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Truth In Lending -- In Support of the Validity of the Regulation Z Four Installment Rule

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protected a corporation's right to retain something of value from a sale of securities.[57]

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Truth In Lending—In Support of the Validity of the Regulation Z Four Installment Rule

In *Mourning v. Family Publications Service, Inc.*,[1] the Court of Appeals for the Fifth Circuit dealt a blow to consumer protection by holding invalid the four installment rule of Regulation Z,[2] a regulation promulgated by the Board of Governors of the Federal Reserve System pursuant to Title I (Truth in Lending) of the Consumer Credit Protection Act.[3] Under Regulation Z the disclosure requirements[4] of Truth in Lending are made applicable to "consumer credit," defined in the regulation as "credit offered or extended . . . for which either a finance charge is or may be imposed *or which pursuant to an agreement, is or may be payable in more than four installments.*"[5] The court of appeals held that promulgation of the so-called "four installment rule" was beyond the authority granted the Board of Governors by Congress and that the rule created a conclusive presumption in violation of the due

[57]The Fifth Circuit adopted a similarly practical approach to the scope of 10b-5 liability in Hooper v. Mountain States Sec. Corp., 282 F.2d 195, 203 (5th Cir. 1960), *cert. denied*, 365 U.S. 814 (1961): "Considering the purpose of 10b-5, it would be unrealistic to say that a corporation having the capacity to acquire $700,000 worth of assets for its 700,000 shares of stock has suffered no loss if what it gave up was $700,000 but what it got was zero."

[1]449 F.2d 235 (5th Cir. 1971), *cert. granted*, 92 S. Ct. 1248 (1972). Two student writers have noted this decision. Note, *Consumer Protection—Credit—Administrative Law—Constitutional Law—Federal Reserve Board Regulation Requiring Disclosure of Credit Terms Any Time Consumer Transaction Involves Four or More Installments Exceeds Authority Granted the Board by Truth In Lending Act and Violates Due Process Clause of the Fifth Amendment*, 40 U. CIN. L. REV. 876 (1971), strongly criticizes the decision and Note, *The Four-Installment Rule of Regulation Z Exceeds the Scope of Authority Granted by the Truth In Lending Act and Creates an Irrebuttable Presumption Prohibited by the Fifth Amendment*, 9 HOUS. L. REV. 552 (1972), generally supports it.

[2]12 C.F.R. §§ 226.1-.1002 (1971).

[3]15 U.S.C. §§ 1601-81 (1970).

[4]Truth in Lending Act §§ 127-28, 15 U.S.C. §§ 1637-38 (1970). Under the Act's disclosure provisions, full disclosure of credit terms must be made to the consumer prior to the consummation of the credit transaction. The Act requires disclosure both where open-ended credit is involved (*e.g.*, credit cards and revolving credit plans) and where credit other than open-ended credit is involved.

[5]12 C.F.R. § 226.2(k) (1971) (emphasis added).

process clause of the fifth amendment of the Constitution.[6] It is submitted that, contrary to the holding, the four installment rule is consistent with the congressional grant of legislative rule-making power[7] and creates a valid rule of substantive law independent of any presumption that a finance charge is present in every installment credit transaction. Under the suggested interpretation, the rule simply requires the disclosure of credit terms in every consumer credit transaction in which the agreement allows payment in more than four installments, whether or not a finance charge is imposed.[8]

Family Publications Service, Inc., a corporation engaged in the business of soliciting subscriptions for well-known periodicals, contracted with Leila Mourning, an elderly widow, for the sale and delivery of four popular periodicals. The contract required the payment of thirty monthly installments of 3.95 dollars each in return for the right to receive the periodicals for sixty months. The agreement contained no disclosure of the total purchase price, finance charge, or the amount financed.[9] After Mrs. Mourning's default, Family Publications attempted to collect the full contract price. In response to these collection efforts, Mrs. Mourning filed a civil suit in federal district court asserting that Family Publications had failed to make the disclosures required by the Truth in Lending Act and requesting the civil penalty[10] and attor-

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[6]449 F.2d at 242-43.

[7]*See* Strompolos v. Premium Readers Serv., 326 F. Supp. 1100 (N.D. Ill. 1971).

[8]The disclosure provisions of the Act are inapplicable to physicians, attorneys, and others who give credit without imposing a finance charge so long as repayment is not made pursuant to agreement in more than four installments. Certain advisory opinions of the Board of Governors which are considered of general interest are published by Commerce Clearing House in Volume 4 of the CCH CONSUMER CREDIT GUIDE. The staff opinions found at ¶¶ 30,180 and 30,434 of the GUIDE emphasize that the Board does not consider the mere fact of payment in more than four installments, in the absence of a specific agreement allowing such payment, sufficient to invoke the disclosure provisions of the Act. Moreover, acceptance of partial payments would not constitute an agreement. *See Legal Problems of Consumer Credit*, 4 U.C.D.L. REV. 261 (1971), for a discussion of the impact of the Act on attorneys.

[9]Family Publications argued that the subscription contract was not subject to the Truth-in-Lending Act because there was no extension of credit. The district court concluded that credit was extended because "[t]he Plaintiff received a present contract right—*a subscription*, in exchange for a promise to pay a certain sum in more than four installments." Mourning v. Family Publications Serv., Inc., 4 CCH CONSUMER CREDIT GUIDE ¶ 99,632 (S.D. Fla. 1970), *rev'd*, 449 F.2d 235 (5th Cir. 1971). The Fifth Circuit did not expressly answer the question of whether credit was extended. However, since a finding that there was no extension of credit would have allowed the court to overturn the conviction without reaching the constitutional issue or the question of scope of authority, it apparently concluded that credit was in fact extended.

[10]Truth in Lending Act § 130(a), 15 U.S.C. § 1640(a) (1970) sets the amount of the civil penalty at "twice the amount of the finance charge in connection with the transaction," except that

ney's fees[11] prescribed by the Act. The district court granted her motion for summary judgment after finding that "the transaction here in question falls squarely within the scope of the [Truth in Lending] Act and its Regulations by virtue of the 'more than four installments' rule . . . ."[12]

The Truth in Lending Act was signed into law on May 29, 1968, as one of five parts of the Federal Consumer Credit Protection Act.[13] It requires certain disclosures by creditors involved in consumer credit transactions,[14] regulates certain credit advertising,[15] and renders rescindable certain transactions which involve a security interest in the consumer's residence.[16] The Act does not attempt to regulate charges for consumer credit; it merely requires disclosure of credit terms. The consumer must then decide for himself whether the credit terms offered are fair and acceptable.

In section 105 of the Act, Congress delegated to the Board broad powers to promulgate regulations to prevent circumvention or evasion of the Act.[17] The necessity and constitutionality of the delegation of rule-making power is well settled.[18] In determining the force to be given rules issued pursuant to rule-making authority, many commentators[19] and

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a maximum and minimum penalty of $1,000 and $100, respectively, is imposed. Criminal penalties for the wilful and knowing failure of a creditor to make the required disclosure of credit information are provided for in 15 U.S.C. § 1611 (1970).

[11]Truth in Lending Act § 130(a)(2), 15 U.S.C. § 1640(a)(2) (1970).

[12]Mourning v. Family Publications Serv., Inc., 4 CCH CONSUMER CREDIT GUIDE ¶ 99,632 at 89,607 (S.D. Fla. 1970). *But see* Castaneda v. Family Publications Serv., Inc., 4 CCH CONSUMER CREDIT GUIDE ¶ 99,564 at 89,521 (D. Colo. 1971).

[13]See R. CLONTZ, TRUTH-IN-LENDING MANUAL 2-6 (rev. ed. 1970) for a concise history of the Act and Regulation Z.

[14]Truth in Lending Act § 121, 15 U.S.C. § 1631 (1970).

[15]*Id.* §§ 141-45, 15 U.S.C. §§ 1661-65.

[16]*Id.* § 125, 15 U.S.C. § 1635.

[17]*Id.* § 105, 15 U.S.C. § 1604.

[18]In American Power & Light Co. v. SEC, 329 U.S. 90, 105 (1946), the Supreme Court said:

> The legislative process would frequently bog down if Congress were constitutionally required to appraise beforehand the myriad situations to which it wishes a particular policy to be applied and to formulate specific rules for each situation. Necessity therefore fixes a point beyond which it is unreasonable and impracticable to compel Congress to prescribe detailed rules; it then becomes constitutionally sufficient if Congress clearly delineates a general policy, the public agency which is to apply it, and the boundaries of this delegated authority.

[19]*E.g.*, Eisenstein, *Some Iconoclastic Reflections on Tax Administration*, 58 HARV. L. REV. 477, 505, 527 (1945); Feller, *Addendum to the Regulations Problem*, 54 HARV. L. REV. 1311, 1320 (1941); Griswold, *A Summary of the Regulations Problem*, 54 HARV. L. REV. 398, 400, 411 (1941).

courts[20] distinguish between interpretive rules, which are not binding upon the courts, and legislative rules, which are binding. For example, Treasury Regulations, which are issued by the Internal Revenue Service to advise the public of the Service's construction of the Revenue Code, are interpretive only and are not binding upon the courts.[21]

A legislative rule, as defined by Professor Davis in his treatise on administrative law,

> is the product of an *exercise of legislative power by an agency, pursuant to a grant* (whether explicit or not) *of legislative power by the legislative body*; a court will no more substitute judgment on the content of a valid legislative rule than it will substitute judgment on the content of a valid statute.[22]

Thus, the crucial difference between an interpretive and a legislative rule is the greater authoritative weight a legislative rule merits by virtue of being issued pursuant to law-making authority.

Congress delegated broad rule-making powers to the Federal Reserve Board to promulgate regulations which would not only offer guidance to creditors in complying with the disclosure requirements of the Truth in Lending Act but also prevent evasion or circumvention of the Act.[23] The Regulation Z four installment rule was created to effectuate this latter purpose. If the four installment rule is consistent with the express purpose of the Act and the congressional delegation of regulatory power, it should be sustained by the courts as a valid exercise of legislative rule-making authority.

The Board's factual basis for determining the necessity for the four installment rule is part of its delegated legislative function and is not subject to review by the courts.[24] The rule itself is presumed to be valid unless "unreasonable and plainly inconsistent with the statute."[25] One

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[20]*E.g.*, United States v. California Portland Cement Co., 413 F.2d 161, 164 (9th Cir. 1969); Allstate Ins. Co. v. United States, 329 F.2d 346, 349 (7th Cir. 1964); American President Lines v. Federal Maritime Comm'n, 316 F.2d 419 (D.C. Cir. 1963); Duke Molner Wholesale Liquor Co. v. Martin, 180 Cal. App. 2d 873, 4 Cal. Rptr. 904, *cert. denied*, 364 U.S. 870 (1960).

[21]General authority to issue interpretive regulations is given the Secretary of the Treasury or his delegate under INT. REV. CODE OF 1954, § 7805(a). However, Congress has also delegated to the Secretary specific authority in certain Code sections to issue binding rules. *E.g.*, INT. REV. CODE OF 1954, §§ 1501-05 (consolidated returns). *See* Rogovin, *The Four R's: Regulations, Rulings, Reliance and Retroactivity*, 43 TAXES 756, 758-60 (1965).

[22]1 K. DAVIS, ADMINISTRATIVE LAW TREATISE § 5.11, at 358 (1958) (emphasis added).

[23]Truth in Lending Act § 105, 15 U.S.C. § 1604 (1970).

[24]*See* United States v. George S. Bush & Co., 310 U.S. 371 (1940).

[25]Review Comm. v. Willey, 275 F.2d 264, 272 (8th Cir.), *cert. denied*, 363 U.S. 827 (1960).

attacking the rule has the heavy burden of persuading the court that the Board has exceeded its authority and employed means inappropriate to the congressional purpose for passing the Act.[26] In authorizing the Board to regulate to prevent circumvention of the Act, Congress clearly manifested an intent to delegate adequate power to deal with the numerous practices which would avoid the technical language of the Act.[27] The Fifth Circuit sought to overcome the presumption of the validity of the rule by invoking the maxim that penal statutes must be strictly construed.[28] The civil enforcement provision[29] of the Act, however, is primarily regulatory and remedial[30] in nature—not punitive. It serves to encourage aggrieved debtors to initiate civil actions to protect their right to disclosure and to bring pressure on creditors to conform to the requirements of the Act. The criminal liability provision[31] of the Act is applicable only when a creditor knowingly and willfully gives false information or no information. All Board regulations are incorporated by reference into the criminal liability provision and thus creditors are put on notice of the disclosure requirements. Although the penal provision should be strictly construed to protect unwitting violators, the same strict construction is inapplicable to the civil liability provision.

The necessity for the rule is clear in view of the expanding use of consumer credit in the United States.[32] The thrust of the Act is to encourage consumers to "credit shop" and thereby encourage competition among creditors.[33] The informed use of credit by consumers would have the dual effect of enabling consumers to maximize the benefit received from each dollar spent for credit and of discouraging deceptive credit practices by placing unscrupulous merchants at an economic disadvantage. Merchants who inflate cash prices in order to minimize stated finance charges would lose sales to merchants who offer lower total prices. The fatal flaw in the Act is that in the absence of the four installment rule, merchants could evade the Act by inflating cash prices and ostensibly charging nothing for the extension of credit. In the absence of disclosure of total price and schedule of payments, many con-

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[26] *Id.*
[27] Truth in Lending Act § 105, 15 U.S.C. § 1604 (1970).
[28] 449 F.2d at 240.
[29] Truth in Lending Act § 130(a), 15 U.S.C. § 1640(a) (1970).
[30] Bostwick v. Cohen, 319 F. Supp. 875 (N.D. Ohio 1970).
[31] Truth in Lending Act § 112, 15 U.S.C. § 1611 (1970).
[32] *See* H.R. REP. No. 1040, 90th Cong., 1st Sess. 10-13 (1968).
[33] Truth in Lending Act § 102, 15 U.S.C. § 1601 (1970).

sumers would be misled by advertisements stressing low monthly payments and "free" credit. This is the kind of deceptive practice the rule seeks to prohibit.

The Board apparently felt the four installment rule was necessary (1) to discourage the "burying" of finance charges in inflated cash prices[34] and (2) to force disclosure of credit terms such as total cost and schedule of payments in installment credit sales in which no finance charge is imposed.[35] Indeed, the rule is seemingly consonant with the congressional purpose of "assur[ing] a meaningful disclosure of credit terms."[36] Nevertheless, the Fifth Circuit ignored congressional intent to delegate broad legislative rule-making powers and invalidated the rule as an unauthorized attempt by the Board to amend the law. While it is evident that Congress was primarily concerned with forcing disclosure of credit terms in transactions in which credit charges were expressly imposed, Congress also included within the coverage of the Act consumer credit transactions which involve hidden finance charges[37] and, through regulations issued by the Board, transactions fashioned in such a manner as to attempt to evade the provisions of the Act.[38] In construing the scope of authority granted the Board, the courts should heed the language of Lord Coke in *Heydon's Case*, decided almost four hundred years ago, and give the statute such "construction as shall suppress the mischief, and advance the remedy, and . . . suppress subtle inventions and evasions for continuance of the mischief . . . and . . . add force and life to the cure and remedy, according to the true intent of the makers of the Act . . . ."[39]

As an alternative ground for overturning the four installment rule, the Fifth Circuit held that the rule created an unconstitutional "conclusive presumption that those who extend credit and permit payment in four or more installments have added a finance charge for the extension

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[34]Letter from J.L. Robertson, December 2, 1969, in 4 CCH CONSUMER CREDIT GUIDE ¶ 30,228, at 66,103 (1972).

[35]Letter from J.L. Robertson, October 9, 1969, in 4 CCH CONSUMER CREDIT GUIDE ¶ 30,180, at 66,078 (1972).

[36]Truth in Lending Act § 102, 15 U.S.C. § 1601 (1970).

[37]*Id.* § 106(a), 15 U.S.C. § 1605(a) (1970).

[38]*Accord*, Gemsco, Inc. v. Walling, 324 U.S. 244 (1945). In *Gemsco* the Fair Labor Standards Act gave the administrator the power to issue orders he found necessary to carry out minimum-wage orders or to prevent circumvention or evasion thereof. Violation of the orders was criminally punishable. An order prohibiting "homework" in the embroidery industry was held valid as necessary to prevent evasion of the minimum-wage requirements.

[39]3 Co. Rep. 7a, 7b, 76 Eng. Rep. 637, 638 (Ex. 1584).

of credit."[40] The decision rests upon the conclusion that a finance charge must necessarily be found in the credit transaction for the disclosure provisions of the Act to be applicable.[41] If the foregoing analysis of the scope of the Board's rule-making power is accurate, that conclusion by the court is erroneous. The four installment rule does not create a factual presumption that a finance charge exists; it extends the Act to include factual situations in which, in the judgment of the Board, disclosure is necessary to prevent circumvention of the purposes of the Act.[42] If the congressional grant of authority to issue regulations is broad enough to permit such an extension of the Act, the rule clearly creates no presumption and the court's attack on its constitutionality is groundless.

The tax cases[43] cited by the Fifth Circuit in support of its holding that the four installment rule creates an unconstitutional conclusive presumption are inapposite. In those cases legislation purported to tax as gifts made in contemplation of death all gratuitous transfers made within a certain period prior to death, without regard to the donor's actual motivation. The Supreme Court held the presumption impermissible since the death of the donor within the designated period following the gift was considered by the Court insufficient evidence of the donor's state of mind at the time of the gift to support a conclusive presumption concerning the donor's motivations. The four installment rule does not presume the existence of a finance charge; it necessitates disclosure without regard to the existence of a finance charge where consumer credit is, by agreement, repayable in more than four installments.

The Fifth Circuit's invalidation of the four installment rule has given rise to the possibility that the Truth in Lending Act will be rendered practically a nullity in some areas of consumer credit.[44] The meaningful disclosure of credit terms will hardly be encouraged by a law

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[40]449 F.2d at 240.

[41]*Id.*

[42]*See* Note, 40 U. CIN. L. REV., *supra* note 1, at 879.

[43]Heiner v. Donnan, 285 U.S. 312 (1932); Schlesinger v. Wisconsin, 270 U.S. 230 (1926).

[44]In the 1971 FED. RESERVE SYSTEM BD. OF GOVERNORS ANN. REP. ON TRUTH-IN-LENDING 21, the Board communicated its concern to Congress that court invalidation of the four installment rule could mean the subsequent invalidation of the Act's provisions on credit advertising and home improvement sales involving a security interest in the consumer's residence. While these provisions are not expressly limited in application to transactions involving a finance charge, they might be interpreted as applying only to "creditors." Creditors are, in turn, covered by the Act only if they regularly extend credit for which a finance charge is or may be imposed. Thus, coverage under the Act could be avoided by "burying" any finance charge imposed on the sale.

which can be circumvented by the "burying" of finance charges, since such a law would permit merchants to decide for themselves whether they will be subject to its disclosure provisions. Unless the four installment rule is validated by subsequent court decision[45] as a legitimate exercise of legislative rule-making power, or some similar rule is enacted by Congress,[46] the Truth in Lending Act may in the future operate to the detriment, rather than to the benefit, of many credit consumers.[47]

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[45]The United States Supreme Court has accepted certiorari to determine the validity of the four installment rule. Mourning v. Family Publications Serv., Inc., 92 S. Ct. 1248 (1972).

[46]The Board has recommended congressional enactment of the four installment rule. 1971 FED. RESERVE SYSTEM BD. OF GOVERNORS ANN. REP. ON TRUTH-IN-LENDING 22. In order to avoid litigation on the presumption issue, such legislation should be clearly applicable to consumer credit repayable by agreement in installments regardless of whether a finance charge is imposed.

[47]The ultimate fate of the four installment rule will have repercussions on the Retail Installment Sales Act passed by the North Carolina General Assembly in 1971. N.C. GEN. STAT. § 25A (Supp. 1971). That Act sets maximum interest rates on consumer credit sales, defined in § 25A-2 as "the sale of goods or services in which . . . (4) Either the debt representing the price of the goods or services is payable in installments or a finance charge is imposed . . . ." In § 25A-3 the Act says that "A debt is 'payable in installments' when the buyer is required or permitted by agreement to make payment in more than four installments, excluding a down payment, and whether or not a finance charge is imposed by the seller." However, § 25A-1 of the Act provides that the Act "does not apply to any party or transaction that is not also subject to the provisions of the Consumer Credit Protection Act (Federal Truth-in-Lending Act)." Consequently, unless the General Assembly deletes this limitation, the applicability of the Retail Installment Sales Act to consumer credit repayable in installments will be conditioned upon the validity of the Regulation Z four installment rule.

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This issue of the *North Carolina Law Review* is dedicated to Graham Kenan Professor of Law and former Dean of the Law School, Henry P. Brandis, Jr., who is retiring this year after thirty-two years at the School of Law.