavior must address the over-optimism effect to be effective); see also Sunstein, *supra* note 41, at 258 (suggesting that over-optimism could be addressed by “vivid narratives of possible harm” involved with over-borrowing, which would be intended to permit Holders to appreciate better the future costs of borrowing).

141. See Sunstein, *supra* note 41, at 254–55 (discussing generally the arguments against “strong

possible to close the “gap between expectations and reality, at least not completely.”¹⁴²

In any event, the reforms suggested in this Article are not intended to supplant the Holder as the ultimate decisionmaker with respect to Holder’s credit and borrowing decisions, but rather to position the Holder on a timely basis with the information necessary to make such decisions.¹⁴³ If Holders are unable to make the “correct” borrowing decision, then the costs will be borne by the Holder (such as increased interest payments) or the Issuer (e.g., if the Holder declares bankruptcy and the debts are extinguished). The choice between respecting a Holder’s preferences for borrowing too much and judging or correcting a Holder’s “defect” that prevents a “proper” amount of borrowing ultimately is a philosophical one,¹⁴⁴ regardless of any empirical evidence suggesting that, in hindsight, people may over-borrow (so long as such decision was made after being provided all relevant information).¹⁴⁵ An author has suggested that “[t]his tendency [to over-borrow because of the optimism bias], once combined with consumers’ poor understanding of interest charges and the rights of credit card companies to retroactively increase rates,” leads to bankruptcy (and presumably other costs) more often than other types of debt.¹⁴⁶ Consequently, the reforms suggested by the CARD Act and this Article are directed in a multi-faceted approach towards burdening Issuers with tempering Holder behavioral biases while at the same time limiting Issuer’s unilateral contracting power.

A stronger criticism is that certain Holders may not have alternatives

paternalism”).

142. Williams, *supra* note 38, at 790.

143. See Camerer et al., *supra* note 18, at 1253 (advising caution when determining whether “patterns of apparently irrational behavior are mistakes or expressions of stable preference.”). Camerer et al. highlight the popularity of extended warranties and discuss how the profitability for retailers from warranties may lead to the inference that buyers are “overpurchasing” them. The author concluded that fully informed purchasers may realize actual benefits from such purchases, which may lead to policy recommendations for increased disclosure rather than prohibitions. *Id.* Similarly, from an efficiency standpoint, mistakes are not relevant, either. Meyerson, *supra* note 7, at 614 (asserting that “[s]ince efficiency is only concerned with informed risk taking, not with whether a given gamble pays off, the consumer should have no valid complaint if she knowingly elects to take a chance that she will be unable to pay all her debt, and thereafter defaults.”).

144. See Sunstein, *supra* note 41, at 253–54 (noting that “for particular people, it is difficult to know whether a particular level of borrowing is optimal In addition, what seems to be bounded rationality may simply involve idiosyncratic tastes.”); see also Camerer et al., *supra* note 18, at 1218 (“In a sense, behavioral economics extends the paternalistically protected category of ‘idiots’ to include most people, at predictable times.”).

145. Williams, *supra* note 38, at 785 (suggesting that the link between credit card debt and bankruptcy indicates that Holders incur more debt than they actually desire).

146. *Id.* at 785–86 (footnote omitted).

for their basic credit needs, which means that disclosure may not be enough to justify enforcing a credit card agreement against a Holder. For example, if a Holder is faced with the decision to use a credit card to purchase food even though the Holder knows that the Holder will be unable to pay off the debt, then the Holder did not in fact have a “decision” to make, which could suggest limiting the enforceability of the credit card agreement.¹⁴⁷ Consumer credit, however, is neither a property right nor a government program to supplement income. In addition, Issuers generally bear the ultimate risk of nonpayment because consumer credit card debt typically is unsecured. Just as the Holder bears the risk that the Holder will be unable to pay a debt incurred (and as a result incur interest or other charges), the Issuer bears the same risk of nonpayment (and risk not collecting any principal, interest, or fees). Finally, contrary to prevailing wisdom, reducing credit card availability would not necessarily lead to more “undesirable” forms of debt for lower income individuals, as credit card debt is not a preferred form of debt for many Holders and may, in fact, be self-stimulating (i.e., incurred because the Holder has the ability to incur it rather than out of necessity).¹⁴⁸

As with any other disclosure, Issuers may be inclined to obfuscate required notice regarding the pending increase in the interest rate and instead to emphasize the loss of the benefits of the credit card itself. This can be rectified through rules clarifying the standard for the affirmative opt-in from Holders to be executed in connection with a Holder’s acceptance of a modification of the rate term. This also can be addressed through the ex post enforcement of the disclosure standard, including through the enforcement standards and mechanisms suggested in Part IV.B–C, *infra*. Consequently, requiring Holders to evidence affirmatively their agreement to any proposed modification to their credit card agreements would induce better and more complete disclosure from Issuers.

147. See Jon Hanson & David Yosifon, *The Situation: An Introduction to the Situational Character, Critical Realism, Power Economics, and Deep Capture*, 152 U. PA. L. REV. 129, 302 (2003) (“Making someone liable for outcomes over which she wielded comparatively little dispositional control and where her situation is relatively controlling would be unjust, unfair, or inefficient, depending on the theoretical focus.”).

148. Littwin, *supra* note 101, at 426, 454 (concluding that “credit cards are actually among low-income consumers’ least-preferred sources of credit, meaning that there is no ‘worse’ alternative to which they would turn if credit card access were reduced,” and noting that “credit cards, in and of themselves, may stimulate spending”).

B. Shifting the Presumption of Enforceability

In certain circumstances, an affirmative opt-in by a Holder to a particular contractual provision is not feasible. At the time of the credit card agreement's initial execution, for example, it is not clear whether a Holder has actually read all or merely some of the agreement's provisions. As demonstrated in Part II, *supra*, consumers generally do not focus on or comprehend many contractual terms, and Issuers draft credit card agreements to their advantage accordingly. Although the CARD Act requires additional disclosure with respect to certain terms, and prohibits certain contractual practices, the CARD Act fails to address the fundamental asymmetries of information and incentives between Holders and Issuers.

Consequently, new reform is needed to induce Issuers, as the actors with the most information and resources, to share the information regarding the contractual provisions with Holders, the actors with the least information and resources. One reform that has been suggested elsewhere in the form contract context is altering the presumption of contract enforceability for the consumer's (Holder's) benefit.¹⁴⁹ This is somewhat intuitive because Issuers control preparation of the credit card agreement and its disclosures, which suggests that Issuers should be responsible for disclosure that is inaccurate or incomplete.¹⁵⁰

149. See Meyerson, *supra* note 7, at 610; see also Hillman & Rachlinski, *supra* note 7, at 460 (explaining that, in some contexts, "the doctrine of reasonable expectations thus creates an affirmative duty on the part of the business to point out and explain reasonably unexpected terms even if they clearly were stated in the contract"). This Article, as will be seen, proposes that, rather than determining which provisions are "reasonably unexpected," there would be a presumption of unexpected terms with respect to the entire credit card agreement, which would induce the desired information-sharing behavior by Issuers. The prevailing theory of "blanket assent," which suggests that reasonable (both in presentation and substance) standard form contracts should be enforced, even though most consumers do not read them, would be set aside and remove the "difficult task of drawing a line between permissible and impermissible pressure and terms." *Id.* at 462. Instead, courts would review the adequacy of disclosure and leave it to sellers to determine what "unreasonable terms" to include and to seek the most effective method of disclosure. See also Eisenberg, *supra* note 3, at 246–48 (arguing that the "law is properly moving toward basing the enforceability of preprinted terms, as well as the role of such terms in contract formation, purely on the limits of cognition, rather than on unfairness").

150. Meyerson, *supra* note 7, at 610–11 (arguing that "because the seller is better able to control the conveying of information, sellers who give incorrect or misleading information to consumers should be held liable for the error"). Requiring a different standard for information disclosure is an example of an "asymmetrically paternalistic" technique, which is designed to have large benefits on those individuals who may be influenced by behavioral biases (such as the optimism bias) versus those who are not so biased. Camerer et al., *supra* note 18, at 1212. Shifting the presumption of enforceability regarding disclosure (with respect to unfavorable changes in terms) should impose very little costs on unbiased Holders (because such unbiased Holders probably already understand or are unaffected adversely by the disclosures), while at the same time providing a significant benefit to biased Holders that might otherwise discount the possibility (versus the certainty) of an unfavorable term being imposed.

Consequently, if Issuers do not share information regarding a particular term, the credit card agreement should be deemed to include provisions that the Holder would have agreed to if such information had been shared.¹⁵¹ This is based on the Issuers being “encouraged to either ascertain those [Holders’] expectations or alter them by providing adequate information.”¹⁵² As a result, the contract can be assumed to be a “value-maximizing transaction” because both parties will be “operating under the same accurate assumptions as to the meaning and value of their contract.”¹⁵³

Taking the doctrine of “reasonable expectations” a step farther, this Article suggests the terms of a credit card agreement would be deemed to be unenforceable unless the Issuer could establish that the Holder was (or should have been) aware and understood the significance of the applicable terms at the time the credit card agreement was executed.¹⁵⁴ This may need to be established beyond reference to the credit card agreement itself.¹⁵⁵ For example, Issuers may need to disclose the applicable interest rate orally when executing the credit card agreement. Of course, Issuers also would be permitted to establish that the interest rate was disclosed such that Holder understood it, or to lessen the impact of a subjective standard, that a credit card holder in Holder’s situation would reasonably be expected to understand it. Issuers thus would have to assess and address fairly the true “costs” of the credit card agreement, either by meeting the disclosure requirements (and ensuring that Holders are consciously and comprehendingly agreeing to the agreement’s provisions) or compensating Holders when the requirements have not been met (by *ex post* interpretation of the agreement to Holder’s benefit).¹⁵⁶ This standard would also avoid relying on courts’

151. Meyerson, *supra* note 7, at 611.

152. *Id.*

153. *Id.*

154. See Bar-Gill, *supra* note 4, at 1377, 1416 (suggesting that “[i]f a contracting party misconceives the future consequences of the contract, then the normative power of contractual consent is significantly weakened Freedom of contract may thus prevent, rather than promote, the fulfillment of the consumer’s true *ex ante* preferences.”); see also Meyerson, *supra* note 7, at 611–13. Meyerson suggests that consumers give explicit consent only to central terms, such a price, in the standard form contract, and as a result, this presumption should be reserved for subordinate clauses. In the credit card agreement context, however, given the uncertainty of most credit card holders of their interest rate, it is not clear why this presumption should not be extended to the interest rate (the price) as well.

155. Meyerson, *supra* note 7, at 612–13 (noting that “[m]erely using a contract with plain language and without fine print is not sufficient, even though such a contract would somewhat decrease the consumer’s information costs.”)

156. Note that enforcing a particular contract for the benefit of the Holder does not suggest that Holder would be entitled to any provision beyond her reasonable expectations. Thus, although the credit card agreement may not be enforced to the detriment of the Holder beyond her reasonable

determination of what was reasonable from a business perspective (as in the traditional application of the “reasonable expectations” doctrine). Instead, courts would make an inquiry into the adequacy of disclosure and nothing more.

In particular, this would augment the new disclosures required for teaser rates under the CARD Act. As noted in Part III.A, *supra*, Issuers are required to inform Holders of the rate that will apply following the expiration of the teaser period, as well as the length of the teaser period. If the obligation is on Issuers to demonstrate, in a dispute situation, that Holders should be expected to understand the teaser rate disclosure and its significance. Instead of obscure or buried disclosures, Issuers would likely find the most efficient and effective manner in which to disclose the teaser rate terms for fear of not receiving the benefit of the increased interest rate.¹⁵⁷ One can also imagine Issuers expending resources to determine how Holders interpret different forms of notices and explanations, which would be useful to the Issuers both for determining the ideal form of teaser rate disclosure as well as evidence of the utility of that form of disclosure.¹⁵⁸ Using evolving common law standards to determine the adequacy of disclosure also may suggest that Issuers will exceed any minimum disclosure requirements of the CARD Act or other regulations, especially if compliance with the applicable regulations is not deemed to satisfy the common law standard.¹⁵⁹

Shifting the presumption of enforceability also is important for ancillary contract terms that Holders are especially unlikely to read or comprehend in the typical credit card agreement.¹⁶⁰ If the significance of a particular ancillary term is adequately disclosed and explained to Holders, then Issuers should be given the benefit of that particular term. It may be too time-consuming or cost-prohibitive, however, to explain every ancillary provision in a credit card agreement. The question

comprehension, neither will it be interpreted to Holder’s benefit beyond Holder’s reasonable expectations.

157. Meyerson, *supra* note 7, at 613 (suggesting that it would be “hard to imagine” a court not enforcing a term if the significance of the terms was explained orally to the consumer).

158. See Sunstein, *supra* note 41, at 255 (“One of the advantages of weak paternalism [such as shifting default rules] is that it may be technology-forcing, in the sense that it can spur innovations that respond to individual needs in ways that government may be unable to imagine.”).

159. See, e.g., Anne Erikson Haffner, *The Increasing Necessity of the Tort System In Effective Drug Regulation in a Changing Regulatory Landscape*, 9 J. HEALTH CARE. L. & POL’Y 365, 398 (2006) (noting that “[u]nder the common law tort system, pharmaceutical companies are encouraged to go beyond the minimal safety and warning requirements of the FDA because regulatory compliance does not presume satisfaction of the standard of care”). In the lending context, lenders are insulated from civil liability for any act in good faith that conforms to any Federal Reserve System interpretation. 15 U.S.C. § 1640 (2006).

160. See Meyerson, *supra* note 7, at 612–13.

remaining, then, is how to interpret and enforce relatively minor or ancillary terms that have not been disclosed adequately to Holders. In the general consumer form contract, it has been argued that such undisclosed terms may be either interpreted against the party better able to bear the risk of loss or by using traditional contract default terms.¹⁶¹ Because many “losses” in the credit card agreement context are revenues to Issuers if suffered by Holders, it makes sense to use the former approach for any term that creates a direct revenue benefit to Issuers. For example, if a credit card agreement included a provision charging a fee if the Holder failed to make payments on the account by wire transfer rather than a check, then the provision should not be enforced if it was not disclosed and explained to the Holder. This reduces the incentive for Issuers to include hidden or unexplained ancillary terms that have a cost to the Holder and a direct dollar-for-dollar benefit to Issuer.

Moreover, credit card agreements and the process by which Issuers engage Holders to explain their terms may alter Holders’ perceptions of the contract disclosures themselves. Currently, credit card agreements may be perceived by Holders as legalistic documents designed to protect Issuers’ interests.¹⁶² If Holders come to view the credit card agreements as containing important and readily understandable information, then Holders may voluntarily attempt to internalize and comprehend the information, which may result in more appropriate borrowing levels.¹⁶³

The most compelling argument against shifting the presumption of enforceability is the administrability of such a regime. The desirability of using a contract is the parties’ certainty of how particular contingencies will be treated. If courts ignore any clause because of perceived efficiency concerns (in the absence of adequate disclosure) or other noneconomic terms, then the costs of contracting may be increased exponentially as Issuers adjust to ensure that Holders are walked carefully through the contract execution process.¹⁶⁴ On the other hand, if Issuers generally include in their credit card agreements “efficient”

161. *Id.* at 617.

162. See Prentice, *supra* note 10, at 372.

163. See Hanson & Kysar, *Some Evidence of Market Manipulation*, *supra* note 61, at 1565 (suggesting that forcing manufacturers to bear the risk of all product liability costs may alter consumer perceptions of product warnings as the “handiwork of overly cautious manufacturer attorneys” and instead provide consumers with “incentives to read, comprehend, and follow them.”).

164. See Jeffrey J. Rachlinski, *Rulemaking Versus Adjudication: A Psychological Perspective*, 32 FLA. ST. U. L. REV. 529, 545–46 (2005) (“[T]he rulemaking approach seems to have a perspective that is better suited to managing social and economic interactions. Adjudicative bodies are apt to be persuaded by misleading signals from individual cases’ emotional content, unable to see how the resolution of the disputes before them fits into a broader scale, and focus excessively on individual conduct rather than social forces.”).

clauses or clauses that comport with traditional contract default rules, then Issuers would only be required to “explain” the clauses that are the exception.¹⁶⁵ In addition, once a decision was announced with respect to a particular means of ensuring that a Holder understood and comprehended a particular term (and that such terms were therefore enforceable), Issuers would have precedent for future agreements.¹⁶⁶

Overall, altering the presumption of enforceability of credit card agreement with respect to pricing and cost terms incentivizes Issuers to make better and more complete disclosure of the material terms of credit card agreements. Although there may be a cost to Issuers to ensuring that Holders understand the existence and significance of such terms, these costs are hopefully offset by the reduced costs or losses suffered by Holders as a result of such understanding.

C. Opening Up the Courts

Another way the shortcomings of the legal framework governing credit card agreements may be addressed is through expanded or enhanced ex post protections of credit card holders. The CARD Act generally fails to include solutions designed to provide this type of protection because it relies almost exclusively on existing regulatory enforcement of the new standards.¹⁶⁷ Similar to the reforms suggested above, the goal of ex post enforcement should be not only to be available to redress contractual breaches but also to be a factor when Issuers prepare, execute, or contemplate breaching credit card agreements.¹⁶⁸ That is, the enforcement regime ideally would serve also as a deterrent against poor drafting or execution decisions by Issuers.

One possibility within this enforcement regime is private legal action, and in particular, actions that aggregate the claims of many disadvantaged consumers.¹⁶⁹ Permitting Holders to recover through class actions (or class-wide arbitrations) would deter Issuer misbehavior, especially regarding individual claims that may not be significant

165. Meyerson, *supra* note 7, at 621.

166. *Id.* at 622 (noting that after a court decision was announced, “it is available to guide future contracting parties and reduce contract transaction costs”).

167. *See* Part III.E, *supra*.

168. Issacharoff & Delaney, *supra* note 6, at 167 (explaining that “soft paternalism searches for mechanisms to improve decisionmaking without having the state assume responsibility for all decisions.”).

169. *Id.* at 169 (noting that “[p]otential legal representatives armed with doctrines such as unconscionability may well provide sufficient smoothing in a market characterized by asymmetric bargaining power and access to information.”); *see also* Hillman & Rachlinski, *supra* note 7, at 463 (arguing that “[w]hen the courts find reason to believe that market forces have failed to discipline businesses, they intervene to protect consumers.”).

enough to induce the individual Holder to seek redress. This would need to be accomplished by preventing binding individual arbitration clauses from precluding class action suits, although arbitration still could be available for individually prosecuted claims.¹⁷⁰

The class action mechanism is specifically and uniquely designed to provide a remedy for individual claims that may not have value after taking into the account the cost of prosecuting such claims (“‘negative value’ claims”), but which are significant when aggregated.¹⁷¹ From an economic standpoint, even if a particular Holder’s losses from an “illegal” or “unenforceable” provision in a credit card agreement are small, such small losses, when aggregated, may prove significant enough to entice a plaintiff’s attorney to seek redress on behalf of similarly situated Holders.

From a social standpoint, class action suits also could effectively serve poor Holders, Holders who are unaware of their contractual and legal rights, and Holders who are otherwise unable to bring claims on their own behalf.¹⁷² As seen above, the class action may transform a “negative value” individual claim into a claim that is worthy of redress. Class action suits also would protect Holders who were unaware of Issuer breaches and provide them a remedy for Issuer breaches.¹⁷³ Finally, class action suits would draw attention to Issuer practices that may need to be reformed, especially with respect to “subprime”

170. See Jane J. Kim, *What Consumers Can Expect As Arbitration Firms Back Away*, WALL ST. J., July 22, 2009, at A2 (reporting that President Obama’s proposed Consumer Financial Protection Agency would have the authority to ban or restrict mandatory arbitration clauses in consumer financial-services contracts). *But see* Bar-Gill, *supra* note 4, at 1423 (“Given the institutional constraints on common law adjudication, it may well be better to leave the regulation of credit card contracts to legislatures and administrative agencies.”). Rather than focusing on the substantive unfairness of the agreement, such as doctrines of unconscionability or the penalty doctrine, however, this Article suggests that courts could focus on the substantive fairness of the disclosure.

171. Issacharoff & Delaney, *supra* note 6, at 177; *see also* Jean R. Sternlight & Elizabeth J. Jensen, *Using Arbitration to Eliminate Consumer Class Actions: Efficient Business Practice or Unconscionable Abuse*, 67 L. & CONTEMP. PROBS. 75, 85 (2004).

172. See Sternlight & Jensen, *supra* note 171, at 82–83 (explaining the *State ex. rel. Dunlap v. Berger*, 567 S.E.2d 265 (W. Va. 2002), decision in light of the court’s emphasis on the class action tool as an effective remedy); *see also* Joshua D. Blank & Eric A. Zacks, *Dismissing the Class: A Practice Approach to the Class Action Restriction on the Legal Services Corporation*, 110 PENN ST. L. REV. 1, 10–14 (2005) (discussing generally the legal and social benefits of the class action as a device to serve poor or marginalized individuals). Although this Article focuses on the ability of the class action device to provide legal redress for poor litigations, many of the same principles apply in the context of credit card holders who are unaware of the significance of the provisions of their credit card agreement, especially given the number of credit card holders in a difficult socioeconomic position.

173. See, e.g., Blank & Zacks, *supra* note 172, at 12 (describing how a class action lawsuit protected Medicare recipients who had been, without their knowledge, denied services or entitlements); Sternlight & Jensen, *supra* note 171, at 89 (noting that “one of the virtues of the class action is that it requires that putative class members be notified of the potential violation of their rights”).

Holders.¹⁷⁴

The class action can be seen in this way as leveling the playing field for Issuers and Holders, as any disadvantages faced by Holders when entering a credit card agreement could be addressed at least in part by their collective ability to seek redress after the fact.¹⁷⁵ The mere threat of a class action may force Issuers to alter their behavior prospectively, as Issuers may no longer be able to rely on the “negative value” of individual claims or the inability of individual Holders to prosecute claims to preclude actions for recovery and may instead fear adverse publicity associated with a public class action lawsuit.

As a result of the threat of class action lawsuits, Issuers will either charge Holders more via express contract or internalize the “costs” of certain Issuer practices, such as charging fees for certain conveniences without disclosing such fees in advance.¹⁷⁶ In other words, Issuers would make a complete determination as to whether the revenue collected from such a fee was necessary for the Issuers to provide the service of the credit card, and Issuers would either charge Holders more for the credit card through increased interest rates or complete disclosure of the fees in advance, or accept less revenue by not charging the fee. Either way, the “cost” has been properly incorporated into the commercial relationship without detriment to the unknowing Holder.

As noted in Part III.E, *supra*, however, mandatory individual binding arbitration clauses generally preclude collective or class actions with respect to Issuer breaches. Permitting (or prohibiting) collective actions could be achieved through a number of means. First, using the new proposed default rule specified in Part IV.B *supra*, which would presume the unenforceability of clauses in the absence of an Issuer demonstrating that a Holder comprehended the significance of a

174. See Blank & Zacks, *supra* note 172, at 13 (suggesting that “class action lawsuits draw public attention to issues that are unique to the poor community.”); Sternlight & Jensen, *supra* note 171, at 90, 92 (noting that many important remedies only can be provided on a group-wide basis rather than through individual claims or through government enforcement actions).

175. See Blank & Zacks, *supra* note 172, at 12 (arguing that “[c]lass action lawsuits also eliminate power imbalances by allowing a class of underrepresented people with similar claims to attract more effectively the attention of a powerful defendant.”); see also Marie A. Failing & Larry May, *Litigating Against Poverty: Legal Services and Group Representation*, 45 OHIO ST. L.J. 1, 17 (1984) (noting that an individual suit cannot “restore the political balance of power between the institution and the individual. By contrast, the class suit can secure relief for the client that is not only longer-lasting but also broader-based.”). See generally Marc Galanter, *Why the “Haves” Come Out Ahead: Speculations on the Limits of Legal Change*, 9 LAW & SOC’Y REV. 95 (1974) (suggesting that class action lawsuits address some of the disadvantages faced by poor plaintiffs).

176. See Blank & Zacks, *supra* note 172, at 13 (suggesting that “[t]he class action lawsuit . . . can be viewed as a tool that requires potential defendants to internalize the costs of socially injurious policies”).

particular clause, could be employed for arbitration clauses.¹⁷⁷ Another method would be to preclude by statute or regulation any class action waiver in the consumer credit context (even if individual arbitration provision still were permitted). Regardless of the method of enactment, opening up the courts to class-wide relief could be a significant tool in addressing the imbalance in the credit card agreement context.

V. CONCLUSION

This Article has suggested that the CARD Act, although providing useful reforms, contains significant flaws regarding its attempt to promote both the fairness and efficiency of credit card agreements. The CARD Act's most substantial flaw is its reliance on passive information disclosure to Holders with respect to credit card agreement default terms or modified terms, without modifying Issuers' incentives to withhold or conceal such information. Holders, as the recipients of such information (often on an untimely basis), are not likely to internalize such information, as a result of behavioral biases that prefer inaction over action and reflect over-optimism about the likelihood of the future application of adverse contractual provisions (such as mandatory individual binding arbitration provisions). Issuers, on the other hand, receive directly all of the benefits of a credit card agreement provision that results in additional interest or fees. As opposed to the product liability context, where externalized costs are not necessarily a benefit to product sellers, Issuers are incentivized to develop contractual situations where Holders are likely to face such revenue-generating "costs." The CARD Act addresses certain egregious practices by prohibiting them or severely restricting them, but in general it does little to alter the basic contractual relationship between Issuers and Holders whereby Issuers are incentivized to conceal credit card agreement terms that result in future costs or charges to Holders. In this way, Issuers are able to impose (externalize) improper costs on Holders, which is only compounded by Issuers' knowledge of the likely inaction by Holders in response to a standard form contract and accompanying disclosures containing unfavorable terms.

Similarly, the CARD Act relies on existing regulatory enforcement to

177. At least one court has taken some steps towards this approach. In *Discover Bank v. Superior Court*, 113 P.3d 1100 (Cal. 2005), the court concluded that class action waivers were unenforceable when the waiver was obtained through "passive disclosure" (a "bill stuffer") and to the extent that such waivers "operate effectively as exculpatory contract clauses." *Id.* at 1008; see also Issacharoff & Delaney, *supra* note 6, at 182 (discussing the "soft paternalism" approach that would permit waivers of class action so long as "the scope of conscionability" was not exceeded by Issuer practices).

provide redress for harms suffered by Holders. As a result, Issuers are not prohibited from including dispute resolution clauses that require individual mandatory arbitration to resolve disputes. These clauses likely have diminished Holders' ability to prevent and address Issuer misbehavior in the credit card agreement context. This result is due to the secretive nature of arbitration hearings, which prevent the general public (and regulators) from becoming aware of Holder complaints, as well as the inherent conflict of interest between arbitration firms that seek additional future dispute referrals from the Issuers while at the same time deciding disputes between Issuers and Holders. Most significantly, the mandatory individual arbitration clauses generally have prevented Holders from seeking remedy as a collective group, which probably has permitted Issuers to create Holders' costs that are improper, as well as to diminish the number of public actions seeking redress. Consequently, the CARD Act has left in place an enforcement regime that does not incentivize or permit all potential interested parties to act to deter, or recover for, Issuer misbehavior.

As a result of the above limitations of the CARD Act, Issuers are likely to continue to draft credit card agreements in their favor, regardless of whether the terms of such agreements are required to be disclosed in an additional manner to Holders. The CARD Act does introduce a useful concept that should be expanded to address the structural flaws in the system. It requires an affirmative act by Holders to opt-in to permit Issuers to charge an over-the-limit fee, which could address some of the behavioral biases described in this Article, by requiring Holders to realize the certainty that the fee will be charged (which addresses the optimism bias) and to act in response (addressing the status quo bias) if the fee is actually desirable. Towards that end, Issuers would be incentivized to ensure that Holders actually opted in, which Issuers would not be able to do without providing meaningful disclosure that the opting in was required. Of course, if the federal rules implementing this provision do not require opting in to be contemporaneous with the fee charge, then the utility of this reform will be limited. In any event, this reform highlights the type of mechanism needed to address Holders' limitations in the contract negotiation context and Issuers' incentives to exploit such limitations.

This Article suggests that requiring Holders to "opt in" to accept any material changes to credit card agreement proposed by Issuers should be required or the agreement would be terminated. Issuers would be incentivized to provide meaningful disclosure because, absent Holder action, the agreement would be determined, and this regime would place the burden of overcoming Holders' status quo bias on the Issuers rather

than Holders. Similarly, Holders' optimism bias would be addressed because of the certainty, rather than Holders' flawed analysis of future probability, of the unfavorable term's effectiveness. Issuers would then have to determine whether to propose changes to the agreement based on underwriting concerns (e.g., that the interest rate needed to be increased because of increased or changed credit risk) as well as the risk that the agreement would be terminated (by Holder failing to opt-in and accept such new term). This reform would force Issuers to face the economic decision and risks associated with proposing unfavorable credit card agreement terms during its initial underwriting of a particular Holder rather than relying on Holder passivity in the future if the underwriting profile changes and Holder's unilateral changes to the agreement are "needed."

To address Issuer incentives to provide actual meaningful disclosure of credit card agreement terms to Holders, this Article suggests shifting the presumption of enforceability of credit card agreements against Issuers. Rather than assuming that all of the terms of the credit card agreements are enforceable if a Holder used the credit card, an Issuer in the dispute context would have to demonstrate that the disclosure of the term seeking to be enforced was meaningful. By shifting the presumption of enforceability, Issuers no longer would be able to rely on a regulatory standard or on the common law's general reluctance to examine *ex ante* contracting behavior. Although this regime has obvious administrability concerns, it is intuitive that such a change would drastically alter Issuer behavior with respect to current credit card agreements and disclosure materials, which are (likely deliberately) written above the comprehension level of most Holders, confusing, complex, and disorganized. If Issuers were cognizant that credit card agreements would only be enforced to the extent that Holders actually comprehended the contract's provisions, then Issuers would be motivated to determine (e.g., by conducting empirical studies) and use the most effective disclosure methods available, or to include reasonable default terms.

Finally, this Article has suggested that the use of mandatory individual arbitration clauses should not be permitted, at least as a device to avoid collective claims of Holders. Class action lawsuits would be a useful tool to deter Issuer misbehavior by publicizing such claims and changing Issuers' calculus with respect to improper costs imposed on individual Holders that are unlikely to be addressed through individual actions.

The CARD Act's inability to address the inequalities in the basic contractual framework facing Issuers and Holders when entering into a

credit card agreement suggests that many of its reforms will be ineffective. Fundamentally, the CARD Act does not address the likely passive response of Holders to additional information disclosure without addressing the incentive or competitive requirement for Issuers to exploit such responses. Similarly, although it prohibits several deceptive contractual practices, the CARD Act does not create mechanisms to prevent future similar types of Issuer misbehavior. This Article suggests that there are several alternate or complementary mechanisms that would realign Issuers' profit motive with the desire for Holders to receive, comprehend, and internalize the relevant terms of the credit card agreement. Through such realignment, credit card agreements may come to reflect an ideal standard form contract where the sellers, as the parties with resources, information, and profit incentive, enable accurate consumer assessment of the risks and costs of a consumer good.

