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COMMENTS

CREDIT CARDS AND THE VIRTUAL ACCEPTANCE

FREDERICK M. HART*

A recent case¹ decided in a lower New York court indicates an interesting use of the virtual acceptance. Neither the decision nor the opinion is of great import, but the case is noteworthy because of the theory advocated by the plaintiff which shows a clever (and successful) attempt to adapt a principle developed during the last century to a modern type of credit transaction. In addition, it furnishes an opportunity to discuss a significant change made by the Uniform Commercial Code in the field of Negotiable Instruments.

The action was brought by the financier of a credit club to collect obligations incurred by a credit card user. The credit plan, a tripartite contract, involved the following parties: the Esquire Club, Gale Creations which was a "company member" of the club, and Kass, an employee of Gale Creations who had been issued a card by the club in accordance with the arrangement. Gale Creations having become insolvent, collection was attempted from Kass who had made the purchases.

When the credit card was delivered to Kass, who was termed a "designated card holder," he was required to sign it, thereby subjecting himself to the regulations of the club. One of these, important to a determination of the case, stated:

"Company Member agrees to pay for all charges incurred by its designated card holders and each of the card holders agrees to pay all charges incurred by him, and *they agree to accept all drafts drawn on them for charges incurred by or in their behalf.*"² [Emphasis supplied.]

The usual process of collecting followed by the club proceeded as follows: The original supplier of goods or services would prepare a club draft which showed the amount of the card holder's purchase and directed him to pay the indicated charges "to Esquire Club, or order, of Franklin National Bank." This draft was addressed to the purchaser, Kass, in the instant case, but forwarded to the Esquire Club which apparently paid the supplier from its own resources. The

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¹ Franklin National Bank v. Kass, 19 Misc. 2d 280, 184 N.Y.S.2d 783 (Sup. Ct. 1959), noted, 1959 Survey of N.Y. Law, 33 N.Y.U.L. Rev. 1442, 1454 (1959).

² Id. at 281, 184 N.Y.S.2d at 784.

Esquire Club then "negotiated" the instrument to the Franklin National Bank which, after having it photographed, mailed the original to the purchaser. The draft also contained the instruction, "If incorrect, please return within ten (10) days. Otherwise, retention constitutes acceptance."³

In the case, *Franklin National Bank v. Kass*,⁴ the defendant had used his Esquire credit card for various purchases and a number of club drafts had been prepared and sent to him in accordance with the billing technique. Upon his failure to pay, this action was brought by the bank to whom the instruments had been transferred. Plaintiff's theory was neither that the defendant had breached his promise to pay, nor that he had breached his promise to accept, but rather was grounded in the assertion that the drafts were negotiable bills of exchange upon which the defendant was primarily liable because he had actually accepted them.

Two possibilities existed for a finding of an acceptance. It could be reasoned that the purchaser, by signing the credit card and agreeing to the club rules, promised to accept all drafts drawn upon him, and such was equivalent under section 135 of the Uniform Negotiable Instruments Law⁵ to an actual acceptance. Or, it might be argued that retention of the drafts beyond the specified ten day period was sufficient to constitute a constructive acceptance. The court chose the former theory, granting relief to the plaintiff on the ground of actual acceptance.

Collateral acceptances⁶ gave rise to considerable litigation in this country during the nineteenth century. Although recognized in England at a relatively early date,⁷ they were never favored, both the virtual⁸ and extrinsic acceptance⁹ eventually being abolished. Following the lead of Chief Justice Marshall in *Coolidge v. Payson*,¹⁰ American courts have been more sympathetic with their use, their main

³ Id. at 282, 184 N.Y.S.2d at 785.

⁴ 19 Misc. 2d 280, 184 N.Y.S.2d 783 (Sup. Ct. 1959).

⁵ N.Y. Negotiable Inst. Law § 223 (1909).

⁶ "Collateral acceptance" is a general term used to designate any acceptance off the face of an instrument. Within its meaning are contained the "extrinsic" acceptance (an acceptance off the instrument subsequent to its issuance) and "virtual" acceptances (acceptances off the face prior to the instrument's issuance).

⁷ *Wilkinson v. Lutwidge*, 1 Str. 649, 93 Eng. Rep. 758 (1726); Britton, Bills and Notes § 174 (1943).

⁸ *Pierson v. Dunlap*, 2 Cowp. 571, 98 Eng. Rep. 1246 (1777). The virtual acceptance had a life span of only nine years as it had been first recognized in 1765. *Pillars & Roses v. Van Mierop & Hopkins*, 3 Burr 1663, 97 Eng. Rep. (1765).

⁹ The extrinsic acceptances had a somewhat longer life. It was abolished by statute in 1794. Stat. 3 & 4 Anne, c. 9, §§ 4 & 5 (1794).

¹⁰ 15 U.S. (2 Wheat) 66 (1817).

concern being the extent to which limitations should be placed upon acceptance off the face of an instrument.

Prior to the NIL, little uniformity existed among the states in the reception afforded to the collateral acceptance, or in the stringency with which there were to be imposed requirements that the promise be in writing, unconditional and definite in its description of the drafts. Nor was there complete agreement as to whether reliance upon the promise to accept was an essential element of the holder's case. The adoption of the NIL settled some questions, generally limiting the use of the collateral acceptance. However, sufficient latitude remained to preclude any real uniformity.¹¹

New York consistently has taken a liberal approach to such acceptances,¹² and the *Kass* case, although perhaps a little surprising because of its novel facts, is not repugnant to the general tenor of cases in this jurisdiction. However, in other jurisdictions governed by the NIL, the decision is subject to doubt both because of the conditional nature of the promise to accept and to the complete failure of the promise to identify the drafts to be drawn.¹³ A contrary decision would be required in those states governed by the Uniform Commercial Code, since the Code has abolished all acceptances off the face of the instrument.¹⁴

A basic proposition of the law of commercial paper, that no person is liable on an instrument unless he has signed it,¹⁵ is the principal objection to recognition of the collateral acceptance.¹⁶ The reason for the rule is clear, being, in fact, closely linked with the theory of negotiability itself. Negotiable instruments, designed to be as much like cash as possible, have an intrinsic value of their own which is distinct and separate from the liabilities arising from any underlying or collateral transaction. In order that they be freely negotiable, as property valuable in their own right, their worth, as well as the rights and liabilities of the parties, must be ascertainable from a mere inspection of the instrument itself—no need should exist to go beyond the four corners of the paper. Only two risks are taken by one purchasing

¹¹ Finklestein, *Acceptances and Promises to Accept*, 26 *Colum. L. Rev.* 685 (1926).

¹² *Merchants' Bank v. Griswold*, 72 N.Y. 472 (1878); *Burns v. Rowland*, 40 Barb. 368 (N.Y. 1863); *Ulster County Bank v. McFarlan*, 5 Hill 432 (N.Y. 1843); 3 *Denio* 553 (N.Y. 1846).

¹³ *First Nat'l Bank v. Clark*, 61 Md. 400 (1883); *Lonsdale v. Lafayette Bank*, 18 Ohio 126 (1849); *Wauchula Development Co. v. Peoples Stock Yard Bank*, 86 Fla. 298, 98 So. 220 (1923).

¹⁴ UCC § 3-410.

¹⁵ NIL § 18. This Act presently makes an exception to the general precept in favor of collateral acceptances. NIL §§ 134 & 135.

¹⁶ UCC § 3-410, Comment No. 3 (1958 Ed.). See also Finklestein, *supra* note 11.

as a holder in due course, that the instrument may not be genuine and that the obligated parties may not be willing and able to pay. Where the liability of a person depends, as it does in all cases involving collateral acceptances, not upon a promise made in the instrument, but upon a completely separate promise, a holder's rights are no longer determinable from a mere inspection of the instrument.

In spite of this theoretical argument against the collateral acceptance, it may be urged that if business practices show a need for acceptances off the face of drafts, they should be tolerated as a useful exception to a general precept. So long as the exception does not adversely affect the motivating purpose of the law, it need not be condemned. From the paucity of litigation during the past twenty-five years involving virtual and extrinsic acceptances, it seems doubtful that substantial legal problems remain unsettled in this area. Thus, the change wrought by the Uniform Commercial Code, in repudiating the collateral acceptance, may appear as a needless and arbitrary legal restriction upon the commercial community.

The answer to this is that the collateral acceptance is of little practical value. The Code does not disturb the right of a party to sue upon the promise to accept itself.¹⁷ It only states that the promise to accept no longer constitutes an actual acceptance. This being true, an advantage is gained by the holder where he can treat the promise as an actual acceptance only if by doing so his rights are thereby enlarged or his burden of proof lightened. Generally, there are two advantages gained by suing on a negotiable instrument, personal defenses (equitable defenses) of the defendant are unavailable against him and there exists a presumption of consideration in his favor.¹⁸

Where the holder sues for breach of a promise to accept a draft, he enjoys the same benefits. They arise, however, not because of any theory of negotiable instruments law, but from the very nature of the promise. This promise is separate and distinct from the underlying transaction giving rise to the draft and whether the drawee-promisor has a personal defense to an action brought either on the draft or upon the underlying transaction is irrelevant in a suit grounded upon the promise to accept.¹⁹

¹⁷ UCC § 3-410, Comment No. 3.

¹⁸ There may also be a question of whether the quantum of damages recoverable differs. It has been noted elsewhere that if a difference does exist, suit upon the promise to accept would result in greater damages because the possibility of recovering for anticipatory breaches would exist. Finklestein, *supra* note 11, at 719.

¹⁹ *Clinch Co. Bank v. Wyatt-Proch Lumber Co.*, 82 Pa. Sup. 305, 308 (1923). "The fallacy of the contention of counsel [that a failure of consideration in the underlying transaction defeated a holder's suit against one who promised to accept] . . . seems to be due to his apparent conception that the suit was on the draft, whereas it

The presumption of consideration, or a satisfactory substitute, is no more difficult to find. Once again, it should be noted that the plaintiff's rights in such an action depend only upon the defendant's liabilities incurred by his promise to accept, not upon the underlying transaction. The consideration given by a holder for this promise to accept is his reliance thereupon.²⁰ This may be compared to the consideration found for an accommodation indorser's promise to be secondarily liable on a negotiable instrument.²¹ Since reliance upon the virtual or extrinsic acceptance is required under the NIL,²² the need of the plaintiff to show it in an action brought for breach of defendant's promise to accept is no additional burden.

The *Kass* case, although indicating a large area in which the virtual acceptance may have use, furnishes evidence in favor of its abolishment rather than retention. In this case the sole purpose of the plaintiff in alleging an acceptance appears to be his plan to use it as a collection device. Such a purpose is deplorable. The only place of the virtual acceptance, if it has a place at all, is in business transactions where the promise to accept is made consciously by one understanding, at least generally, its implications. Hidden, as it was, in this case, among other "club regulations" where the word "accept" might have many meanings to the layman, it seems unfair to hold the promisor liable under the technical rules of negotiable instruments law.

was on the contract growing out of the letter [in which the defendant promised to accept the draft]." *Contra*, *Renfrow v. Citizens State Bank*, 87 Ind. App. 318, 158 N.E. 919 (1927). It should be noted that in both of these cases the suit was brought by the payee of the instrument, not by a transferee from him.

²⁰ See, *Nelson v. First Nat'l Bank*, 48 Ill. 36 (1868), and *Clinch Co. Bank v. Wyatt-Proch Lumber Co.*, *supra* note 19.

²¹ *Britton*, *Bills and Notes* § 364 (1943).

²² NIL §§ 134 & 135.

