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Consumer Credit-Computation of Revolving Credit Finance Charges-Death and Rebirth of the Previous Balance Method in New York

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Consumer Credit—COMPUTATION OF REVOLVING CREDIT FINANCE CHARGES—DEATH AND REBIRTH OF THE PREVIOUS BALANCE METHOD IN NEW YORK

Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 293 N.E.2d 80, 340 N.Y.S.2d 908 (1972)

The three methods most frequently used to calculate finance charges on revolving credit are the previous balance method, the adjusted balance method, and the average daily balance method. Under the previous balance method, the periodic finance charge rate is applied to the balance at the beginning of the billing cycle, and the finance charge is computed without first deducting payments made during the cycle.[1] This practice has drawn considerable criticism from consumers, legislators, and commentators,[2] but creditors resist change since the pre-

1 Under the previous balance method, the finance charge (typically 1.5%) is computed on the basis of the balance at the beginning of the billing cycle (typically 30 days) without first deducting partial payments made during the current cycle. For example, if a consumer makes a $100 purchase at the beginning of the cycle and pays $50 on account during the cycle, the finance charge will be $1.50 (1.5% × $100). Generally, no finance charge is assessed if the entire bill is paid during the billing cycle, a result mandated by common sense on the part of the creditors, not by mathematical necessity.

The adjusted balance method deducts partial payments from the balance at the beginning of the cycle before computing the finance charge. Thus, using the above figures, the finance charge would be $.75 (1.5% × $50). The $50 figure represents the initial balance ($100) minus the payments during the cycle ($50).

The average daily balance method takes the average balance owed during the cycle as the basis for the finance charge. Suppose the consumer made his $50 payment at the end of 20 days in a 30-day cycle. There would be an outstanding unpaid balance of $100 for 20 days and a balance of $50 for 10 days. The average daily balance would be computed as follows:

$$\frac{(20 \text{ days} \times \$100) + (10 \text{ days} \times \$50)}{30 \text{ days}} = \$83.34$$

The finance charge would then be $1.25 (1.5% × $83.34).

Other less frequently employed methods include the closing balance method and the past-due balance method. Under the closing balance method, the finance charge is computed by deducting partial payments made during the billing cycle (as in the adjusted balance method) and adding all purchases made during the cycle to the balance. The past-due balance method allows a consumer to pay his bill in full every other month without incurring any finance charge. *See generally* Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 293 N.E.2d 80, 340 N.Y.S.2d 908 (1972); FTC Consumer Policy Statement No. 4 (May 7, 1970), *reprinted in* 4 CCH CONSUMER CREDIT GUIDE ¶ 30,369 1970: *Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 90th Cong. 1st Sess., 199-223 (1967) (testimony of W. Batten, Chairman of the Board, J.C. Penney Co.); Brandel, *Open End Credit Disclosure*, 26 BUS. LAW. 815 (1971).

Quite obviously, the choice of a particular method can make a siguificant difference in the ultimate amount billed to a consumer as a finance charge.

2 *See* Seibert v. Sears, Roebuck & Co., *summarized in* 4 CCH CONSUMER CREDIT GUIDE

vious balance method is highly favorable to them. This method generally yields the highest finance charge possible under the various methods[3] and is simpler to administer than the others.[4] It has very real disadvantages, however, especially for the low income consumer. Advocates of consumer legislation have observed that there is a large market for consumer credit among persons near, or even below, the poverty level.[5] The poor frequently turn to the use of consumer credit as their one hope of realizing some semblance of the American dream,[6] but the previous balance method works to their financial detriment.

Low income consumers, in particular, need to be able to shop for credit terms. Consequently, they should be made fully aware of the various methods of computing revolving credit finance charges.[7] The federal truth-in-lending disclosure requirements for annual percentage rates (APR) are merely nominal. The regulations permit a retailer to calculate the APR by multiplying the periodic rate by the number of periods in a year.[8] The nominal APR for all methods (*e.g.*, 1.5 percent per month $\times$ 12 months = 18 percent per year) will be identical. However, the effective APR under the previous balance method will generally be higher than that obtained under other methods because the balance to which the periodic rate is applied will usually be larger.[9] For substantial purchases, the difference in the effective cost of credit can become tremendous over a period of months. Critics have noted that

> most consumers will focus their attention on the APR figure, which under both [the previous balance and the adjusted balance

¶ 99,164 (Cal. Super. Ct. May 1, 1972); Johnson v. Sears Roebuck & Co., 4 CCH CONSUMER CREDIT GUIDE ¶ 99,289 (Ill. Cir. Ct. 1971); Brown v. Marcor, Inc., 4 CCH CONSUMER CREDIT GUIDE ¶ 99,288 (Ill. Cir. Ct. 1971); Montgomery Ward & Co. v. Kelley, Civil No. 12,211, C. (Mich. Cir. Ct., Ingham County, Sept. 22, 1971); Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 293 N.E.2d 80, 340 N.Y.S.2d 908 (1972); 118 CONG. REC. S 6902 (daily ed. April 27, 1972) (statement of Senator Proxmire); Brandel, *supra* note 1.

3 The closing balance method can yield a higher return to creditors if the amount purchased during the billing cycle is greater than the partial payments, but this method is not widely utilized. *See* note 1 *supra*.

4 *See* note 1 *supra*.

5 *See, e.g.*, Caplovitz, *Consumer Credit in the Affluent Society*, 33 LAW & CONTEMP. PROB. 641, 647 (1968).

6 *Id.*

7 *See* FTC Consumer Policy Statement No. 4 (May 7, 1970), *reprinted in* 4 CCH CONSUMER CREDIT GUIDE ¶ 30,369 1970.

8 Regulations permit this method of calculation in the initial statement when an account is opened (12 C.F.R. § 226.7(a)(4) (1972), and in the periodic statements. *Id.* §§ 226.5(a)(1), .7(b)(6).

9 *See* note 1 *supra*.

> methods] will be identical, and will not have the sophistication to realize that one of those plans provides a lower interest rate than the other.[10]

Even with the information needed to shop for credit, the low-income consumer may not be able to avoid making purchases subject to previous balance finance charges, due to an often limited access to shopping facilities.[11] If the accessible retailers all use the previous balance method, complete finance charge information is of little practical significance.

An outspoken opponent of the previous balance method, Senator William Proxmire, contends that this method encourages low income consumers to overextend themselves financially.[12] The Senator claims that the failure to reduce finance charges commensurate with partial payments made during the billing cycle decreases a consumer's incentive to reduce his indebtedness.[13] Another of the Senator's criticisms concerns the effect of the previous balance method on a consumer with a billing dispute. If a customer elects to pay his entire indebtedness during the billing cycle, there will be no finance charge levied for that month. If, however, even a small amount is withheld by the consumer because of a billing error or dispute, the retailer will assess a finance charge on the whole balance as of the beginning of that cycle. Thus, the previous balance method pressures consumers to pay charges which they may not owe, in order to avoid finance charges.[14] Proxmire estimates that the previous balance method costs the American consumer $200 million a year.[15]

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10 Brandel, *supra* note 1, at 819.

11 *See* Johnson, *The New Law of Finance Charges: Disclosure, Freedom of Entry, and Rate Ceilings,* 33 LAW & CONTEMP. PROB. 671, 676-77 (1968).

12 118 CONG. REC. S 6883, 6902-03 (daily ed. April 27, 1972) (statement of Senator Proxmire).

13 *Id.* Under the previous balance method there is no advantage to paying off part of the principal since the interest will still be computed on the entire amount due at the beginning of the month. Therefore, a knowledgeable and able consumer will pay the principal due under the previous balance method on the last possible day, thus, effectively retaining control over the money for the entire month free of finance charges.

Although partial payments made during one billing cycle will not reduce the finance charge in the periodic statement sent out at the end of that cycle, they will reduce the finance charge in the following month's statement. To reduce the finance charge assessed next month, there is at least some incentive to make current partial payments.

14 *Id.* at S 6885. Under the adjusted balance method, the same statement would only contain a finance charge on the small unpaid amount. *See* note 1 *supra.* If the consumer were ultimately successful in his contention that he did not owe the disputed amount, he probably would not have to pay any finance charge.

15 *Id.*

I

The Context of the Controversy

Allegations have been made that the previous balance method is not only unfair, but that it is also illegal under existing state retail installment sales acts. During the last three years, these contentions have resulted in official challenges to the method. In 1970, Michigan Attorney General Frank J. Kelley issued a formal opinion[16] in which he declared the previous balance method violative of the Michigan retail installment sales act.[17] Shortly thereafter, the Attorney General initiated suit against three large retailers to enjoin the practice.[18] In September 1970, the Circuit Court of Ingham County, Michigan, determined in *Montgomery Ward & Co. v. Kelley*[19] that the words "computed on all amounts unpaid" in the statute meant computed on the balance after payments made during the billing cycle had been deducted. Pursuant to this determination, a settlement was reached whereby the three retailers, together with two others, abandoned the previous balance method and switched to the average daily balance method.[20]

Unfortunately, such victories over the practice are the exception and not the rule. In several states with statutes similar to that of Michigan, the judiciary has reached conclusions favoring the retailer. In 1971, the Illinois Circuit Court of Cook County held that the Illinois

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16 [1969-1970] MICH. ATT'Y GEN. BIENNIAL REP. 163.

17 MICH. STAT. ANN. § 19.416(112) (Supp. 1972). The statute provides in pertinent part:

> A retail charge agreement may provide for, and the seller or holder may then, notwithstanding the provisions of any other law, charge, collect and receive a time price differential for the privilege of paying in installments thereunder, in an amount not exceeding 1.7% of the unpaid balance per month. The time price differential under this subsection shall be computed on all amounts unpaid thereunder from month to month, which need not be calendar months . . . .

Id.

18 Office of the Michigan Attorney General, Press Release (Sept. 22, 1971), *reprinted in* 4 CCH CONSUMER CREDIT GUIDE ¶ 99,357 1971.

19 Civil No. 12,211, C. (Mich. Cir. Ct., Ingham County, Sept. 22, 1971), *cited in* Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 460 n.6, 293 N.E.2d 80, 89 n.6, 340, N.Y.S.2d 908, 921 n.6 (1972).

20 Office of the Michigan Attorney General, Press Release, *supra* note 18.

In other jurisdictions, retailers employing the previous balance method have recently felt similar official pressures. In March 1972, New York Attorney General Louis J. Lefkowitz singled out W. & J. Sloane & Co., because "we have to start someplace." N.Y. Times, March 13, 1972, at 70, col. 3. Shortly thereafter, he brought actions against Macy's and Gimbels. *Id.*, March 22, 1972, at 51, col. 7.

J.C. Penney Co., has voluntarily changed to the adjusted balance method. *Hearings, supra* note 1, at 201 (testimony of W. Batten, Chairman of the Board, J.C. Penney Co.). Sears, Roebuck & Co. switched to the average daily balance method in 32 states and the District of Columbia because of criticism it had received on its use of the previous balance method. N.Y. Times, July 8, 1972, at 31, col. 1.

retail installment sales act[21] governed revolving charge accounts and construed the statute's phrase "computed on all amounts unpaid from month to month" to permit retailers to use the previous balance method.[22]

A challenge to the California law was similarly resolved. In May 1972, the Alameda County Superior Court of California held that the words "computed on the outstanding balances from month to month" in the California retail installment sales law[23] did not preclude use of the previous balance method.[24] Because the legislative history of the statute did not reveal an intention to prohibit the method, and since the statute specifically required disclosure of the method of finance charge calculation, the court inferred that alternative methods were permissible.[25] Although it conceded that the adjusted balance method would be more advantageous to the consumer, the court stated that it was the responsibility of the legislature, not the judiciary, to change the law.[26]

II

THE *Zachary* CASE

During 1971 five New York consumers instituted lawsuits against most of the large, well-established department stores in New York.[27]

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21 ILL. ANN. STAT. ch. 121 ½, § 528 (Smith-Hurd Supp. 1972). The rate ceilings are specified as follows:

> Notwithstanding the provisions of any other statute, a retail charge agreement may provide for, and the seller or holder may, if the agreement does so provide, charge, collect and receive, a finance charge not exceeding 18¢ per $10 per month, computed on all amounts unpaid thereunder from month to month, which need not he a calendar month.

Id.

22 Johnson v. Sears, Roebuck & Co., 4 CCH CONSUMER CREDIT GUIDE ¶ 99,289 (Ill. Cir. Ct. 1971); Brown v. Marcor, Inc., 4 CCH CONSUMER CREDIT GUIDE ¶ 99,288 (Ill. Cir. Ct. 1971).

23 CAL. CIV. CODE § 1810.2 (West Supp. 1972). The statute provides:

> Subject to the other provisions of this article the seller or holder of a retail installment account may charge, receive and collect the finance charge authorized by this chapter. The finance charge shall not exceed the following rates computed on the outstanding balances from month to month:
>
> (a) On so much of the outstanding balance as does not exceed one thousand dollars ($1,000), 1½ percent.
>
> (b) If the outstanding balance is more than one thousand dollars ($1,000), 1 percent on the excess over one thousand dollars ($1,000) of the outstanding balance.

Id.

24 Seibert v. Sears, Roebuck & Co., *summarized in* 4 CCH CONSUMER CREDIT GUIDE ¶ 99,164 (Cal. Super. Ct. May 1, 1972).

25 *Id.*

26 *Id.*

27 Actions were brought against R.H. Macy & Co., Federated Department Stores, Inc.,

Plaintiffs brought individual and class actions in the Supreme Court for New York County alleging that use of the previous balance method violated section 413(3) of the New York Personal Property Law.[28] The relevant provision states:

> A seller may, in a retail installment credit agreement, contract for and, if so contracted for, the seller or holder thereof may charge, receive and collect the service charge authorized by this article. The service charge shall not exceed the following rates computed . . . on the outstanding indebtedness from month to month:
>
> (a) On so much of the outstanding indebtedness as does not exceed five hundred dollars, one and one-half per centum per month;
>
> (b) If the outstanding indebtedness is more than five hundred dollars, one per centum per month on the excess over five hundred dollars of the outstanding indebtedness . . . .[29]

Pursuant to section 414 of the Personal Property Law,[30] the plaintiffs

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Spartans Industries, Inc., and Gimbel Brothers, Inc. *See* Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 293 N.E.2d 80, 340 N.Y.S.2d 908 (1972).

28 N.Y. PERS. PROP. LAW § 413(3) (McKinney Supp. 1972).

29 *Id.* The statute became effective in 1957, ch. 599, § 1 [1957] N.Y. Laws 1361, and was the first of its kind to deal with revolving credit. *See* Statement of Governor Harriman on approving chs. 594-99, [1957] N.Y. Laws 1349-75, *reprinted in* 1957 N.Y. Sess. Laws 1861 (McKinney). The New York statute was probably the model for the Michigan, Illinois, and California statutes. *See* notes 17, 21, & 23 and accompanying text *supra.* Neither the statement of the Governor, nor the Memorandum of the Consumer Council to the Governor, 1957 N.Y. Sess. Laws 2113 (McKinney), provides any insight into which method of computing service charges was intended by the statute. These documents do indicate, however, that § 413(3) of the Personal Property Law was designed to benefit the consumer. *See* note 53 and accompanying text *infra.*

New York Attorney General Lefkowitz and the Department of Law have undertaken an evaluation of the legislative history of § 413(3) of the Personal Property Law in order to determine the propriety of using the previous balance method. As Lefkowitz stated:

> [T]he Department concluded that it was the intention of the Legislature to prohibit the previous balance method.
>
> Both the wording and the legislative history of Personal Property Law section 413, subd. 3 require the creditor to compute the service charge on the actual unpaid outstanding indebtedness, giving the purchaser an allowance for payments made during the billing period.

Memorandum of the New York Attorney General on (1972) Sen. Int. No. 7237-B (Mr. Laverne), (1972) Assy. Int. No. 8254-A (Mr. Field) (March 2, 1972).

On the other hand, the New York Court of Appeals stated:

> [The previous balance method] was the method most commonly used by retailers . . . offering revolving credit at the time of the enactment of the Retail Instalment Sales Act; and a review of the legislative history of that act discloses no intention to foreclose its continued use, though the legislature must be presumed to have been aware of the practice . . . .

Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 460, 293 N.E.2d 80, 89, 340 N.Y.S.2d 908, 920-21 (1972).

30 N.Y. PERS. PROP. LAW § 414(2) (McKinney 1962) provides:

> In case of failure by any person to comply with the provisions of this article, the buyer shall have the right to recover from such person an amount equal to the

demanded recovery of an amount equal to the total finance charges they had paid, as well as declaratory and injunctive relief. In *Zachary v. R.H. Macy & Co.*,[31] the supreme court granted the defendants' motion to dismiss, reasoning that the legislature had acquiesced in the use of the previous balance method by consistently rejecting numerous bills specifically intended to outlaw the method.[32]

The appellate division reversed,[33] granting the plaintiffs' cross motion for summary judgment on the representative causes of action for declaratory and injunctive relief. The majority stated that when a statute was "unambiguous," it was immaterial that many retailers continued to use a method which violated the statute and that the legislature had declined to clarify or modify the statute.[34] The court held that the plain meaning of the words "outstanding indebtedness from month to

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credit service charge or service charge imposed and the amount of any delinquency, collection, extension, deferral or refinance charge imposed.

31 66 Misc. 2d 974, 323 N.Y.S.2d 757 (Sup. Ct. 1971).

32 *Id.* at 979-80, 323 N.Y.S.2d at 762-63.

> Defendant's method of computing finance charges on revolving charge accounts has been employed by retailers and others to the extent of millions of statements monthly, both before and after the enactment in 1957 of the New York Personal Property Law provisions. It has been used with the full acquiescence of the New York State Legislature. Since 1957, bills have been introduced time after time to amend subdivision 3 of section 413 so as to invalidate the previous balance method of computing finance charges employed by defendant, but these efforts have been rejected consistently . . . . This legislative intention is supported by the history of the enactment and repeal of the New York Truth-in-Lending Act . . . and that of the Federal Truth-in-Lending Act . . . .

Id.

A contrary viewpoint was expressed in Flanagan v. Mount Eden Gen. Hosp., 24 N.Y.2d 427, 248 N.E.2d 871, 301 N.Y.S.2d 23 (1969). There the court asked:

> Are we to hold that a majority of a legislative committee, who give no reason for their failure to allow the whole body to vote on a measure, impart a legislative judgment which must be transmuted into a conclusive legislative intent? "The practicalities of the legislative process furnish many reasons for the lack of success of a measure other than legislative dislike for the principle involved in the legislation. Legislative inaction is a weak reed upon which to lean in determining legislative intent."

Id. at 433, 248 N.E.2d at 874, 301 N.Y.S.2d at 28, *quoting* Berry v. Branner, 245 Ore. 307, 311, 421 P.2d 996, 998 (1966); *see* Dana, *Background Materials for Statutory Interpretation in New York*, 14 RECORD OF N.Y.C.B.A. 80, 99-100 (1959).

Concerning judicial treatment of legislative inaction, Professor John MacDonald, Chairman of the New York State Law Revision Commission, has stated:

> [W]hen the courts do proceed notwithstanding the fact that the Legislature has refused to enact the rule they are about to announce judicially, they do not very often refer to the bill which failed. I believe that when they do refer to the bill which failed, and treat the non-enactment as indicating legislative policy, they do it to buttress a conclusion which they have already reached.

Willard & MacDonald, *The Effect of an Unsuccessful Attempt To Amend a Statute*, 44 CORNELL L. Q. 336, 352 (1959) letter from Professor MacDonald to C. Willard.

33 Zachary v. R.H. Macy & Co., 39 App. Div. 2d 116, 332 N.Y.S.2d 425 (1st Dep't 1972).

34 *Id.* at 120, 332 N.Y.S.2d at 430.

month" meant only those portions of the purchase price not paid during the billing cycle.[35] Thus, according to the majority's reasoning, the use of the previous balance method violated the statute.

Echoing the supreme court's remarks concerning the legislative failure to counteract the widespread use of the previous balance method, the New York Court of Appeals reversed the judgment of the appellate division and reinstated the decision of the trial court.[36] Writing for the majority, Judge Scileppi conceded that there was something "distinctly artificial" about a method which computes finance charges on the basis of an amount other than that currently due and owing.[37] Moreover, he agreed that "[i]n terms of its overall effect, the previous balance method from the consumer's vantage, is perhaps the least favorable method for computing finance charges."[38] Nevertheless, he asserted that the method makes sound business sense; the retailer uses the previous balance for the basis of the finance charge as the *quid pro quo* for not including current purchases in the calculation.[39] Because this argument is premised on continued activity in the account, its rationale clearly favors the retailer. If the consumer chooses not to make further purchases for several months, the previous balance method can serve only as a detriment to him.

Citing *Seibert v. Sears, Roebuck & Co.*,[40] Judge Scileppi rejected the appellate division's "plain meaning" rule.[41] He reasoned that out-

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35 *Id.* at 119-20, 332 N.Y.S.2d at 429-30.

> As used here to qualify the term "indebtedness from month to month," the word "outstanding" plainly means owing and unpaid; "outstanding indebtedness" is that amount which a debtor owes "month to month." Indebtedness or a part thereof which has been paid is not "outstanding." This is clear and, plainly, the statute was not intended to and does not authorize finance charges at the specified maximum rate "from month to month" on any indebtedness which has been paid.
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> . . .
>
> The plain meaning of the statute may not be circumvented for the purpose of approving a convenient method of computing finance charges. Nor should we be unduly concerned with the arguments of the retail sellers based upon their additional inconvenience and expense in computing the charges on the basis of an indebtedness which is "outstanding." The wisdom of the Legislature in enacting the statute in its particular terms is not to be questioned by the courts.

Id.

36 Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 461, 293 N.E.2d 80, 90, 340 N.Y.S.2d 908, 922 (1972). The majority made it clear that its holding in *Zachary* was confined to the individual claims for relief. The court did not decide whether such actions for declaratory and injunctive relief were maintainable on a class basis. *Id.* at 449, 293 N.E.2d at 90, 340 N.Y.S.2d at 922.

37 *Id.* at 451, 293 N.E.2d at 84, 340 N.Y.S.2d at 914.

38 *Id.* at 454, 293 N.E.2d at 86, 340 N.Y.S.2d at 916.

39 *Id.* at 453, 293 N.E.2d at 85, 340 N.Y.S.2d at 915.

40 4 CCH CONSUMER CREDIT GUIDE ¶ 99,164 (Cal. Super. Ct. May 1, 1972).

41 Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 456, 293 N.E.2d 80, 87, 340 N.Y.S.2d 908, 917-18 (1972).

> [T]he battle is one of words and we are provided with no real answer to the

standing indebtedness can be measured only by reference to a particular point in time, which may be at the beginning of the billing cycle as easily as at the end.[42] Accordingly, the previous balance method is simply deferred computation of the finance charge on an "outstanding indebtedness," "but for other than the current billing cycle."[43] In a footnote, he observed that if the words "outstanding indebtedness" are construed to mean "owing and unpaid balance," the adjusted balance method is no more computed on such a basis than is the previous balance method, for under the former system purchases made during the current billing cycle are not *added* to the balance.[44] Given the disparate rulings in Michigan, Illinois, and California,[45] the majority was probably justified in holding that there is no "plain meaning" to the statute. The statutory language itself suggests that the draftsmen did not consider the problem or, more likely, deliberately avoided approval or disapproval of particular methods.

Judge Scileppi also rejected the contention that in realizing an effective rate which may exceed the statutory nominal maximum rate (1.5 percent per month or 1 percent per month),[46] the previous balance method is illegal. He explained that for revolving credit the effective rate cannot be determined in advance because the time and amount of payments are under the consumer's exclusive control.[47] It is therefore the nominal rate which the statute regulates, and not the effective rate.[48] In summary, Judge Scileppi construed the law to permit

> problem posed. In suggesting that the statutory requirement may be satisfied by any charge which is computed on the amount actually owing at some point in time, here the beginning of a current billing cycle, so long as that computation is applied at consistent monthly intervals, it, nonetheless, points to the fact that the statute has no "plain meaning" and that its true import can only be culled from its legislative history including the uses and practices existing at the time of its enactment, as well as the statutory scheme of which it is but a part.

Id.

42 *Id.* at 455, 293 N.E.2d at 86, 340 N.Y.S.2d at 916-17.

43 *Id.*

44 *Id.* at 461 n.7, 293 N.E.2d at 90 n.7, 340 N.Y.S.2d at 921 n.7.

45 *See* notes 17-26 and accompanying text *supra.*

46 In an example cited by Senator Proxmire, a consumer makes a purchase for $100 and makes partial payments totalling $90 during the billing period. If the nominal rate is 1.5% per month and the previous balance method is used, the consumer will be assessed a finance charge of $1.50 (1.5% × $100). Since the consumer has only a $10 unpaid balance at the end of the billing cycle, the finance charge is ten times as much as a finance charge computed on the adjusted balance method. The effective rate, according to Proxmire, is 15% per month under these facts, or "a whopping 180 percent a year." 118 CONG. REC. S 6902 (daily ed. April 27, 1972) (statement of Senator Proxmire).

47 Zachary v. R.H. Macy & Co., 31 N.Y.2d 443, 459, 293 N.E.2d 80, 89, 340 N.Y.S.2d 908, 920 (1972).

48 *Id.* Section 413 of the Personal Property Law is the only provision affecting the rate structure of revolving credit finance charges. As the court pointed out, in New York the finance charge on retail credit sales is not treated as interest, and therefore is not governed

calculation of finance charges on the basis of the amount owed at any time during the billing cycle, so long as computation is made at consistent monthly intervals.[49]

Judges Bergan and Jasen dissented, contending that the appellate division's construction of the words "outstanding indebtedness from month to month" was "altogether reasonable."[50] Judge Bergan found it "incredible" that the legislature would have intentionally sanctioned a practice so adverse to New York consumers.[51] Instead, he argued, the legislature's intent must be deemed to have been the one most favorable to consumers.[52] This approach is not without merit if Personal Property Law section 413 is considered as a provision to protect consumers from excessive finance charges. The legislative history, although sparse, indicates that the statute was passed for the benefit of the consumer.[53] Therefore, it would not have been unreasonable for the court to have invalidated the previous balance method by giving the statute a construction favorable to consumers.

Until its reversal, the opinion of the appellate division was the country's strongest judicial authority for outlawing the previous balance method in states with statutory provisions similar to that of New York.[54] Now, however, the decisional trend is in the opposite direction.[55] The New York Court of Appeals had an opportunity to break new ground in an area where legislative efforts have been minimal, but it chose not to do so.[56] At least one thing now is certain—if change is to come in this

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by the state usury laws. *Id.* at 457 n.5, 293 N.E.2d at 88 n.5, 340 N.Y.S.2d 918 at n.5. Instead, the finance charge is viewed as "a 'time price differential' designed to compensate sellers for additional risks and losses of interest which would ordinarily accrue had he [*sic*] received immediate payment." *Id.*

49 *Id.* at 461, 293 N.E.2d at 90, 340 N.Y.S.2d at 922.

50 *Id.* at 462, 293 N.E.2d at 91, 340 N.Y.S.2d at 922 (Bergan, J., dissenting).

51 *Id.* at 463, 293 N.E.2d at 91, 340 N.Y.S.2d at 923.

52 *Id.*

53 On approving the legislation which governs revolving credit finance charges, Governor Harriman remarked that "[t]hese six bills relating to the regulation and supervision of instalment sales mark one of the greatest advances in the history of the State in the field of consumer protection." Statement of Governor Harriman, *supra* note 29, at 1861. The Consumer Gouncil to the Governor underscored the importance of this law, saying: "For the first time in this, or any other state, the law now gives protection to the buyer of goods and related services under any instalment sales plan." Memorandum of the Consumer Council to the Governor, *supra* note 29, at 2113.

54 N.Y. PERS. PROP. LAW § 413(3) (McKinney Supp. 1972).

55 *See* notes 21-26 and accompanying text *supra*. *Zachary*, of course, adds considerable weight to the list of authorities upholding the previous balance method.

56 The administrative problems that might have arisen following an affirmance of the appellate division do not seem insurmountable.

> Courts aud legislatures need not be viewed as antagonists . . . . Developing the law is the province of both, and the peculiar attributes of these institutions are

area of consumer credit law, it must await legislative action[57] or a fresh judicial challenge.[58]

> complementary in getting the task performed. Judicial action is often necessary to bring to the attention of the Legislature a particular problem in order for it to accomplish the necessary reform which only legislative action can fashion. (footnotes omitted)

Flanagan v. Mount Eden Gen. Hosp., 24 N.Y.2d 427, 435, 248 N.E.2d 871, 875-76, 301 N.Y.S.2d 23, 30 (1969).

Until *Zachary*, Personal Property Law § 413(3) had never been construed by the New York Court of Appeals, and the legislature had not provided clarification. Presumably the court was free to develop rules within the limits of the statutory language.

> While we still have a long way to go in recognizing the appellate court as an explicit law creating institution, it is nonetheless true that the lawmaking function has assumed a far more self-conscious direction in our own day. Courts have been remaking law with increased frankness and deliberateness and in doing so have been more sensitive to social implications and social data footnote omitted.

Levy, *Realist Jurisprudence and Prospective Overruling*, 109 U. PA. L. REV. 1, 26 (1960). Since the previous balance method has attracted considerable public attention in the last few years, it is arguable that the court is a proper vehicle for legal change, given the recurring legislative inactivity.

Certainly, if the court had construed the statute to preclude the previous balance method, problems of reliance and stability for planning purposes would have been raised. Many New York retailers who have been using the method have relied on the belief that they were obeying the law. Affirmation of the appellate division opinion would have raised the spectre of litigating all the "violations" back to 1957, the year in which the statute was enacted. Nevertheless, these difficulties could have been overcome if the court of appeals had limited its decision to prospective effects, a practice which Mr. Justice (then Judge) Cardozo espoused while on the Court of Appeals. *Id. See also* Currier, *Time and Change in Judge-Made Law: Prospective Overruling*, 51 U. VA. L. REV. 201 (1965).

57 At both federal and state levels, legislators have sought to abrogate the use of the previous balance method. Legislative attempts on the federal level have failed. The most recent defeat occurred during 1972, when the Senate rejected a proposal by Senator Proxmire to amend the Federal Truth-in-Lending Act (15 U.S.C. §§ 1601-81 (1970)) to forbid use of the previous balance method. 118 CONG. REC. S 6885 (daily ed. April 27, 1972).

On the other hand, several states have enacted such statutes in recent years. Each of these statutes sanctions particular methods of calculating the finance charge on revolving credit accounts, conspicuously omitting the previous balance method from the authorized list. The Massachusetts truth-in-lending act (MASS. ANN. LAWS ch. 140c, § 6B (Supp. 1972)), as well as the Retail Instalment Sales and Services Law (MASS. ANN. LAWS ch. 255D, § 27 (A)(3) (Supp. 1972)), now permit only use of the adjusted balance method and the average daily balance method. The Wisconsin legislature passed the Wisconsin Consumer Act (WIS. STAT. ANN. §§ 422.101-.419 (Spec. Pamphlet 1973)), which became effective on March 1, 1973. Under that scheme, a creditor may use only the average daily balance method, the adjusted balance method, or a "range" method whereby the same rate is applied to average daily or adjusted balances within a certain range. *Id.* § 422.201(a). As in Massachusetts, the previous balance method is not authorized. Arizona, Counecticut, Maryland, and the District of Columbia have passed similar statutes. *See* ARIZ. REV. STAT. ANN. § 44-6003B (1972) (average daily balance method, adjusted balance method, or a "range" method applied to either of the two); CONN. GEN. STAT. ANN. § 42-133C (1972) (average daily balance method, or on "outstanding unpaid balance as of the end of the current billing cycle"); MD. ANN. CODE art. 83, § 153D(3) (1972) (adjusted balance method, or average daily balance method; finance charge not to exceed that calculated under the average daily balance method); D.C. CODE ENCYCL. ANN. § 28-3702 (1972) (adjusted balance method, average daily balance

CONCLUSION

The *Zachary* decision may generate enough dissatisfaction with the present form of New York Personal Property Law section 413(3) to prompt legislative action.[59] New York was a pioneer in regulation of re-

method, or a "range" method applied to either of the two). A chart summarizing the law of every state on this question is contained in 1 CCH CONSUMER CREDIT GUIDE ¶ 630 (1972).

The Colorado Uniform Consumer Credit Code, ch. 207, no. 73-2-207 [1971] Colo. Laws 786, requires that service charges for revolving credit accounts be computed on an "adjusted balance." A Colorado UCCC Administrative Interpretation Letter, issued by the Assistant Attorney General in December 1971, ruled that the section precludes use of the previous balance method. *See* 4 CCH CONSUMER CREDIT GUIDE ¶ 99,244 (1971). The other UCCC states —Idaho, Indiana, Oklahoma, Utah, and Wyoming—require that the finance charge be computed on the "monthly balance." A summary of the rate structures of these states is contained in 1 CCH CONSUMER CREDIT GUIDE ¶ 505 (1972). Uniform Consumer Credit Code § 2.201 (Working Redraft No. 4, 1972), now provides alternate provisions—one prescribing the previous balance method and one proscribing it.

58 Even after *Zachary* was decided, the *New York Times* reported that the New York Attorney General was pressing several similar cases against upstate retailers on the theory that the previous balance method is "unconscionable" within the meaning of N.Y. U.C.C. § 2-302 (McKinney 1964). N.Y. Times, Jan. 25, 1973, at 64, col. 1. Perhaps this theory will receive more favorable treatment in the courts.

59 Bills to eliminate the previous balance method have been introduced into the New York legislature in the past. *See, e.g.*, (1972) Sen. Int. No. 7237-B (Mr. Laverne), (1972) Assy. Int. No. 8254-A (Mr. Field). This year, Asemblyman Fred G. Field, Chairman of the New York State Assembly Subcommittee on Consumer Credit, and Senator John R. Dunne have introduced another such bill, (1973) Sen. Int. No. 1082 (Mr. Dunne), (1973) Assy. Int. No. 1468 (Mr. Field). The bill would amend Personal Property Law § 413(3) by adding the following paragraph:

> If a service charge is imposed, except where the seller or holder uses an average outstanding indebtedness method, it shall be computed only upon the indebtedness outstanding at the beginning of the monthly billing period reduced by all payments and all adjustments and other credits to such outstanding indebtedness received by the seller or holder during the first twenty-five days of such period. If a seller or holder uses an average outstanding indebtedness method, in no case shall purchases made during the current monthly billing period be added to the indebtedness outstanding at the beginning of the monthly billing period for the purpose of computing the service charge.

Id. The bill is somewhat closer to the Wisconsin statute than the Massachusetts one in that the average daily balance method is listed as the first permissible method, without precisely describing how the average daily balance is to be computed. *See* note 57 *supra*. However, like the Massachusetts scheme, the bill does not expressly authorize the establishment of "ranges" within which the same finance charge may be imposed. The bill also provides that only payments made within the first 25 days of the billing cycle need be considered in using the adjusted balance method.

The bill has the strong support of New York Attorney General Lefkowitz. *See* N.Y. Times, Jan. 25, 1973, at 64, col. 4. He has commented that "[t]his bill will end this regressive, anti-consumer provision [Personal Property Law § 413(3)] which, as construed by the courts, sanctions the use of a method of computing finance charges which is grossly unfair and in effect requires the consumer to pay finance charges on purchases already paid for." Memorandum of the New York Attorney General on (1973) Sen. Int. No. 1082 (Mr. Dunne), (1973) Assy. Int. No. 1468 (Mr. Field) (Jan. 3, 1973).

volving credit;[60] it is appropriate that she resume her place as a leader in this area.

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Of the nine consumer protection bills which Governor Rockefeller sent to the legislature in January 1973 and the two additional such bills he plans to send by the end of the 1973 session, none deals with the problem of the previous balance method. *See* N.Y. Times, Jan. 28, 1973, § 1, at 47, col. 1. It is not clear whether the Governor felt that the previous balance method issue was unimportant, or simply felt that the matter was being handled satisfactorily by the Attorney General.

60 "This is the first time that 'revolving credit,' which is being used increasingly by department stores, has been legally identified and brought under public control." Statement of Governor Averill Harriman, *supra* note 29, at 1862.