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# Kentucky Passes a Retail Installment Sales Act

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## KENTUCKY PASSES A RETAIL INSTALLMENT SALES ACT\*

## INTRODUCTION

The Kentucky Retail Installment Sales Act, effective January 1, 1963, provides for most of the essential consumer oriented safeguards which have been recognized as desirable in the many states that have enacted retail installment sales legislation. State regulation in this field began in 1935 when Indiana passed the first such law.<sup>1</sup> Since then, thirty-one states have adopted similar measures. The impetus toward state regulation of the retail installment sale is attributable mainly to volume. In 1939, the total amount of retail installment credit for the entire country was 4.5 billion dollars, but by November 1962, it had risen to over 47 billion dollars.<sup>2</sup> The volume of installment credit indicates the number of people affected by the installment sale. This great number coupled with the possibility of abuses clearly justifies state regulation in this field.

The act, by its terms, addresses itself to the retail installment contract and the seller and does not speak in express terms of the financing agency except in reference to the "holder" of the contract. Yet clearly, the financing agency is more affected by the act than the seller since the agency finances the installment sale and the installment sales contract is prepared by, discounted to, and enforced by the financing agency. Therefore, in studying the act, attention should be focused on the rights and duties it created in banks, finance companies, and other financing agencies engaged in retail installment financing.

Excluding motor vehicles, the act relates to the sale of goods.<sup>3</sup> "Goods" as defined in the act means all tangible chattels purchased primarily for personal use as distinguished from commercial, industrial, or agricultural use.<sup>4</sup> Generally, the act applies to all retail installment sales of goods (a) evidenced by a retail installment sales contract,<sup>5</sup> (b) entered into in this state,<sup>6</sup> and (c) payable in one or

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\* Ky. Rev. Stat. ch. 371 (1962).

<sup>1</sup> Ind. Stat. Ann. § 58-901 to 58-945 (1951).

<sup>2</sup> Of this, over 19 billion dollars was automobile paper and over 12 billion dollars was other consumer goods paper. 49 Fed. Reserve Bull. 64 (1963).

<sup>3</sup> Installment motor vehicle sales are covered by Ky. Rev. Stat. ch. 190 (1962) [hereinafter cited as KRS].

<sup>4</sup> KRS 371.210(1).

<sup>5</sup> The retail installment sales contract may include a chattel mortgage, a security agreement, a conditional sales contract, and a contract in the form of a bailment or a lease if the bailee or lessee agrees to pay for their use a sum substantially equivalent to or in excess of the value of the goods sold, and if the bailee or lessee has the option to become, or is bound to become, the owner of the goods upon full compliance with the provisions of the contract. KRS 371.210(7).

<sup>6</sup> KRS 371.210(7).

more installments.<sup>7</sup> Prior to the passage of the new act, the Kentucky retail consumer who bought on time had to look primarily to the Petty Loan Act,<sup>8</sup> the usury laws,<sup>9</sup> or the common law of conditional sales for protection. There was a catalogue of abuses not protected by this body of law, resulting from such situations as the lack of disclosure requirements, excessive finance charges, and the absence of a right of prepayment. This act, which is in line with current state regulation of the installment sales field, is an attempt to remedy some of these abuses.

*The Usury Laws and the Retail Installment Sale.* The retail consumer who wishes to buy tangible personal property on time usually chooses between one of the two chief methods of financing such a transaction. First, he may obtain a direct loan from a bank or other financing agency and then pay the retail dealer the cash sale price of the purchased goods. Under this method, the consumer agrees to repay the financing agency in installments over a period of time. The maximum interest that the financing agency may charge is governed by the usury statute.<sup>10</sup> The other chief method of financing the purchase is by the retail installment sale, the characteristic feature of this method being the installment sales contract. In this transaction the retail buyer receives the goods from the seller, after making a down payment, and contracts to repay the balance in installments over a certain period of time. As is the usual practice, the financing agency supplies the retail seller with the installment sales contract. The seller determines the finance charge by referring to the financing agency's rate schedule and adds this amount to the cash sale price. After the buyer has signed the contract, it is "discounted" to the financing agency, who enforces it. However, in this latter method of sales financing, it is the majority view that the usury laws do not apply.<sup>11</sup>

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<sup>7</sup> KRS 371.210(6).

<sup>8</sup> KRS ch. 288.

<sup>9</sup> KRS Ch. 360.

<sup>10</sup> KRS 360.010 provides that the maximum legal bank interest rate is six per cent per annum. Some financing agencies in Kentucky are permitted to charge in excess of the legal interest rate. For the charges that a petty loan company may make, see KRS 288.530.

<sup>11</sup> *Hogg v. Ruffner*, 66 U.S. (1 Black) 115 (1860); *Beete v. Bidgood*, 7 B. & C. 453, 108 Eng. Rep. 792 (K.B. 1827). Colorado and Texas have codified the rule by statute. Colo. Rev. Stat. Ann. § 13-16-1(8) (Supp. 1957); Tex. Rev. Stat. Ann. Art. 5074a (Supp. 1959). A few jurisdictions, however, have held that under certain circumstances installment sales are within the usury statutes. *Hare v. General Contract Purchase Corp.*, 220 Ark. 601, 249 S.W.2d 973 (1952); *Powell v. Edwards*, 162 Neb. 11, 75 N.W.2d 122 (1956); *G.F.C. Corp. v. Williams*, 231 S.W.2d 565 (Tex. Civ. App. 1950; Kentucky follows the majority view. *Munson v. White*, 309 Ky. 295, 217 S.W.2d 641 (1949); *Cartwright v. C.I.T. Corp.*, 253 Ky. 690, 70 S.W. 2d 388 (1934).

It would seem that there would be no basis for such a distinction since both methods are so strikingly similar. In both cases the buyer defers payment over a period, paying an amount in excess of the cash sale price for this privilege. In both cases the financing agency, not the seller, finances the transaction. The distinction is best explained by history. During the era in which the usury statutes were enacted, there was little installment buying, the statutes being aimed primarily at the direct loan.<sup>12</sup> As installment buying began to increase, the courts held that a retail seller may choose, at his discretion, one price for a cash sale and another for an installment sale. The famous rationale of the Missouri Supreme Court best explains the policy basis:

The reason is that the statute against usury is striking at and forbidding the exaction or receipt of more than a specified legal rate for the hire of money and not anything else; and a purchaser is not like the needy borrower, a victim of a rapacious lender, since he can refrain from the purchase if he does not choose to pay the price asked by the seller.<sup>13</sup>

This reasoning seems outdated today since one may need an article of personal property just as desperately as a loan. The distinction has been criticized by many writers.<sup>14</sup> However, the doctrine has been recognized for so long in the majority of jurisdictions that it is doubtful whether many courts will change their positions.<sup>15</sup> Clearly this problem is in the lap of the state legislatures.

#### REGULATORY FEATURES OF THE ACT

*Disclosure.* Generally a financing agency furnishes the retail seller with the printed contract forms.<sup>16</sup> The buyer's participation in the contract is usually limited to the signing of his name, often without giving the contract more than a cursory glance. This setting encourages the camouflage of important contract provisions such as the lack of separation of price and charges, the concealment of important terms in fine print, and the leaving of blank spaces to be filled in after the buyer has signed. The new act squarely meets these problems. The pertinent disclosure provisions of the act require that the contract be in writing, dated, signed by the buyer, and completed

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<sup>12</sup> Warren, *Regulation of Finance Charges in Retail Installment Sales*, 68 Yale L.J. 839, 842 (1959).

<sup>13</sup> *General Motors Acceptance Corp. v. Weinrich*, 218 Mo. App. 68, 77-78, 262 S.W. 425, 428 (1924).

<sup>14</sup> Warren, *supra* note 12, at 842; Comment, 55 Nw. U.L. Rev. 301, 303 (1960); Berger, *Usury in Installment Sales*, 48 Yale L.J. 1102 (1939).

<sup>15</sup> *But see* position taken by the Arkansas, Texas, and Nebraska courts, *supra* note 11.

<sup>16</sup> See generally Adelson, *The Mechanics of the Installment Credit Sale*, 2 Law & Contemp. Prob. 218 (1935).

as to all essential provisions;<sup>17</sup> that the terms of the contract be made clear, including the itemizing of the cash price, down payment, aggregate amount of insurance, aggregate amount of official fees, principal balance, amount of the time price differential (finance charge), and time balance;<sup>18</sup> that the printed portion of the contract be in a size equal to at least eight point type;<sup>19</sup> that the buyer may request and receive a statement of account balance when desired;<sup>20</sup> and that a "balloon" payment be itemized.<sup>21</sup> Such provisions are standard and largely non-controversial.<sup>22</sup> Clearly provisions requiring disclosure represent one of the basic philosophies of retail installment sales legislation.<sup>23</sup>

*Right of Prepayment and Rebate.* Every state passing a retail installment sales act has permitted the buyer to prepay the time balance and receive a rebate.<sup>24</sup> Such a provision strikes at one of the most serious abuses in the installment sale since some financing agencies have refused rebate on prepayment on the theory that the finance charge is part of the time sale price.<sup>25</sup> The act provides that upon prepayment the buyer is entitled to a rebate computed by apportioning the finance charge after deducting a maximum of ten dollars, except that an amount less than one dollar need not be refunded.<sup>26</sup>

*Consolidation.* If a buyer purchases goods from a seller from whom he has previously purchased under a retail installment sales contract, it may be to the buyer's advantage to consolidate the contracts. This is true because it may be financially easier for the buyer to make one payment than several. The new act provides for such a contingency.<sup>27</sup> In the event of consolidation of an outstanding contract with a new one, it is sufficient if the seller supplies the buyer with a written memorandum of the new purchase which itemizes all the essential terms of the consolidation.<sup>28</sup>

<sup>17</sup> KRS 371.220(1).

<sup>18</sup> KRS 371.220(5).

<sup>19</sup> KRS 371.220(2).

<sup>20</sup> KRS 371.280.

<sup>21</sup> KRS 371.220(5). Balloon payment contracts schedule a substantially higher final payment than the preceding ones. Such a device is sometimes used to induce refinancing. The buyer becomes accustomed to paying the smaller installments, but when the final installment becomes due, he finds himself unable to meet it. The result is that he is often forced to refinance the contract on the terms of the financing agency.

<sup>22</sup> Britton & Ulrich, *The Illinois Retail Installment Sales Act—Historical Background and Comparative Legislation*, 53 Nw. U.L. Rev. 137, 158 (1958).

<sup>23</sup> Comment, 45 Marq. L. Rev. 555, 570 (1960).

<sup>24</sup> *Id.* at 575.

<sup>25</sup> Britton & Ulrich, *supra* note 22, at 163.

<sup>26</sup> KRS 371.260(2).

<sup>27</sup> KRS 371.290.

<sup>28</sup> KRS 371.290(2).

*Delinquency charges.* Most retail installment sales contracts provide that if the buyer fails to meet an installment when due, the financing agency may assess a delinquency charge. This would appear to be a fair procedure since the finance charge in the contract is computed in advance under the assumption that all installments will be promptly met. When an installment is not paid as agreed, the precomputed finance charge does not reflect the actual situation. Therefore, the financing agency should be compensated for the necessary adjustment. However, the delinquency charge may become an instrument of abuse. A financing agency may be encouraged to let installments fall overdue in the hope of extra income.<sup>29</sup> Also the financing agency may assess an exorbitant delinquency charge since the majority rule is that such charges are outside the usury statutes.<sup>30</sup> The new act effectively combats these abuses. It provides for a ten day grace period, after each installment falls due, during which the delinquency charge may not be made.<sup>31</sup> This gives the tardy buyer ample time. Secondly, the act provides for a maximum delinquency charge.<sup>32</sup>

*Refinancing.* When a buyer finds himself unable to keep up the installments on his contract at the scheduled payment rate, he may want to refinance the obligation to permit him to make payments of a lesser amount. The refinancing of an installment sale bears a strong resemblance to the direct loan, which is subject to the usury statutes.<sup>33</sup> Therefore, regulation of one and not the other may not be justified. The act provides that, at the buyer's request to refinance the contract,<sup>34</sup> a refinance charge may be assessed not to exceed a maximum provided for in two optional methods of computation.<sup>35</sup>

*Retail Charge Agreements.* Retail charge agreements (commonly called revolving credit plans) represent one of the newest techniques in ready consumer financing.<sup>36</sup> Nearly every large department store

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<sup>29</sup> Hogan, *A Survey of State Retail Installment Sales Legislation*, 44 Cornell L.Q. 38, 60 (1958).

<sup>30</sup> Gerber, *Do Late Charges in Excess of the Usury Statutes Constitute Usury?*, 12 Personal Finance L.Q. 62 (1958).

<sup>31</sup> KRS 371.270(1).

<sup>32</sup> The delinquency charge may not exceed five per cent of each installment or five dollars, whichever is less, provided that a minimum charge of one dollar may be made, or in lieu thereof, interest after maturity on each such installment not to exceed the highest lawful contract rate. KRS 371.270(1). Similar provisions have been enacted in many states. Comment, *supra* note 23, at 578.

<sup>33</sup> Britton & Ulrich, *supra* note 22, at 172.

<sup>34</sup> This is a common provision in retail installment sales acts, but it is doubtful whether such a provision will have any substantial effect. Comment, *supra* note 23, at 575.

<sup>35</sup> KRS 371.270(2).

<sup>36</sup> To avoid confusion with other retail charge plans not involving a finance or service charge, the transaction will be referred to as a revolving credit plan.

in this country offers a revolving credit plan.<sup>37</sup> Under the typical plan the retail buyer agrees to pay an installment of a certain amount each month in return for the privilege of "charging" purchases at the department store over an indefinite period of time. Usually a credit limit is fixed beyond which the outstanding indebtedness may not reach. The outstanding indebtedness of the buyer consists of the amount of purchases plus the service (finance) charge less the aggregate amount of monthly installments paid. Such a plan is convenient to the buyer since he may purchase department store goods as his needs require at any time by setting up a schedule of monthly payments that his budget will withstand. The buyer's convenience means increasing sales for the department store. Since it would be in the interest of the department store to encourage the buyer to purchase from it rather than from a competitor, it might seem that abuses in revolving credit plans would be rare. However, the volume of such transactions probably justifies special regulative legislation.

The act provides for essentially the same disclosure requirements as in the installment sales contract.<sup>38</sup> However, the chief problem in revolving credit transactions is the finance charge. Most revolving credit plans add at the beginning of the month a charge of 1½ per cent per month on the outstanding indebtedness at the end of the month. This would amount to eighteen per cent annually. But if a purchase was made on the last day of the month and the account was billed the next day, the finance rate would be 540 per cent annually.<sup>39</sup> Such charges are clearly over the maximum set by the usury statutes. But do the usury laws apply to revolving credit plans? Since the revolving credit plan is relatively new, there is no precise authority on this point. However, since there are cases holding similar charge account transactions not subject to the usury statutes,<sup>40</sup> revolving credit plans will probably be held to be outside the usury statutes.<sup>41</sup> Because of this doubt and for the protection of the consumer, states regulating revolving credit plans should prescribe maximum finance charges. The original draft of the act provided for such a maximum.<sup>42</sup> But such measures were excluded from the present act. The act provides only that the maximum amount or rate of the finance charge must be stated in the revolving credit agreement.<sup>43</sup>

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<sup>37</sup> Comment, *supra* note 14, at 332.

<sup>38</sup> KRS 371.300.

<sup>39</sup> See Doyle, *Charges for Revolving Credit and Charge Accounts, Subject for Scrutiny*, 12 Personal Finance L.Q. 33 (1958).

<sup>40</sup> Comment, *supra* note 14, at 337 n.35.

<sup>41</sup> *But see* Doyle, *supra* note 39.

<sup>42</sup> S. 97, Ky. Legis. Regular Sess. (1962) (original draft).

<sup>43</sup> KRS 371.300(1).

## REGULATORY FEATURES NOT INCLUDED

*Finance Charges.* The great increase in retail installment sales over the years has tended to magnify abuses in the area. Finance charges are at the heart of the abuses.<sup>44</sup> The reason for state regulation of these charges is not economic policy, but simply to prevent the exaction of exorbitant charges from an unwary buyer. It is a question of fiscal morality, not economics.<sup>45</sup> Yet, invariably, financing agencies have opposed such regulation. However, it would appear that the regulation of the finance charge would be to the advantage of the financing agency. First, maximum finance charges would fix a legal standard making an offender of the more "fly-by-night" financier. Such financiers are the ones who damage the reputation of the entire sales financing industry. Second, the usual statutory rate maxima substantially exceed the prevailing competitive rates for finance charges.<sup>46</sup> When the maximum finance charge rate is geared to the needs of the consumer financing business, it would seem that such regulation would not be detrimental to the interests of the financing agency.

Of the thirty-two states enacting retail installment sales legislation, a majority limit finance charges on installment motor vehicles sales, while only six states regulate rates on all tangible personal property.<sup>47</sup> Why have states limited finance charge regulation to motor vehicle sales? Volume can not be the reason since installment motor vehicle sales exceed other installment sales only by about one-third.<sup>48</sup> The reason probably lies in the substantial difference in the amount of credit allowed in a motor vehicle sale and a non-vehicular sale. Since the cost to the financing agency of processing a low balance installment sale is substantially the same as that of a high balance sale, the finance charge on a hundred-dollar appliance must be a greater percentage of the balance due than the finance charge on a thousand-dollar automobile.<sup>49</sup> Therefore, it is relatively simple to draft a statute just for automobiles,<sup>50</sup> but difficult to draw up a statute that

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<sup>44</sup> Of the thirty-one states (excluding Kentucky) enacting retail installment sales legislation, a majority limit finance charges on motor vehicle sales only. The Kentucky motor vehicle sales act is in KRS ch. 190. KRS 190.110 fixes the maximum finance charges on automobiles. Six states regulate finance charges on all tangible personal property. Ind. Stat. Ann. § 58-926 (1951); Kan. Laws Spec. Sess. 1953, ch. 9, § 2(a), at 29; N. Y. Pers. Prop. Law § 404; N. D. Laws 1957, ch. 322 § 3, at 627; Ohio Rev. Code Ann. § 1317.06; Utah Code Ann. § 15-1-2aB(3) (1953).

<sup>45</sup> Warren, *supra* note 12, at 854.

<sup>46</sup> Warren, *supra* note 12, at 854 n.52.

<sup>47</sup> Doyle, *supra* note 39.

<sup>48</sup> 19 Fed. Reserve Bull., *op. cit. supra* note 2.

<sup>49</sup> Warren, *supra* note 12, at 855.

<sup>50</sup> The Kentucky motor vehicle sales act puts finance charges on motor vehicles in three classes: nine dollars per hundred on a vehicle not more than

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will fairly regulate the finance charges on the sale of all types of tangible personal property.

The original draft of the present act fixed the permissible finance charge rate on the amount of the unpaid balance: on so much of the principal balance as does not exceed three hundred dollars, fifteen dollars per hundred per year; on so much of the principal balance as exceeds three hundred dollars, twelve dollars per hundred per year on that portion over three hundred dollars up to one thousand dollars; on so much of the principal balance as exceeds one thousand dollars, ten dollars per hundred per year on that portion over one thousand dollars.<sup>51</sup> But these regulatory measures were excluded from the present act. Presumably, the sky is still the limit as to finance charges. Interestingly, of the six states limiting finance charges on all personal property, three have fixed the permissive rate upon the amount of the unpaid balance, as did the original draft to the new act.<sup>52</sup> Yet, the maximum permissive finance charge in these three states is substantially less than in the original draft to the present act! There is no indication in these states of an exodus of financing agencies from the consumer financing field. If a statute providing maximum rates in these states is workable, presumably a higher maximum in Kentucky would not be damaging to those engaged in consumer financing.

#### CONCLUSION

Volume clearly justifies regulation of the retail installment sale, but because of the distinction that the courts have drawn between the direct loan and the time sale, such regulation must come from the state legislatures. Disclosure is the basic philosophy of state installment sales legislation. The new act contains the standard disclosure provisions. The act also addresses itself to the important problems of rebate upon prepayment, consolidation, delinquency charges, refinancing, and revolving credit. At the heart of the installment sale is the problem of finance charges. Clearly, the usury statutes have not afforded the consumer the protection that he deserves. The new act does not contain finance charge limitations, although proposed in the original draft of the act. It is hoped that the experience of those states which do have finance charge maxima will act as an inducement to supplement the present act to include this all-important safeguard.

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one year old; thirteen dollars per hundred on a vehicle not more than two years old; fifteen dollars per hundred on all others. KRS 190.110.

<sup>51</sup> S. 97, Ky. Legis. Regular Sess. (1962) (original draft).

<sup>52</sup> Kan. Laws Spec. Sess. 1958, ch. 9, § 8(a), at 19-20; N. Y. Pers. Prop. Law § 404 (1959); Ohio Rev. Code Ann. § 1317.06 (1962).