MISSISSIPPI COLLEGE WRITING REQUIREMENT

Merchant Credit Card Fraud

Bad Merchant Bad!

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Fraud Investigation Final Paper

I. Introduction to Merchant Credit Card Fraud

The modern credit card was not born until the 1960s.[1] As the credit card's popularity grew, so did the ways to commit fraud through its use.[2] Identity theft is usually mentioned first when credit card fraud is discussed.[3] There are many lesser known types of credit card fraud that are just as costly.[4] One source of credit card fraud, merchant fraud, occurs through the person at the cash register the store owner or an employee. The merchant will commit credit card fraud by changing stolen credit cards for goods not actually sold, overcharging legitimate customers' credit cards, and the process of factoring. This paper will discuss the history of the credit card, the different ways that merchant credit card fraud occurs, statutes that were enacted to prevent merchant credit card fraud, and the issues that have arisen because of these statutes.

A. The Brief History of the Credit Card

By the early twentieth century, the first credit cards were born.[5] Sears, Roebuck, & Company began lending money to customers who wanted to buy goods from Sears but did not have the money to pay for the goods.[6] Sears began giving merchant charge cards to customers.[7] These charge cards were only accepted by Sears.[8] The debit charged on the account had to be paid off within a 30 day period.[9] Soon other stores began issuing charge cards to their customers that could be used just at that specific store.[10]

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[1] Oren Bar-Gill, Comment, *Seduction by Plastic*, 98 Nw. U. L. Rev. 1373, 1381 (2004).
[2] H.R. REP. 98-894 at 4 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3689, 3690.
[3] Jennifer Lynch, *Part 1: Law and Technology Cyberlaw: Identity Theft in Cyberspace: Crime Control Methods and Their Effectiveness in Combating Phishing Attacks*, 20 Berkeley Tech. L.J. 259, 261-262 (2005).
[4] Theresa L. Kruk, J.D., *What Constitutes violation of 18 U.S.C.A. § 1029, prohibiting fraud or related activity in connection with credit card or other credit access device*, 115 A.L.R. FED. 213, *2 (2009).
[5] Oren Bar-Gill, Comment, *Seduction by Plastic*, 98 Nw. U. L. Rev. 1373, 1381 (2004).
[6] Teresa A. Sullivan, Elizabeth Warren, & Jay Lawerence Westbrook, *The Fragile Middle Class: Americans in Debit* 109 (2001).
[7] *Id.*
[8] *Id.*
[9] *Id.*
[10] *Id.*

In the 1950s these store specific charge cards had transformed into all purpose charge cards that could be used at many different merchants.[11] These cards were still charge cards since the entire balance had to be paid off at the end of each 30 day period.[12] By the 1960s the credit card as it is today was born.[13] The modern day credit card is a combination of the all purpose charge card and the merchant card.[14] However, the modern credit card allows a balance to be carried past the standard 30 day period.[15]

B. What is Merchant Fraud?

To understand how merchant credit card fraud takes place, the process of charging a credit card for a transaction must be understood. When a customer makes a purchase from a merchant with a credit card, the merchant processes or

> swipes the cards electronically through electronic card terminals installed at the merchant's business. When the merchant swipes a customer's card and enters the transaction amount, the information is electronically wired to the credit card company or a merchant processor. If the credit card has the funds to pay for the transaction, the transaction will be completed. If the automatic electronic imprint fails to register, the merchant takes a physical imprint of the card and manually types in the credit card number. After receiving the purchase information, in about two or three days the merchant receives the money charged on the credit card.[16]

Occasionally a charge may be approved, but the customer does not receive the merchandise, such as through a catalog order or Internet purchase.[17] The customer has 60 days from the receipt of notice of the charges to notify the credit company about the issue.[18] The

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[11] David S. Evans & Richard Schmalensee, *Paying with Plastic: The Digital Revolution in Buying and Borrowing,* 251-256 (2d. Edition 2005).
[12] *Id.*
[13] *Id.*
[14] Teresa A. Sullivan, Elizabeth Warren, & Jay Lawerence Westbrook, The *Fragile Middle Class: Americans in Debt*, 109 (Yale University 2000).
[15] *Id.*
[16] 295 F.3d 461, 464 (2002).
[17] *Utica Mut. Ins. Co. v. Bancinsure, Inc*., 2007 WL2860237, 1 (E.D. Mo.)
[18] 15 U.S.C.A. § 1644(a)(B)(i)

credit card company of the merchant processor will then go to the merchant to try to collect the amount charged for the product.[19] If the merchant can provide the proper supporting documentation, the credit card company has to pay the merchant and "chargeback" the transaction to the customer's credit card.[20] In situations like these, the credit card company is out the price of the transaction. While some of these occurrences are legitimate, other of these occurrences are fraudulently made by the merchant.

C. Types of Merchant Fraud Perpetrated Through Credit Cards

Credit card fraud occurs when a merchant uses a lost or stolen credit card to purposely pay for merchandise that was never sold and forge the proper documentation so that he may keep the transaction amount from the credit card company.[21] In some instances, merchants may charge previous customers' credit cards for goods that were never bought.[22] In other common instances, merchants collaborate with credit card thieves.[23] The merchant will use the fraudulent credit card to charge for goods that are never sold and split the amount of the purchase with the thief.[24]

Another fraudulent merchant practice is the crime of factoring.[25] Factoring may be illegal or legitimate based on the contract that is formed between the merchant and the merchant bank.[26] For a business to accept credit cards for a purchase certain steps must be taken.[27]

> In order to conduct credit card sales, a business must first enter into a merchant account agreement with a bank (merchant bank) pursuant to which the merchant bank agrees to process future credit card transactions. The business then opens an account (merchant account). In most retail credit card transactions, the business provides the merchant bank with a sales slip (draft)

[19] *Utica Mut. Ins. Co. v. Bancinsure, Inc*. 2007 WL 2860237, 1 (E.D. Mo.).
[20] *U.S. v. Rivera*, 295 F.3d 461, 464 (5th Cir. 2002).
[21] *Id.*
[22] *Id.* at 465.
[23] *Id.* at 465-466.
[24] *Id.* at 466.
[25] *Pa Dilla v. State*, 753 So.2d 659, 661 (Fla. Dist. Ct. App 2002).
[26] *Id.*
[27] *U.S. v. Dabbs*, 134 F.3d 1071, 1074 (11th Cir. 1998).

> representing the customer's credit card information and signature authorizing the charge. The business deposits the draft in its merchant account. The merchant bank subsequently transfers the balance of the charge into the business's merchant account. The business may then draw from that amount and transfer money to separate commercial accounts. The merchant bank thereafter contacts the issuer of the customer's credit card (issuing bank), presents the sales draft and requests reimbursement.[28]

Factoring is when a business that does not have a merchant account uses a third party business as a "conduit for depositing credit card sales."[29] The third party business uses their merchant account to process the other business's sales.[30] The third party business also called the "factoring merchant" will keep a percentage of the deposited credit card sales as payment.[31] Sometimes factoring may be allowed by the merchant bank.[32] Factoring becomes illegal when the contract between the merchant and the merchant bank strictly prohibits this practice.

In *U.S. v. Dabbs*, the court examines why factoring becomes illegal in certain circumstances.[33] Susan and William Dabbs, along with Thomas Moorehead and John Floyd, owned P.S.T. Ltd, Inc.[34] P.S.T. was a telemarketing business that sold travel packages and cosmetics.[35] As a telemarketing company, P.S.T. could not provide signed customer sales slips or other documentation for customer sales.[36] Telemarketing businesses are often prohibited from opening merchant accounts with many merchant banks because sales authorization is difficult to provide the banks.[37]

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[28] *Id.* at 1074.
[29] *Id.* at 1075.
[30] *Id.*
[31] *Id.*
[32] *Padilla v. State*, 753 So.2d 659. 661 (Fla. Dist. Ct. App 2002).
[33] *U.S. v. Dabbs*, 134 F.3d 1071, 1074 (11th Cir. 1998).
[34] *Id.*
[35] *Id.*
[36] *Id.*
[37] *Id.* at 1074-1075.

To get around this problem, P.S.T. had other third party merchants open merchant accounts with First Interstate Bank of South Dakota beginning in 1991.[38] P.S.T. managers submitted fraudulent applications using fake company names to open merchant accounts with First Interstate Bank of South Dakota.[39] The United States Postal Inspection Service began an investigation into illegal factoring in 1992.[40] As part of this investigation, P.S.T. activities were discovered in an undercover operation.[41] First Interstate Bank of South Dakota lost $663,456.82 as a result of this scheme within a little over a year.[42] Susan and William Dabbs were sentenced to a thirty-month jail sentence, Thomas Moorehead was sentenced to a forty-five month term of imprisonment, and John Floyd was sentenced to thirty-seven months.[43]

II. Legislative Statutes

In an attempt to curb the every growing fraud related to the evolution of the credit card, Congress enacted the Consumer Credit Protection Act and the Credit Card Fraud Act. These statutes were meant to stop what was quickly becoming an area rampant with fraud. This section of the paper will discuss the purpose of these statutes and their effects on punishing merchant credit card fraud. This section will also explain older laws that are being used to punish merchant credit card fraud and why the newer laws need to be applied instead.

A. The Consumer Credit Protection Act and The Credit Card Fraud Act

As credit cards grew in popularity, so did crimes perpetrated by stolen or fraudulent credit cards.[44] Congress, aware of the growing credit card fraud throughout the United States, sought to provide a remedy by enacting the Consumer Credit Protection Act which broadly describes what

[38] *Id.* at 1075.
[39] *Id*. at 1076.
[40] *Id.*
[41] *Id.*
[42] *Id.*
[43] *Id.* at 1077.
[44] Theresa L. Kruk, J.D. *What constitutes violation of 18 U.S.C.A. § 1029, prohibiting fraud or related activity in connection with credit card or other credit access device*, 115 A.L.R. Fed. 213, *2a (2009).

was considered fraudulent use of credit cards in interstate and foreign commerce.[45] A factor that shaped the content of the Consumer Credit Protection Act was the proven inability of the current legislation to combat the ever changing schemes employed in credit card fraud.[46]

15 U.S.C.A. § 1644 was enacted in 1970.[47] In 1974 amendments to the Act generally reorganized provisions that were previously unlettered paragraphs and "expanded prohibitions relating to fraudulent use of credit cards, decreased amount required for fraudulent use from a retail value aggregating $5,000, or more, to enumerated amounts for particular activities, and increased the punishment from a sentence of not more than five years to a sentence of not more than ten years."[48] The Consumer Credit Protection Act also outlined six acts that are punishable by a fine up to $10,000 and/or imprisonment of up to 10 years.[49] The Consumer Credit Protection Act covers offenses whose common element is the use of or affecting interstate commerce, such as using an unauthorized credit card, transporting unauthorized credit cards, receiving goods or services as the result of using an unauthorized card, and furnishing goods and services through the use of unauthorized credit cards while knowing it was unauthorized.[50]

Under the Consumer Credit Protection Act, the courts split on the issue of whether a defendant must be in actual possession of the physical credit card or if an unauthorized account number is enough to fall under a violation of the Act.[51] In *U.S. v. Callihan*, the Court of Appeals held that "credit card account numbers are not the same as credit cards for purposes of statute prohibiting the interstate transportation of fraudulently obtained credit cards."[52] The *Callihan*

[45] *United States v. Abod,* 770 F.2d 1293 (5th Cir. 1985).
[46] H.R. REP. 98-894 at 4 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3689, 3689.
[47] 15 U.S.C.A. § 1601.
[48] *Id*.
[49] *Id.*
[50] *United States v. Lomax*, 598 F.2d 582,583 (10th Cir. 1979).; 15 U.S.C.A. 1644(a).
[51] *United States v. Bice-Bey*, 701 F.2d 1086 (4th Cir. 1983).
[52] *United States v. Callihan*, 666 F.2d 422, 422 (9th Cir. 1982).

Court believed that the word "credit card" was meant to have a narrower reading.[53] The Court found support for this view based on the fact that "Congress has already provided for the fraudulent use of credit card account numbers in the statutes prohibiting wire and mail fraud.[54] Further support was found because the "appellant himself was convicted under section 1343" or the wire fraud statute.[55] The Court of Appeals also ruled that "Section 1644, by its plain language, was intended to cover credit cards and not accounts."[56] The Court held that "the term 'credit card' as used in section 1644 means the small, flat tablet upon which a credit card account number is imprinted, but does not mean that number alone."[57]

In *U.S. v. Bice-Bey*, Fatimah Bice-Bey was convicted for violating 15 U.S.C.A. 1644(a).[58] On appeal, Bice-Bey contends that she was never in possession of the stolen credit cards.[59] 15 U.S.C.A. § 1644(a) criminalizes the actions of any person who:

> knowingly in a transaction affecting interstate or foreign commerce, uses or attempts or conspires to use any counterfeit, fictitious, altered, forged, lost, stolen, or fraudulently obtained credit card to obtain money, goods, services, or anything else of value, which within any one-year period has a value aggregating $1,000 or more.[60]

Bice-Bey argued that the statute should not have applied to her actions.[61] Bice-Bey did not have the actual credit cards in her possession.[62] She contended that 15 U.S.C.A. § 1644 "is concerned with the misappropriation and misuse of the plastic card itself and not of the credit account

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[53] *Id.* at 424.
[54] *Id.* at 424.
[55] *Id.* at 424.
[56] *Id.*
[57] *Id.*
[58] 701 F.2d 1086, 1088 (4th Cir. 1983).
[59] *Id.* at 1089.
[60] *Id.* at 1091.
[61] *Id.*
[62] *Id.*

number.[63] Unlike the Ninth Circuit Court in *U.S. v. Callihan*, this Court did not agree with that view.[64] Bice-Bey's view of the statute was ruled as being too literal.[65] The Court of Appeals held that "the core element of a 'credit card' is the account number, not the piece of plastic."[66] By using these numbers, Bice-Bey was "fraudulently obtaining the essential element of the cards."[67]

In *U.S. v. Lomax*, the Court ruled that account numbers, credit card invoices, and tickets are included under 15 U.S.C.A. § 1644(a).[68] Lomax along with his cousin stole his aunt's credit card.[69] Lomax was convicted under 15 U.S.C.A. 1644(a).[70] On appeal, Lomax argued that the credit card invoices or tickets received after the credit card purchases "were insufficient to establish that use of the credit card by the defendant" was evidence under the statute.[71] The Court decided that the 1974 amendments Congress passed to rewrite Section 1644 were "for the purpose of liberalizing federal assistance to cope with this rapidly expanding problem."[72] The Court recognized that only ten years prior to this action in 1969, 1.5 million credit cards were lost or stolen.[73] This fraud surpassed 100 million dollars.[74]

Only amounts of $1,000 on each credit card that were fraudulent could be prosecuted in violation of 15 U.S.C.A. § 1644(a).[75] An example of this is in *U.S. v. Helgesen.* In 1978 Valeria Helgesen and Jane Blangiardo opened a retail decorating business.[76] In July 1979, Blangiardo

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[63] *Id.*
[64] *Id.* at 1092.
[65] *Id.*
[66] *Id.* at 1092.
[67] *Id.*
[68] *United States v. Lomax*, 598 F.2d 582, 583 (10th Cir. 1979).
[69] *Id.* at 583.
[70] *Id.*
[71] *Id*. at 582.
[72] *Id.* at 583.
[73] *Id.*
[74] *Id.*
[75] 15 U.S.C.A. § 1644(a).
[76] *U.S. v. Helgesen*, 660 F.2d 69, 73 (2d Cir. 1982).

left the business.[77] Between August 17, 1979 and September 24, 1979, more than $220,000 in credit card sales was recorded.[78] More than three thousand of the credit card sales were from lost or stolen credit cards and were falsely signed.[79]Helgesen was convicted for sixteen counts of fraudulent use of credit cards because the fraudulent amounts were more than $1,000 on each card.[80] If Helgesen had not met the standard of $1,000 or more fraudulently charged on each card, she would not have been able to be prosecuted and convicted 15 U.S.C.A. § 1644.[81]

The legislative history of 15 U.S.C.A § 1644 is sparse.[82] Ambiguity in the statutory text can only be resolved, therefore, by reference to "the mischief and defect" Congress sought to cure.[83] Statutes must be interpreted as a whole, giving effect to each word and making every effort not to interpret provision in manner that renders other provisions of same statute inconsistent, meaningless, or superfluous.[84] Through the application of the Consumer Credit Protection Act, many gaps in the statute were exposed. The Act did not include how to punish people who fraudulently used sales slips or credit slips to buy merchandise.[85] The Consumer Credit Protection Act did not include punishments for only possessing fraudulent credit cards.[86] The Act did not criminalize using credit cards obtained from a third party with his knowledge and consent that fraud would be committed.[87] Somebody caught with numerous stolen or

[77] *Id.* at 74.
[78] *Id.*
[79] *Id.*
[80] *Id.* at 75.
[81] 15 U.S.C.A. § 1644.
[82] *Id.*
[83] See Heydon's Case, 3 Co.Rep. 7a (Ex.1584)
[84] *Saks v. Franklin Covey Co*., 316 F.3d 337, 337 (2d Cir. 2003).
[85] H.R. REP. No. 98-894, at 5 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3689, 3691.
[86] *Id.*
[87] 15 U.S.C.A. § 1644

fraudulent credit cards could not be prosecuted unless it was proved that the defendant had used, transported, or sold some of the credit cards.[88]

In an effort to close loopholes in the Consumer Credit Protection Act, the Credit Card Fraud Act was enacted. Congress explicitly designed 18 U.S.C.A. § 1029, part of the Comprehensive Crime Control Act of 1984, to curb the increasingly inventive use of credit card fraud.[89] Under the Credit Card Fraud Act, Congress meant to make "broader statutory language in an effort to anticipate future criminal activities…and thereby provide greater protection to all participants in the payment device system, including those that honor payment devices and consumers."[90]

Congress admitted that "Dishonest merchants and/or their employees can obtain valid numbers taken from authorized sales at the merchant's place of business, transcribe those numbers onto blank sales slips, and either submit them to their banks for payment or sell them to other colluding merchants."[91] Congress acknowledged that federal laws need to be strengthened to fight credit card fraud. With the majority of credit card fraud causes being interstate in nature, most state statutes are ineffective. Congress meant to shore up the loopholes and circuit splits from the Consumer Credit Protection Act with the Credit Card Fraud Act.

Congress stated that:

> Despite efforts by industry to cooperate with law enforcement agencies in developing procedures to thwart this type of fraudulent activity, evidence in the hearing record demonstrates that federal law must be improved to deal effectively with the growing problem of fraudulent activity relating to debit and credit cards. Testimony indicates that in many cases state statutes cannot deal effectively with the growing problem in large part because the

[88] H.R. REP. No. 98-894, at 5 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3689, 3691.
[89] *Id.* at 3690.
[90] *Id.* at 3691.
[91] *Id.* at 3693.

> major fraud cases are generally interstate in nature and often extend internationally.[92]

At this time the only other statute that remotely dealt with unauthorized credit card use alongside the Consumer Credit Protection Act was a section of Electronic Funds Transfer Act, 15 U.S.C.A. 1693N.[93] 15 U.S.C.A. 1693N covers transactions involving debit instruments much like the Consumer Credit Protection Act was applied to fraudulent credit card use.[94] Much like the Consumer Credit Protection, this section of the Electronic Funds Transfer Act did not spell out penalties for the possession of fraudulent debit cards.[95]

To fill in these gaps and punish the ever evolving ways of committing credit card fraud, the Credit Card Fraud Act was enacted.[96] The Credit Card Fraud Act was enacted in 1984 in response to significant increases in credit-related criminal activity.[97] The statute has an even broader scope than 15 U.S.C.A. § 1644 about the type of activity criminalized.[98] The Credit Fraud Act criminalized making, using, or selling fake devices; selling or using "one or more unauthorized access devices during a one-year period and by doing so obtaining anything of value aggregating $1,000 or more"; possessing 15 or more access counterfeit or unauthorized devices; and producing, selling, or controlling device-making equipment.[99] To ensure that the $1,000 minimum may easily be met, the courts have held that sales tax may be included in the transaction amount to meet the jurisdictional requirement.[100] The Act also solved the previous

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[92] *Id.* at 3694.
[93] *15 U.S.C.A. 1693N.*
[94] *15 U.S.C.A. 1693N(a).*
[95] *Id.*
[96] *Id.* at 3689.
[97] 18 U.S.C.A. § 1029.
[98] H.R. REP. No. 98-894, at 5 (1984), *reprinted in* 1984 U.S.C.C.A.N. 3689, 3691.
[99] 18 U.S.C.A. § 1029(a)(1)-(a)(3).
[100] 18 U.S.C.A. § 1029(a)(2).

issue of being in possession of fraudulent credit card numbers but not using them which was not considered fraud under the Consumer Credit Protection Act.[101]

Under the Credit Card Protection Act, credit card or account numbers are considered "access devices" and protected under the Act.[102] This definition put an end to the circuit split that developed under 15 U.S.C.A. § 1644. This split, as previously mentioned, concerned the term "credit card" defined to mean "any card, plate, coupon book or other credit device existing for the purpose of obtaining money, property, labor, or services on credit."[103] The Ninth Circuit read this definition to mean that section 1644 "is concerned with the misappropriation and misuse of the plastic card itself and not of the credit account number", while other courts viewed that account numbers were included.[104] Access devices also include personal identifiers that can be used to "obtain money, goods, services or any other thing of value, or that can be used to initiate a transfer of funds."[105]

B. Other Statutes Applicable to Credit Card Fraud

Along with the Consumer Credit Protection Act and the Credit Card Fraud Act, other statutes can be applied to credit card fraud. These statutes are the mail fraud statute and the wire fraud statute. The mail fraud statute (18 U.S.C.A. § 1341) makes it a crime when anyone with an intent or scheme to defraud uses the U.S. Postal Service or any private or commercial carrier to send or receive anything in the course of the scheme.[106] People are convicted under 18 U.S.C.A. § 1341 for the unauthorized use of credit cards. The main issue in these cases is to what extent the mail was used as part of the scheme to defraud. The mail fraud law was the primary law to

[101] 18 U.S.C.A. § 1029(e).
[102] 18 U.S.C.A. § 1029.
[103] 15 U.S.C.A § 1644(c).
[104] 15 U.S.C.A. § 1644(a).
[105] 18 U.S.C.A. § 1029(e)(1).
[106] 18 U.S.C.A. § 1341.

deal with credit card fraud until the two specific statutes that deal with credit card fraud were enacted.

The wire fraud statute made it a crime for any one with fraudulent intent to "transmit or cause to be transmitted by wire, radio, or television communications in interstate or foreign commerce, any writings, signs, signals, pictures, or sounds for the purpose of executing such a scheme or artifice."[107] As schemes have moved from the telephone to the Internet, the wire fraud act may be applied as well as more recent credit card fraud statutes. The wire fraud statute and the mail fraud statute were written in such broad language that they are still an effective tool in the fight against fraud.

In order to understand the intent and proper application of the Credit Card Fraud Act, an example of its correct prosecution should be examined. In *U.S. v. Farkas,* John Farkas owned several telemarketing businesses that were involved in this credit card scam.[108] Farkas' employees made unauthorized charges to consumers' credit cards and deposited the credit slips in a merchant bank account.[109] Farkas' employees made these unauthorized credit card charges in three different ways.[110] First, the employees would charge consumers for items that they refused to buy over the phone. Second, the employees would tell customers that there was a free trial period for vitamins and then charge the customers before the trial period was over. Third, the employees would charge customers without even notifying them.[111] When consumers discovered these unauthorized charges, they would go through the chargeback process and the charges would be removed from their credit cards.[112]

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[107] 18 U.S.C.A. § 1343.
[108] *U.S. v. Farkas,* 935 F.2d 962, 962 (8th Circuit, 1991).
[109] *Id.*
[110] *Id.*
[111] *Id.* at 964.
[112] *Id.*

The bank holding Farkas' merchant account permitted him to make immediate withdrawals for cash upon deposit of the charge slips. When a customer demanded a chargeback, the amount would be deducted from Farkas' merchant account. These charge backs could take up to six months to be deducted from Farkas' merchant account. This delay and Farkas' ability to receive cash upon deposit of the fraudulent credit card slips, allowed Farkas' to withdraw these credit card transaction payments before the chargeback could go through.[113]

Riverside Bank, who held Farkas' merchant account, had the merchant account closed. A federal grand jury indicted Farkas on one count of wire fraud, under 18 U.S.C.A. § 1343, with Riverside Community Bank the victim and two counts of credit card fraud, in violation of 18 U.S.C.A. § 1029(a)(2) and 18 U.S.C.A. § 1029(a)(3).[114] The government brought the first count of credit card fraud under 18 U.S.C.A. § 1029(a)(2) stating that Farkas "knowingly and with intent to defraud trafficking in or using one or more authorized access devices during any one-year period, and by such conduct obtaining anything of value aggregating $1,000 or more during that period." Witness testimony proved Farkas' violation. The second credit card fraud charge brought was that Farkas "knowingly and with intent to defraud possessing fifteen or more devices which are counterfeit or unauthorized access devices" under 18 U.S.C.A. § 1029(a)(3). The same witness testimony was used to prove this violation. Farkas was convicted on the two credit card fraud charges but not on the wire fraud charge. Farkas was sentenced to four years in jail and ordered to pay the victim of the credit card fraud charge $76,545.44 in restitution.

On appeal Farkas challenged both of his convictions claiming that there was insufficient evidence to support them. Concerning his conviction under 18 U.S.C.A. § 1029(a)(2), Farkas argued that it was his employees that obtained credit card numbers and made unauthorized

[113] *Id.*
[114] *Id.* at 964.

charges to the access device.[115] The Court held that Farkas' had sole control over the merchant account. Farkas' was responsible for the credit card fraud.[116] Farkas argued that the evidence presented at trial did not establish the $1,000 value or more that was placed fraudulently on one or more credit card.[117] The Court held that Farkas ignored the statutory provision allowing aggregation of $1,000 or more during a one-year period.[118]

Farkas argued that the government failed to prove that he possessed fifteen unauthorized access devices or that he possessed there fifteen unauthorized access devices at one time.[119] The Court upheld that the witnesses' testimony proved that their credit cards had been used without their authorization.[120] The Court upheld that Farkas' use of the same credit card numbers proved that Farkas had continuous possession of the unauthorized access devices. There were no grounds to reverse the trial court's decision. Farkas was tried in the manner proscribed with the correct statutes.

In some cases, the court arrived at the wrong conclusion despite using the Credit Card Fraud Act. In *U.S. v. Kosth*, the court held the defendant convicted of fraud offense for submitting fraudulent credit card slips through a bank where he had a merchant account.[121] The Court held that while he had a merchant account at the bank, he did not occupy a position of trust as defined by the sentencing guidelines.[122] While there was an element of reliance present in the credit transactions, the defendant's relationship with the bank was a standard and commercial relationship.[123]

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[115] *Id.* at 966.
[116] *Id.*
[117] *Id.*
[118] *Id.*
[119] *Id.*
[120] *Id.* at 965.
[121] *U.S. v. Kosth*, 943 F.2d 798, 798 (7th Circuit, 1991).
[122] *Id.* at 798.
[123] *Id.*

Daniel Kosth owned his own business named The Quad Cities Credit Bureau, Inc.[124] Kosth obtained a merchant account with First Midwest Bank of Moline.[125] He used this account to process his company's credit card sales.[126] For eight months, Kosth deposited credit card sales from fraudulent and stolen credit cards.[127] A three count indictment was brought against Kosth.[128] He was charged with conspiracy to commit fraud by access device in violation of 18 U.S.C.A. §§ 1029(a)(1), (a)(2), and 371.[129] Two of the counts were dismissed but Kosth plead to the one count of conspiracy. The court found that Kosth had abused a position of private trust according to the sentencing guidelines.[130]

The Sentencing Guidelines state that: "If the defendant abused a position of public or private trust, or used a special skill, in a manner that significantly facilitated the commission or concealment of the offense" the sentencing should increase by two levels.[131] On appeal, Kosth argued that he did not occupy a position of trust as stated by the Sentencing Guidelines.[132] The Court believed that Kosth's arrangement with the bank was the same as that of a restaurant, shoe store or hotel.[133] The relationship that Kosth had with the bank was a standard commercial relationship.[134] The Seventh Circuit Court agreed that Kosth did not occupy a position of trust.[135]

The Seventh Circuit Court should have upheld the district court's ruling that Kosth occupied a position of public or private trust and that he abused this position. While Kosth may

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[124] *Id.*
[125] *Id.* at 799.
[126] *Id.*
[127] *Id.* at 799.
[128] *Id.* at 800.
[129] *Id.*
[130] *Id.*
[131] USSG, § 3B1.3, 18 U.S.C.A. 1029.
[132] *U.S. v. Kosth,* 943 F.2d 798, 800 (7th Cir. 1991).
[133] *Id.*
[134] *Id.*
[135] *Id.*

have had what the Court considered an ordinary merchant customer of the bank who committed fraud by taking advantage of his contractual and commercial relationship, this was the wrong conclusion. Kosth went to the bank and collected money upon the presentation of a slip of paper indicating that a customer had made a purchase with a credit card.[136] While this might be considered a normal relationship between Kosth and the bank, it is not.

The bank believed that Kosth was an upstanding merchant. The bank allowed Kosth to receive money in exchange for a slip of paper. At the least, it shows that Kosth was trusted by the bank. While banks have many customers, most customers do not have a commercial account. Regular customers do not receive payment by credit cards. The average customer cannot take a slip of paper stating an amount that was earned and receive cash back. By presenting himself as a business owner and using this position to open a commercial count, Kosth abused his position of trust under Guideline § 3B1.3.

While Kosth was not found to occupy a position of trust, courts have found low-level employees as holding positions of trust. In *U.S. v. Lamb*, thirty-seven opened pieces of mail along with the materials inside the envelopes were found stuffed in a collection box on Lamb's assigned mail route.[137] Around this time, a master postal collection box key was stolen.[138] A short time later, 200 pieces of mail from Lamb's route were discovered along the local railroad tracks.[139] Based on these events, the U.S. Postal Inspection Service set up an investigation.[140] Two test letters with currency were placed into mail for Lamb's route.[141] Each letter was undeliverable and according to procedure should have been returned to the U.S. Post Office.[142]

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[136] *Id.* at 799.
[137] *U.S. v. Lamb*, 6 F.3d 415, 416 (7th Cir. 1993).
[138] *Id.*
[139] *Id.*
[140] *Id.* at 417.
[141] *Id.*
[142] *Id.*

Inspectors trailed Lamb on his route and found that Lamb had pocketed the money in the tester envelopes.[143] Lamb was immediately arrested.[144] The Court found that Lamb, a Postal Service letter carrier did abuse a position of public trust.[145] "By taking an oath to uphold the law and performing a government function for a public purpose, and using his position to commit or conceal his crime", Lamb was eligible for increased sentencing.[146] Although Kosth did not take an oath prior to representing himself as a merchant or work as a federal employee, his position as a merchant entailed him with the same amount of trust as a normal mailman. Kosth should have been judged by the same standard that Lamb was judged.

This issue of what is a position of trust has caused much discussion in the courts. The courts have defined many tests to help settle the question of what is considered a position of trust within the scope of U.S.S.G. § 3B1.3.[147] The Court disagreed with a "low-level" employee exception used in *United States v. Arrington* that Lamb tried to raise.[148] This exception prevents a court from increasing a defendant's sentence "whose crime was facilitated or made possible because of his employment position."[149]

The *Lamb* Court held that "it would be contrary to logic and common sense to hold that just because a person has a 'low-level' job, he cannot be considered to occupy a position of trust."[150] The employee's access to valuable items or "if the employee was a sworn public servant engaged in the performance of public duties" were determined to be a better test by the Lamb Court.[151] Ultimately, the court in *U.S. v. Lamb* agreed with the test defined in *United*

[143] *Id.*
[144] *Id.*
[145] *Id.* at 416.
[146] *Id.* at 415.
[147] *Id.* at 418.
[148] *Id.* at 419; 765 F.Supp. 945 (N.D. Ill. 1991).
[149] *Id.* at 419.
[150] *Id.*
[151] *Id.*

States v. Odoms.[152] The test defined in *Odoms* used "access or authority over valuable things" to determine if an employee occupied a position of trust.[153] Applying the *Odoms* test to *U.S. v. Kosth*, proves that Kosth occupied a position of trust. Although Kosth was not a governmental employee nor did he take an oath, his representation as a merchant did give him "access or authority over valuable things".[154] As a merchant, Kosth had access to customers' credit card information which is valuable to each customer.

C. The Consumer Credit Protection Act and the Credit Card Fraud Act are Underutilized.

Prosecution seems to use the mail fraud statute and the wire fraud statute instead of the two credit card statutes that were enacted to deal specifically with the ever evolving credit card fraud. By not using the credit card fraud statutes, the legislative intent for their enactment is being ignored. Laws that have been enacted for a purpose should be used for that purpose. Through the use of these specific credit card laws, courts are able to influence legislation to keep these newer laws updated and useful. By relying on older law, criminals become familiar with ways around being prosecuted.

In *U.S. v. Adamo*, the Government chose to proceed under the federal mail statues rather than under 15 U.S.C.A. § 1644, the first law specifically enacted with credit card fraud.[155] The government rejected this specific law and continued to use old mail statutes. In this case, two merchants were convicted as using the mails as part of a fraudulent credit card scheme.[156] The Government established that more than a dozen people were involved in a conspiracy ring that lasted over two years. Kearney, the co-defendant of the case, used lost or stolen credit cards and

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[152] *Id.* at 420.
[153] *U.S. v. Odoms*, 801 F.Supp. 59, 64 (N.D. Ill. 1992).
[154] *Id.* at 64.
[155] 534 F.2d 31, 33(3d Cir. 1976).
[156] *Id.* at 35.

sold them to other co-conspirators.[157] The ring operated out of Paterson, NJ in the Alexander Hamilton Hotel.[158] The members of the ring would use the unauthorized credit cards to buy goods and sell the goods at the hotel.[159] Businesses at the hotel regarded these persons as merchants or running a business that sold goods.[160] The prosecution was able to prove that this conspiracy was closely aligned with the use of the mails for carrying out the schemes.[161] Kearney was convicted and sentenced to five years' imprisonment on each count to run concurrently. His sentence was affirmed upon appeal.[162]

The prosecution chose to go forth using the federal mail statues rather than 15 U.S.C.A. § 1644 because at this point in the credit card fraud statute there was no allowance of aggregating $1,000 or more on one or more unauthorized access device.[163] The credit card fraud ring used all of the credit cards in Paterson, NJ. The prosecution's job to prove that there was a use, attempt or conspiracy to use the card in transactions affecting interstate or foreign commerce would have been more difficult. While there were sales slips being passed over state lines, this happened mainly through the use of the mails.

While the structure of 15 U.S.C.A. § 1644, was broadly enacted to cover many types of credit card fraud, the mail fraud statute was easier to prove in court. Although "the credit card fraud provision of 15 U.S.C.A. § 1644 were not intended to constitute the sole vehicle for prosecution of credit card frauds or to preclude prosecution under the mail fraud statutes."[164] The mail fraud statute is appropriate to:

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[157] *Id.* at 34.
[158] *Id.*
[159] *Id.*
[160] *Id.*
[161] *Id.* at 35.
[162] *Id.* at 39.
[163] 18 U.S.C.A. 1029(a)(2).
[164] Erica C. Surette, J.D., *Credit Cards and Charge Accounts,* 20 Am. Jur. 2d § 17(2010).

> a fraudulent scheme involving use of stolen credit cards may properly be prosecuted under the mail fraud statute where the plan, which involves participation by merchants, does not reach fruition at presentation of the cards, but after the bank or credit card company makes mail payments to the merchants in response to the mailing of invoices, rendering the use of the mails integral to the scheme.

In *U.S. v. Green*, the defendants were convicted after mailing applications to for credit cards for the "purpose of executing a scheme to defraud companies" by purchasing merchandise with credit cards they had no intention to pay off.[165] At no point did the defendants represent themselves as merchants.[166] By not representing themselves as merchants, the mail fraud statute was applied correctly to this case. Situations like *Adamo,* where people viewed the defendants as running a business, should have pushed the legislators to amend the Consumer Credit Protection Act concerning credit card fraud activity that was easier to prove under the older mail fraud statute.

The wire fraud statute continues to be used to prosecute cases that should be brought under the Credit Card Fraud Act. In *U.S. v. Rivera*, Rivera was convicted of seven counts of aiding and abetting wire fraud, conspiracy to launder monetary instruments, and aiding and abetting money laundering.[167] Rivera and Robert Swanson were co-owners of a Houston business. Beginning in March 1998, large, unauthorized charges were made to credit cards that had been lost or stolen. Some of these charges were made to former customers who had made previously legitimate purchases. In each instance, Rivera proved the proper documentation supporting each charge. The issuing bank received several uncollectible charge backs and investigated the credit card charges.[168] "In order to obtain a conviction for aiding and abetting wire fraud, the prosecution

[165] 494 F.2d 820, 820 (5th Cir. 1974).
[166] *Id.*
[167] *U.S. v. Rivera*, 295 F.3d 461, 461 (5th Cir. 2002).
[168] *Id.* at 464.

would only have to prove that the defendant assisted the actual perpetrator of the wire fraud while sharing criminal intent, not that the defendant completed each specific act charged in the indictment."[169]

Under 18 U.S.C.A. § 1029, the prosecution would have to prove that Rivera "knowingly and with intent" used the unauthorized credit cards or forged the customer's signature of the credit card sales slip.[170] One of the legitimate previous customers testified to signing a blank charge slip.[171] The prosecution was not able to prove that the unauthorized sale that appeared on that customer's credit card was forged by Rivera. The proof of intent required under the wire fraud statute that intent can arise "by inference from all of the facts and circumstances surrounding the transaction" is easier to meet.[172] As long as it is easier to prove wire fraud rather than credit card fraud under the Credit Card Fraud Act, there is no reason to suspect that the credit card fraud legislation will increase credit card fraud prosecution. The events in *U.S. v. Rivera* are the exact circumstances the legislature meant to punish by the enactment of the Credit Card Fraud Act. This situation is warned about in the legislative background of the Credit Card Fraud Act. Unless the Government amends the Credit Card Fraud Act to become easier to use, wire fraud will be the main statute to go to when prosecuting criminal merchants.

First National Bank and Trust Company v. Hollingsworth is a case that should have been tried under the Credit Card Fraud Act.[173] Instead, First National Bank and Trust Company brought the action alleging violation of RICO and Arkansas fraudulent conveyance law in connection with a fraudulent credit card charge scheme.[174] The bank brought this allegation

[169] 18 U.S.C.A. § 1343.
[170] *U.S. v. Rivera*, 295 F.3d 461, 467 (5th Cir. 2002).
[171] *Id.* at 464.
[172] *Id.* at 466.
[173] *First National Bank and Trust Co. v. Hollingsworth*, 931 F.2d 1295, 1295 (8th Cir. 1991).
[174] *Id*.

against a telemarketing venture.[175] In 1987 Consumer Home Marketing, Inc. (CHM) was formed by A.L. Hollingsworth and Romano Schreiber.[176] CHM was a telemarketing corporation.[177] In 1987 Schreiber left the business.[178] After several attempts to secure a merchant account, Hollingsworth opened a merchant account after representing that CHM was a computer retailer and not a telemarketing corporation.[179]

Almost immediately, CHM began depositing credit card sales slips into the merchant account.[180] CHM was "factoring" sales slips for other merchants who could not open their own merchant accounts.[181] CHM deposited the slips, received the money, returned the money to the other merchant and kept a percentage of the factored money. Many banks refuse to process factored charges and put this in the customer account contracts.[182] In August 1988, First National had discovered what was occurring in the Hollingsworth account.[183] First National gave Hollingsworth a notice that the account would be terminated in 60 days.[184]

On November 26, 1988 First National filed the action alleging that various individuals were participating in a credit card scheme in violation of the RICO provision under 18 U.S.C.A. § 1962(a)-(d) and other claims under the Arkansas Fraudulent Transfer Act because certain defendants had received money transferred from the CHM account.[185] The claims against CHM and Hollingsworth should have been brought under 18 U.S.C.A. § 1029. These charges are the classic credit card fraud perpetrated by dishonest merchants. The RICO provision is intended to

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[175] *Id.*
[176] *Id.* at 1299.
[177] *Id.*
[178] *Id.*
[179] *Id.*
[180] *Id* at 1299.
[181] *Id.* at 1299.
[182] *Id.* at 1300.
[183] *Id.* at 1300.
[184] *Id.* at 1300.
[185] *Id*. at 1301.

take aim against organized crime relating to the Mafia. The Credit Card Fraud Act is intended for this situation. The Hollingsworth case is classic merchant credit card fraud. Hollingsworth committed fraud when he opened the merchant account to factor credit card sales slips. Hollingsworth falls neatly under the Credit Card Fraud Act and should be held to its standards. This case is another example of why the Credit Card Fraud Act is not effective because it is not being used.

D. Where Does This Leave Merchant Perpetrated Fraud?

With the enactment of the Consumer Credit Protection Act, Congress realized that the new credit card industry was susceptible to various types of new and evolving fraud. The Consumer Credit Protection Act took baby steps to curb new types of fraud. When this statute caused a circuit court split, legislators attempted to make a remedy to this Act. This remedy was born under the name of the Credit Card Fraud Act. The legislative history set forth the intent of the law. The history outlined the problem of merchant credit card fraud that had started to grow with the increase of credit cards. Congress stated its awareness of the different types of merchant credit card fraud. While their awareness and intent was recognized, the statute fails to specifically enact punishments for fraudulent merchants. The courts' holdings seem to occasionally act opposite to the intent of the Credit Card Fraud Act. The Government still prosecutes using the wire fraud statute due to the fact that it is easier to prove.

Congress needs to acknowledge that technology is advancing at an even faster rate than in 1984. The Credit Card Fraud Act, the wire fraud statute, and the mail fraud statute needs to be blended together to form one body of legislation that is clear in its prohibitions and punishments. Standing alone, each statute must be dissected before it can be deemed acceptable to charge a fraudulent merchant. The ease of proving intent must be examined along with the statutory

sentence. Despite credit cardholders often getting their accounts charged back for fraudulent charges, the entire credit industry is victimized by each fraudulent charge.

As long as the Credit Card Fraud Act is not being applied based on its intent it will not be one hundred percent effective. Congress intended that the Credit Card Fraud Act be used to prosecute merchants committing credit card fraud. This law is only as good as its enforcement. Merchant fraud should be prosecuted under a criminal statute. Many times the criminal prosecution is not seen through because the Credit Card Fraud Act does not exist at the state level of the crimes jurisdiction. Other times, it is prosecuted under laws that are seen to be easier to prosecute than the Credit Card Fraud Act. In order for Congress to enforce the purpose of the Credit Card Fraud Act, it needs to give the statute as much ease and power as the other laws merchant credit card fraud seems to be prosecuted under instead.

The general public and the judicial system tend to be behind advances in technology. Often technology has been invented many years before it has become common place in the average home. In order for the laws to catch up to the crimes, the Consumer Protection Act and the Credit Card Fraud Act needs an overhaul. Since the enactment of the Credit Card Fraud Act most of the loop holes in the Consumer Protection Act were closed. Looking at certain cases and holdings seem to point out that the judges do not get the intent of the Credit Card Fraud Act. If the judges get the intent of the Act, the sentences for the convictions seem to be not as strict as the guidelines.

In most cases the major victim is the credit card issuer. The credit card holder will spend time having to make complaints but gets a chargeback to the account. The credit card issuer is out the chargeback to the client and if fraud is involved does not receive the money back from

the merchant. While it seems that this is a faceless fraud, it is not. The money the credit card issuer loses is passed on as higher interest rates and other fees to the credit card holders.

The easiest way to fix the "softness" of the Credit Card Fraud Act has would be to increase penalties upon conviction, pass immediate legislation that would make the Credit Card Fraud Act as easy to prosecute under as the broader mail fraud or wire fraud statute. With the evolution of the credit card and now the availability of buying merchandise not only through catalogs, over the phone, and the Internet, credit card fraud is here to stay.