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# Installment Credit: A Social Perspective

THOMAS E. WILLGING\*

## I. INTRODUCTION

POVERTY IN AMERICA has recently become the focal point for government action on the federal level, and indirectly on the state level, in the Economic Opportunity Act of 1964. Implicit in the fiber of that legislation is the principle that local social welfare agencies can help the poor improve their condition by providing a broad range of social services, focusing principally on job training and community action programs designed to uplift the neighborhood environment.<sup>1</sup> Included in the shot-gun spray of this anti-poverty legislation, at least in some of the local plans thus far approved by the Office of Economic Opportunity, is an attack on the problems of the low-income consumer. While consumer problems among low-income families are myriad and often camouflaged in the economic structure of our society, the author seeks to document in this article some of the "unfair sales practices" of local merchants and to discuss existing, proposed, and potential remedies to these abuses.

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<sup>1</sup> For an introduction to the conceptual framework of the War on Poverty and a suggested approach to this massive governmental effort, see Cahn & Cahn, *The War on Poverty: A Civilian Perspective*, 73 YALE L. J. 1317 (1964). The literature on the poverty problem in America includes BAGDIKIAN, IN *THE MIDST OF PLENTY: POVERTY IN AMERICA*

As a general thesis, Michael Harrington postulates and dramatically demonstrates in *THE OTHER AMERICA*<sup>2</sup> the existence of a separate poverty subculture in our society, unaffected by welfare legislation and private charity:

... there are some tens of millions of Americans who are beyond the welfare state. Some are simply not covered by social legislation: they are omitted from Social Security and from minimum wage. Others are covered, but since *they are so poor they do not know how to take advantage of the opportunities*, or else their coverage is so inadequate as not to make a difference.<sup>3</sup>

Broadening this thesis to include general legislation which is beyond the reach of the poor, it is the hypothesis of this writer that the members of the "economic underworld" described by Mr. Harrington are not being given the basic protections afforded to buyers by existing commercial laws. This condition obtains because of the ignorance on the part of the "poor"<sup>4</sup> of the means of redress available through the courts and the administrative and welfare agencies and also because of loopholes in existing credit-regulation laws which have been extended and applied in judicial decisions. Of course, the study of installment credit is only one of many areas in which this hypothesis might be tested. Thus, this paper will attempt to show that in the area of installment sales among low-income consumers: 1. economic, social and psychological factors make the business of extending credit to the poor a profitable low-risk business venture; 2. the existing legislation and court doctrine is inadequate to protect the interests of the poor; 3. the poor lack knowledge of their fundamental legal rights as consumers and of the means of redress currently available through legal aid and other socio-legal agencies; and 4. as a consequence of this exclusion from the legal framework of our society,

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(1964); CONANT, *SLUMS AND SUBURBS* (1961); CONFERENCE ON ECONOMIC PROGRESS, Washington, D. C.; *POVERTY AND DEPRIVATION IN THE UNITED STATES: THE PLIGHT OF TWO FIFTHS OF THE NATION* (1962); ELIAS, GILLIES & RIEMER (ed.), *METROPOLIS: VALUES IN CONFLICT* (1964); HANDLIN, *THE NEWCOMERS* (1959); HARRINGTON, *THE OTHER AMERICA* (1962); HUMPHREY, *WAR ON POVERTY* (1964); HUNTER, *THE SLUMS* (1964); MAY, *THE WASTED AMERICANS* (1964); MILLER, *RICH MAN, POOR MAN* (1964); MORGAN, DAVID, COHEN & BRAZER, *INCOME AND WELFARE IN THE UNITED STATES* (1962). The above titles are extracted from a bibliography prepared by Gary Bellow of the United Planning Organization, Washington, D. C.

<sup>2</sup> HARRINGTON, *THE OTHER AMERICA* (1962).

<sup>3</sup> *Id.* at 171 (Emphasis added).

<sup>4</sup> Definitions of poverty are many and varied. Recently conducted government and private studies of poverty have agreed on a figure of \$3,000 per year for a family and \$1,500 a year for an unattached individual as the income figure which is a realistic "dividing line" between "poverty" and adequate income status. See, e.g., KEYSERLING (CONFERENCE ON ECONOMIC PROGRESS), *PROGRESS OR POVERTY* 17-18 (1964), and speech of Sargent Shriver to Woman's National Democratic Club, April 29, 1964, reported in *The Washington Post*, April 30, 1964, p. C1, col. 1. That this income figure is conservative is attested to by the allowance for food in a budget at this income level—23 cents per meal per person—which allows a diet primarily consisting of potatoes, cereals, bread, and dry beans. Such a diet produces the personal appearance described by Michael Harrington as "fat with hunger."

the low-income consumer obtains less value in goods for his dollar than the average consumer, thereby aggravating and perpetuating his poverty status.

## II. INCIDENCE OF INSTALLMENT BUYING IN AMERICA

That consumer credit has achieved a significant place in the American economy is a fact that hardly requires demonstration. Figures released by the Board of Governors of the Federal Reserve System in August of 1965 show that the non-real-estate consumer debt of the American public totals \$79.8 billion, that this amount has increased at the rate of \$0.5 billion monthly in a consistent pattern since 1961, and that after leveling off in the first quarter of 1965, it has increased \$3.8 billion in the three months of the second quarter of 1965.<sup>5</sup> Of the total consumer debt, \$62 billion, or almost three-fourths, consists of payments due on installment purchases. Non-installment credit, consisting of single payment loans, charge accounts, and other "service" credit, has been comparatively constant since 1961, whereas installment credit has accounted for almost all of the \$0.5 billion annual growth of consumer credit.<sup>6</sup>

For the second quarter of 1965 the disposable personal income of the American people was measured at \$455.3 billion, of which \$423.0 billion was actually expended for goods and services.<sup>7</sup> These figures show that almost one-fifth of all sales involve some form of credit and that about 15 per cent involve the use of the installment plan. And the trend, dependent on the continuance of the optimistic atmosphere of a thriving economy which has obtained since 1961, shows an increasing reliance on the now-institutionalized American Way—"easy credit."

Increased use of consumer credit reflects the changing nature of the goods available in our society. Credit is rarely used for the everyday purchases such as food and clothing. The expansion of the durable goods market preceded the credit economy boom.<sup>8</sup> Automobiles, television sets, stereo phonographs, refrigerators, washers, and other household appliances have ceased to be luxury items in our affluent society. The availability of credit brings these items within the reach of poverty-level consumers—whether they can afford them or not.

## III. IMPACT OF INSTALLMENT BUYING ON POVERTY- INCOME GROUPS

Further dissection of the data on credit buying reveals what our knowledge of the extent of poverty in America implies: the institution of installment

<sup>5</sup> FEDERAL RESERVE BULLETIN, BOARD OF GOVERNORS OF THE FEDERAL RESERVE SYSTEM 1152 (August 1965).

<sup>6</sup> *Ibid.*

<sup>7</sup> *Id.* at 1167.

<sup>8</sup> See PHILLIPS, CONSUMER ECONOMIC PROBLEMS 44-45 (1957), and see generally, KATONA, THE POWERFUL CONSUMER (1960).

buying has not bypassed the large segment of our society classified as "poor."<sup>9</sup> While up-to-date studies of the income distribution of installment buyers are lacking, a 1960 survey of consumer finance discloses the following data:

The incidence of installment debt is closely related to income. The peak incidence occurs in the classes closest to the BLS maintenance level, which are probably most conscious of their economic life. In early 1960, 25 per cent of those in the \$0-\$2,000 class, 60 per cent of those in the \$5,000-\$7,500, and 46 per cent of those in the \$10,000-and-over class had some installment debt. *The low-income spending units going into debt are much more likely to commit a large portion of the income—40 per cent or more—to installment payments.* In the much more numerous quarter of spending units that pledged 10 to 39 per cent of their incomes in 1960 to meet payments, the middle-income classes predominate.

. . . the lowest income tenth is by far the most committed in relation to income, a reflection of its need to exploit credit to keep body and soul together.<sup>10</sup>

A phenomenon related to the growing use of credit among low-income individuals is the increased use of individual bankruptcy by those who become so entrenched in installment debts and harrassed by creditors that bankruptcy is an acceptable solution. Data released by the Administrative Offices of the U. S. courts reveal that 163,413 individual bankruptcies were filed during the most recent year, and that individual bankruptcies comprised almost 90% of total bankruptcies filed in that year.<sup>11</sup> While these figures include middle-income families, studies in Flint, Michigan show that the median income of bankrupts who filed in Flint was \$4,656.<sup>12</sup>

Although data in this area are incomplete, the borders of the problem emerge clearly enough—low-income groups make extensive use of credit facilities which appear to be readily available to them regardless of their "poor risk" status. More important, when a poverty-ridden family turns to credit to make ends meet or to add some light to a dreary life, it, in effect, "sells its soul" to the finance company in terms of the size of its payments relative to its already meager income. This is the tragedy of the situation. The low-income family pledges 40 per cent or more of its income to installment payments for

<sup>9</sup> It is submitted that the same phenomenon being discussed—the use of credit by low-income consumers—has been noted indirectly by many observers of the social scene who have optimistically misinterpreted it as signifying a leveling of the distribution of income and the movement of America into a "classless society." See REISMAN, *THE LONELY CROWD* 286 (1953). What has been observed is really just a leveling of consumption caused by the easy accessibility of credit. The income figures do not support the thesis that we have undergone a commensurate leveling of income. See KOLKO, *WEALTH AND POWER IN AMERICA* 111-112 (1962), MILLER, *RICH MAN, POOR MAN* (1964).

<sup>10</sup> KOLKO, *supra* note 9 at 105-106 (Emphasis added). More complete data is necessary in this statistical area. For a picture of the saving and "dissaving" habits of the rich and poor, see SAMUELSON, *ECONOMICS* 210 (1964).

<sup>11</sup> ADMINISTRATIVE OFFICES OF THE U.S. COURTS, *ANNUAL REPORT* (1965).

<sup>12</sup> DOLPHIN, *AN ANALYSIS OF ECONOMIC AND PERSONAL FACTORS LEADING TO CONSUMER BANKRUPTCY* (1965).

goods which are at the fringe of the luxury-necessity line. To meet the payment obligations the family must either forego some of the necessities of life or else default on payments and lose the benefit of the merchandise, usually without significantly altering its repayment obligations. Needless to say, the poor do not receive full benefit for their dollar in this process, even in the unlikely event that quality merchandise is obtained in the purchase.

The automobile purchase is a typical example of the type of credit purchase made by the low-income consumer. While the car has in many cases become a "necessity" item in many suburban communities, it more often is appropriately classified as a luxury for the urban-centered low-income family with public transportation at its disposal. As such, it is not necessary to sustain the individual or his family and would not be part of a rationally-planned budget placing primary emphasis on the subsistence items of food, shelter, and clothing. Yet its attractiveness lies in its very irrationality.<sup>13</sup> It is an escape from the boredom of poverty and provides the prestige-deprived low-income consumer with a status symbol, allowing him to partake, however marginally, in the affluence of our "Great Society." The extent to which this explanation reflects the subconscious motivation of the consumer is amply portrayed by the datum that "in 1959, 23 per cent of those earning less than \$1,000 owned a car."<sup>14</sup> As a substantially-priced item in most instances, the percentage of the purchaser's income committed to car payments is high

<sup>13</sup> George Katona would dismiss this charge of irrationality as totally unfounded in consumer psychology. He finds installment buying, even at high interest rates to be rational and understandable:

Two major practices of present-day American consumers . . . sometimes cited as proof of irrationality, are well motivated and understandable. One of these, buying on installment and paying high interest charges even though cash is available or could be accumulated fairly soon . . . may be called "superrational" rather than irrational; it appears that many consumers take their own shortcomings into account (namely, that they would not save money if they were not pressured to save). KATONA, *supra* note 8 at 148.

Mr. Katona, however, does not appear to consider the low-income consumer who purchases on time goods which he can never afford in a realistic view of his future income prospects, and who must make future payments out of money which would rationally (or "super-rationally") be budgeted for subsistence items. It appears from this and many other statements in Mr. Katona's interdisciplinary study of consumer problems that the poverty-level consumer's economic strength is not potent enough to merit consideration in a study of the aspirations and motivations of the "powerful consumer." Yet the low-income consumer appears to be subject to many of the same social forces which motivate higher income groups. But what is rational in one case may not be so in the other. A study of the motivations of the less powerful consumer, following the format of Mr. Katona's work, is essential to an understanding of the field and the lack of such an intensive study is a severe handicap. Mr. Katona, for the most part, has dismissed the problems of the low-income consumer with statements like "for the most part low-income people have no assets on which to draw and no credit on which to borrow." *Id.* at 102. He thereby ignores a thriving class of merchants, eager to extend credit to the "poor risks" on the basis of psychological and legal pressures available to enforce payment, so graphically described by David Caplovitz in *THE POOR PAY MORE* (1963). This is an area in which further research is necessary.

<sup>14</sup> *Id.* at 123.

among the low-income groups. Car payments necessarily absorb a large portion of the budget of a low-income family.

#### IV. THE ECONOMIC AND SOCIAL PROBLEM IN A NUTSHELL

The consumer does not create this spectre of payments, defaults, and repossessions. Economic and psychological pressures contribute largely (and automatically) to the existence and perpetuation of such a structure. The American economic system depends entirely on the generation and regeneration of demand within itself.<sup>15</sup> A growing economy requires that a large percentage of the consumer's available income be used to purchase goods immediately. This is even more important than the need for investment. Demand for goods provides the incentive—the profit motive—for capitalists to produce a given item. The starting point of the now-established cycle is demand for goods. And stimulation or “creation” of demand through advertising, easy credit and other high pressure sales techniques is a necessary outgrowth of this need for a high propensity to consume. As concisely stated by George Katona, consumer economics expert of the Survey Research Center at the University of Michigan:

Demand depends both on ability to buy and on willingness to buy. Fluctuations of demand, whether by consumers or by business firms, may originate in changes either in the former or in the latter. It goes without saying that nobody can buy if he has no income, assets, or credit.<sup>16</sup>

Consumption is further stimulated by the availability of credit. When the consumer does not have to save cash until he accumulates enough for a particular purchase, he is more apt to make that purchase. The need of merchants to insure purchasing power is greatest in the area of the higher-priced durable goods such as automobiles and appliances. The availability of credit allows consumers to buy these articles without a savings process which removes money from the economy for a substantial period of time. Thus, the availability of credit makes it easy for the consumer to fulfill his vital role in the economy. The excess of credit purchases over repayments in a given period—over-spending or dissaving—has the same effect on the economy as a commensurate increase in income.<sup>17</sup>

<sup>15</sup> See PHILLIPS, *CONSUMER ECONOMIC PROBLEMS* 33-34 (1957), also, on the necessity of increasing consumer demand see GALBRAITH, *THE AFFLUENT SOCIETY* 139-151 (1958).

<sup>16</sup> KATONA, *supra* note 8 at 3.

<sup>17</sup> Of course, in the long run, credit does not increase consumption in the economy as a whole because the items bought on credit today must be paid for tomorrow. However, consumption of major durables is stimulated by the availability of credit at the expense of consumption in another segment of the overall market for consumer goods. In terms of the individual low-income consumer, the “substituted” demand is most graphic: major dur-

Looking at the individual entrepreneur, we find that the profit motive explained above is not just a vague theory of macroeconomics but is meaningful to the neighborhood merchant. The local appliance dealer finds that by offering easy credit terms he is able to move his merchandise much more quickly. His sales potential is augmented by all those consumers who can afford to buy only on credit. He makes sales which ordinarily would not be directed to the durable goods market. And he gleans a substantial profit from the credit transaction either by maintaining his own credit outlet or by obtaining a rebate ("pack") from the finance company.<sup>18</sup> And experience has shown him that the risk is not great.<sup>19</sup> If necessary, he can discount the installment note and obtain the cash immediately, and this appears to be the general practice.<sup>20</sup> In either event he has found that the risk involved in such

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ables are purchased instead of non-durable necessity items such as food and clothing. Thus, credit stimulates consumption within a specific industry or a specific store for a specific type of product. See CAMPBELL, *THE CONSUMER INTEREST* 284 (1949) and WYAND, *THE ECONOMICS OF CONSUMPTION* 46-47 (1937).

<sup>18</sup> As described by Cohen and Hanson, the "pack":

is an amount arbitrarily added by an automobile dealer to the normal authorized finance charge called for by the finance company. It is kicked back to the car dealer by the finance company when the car buyer has made his last payment. The swollen finance charge is paid by the installment purchaser who does not know that it is more than he needs to pay for credit and who also does not know that later the finance company will pay (kick) back the extra charge (pack) to the dealer. COHEN & HANSON, *PERSONAL FINANCE . . .*, reproduced in *Hearings on S. 1740 Before a Subcommittee of the Senate Committee on Banking and Currency*, 87th Cong., 1st Sess. at 677 (1961). [Hereinafter cited as *1961 Hearings*].

A recent analysis of the testimony gleaned from hearings of the California Corporations Commissioner on the application of Sears Roebuck for a license to enter the automobile loan field appears in *30 CONSUMER REPORTS* 258 (May 1965). Significantly, the testimony of car dealers showed a marked preference for the credit sale over the cash sale based on the following reasoning:

The amount of profit to be made from selling cars on time depends, in large part, on the opportunities offered for manipulating charge—or making a "package" as they say in the trade. A package consists of trade-in, insurance, and finance rates. *Id.* at 259.

This same hearing reveals the particular consideration given to the low-income consumer, for whom the price is "adjusted" as follows:

In auto salesrooms, the charge is an inverse of the ability to pay—the lower the ability, the higher the price. This too was freely admitted by the dealers. There was, in fact, a good deal of testimony from both dealers and lenders about the amount of poor risk credit they extended. Nevertheless, the dealers, in particular, made it plain that they preferred the gamble of extending credit to the assurance of selling cars for cash. *The gamble, of course, is not great.* The car can always be repossessed to serve as a lure to another, and still higher-cost, credit deal. *Id.* at 259 (Emphasis added).

<sup>19</sup> See note 18, *supra*. See also COHEN & HANSON, *supra* note 18, at 682 in which the following observation is made: "Nevertheless, the installment contract usually so binds and ties the customer that losses are very low, less than one half of 1 per cent of total sales."

<sup>20</sup> The figures can be derived from the data furnished by the Federal Reserve Board. Suffice it to say that approximately 85 per cent of the installment credit outstanding is held by commercial banks, sales finance companies and other financial institutions. *FEDERAL RESERVE BULLETIN*, *supra* note 5 at 1152-1153. See also, *Hare v. General Contract Purchase Corp.*, 220 Ark. 601, 249 S.W.2d. 973 (1952). In this case, the Supreme Court of Arkansas, as one of the factors in determining whether an installment sale was a time sale or a loan for purposes of the usury statute, found as a fact "the seller increased his cash price with



transactions, especially if he limits his credit transactions to residents of the neighborhood, are largely mythical. In addition to increased sales, he can make a tidy profit on the credit transaction. All in all, the incentives to selling on credit are present even in the slum neighborhood setting and the risk is minimal.

The individual's motivation for using credit generally falls into one of these categories: convenience, a desire for an improved standard of living, and necessity.<sup>21</sup> The convenience motive usually finds expression in charge account buying or other means of deferred payment where the transaction is completed within a short period of time by a lump sum payment. Use of credit out of necessity generally takes the form of debt consolidation or other forms of cash loans to meet a crisis. Primarily, however, the consumer, especially the low-income consumer, uses installment credit to improve his standard of living.

In summary, we have painted the picture of an economy dependent on demand stimulation and dedicated to inducing all consumers to want to buy more and more goods. And the merchant and the finance company are easily drawn to the poor neighborhood—they can make money there. The entire economic structure promotes the use of credit, even by those who cannot afford it. Coupled with the already strong and well-documented tendency of the consumer to spend a large portion of his income,<sup>22</sup> the credit economy promotes a higher rate of consumption. The natural propensity to consume<sup>23</sup> provides fertile ground for the credit salesman to plant the idea of buying on credit.

These fundamental economic concepts take on added significance in the low-income stratum of our society. At the subsistence level, the natural propensity to consume, without extraordinary outside stimulus, is higher than at other income levels and generally exceeds the income of the consumer.<sup>24</sup> Relatively little, if any, saving is accomplished, and a high proportion of income is utilized for the basic necessities of food, shelter, and clothing. In many cases, the low-income family engages in dissaving by borrowing money, buying on credit, or depleting its savings.

Despite this already high propensity to consume, the low-income family

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the reasonable assurance that he could . . . discount the paper to . . . [an] individual or finance company." *Id.* at 978.

<sup>21</sup> BECKMAN, MAYNARD, & DAVIDSON, *PRINCIPLES OF MARKETING*, ch. 26, reproduced in *1961 Hearings*, *supra* note 18, at 653.

<sup>22</sup> See generally PHILLIPS, *supra* note 15, at 10, 34 (1957).

<sup>23</sup> For a general treatment of the propensity to consume the reader is referred to SAMUELSON, *supra* note 10, at 210-219 (1964).

<sup>24</sup> According to Samuelson's figures, the propensity to consume of all families with an income of \$5,000 is at least 100 per cent, with families in the \$3,000 and \$4,000 annual income bracket tending to spend more than their income. *Id.* at 210.

is exposed to the lure of buying on time. Psychologically, the low-income consumer has a greater tendency to heed the call of "easy credit." His prospects for improving his income status, however, are extremely low as compared to his middle-class counterpart. Low-income wage earners, and especially the unemployed recipient of public welfare, have little chance of breaking out of the "hard-core" pocket of poverty.<sup>25</sup> Unlike the middle-income consumer, therefore, the low-income wage earner is not realistic when he justifies his debt purchases by the optimistic assumption that his income is on the rise. In most cases, our prosperity and rising income levels have not affected the lower income brackets. Yet, our low-income consumer does buy on time with considerable frequency. The motivation, to a great extent, lies in the fact that his value as a breadwinner has become suspect over the years, both in his own eyes and those of his family, and his self-respect is constantly under stress.<sup>26</sup> By the same token, he sees that more successful members of society measure their success and prestige by the quality of their material goods, especially their cars.<sup>27</sup> When a salesman or a newspaper ad informs him that he can have the same type of car for \$1 down with "easy monthly payments," he (or his wife) becomes an eager customer. Even though he cannot afford to be a Cadillac owner, his natural striving for self-respect and esteem in the eyes of his family and friends may well blind him to the practical economics of the situation. The car—or television or stereo—helps to compensate for his other failures.<sup>28</sup> This phenomenon, observed by David Caplovitz in his study of the consumer problems of inhabitants of low-cost housing projects in Manhattan, is well described by the shorthand phrase "compensatory consumption."<sup>29</sup>

In short, the problem can be seen as a concurrence in time and space of a merchant eager to sell unnecessary goods to low-income buyers equally eager

<sup>25</sup> An excellent portrayal of the stickiness of the web of poverty is given in HARRINGTON, *supra* note 2. Generally, poverty is in-bred, being passed on from generation to generation together with an attitude of frustration and despair which becomes instilled early in life in the children of the poor. Lack of decent education, training, diet, and satisfying achievements help to perpetuate poverty in its hereditary cycle.

<sup>26</sup> CAPLOVITZ, *supra* note 13, at 12.

<sup>27</sup> PHILLIPS, *supra* note 15, at 7-8.

<sup>28</sup> As aptly described by David Caplovitz:

The popular image of the American as striving for the material possessions which bestow on him comfort and prestige in the eyes of his fellow does not hold only for the ever-increasing middle class. The cultural pressures to buy major durables reach low- as well as middle-income families. In some ways consumption may take on more significance for low-income families than for those in the higher classes. Since many have small prospect of greatly improving their low social standing through occupational mobility, they turn to consumption as one sphere in which they can make some progress toward the American dream of success. CAPLOVITZ, *supra* note 13, at 12-13.

<sup>29</sup> *Ibid.* Vance Packard notes this same phenomenon when he states:

Although people in the lower social brackets do not seem to strive particularly hard to get into a higher social layer, they can be persuaded, merchandisers have learned, to move up their consumption. PACKARD, *THE HIDDEN PERSUADERS* (1957).

to buy. This meeting of the minds and purses is strongly supported by the existing economic structure and consumer psychology. Only a modification of one or both will serve to alleviate the evils which arise out of the encounter.

#### V. UNFAIR SALES PRACTICES

We now turn to an investigation into the actual practices which occur in the confrontation between consumer and merchant. It is the thesis of this article that the existing legal structure is inadequate to cope with the imaginative practices of merchants who prey on the lack of legalistic savvy and resources of the low-income consumer.

Legislation among the states has traditionally been directed toward the control of interest charges. A majority (about 27) of the states have such retail installment laws in effect,<sup>30</sup> establishing a ceiling on permissible interest charges that is usually somewhat higher than the limits of the general usury laws and lower than the limits of the small loan laws. A small minority of states require that the terms of an installment sale be incorporated in a written contract which contains an itemized list of the cash price, the interest charges, and any other service fees. Sanctions embodied in this type of legislation have occasionally included licenses for finance companies and criminal penalties; more often, the laws rely on ordinary civil remedies.<sup>31</sup>

Regulation of unfair sales practices has been traditionally a matter of state initiative. The Federal Trade Commission has, however, entered the field to a certain extent, principally in the area of false advertising, under Section 5 of the Federal Trade Commission Act<sup>32</sup> which authorizes the FTC to curb unfair and deceptive acts and practices and unfair methods of competition in interstate commerce. The FTC has also promulgated rules designed to control installment credit practices in the automobile industry, by including in the definition of an unfair trade practice the failure of the seller of an automobile to furnish the buyer, prior to the sale, with a written statement of the terms of the sale, including finance charges, insurance costs and other charges.<sup>33</sup> Disclosure of the manufacturer's suggested retail price

<sup>30</sup> See CURRAN, *TRENDS IN CONSUMER CREDIT LEGISLATION* (1965). See also Hogan, *A Survey of State Retail Installment Sales Legislation*, 44 *CORNELL L. Q.* (1958); Mors, *Recent Trends in State Regulation of Installment Credit*, *JOURNAL OF FINANCE* (1960), *Symposium on Consumer Credit*, 55 *Nw. U. L. REV.* 301, 317 (1960).

<sup>31</sup> 55 *Nw. U. L. REV.* 403-418 (1960).

<sup>32</sup> 38 Stat. 719 (1914), 15 U.S.C. § 45 (1964). See also 52 Stat. 114 (1938), 15 U.S.C. § 52 (1964) for the proscription of false advertising.

<sup>33</sup> 16 C.F.R. §§ 197.1-5 (Supp. 1957). See also for a statement of Commissioner Paul Dixon and a reproduction of the FTC regulations of advertising practices in the automobile industry as well as the complaints issued in four cases, *1961 Hearings*, *supra* note 18, at 18-31. Recent reports of the Commission reflect the inadequacy of existing remedies. As gleaned from the information furnished in the report, the only credit-related activity of the Commission during 1963 involved "advertising of 'debt consolidation services'." *FTC ANN. REP.*

is required by the Automobile Information Disclosure Act.<sup>34</sup>

Other Federal activity has been proposed by Senator Douglas<sup>35</sup> and others in the form of a "Truth in Lending" bill, but attempts to enact such a bill have fallen before the staunch opposition of a powerful lobby which included the retail merchants and bankers. Such a bill would require the seller to furnish the buyer with an itemized statement of the cash price less trade-in, service charges, the amount to be financed, finance charges, and a simple annual interest rate on the unpaid balance.

Of course, all the traditional buyer's remedies are available to the purchaser on the installment plan, if he is astute enough to demand his rights. There is no remedy for a buyer who pays much more than the value of an item or who fails to return defective merchandise. In other words the existing legal structure does not, it is submitted, operate to protect the low-income consumer from flagrant abuses of both legal and moral principles by neighborhood merchants.

The most blatant, and legal means of evading usury and other commercial laws lies in the pricing of the product. Small neighborhood appliance stores are not in competition with discount houses in the out-lying areas; the low-income consumer, for the most part, does his business in the neighborhood. These merchants can charge exorbitant prices for inferior goods and still attract the low-income inhabitant of the neighborhood. By marking up his price sufficiently above cost, the storekeeper can provide "easy credit" at a legal interest rate. Of course part of the "real" interest rate is hidden in the cost of the goods, but it does not appear that a court would apply the usury law to such a transaction. Even the most liberal courts require that a "cash price" comparison be obtained by the seller before the differential between a "cash price" and a "time price" becomes significant.<sup>36</sup> And this is highly unlikely to be the case where the buyer because of his economic circumstances

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11-13 (1963). During this period, about \$4 million was spent by the FTC "to halt the cheating of consumers, principally by false advertising." The 1964 report discloses a somewhat more extensive consideration of the unfair credit practices described above. In the area of home improvement and repair products the commission investigated "bait and switch tactics, fictitious 'regular' prices, misleading guarantees, misrepresentation of interest rates. . . ." FTC ANN. REP. (1964). Only \$4.4 million was spent for investigation and litigation in consumer-related activities, with \$1 million of that total directed to the textile and fur industry. *Id.* at 41. Considering the broad spectrum of activities over which the FTC has potential regulatory power, it is apparent that the FTC appropriations are patently inadequate to cope with the widespread, multi-industry deceptive credit practices of merchants. The history of FTC regulation, as discussed above, supports this proposition, confirming the writer's impression that any Federal action in the field has been haphazard.

<sup>34</sup> 15 U.S.C. §§ 1231-1233 (1964).

<sup>35</sup> On July 12, 1965, Senator Paul Douglas (D. Ill.) renewed his proposal for "Truth in Lending" legislation. S. 2275, 89th Cong., 2d Sess. (1965).

<sup>36</sup> See, e.g., *Hare v. General Contract Purchase Co.*, *supra* note 20; *Daniel v. First National Bank*, 227 F.2d 353 (5th Cir. 1955); *Beatty v. Franklin Investment Co.*, 115 App. D.C. 311, 319 F.2d 712 (1963).

never considers the possibility of buying in cash. An example of the price mark-up as a technique of the credit merchants is documented by David Caplovitz in his New York study. There it was found that the median price paid for a television was \$275, with 77 per cent of the 313 families who had bought sets paying over \$200. Breaking these figures down, it was found that the lower-income families more often paid a higher price for television sets, phonographs, and washing machines. Also, the study showed that low-income consumers who shopped primarily at neighborhood stores paid more for those items than low-income consumers with a shopping pattern which extended beyond the neighborhood and involved shopping at discount houses and chain stores.<sup>37</sup> This most simple device is probably the most pernicious due to the facility with which it is practiced within the circle of the neighborhood and because of its absolute legality. Prospective remedies will be discussed as part of overall proposals.

Overpricing of goods to disguise an interest charge is only one means of obtaining the same result. In a credit transaction, the seller can hide the interest charges, and thereby comply with the already generous retail installment and/or small loan regulation of interest rates, by including the interest charge in any of the other charges incidental to such a transaction. These include insurance costs, brokerage fees, credit investigation charges, loan procurement charges, attorneys' fees, bonuses, commissions, and myriad other charges.<sup>38</sup> While "Truth in Lending" legislation may, if it can be effectively enforced, eliminate many of these devices, it would not remove the price mark-up as a device for camouflaging interest charges. Likewise, it is doubtful that such legislation would pierce these disguises of the interest rate. In any event it is doubtful that disclosure of the interest rate rules would provide any meaningful protection to the low-income consumer who, even in the unlikely event that he reads the contract of sale, has little of the bargaining power or skill necessary to obtain better terms.

The above is by no means an exhaustive catalogue of deceptive practices in the area of interest charges. The seller also has at his disposal the general lack of understanding among the public as to the nature of interest. There is a vast and little understood difference between the interest rate on the unpaid balance and the interest rate computed from a constant base. The declining balances method of computation results in interest charges, generally referred to as "true" interest, which are approximately half those of the fixed balance method,<sup>39</sup> using the same rate and same initial principal. Likewise,

<sup>37</sup> CAPLOVITZ, *supra* note 13 at 82-93.

<sup>38</sup> For a partial catalogue of these practices, see Meth, *A Contemporary Crisis: The Problem of Usury in the United States*, 44 A.B.A.J. 637 (1958). The "truth in lending" 1961 Hearings, *supra* note 18, are replete with accounts of disguised and misstated interest charges. See, e.g., pp. 690-692.

<sup>39</sup> As explained by Cohen and Hanson:

the use of a discount rate rather than a simple interest rate substantially distorts the true interest charges. This is not a problem peculiar to low-income consumers. Many well-educated middle-class consumers fail to understand the basic difference between interest rates according to the method of computation.

Often the high-priced neighborhood store supplements the natural tendency of the consumer to shop in the local store by the use of "bait ads" and the "switch sale."<sup>40</sup> This technique can best be described by citing an example encountered by David Caplovitz in his survey:

*I saw a TV ad for a \$29 sewing machine, so I wrote to the company and they sent down a salesman who demonstrated it for me. It shook the whole house, but I wanted to buy it anyway. But he kept saying it would disturb all the neighbors by being so noisy, and went out to the hall and brought in another model costing \$185 . . .*

*I actually had to pay \$220. He promised if I paid within a certain amount of time I would get \$35 back. But since my husband was out of work, we couldn't pay within the time period, so I didn't get the refund . . . I was taken in by the high-pressure sales talk.<sup>41</sup>*

The essential elements of this widespread sales technique are (1) advertisement of goods at a substantially reduced price, (2) disparagement of the advertised good as inferior and below the taste of the prospective buyer, and (3) demonstration and high-pressure sale of higher priced goods in the same line. One need only follow up the furniture ads in the local Sunday supplement to attest to the commonplace nature of this sales technique.

A deviation from the "bait ad" is the allurements of the customer through advertisement of "easy credit terms," "low bank rates," or "no charge for interest."<sup>42</sup> The slogan "dollar down and dollar a week" also occurs frequently in auto ads. When the prospective customer is lured into the dealer's showroom, he finds out that the credit terms are considerably more onerous.<sup>43</sup>

Another device of the credit merchants which flagrantly plays on the ignorance of the consumer is a pure and simple misstatement of the cost of the merchandise. The seller quotes one price and inserts another into the contract. This can be accomplished by having the customer sign a blank con-

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When installment sellers, who are to be repaid in equal installments, state their charge . . . as a percentage of the total unpaid balance at the start, since this balance is reduced by installment payments, the average balance outstanding during the term of the installment contract is only about half the original unpaid balance. Therefore, the true rate, in the absence of other manipulations and distortions, when payments are spread over a year, is roughly twice the stated rate. *Id.* at 689.

<sup>40</sup> CAPLOVITZ, *supra* note 13, at 142-143; BLACK, BUY NOW, PAY LATER 140-142 (1961).

<sup>41</sup> *Id.* at 142-143. (Emphasis in original).

<sup>42</sup> Advertisements such as these led to complaints by the FTC in 1959 of unfair and deceptive trade practices. 1961 Hearings, *supra* note 18 at 24-31.

<sup>43</sup> *Ibid.*

tract<sup>44</sup> or by filling in the higher amount in the contract with the hope that it will not be noticed.<sup>45</sup>

Caplovitz also reports that merchants are not reluctant to substitute used merchandise for the showroom item which the customer thinks he has purchased.<sup>46</sup> These and other obviously illegal practices depend on the timidity of the consumer and the temerity of the salesman for their successful perpetration. Yet the available evidence indicates that these practices are not uncommon.

Another wide-spread technique designed to give the seller added security for the installment sale is the revolving account coupled with a clause in the conditional sales agreement allowing the seller to repossess all the merchandise purchased on the account if there is a default on any payment regardless of the extent to which the balance has been reduced.<sup>47</sup>

In a recent case a woman on relief with seven children to support (whose financial status and source of income was known to the seller) made purchases from a furniture store in 1957 and continued to make such purchases until 1962 at which time she had purchased almost \$1300 worth of goods and had paid all except \$164.00. In 1962 she bought a stereo priced at \$514.95 and shortly thereafter the furniture store sought to repossess all of the items purchased from 1957 to 1962, citing a clause in the contract by which the seller retained title to all goods sold until the account was closed.<sup>48</sup>

A device which has frequently been observed by the author during his work

<sup>44</sup> COHEN & HANSON, *supra* note 18, at 682. See also CONSUMER REPORTS, *supra* note 18; Black, *supra* note 40, at 137-140.

<sup>45</sup> Several shocking examples of this practice are cited by CAPLOVITZ, *supra* note 12, at 147.

<sup>46</sup> *Id.* at 150-153.

<sup>47</sup> COHEN & HANSON, *supra* note 18, at 682.

<sup>48</sup> Williams v. Walker-Thomas Furniture Co., No. 18,604, U.S. Court of Appeals (D.C. Cir. August 11, 1965). In its decision, the Court ruled that the contract should be subject to the following test of unconscionability:

Did each party to the contract, considering his obvious education or lack of it, have a reasonable opportunity to understand the terms of the contract, or were the important terms hidden in a maze of fine print and minimized by deceptive sales practices? *Id.* at 6-7.

In addition, the Court laid down a general rule of unconscionability which was defined as "an absence of meaningful choice on the part of one of the parties together with contract terms which are unreasonably favorable to the other party." *Id.* at 6.

This decision marks a breakthrough into judicial investigation of the bargaining relationship of parties to installment contracts with the view toward unenforceability of oppressive clauses which, if generally applied, would rule out many of the deceptive practices described in this article.

Under the UNIFORM COMMERCIAL CODE, courts have been given explicit authorization to use the "unconscionable contract" approach in dealing with contracts of sale. Section 2-302 provides:

1. If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made, the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.

at the Neighborhood Legal Services Project in Washington, D. C. is the sale of defective merchandise or the sale of merchandise with a promise to service the product and subsequent departure from the jurisdiction without satisfying any complaints or service requests. The buyer finds that his promissory note has been transferred to a finance company insulated from the defense of failure of consideration by the legal protection afforded to a holder in due course.<sup>49</sup>

The catalogue of these practices could continue endlessly. The unscrupulous merchant appears able to practice such frauds on the unknowing consumer almost at will. The supply of unscrupulous merchants seems closely linked to the demand of the low-income consumer for prestige goods he cannot afford. The unequal terms of the encounter do not allow us to dismiss the problem with a perfunctory "caveat emptor." Some form of control is essential.

## VI. REMEDIAL PROPOSALS

### A. *Judicial solutions*

Many legal defenses are available to the low-income consumer who refuses to continue payments on his installment contract and is sued. Traditional buyers' remedies which may be invoked include fraud in the inducement, lack of genuine consent, failure of consideration, usury, inadequacy of consideration, unconscionability of terms,<sup>50</sup> and failure to comply with a regulatory statute.

Several conditions, however, must be satisfied prior to successful assertion of these defenses. First, the low-income consumer needs legal representation for the effective presentation of his legal defenses in the complex field of commercial law. Legal services available to the indigent defendant in civil cases, such as Legal Aid or Neighborhood Legal Services, generally are beyond the reach of those who need them simply because of ignorance of the existence of such services.<sup>51</sup> Second, assuming that the defendant in such a case knows how to obtain legal services, he must have a desire to consult a lawyer. It is a well-known fact to lending agencies that judges and lawyers are relatively poor credit risks,<sup>52</sup> due to their knowledge of legal defenses to unenforceable contracts and their capacity to assert a defense. The low-income consumer,

<sup>49</sup> For an example of this type of dealing, see *Russell v. Universal Acceptance Corp.*, No. 3656 (D.C.Ct. of App., June 16, 1965). In this case, the D.C. Court of Appeals refused to apply the rule of *Beatty v. Franklin Investment Co.*, *supra* note 36, despite a strikingly similar fact situation clouded only by the use of a "reserve fund" as a cloak for thinly-disguised finance charges in the amount of 55 per cent of the base price.

<sup>50</sup> See note 48, *supra*.

<sup>51</sup> See DEPARTMENT OF HEALTH, EDUCATION AND WELFARE, CONFERENCE PROCEEDINGS, THE EXTENSION OF LEGAL SERVICES TO THE POOR 64-65 (1964).

<sup>52</sup> BLACK, *supra* note 40, at 50-51.



on the other hand, is unaware of these possible defenses and feels an obligation to pay the contractual amount.<sup>53</sup> Thus, he may prejudge his case, decide that the plaintiff is entitled to recover and not oppose the suit.

A fundamental condition for assertion of legal defenses in court is notice of the proceedings. Failure of service of process on defendants in the lower courts, which decide a great number of cases, has reached such frequency that a term has evolved to describe this phenomenon—"sewer service."<sup>54</sup>

Of course, the case may never reach the courts. The buyer may simply pay the amount called for under the contract without protesting the exorbitant price or defects in the merchandise or fraudulent sales practices. Unless he consults a lawyer who advises him to cease making payments, the problem will never be aired. This result is always in the mind of the neighborhood merchant who adopts an approach that any complaints can be "settled" amicably without resort to lawyers and the courts.<sup>55</sup>

In addition to these problems of legal assistance, the judicial solution to deceptive and unfair sales practices has other inadequacies. Use of the above defenses to a suit on an installment contract frequently requires that an almost insurmountable legal obstacle be overcome, the legal doctrine that a holder in due course of a negotiable instrument takes the instrument free and clear of all personal defenses which the maker has against the original holder.<sup>56</sup> The shield of this doctrine has become institutionalized by the neighborhood merchant, who often signs a contract with a finance company guaranteeing that all promissory notes attached to merchants' conditional sales contract will be promptly discounted.<sup>57</sup> In many cases the finance company supplies the dealer with the forms for the conditional sales agreement and the promissory note and has an unwritten continuing business relationship with the merchant.<sup>58</sup> It is ordinary practice for the seller to transfer a note immediately to a finance company or bank which discounts the note and pays the face value to the merchant less an amount euphemistically labelled "dealers

<sup>53</sup> *Id.* at 53-60. Mr. Black notes that during the depression years 95% of outstanding installment debts continued to be paid. *Id.* at 54.

<sup>54</sup> As depicted by Caplovitz, a common occurrence in New York is as follows:

Instead of finding the defendant, the process server simply throws the summons away. Low-income families are especially likely to be victims of this practice since they are not apt to know how to protect their legal rights. Merchants are well aware that judgments by default are common and take advantage of this fact. HEW CONFERENCE PROCEEDINGS, *supra* note 51, at 66.

<sup>55</sup> In this author's experience, one merchant gave a client an expensive blanket, asked her not to consult again with the lawyer from the Neighborhood Legal Services Project, and told her to write down her complaints without legal assistance.

<sup>56</sup> See UNIFORM NEGOTIABLE INSTRUMENTS LAW, § 57; UNIFORM COMMERCIAL CODE, Section 3-305.

<sup>57</sup> See, e.g., Russell v. Universal Acceptance Corp., *supra* note 49, at 1-2.

<sup>58</sup> Beatty v. Franklin Investment Co., *supra* note 36; Hare v. General Contract Purchase Corp., *supra* note 20.

reserve" which will be rebated to the merchant if the debt is paid.<sup>59</sup> The finance company thereby obtains independent status as a holder in due course unless the court scrutinizes the transaction, finds a substantial business relationship between the merchant and the finance company, and applies the minority rule of the *Hare* case<sup>60</sup> or finds that the holder of the note had notice of defenses available to the maker against the prior holder.

In conclusion, it appears that the contracts of the neighborhood merchant escape the scrutiny of the courts in most instances due to the lack of legal representation among his customers, a lack of desire on the part of his customers to challenge him in court, or the legal doctrine protecting the holder in due course of the buyer's promissory note.

In scattered instances, the courts have provided relief from oppressive contracts in behalf of the consumer by avoiding the holder in due course doctrine, as in *Beatty*<sup>61</sup> and *Hare*<sup>62</sup> or by applying the traditional<sup>63</sup> doctrine of unconscionability to installment sales contracts.<sup>64</sup> These judicial remedies to the unfair sales practices of neighborhood merchants have a limited range of effectiveness. The percentage of cases in which buyers successfully assert legal defenses to an installment contract is not large enough to serve as a deterrent to the continuance of such practices. The cost of litigation and the loss of an occasional contract claim is easily absorbed as a business expense in this profitable market.

These judicial solutions to the problems of the low-income consumer fail to reach the essence of the problems. In many instances the poor pay more because prices in the neighborhood store are excessive or the low-income consumer has so marginal an existence on an unsteady income that he should not buy on credit. Bankruptcy filings of individuals tend to show the wide-spread incidence of overextension of debts among low-income individuals.<sup>65</sup>

A problem of such wide social impact must look beyond the courts for solution. Individual miscarriages of justice and social inequity can be redressed by the courts, but the problem is of such scope that the courts have a minimal impact. Furthermore as shown by the materials cited in this article, policy considerations based on sociological, psychological and economic concepts as well as empirical data furnish the most compelling reasons for a change in the law. Arguments based on legal precedents divorced from their social con-

<sup>59</sup> *Russell v. Universal Acceptance Corp.*, *supra* note 49.

<sup>60</sup> *Supra* note 36.

<sup>61</sup> *Supra* note 36. But see *Russell*, *supra* note 49.

<sup>62</sup> *Supra* note 20.

<sup>63</sup> See *Campbell Soup Co. v. Wentz*, 172 F.2d 80 (3rd Cir. 1948).

<sup>64</sup> *Williams v. Walker-Thomas*, *supra* note 48.

<sup>65</sup> Approximately 90% of all bankruptcies filed are under the nonbusiness (i.e. individual) provisions of the Bankruptcy Act by debtors who are unable to meet the demands of their many creditors. Comment, *The Problem of Consumer Bankruptcy: Is Amendment of the Bankruptcy Act the Answer*, 63 MICH. L. REV. 1449 (1965).

text are inadequate by themselves to explain and/or rectify abuses in this area. Courts are not well adapted to sift through the materials necessary for a complete study of the problems, nor is it the nature of a court to develop a broad set of rules designed to cure a social ill. This is a legislative problem of the purest form and courts are ill-equipped to take the broad social factors into consideration in a more than perfunctory manner.

### B. *Long-range solutions*

#### 1. *Consumer Education*

As a result of several regional conferences conducted recently, the President's Committee on Consumer Interests, Mrs. Esther Peterson, Chairman, made the following recommendations for a long-range attack on all consumer problems: 1. that the Office of Education of HEW encourage schools to add consumer economics to their curricula and stimulate the development of a thorough literature in the field; 2. that a special committee be established to compile information and that existing Federal agencies with consumer responsibilities undertake more research and also study methods of improving dissemination; 3. that the Department of Commerce establish a liaison with the business community to publish existing performance standards and other information about specific products; and 4. that programs be established to consider the need of special groups such as the poor, the elderly, the non-English speaking and the poorly educated. The breadth of these proposals serves to demonstrate the enormity of consumer-related problems in the nation as a whole. In regard to the specific problems discussed in this article, it would appear that the committee's recommendations, while extremely beneficial and far-reaching, will only indirectly approach a problem which should be attacked frontally. It appears illogical to educate the consumer to avoid illegal schemes—or at least immoral practices which should be proscribed—when the fault lies in the failure of society to develop sanctioning measures which are effective to deter and eliminate the practices themselves.<sup>66</sup>

The efforts of the President's Committee coupled with the efforts of neighborhood workers in the community action programs of the War on Poverty will indeed have a salutary effect on the consumers who receive the education and have the available resources for translating sound consumer habits into practice.

It is naive, however, to assume that such a Utopian society of well-educated buyers will ever come to pass. To paraphrase John Maynard Keynes, by the time such a goal is attained, we will all be dead. Education will have an impact and will tend to improve conditions, but the causes of the problem fol-

<sup>66</sup> See PRESIDENT'S COMMITTEE ON CONSUMER INTERESTS, REPORT TO THE PRESIDENT (March 1965).

low in the wake of an educational program—teaching the people about problems does not change the existing conditions.

## 2. *Legal Services*

A component of the Community Action Programs of several cities including Washington, D. C. and Oakland, California, has been a provision for “neighborhood law offices” to supplement existing Legal Aid programs. These projects, modeled on the framework proposed by Edgar and Jean Cahn,<sup>87</sup> are designed to provide legal assistance, primarily in civil cases, to neighborhood residents who qualify for such assistance. The availability of a neighborhood lawyer to act as “house counsel” for the low-income residents should provide vigorous presentation of available legal defenses for those residents who avail themselves of this service. The expansion of this program to other cities, as recently announced by the Office of Economic Opportunity, should have a dramatic impact on the practices of neighborhood merchants.

The neighborhood lawyer, however, works under the same limitations as the courts. Traditional judicial doctrines such as the protection of the holder in due course of an installment note, the enforcement of oppressive clauses in “contracts of adhesion” despite the buyer’s lack of bargaining power, or the general rule that a court will not question the adequacy of the consideration will prevent an effective attack by the neighborhood lawyer on many of the practices outlined above.

## C. *Legislative Solutions*

### 1. *State Legislation*

Existing and proposed legislation is inadequate to cope with the imaginative schemes depicted above. The small loan laws, “truth in lending” legislation, and retail installment sales acts suffer from a common defect. They are not self-enforcing. Dependent on the initiative of the buyer to invoke them, the sanctioning effect of these laws is minimal and easily absorbed by the successful businessman as an operating cost. A successful merchant can flagrantly ignore any of these laws in the manner described above and still come out ahead in the long-run. He may have to pay a nominal fine in the unlikely event that he is prosecuted for the violation of a regulatory statute or he may lose several court cases to resourceful lawyers, but these setbacks are insignificant when compared to the overall profitability of ignoring the law.

Licensing laws embody somewhat stricter sanctioning. If merchants engage in the above-described practices to a significant degree and are detected, in some states they could be denied a license to engage in the credit business.<sup>88</sup> This sanction, however, is rarely applied. This type of law appears to suffer

<sup>87</sup> *Supra*, note 1.

<sup>88</sup> CURRAN, *supra* note 30.

from a lack of enforcement due to inadequate investigation into unfair practices.

A potential solution to the inadequacy of current legislation in many states is the uniform law currently being drafted by the National Conference of Commissioners on Uniform State Laws. Such a law would undoubtedly be more palatable to business interests who have vigorously opposed the entry of the Federal government into the field of credit regulation as evidenced by the repeated defeats of Senator Douglas' "Truth in Lending" legislation, which must be deemed a mild regulatory measure.

There seems to be little dispute as to the constitutional authority of Congress to regulate the credit business to the extent that it affects interstate commerce. As stated by Professor Arthur E. Sutherland:

I have little doubt that the Supreme Court of the United States would uphold this measure [Truth in Lending] as constitutional if Congress were to pass it. Since 1936, the commerce power of the Congress has been used to control many local matters which have an effect upon interstate matters, and the commerce power is fortified by the somewhat nebulous power to control the value of money under article 1, section 8, clause 5. In August 1963, there were more than \$66 billion of consumer credit outstanding in the United States. More than \$51 billion of this consisted of installment credit . . . Congress seems clearly to have the power to regulate this immense volume of credit, which affects every state in the Union, which has much to do with the prosperity of the entire economy, and which makes practicable the marketing of automobiles, household equipment and every other sort of consumer commodity throughout the United States.<sup>69</sup>

Professor Sutherland, however, as spokesman for the National Conference of Commissioners on Uniform State Laws, contends that the benefits of uniform Federal legislation would be greatly outweighed by the practical problems which would arise under overlapping Federal-State legislation.<sup>70</sup> This objection does not seem insoluble. The argument was raised with respect to Federal legislation in the area of labor-management relations in the 1930's and the courts have been equal to the task of defining the areas of state and Federal jurisdiction over union activities. The argument that chaos will result from Federal legislation overlooks the fact that chaos already exists in the field of credit regulation.

The approach advocated by Professor Sutherland is the adoption by the states of uniform legislation designed to cover the entire field of consumer credit, including installment sales, usury and small loans.<sup>71</sup> Such an act would,

<sup>69</sup> *Hearing on S. 750 Before a Subcommittee of the Senate Committee on Banking and Currency*, 88th Cong., 1st & 2d Sess. at 1035-1036 (1963).

<sup>70</sup> *Id.* at 1036.

<sup>71</sup> *Id.* at 1031.

of course, resolve any doubt as to conflict with existing law; a state adopting the uniform legislation need only displace existing inconsistent laws.

The problem arising out of this approach is that many of the inadequacies of existing legislation<sup>72</sup> will of necessity be incorporated in the uniform legislation. Lack of effective sanctions due to inadequate investigation of abusive practices or to lack of prosecutorial resources will not disappear with a change in substantive rules of law. Nor is it customary to enact penal legislation by means of a uniform statute or to create a regulatory agency by this means. To combat the resourcefulness of unscrupulous lenders, it is necessary to go beyond the traditional methods which have proved to be unsuccessful.

A further disadvantage of a uniform law is that adoption by states in which the problem is most acute has no assurance of success. And even adoption does not insure a "uniform" attack on the problem. Differing interpretations of the act could lead to widely divergent results and the lack of Federal legislation in the field would operate as a deterrent to Supreme Court concern in a field which has vital national overtones.

Clearly, a uniform act would be better than the current status of state legislation in random directions. The literature in the field indicates that the practices in the consumer credit area do not vary widely from jurisdiction to jurisdiction. The same phenomena are reported in the poverty areas of the large cities throughout the country, and a uniform consumer credit code would be a sound initial step toward remedy of existing abuses.

## 2. *Federal legislation*

Effective regulation of the credit industries with its dramatic impact on national stability, monetary policy, and distribution of income clearly lies within the ambit of constitutional Federal action. The experiences depicted by observers of the credit field indicate that novel and far-reaching Federal legislation is essential because of the failure of existing remedies in the states and the courts to remedy the flagrant practices of some merchants.

While data in many areas is lacking, it is clear from the existing information that one of the causes of self-perpetuation of poverty lies in the credit abuses visited on many of the poverty-stricken citizens. To effectuate one of the primary national goals, i.e. the eradication of poverty conditions, sweeping legislation is essential.

## 3. *Substantive Proposals*

a. *Truth in Lending*—Proposed Federal legislation in this area has centered around the "Truth in Lending" bill. In a speech accompanying the introduction of the bill, Senator Douglas explained that his bill would require creditor to furnish the buyer with a statement of the total finance charge, "in

<sup>72</sup> See text accompanying notes 50 to 65.

dollars and cents," and of the "true annual interest rate" on the outstanding unpaid balance of the debt. The philosophy of the bill is one of enhancing the opportunity of the installment purchaser to shop for credit by providing him with enough information to compare finance charges. As expressed by Senator Douglas, "Truth in Lending would obviously work to the disadvantage of those who charge an excessively high rate of interest. If we pass this bill, these firms will either have to lower their rates or face a loss of business to their competitors. Up to now, these operators have been able to get by with charging exorbitant rates through confusion or subterfuge."<sup>73</sup>

This legislation has been attacked on many fronts in previous sessions of Congress. Small businessmen have deplored the clerical burden which would be placed upon them by requiring a statement of the true rate of interest, using the unpaid balance as a base. For example, a formula for determining the "true" interest rate, i.e., the amount of interest to be paid on the declining balance of payments due, is as follows:

$$I = \frac{2 y c}{m(n+1)}$$

I = true interest rate

y = number of payments per year

c = cost of loan

m = money received

n = number of installments<sup>74</sup>

Yet, proponents of the bill have demonstrated calculators which would allow easy computation of the interest rate.<sup>75</sup>

The brunt of the attack on "Truth in Lending" legislation has focused upon the wisdom of Federal control over the business of consumer credit.

In terms of the subject matter of this paper, the consumer problems of the low-income segment of our society, the "Truth in Lending" legislation is substantively inadequate to curb existing "unfair sales practices." As expressed by the principal proponent of the bill, it is designed to foster competition among lending institutions and to allow comparative shopping for credit. Yet, as we have shown above, the neighborhood merchant has a built-in monopoly due to the tendency of low-income purchasers to restrict their "shopping" to the immediate neighborhood. With the current lack of knowledge among low-income consumers regarding alternative forms of credit, this theoretical increase of competition would have little practical impact for the low-income consumer. The "Truth in Lending" approach presupposes a more competitive market and a higher level of consumer education than currently

<sup>73</sup> United Press International Wire Service, Release No. GE 1155A, July 12, 1965.

<sup>74</sup> See 1961 *Hearings*, *supra* note 18, at 1131.

<sup>75</sup> *Id.* at 158-159, 191-195, 490-496.

exists in the low-income neighborhood. As such, the approach of Senator Douglas and the proponents of "Truth in Lending" will have its primary impact on the middle-income consumer and the more reliable merchant with whom he does business.

b. *Minimal Credit Standards*—In the area of suggested legislative solutions to the problems of low-income consumers, David Caplovitz makes the suggestion that minimal credit requirements be established and that enforcement of any debt contracted by a consumer who failed to meet these minimal standards be denied enforcement in the courts, much in the manner that contracts of minors are treated by the courts.<sup>76</sup> This proposal appears to cut too deeply, removing the benefits of credit from needy consumers to remedy the abuses of merchants, whereas the problem lies more in excessive charges for interest and higher pricing of goods for low-income consumers, as well as misleading advertisements. But for these oppressive practices, credit can benefit the low-income consumer in many ways.<sup>77</sup>

c. *Fair Trade to Consumers*—At first blush, it would appear that legislation aimed at limiting the price which a merchant can charge for goods is a substantial encroachment on time-honored sensibilities such as "freedom of contract" and the "free enterprise" system of pricing which allows the seller to charge whatever the market will bear and places the burden of determining the value of goods on the buyer. Yet when one considers existing "fair trade" laws which allow the manufacturer to place a minimum price on goods, legislative control of the maximum mark-up no longer appears distasteful. Why pay tribute to a vague concept such as "free enterprise" in one instance and not in the other?

Survival of the American system of government has depended in the past on adjustment of traditional concepts to social realities in an effort to remedy inequities, as in the depression era. The inequity of a different pricing standard for rich and poor consumers is patent, and the only apparent remedy is a limitation on the pricing of consumer goods.

d. *Regulatory Agency Supervision*—A uniform Federal licensing law, enforced at the behest of regional offices with investigative authority and funds would appear to be the only effective means of coping with blatant disregard for legal principles. Such an agency, established under the commerce power of the Federal government, modeled on the Federal Reserve System's supervision of member banks, endowed with authority to issue complaints on its own initiative, and empowered to revoke licenses or impose intermediate sanctions such as cease-and-desist orders, could attack the unfair consumer practices of merchants at the roots—in the neighborhood itself. Nothing short

<sup>76</sup> CAPLOVITZ, *supra* note 13 at 191.

<sup>77</sup> See COHEN & HANSON, *supra* note 18.



of such a sweeping legislative enactment would effectively eradicate the unjust practices which our society has allowed to become widespread. A poverty-conscious Congress should be able to see the anomaly in providing welfare aid to the poor and then allowing unscrupulous merchants to be the primary beneficiaries of such aid.

e. *Amending Rules of Law*—Adoption of the “unconscionability” doctrine by the framers of the Uniform Commercial Code was a stride toward altering traditional judicial protections afforded to credit merchants. Legislation would be necessary to alleviate many of the other abuses in this area. One study group has recommended a proposal which would limit the protection of the finance companies under the holder in due course rule where the finance company is in reality acting as a principal to a transaction.<sup>78</sup> This proposal would be beneficial in attacking some of the problems discussed above. The parol evidence rule also operates with undue harshness where a consumer has been induced by misleading promises of salesmen.<sup>79</sup>

While these are the two protective legal doctrines which have the greatest impact on the consumer, other areas where review of the law is necessary will come to light upon further investigation of the consumer credit area of our economy which, in this author’s opinion, is desperately needed in many cases. The proposals suggested above are designed to stimulate further consideration of a serious problem for our society.

<sup>78</sup> See, e.g., the proposal of a Washington, D. C. commission to amend retail installment legislation, *Washington Post*, September 24, 1965, p. A1.

<sup>79</sup> See BLACK, *supra* note 40, at 148.

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