THE SUBSTANTIVE PROVISIONS OF THE UNIFORM CONSUMER CREDIT CODE: 20th CENTURY CONSUMER PROTECTION IN A FREE ENTERPRISE SYSTEM

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I. AN OVERVIEW OF THE UNIFORM CONSUMER CREDIT CODE

The proposed Uniform Consumer Credit Code has gone through several drafts to date. This article is addressed to the latest version, Working Draft No. 6, dated December 4, 1967. References to the Code or to the "U3C" are to Working Draft No. 6, unless otherwise specified.[1] The U3C itself is the product of the National Conference of Commissioners on Uniform State Laws. It was painstakingly drafted by the Conference[2] and has been subjected to thorough and highly critical review by various members of an advisory committee which consists of representatives of different kinds of lending organizations and representatives of various consumer or public groups.

The U3C is designed to replace a myriad of piecemeal and nonuniform state laws[3] dealing with such consumer credit transactions

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1 Copies of Working Draft No. 6 of the U3C may be obtained, to the extent available, from the National Conference of Commissioners on Uniform State Laws, 1155 E. 60th St., Chicago, Ill. 60637. See footnote 1 of Prof. Spanogle's article, this issue, for explanation of "U3C" citation.

2 The principal draftsmen have been Professors William D. Warren and Robert L. Jordan, both of the University of California School of Law, Los Angeles (UCLA), and they have been assisted by Professor Robert W. Johnson, School of Industrial Administration, Purdue University. A number of the Commissioners on Uniform State Laws have personally participated in the project, and consultants and researchers have also participated in various capacities.

A public hearing on the U3C was conducted in Chicago on June 16-17, 1967, attended by members of the advisory committee and others. That hearing considered a prior draft of the U3C and consisted of both written memoranda and oral presentations. See Proceedings, Public Hearing on Second Tentative Draft of the Proposed Uniform Consumer Credit Code, which may be obtained from the National Conference on Commissioners on Uniform State Laws, 1155 E. 60th St., Chicago, Ill. 60637. [Hereinafter cited as Proceedings.]

3 For a thorough analysis of existing consumer credit laws as of a few years ago, *see* CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965). For a briefer analysis by the same author, *see* Curran, *Legislative Controls as a Response to Consumer-Credit Problems*, 8 B.C. IND. & COM. L. REV. 409 (1967).

For some of the background, see Jordan and Warren, *A Proposed Uniform Code for Consumer Credit*, 8 B.C. IND. & COM. L. REV. 441 (1967). [Hereinafter cited

(and sometimes other credit transactions as well) as retail installment sales,[4] revolving credit agreements or so-called "revolving budget" agreements,[5] small loans,[6] bank installment loans,[7] second mortgage loans,[8] and assignments of wages or earnings,[9] and is further designed to replace the general laws relating to limitations on interest and usury.[10]

The "substantive" provisions dealing with consumer credit sales and leases and consumer loans are found in articles two and three of the U3C.[11] The draftsmen considered it preferable to separate substantive treatment of consumer credit sales (and leases) from that of consumer loans. This accords with the traditional separation of credit sales and loans arising under the time-price doctrine with regard to sales.[12] However, because the provisions of Article 2 on sales and Article 3 on loans are for the most part parallel in coverage and quite similar in language and draftsmanship, it is expedient to consider the two articles together.

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as Jordan & Warren.] Current news of the consumer credit project is given in virtually every issue of the PERSONAL FINANCE LAW QUARTERLY REPORT.

Texas has varied to some degree from the general trend of enacting piecemeal legislation, by enacting in 1967 a comprehensive statute regulating most consumer credit transactions, including loans of $2,500 or less and most retail installment sales. The language and form of the Texas statutes is rather similar to that found in many of the separated and piecemeal consumer credit statutes found in other states. TEX. REV. CIV. STAT. ANN., art. 5069 (Supp. 1967).

4 *E.g.*, OHIO REV. CODE ANN. §§ 1317.01-.11 (Page 1962).

5 *E.g.*, OHIO REV. CODE ANN. § 1317.11 (Page 1962).

6 *E.g.*, OHIO REV. CODE ANN. §§ 1321.01-.19 (Page 1962).

7 Loans payable in installments or by means of periodic deposits are permitted on the part of banks under a provision of the new Ohio Banking Code, OHIO REV. CODE ANN. § 1107.26 (Page Supp. 1967). A similar provision of former law applied to "special plan" banks, similar to industrial banks of other states. OHIO REV. CODE ANN. § 1115.10 (Page 1953 now repealed).

Some states have rather extensive installment loan statutes applicable to such loans by banks. *E.g.*, N.Y. BANK. LAW § 108 (McKinney 1950).

8 *E.g.*, OHIO REV. CODE ANN. §§ 1321.51-.60 (Page Supp. 1967).

9 *E.g.*, OHIO REV. CODE ANN. §§ 1321.31-.33 (Page 1962).

10 *E.g.*, OHIO REV. CODE ANN. §§ 1343.01-.05 (Page 1962).

11 In a manner analogous to that of the Uniform Commercial Code, the U3C is organized in numbered articles and sections, *i.e.*, "U3C § 2.101."

12 Under the time-price doctrine, a credit sale may be made at a higher price than that charged for a cash sale of the same item of property, and such price differential is not "interest" within the ambit of the usury law limitations on interest. The time-price doctrine has been the law of most states, including Ohio. *See* 54 OHIO JUR. 2D *Usury* § 13 (1962). Credit sales, however, are subject to retail installment sales statutes, such as OHIO REV. CODE ch. 1317 (Page 1953). *See* Annot., 14 A.L.R.3d 1065 (1967).

II. Disclosure of Financing Rates

A. *Simple Annual Interest*

The most controversial subject in the entire area of consumer credit has been that relating to required disclosure of the essential terms of a consumer credit transaction in such a manner as to enable a consumer to have some meaningful information as to what he must pay for credit, and thus to enable him to "shop" for credit by comparing the rates of different credit extenders.[13] There are state disclosure statutes of various kinds.[14] At the federal level considerable attention has been directed to legislation that would require written disclosure to the borrower in a consumer credit transaction of the cost of his credit in terms that he should presumably understand. Such disclosure will require that the finance charge be stated as a simple annual percentage rate of interest. The federal Truth in Lending Act[15] contemplates that states will adopt laws requiring disclosure in a manner substantially similar to the federal requirements.[16]

The U3C provisions on disclosure have been drafted to coincide with expected Congressional thinking, and it would seem that ultimately the U3C disclosure provisions[17] must depend on the Congressional action taken. Since most of the Congressional proposals to date had called for disclosure in terms of an annual percentage rate of interest,* that method is followed in the current draft of the U3C.[18]

To cover the credit sale and consumer loan dichotomy, the disclosure provisions are double-jointed. They do not apply to sales "other than sales of interests in land" or to leases,[19] where the

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13 *See* Jordan & Warren, *Disclosure of Finance Charges: A Rationale*, 64 Mich. L. Rev. 1285 (1966); 18 Vand. L. Rev. 856 (1965).

14 For summary of some state disclosure statutes, *see* 16 De Paul L. Rev. 464 (1967).

For a decision dealing with the effect of non-disclosure under a state statute, *see* American Home Improvement, Inc. v. MacIver, 105 N.H. 435, 201 A.2d 886 (1964). *See* Annot., 14 A.L.R.3d 330 (1967).

15 82 Stat. 146 (1968), 1968 *United States Code, Cong. and Admin. News* 1232.

16 *Id.* at 1245.

17 U3C § 2.301 *et seq.* apply to credit sales and § 3.301 *et seq.* apply to loans.

18 *See* U3C § 2.301 *et seq.* Working Draft No. 4, prepared earlier in 1967, had required disclosure in terms of dollars per one hundred dollars per year.

* This article was in galley proofs when the Truth in Lending Act was enacted. The editors have made some adjustments, but some anachronisms necessarily appear.—Ed.

19 The general coverage of Article 2 with respect to consumer credit sales and consumer leases is set forth in U3C §§ 2.102, 2.104 and 2.106.

amount involved is 25,000 dollars or more.[20] Similarly, the disclosure provisions do not apply to loans[21] other than those "secured primarily by an interest in land" of 25,000 dollars or more.[22]

For the ordinary consumer installment credit sale or loan, the key requirement is disclosure of the approximate annual percentage rate of the finance charge, where the charge is ten dollars or more,[23] calculated under what is termed in the U3C as the "United States rule."[24] For example, assume that 500 dollars is financed for four months at a total service charge of $12.56. The total balance to be repaid is $512.56 and the monthly payment is $128.14. A monthly interest rate of one percent will satisfy the rule;[25] and that rate would be multiplied by twelve to give an annual rate of twelve percent which must be disclosed.[26] "Approved" tables will likely be compiled for use by credit sellers and lenders which will carry rates expressed in terms of annual percentages for varying amounts and number of installments of credit.[27]

In addition to the annual percentage rate, other elements must also be disclosed in the ordinary consumer credit transaction. Where there is a credit sale, the cash price, the down payment (including trade-in allowance), license fees, official or filing fees, insurance premiums, certain "permitted" additional charges, the credit service charge, the total unpaid balance, and the number of payments, including the amount and due date of each, must be disclosed.[28] These requirements are similar to those of a number of existing retail installment sales statutes.[29] Analogous requirements of itemization and

20 U3C § 2.301(1).

21 The general coverage of the disclosure provisions of Article 3 with respect to consumer loans is set forth in U3C §§ 3.302, 3.304, and 3.306.

22 U3C § 3.301(1).

23 U3C §§ 2.306(3), 3.306(2)(j).

24 "United States rule" indicates the actuarial method of allocating payments made on a debt between principal or amount financed and loan finance charge or credit service charge, pursuant to which a payment is applied first to the accumulated loan finance charge or credit service charge and the balance is applied to the unpaid principal or amount financed. U3C § 1.301(15).

25 Complete mathematical accuracy is not required. A calculation of the rate which will equal the finance charge to the nearest whole dollar is all that is necessary. U3C §§ 2.304(2), 3.304(2).

26 The example in the comment to U3C § 2.304, while illustrating the proper method, has been garbled by the misplacing of decimal points. The figures there illustrate an annual rate of 120%, not 12% as indicated.

27 The enforcing agency is empowered to publish guidelines, in the form of tables or otherwise, for determining rates to be disclosed. U3C §§ 2.304(7), 3.304(7).

28 U3C § 2.306(2).

29 *See, e.g.*, the present Ohio Retail Installment Sales statute. OHIO REV. CODE ANN. § 1317.04 (Page 1962).

disclosure of the elements of a consumer loan also exist.[30] This, too, has counterparts in existing small loan statutes.[31]

Some additional provisions of the U3C require disclosure where there is refinancing of an existing credit,[32] consolidation of credits,[33] or deferment of one or more due payments.[34] Disclosure is also called for where installment loans are made pursuant to the use of a credit card or similar arrangement[35] and where a consumer lease is entered into which is payable in installments.[36] Disclosure on an estimated basis is permitted, since advance disclosure may at times be impossible.[37] The debtor, however, is entitled to a copy of any writing which he signs.[38] Where a sale or lease is arranged by mail or telephone, the required disclosure may be made within a reasonable time, and before the first installment is due.[39] Where a loan is arranged by mail, disclosure is necessary at the time of reciept of the proceeds of the loan by the debtor.[40] Where the credit is repayable

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30 U3C § 3.306(2).

31 The present Ohio Small Loans Act requires delivery to the borrower of a statement of the amount and date of the loan, a schedule of payments or a description thereof, the type of security, the name and address of the licensed office of the lending organization and of each borrower, and "the agreed rate of charge," or in lieu thereof, a copy of all obligations signed by the borrower. A copy of a lengthy statutory provision is also required to be furnished to the borrower. OHIO REV. CODE ANN. § 1321.14(A) (Page 1962). Apparently, all borrowers are assumed to be able to read and understand the wording of lengthy statutes, at least as well as law students. Somewhat similar requirements exist with respect to certain second mortgage loans in Ohio. *See* OHIO REV. CODE ANN. § 1321.58 (Page Supp. 1967).

32 U3C § 2.307.

33 U3C §§ 2.308, 3.307. This refers to consolidation of the amount owed on a previous credit sale or loan with a current credit sale or additional loan. *See* U3C §§ 2.206, 3.206.

34 U3C §§ 2.309, 3.308.

35 U3C § 3.310, which requires basic disclosure of the rate and additional charges before a credit card installment loan is made and which then refers to U3C § 3.306 for other disclosure requirements similar to those for other installment loans after a credit card loan is made. This does not apply to revolving credits.

36 U3C § 2.311 contains no requirement of disclosure of an annual percentage rate, since there is no "interest" normally connected with a lease. This raises, however, the question whether credit sales can be disguised as installment leases by those who desire to avoid disclosure on the basis of an annual percentage rate.

37 U3C §§ 2.302(4), 3.302(4), which permit disclosure of estimates of the required information with an indication that such are estimates where "it is not commercially feasible" to give the exact information.

38 U3C §§ 2.302(5), 3.302(5).

39 U3C § 2.305.

40 U3C § 3.305, which, perhaps on the assumption that no loans are ever made by telephone, makes no provision for such loans. It might also be noted that no provision

in installments, but one of the installments is not equal to the others, or where the due date of the first payment is not equal to the interval between installment payments, or where provision is made for dispensing with an installment payment in any one or more payment periods, disclosure of the rate may be made as if the debt is payable under an agreement having the same amount or principal, the same term or maturity, and "a regular schedule of payments having the same interval between payments as under the actual contract."[41]

The U3C also restricts to some extent the content of advertising in connection with consumer credits. False advertising concerning the terms and conditions of a credit or loan is prohibited.[42] In general, advertising of consumer credit transactions need not follow the "disclosure" requirements; however, if credit or loan advertising states the rate or dollar amount of credit or finance charge or the amount of installment payments, then the advertisement must disclose the rate in terms of a simple annual percentage.[43] Guidelines as to the kinds of advertising permitted may be issued by supervisory authorities.[44]

B. *Disclosure Where There Is A Revolving Credit*

Where a credit of fixed amount is extended on a set date for a definite term repayable in equal installments of equal amounts during equal intervals of time, the terms of the credit are predictable. Even to calculate a simple annual interest rate in percentage for such a predictable credit requires a degree of mathematical wizardry beyond the ken of the average individual, including the average attorney, law student, or law faculty member. However, the use of tables will probably make it possible even for sales or clerical personnel of credit sellers or installment lenders to compute for each loan the simple annual percentage rate that must be disclosed. In any event, such credits consist of constants which make computation of an annual percentage rate possible at the inception of the credit.

On the other hand, where a revolving credit is created under

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is made for cases where the proceeds of a loan are not directly advanced to the debtor but are used to pay a third person, such as a seller, the fact situation of Ohio Loan & Discount Co. v. Tyarks, 173 Ohio St. 564, 184 N.E.2d 374 (1962).

41 U3C §§ 2.304(3), 3.304(3), which in effect permit disclosure of such "irregular" loans as if they were for the same total term and same amount but repayable in substantially equal payments over equal periods of time.

42 U3C §§ 2.303(1), 3.303(1) which might be said generally to "prohibit sin."

43 U3C §§ 2.303(2), 3.303(2). Some exemption exists for charges of $10 or less.

44 U3C §§ 2.303(3), 3.303(3).

a credit card, charge account, or check loan or overdraft by a bank, variables exist which make it impossible to compute an accurate rate on an annual percentage basis. In the typical revolving credit situation, there may be no service or finance charge where payment is made within a fixed period, such as thirty days after the date the bill is sent.[45] After such period a service or finance charge might be computed at a certain rate, such as one and a half percent per month, on the average unpaid balance during the next month or on the unpaid balance as of a certain date in the next month. The actual rate measured on a monthly or annual percentage basis will increase or decrease because of such variables as the time and amount of new purchases or credit extensions or the time and amounts of payments made.

The draftsmen of the U3C recognized the practical impossibility of making accurate advance disclosure in a revolving credit situation on the basis of a simple annual percentage rate; they merely required disclosure at the time the account is opened of the conditions under which a service or finance charge is to be made, the method of computation, and description of any additional charges made. In the usual revolving credit situation this must be stated as a percentage and the equivalent annual rate must be given.[46] Certain information must be given at each monthly billing including the same information as to rates as is required at the inception of the arrangement.[47] Although revolving charge account sales and revolving loan transactions are separately treated with respect to disclosure requirements,[48] the treatment is so similar as to be identical for all practical purposes. In fact, if a person makes both revolving credit sales and revolving credit loans, he may treat all transactions the same and need give only a single statement at the time any statement is required.[49]

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45 For example, a purchase may be made on December 1, the billing may be made as of January 2; payment in full received by February 1 will excuse any service or finance charge. Thus virtually two months of free credit are possible. On the other hand, another purchase may be made on December 31, which is caught in the same January bill. Only one month of free credit exists as to this second purchase.

46 U3C §§ 2.310(1), 3.309(1). For example, if a charge is made at the rate of 1½ percent of the average daily balance in the account for the month, exclusive of purchases made that month (a typical revolving charge account arrangement) such must be disclosed and the equivalent annual percentage rate of 18% must be stated.

47 U3C §§ 2.310(2), 3.309(2).

48 U3C § 2.310 (revolving credit sales or sales pursuant to revolving charge accounts); U3C § 3.309 (revolving loan accounts).

49 U3C §§ 2.310(3), 3.309(3). An example where one person might be both a seller on revolving credit and a revolving credit lender might arise where a particular credit

In summary, disclosure in connection with a revolving credit is sufficient if it merely states the conditions under which a charge is made and the monthly rate and basis multiplied by twelve. It is not necessary for the credit extender to be a fortune-teller and estimate the rate based on actual charges incurred and payments made.

> It is irony indeed that during the decade in which adherents of 'truth-in-lending' legislation fought so valiantly for its passage, the only sales transaction in which disclosure on an annual interest basis can be made with accuracy—the closed-end installment sale—was greatly diminishing in importance in all but high-price transactions like the sale of automobiles. This was due to the rapid growth of revolving credit, and if this trend continues, 'truth-in-lending' legislation may well offer a solution to a problem that has largely disappeared.[50]

C. *Disclosure: Does The U3C Do The Job?*

The disclosure requirements of the U3C must, of necessity, conform with those of any federal enactment, but the provisions proposed in the current draft of the U3C are ones with which a legitimate lender or credit seller can live.[51] The U3C draftsmen appear to have been more realistic than certain elected public servants in not expecting the impossible or the extremely impracticable in connection with "truth in lending." It is hoped that no ultimate Congressional enactment on the subject will be so politically motivated as to ignore the realities and force into an unacceptable mold any state legislation dealing with disclosure.

A few comments might be in order. First, U3C disclosure requirements, unlike those of some prior statutes, do not prescribe exact formats in sales or loan contracts, such as signatures, size of type, notice to the buyer or borrower, and the like.[52] Since there are many kinds of credit sellers, some statutory format might perhaps be desirable. This might be covered by a comment, when comments

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card issued by a selling organization is used both to charge sales of products of that company through its own outlets and sales by independents, who write up charge sales and turn them over to the company, which bills the customer directly. *See* Jordan & Warren, *supra* note 3, at 446.

50 Jordan & Warren, *supra* note 3, at 446-47.

51 This presupposes that the purpose of any consumer credit legislation is to regulate reasonably and not to "kill the goose that laid the golden eggs," thus making loan sharks the sole source of consumer credit.

52 For example, the "Unruh Act" dealing with retail installment sales in California has a number of requirements as to provisions and sometimes exact wording to be included in a retail installment sales contract and, in some instances the size of type to be used. *See* CALIF. CIV. CODE ch. 1803 (West Supp. 1967).

are finally drafted. The great majority of sellers and lenders who desire to obey the law might find such guidance helpful. It might also be desirable to require disclosure of any balloon payment (where permitted) in some conspicuous manner. Furthermore, although it is probably impracticable to forbid blanks completely, some form of statutory protection for the consumer or borrower who signs a blank contract or obligation might be desirable.[53]

III. Rate Limitations

A. *Rate Ceilings and Usury*

The U3C makes some fundamental changes in the general law with respect to credit ceilings or maximum rates. It does away with general usury laws which limit the "contract" rate[54] charge for the use of money.[55] This is justified on the following grounds:

> . . . [U]sury laws imposing inflexible price ceilings on money and credit are historical vestiges of the 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 each type of credit transaction requiring a charge higher than the usury rate.[56]

The U3C might have been drafted as an exception to the general usury laws, thus permitting higher rates with respect to consumer credit while leaving the general usury laws operative in areas of non-consumer credit.[57] For a number of reasons, such an ap-

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53 Suggestions here are difficult, but it might be provided that a copy of the completed contract be furnished the debtor promptly upon completion, and that the debtor be given a period in which to question the accuracy of the completion and possibly to rescind the transaction if the completed form does not conform with the debtor's understanding. For examples of what might be possible see U3C §§ 2.501-.505 on home solicitation sales.

54 Existing state usury laws set a "legal" or "judgment" rate of interest when the rate is not otherwise stipulated and a "contract" rate, which is the highest rate that may be charged by agreement of the parties. In many states the permitted "contract" rate is higher than the "legal" rate. The intent of the U3C draftsmen is to do away with general "contract" rate limitations, although preserving "legal" or "judgment" rates. In Ohio, the "contract" rate is 8 percent; the "legal" rate is 6 percent. Ohio Rev. Code Ann. §§ 1343.01 (contract rate) and 1343.03 (legal rate) (Page 1962).

55 U3C §§ 2.605 and 3.605 expressly permit the parties to agree in writing to any service charge in the case of credit sales or loans which are not subject to the various ceilings or protective provisions of the U3C. In addition, U3C § 9.102 expressly calls for the repeal of laws relating to usury in general.

56 Prefatory Note to Working Draft No. 6, U3C, at 2 (1967).

57 This is similar to the present statutory scheme of many states whereby there

proach was not followed. It is more in keeping with our economic development to limit rate ceilings only on those loans which need limitation, leaving it to "free enterprise" to limit rates on such loans as those of large amounts made to business organizations.[58] Furthermore, general usury laws have often failed to protect consumer credit sale transactions because of the time-price doctrine, which holds that a sale in a free market on credit might be made at a higher price than a cash sale and that such a higher credit price is not a loan of money.[59] Moreover, there is at least a slight possibility that the statutory combination of a general usury law and special higher rates for certain kinds of loans or credit transactions might run into state constitutional difficulties.[60] In any event the maximum limits of general usury laws are too low to afford any practical protection to the consumer.[61] In fact, general usury laws in many states have the sole effect of setting rate ceilings on commercial-type loans, as to which price-control protection is hardly needed. Finally, although general usury laws ordinarily carry maximum rates too low to give adequate protection at a realistic level, such general usury laws may present an unexpected trap to unwary lenders in commercial credit transactions.[62] Although abolition of general usury rate limitations will seem to many to be a radical change in the law and thus subject to

is a general usury law setting a maximum contract rate, accompanied by certain exemptions, such as that for loans to corporations, and also accompanied by higher rates with respect to consumer credit transactions.

58 This is the statutory scheme in Maine, Massachusetts, and New Hampshire, which have no general usury laws, although certain credit transactions such as consumer credits are regulated. The other states have "contract" rate limitations ranging from 6 percent in New York and some other states to 21 percent in Rhode Island. The rate limitation in Ohio is 8 percent. OHIO REV. CODE ANN. § 1343.01 (Page 1962).

59 *See, e.g.*, Theodore Roosevelt Agency, Inc. v. General Motors Acceptance Corp., 156 Colo. 237, 398 P.2d 965 (1965) and Lundstrom v. Radio Corp. of America, 17 Utah 2d 114, 405 P.2d 339 (1965). *See* 14 A.L.R.3d 1058 (1967).

60 Such a problem arose in Nebraska a few years ago under a state constitutional provision prohibiting "special laws" fixing interest rates, in Elder v. Doerr, 175 Neb. 483, 122 N.W.2d 528 (1963), *petition for cert. dismissed*, 377 U.S. 973 (1964). It is not likely, however, to arise in Ohio which lacks a similar constitutional provision.

61 Legitimate consumer lenders could not operate profitably while making consumer installment loans at rates permitted by general usury laws. *See* Curran, *Legislative Controls as a Response to Consumer-Credit Problems*, 8 B.C. IND. & COM. L. REV. 409, 411 (1967) which points out that this inability to operate profitably brought about the Uniform Small Loan Law of the Russell Sage Foundation which now exists in some form in many states.

62 *See, e.g.*, Hollamon v. First State Bank, 389 P.2d 352 (Okla. 1963). In that case a bank loan of $20,000, repayable in 23 monthly installments of $1,000 each, was held to exceed the 10 percent per year usury limit.

condemnation, this writer finds the preferable approach is to do away with all existing rate ceilings and make a new start with the realistic rate ceilings of a uniform consumer credit code.[63]

In practice, not too many loans are freed from the statutory rate ceilings by the suggested repeal of general usury laws. The U3C sets rate ceilings for consumer credit transactions. Furthermore, there are rate ceilings covering non-consumer credit extensions to individuals in the amount of 25,000 dollars or less. Most corporate credits and all credits over 25,000 dollars, however, are freed of rate ceilings.[64]

B. *Specific Rate Limitations*

Another unusual approach taken in the U3C with respect to maximum rates is to set rate ceilings that are rather high, often much higher than those under statutes which the U3C will replace. The draftsmen here recognized the risk that

> too low ceiling rates, too substantial restrictions on creditors' rights and remedies, or too great enhancements of debtors' rights or remedies, might deprive the less credit-worthy of lawful sources of credit and drive them to "loan sharks" and other illegal credit grantors in whose hands they will enjoy no legal protections.[65]

In short, the setting of restrictively low ceiling rates would merely deny credit extension by any reputable organization to the marginal borrower and relegate such borrower to those who operate illegally.[66] High maximum rates are also justified on the ground that a maximum ceiling on a credit sale is of limited utility, since the seller can exceed the ceiling by merely raising the price of the articles sold.[67]

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63 There will be an added problem in a few states where the usury limitations are embodied in state constitutions. Arkansas illustrates the extreme rigidity in this regard with its constitutional ceiling of 10 percent per year. ARK. CONST., art. 19, § 13.

64 A person who can borrow over $25,000 is probably "sophisticated" enough to bargain for reasonably favorable rates. In practice, the rates on such larger loans should rarely come close to the 18 percent figure limiting individual nonconsumer loans of $25,000 or less.

65 Prefatory Note to Working Draft No. 6, U3C, at 3 (1967) which also points out that it was the "loan shark" evil that the Russell Sage Foundation proposed to remedy with its Uniform Small Loan Law.

66 There are no penal provisions in the U3C directed at loan sharks. Such lenders are already subject to the penalties of prohibitory statutes in many jurisdictions. The U3C approach is to make rates high enough so that reputable lenders may operate. This should result in legitimate lenders charging rates that are considerably lower than those charged by illegal operators.

67 Jordan & Warren, *supra* note 3, at 451. The authors, who are also the principal

The rate limitations for consumer credit sales and consumer loans are set forth currently in two alternatives. The first permits eighteen dollars per 100 dollars per year on the first 300 dollars, twelve dollars per 100 dollars per year on the amount from 300 dollars to 1,000 dollars and eight dollars per 100 dollars per year on amounts over 1,000 dollars. The second permits percentages per year on unpaid balances of thirty-six percent on the first 300 dollars, twenty-one percent on the amount from 300 dollars to 1,000 dollars, and fifteen percent on the amount over 1,000 dollars. In lieu of either alternative, a flat eighteen percent per year on the unpaid balance is also permitted.[68] In the case of a revolving credit, the maximum rate may not exceed two percent per month on the amount outstanding[69] which is 500 dollars or less and one and a half percent on that part of the amount over 500 dollars.[70]

The maximum rates apply to all consumer credits, regardless of the identity of the lender. In other words, the U3C does not (like some prior statutes) set one rate for small loan companies or personal finance companies, another rate for banks making installment loans, still another rate for retail installment sales, and perhaps varying rates for retail installment sales of motor vehicles dependent upon the model year of the vehicle. In any instance, however, where rates are filed with and approved by a subdivision or agency of the enacting state or of the United States, the rate ceilings of the U3C do not apply.[71]

Additional charges permitted include official fees, charges for insurance, and "reasonable" charges "for other benefits conferred upon" the debtor.[72] In the case of a loan, a permitted additional

draftsmen of the U3C, point out that this would cause the cash buyer to pay part of the credit charge in lieu of the credit buyer.

68 U3C §§ 2.201(2), 3.508(2) (drafted in alternatives). The flat 18 percent alternative rate is computed under the United States rule.

69 A formula is given for calculating the amount outstanding in U3C §§ 2.207(2), 3.509(2) to cover fluctuating amounts resulting from additional charges incurred during the billing period or payments received during the billing period. The amount may be computed on the average daily balance, the balance as of a certain day each month, or the "median" amount.

70 U3C §§ 2.207(3), 3.509(3). Where the billing cycle is other than monthly, there is provision for a statutory translation into monthly terms.

71 U3C §§ 2.211, 3.207. An example might be loans for home improvement guaranteed by the Federal Housing Administration, which may be made at rates permitted by that agency.

72 U3C §§ 2.202, 3.202.

The provision for "reasonable" charges "for other benefits conferred upon" the debtor is rather indefinite and might open the door to abuse. What is probably con-

charge may include an annual fee for the privilege of using a credit card, as where the credit card may be used in widespread purchases.[73]

The provision on additional charges may be criticized for incompleteness. Some prior consumer credit statutes have spelled out in more detail what additional charges are permissible.[74] In general, it seems that additional charges are permitted by the U3C for any necessary and legitimate payments which are made to third persons. Examples include insurance premiums, filing fees, and the like. Some closing fees, if reasonable and related to actual handling expenses, might also be separately collected.[75]

Other charges permitted include delinquency charges,[76] charges where one or more payments are deferred,[77] charges where a credit is refinanced,[78] and charges permitted where a new credit sale or loan is consolidated with a prior credit sale or loan.[79] A charge may also be made where the creditor makes an advance to perform certain duties normally required of the buyer, such as insuring or preserving the collateral.[80]

The U3C gives the buyer the right to prepay in full any consumer credit without penalty.[81] Upon such prepayment in full, a rebate is required under the familiar "rule of seventy-eights."[82]

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templated here are charges for possible benefits or services given the debtor, such as a charge per check drawn in a check loan, or possible service or closing charges. Abuse in this area might be limited by a provision permitting the state official charged with enforcement of the U3C to adopt rules as to additional charges. U3C §§ 2.202(2), 3.202(2).

73 U3C § 3.202(1)(c). There is no equivalent in connection with credit sales.

74 This is not so in Ohio. The chief additional charge permitted in a retail installment sales contract is a "service charge" dependent on the term of the credit and the principal balance. OHIO REV. CODE ANN. § 1317.06(A)(2) (Page 1962). A separate charge for insurance is also permitted. OHIO REV. CODE ANN. §§ 1317.04(D), 1317.05 (Page 1962). For charges in connection with small loans, see OHIO REV. CODE ANN. § 1321.13 (Page 1962).

75 Abuses are possible in connection with excessive closing fees and also in connection with such matters as broker's or finder's fees.

76 U3C §§ 2.203, 3.203.

77 U3C §§ 2.204, 3.204.

78 U3C §§ 2.205, 3.205.

79 U3C §§ 2.206, 3.206.

80 U3C §§ 2.208, 3.208.

81 U3C §§ 2.209, 3.209. The Comment points out that there is no right to prepay a sale of an interest in real property or to make a partial prepayment.

82 U3C §§ 2.210, 3.210. A somewhat similar rule exists in connection with retail installment sales in Ohio. OHIO REV. CODE ANN. § 1317.09 (Page 1962).

C. *Rate Ceilings for Non-Consumer Credit*

Although the repeal of general usury laws is contemplated, some non-consumer credit sale and loan transactions are also subjected to rate ceilings. These consist of credits of 25,000 dollars or less where the debtor is an individual, or where the debtor is an organization and the debt is secured primarily by a security interest in a one or two family dwelling occupied by a person related to the organization.[83] In addition, when a credit sale is involved, the special non-consumer ceiling governs where " . . . the credit is granted by a seller who regularly engages in credit transactions as a seller."[84] There is no ceiling on loans or credit sales over 25,000 dollars. There is also no ceiling on non-consumer sales by a person not in the business of selling on credit or on non-consumer credits to corporations or other organizations, except where a one or two-family dwelling is used as security.

Non-consumer credits which are subject to rate ceilings are governed by a ceiling of eighteen percent per year on unpaid balances. In other words, there is a "partial usury law" of eighteen percent on many non-consumer credit transactions.[85] However, the parties may agree to subject any non-consumer credit transaction to the provisions of the U3C applicable to consumer credit transactions,[86] including the rate ceilings previously discussed, which often may exceed eighteen percent.

Revolving credit transactions in the non-consumer category discussed here are subject to the same maximum rates as consumer revolving credits.[87] A special provision of the U3C exempts any consumer loan with a rate of ten percent per year or less on unpaid balances, which is not a revolving credit loan.[88]

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83 U3C §§ 2.602(1), 3.602(1). This sort of requirement would curb the abuse that occasionally has existed where a loan is made on a dwelling house at excessive rates and the lender requires the debtor to incorporate, as a condition to receiving the loan, so that rates in excess of usury ceilings may be charged. *See* Jenkins v. Moyse, 254 N.Y. 319, 172 N.E. 521 (1930). U3C § 1.301(12). defines the term "person related to" with respect to an organization.

84 U3C § 2.602(1)(a). This would subject to non-consumer ceilings such sales as agricultural equipment to a farmer, an automobile to a doctor for professional use, and the like, if under $25,000.

85 U3C §§ 2.602(2), 3.602(2).

86 U3C §§ 2.601, 3.601.

87 U3C §§ 2.602(3), 3.602(3).

88 U3C § 3.201.

D. *Summary of Rate Limitations*

The U3C sets rather high maximum rates on consumer credit transactions, both sales and loans. In addition, certain other credit transactions while not subject to other provisions of the U3C, such as those dealing with disclosure, are subject to the rate limitations. The intent is to cover in one group of statutes all credit transactions that should be subjected to rate ceilings in order to prevent abuse by unscrupulous lenders. On the other hand, rate ceilings are eliminated with respect to such loans as large business loans on the theory that the rates are, and should be, governed by forces of normal competition among lenders. This realistic reappraisal of rate ceilings is a most salutary reform and should of itself justify widespread enactment of the U3C.

IV. Licensing and "Notification" Requirements

A basic tenet of those involved in drafting the U3C is that competition should effectively determine the pricing of money and credit. One means of furthering competition in the credit granting field is to permit credit grantors ". . . relatively easy entry into the market to avoid monopoly."[89] This approach is carried out in the U3C by not requiring the licensing of credit sellers or sales financing companies.[90] Moreover, although the U3C follows the approach of prior statutes[91] in requiring the licensing of companies making so-called "regulated" loans,[92] there are no restrictions on the number of entrants into this field. In other words, there is no "convenience

89 Prefatory Note to Working Draft No. 6, U3C, at 2.

90 The Ohio Retail Installment Sales Act also has no licensing provisions for sales finance companies. Ohio Rev. Code Ann. §§ 1317.01-.99 (Page 1962). On the other hand, some states require licensing of those involved in retail installment sales. For example, Florida requires an annual license for a retail installment seller, Fla. Stat. Ann. § 520.32(2) (Supp. 1968), and also for a sales finance company, Fla. Stat. Ann. § 520.52 (Supp. 1968). For some other statutes requiring licensing of sales finance companies, see Ill. Ann. Stat. ch. 121½ § 403 (Smith-Hurd Supp. 1967); N.Y. Bank. Law ch. 492 (McKinney Supp. 1967). Banks and other financial organizations chartered and regulated under other statutes are generally exempt from licensing requirements applicable to sales finance companies.

91 Many states have "small loan" laws, often derived from the Uniform Small Loan Law devised many years ago by the Russell Sage Foundation, which among other matters requires licensing of small loan companies. Ohio requires that small loan companies be licensed. Ohio Rev. Code Ann. §§ 321.02-.44 (Page 1962).

92 U3C §§ 3.501-.507.

and advantage" test as a condition to the issuance of a license.[93] The stated purpose of the U3C licensing requirement is to facilitate entry into the cash-loan field so that the resultant rate competition fostered by disclosure will generally force rates below the permitted maximum charges, with a secondary purpose of reducing the likelihood of localized monopolies in the granting of credit, which would tend to push rates to the maximum permitted levels.[94] There is also no restriction on the carrying on by a loan licensee of some other business ". . . unless he carries on the business for the purpose of evasion or violation of this Act."[95]

In other respects, the licensing provisions applicable to those who make consumer loans are not unlike those of many prior small loan statutes. It is provided that no one may make a "regulated" loan, that is, a consumer loan, pursuant to a revolving credit account or a consumer loan at a rate over ten percent per year on unpaid balances[96] without a license unless the lender is a bank, savings and loan association, credit union, or other financial organization of similar nature, chartered under state or federal law and authorized by such law to make loans and receive deposits, savings or the like.[97]

Provision is made for application for a license,[98] revocation or suspension of a license,[99] the keeping of books and records by licensees,[100] and examination or investigation of licensees by the supervisory authority.[101] It is also provided that administrative action taken by the supervisory authority is to be governed by the state administrative procedure act.[102]

The U3C licensing provisions are similar to, but much simpler than, those of the small loan statutes which are to be replaced. They apply to any consumer lender other than banks, savings and loan associations, credit unions, and the like. They would thus apply in

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93 The basic licensing provision, U3C § 3.503, requires only a finding of ". . . financial responsibility, character and fitness." OHIO REV. CODE ANN. § 1321.04(B) (Page 1962), provides that a license may be granted if the Division of Securities finds that allowing the applicant for a license "to engage in such business will promote the convenience and advantage of the community in which the licensed office is to be located."

94 U3C § 3.503, Comment.

95 U3C § 3.514.

96 *See* U3C § 3.501, which defines "regulated loan."

97 U3C § 3.502, which refers to U3C § 1.301(14).

98 U3C § 3.503.

99 U3C § 3.504.

100 U3C § 3.505.

101 U3C § 3.506.

102 U3C § 3.507.

some instances to lending organizations which are now governed by different statutes in the same state.[103]

While a person making consumer credit sales or consumer leases is not required to obtain a license, such a person is required to file a notification with the supervisory authority[104] and, if the credit seller is a nonresident of the state or unqualified out-of-state corporation,[105] to appoint an agent for the service of process. Such requirements apply also to consumer lenders (including those required to be licensed) and to ". . . persons taking assignments or obligations arising from [consumer] sales, leases, or loans, other than assignments in bulk as security for loans."[106] A notification fee must be paid by all persons who are required to file notification. The amount of the fee is based on the volume of credit outstanding.[107]

In general, the U3C licensing provisions are commendable. The approach of dispensing with licensing in connection with sales financing, of simplifying license requirements for lenders, and of permitting entry into the consumer loan field on a purely competitive basis is preferable to the burdensome and often useless requirements of many prior statutes that seem primarily to raise the cost of doing business and thus the cost of consumer credit. It is suggested, however, that the licensing and notification requirements overlap with respect to consumer lenders who make "regulated" loans; therefore, it might be desirable to have the licensing process serve as notification, and to have the notification fees paid by licensees. This would presumably defray the expenses of supervision and examination of licensees,[108] thus forcing credit users, rather than taxpayers in general, to bear the expenses of enforcing the U3C.[109]

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103 Examples are three kinds of lenders in California governed by different statutes, such as personal property brokers, governed by CAL. FIN. CODE § 22000 (West 1968); small loan companies, governed by CAL. FIN. CODE § 24000 (West 1968); industrial loan companies, governed by CAL. FIN. CODE § 18000 (West 1968). Pennsylvania also has several kinds of lenders: small loan companies, governed by PA. STAT. ANN. tit. 7 § 6151 (1967), and consumer discount companies, governed by PA. STAT. ANN. tit. 7 § 6201 (1967).

104 U3C § 6.202.

105 U3C § 6.203.

106 U3C § 6.201.

107 U3C § 6.204.

108 This is not a suggestion that sales finance companies or the like should be licensed.

109 This is probably the situation with respect to most existing consumer credit statutes. It might also be noted that such supervised financial institutions as banks,

V. Contract Limitations

A. *Contract Requirements and Prohibitions*

The U3C confers a number of rights and benefits upon the consumer which may not be waived or may be waived only after default.[110] Certain limitations on agreements and practices are applied to sales involving less than 25,000 dollars credit, leases for less than 25,000 dollars, or loans of less than 25,000 dollars, but not to real estate sales.[111] This avoids the imposition of contract terms that unduly favor the creditor or burden the debtor, which may arise in the smaller credit transactions because of unequal bargaining power or the use of standard-form contracts or contracts of adhesion. The U3C contains a number of protective provisions intended to relieve the consumer from the effects of a hard bargain.[112]

B. *Home Solicitation Sales*

The purpose of the U3C is to regulate credit, not to regulate sales practices, quality of products sold, misleading advertisements, or other non-credit matters; however, the U3C spills over to regulate a type of sale often associated with credit which has caused particular abuses. This is the "home solicitation sale."[113] Such sales often involve a representative of a credit-selling organization who calls on a family at home and through high pressure salesmanship induces the purchase of grossly overpriced goods.[114] The U3C approaches the problem of such sales[115] by giving the buyer the right to cancel up to

savings and loan associations, credit unions, and the like bear the expenses of examination and other supervision in virtually all states.

110 U3C § 1.107.

111 U3C §§ 2.401, 3.401.

112 Jordan & Warren, *supra* note 3, at 455.

113 A lengthy discussion which highlights many of the abuses in home solicitation sales, particularly where coupled with so-called "referral" plans, is found in State v. ITM, Inc., 52 Misc. 2d 39, 275 N.Y.S.2d 303 (1966), an action by the New York Attorney General to enjoin certain practices deemed "fraudulent and illegal."

114 *See, e.g.*, Frostifresh Corp. v. Reynoso, 54 Misc. 2d 119, 281 N.Y.S.2d 964 (App. Div. 1967), where a refrigerator-freezer was sold under such conditions to a person of Spanish-speaking background, with the sales contract written in English. The facts are given in a lower court opinion in the same case, 52 Misc. 2d 26, 274 N.Y.S.2d 757 (Dist. Ct. 1966).

115 The U3C definition of "home solicitation sale" contemplates a consumer credit sale, payable in installments, of goods or services, where the solicitation is made and the purchase order or offer is given "at a place other than a place of business of the seller." Sales under revolving charge accounts or other sales completed at a permanent store or similar establishment are exempted. Sales arising from solicitations by mail or telephone are probably not included, although this matter might be clarified.

midnight of the third day after the buyer signs the order, by giving written notice to the seller at the address stated in the order.[116] Such notice may be given by mail and is deemed given at the time sent.[117] The agreement in a home solicitation sale must be signed by the buyer, must state the seller's address and must contain a prescribed form of notice of the buyer's right to cancel.[118] Failure to comply with these requirements gives the buyer the absolute right to cancel until such time as there has been compliance.[119] Where the buyer cancels, the seller may retain a fixed amount as a cancellation fee.[120] Within ten days after cancellation the seller must tender to the buyer any payments made, any note or evidence of indebtness given, and any goods traded in or an amount equal to the trade-in allowance given.[121] The buyer has a lien on goods delivered under the cancelled contract to insure return of these items,[122] but on demand by the seller he must make such goods available. If the seller does not make such demand within a reasonable period (presumably forty days) the buyer may keep such goods without payment. While the goods remain in the buyer's possession, he has the duty only to use reasonable care toward them. The seller is entitled to no compensation other than the cancellation fee for services performed prior to cancellation.[123]

The net effect of the "home solicitation sales" provisions is a three day delay in the binding effect of such sales and an option in the buyer to back out during that period without penalty, except the cancellation fee. While some might criticize these provisions as not directly relevant to consumer credit, but rather as aimed at "sharp" sales practices, they do succeed in correcting a substantial evil and for that reason are desirable. Possibly the waiting period might be somewhat longer, such as one week.

C. *Non-Negotiable Instruments*

One of the major abuses in credit sales comes from the use of negotiable notes. In many instances such a note is executed in favor

116 U3C § 2.502(1)(2). Any expression of intent not to be bound is sufficient notice of cancellation. U3C § 2.502(4).

117 U3C § 2.502(3), which requires deposit in a mailbox, with proper address and postage prepaid.

118 U3C § 2.503(1), (2).

119 U3C § 2.503(3).

120 U3C § 2.504(3).

121 U3C § 2.504(1), (2).

122 U3C § 2.504(4).

123 U3C § 2.505, which also provides that the seller must restore to its original condition any property of the buyer which he has altered.

of the seller, together with a conditional sale contract or other security agreement. The buyer may well be under the impression that he can refuse to pay installments which are due if the purchased goods are defective or if there is other absence or failure of consideration. Such a buyer will often find that he is compelled to deal with a third party such as a bank or finance company, with which he did not contemplate any relationship. If the third party has avoided too close a relationship with the seller,[124] and has remained ignorant of the circumstances of the sale,[125] he may be a holder in due course,[126] against whom the buyer has no defense.[127]

The U3C deals with this problem by flatly prohibiting the use of negotiable notes in consumer sales or consumer lease transactions other than those primarily for an agricultural purpose. A negotiable note issued in violation of the U3C provision may nevertheless be enforced by a holder in due course.[128] To be really effective this provision should not only prohibit a seller of consumer credit from using a negotiable note, but also should bar any other person taking a note with knowledge that it was issued in a consumer credit transaction from attaining holder in due course status. Subsequent takers,

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124 Too close a business relationship between the finance company and the seller has resulted in a denial of holder in due course status to the finance company. *See* Mutual Finance Co. v. Martin, 63 So. 2d 649 (Fla. 1953). For a particularly flagrant situation where due course holding was denied, see Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967).

125 *See* Lundstrom v. Radio Corp. of America, 17 Utah 2d 114, 405 P.2d 339 (1965). For an example of "too much knowledge," see Norman v. World Wide Distrib., Inc., 202 Pa. Super. 53, 195 A.2d 115 (1963).

126 UNIFORM COMMERCIAL CODE § 3-302.

127 A recent example in a case arising under the Uniform Commercial Code is Burchett v. Allied Concord Financial Corp., 74 N.M. 575, 396 P.2d 186 (1964), where the court would not permit the buyer to assert a "personal" defense against a finance company which had taken his note and consumer obligation as holder in due course.

In Ohio, a finance company or other third person that has taken a note, together with a chattel mortgage, conditional sale agreement, or other security agreement, has not been denied holder in due course status merely by reason of such facts alone. Dennis v. Rotter, 43 Ohio App. 330, 183 N.E. 188 (1932). *See generally* 40 OHIO JUR. 2d *Negotiable Instruments* §§ 353, 362; 48 OHIO JUR. 2d *Secured Transactions* § 131. *But cf.* David v. Commercial Credit Corp., 87 Ohio App. 311, 94 N.E.2d 710 (1950), where holder in due course status was denied a finance company which had worked closely with a seller of asbestos siding for dwelling houses, and was, because of its relationship with the seller and knowledge of seller's inferior work for others, charged with knowledge of the seller's inferior work in the particular instance.

For general discussion, see Annot., 44 A.L.R.2d 8 (1955).

128 U3C § 2.403.

however, such as banks that rediscount paper without dealing with the seller, might be permitted to qualify as holders in due course.[129]

The provision might be improved by broadening its prohibition to include all negotiable instruments, rather than just notes.[130] Moreover, the language designating the rights of a holder in due course might be clarified by specifying that any person taking an instrument with knowledge that it was issued in a consumer credit sale or lease transaction, other than a sale or lease for an agricultural purpose, is barred from holder in due course status. This would make it impossible for anyone who takes a note and separate agreement referring to a consumer credit sale or lease to qualify as a holder in due course. Only one taking a note separated from the agreement might so qualify.[131] Nonetheless, the provision is a desirable one and should provide substantial protection to consumers by preventing many of the abuses which now exist.

The U3C does not bar the use of a negotiable note in a consumer loan transaction. In rare instances abuses might arise in a transaction where a buyer chooses to borrow from a third person and use the loan proceeds to buy goods. Although the lender in such circumstances will probably be completely independent of the seller,[132] there is a possibility that the provision prohibiting negotiable notes in consumer sales will be evaded by subterfuge, such as use by the selling organization of a note which names the financer as payee or the referral of the buyer to a related financing organization to arrange his own financing.[133]

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129 *See* U3C § 2.403, Comment.

130 Some clever financer might resort to use of a series of time drafts or possibly postdated checks as an attempt to circumvent the restriction.

131 The purpose of the exception relating to a sale or lease primarily for an agricultural purpose is also none too clear.

132 Where a money-loaning institution lends its money directly to the purchaser of equipment for the payment of such equipment and accepts his promissory note as evidence of the indebtedness, a failure or want of consideration in the transaction on the part of the seller of the equipment without participation or knowledge on the part of the loaning institution does not constitute a valid defense in an action to collect the note, even though the note was procured from the purchaser in the first instance by the seller and the proceeds thereof were paid by the lender directly to him. Ohio Loan & Discount Co. v. Tyarks, 173 Ohio St. 564, 184 N.E.2d 374 (1962).

133 Possibly the courts could be relied upon to maintain the "spirit" of U3C § 2.403 on the ground that the substance of the transaction will be scrutinized, and that only a completely independent lender dealing directly with the buyer may take a negotiable note as holder in due course.

D. *Waiver of Defense Where Obligation Is Transferred*

Related to the negotiable instrument problem is the question of what effect should be given to a buyer's agreement not to assert any claim or defense arising out of the sale against a transferee of the obligation.[134] Two alternatives have been proposed. The first gives limited and delayed effect to an agreement not to assert a defense. Such an agreement only becomes effective six months after the transferee has given a prescribed notice to the buyer or lessee. Prior to that time the defense may be asserted. If the transferee is "related" to the seller or lessor,[135] or a continued course of complaints in connection with other transactions by the same seller or lessor is known to the transferee, the agreement not to assert a defense will be entirely inoperative.[136] The second alternative flatly makes any transferee subject to all claims and defenses against the seller or lessor, notwithstanding agreement to the contrary.[137] Where the sale or lease is primarily for an agricultural purpose, an agreement not to assert a defense may be effective under both alternatives.[138] The result of either alternative should be a closer policing by finance companies and others who discount consumer paper to satisfy themselves of the integrity and reliability of the sellers from whom they take such paper.[139]

E. *Other Contract Requirements and Prohibitions*

Certain other contract limitations are applied to sales involving credit, leases, or loans of less than 25,000 dollars, but not to

134 Such an agreement not to assert a defense is valid, subject to any statute or decision which establishes a different rule for buyers or lessees of consumer goods. UNIFORM COMMERCIAL CODE § 9-206(1). For a lengthy collection of decisions see Annot., 44 A.L.R.2d 8 (1955); 36 FORDHAM L. REV. 106 (1967).

135 U3C § 1.302(12) states when a person is "related" to another person, both with respect to an individual and with respect to an organization.

136 U3C § 2.404 (alternative A). In general accord, but with much shorter periods during which a waiver of defense is ineffective are the California Motor Vehicle Sales Finance Act, CAL. CIV. CODE § 2983.5 (West Supp. 1967), (15 days), N.Y. PERS. PROP. LAW §§ 302(9), 403(3) (McKinney 1962) (10 days with respect to retail installment sales generally and sales of motor vehicles).

137 U3C § 2.404 (alternative B), the text of which is virtually identical with that of the Unruh Act of California regulating retail installment sales of goods other than motor vehicles. CAL. CIV. CODE § 1804.2 (West Supp. 1967). A similar provision exists in Oregon, ORE. REV. STATS. § 83.150 (1965). With respect to motor vehicle retail installment sales, Oregon in effect prohibits negotiable notes. ORE. REV. STATS. § 83.650 (1965).

138 U3C § 2.404 (alternatives A and B).

139 A financer may discount with or without recourse and may withhold discount proceeds in a reserve fund to cover off-sets arising from buyers' defenses.

real estate sales.[140] First, although contracts calling for "balloon" payments (any payment other than the first which is more than twice as large as the average of the other payments) are not prohibited, the debtor has the right to refinance at the time the payment is due without penalty or charge and under terms no less favorable than those of the original sale or loan. This does not apply to a schedule of payments adjusted to a buyer's seasonal income, to a credit transaction for agricultural purposes, or to a revolving credit.[141] A special provision makes a balloon provision at the end of a lease period void;[142] and a balloon payment may not be required in connection with a "regulated" loan of 1,000 dollars or less.[143]

There are also restrictions designed to prevent an overreaching seller or lessor from taking a security interest in goods other than those which are the subject of the credit sale or lease. A security interest may not be taken on real property in connection with a "regulated" loan of 1,000 dollars or less.[144] Moreover, with limited exceptions, only the property that is sold or leased may be security for the credit.[145] There are also restrictions on the taking of cross-collateral. A buyer may permit previously sold goods to be security for a subsequent sale, but only until the amount of debt arising from the original sale has been paid.[146] Where a buyer contracts more than one indebtedness to the same seller and the debts are consolidated, provision is made for release of the security interests in the goods represented in the respective debts.[147]

Credit sales, leases or loans secured by assignment of earnings,[148] the use of multiple agreements to obtain higher rates,[149]

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140 U3C §§ 2.401, 3.401.

141 U3C §§ 2.405, 3.402.

142 U3C § 2.406.

143 U3C § 3.513, which requires such loans to be repayable in substantially equal installments over a maximum range of 25 months. This is the only maximum-term provision in the U3C.

144 U3C § 3.511.

145 U3C § 2.407.

146 U3C § 2.408. For an example of the mischief that may arise where a creditor retains a security interest in previously sold goods as security for subsequent sales of other goods *see* Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir. 1965).

147 U3C § 2.409 (drafted in two alternatives).

148 U3C §§ 2.410, 3.403. The sale of unpaid earnings is prohibited in U3C § 3.109.

149 U3C §§ 2.042, 3.510. In other words, a seller or lender who is permitted by U3C §§ 2.201(2)(a), 3.508(2)(a) to charge a certain rate on the first $300 may not charge the same maximum rate on a $600 credit by setting up two different $300 sales or loans.

and the use of judgment notes or cognovit notes in consumer credit transactions[150] are declared void. Default charges may not by contract be made higher than the rates authorized by the U3C.[151] A provision for attorneys' fees may be set forth in a consumer credit agreement if limited to fifteen percent of the unpaid debt,[152] but no attorneys' fees may be agreed upon in connection with a "regulated" loan of 1,000 dollars or less.[153] The debtor is authorized to pay the original seller, lessor, or lender until he receives notice of the transfer of the obligation and a direction to make payment to the transferee.[154]

Two other provisions which might be said to limit traditional freedom of contract are included in the U3C. The first is directed to referral sales[155] and prohibits the giving of a rebate, discount, or other value to the buyer or lessee for the furnishing of prospects' names or otherwise aiding in the making of other sales if such rebate, discount or other value ". . . is contingent upon the occurrence of an event subsequent to the time the buyer or lessee agrees to buy or lease."[156] The other provision is an "unconscionability" section, generally applicable to an agreement or any clause thereof in connection with any consumer credit sale, consumer lease, or consumer loan, which, like the similar "unconscionability" provision of the Uniform Commercial Code,[157] permits a court to

150 U3C §§ 2.415, 3.407. Judgment notes are generally permitted in Ohio. 40 OHIO JUR. 2d *Negotiable Instruments* § 154 (1967).

151 U3C §§ 2.414, 3.405.

152 U3C §§ 2.413, 3.404. Reasonable expenses may also be collected.

This represents a change in Ohio law which, unlike the law of some other jurisdictions, does not give effect to provisions in notes or other obligations for the collection of attorney's fees. 40 OHIO JUR. 2d *Negotiable Instruments* § 133 (1967).

153 U3C § 3.512.

154 U3C §§ 2.412, 3.406, which give the debtor the same rights as are given the debtor in a secured transaction under UNIFORM COMMERCIAL CODE § 9-318(3), where there is an assignment of a security interest.

155 For cases dealing with this sometimes unsavory practice of making an overpriced sale coupled with a promise (often never carried out) to rebate for any referrals to other prospects by the buyer that also result in a sale see Norman v. World Wide Distrib., Inc., 202 Pa. Super. 53, 195 A.2d 115 (1963); Sherwood & Roberts Yakima, Inc. v. Leach, 67 Wash. 2d 630, 409 P.2d 160 (1965); Annot., 14 A.L.R.3d 1420 (1967).

156 U3C § 2.411.

157 UNIFORM COMMERCIAL CODE § 2.302, which was applied or at least furthered the action of the court in such "consumer credit" cases as American Home Improvement, Inc. v. MacIver, 105 N.H. 435, 201 A.2d 886 (1964); State v. ITM, Inc., 52 Misc. 2d 39, 275 N.Y.S.2d 303 (1966).

It might be noted that the Uniform Commercial Code unconscionability provision deals with the sale of goods only. There is no counterpart of Article 9 on

strike down a contract or term thereof on the ground of "unconscionability."[158] In general such limitations are desirable in that they eliminate many abuses which have made consumer-debtors the victims of overreaching or unscrupulous sellers and creditors.[159]

VI. A Hedge Against Inflation

The U3C contains a novel and perhaps controversial provision. A number of dollar amounts stated in various sections of the Act are subject to change

> . . . in accordance with 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. The Index for December, 1967, is the Reference Base Index.[160]

The changes are to be made when there is a change in the Index of ten percent or some multiple thereof, but only changes of an even ten percent or multiple thereof are to be made. For example, a rise in the Index of ten percent could result in the raising of the maximum rate differentials to cover the first 330 dollars, rather than the first 300 dollars, at the highest rate, the amount from 330 dollars to 1,100 dollars, rather than from 300 dollars to 1,000 dollars, at the next rate, and over 1,100 dollars rather than over 1,000 dollars, at a lower maximum rate.[161]

Many, if not most, of the dollar amounts stated in various parts of the U3C are subject to similar change if the Index changes by ten percent or some multiple thereof. Substantial confusion will

secured transactions. *See* In re Advance Printing and Litho Company, 277 F. Supp. 101 (E.D. Pa.), *aff'd*, 387 F.2d 952 (3d Cir. 1967).

158 U3C § 5.106. This provision is set forth as a remedial, not a substantive, section of the U3C, but it would seem to be substantive in its possible application, and might be regarded as an additional contract limitation prohibiting unconscionability.

159 The unconscionability provision, U3C § 5.106, might be criticized, as has the similar Uniform Commercial Code provision, on the ground that it affords to a court too much discretion to make "indefinite" law. However, the Uniform Commercial Code provision has not been judicially abused to date. Moreover, several courts have indicated that a court will override an "unconscionable" contractual provision, notwithstanding the non-existence of an express statutory provision on "unconscionability." Williams v. Walker-Thomas Furniture Co., 350 F.2d 445 (D.C. Cir; 1965); Unico v. Owen, 50 N.J. 101, 232 A.2d 405 (1967), both involving pre-Uniform Commercial Code fact situations.

160 U3C § 1.106(1).

161 The amounts of $300 and $1,000 are declared subject to change under U3C § 1.106. *See* U3C §§ 2.201(6), 3.508(6), in all alternatives.

likely result from subjecting so many dollar amounts to change with Index variations. The benefit of providing a statutory hedge against inflation seems more than negated by such confusion. If a statutory hedge against inflation is deemed desirable, only a few of the more important dollar amounts should be so subjected. Another serious objection is that the changes will in most instances produce amounts that are not in round numbers.[162] This writer therefore suggests that the "change" provision of the U3C be either eliminated or redrafted so that changes of the Index will affect fewer dollar amounts and will be made in such a manner as to retain round figures and even-dollar amounts.

Other possible objections to the "anti-inflation" provision of the U3C deserve mention. For one thing, although it is made mandatory for the administrator or supervisor of the Uniform Consumer Credit Code in each state to issue a rule announcing the changes,[163] there is a practical problem of continuing uniformity in the U3C if it is left to the administrators of fifty states (assuming all adopt the identical text of the U3C) to declare the changes.[164] Furthermore, it might be difficult to obtain enactment of the U3C in some states if the local legislatures are to find that the sum of 300 dollars now means 330 dollars and that there is a similar change in other figures.[165] Finally, a constitutional problem might exist when the operation of a state statute is made dependent upon figures compiled by a federal bureau or agency not subject to the jurisdiction of the local legislature.[166]

VII. Conclusion

In spite of the various criticisms which can be leveled at certain provisions of the U3C, the current draft is on the whole a

162 A statutory delineation between such amounts as the first $300 and from $300 to $1,000 is handier to deal with than one between the first $330 and amounts from $330 to $1,100. Even more of a problem is a delineation that changes from small even-dollar amounts, such as $2 and $5 to amounts expressed in dollars and cents, such as $2.20 and $5.50. The latter figures represent the maximum delinquency charges which may be collected under U3C §§ 2.203(1)(a), 3.203(1)(a).

163 U3C § 1.106(3),(4) which speaks in terms of "shall."

164 Proceedings, *supra* note 2, at 4A-7, discussing U3C § 1.106.

165 U3C § 1.106(4) so requires. This could also result in varying U3C § 1.106 to choose a different reference base index than that of December, 1967, if the statute is enacted in a particular state at some later time.

166 Proceedings, *supra* note 2, at 4A. This might be deemed an unconstitutional delegation of authority to the United States Bureau of Labor Statistics, which is not charged with enforcing the U3C.

commendable and a superior job. The draftsmen have attained a workable balance between the protection of the consumer-debtor and the right of a person extending credit to have just debts repaid and to make a reasonable profit in his business of marketing money. The U3C affords consumer protections which exceed those found in most existing state statutes dealing with consumer credit;[167] yet the draftsmen and the Commissioners on Uniform State Laws take the realistic position that consumer credit should be sensibly regulated, not stifled, and that the business of extending credit to consumers is a desirable public service, notwithstanding the abuses which may occur in extension of such credit.[168]

The current draft of the Uniform Consumer Credit Code is far superior to the confused mass of diverse and piecemeal statutes which now exist;[169] and enactment of this Code in its present or similar form would represent a great stride in the development of a workable statutory pattern for control of consumer credit transactions.

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167 Examples are the "disclosure" provisions, the provisions dealing with home solicitation sales, those restricting such matters as judgment notes, balloon payments, referral sales, and wage assignments, as well a those prohibiting the use of negotiable notes in connection with credit sales, all discussed above.

168 Examples include the setting of relatively high maximum rates, the furthering of competition in the consumer credit industry by such methods as "open" licensing provisions limited to lenders only, and the elimination of such traps for the unwary lender as general usury statutes, all discussed above.

169 An analogy might be drawn by comparing Article 9 of the Uniform Commercial Code on secured transactions with the diversity of piecemeal prior statutes and rules of case law on such matters as pledges, chattel mortgages, conditional sales, bailment leases, trust receipts, assignments of accounts receivable, and factor's liens. Article 9 is not perfect and has generated considerable criticism; yet, it represents substantial improvement over former secured transactions law. In the same way, the U3C represents substantial improvement over prior consumer credit law.