

LEGISLATIVE CONTROLS AS A RESPONSE TO CONSUMER-CREDIT PROBLEMS

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I. INTRODUCTION

Consumer-credit legislation consists of numerous statutes of varying length and complexity, which regulate the substance and form of consumer-credit arrangements and the conduct of parties participating in those arrangements. If adequacy and appropriateness of statutory regulation of an activity were to be judged by the quantity of words used by the legislature to express that regulation, consumer-credit legislation would undoubtedly qualify as a highly successful effort. The aggregate of consumer-credit regulation in all states, or in any one state, does not, on balance, however, fulfill the promise made by the quantity of words or the number of statutory provisions devoted to the subject. Legislation regulating consumer credit is generally considered unsatisfactory, and suggestions for improving it have been the subject of what seems almost endless comment and irreconcilable diversity of opinion.¹

Consumer-credit legislation suffers from two readily observable defects. The first is a matter of form. Statutory provisions regulating consumer credit are poorly organized, subject to redundancies, and unnecessarily complex. The second is a matter of substance. The legislation is an inadequate response to a felt need for melioration or resolution of problems perceived to exist in the consumer-credit market. The inadequacy of the response is revealed in several ways—in superficiality of treatment, in arbitrary limitation of scope, in irrelevancy of response to the problem, in half-measure controls that may be more invidious than no controls at all, and in differential treatment of several manifestations of the same underlying problem. Statutory controls imposed for the purpose of achieving or approximating designated outcomes have, therefore, a curious propensity toward producing unanticipated results.

The general uneasiness over existing legislation, the conflicting and apparently irreconcilable arguments over the adequacy and appropriateness of that legislation, and the readily observable defects in legislative controls, noted above, are symptoms of a fundamental

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¹ See, e.g., the U.S. Senate subcommittee hearings on "Truth in Lending." Hearings on S. 750 Before a Subcommittee of the Senate Committee on Banking and Currency, 88th Cong., 1st & 2d Sess. (1963-1964); on S. 1740, 87th Cong., 1st & 2d Sess. (1961-1962); on S. 2755, 86th Cong., 2d Sess. (1960).

epistemological difficulty underlying all consumer-credit legislation. Inadequacies in legislation can be attributed to a general failure to recognize and treat the consumer-credit problem as a total process represented by the consumer-credit market. Instead, each symptom of an underlying malfunctioning or imperfect operation of the market has been treated as an isolated phenomenon, incidentally related to other consumer-market problems, and the resultant legislative response, being specialized to the symptom and not related to the underlying cause, has not only failed to deal with the underlying cause, but has been ineffectual in allaying the symptom. Even when it has been recognized that consumer-credit regulation is regulation of some aspect of a larger process, the creation of statutory controls has not reflected this perception. Since problems have not been treated as arising out of the operation of the larger process, legislation has been created without a realistic appraisal, in most instances, of the causes of the problems that the legislation is intended to resolve. This difficulty has been further compounded by the fact that periodic reevaluation and revision of statutory controls has been based on the assumption that prior appraisals of consumer problems are valid. New or revised legislation therefore reinforces inadequate responses by replicating earlier evaluative errors.

These introductory remarks will be amplified in Section IV, A Critique of Consumer-Credit Legislation. As a background for the critique itself, this article will (1) review the role that legislation has played in the development of the market and analyze the extent to which the growth of the market has shaped the nature and scope of regulation, (2) examine the similarity of controls imposed by legislation on all aspects of the market in all jurisdictions, and (3) explore the substantive nature of the controls established.

II. DEVELOPMENT OF CONSUMER-CREDIT LEGISLATION

The Uniform Small Loan Law. Enactment of consumer-credit legislation accompanied the development of consumer-credit arrangements as they were created to meet the needs of an expanding market. Prior to the twentieth century, the credit activities of financial institutions were limited to the business- and commercial-credit market. Financial institutions granted credit to individual persons for personal purposes only when amounts involved were substantial and only when adequate collateral security in the form of real or personal property was available. Since the wage earner desired only a small loan and had no security other than the prospect of his future wages, financial institutions usually denied him credit for the acquisition of consumer goods and services. Generally he was able to obtain such credit only from his

employer, small retailers, and some private lenders.² Few commercial-credit lenders engaged in consumer financing, because, in a growing economy, the business-credit market represented a ready investment outlet. Moreover, maximum rates of interest authorized under interest and usury statutes were too low to provide an attractive yield to lenders for a small loan repayable in installments.

The inability to obtain small loans from legitimate sources of money often forced the hard-pressed wage earner to borrow at usurious rates. The Uniform Small Loan Law, drafted in 1916 and thereafter enacted in most states, was primarily a response to the plight of the necessitous borrower who needed relatively small amounts of cash and who could repay amounts borrowed only out of deductions from future wages.³ By authorizing substantially higher rates of interest than were permitted under general interest and usury laws for installment loans less than three hundred dollars,⁴ the small loan law encouraged commercial lenders to engage in the business of making small loans to wage earners. Only lenders licensed under the provisions of the small loan law were permitted to take advantage of the higher interest charges authorized by it, and their activities were supervised by a state administrative agency. Terms and conditions of the loan contract, including maximum amount of loan, interest charge, duration of loan, and method of repayment, were regulated by the law.⁵

Small loan laws patterned after the first and subsequent drafts of the Uniform Small Loan Law are in force in most states today.⁶ Consumer-finance companies, which presently hold about eight per cent of outstanding consumer installment debt, are generally licensed to operate under these small loan laws.⁷ Although the provisions of small loan laws presently in force are substantially the same as the uniform act, there have been some major modifications in them over the years. Maximum authorized loan amounts have been increased; precomputation of rates has been authorized; refunds for prepayment

² For particular examples of the credit that was available to the wage earner and of the resultant abuses, see Board of Governors, Federal Reserve System, 1 *Consumer Installment Credit* pt. 1 (1957) (general); Cash, *The Mind of the South* 189-238 (1941) (employer, company store); Sinclair, *The Jungle* 54-62, 75-85, 118-20 (1906) (purchasing real estate on installment contract).

³ The Uniform Small Loan Law was enacted primarily through the support and effort of the Russell Sage Foundation. See Glenn, Brandt & Andrews, *The Russell Sage Foundation* (1907-1946) 136-51, 336-50, 531-48 (1947). For a reprint of the original Uniform Small Loan Law, see Hubachek, *Annotations on Small Loan Laws* 181-85 (1938). For a reprint of its seventh draft, see Curran, *Trends in Consumer Credit Legislation* 144-57 (1965) [hereinafter cited as Curran].

⁴ The uniform act authorized 3% per month on the declining outstanding balance for the first \$100; 2% per month on the excess over \$100.

⁵ See generally Curran 2, 6, 9, 15-45.

⁶ For materials on small loan laws generally, see *id.* at 15-45, 140-42, 158-93.

⁷ 52 Fed. Reserve Bull. 1692 (1966).

by borrowers may be calculated on the basis of the "Rule of 78"; and charges for credit life, accident, and health insurance are permitted. The effect of these modifications is to coordinate the regulation of small loans made by licensees under the small loan laws with the regulation of installment credit extended by other installment credit lenders.⁸

The Industrial Loan. A development in consumer credit, contemporaneous with the Uniform Small Loan Law, was the emergence of the industrial loan or "Morris Plan" loan. This Plan was devised by Arthur J. Morris in 1910 as a means of overcoming the impediment, created by general interest laws, to the extension of installment credit to the wage earner. Under the Plan, the debtor agreed to repay the principal amount of the loan in a lump sum at the end of a specified period of time, such as a year, with interest calculated at the maximum authorized statutory rate for the full period. At the same time, he agreed to open with the lender a noninterest-bearing account wherein he would periodically deposit amounts sufficient to pay off the loan when it became due. The deposit account technically constituted collateral for the loan. By this device, the lender was able to obtain a greater yield on the loan, simply because he had the use of deposits made while the original note was maturing.⁹ Such loans were treated as complying with general interest statutes.¹⁰

Industrial banks were organized under different statutes and had powers different from commercial banking institutions; their activities expanded greatly during the two decades following 1910. The objective of the founders and organizers of industrial banks was to create a banking system that would specialize in servicing the consumer savings and loan market. It was thought that a profitable enterprise could be operated by limiting activities to consumer financing and banking. Since the 1930's, however, small loan companies and commercial banks have assumed a major share of this market. Nevertheless, industrial-type loans may still be obtained from extant industrial banks and from industrial-loan departments of commercial banks.¹¹

⁸ Curran 134.

⁹ Industrial banks customarily assessed a service fee in addition to the interest charge.

¹⁰ See Saulnier, *Industrial Banking Companies and Their Credit Practices* 2-4, 29-31, 43-46 (1940).

¹¹ For background, see Curran 52-55, 59-60; Saulnier, *Industrial Banking Companies and Their Credit Practices* (1940). At the present time, about one-half of the states have statutes regulating industrial loans as such. In most of these states, industrial-loan makers are not only authorized to make the traditional industrial loan, taking the deposit account as security, but they are also permitted to make installment loans at rates higher than general interest rates without using the deposit-account security device. In a number of states, industrial lenders are permitted to make installment loans under the provisions of installment loan laws applicable to banks generally. For a fuller discussion, see Curran 54-60, 141, 143, 204-19.

Credit Unions. Credit unions were organized in the early part of the twentieth century as a source of credit for consumers. They were then, as they are now, cooperative societies of consumers with a common interest, established to provide for their members a savings facility and a source of small installment loans. Such organizations were not authorized in all states. It was not until after enactment of the Federal Credit Union Act of 1934¹² that the credit-union movement expanded to become a significant participant in the consumer-credit market. Today, most states have laws permitting the formation of credit unions. These regulatory statutes authorize credit unions to make loans repayable in installments at rates of interest in excess of those permitted by general interest laws.¹³

Retail Installment Sales Credit. By the 1920's, retail installment sales credit—the prototype of contemporary retail sales credit—had emerged. Prior to that time, sales credit was extended by retail sellers, such as grocers and small neighborhood stores, but it was the increase in consumers' discretionary income, together with the growth of the automobile industry and the increase in production of other durable, high-cost consumer goods such as washers, refrigerators, and vacuum cleaners, that provided the impetus for mass marketing of goods on an installment-credit basis.¹⁴

Under a retail installment sales credit arrangement, credit was extended by the seller, and not by a financial institution, to the purchaser, enabling the latter to take immediate delivery of the item purchased and to pay for it thereafter in periodic installments. The privilege of paying for the goods on time cost the purchaser an amount over and above the price of the goods. This excess was often not identified to the purchaser as a separate charge for credit. In addition, the seller usually retained a security interest in the goods sold until the buyer paid all the installments. The seller might sell the credit contract immediately to a sales financing agency for an amount less than the aggregate amount of all installments to be paid under the contract.¹⁵

Sales credit was not considered a loan of money. Consequently,

¹² 48 Stat. 1216 (1934), as amended, 12 U.S.C. §§ 1751-72 (Supp. 1966).

¹³ This is generally 1% per month on the declining outstanding balance, or approximately 12% per year. See Curran 45-52, 141, 143, 194-203.

¹⁴ See generally the four-part study of the Board of Governors, Federal Reserve System, *Consumer Installment Credit* (1957). In particular, see pt. 1 (Growth and Import) and pt. 4 (Financing New Car Purchases).

¹⁵ Automobile dealers, who traditionally have had to finance their own inventories, customarily sold their paper to a financing agency, either a subsidiary of the automobile manufacturer or an independent agency. Although some other retailers financed consumer paper through their own subsidiary financing agencies, they more often dealt with independent agencies. See Kripke, *Inventory Financing of Hard Goods*, 1956 U. Ill. L.F. 580; Skilton, *Cars for Sale: Some Comments on the Wholesale Financing of Automobiles*, 1957 Wis. L. Rev. 352.

retail installment sales credit was not subject to any statutory regulation, such as interest and usury laws, other than those imposed on sales transactions generally.¹⁶ The seller was considered to have different sales prices for goods—one price if the purchaser paid cash, and a higher price if the purchaser deferred payment.

In 1935, Indiana enacted the first legislation regulating retail installment sales credit, but by the close of World War II, only a few additional states had moved in this direction.¹⁷ Most such legislation has been enacted since 1957.¹⁸ The matters that are regulated by retail installment sales credit statutes vary. Some acts apply to the credit sale of automobiles only;¹⁹ some apply only to consumer goods other than automobiles; others apply to both automobiles and other consumer goods. All such statutes require that information relating to the purchase price of the item and to the cost of financing be set forth in the retail installment sales credit contract. Many statutes regulate the maximum amount of the finance charge and related matters, such as late charges and refunds. Many prohibit the inclusion of certain types of contractual provisions relating to the creditors' remedies.²⁰ A number of states require licensing of finance agencies that purchase retail installment sales credit contracts. As a rule, however, there is no regulation of the terms of the transaction by which the contract is transferred by the original seller to a financing agency.²¹

Provisions of retail installment sales credit acts were originally drafted to regulate the traditional one-item or one-sale contract. Under this arrangement, when a debtor made a new purchase, a new contract

¹⁶ The Arkansas Supreme Court refused to continue to apply the "time-price doctrine" to retail installment sales contracts in 1952. In 1963, the Nebraska Supreme Court characterized as interest the finance charges authorized under the Nebraska Retail Installment Sales Act of 1959. For a fuller discussion of the time-price doctrine and the Arkansas and Nebraska exceptions, see Curran 13-14, 83-90. For arguments pro and con about the rationality of the doctrine, see Senate hearings on Truth-in-Lending Bill, *supra* note 1.

¹⁷ Those states were Maryland, Massachusetts, Michigan, and Wisconsin. In 1947, Connecticut and Pennsylvania enacted similar legislation. 1 CCH Instalment Credit Guide ¶ 35 (1966) provides a quick reference for the effective dates of such legislation.

¹⁸ See *ibid.*

¹⁹ In 1951, the Federal Trade Commission promulgated trade-practice rules regulating the sale and financing of motor vehicles. It was stated that it was an unfair trade practice (a) for the seller or financing agency to make misleading or false statements to the buyer about financing an automobile; (b) for the seller to fail to give specified information about the cost of financing to the buyer; (c) for the seller to permit the buyer to execute the credit contract in blank; and (d) for the seller or financing institution to make purchase of insurance from a specified insurer a condition for granting credit. 16 C.F.R. § 197 (1960). See Note, Protection of Automobile Installment Buyers: The FTC Steps In, 61 Yale L.J. 718 (1952).

²⁰ For a comparison of various statutes, see Curran 91-123, 254-329, 348-78.

²¹ As to restrictions on dealer's reserve, see Curran 113-15. As to transferee of seller as holder in due course, see N.Y. Pers. Prop. Law §§ 302(9), 403(3)(a) (McKinney Supp. 1966); Mass. Gen. Laws Ann. ch. 255, § 12C (Supp. 1966).

would be executed covering that purchase only, or consolidating prior and new purchases. In recent years, new types of arrangements, such as revolving-credit and add-on contracts, permit the buyer to add new purchases to his existing contract. These new devices are not necessarily regulated under old retail installment sales credit acts. When they are, special provisions relating to disclosure and finance charges are usually added to such acts to take into account the special characteristics of these new arrangements.²²

Role of Commercial Banks. Commercial banks played a minor role in the consumer-credit market prior to the 1930's. Since then, their share of the market has increased from less than 25 per cent of outstanding consumer installment debt in 1939 to more than 40 per cent by the third quarter of 1966.²³ Today, banks participate in the market both as direct lenders to consumers and as purchasers of consumer retail installment sales credit paper. Although banks engage in sales financing and are subject to provisions in retail installment sales credit acts applicable to sales financing agencies, they are not usually required to be licensed.²⁴ As direct lenders, banks encountered difficulties similar to those which other lenders encountered with general interest and usury laws. Banks considered maximum rates permitted under those statutes to be too low to yield an adequate return on small installment loans. Consequently, in most states an exception was made to general interest laws in order to permit banks to charge consumers higher interest rates for such loans.

The exception is embodied in statutes usually referred to as installment loan laws. Provisions designating lenders as eligible to extend credit under such laws vary from state to state. In some states, these laws are applicable only to certain categories of lenders, such as financial institutions regulated by the state; in others, any person or organization is permitted to take advantage of the more liberal statutory interest maximum as long as he otherwise complies with the provisions of the act. Eligible classes of lenders under installment loan laws in all states include banks, however.²⁵ Despite their variations, they all permit authorized lenders to charge a rate of interest in excess of that permitted under the general interest laws. To qualify under the law, loans must be less than the maximum principal amount specified in the statute and must be repayable in periodic installments.²⁶

In recent years, banks have experimented with making available

²² See generally Curran 93, 98-100, 102.

²³ 52 Fed. Reserve Bull. 1092 (1966). See also American Bankers Association, *The Commercial Banking Industry, Commercial Banks and Consumer Credit* 162-89 (1962).

²⁴ Curran 115.

²⁵ See *id.* at 65-68, 226-43.

²⁶ *Id.* at 69-75, 226-43.

to consumers check-credit loans, revolving-credit accounts, and line-of-credit arrangements. Few states have specific regulations covering such innovations, but authority for them may be inferred from the terms of the installment loan law.²⁷

Home-Improvement Loans. Although home-improvement loans may usually be made under the general provisions of installment loan laws, and credit extended by home-improvement contractors may be subject to the general provisions of some retail installment sales credit acts, many states have special statutory provisions applicable to home-improvement financing.²⁸ The expansion of the home-improvement credit market was substantially accelerated by the passage of Title I of the National Housing Act, under which the Federal Housing Commissioner is authorized to insure unsecured loans made for the purpose of repair, alteration, or renovation of residential real property.²⁹ Loans may qualify for insurance only if the requirements relating to maximum finance charge, duration, and amount of loan established by the act are met.³⁰

In order to take advantage of Federal Housing Administration (FHA) insurance, however, the lending institution must also comply with state laws. Although any lender eligible to make loans under a state installment loan law may usually make FHA home-improvement loans, some financial institutions, such as savings and loan associations, are prohibited by statute from making such loans. Consequently, statutes have been enacted in most states permitting such institutions to make loans complying with FHA requirements.³¹ Furthermore, in those states in which installment loan laws impose more restrictions on loans than are specified in the National Housing Act, special exceptions are made for FHA-insured home-improvement loans.³²

Effects of Piecemeal Legislation. As briefly sketched in the preceding paragraphs, the pattern of enactment of consumer-credit legislation approximated that of the development of the market. As the market grew, and as new types of consumer-credit arrangements were created, legislation was enacted applicable to those arrangements or to new participants in the market. Prospective participants in this market supported and often sponsored such new legislation since the restrictions imposed by general usury laws prevented them from making small installment loans. Consequently, the enactment of consumer-loan

²⁷ Id. at 76-79.

²⁸ A small number of states regulate home-improvement financing in a separate statute. Id. at 93-94.

²⁹ 68 Stat. 596 (1954), as amended, 12 U.S.C. § 1715k (Supp. 1965).

³⁰ 48 Stat. 1246 (1934), as amended, 12 U.S.C. § 1703 (Supp. 1965). See also 24 C.F.R. § 201 (1966); Curran 63-64.

³¹ Id. at 60-65, 220-25.

³² Id. at 75-76.

statutes was a process of successively carving out exceptions to the existing interest and usury laws. This new legislation, however, was not formally related to, or integrated with, statutes previously enacted. The predictable outcome of this piecemeal legislation was the accumulation of the numerous statutes still in effect in each state—all relating to the consumer-credit market, but each regulating a different class of credit arrangement.

The primary function of consumer-loan legislation was to relax the controls imposed by what was essentially a price-fixing statute, *i.e.*, the general interest and usury law. Many provisions in such statutes that seem to regulate other matters are simply dealing with some aspect of the process of regulating credit cost.³³ However, some statutes, and small loan laws in particular, also regulate, in a limited way, matters other than maximum credit cost.³⁴ Lenders already in the market, to the extent that they resisted such enabling legislation, did so at least partly out of a desire to minimize competition. This resistance also materially shaped the nature of the legislation and its impact on the market. Legislators tended to authorize different maximum rates for different types of loans and lenders. As a result, some lenders who operated under statutes permitting high loan rates had almost exclusive access to certain segments of the market.³⁵

Regulation of retail installment sales credit succeeded the emergence of that type of credit by more than thirty years in most states. As noted above, retail installment sales credit was not subject to interest and usury laws. Since prospective participants were not excluded from the market by any existing regulation, they did not pressure for legislation as prospective lenders had to do. Whereas consumer-loan legislation was initially a response to pressure for broader participation and, in some measure, for more competition, in the market, retail installment sales credit legislation was essentially a response to pressure for elimination of abuses occurring within an unregulated market.

Imposition of a duty to disclose specified information relating to the cost of credit was the common characteristic of all retail installment sales credit legislation. Additional controls, such as ceilings on finance

³³ For instance, there are provisions relating to refunds upon prepayment of loans, to refinancing, and to maximum duration of loan.

³⁴ *E.g.*, advertising. See Curran 35-42, 50-52, 58-59, 74-75.

³⁵ *E.g.*, licensed small loan lenders, in particular. It would not have been an entirely unreasonable experiment to have allowed full competition by authorizing rates for all lenders in line with those permitted under small loan laws or by eliminating ceilings altogether. The resistance of lenders already in the market was not the only operative factor impeding such a move. The almost religious devotion to long-established general interest ceilings on the part of the community should not be underestimated as a significant factor. For further discussion of ceilings, see Curran 158-66, 194-219, 226-43.

charges and the prohibition of certain contractual provisions, never were included in such acts in the absence of disclosure provisions—although the reverse was often the case.³⁶

The imposition of rate controls in retail installment sales credit legislation is, in a sense, a form of disclosure—not effective credit price control. As no attempt is made in such acts to regulate the price of the item purchased, the seller is at liberty to increase its cost and thereby insure a particular yield on the sale. In sales situations where the buyer is unable to compare prices and related information, the imposition of finance-charge ceilings, even coupled with the disclosure of the cash price of the item sold, is of questionable value as a method of price control. As a result, it may be viewed as a control on the maximum amount that may be stated to be finance charges.

III. COMPARISON OF STATUTORY PROVISIONS REGULATING CONSUMER CREDIT

Statutory provisions regulating both loans and credit sales have, over the years, become increasingly similar in form and substance, despite differences in their initial objectives and ultimate market impact. This section will examine the similarities and differences in these provisions.

Laws regulating consumer-credit arrangements exist in all states.³⁷ As noted above, large quantities of statutory materials deal with different types of consumer-credit arrangements and with different phases of the consumer-creditor relationship. Statutes tend to be specialized to particular consumer-credit arrangements that are classified not only on the basis of the characteristics of those arrangements, but also on the basis of the identity of the credit institution. Thus, small loan acts apply to consumer loans made by small loan licensees; installment loan laws usually apply to consumer loans made by banking institutions; and retail installment sales credit acts apply to consumer credit extended by sellers of goods or services. Special statutes regulate consumer loans made by credit unions, savings and loan associations, industrial banks, and pawnbrokers. A few statutes, however, regulate a particular aspect of the consumer-creditor relationship without being restricted to specific arrangements. Credit-insurance laws and general disclosure laws, for example, apply, with some exceptions, to consumer-credit arrangements generally, without regard to the usual classifications established for the purpose of statutory regulation.

The specialization of legislation to particular arrangements has resulted in the now characteristic fragmentation of statutory regula-

³⁶ See generally *id.* at 91-123.

³⁷ *Id.* at 140-43, 254-55.

tion of the consumer-credit market. In spite of this, a comparative analysis of that legislation reveals two significant facts. First, among different jurisdictions there are substantial similarities in statutory provisions regulating the *same* types of credit arrangements. Second, in any given jurisdiction, and among jurisdictions, there are similarities in statutory provisions regulating *different* types of credit arrangements insofar as such provisions actually regulate the same aspects of the consumer-credit process. Terminology often tends to obscure such similarities.³⁸

Although differences exist among jurisdictions in respect to items that one would expect to be varied, such as the amount of the ceiling specified for finance charges, the basic nature and scope of the regulation of such charges are usually the same; differences tend to be in degree rather than in character. A shift in emphasis of regulation from one aspect of the consumer-creditor relationship to another is the basis for differences observed in legislation covering different arrangements. The incidence of regulation of certain phases of the consumer-creditor relationship may be higher for one class of arrangements than for others. For example, the emphasis in retail installment sales credit acts has traditionally been on disclosure to the consumer of information relating to the nature and scope of the obligation and of the cost of credit. On the other hand, emphasis in installment loan laws has been on control of the rate of the loan charge. Consequently, as noted above, all installment loan acts set maximum rates of charge, and all retail installment sales credit acts require disclosure. In addition, some installment loan acts contain provisions requiring disclosure, and a number of retail installment sales credit acts contain provisions limiting finance charges.³⁹ When regulation of the same subject matter occurs in acts that apply to different classes of arrangements, similarity of treatment may be observed.

A survey of consumer-credit legislation also indicates that, if the coverage of laws regulating different classes of arrangements continues to expand at the rate that it has in the past, and along the same patterns as in the past, such laws will increasingly deal with the same aspects of the consumer-creditor relationship, and the substance of regulation contained in such laws will become increasingly the same. An example of the trend to similarity in regulatory treatment of different arrange-

³⁸ For example, provisions regulating minimum refunds of unearned finance charges are the same in a variety of consumer-credit laws. Generally, the minimum refund is based on the Rule of 78 (computation formula) in retail installment sales credit acts, id. at 288-92, in installment loan acts, id. at 226-43, in some industrial-loan acts, id. at 204-19, and in small loan acts that permit precomputation of interest. See id. at 167-69 for a collection and summary of statutes containing prepayment provisions.

³⁹ For a discussion of rate ceilings in retail installment sales credit acts, see id. at 266-69; for disclosure provisions in installment loan acts, see id. at 229-33, 235, 238, 240-43.

ments may be seen in revisions relating to the computation of loan charges in small loan acts.

A characteristic provision of state laws patterned after the Uniform Small Loan Law is that loan charges must be computed from month to month on the basis of the declining principal balance of the loan. During the last decade, however, many small loan acts have been amended to permit lenders to precompute loan charges.⁴⁰ A provision that authorizes precomputation is usually accompanied by other provisions requiring refunds of unearned charges in the event the borrower prepays any loan, and by provisions authorizing the assessment of delinquency and deferral charges. The precomputation authorization and the supplementary provisions make the substance of the interest-calculation sections of small loan laws comparable to the finance-charge-calculation provisions found in most retail installment sales credit acts and installment loan acts.

A comparative analysis of consumer-credit statutes, therefore, reveals that there exists an overall trend in consumer-credit legislation toward a uniformity in regulation of the same aspect of the consumer-creditor relationship, for all classes of arrangements and for all creditors participating in the consumer-credit market. This trend, however, is obscured by the fragmented nature of consumer-credit legislation.

IV. THE NATURE OF STATUTORY CONTROLS IMPOSED IN CONSUMER-CREDIT LEGISLATION

The fact that the similarities described above exist among state statutes regulating consumer credit simplifies review and analysis of the nature of the controls that those statutes impose. It is unnecessary, for purposes of the general discussion here, to deal, except by way of example, with the innumerable minor⁴¹ variations in the provisions of those statutes.

Any statute specialized to consumer credit regulates one or more of the four following aspects: (1) the access of creditors to the market; (2) the information the creditor must give to the consumer; (3) the terms and conditions of the consumer-credit arrangement; and (4) the remedies of consumer and creditor when either has not satis-

⁴⁰ Under such a provision, the lender may compute all loan charges at the time that the loan is made, based on the assumption that the loan will be repaid in accordance with the agreed schedule of installments. In addition, he may add these loan charges to the principal amount of the loan and divide that figure by the number of scheduled installments in order to determine the amount of each installment payment.

⁴¹ The variations are not "minor" for participants in the market. "Minor," as used here, is intended to mean that the basic nature and scope of controls can be dealt with without dealing with all the variations of each type of control. For example, controls on cost of credit can be discussed without dealing with all the variations in maximum-finance-charge provisions in all states.

factorily performed his obligations under the consumer-credit arrangement.⁴²

A. *Access to the Market*

Access to and participation in the consumer-credit market are regulated formally by licensing provisions and informally by maximum finance charges. In some cases, limitation on access restricts competition among responsible creditors; in other cases, it excludes marginal or irresponsible operators.⁴³

1. *Licensing.* Licensing is required of credit institutions that want to make loans under the authorization of small loan laws and, in some states, of credit institutions that want to engage in the business of purchasing retail installment sales credit paper from sellers.⁴⁴ The extent to which licensing requirements operate to exclude potential participants from any portion of the market depends, of course, on the conditions imposed upon securing a license.

When the licensing requirement is primarily a revenue-raising device, potential licensees often need only file the appropriate forms and pay the required fee. The fact that a creditor possesses such a license may mislead the public into thinking that the state licensing agency considers the licensee to be competent, honest, qualified by experience, or financially able to engage in the licensed activity. In fact, however, issuance of the license itself does not connote any prior investigation by the licensing agency, and, consequently, it cannot be considered as the agency's endorsement of the licensee's character and fitness.

When licensing provisions require the licensing agency to determine that the applicant has met enumerated qualifications, and when those qualifications are something more than paying a license fee and filing the required forms, then participation in the regulated consumer-credit activity is more likely to be restricted. Qualifications for securing licenses may relate to the character and fitness of the applicant as indicated, in some measure, by the pattern of his past activities. Under such conditions, the marginal operator, possessing inadequate or dubious qualifications, is presumably excluded from participating in the

⁴² In a sense, regulation of the terms and conditions of the arrangement also operates to regulate rights and remedies available to the contracting parties. The remedies referred to in item (4) are those rights and remedies that arise by operation of law and are dealt with by the statute without regulation of the stated terms or conditions of the contract, e.g., rights of creditor and debtor upon repossession of goods.

⁴³ See Felsenfeld, *Some Ruminations About Remedies in Consumer-Credit Transactions*, p. 542 *infra*.

⁴⁴ In a very few states, designated nonlicensees may make loans under the provisions of the small loan law. See, e.g., Mass. Gen. Laws Ann. ch. 140, § 114A (Supp. 1966). As to licensing of sales financing agencies, see Curran 115-77, 323-29.

market as a licensee under the particular act in question.⁴⁵ He may, however, be able to engage in a similar activity in a segment of the market that is not so regulated.

Additional qualifications, set forth in licensing provisions of small loan laws, relate, not to control of legitimacy of operation, but to allocation of market share. Under such laws, the licensing agency must be satisfied "that allowing such applicant to engage in [the] business [of small loans] will promote the convenience and advantage of the community in which the licensed office is to be located"⁴⁶ This provision has been applied to refuse licenses to organizations which might otherwise qualify on the basis of "financial responsibility, experience, character, and general fitness . . . such as to command the confidence of the public and to warrant belief that the business will be operated lawfully, honestly, fairly, and efficiently, within the purposes of [the] . . . Act"⁴⁷

2. *Maximum Finance Charges.* When small loan laws were first enacted, the "convenience and advantage" test operated to exclude qualified but unlicensed lenders from participating in the consumer-loan market, because only the licensees could charge interest rates above those provided in general interest laws. When consumer-loan legislation was thereafter enacted to permit other lenders to make consumer loans at rates higher than general interest ceilings, the effect of small loan licensing provisions on the market was modified. Non-licensees were still prohibited from extending credit at the high rates authorized under small loan laws, but they were no longer completely excluded from participating in the consumer-loan market.⁴⁸

When statutory ceilings on interest, as well as restrictions on the maximum amount of loans, are not the same for those engaged in the market, they operate to restrict participation and, consequently, competition. As noted in Section II above, the consumer-loan market has been made more accessible to new participants as a result of the enactment of a series of statutes by which interest restrictions under general interest laws were relaxed for specified classes of lenders. Any person or organization ineligible to make loans under any of those statutes is, as a practical matter, also precluded from engaging in the business of making consumer loans to the extent that general interest ceilings

⁴⁵ The extent to which such licensing requirements exclude potential participants from the market depends, however, not only upon the conditions to be satisfied but also upon the energy of, and resources available to, the licensing agency in exercising the powers granted to it.

⁴⁶ Uniform Small Loan Law § 4(b) (Tent. Draft No. 7, 1942).

⁴⁷ *Ibid.*

⁴⁸ Sanctioning provisions aim at excluding participants by permitting licensing agencies to revoke licenses of those who violate the spirit or letter of the act.

produce insufficient yields on such loans. It may, however, engage in credit-sales financing.

In summary, the statutory provisions, noted above, that affect access to and participation in the consumer-credit market produce a curious effect. They do not completely exclude marginal operators from the market, but they do reduce competition among responsible credit institutions. To the extent that the objective of such provisions is to exclude entirely from the market the organization that engages in objectionable activities, it succeeds, under the best conditions, in excluding any such operator only from engaging in the activity which is subject to the licensing requirements. The operator may still engage in a consumer-credit activity for which a license is not required and which may or may not be otherwise regulated by statute.

B. *Exchange of Information*

Consumer-credit laws require that specified information be provided by the creditor to the consumer disclosing the cost and terms of the consumer-credit arrangement.⁴⁹ The purpose to be achieved by so informing the consumer depends upon the nature of that information and the circumstances under which it is to be disclosed.

Disclosure provisions in consumer-credit laws have two objectives. The first is to provide the consumer with information that will enable him to make an intelligent appraisal as to which of the available credit arrangements is best suited to his needs and objectives or, at the least, to make an intelligent decision as to whether he should undertake a particular credit obligation. The second is to provide a statement of the terms and conditions of a consumer-credit obligation already incurred and to inform the consumer of his rights and duties under that contractual arrangement. The extent to which the information so provided can be or is effectively utilized by consumers is a matter for conjecture.⁵⁰

A number of statutes require creditors to provide the consumer with information relating to contract terms prior to the consummation of the agreement.⁵¹ A few such statutes require the creditor to give the consumer a written statement of credit charges.⁵² Such provisions,

⁴⁹ Consumer-credit laws, most notably small loan laws, regulate disclosure of such information partly by establishing controls on advertisements. Curran 38, 58, 74. Under such regulations, the creditor is not, however, required to disclose specified information. He is required to conform to statutory requirements only if he *elects* to disclose certain information in his advertisements.

⁵⁰ For a general discussion of disclosure, see Jordan & Warren, *Disclosure of Finance Charges: A Rationale*, 64 Mich. L. Rev. 1285 (1966).

⁵¹ See Curran 39.

⁵² See, e.g., Hawaii Rev. Laws § 191A-2 (Supp. 1965); N.H. Rev. Stat. Ann. § 399-B:2 (Supp. 1965); 16 C.F.R. § 197 (1960).

however, do not guarantee that the statements will be given to the consumer under circumstances that will permit him to reflect upon their contents prior to committing himself to a particular contract.

If the value of precontractual written statements is questionable, then statutory provisions that make the contract form itself a disclosure instrument are even more questionable. All retail installment sales credit acts and many consumer-loan laws require that certain information be included in the contract form. Under retail installment sales credit acts in particular, such contracts are expected to perform the double task of disclosing to the consumer the nature of the arrangement before contractual obligations are incurred and of being a written memorial of the obligation after the contract has been executed. For example, retail installment sales credit acts provide that the installment sales contract be identified as such and that it include an itemization of charges, including the cost of the goods or services, the cost of the finance charge and other charges, the amount and due date of each installment, and the number of installments. The creditor may also be required to inform the consumer of rights and obligations arising by operation of law, such as the consumer's right of redemption in case of repossession of the goods and his obligation to pay any deficiency if the sale of the repossessed goods does not cover the balance owing under the contract. Such information must be stated conspicuously in the contract—often in bold-face type or in capital letters. The creditor is often required to include in the contract clear instructions to the consumer not to sign it until he reads it thoroughly and it is completely filled in. The legal effect of an acknowledgement may often be stated in the contract.

Small loan laws require inclusion of important items, such as the amount of the loan and the credit cost, whereas bold-face type and special legends are not usually required. In addition, however, the lender is, under most such acts, required to deliver to the borrower along with the executed contract a statement setting forth other significant terms of the arrangement.⁵³

If provisions in the contract form are to disclose information sufficient to permit the consumer to make an intelligent decision, then he must be given an opportunity not only to read the form but to reflect upon the information provided in it. In most cases, negotiation of terms may seem to the consumer to be complete when the contract is presented to him for his signature. He therefore believes that the delivery of the contract form is merely part of the execution of the formal legal documents which evidence the negotiated agreement. For a disclosure requirement to have practical meaning, it is probably

⁵³ For provisions in other consumer-loan laws, see Curran 204-19, 226-43.

necessary to require that the consumer be provided with (1) reasonable time to read the contract carefully if he so wishes, and (2) a clear statement that the unexecuted contract is given to him not only for the purpose of signing it, but also for use in deciding whether to undertake the obligation.

One of the most significant developments in precontractual disclosure was the inclusion in the Massachusetts Retail Installment Sales Act of 1966 of a provision applying to door-to-door credit sales.⁵⁴ This provision gives the consumer a specified period of time after signing the retail installment sales credit contract and before delivery of "a substantial part" of the goods or services during which he may notify the creditor that he does not intend to assume the obligation represented by the contract. If the consumer so informs the creditor, he is relieved of all obligations under the contract.⁵⁵ If such a provision attended all credit-sale transactions and insured proper notice to the consumer of his right to cancel, there would be true meaning to the precontractual disclosure requirements currently in force in most acts.⁵⁶ The significance of the Massachusetts provision, when coupled with standard disclosure provisions, lies in the fact that the consumer is assured by statute of having sufficient time and information to make a reflective decision as to whether he should incur a specific obligation.

Retail installment sales credit legislation has emphasized the precontractual disclosure function of the contract form. However, many consumer-credit laws, including retail installment sales credit acts, also require that the executed contract form include all the terms and conditions of the arrangement, and that the creditor deliver to the consumer a copy of the executed contract. These requirements are intended to insure that the consumer has a complete statement of his obligation. It is unlikely, however, that many consumers actually read these documents. The consumer has, or thinks he has, a general notion of the nature of his obligation and probably expects to refer to the contract only if a dispute arises. Moreover, even if the consumer were to read the contract, he might have difficulty understanding some parts of it and would probably be unaware of the legal implications of many of its provisions. Knowledge of the contractual terms, or of their legal implications, becomes crucial for the consumer when his rights under the

⁵⁴ Mass. Gen. Laws Ann. ch. 255D, § 14 (Supp. 1966).

⁵⁵ The consumer has until 5:00 p.m. on the next business day to give notice of cancellation.

⁵⁶ See, e.g., Mass. Gen. Laws Ann. ch. 255D, § 9D (Supp. 1966). The notice to the consumer is to be included in at least ten-point type under the heading "Notice to Buyer" and above the place where the consumer is to sign the agreement. If the seller takes a security interest in the goods, five other items are also included in this notice. If he takes no security interest, three other items are included.

contract, in order to be preserved, must be seasonably exercised.⁵⁷ In order to solve this problem, many statutes, particularly retail installment sales credit acts, require special legends and notices to be set forth conspicuously in the contract.

Generally, legislators must make a value judgment as to which disclosure provisions ought to be emphasized, since any contractual provision may, under certain circumstances, be of importance to the consumer. The difficulty of selection is compounded by the fact that the contract form is often expected to serve also as an instrument for precontractual as well as postcontractual disclosure. Different information is necessary for each type.⁵⁸ Some jurisdictions have placed too much emphasis on too many disclosure provisions. Such an approach, however, tends toward a point of marginal utility.⁵⁹

In addition to requiring information to be disclosed in the contract form, statutes also require the creditor to provide certain information to the consumer during the term of the contract. In some cases, such information (*e.g.*, periodic statements of account) is merely a method of notifying the consumer of the extent to which he has performed his contractual obligation.⁶⁰ Other information is intended to apprise the consumer of contract rights that he may wish to exercise. For example, the transferee of the credit obligation may be required not only to notify the consumer of the transfer of the obligation itself, but also to inform the consumer that, in order to assert against the transferee a claim arising out of the original transaction, he must notify the transferee of such claim within a specified period of time.⁶¹

Although statutory disclosure requirements impose a major burden on a contract, the usual function of which is only to state in full the terms and conditions of the parties' agreement, the selection of the contract form as the means of supplying precontractual and postcontractual disclosure is not necessarily inappropriate. However, if the document is to serve these functions, statutory provisions must go further than merely making the contract form the repository for a collection of disclosure provisions. At a minimum, a distinction should be made between information that is relevant for precontractual dis-

⁵⁷ For example, in order to assert against the transferee of the seller claims held against the seller, the consumer must, under the New York statute, notify the transferee of those claims. N.Y. Pers. Prop. Law §§ 302(9), 403(3)(a) (McKinney Supp. 1966). Another example is the buyer's right of redemption when goods have been repossessed. See Curran 111-12.

⁵⁸ For example, the amount of the credit charge is important to the consumer while he is contemplating assuming a credit obligation. After execution of the contract, however, it is not as important as information relating to timely assertion of rights against a transferee of the credit contract.

⁵⁹ See Curran 293-300.

⁶⁰ *Id.* at 39, 109.

⁶¹ See, *e.g.*, N.Y. Pers. Prop. Law §§ 302(9), 403(3)(a) (McKinney Supp. 1966).

closure and that which is relevant for postcontractual disclosure. The consumer should be made aware of this distinction and the purpose for which these provisions are included in the contract. Finally, if precontractual disclosure is to be provided by way of the contract form, statutory provisions must assure that the consumer not only recognizes its purpose but also, if he wishes, has an opportunity to utilize the information disclosed.

C. Terms and Conditions of the Arrangement

As a general rule, negotiations between the parties to a consumer-credit arrangement deal with only a portion of the matters covered in the final contract. Negotiable terms usually relate to matters that are peculiar to each arrangement, such as the principal amount of the obligation, the duration of the contract, the amount and due date of installment payments, and, in some cases, the inclusion of insurance protection and a provision for collateral security. The cost of credit and other terms which deal primarily with the rights of the creditor and the duties of the debtor are not usually subject to negotiation.

Consumer-credit contracts are standard, printed documents with blank spaces for the negotiated items noted above. Standardized, preprinted contract forms save creditors time and money. Consumer credit is generally marketed and serviced on a mass basis like any high-volume, low-unit-price item of standard specifications. Under such circumstances, contract negotiations with the consumer must be expeditiously carried out by low-priced, nonprofessional personnel representing the creditor. Such personnel need only know which standard form to use for the particular arrangement and how to fill in its blank spaces in order to prepare it for execution by the parties. Terms of consumer-credit arrangements, when standardized, permit ease of administration and extend cost savings to the consumer. Moreover, standardization facilitates the original creditor's sale of credit contracts to financing agencies.

The use of "boilerplate" contract forms also operates, however, to the disadvantage of the consumer. Under present market conditions, and in spite of disclosure provisions noted in the preceding section, the consumer does not bargain with the creditor in respect to contract terms, but merely signs the standard contract as offered. Standard printed contracts favor the creditor and protect his interests to a much greater extent than if he had to bargain over terms. Consumer-credit contracts are prepared by expert legal counsel on behalf of the creditor and provide him with the maximum amount of protection that the law permits.

It is not surprising that the drafter of the contract forms provides every possible protection for the credit institution without comparable

concern for the consumer. Such documents are designed to be used in all consumer-credit arrangements, regardless of the character or credit-worthiness of any individual consumer. The form contract also provides the creditor with an arsenal of remedies, thereby permitting him to extend credit with minimal precontractual credit investigation that might otherwise be required.

It would seem that the consumer's only leverage against the creditor is to threaten not to enter into the arrangement. In many cases, however, such a power may be illusory. The loss of one customer may not be as significant a factor to the creditor in the operation of his business as the decision not to undertake that particular credit obligation may be to the consumer. Theoretically, of course, the consumer may take his business elsewhere. However, with the increasing standardization of credit contracts, it is unlikely that competitors will offer the consumer significantly different terms, with the possible exception of credit cost.

Finally, the execution of standard contracts by the creditor's non-professional representative further limits the consumer's ability to bargain for contract terms or for changes in printed provisions. The representative is often as ignorant of the significance of printed contract terms as the consumer, and is not usually authorized to make changes in those portions of the contract. Consequently, in the present consumer-credit market, the creditor, for all practical purposes, controls all the terms of the contract other than those that must be adjusted for each arrangement.

Provisions in consumer-credit contracts deal primarily with the consumer's contractual duties and the rights and remedies of the creditor if the consumer breaches.⁶² Statutory regulation of the content of such contracts reflects a recognition of the consumer's inability to adequately protect his interests. Such regulation is intended to alleviate harsh effects occasioned by enforcement by some creditors of contract terms that are not the product of bilateral negotiations and that legislators seem to think unfair.

Although consumer-credit contract terms are often standardized, they are not established by statute; they are, however, regulated in two principal ways. First, some restrictions are imposed on contract provisions relating to matters that are the subject of negotiation, such as the amount and due date of installments. Subject to such restrictions, the creditor and consumer are free to modify these terms.⁶³ As noted

⁶² Contract provisions do not reinforce remedies of the consumer. In fact the reverse may be the case. For example, some retail installment sales credit contracts have provided that the consumer, by signing the document, agrees not to assert against the original seller or his transferee any claims arising out of the underlying transaction.

⁶³ For example, a statute may prohibit a "balloon" installment by requiring that all

above, most provisions in consumer-credit contracts relate to the duties of the consumer and the rights of the creditor. Consequently, the second type of statutory control over contract provisions is that which prohibits the inclusion of provisions that strengthen the creditor's remedies by enlarging the scope of existing remedies, by restricting debtor's remedies, or by reinforcing the creditor's position in relation to security. Examples of provisions so prohibited include those permitting the creditor to accelerate installment payments for any reason other than the debtor's default; those permitting the debtor to agree not to assert against the creditor or his transferee a right arising out of the underlying transaction; or those permitting confession of judgment. Certain types or amounts of security may also be prohibited. For example, some retail installment sales credit acts prohibit the taking of collateral such as a wage assignment or a lien on real estate. In addition, the creditor may not be permitted to take a security interest in goods other than those that are the subject matter of the underlying sales transaction.⁶⁴

All consumer-loan statutes, and many retail installment sales credit acts, impose ceilings on the amount of finance charges or interest. As noted earlier, these ceilings differ as to various credit arrangements and classes of creditors. Whenever rates are regulated, other matters relating to the cost of credit are also regulated, including methods of calculating charges, special charges, fees, and prepayment credits. It is not easy to assess the practical effect of these controls on the market and on individual contractual arrangements.

It should be clearly understood that statutes setting rate ceilings only limit the amount that a creditor may charge for the extension of credit. They do not purport to fix, or otherwise regulate, the charges made by the creditor. Ceilings are set in order to prevent creditors from charging unreasonably high rates, while permitting rates generally to be fixed by market conditions. The complex pattern of rate controls in many jurisdictions makes it difficult, however, to evaluate the extent to which those ceilings are an effective measure for protecting consumers against what legislatures have declared to be exorbitant charges.⁶⁵ Different ceilings apply to different types of arrangements

installments be substantially equal in amount and period. Amount and number of installments are also affected by statutory provisions limiting the maximum duration of the contract.

⁶⁴ For types of prohibited provisions in retail installment sales credit acts, see Curran 312-22. Generally speaking, statutory prohibitions against certain types of contractual provisions occur with greater frequency in retail installment sales legislation than in consumer-loan legislation. Restrictions relating to security occur more frequently in consumer-loan laws. See, for small loan laws, *id.* at 36-37; for industrial-loan laws, *id.* at 58-59; for installment loan laws, *id.* at 73-74; and for credit-union loan laws, *id.* at 50-51.

⁶⁵ "Unreasonable charges" are those which the legislature labels such. Legislatures

and classes of creditors. Some arrangements, such as retail installment sales credit contracts, may not be subject to any ceilings. Consequently, the sharp operator, against whom the consumer is supposedly being protected, may, in many jurisdictions, participate in the market subject to no rate controls at all by electing to extend credit of a type that is subject to no ceiling.

Ceilings do not always function simply as outside limits to credit charges. In some cases, they may in fact approximate what would be the going rate absent any rate controls. Sometimes, because of the character of the market, the ceiling tends also to shape the amount of the going rate in a manner not unlike what a rate-fixing control would do. In general, ceilings will exceed going rates at any given time. The problem is that the establishment of ceilings presupposes a pattern of price behavior that has not existed in the past and does not now exist in the consumer-credit market. The absence of rate controls, other than the ceilings, indicates that consumer finance charges are expected to be responsive not only to fluctuation in the cost of money generally but also to competition among creditors within the consumer-credit market and, in some measure, to the individual consumer-creditor bargaining process.

Competitive pricing of credit charges among creditors cannot be expected to occur, however, as long as consumers as a group remain indifferent to credit costs. This lack of consumer sensitivity has meant that the cost of credit has not been a significant factor influencing selection by the consumer of one credit arrangement over another. Other factors, such as ease in obtaining credit, liberality of repayment terms, and availability of alternative arrangements, tend to shape the consumer's decision to undertake a particular arrangement. As a result, competition for customers is directed at these matters rather than at credit cost itself.⁶⁶

Although other factors may be involved in producing market rates, consumer pressure for lower rates does not operate to prevent them from drifting toward statutory ceilings. It does not necessarily follow, however, that rates should be regulated in some other fashion or that they should not be regulated at all. Ceiling rates may be an entirely appropriate way to deal with the problem of these creditors

seem to arrive at criteria for deciding upon ceilings from information about going rates in the market and ceilings in other jurisdictions. The determination is, in many cases, based on inadequate and conflicting statements as to what going rates are, and is not based on criteria that are entirely objective or fully articulated.

⁶⁶ For a full discussion of consumer sensitivity to rates, see Juster & Shay, *Consumer Sensitivity to Finance Rates: An Empirical and Analytical Investigation* (1964); Mors, *Consumer Credit Finance Charges: Rate Information and Quotation* (1965). Both were products of a consumer-credit study conducted by the National Bureau of Economic Research.

who, if given the opportunity, would charge rates that are far in excess of market rates. If, however, ceiling rates, rather than broader rate control, are justified on the basis that going rates will always be reasonable because they reflect competitive pricing in the market, then other controls may be necessary to insure that the market produces that result.

Proponents of uniform precontractual rate disclosure expect to promote competitive pricing by increasing consumer awareness of the credit-cost problem. Present disclosure requirements have, for the reasons noted above, failed to realize this objective. Moreover, as long as such provisions remain in their present form, they will probably continue to fail to foster consumer sensitivity to credit costs. The lack of consumer concern, in turn, tends to reduce price competition among lenders. Furthermore, if statutory controls tend to exclude some creditors from extending certain types of credit, the effect may be to limit the number of alternative arrangements available to the consumer, thereby reducing any gains attained by increasing consumer sensitivity to rates. Consequently, other revisions in existing consumer-credit legislation may be necessary. If other controls are not imposed, existing controls, although ceilings nominally, will continue to take on the characteristics of price-fixing.

D. Regulation of Remedies

Although restriction of creditor remedies is often viewed both as a means of controlling inequitable arrangements and as a means of discouraging extensions of risky credit, statutory provisions restricting creditor remedies or strengthening consumer remedies arising by operation of law are neither numerous nor substantial.⁶⁷ By focusing on creditor remedies that arise by operation of law, many proponents of reform often fail to confront the central issue by confusing the problem of unfairness of an original bargain with unfairness of the creditor's remedies for breach of the bargain. Pressure to weaken such remedies arises primarily because of those cases in which the initial obligation seems particularly unfair to the consumer and where application of creditor remedies can mean substantial economic disruption for the consumer. Care must be taken, however, not to characterize the problem as one arising out of harsh creditor remedies when it essentially stems from abuses occurring in the process of bargain and exchange. In a great number of cases in which the creditor asserts his rights against the consumer, the creditor has a valid claim but the consumer does not. Statutory weakening of creditors' remedies will not remove

⁶⁷ Regulation of contractual provisions is a form of regulation of remedies. See note 42 *supra*, and see generally Felsenfeld, *supra* note 43, at 555-65.

abuses which occur when the creditor takes unfair advantage of the consumer at the inception of the arrangement. Although weakening of remedies may make creditors more cautious about entering the market, it is entirely possible that it may be the responsible creditors that become cautious and not the marginal operators.

A problem arises as to how much contract terms which create or strengthen creditor remedies should be regulated to prevent the creditor from weighting the contract in his favor. It may also be true that modifications need to be made in creditor remedies arising by operation of law. For example, modification of the transferee's rights as a holder in due course may be appropriate to aid the consumer in asserting meritorious claims growing out of the underlying transaction. The necessity for modifying both creditor and consumer remedies must, however, be determined on the basis of an evaluation of why creditor remedies seem harsh and consumer remedies inadequate. The apparent harshness of creditor remedies may often be the manifestation of a problem occurring at a different point in the consumer-creditor interaction than when the creditor asserts his claim. A more effective resolution may be found by dealing with the underlying causative factor and not with manifestation of it occurring thereafter.

V. A CRITIQUE OF CONSUMER-CREDIT LEGISLATION

The aggregate of statutes regulating consumer credit represents an authoritative and formal statement of the standards of conduct to be observed by credit institutions and consumers participating in the consumer-credit market and of the sanctions that may be imposed upon those who fail to comply with those standards. As a formal statement, consumer-credit legislation leaves much to be desired. It is overly complex, often internally inconsistent, rife with surplusage, and otherwise confusing and perplexing because of a lack of systematic order and structure. These inadequacies are in no small measure attributable to the fact that consumer-credit legislation is a conglomeration of numerous distinct pieces of legislation enacted at different times and as responses to apparently different problems. The failure of legislatures to integrate or relate these separate pieces of legislation is not meliorated by the fact that much has emerged from the legislative process reasonably well organized and constructed. Obscurity of provision and absence of overall design are not, of course, peculiar to consumer-credit legislation. In this type of regulation, however, the complexity created by fragmentation has tended to conceal the magnitude of the inadequacies in the substance of the regulation.

Consumer-credit legislation is not only fragmented in form, but is also characterized by differential treatment of functionally similar arrangements of various participants in the market. The latter character-

istics, together with those generated by the fragmentation noted above, are symptomatic of a fundamental difficulty, far more serious than the fragmentation itself; namely, that the nature of the subject matter with which consumer-credit legislation deals has not been clearly apprehended.

Consumer-credit legislation is not unlike other legislation in that, in the long run, it is the instrument by which the community reinforces its policy decisions and value judgments about a particular activity. The expectations of the community about the standards of conduct to which participants in a particular activity are to be held must be based upon some underlying notion about the nature of the process in which that conduct occurs. Such expectations are also shaped by the community's judgment that the continued existence of a process in a particular form and having particular characteristics is beneficial (or at least not bad) and for that reason should be encouraged (or at least tolerated).

Consumer-credit legislation reflects the underlying notions, as muddled as they may be, that the community holds about behavior in the consumer-credit market. It is also evidence of a general failure to conceptualize particular types of credit, the negotiation of specific arrangements, and the performance and enforcement of obligations as integral parts of the general process of the consumer-credit market. Within this market, general characteristics are shared, on the one hand, by all participant-creditors and, on the other hand, by all participant-consumers. For purposes of regulation, conflicts occurring from time to time in the consumer-credit market, and abuses arising out of those conflicts, have been identified as isolated phenomena unrelated to each other or to any unifying concept. Consequently, legislative attempts at resolution of those conflicts have been specialized to the particular phenomenon without reference to the matrix within which it occurs.

It is possible that not only the fragmentation but also the disparities and apparent inconsistencies in consumer-credit regulation might remain, even if all consumer-credit problems were, for regulatory purposes, treated as part of a "process." Differential treatment of participants or arrangements is not, in and of itself, right or wrong. One becomes suspicious about such differences, however, when all of the available evidence suggests that their existence is not the result of a cognitive decision to differentiate based upon intelligent appraisal and analysis of the role of such participants or the function of such arrangements in the consumer-credit market. The differences are, instead, the predictable result of tradition and inertia, perpetuating discrete treatment of credit institutions and credit arrangements.

Even if differences in treatment of participants and arrangements in the consumer-credit market, under appropriate analysis, may be justified, irrelevant statutory prescriptions and sanctions cannot be justified on any basis. In a number of areas, such as disclosure, a consumer-credit statute will require standards of conduct of particular participants in the market that, even if complied with, could not, by any standard of measurement, claim to remedy the problem with which it purports to deal because the regulation itself is unresponsive to the need, inappropriate to the nature of the problem, and consequently meaningless when its practical application is examined.

The irrelevance of specific regulatory provisions may be the consequence of one or more specific evaluative errors. For example, the nature of the abuse that the regulation was designed to correct may be perceived inaccurately; the specific statutory provision may apply the force of regulation to a phase of the process which bears insufficient relationship to an abuse adequately perceived; the statute may specify minimum standards for a class of participants in the market other than those whose activities create or perpetuate the abuse; or the statute may afford protection for a class of participants to whom such protection is not necessary. Although such errors may be the immediate cause for specific incidents of irrelevancy, they are merely indicative of another difficulty that inheres in all consumer-credit legislation; namely, the absence of firmly postulated and clearly articulated objectives for such legislation. It is an underlying and persistent confusion and lack of clarity about the aims and functions of consumer-credit regulation, coupled with a misconception about the nature of the consumer-credit market, that produces statutory provisions characterized by a curious kind of vagueness or unrelatedness to subject matter—a double-vision effect produced by an imprecise superimposition of the image of the legislation over the reality of the consumer-credit market.

Specific statutes now on the books reflect the legislators' uncertainty as to the *effects* that such regulations are intended to produce or at least approximate, largely because they never had any clear idea of the results that they were attempting to achieve. To be sure, one can say that the purpose of any specific regulation is to remedy a particular identified abuse or conflict. However, the determination as to whether a particular activity is an abuse, and if so, how it ought to be rechanneled or eliminated, cannot be debated, let alone decided upon, in the absence of some attempt to relate the activity to the operation of the total process and to articulated over-all objectives for the process. Even though specific areas of regulation, such as the small loan laws, were at one time an appropriate response to defined and well-understood needs, the notions originally relating to those laws have long since

become obsolete because the nature of small loan lending has changed as a result of the development of the consumer-credit market itself. Consequently, those regulations cannot be assumed to be an adequate response to the needs of the market or even a segment of the market, as now constituted.

The consumer-credit market, like any other economic process, is essentially a process of exchange.⁶⁸ The general nature of the exchange is shaped by the objectives and relative bargaining power of each of the parties. Simply stated, the objective of the creditor in any such exchange is to obtain a profit, and the objective of the consumer is to acquire credit for personal nonbusiness purposes. In almost any process of exchange, whether it is consumer credit or otherwise, differential bargaining power exists between the parties. The party in whose favor the balance of power rests is better able to shape the terms of the exchange to his advantage and to enforce rights created by those terms. A differential in bargaining power generally exists because of the inequality of economic resources possessed by the participants to the exchange. Other factors, not necessarily related to economic resources, such as experience and acuity, may also affect the ability of one party to achieve an advantage.

The significant characteristic of the consumer-credit transaction, however, is that there is almost always a substantial balance in favor of the creditor—a balance that gives him the power to shape any exchange to his advantage. The creditor has greater economic resources that permit him to obtain the advice of experts; he has, under the present system of marketing consumer credit, more time to reflect about the specific terms of the exchange prior to the time of contract negotiations with the consumer; and he has more knowledge and sophistication, derived from his own experience and that of others, about how to strengthen his own position in consumer-credit arrangements. Moreover, although the creditor must make a certain number of credit extensions to remain in business, his stake in undertaking any particular arrangement is not as great as that of the consumer: other potential customers available to the creditor are greater in number than are other sources of credit available to the consumer.

Both creditors and consumers possess other characteristics that may affect the way in which they conduct themselves in the exchange. Consumers, as a group, are no more or less well intentioned, responsible, or moral than creditors as a group. In any exchange, one party may, for example, be willing to take advantage of the other by resorting to trickery or falsehoods. The factors accounting for the differential in

⁶⁸ For an excellent discussion of the concept of exchange and its relationship to social process, see Blau, *Exchange and Power in Social Life* 338 (1964).

bargaining power, however, permit the creditor who is prone to irresponsibility or deceit to more readily take advantage of the consumer. Moreover, those same factors make the creditor better able than the consumer to adapt to or neutralize the impact of a single imprudent or unfair exchange.

Another significant characteristic of consumer-credit exchanges is that only a few of the agreed-upon terms are truly the subject of negotiation. Three interrelated factors account for this. First, as noted earlier, consumer credit is marketed on a mass basis, and arrangements have tended to become standardized. Only those terms of the exchange that, by necessity, must be tailor-made for each consumer, such as amount of credit extended and time for repayment, are generally the subject of consumer-creditor negotiation. Doubtless, the cost of consumer credit would become prohibitive if every term of every arrangement were to be negotiated by the creditor and consumer, or their attorneys. Second, the consumer is often so preoccupied with achieving his primary objective of obtaining credit that he does not evaluate any creditor's offer of exchange in terms of whether the benefit sought is to be paid for at a higher price, in terms of dollars and relinquishment of rights, than he perhaps should pay. The lack of sensitivity to contract terms tends to prevent the consumer from considering alternative arrangements that may be available to him in the market, limited though those alternatives may be. Third, the superior bargaining position of the creditor enables him to limit those matters that might be the subject of negotiation.

The community has an interest in insuring that any process of exchange between private persons conforms to a generally accepted notion of what a private exchange should be, and that it meets community-imposed standards of fairness and decency. A fair and decent exchange does not imply an even exchange; as a rule, no inquiry is made into the relative value of the obligations undertaken and the benefits derived by the participants. Furthermore, a differential in bargaining capabilities of private persons transacting business is acceptable to the community. The community does not, however, tolerate such a differential where the factors creating it are such that the exchange is not, and cannot under any circumstances, be considered to be the outcome of a bargaining process. For example, infants and mental defectives are considered to be incompetent to engage in a bargaining process. Similarly, the community does not approve an exchange in which one party has willfully misrepresented material information on which the other party has reasonably relied. The characteristics which make a person incompetent to bargain, and the kinds of representations that affect the validity of the exchange, are questions

for the community to decide on the basis of its own notions of the nature of a decent and fair exchange.

The problems that may be identified as existing in or arising from the consumer-credit market are also the outcome of a system of private bargain and exchange. Some of those problems are characteristic of any system of private exchange (*e.g.*, persons making improvident bargains, or persons resorting to trickery and cheating). Others are attributable to the special characteristics of the consumer-credit exchange and the bargaining process leading up to that exchange (*e.g.*, the superior bargaining power of the creditor). Although the credit transaction has been traditionally considered one of private bargaining, the characteristic differential in bargaining positions generally prevents such an arrangement from being a bargained-for exchange. To remedy this situation, extension of consumer credit might be regulated like services rendered by public utilities. On the other hand, one could take the position that the terms of consumer-credit exchanges should be the subject of collective bargaining between groups of creditors on the one hand and groups of consumers on the other. Whether the community is prepared both to support the organization of consumers into effective collective-bargaining units and to enforce collective-bargaining agreements are further questions. Extension of consumer credit could, like the system for distribution of public welfare funds, be made the exclusive responsibility of a governmental agency. In such a case, assuming the consumer were to pay the cost of credit as a purchaser or borrower, rather than as a taxpayer, the terms and conditions of the exchange could be established by the agency pursuant to guidelines set forth in the legislation. Experience with public aid programs suggests, however, that, although some of the disadvantages of the present system of exchange might be eliminated, new and perhaps even more serious problems could be created. The issue, however, apart from difficulties in establishing and administering any of the above systems of regulation, is whether the problems of the consumer-credit market are such that they cannot be dealt with effectively without sacrificing a basic community presumption in favor of a private system of exchange.

The community, since the first small loan legislation, has made clear its preference for extension of consumer credit through a system of private exchange. To the extent that exchanges made in an unregulated market do not meet community standards of fairness and decency, it becomes necessary to impose those standards by community prescription through legislation. What specific elements constitute a fair and decent exchange for consumer credit? What are the indices of the existence or nonexistence of these attributes in an exchange? Assuming that operational definitions may be given to these terms,

what type of legislative control, consistent with other values held by the community, can be devised to shape the exchange to conform to community expectations? An assumption will be made here that a decent and fair consumer-credit exchange is one in which the consumer, as well as the creditor, can effectively represent and protect his own interests, and in which the nonnegotiable terms also adequately represent the interests of each. It is also assumed that the present system of exchange does not meet these specifications. An attempt will be made here to point out those aspects of the transaction that need regulation if any real effort is to be made to make the extension of consumer credit, as an outcome of a private exchange, conform to these standards.

Overextension by consumers, excessive charges by creditors, and overly harsh creditor remedies are often identified as evidence of malfunctioning of the consumer-credit exchange. One cannot say that such problems exist in all or even most of such arrangements. What constitutes excessive charges or harsh remedies for one exchange may not for another; what constitutes overextension for one consumer may not for another. Any legislative controls that attempt to deal directly with these issues will be ineffective unless the control is such as to insure an evaluation of each consumer-credit exchange, based on the special circumstances of that exchange, by someone other than the participants to it. Instead, legislation should attack the problems by dealing with those aspects of the exchange, and, in particular, of the bargaining process, which create the problems.

The nature of a private exchange is such that problems of the type noted will always occur in the market to some extent. Controls should be such that they minimize the possibility of those problems resulting from the inferior bargaining position of the consumer. The factors that give the creditor a bargaining advantage as well as an advantage in enforcing the terms of the exchange can be modified by appropriate legislative controls. For example, if all segments of the market were opened to creditors generally, the consumer would have a greater number and variety of alternatives to a particular creditor's offer of exchange. Effective disclosure provisions relating to truly negotiable terms of the exchange can provide the consumer with relevant information on which to base his bargain and with which to consider alternative arrangements. Time for reflection about terms of an exchange may be provided by permitting the consumer to reject the arrangement within a specified period after the formal documents are signed.

It must be recognized, however, that all terms of the exchange will not, by the very nature of the market, be the subject of negotiation. In these matters, regulation may have to take the form of specifying what those terms may be. Since cost of credit is not generally a negotiable item, perhaps rate controls in the nature of price fixing should be im-

posed. However, if there is competition among creditors as to their rate *structures*, and if the market is easily accessible to all creditors for all types of transactions, rate structures may well be optimal, even though the rates for individual transactions are not negotiated. If such competition is lacking, the simpler cure may well lie in freeing or stimulating it and not in trying to compensate for its absence with price controls on rates. There is a real question whether cost can ever truly be a negotiable item, but if an attempt is to be made to make it so, then a realistic program aimed at creating consumer sensitivity to and understanding of credit costs must be undertaken. It is questionable whether the effective disclosure of credit costs before the consumer's obligation becomes final is sufficient to accomplish this. Whether educational programs conducted by a state consumer advisory agency under the mandate of legislation, coupled with meaningful disclosure requirements, will be effective remains to be seen. In any event, the present statutory approach of "ceiling" rates and cost disclosure provisions that are of dubious informational value cannot be viewed as a satisfactory resolution. Such an approach favors neither negotiable nor nonnegotiable costs and therefore is no resolution at all. Many of the creditors' present remedies might not seem as harsh as they seem now, if other effective controls are established assuring fairness and decency in the exchange. The consumer's ability to enforce his rights may be enhanced by providing him with recourse to public agencies for pursuing complaints or by permitting him to assert his complaints against a particular creditor in a class action with other consumers having similar complaints.

All of the above devices are aimed at creating a true bargained-for exchange by neutralizing, in some respects, the effect of the creditor's present superior bargaining position. Even with appropriate controls on bargaining, not every arrangement will be fair by community standards. The community should not consider unfair those cases in which the consumer refuses to make use of effective aids provided for him, even if the creditor may have taken advantage of the consumer, unless the consumer is prevented from using these aids. Such cases include those in which the creditor uses trickery or deceit of a type peculiar to consumer-credit transactions, and those in which the consumer has a special disability associated with membership in a minority group, such as language difficulties. In such cases, it may be essential to provide additional protection for the consumer. It may be necessary to expand the definition of fraud to include particular types of reprehensible behavior peculiar to the consumer-credit market. In addition, the notion of unconscionability, as expressed in Section 2-302 of the Uniform Commercial Code, may need to be modified in order to insure its application to consumer-credit contracts.

In summary, there is no question but that a complete reappraisal of consumer-credit regulation is in order. Caution, however, must be exercised in any reassessment. Existing legislation should not serve as a basis for any new legislation without first appropriately defining the subject matter of the new regulation and clarifying objectives for it. An intelligent and thoughtful appraisal of the nature of the subject matter requires an understanding of the market in functional and operational terms and not in terms of traditional characterizations based on source and type of credit. The consumer-credit process should be defined in terms of the characteristics that differentiate it from other economic or credit processes and that are common to all participants and arrangements involved in the consumer-credit process. Legislation must be viewed as merely an instrument by which to further or achieve general community objectives for the process regulated. Consequently, any determination about the nature of the legislation must be preceded by a determination of the desired nature of the processes of the consumer-credit market. In the long run, both consumers and creditors have a community of interest in a viable, healthy market and in a fair and decent process of exchange, and both groups should support efforts directed at attaining this result.