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THE UNIFORM CONSUMER CREDIT CODE: AN ECONOMIST'S VIEW

Robert P. Shay†

I

A CONSIDERATION OF OBJECTIVES

To an economist the first two basic assumptions of the Uniform Consumer Credit Code (UCCC) represent a real step forward from the philosophy underlying existing legislation governing the extension of credit to consumers:

First, the successful American way of permitting competition to determine prices of non-monopoly commodities and services should also be allowed to apply to the pricing of money and credit;

Second, usury laws imposing inflexible price ceilings on money and credit are historical vestiges of the erroneous supposition that emperors, kings and governments could effectively fix all prices; the need to escape the rigidity of usury laws has led to special laws, which only the expert can find or understand, for most types of credit transactions requiring a charge higher than the usury rate.¹

In the automobile finance market, the price of financing has been established competitively at average levels well below legal rate ceil-

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¹ Uniform Consumer Credit Code, Prefatory Note at 6 (Revised Final Draft 1968) [hereinafter cited as UCCC]. The final draft was approved by the National Conference of Commissioners on Uniform State Laws on July 30, 1968 and by the American Bar Association on August 7, 1968. The revised final draft appears in the CCH Instal. Credit Guide No. 191 (extra ed. Dec. 12, 1966).
The automobile credit market is not the sole province of one type of creditor—indeed it is shared by sales finance companies, commercial banks, credit unions, retailers, and others. Over the years, the price of automobile financing has declined, due to both the increased credit-worthiness of consumer borrowers and the increased interest among institutional creditors in financing their purchases. Entry into the automobile financing market is easy. Virtually anyone can set up a business to purchase credit contracts from dealers, even though the right to make automobile cash loans at rates which exceed usury is restricted to certain types of financial institutions. Surely other consumer credit markets can be made to function competitively as well, and the basic assumption of the UCCC that money and credit can be priced competitively is indeed refreshing and relevant to most participants in the consumer credit market. To further enhance competition, the Code, under the influence of the federal Consumer Credit Protection Act, now provides for complete disclosure of annual rates of charge to a borrowing public which should be capable, for the most part, of managing its own finances with such information. Yet it is questionable how effectively the Code deals with those consumer borrowers requiring protection from free market prices. In general, however, the basic assumptions of the UCCC deserve praise, since usury and other restrictive rate ceilings represent an obvious interference with price competition.

I shall concur in and let the readers of this article applaud the next basic assumption of the UCCC:

Third, consumer credit legislation should be contained in one law so that any attorney can quickly and effectively advise his consumer client.

The fourth assumption is complex, and has led to difficulties among the "interest groups" affected by the Code:

Fourth, for competition effectively to determine the pricing of money and credit requires:

a. for credit grantors, relatively easy entry into the market to avoid monopoly;

b. for knowledgeable and sophisticated credit recipients, eliminating or at least minimizing controls;

c. for the protection of less knowledgeable and less sophisticated credit recipients:

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4 UCCO, Prefatory Note at 6.
1. uniform disclosure of the costs and terms of credit to permit informed judgments as to whether or not to use credit, to facilitate "shopping for credit," and to enable the forces of competition to work freely;

2. ceilings on the price of credit, restriction on creditors' rights and remedies, and enhancements of debtors' rights and remedies sufficient to prevent overreaching by creditors without unduly limiting the availability of credit;

3. administrative powers and self-executing judicial remedies ample to assure compliance with statutory requirements;

4. enough financial resources available to the Administrator to enable him effectively to exercise the powers of his office; and

5. a broad-gauged Advisory Council to advise the Administrator in the exercise of his powers in the interests of our entire society and economy.5

The fourth basic assumption poses the major problems confronted by the Code's proponents because, unlike the general goals to which no one would object, it charts the specific means to achieve those goals. The effort to implement competition with an "umbrella-type" Code covering all vendors and lenders who offer consumer credit raises the question of how to reach a consensus among those affected when competition replaces the protection of existing statutes. Everyone is in favor of competition when it doesn't hurt, but the social justification for competition is that it must harm someone when it removes those elements of profit based upon privilege rather than performance. The draftsmen and Special Committee charged with drawing up the UCCC were given the opportunity and challenge of working with an Advisory Committee composed of twenty-one persons "representative of affected segments of the public and of the consumer credit industry,"6 as well as with twenty-six members of panels of advisors on specific subjects drawn from similar sources but with more specialized backgrounds.7 Good legislation could not have been written without the specialized knowledge possessed by members of the Advisory Committee and the panels. A challenge, however, was posed by those on the Advisory Committee who considered withdrawing the support of their interest groups when realignment of laws would threaten their constituencies. The theory, of course, was to iron out basic disagreements before the

5 Id. at 6-7.
6 Id. at 9.
7 Id. at 9-10.
Code was adopted by the National Conference of Commissioners on Uniform State Laws (NCCUSL) and then to go to the state legislatures with as many supporters as could be marshalled from those consulted. But the result is that elements of the desired program may have been compromised to solve disagreements.

This article will examine the major features of the UCCC against the "basic assumptions" listed above. Then, the following questions will be considered: How well does the Code meet the objectives set? What are the areas of compromise and what appear to be the costs? Will the consumer credit market be better served by the UCCC?

II
RATE CEILINGS, COMPETITION AND THE PRICING OF MONEY AND CREDIT

One reason the UCCC represents such a startling departure from the past is its willingness to rely, as much as it does, upon competition to govern the cost of loans to consumers. It effectively repeals legal ceilings upon contractual rates set under general usury statutes for consumer loans. It also repeals all previous rate ceilings applicable to consumer credit transactions covered in the UCCC except for the maximum charges applicable to pawnbrokers.

A. Closed-end Credit Transactions

A single set of rate ceilings in the UCCC, graduated downward as size of credit increases, replaces most other rate ceilings now existing in current statutes. The UCCC ceilings are intended merely to set an upper boundary for rates which are expected to be set competitively at lower levels. The rate ceilings limit finance charges to the greater of either of the following, calculated according to the United States rule:

(a) the total of
   (i) 36 per cent per year on that part of the unpaid balances of the amount financed which is $300 or less;
   (ii) 21 per cent per year on that part of the unpaid balances of the amount financed which is more than $300 but does not exceed $1,000; and
   (iii) 15 per cent per year on that part of the unpaid balances of the amount financed which is more than $1,000; or
(b) 18 per cent per year on the unpaid balances of the amount financed.10

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8 Id. § 9.103.
9 Id.
10 Id. § 2.201. This section applies to consumer credit sales other than revolving charge accounts. Section 3.508 applies to supervised loans and embodies identical lan-
The rate ceilings listed under (a) are applicable to all closed-end retail instalment sales and contracts and closed-end and open-end instalment loans made by supervised financial institutions. Unsupervised instalment loans are subject to a single rate ceiling of eighteen per cent per year.\textsuperscript{11}

The reliance upon competition, rather than regulation, to set rates is consistent with the stage of development of consumer credit in the United States. Although consumer credit has grown faster than income, this growth is justified by the greater affluence of society as a whole. No longer is credit use, either in the form of money loans or the credit sale of goods and service, regarded as a stigma indicating inability of a family to manage its resources wisely. No longer is consumer credit considered an "unproductive" use of loanable funds in the lexicon of economists—rather, it is an important, and probably essential, means of maintaining production and employment in our mass production economy. Finally, with widespread credit use at all but the very highest and lowest income levels, the instalment credit market is certainly broad enough, and can be made competitive enough, to allow its price to be set by the forces of supply and demand. The UCCC has, however, adopted rate ceilings. The main purpose for price ceilings in this or any other market is to offset the superior position of the monopolist who, like the traditional Shylock, could exploit the needy and underprivileged. Another reason for price ceilings would be to discourage credit use by enacting restrictive rate ceilings on the grounds that credit should be diverted elsewhere. Neither argument has relevance today except in areas of poverty where both ignorance and need abound.

The rate ceilings set by the UCCC are not high when compared with some state statutes.\textsuperscript{12} But since the UCCC rate ceilings cover all forms of consumer instalment credit, they should be compared with the highest existing rate ceilings or with rates in areas currently without ceilings. In cash lending, the relevant statutes are the consumer finance or small loan laws,\textsuperscript{13} and, on the non-money lending side, the

\textsuperscript{11} Id. § 3.201.


\textsuperscript{13} These laws, for the most part, are based upon the Uniform Small Loan Law, drafted by the Russell Sage Foundation with the assistance of a group of money lenders in 1916. Successive revisions of the model act were recommended in 1918, 1919, 1923, 1932, 1935, and 1942. See B. \textsc{Curran}, \textit{Trends in Consumer Credit Legislation} 16 (1968).
statutes governing retail instalment selling.¹⁴

1. Cash Lending Rate Ceilings

Of those states with small loan laws, fifteen would find some segment of the UCCC rate ceilings below current ceilings.¹⁵ For the most part, these are the rate ceilings on small-sized loans up to $300 which are governed by the thirty-six per cent limit under the UCCC.¹⁶ The impact of lower rate ceilings in the smallest size loan brackets will fall primarily upon marginal borrowers who cannot qualify for larger loans. There are two schools of thought concerning the desirability of such loans. One school holds that the poorest class of borrowers deserves the right to borrow at any rate which reflects the true costs of extending credit (including a competitive return for the risk assumed). Under this theory, the true test of the loan should be whether the borrower can repay without the harassment practiced by illegal (unlicensed) lenders. The other school holds that the availability of credit to borrowers who can qualify for credit only at rates above thirty-six per cent does a disservice because it leads them to take on liabilities which are costly and which they cannot afford.

To the economist, however, the real test of what one can afford stems from the intensity of the want or need for credit in relation to the borrower's ability to repay. Many expenditures have an urgency to individuals which are well worth more than thirty-six per cent per annum, but the political question is whether removing all rate ceilings will not only allow those expenditures but will also permit other less essential borrowing by persons whose ability to judge the relation between desire, need, and cost is questionable. What is often not realized is that a legal rate ceiling merely drives cash borrowers to loan sharks where they must pay the added premium for the lender's risk that he will be caught breaking the law.

The UCCC fully recognizes the dangers of driving borrowers to loan sharks,¹⁷ but it succumbed to the thirty-six per cent rate ceilings which will make loans of $100 or less virtually unobtainable. The high

¹⁴ See id. at 91-123.
¹⁵ E.g., Alaska, Florida, Georgia, Hawaii, Iowa, Indiana, Louisiana, Mississippi, Nevada, Oklahoma, Rhode Island, South Carolina, South Dakota, Utah, and Wyoming, as of Jan. 1, 1968. Data for these comparisons were supplied to the author by Mr. Helmhuth Miller of the Beneficial Finance Company.
¹⁶ UCCC § 3.508. Nine states legislated higher rate ceilings on $300 loans, eleven had higher rate ceilings on $200 loans, and fourteen had higher rate ceilings on $100 loans. Finally, Georgia's peculiar rate ceiling was higher only on loans of $500 or more. Data based on small loan laws existing on Jan. 1, 1968 in 47 states. States included are those whose laws bear some similarity to the Uniform Small Loan Law.
¹⁷ UCCC, Prefatory Note at 7.
fixed costs of placing a loan on the books requires the rate of gross income in relation to the amount outstanding to be progressively higher as loan size becomes smaller, and, on loans of less than $300, the rate required to cover costs and obtain profit rises much more rapidly than, say, the rate on loans between $1,000 and $500.

On the other hand, the thirty-six per cent rate ceiling on loans up to $300 represents a higher rate ceiling than is now in effect in many states, so the UCCC determination represents a compromise among diverse philosophies of rate ceilings in existing small loan laws. Yet, to be consistent with the UCCC philosophy "to set ceilings and not to fix rates," a more desirable step would have been to raise the rate ceiling on loans of $300 or less: perhaps to forty-eight per cent on loans of $100 or less, and forty-two per cent on loans between $100 and $300. The expectation, of course, would be that loans which would have been made at thirty-six per cent per annum under the present rate ceiling would still be made at thirty-six per cent for competitive reasons. If it turned out that all rates rose to the forty-eight or forty-two per cent levels, this would provide evidence that competition did not work and that regulation is necessary to keep rates lower. Furthermore, it is easier to obtain legislative action to lower rate ceilings than to try to raise rate ceilings after low ceilings have been in effect.

The remaining slope of the rate ceiling structure for small loans in the UCCC appears to be consistently within the range of the higher ceilings currently in effect. The justification for high rate ceilings as explained by the Code is that they are designed to provide for more effective competition and limitations on creditors' remedies. The absence of special rate ceilings by type of lender or item financed, increased freedom of entry, and disclosure requirements are all expected to provide added competitive impetus so that the presence of higher rate ceilings will not increase the cost of credit to current borrowers. Yet the limitation on creditors' remedies directly requires higher rate ceilings if marginal credit risks are to continue to be served.

2. Retail Installment Sales and Installment Loan Rate Ceilings

A major accomplishment of the UCCC is that it provides uniform rate ceilings for both installment credit sales and installment cash loans of the closed-end variety. This encompasses the great bulk of consumer installment credit. This uniformity breaks down in the open-
end sector where open-end credit sales (retailers' revolving credit plans) are allowed to have higher rate ceilings than open-end loans (bank credit cards and check-credit plans), unless these loans are made by supervised lenders.\textsuperscript{22}

Because of the exemption from usury statutes given by most courts to retail instalment sales, retail instalment financing developed in the early twentieth century largely free of regulation until 1935 when Indiana enacted legislation governing the financing of "all goods," and Wisconsin passed a motor vehicle instalment sales act. Today all but four states have laws governing some aspects of retail instalment sales.\textsuperscript{23} These laws all contain contract and disclosure requirements for protection of the borrower, but only twenty-eight of the fifty states (plus the District of Columbia and Puerto Rico) have established rate ceilings.\textsuperscript{24} The rate ceilings in the twenty-one states with ceilings in January 1968 were all below the UCCC ceilings. But UCCC rate ceilings would be a new element in the states that have no rate ceilings on retail instalment sales.

What are the arguments for placing rate ceilings on retail transactions? The answer, briefly, is that both retailers and the financial institutions which purchase retail credit contracts have the same opportunity as cash lenders to serve customers who have urgent desires or needs for goods and services, and who may not be able to judge the relation between their needs and the cost. For the most part, the dilemma posed by enacting a rate ceiling on retail instalment sales is identical to that posed with respect to small cash loans. There is one important difference, however. The retail seller can avoid the impact of a rate ceiling by raising the price of the article he is willing to

cannot be ascertained, the sum of automobile credit, other consumer goods credit, and repair and modernization loans represent about 70\% of the total. Only a very small part of this proportion could be open-end retail credit. The proportion of the remaining segment, personal loans, which is closed-end, is probably larger than the proportion of open-end loans outstanding. See the August, 1968 figures in the Fed. Reserve Bull., Table A-52 (Dec. 1968).

\textsuperscript{22} Compare the rate ceilings in UCCC § 2.207 (revolving charge accounts) with those contained in § 3.201 (unsupervised consumer loans) and § 3.508 (supervised loans).

\textsuperscript{23} Alabama, Rhode Island, South Carolina, and Wyoming. The law in a fifth state, Arkansas, was upset by Hare v. General Contract Purchase Corp., 220 Ark. 601, 249 S.W.2d 973 (1952), which held that most ordinary sales finance transactions were subject to the 10\% constitutional usury provision.

\textsuperscript{24} Most retail instalment financing laws are either motor vehicle laws or "all goods" laws. The latter may or may not cover the financing of motor vehicles and revolving credit transactions. Within the "umbrella ceiling" set by the UCCC, the rate ceiling set under the "all goods" laws would most closely approximate the ceilings placed on the highest cost credit transactions.
finance. Viewed realistically, the practice presents the same potentiality for exploitation as loan sharking. And like loan sharking, it need not trade solely on the ignorance of the borrower to reach agreement but it may apply to a credit sale intelligently transacted by the buyer. For example, if the urgency of the borrower’s need is well above the legal thirty-six per cent rate ceiling and the likelihood of repayment from the borrower warrants a fifty per cent per annum rate, then even if the borrower knows that he cannot be charged more than thirty-six per cent, he may be perfectly willing to be charged a cash price which is inflated by the present value of the finance charge in excess of thirty-six per cent. There are no elements of exploitation in this transaction, since the market is merely giving both buyer and seller the desired transaction consistent with a legal framework which limits finance charge revenues to thirty-six per cent per annum. The potentiality for exploitation, however, arises when the buyer cannot compute the present value of the “hidden finance charge” in excess of the UCCC rate ceiling.

Under the UCCC, the borrower desirous of purchasing the article cannot get a cash loan at all if he cannot qualify for it at the ceiling rate unless supervised cash loans are made jointly with the sale of goods and nonfinancial consumer services.25 The cash lender typically has no price to inflate to offset the ceiling on his finance charge revenue. Thus the credit seller who caters to marginal credit buyers has the only legal avenue for exploiting his customer—by inflating his cash prices. The typical retail seller who caters to both a cash and a credit clientele will find that if he raises his cash prices to accommodate his high-risk credit customers, he will lose cash customers. So most retailers will not utilize this avenue for meeting the demands of marginal credit purchasers beyond whatever point their decline in revenues from cash sales makes inflating cash prices unprofitable. However, the retailer who locates in a poor area, and sells his commodities or services almost totally on credit is free to charge whatever cash price is consistent with the credit needs of his clientele. If he charges a single, high cash price for a given product plus the ceiling rate for credit, that cash price indicates that the bulk of his credit customers cannot qualify for cash loans at legal rates and that they have behind their willingness a high collective degree of urgency (or ignorance) to finance the goods. Such a seller today is a “sales credit shark,” the modern day counterpart of the loan shark.

25 See generally UCCC § 3.501.
The UCCC does not prevent such legal exploitation but it does discourage it in several ways. First, the enactment of a legal rate ceiling prevents an unscrupulous seller or lender from inflating the finance charge, but not the cash price, beyond a certain point. Nevertheless, the very enactment of rate ceilings has the effect of sending marginal credit customers either to illegal loan sharks or to sales credit sharks who are willing to inflate cash prices. By setting rate ceilings high, the UCCC limits their relevance to fewer cases which involve unconscionable rates. Accordingly, there must be enforcement aimed specifically at the credit sellers who are in a position to evade the purpose of the rate ceiling. Later, I shall contend that enforcement provided by the UCCC is less than adequate.

Second, the UCCC proponents can argue, and rightly so, that an unscrupulous retailer would, in the absence of rate ceilings, charge both the highest possible price and the highest possible finance charge. Thus, the rate ceiling limits his methods of exploitation to price adjustment which can only partially compensate for the lower finance charge revenue. But this reply is not enough to justify the shifting of marginal borrowers away from highly supervised, licensed cash lenders to illegal lenders and largely unsupervised credit retailers. Even with lowered profits on each transaction, they will gain volume as business shifts to them in states where rate ceilings on cash loans are lowered by the UCCC and will retain existing business in states which already limit rates on cash loans at the UCCC ceilings. In those states where rate ceilings on cash loans will be raised by the UCCC, there will be a redistribution of borrowers back towards the supervised cash loan lenders. This is the quid pro quo which can obtain a consensus from lenders whose interests are national in scope. The borrowers who will be served by cash lenders at the UCCC rate ceilings are not as marginal as those who must go to high-price, low-quality credit retailers and to loan sharks. Yet this kind of compromise is a poor substitute for reform aimed at benefiting the poorest segment of society.

Proponents of the Code have a third argument to answer the criticism that recommended rate ceilings do not adequately control exploitation by unscrupulous credit retailers. The Code gives the state official who serves as Administrator power to initiate court injunctions against credit sellers or lenders who make or enforce unconscionable

26 Id. § 5.108. Since a charge or practice expressly permitted by the UCCC is not, in itself, unconscionable, setting higher rate ceilings narrows the range of unconscionable rates.

27 See pp. 516-22 infra.
terms in consumer credit transactions. If the state official, either by complaint or on his own discovery, finds that a retailer is setting credit terms in accordance with the law but charging exorbitant prices because his clientele must have credit in order to purchase, a court could conceivably enjoin such behavior. In this manner, the UCCC skirts the problem of directly regulating pricing practices of credit retailers.

The protection offered by rate regulation and the dubious use of injunctions is not enough. Since a seller can raise prices partially to compensate for a rate ceiling which does not otherwise permit him to extend credit to a marginal risk, he has, in effect, a higher effective rate ceiling than that allowed cash lenders—up to a point. That point is reached when, in the judgment of the Administrator and the court, there exists an unconscionable credit transaction or series of transactions from a given credit seller. But no one knows whether a court will take action or how far out of line with comparable prices a credit retailer's prices would have to be for a court to enjoin his behavior as unconscionable. Accordingly, there is a permissible margin between the allowable credit risk that a retailer can accept and that which a cash lender can accept when the rate ceiling is the same for both. This means that the marginal borrower can transact legally with certain unsupervised credit retailers while the same transaction with a highly supervised cash lender would be illegal. Thus, the Code itself wrongly diverts transactions away from highly supervised lenders whose financial records and operations are now subject to regular examination by state officials.

To subject all closed-end credit sales transactions to the same constraints imposed upon high-risk lenders would require a system of examination and record keeping that would be expensive in light of the small percentage of borrowers protected. But this problem could be resolved by framing a distinction between "supervised" and "unsupervised" credit sellers which parallels that between "supervised" and "unsupervised" lenders under the UCCC. For example, supervised credit sellers and supervised lenders would be those able to charge more than, say twenty-four per cent per annum, provided that they undergo the same degree of supervision.

A revised rate ceiling could be enacted at forty-eight per cent per annum on supervised credit extensions up to $100 and forty-two per cent on supervised credit extensions between $100 and $300 and from

28 UCCC § 6.111.
29 Id.
30 See p. 497 supra.
twenty-one per cent to twenty-four per cent on supervised credit extensions up to $1,000. Both unsupervised credit sellers and unsupervised cash lenders could be barred from making credit extensions at rates above twenty-four per cent per annum. Thus, supervised credit sellers who are heavily dependent upon the business of marginal credit risks could be subject to the same supervision and extra costs of reporting the details of income, expense and balance sheet information about their credit operations as are presently carried by supervised cash lenders. Both groups should also be subject to regular examination instead of the looser procedures now prescribed by the UCCC. 31 The advantages of such a system are twofold. First, smaller-sized, higher-risk credit extensions would be subject to scrutiny. The reporting information and examination procedures would reveal the degree to which credit losses are being subsidized by high prices so that an Administrator could more easily judge what is unconscionable. Second, the potential for exploitation of marginal borrowers by credit retailers through price shifting would be limited by the extra supervision applicable to sellers catering to marginal credit risks.

To summarize, the rate ceilings enacted in the UCCC free the great mass of transactions from current limits so that, if the impetus given to competition by other sections of the Code remains, most closed-end consumer credit transactions will be priced competitively for both the credit sales and cash lending alternatives. However, in the actual setting of rate ceilings in the credit (or loan) bracket of $300 or less, the UCCC departed from its objectives of setting rate ceilings high relative to the costs of extending credit. A large proportion of these loans will necessarily be made at ceiling rates because of the fixed cost element in the finance charge. Finally, in many areas of the country where poorer credit risks are located, the lowered UCCC rate ceilings on both small loans and small sales credit extensions will enhance the exploitation of marginal credit risks by illegal lenders and their legal counterparts, the low-quality, high-priced retail stores who can, under the Code, extract what I shall deliberately call "unconscionable prices." The price is unconscionable because the usury in the finance charge is transferred to the price of the product or service sold. This technique is analogous to the practice of loan sharks who charge legal finance rates but add fees and other charges. The decision as to what constitutes usury remains as imprecise as ever; the UCCC, outside of regulating usury laws, avoids the term. The concept of un-

31 UCCC §§ 6.104 -.106.
as applied to the loan contract and the credit contract or lease, is a good substitute for "usury" since it permits the court to go beyond the express terms of the UCCG to determine what is illegal. It is inadequate, however, as the only check upon unconscionable prices resulting from credit agreements with marginal credit risks.

My solution for these inconsistencies in what otherwise is most constructive legislation is to maintain the uniformity in rate ceilings for supervised credit transactions under the UCCG for both credit sales and cash loan closed-end credit, raise the ceiling rates in the two lowest credit size brackets, and require credit sellers who wish to qualify for the higher rate ceilings to submit to the same degree of supervision and examination as cash lenders. Otherwise, if the credit seller does not wish to take advantage of the rate ceilings which will allow him to compete for marginal credit risks, he can remain unsupervised and subject to a twenty-four per cent per annum rate ceiling.

B. **Open-End Credit: Sales and Loans**

Open-end instalment credit sales and loan transactions represent the widely burgeoning phenomenon in the United States known as "revolving credit." There are a number of variants of revolving credit, known popularly as revolving charge accounts, credit cards, charge account banking, and check-credit plans. All such plans have in common the open-end characteristic; that is, the outstanding balance can be changed during the life of the agreement by additional credit purchases or loans with some provision for fractional instalment repayment of the outstanding balance.

Rate ceilings under the UCCG differ according to whether the revolving credit account is a credit sale or a cash loan. Rate ceilings on revolving charge accounts (credit sales) allow a two per cent monthly rate on that part of the balance which is $500 or less and a one and one-half per cent monthly rate on that part of the balance which is more than $500. On revolving loan accounts (cash loans) made by

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32 **Id.** § 5.108.

33 See id. §§ 5.111(2), (3) & Comment. When credit is consistently granted at rates which do not cover cost, and when profits from the credit sale of goods or services cover losses and provide above-normal operating profits, and when cash prices are higher than on similar products and services in the same geographic area, there is a prima facie case for unconscionability under the UCCC.

34 In retail transactions, there is usually an interest-free period for lump-sum repayment.

35 UCCG § 2.207(3).
unsupervised lenders, there is a single, flat ceiling rate which, with minor exceptions, may not exceed eighteen per cent per year based on a one and one-half per cent monthly rate applied to the balance(s) outstanding.\textsuperscript{36} Supervised lenders may extend revolving loans at the ceilings provided for closed-end loans.\textsuperscript{37}

The rationale for setting open-end credit rate ceilings lower than closed-end transaction ceilings for credit sellers and unsupervised lenders is not given in the final draft of the UCCC, despite regular explanatory comments inserted after each major section. The omission is particularly glaring in view of the following comment made to explain rate ceilings for consumer credit sales other than revolving credit accounts:

The absence of special rate ceilings according to the type of credit grantors, type of item financed, or the form of credit extension is by design. Segmentation of the market for credit by differentiated rate ceilings tends to reduce competition and introduce rigidities into the market that benefit a few suppliers at the expense of others and work to the disadvantage of consumers.\textsuperscript{38}

Why should open-end credit plans be a special case? Jordan and Warren, the Reporter-Draftsmen of the UCCC, have offered some clues, but not an answer:

The maximum rates allowed in revolving credit, which reflect in large measure prevailing market rates, are considerably lower than those allowed in the smaller non-revolving credit transactions. For small transactions revolving credit is a more effective and efficient method of providing credit to the consumer, and the lower rates reflect this efficiency. But revolving credit is generally available only to consumers who are relatively good credit risks. The less efficient non-revolving credit is still very prevalent and will continue to be widely used, particularly with higher-risk customers. \textit{The higher ceilings applicable to non-revolving credit will allow it to continue.} But the phenomenal growth of low-cost revolving credit and the prospect of its future growth demonstrate that reduction of cost to the consumer is more likely to come about through efficient marketing spurred by competition than through the existence of rate ceilings.\textsuperscript{39}

This indicates that the reasoning behind special, lower rate ceilings for open-end credit is not consistent with the UCCC's objective

\begin{enumerate}
\item \textsuperscript{36} \textit{Id.} § 3.201.
\item \textsuperscript{37} \textit{Id.} § 3.508.
\item \textsuperscript{38} \textit{Id.} § 2.201, Comment 1(2) (emphasis added).
\item \textsuperscript{39} Jordan \& Warren, \textit{The Uniform Consumer Credit Code}, 68 Colum. L. Rev, 387, 405 (1968) (emphasis added).  
\end{enumerate}
of competition. The economic effect of a lower rate ceiling on open-end credit transactions is to segment the market, allowing supervised lenders the only chance to extend this kind of credit to high-risk borrowers. By setting the rate ceiling on unsupervised loans and credit sales substantially below that proposed for closed-end credit transactions on credit amounts below $1,000, the Code discourages extension of open-end credit to high-risk borrowers and limits competition for these borrowers to supervised lenders.

Why place these limits on the market for open-end credit? In the long run, the procedures of credit-granting and collection, aided by a virtually instantaneous flow of complete credit information, may well justify the extension of open-end credit to marginal risks at rates similar to or somewhat below what they now pay on closed-end credit. Robert W. Johnson, Reporter-Economist for the UCCC's Special Committee, stated:

In spite of the desire to avoid segmentation of the rate ceiling, it appeared necessary to make a distinction between the two basic types of credit. . . . In part, the methods of levying finance charges are quite different. Also, it was believed that the continuing relationship of the revolving-credit grantor with his customer should result in relatively lower operating costs over time. Consequently, rate ceilings on revolving credit are somewhat lower than on other forms of consumer instalment credit.40

The difference in methods of levying finance charges has little relevance. Rather, it is primarily the difference in levels of rate ceiling that brings about segmentation of markets. To remove differences in the level of rate ceilings, the UCCC could have specified rate ceilings on both revolving charge accounts and revolving loan accounts for regulated lenders and credit sellers which were similar to those on closed-end credit; i.e., three per cent per month on that part of the balance which is $300 or less, one and three-fourths per cent per month on that which is more than $300 but less than $1,000, and one and one-fourth per cent per month on that which is above $1,000.

The statement that a continuing relationship between the debtor and his open-end creditor should eventually bring lower costs is inconsistent with the UCCC's philosophy—to set rate ceilings high and encourage competition to set rates. Setting rate ceilings at actual or expected future levels will only allow the market to grant credit to borrowers currently receiving credit of this type. Moreover, it is hard

to find any logic behind the Reporter-Draftsmen's justification—"that the higher [rate] ceilings applicable to non-revolving credit will allow it to continue." If revolving credit is eventually to supplant non-revolving credit, the case for allowing it to be a competitive alternative for all competitors under a single, uniform rate ceiling is strong.

A further inconsistency with the UCCC's stated rate ceiling philosophy is represented by the different rate ceilings applied to revolving charge accounts and revolving loan accounts. The UCCC again offers no explanatory comment. Nor is the reason inherent in the difference between the two categories—that the contractual arrangement for a revolving charge account is between seller and buyer whereas the contractual arrangement for a revolving loan account is between lender and buyer. Perhaps the drafters of the Code believed the same ceiling was not needed for revolving loans because the lender typically charges a discount on the value of the purchases made by the card holder when he remits his payment to the seller. But the competition for the seller's accounts fixes the size of the highly variable discount. Furthermore, the growth of credit card arrangements has decreased the size of discounts which lenders can obtain from sellers, and the day may not be far away when there will be no discount at all.

Thus, one objection to a different (lower) rate ceiling on revolving loan accounts than on revolving charge accounts is that it fosters the current practice of the lender discounting sellers' receivables instead of obtaining all of the credit revenue from the finance charge paid by the buyer-debtor. Whenever the allowable rate ceiling provides insufficient revenue to offer the loan service, the lender is forced to discount receivables. Legislating a rate ceiling of eighteen per cent per annum, when the current rates (excluding discounts) are predominantly at that level, offers little chance that the practice of discounting will disappear entirely. Even if rate ceilings on the two open-end categories are uniform, the problem remains if the ceilings are set at a low level.

41 Jordan & Warren, supra note 39, at 405. See p. 504 supra.
42 Perusal of the previous drafts of the UCCC will show that the difference in rate ceiling crept in some time after Working Draft No. 6, dated Dec. 4, 1967, and before the Tentative Final Draft (Working Draft No. 8) prepared for the meeting of the NCCUSL, July 22-Aug. 1, 1968. All of the previous drafts, beginning with the second working draft, contained a uniform rate ceiling for open-end credit accounts (which was below the ceiling for closed-end credit accounts).
43 Indeed, in automobile financing it is customary for the bank or sales finance company to rebate to the dealer some portion of the finance charge, rather than to charge him for the privilege of having his customer's purchase financed on a closed-end credit transaction.
But if the higher rate ceilings recommended for closed-end transactions are utilized for all categories, there would be no fostering of discount practices on credit card arrangements. Nevertheless, even removal of rate ceilings would not completely end discounting. Some lenders prefer to charge relatively low rates to borrowers and then charge the seller a discount, and they are free to do so with or without rate ceilings. But market forces under the freedom of no or high rate ceilings could change the practice.

Finally, it is difficult to imagine appreciable cost differences between financing purchases with credit cards issued by lenders and with credit cards issued by sellers. This alone is sufficient reason for uniform ceilings on revolving credit accounts.

C. Unsupervised Loans

The UCCC introduces new regulatory classifications in order to clarify differential treatment of vendors and lenders. First, all consumer credit sales (and consumer related sales) are regulated under the Code. Second, only those consumer loans carrying a rate of charge in excess of ten per cent per annum on the unpaid balance are regulated loans. Third, a supervised (licensed) consumer loan is “a regulated loan in which the rate of the loan finance charge exceeds 18 per cent per year . . . .”

These definitions mean, in effect, that all credit sales are regulated and none are supervised; a loan with a finance charge rate of less than ten per cent per annum is unregulated and unsupervised, between ten and eighteen per cent is regulated but unsupervised, and over eighteen per cent is both regulated and supervised. One major reason for these distinctions is that the time-price doctrine—carefully preserved by the framers of the UCCC—provides justification for continuing differential treatment of sellers and lenders who, despite this antiquated doctrine, are in essence both selling the same product—consumer instalment credit. By leaning upon this weak reed from the past which has allowed credit sales greater freedom from regulation than cash loans, the UCCC contents itself with broadening the regulation of credit sales—but not by so much as to make it equivalent to the regulation of cash loans.

Clearly the eighteen per cent rate ceiling on unsupervised loans

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44 UCCC §§ 2.102, 2.602.
45 Id. § 3.501(1).
46 Id. § 3.501(3).
47 See pp. 508-11 infra.
is meant to allow unlicensed lenders to make larger loans on a basis comparable to credit sales. But on loans that require rates above eighteen per cent, the lender must get a license, granted only with the approval of the Administrator, who approves the financial responsibility, character and fitness of the owners, officers and directors of the lending corporation. Financial organizations chartered to make loans and to receive deposits, including share or thrift accounts, and who are already supervised by a state or federal official do not have to obtain a license from the Administrator of the UCCC. Nevertheless the degree of supervision contemplated under the UCCC is so moderate as to make the only real barrier a questionable record of financial responsibility, character and fitness. It would be preferable to make parallel requirements applicable to credit sales as well as to cash loans where supervised credit agencies in both categories would be those charging more than twenty-four per cent. Moreover, an Administrator should refrain from interpreting character and fitness requirements strictly and instead place greater emphasis upon regular examination and supervision of supervised credit agencies than is now required in the UCCC. The Reporter-Draftsmen point up the dilemma faced by the framers of the UCCC:

A persuasive case can be made that whatever potential for mis treating and deceiving the borrower that may exist in the loan field exists in equal or greater measure in the sales field. But the licensing of sellers of goods or services has never been the practice in this country. Indeed, many would find it completely repugnant to our notions of free enterprise. True, if lenders and credit sellers are performing economically similar functions it seems reasonable to impose the same restrictions—or grant the same freedom—to both. But hundreds of years of suspicion of moneylending, often grounded in religious convictions, are not easily overcome.\footnote{Jordan & Warren, supra note 39, at 402-03.}

It is unfortunate that matters of substance must bow to political realities based upon the tradition of suspicion of money lenders. Must the NCCUSL ignore the fact that changing times have shifted the source of many abuses of the poor from money lenders to credit sellers?

III

MARKET SEGREGATION AND LIMITATION

A. The Time-Price Doctrine

The foregoing discussion of UCCC rate ceilings points up the difficulties in achieving stated objectives while trying to reach a con-
sensus among representatives of affected segments of the public and of the consumer credit industry. But one of the first compromises, which opened the door to virtually all of the diversity in UCCC rate ceilings, was the decision to preserve the artificial distinction between credit sales and cash lending based upon the legal fiction that marking up of a cash price to a time price established a time-price differential which was not interest and therefore not subject to usury laws.49 This doctrine had been sharply criticized by William D. Warren, one of the Reporter-Draftsmen,50 and the first tentative draft submitted to the 1966 Annual Meeting of the NCCUSL did not separate credit sales from cash loans. Warren described the legal situation then in a manner applicable today:

Traditionally, credit sales have been exempt from the usury acts on the theory that the finance-charge increment of a time "sale" differs from the interest obligation of a "loan." In recent years, however, in obvious recognition of the artificiality of the time-price-cash-price dichotomy, courts have adopted hypertechnical exceptions to the traditional rule whenever the equities of a case have so prompted. Overall, the result is unfortunate: a general rule—to the effect that a time price cannot be usurious—which is hard to support when the true incidents of the credit transaction are comprehended; and numerous exceptions to the rule that seem arbitrary and unreal in the context of contemporary commercial practices. The bold alternatives open to courts under the usury acts are no more appealing. By indiscriminately applying usury statutes to credit sales, they would threaten the flow of capital into instalment credit; and if they give a blanket exemption to these transactions, they leave the consumer with no protection against excessive finance charges.51

Clearly, the UCCC, if enacted in its present form, will represent a giant step forward from the current hodge-podge of state laws, many of which are based on the time-price distinction between credit sales and loans. Nevertheless, the function of an academic observer is not to pretend that what has been formulated is ideal in order that it can be implemented in the legislatures. Rather it is to point out what, in the opinion of one economist, might have better served the interests of the market for consumer instalment credit.

Homer Kripke claims that debate over the time-price doctrine is a waste of energy: "Since sale credit and loan credit are both regulated

50 Warren, Regulation of Finance Charges in Retail Instalment Sales, 68 YALE L.J. 899, 845, 851 (1959).
51 Id. at 866-67.
in the proposed NCCUSL Bill, and for the most part in identical terms, what difference does it make to these zealots [advocates of consumer protection] what one calls the regulated amount?"\(^5\) I would contend that maintaining the time-price distinction has been costly to the achievement of the UCCC's objectives in three ways. First, it has provided a basis for lack of uniformity in rate ceilings on credit transactions having equivalent economic status in the market. What difference does it make if a purchase is financed by a credit card originated by a seller or lender—a department store card system or a bank card system under which a department store contracts with a bank to finance his customers? Second, it has permitted the UCCC to extend a historical bias to license high-rate lenders without providing similar constraints upon those retailers who are competitors with lenders in the high-rate credit field. Third, it has multiplied the verbiage in what was intended to be a simple, clear-cut model bill. To assess the degree of uniformity in the treatment of credit sales and cash loans, one must refer back and forth from credit sales (Article 2) to loans (Article 3) comparing language which is for the most part identical but which contains some significant differences—differences which work only to the advantage of the favored. If there were some social advantage to be obtained by interfering with the market along these lines, I would not complain. But I see none.

In the prefatory note, the UCCC offers an explanation:

[T]he Committee was and is aware that, sociologically and economically, sales credit and loan credit are alike and that their separate treatment results in much duplication in drafting. Nevertheless, we are mindful of the weight given to Uniform Acts by Courts of States which have not enacted them. Thus, long before the Uniform Commercial Code was enacted or even introduced in New York, the New York Court of Appeals relied in part on a provision of the Uniform Commercial Code in overruling the Court's prior decisions on privity of contract and determining who may recover upon a breach of warranty in a sale of goods. The Committee believes that any encouragement to the courts of a State which has not enacted the Uniform Consumer Credit Code to rely on the Code's provisions to reject the time sale price doctrine would have most unfortunate social and economic consequences for both consumers and credit grantors.\(^5\)

Perhaps because I am not a lawyer, this reasoning seems short-
sighted. If a code is being drawn up to replace statutes based upon obsolescent court doctrines, is it worth the extra cost of trying to preserve the doctrines until the code is passed? In verbiage alone, the cost is huge. The UCCC is roughly twenty-five per cent longer than it would be if Articles 2 and 3 were combined and the numbers of legal definitions could be sharply reduced. The Consumer Credit Protection Act provides a much simpler format: It lumps both credit sales and loans under the same general term, credit,\(^54\) treats the seller or lender as the creditor, and applies the term finance charge to both credit sales and loans.\(^55\) Open-end credit plans are not differentiated according to whether they are offered by sellers or lenders.\(^56\) Finally, the federal act contains a disclaimer, designed to prevent its passage from undermining the time-price doctrine in the states.\(^57\) Yet the example of the federal Consumer Credit Protection Act does not meet entirely the argument of the Commissioners quoted above, since it superimposes its provisions upon, rather than replaces, existing state law.

Verbiage, however, is not the main problem. Rather it is the lack of uniform treatment which crept in when credit sales and cash loans were differentiated, adding segmentation and rigidity to the credit market. It would take several years to get further agreement on uniformity. Meanwhile, and it may be quite a while, the stated objectives of the Code's prefatory note will not be entirely achieved when and if the UCCC is enacted by the states in its present form.

B. Ease of Entry

To make competition work, the UCCC prescribes relatively free entry into all segments of the market for consumer instalment credit. Credit sellers will be able to enter the cash lending business at rates above the old usury limits, banks will be able to enter the consumer finance business, and licensed lenders will be able to purchase credit contracts originated by credit sellers. In short, under the umbrella of UCCC regulation, virtually anyone can extend consumer instalment credit in any form, unless other limitations apply. Only supervised cash lenders are restrained under the UCCC and then only by the license qualifications of character, financial responsibility, and fitness. Ease of entry was deemed necessary to make price competition effec-

tive and to bring rates for all but truly marginal credit risks below legal rate ceilings.

Will the experiment work? Some fifty years of experimentation under state legislation based on the Uniform Small Loan Law (USLL) offers some clues. Before the fifth draft of the USLL, entry into the regulated small loan business was relatively free. The fifth draft, promulgated in 1932, conditioned licenses upon the applicant's fitness, the convenience and advantage of the community, and minimum capital requirements. The provision authorizing the restriction upon licenses according to "convenience and advantage" of the community now permeates thirty-three of the forty-eight small loan laws, but it is applied with different severity among these states. The fifth draft implemented this change in regulatory philosophy based upon events of the 1920's. According to F. B. Hubachek,

Between 1923 and the publication of the Fifth Draft in January, 1932, far reaching changes took place in the business carried on by licensees and in the entire consumer credit field.

A certain sequence of events had followed the enactment of many small loan laws. First, the loan sharks disappeared. Then the regulated business began to expand. Due to improved lending techniques, increased volume of business, and the availability of public capital, it had become possible to make an attractive net return. A time came when there were too many licensed lenders and too many dollars . . . to be lent. Competition so far had been effective only to a very limited extent in reducing the rates of charge. Instead, it took the form of excessive solicitation and over-lending. This in turn led to the borrower's delinquency which fostered collection abuses. These troubles gradually came into bold relief as the industrial states accumulated ten to fifteen years of experience.

By 1931 it had become apparent that increased regulation of the licensed lending business was required. This was provided in the Fifth Draft which contained sweeping innovations. The higher interest privilege became more incidental and the general import of the act was changed to a code of business regulation.\(^5\)

It was common for legislative reform in the 1930's to stress competitive excesses in the 1920's as a cause for difficulties experienced by financial institutions during the Great Depression. The mood of that time was to establish regulatory codes which did not rely upon com-

\(^5\) The USLL is reprinted in B. Curran, TRENDS IN CONSUMER LEGISLATION 144-57 (1965). See note 13 supra.

petitive forces to revive a depressed economy. The enactment of rate ceilings on time deposits solicited by commercial banks and the prohibition of interest paid on demand deposits are cases in point. These measures were taken to keep commercial banks' loans and investments conservative by removing the pressures of rate competition for deposit funds which had encouraged them to seek for riskier, higher-yielding loans and investments. Yet recent studies of commercial bank behavior during the period prior to the banking collapse do not support this hypothesis. Nor does it seem evident that excesses in overlending characterized the consumer finance industry. The ratios of the expense of bad debts and insurance against loss to average employed assets in 1929 and 1930 were less than two per cent, well below ratios reached between 1932 and 1934 and similar to the ratio in 1936. The causes of increased delinquency noted by Hubachek may well have been the fact of economic recession, not "too many licensed lenders and too many dollars . . . to be lent."

More relevant, however, to the relative ease of entry proposed by the UCCC, is Hubachek's comment that "competition so far had been effective only to a very limited extent in reducing the rate of charge." If this was the case, can we expect the easing of entry in the UCCC to accomplish the desired end of bringing rates below legal rate ceilings? The structure of the consumer finance industry has remained one which is basically oligopolistic, described by Clyde Phelps in 1944 as follows: "Because of service differentiation the elasticity of demand for . . . loan services . . . is low, and therefore [the lender] may be still further inclined to avoid initiating rate competition and to utilize other means of maximizing profits or minimizing losses." As experience since World War II has demonstrated, there has been little rate competition to disprove this description. Before 1932, however, there was more reason for price competition to have brought rates below legal ceilings. Yet there was little rate competition between 1916 and 1932 except for one major effort to cut rates.

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61 R. Young, Personal Finance Companies and Their Credit Practices 110, Table 31 (1940).
62 Phelps, Monopolistic and Imperfect Competition in Consumer Loans, 8 J. Mark. 382, 383 (1944).
63 The development of vigorous competition among the licensed small loan companies began in 1928 when one of the great chains, operating in practically all of the industrial states having effective small loan laws, took the initiative in cutting its rates to 2½% per month on unpaid principal balances. At first very
Under the UCCG proposals, however, entry into the cash lending business has a much broader base. By putting existing financial institutions under the same legal rate ceilings, there should be many more lenders willing to make higher-risk loans than the existing consumer finance companies—presently the only group allowed to charge the highest rates. Moreover, the consumer finance companies will be free to expand the number of their offices, especially in those states which had restrictive “convenience and advantage” control of entry. In addition, there are no restrictions, beyond those of financial responsibility, character, and fitness of the applicant, to govern eligibility for a license to make supervised cash loans, and no license is needed to make regulated loans. There is no reason why retailers and other non-financial firms cannot apply for licenses to make supervised cash loans on the same premises where they sell products and services. Meanwhile, there are no restrictions upon eligibility to make unsupervised, regulated loans at rates which are less than eighteen per cent. Finally, the lack of any licensing or other constraints upon sales credit will continue to subject cash lenders to unrestricted competition from credit sellers of goods and services.

The framers of the UCCG state plainly that their intent is to rely upon “competition fostered by disclosure [to] generally force rates below the permitted maximum charges.” And, “[a] secondary purpose is to reduce the likelihood of establishing localized monopolies in the granting of cash credit.” Given past experience, it would appear that few competitors met the cut (perhaps partly because they felt somewhat protected by service differentiation but probably mainly because they had been accustomed to charging the legal maximum rates for so long that they regarded rate-cutting as incomprehensible and undoubtedly a temporary phenomenon) so the company greatly expanded its business, thus setting the stage for a bitter competitive struggle.

But before this could materialize, the great business depression struck, substantially increasing losses and costs, and it was not until 1936 that rate competition among small loan companies was renewed on a widespread scale. . . . By 1941, because of this price competition among the licensed small loan companies, the maximum rates charged on a large part of their loans in most of the states having effective small loan laws were lower than the legal maximums.

Id. at 386. Phelps portrays a more active state of price competition than that implied by Hubachek. Yet it is fair to assume that price competition was limited even in the 1930's, and more so in the years since World War II.

64 This contrasts sharply with the provisions of many small loan statutes based on the Uniform Small Loan Law which prohibited any other business in the same office unless the Commissioner found that such business would not facilitate evasions of the USLL. USSL § 12(a) (7th Draft 1942), reprinted in Curran, supra note 13.

65 UCC § 3.503, Comment.

66 Id.
if competition is to work at all in the pricing of higher-risk credit, there had better be free entry. Other than the plaintive cry of self-interest, the only logical attack upon free entry should come from an alleged lack of benefit to the borrower from competition. I have suggested that parallel regulation and supervision should be extended to high-rate credit selling in order to protect the marginal consumer borrower. But the test of the effectiveness of competition in providing benefits to other borrowers will come when it is determined that the structure of the entire consumer credit industry will allow finance rates to fall below legal rate ceilings for all but marginal credit risks.

There can be no assurance, under the conditions set by the UCCC, that finance rates will fall below ceilings for borrowers formerly served under the small loan statutes. For example, if most retailers and commercial bankers choose not to offer cash loans at rates above eighteen per cent, if there is no rush to establish new offices by consumer finance companies, and if credit sellers do not adopt policies designed to compete for cash borrowers, the status quo might prevail with consumer finance company rates at or close to the newly-established rate ceilings. But one thing is clear. If the Commissioners were to give ground and compromise their position on relatively free entry, their whole concept of setting high rate ceilings might become a device by which vendors and lenders could set non-competitive (monopolistic) rates to divide the high-risk market. The losers in this regard would be the higher-risk consumer borrowers. Disclosure and the ability to substitute liquid assets for debt would suffice to protect the better credit risks.

Predictably, those most concerned about the effects of free entry upon the consumer borrower are the commercial banks, whose trade associations registered strong dissents to the NCCUSL at its July 1968 meeting. Commercial banks, already subject to "convenience and need" requirements for the establishment of new banks and branches, stand to gain nothing from the free entry aspect of the Code except the prospect of more non-bank competitors in every neighborhood. Bankers are also concerned about removal of the limits on size of loan, term, and types of lending allowed under consumer and sales finance company laws today. In short, although banks have enjoyed a great expansion in the kinds and types of activities which they are allowed to pursue under recent rulings of the United States Comp-

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67 Telegrams dated July 24, 1968 from Charls E. Walker, Exec. Vice Pres., ABA, to Alfred A. Buerger, Chairman of the Special Comm. on Retail Installment Sales, Consumer Credit, Small Loans and Usury, and from Robert A. Fischer, Exec. Dir. of the Consumer Bankers Ass'n to William J. Pierce, Pres., NCCUSL.
troller of the Currency and liberalization of state laws, they are not prepared to endorse the concept of competition when their prerogatives are threatened, at least as far as consumer credit is concerned. Although commercial bank opposition smacks strongly of self-interest rather than concern for the consumer borrower, there is a question of conflicting regulatory philosophies governing banks relative to other non-bank financial institutions. If non-bank institutions are not subject to standards of convenience and need, why should banks be? The answer is that commercial banks hold deposit funds, and bank failures are a calamity to depositors who find themselves without liquid funds when banks are closed. Academic economists have argued that today, with deposit insurance and other protections against severe depressions, banks can be allowed to compete and fail in the same manner as non-banking institutions. Until this question is resolved in favor of competition and the equal right to fail in banking, enactment of the UCCC will place commercial bankers at a competitive disadvantage as far as free entry is concerned. But this does not mean that the consumer borrower will not be better served when relatively free entry is a basic element of the UCCC.

The UCCC provision of relatively free entry is essential if competition is to be effective in the higher-rate, “supervised” loan category. In advocating parallel supervised credit status for consumer credit sales, I recognize the risk that entry by retailers and others who do not want to submit to supervision may be discouraged, but the risk is worth taking in order to protect the marginal borrower from credit abuse. These are the people whose needs are strongest and whose vulnerability to exploitation is greatest. Not that the great mass of typical credit transactions require supervision, but rather closer attention must be paid to vendors and lenders catering to high-risk customers. But it is in the area of administration and enforcement that I find the UCCC weakest.

IV

Administrative Powers and Enforcement

The framers of the UCCC steered a middle path between heavy administrative controls which characterize small loan legislation and private remedies available to consumers who are willing to invoke legal processes under retail instalment sales acts. The Administrator, charged with enforcement of the Code, is freed from many of the
stipulations binding him to annual examination of every licensee, collection and publication of composite reports collected from every licensed office, and application of "convenience and advantage" standards to applications for a license for each new office. Under the UCCC, a supervised lender may get a single license which does not limit the number of his offices, he does not have to file an annual report, and he does not have to pay for the Administrator's investigations.

In place of close examination and supervision of licensees, the UGCC's Administrator is empowered to act to terminate objectionable conduct by credit sellers as well as by supervised and unsupervised lenders and is given ample powers to investigate and issue enforcement orders against violations of the Act. He may apply for injunctions to prevent "Unconscionable Agreements and Fraudulent or Unconscionable Conduct" as well as to restrain more specific violations of the Act. He can bring a civil action against a creditor for making or collecting charges in excess of those permitted by the Code and the court can require the respondent to pay not more than "the greater of either the amount of the credit service or loan finance charge or ten times the amount of the excess charge" if the creditor has deliberately or recklessly violated the Code or refused to return an excess charge. Finally, the Administrator can bring a civil action against an offender who willfully and repeatedly violates the Act, in which case the civil penalty may be up to five thousand dollars. Thus, the UGCC places a large grant of power in the hands of the Administrator and considerable freedom to utilize it.

Nevertheless, the Administrator's enforcement is looked upon as supplementary to private enforcement claims by the debtor. The debtor can refuse to perform part of his contractual obligations (not pay the credit service or loan finance charge) or obtain a refund of an excess charge when the Act has been violated. For violations of the prohibited negotiable instrument provisions, or limits on the schedule

68 UCCC § 6.106.
69 Id. § 6.108.
70 Id. § 6.111.
71 Id. § 6.110.
72 Id. § 6.113(1).
73 Id. § 6.113(2).
74 The debtor can collect his refund by lowering his payment or by bringing suit against the creditor or his assignee. Id. § 5.202(3). If the refund is not made within a reasonable time, the debtor may sue and recover a penalty set by the court in an amount "not exceeding the greater of either the amount of the credit service charge or ten times the amount of the excess charge." Id. § 5.202(4).
of payments or loan term for regulated loans, the debtor has the right to bring suit and recover an amount "not in excess of three times the amount of the credit service charge or loan finance charge." For violations of the disclosure provisions, a creditor is liable to the debtor for twice the amount of the credit service or loan finance charge, provided that the amount is within the range of $100 to $1,000. Further, the debtor can, within three business days, rescind home solicitation purchases and consumer credit sales or loans when a security interest is taken in land now used or expected to be used as the debtor's residence. Finally, the debtor who is successful in his action may recover reasonable attorney's fees.

Allison Dunham, Executive Director of the NCCUSL, has sought to justify the balance struck in the UCCC between private and administrative enforcement:

To utilize private enforcement as the major sanction of this Code requires us to make an unverifiable prediction as to the future. The decision to rely on private sanctions is based in part on an assumption that in the future, provision of legal services for the lower economic segment of society and awareness of rights and of legal services will increase as substantially as they have increased in the past few years. Although there is nothing in the Code which provides for legal services for the lower income portion of society, a statutory scheme giving debtors rights can work as well as a deterrent only if the creditor segment of society takes into account the probability of law suits for violations of the Code.

We have not left the problem at this point, however. The amount of recovery for an excess charge and the amount of damage suffered from a failure to disclose is likely to be so small that a consumer will not find it worth while [sic] to proceed. This problem can be met partially in the legal system by assuming or providing for a group or class action in which a group of persons similarly situated join together and seek vindication of their rights in one proceeding. Developments in the field of group or class actions have been so rapid in recent years that we have concluded that special provision for class action is unnecessary. The possibility of this type of concerted legal action is one sanction which we expect to operate. Finally, we have introduced two factors which may encourage self-help or use of the legal process. We have a specific provision allowing debtors to recover more than their proved damage in order to stimulate debtors to protect

75 Id. § 5.202(1).
76 Id. § 5.203(1)(a).
77 Id. § 2.502.
78 Id. § 5.202(8).
themselves against proscribed conduct. . . . Furthermore, we have tried to enlist the active participation of the legal profession in supporting debtors in their defenses by providing that the debtor who is successful in establishing that the creditor has violated the act may be awarded from the creditor the reasonable attorney's fees incurred in prosecuting the successful lawsuit.\textsuperscript{79}

Although these arguments are impressive, I am not wholly convinced. In the bulk of credit sales and cash lending which is extended to borrowers at rates of twenty-four per cent or less, the debtor's defenses appear to be adequate. This covers virtually the whole range of automobile financing (excepting older used cars), most of the typical rates of charge on durable goods financing, revolving credit, repair and modernization loans, and personal loans (excepting small consumer finance company loans). But, as in the past, those who need financing at rates above twenty-four per cent are mostly urban residents who cannot qualify for credit at lower rates.

These individuals have need for credit and will obtain it, whether from legal or illegal sources. The UCCC offers a rate ceiling structure that will allow many such citizens to qualify for credit when there is a reasonable expectation that it can be repaid. For most other groups, the provisions for rate disclosure and debtors' remedies will have meaning and significance. But for the urban poor, many of whom are alienated from society and afraid to assert their rights, there will be no rush to utilize the procedures (including class actions) available to them under the UCCC. Unless the militant organizations which have sprung up in urban areas rally to the cause of the underprivileged debtor, the efforts of others, the outside philanthropically-motivated groups, will, I am afraid, be as insufficient in the future as they have been in the past. The broader social, political and economic problems facing the more militant organizations in urban poverty areas may well deprive them of the resources and personnel to fight the battles of the local debtor. Thus, even with disclosure and competition, the marginal borrower, hampered by lack of knowledge and unable to shop competitively, will retain his disadvantage.

The transition from highly regulated markets in states with effective small loan laws and retail installment sales acts to a relatively free market where borrower and creditor confront one another with relatively loose administrative regulation may prove difficult. An abrupt shift from administrative enforcement to self-help could revive

\textsuperscript{79} Dunham, \textit{Unconscionable Conduct and the Uniform Consumer Credit Code}, 23 \textit{J. Fin.} 312, 316-17 (1968).
abuses as lenders and sellers test their rights under the UCCC. It will take some time for precedents to set the standard of unconscionability, and the new market conditions could foster a double standard—stores that cater to marginal credit risks and offer rates of charge (buried in goods prices) substantially higher than those offered by licensed cash lenders. For this reason, as well as those noted earlier,\textsuperscript{80} I would ask for a broadening of the class of supervised lenders to include supervised credit sellers, thus placing all credit at rates above twenty-four per cent under close administrative supervision.

As Allison Dunham explains, the UCCC does not rest its case solely on self-help but utilizes the Administrator to set precedents for the standard of unconscionability and to police the Act:

Thus, the current draft of the Code does not abolish licensing but it attempts to reduce the routine business of the administrator to a minimum so that he can concentrate his personnel on ferreting out courses of dealing which violate the act. The act does not eliminate license revocation altogether, but it tries to force proceedings leading to elimination of wrongful conduct into judicial proceedings rather than administrative determinations which may or may not be made with full record and hearing.\textsuperscript{81}

This puts a tremendous responsibility on the Administrator without fully indicating how he should allocate his efforts and resources. If I were convinced that he would devote at least three-quarters of his investigations to credit sellers and lenders charging more than twenty-four per cent (or the equivalent when finance charges are buried within the cash prices of the goods), I would be less concerned. There is also tremendous incentive for bribery when the Administrator does not have to examine everyone’s records during a stated time period. The UCCC’s omission of the requirement for an annual financial report by each supervised lender deprives the Administrator of relevant clues as to where to investigate. Besides acting upon complaints, his investigating efforts will have to be based largely upon random sampling to discover violations of the Code. These omissions suggest a lack of concern for those whose bargaining positions are weakest.

If my suggestion were adopted (that supervised lenders and credit sellers be defined to include those charging rates higher than twenty-four per cent), the following administrative procedures would be both practical and desirable:

\textsuperscript{80} See p. 508 \textit{supra}.
\textsuperscript{81} Dunham, \textit{supra} note 79, at 319.
(1) Require annual examination of the credit accounts of supervised lenders and sellers.

(2) Require submission of an annual report from each supervised lender or seller detailing operating income and expenses and balance sheet data of the credit department and description of the procedures used to establish rates of charge at each credit outlet.

(3) Require the Administrator to include in his published annual report the composite income and expense and balance sheet data collected from supervised lenders and sellers.

Possibly these procedures were not included because they could apply only to supervised lenders, not to the unsupervised credit sellers and their assignees. After permitting credit sellers the right to extend credit at rates equivalent to (or greater than) those allowed to supervised lenders, it would have been inequitable to impose added costs of examination and disclosure on only a segment of those serving higher-cost borrowers.

But the advantages of these three requirements outweigh the disadvantages. First, annual examination would ensure that each supervised firm would know with certainty that its books would receive detailed examination once a year and that its probability of successfully evading the law is reduced. Second, the annual report would provide a historical record against which current operating procedures and current financial data could be appraised and would provide data for the Administrator's departmental research. It would also offer clues as to where possible violations of the act were occurring. Third, the publication of the composite figures of income, expense, and balance sheet data would serve to notify the public of the revenue-cost conditions under which high-risk borrowers were being served in their state. The public generally, and academic researchers in particular, would have an opportunity to appraise the manner in which the act was functioning. The main disadvantage of requiring these procedures involves the extension of licensing to credit sellers. Credit sellers who would otherwise enter the high-cost segment of the market could resist direct supervision of their operations by not participating; this might cut down competitiveness of the market for higher-risk borrowers.

Jordan and Warren explain why the Special Committee decided to exempt retailers from licensing:

The Committee's decision not to license retailers was probably due to its common sense belief that the expense of doing so would be great and the gain to the consumer scant. Limitation of entry into retailing is not in the economic tradition of the nation. Im-
position of convenience and advantage limitations on entry was so abhorrent that it was never considered, and there was no sentiment for even the lighter form of entry limitation embodied in the character and fitness test. If entry into the field was not to be limited, the only other legitimate functions that licensing retailers could perform would be (1) administrative enforcement of the Code, (2) notification to state officials of where the retailer is operating and who he is, and (3) financial contribution by retailers to the upkeep of the Administrator's office. Since each of the enumerated functions is provided for all creditors in existing Code provisions, the decision of the Committee to exclude retailers from the licensing requirement seems sound.82

These arguments do apply to most retailers. But for those retailers who wish to serve high-risk borrowers and set their prices accordingly, I think their character, fitness, and financial responsibility is as relevant for review as any lender's. If the rate for qualifying for licensing supervision were raised from the Code's eighteen per cent to twenty-four per cent, there would be less added expense in the coverage of credit sellers. Those who did not wish to be licensed would not have to submit to detailed supervision and could continue their normal credit operations which are now largely priced at equivalent annual rates of less than twenty-four per cent. Yet those who decide that it is economically desirable to serve this segment of the market could overcome their scruples against licensing, as others have done. This segment of the market, composed of people who have long since relinquished their right to complain, is easily susceptible to harassment and abuse and it is essential that gangster elements are not given easy access to the market.

V

ADJUSTMENT OF DOLLAR AMOUNTS

Probably the least heralded but most important provision in the UCCC is the specification that:

From time to time the dollar amounts in this Act designated as subject to change shall change, as provided in this section, according to and to the extent of changes in the Consumer Price Index for Urban Wage Earners and Clerical Workers: U. S. City Average, All Items, 1957-59 = 100, compiled by the Bureau of Labor Statistics, United States Department of Labor, and hereafter referred to as the Index.83

Nothing to my knowledge has caused consumer credit legislation

82 Jordan & Warren, supra note 37, at 431.
83 UCCC § 1.106(1).
to become obsolete more quickly during its history than changes in prices. This is especially true of small loan laws, where rate ceilings are graduated downward in intervals based upon fixed dollar amounts. As prices rise, some portion of the dollar amount needed to keep the purchasing power of the loan constant must be made under a lower rate ceiling when it enters the next interval. Since the UCCC has adopted the principle of graduated rate ceilings for closed-end credit transactions, it is essential that dollar amounts be escalated accordingly.

CONCLUSION

Let us consider now the three questions posed earlier. How well does the UCCC meet the objectives set? In general, it sharply increases reliance upon competition to govern the consumer credit market, but it falls far short of implementing competition through an umbrella-type code with uniform treatment of financing sources. It differentiates the treatment of vendors from that accorded lenders in both application of rate ceilings and administrative supervision. It continues stratification of the market by enacting lower rate ceilings for open-end transactions than for closed-end transactions. In short, it lessens but does not eliminate the stratification of consumer credit markets.

The answers to the second question, involving areas of compromise, are apparent. First, and most important, the UCCC perpetuates the time-price doctrine for superficial reasons. Second, credit sellers are offered favored treatment both in terms of rate ceilings and supervision despite the fact that cash lenders are given substantially higher rate ceilings and less supervision than have hitherto existed. Third, concessions made in the name of the consumer in the form of sharply reduced creditors' remedies will accentuate the problems of the poor in obtaining credit without providing them with opportunity to seek competitive legal rates of charge reflecting their high-risk status on loans of three hundred dollars or less. By leaving them the loophole of obtaining accommodation from unsupervised credit sellers or loan sharks, the UCCC has driven them outside of its umbrella of protection.

But finally, with respect to the question whether the consumer credit market will be better served by the UCCC, the answer must be an unqualified yes. Despite its compromises and concessions it represents a giant step forward in providing lower-cost competitive services for consumer borrowers.

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84 See p. 494 supra.