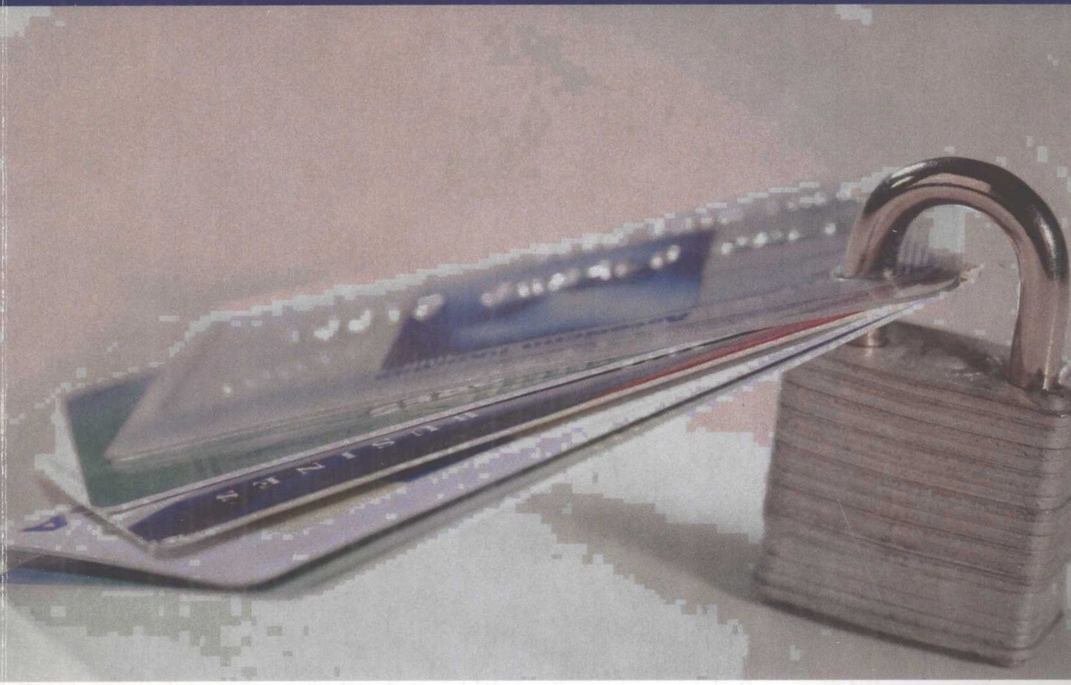

Safari Kasiyanto

Losses from Carding: The Flaws of the Laws

A Comprehensive Review of Liability Frameworks for Unauthorized Uses of Credit Cards in the US, EU and Australia

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Impressum/Imprint (nur für Deutschland/ only for Germany)
Bibliografische Information der Deutschen Nationalbibliothek: Die Deutsche Nationalbibliothek verzeichnet diese Publikation in der Deutschen Nationalbibliografie; detaillierte bibliografische Daten sind im Internet über http://dnb.d-nb.de abrufbar.

Coverbild: www.ingimage.com

Verlag: LAP LAMBERT Academic Publishing AG & Co. KG
Dudweiler Landstr. 99, 66123 Saarbrücken, Deutschland
Telefon +49 681 3720-310, Telefax +49 681 3720-3109
Email: info@lap-publishing.com

Herstellung in Deutschland:
Schaltungsdienst Lange o.H.G., Berlin
Books on Demand GmbH, Norderstedt
Reha GmbH, Saarbrücken
Amazon Distribution GmbH, Leipzig
ISBN: 978-3-8383-9616-3

Imprint (only for USA, GB)
Bibliographic information published by the Deutsche Nationalbibliothek: The Deutsche Nationalbibliothek lists this publication in the Deutsche Nationalbibliografie; detailed bibliographic data are available in the Internet at http://dnb.d-nb.de.

Cover image: www.ingimage.com

Publisher: LAP LAMBERT Academic Publishing AG & Co. KG
Dudweiler Landstr. 99, 66123 Saarbrücken, Germany
Phone +49 681 3720-310, Fax +49 681 3720-3109
Email: info@lap-publishing.com

Printed in the U.S.A.
Printed in the U.K. by (see last page)
ISBN: 978-3-8383-9616-3

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List of Abbreviations

ASIC	Australian Securities and Investments Commission
ATM	Automated Teller Machine
AUD	Australian Dollar
CCFA	Credit Card Frauds Act
EC	European Commission
ECB	European Central Bank
EDC	Electronic Data Capture
EFT	Electronic Funds Transfer
EFTCC	Electronic Funds Transfer Code of Conduct
EU	European Union
EUR	Euro
FACTA	Fair and Accurate Credit Transactions Act
FCBA	Fair Credit Billing Act
FCRA	Fair Credit Report Act
FTC	Federal Trade Commission
JCB	Japanese Credit Bureau
MOTO	Mail Order Telephone Order
PIN	Personal Identification Number
PSD	Payment System Directive
RBA	Reserve Bank of Australia
TILA	Truth in Lending Act
US	The United States of America
USD	American Dollar

Acknowledgement

My deepest gratitude goes to Professor J.E.J. Corien Prins and Dr. Ir. Mr. M.H. Maurice Schellekens, both from Tilburg University, who had assisted and given valuable feedbacks during the writing period of this book. Also, to Bank Indonesia, the central bank of Indonesian Republic, which had provided the funds to the author to conduct research and to pursue a higher education in the Netherlands. And finally, no words can express my gratitude to my mother (rip) who had been and would always be my inspiration, my father who keeps supporting me during my suffering time, my little sister and brothers who are never tired to greet me from my lovely hometown.

Bandung, 10th August 2010

Chapter I
Introduction

1.1. Study Background

It took a while for the world to accept the idea of using credit as a way of life, but when it did -in the form of credit cards- it embraced it unambiguously.[1] According to data from the US Census Bureau, there were almost 1.5 billion credit cards held by approximately 173 million people in the US alone, with a debt of nearly USD886 billion in 2006.[2] In other parts of the world, such as EU members region and Australia, the numbers of credit card holders had reached 142 million by 2007 for EU[3] and 20.3 million by 2008 for Australia[4]. It is a proof of what Karl Marx said a couple decades ago that the credit system appears furtively as it were in the beginning, but in the end it manifests itself as a gigantic social mechanism.[5]

One reason why credit cards have grown so rapidly is because they bring about new benefits in payments. Credit cards as a "new" method of payment have succeeded in replacing older methods, such as cash. Among other advantages of this payment method is that it is easier to use, flexible and convenient for the consumers, and brings profits for the issuers as well as the merchants.[6] When shopping was available through the internet, credit

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1 The leading state in the use of credit cards for payment instruments is the US. It was discussed by Menninger in *Identity Theft and Other Misuses of Credit and Debit Cards.* For detail see Menninger, Karl A., II, J.D., American Jurisprudence Proof of Facts 3d, Database updated December 2008, Thomson Reuters/West, 2009, p. 5-8.

2 Available at http://www.census.gov/compendia/statab/tables/09s1148.pdf, last visited on 27 February 2009.

3 Based on data of European Central Bank. In such data, a credit card is defined as a card with a credit function. It is available at http://sdw.ecb.europa.eu/reports.do?node=1000001453, last visited on 1 March 2009.

4 Based on data presented by Australian Payment Clearing Association, a self regulatory organization in clearing of payment instruments in Australia. The data includes what so-called multifunction cards, and available at http://www.apca.com.au/Public/apca01_live.nsf/All/3B9C3340E2266555CA257553001C9607?OpenDocument, last visited on 1 March 2009.

5 Drury, Tony, and Ferrier W. Charles, *Credit Cards*, Butterworths, London, 1984, p. 3.

6 Jones, A. Sally, *The Law Relating to Credit Cards*, BSP Professional Books, London, 1989, p. 12-15. In this book, Jones used terms of creditor, debtor, and supplier instead of issuer, user/consumer, and merchant.

cards became the preferred payment method for internet shoppers.[7] However, the usage of this technological scheme has also brought new forms of crimes with fraudsters employing entirely new technologies to manipulate it for illegal economic gains.[8] The crimes committed with credit cards as payment methods vary, from a simple but ingenious type of crimes to technologically advanced versions.[9] The aim of the crimes is mostly to obtain financial gains.[10] Moreover, in many cases, it is obvious that credit card issuers as service providers fail to recover funds from the fraudsters since those criminals are rarely held accountable for their fraudulent actions.[11] In this respect, it becomes financial losses and these losses are very significant. In 2004, total losses from fraud amounted to USD788.3 million, "slightly" down from USD882.5 million in 2003.[12]

The question arises when a credit card is fraudulently used for (unauthorized) payments and it fails to recover the funds from the fraudsters, who will be liable: the card issuer, the holder/consumer or other third parties?[13] In order to elaborate on the answer, the relationship

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7 Based on a result of survey conducted by Global Concepts, Inc., during May-August 1995. The consumers ranked credit cards as their first preference of payment method for making purchases on-line. The similar survey with the same result had also been conducted by principal of credit cards. For details see Gainer, Randy, *Allocating The Risk of Loss for Bank Card Fraud on the Internet,* John Marshall Journal of Computer and Information Law, Fall 1996, p. 1, f.n. 5.

8 Sharma, Dhruv, and Thakur Divyang, *Data Theft: An Emerging Crime in the Information Technology & Intellectual Property Regime (with Special References to Credit Card Frauds),* p. 5-7, available at http://ssrn.com/abstract=1103286, last visited on 25 February 2009.

9 Sharma, *Ibid.* More extensively on credit card frauds, in particular carding, will be discussed in Chapter 2.

10 See Wall, David S., *Cybercrime*, Polity Press, Cambridge, UK, 2007, p. 72-102. In his book, Wall does not discuss specific issues on credit card frauds but elaborate a very detail issue on computer-assisted crimes such as virtual robberies, scams and thefts. It can be concluded, however, that all those crimes leave financial losses to the consumers and financial institutions.

11 See Chaikin, David, *Network Investigations of Cyber Attacks: The Limits of Digital Evidence*, Crime Law Soc Change (2006) 46:239-256, 15 March 2007, p. 239. In this article, Chaikin highlights the limits of digital evidence as one important reason causing the failure of criminal prosecutions.

12 *The Nilson Report No. 830*, March 2005 in Cheney, Julia S., *Identity Theft: Do Definitions Still Matter?,* Discussion Paper, Payment Card Center, Federal Reserve Bank of Philadelphia, August 2005, p.8.

13 Merely relating to consumer protections in online contracts Steennot, a Professor of Consumer Law of Ghent University, Belgium, have ever risen the question. However, this study will have different focuses on elaborating the issues, among others are focusing on the liability in case of carding regardless the payment is made in an on-line or off-line method and comparing the liability regimes of the subject in several countries. For details of consumer protections in online wolrd, see Steennot, Reinhard n.d., *Consumer Protection Relating to Contracts Concluded Online*, Journal of Texas Consumer Law, available at http://www.jtexconsumerlaw.com/V9N1pdf/V9N1european.pdf, last visited on 1 March 2009.

between issuer, cardholder, and merchant needs to be outlined.[14] As shown in Figure 1, the relationship among the parties in a credit card transaction is rather complicated, although their legal position has never been tested in the courts.[15] The legal relationship between the parties is mainly contractual, but there are also public laws that apply to several issues out of contractual coverage. One important issue is who will be liable when a credit card is fraudulently used and results in financial losses to the parties.

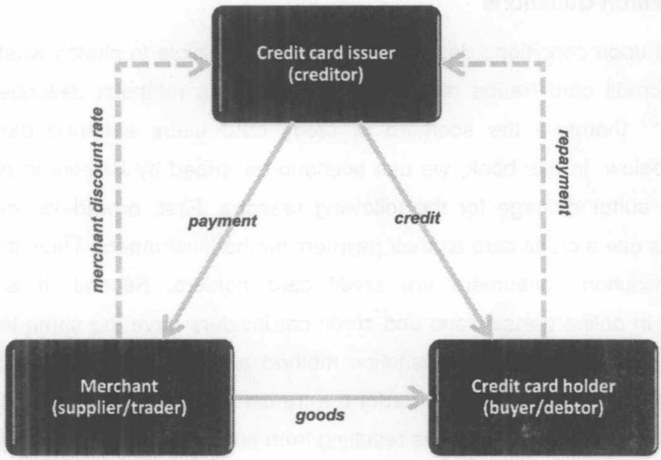

Figure 1 Relationship between Parties in Credit Card Transactions

Different legal systems in different countries or regions have different regulatory frameworks on ruling liability for losses resulting from fraudulent use of credit cards. There is a general principle that issuers are prohibited from charging consumers for losses incurred by the fraudulent use of bank cards including credit cards.[16] But whatever the principle says,

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[14] These are the obvious parties involved in a credit card transaction scheme. Currently, a credit card scheme is involving one more party, which is also a financial institution, playing as an acquirer. For detail on this four party credit card, see section 2.1 of this book.

[15] Drury, *op. cit.*, p. 85-97. In his book, Drury provides an evidence that the legal relationship between parties involved in a credit card mainstream has never been questioned before the court in the UK.

[16] For instance, two federal statues in the US: Electronic Funds Transfer Act 1978 and Consumer protection Act 1970 regulate fraud losses from unauthorized use of credit and debit cards in this favor. For details discussion on this issue, see Grainer, *op. cit.*, p. 2-4.

it seems that consumers always lay on the weak positions.[17] Since more than four decades ago, issuers had been trying to shift every loss in credit card frauds to the consumers. [18] At that time when credit cards were introduced, the issuers had already put a strict but wide-range clause in the contract to hold consumers fully responsible for all transactions they have made.[19] Facing those conditions, the consumers will then in fact suffer damage for the financial losses from the fraudulent use of their credit cards.

1.2. Research Questions

Based upon conditions described above, it is possible to sketch what a typical liability regime in credit card frauds may look like. Using the methods described by Balboni on trustmarks,[20] therefore the scenario of credit card users suffering damage will be as explained below. In this book, we use scenario described by Balboni to explain how credit card users suffer damage for the following reasons. First, nowadays, most of the online transactions use a credit card as their payment method/instrument. Thus, the biggest parts of online transaction consumers are credit card holders. Second, it is undoubted that consumers in online transactions and credit cardholders have the same level of knowledge concerning the security of a transaction method and therefore they put their trust on the service providers or merchants to perform a transaction; and finally, they stand at the same position to bear the potential losses resulting from unauthorized transactions.

A credit card holder, trusting the security, privacy and business practices promoted by merchant, decides to perform a transaction using a credit card as payment method. To complete the transaction, the credit card user must provide personal data to the merchant together with the relevant payment details such as the credit card number, expiry date and bank details.[21] The transactions may have been succeeded but then the consumer receives over charges in the billing statement, stating that she has made another transaction. It seems obvious here that the consumer's card has been fraudulently used to perform an unauthorized transaction, but in fact it will be very difficult for the consumer to make a claim

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[17] This is one of the underlying issues of this book. In the analysis and comparative elaboration of this book, we will discuss on how laws and private network rules weaken the consumer's position. For detail discussion, see Chapter 3 and 4.

[18] *Credit Cards: Distributing Fraud Loss*, Notes and Comments, Yale Law Journal, June 1968.

[19] See *Id.*

[20] Balboni, Paolo, *Trustmarks: Third-party Liability of Trustmarks Organizations in Europe*, Tilburg University, Tilburg, 2008, p. 14-18. In his dissertation, Balboni elaborates the legal underlying issues to hold trustmark companies liable for losses resulting from unauthoized transaction caused by unsecured infrastructures of online transactions provided by those companies.

[21] Balboni, *Ibid.*

and then remove those over charges. Some barriers on regulations such as notification obligations for consumer for card lost or stolen, consumer' obligation to avoid negligence in using credit cards as payment instruments, a presumption of extreme negligence applied in some countries, questions on who should bear the burden of proof, and difficulties on providing evidences, have placed consumer in a very precarious situation. Do the laws rule the condition explained above in the favor of issuers or are they merely because of the implementation of the laws that ruins the balance?

To guide this book in a narrow path, the background above leads to the following legal questions:

1. *How do different legal jurisdictions rule on the liability for unauthorized transaction in case of carding[22]?*

To have a comprehensive input on liability in different legal jurisdictions, this book will analyze regulatory frameworks in the US, EU level, and Australia.[23]

2. *Do the laws on liability in case of carding in those different countries regulate the position of consumer in an adequate manner?*
3. *How to improve the rules on liability for losses resulting from carding in those countries?*

1.3. Aim and Trigger

Ultimately, the goal of this book is to provide an analysis of laws on liability for losses resulting from fraudulent use of credit cards in different legal systems. In the information age where the payment methods have been rapidly developed, in particular since the introduction of internet and electronic commerce, the evaluation of such laws becomes greatly important for all stakeholders in payment system activities, including consumers, authorities or regulators, business, and financial institutions as service providers. The focus of the elaborations on the adequacy of the existing laws and how to improve them will give benefits in particular for regulators to put more balanced rules on liability allocations.

Furthermore, this book has also been triggered by personal experience of the author. During the finalization of his study to pursue master degree in Law and Technology, the

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[22] Carding refers to the unauthorized use of credit card account information to fraudulently purchase goods and services. For detail elaboration on carding, see section 2.2. under title of "carding".

[23] For details of the reasons why the US, EU and Australia have been chosen, see Section 3 of this chapter.

author had received a notification from Rabobank, the bank where the author has saving accounts, stating that his card has been skimmed.[24] The notification also states that the card has been blocked to avoid loss from unauthorized transactions, and that the bank will send a new card within 5 days after notification and a new PIN within 3 days afterward. Although the card in this case is a debit card[25] and Rabobank has refused the author's request to have a short discussion on the issue[26], this personal experience is evidence that nowadays skimming or other types of identity theft crimes can easily occur. Thus, elaboration on how laws protect parties involving in payment card scheme, specifically consumers, what are advantages and disadvantages of the legislations, and how to improve them is very important to prevent further damages into the society and to increase the confidence of the use of credit cards as a payment instrument.

1.4. Methodology

To answer the research questions described above, this book will be fully based on literature research. This book will start off by reviewing the regulatory frameworks of liability regimes in cases of carding in different countries: US, Australia and EU. They have been selected because: (1) they represent areas where the use of credit cards as payment instruments is the biggest among others,[27] (2) identity theft, which is usually the main source of credit card frauds including carding, often happened, conducted, or had victims in that areas,[28] and (3) each has different legal systems and distinctions in regulating liability for credit card consumer or issuer in particular when frauds occurred. The EU has issued a new Directive 2007/64/EC of 13 November 2007 on Payment Services in the Internal Market amending 4 Directives and repealing 1 Directives.[29] This directive must be forced into member states' national laws before 1 November 2009. Before this new Directive, there was only a non-binding Recommendation 97/489/EC of 30 July 1997 concerning transactions carried out by electronic payment instrument, which has not been very successful in

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[24] See appendix 1 for detail Rabobank's notification that has been received by email.

[25] Debit card is a payment card that directly connects to a saving account and needs a personal identification number or a signature to perform a transaction. In this case, the card is Maestro card under MasterCard International private network and uses PIN to perform transaction.

[26] See the author's email to request a discussion and the answering email from the Rabobank's management on appendix 2.

[27] For detail data of credit card use in these three countries see section 2.1.1-2.1.3.

[28] For details discussion on identity theft see section 2.2.1-2.2.3, and for statistics of top ten countries where the victims of identity theft live see appendix 3 of this book.

[29] This regulation will be elaborated in section 3.2.

Europe[30]. On the other hand, the US has specific laws regulating the subject: the amendment of the Truth in Lending Act 1970 and Regulation Z, while Australia has "only" implemented soft laws for the subject: Australian Electronic Funds Transfer Code of Conduct.

1.5. Structure

For the structure, this book will firstly give an overview on credit cards, an elaboration of credit card frauds e.g. identity and data thefts, skimming, and account take over, and an explanation of carding. They will be discussed in Chapter 2. Subsequently, in Chapter 3 of this book it will be outlined the regulatory frameworks of liability in case of carding in the US, EU, and Australia. As a bridge to answer the research questions, Chapter 4 of this book will analyze why such frameworks are not adequate. After having an understanding on regulatory frameworks of liability in case of carding in the US, EU level, and Australia, Chapter 5 of this book will confirm the in-depth comparative analysis among three regulatory frameworks and recommendations.

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[30] Steennot, Reinhard, *Allocation of Liability in Case of Fraudulent Use of an Electronic Payment Instrument: The New Directive on Payment Services in the Internal Market*, Computer Law and Security Report 24 (2008) 555-561.

Chapter 2
Credit Cards, Credit Card Frauds, and Carding

To give a good understanding of the underlying issues on the topic, in this chapter we will have a brief overview of what a credit card is, which parties are involved and what agreements they use. It will then be followed by a description of the use of credit cards in the three different countries chosen. Since the main problem of this book is liability for losses resulting from credit card fraud transactions, it is also important to know what credit card frauds mean. Thus, this chapter will also explain the definition of credit card frauds, including carding, and elaborate on the frauds of credit cards in the US, EU and Australia.

2.1. Credit Card: An Overview

The term "credit card" was first introduced by Edward Bellamy in his 1887 utopian socialist novel, *Looking Backward*.[31] It was used to name a utopian payment instrument that can be used to purchase goods by borrowing money. Beside Bellamy's use of the term more than 120 years ago, what is a credit card? Nowadays, there are several definitions of a credit card. The US Truth in Lending Act 1970 for instance defines a credit card as "*any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor or services on credit*".[32] It is, however, physically a flat, -by- piece of plastic engraved with a name and an account number that allows its holder to perform two functions: (1) to transact quickly and efficiently, and (2) to borrow a certain amount of funds to finance a specific purchase or service[33], a key feature that simultaneously enhances the utility and risks of credit cards.[34]

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[31] See Bar-Gill, *Seduction by Plastic*, Northwestern University School of Law, Northwestern, 2004, p. 1380-1381.

[32] 15 U.S.C.A. § 1602 (k)(1994). See also Reg. Z, 12 C.R.F. § 226.2(a)(15)(1998).

[33] Bar-Gill, *Supra note* 31, p. 1380.

[34] Porter, Katherine, *The Debt Dilemma,* Michigan Law Review, 2008, p. 1169.