

REGULATION OF FINANCE CHARGES IN RETAIL
INSTALMENT SALES

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A significant development in the economic habits of the twentieth-century American consumer is the pronounced trend toward individual ownership of personal assets that provide transportation, household services, and recreation—needs formerly satisfied by the purchase of services from others. Wide extension of consumer credit has played a dominant role in making asset ownership possible for persons in the middle- and lower-income levels. From a dark beginning when unscrupulous commission agents used the periodic-payment device to feed upon the very lowest economic groups, the practice of instalment selling achieved a measure of respectability in the nineteenth century and spread to a variety of home furnishings, particularly sewing machines and pianos.¹ Not until the advent of mass production techniques in the automobile industry created pressure for greater markets, however, did instalment purchasing come into its own. From less than one billion dollars in 1918, the amount of consumer instalment credit outstanding rose to over three billion in 1929, and the 1929 figure had doubled by 1941. The postwar boom occasioned a jump in consumer instalment credit to \$14.7 billion in 1950 and \$33.1 billion in 1958.²

This spectacular rise in instalment credit magnified abuses prevalent in credit selling and intensified a drive for comprehensive statutory regulation of the retail instalment sales business which has produced a wave of statutes in the last decade. At the core of consumer protection in instalment buying is control of the finance charges imposed on credit buyers. The objective of this Article is to examine this subject, first, by considering the application of the usury acts to credit sales and, then, by evaluating the many new statutes regulating finance charges in retail instalment selling.

A buyer unable to pay cash to a seller for a chattel generally has a choice between two methods of financing the sale. He may borrow the money out-

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1. For a brief historical treatment of the growth of instalment credit, see FEDERAL RESERVE SYSTEM BOARD OF GOVERNORS, CONSUMER INSTALMENT CREDIT pt. I, vol. 1, at 22-24 (1957) [hereinafter cited as FEDERAL RESERVE REPORT]. This report consists of four parts: Part I. Consumer Instalment Credit, Growth and Import (2 vols.); Part II. Conference on Regulation (2 vols.); Part III. Views on Regulation; Part IV. Financing New Car Purchases.

2. Ill. Bus. Rev., Nov. 1958, p. 5. Nearly \$15 billion of this \$33 billion amount consisted of automobile paper.

right, usually from a bank or a consumer-finance company, and pay the seller in cash, repaying his lender at a later time. Alternatively, he may purchase the article on credit with an agreement to pay the price in monthly instalments. If the nature of the article permits, the seller will retain a security interest in the goods by use of a chattel security device which, depending on the jurisdiction, may be called a conditional sale contract, a chattel mortgage, a bailment-lease agreement or—in a state which has enacted the Uniform Commercial Code—a “purchase money security interest.”³ Often, the seller will take a promissory note from the buyer for the unpaid balance. The seller may avoid having his working capital tied up in instalment contracts by transferring his interest in the security agreement and note to a sales-finance company or commercial bank, at a discount.

In the boom year of 1955, forty-five per cent of new automobile instalment purchases were financed through sales-finance companies and forty-one per cent through commercial banks, with the bank financing distributed about equally between direct loans and purchased contracts.⁴ Upper-income groups tended to obtain direct loans from banks more frequently than lower-income groups,⁵ while sales-finance companies had their greatest appeal to lower-income buyers. These companies were the source of credit for over half the instalment buyers with incomes of less than \$5,000 and for two-fifths of those with incomes in excess of \$7,500.⁶ The higher incidence of direct bank loans in the upper-income group is probably attributable in part to the banks' greater emphasis upon the borrower's credit-worthiness.⁷ The borrower's choice is also an important factor in selecting the source of credit; and the sales-finance companies attract lower-income groups largely because their credit terms—the size of down payments and the length of debt maturities—are more liberal.⁸

APPLICATION OF USURY STATUTES TO RETAIL INSTALMENT SALES

Traditionally, usury has been defined as the loan or forbearance of money, repayable absolutely, at a charge in excess of the interest allowed by law.⁹

3. UNIFORM COMMERCIAL CODE § 9-107.

4. FEDERAL RESERVE REPORT pt. IV, at 48. The remaining 14% was divided among consumer finance companies, credit unions, automobile dealers, individuals, and unclassified lenders.

5. *Id.* at 49-50. Twenty-six per cent of those instalment buyers with incomes over \$7,500 obtained direct bank loans as compared with 14% of those with incomes under \$5,000.

6. *Ibid.*

7. *Id.* at 49, 75. That buyers with higher incomes are more accustomed to dealing with banks is doubtless also a factor.

8. Of course, this liberality results in higher finance charges. Thus, in 1955, rates charged by sales-finance companies (median of 11.4%) and banks (median of 10.7%) on purchased paper were higher than those charged by banks on direct loans (median of 9.3%). *Id.* at 74-75.

9. This is in substance the definition given in 6 WILLISTON, CONTRACTS § 1684 (rev.

The direct loan from financing agency to buyer thus comes clearly within the ambit of the usury statutes (or of the special statutes regulating the personal instalment loans of commercial banks).¹⁰ Courts have differed considerably, however, about the applicability of usury statutes to retail instalment sales.

Most jurisdictions have exempted credit sales from usury statutes by invoking the doctrine that a seller may offer an article at two different prices, one a cash price and the other a time or credit price. The fact that the time price exceeds the cash price by an amount representing a rate of interest greater than that allowed under the usury statute is deemed immaterial on the theory that the credit transaction is merely a sale at a higher price which the seller is entitled to charge to cover the risks of selling on time.¹¹

Complementing the time-price exception is the doctrine that a note valid at its inception can be sold by the payee for any price without violating the usury law. This rule permits a dealer to discount a buyer's paper to a finance company or bank even though the amount of the discount exceeds the interest allowable by statute.¹² A potentially usurious discount transaction occurs

ed. 1938). Williston states in § 1685 that the loan or forbearance must concern money, but the Statute of Usury, 1713, 12 Anne, c. 16, states: "[N]o person . . . [shall] take, directly or indirectly, for loan of any monies, wares, merchandise, or other commodities whatsoever, above the value of five pounds for the forbearance of one hundred pounds for a year" See also COMYN, USURY 1 (1817); ORD, USURY ch. 2 (3d ed. 1809). Some of the modern statutes include goods and things in action as well as money. See, e.g., ALA. CODE ANN. tit. 9, § 60 (1941) ("money, goods, or things in action"); ARIZ. CODE ANN. § 36-102 (1940) ("money, goods, or things in action"); ARK. STAT. ANN. § 68-603 (1957) ("money, goods, things in action"); CAL. CONST. art. 20, § 22 ("money, goods, discounts or things in action"); ILL. REV. STAT. ch. 74, § 5 (1957) ("money, goods or things in action").

10. For a compilation of these laws, see FEDERAL RESERVE REPORT pt. I, vol. 1, at 65. These statutes, enacted in 35 states, usually allow a bank to discount interest rates of from 6 to 8%, and they often impose a ceiling of from \$100 to \$5,000 on the size of a loan.

11. *Beete v. Bidgood*, 7 B. & C. 453, 108 Eng. Rep. 792 (K.B. 1827), is the pioneer case on this point. The court held that where an estate was sold at a certain figure with a sum described as "interest" added to the original price as consideration for the purchaser's privilege of paying in instalments at a future date, notwithstanding that the amount of the "interest" was in excess of that allowed by the usury statute, no violation of the usury statute was involved. The entire amount of money promised was considered the price of the estate. Said Lord Tenterden: "The agreement was founded partly upon what was considered the present price of the estate, and partly upon what was considered its price if paid for at a future day. The only difficulty has been occasioned by calling the difference between these two prices interest" The leading American case is *Hogg v. Ruffner*, 66 U.S. (1 Black) 115 (1861). Numerous other cases are marshalled in 6 WILLISTON, CONTRACTS § 1685 (3d ed. 1938); Annot., 48 A.L.R. 1442 (1927); Annot., 57 A.L.R. 880 (1928); Annot., 91 A.L.R. 1105 (1934); Annot., 143 A.L.R. 238 (1943).

12. *Nichols v. Fearson*, 32 U.S. (7 Pet.) 101 (1833) (transaction is a sale, not a loan; hence, usury is inapplicable). The multitude of cases on the point are gathered in Annot., 165 A.L.R. 626, 663 (1946).

only when the lender advances funds directly to a borrower in exchange for the borrower's note and deducts his charge therefrom.¹³

The soundness of the rule exempting credit sales from usury statutes may be better evaluated when the economic incidents of the direct loan transaction are compared with those of the credit sale. Take the case of a buyer who desires to purchase a \$1,500 automobile but has only \$500 in cash. If he borrows the \$1,000 balance from a bank for one year at a charge of \$100, the usury statute applies. If, on the other hand, he buys the same automobile under a conditional sale contract, the time price will probably be quoted as \$1,600 and the seller will discount the \$1,100 balance of the contract to a sales finance company for \$1,000, leaving the finance company a \$100 profit on its advance. Under the cash-price-time-price dichotomy, the usury act would fail to protect the buyer in the second transaction, even though the credit-sale financing is similar, in several significant respects, to the direct-loan financing. In neither case does the seller finance the sale or the buyer have sufficient money to pay for the article immediately. In both cases, the advance of money is made by a financial institution, and in both the buyer pays a sum of money over and above the article's cash price for the privilege of deferring payment.

If the economic incidents of the two transactions are so compellingly similar, is there any rational basis for granting the protection of the usury laws to the buyer in the first case and withholding it in the second? A historical basis explains the distinction. Little instalment buying was done in the era during which usury statutes were enacted, and these statutes were directed primarily toward the evils associated with the direct loan.¹⁴ Moreover, when courts were first asked to construe the usury law in relation to the credit sale, the instalment device was still a comparative infant, normally associated with (then) "luxuries," and they easily found a policy basis for treating it

13. "The term 'discount,' as used in the Usury Statute, Cahill's St. ch. 74, applies to a discount of a borrower's note, and not to the so-called discount when the note is purchased by a third person from the payee of the note." *Manufacturers Fin. Trust v. Stone*, 251 Ill. App. 414, 422 (1929). See also *Valley Mortg. Co. v. Patterson*, 30 Ala. App. 492, 8 So. 2d 213 (1942). However, what purports to be a sale of commercial paper at a discount may be held to be a cover for a loan transaction. *Bjorkman v. Columbia Wrecking & Fuel Co.*, 130 Ore. 189, 279 Pac. 633 (1929).

14. Although instalment credit began to grow after the Civil War, it did not become a really significant factor in the economy until the advent of mass production in the automobile industry during the second and third decades of the present century. See *FEDERAL RESERVE REPORT* pt. I, vol. 1, at 22-24. The early treatises on the subject of usury, *COMYN, USURY* (1817), and *ORD, USURY* (3d ed. 1809), give no indication that instalment selling was an object of parliamentary intent in enacting the various usury statutes. The treatises enumerate many subterfuges employed to avoid the usury statute but do not mention instalment selling as among them. One wonders if the concept of a time price as separate and independent of a cash price was not more compatible with mercantile practices of the nineteenth century, when goods were less standardized and less likely to bear a set price than they are in this age of price tags.

differently from the direct loan. Thus, in justifying the loan-sale distinction, a Missouri court declared:

The reason [that an instalment sale cannot be usurious] is that the statute against usury is striking at and forbidding the exaction or receipt of more than a specified legal rate for the hire of money and not of anything else; and a purchaser is not like the needy borrower, a victim of a rapacious lender, since he can refrain from the purchase if he does not choose to pay the price asked by the seller.¹⁵

Today, the belief that one borrows money from need but purchases on credit by choice is manifestly anachronistic. By the standards of contemporary society, one can "require" a washing machine or automobile quite as desperately as a loan of money. If the usury laws were designed to protect weak and needy persons from the overreaching of economically superior renters of capital, then it should be recognized that the bargaining position of instalment buyers may be as disadvantageous as that of borrowers of money. That courts are justified in limiting the scope of usury statutes by interpreting them in the light of the economic needs and social attitudes of the last century is, therefore, highly questionable.

Exceptions to the Time-Price Rule

Although generally accepting the principle that a seller may charge as a time price a sum which exceeds the cash price by an amount greater than that which the permissible rate of interest would allow, some courts have purported to look through the form of the instalment-sale transaction to determine whether usury was present in substance. These courts have singled out certain factors which, they say, bring what is ostensibly a credit sale under the limitations of the usury laws. Three basic patterns emerge from these decisions. First, usury may be found to exist if the buyer and finance agency have agreed before a sale that the latter will finance the transaction by purchasing the buyer's contract from the seller,¹⁶ (or if some significant contact has occurred between the financier and buyer before the sale is closed).¹⁷ Apparently, this type of situation is viewed as the equivalent of the

15. *General Motors Acceptance Corp. v. Weinrich*, 218 Mo. App. 68, 77-78, 262 S.W. 425, 428 (1924).

16. See *Jackson v. Commercial Credit Corp.*, 90 Ga. App. 352, 83 S.E.2d 76 (1954); *Benton v. Sun Indus., Inc.*, 277 App. Div. 46, 97 N.Y.S.2d 736 (1950); *Krim v. Morris Plan Industrial Bank*, 173 Misc. 141, 17 N.Y.S.2d 472 (N.Y.C. Munic. Ct. 1939); *Nazarian v. Lincoln Fin. Corp.*, 77 R.I. 497, 78 A.2d 7 (1951); *United Tire & Inv. Co. v. Trone*, 189 Okla. 120, 113 P.2d 977 (1941).

17. An important factor in several cases is participation of the financing agency's representative in the closing of the transaction. *Frankfurt Fin. Corp. v. Cox*, 142 S.W.2d 553 (Tex. Civ. App. 1940); *Higgins v. Mossler Acceptance Co.*, 140 S.W.2d 532 (Tex. Civ. App. 1940); see *Mossler Acceptance Co. v. Alexander*, 137 S.W.2d 815 (Tex. Civ. App. 1940). *Contra*, *Lamula v. Morris Plan Industrial Bank*, 173 Misc. 874, 19 N.Y.S. 2d 357 (N.Y.C. Munic. Ct. 1940). *Compare* *McNish v. Grand Island Fin. Co.*, 164 Neb.

buyer's borrowing the money directly from the financier. Second, some courts are prone to find that the usury statutes apply whenever a close relationship exists between the dealer and the financing agency, particularly when this relationship is manifested by the agency's practice of rebating a portion of the finance charge to the dealer and furnishing him with forms and related services.¹⁸ Third, though they concede that a valid time price is outside the pale of the usury acts, an increasing number of courts are challenging the bona fides of the dealer's total charge in a credit sale as a true time price.¹⁹ To avoid the usury law, the decisions in the third group would require the seller to quote the buyer both a time price and a cash price and allow him an option between the two. Thus, if the dealer initially negotiates with the buyer in terms of a cash price and determines the time price only after an agreement to purchase has been reached, and if the time price is found merely by adding the finance and insurance charges to the cash price, these courts hold that the ultimate contract statement of the time price is merely a cloak for usury.²⁰

543, 83 N.W.2d 13 (1957) (finding usury), in which the seller's salesman was considered an agent for the finance company in representing to the buyer that the finance company would handle the sale, *with* Luchesi v. Capitol Loan & Fin. Co., 113 A.2d 725 (R.I. 1955), in which no usury was found even though the retail business and the finance company were operated by the same man.

18. Daniel v. First Nat'l Bank, 227 F.2d 353 (5th Cir. 1955) (bank furnished dealer with forms and assisted in calculating charges); Jackson v. Commercial Credit Corp., 90 Ga. App. 352, 83 S.E.2d 76 (1954) (dealer and finance company have a common agent); McNish v. Grand Island Fin. Co., 164 Neb. 543, 83 N.W.2d 13 (1957) (dealer's salesman considered agent for finance company); State *ex rel.* Beck v. Associates Discount Corp., 162 Neb. 683, 77 N.W.2d 215 (1956) (finance company's practice of rebating to dealer portion of finance charge held factor in court's determination that finance company was operating in violation of state instalment loan act); White v. Disher, 232 N.C. 260, 59 S.E.2d 798 (1950) (person selling automobile was partner in both dealer and finance company); see Hare v. General Contract Purchase Corp., 220 Ark. 601, 249 S.W.2d 973 (1952) (prospective ruling) (finance company furnished forms and rate charts). *But see* General Motors Acceptance Corp. v. Weinrich, 218 Mo. App. 68, 79, 262 S.W. 425, 429 (Ct. App. 1924), in which the court said:

The mere fact that, prior to the transaction, plaintiff furnished Reuter with blank forms of chattel mortgages and notes together with the rates of discount it would pay, and also forms of statements relative to the sale and solvency of the purchaser and directions how to proceed, certainly does not conclusively show that the transaction is a scheme to enable plaintiff to effect an usurious loan

19. The type of decision involved in these cases is illustrated by the following extract from Daniel v. First Nat'l Bank, *supra* note 18, at 357: "The evidence leaves us in no doubt that there was never any bona fide 'time price' in any one of the three contracts, but that the real transaction was a sale at a cash price accompanied by a loan or extension of credit to which the bank was privy throughout." See also Hare v. General Contract Purchase Corp., *supra* note 18; Jackson v. Commercial Credit Corp., *supra* note 18; McNish v. Grand Island Fin. Co., *supra* note 18; McNish v. General Credit Corp., 164 Neb. 526, 83 N.W.2d 1 (1957); State *ex rel.* Beck v. Associates Discount Corp., *supra* note 18; Powell v. Edwards, 162 Neb. 11, 75 N.W.2d 122 (1956).

20. "[I]t must appear that the buyer actually was informed of and had the opportunity

If the doctrine that the usury acts do not comprehend a sale at a time price is sound—a proposition difficult to concede—then it is questionable whether any of these three decisional patterns marking exceptions to the time-price rule presents a particularly convincing basis for a finding of usury. An appreciation of the shortcomings of these decisions depends upon an understanding of the commercial background of retail instalment selling. Customarily, in those businesses in which manufacturers or distributors will not extend credit to retailers—the automobile business is the best example—financing agencies, usually sales-finance companies or banks, undertake to advance cash for a retailer's purchases from the manufacturer, taking as security a trust receipt on the article financed. This practice is called "floor-planning." At the wholesale level, only one finance company usually deals with a given retailer, for a finance company engages in trust-receipt financing at a considerable risk when it deals with a retailer who is being financed by a second company. In exchange for financing the dealer's inventory at a comparatively low rate of interest, the finance company anticipates that the dealer will sell to it the bulk of his lucrative retail instalment sales contracts. The finance company customarily furnishes the dealer with blank contract and note forms and rate charts. Varying portions of instalment-sale finance charges are rebated to the dealer by the financier, usually through the device of a dealer reserve fund.

In the first line of exceptions to the time-price rule, direct contact between financial institution and buyer opens the ostensible sales transaction to a charge of usury. Clearly, when a prospective automobile purchaser goes to a bank and receives a commitment that the bank will finance the subsequent sale, the transaction is in fact a loan and the usury statute should apply even though the financing is secured by an instalment-sale contract drawn by the bank and taken to the automobile dealer merely for his *pro forma* assignment to the bank. Here, the loan is directly procured by the financial institution, and the use of the instalment-sale contract is a mechanism which might well be intended to avoid one or more statutes which may govern a direct-loan transaction—the usury acts, chattel mortgage recording acts, or statutory provisions regulating chattel-mortgage terms and foreclosure. On the other hand, when a dealer, rather than a financier, is the effective agent in selling to the buyer the credit plan of a financial institution with which the dealer has a working agreement, a rule of law which brands an instalment contract as potentially usurious because of minor contacts between the buyer and financier seems unrealistic. Nearly every dealer functions as a representative of the finance company that floor-plans his inventory. He strives to persuade his buyers to use the plan offered by this company, and he is usually suc-

to choose between a time sale price and a cash sale price. It is not enough to merely show that the instruments signed evidencing the indebtedness refer to a time price or time differential when, in fact, the buyer was never quoted a time sale price as such." *McNish v. General Credit Corp.*, 164 Neb. 526, 537, 83 N.W.2d 1, 9-10 (1957).

cessful in channeling to it most of the paper originating from his instalment sales.²¹ For this, he is well compensated, receiving from the financier a substantial share of the charge paid by the consumer for the financing.²² To this extent, even when it deals only with the retailer in purchasing the buyer's paper, the financial institution does have effective, though indirect, contact with a consumer. Actual contacts between a buyer and a financier in the credit-sale situation must be viewed from this perspective, and, when so examined, seem largely irrelevant criteria for determining the application of usury law. Thus, when a dealer has actually been responsible for selling a purchaser on the financing terms of a particular agency, it should not be determinative of the usury issue that an agent of the financial institution is present at the closing of the sale, or even that the agent participates to some extent in the closing.²³

One unhappy consequence of the rule that an instalment-sales contract is potentially usurious when the financier has had some direct contact with the buyer is that it tends to turn over to the retailer the choice of financing agency and effectively deprives the consumer of the power to make this decision. This is true because, in states whose usury rates are too low to permit successful sales-finance operations, the financier can only compete for dealer-originated paper, the assignment of which is usually effectively controlled by the dealer; if the financier directly solicits a buyer's patronage, the transaction is likely to be considered a direct loan subject to the usury statutes. The danger of ceding to the dealer the choice of financing agency lies in the fact that a dealer, in exercising his choice, is likely to be more influenced by the size of the finance-charge rebate accruing to him than by the reasonableness of the charge which the buyer will have to pay.²⁴ If the buyer is allowed

21. See the testimony set out in *Teegardin v. Foley*, 166 Ohio St. 449, 459, 143 N.E.2d 824, 830 (1957), wherein a witness with many years of experience in both automobile selling and financing was asked:

Q. Would you say that from your experience that the dealer does control the placing of credit by consumers from his business? A. Well, I would like to answer that question two ways; there are some dealers who do and there are some who don't. *When I was in the finance business, I used to, we will say, tell the dealer that he wasn't controlling it like he could.* Q. In other words, it is possible for a dealer to control a very high percentage of the credit transactions going through his business? A. *He can control a majority of them, yes sir.* [Italics in original.]

22. See text accompanying notes 71-74 *infra*.

23. Compare the cases cited note 17 *supra* (finding usury when a finance company representative participates in closing the transaction).

24. "The two factors mentioned most frequently by dealers as having an influence in their selection of lenders are: (1) the generosity of the arrangement under which the lender shares finance charges with the dealer—the 'dealer reserve'—and (2) the character of the lender's credit standards and the flexibility with which they are applied." FEDERAL RESERVE REPORT pt. I, vol. 2, at 151.

An automobile dealer was questioned concerning finance charges in *Teegardin v. Foley*, 166 Ohio St. 449, 459, 143 N.E.2d 824, 830 (1957): "Q. The other day I asked

to arrange his own financing, he will doubtless do so on the basis of rates. Therefore, the effect of competition among finance companies for a dealer's paper is, paradoxically, to raise finance rates rather than to lower them, for the need to offer the dealer a rebate arrangement liberal enough to attract his business tends to force the financier to exact high finance charges from consumers.²⁵

In the second group of cases—those considering finance charges to be potentially usurious on the basis of contacts between the dealer and the finance company—the very financing agencies held exempt under the rationale of the first type of case because they refrain from dealing directly with buyers are now brought under the guns of the usury statute because of their close and continuing relationship with dealers. Why the convenient arrangement typically existing between dealer and finance company, under which the latter furnishes contract forms, rate charts, and other services, should make credit sales any more potentially usurious than a random or casual relationship is difficult to perceive. Whether, during a given month, a dealer sells one hundred retail contracts to one finance company or one contract to each of a hundred different companies seems to have little bearing on whether a credit buyer is being charged usurious interest. If this be true, of what consequence is the closeness of his relationship to the financing agency? The reason finance companies furnish rate charts is obvious, and certainly their motive in supplying dealers with printed forms is legitimate. Since the finance agency must be sure of its rights under the retail contracts and notes purchased, the most convenient procedure is for the agency to supply retailers with a form prepared by its own attorneys.²⁶

The third line of authority—those cases which purport to look into the bona fides of the time price in each case—seems even more incompatible with the economic facts of life in the credit retailing field. The requirement that a dealer negotiate with the buyer in terms of a time price before the deal is

you this question: 'Are you concerned with the rate which a customer has to pay?' And you answered: 'No, not as it is today.' Is that correct? A. That's right. Q. *But you are concerned with the amount of reserve which is paid to you?* A. *Yes, sir.*" [Italics in original.]

25. See the discussion of the interaction of dealer participation payments and finance charges, text accompanying notes 107-14 *infra*.

26. Finance companies and banks hesitate to purchase such notes, contracts, and chattel mortgages, if executed on printed forms with which they are not familiar, without first submitting them to the scrutiny and opinion of their attorneys. To obviate such delays and expense, these financial institutions have widely adopted the practice of having their own attorneys draft forms . . . and then have had the same printed and supplied to the dealers from whom they customarily purchase customer paper. . . . We can perceive of no reason based upon either logic or public policy why a finance company or bank which supplies such blank printed forms should be held thereby to have constituted the dealers their agents, or should be deemed to have participated in the sale by the dealer to the customer

Implement Credit Corp. v. Elsinger, 268 Wis. 143, 161, 66 N.W.2d 657, 666 (1954).

closed, and that this price somehow be derived other than by adding finance and insurance charges to the cash price, is totally unrealistic. In the typical automobile transaction, after the cash price of the vehicle is stated, the principal bargaining concerns the allowance to be made on the trade-in. Only after this issue is settled do the parties know the amount to be financed. Since even a valid time-price increment would doubtless fluctuate in accordance with the amount of credit extended, it would be useless to require the salesman to determine a time price and state it to the buyer before the process of negotiating the trade-in allowance had been completed. And it is patently absurd to assert that a time price can fairly be computed in any way other than by calculating finance and insurance charges and adding them to the amount to be financed. Those courts which hold a time price invalid when it is established in the course of normal dealer procedures would therefore demand that, as a condition of avoiding the usury statutes, buyer and seller cloak their actions with pretenses that, to a businessman, are farcical.²⁷

The doctrine advanced by these courts is, furthermore, inconsistent with the approach which several states have taken in regulating credit sales. One of the fundamental safeguards afforded consumers by these retail instalment sales acts is the requirement that dealers itemize in the sales contract the various amounts involved in the credit sale—cash price, down payment, allowance on trade-in, insurance premiums, and finance charge.²⁸ To supplement the state provisions, the Federal Trade Commission, acting under its authority to prevent unfair methods of competition in interstate commerce, promulgated rules requiring written disclosure of this information to buyers.²⁹ These disclosure requirements seem repugnant to the view that a time price is not bona fide if it is determined by adding the cash price, less trade-in and down payment, to the insurance premiums and finance charges, for these statutes command that the time price be calculated in just this manner. Nonetheless, in those states having disclosure provisions but no separate limitations

27. Consider the typical credit-sale transaction in *Daniel v. First Nat'l Bank*, 227 F.2d 353, 357 (5th Cir. 1955). The court, concerned that no time price was mentioned prior to the sale's completion and that the time price was obtained merely by adding finance and insurance charges to the cash price, held the time price to lack bona fides.

28. For a recent discussion of disclosure provisions in the various retail instalment sales acts, see Britton & Ulrich, *The Illinois Retail Installment Sales Act—Historical Background and Comparative Legislation*, 53 NW. U.L. REV. 137, 156-58 (1958); Hogan, *A Survey of State Retail Installment Sales Legislation*, 44 CORNELL L.Q. 38, 44-47 (1958); Note, *Retail Installment Sales Legislation*, 58 COLUM. L. REV. 854, 866-72 (1958). In 1958, Congress passed the Automobile Information Disclosure Act requiring manufacturers to affix to the automobile a label disclosing, *inter alia*, the suggested retail price of the vehicle, suggested prices of accessories, and the amount charged for transportation. 72 Stat. 325, 326 (1958). For citations of all retail instalment legislation see notes 116-20 *infra*.

29. Trade Practice Rules Relating to the Sale and Financing of Motor Vehicles, 16 C.F.R. § 197.2 (Supp. 1958).

on finance charges,³⁰ dealers face the question of whether compliance with disclosure requirements subjects the transaction to the usury acts on the ground that a time price so calculated is not bona fide. The disclosure statutes would seem not only to reflect legislative recognition that a time price cannot spring, Minerva-like, from the head of Jove, but also to imply that, in fact, a time price can only be fairly computed in the manner set out, the consumer being sufficiently protected when he is given full information regarding the transaction. There is no reason to believe that, in requiring disclosure, the legislatures had any desire to bring the onus of the usury acts upon the sales-finance business. In fact, apparently recognizing that the FTC disclosure rules might be construed to undermine the time-price theory, the Texas and Colorado legislatures have passed statutes providing, in effect, that itemization of the constituent elements of a time price does not affect its bona fides.³¹

In retrospect, it thus appears that the courts which have purported to look through the form of a credit sale to determine whether it is in substance a loan have based their findings of usury on factors that are largely unrelated to the policies underlying usury law. In short, these courts look through form not to substance but merely to another kind of form. Though proclaiming the time-price doctrine, they have made compliance with its strictures infeasible in the light of modern instalment-credit practices. If the time-price rule should be abolished, direct abrogation is preferable to hamstringing the operation of the rule by the creation of arbitrary and anachronistic judicial exceptions.

Arkansas has gone further toward abolishing the time-price exemption by judicial fiat than any other state, but even here a vague sort of lip service is still paid the old shibboleth. In the 1952 case of *Hare v. General Contract Purchase Corporation*,³² the Supreme Court of Arkansas, in an unabashed piece of judicial legislation, laid down the following guides for determining usury:

(1) A seller may charge as a time price an amount which exceeds the cash price by a percentage greater than the allowable rate of interest, but the bona fides of the time price is a question of fact.

(2) Even if the seller quotes both a time and a cash price, whenever the seller transfers the buyer's paper to a finance company at a discount greater

30. The following statutes impose disclosure requirements but do not limit finance charges: ALASKA COMP. LAWS ANN. § 50-6-5(2)(f) (Cum. Supp. 1958); COLO. REV. STAT. ANN. § 13-16-6 (1954); IDAHO CODE ANN. § 64-806 (Supp. 1957); ILL. REV. STAT. ch. 121½, § 225 (1957); MASS. ANN. LAWS ch. 255, §§ 12, 12a (Supp. 1958); NEB. REV. STAT. ANN. § 60-617 (Cum. Supp. 1957); N.J. STAT. ANN. § 17:16B-6 (Supp. 1958); VA. CODE ANN. § 46.1-545 (1953).

31. TEX. REV. CIV. STAT. ANN. art. 5074a (Supp. 1958). Texas has no disclosure statute. In Colorado the legislature has provided that the "time price differential" shall not "be in any wise considered as interest as defined by the laws of this state." COLO. REV. STAT. ANN. § 13-16-1(8) (1954).

32. 220 Ark. 601, 249 S.W.2d 973 (1952).

than the legal rate of interest, "a question of fact arises as to whether the seller increased his cash price with the reasonable assurance that he could so discount the paper to such individual or finance company. If that reasonable assurance existed, then the transaction is in substance a loan, and may be attacked for usury."

(3) "When finance companies or purchasers of title paper supply dealers with a set of forms and a schedule for credit price increases, such will tend to show that the dealer had reasonable assurance that such finance company or purchaser of the paper would take the paper at such discount."³³

Clearly, under these tests, it will be virtually impossible for a dealer using the usual sales-financing procedures to escape the ambit of the usury statute. Cases decided after *Hare* demonstrate that the time-price exemption is dead in Arkansas if a financial institution is involved in the instalment sale.³⁴

What should be the community policy in the area of finance charge regulation, and how should this policy be effected? The distinction between finance charges and interest has been described by economists as of "little economic significance."³⁵ Each is the cost of credit, and if consumers must be protected against excessive credit charges, finance charges are as deserving of regulation as interest rates. To the consumer, the distinction must seem pure legalese. To subject sales-finance companies to the usury acts, however, might constitute a death blow to this vital enterprise. Instalment credit is so expensive to service³⁶ that a finance company often cannot operate profitably within the limitations of most usury acts.³⁷ Manifestly, the vast product of American industry cannot be marketed without instalment selling; hence, instalment-finance institutions must be kept healthy. The basic problem is therefore to strike a fair balance between protecting consumers against excessive finance charges and maintaining conditions in the instalment-finance business which will encourage financial institutions to meet the credit needs of an ever-growing economy.

33. *Id.* at 609, 249 S.W.2d at 978. The *Hare* court, believing that the parties had relied on previous Arkansas decisions supporting the seller's course of action, affirmed the lower court's finding of no usury in the case at bar. The rules laid down which represent a reversal of prior authority are prospective in their operation. To the effect that the new rules are not applicable to contracts entered into prior to the *Hare* case, see *Crisco v. Murdock Acceptance Corp.*, 222 Ark. 127, 258 S.W.2d 551 (1953).

34. See *Universal C.I.T. Credit Corp. v. Lackey*, 305 S.W.2d 858 (Ark. 1957); *Whiddon v. Universal C.I.T. Credit Corp.*, 227 Ark. 824, 301 S.W.2d 567 (1957); *General Contract Corp. v. Duke*, 223 Ark. 938, 270 S.W.2d 918 (1954); *Thompson v. Murdock Acceptance Corp.*, 223 Ark. 483, 267 S.W.2d 11 (1954).

35. FEDERAL RESERVE REPORT pt. I, vol. 1, at 49.

36. "Consumer credit is expensive in comparison with most types of business credit, but this appears to be due mainly to the relatively high costs of operation rather than to exorbitant profits of lenders." *Id.* at 68.

37. Significantly, in the two states, Arkansas and Texas, in which the courts have been most willing to limit or abrogate the time-price exception, the usury laws allow a comparatively high rate of interest (10%). ARK. CONST. art. 19, § 13; TEX. CONST. art. 16, § 11.

This dual community goal cannot be satisfactorily achieved by judicial regulation. Neither of the alternatives open to the courts is a solution to the problem. A judge may look through the form of a credit transaction and find it usurious, but this decision shackles instalment-credit contracts to the rigors of anachronistic usury statutes. If he chooses the other alternative and perpetuates the time-price exemption, he denies consumers all legal protection against excessive charges. As the matter now stands, the time-price exemption is firmly embedded precedent in a number of states, and the only judicial movement to be expected in this area is continued attenuation of the doctrine by economically irrelevant refinements and limitations. The flexibility achieved under this trend of authority will continue to blunt predictability, although it may allow the courts to aid consumers in hardship cases. Both financial institutions and consumers deserve better legislation.

STATUTORY LIMITATIONS ON FINANCE CHARGES

As of January 1959, twenty-three of the thirty-one states having retail instalment sales legislation imposed limitations on finance charges.³⁸ Six of these states limit finance charge rates on all tangible personal property sold at retail,³⁹ while the remaining seventeen restrict rate regulation to motor vehicle sales.⁴⁰ The most common type of statute recognizes the increased risk that attends the selling of used cars, and classifies motor vehicles in three or four age groups, with higher finance charges allowed for older models.⁴¹ If three

38. The states regulating finance charges on the retail sales of personal property lie principally in the Northeast, the Midwest, and the Pacific Coastal regions. See notes 39, 40 *infra*.

39. IND. STAT. ANN. § 58-926 (1951) (authorizes the Department of Financial Institutions to set maximum finance charges; the act applies to all goods sold with a cash price not in excess of \$2500, § 58-901); Kan. Laws Spec. Sess. 1958, ch. 9, § 2(a), at 29 ("all chattels personal"); N.Y. PERS. PROP. LAW § 303 (motor vehicles), § 404 (other goods); N.D. Laws 1957, ch. 322, § 3, at 627 (personal property); OHIO REV. CODE ANN. § 1317.06 (Page 1953) (goods); UTAH CODE ANN. § 15-1-2aB(3) (Supp. 1957) (tangible personal property).

40. CAL. CIV. CODE ANN. § 2982(c) (Supp. 1958); CONN. GEN. STAT. § 42-85 (1958) (applicable to all goods but regulating finance charges only on sales of motor vehicles); FLA. STAT. ANN. § 520.08 (Supp. 1958); IOWA CODE ANN. § 322.19 (Supp. 1958); KY. REV. STAT. § 190.110 (1956); La. Acts 1958, No. 74, § 7; ME. REV. STAT. ANN. ch. 59, § 255 (Supp. 1957); MD. ANN. CODE art. 83, § 132(b) (1957) (covering all goods but regulating finance charges only on sales of motor vehicles); MASS. ANN. LAWS ch. 255B, § 14 (Supp. 1958); MICH. STAT. ANN. § 23.628(18) (Supp. 1955); MINN. STAT. ANN. § 168.72 (Supp. 1958); Miss. Laws 1958, ch. 495, § 27, at 809-10; NEV. REV. STAT. § 97.040 (1957) (covers all vehicles); Ore. Laws 1957, ch. 625, § 19, at 1017; PA. STAT. ANN. tit. 69, § 619 (Supp. 1958); S.D. Sess. Laws 1957, ch. 241, § 4; WIS. STAT. § 218.01(6)(b) (1955). For those states having retail instalment sale legislation which does not fix finance rates, see note 30 *supra*.

41. CONN. GEN. STAT. § 42-85 (1958); FLA. STAT. ANN. § 520.08 (Supp. 1958); IND. STAT. ANN. § 58-926 (1951) (by rule of Department of Financial Institutions, General Order No. 1, § T (1958), 1 CONDIT. SALE-CHAT. MORT. REP. 5475); IOWA CODE ANN. § 322.19 (Supp. 1958); Kan. Laws 1958, ch. 9, § 8(a), at 19; KY. REV. STAT.

classes are used, they usually comprise current models, used cars up to two years old, and used cars over two years old. When four groups are employed, the third category may include cars from two to four years of age and the fourth, cars older than four years.⁴² Rate maxima for current models vary from the six dollars per one hundred dollars per annum figure in Michigan and Pennsylvania to the nine dollars per one hundred dollars per annum limit in Kentucky and Maryland.⁴³ Allowable charges on models over four years old run as high as Florida's rate of seventeen dollars per one hundred dollars per annum.⁴⁴

Other features of the statutes are so varied as to defy generalization. California, Nevada, and Utah set the finance-charge limit at one per cent of the balance remaining unpaid at the time of the sale multiplied by the number of months the contract has to run.⁴⁵ No gradation is made in these states on the basis of the obsolescence of the merchandise. Iowa, Louisiana and South Dakota (depending on the age of the vehicle) allow a charge of from one and one-quarter per cent to two and one-quarter per cent of the declining balance each month.⁴⁶ In Ohio, a base finance charge of eight dollars per one hundred dollars per year on the principal balance is supplemented by a service charge measured by the number of fifty-dollar units owed.⁴⁷ (Minimum charges are fixed in fourteen states.)⁴⁸

§ 190.110 (1956); La. Acts 1958, No. 74, § 7; ME. REV. STAT. ANN. ch. 59, § 255 (Supp. 1957); MD. ANN. CODE art. 83, § 132 (1957); MASS. ANN. LAWS ch. 255B, § 14 (Supp. 1958); MICH. STAT. ANN. § 23.628(18) (Supp. 1955); MINN. STAT. ANN. § 168.72 (Supp. 1958); Miss. Laws 1958, ch. 495, § 27(a), at 809; N.Y. PERS. PROP. LAW § 303 (motor vehicles); § 404, covering other goods, allows \$10 per \$100 per annum on the principal balance under \$500 and \$8 per \$100 per annum on the excess over \$500); N.D. Laws 1957, ch. 322, § 3, at 627; Ore. Laws 1957, ch. 625, § 19, at 1017; PA. STAT. ANN. tit. 69, § 619 (Supp. 1958); S.D. Sess. Laws 1957, ch. 241, § 4, at 352-53; WIS. STAT. § 218.01(6) (b) (1955).

42. Of the statutes set out in note 41 *supra*, those of 5 states have four age categories (Florida, Iowa, Louisiana, Mississippi, Wisconsin), one has five classes (Connecticut), and the remainder have three groups.

43. See note 41 *supra*, for the statutory citations.

44. FLA. STAT. ANN. § 520.08 (Supp. 1958).

45. CAL. CIV. CODE ANN. § 2982(c) (Supp. 1958); NEV. REV. STAT. § 97.040 (1957); UTAH CODE ANN. § 15-1-2aB(3) (Supp. 1957).

46. IOWA CODE ANN. § 322.19 (Supp. 1958); La. Acts 1958, No. 74, § 7; S.D. Sess. Laws 1957, ch. 241, § 4, at 352-53.

47. OHIO REV. CODE ANN. § 1317.06 (Page 1953).

48. CAL. CIV. CODE ANN. § 2982(c) (Supp. 1958) (\$25); CONN. GEN. STAT. § 42-85 (1958) (\$15); FLA. STAT. ANN. § 520.08 (Supp. 1958) (\$25); IOWA CODE ANN. § 322.19 (Supp. 1958) (\$25); Kan. Laws Spec. Sess. 1958, ch. 9, § 8, at 19 (\$15); ME. REV. STAT. c. 59, § 255 (Supp. 1957) (\$25); MICH. STAT. ANN. § 23.628(18) (Supp. 1955) (\$15); Miss. Laws 1958, ch. 495, § 27, at 809 (\$25); NEV. REV. STAT. § 97.040 (1957) (\$25); N.Y. PERS. PROP. LAW § 404 (\$12 for goods other than motor vehicles, except contracts running eight months or less, where \$10 minimum is allowed); Ore. Laws 1957, ch. 625, § 19, at 1017 (\$25); S.D. Sess. Laws 1957, ch. 241, § 4, at 352 (\$20); UTAH CODE ANN. § 15-1-2aB(3) (Supp. 1957) (\$5, except in case of motor vehicles, where \$15 minimum is allowed); WIS. STAT. § 218.01(6) (b) (1955) (\$15). This compilation does not in-

The finance charge maxima prescribed by these statutes are liberally drawn in favor of the financier. Of the three methods of calculating finance charges usually specified—add-on, discount, and interest on the unpaid balance⁴⁹—the add-on method is most common, having been incorporated into the majority of the statutes regulating instalment sales of durable consumer goods. This method simply entails adding the finance charge to the amount the buyer finances, and is the system ordinarily used by dealers in computing finance charges on such goods. A statutory add-on maximum of six dollars per one hundred dollars of the principal balance financed does not limit the dealer to a true interest rate of six per cent, for the buyer does not have the use of the entire principal balance for the whole year. Since he is discharging his obligations by monthly payments and has the use, on an average, of only slightly more than one-half of the original principal balance throughout the year, the true interest rate on a six per cent add-on charge is something over eleven per cent.⁵⁰ When this method of computation is understood, it is possible to appreciate the economic significance of add-on charges permitted by various state statutes to run from six to nine per cent on new cars, nine to thirteen per cent on late model used cars, and twelve to seventeen per cent on older used cars. In most states, the statutory rate maxima are well above finance-rate averages actually charged in recent years. In 1956, for example, a typical range of add-on rates was approximately six per cent on new cars, eight and one-half per cent on late model used cars, and twelve per cent on older used cars.⁵¹

clude those statutes allowing the holder a portion of the finance charge as an acquisition charge upon the buyer's prepayment.

49. The "discount" and "interest-on-the-unpaid balance" methods of calculating finance charges are briefly explained in FEDERAL RESERVE REPORT pt. I, vol. 1, at 50:

The discount method of calculating finance charges involves starting with the total amount of the note and deducting the rate of discount in order to determine the proceeds going to the borrower. If the note were written for \$100 for a year and the discount rate were 6 percent, the borrower would receive \$94 and his payments would be \$8.33 per month. The discount method is used for FHA title I repair and modernization loans and for some personal instalment loans.

The calculation of interest on the unpaid balance involves computing each month the amount of interest due on the balance outstanding since the previous payment. The consumer may thus pay a different amount each month, or the payment schedule can be arranged to provide for equal monthly payments with a declining portion of the payment going to pay the finance charge and an increasing proportion to reduce the principal as the loan matures. This method of computing the finance charge is generally used for personal instalment loans granted by consumer finance companies and credit unions.

50. The true or effective interest rate is sometimes estimated at about twice the add-on rate, but this yields a figure somewhat too high. For a discussion of the various methods used to calculate the true or effective interest rate from the add-on rate, see *id.* at 54.

51. *Id.* at 53. This study notes that in individual cases rates were much higher and that rates on used cars were much less uniform than those on new cars.

What is the purpose of state regulation of finance charges? Quite clearly, these statutes are neither conscious nor effective efforts to reduce the un-stabilizing effect of untoward instalment-credit expansion on the national economy.⁵² Efficient inflation control measures would have to regulate down payments and prescribe permissible maturities in instalment-sale contracts. National legislation would be required. The statutes, moreover, are not an attempt at rate making; state legislatures are too insensitive to the dictates of the money market and to the legitimate demands of sales financiers and consumers to be able to sponsor an effective program of "price fixing" by which finance charges would be restricted to rates shown by past competitive experience to be "fair" to all parties at all times throughout the economic cycle.

The principal function of these statutes appears simply to be the protection of credit consumers against excessive gouging by those dealers and financiers who, taking advantage of the public's notorious indifference to finance rates, exact exorbitant charges.⁵³ That such overreaching is widespread is well known in the business community. Hence, these statutes stand, like the usury acts, above the fluctuations of the credit market, constituting the outer limits, as it were, of fiscal morality.

Surely the public interest is as great in stopping scalping in the area of instalment credit as it was decades ago in frustrating the activities of loan sharks in direct-loan cases. With only six states regulating finance charges on tangible personal property other than motor vehicles, however, one can hardly say that this urgent public interest has found adequate legislative expression. Why have legislatures been reluctant to set rate maxima on sales of appliances, furniture, and other nonvehicular personal property commonly sold by

52. The effect of finance-charge limitations on the volume of instalment credit is not easy to weigh. Since the cost of credit would be reduced by lower finance-charge ceilings, it might seem to follow that more people would be encouraged to buy on time. On the other hand, lower rate ceilings cause financiers to be more selective in their choice of credit risks. By discouraging credit to marginal risks, low rates thus tend to constrict the instalment-sale market. Moreover, the fact that increases in finance charges are scarcely noticeable when spread over the full maturity of the contract tends to lessen the likelihood that a consumer will be deterred by an increase in finance rates. *Id.* at 60-61, notes that:

. . . an \$1,800 note financed at 6 percent add-on for 24 months would require a finance charge of \$216 and monthly payments of \$84. If the finance rate were increased by one-third to 8 percent, the dollar charge would rise to \$288, but monthly payments would increase only \$3 to \$87. Thus an increase in the finance charge of 33 $\frac{1}{3}$ percent would raise monthly payments only 3.6 percent.

Of course, the effect of greater finance charges on the amount of monthly payments can be obliterated altogether by lengthening the maturity of the contract.

Doubtless, the fact that the usual statutory rate maxima substantially exceed prevailing competitive rates indicates that the legislatures did not intend rate regulation to have any particular effect on instalment credit growth.

53. See Due, *Consumer Knowledge of Installment Credit Charges*, 20 J. OF MARKETING 162 (1955).

retail instalment contracts? No convincing reason comes to mind why the need for consumer protection here is less pressing than it is in motor vehicle sales. The volume of nonvehicular instalment-credit sales is huge, well over one-half the amount involved in motor vehicle credit sales;⁵⁴ and it promises to keep growing as more expensive articles like television sets, power mowers, air-conditioning units, and deep-freezers leave the shrinking realm of "luxury" and enter the burgeoning area of what, in the consumptive gallop known as "modern living," is considered a necessity. Finance rates tend, furthermore, to be even higher on appliances than on motor vehicles. For example, they ranged in a recent year from seven to ten per cent (add-on) per annum.⁵⁵

One possible explanation for the dearth of nonvehicular finance-charge regulation is the difficulty of drawing statutes that will apply justly to sales of all forms of personal property. Since the cost of acquiring, servicing, and terminating an instalment-credit account with a low balance may not differ materially from the cost of processing one with a much higher balance,⁵⁶ the finance charge on a fifty-dollar account must be a greater percentage of the balance financed than the finance charge on a thousand-dollar account. The comparatively low amounts financed in appliance sales, together with the rather more risky nature of the credit extended, contribute to the practice of charging higher finance rates on this type of goods than on new automobiles. Perhaps these same factors are responsible in part for the somewhat greater variation of finance rates in the appliance-sales field than in that of new automobiles.⁵⁷

That no uniform view has developed about the best way to regulate finance charges on goods other than motor vehicles is demonstrated by the variety of legislative devices presently employed to meet this problem. Neither the Indiana administrative-type regulation⁵⁸ nor the Utah statute⁵⁹ varies the allowable rate of finance charge according to the size of the balance to be financed. The Indiana regulation permits a finance rate of two per cent of the principal balance plus 1.875 per cent per month on the declining balance, while Utah allows an amount equal to one per cent of the unpaid balance multiplied by the number of months over which payment is to be extended.

54. *Financial and Business Statistics—Consumer Credit*, 44 FED. RES. BULL. 1289, 1324 (1958), lists the amount of automobile paper outstanding in September 1958 at \$14.3 billion; of other consumer goods paper, at \$8.3 billion.

55. FEDERAL RESERVE REPORT pt. I, vol. 1, at 57.

56. Per account financed, the overhead costs of administration, heat, light, rent, and depreciation are relatively fixed. However, bad debt expenses, money costs, and to some extent, the expenses of credit investigation, vary with the size of the balance financed. *Id.* at 68.

57. *Id.* at 57.

58. Authorized by IND. STAT. ANN. § 58-906 (1951) (rate limits for goods differ from those for motor vehicles).

59. UTAH CODE ANN. § 15-1-2aB(3) (Supp. 1957) (same rates for all types of tangible personal property, including motor vehicles).

Each state provides for a five-dollar minimum charge. North Dakota, on the other hand, in establishing three classes of personal property—new property, used property not over two years old, and used property over two years old—and in allowing progressively higher rates for each class, has adapted to the finance-charge regulation of nonvehicular goods the approach used in most states for motor vehicle sales.⁶⁰ In so doing, it has indirectly allowed the rate to vary in accordance with the amount financed, since lower balances are more common in sales of used merchandise. Kansas,⁶¹ New York,⁶² and Ohio⁶³ fix the permissible rate upon the amount of the balance. The Kansas law allows twelve dollars per one hundred dollars per year on the first \$300 of the principal, nine dollars on the next \$700, and eight dollars on that portion of the principal balance over \$1,000. The New York measure establishes two rates, ten dollars per one hundred dollars per annum on the principal balance under \$500 and eight dollars per one hundred dollars per annum on any amount in excess of \$500. A minimum charge of twelve dollars is sanctioned for all contracts except those having a duration of eight months or less, in which case a ten-dollar minimum is fixed. The Ohio statute goes furthest toward varying the rate in relation to the amount of money financed. The base finance charge is eight dollars per one hundred dollars per annum; in addition, a service charge is permitted amounting to fifty cents per month on the first fifty-dollar unit, and twenty-five cents per month on each of the next five fifty-dollar units, of the principal balance for each month of the term of the instalment contract. A fifteen-dollar minimum charge is apparently allowed.⁶⁴

The problem of what constitutes a fair minimum charge assumes greater importance in sales of nonvehicular personal property than in motor vehicle transactions because of the lower balances involved. In the latter case about the only impact of the ten to twenty-five dollar minima allowed by the various statutes is in sales of old-model used cars involving small sums financed over a comparatively short period of time. On the other hand, in view of the large number of articles priced at less than one hundred dollars that are commonly marketed by instalment contracts, a ten-dollar minimum seems questionable and a fifteen-dollar minimum appears exorbitant.⁶⁵

60. N.D. Laws 1957, ch. 322, § 3, at 627 (same rates for all types of tangible personal property, including motor vehicles).

61. Kan. Laws Spec. Sess. 1958, ch. 9, § 8(a), at 19-20 (rate limits on goods differ from those on motor vehicles).

62. N.Y. PERS. PROP. LAW § 404 (rate limits on goods differ from those on motor vehicles).

63. OHIO REV. CODE ANN. § 1317.06 (Page 1953) (same rates for all types of tangible personal property, including motor vehicles).

64. OHIO REV. CODE ANN. § 1317.06 (Page 1953) states that the provisions of the Retail Instalment Sales Act do not apply to any sale in which the base finance and service charge does not exceed the sum of \$15.

65. FEDERAL RESERVE REPORT pt. I, vol. 1, at 57, reports that minimum finance charges of \$5 to \$10 are frequently found in credit sales of nonvehicular goods.

To formulate rate schedules that equitably treat the instalment sale of all forms of personal property is not an easy task; nevertheless this is the job that the legislatures must undertake. Such legislation is essential, for the common-law rules in this field allow much abuse. In this connection, the workability of the six statutes presently taking a general approach to the problem of finance-charge regulation should be assayed, for they will doubtless serve as models for future legislative action in other jurisdictions.⁶⁶

DEALER-PARTICIPATION REGULATION

To the General Motors Acceptance Corporation (GMAC) is attributed the origination, in 1925, of dealer participation, the practice by which finance companies rebate to retailers a portion of the finance charges paid by consumers.⁶⁷ This innovation—which in the sales-finance world proved to be the rough equivalent of the invention of the wheel—was employed to offset the competitive advantage of independent finance companies. In 1924, these companies had begun to turn dealers' heads with the ineluctable attractions of nonrecourse financing.⁶⁸ Until that year, automobile financing was a rudimentary process in which a sales-finance company's principal accommodation to its dealers was converting their paper into cash. No dealer profit was anticipated from this transaction, and no risk was assumed by the finance companies, for all paper was purchased with full recourse against the dealer in case of consumer default.⁶⁹ After GMAC's spectacular success with its dealer-participation plan, similar schemes quickly spread throughout the automobile financing business.⁷⁰

66. Enactment of the Uniform Commercial Code by a jurisdiction will have no effect on the rate regulations under the various retail instalment sales acts. See UNIFORM COMMERCIAL CODE § 9-203(2) and note thereto.

67. Hardy, *Another View on the Origin of Dealer Participation in Automobile Finance Charges*, 30 IND. L.J. 311 (1955). For judicial statements regarding the origin of dealer participation, see *United States v. General Motors Corp.*, 121 F.2d 376, 391-92 (7th Cir. 1941); *General Motors Acceptance Corp. v. Commissioner of Banks*, 258 Wis. 56, 58-59, 45 N.W.2d 83, 85 (1950).

68. Under nonrecourse financing, the finance company buys instalment paper "without recourse"; that is, it relieves the dealer of any liability in case of the automobile purchaser's default. FEDERAL RESERVE REPORT pt. I, vol. 1, at 27.

Late in 1925 Chevrolet sales in southern California dropped to fourth place, the other cars outselling Chevrolet because they were being sold on a smaller down payment, longer terms and on a non-recourse basis. Moreover, certain Chevrolet dealers had resorted to the facilities of non-recourse companies with the result that they were securing business at the expense of other Chevrolet dealers in the same area who were using the new GMAC sales time plan. There is evidence by a defense witness that the non-recourse company rates were considerably higher than the GMAC rates, but despite this fact the non-recourse company terms appealed to many dealers and to the purchasing public generally.

United States v. General Motors Corp., *supra* note 67, at 392.

69. FEDERAL RESERVE REPORT pt. I, vol. 1, at 27.

70. The adoption by GMAC of dealer participation in 1925 was in part responsible

Dealer-participation plans today take differing forms. If a financing institution is purchasing a dealer's paper on a nonrecourse basis, a part of the finance charge may be immediately rebated to the dealer.⁷¹ The rebate is, in effect, the price the financier is willing to pay for the privilege of purchasing the consumer paper to gain the lucrative finance fees. The bulk of automobile and appliance financing, however, is done under some form of recourse plan, usually involving a repurchase agreement.⁷² In automobile financing under a repurchase arrangement, the financing agency ordinarily pays into a reserve account a portion of the finance charge on paper purchased from a particular dealer. Such payments continue until the account reaches either a minimum dollar amount or, more commonly, a percentage of the dealer's outstanding paper (usually three per cent). Upon default by a buyer and repossession by the financier, the dealer is obligated to repurchase the vehicle, and the unpaid balance of the note is charged to the reserve account. The dealer's liability may be limited to the amount of the fund in reserve. Once the stipulated reserve-account balance is attained, subsequent sums payable under the dealer-participation agreement are periodically distributed to the dealer.⁷³ Since the dealer's share of the finance charges typically ranges from one-fifth to one-third, dealer participation constitutes a major element of his income.⁷⁴

Another source of income to retailers stemming from their relationship to finance companies is represented by tie-in sales of insurance. Dealers are often agents of insurance companies and in connection with instalment sales dispense both protection against fire, theft, and collision, and credit life and health insurance.⁷⁵ If the insurance company is an affiliate of the finance

for the 225% increase in that company's business in 1926. *United States v. General Motors Corp.*, 121 F.2d 376, 397 (7th Cir. 1941).

71. FEDERAL RESERVE REPORT pt. I, vol. 1, at 55. The dealer's rebate on nonrecourse paper is on the average lower than it is on paper purchased under some form of recourse plan. *Ibid.*

72. Contracts sold under a full recourse agreement with no repurchase provision are more commonly found in used-car than in new-car financing. Under this arrangement, upon default by the consumer, the dealer must not only pay the financier the balance of the contract but also repossess and resell the auto at his own expense. *Id.* vol. 2, at 164. For details on the financing of appliances, see *id.* vol. 1, at 57.

73. *Id.* at 54-56; *id.* vol. 2, at 164.

74. *Id.* vol. 1, at 55.

It should be added that the automobile dealer's share in finance and insurance charges does not necessarily represent windfall gains that dealers obtain from customers. Dealers nowadays are likely to consider their return from finance charges as part of their overall income and, were this income eliminated, customers might have to pay more for cars through either higher prices or lower trade-in allowances.

Id. at 56. In a recent case a witness stated, without disclosing the source of his information, that in one recent year 60% of the net income of the average automobile dealer came from his dealer-participation share. *Teegardin v. Foley*, 166 Ohio St. 449, 461-62, 143 N.E.2d 824, 832 (1957).

75. Insurance commissions usually amount to 25 to 30% of the premium paid on col-

company, as the Motors Insurance Corporation (MIC) is of GMAC, insurance premiums may be considered part of the finance-charge "package." GMAC, for example, collects the insurance premium from the retail buyer and remits the substantial commissions involved to the dealer through MIC.⁷⁶

As already suggested, because of the practice of dealer participation, increased competition among sales-finance companies tends to exact not lower finance rates from the instalment purchaser but higher ones.⁷⁷ The finance company that establishes a working arrangement with a dealer can confidently anticipate that the dealer will sell to it most of his retail instalment contracts.⁷⁸ And since dealers can, within limits, induce most buyers to finance on the terms offered by the dealer-chosen financier, sales-finance companies and, to some extent, banks compete directly for the dealer's business rather than for the consumer's. By common knowledge in the business, the rate of dealer participation is a principal factor in influencing the dealer's choice of financing agencies.⁷⁹ To the extent that financiers compete for the paper of dealers by increasing participation percentages, they exert a pressure tending to force finance rates upward.

Probably without careful analysis of its economic significance, dealer participation has become a whipping boy for critics of automobile-financing practices.⁸⁰ Words with invidious connotations like "kickback" or "rebate" are often associated with dealer participation. Abuses of dealer participation have resulted in the practice of "padding" or "padding" retail prices by unwarranted finance charges.⁸¹ Consumers are doubtless disquieted to learn that

lision policies and 15 to 20% on credit life and personal accident insurance. FEDERAL RESERVE REPORT pt. I, vol. 1, at 56.

76. See *General Motors Acceptance Corp. v. Commissioner of Banks*, 258 Wis. 56, 61, 45 N.W.2d 83, 86 (1950). GMAC has advertised to its dealers that insurance is a part of a "one package plan" that enables them to make more profit dealing with GMAC than with banks. It has advertised to the public that one of the advantages of doing business with GMAC is that it offers insurance protection as part of a "one package" transaction. *Id.* at 63-64, 45 N.W.2d at 87.

77. See Britton & Ulrich, *The Illinois Retail Installment Sales Act—Historical Background and Comparative Legislation*, 53 Nw. U.L. REV. 137, 169 (1958), for the most recent discussion of this economic phenomenon.

78. See the testimony set out in *Teegardin v. Foley*, 166 Ohio St. 449, 143 N.E.2d 824 (1957), where a witness with 18 years' experience in selling and financing automobiles stated that when he was a dealer he sold "*a finance plan to the customer, the same as I sell him an automobile and the accessories that go on it.*" *Id.* at 460, 143 N.E.2d at 831. (Italics in original.) The witness added that he was successful in selling a particular finance plan about 75% of the time.

79. See note 24 *supra*.

80. WIS. STATE BANKING COMM'N & INTERIM ADVISORY LEGISLATIVE COMM. TO INVESTIGATE FINANCE COMPANIES, REPORT 33-38 (1935); Note, *Is Control of Dealer Participation a Necessary Adjunct to Regulation of Installment Sales Financing?*, 28 IND. L.J. 641 (1953); Backman, *The Big Cheat*, Harper's Magazine, Oct. 1948, p. 105.

81. "Because of the keen competition between finance companies, certain abuses grew or developed in trying to obtain these contracts from dealers. These abuses were known

dealers have a secret, though substantial, financial stake in selling to them the plan of a particular financial institution. Basically, however, the only direct harm of dealer participation, whatever its form of abuse, is that it increases finance charges. Hence, the regulation of finance charges would appear a sufficient prophylaxis against the evils associated with the practice.

Four states—Indiana,⁸² Michigan,⁸³ Ohio,⁸⁴ and Wisconsin⁸⁵—refused to concede that statutory ceilings on consumer-finance charges would adequately resolve the matter, and imposed direct limitations on dealer participation. In three of these jurisdictions, the close connection between commissions on insurance sales and dealer participation also brought about the regulation of rebates from insurance companies to dealers.⁸⁶ The Wisconsin statute has since been repealed,⁸⁷ and the Indiana act has been seriously impaired by judicial decision.⁸⁸ The Ohio measure, whose constitutionality was upheld in 1957,⁸⁹ restricts the dealer's participation to two per cent of the principal balance, although it lifts this restriction if the dealer agrees to act as an agent for the finance company in servicing the contract—making all collections and doing the bookkeeping.⁹⁰ In Michigan, dealer participation in finance charges is forbidden unless the seller performs specified acts, such as preparing the

as 'packs' and 'rebates' and became an excessive and a hidden expense to the automobile buyer." *General Motors Acceptance Corp. v. Commissioner of Banks*, 258 Wis. 56, 59, 45 N.W.2d 83, 85 (1950).

82. The first Indiana statute, IND. STAT. ANN. § 58-910 (1951), was declared unconstitutional in *Department of Financial Institutions v. Holt*, 231 Ind. 293, 108 N.E.2d 629 (1952). The second attempt to regulate dealer participation, IND. STAT. ANN. §§ 58-935 to -945 (Supp. 1955), was largely nullified by judicial interpretation in *Department of Financial Institutions v. Universal C.I.T. Credit Corp.*, 146 N.E.2d 93 (Ind. 1957). See text accompanying notes 99-106 *infra*.

83. MICH. STAT. ANN. § 23.628(31)(c) (Supp. 1955).

84. OHIO REV. CODE ANN. § 1317.08 (Page 1953).

85. From 1937 to 1953 the Banking Commission regulated dealer participation under the authority of a statute giving the Commission the power to define "unfair practices" in the motor vehicle industry. Wis. Laws 1937, ch. 417.

86. IND. STAT. ANN. § 58-910 (1951); MICH. STAT. ANN. § 23.628(31)(c) (Supp. 1955). Under the authority of Wis. Laws 1937, ch. 417, the Banking Commission promulgated Rule II A which defined dealer participation as including dealer sharing in insurance premiums. In Ohio, compensation received by a retailer as an insurance commission is not considered to be dealer participation. OHIO REV. CODE ANN. § 1317.08 (Page 1953).

87. In 1953 the following change was made:

[The Commission] shall have power to define unfair practices in the motor vehicle industry and trade between licensees or between any licensees and retail buyers of motor vehicles, *but such power shall not include the power to limit the price at which licensees may sell, assign or transfer receivables, contracts or other evidence of any obligation arising out of an instalment sale made pursuant to this section.*

Wis. Laws of 1953, ch. 302, § 2(5)(a), Wis. STAT. § 218.01(5)(a) (1955).

88. See note 82 *supra*; text accompanying notes 99-106 *infra*.

89. *Teegardin v. Foley*, 166 Ohio St. 449, 143 N.E.2d 824 (1957).

90. OHIO REV. CODE ANN. § 1317.08 (Page 1953).

credit information form, contract, note, mortgage, and application for title—all of which the retailer ordinarily handles in any case.⁹¹

In Wisconsin, a legislative committee report⁹² detailing abuses in sales-financing practices led to a 1935 licensing provision for finance companies and other safeguards for instalment buyers.⁹³ A 1937 amendment granting the Banking Commission power to define "unfair practices"⁹⁴ was followed by Commission regulations limiting dealer-participation rates and requiring that insurance commissions be counted as part of the dealer-participation amount.⁹⁵ In 1953, however, the statute was amended to deprive the Commission of its power to fix dealer-participation rates.⁹⁶ There is good reason to believe that this action stemmed, in part, from displeasure with the control of insurance commissions; for the 1953 amendment followed soon after the Wisconsin Supreme Court had sustained the Commission's insurance-fee regulation,⁹⁷ and it contained a provision expressly excluding insurance commissions from the definition of finance charges.⁹⁸

Indiana experience in regulating dealer participation has been turbulent.⁹⁹ A provision of the Retail Instalment Sales Act of 1935 prohibited rebates exceeding an amount fixed by the Department of Financial Institutions.¹⁰⁰

91. If the seller performs the requisite acts, he may receive a "service fee" of not more than 2% of the principal amount financed on all motor vehicles not more than one year old and 3% on all others, plus an additional amount of not more than $\frac{1}{12}$ of the amount so paid to the seller for each month the principal amount is financed in excess of 12 months but for not more than 24 months. MICH. STAT. ANN. § 23.628(31)(c) (Supp. 1955).

92. WIS. STATE BANKING COMM'N & INTERIM ADVISORY LEGISLATIVE COMM. TO INVESTIGATE FINANCE COMPANIES, REPORT (1935).

93. Wis. Laws 1935, ch. 474. For a detailed discussion of the evolution of the Wisconsin statute, see Holz, *The Regulation of Consumer Credit*, 1943 WIS. L. REV. 449, 529-50.

94. Wis. Laws 1937, ch. 417.

95. These regulations are set out in *General Motors Acceptance Corp. v. Commissioner of Banks*, 258 Wis. 56, 60-61, 45 N.W.2d 83, 85-86 (1950). They limited dealer participation to 2% per annum (for a period not to exceed 18 months) of the unpaid balance due on new motor vehicles, to 3% of the balance on used motor vehicles not over two years old, and 5% of the balance on used motor vehicles over two years old. In each case a maximum participation was not to exceed \$20 and a minimum participation of \$8 was required.

96. Wis. Laws 1953, ch. 302.

97. *General Motors Acceptance Corp. v. Commissioner of Banks*, 258 Wis. 56, 45 N.W.2d 83 (1950). The court sustained the Commission rule that insurance commissions constitute dealer participation on the ground that the close association of GMAC and its affiliate, MIC, rendered payment of commissions on insurance merely a guise for granting retailers additional dealer-participation rebates.

98. Wis. Laws 1953, ch. 302, § 2.

99. For a detailed discussion of dealer participation regulation in Indiana, see Note, *Is Control of Dealer Participation a Necessary Adjunct to Regulation of Installment Sales Financing?*, 28 IND. L.J. 641 (1953).

100. Ind. Acts 1935, ch. 231.

This provision was declared unconstitutional as an invalid use of the police power in the 1952 case of *Department of Financial Institutions v. Holt*.¹⁰¹ In support of the act, the Department contended that capping finance charges would necessitate limiting dealer participation lest the behemoths of the finance business eliminate smaller companies by taking advantage of their greater resources to increase the portion of the finance charge rebated to dealers. The smaller finance companies, facing the same upper limit as the larger companies but having a higher cost of doing business, would be unable to compete successfully, since, to maintain competitive rebates, they would have to be content with a comparatively smaller profit margin.¹⁰² In refutation of this argument, the Indiana Supreme Court postulated that the act's major objective was simply to safeguard consumers from exorbitant finance charges. The court concluded that this end was adequately attained by the limitation on finance rates, and that the dealer-participation regulation bore no reasonable relation to the legitimate purposes of the act. The court rejected the assumption that free price competition in the purchase of instalment-sale contracts would result in monopoly and concluded that the public has no legitimate interest in the relative profits of retailers or finance companies.¹⁰³ Reaction to this opinion was forthcoming in the next legislative session. Openly designed to evade *Holt* by approaching the problem from an antimonopoly viewpoint, the new statute declared illegal all retailer-finance company arrangements which tended to lessen competition or create monopoly in the field.¹⁰⁴

In a 1958 decision—*Department of Financial Institutions v. Universal C.I.T. Corp.*¹⁰⁵—the Indiana court held invalid a Department order under this statute restricting the dealer-participation payments of the Commercial

101. 231 Ind. 293, 108 N.E.2d 629 (1952); see Gilmore, *The Commercial Doctrine of Good Faith Purchase*, 63 YALE L.J. 1057, 1097 n.120 (1954) ("an outrageous decision").

102. The Department furthermore argued that unless dealer participation was limited, the pressure by finance companies for increases in finance rates would be so great that the Department would be unable to hold the line on the overall cost of financing to the general public. 231 Ind. at 306-07, 108 N.E.2d at 636.

103. The *Holt* decision was discussed and distinguished in the case upholding the constitutionality of the Ohio dealer-participation statute, *Teegardin v. Foley*, 166 Ohio St. 449, 458, 143 N.E.2d 824, 830 (1957).

104. Ind. Acts 1953, ch. 207, IND. STAT. ANN. §§ 58-935 to -945 (Supp. 1955). Section 58-935 declares:

[A]ny acts or practices which would, or would tend to, reduce the number of persons competing for the purchase of such contracts, or would, or would have the tendency to, make it difficult for the smaller purchaser to compete, or would, or would tend to, concentrate such business in one or more of the larger and more economically powerful purchasers, is a tendency toward monopoly and not in the ultimate public interest in that a few such dominant purchasers may then use their economic power and their position to control the entire business field

Section 58-937 then outlaws any agreement or practice "which would tend to lessen competition or tend to create a monopoly in such business field."

105. 146 N.E.2d 93 (Ind. 1957).

Investment Trust (CIT) to ten per cent of the gross finance charge. The court found that CIT's practice of rebating to dealers twenty per cent of the gross finance charge plus twenty per cent of any insurance premiums failed to constitute unreasonable competition and therefore did not violate the anti-monopoly statute which formed the basis for the Department's order.¹⁰⁶ Manifestly, in so holding, the court has effectively emasculated the act and put an end to dealer-participation control in Indiana—at least for the present.

Thus, only two states, Ohio and Michigan, presently exert a measure of control over dealer participation. Is this form of economic regulation justified? The practice of allowing dealers to participate in finance charges is perfectly legitimate, for, unquestionably, the services rendered by the dealer to the financial institution are worthy of compensation. Not only does the dealer benefit the financier by performing a number of routine acts like filling in contract and note forms and gathering credit information, but, of far greater importance, he also functions as the finance company's prime salesman. Since the companies or banks which purchase dealer-originated paper ordinarily have no direct contract with buyers, their finance plans can be sold to consumers only through dealers. In this day, when automobile buyers are constantly subjected to advertising about the attractive "bank rates" available through direct financing, the dealer's role as a credit salesman is especially vital. Hence, legislative intervention in this area can, at best, seek only to regulate dealer participation, not to proscribe it.

As previously indicated, the difficulty with dealer participation is that competition among financial institutions for dealer-originated paper often means increased dealer-participation allowances, and this in turn tends to force finance rates upward. The basic argument in favor of controlling the rebate practice is the one which was advanced by supporters of the Indiana statute: that dealer-participation regulation is a necessary corollary of finance-charge limitation because, if finance rates are held down without restraining dealer participation, the large national companies, which can afford to rebate a greater portion of the finance charge, will force the independents out of the field unless, of course, separate and higher rate maxima are established for the small financier. Under these circumstances, the pressures that would be brought to bear on the regulating authorities by various components of the sales-financing industry might be irresistible. The fact that the theories of constitutional law invoked by the Indiana court to invalidate the dealer participation statute seem antiquated and arbitrary,¹⁰⁷ however, does not necessarily mean that these measures—though probably constitutional in most jurisdictions—are wise ones.

106. The court noted that Universal had only 7% of the total retail contract market in Indiana and that it did not appear that Universal had entered into any agreement or conspiracy which would tend to create a monopoly. *Id.* at 99.

107. See Paulsen, "Natural Rights"—*A Constitutional Doctrine in Indiana*, 25 *IND. L.J.* 123 (1950), for an exposition of the views of Indiana courts on judicial review of legislative economic controls.

Admittedly, the case for dealer-participation regulation has a plausible sound to it. The emotional appeal of protecting the small local businessman against "chain-store" giants is still great, even in a society that has cheerfully abandoned the nostalgic corner grocery for the gleaming efficiency of the nationally affiliated supermarket. But it is questionable whether, upon the facts now available for observation, the need for legislation to preserve independent finance companies has been convincingly demonstrated.¹⁰⁸ A survey conducted in 1956 found that two-thirds of the credit used to finance automobile purchases came from regional and local finance companies—banks, credit unions, and consumer-finance companies.¹⁰⁹ No national automobile credit market exists, dominated by a few huge national lenders dictating uniform credit standards. Rather, credit markets are numerous and localized; and, within each, the nationals compete with regional and local institutions. In these local markets, a lender's size may be far less important than its relative national standing would indicate, and the large lenders may be followers as often as leaders in setting credit terms.¹¹⁰

No evidence has come to light during the preparation of this Article suggesting that national companies have taken advantage of statutory finance ceilings to bludgeon independent concerns by increasing dealer-participation payments to levels which small companies cannot reasonably match. Quite the contrary, the nationals, and notably GMAC, have in general maintained lower dealer-participation percentages than the independents.¹¹¹ Nor is there any indication that the nationals rebate any greater proportion of the finance charge in states having ceilings on such charges than in those not having them. Moreover, despite the inflationary influence of rebate competition on

108. In Mors, *State Regulation of Instalment Financing—Progress and Problems* (pt. 2), 24 J. OF BUS. OF U. CHI. 43, 44-45 (1951), the author gives as one reason for favoring passage of dealer-participation limitations that such measures would do away with finance-charge "packing." This word has different connotations, but here reference is made to the practice adopted by some dealers of charging finance rates exceeding the amount called for in the rate charts which the finance companies invariably supply. Professor Mors contends that if the dealer's rebate is limited by statute to a certain percentage of the buyer's unpaid balance, the dealer will lose his incentive to "pack"; for any enlargement of the finance charge would principally benefit the finance company and not the dealer. It is questionable, however, how great a problem packing presents in those states having finance-charge ceilings. Statutory finance-rate ceilings, though they may exceed average finance rates somewhat, are adequate to halt the more serious occurrences of packing, since no matter how large the portion of the finance charge retained by the dealer, the total finance charge cannot exceed the statutory limitation. Moreover, as Mors himself states, *id.* at 45, the larger companies have been successful in reducing packing among their dealers. Some companies attack the practice by refusing to buy paper written with finance charges higher than those recommended on their charts. FEDERAL RESERVE REPORT pt. I, vol. 1, at 55.

109. *Id.* vol. 2, at 160.

110. *Id.* at 160-61.

111. Pecar, *Dealer Participation in Automobile Finance Charges: A Reply*, 30 IND. L.J. 319, 320-21 (1955).

finance charges, other competitive factors—not the least of which is the commercial banks' intrusion into the retail instalment financing field in the last twenty-five years with their well publicized "bank rates"¹¹²—have been effective in keeping average finance rates well below statutory maxima.¹¹³ It is difficult to perceive how the economic squeeze of independent companies between fixed finance-charge ceilings and increased dealer-participation percentages is critical when statutory finance-charge limits still exceed average rates. In fact, considering only the interests of the small companies, one might theorize that whenever average finance rates are below the statutory maximum small companies are harmed by the freezing of dealer-participation percentages: these companies apparently make use of higher dealer-participation allowances to offset certain competitive advantages of the larger companies,¹¹⁴ and charge higher fees to cover the resulting increase in cost of operation.

The interest of the small financier demands just consideration, for a free flow of capital into retail instalment financing must be maintained. Paramount, however, is the interest of the credit consumer. The issue is whether he is well enough protected by finance-rate control or whether this type of regulation should be supplemented by a ceiling on dealer-participation allowances which will remove the rebate as a competitive factor and, with it, a cause of finance-rate inflation.

Whatever further experience in this area will disclose the correct answer to be, law-makers should recognize that dealer-participation regulation is a type of economic control different from finance-rate regulation. As already noted, finance-charge limitations have been enacted as parts of statutes generally designed to protect retail-instalment buyers from fraud and overreaching on the part of instalment sellers and financiers. The thrust of these measures has not been to limit the profits of either retailer or financier through "price fixing," but merely to safeguard the consumer from exorbitant gouging. Hence, the high ceilings allowed by finance-charge legislation represent the outer limits of what the retail instalment consumer should have to bear, and not a legislative directive of what is a fair profit for the financier—the

112. A survey of 600 automobile dealers in 1956 indicated that nearly every dealer used bank financing to some extent. The survey discloses that "in the opinion of a good number of the dealers interviewed, buyers are becoming increasingly aware of carrying charges and thus are likely to be attracted by the lure of the phrase 'bank terms.'" FEDERAL RESERVE REPORT pt. I, vol. 2, at 151. In 1940, commercial banks held 26.3% of the total consumer credit market, while sales-finance companies held 28.6%. By 1952, the banks held 38.8% and the finance companies 24.3%. By 1955, the finance companies had regained their losses and held 29.1% of the market, but the banks still accounted for 36.5%. *Id.* at 51.

113. In 1956, the average add-on finance charges of national finance companies were 6.1%, of regional finance companies 6.2%, and of local finance companies, 6.3%. The average bank rate was 5.8%. *Id.* at 165.

114. Among the competitive advantages of national finance companies are: lower money costs, lower costs of acquiring paper from dealers, and greater ease in servicing the contracts of itinerant buyers. *Id.* at 26, 152.

latter determination being one that a legislature is by nature ill-equipped to make. Finance-charge legislation thus resembles the usury statutes; both set up somewhat arbitrary standards, distinctly ethical in derivation and unresponsive to fluctuations in the business cycle. In contrast, the regulation of dealer-participation allowances cannot be approached as an attempt to codify the limits of financial rectitude. Rather, these regulations involve a precise determination, for they perform the intensely practical function of cutting the finance-charge melon between dealer and financier. Not surprisingly, they pose an exasperatingly difficult problem of legislative drafting.

At a time when it has become commonplace for legislatures to intervene in the retail instalment sale process, dealer-participation regulation must be considered one of the more controversial problems in this area. On present evidence, the case for this regulation must be given a Scots verdict. But then, only in very recent years have a substantial number of states worked with finance-charge ceilings; whether, without dealer-participation control, this form of legislation can provide adequate protection for consumers should be known within a few years.

CONCLUSION

A new generation has reached consumer maturity since the Great Depression, and even in the minds of many of those who knew the bread line the possibility of national financial collapse is not seriously regarded. To these people, the mass-production-mass-consumption process is accepted virtually as a law of nature, and the astonishing growth of consumer credit which has made this level of consumption possible is not considered an economic phenomenon but a way of life. Millions of people commit themselves to face a monthly battery of instalment-payment coupons, even though their "only insurance against disaster is, not savings, which do not exist, but a single bet: continuity of the job."¹¹⁵ Whatever may be said about the danger of consumer overcommitment in instalment buying, then, the fact remains that much of the "American way of life" is being paid for on the instalment plan, through the willingness of financiers and dealers to broaden the base of consumer credit. The increasingly popular reliance upon the instalment plan as a method of asset accumulation has emphasized the need for effective consumer protection.

Clearly, the usury statutes have not afforded this protection. Traditionally, credit sales have been exempt from the usury acts on the theory that the finance-charge increment of a time "sale" differs from the interest obligation of a "loan." In recent years, however, in obvious recognition of the artificiality of the time-price-cash-price dichotomy, courts have adopted hypertechnical exceptions to the traditional rule whenever the equities of a case have so prompted. Overall, the result is unfortunate: a general rule—to the effect

115. See Grattan, *Buying on Time: Where Do You Stop?*, Harper's Magazine, April 1956, pp. 73, 75.

that a time price cannot be usurious—which is hard to support when the true incidents of the credit transaction are comprehended; and numerous exceptions to the rule that seem arbitrary and unreal in the context of contemporary commercial practices. The bold alternatives open to courts under the usury acts are no more appealing. By indiscriminately applying usury statutes to credit sales, they would threaten the flow of capital into instalment credit; and if they give a blanket exemption to these transactions, they leave the consumer with no protection against excessive finance charges.

The first response to the need for comprehensive legislative regulation of retail instalment selling came with the pioneer acts of Indiana and Wisconsin in 1935.¹¹⁶ By 1950, eleven more states had enacted similar statutes,¹¹⁷ and from 1950 to 1956 five other states followed.¹¹⁸ Nine additional states fell in line in a single year, 1957,¹¹⁹ and 1958 saw three jurisdictions enact sales-finance laws.¹²⁰ All of these acts regulate credit sales of motor vehicles, but only six relate to other goods as well.¹²¹ Twenty-two of the acts place limits on the finance charges that can be imposed upon credit buyers.¹²² Though finance-rate maxima in several states seem generously drawn to favor the financier and dealer, these statutes do perform their function of protecting consumers against exorbitant finance charges.

Experience has shown that once a state enacts a retail instalment sales act, frequent amendments must be anticipated. Those states having legislation restricted to the sales of motor vehicles should give serious consideration to extending their statutes to cover all chattels. Furthermore, the need for finance-charge limitations must be recognized in those jurisdictions which

116. The present statutes in these states are: IND. STAT. ANN. §§ 58-901 to -945 (1951, Supp. 1955); WIS. STAT. §§ 218.01(1)-(8) (1955).

117. After the name of the state and the year of enactment follows the citation of the present statute; Massachusetts, 1937, MASS. ANN. LAWS ch. 255, §§ 12-13H, ch. 255B, §§ 1-24 (Supp. 1958); Maine, 1939, ME. REV. STAT. ANN. ch. 59, §§ 249-60 (Supp. 1957); Michigan, 1939, MICH. STAT. ANN. §§ 23.628(1)-(40) (Supp. 1955); Maryland, 1941, MD. ANN. CODE art. 83, §§ 128-65 (1957); New York, 1941, N.Y. PERS. PROP. LAW §§ 301-11, 401-18; Virginia, 1944, VA. CODE ANN. § 46.1-545 (1958); California, 1945, CAL. CIV. CODE ANN. §§ 2981-82 (Supp. 1958); Connecticut, 1947, CONN. GEN. STAT. §§ 42-83 to -100 (1958); Pennsylvania, 1947, PA. STAT. ANN. tit. 69, §§ 601-37 (Supp. 1958); Ohio, 1949, OHIO REV. CODE ANN. §§ 1317.01-12, 1317.99 (Page 1953).

118. COLO. REV. STAT. ANN. §§ 13-16-1 to -10 (1954); KY. REV. STAT. §§ 190.090-990 (1956); NEB. REV. STAT. § 60-617 (Cum. Supp. 1957); NEV. REV. STAT. §§ 97.010-.060 (1957); UTAH CODE ANN. § 15-1-2a (Supp. 1957).

119. ALASKA COMP. LAWS ANN. § 50-6-5(2)(f) (Cum. Supp. 1958); FLA. STAT. ANN. §§ 520.01-.13 (Supp. 1958); IDAHO CODE ANN. § 64-806 (Supp. 1957); ILL. REV. STAT. ch. 121½, §§ 223-53 (1957); IOWA CODE ANN. §§ 322.2-.26 (Supp. 1958); MINN. STAT. ANN. §§ 168.66-.77 (Supp. 1958); N.D. LAWS 1957, ch. 322, at 621; Ore. LAWS 1957, ch. 625, at 1011; S.D. Sess. LAWS 1957, ch. 241, at 347.

120. Kan. LAWS Spec. Sess. 1958, ch. 9, at 11; La. ACTS 1958, No. 74; Miss. LAWS 1958, ch. 495, at 801.

121. See note 39 *supra*.

122. See notes 39, 40 *supra*.

have not yet enacted such legislation. Only two of the many states presently regulating finance charges have supplemented their acts with dealer-participation controls; hence, in general, finance-charge limitations are on trial to determine their effectiveness without supplementary regulation of this type. Should the evidence disclose that finance-charge provisions are inadequate to safeguard the consumer, dealer-participation statutes, and the tight economic control they represent, may be expected as the legislative refinement of the future.