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Regulation of Consumer Instalment Credit

DONALD J. M. BROWN*

The relatively modern phenomena of instalment sales financing has been the subject of much public controversy of late. In particular, legislators, journalists and consumer associations have been advocating the need for some regulation of consumer instalment credit. The objective of this article is to examine some of the problems involved. In the first place, the operation of consumer credit in its commercial setting will be outlined; secondly, the current legal position will be considered; and finally, some of the methods of regulation will be examined with particular emphasis directed to Senator Croll's proposed "Finance Charges (Disclosure) Bill."¹

I THE COMMERCIAL SETTING

The magnitude of consumer credit outstanding is astounding. Since World War II there has been an unprecedented increase in ownership of personal assets such as automobiles, television sets, appliances and power boats.² There has been a corresponding increase in the amount of outstanding consumer instalment credit. For example, consumer instalment credit outstanding in the United States jumped from 15 billion dollars in 1950 to 40 billion by 1960.³ In Canada, outstanding consumer instalment credit has climbed from 57 million dollars in 1946 to 1,466 million in 1962.⁴

Basically, a consumer has two alternatives in financing his purchase; cash, or some form of deferred payment. There are several methods of deferring payment including secured or unsecured loans from banks, finance companies and credit unions, or by some

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¹ *Finance Charges (Disclosure) Bill*, Bill S-2, Senate of Canada Bills, 24th Parliament (1962). Re-introduced; Bill S-3, Senate of Canada Bills, 25th Parliament (1962).

² *46 Federal Reserve Bulletin 675 (June 1960)*; Consumer Instalment Credit, Board of Governors, Federal Reserve Report, Part I, Vol. I, pp. 22-24 (1957).

³ *Ibid.*

⁴ *Royal Commission on Canada's Economic Prospects; Financing Economic Activity in Canada*, Hood (1958), 135. Also see *Submission To The Royal Commission On Banking And Finance*; Laurentide Financial Corporation Ltd. (1962) p. A1382.

"revolving credit"⁵ scheme, popular in department store sales financing. However, the deferred payment plan most frequently employed in financing consumer durables is the instalment sale.

The distinguishing feature of a purchase by instalment is an agreement for periodic payment of the purchase price while the buyer enjoys use of the goods. The conditional sale contract is utilized as a security device, and usually the seller further protects himself by requiring a promissory note for the purchase price. As well, the agreement often includes insurance against loss of the article and sometimes a policy of insurance on the life of the buyer for the amount of the purchase price outstanding.⁶

The usual consumer sales financing scheme is a much more complex arrangement. The automobile industry, where manufacturers do not extend credit to their dealers, is an apt illustration. The majority of automobile dealers finance their inventories and provide credit facilities for purchasers by means of a "floor-plan" arranged with one or more financing institutions. Under a "floor-plan" the financing institution advances cash to the retailer to purchase inventory taking back some security, usually a chattel mortgage, thus creating "wholesale" paper. In exchange for this financing, usually at a very low rate, the dealer agrees to sell all of his retail instalment sales contracts, which carry a much more favourable rate of interest, to the financing institution. Generally, this relationship between the dealer and finance company will involve the finance company furnishing the blank contracts, promissory note forms, rate charts, and often a telephone credit checking service. As well, the arrangement almost invariably involves "dealer participation" by way of so-called "dealer reserves". That is, the finance company requires the dealer to build up a percentage of the instalment credit outstanding in reserve against which the financier may make claim in the event of a customer's default. Upon a certain level being reached these reserves are returned to the dealer in the form of commissions and they often comprise a sizeable portion of his income. Under these arrangements it is obvious that the only "customer" of the finance company is the retail dealer. The consumer is of interest to the financier only when his payment comes due.⁷

⁵This rather recently developed credit device operates as follows: The parties decide what minimum monthly payment the customer should be expected to make and by multiplying the sum by the number of months in the duration of the plan, thereby the customer's maximum allowable credit is arrived at. The customer then makes a monthly payment including a "service charge" on the outstanding balance each month.

⁶See generally Warren, *Regulation of Finance Charges in Retail Instalment Sales*, 68 Yale L.J. 839; 845 (1959); *Retail Instalment Sales Legislation*, 58 Col. L.R. 854, 857 (1953); Hogan, *A Survey of State Retail Instalment Sales Legislation*, 44 Cornell L.Q. 38, pp. 40-41 (1958-59); Ivan R. Feltham & Kristine Feltham, *Retail Instalment Sales Financing—Rights of The Assignee-Endorsee—Identification of The Finance Company with the Dealer to Protect The Buyer*, 40 Can. B. Rev. 461. (1962).

⁷*Ibid.*

Under these conditions competition among finance companies is not at the consumer level at all. The financing institutions are concerned almost solely with selling and establishing "floor-plans" with dealers. This being so, competition between financiers reflects itself less in a reduction of the finance charge to the consumer than in more favourable "participation" terms for the dealer. The most attractive plan to the dealer is the one with the highest rate of dealer participation coupled with the lowest reserve requirements. When insurance is part of the instalment sale contract, with the dealer acting as agent, the plan with highest commissions rather than the lowest rates will similarly be the most attractive. Experience has shown that this condition of "reverse competition" tends to force finance rates to the consumer upward rather than downward.⁸

This would not be so if consumers "shopped" for credit. It appears from the surveys made that the majority of consumers are ignorant as to the cost of their financing purchases by deferred payment.⁹ As one commentator states:

"What is surprising is not that the interest rates for direct consumer loans range from 12% to 37%, for those rates are fairly conventional; rather, it is that very few borrowers have any comprehension of the true interest rates; nor are the direct lending institutions required to so inform the public. Instead one is faced with charts and tables and other graphic evidence of what one must repay over the period of the loan in so many installments of so much each in order to borrow a certain sum. Aside from the very few who are aware of the rule of thumb that monthly installments make the effective rate about twice the discount, most consumers have completely inaccurate approximations of the true interest rate on consumer loans."¹⁰

These remarks would seem to apply to consumers financing their purchases by instalment sale despite the fact that most finance companies clearly state the amounts of the purchase price, the periodic instalment, and the total cost in dollars on the face of their contracts. Undoubtedly this lack of discrimination by consumers, coupled with the complexity of the calculations necessary to translate the dollar amounts into the effective simple interest rate, complement "floor-planning" arrangements in creating the paradox of "reverse competition".

From the preceding observations regarding instalment sales financing a few points may be summarily noted. The vast increase in consumer credit outstanding in the past two decades has been largely implemented by instalment sales. A paradoxical situation termed "reverse competition" exists which results in upward pressure on interest rates to consumers. This seems to be due, in part, to the nature of the usual "floor-plan" arrangement between dealers and financiers whereby competition among financiers is only at the dealer level; and in part, to the consumers' lack of care and understanding

⁸ *Supra*, footnotes 2, 4 and 6.

⁹ Hood, *supra*, 182; Schuchman: *Consumer Credit by Adhesion Contracts II*, 35 Temple L.Q. 281 (1962).

¹⁰ *Ibid.* Schuchman, 290.

as to the cost of consumer credit. In these circumstances one is not surprised to find many people claiming abuses exist and that some form of regulation is needed for the protection of consumers.

II THE LEGAL POSITION

It is perhaps surprising that at present, in Ontario, there is no regulation of instalment sales financing either requiring disclosure of interest charges or limiting the rate of finance charges.¹¹ Loans from banks are governed by the *Bank Act*.¹² All other loans under \$1,500 must comply with the maximum rates set out in the *Small Loans Act*.¹³ Apart from these enactments, there is no other regulation of the cost of credit to the consumer. Section 2 of the *Interest Act*¹⁴ states:

The question arises; does the *Small Loans Act* cover instalment sales financing situations? In the first place it is necessary to analyze the instalment sale as a financing technique from the legal point of view. The instalment sale has been developed through the utilization of several legal concepts. The *Sale of Goods Act*¹⁵ governs the buyer-seller relationship; the law of negotiable instruments deals with the rights and obligations of the parties to the usual promissory note; the law of assignment is brought into play; where insurance is involved, the law of insurance applies; and finally, the law regulating the various chattel security devices operates upon the rights of the dealer and his successor in interest, the financing institution. Thus an instalment sale in law involves a complex interaction of several legal concepts.

Does this arrangement fall within the thrust of the maximum interest rate provisions of the *Small Loans Act*? The *Small Loans Act*¹⁶ speaks in terms of "interest" which it leaves undefined. Thus, is

¹¹ It is possible that some remedy may be obtained under the Unfair Competition provision, Section 7 of the *Trade Marks Act*, R.S.C. 1953 c. 49. The possibility is remote however, and the problems raised by this section are beyond the scope of this article. It should also be noted that the *Unconscionable Transactions Relief Act*, R.S.O. 1960, c. 410 was recently declared *ultra vires* the provincial legislature by the Ontario Court of Appeal in *Re Sampson and Barfried Enterprises Ltd.* (1962) 35 D.L.R. (2d) 449. This decision is currently on appeal to the Supreme Court of Canada. As well, an identical enactment has been introduced in the House of Commons; Bill C-67, House of Commons of Canada, 25th Parliament (1962). However, an extensive comment would be unwarranted as it will not likely be enacted in its present form.

¹² S.C., 1953-54, c. 48.

¹³ R.S.C., 1952, c. 251, as amended S.C., 1956, c. 46.

¹⁴ R.S.C., 1952, c. 156.

"2. Except as otherwise provided by this or by any other Act of the Parliament of Canada, any person may stipulate for, allow and exact, on any contract or agreement whatsoever, any rate of interest or discount that is agreed upon."

¹⁵ R.S.O., 1960, c. 358.

¹⁶ The maximum interest provisions form the pith and substance of the Act. These are; 2% per month on the unpaid principal balance up to the amount of \$300.00; 1% per month on the unpaid balance exceeding \$300.00 but under \$1,000.00 and 2% per month on any remainder up to \$1,500.00. A special long term provision provides that where loans of

a finance charge "interest"? In England, traditionally an article had both a "time-price" and a "cash-price". The Courts devised this distinction and held the difference between the "time-price" and the "cash-price" was not "interest" and hence, not subject to the old usury laws. This question has not come before a Canadian Court and cannot authoritatively be answered. It is submitted, however, that any court desiring to find a finance charge "interest" would have little difficulty in so doing. Both the "interest" on a loan and the "finance charge" on an instalment sale represent the cost to the consumer of using another's money.

A more perplexing question is whether the instalment sale arrangement could be regarded as a loan? The root of the instalment sale concept is a sale of goods, but when the promissory note is added and the dealer-finance company relationship is superimposed, does the transaction not take the colour of an indirect loan? Although there is little jurisprudence on the issue of "sale" or "loan" where a dealer sells his instalment sales contracts to a financing institution, the question of whether a finance company was a "money-lender" within the old *Money Lenders Act*,¹⁷ in the same circumstances, was considered by an Assistant Master of the Supreme Court of Ontario.¹⁸ It must be noted that in this decision the concept of the finance company *vis a vis* the *buyer* under a "floor-plan" was not explored, although it appears such a plan was employed. The case concerned a *dealer* and a finance company. The Assistant Master found the finance company not to be a money lender and shortly dismissed the question, saying:

"In answer to the charge that the defendant is a money lender. . ."¹⁹
"It is admitted that no one can walk into the defendant company's office and obtain a loan. A witness from the government department concerned stated on cross-examination that he doubted whether an application from the company for registration would be accepted, and that no corporation carrying on a similar business is registered. There must be some sound reason for what appears to be an established policy. It is contrary to that policy to fetter ordinary commercial transactions with prohibitions designed to protect the public at large. The defendant restricts its activities to a certain type of transaction and to a certain class of persons, namely businessmen or organizations seeking to finance their undertakings in volume, organizations presumably operated by trained and experienced businessmen."²⁰

Clearly this reasoning should not be applicable to the situation that exists between the consumer and finance company under a "floor-plan" as outlined above.

\$500.00 or less are repayable over a period greater than 20 months or a loan exceeding \$500.00 is repayable over a period exceeding 30 months, the cost of the loan must not exceed 1% per month on the unpaid balance. "Cost of the Loan" is defined in Section 2(a) in very broad terms which include, *inter alia*, discounts, commissions, fees and other charges whether called interest or not. There have been no reported decisions interpreting the *Small Loans Act*.

¹⁷ R.S.C., 1952, c. 181. Repealed S.C., 1956, c. 46, s. 8.

¹⁸ *Igloo Refrigeration Co. Ltd. v. I.A.C. Limited*, [1943] O.W.N., 604, per Master Lennox.

¹⁹ *Ibid.*, p. 608.

²⁰ *Ibid.*, p. 609.

The English judges dealing with the same issue have been more forthright.²¹ For example, Mr. Justice Porter, in a case twenty-five years ago, specifically, took the position that the form of the transaction overrode its substance. He stated:

"On the other hand, the defendants say that in fact there was no such sale at all, that this so-called sale was merely a sham, and that this transaction was merely a method of borrowing money by Messrs. Brights from the plaintiffs and that therefore the plaintiffs were money-lenders, and, not being registered as such, they cannot recover the money. There is something to be said for that argument, but what one has to remember—and I think this might be said of almost all bodies which finance hire-purchase agreements (and they are very numerous at the present time)—is that their real function is the lending of money and it must necessarily be so. Although that may be the object and intention for which they exist, the question is not with what object they employ their money, but the method they have of employing it. If the method employed constitutes a sale, then the transaction is not only the lending of the money but also a purchase of the goods, even although it is only for the purpose of lending money that it is being done in that way."²²

Technically, it would seem that a typical instalment sale transaction is a purchase and sale. However, this issue has not come before the courts of Ontario, and the desirability and possibility of the *Small Loans Act* applying to instalment sales has yet to be considered.

III REGULATION BY JUDICIAL INTERPRETATION

If faced with the question of the applicability of the *Small Loans Act* to instalment sales an Ontario court could follow the technical line of the English decisions. On the other hand, some American judges have said that in certain circumstances instalment sales are substantially loans, and as such subject to the usury legislation. Couched in terms of "time-price" and "cash-price", American jurisprudence has evolved three such exceptions to the traditional concept of instalment sales.²³

The major exception, based on an agency concept, is most clearly expounded in *Hare v. General Contract Purchase Corpn.*,²⁴ a decision of the Arkansas Court of Appeal. Here, the contract blanks and rate schedules were supplied to the dealer by the finance company, and the promissory note and contract were assigned to the company by the dealer immediately following the sale to the purchaser. Because of this "close relationship" the Court held the transaction not a sale but a loan from the finance company to the buyer through the agency of the dealer and thus subject to the usury law. In a *caveat* following the decision the Court postulated three guides summarily stated as follows:

²¹ In *Re George Inglefield Limited*, [1933] Ch. 1; *Olds Discount Corp. Ltd. v. John Playfair*, [1938] 3 All E.R. 275; *Olds Discount Corp. Ltd. v. Cohen*, [1938] 3 All E.R. 281; *Transport Corporation Ltd. v. Morgan*, [1939] 2 All E.R. 17; *Chow Yoong Hong v. Choong Fah*, [1961] 3 All E.R. 1163.

²² *Olds Discount Corp. Ltd. v. Cohen* [1938] 3 All E.R. 281.

²³ See generally *supra* footnote 6.

²⁴ 249 S.W. 2d 973 (1952).

"A. It reaffirmed that a seller may charge a genuine time-sale price, but declared that the "good-faith" of the seller would be a question of fact.

B. If the seller, whether or not he has quoted the buyer a cash price and a credit price, subsequently transfers the contract to a finance company having had a reasonable assurance at the time of the sale that the finance company would discount the contract and the discount rate is greater than the legal interest rate, then the transaction will be considered a loan and the buyer may have the protection of the usury statutes.

C. Assurance that the finance company would discount the sales contract may be implied when the finance company has furnished the dealer with forms and rate information."²⁵

The second situation in which the usury laws have been held applicable to instalment sales is where the finance company directly negotiates the terms, or where the nature of the relationship is such that the finance company imposes the terms of the conditional sale on both the buyer and the seller.²⁶ The third situation in which the American Courts have found the instalment sale to be a loan is where the "time-price" has been computed by adding finance charges to the "cash-price".²⁷

The choice is open. There are clear routes to each conclusion. On the one hand, a technical analysis, such as that found in the English decisions, referred to earlier, would lead to the conclusion that the transaction is a sale of goods. On the other hand, some American decisions hold that substance rather than form is paramount. They state that as a commercial reality there is little or no difference between the buyer borrowing the purchase price and giving back a chattel mortgage as security and a purchase by instalment wherein the buyer executes a conditional sale contract as security. They recognize that in both cases the seller does not finance the sale nor does the buyer have sufficient money to make immediate payment. They realize in both cases the advance is made by a financial institution and for this service the buyer pays a sum of money over and above the cash price of the article. The American Courts say, in effect, that any distinction between a loan and financing a purchase by instalment sale is transparent in the present day situation where credit sales are essentially tripartite transactions involving buyer, seller and finance company, with the buyer bearing the cost of the credit as he would under a secured loan arrangement.

The difficulties involved in choosing between these two avenues of reasoning are by no means novel. Throughout the history of commercial law the courts have struggled with two countervailing policies. They have been faced with the difficulty of keeping abreast of commercial practice while at the same time preserving certainty in the law. *Cockburn, C.J.*, in the famous case of *Goodwin v. Ro-*

²⁵ *Consumer Credit Symposium: Developments In the Law* 55 Northwestern L.R. 301 at 305, (1960-61).

²⁶ *Ibid.*, at 308; *Nazarin v. Lincoln Finance Co.*, 78 A. 2d 7 (1951); *Jackson v. C.C.C.*, 83 S.E. 2d 76. (1954).

²⁷ *Daniel v. First Nat'l. Bank* 227 F. 2d 353; *Thompson v. C. C. Equipment Corp.*, 99 N.W. 2d 761 (1959).

barts,²⁸ coped with these considerations when he found debenture scripts to be negotiable. He states on one hand, the need for growth and flexibility:

"The universality of a usage voluntarily adopted between buyers and sellers is conclusive proof of its being in accordance with public convenience; and there can be no doubt that by holding this species of security to be incapable of being transferred by delivery, and as requiring some more cumbersome method of assignment, we should materially hamper the transactions of the money market with respect to it, and cause great public inconvenience."²⁹

On the other hand he cautions:

In a recent case in the Ontario Court of Appeal Mr. Justice Kelly grappled with the same problem. In *Federal Discount Corp. v. St. Pierre*,³¹ a finance company attempted to enforce a promissory note in the same "floor-plan" circumstances as previously outlined. The question arose as to whether the finance company could be said to receive the note in "good faith" and in so doing be a holder in due course. He states on page 97:

"There can be no doubt that everyday commercial life demands that the integrity of bills of exchange be recognized and that those acquiring them in good faith should not be required unnecessarily to make inquiries to establish their authenticity."³²

Further, he states the countervailing policy:

"It is not necessary for the support of ordinary commercial transactions that the holder of a bill of exchange should under all circumstances be permitted to shield himself behind the guise of a holder in due course. . . .

With the growth of the sale of household and personal goods on the extended payment plan, the promissory note, the conditional sales contract and the finance company have become inseparable parts of the procedure whereby the merchant realizes immediately cash from the extended obligation of the purchaser from him. The very existence of the seller's business depends on his ability to convert into cash these obligations and the finance company, standing ready and willing to buy them, has become not only an essential part of retail selling on the time payment plan, but is in effect a department of the seller's business, exercising a measure of control over the seller's sales by the requirements laid down with regard to the negotiable paper proposed to be purchased.

In the course of this development an attempt has been made to project into the field of household law the law merchant originally designed for dealings between merchants. The fiction has been permitted to flourish that the finance company is a foreign and independent agency."³³

A court faced with determining the applicability of the *Small Loans Act* to "floor-planned" instalment sales, likewise, would be confronted with a similar dilemma.

²⁸ (1875) L.R. 10 Ex. 337.

²⁹ *Ibid.*, 353.

"We must by no means be understood as saying that mercantile usage, however extensive, should be allowed to prevail if contrary to positive law."³⁰

³⁰ *Ibid.*, 357.

³¹ [1962] O.R. 310, 32 D.L.R. (2d) 86.

³² *Ibid.*, 97.

³³ *Ibid.*, 97-8.

As well as making a choice between these two competing policies, the Court will necessarily be forced to determine the extent of creative power it may legitimately exercise without usurping the function of the legislature. In the well known American decision, *International News Service v. Associated Press*,³⁴ the Supreme Court of the United States faced the same problem in a different context. As to the proper creative power of a court Mr. Justice Brandeis had this to say:

"The injustice of such action is obvious. But to give relief against it would involve more than the application of existing rules of law to new facts. It would require the making of a new rule in analogy to existing ones. The unwritten law possesses capacity for growth; and has often satisfied new demands for justice by invoking analogies or by expanding a rule or principle. This process has been in the main wisely applied and should not be discontinued. . . . But with the increasing complexity of society, the public interest tends to become omnipresent; and the problems presented by new demands cease to be simple."³⁵

Mr. Justice Brandeis goes on to point out that the courts are not equipped to make the investigation and enquiry necessary before a major change in the law is made. He states:

"A Legislature . . . would consider such facts and possibilities and others which appropriate inquiry might disclose."³⁶

For the reasons suggested by Mr. Justice Brandeis, it is submitted that for a court to interpret the *Small Loans Act* so as to include instalment sales would be entirely unsatisfactory. It has no machinery to investigate the appropriateness of such a holding. Perhaps the schedule of interest rates would not be flexible enough to cover all aspects of consumer sales financing. Further, a straight application of the terms of that legislation without administrative machinery to assist in determining a standard calculation of simple interest, would likely be cumbersome and dilatory in operation. If retail instalment credit is to be regulated at all it would be done most effectively by legislation based on thorough research.

IV REGULATION OF INSTALMENT CREDIT BY LEGISLATION

Currently in the United States, thirty-one States have motor vehicle instalment sales regulation statutes and eighteen have legislation covering all goods. Of these, twenty-three States regulate finance charges and rebates, but only a few have interest rate disclosure requirements. In Canada,³⁷ only Alberta, New Brunswick and Quebec have regulatory legislation, and none of these require disclosure of the simple interest rate per annum, although some have "dollar disclosure" provisions.³⁸ The proposed *Finance Charges (Disclosure) Act* would, if enacted, require disclosure of the dollar amount

³⁴ (1918) 248 U.S. 215.

³⁵ *Ibid.*, 262.

³⁶ *Ibid.*, 264.

³⁷ The *Time Sale Agreement Act*, R.S.M. 1960, c. 76, is similar to Senator Croll's Bill but has not yet been proclaimed.

³⁸ See generally Ziegel; *Retail Instalment Sales Legislation: A Historical and Comparative Survey* (1962) 14 U. of Toronto L.J. 143 at 154-155.

of "finance charges" as well as a statement of the effective simple interest rate.³⁹

The legislation appears to be the result of W. C. Hood's comments in his report, *Financing Economic Activity in Canada*.⁴⁰ Mr. Hood is of the opinion that few car buyers financing their purchases considered the alternate methods and costs of credit. He states:

"But without being able to prove the point, there seems to be abundant evidence that the bulk of credit supplied to consumers is made available without the consumer having clear, full knowledge of the alternatives available to them and the costs of each."⁴¹

He goes on:

"We are however concerned with one aspect of this matter. This is the burden imposed on the economy by the consumers ignorance of the cost of money he borrows. We have contended in this chapter that such ignorance is widespread. We have also contended one of the reasons finance companies did not respond to the pressures of tight money was because they could, to some degree at least, pass higher interest costs on to the consumer in the form of higher charges. This was done in very large measure by lengthening the terms of the loans as charges were raised so that the increase in monthly payments could be kept to modest proportions."⁴²

"It may be that even if consumers know and appreciate the rates of interest they are paying they will even pay high rates. If so, the price system must be said to allocate the funds and the real resources they command to those willing and able to pay for them and this is the essential function of the price system. But there are reasonable grounds for doubt that there are no attainable limits to the rates of interest consumers will pay for borrowed funds if they are fully aware of the charges imposed on them. And, if consumers are led, through ignorance of the facts, to borrow more than they would otherwise do, a misallocation of resources results, and under conditions of excessive demand for resources, support is given to the forces of inflation."⁴³

Mr. Hood then mentions the difficulty of forecasting the effectiveness of monetary pressure on future financing and states that direct governmental control over finance companies borrowing and reserves

³⁹ Section 3 contains the substance of the legislation:

"3. Every credit financier who enters into a transaction extending credit to another person, as referred to in paragraph (a) of section 2, shall in accordance with regulations made under section 5, and before the transaction is complete, furnish such other person with a clear statement in writing setting forth

- (a) the total amount of the unpaid balance outstanding;
- (b) the total amount of the finance charges to be borne by such other person in connection with the transaction; and
- (c) the percentage relationship, expressed in terms of simple annual interest, that the total amount of the finance charges bears to the unpaid balance outstanding under the transaction."

In this connection "finance charges" means the total cost of the credit to the consumer thereof, and includes interest, fees, bonuses, service charges, discounts and any other type of charge.

⁴⁰ *Supra*, footnote 4.

⁴¹ *Ibid.*, 182.

⁴² *Ibid.*, 196.

⁴³ *Id.*

is undesirable. However, in conclusion he does recommend disclosure, saying:

"But we are of the view that there is one form of legislation which is as desirable in periods of inflation as in other periods, whose effects would be wholly salutary both in assisting the price mechanism and in the performance of its essential function and in controlling inflation, which is apparently within the competence of the federal parliament. This is legislation designed to ensure that those institutions such as instalment finance companies, loan companies, money lenders, banks and retail dealers, which extend credit to consumers, state the rate of interest being charged clearly and in such form as will permit consumers readily, without elaborate calculation, to compare the rates charged by different lenders. The price system and monetary policy which works through the price system, cannot work if prices are not known generally."⁴⁴

Mr. Hood recognizes the complexity of the instalment sales financing transaction, with the practice of dealer participation, and he realizes the difficulties legislators would have in drafting legislation to meet the requirements of business by means of imposing a schedule of maximum rates. To construct a schedule of rates sufficiently flexible to equitably cover all transactions would be almost an impossibility. For example, there would need to be one rate for new automobiles and others for used automobiles in various degrees based on value. Rates would have to be established for luxury items in various price ranges. White goods, such as stoves and refrigerators, would need special consideration as well. Legislation which attempted such regulation of retail instalment credit would probably be too cumbersome to be effective. Perhaps it would also be an unwarranted interference with private enterprise.

At present, most finance companies clearly disclose on the face of their contracts the price of the article purchased, the amount of the finance charge, the amount of each periodic instalment and the total cost in dollar amounts.⁴⁵ The framers of the *Finance Charges (Disclosure) Bill* intend, that by making this legally necessary, plus requiring a translation of the dollar amounts into an effective simple interest rate, consumers will become more discerning and sensitive to the cost of their credit. It follows, it is argued, that the price system would then operate more effectively and that the desired benefits of competitive behaviour in the consumer oriented market, namely: an equitable diffusion of the resulting real income among consumers; a more accurate reflection of supply and demand; and more effective contra-cyclical programs of stabilization, primarily utilizing methods of monetary and fiscal policy; would be more readily achieved.⁴⁶ The legislation by requiring disclosure of a simple interest rate, aims to alleviate the believed widespread consumer

⁴⁴ *Ibid.*, 197.

⁴⁵ The writer has examined the standard contract forms of several of the leading finance companies.

⁴⁶ Brecher, *Combines and Competition: A Re-Appraisal of Canadian Public Policy*, 38 Can. Bar Rev., 523, at 554-558 (1960).

ignorance as to the cost of credit and in so doing, thereby remove that blight from the working of the price system.

However, there would appear to be one serious fault with the proposed legislation. Its underlying assumption is that disclosure of the effective simple interest rate would result in consumers comparing credit costs and shopping for the most advantageous method of deferring payment. However, the *Finance Charges (Disclosure) Bill* limits itself to instalment sales as evidenced by the definition of "credit financier" as follows:

"2(a) 'credit financier' means any person who in the ordinary course of business, whether operated separately or in conjunction with some other business, enters into a transaction with another person arising out of a sale or agreement for sale of personal property, or the provision or agreement for the provision of services to such other person, either for present or future delivery or performance, whereby the whole part of the price or remuneration therefor is to become payable to such person after the transaction is complete."⁴⁷

To give the consumer freedom to make an intelligent choice the legislation should apply to all modes of credit financing including loans from banks, loan companies and credit unions. It is a well known fact that the *Bank Act* limits banks to a maximum rate of interest of 6%, but when discounted the effective annual simple interest rate can vary from 9-12% depending on the method of repayment. To allow the consumer a proper choice, the whole field of consumer credit should be subject to the same disclosures requirements.

Also, for breach of its provisions, the Bill provides that there is to be "no remedy" for collection of finance charges. However, the Bill would not seem to affect a holder in due course of a promissory note. If this be so, the whole purpose and effect of the legislation would be frustrated.

As well, there are practical difficulties in requiring disclosure of finance charges in terms of the effective simple interest rate. One of the difficulties is the calculation of true simple interest. The several different formulae and different calculations make uniformity almost impossible unless a standard schedule is compiled. Another related difficulty is determining accuracy in pricing. It is trite to state that the calculation of simple interest requires a cash price and a finance charge; but a correct cash price is extremely illusive. Credit costs in some cases could be buried and misleading advertising could result. This is a fear of some financing institutions. One such firm in its monthly bulletin stated:

"If in spite of these difficulties, Senator Croll's Bill became law, the net effect would probably be to drive the cost of consumer credit 'underground'. The inability to comply, or competitive pressure to quote the lowest possible 'interest' rate, would force merchants to 'bury' all or part of the finance charge in the price of goods sold. This could be done today because it is difficult for the consumer to establish the

⁴⁷ *Supra*, footnote 1.

actual cash price of most merchandise. Prices cannot be set by the manufacturer; they vary from merchant to merchant; from brand to brand and model to model. If the true cash price cannot be established, neither can the relative credit price. If the credit differential—the difference between the cash price and credit price—cannot be established, it is impossible to calculate or compare equivalent rates of interest.”⁴⁸

V THE CONSTITUTIONAL ISSUE

Any legislation regulating instalment sales faces a constitutional problem embodied in Sections 91 and 92 of the *British North America Act*. That is, does the legislation fall within the subject matter of “interest” under head 91(19) or, is it a provincial matter properly contained in 92(13) which grants jurisdiction over “civil rights and property in the province” to the provincial legislature? The leading authority is a decision of the Privy Council, *Lethbridge Northern Irrigation District vs. Independent Order of Foresters*.⁴⁹ The question as to whether 91(19) was confined only to usury was answered as follows:

“Their Lordships are of the opinion that so far from supporting the argument for a restricted interpretation of head 19 of s. 91 in order to confine it to usurious interest, the history of the usury laws in Canada destroys it. Their Lordships do not find it necessary to attempt to lay down any exhaustive definition of ‘interest’. The word itself is in common use and is well understood. It is sufficient to say that in its ordinary connotation it covers contractual interest and contractual interest is the subject of the Act now in question.”⁵⁰

In a subsequent decision, the Privy Council approved the *Independent Order of Foresters*⁵¹ decision stating:

“It is therefore clear that a provincial statute which varies the stipulation in a contract as to the rate of interest to be exacted would not be consonant with the existence and exercise of the exclusive Dominion power to legislate in respect of interest. The Dominion power would likewise be invaded if the provincial enactment was directed to postponing the contractual date for the payment of interest without altering the rate, for this equally would be legislating in respect of interest.”⁵²

In a recent Ontario Court of Appeal decision, *Re Sampson and Barfried Enterprises Ltd.*, the *Unconscionable Transactions Relief Act*⁵³ was held *ultra vires* the provincial legislature as being legislation in relation to interest. Schroeder J.A. made these comments:

“The word ‘interest’ is not, then, a technical term and it is not restricted in any sense to compensation determinable by the application of a rate percentum to the principal amount of a loan.”⁵⁴

On page 457 he states further:

“In the past it has been contended on behalf of the Provinces in support of provincial legislation touching the subject of interest that the operation of 91(19) is limited in its scope and application and applies only to

⁴⁸ *Merit News*, Industrial Acceptance Corporation, Vol. 14, No. 4, April-May, 1962.

⁴⁹ [1940] A.C. 513.

⁵⁰ *Ibid.*, 531.

⁵¹ *A.G. of Saskatchewan v. A.G. of Canada*, [1949] A.C. 110.

⁵² *Ibid.*, 124.

⁵³ (1962), 35 D.L.R. (2d) 449.

⁵⁴ *Ibid.*, 454.

interest which may be said to be usurious, or to the 'rate of' interest, and that it does not extend to interest in the broader sense. It has been made clear, however, in earlier authorities, that if the Fathers of Confederation had so intended to limit Parliament's powers the words 'rate of' could have been inserted before the word 'interest' in Section 91(19)."⁵⁵

Although the courts seem to give "interest" a wide meaning, there can be no doubt that the proposed legislation does concern contracts of sale. In *Traders Finance Corporation v. Casselman*⁵⁶ the Manitoba Court of Appeal, later affirmed by the Supreme Court of Canada, held a statute limiting recovery on an instalment sale contract to the value of the vendor's lien, to be *intra vires* the provincial legislature under 91(15) of the *British North America Act*.

Nevertheless it would appear that in substance the proposed federal legislation deals with interest. It may incidentally affect property and civil rights within the province; indeed, the legislation may be within the competence of the provincial legislature as well. However, if the courts continue to apply a broad interpretation to "interest" when considering legislation in the nature of the *Finance Charges (Disclosure) Bill*,⁵⁷ they would probably find it *intra vires* the Parliament of Canada.

VI CONCLUSION

It has been pointed out that there has been a huge increase in consumer debt outstanding since the Second World War and that much of this has been in the form of instalment sales, a relatively novel commercial device involving the interaction of several legal concepts. This development has not been paralleled by the law and an anomalous situation has developed in which a consumer, by borrowing money and purchasing by cash, is protected by the *Small Loans Act*, whereas, if he finances an acquisition by means of an instalment sale, there is no protection. In the consumer sales financing industry, competition works to the disadvantage of the consumer. Also, it appears that "dollar disclosure" is not sufficient to allow comparison of credit costs. In these circumstances there has been considerable agitation for regulation of retail instalment credit.

The *Small Loans Act* is not designed to apply to the consumer instalment sale and to be so interpreted would be an unsatisfactory solution. Secondly, legislation establishing a schedule of maximum rates would not only be cumbersome and inefficient but also could amount to an unwarranted interference with private enterprise. The proposed legislation requiring disclosure of "dollar amounts" and "simple interest rates" would seem to be the most appropriate measure.

It is submitted, however, that a few minor amendments would greatly increase its effectiveness. To properly allow complete con-

⁵⁵ *Id.*

⁵⁶ (1960), 25 W.W.R. 289; 22 D.L.R. (2d) 177.

⁵⁷ *Supra*, footnote 1.

sumer choice, the legislation should be made applicable to all forms of consumer credit. Administrative machinery similar to that provided by the *Mortgage Brokers Registration Act*,⁵⁸ where the Superintendent of Insurance licenses mortgage brokers annually, would be an effective means of implementing the legislation. Through the instrumentality of such an office, a standard simple interest rate could be maintained, alleged breaches could be investigated and the threat of possible refusal to renew a licence would be a potent sanction. Also, the present remedy of barring recovery of finance charges should be enlarged to expressly cover actions on the promissory note.

In the last analysis, however, the ultimate responsibility for effective working of the proposed legislation, should it come into force, will rest with consumers themselves. If disclosure of the simple interest rate does not remedy the alleged lack of knowledge and understanding, the fault will not be with the law. Legislation cannot dispel apathy.

⁵⁸ R.S.O. 1960 c. 244 Am. 1960-61 c. 57 Am. 1961-62, c. 82.