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A PROPOSED UNIFORM CODE FOR CONSUMER CREDIT

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For a long time, all states have regulated, in greater or lesser degree, the conditions under which credit is granted to the consumer to finance his purchases of goods and services. The pattern of this legislation has been to focus on particular types of creditors or particular types of transactions for special regulation. The result has been a piecemeal growth of legislation which has often been inconsistent and unevenly balanced in regard to the various types of creditors and the various types of transactions that characterize the consumer-credit business. For the past three years, the National Conference of Commissioners on Uniform State Laws has been engaged in the drafting of the Uniform Consumer Credit Code for adoption by the several states. This Code, which is now in preliminary draft form, is a single comprehensive statute regulating the whole spectrum of consumer credit, and is designed to replace existing consumer-credit legislation in any jurisdiction in which it may be adopted. This article briefly traces the pattern of the existing system of consumer-credit regulation, notes some of the shortcomings of this system which have led to comprehensive revision of the whole field through the new Code, and outlines the more important features of the new Code.

I. THE EXISTING SYSTEM OF CONSUMER-CREDIT REGULATION

A. *Historical Background*

The first legislation in the consumer-credit field—the Uniform Small Loan Law—was necessary because of the existence of usury laws.[1] Since lenders could not profitably loan money to the ordinary consumer within the permitted rates, many borrowers were forced to

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The authors have served since 1964 as Reporters-Draftsmen of the Consumer Credit Project of the National Conference of Commissioners on Uniform State Laws. The opinions expressed in this article are their own and are not intended to reflect the views of the National Conference or of the Special Committee on Retail Installment Sales, Consumer Credit, Small Loans and Usury. The discussion of the proposed Code contained in this article is based on the draft to be presented to the NCCUSL annual meeting in August 1967. The Code is not being presented at that time for final approval, and further changes are anticipated before it is promulgated by the Commissioners.

1 For a discussion of the Uniform Small Loan Law, see Curran, Trends in Consumer Credit Legislation 16-44 (1965). The Seventh Draft of the USLL is set out id. at 144-57.

meet their credit needs by dealing with lenders who operated outside of the law. The elemental problem facing legislatures was that of legitimizing consumer loans. This might have been done by simply providing for a higher usury rate to cover consumer loans, but instead, the campaign, which culminated in the proposal of the Uniform Small Loan Law in 1916, took on some of the aspects of a social-welfare movement to save the "necessitous borrower" from the hands of the "loan shark." The legislative response reflected the low esteem in which the public apparently held consumer "moneylenders" at that time. Instead of legislation which merely authorized lenders to charge higher rates to a defined class of consumer borrowers, the approach adopted was that of creating a narrow class of lenders who were privileged to charge higher rates. The class was limited to those who were able to meet specified standards of character and fitness, and who were willing to submit to heavy administrative supervision of their activities. In short, legislatures viewed the problem of consumer lending in terms of the character and reputation of the lender. Only "good" people should be allowed to make loans in excess of the usury rates, and only if they were carefully watched. Given the somewhat illicit background of consumer credit in these early years, this may have been the only feasible legislative solution. The consumer could obtain small loans; the lender could make a profit; and the deep public suspicion of those who charged high rates was assuaged by the onerous licensing provisions.

In succeeding years, other types of lenders were authorized to make consumer-type installment loans at rates in excess of those permitted by the usury laws.[2] Among the earliest of these were the industrial banks, followed by federal and state credit unions. Later, most of the states enacted installment loan laws whose principal effect was to allow commercial banks to enter the consumer field by making direct installment loans at above-usury rates. For the most part, these statutes continued the approach of the small loan laws: loans in excess of usury rates could be made only by lenders whose entry into the credit field was restricted by licensing or chartering requirements and whose operations were administratively supervised.

Regulation of credit sales of goods and services came later, and revolutionary changes in this area over the past forty years have posed the greatest problems in legislative control of consumer credit.[3] The need for sellers of high-priced items to utilize credit in selling their goods led to the formation, in the 1920's, of sales finance com-

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[2] See id. at 5-14.

[3] The historical background is sketched in Britton & Ulrich, The Illinois Retail Installment Sales Act—Historical Background and Comparative Legislation, 53 Nw. U.L. Rev. 137, 140-48 (1958).

panies. These organizations purchased retail installment contracts from dealers and often "floor-planned" their inventories. Commercial banks, which at first had restricted their consumer activities to lending to sales finance companies, moved into direct competition with them in purchasing dealer paper in the 1930's and 1940's. By the 1930's the "installment plan" had gained wide acceptance in most hard-goods merchandising. In the dramatic rise in consumer credit after World War II, the major retailers converted to revolving credit and thereby made even soft goods available on a credit basis. Thus, in one generation, the country evolved from what had been virtually a cash economy to a credit economy in the sale of goods. Credit was made available to economic classes that had never before had experience with it. Lower down-payments, lengthened maturities, and lower standards of creditworthiness contributed to broadening the base of the retail credit market to include almost anyone with a steady job. The mass-production economy thrived, and the standard of living soared.

The judge-made "time-price doctrine" made it possible for sellers to utilize installment credit at consumer rates without seeking legislative exemption from usury laws.[4] So long as the time-price doctrine went unchallenged for retail installment contracts (and before the advent of revolving credit which raised serious usury problems for retailers), sellers and their financers had no need for legislation in the credit area. Legislation in vendor credit, unlike lender credit, had to come from the public rather than from the industry; hence, it was a long time in coming. Not until after World War II, when credit selling became a mature business, did legislative regulation begin to appear in volume.[5]

The first abuse to receive widespread legislative attention was the practice of some sellers of failing to make fair disclosure of significant aspects of the retail installment credit sale. In some cases, the buyer was not even told the total amount he owed and might not receive a copy of the contract he signed. Lack of disclosure enabled the unscrupulous seller to burden the buyer with exorbitant credit charges. Abuses in disclosure appeared in greatest volume in automobile sales, and the first retail installment sales acts were almost entirely devoted to motor vehicle transactions.

[4] The courts in most jurisdictions have exempted credit sales from usury laws by holding 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 ground that the credit transaction is merely a sale at a higher price. The leading American case is Hogg v. Ruffner, 66 U.S. (1 Black) 115 (1861).

[5] The legislative patterns in this area are described in Curran, op. cit. supra note 1, at 91-123.

The first motor vehicle retail installment sales acts were rudimentary measures. California, the largest automobile market in the nation, operated until 1962 on the basis of a brief statute which merely (1) limited finance charges to an add-on rate of one per cent per month for each month of the contract, (2) required that a copy of the contract be given to the buyer and that it itemize all charges made, (3) gave the buyer the right to prepay and prescribed a formula governing the amount of refund of unearned finance charges, and (4) gave the buyer the right to a five-day written notice of intent to sell a repossessed vehicle.[6] If the seller violated the rate ceiling or the provisions regarding refund of finance charge upon prepayment, the contract was unenforceable, except by a bona-fide purchaser, and the buyer could bring a civil action to recover the amount that he had paid. The statute gave the buyer no remedy at all for a violation of the disclosure provisions. Nor were any administrative remedies provided.

Similar statutes were enacted in a number of states to cover the installment sales of goods other than motor vehicles—the so-called "all-goods" acts. As retail selling continued to grow, and additional abuses appeared, several states began to enact more detailed installment sales acts to deal specifically with problems arising from insurance, add-on sales, unfair contract provisions, the transferee's status in relation to the buyer, default and deferral charges, refinancing, and so forth. When revolving credit became widespread among department-store retailers, they became uneasy about the possibility that courts might be reluctant to apply the time-price doctrine to a situation in which monthly charges were made on the basis of outstanding balances. This apprehension led to concerted efforts to secure legislation legitimizing revolving-credit charges.

B. *Modern Trends*

By the early 1960's, a huge body of consumer-credit regulation had been enacted throughout the country, and today almost all suppliers of consumer credit are subject to some form of control. Unfortunately, this legislation is characterized by a failure to treat consistently the various types of creditors and transactions regulated. Frequently, creditors performing essentially the same economic function are subjected to widely varying regulation. For instance, in New York nine separate statutes regulate different segments of the consumer-credit industry: (1) installment loans by commercial banks; (2) installment loans by industrial banks; (3) bank check-credit plans; (4) revolving-charge-account credit; (5) motor vehicle installment sales financing; (6) installment sales financing of other goods

[6] Cal. Civ. Code § 2982 (repealed).

and services; (7) insurance-premium financing; (8) loans by consumer finance or small loan companies; and (9) credit-union loans. These statutes set fourteen different statutory maximum rates.[7]

One reason for this diversity can be found in the fact that consumer-credit legislation has, in large part, been a reaction to specific problems which have been solved specifically. Legislation has closely followed existing industry practices, or has been tailor-made to fit a particular kind of transaction. Since the purpose of small loan legislation was to allow the servicing of low-income borrowers, very high rates were permitted, and very onerous regulation imposed. Since the purpose of charge-account legislation was to legitimize existing practices, such statutes adopted the prevalent rate as the maximum, and provided for little else in the way of regulation beyond very minimum disclosure requirements. Similarly, maximum automobile finance rates were set to permit legitimate dealers to continue to charge the rates common in the industry. Thus, the legislation tended to take the status quo as the basis of regulation.

Whenever legislation grows in a fragmented manner, there is a tendency for the law to lag behind new developments in the field regulated. Most consumer-credit legislation is based on a conception of the installment loan and the installment sale as the stereotype of the consumer-credit transaction. Such legislation assumes: (1) that the consumer loan or credit sale is a single, isolated transaction; (2) that the terms of the transaction are entirely included in a written contract usually resulting from a personal confrontation between the parties; (3) that the total amount of the finance charge can be determined at the time of the contract; and (4) that the transaction can be treated as either a loan or a sale, and regulated accordingly. The computer, the telephone, several decades of experience on the part of credit grantors, and, perhaps, the affluence of our society, have combined to make these assumptions inappropriate for a greatly expanding body of consumer transactions.

The trend is decisively away from the static, "closed-end" credit transaction and toward the fluid, "open-end" form of credit extension. The development of revolving credit has been the innovation that made the trend inevitable, and the credit card has been the vehicle of the transformation. The old-fashioned thirty-day charge account and the customer's "charge plate" appear to be the lineal ancestors of today's system of revolving credit and credit cards. Merchants, weary of not being able to collect some of their Christmas bills until March

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[7] This count represents the opinion of Roger S. Barrett, Esq., as stated in his address to the Banking, Corporation and Business Law Section of the New York State Bar Association, Jan. 26, 1967, on the subject of the proposed Credit Code.

or April, began to impose a monthly service charge on accounts unpaid for a given period after billing. The familiar department-store charge plate was adopted by the oil companies to provide identification for their customers at the service stations selling their products. Organizations which were not themselves sellers provided credit cards as a convenience to consumers in obtaining hotel, restaurant, and travel services. Lenders of money, such as banks, also entered the field and issued credit cards which allowed card holders to buy goods and services and to be billed on a revolving-credit basis by the lender.

The reliance upon credit cards has resulted in a breakdown of the traditional dichotomy between loans and sales. For example, an oil company may issue a credit card which can be used at all service stations selling the oil company's products, as well as for purchases of goods and services from other sellers. If the card is used at a service station owned by the oil company, the transaction is simply a credit purchase of goods or services, but if the card is used at a service station not owned by the oil company, or to buy completely unrelated goods or services, it would seem that the transaction is tantamount to a loan of money by the oil company to the card holder. Yet all transactions are necessarily treated the same by the oil company. It should not be important whether a given transaction is a loan or a credit sale. The important thing for the purposes of regulation is that all the transactions do involve basically similar extensions of credit by the issuer of the credit card.

The advantages of the revolving-credit *cum* credit-card method of conducting consumer-credit business are great. The one-shot installment sale is an expensive transaction. A retail installment sale contract form—which grows more complex with each legislative session—must be filled in to the last blank. In the absence of some previous relationship between seller and buyer, a credit investigation may have to be made. In case of prepayments, or deferral of payments, time-consuming paper work must be done. Under revolving credit, on the other hand, credit supplier and consumer need only enter into a simple general agreement at the beginning of the relationship. The debtor can pay off the entire balance at any time with no problem of calculating complex prepayment refunds. The credit card establishes the consumer's creditworthiness, and he is treated as a cash buyer by sellers with whom he deals.

It is irony indeed that during the decade in which adherents of "truth-in-lending" legislation fought so valiantly for its passage, the only sales transaction in which disclosure on an annual interest basis can be made with accuracy—the closed-end installment sale—was greatly diminishing in importance in all but high-price transactions like the sale of automobiles. This was due to the rapid growth of revolving

credit, and, if this trend continues, "truth-in-lending" legislation may well offer a solution to a problem that has largely disappeared.

C. *Inadequacies in the System*

Despite the mass of legislation devoted to consumer credit, there were strong indications by the early 1960's that major problems of protecting consumers in credit transactions had not yet been solved. In addition to the vigorous movement among consumer groups to enact "truth-in-lending" legislation, creation of the federal poverty program called attention to the consumer-credit problems of the poor. Caplovitz' popular book, *The Poor Pay More*, published in 1963, dramatized the consumer-credit area as one in which the lower economic groups most desperately needed legal assistance. Agitation by consumer groups at the state level focused attention on garnishment, deficiency judgments, and other creditors' remedies. The belief became current that harsh collection laws had contributed to the rise in personal bankruptcies. Demands were made for better administrative enforcement of consumer-credit legislation and for strong enforcement measures which could effectively deal with unscrupulous creditors.

Not until the early 1960's could it be said that concern for the plight of the credit consumer had assumed national proportions. Ironically, this came about after most of the industrial states had enacted a mature system of legislation on the subject. Why was this legislation inadequate to solve the problems of the consumer? The following example will illustrate a typical situation. A young man with limited education and a small income lives with his wife in a small apartment. A personable salesman calls at their apartment and, in the course of an evening, convinces them that they should buy a certain model of stereo equipment, the cash price of which is carefully concealed during the selling process. The buyer is assured that for every qualified buyer he can produce, the price of the equipment will be reduced by fifty dollars. Don't they have friends that like good music? Finally the couple sign a contract which discloses that the cash price of the stereo is $1,000; the addition of credit insurance and finance charges results in a total of $1,380 for a 36-month contract. By the next morning the buyers are remorseful; they doubt that they have friends who will be willing to buy stereos at this price, and they have discovered that a comparable model could be obtained at a nearby appliance store for $300. When the stereo is delivered, they attempt to reject it, but the delivery man leaves it with them. If they refuse to make the payments, they will soon receive papers indicating that an action on the contract has been brought against them. A default judgment may be followed by garnishment of the buyer's

wages, which very often means loss of employment. The young man, as a practical matter, may have only the alternative of making the payments or risking the loss of his job.[8]

Even if the buyer in the above transaction can obtain legal assistance, he may have to be told that the transaction is perfectly legal under the consumer-credit laws, and that he will have to pay even though he has been cheated. The seller has no need to exceed the permissible finance-charge rates in order to make a profit, for he has greatly inflated the price of the goods to cover the increased risk of dealing with people in the economic position of the buyer. The statutory disclosure provisions are scrupulously complied with: each item of charge is set out. But all this means little to the buyer, for he is sold on the stereo before seeing the contract, and is assured that he will never have to pay the full amount of the contract because of the referral agreement. Having a contract which complies with the state's credit laws, the seller, or more likely a sales finance company that purchased the contract, is now entitled to use the state courts to compel the buyer to pay his debt.

Present consumer-credit laws are inadequate to protect consumers, because they are largely unrelated to many of the important economic and sociological problems caused by the rapid extension of "easy credit."[9] As previously indicated, consumer-credit laws have been aimed at permitting credit suppliers to charge profitable rates and at regulating the strictly "credit" aspects of transactions—namely, placing ceilings on, or requiring disclosure of, finance and related charges. These laws have emphasized protecting the consumer at the contract-formation stage, and have largely ignored safeguarding him at the vital default and collection stages of the credit process. Hence, our society has erected a heavy bureaucracy to compel a small loan company to refund a five-dollar overcharge to a borrower, but it is relatively unconcerned by the possibility that the same borrower may lose his job if his wages are garnished upon his default on the debt. The theory has been that if the consumer is told what his charges are, and if the creditor is limited in what he can charge for credit, the consumer should be able to take care of himself.

If personal bankruptcy rates are any indication, many consumers have not been able to ration wisely their own use of credit. Many find themselves so heavily committed that any interruption in their weekly paycheck, due to sickness, pregnancy, lay-off, garnishment, and so forth, triggers a series of defaults on all of their consumer contracts.

[8] A detailed description of the operations of referral-scheme sellers is set out in In re State of New York (ITM, Inc.), 3 UCC Rep. Serv. 774 (N.Y. Sup. Ct. 1966). See also Frostifresh Corp. v. Reynoso, 274 N.Y.S.2d 757 (Dist. Ct. Nassau County 1966).

[9] See Comment, Translating Sympathy for the Deceived Consumers into Effective Programs for Protection, 114 U. Pa. L. Rev. 395 (1966).

In many states the creditor possesses a formidable arsenal of rights and remedies to enable him to collect his debts. Garnishments, wage assignments, deficiency judgments, confessions of judgment, and the right to take assignments free of defenses are all rights developed in the law long before the mass of consumers came into the credit process. These rights are more appropriate in their original commercial context, in which the parties enjoyed some equality of bargaining position. For the overcommitted consumer dealing with an unscrupulous creditor, the full application of these rights can lead to catastrophe.

Overcommitment has not been the only undesirable consequence of readily available credit. In a significant number of cases, goods or services sold are exorbitantly priced, of extremely low quality, or of absurdly little utility to the consumer. The selling techniques used to merchandise these goods or services are sometimes either openly fraudulent, or border on being so. Apparently, when a consumer can "buy" goods or services by signing his name, often with no down-payment, his sales resistance is radically lowered. It is probably fair to conclude that many of the more outrageous selling practices exposed in recent years, typically in cases concerning housing siding, food freezers, encyclopedias, dancing lessons, or correspondence-school courses, were made possible only because of the availability of credit.

The foregoing critique of the present system of consumer-credit legislation suggests that a shift in emphasis is necessary. The existing scheme of consumer-credit laws—although well intended and carefully devised—is vulnerable to the criticism that it supplies largely middle-class solutions (*e.g.*, rate ceilings, disclosure) to what has increasingly become a lower-class problem. The concentration of credit legislation on the narrow "credit" aspects of consumer transactions tends to leave the consumer with little or no protection at the time when he most needs it. Current practices of high-pressure consumer-credit selling or lending make it easy for a consumer to become over-committed, and our strict system of collection laws makes it difficult for him to extricate himself. The result may be that the defaulting consumer is driven into bankruptcy or to welfare relief. The widening conflict between the existing structure of credit laws and practices and the governmental aspirations for the assistance of the poor must be resolved in a manner that will bring credit legislation into greater harmony wth legitimate community objectives in this area.

II. Major Provisions of the Proposed Code

A. *Coverage*

The proposed Uniform Consumer Credit Code is divided into seven articles. Article 1 contains definitions of terms used in the

Code and some general provisions. Articles 2 and 3 are parallel and contain the principal regulatory provisions in relation to consumer-credit sales and leases, and consumer loans, respectively. Article 4 contains provisions regulating some aspects of the sale of insurance in connection with consumer-credit transactions. Article 5 gives certain judicial remedies to debtors for violations of the Code, and also contains limitations on certain creditor remedies. Article 6 provides an administrator for the Code, defines his powers, and provides administrative remedies for enforcement. Article 7 contains provisions which would allow the formation and licensing of nonprofit debt-counseling corporations.

The Code applies to "consumer-credit sales," "consumer leases," and "consumer loans." These terms refer to transactions between professional creditors and natural persons, where the purpose of the transaction is primarily a personal, family, or household purpose, or, to a limited extent, a farm purpose. The primary intent of the Code is to cover the extension of credit, whether it be by lenders, lessors, or vendors, to finance the acquisition of consumer goods and services. The ordinary long-term, low-interest-rate, home-mortgage loan, although made for a consumer purpose, presents problems quite diverse from those incident to the financing of other consumer goods and services, and will probably not be covered in any way by the Code. There has, however, been a growing tendency for certain lenders to take real-estate security in connection with loans made to finance the purchase of goods and services. These loans differ from ordinary home-mortgage financing in that normally they involve much higher costs to the borrower, are of much shorter maturity, and are secured by junior liens. They are essentially competitive with traditional short-term consumer credit and will be regulated under the Code.

B. *Rate Limitations*

Historically, the core of consumer-credit legislation has been the idea that creditors should be limited in the amount that they can charge for credit. The concept of usury is deeply ingrained in our thinking, and it is fair to say that this concept has been the *raison d'être* of most of our consumer-credit laws. However, as we have departed more and more from a cash economy in which the use of credit by the ordinary consumer was unusual, to an economy in which the use of credit is the norm, usury laws have become less and less relevant. It is no longer useful to think of usury as applying only to loan transactions. There is no meaningful distinction between lenders and sellers when each extends credit to buyers of consumer goods or services. A buyer of goods or services on credit pays a price which can be divided between the price for the product and the price for the credit, but,

from the point of view of the consumer, the important figure is the *total* price of the goods or services; how that price is allocated between "cash price" and "credit charge" is largely unimportant.

In this country, our thinking about usury has led us to fix ceilings on the amount that can be charged for credit, but our *laissez-faire* heritage has prevented us from fixing ceilings on the price of the goods or services themselves. Thus, we have been caught between opposing theories concerning how best to protect the buyer. Rate ceilings indicate the necessity of government intervention to prevent "unfair" pricing, while the absence of ceilings on goods indicates a belief that the forces of a competitive market will drive prices to a proper level.

Yet, with respect to a single transaction—the credit sale of goods or services—modern consumer-credit legislation applies both theories. As credit becomes more the norm, it becomes easier for a creditor simply to allocate more of the total price paid by the credit buyer to the price of the goods or services if the ceiling on the credit charge is too low. Most sales of goods or services are financed either by a sales finance company that buys the debt from the seller or, to an increasing extent, by a lender who, in effect, makes a loan to the buyer by allowing him to pay for the goods or services by means of a credit card. In both cases part of the return to the financial institution is, or can be, in the form of a discount from the face amount of the obligation. In other words, part of the "cash price" goes to the institution which provides the credit.

Any discussion of rate ceilings—if it is to be at all realistic—must recognize two factors. First, a ceiling on the credit charge with respect to a sale is of very limited utility in restricting the price which the consumer will pay for the goods or services, since the seller can simply allocate more of the total price to the price of the goods or services. This ability to allocate depends upon the degree to which the seller is able to raise his "cash" price. Naturally, the more a seller bases his transactions on credit rather than cash, the more is he free to allocate price. But that class of people which most needs the protection of a rate ceiling is likely to be dealing with sellers who sell primarily on credit. And even sellers who do a large amount of cash selling might be so dependent on their credit business that it would be profitable for them to raise their cash price even if the result is to lose some cash buyers. When cash prices are thus raised, cash buyers subsidize credit buyers by paying for part of the cost of giving credit.

The second factor to be recognized is that, if the ceiling is effective—as it can be in the case of cash lenders who have no power of allocation—the result is to limit the people who can obtain credit from that source. For example, if the ceiling on the annual interest rate

for loans is ten per cent, only very good credit risks, borrowing relatively large amounts of money, will be able to get loans. As the rate is raised, more people will get loans, and more small-principal loans will be made. To the extent that the rate is low, some people will either not have access to credit at all, or else they will be required to get it from creditors who are not effectively limited by the credit-charge ceiling because of their ability to allocate part of the credit charge to the "cash" price.

As a result of these inherent weaknesses in rate regulation, it has been forcibly argued that protection of the consumer must be found in the forces of competition. This, of course, is one of the principal arguments in favor of "truth-in-lending" legislation. Since credit charges have been described to the consumer in so many different ways, it has been difficult for him to make the comparisons upon which competition depends. A single method of rate disclosure would thus facilitate competition. Another impediment to competition has been the presence of licensing requirements and other limitations on lenders and sales finance companies which have provided artificial barriers to entry into the market.

The proposed Code has followed the traditional pattern of providing for rate ceilings, but has tried to put them on a more rational basis. The Code follows the theory that rate ceilings should set a maximum limit on rates, rather than set the rate itself. Primary reliance must be placed on competition to insure "fair" rates of charge. In other parts of the Code, attempts have been made to encourage competition. The Code provides for uniform disclosure of credit charges as annual rates in those cases in which competition can play a useful part, and also encourages free entry into all phases of the consumer-credit business by minimizing restrictive licensing and other artificial barriers to entry. Moreover, the Code recognizes the essential similarity between creditors operating in the various segments of the industry, by attempting to make uniform the rates applicable to both loan and sale transactions.

C. *Disclosure*

Provisions requiring that the debtor be given adequate information relating to the critical elements of his contract with the creditor are an essential, and in many cases, principal ingredient of much of the consumer-credit legislation in effect today. Elementary notions of fairness dictate that the debtor at least be told, in understandable terms, the substance of his obligation. Many sophisticated debtors with bargaining power and alternative sources of credit do not need this kind of protection; they can obtain for themselves the information that they desire. But many more debtors probably do need legislative

protection, and, without that protection, might not get essential information.

It is important to recognize, however, that detailed disclosure provisions entail economic costs. The more detailed the requirements, the more creditors are saddled with inflexible business forms that might hinder efficiency in transacting business. Precautions that must be taken by creditors to prevent error in complying with statutory mandates necessarily add to clerical and supervisory costs.[10]

In the proposed Code, the above factors have been recognized, and an attempt has been made to require the creditor to disclose only that information which is necessary and meaningful to the debtor, and which can be given without undue burden to the creditor and without the concomitant costs that would be passed on to the debtor. Therefore, the disclosure provisions of the Code do not apply to either loans or sales if the amount of the loan or sale is $50,000 or more. The reason for this limitation is obvious. Very large transactions do not require this special kind of statutory protection. A person with the economic resources to incur a debt of this size should be able to obtain whatever information he needs without legislative help. The figure of $50,000 is arbitrary and might have been set much lower; the use of this figure, however, will allow very few transactions to be excluded because of size. With respect to consumer-credit sales, the disclosure provisions of the Code also do not apply if the debt is payable in four installments or less *and* if there is no charge imposed for credit. Transactions fitting into this category are basically "cash" transactions and are not characteristic of the typical consumer-credit sale, in which an extended period of payment is an essential feature.

The disclosure provisions are quite simple. If the debtor signs anything that obligates him to pay money or perform a duty, he must be given a copy of the writing. With respect to the basic installment sale or installment loan (excluding revolving credit), he must be told what he is buying or borrowing: in the case of a loan, this means the amount paid to him or for his account; in the case of a sale, the cash price of the goods or services and a description or identification of them. He is then given an intemized list of what he must pay, including: (1) the down-payment, if any, with a statement regarding any allowance for goods traded in; (2) the amount charged for fees paid to public officials in connection with the credit, such as a fee to record a security interest; (3) the amount charged for insurance and other incidental credit charges; (4) the dollar amount of interest or credit charge payable under the contract; (5) the total amount due under the contract; and (6) the schedule of installment payments. All of this

[10] The authors' analysis of disclosure of finance charges is found in Jordan & Warren, Disclosure of Finance Charges: A Rationale, 64 Mich. L. Rev. 1285 (1966).

information can be given without difficulty to a debtor, and most of it is already. The only exception is that, under these provisions, the creditor is required to precompute the contract payments and to tell the debtor in advance the total amount payable for the credit and the total amount due under the contract. Under current practice, this information is not always made available to the debtor.

In addition to the items of disclosure stated above, the Code requires in some cases that the creditor state the annual rate of the finance charge as applied to the amount financed. This rate must always be given in the case of a loan, and, with respect to sales, whenever the amount financed is $300 or more. This requirement satisfies the arguments of the advocates of "truth-in-lending" legislation that, unless the debtor is given some uniform method of quotation of the finance charge, he is unable to make comparisons among various creditors to determine where he can get credit most cheaply.

There are two principal methods of quoting a rate with respect to a finance charge. The charge may be put in terms of an annual interest or percentage rate, or it can be put in terms of dollars per $100 per year. For example, if a person borrows $100 and is required to repay $9 per month for 12 months, the finance charge is $8. In terms of dollars per $100 per year, the finance charge is $8 per $100 per year; in terms of an annual percentage rate, it is approximately 15 per cent. Either method, if adopted uniformly by all sources of consumer credit, will allow consumers to make meaningful comparisons for shopping purposes. The relative merits of the two methods have been endlessly debated, and both have strong adherents. The latest draft of the Code adopts dollars per $100 per year.

As a practical matter, the disclosure of the rate of the finance charge cannot be given in revolving-credit situations typified by the credit card and the department-store revolving charge account. For this reason, rate disclosure is not required in these transactions. It is also not required by the Code in sales transactions where the amount financed is $300 or less. Rate could be disclosed in these latter transactions, but would probably involve substantial clerical costs. In these small transactions, the rate-statement has minimum effect, because the consumer is more concerned with the total price of the goods or services than with the price of the credit. Therefore, the costs of requiring rate disclosure far outweigh the benefits to be derived.

In the case of credit-card and other revolving-credit and charge-account transactions, the Code merely provides that the debtor be told in advance the conditions under which he will incur credit charges and how these charges will be computed. With each monthly bill he must again receive this information. In addition, the bill must contain a statement of his previous balance, amounts debited and credited

to his account (with separate itemizations of credit charges), his current balance, and the amount presently payable.

If one of the purposes of disclosure requirements is to discourage consumers from entering into onerous or unfavorable contracts, disclosure comes too late once the contract is made. It is well recognized that many, if not most, consumers do not carefully read the contracts that they sign, and may well have been induced to enter into the contract by advertisements or by blandishments of the salesman. One of the principal weaknesses of some disclosure statutes is that the statutory control applies only to disclosure in the contract; the pre-contractual period is ignored. To meet this problem, the proposed Code contains a general provision making it unlawful to engage in false or misleading advertising concerning the terms or conditions of credit. Violation of this provision can be the basis for a cease-and-desist proceeding by the Administrator of the Code or for an injunction by a court. The Code also provides that if an advertisement states the dollar amount of the finance charge or installment payment, it must also state the rate, in the statutory form, of the finance charge and the number and amount of installment payments. This provision is designed to prevent advertisements that entice buyers or borrowers by disclosing only a very low monthly payment without disclosing the true cost, which can be determined only by knowing the rate of the finance charge or the length of the contract.

D. *Prohibited Contract Terms*

Creditors are often able to impose upon debtors contract terms that are very favorable to the creditor and onerous to the debtor. Typically, this has been possible because of inequality in the economic bargaining strength of the parties or because of the debtor's ignorance. Moreover, consumer-credit transactions are completed by means of standardized forms, and there is very little chance for the individual debtor to have these forms changed for his particular transaction. The forms naturally are written to favor the creditor and cannot be avoided by the consumer due to the tendency of forms to permeate an industry. In the absence of effective individual bargaining over contract terms, legislation must protect the consumer.

The proposed Code contains a number of provisions which are designed to protect the consumer from a harsh bargain. The concept of negotiability, which is a creature of the commercial law designed to foster the free flow of commercial paper, has served a very different purpose in the consumer-credit area. The credit contract between buyer and seller is often transferred to a sales finance company which succeeds to all the rights of the seller, but which, in some states, under certain conditions, is not subject to any of the defenses that the buyer

may have against the seller. The result is that even if the buyer has a good claim or defense against the seller he must pay the finance company and resort to a law suit against the seller.

The proposed Credit Code prohibits a seller from taking a negotiable promissory note from a buyer. It also provides that, notwithstanding any agreement to the contrary, the transferee of the seller's rights is subject to all claims and defenses of the buyer up to the amount owed by the buyer at the time the claim or defense is asserted. One result of these provisions may be to discourage finance companies from dealing with unscrupulous sellers whose practices give rise to large numbers of claims or defenses by buyers. In the case of scrupulous sellers, the occasional instance of a claim or defense can be easily handled by having the seller repurchase the paper involved. Finance companies should have no difficulty protecting their interests through provisions in their contracts with sellers.

The Code also contains restrictions on the collateral that can be taken by sellers as security for payment. It provides that a seller can take a security interest only in goods sold in the transaction, or, if the sale involves maintenance, repair, or improvement of the buyer's property, only in the property affected. The Code adopts the view that a seller should be able to secure payment of his debt, but that a security interest in the goods sold is adequate security. It is not unjust that the buyer should have to give up goods that he has not paid for, but he should not have to lose other goods which are his own property. The only exception to this is presented by the case of a seller who sells a number of different items to a buyer in a series of sales. The Code allows each sale to be secured by goods sold in the other sales, subject to a formula which releases goods as the respective debts are paid off.

There is also a general provision in the Code against enforcement of unconscionable contracts. This provision is basically identical to Section 2-302 of the Uniform Commercial Code, but extends the U.C.C. provision to leases of goods and sales of services. In addition, the proposed Code makes unlawful any referral scheme which bases the earning of a rebate or discount upon the occurrence of an event subsequent to the time the buyer agrees to buy.[11]

One type of sale, in which there have been particular abuses, has been singled out in the Code for special treatment. Although high-pressure salesmanship can be practiced anywhere, there is considerable evidence that the sale in the home is particularly susceptible to such methods. The proposed Code provides that, if the cash price of the goods or services in such a sale is $100 or more, the buyer has a right to rescind the sale by sending a notice of cancellation within

[11] See note 8 supra and accompanying text.

two days after he signs the agreement of sale. To the extent that the buyer has made any payment to the seller, the seller is entitled to retain as a cancellation fee $15, or five per cent of the cash price of the goods or services, whichever is less. The effect of these provisions is merely to delay the consummation of sales made in the home until the forty-eight-hour period has passed. Satisfied buyers will not cancel, and dissatisfied buyers will have some short period of repose away from the pressure of the salesman in order to decide whether they want to go through with a purchase which may involve a major commitment.

E. *Limitations on Creditors' Remedies*

To many consumers faced with an onerous debt, the legal system appears to be an instrument for oppression rather than a force for justice. Under the existing system, the state generally remains neutral and allows the creditor and the debtor to make whatever bargain they want. Some limitations are imposed, but the state does not, and probably cannot, prevent the debtor from making improvident commitments that may spell disaster for himself and his family. A position of relative neutrality by the state is necessary and desirable if we are to maintain our notions of freedom of contract.

After the bargain has been made, however, the state does not remain neutral. The full power of the state is available to the creditor to enable him to collect his debt once he has obtained a judgment. The ability to use the courts as collection agencies no doubt has encouraged some creditors to induce debtors to incur more debt than they can actually manage. Coercion by the state to pay debt is defensible where the debtor can pay but will not, and the specter of the "deadbeat" is constantly invoked by creditors to justify tough collection remedies. All too often, however, it is not the "deadbeat," but rather the naive victim of the overreaching creditor, who is subjected to the worst collection practices. Moreover, it is becoming increasingly doubtful whether many of the traditional creditor remedies are needed by legitimate creditors. With the use of computers and other sophisticated information systems, creditors will soon have the ability to make very accurate determinations of the creditworthiness of the applicant. The consumer today is very dependent upon credit, and, if his ability to get credit depends upon his paying his bills, he will pay them without the coercion of the state. The proposed Code has severely limited two creditor remedies which have been the cause of much injustice in the consumer-credit field—deficiency judgments and wage garnishments.

If the seller finds it necessary to repossess the property sold in a credit sale, the Code provides that, in the case of amounts of $500

or less owed at the time of repossession, the repossession is the exclusive remedy of the seller. Sale of repossessed goods normally brings a price which is very low in relation to the original purchase price of the goods. Some high-priced products, such as automobiles, have a reliable resale market and bring reasonable prices, but for many products, such as furniture and appliances, resale values are woefully small. In these cases, a debtor who must pay a deficiency judgment loses the goods but still owes the purchase price. Indeed, with the addition of collection costs, he frequently has to pay more than the purchase price. Under the provisions of the proposed Code, the creditor is asked to assume some of the risk of nonpayment, at least in the case of relatively small debts. This is not an unreasonable burden for him to assume, because he does have the means of protecting himself. If he takes a reasonable down-payment, if he does not sell to a buyer overloaded with debt, and if the price of his product is commensurate with its value, the right to repossess will be a sufficient remedy in most cases. In any event, he can always sue for the unpaid debt; however, he must allow the debtor to keep the goods if he does.

Wage garnishment has been, without question, the creditor remedy most devastating to the debtor, because the wage-earning consumer is completely dependent on his job to provide for the welfare of himself and his family. It is customary in most states to protect some part of the debtor's wages, but these laws do not prevent garnishment. Even if a creditor can reach only a small per cent of the wages, the threat of garnishment is a powerful weapon, because it is a well-recognized fact that many employers find garnishment expensive and onerous and will discharge employees whose wages are garnished. The authors believe that it is vital for the protection of consumers—particularly those in low-income brackets—that a minimum "living wage" be exempt from garnishment with respect to consumer-credit transactions. The proposed Code provides that a creditor in such a transaction may not garnish wages except to the extent that the debtor's earnings are in excess of $100 per week, or, in the case of a debtor without dependents, $65 per week. The Code prohibits garnishment of wages prior to judgment and also prohibits the taking of a wage assignment as security.

F. *Debtors' Remedies and Enforcement*

A debtor need not pay any charge in excess of that allowed by the Credit Code, and, if he has paid an excess charge, he is entitled to a refund. If, after demand, a creditor refuses to make a refund, the debtor may recover a penalty fixed by the court at not greater than ten times the amount of the excess charge. If the creditor has violated

the Code in any other way, the debtor need not pay any finance charge, and, if he has already paid, he may recover the payment. In all cases in which the creditor violates the Code, the court may award reasonable attorney's fees incurred by the debtor.

It is contemplated that the principal enforcement of the Code will come from the Administrator, who is given broad investigatory powers, including the subpoena power, to determine whether unlawful acts are being committed. He may take enforcement action either by administrative procedures subject to judicial review or by direct actions in court. After notice and hearing, he may order a creditor or person acting in his behalf to cease and desist from engaging in any violation of the Code. He may also order any creditor who has made charges in excess of those permitted by the Code to refund the excess charges. Whatever the Administrator may do by administrative order can also be done by court order, and he may bring an action to enjoin violations of the Code or for an order to refund charges made in excess of those permitted by the Code. If the Administrator brings a court action with respect to excess charges, the court may also impose a penalty of not more than ten times the excess charges if the creditor has not agreed to refund prior to the time the action is brought. In addition, if the court finds that a creditor, or a person acting in his behalf, has engaged in a course of repeated and willful violations of the Code, it may assess a civil penalty of not more than $5,000.

One of the great weaknesses of consumer-credit laws has been a tendency to emphasize formal aspects of the debtor-creditor relationship and to restrict the reach of the laws to the strictly "credit" aspects of transactions. It is a fact, however, that there are unscrupulous creditors who prey on the ignorant and the gullible, and who do so without violating consumer-credit laws. The proposed Code contains a provision which could be a powerful weapon in ridding the market of predatory creditors. Under the Code, the Administrator may bring an action to restrain a creditor, or a person acting in his behalf, from making credit sales, leases, or loans, whose terms are unconscionable, or from engaging in a course of fraudulent or unconscionable conduct to induce consumers to enter into credit transactions or to collect debts arising from credit transactions. The court may grant an injunction if it finds as a matter of law that the contract or conduct is fraudulent or unconscionable, that substantial injury is threatened, and that the ability to cause the injury is present primarily because the transactions are credit transactions.

Fraud in consumer-credit transactions, to the extent that it can be reached today by actions of public officials, normally is governed only by the criminal laws, and these have not been notably successful.

Even if criminal laws could be fashioned to deal with problems in this area, they would not be given high priority by understaffed prosecutors also charged with dealing with perpetrators of "more serious" crimes. Under the proposed Code, fraud can be used as the basis for injunctive relief sought by a public official whose only concern is consumer credit.

The courts have long dealt with the notion of fraud, and a definition of it is not included in the Code; "unconscionability" in inducing contracts or collecting debts is also undefined. However, the latter term is designed to reach those cases in which creditors go far beyond the bounds of reasonable behavior and subject debtors to coercion that would "shock the conscience" of a court of equity. In the case of unconscionability with respect to the terms of the consumer transaction, the Code does set forth some guidelines for the judge. A finding of unconscionability is precluded where the bargaining position between the creditor and the debtor is such that the debtor is able to fend for himself; the Code applies only where the debtor cannot protect himself. The court may not find the terms of a contract to be unconscionable unless it first finds that the creditor has knowingly taken advantage of the consumer's inability to make a reasonable contract because of physical or mental infirmities, ignorance or lack of sophistication concerning transactions of the type involved, or similar factors resulting in a gross inequality of bargaining strength between the two parties. The Code provides that each of the following is evidence of unconscionability: (1) the creditor's belief at the time the transaction was made that there was no reasonable probability of full payment of the obligation by the consumer; (2) the creditor's knowledge at the time of a sale or lease of the debtor's inability to receive substantial benefits from the goods or services; and (3) gross disparity between the price of the goods or services and the price at which similar goods or services are readily obtainable in credit transactions in the same market by buyers of similar creditworthiness.

The proposed Code provides for a procedure whereby a creditor, charged with conduct that could be the basis of administrative or judicial proceedings, may be allowed to sign an "assurance of discontinuance" in which he agrees to discontinue commission of the acts charged. If the person giving the assurance fails to comply with its terms, the assurance may be used by the Administrator in subsequent proceedings as prima facie evidence that the conduct described in the assurance was committed. This procedure is designed to encourage informal settlements in those cases in which the Administrator does not consider formal administrative enforcement to be necessary.

In order to aid the Administrator in keeping abreast with current developments in the consumer-credit field, and in order to give the

various interests affected by the Code a chance to make their views known to the Administrator, the Code provides for a Council of Advisors on Consumer Credit. Members of the Council will serve without compensation and will be appointed by the Governor, who is charged with the duty of achieving a fair representation from the public and from the various segments of the consumer-credit industry. The term of each member of the Council will be fairly long, perhaps four years, and terms will be staggered so that there is continuity of membership. The duty of the Council is to advise and consult with the Administrator concerning the exercise of his powers under the Code and to make recommendations to him.

III. Conclusion

Articles on consumer credit—particularly those written by college professors—tend toward gloomy enumerations of the ways in which the unscrupulous creditor is currently taking advantage of the oppressed consumer, spiced by some self-righteous pronouncements on how all the trouble could be cleared up if the author's solutions were seized upon by legislators. This article has been no exception. The truth of the matter is that the American consumer is the marvel of the world. In the great majority of credit transactions, he is very well treated indeed and has abundant credit available if he meets minimal standards. A fact that legislative draftsmen are reluctant to admit is that the favorable treatment presently accorded to the American consumer probably owes little to the legislative process. Most likely the consumer is well off today because a number of reputable credit grantors are competing for his business.

Clearly discernible trends promise an even better lot for the consumer. The process of diversification among credit suppliers is accelerating; old barriers between segments of the finance industry are falling away. The result is that more credit suppliers are competing for the consumer dollar. The Code recognizes this development and encourages it to continue. A major objective has been to do away with limitations on the entry of credit suppliers into the credit arena. Only in the small loan area does the Code retain "character and fitness" licensing, and it abandons the "convenience and advantage" limitation even there. Moreover, the consumer should have access to information which will enable him to decide more easily which of the competing deals offered to him is better.

Another major development in consumer credit is abandonment of the expensive, one-shot, closed-end installment sale or loan, and creation of an open-end continuing relationship between creditor and consumer. This will result in greater convenience for the consumer and should in time lower the cost of consumer credit. The proposed

Code is the first consumer-credit law to deal comprehensively with the open-end credit arrangement. It allows the modern system of revolving credit (*e.g.*, the credit card) to continue its extraordinary growth unimpeded by doubts regarding the classification of the transaction under installment sales laws or usury laws.

Though most consumers are getting good treatment, some are not. Previous consumer-credit legislation has been remarkably unresponsive to the plight of the latter group. Though competition is the boon of the middle-class consumer, it is not the answer to the difficulties of the low-income consumer. The unscrupulous retailer, preying upon the disadvantaged consumer, has flourished under present consumer laws. Now the Code gives an administrator the power (never before present in the retail field) to eliminate the criminal element. Past credit laws have contained enumerations of prohibited conduct, which served as guideposts to the illicit credit supplier of what not to do in conceiving his next scheme. The Code, in its unconscionability provisions, gives the Administrator the flexibility necessary to deal with such businessmen. What is more, the Code seeks to ameliorate the condition of the overcommitted consumer by limiting somewhat the harsher remedies the creditor can use against him.

Rapidly changing conditions in the consumer-finance industry, together with new social attitudes toward the legitimate expectations of consumers—particularly those in the lower economic groups—require new approaches in consumer-credit legislation. Both creditors and consumers can benefit from them. The 1967 draft of the proposed Uniform Consumer Credit Code is the fruit of three years of work toward this end.