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Truth in Lending: The Impossible Dream

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NOTE

Truth in Lending: The Impossible Dream

I. INTRODUCTION

THE RIGHT OF A CONSUMER to defer payment for a debt or for the purchase of property or services is at least as much a part of the American way of life as apple pie and Saturday afternoon football.[1] Everybody buys on credit, and, what is more, no one is ashamed to admit it.[2] Buying on credit has been cited as a principal cause of the rapid acceleration of economic growth in the United

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[1] *See* D. BELL, THE END OF IDEOLOGY 246 (1960). *See also* BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM, CONSUMER INSTALLMENT CREDIT pts. I-IV (1957) [hereinafter cited as CONSUMER CREDIT STUDY], a massive study of the institution of consumer credit, especially Part I, *Growth and Import.*

The availability of credit to anyone who meets the minimum qualifications may serve to reinforce American democracy:

> Credit, if used properly, serves as an important democratizing force. Stated in its simplest terms, people with modest incomes usually do not have the cash with which to purchase furniture, TV sets, refrigerators, cars, and washing machines. Time buying does afford low- and middle-income couples greater opportunity to marry earlier, raise families while they are young, and to enjoy many of the benefits that others take for granted. *Hearings on S. 1740 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency*, 87th Cong., 1st Sess. 75 (1961) [hereinafter cited as *1961 Hearings on S. 1740*] (statement of Hillel Black, author of BUY NOW, PAY LATER (1961)).

[2] In the past the use of credit was considered a taint of the lower classes. *See Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 38, 56 (1967) [hereinafter cited as *Hearings on S. 5*]. The advent of the automobile, however, encouraged installment buying, and today the "buy now, pay later" philosophy has been adopted in every economic stratum of our society. *See generally* J. GALBRAITH, THE AFFLUENT SOCIETY (1960). Outstanding consumer credit increased from $64 billion in 1962 to $117 billion in August 1969, and rose at a rate of over $1 billion a month in the latter half of 1968. This growth of installment debt has been horizontal — an increase in the number of debtors — rather than vertical — an increase in the volume of debt among prior debtors. Shapiro, *Installment Credit*, in INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES 354, 357 (1968).

Professor Galbraith attributes much of the change in consumer credit attitudes to advertising: "The relation of emulation [due to advertising] to indebtedness is even more direct. . . . People have changed their view of debt. Thus there has been an inexplicable but very real retreat from the Puritan canon that required an individual to save first and enjoy later. . . ." J. GALBRAITH, *supra* at 159. This change in attitude is reflected in the present use of credit from the cradle to the grave.

> [M]any [Americans] are virtually living on time. Babies are born on the installment plan, people go on African safaries and hunt polar bear and if they outsmart the bear have him stuffed, all through the flick of a credit card. Even funerals are being paid for on what the English quaintly call the never-never. *1961 Hearings on S. 1740, supra* note 1, at 75 (statement of Hillel Black).

States since World War II.[3] In addition, the American consumer is able to make the most of his leisure time because he can buy goods today and pay for them tomorrow. Most consumers would agree that buying on credit is a worthwhile convenience which is here to stay. Creditors feel the same way because most consumers are faithful about making their payments.[4]

Yet, despite the general post-World War II prosperity,[5] there was a growing awareness among consumers that all was not so well. Many consumers were unable to shop for the best credit terms. Consumers were not adequately informed when they bought on credit, and they were often exploited by overreaching merchants.[6]

In an effort to provide the uninformed consumer with some protection from being gouged by excessive interest rates, Congress recently enacted the Truth in Lending Act[7] as Title I of the Consumer Credit Protection Act.[8] Truth in Lending applies to both kinds of

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[3] 11 CONG. REC. 16,425 (1965) (remarks of Senator Douglas).

Expressed in 1958 dollars, the gross national product doubled from 1950 to 1968, rising from $355 billion to $707 billion. BUREAU OF THE CENSUS, STATISTICAL ABSTRACT OF THE UNITED STATES Table No. 457, at 312 (1969). Per capita personal income rose from $1,800 in 1950 to $2,900 in 1968. *Id.* Table No. 459, at 313. The entire economy has experienced constant growth since 1946. *Id.* Table No. 460.

For a brief history of consumer credit extension in this country, see Shapiro, *supra* note 2. *See also Hearings on S. 2755 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency*, 86th Cong., 2d Sess. 23-24, 353-55, 537-39 (1960) (Consumer Credit Labelling Bill) [hereinafter cited as *Hearings on S. 2755*]; Note, *Consumer Credit — Proposed Truth-in-Lending Legislation*, 16 DEPAUL L. REV. 464, 465 (1967).

[4] That creditors are making money from their credit operations is demonstrated by the tremendous growth of credit extension since World War II. *See* note 2 *supra.* There is evidence that some merchants make as much profit from the credit aspect of their sales as from the mark up on the product itself. *1961 Hearings on S. 1740, supra* note 1, at 75-76. In 1960, Spiegel's, Inc., one of the country's largest mail-order houses, made $39.7 million from its credit charges, which accounted for 55 percent of its gross income. *Id.* at 220-21. Nevertheless, creditors repeat the lament that credit operations cost them money. *See Hearings on S. 750 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency*, 88th Cong., 1st Sess., pt. 2, at 1493-542 (1963) [hereinafter cited as *1963 Hearings on S. 750*]; *Hearings on S. 1740 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency*, 87th Cong., 2d Sess. 15 (1962) [hereinafter cited as *1962 Hearings on S. 1740*]. *See also* N.Y. Times, Nov. 5, 1963, at 39, col. 2.

[5] *See* note 3 *supra.*

[6] One of the examples of excess credit charges presented to a subcommittee conducting hearings on Truth in Lending was the case of an electrical worker who owed $182 on a $123.88 television set after paying $175 in 11 months. N.Y. Times, Aug. 17, 1963, at 25, col. 5.

[7] 15 U.S.C. §§ 1601-13, 1631-41, 1661-65 (Supp. IV, 1969).

[8] Pub. L. No. 90-321, tits. I-V, 82 Stat. 144 (1968) (codified in scattered sections of 15, 18 U.S.C.). The Act was passed on May 29, 1968. Truth in Lending went into effect on July 1, 1969. *See* Andrews, *Truth in Lending Law Takes Effect Today As Consumers Cheer But Lenders Grumble*, Wall Street J., July 1, 1969, at 9, cols. 1-2 (Midwest ed.). Title II of the Consumer Credit Protection Act regulates extortionate

consumer credit — consumer credit purchases and consumer loans. The basic requirements of the Act and the regulations thereunder[9] (Federal Reserve Regulation Z) are that certain items be disclosed to the buyer or borrower before the credit transaction is completed, including the total amount of the finance charge and the finance charge stated as an annual percentage rate of the unpaid balance.[10] The finance charge is the sum of all direct and indirect charges imposed by the creditor incident to the extension of credit, including interest or time-price differential, service or carrying charges, loan fees, credit investigation fees, and insurance premiums if coverage is required before credit will be extended.[11] The annual percentage rate is that rate which will yield an amount equal to the finance

credit transactions; Title III restricts garnishments; Title IV establishes a National Commission on Consumer Finance; and Title V contains miscellaneous guidelines for judicial interpretation of the Act.

The Consumer Credit Protection Act was first introduced by Senator Douglas of Illinois in 1960 as the Consumer Credit Labelling Bill. *See generally, Hearings on S. 2755, supra* note 3. After its initial rejection in 1960, Senator Douglas reintroduced it the following year [*See generally 1961 Hearings on S. 1740, supra* note 1], but it was again short-lived. *See* N.Y. Times, Sept. 7, 1962, at 15, col. 1. The bill was revived in 1963 [*see Hearings on S. 750 Before the Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency*, 88th Cong., 2d Sess., pt. 1 (1964) [hereinafter cited as *1964 Hearings on S. 750*]; *1963 Hearings on S. 750, supra* note 4], and was introduced a fourth time in 1965 as S. 2275 [*see* 111 CONG. REC. 16,428 (1965) (remarks of Senator Douglas)], but never got out of committee. Senator Douglas labeled this defeat a "victory for the usurers and money lenders." Wall Street J., June 24, 1964, at 2, col. 3. In its final form, the bill passed the Senate under the aegis of Senator Proxmire on July 11, 1967, by a vote of 92-0. Wall Street J., July 12, 1967, at 3, col. 2 (Midwest ed.). *See generally Hearings on S. 5., supra* note 2; 113 CONG. REC. 2042 (1967) (remarks of Senator Proxmire).

It was not until the Truth in Lending Bill reached the House of Representatives in 1967, after being delayed in the Senate for 7 years, that the broader consumer protection package was conceived. The bill's leading supporter in the House was Representative Leonor Sullivan, who introduced the provisions restricting garnishment (Title III) and establishing a National Commission on Consumer Finance (Title IV). The following Truth in Lending (Title I) proposals by Representative Sullivan failed to receive approval: required disclosure of total finance charges on first mortgage loans to home buyers [*see* note 44 *infra*]; a statutory ceiling of 18 percent on annual interest rates; authorization for the Federal Reserve Board to exercise credit controls during a national emergency; and authorization for the Federal Reserve Board to regulate downpayments for credit purchases or contracts for future delivery of commodities traded on commodity exchanges. *See* Wall Street J., July 21, 1967, at 3, col. 2 (Midwest ed.); *id.*, Oct. 5, 1967, at 9, col. 1 (Midwest ed.). But two important parts of the Truth in Lending title were added in the House: (1) the advertising provisions [*see* text accompanying notes 69-72 *infra*], and (2) the requirement that the cost of credit life insurance be figured as a part of the total finance charge if the customer is required to buy such insurance. Truth in Lending Act, 15 U.S.C. § 1605(b) (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. 226.4(a)(5) (1970).

[9] Fed. Res. Reg. Z, 12 C.F.R. §§ 226.1-.12 (1970).

[10] 15 U.S.C. §§ 1631, 1637-39 (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.1(a)(2) (1970).

[11] 15 U.S.C. § 1605 (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.4(a) (1970).

charge when applied to the unpaid balances of the amount being financed.[12]

The premise behind Truth in Lending is that disclosure of finance charges as an annual percentage rate will accomplish two things: (1) it will enable the consumer to more easily identify and compare credit terms and thus make better use of his credit dollar, and (2) it will enhance economic stability because consumer credit will be more responsive to variations in general monetary policy.[13]

This Note attempts to demonstrate that Truth in Lending does not deserve all the praise it has been receiving.[14] Held out by politicians as a comprehensive program of consumer protection, it gives the consumer only mild protection at best because it employs the vehicle of disclosure rather than regulation.[15] Truth in Lending will only help those who are both able and willing to shop for credit.[16] In addition, Truth in Lending will fail to enhance economic stability because the average consumer is insensitive to the interest rates he pays.[17] The discussion will begin with an examination of consumer confusion over credit charges, followed by a review of the legislative responses of the states, a description of Truth in Lending's major provisions, and an evaluation of the Act.

II. TRUTH IN LENDING: A NECESSARY ITEM

Truth in Lending grew out of the existing consumer confusion

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[12] 15 U.S.C. § 1606 (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.5 (1970).

The annual rate may be rounded off to the nearest one-quarter of 1 percent (15 U.S.C. § 1606(c) (Supp. IV, 1969)), and until July 1, 1971, creditors have the option of disclosing finance charges in dollars per hundred instead of an annual percentage. *Id.* § 1606(f).

[13] *See* 15 U.S.C. § 1601 (Supp. IV, 1969).

[14] *See* Hodges & Flint, *Full Disclosure of Credit Charges*, 23 FED. B.J. 170 (1963); Jordan & Warren, *Disclosure of Finance Charges: A Rationale*, 64 MICH. L. REV. 1285 (1966); McEwen, *Economic Issues in State Regulation of Consumer Credit*, 8 B.C. IND. & COM. L. REV. 387, 396 (1967); Zeisel & Boschan, *The Simple Truth-in-Lending*, 116 U. PA. L. REV. 799 (1968); Note, *Consumer Credit — Proposed Truth-in-Lending Legislation, supra* note 3; Comment, *The Consumer in the Market Place — A Survey of the Law of Informed Buying*, 38 NOTRE DAME LAW. 555 (1963); 18 VAND. L. REV. 856 (1965).

But the comments have not been altogether favorable. *See* Johnson, *Regulation of Finance Charges on Consumer Installment Credit*, 66 MICH. L. REV. 81 (1967); Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 81 (1968); Note, *Truth in Lending? — A Viable Subject*, 32 GEO. WASH. L. REV. 861, 888-91 (1964).

[15] *See* notes 110-26 *infra* & accompanying text.

[16] *See* text accompanying notes 110-12 *infra.*

[17] *See* notes 104-07 *infra* & accompanying text.

over credit costs.[18] Before Truth in Lending, the "6 percent myth" prevailed. This was the belief, held by most consumers, that honest creditors would never charge more than 6 percent interest.[19] In addition, creditors were waging a battle of euphemisms in the competition for the consumer's credit dollar. They would give different names to their credit charges in an effort to minimize the one charge that everyone knew about, the interest rate.[20] The following situation is typical of the existing consumer confusion:

> [C]onsider the case of a man who wants to buy an automobile which has a cash price of $2500. He may be told by the dealer that he can finance the purchase at a rate of six dollars per hundred per year on a thirty-month contract through a sales finance company. A bank might offer to lend him the purchase price at six per cent per year, discounted, with a maturity period of twenty-four months. He might also obtain a loan from a small loan company whose rates are 2½ per cent per month on the first $200, two per cent per month on the next $300, and 5/6 of one per cent on the remaining balance, over thirty-six months. A credit union to which the buyer belongs lends money at one per cent per month and pays an annual patronage dividend of uncertain amount. In addition, the buyer may have a savings account at a bank on which he re-

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[18] *Hearings on S. 2755*, *supra* note 3, at 239, 241-45; *see* CONSUMER CREDIT STUDY, *supra* note 1, pt. I, at 191.

[19] *See Hearings on S. 2755*, *supra* note 3, at 309, 322, 465-66, 605.

[20] Truth in Lending uses the single term "finance charge" to represent all the credit costs incident to a transaction. 15 U.S.C. § 1605 (Supp. IV, 1969); *see* text accompanying note 11 *supra*.

Thus, "finance charge" is broader than the conventional term "interest." A banker defines interest:

> Interest is, of course, a charge that is made for the use of money. In determining the charge that is to be made on any loan, we must first figure the basic value of money. Two other matters must then be considered, and one of those would be the element of risk involved, and the other the amount of work required to process and keep records over the term of the loan. *1961 Hearings on S. 1740*, *supra* note 1, at 218.

"Pure interest" involves only the first of these three elements, since it is merely payment for forbearance on a riskless investment. R. JOHNSON, STUDIES IN CONSUMER CREDIT NUMBER 2, METHODS OF STATING CONSUMER FINANCE CHARGES 57 (1961). Finance charges include all of these elements:

> Finance charges can be divided into two elements: (1) a charge for the use of money, which can be termed the interest charge (this includes both the economist's concept of "pure interest" and the compensation for the risk of not being paid), and (2) service charges for administrative costs with respect to the credit, such as the costs of processing the credit and investigating the risk. If the amount of credit extended is very large, the proportion of the credit charge applicable to service charges will be small and the proportion applicable to interest charges will be large. The converse will be true where the amount of credit extended is small. Jordan & Warren, *supra* note 14, at 1297.

See also 1961 Hearings on S. 1740, *supra* note 1, at 592, 596, 609, 628.

Professor Johnson argues, however, that the terms finance charge and interest rate represent two different concepts, and thus the former should not include the latter. R. JOHNSON, *supra* at 57.

> ceives four per cent per year interest. It is virtually impossible for the average buyer to determine which of the competing credit suppliers is offering him the cheapest credit.[21]

It was obvious that only through legislation would the consumer's confusion be cleared up.

Further support for remedial legislation came from economic circles. It was felt that excessive consumer credit might contribute to economic instability or even recession, and that complete credit disclosure would combat this by causing a decline in the volume of consumer debt.[22]

III. Background of Consumer Credit Legislation

Until the early 20th century, the principal credit legislation in this country consisted of state usury laws.[23] These statutes set limits on the amount of interest that can be charged for the use of money. The limits vary from state to state, the most common being a rate of 6 percent a year. The usury statutes generally contain a proviso that the statutory limit will not apply if the interest rate is specified in the loan contract. Most states, however, have a maximum rate

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[21] Jordan & Warren, *supra* note 14, at 1293. *See also Hearings on S. 2755*, *supra* note 3, at 586-90.

[22] *See 1961 Hearings on S. 1740*, *supra* note 1, at 373. *See also* J. Galbraith, *supra* note 2, at 163.

> The effect of the expansion of consumer credit is to add an uncertainty, paralleling that which business borrowing brings to business spending, to the hitherto more reliable consumer spending. The instability may be greater, for the terms of consumer credit will be eased — down payments reduced and repayment periods lengthened — as an aspect of competitive merchandising techniques. *Id.*

There is little danger, however, of an increase in consumer debt contributing to economic instability as long as the quality of that debt is good. The percentage of disposable income used to repay installment debt rose from 6 percent in 1947 to about 14.3 percent in 1965. Shapiro, *supra* note 2, at 356. But "[t]he [Federal] Reserve's economists commented that 'although prepayments on installment debt have been accounting for a growing share of disposable income, there is little evidence of significantly increased difficulty in collections.'" N.Y. Times, July 11, 1965, § 3, at 1, col. 5.

Thus, although the first two Truth in Lending bills reported to committee tied the need for a disclosure act to an excessive use of credit, the emphasis soon changed to making consumer credit responsive to changes in general monetary policy. *Compare 1961 Hearings on S. 1740*, *supra* note 1, at 4; *Hearings on S. 2755*, *supra* note 3, at 3, *with 1962 Hearings on S. 1740*, *supra* note 4, at 4. For a discussion of how the responsive use of credit is supposed to enhance economic stability, see notes 104-09 *infra* & accompanying text.

[23] *See* B. Curran, Trends in Consumer Credit Legislation 2 (1965). In 1962 the National Conference of Commissioners on Uniform State Laws suggested to the American Bar Foundation that the latter undertake a study of consumer credit. The above work by Miss Barbara Curran was the result of that study and has become the starting point for any work in the consumer credit field.

— ranging from 4 to 30 percent, but usually in the 6 to 12 percent range — which cannot be exceeded, even by an express waiver.[24]

The usury laws do not apply to the credit sales of goods, however, because of the time-price doctrine. According to this doctrine, approved by the United States Supreme Court,[25] merchants who sell goods on credit are not lenders. Because the cash paid over a period of time is not worth as much to a merchant as the same amount paid at the time of the purchase, he must increase the price of the goods to make up for the loss. This credit charge merely represents the difference between the time price and cash price; it is not interest, which is a charge for the use of money. Thus, the usury limits were inapplicable to credit sales.[26]

The usury laws were of little help to the wage earner. He was seldom able to obtain loans from legitimate lending institutions because the legal interest rates were too low to compensate lenders for the risk and administrative costs involved. Thus, many wage earners were driven to loan sharks with their exorbitant interest rates.[27]

Although loan-sharking had long been a hard fact of consumer life, the legislative response did not come until 1916. In that year the Russell Sage Foundation drafted the Uniform Small Loan Act.[28] This Act was the model for the small loan legislation now in effect in 49 of the 50 states.[29] It established a licensed small loan industry, setting strict standards to be followed by all lenders covered by the Act. The Act set an interest rate ceiling of 3½ percent a month on the unpaid balance, which amounts to 42 percent a year. This provided a high rate of return for legitimate lenders, thus discouraging loan sharks, and at the same time satisfied the legislators laboring under the "6 percent myth."[30] The scope of most state small

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[24] *Id.* at 15.

[25] Hogg v. Ruffner, 66 U.S. (1 Black) 115 (1861). *See also* Brooks v. Avery, 4 N.Y. (4 Comstock) 225 (1850).

[26] B. CURRAN, *supra* note 23, at 13.

[27] *Id.* at 2.

[28] *Id. See Hearings on S. 2755, supra* note 3, at 416. *See generally* L. BRANDT & F. ANDREWS, RUSSELL SAGE FOUNDATION 1907-1946 (1947). The seventh draft of the Uniform Act is reprinted in B. CURRAN, *supra* note 23, at 144-57.

[29] *See* B. CURRAN, *supra* note 23, at 158-93 (charts 2-5); *Hearings on S. 5, supra* note 2, at 415-22. Arkansas is the only state without a small loan act. *See* B. CURRAN, *supra* note 23, at 158 (chart 2).

[30] *Hearings on S. 5, supra* note 2, at 56; *see* B. CURRAN, *supra* note 23, at 6.

loan legislation is limited, however, by its inapplicability to loans over $5,000[31] and to credit sales transactions.[32]

Although people have borrowed money since early times, the American consumer rarely purchased goods on credit due to the Puritan canon that one should be able to pay for what he buys. The picture began to change in the 1930's, however, with the advent of the automobile. Unless people were willing to save 3 or 4 years to buy a car, they had to obtain financing. Buying on credit quickly gained respectability and is now common practice for most consumers.[33] Because it was not regulated by the state small loan statutes, this popular use of credit exposed consumers to abuse by merchants.

The legislative response was again slow, however, with only a few states enacting retail installment sales acts before the 1950's.[34] Today, 42 states and the District of Columbia have some kind of retail installment sales act.[35] Although most of these acts regulate some of the substantive provisions of retail sales contracts,[36] their major emphasis has been disclosure rather than control.[37] The rationale was that a purchase of goods, such as an automobile, is not dictated by the same necessity that drives one to borrow money. Thus, the only protection the consumer needed was sufficient information to enable him to make a rational decision to postpone his purchase if the credit terms were not agreeable.

In general, retail installment sales acts apply to installment contracts for goods or services. Most of the acts require that the installment contract be written, dated, and, if printed, printed in a type size no smaller than a specified minimum; that various legends, in large boldface type, be included in the contract; and that the contract be labeled with a descriptive title, such as "Installment Sales Contract." The consumer must receive notice of his rights and obligations under the contract, including his right to a copy of the con-

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[31] B. CURRAN, *supra* note 23, at 21. Most states have a maximum somewhat less than $5,000; the lowest is $200. *Id.*

[32] *Id.* at 18; *see* text accompanying note 26 *supra.*

[33] *See* note 2 *supra.*

[34] *See* B. CURRAN, *supra* note 23, at 254-55 (chart 11).

[35] *Id. See generally* Hogan, *A Survey of State Retail Installment Sales Legislation,* 44 CORNELL L.Q. 38 (1958).

In 1951, the Federal Trade Commission (FTC) promulgated trade-practice rules for the sale of automobiles, which contain disclosure requirements similar to many retail installment sales acts. *See* 16 C.F.R. § 197 (1970).

[36] *See* B. CURRAN, *supra* note 23, at 100-08.

[37] *Id.* at 95.

tract, his right to accelerate payment and receive a discount representing the finance charge that will not be earned, his right to redeem repossessed property, and a notice that he has not paid for insurance, if such is the case.[38]

Thus, as in Truth in Lending, the primary thrust of the typical retail installment sales act is toward disclosure of the consumer's rights and obligations, rather than regulation of the merchant. The coverage of these acts, however, is not as broad as Truth in Lending. In only a few states do they apply to the sale of all goods and services, and in some they apply only to the sale of automobiles.[39] Moreover, they do not apply to advertising.

The preceding discussion, although necessary for an understanding of the protection afforded the consumer before Truth in Lending, is presented in the most general terms. It merely illustrates that none of the principal kinds of legislation in this area — usury statutes, small loan acts, and retail installment sales acts — gives all-inclusive coverage to consumer credit transactions.[40] Truth in Lending is a welcome attempt to include all consumer credit transactions within the coverage of one statute.[41]

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[38] *Id.* at 95-100.

[39] *See id.* at 92-95.

[40] The *Uniform Consumer Credit Code* [hereinafter cited as U3C] (all citations are to the 1969 revised final draft) was drafted by the National Conference of Commissioners on Uniform State Laws for the purpose of consolidating consumer credit law as well as providing protection and legal remedies for the consumer. However, it has been enacted by only two states, Oklahoma and Utah. OKLA. STAT. ANN. tit. 14A §§ 1-101 to 9-103 (Supp. 1970); UTAH CODE ANN. §§ 70B-1-101 to -9-103 (Supp. 1969).

The U3C, like Truth in Lending, applies to both consumer credit sales and consumer loan transactions and requires full disclosure of credit terms. In addition, however, it sets rate ceilings, limits some traditional creditor remedies — repossession and garnishment — and expands and creates some debtor safeguards — unconscionability, defenses to enforcement of transactions which violate the Act, and a right to rescission within 3 days of any home solicitation sale. The Act establishes an office of Administrator to enforce compliance with its provisions.

[41] Regulation Z gives the following definition of consumer credit:

> 'Consumer credit' means credit offered or extended to a natural person, in which the money, property, or service which is the subject of the transaction is primarily for personal, family, household, or agricultural purposes and 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 4 installments. 'Consumer loan' is one type of 'consumer credit.' Fed. Res. Reg. Z, 12 C.F.R. § 226.2(k) (1970).

Expressly exempted from Truth in Lending are extensions of credit to business or government organizations, stockbroker transactions, non-real property credit extensions in excess of $25,000 [*accord*, U3C § 2.104(1)(3)], and transactions under public utility tariffs (utility bills). 15 U.S.C. § 1603 (Supp. IV, 1969). The U3C does not exempt credit to businesses or stockbroker transactions, but does exempt pawnbroker transactions. U3C § 1.202.

IV. Features of the New Act

This section of the Note examines four parts of Truth in Lending which the writer feels are of particular importance: (1) the requirement that the finance charge be stated in terms of an annual percentage rate of the unpaid balance, (2) the consumer's right of rescission when he has given a security interest in his residence, (3) the requirement of full disclosure when certain statements are made in an advertisement, and (4) the enforcement machinery.

A. *Annual Percentage Rate*

Truth in Lending adopted annual percentage rate disclosure instead of the dollars per hundred method, primarily for the following reasons: interest rates, which constitute a large portion of the finance charge, have traditionally been stated in percentages; financial institutions use an annual percentage rate when borrowing money from the public (savings accounts); and it is easier to compare credit costs according to a percentage rate than according to a dollar rate, which is tailored to the particular transaction.[42] Although the idea of disclosure of finance charges[43] in terms of an annual percentage

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[42] *See Hearings on S. 5*, *supra* note 2, at 92-93.

[43] For purposes of disclosure of finance charges, Truth in Lending divides consumer credit transactions into open end consumer credit plans (section 127, 15 U.S.C. § 1637 (Supp. IV, 1969)), other than open end consumer credit sales transactions (section 128, 15 U.S.C. § 1638 (Supp. IV, 1969)), and other than open end consumer loan transactions (section 129, 15 U.S.C. § 1639 (Supp. IV, 1969)). A creditor must disclose the following items of an open end plan (*see* text accompanying notes 48-50 *infra*) *before* the account is opened:

(1) the conditions under which a finance charge will be imposed together with the "free time" allowed,
(2) the method of determining the balance subject to a finance charge,
(3) the method of determining the finance charge,
(4) the nominal annual percentage rate computed by multiplying the periodic rate by the number of periods in a year,
(5) if the creditor so elects,
  (A) the effective annual percentage rate, or
  (B) where (A) is not feasible or will be meaningless, a projected rate based on future accounts,
(6) the conditions under which extraordinary charges will be imposed,
(7) the conditions under which a security interest will be retained, and a description of the interests which may be so retained.

With each billing where there is an outstanding balance or where a finance charge is imposed, the following disclosures must be made to the extent applicable:

(1) the outstanding balance,
(2) the amount and date of the extension of credit, and an identification of the goods if a purchase was involved,
(3) the amount credited to the account during the billing cycle,
(4) an itemized statement of the finance charges imposed,
(5) the periodic rate(s) the creditor uses to compute the finance charge and the

rate of the unpaid balance was applauded by consumer, economist, and politician alike, it was the biggest obstacle to the passage of the Act.[44]

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balances to which it is applicable, and, unless the annual percentage rate is required to be disclosed under (6), the nominal annual percentage rate,
(6) if the monthly finance charge exceeds 50 cents, the quotient of the finance charge for a period divided by the amount on which the finance charge was based, multiplied by the number of periods in a year,
(7) the effective annual percentage rate if the creditor so elects,
(8) the portion of the balance on which a finance charge was imposed, and how that balance was arrived at,
(9) the outstanding balance at the end of the period,
(10) the last date by which payment must be made to avoid additional finance charges.

Not all of the above items will be applicable to each billing, however. For example, if a consumer makes one purchase during the month and no payment, assuming a zero balance and the forms of the creditor are well drawn, only four items ((1), (2), (9), and (10)) will have to be disclosed.

In an other than open end consumer credit sales transaction (one in which the amount financed and the finance charge are fixed when the contract is consummated), the creditor must disclose the following before extending credit:

(1) the cash price,
(2) the down payment,
(3) the balance remaining after subtracting the down payment from the cash price,
(4) any credit charges not a part of the finance charge,
(5) the sum of (3) and (4),
(6) the finance charge,
(7) the finance charge, above a specified minimum, expressed as an annual percentage rate,
(8) the number, amount, and due date or periods of payments,
(9) late charges which may be incurred,
(10) a description of the security interest, if any, and the collateral thereof.

In an other than open end consumer loan transaction, the following disclosures must be made before credit is extended:

(1) the full amount of credit over which the debtor will have actual use,
(2) incidental credit charges which are not finance charges,
(3) the sum of (1) and (2),
(4) the total finance charge, except in the case of a purchase money mortgage for a house,
(5) the finance charge, above a specified minimum, expressed as an annual percentage rate.

The first disclosure is aimed at the lender practice of granting the debtor the amount requested and then subtracting expenses from that amount so that the debtor receives less than he bargained for.

[44] Representative of the views of the opponents of annual percentage rate disclosure is a statement made during the hearings by the vice president of the American Bankers Association. He testified that a statement in terms of the simple annual interest rate "is not necessary to enable the public to compare the cost of consumer credit. Moreover, we believe such a requirement is impractical, would be very difficult to administer, would increase the expense of extending credit, and would confuse the public." *Hearings on S. 2755*, *supra* note 3, at 695. *See also* R. JOHNSON, *supra* note 20, at 99-102. *But see Hearings on S. 2755*, *supra* note 3, at 524, 737.

But underlying many of the arguments marshalled against the annual percentage rate was the creditors' fear of the shock effect on consumers when the latter discovered they were paying finance charges at rates often amounting to 18 percent or more.

Mortgage lenders, on the other hand, were concerned with the shock effect of dis-

The main argument against annual percentage rate disclosure was that the added clerical burden of printing new disclosure forms, educating employees, and calculating percentage rates on individual transactions was an unreasonable interference with business.[45] This burden was exaggerated, however, because most credit transactions are standardized,[46] and the tables provided by the Federal Reserve Board make determination of the annual rate a quick, simple process which most clerks can learn in a short time.[47]

A second argument was that it would be impossible to compute the annual percentage rate when dealing with revolving charge accounts.[48] In this kind of credit arrangement the amount of money owed is considered due and payable on the monthly billing date, but the buyer has the option of making a fractional payment on that date and incurring a finance charge on the unpaid balance. Thus, the buyer can pay his bill in full on the first due date, incurring no finance charge,[49] or pay it in two or more installments, the finance charge depending on the number of installments. Consequently, the creditor is unable to make an accurate disclosure of the annual percentage rate at the time of the purchase.[50] Truth in Lending's solution was to require creditors to disclose a nominal annual percentage rate computed by multiplying their periodic rates

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closure of the *amount* of the finance charge. Because the normal mortgage is payable over a 20 to 30 year period, the finance charge often equals the sale price of the property. Thus, mortgage lenders were able to include provisions in the Act stating that in a credit sale or loan transaction involving the purchase of a dwelling the creditor is required to disclose the annual percentage rate, but not the finance charge. 15 U.S.C. §§ 1637(a)(6), 1638(a)(4) (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. §§ 226.8(c)(8)(i), 226.8(d)(3) (1970).

[45] *See 1961 Hearings on S. 1740, supra* note 1, at 569-70; N.Y. Times, April 7, 1960, at 20, col. 1.

[46] Spanogle, *How Much Truth in What Kinds of Lending?*, 16 J. PUB. L. 296, 310 (1967).

[47] For a description of the tables, see Wall Street J., April 14, 1967, at 8, col. 2. *See also 1961 Hearings on S. 1740, supra* note 1, at 448-96; *1962 Hearings on S. 1740, supra* note 4, at 51-52.

[48] *See generally* R. JOHNSON, *supra* note 20, at 16; Wall Street J., Feb. 1, 1968, at 12, col. 4 (Midwest ed.).

In 1967 revolving credit accounted for only about 3 percent of consumer debt. Wall Street J., June 9, 1967, at 3, col. 2 (Midwest ed.). But its use is rapidly expanding. *Cf.* Jordan & Warren, *supra* note 14, at 446-47.

For a good example of the typical revolving credit transaction and an analysis of its counterpart in the banking system (the check credit plan), see *id.* at 1306-07.

[49] It is common practice for retailers to allow between 30 and 90 days of free time before a finance charge is imposed. *See* Spanogle, *supra* note 46, at 315-16. *See also* McAlister, *Illusory Quest for 'Truth' in Lending*, Wall Street J., May 2, 1968, at 16, col. 6.

[50] *See* Jordan & Warren, *supra* note 14, at 1306-07.

by the number of periods in a year.[51] This nominal rate will normally be higher than the rate paid by the average consumer because it does not take into account the free time consumers are often given before they are charged interest.[52] Therefore, creditors are given the option of also disclosing an effective annual percentage rate. The effective rate is the average rate of interest paid by the creditor's revolving credit customers over a representative period of time.[53]

Opponents of the Act argued further that requiring disclosure of the annual percentage rate would cause merchants to bury the finance charge in the retail price, enabling them to advertise a misleading annual rate or no annual rate at all.[54] Merchants catering to high risk consumers have, in effect, been burying their finance charges by raising the retail price of their goods to compensate for the risk involved.[55] But Truth in Lending will only encourage more burying if merchants consider it better business to advertise low interest rates than low retail prices.[56] And because the merchant dealing with low income, high risk consumers usually has a captive market,[57] it should not make any difference to him whether the finance charge is reflected in the interest rate or the retail price.

Finally, opponents of the annual percentage rate provision argued that consumers do not really care about this kind of information.[58] The proponents, of course, countered with the argument that an

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[51] 15 U.S.C. §§ 1637(a)(4), 1637(b)(5) (Supp. IV, 1969).

[52] Jordan & Warren, *supra* note 14, at 1306-07; *see* note 49 *supra.*

[53] 15 U.S.C. §§ 1637(a)(5)(A), 1637(b)(7) (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.11 (1970). If computation of the effective annual rate would be impractical or meaningless, the creditor may disclose, instead, a projected future rate of return from his revolving credit plan. 15 U.S.C. § 1637(a)(5)(B) (Supp. IV, 1969).

An executive from the J. C. Penney Co. testified that a survey conducted by that company found that the average customer using the revolving credit plan incurred a finance charge of slightly more than 10 percent. *See Hearings on S. 5, supra* note 2, at 217-20; *cf. id.* at 505. Another sample, however, put the figure at 15.77 percent. *1962 Hearings on S. 1740, supra* note 4, at 284-85.

[54] *See 1961 Hearings on S. 1740, supra* note 1, at 127-30, 685; *Hearings on S. 2755, supra* note 3, at 471; Note, *Consumer Legislation and the Poor*, 76 YALE L.J. 745, 762 n.104 (1967).

[55] *See* Jordan & Warren, *supra* note 14, at 1301.

Regulation Z specifically excludes finance charges from its definition of "cash price." Fed. Res. Reg. Z, 12 C.F.R. § 226.2(i) (1970).

[56] *See 1962 Hearings on S. 1740, supra* note 4, at 136; *1961 Hearings on S. 1740, supra* note 1, at 502; *Hearings on S. 2755, supra* note 3, at 542.

[57] *See* notes 115-17 *infra* & accompanying text.

[58] *See, e.g., 1961 Hearings on S. 1740, supra* note 1, at 254-55. *See also* Wall Street J., July 23, 1969, at 18, col. 1 (Midwest ed.); Bloomfield, *Credit Unions Divided on Truth-in-Lending Act*, The Plain Dealer (Cleveland, Ohio), Aug. 9, 1970, at 25-A, col. 1.

assessment of consumer interest can hardly be made until the consumers have received the information.[59] This counterargument is not as convincing as it first appears, however, and consumer apathy about credit costs may be the strongest argument against the annual percentage rate.[60]

B. *Right of Rescission*

A second innovation in Truth in Lending is a right of rescission in any transaction in which a consumer has given a security interest on his residence,[61] other than a purchase money mortgage.[62] The right extends until midnight of the third business day following consummation of the transaction or delivery of the required disclosures, whichever is later.[63] The consumer must notify the creditor of his decision to rescind by either mail, telegram, or other writing.[64] Within 10 days of receipt of notice of rescission, the creditor must return any consideration received and take steps to terminate the security interest. If the consumer has received any property through the transaction, the creditor has 10 days after the performance of his obligations to reclaim the property, with title vesting in the consumer if the creditor fails to reclaim the property.[65]

The right to rescission is not, however, as valuable a consumer protection device as it first appears. First of all, the right may be waived in emergency situations where the consumer cannot wait 3 days for the creditor's performance.[66] Although printed forms are not permitted for this purpose,[67] the waiver provision is still subject

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[59] *See* N.Y. Times, Jan. 7, 1960, at 27, col. 8.

[60] *See* text accompanying notes 104-07, 110-13 *infra.*

[61] 15 U.S.C. § 1635 (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.9 (1970). *Accord*, U3C § 5.204.

The U3C also gives the consumer the right to rescind all home solicitation sales within 3 days of the sale. *Id.* § 2.502.

[62] 15 U.S.C. § 1635(e) (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. §§ 226.9 (g), 226.2(z). *Accord*, U3C § 5.204(5); *see* N.Y. Times, April 24, 1969, at 65, col. 2.

[63] 15 U.S.C. § 1635(a) (Supp. IV, 1969).

A transaction is considered consummated at the time a contractual relationship is created between the creditor and consumer, irrespective of the time set for performance. Fed. Res. Reg. Z, 12 C.F.R. § 226.2(cc) (1970). If the creditor sets the performance date at least 3 days after consummation of the contract the consumer will have to exercise his right before receiving what he purchased. Thus, his "cooling off" period will lose some of its value. Interview with Wilbur Leatherberry, Attorney, Cleveland Legal Aid Society, in Cleveland, Ohio, Sept. 23, 1969.

[64] Fed. Res. Reg. Z, 12 C.F.R. § 226.9(a) (1970).

[65] 15 U.S.C. § 1635(b) (Supp. IV, 1969).

[66] *Id* § 1635(d); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.9(e) (1970).

[67] Fed. Res. Reg. Z, 12 C.F.R. § 226.9(e)(3) (1970).

to abuse because of the inherently unequal bargaining positions of creditor and debtor. And, apart from the waiver provision, whenever a creditor challenges the exercise of the rescission right, the consumer must be prepared to establish that he gave a security interest in his residence, the date the transaction was consummated, and whether and when he gave notice of rescission.

But the principal defect of the right of rescission is that it is not broad enough. It is of no benefit to that segment of the population who cannot afford to own their own homes, yet who need this protection the most. And it is available to the homeowning consumer only in that rare situation in which he gives a security interest other than a purchase money mortgage on his home. The right of rescission is designed to give the consumer a cooling off period to reflect upon the bargain he has just made rather than to prevent fraud. The rationale behind a cooling off period applies just as strongly to credit transactions which are not secured by a consumer's residence. In fact, a consumer is more likely to carefully deliberate before entering into a transaction which involves mortgaging his home than one which does not. Truth in Lending could have afforded more consumers more protection by adopting a provision like the Uniform Consumer Credit Code's right to rescission in all home solicitation sales.[68]

C. *Advertising*

Unlike any of the previous consumer credit legislation, Truth in Lending applies to advertising.[69] The Act provides that no specific installment or downpayment can be advertised unless the creditor usually and customarily arranges installments or downpayments in that amount.[70] And when certain statements are made in an advertisement, additional disclosures must be made in the same advertisement. No specific term of an open end credit plan can be advertised unless accompanied by substantially the same disclosures that must be made to a consumer before he opens an account.[71] An advertisement of an other than open end plan that states the downpayment, the amount of an installment, the finance charge, the num-

[68] U3C § 2.502.

[69] 15 U.S.C. §§ 1661-64 (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.10 (1970).

[70] 15 U.S.C. § 1662 (Supp. IV, 1969).

[71] *Id.* § 1663; *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.10(c) (1970). For the disclosures that must be made to a consumer before he opens an open end credit account, *see* note 43 *supra.*

ber of installments, or the period of repayment, must also disclose the cash price, the downpayment, the schedule of payments, the annual percentage rate, and the deferred payment price or the sum of the payments.[72] Thus, for example, a furniture store which advertises a bedroom set in its store window for "only $50.00 down" must also disclose that the entire set costs $550, that the balance is repayable over 24 months in installments of $26.92 per month due on the first of each month, that the annual percentage rate is 16 percent, and that the deferred payment price is $646.25.

D. *Enforcement*

1. *Administrative Enforcement.*— It was the proponents' original intention that the Federal Reserve Board would be the exclusive administrator of Truth in Lending.[73] The Board had previously enforced Regulation W, an emergency credit control measure promulgated during World War II.[74] In addition, the bill's sponsor, Senator Douglas, was a member of the Banking and Currency Committee, which has jurisdiction over the Federal Reserve System. But William McChesney Martin, then Chairman of the Federal Reserve Board, repeatedly argued that Truth in Lending was not within the scope of general monetary policy which the Federal Reserve System ordinarily administers.[75] After assurances from other agencies, especially the Federal Trade Commission (FTC), that they would be able to undertake or supplement enforcement of the Act,[76] administrative enforcement was divided among nine agencies of the Federal Government.[77] The Federal Reserve Board was authorized to prescribe regulations for the entire Act.[78] The Board and seven other

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[72] 15 U.S.C. § 1664 (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.10(d) (1970).

"A good 'rule of thumb' to apply to all credit advertising . . . is that a retailer may not state any specific credit term (cash price is not a credit term) unless he makes full disclosure of his credit plan." N.Y. Times, April 30, 1969, at 59, col. 3.

Truth in Lending's advertising provisions, however, will probably not apply to such statements as "charge accounts available" or "just say charge it." "General statements that credit is available or that a particular item may be charged to a revolving or flexible account *will not* cause the provisions of the advertising sections of the Truth in Lending Act to come into play." Kinter, Henneberger & Neill, *A Primer on Truth in Lending*, 13 ST. LOUIS U.L.J. 501, 511 (1969).

[73] *See 1962 Hearings on S. 1740*, *supra* note 4, at 108; N.Y. Times, April 4, 1960, at 45, col. 3.

[74] Fed. Res. Reg. W, 12 C.F.R. §§ 222.1-.11 (Supp. 1941).

[75] *See, e.g., 1961 Hearings on S. 1740*, *supra* note 1, at 276.

[76] *See, e.g., 1962 Hearings on S. 1740*, *supra* note 4, at 130.

[77] 15 U.S.C. § 1607 (Supp. IV, 1969).

[78] *Id.* § 1604.

agencies[79] were authorized to regulate creditors — for example, banks, credit unions, and common carriers — falling within their respective jurisdictions. The FTC was given residual jurisdiction,[80] which will make it the primary enforcer of the Act because most violations will occur in the credit sales area.[81]

The FTC has only limited enforcement powers.[82] A violation of a final cease and desist order can result in a $5,000 fine per violation per day,[83] but such an order is issued only after months of fact-finding sessions and does not become final until the respondent has exhausted his judicial remedies.[84] In the meantime the creditor can continue to violate the Act, subject, of course, to possible civil and criminal penalties.[85] Truth in Lending, however, broadens the area in which the FTC can employ the enforcement powers it does possess. In 1941 the Supreme Court held in *FTC v. Bunte Bros.*,[86] that the FTC has jurisdiction only over activities *in commerce*, not those merely *affecting commerce*. Truth in Lending nullifies that decision with respect to its provisions, providing that the FTC can enforce compliance by any person with the requirements "under this subchapter, irrespective of whether that person is engaged in commerce . . . ."[87]

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[79] The Comptroller of the Currency; the Board of Directors of the Federal Deposit Insurance Corporation; the Federal Home Loan Bank Board; the Director of the Bureau of Federal Credit Unions; the Interstate Commerce Commission; the Civil Aeronautics Board; the Secretary of Agriculture.

[80] 15 U.S.C. § 1607(c) (Supp. IV, 1969).

[81] The FTC was the most likely candidate to bear the brunt of enforcement of Truth in Lending because of its previous experience in preventing deceptive trade practices under section 5 of the Federal Trade Commission Act (FTCA), 15 U.S.C. § 45 (1964). *See, e.g.*, Ford Motor Co. v. FTC, 120 F.2d 175 (6th Cir.), *cert. denied*, 314 U.S. 668 (1941) (FTC prohibited use of the term "6 percent" in a finance plan which resulted in payments in excess of that figure). *See also 1961 Hearings on S. 1740*, *supra* note 1, at 20-31; *1962 Hearings on S. 1740*, *supra* note 4, at 155-57.

[82] A violation of Truth in Lending is considered a violation of the FTCA for purposes of the FTC's enforcement powers. 15 U.S.C. § 1607(c) (Supp. IV, 1969).

[83] FTCA § 5(1), 15 U.S.C. § 45(1) (1964).

[84] *Id.* § 45(g). As of this writing there have been no final cease and desist orders under Truth in Lending. The FTC has, however, made an initial decision and issued a cease and desist order against Zale Corporation, a jewelery store chain. Zale Corp., 3 CCH CONSUMER CREDIT GUIDE ¶ 99,688 (FTC Aug. 10, 1970).

[85] *See* text accompanying notes 88-97 *infra*.

A former Chairman of the FTC, Caspar Weinberger, has recently expressed his hope that the FTC will soon be given the power to issue preliminary injunctions pending hearings on unfair trade practices. Weinberger, *The Federal Trade Commission: Progress and a New Profile*, 22 CASE W. RES. L. REV. 5, 9 (1970), (*supra* in this issue).

[86] 312 U.S. 349 (1941).

[87] 15 U.S.C. § 1607(c) (Supp. IV, 1969).

Truth in Lending preempts state laws only to the extent of an inconsistency. *Id.*

2. *Criminal and Civil Enforcement.*— Anyone who willfully or knowingly gives inaccurate information under Truth in Lending or fails to comply with any of its provisions is subject to a $5,000 fine or a year in prison or both.[88] It was in private enforcement of the Act, however, that the drafters foresaw the most effective implementation of its provisions.[89] Under the Act, a creditor who fails to make a required disclosure is subject to liability for twice the finance charge up to $1,000, but no less than $100, plus reasonable attorneys' fees.[90] Actions may be brought by an aggrieved consumer in a federal district court regardless of the amount in controversy.[91] The statute of limitations is 1 year from the date of the *occurrence* of the violation.[92]

The liberal recovery allowance is designed to encourage consumers to bring actions, and to encourage attorneys to prosecute these actions in situations where they would not be adequately compensated by a contingent fee arrangement. If this second purpose is to be achieved, the courts will have to determine fees on some other basis than a percentage of the judgment. In the first action brought under Truth in Lending, the plaintiff's attorneys suggested three ways of determining attorneys' fees: (1) a minimum fee schedule, (2) normal billing practices of plaintiffs' attorneys in commercial cases, and (3) a reasonable hourly rate.[93] Early court determinations of a $30 or $40 an hour rate would be a great boost to the Act, although they would increase the danger of a new kind of "ambulance chasing."[94]

The Act specifically provides creditors with defenses. A creditor cannot be held civilly liable if he shows by a preponderance of the

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§ 1610(a); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.6(b) (1970). And if the laws of a state subject any class of credit transactions to requirements substantially similar to the disclosure, rescission, or civil liability provisions of Truth in Lending, the state can obtain an exemption from the Act for that class of transactions. 15 U.S.C. § 1633 (Supp. IV, 1969); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.12 (1970). As of this writing four states — Maine, Massachusetts, Oklahoma, and Connecticut — have obtained partial exemptions from the Act. 1 CCH CONSUMER CREDIT GUIDE ¶ 3682, at 3381-82 (1970).

[88] 15 U.S.C. § 1611 (Supp. IV, 1969).

[89] *See 1961 Hearings on S. 1740, supra* note 1, at 66.

[90] 15 U.S.C. § 1640 (a) (Supp. IV, 1964).

[91] *Id.* § 1640 (e).

[92] *Id.*

[93] Plaintiff's Memorandum of Law in Support of Motion for Summary Judgment, at 8, White v. Belogonis, Civil No. 69-2858 (S.D.N.Y. filed July 1, 1969).

[94] *See 1961 Hearings on S. 1740, supra* note 1, at 610. *See also* Elsman, *Federal Truth in Lending Act: Due Date for Creditors — July 1*, 48 MICH. ST. B.J. 12, 16 (May 1969).

evidence that the violation was unintentional and that the error occurred in spite of procedures reasonably adopted to avoid it.[95] This provision protects creditors from liability for the negligence of their employees, and may result in some creditors merely setting up formal disclosure procedures. Creditors can also escape liability if they correct an error within 15 days after discovering it and before an action is instituted or they receive written notice of the error.[96] But when correcting an error, a creditor cannot impose a finance charge in excess of the percentage rate originally disclosed.[97] Thus, in situations where a creditor has disclosed too low a rate or no rate at all, and the error is corrected in time, the consumer's finance charge will remain at the originally disclosed rate.

V. SHORTCOMINGS OF A DISCLOSURE ACT

A. *Does Truth in Lending Disclose?*

Truth in Lending requires that credit information be disclosed clearly and conspicuously.[98] The regulations add that the disclosures must be in meaningful sequence and that the terms "finance charge" and "annual percentage rate" must be printed more conspicuously than the rest of the information.[99] Thus, if consumers read their contracts, they should be aware of both the total amount of finance charges they are paying, and the annual percentage rate these charges represent.

It is one of the facts of consumer life, however, that most consumers do not read their contracts. This is partly attributable to the consumer's having made the decision to buy by the time he reaches the contract stage, giving him cause to read his contract only if he distrusts the salesman.[100] A second reason is that the unintelligibility of most installment sales contracts discourages the consumer from trying to decipher one a second time.[101] Truth in Lending ap-

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[95] 15 U.S.C. § 1640(c) (Supp. IV, 1969).

[96] *Id.* § 1640(b).

[97] *Id.*

[98] *Id.* § 1631(a); *see* Fed. Res. Reg. Z, 12 C.F.R. § 226.6 (1970).

[99] Fed. Res. Reg. Z, 12 C.F.R. § 226.6(a) (1970).

[100] Jordan & Warren, *supra* note 14, at 1320. "The consumer is sold before he ever signs the contract and he seldom reads it before *or* after he signs." *Id.*

[101] William McChesney Martin, former Chairman of the Federal Reserve Board, former Assistant Secretary of the Treasury, and former president of the New York Stock Exchange, admitted that he was confused by automobile installment contracts. *Hearings on S. 2755*, *supra* note 3, at 204-05; N.Y. Times, April 6, 1960, at 28, col. 3. *See also Hearings on S. 2755*, *supra* note 3, at 600.

parently cures this confusion as far as credit terms are concerned,[102] but until consumers are made aware of the Act's requirements, their past experience with contracts may discourage them from even looking for the credit disclosures. Thus, whatever the merits of disclosure, consumers will have to be educated, at least to the point where they will read their contracts, before Truth in Lending can accomplish its purposes.

B. *Disclosure and the Purposes of Truth in Lending*

Truth in Lending's two main purposes are to enhance economic stability and to enable consumers to avoid the uninformed use of credit.[103] This section of the Note will examine how the Act is supposed to bring about these results and whether it will be successful.

1. *Economic Stability.*— The premise behind the finding that economic stability will be enhanced is that disclosure of credit costs will make consumers more responsive to fluctuations in general monetary policy. Consumers will supposedly regulate their credit spending according to the rise and fall of interest rates, thus contributing to the stabilization of the economy.[104] For example, when interest rates go up in an inflationary period, knowledge of the increase will result in a reduction in consumer credit spending, reversing the inflationary trend. And in periods of recession, knowledge of the decline in interest rates will result in an increase in credit spending, with its consequent rehabilitative effect on the economy.

There are two flaws in the above argument, however, which invalidate the finding that Truth in Lending will enhance economic stability. First, the premise that disclosure of credit costs will make

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[102] *See* text accompanying notes 98-99 *supra.*

[103] *See* 15 U.S.C. § 1601 (Supp. IV, 1969).

[104] *See, e.g., 1961 Hearings on S. 1740, supra* note 1, at 560.

> [T]he cost of credit is a natural countercyclical influence on the timing of credit purchases and repayments. . . .
>
> However, the stabilizing effect of changes in credit costs depends on awareness by consumers that the changes have occurred. If buyers are ignorant of the true costs of credit, they are less subject to influence by cost changes. By increasing consumer awareness, this bill will help to make the cyclical fluctuation of credit costs a more stabilizing influence on the economy. *Id.* at 45-46 (statement of James Tobin, Council of Economic Advisers).

For a similar statement by Senator Douglas, see *Hearings on S. 750 Before The Subcomm. on Production and Stabilization of the Senate Comm. on Banking and Currency,* 88th Cong., 1st Sess., pt. 1, at 7-8 (1963). *See* N.Y. Times, July 18, 1961, at 10, col. 6. *See also* REPORT OF THE CHAIRMAN OF THE COUNCIL OF ECONOMIC ADVISERS, *reprinted in 1961 Hearings on S. 1740, supra* note 1, at 15-16; Wall Street J., July 5, 1961, at 3, col. 2. *But see 1961 Hearings on S. 1740, supra* note 1, at 252 (statement of Professor Robert Johnson); *Hearings on S. 2755, supra* note 3, at 808.

consumers more responsive to fluctuations in monetary policy is an invalid one for several reasons. The cost of credit is usually a minor consideration to the consumer, the primary consideration being the product. Once the consumer is sold on the product, it is unlikely that disclosure of the annual percentage rate will result in his changing his mind. Even more influential in the consumer's decision to buy is the size of the monthly payment.[105] For a person with a fixed amount of money to spend each month, the difference between a monthly payment of $12 and one of $18 assumes much more importance than the difference between an interest rate of 12 percent and one of 18 percent.

Two additional observations concerning consumer credit buttress the argument that it is unresponsive to interest rates. One is that fluctuations in consumer credit spending are often a result of expectations of future income.[106] The second is that the growth of installment debt has been horizontal — an increase in the number of debtors — rather than vertical — an increase in the volume of debt among prior debtors.[107] It is doubtful that a change of a few percentage points in the interest rates will control a family's decision whether or not to begin using credit.

But even if consumer credit were responsive to fluctuations in interest rates, the argument that Truth in Lending will enhance economic stability is a faulty one. The cost of money represents only a minor portion of the expenses of lending institutions.[108] Thus, when the interest rates paid by these institutions change, the rates charged the consumer will not reflect the entire amount of the change. In addition, because most lending institutions obtain a large part of their funds by long-term borrowing, a change in interest rates will not effect them immediately, and thus even that portion of the rate change that does reach the consumer will be delayed.[109]

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[105] *See, e.g., 1962 Hearings on S. 1740, supra* note 4, at 84; *1961 Hearings on S. 1740, supra* note 1, at 261, 569; *Hearings on S. 2755, supra* note 3, at 133, 773, 807; Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445, 469 (1968).

[106] Shapiro, *Installment Credit*, in INTERNATIONAL ENCYCLOPEDIA OF THE SOCIAL SCIENCES 354, 356 (1968).

[107] *Id.* at 357.

[108] *1961 Hearings on S. 1740, supra* note 1, at 252 (statement of Professor Robert Johnson).

[109] *Id.* Professor Johnson gave the following illustration:

> Let us assume that a consumer is considering the time purchase of a $100 radio, but is waiting until finance rates decline. Let us say that at the peak of the boom, when short-term money costs 6 percent, his finance charge would be $8 on a 12-month contract, or an effective annual rate of about 14.8 percent.

The result is that even large changes in interest rates become negligible by the time they reach the consumer, and will hardly influence even the responsive consumer to change his buying habits.

2. *Consumer Protection.*— The principal purpose of Truth in Lending is to enable consumers to easily compare credit costs and thus intelligently shop for credit.[110] There is little dispute that disclosure of finance charges as an annual percentage rate of the unpaid balance will make it easy to compare credit costs. Even the most unsophisticated consumer knows, for example, that 15 percent is less than 18 percent. But the question remains whether disclosure is an effective consumer protection device.

Annual percentage rate disclosure will dispel the "6 percent myth." Upon discovering the interest rates they are being charged, some consumers may reduce their volume of credit spending or refrain from using credit altogether.[111] A reduction in their volume of credit spending, however, would result in a lower standard of living for most consumers. And those consumers who could pay cash and still maintain their standard of living will more than likely decide that if the convenience of credit shopping was worth paying 12 percent when they thought they were paying 6 percent, the convenience is worth paying 12 percent when they know they are paying 12 percent.

Thus, annual percentage rate disclosure will only be meaningful to those consumers who are both willing and able to shop for credit. It is submitted, however, that few among those able to shop for credit — those who have both the necessary mobility and the boldness to ask about credit terms — will begin to do so after Truth in

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> In the recession that follows, money rates are cut in half; they fall to 3 percent. Sales finance companies are now able to obtain short-term loans at half their earlier cost, and they pass the full reduction along to consumers. If we assume the sources and costs of funds described earlier, it can be shown that the total finance charge to the consumer will decline to $7.33 from $8, and the annual rate will decline to 13.5 percent from 14.8 percent. . . . Thus, even a dramatic change in money rates will produce a relatively minor change in consumer finance rates and a negligible change in the time price of a product. *Id.*

110 *See* 15 U.S.C. § 1601 (Supp. IV, 1969). *See also Hearings on S. 2755, supra* note 3, at 585.

111 Opponents of Truth in Lending predicted that the shock effect of increased knowledge of credit costs would have a massive depressant effect on the economy. *See 1961 Hearings on S. 1740, supra* note 1, at 259-60; *cf. Hearings on S. 2755, supra* note 3, at 738, 809. *But see* Burman, *Bay State Assays Truth-in-Lending Law*, Christian Science Monitor, April 17, 1967, at 13, col. 2 (a survey of the 3½-month-old Massachusetts truth in lending law which the author found to have no discernible impact on consumer behavior or loan volume).

Lending.[112] Consumers are more interested in the primary product and the monthly payments than in the finance charge.[113] Added to these considerations are factors such as the convenience and goodwill of a certain store or shopping center, which a few percentage points of credit savings are not likely to overcome.

The chief criticism of Truth in Lending is that it will only help those who need help the least — the sophisticated consumers who have both the ability and motivation to shop for credit.[114] The low income consumer is no better off than before, except that if he reads his contract, he now knows how large a finance charge he is paying. The low income consumer is by definition a poor credit risk.[115] Consequently he is driven to the "neighborhood stores," which are not only willing to extend him credit, but actually encourage him to use credit.[116] And because of their captive market, these stores are able to sell low quality goods at high prices.[117] The low income consumer has little real choice. He is trained by society to want the symbols and appurtenances of the good life, but lacks the means to obtain them.[118] He must purchase on whatever terms the neighborhood store offers or do without.

Thus, increased information about credit costs is of little value to the low income consumer. Often a member of a minority racial

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[112] A study commissioned by the Federal Reserve Bank of Boston on the former Massachusetts truth in lending law, which required annual percentage rate disclosure [Act of August 31, 1966, ch. 587, § 1, Mass. Laws 539, *as amended* MASS. GEN. LAWS ANN. ch. 140C, §§ 6(a)(4), 6(b)(6), 7(b)(2) (Supp. 1970)], found that consumers "are apparently either unaware of the requirement for disclosure or indifferent to it. . . . The annual rate disclosure has not stimulated active consumer shopping for credit and has had no appreciable effect on competition." Wall Street J., July 11, 1969, at 22, col. 1.

[113] *See* text accompanying note 105 *supra.*

[114] "The existing scheme of consumer-credit laws — although well intended and carefully devised — is vulnerable to the criticism that it supplies largely middle-class solutions (*e.g.*, rate ceilings, disclosure) to what has increasingly become a lower-class problem." Jordan & Warren, *supra* note 14, at 449.

[115] D. CAPLOVITZ, THE POOR PAY MORE 14 (1963).

[116] *See id.* at 15-20, 87-90. For a frank description of how a ghetto merchant operates, given by a ghetto merchant himself, see Drosin, *Spanish Harlem Furniture Seller Provides Credit, Plus High Prices and Hard Dunning*, Wall Street J., Aug. 28, 1970, at 22, col. 1 (Midwest ed.).

[117] In large part, these merchants have a "captive" market because their customers do not meet the economic requirements of consumers in the larger, bureaucratic marketplace. But also, they can sell inferior goods at high prices because, in their own words, the customers are not "price and quality conscious." Interviews found that the merchants perceive their customers as unsophisticated shoppers. [One] merchant . . . said, "People do not shop in this area. Each person who comes into the store wants to buy something and is a potential customer. It is just up to who catches him." D. CAPLOVITZ, *supra* note 115, at 19.

[118] *Id.* at 14.

or ethnic group,[119] he is uncomfortable shopping away from his own neighborhood where the creditors speak his language. And even if he were able to obtain credit on more reasonable terms outside his neighborhood, he often lacks the sophistication and boldness to effectively shop for credit.[120] Disclosure is a necessary part of any consumer protection plan,[121] but to solve the credit problems of those members of our society who need protection the most — the low income consumers — something more is needed.[122]

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[119] *See id.* Caplovitz has demonstrated that there is a relationship between minority races and higher costs. *Id.* at 90-93.

[120] *Id.* at 14-15. *See* Note, *Consumer Legislation and the Poor*, 76 YALE L.J. 745 (1967).

> Low income consumers normally lack all of the model characteristics:
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> (1) *Belief in Comparative Shopping*: Low income consumers are often not aware that they could get more for their money by visiting a number of stores, particularly those outside their immediate neighborhood. . . . (A) Low income consumers usually shop primarily [on] credit. . . . (B) Low income consumers are frequently concerned to satisfy non-material needs by their purchases: status-seeking and escapism heavily influence their buying patterns. . . . (C) Many of the poor are shy and unwilling to deal with strangers, preferring instead to trade with local people whom they already know, and who are more likely to be personable and speak their language. . . .
>
> (2) *Ability to Pick Out the Best Buy*: Low income consumers generally lack the technical knowledge needed to choose among consumer durables such as appliances or cars; they are usually less educated, less likely to read publications such as *Consumer Reports*, and generally less able to make rational choices among products than their middle income counterparts. . . .
>
> (3) *Freedom to Engage in Comparative Shopping*: . . . They feel, usually correctly, that they cannot get the credit they need outside of their own neighborhood. . . . This pressure to shop within the local business community is compounded by shyness, the need to care for children, and the inconvenience of a time-consuming trip to a more affluent area. . . .
>
> (4) *Knowledge of Legal Rights and Liabilities*: Most laymen lack more than a superficial knowledge of their rights and liabilities in a post-sale legal conflict. . . .
>
> (5) *Motivation*: . . . Many of the poor who do have a conscious desire to get more goods and services for their money have failed so often in attempting to do so that they no longer regard the attempt as worthwhile. . . .
>
> In sum, the new wave of informational legislation will be of little help to the poor because it presupposes values, motivation and knowledge which do not generally exist among them. *Id.* at 749-54.

[121] "[Truth in Lending] does not seek to regulate creditors, and only regulation can solve some problems. However, Truth in Lending legislation should not be abandoned for failing to provide regulation. The legislation can be effective within its limits, but its beneficial aspects should not be overrated." Spanogle, *How Much Truth in What Kinds of Lending?*, 16 J. PUB. L. 296, 299 (1967).

[122] The Committee on Uniform State Laws has concluded:

> [C]onsumer protection in the area of consumer credit can be realized only if the many facets of the problems involved are considered. Disclosure is but one of the problem areas. Equally, if not more important for consumer protection are rate ceilings, contract limitations and other requirements, restrictions on insurances and insurance coverages, advertising restraints, limitations

The real problem of the low income consumer will require a solution utilizing political, economic, and educational forces. But until such a solution is forthcoming, the consumer should be protected from merchants who are continually pressuring him to overextend his credit and purchase inferior merchandise. Of course, the most effective solution to the credit problems of the low income consumer would be a refusal by merchants to sell on credit to consumers who are obviously overextending themselves.[123] It is unrealistic to rely on such a solution, however, while a significant number of merchants continue to direct their sales efforts primarily toward high risk consumers.[124] The foothold of some of these neighborhood merchants might be weakened in part if the more "respectable" retailers would open their doors to the better risks among low income consumers who do not appear to be overextending their credit. This greater availability of reasonable credit for reasonable consumer needs might prevent at least a few low income buyers from dealing with the neighborhood merchant and becoming victims of his pressure tactics.

The most effective means of protecting the low income consumer appears to lie in the statutory regulation of credit. Although credit regulation is objectionable to lenders and installment retailers, it offers the only reliable protection against the exploitation of low income consumers. To be effective, credit regulation would have to consist of basic restrictions, including a minimum down payment (computed as a percentage of the total purchase price) and a maximum length of maturity for all credit sales.[125] In addition, an annual percentage rate ceiling should be imposed on all credit transactions, prohibiting at least legal gouging on interest rates. The

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on creditors' remedies, provisions for debtors' rights and remedies, and adequate facilities for administration and enforcement of the established rules. *Hearings on S. 5 Before the Subcomm. on Financial Institutions of the Senate Comm. on Banking and Currency*, 90th Cong., 1st Sess. 283 (1967).

[123] *Cf.* 115 CONG. REC. 13,471 (daily ed. Oct. 30, 1969) (President Nixon's address to Congress on consumer problems).

The canons of ethics of the American Bankers Association require self restraint in extending credit to bad risks. The canons are cited in *1961 Hearings on S. 1740*, *supra* note 1, at 527-28.

The practice by some merchants of contacting recent bankrupts and offering them credit, with the knowledge that they cannot be discharged again for 6 years, could be curtailed if the local legal newspapers would refrain from publishing lists of recently discharged bankrupts.

[124] *See* D. CAPLOVITZ, *supra* note 115, at 15-20; Drosin, *supra* note 116. *See also* note 117 *supra*.

[125] *See* D. CAPLOVITZ, *supra* note 115, at 190-91; N.Y. Times, Aug. 28, 1960, § 6 (Magazine), at 38.

level of this ceiling, as well as the minimum down payment and the maximum repayment period, would have to be determined from a careful study of long range financial data. Ultimately, the extent of the credit restrictions would have to be balanced against the fact that too great a restriction on credit terms will prevent even "respectable" retailers and lenders from realizing a fair profit in dealing with high risk consumers.

The enactment of consumer credit regulations appears to be the only effective solution to the current problems of the low income consumer. Disclosure is of little help to him because he is not able to effectively utilize the information he receives. Restrictions on creditors' remedies provide some relief, but it comes "after the fact."[126] Until the economic and social problems of low income consumers are solved, government regulation of credit extention is necessary. The government may not be ready to take affirmative steps to eliminate poverty in our country, but it can at least help the poor make the most efficient use of what resources they have by protecting them from exploitation.

VI. CONCLUSION

Truth in Lending has strengthened the consumer's position in the battle of forms. If the consumer reads his contracts, if he attaches as much importance to the finance charge as he does to the monthly payment, if he is not shy in his dealings with salesmen, and if he is willing and able to do comparison shopping, he is somewhat better off now than before the Act. Consumer education about their rights under the Act and about credit in general is the most important factor in making disclosure an effective method of consumer protection. But disclosure is far from the final answer. In a society where credit buying is a way of life, stronger measures must be taken to protect the consumer, sometimes from overreaching merchants, sometimes from himself.

JOHN M. DRAIN, JR.*

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126 For example, section 5.103 of the U3C provides that where the cash price of an article is $1,000 or less and the purchaser defaults, the creditor is restricted to either repossession or an action for the unpaid balance; he cannot both repossess and obtain a deficiency judgment. *See also* note 40 *supra*. The Consumer Credit Protection Act [Pub. L. No. 90-321, tits. I-V, 82 Stat. 144 (1968) (codified in scattered sections of 15, 18 U.S.C.] itself regulates extortionate credit transactions (Title II) and limits the garnishment remedy (Title III).

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