University of Richmond Law Review

Volume 14 | Issue 1 Article 7

1979

Regulation of Consumer Credit in Virginia: A Suggestion for Legislative Improvement

Douglas P. Rucker Jr.

William C. French

REGULATION OF CONSUMER CREDIT IN VIRGINIA: A SUGGESTION FOR LEGISLATIVE IMPROVEMENT

*Douglas P. Rucker, Jr.**
*William C. French***

The American economic system is the most successful yet developed, and consumer credit has played a vital role in that economy. Consumer credit has experienced tremendous growth, and has adjusted to the demands of changing life-styles, economic needs, and geographic distinctions, as well as to the different types of consumer goods which have become available with a minimal amount of government intervention. What government intervention there has been has involved restraint and restriction.[1] There now exists the need to improve the consumer credit industry to enable the citizens of Virginia to continue to be able to obtain both the necessities and amenities of life.

Our economic system has always relied heavily upon the marketplace. If sufficient alternative sources compete in that marketplace for patronage, our system assumes, the price and supply are "fair" because they are set by free competitive forces. Competition will have the same effect on the consumer credit marketplace which will be competitive if its essentials — how much credit, to whom and at what price — are left to the free choice of consumers.

---

* B.A., Hampden-Sydney College, 1968; J.D., University of Virginia, 1972. Partner, Sands, Anderson, Marks & Miller, Richmond, Virginia.

** B.A., Washington & Lee University, 1973; J.D., University of Richmond, 1978; M.B.A., University of Richmond, 1979. Associate, Sands, Anderson, Marks & Miller, Richmond, Virginia.

1. THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES: REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE [hereinafter cited as NATIONAL COMMISSION REPORT] at 3 (1972). If anything, state legislation, especially, has unnecessarily segmented the consumer credit market, thus restraining competition. Many existing laws and regulations consist of unrealistic rate structures, restrictions on size and maturities of certain types of loans and licensing practices (convenience and advantage statutes) which restrain free access to the lending market, statutes which promote segmentation of the supply of credit by limiting the ability of retailers and other types of firms from marketing "on-premise" cash loans, and other statutes which prohibit savings and loan associations, mutual savings banks and life insurance companies from providing consumer credit. Also, most state legislation restricts banks as to branching practices, both inter and intrastate branch banking, and prohibits banks from availing themselves of legal small loan rates. *Id.*

Virginia legislation, which is similar to that of other states, has restrained competition, unnecessarly segmented the consumer credit market, and inhibited competition in that market.[2] These impediments to competition should be removed, and the segmentation of consumer credit suppliers should be de-emphasized, in order to achieve, insofar as it is consistent with other state policies, the broadest penetration by all creditors in all areas of consumer credit.

The Virginia General Assembly should assume the role of promoting and maintaining, through appropriate legislation, real competition in the form of numerous alternate sources of supply of a variety of forms of consumer credit, and should protect the consumer by assuring him the "right to know" about such alternate sources. Furthermore, such competition should regulate the rates as well as all aspects of credit. It is inconsistent and harmful to both the consumer and the industry to attempt, as Virginia is now doing, to regulate and eliminate practices which affect operating costs while limiting by fiat, the rate charged so that it cannot seek its own level.[3] A competitive system, as will be demonstrated, cannot be "half free."

I. Economic Developments and Consumer Credit

Our economy is now experiencing serious and rampant inflation. The federal government, in attempting to control this inflation, has

2. Virginia interest rate legislation is based on a general contract maximum (VA. CODE ANN. § 6.1-330.11 (Repl. Vol. 1979) with numerous narrowly defined exceptions. These exceptions include statutory provisions for add-on rates (VA. CODE ANN. §§ 6.1-330.12 to -330.16 (Repl. Vol. 1979)), revolving and monthly rates (VA. CODE ANN. §§ 6.1-330.18 to -330.21 (Repl. Vol. 1979)), other charges on real estate loans (VA. CODE ANN. §§ 6.1-330.23 to -330.25 (Repl. Vol. 1979)), transactions not subject to usury (VA. CODE ANN. §§ 6.1-330.37 to -330.42 (Rep. Vol. 1979)) and borrowers not entitled to plead usury (VA. CODE ANN. §§ 6.1-330.43 and -330.44 (Repl. Vol. 1979)). Also interest rate regulations for small loan companies provide an exception to the general contract maximum rate. VA. CODE ANN. §§ 6.1-244 to -310 (Repl. Vol. 1979). There are separate rate regulations which govern every type of lender thus greatly segmenting the credit market and preventing overall competition for the same, highly mobile capital.

3. NATIONAL COMMISSION REPORT, *supra* note 1, at 4.

In Virginia, the Small Loan Act (VA. CODE ANN. §§ 6.1-244 to -.310 (Repl. Vol. 1979)) contains convenience and advantage statutes, basic licensing laws, which restrain free access to the consumer credit market without undue costs. Also, this Act has effectively eliminated some creditors' legal collection devices thus increasing bad debt and collection expenses. When such practices are accompanied by rate structures inconsistent with increased costs which must be covered, less credit is available than would be during equilibrium conditions.

imposed certain price controls and ceilings on some goods and services. But these controls and ceilings have not only failed to significantly control prices, but have caused a severe dislocation of the supplies of some goods and services.[4] Past attempts to control the price of credit by legislation have been similarly unsuccessful in protecting and meeting the needs of the citizenry.[5]

For example: "General usury statutes and other state laws limiting rates on home mortgages below free market rates have drastically reduced the availability of mortgage funds, the volume of home construction, and employment in the building trades."[6] Future attempts to control the price of credit by legislation should be avoided.

Since World War II, consumer credit has experienced such growth that it has become an almost expected part of everyday life.[7] However, "[c]onsumer credit is not a Twentieth Century phenomenon in the United States; it was an accepted fact of life in the early Colonies."[8] During the Nineteenth Century, usury laws, which this country had inherited from England, often prevented the granting of cash loans at economically feasible rates, so a legal installment loan market was, in essence, nonexistent. By 1900 a flourishing illegal market developed to meet the existing need for small cash credit.[9]

"As a result . . . a model bill known as the Uniform Small Loan Law was drafted to provide an exception to the usury law so that consumers could obtain small amounts of legal cash credits at cons-

---

4. Installment Credit Guide: Consumer Credit, UNIFORM CONSUMER CREDIT CODE, Issue No. 299, Aug. 1, 1974 (CCH) [hereinafter cited as U.C.C.C.], Prefatory Note at xii (Final Draft, Working Redraft No. 6).

5. *Id.* at x.

6. *Id.* at xii.

7. NATIONAL COMMISSION REPORT, *supra* note 1, at 5.

8. *Id.*

Not every sturdy and resourceful pioneer paid cash for his staples and his tools as some accounts of colonial life would have one believe. Furniture was often sold on an installment basis, and in the Nineteenth Century, pianos, books and sewing machines were sold on the same basis. M. NEIFELD, NEIFELD'S MANUAL ON CONSUMER CREDIT 16 (1961). In the early Twentieth Century, automobiles were paid for in monthly payments, and "[t]he rapid growth of the credit sale of automboiles provided the basis for both the mass market necessary to their economical production and a remarkable increase in the volume of consumer credit." E. SELIGMAN, THE ECONOMICS OF INSTALLMENT SELLING 42 (1927).

9. I. MICHELMAN, CONSUMER FINANCE: A CASE HISTORY IN AMERICAN BUSINESS 108 (1970).

cionable rates."[10] The development of credit unions (1909) and Morris Plan banks (1910) provided an increasingly important source of credit for consumers.[11] Thereafter, commercial banks entered the installment lending area and became virtually indistinguishable from Morris Plan banks whenever they were given the privilege of accepting demand deposits.[12]

Since 1950, consumer credit in this country has experienced tremendous growth, increasing over five times — a compound annual rate of growth of over nine percent.[13] The increase in the consumer credit outstanding was caused, in part, by changes in the ability and willingness of consumers to incur debt and by a continued shift towards the ownership of assets.[14]

Several factors have encouraged consumers' use of credit. There has been a profound change in the consumers' "discretionary income" — income over and above that required for necessary expenditures for food, clothing and shelter.[15] Such change can be seen in the shifts of family incomes in constant dollars.[16] Furthermore, the development of unemployment benefits and various forms of health insurance have resulted in more stable real income.[17] In-

10. NATIONAL COMMISSION REPORT, *supra* note 1, at 5. Initially, the model bill set the rate ceiling at 42% per annum. *Id.*

11. I. MICHELMAN, *supra* note 9, at 191-203. A Morris Plan bank is an industrial bank which accepts money from depositors for investment in certificates which draw interest periodically. These banks extend credit primarily to steadily employed salaried people requiring as security for repayment the endorsement of two other employed salaried people. The credit requirements usually call for installment payments over a one year period. Also, these banks will make other types of secured loans. Bd. of County Comm'rs of Tulsa County v. Remedial Fin. Corp., 186 Okl. 648, 100 P.2d 240, 242 (1940).

12. NATIONAL COMMISSION REPORT, *supra* note 1, at 5, 93.

13. *Id.* at 5.

14. *Id.*

15. *Id.;* discretionary income or supernumerary income is disposable personal income (income after income tax) less necessary living costs such as food and clothing and less fixed commitments such as debt payments. Many economic forecasters make use of measurements of discretionary income rather than the usual measures of Gross National Product or disposable personal income because they feel that the sale of consumer durables relates more closely to income after the deduction of certain regular expenses than it does to total income. W. HAYNES AND W. HENRY, MANAGERIAL ECONOMICS: ANALYSIS AND CASES 149 (1974).

16. DEPARTMENT OF COMMERCE, *Current Population Reports,* Series P-60, No. 83 at 6 (1972). In 1950 less than 50% of all families had incomes of $5,000.00 or more in terms of 1971 dollars, but by 1971 over 80% had incomes of at least $5,000.00. *Id.;* NATIONAL COMMISSION REPORT, *supra* note 1, at 5-6.

17. NATIONAL COMMISSION REPORT, *supra* note 1, at 6. Real income is a measure of the real

creased urbanization of the population coupled with the greater dependence on money incomes, created a greater dependence on credit to finance the urban life and to cushion the variability in money incomes, which encouraged consumers' use of credit.[18] The changing age distribution of the population has affected consumers' use of credit by allowing young married consumers to use future income to pay for present purchases.[19]

In the last two decades consumers have become asset ownership oriented, increasing their ownership of durable consumer goods through the use of credit. This shift to asset ownership is exemplified by the increase in ownership of homes since the 1950's.[20] This increase in home ownership has been accompanied by a suburbanization of the population, creating needs for credit to enable consumers to purchase refrigerators, washing machines, lawn mowers, clothes dryers and, often, second cars.[21] Such shift to asset ownership can probably be explained as the consumers' desire to substitute the use of consumer-owned capital goods for the use of commercially-owned capital goods.[22] Furthermore, the trend to asset ownership was furthered by the movement of women to the labor force which freed the housewife from the kitchen and the

---

dollars of income as compared with some point in time in history thus yielding a constant dollar value of income for comparable times in history. No doubt, real income has been bolstered by the addition of unemployment benefits and constant disposable income has increased with less need for individuals to pay medical expenses and health insurance premiums.

18. *Id.* Over 15% of the total population of the United States lived on farms in 1950, however less than 5% lived on farms in 1970. Today the electronic media's widespread availability has created a uniformity in life styles among farm and urban consumers, therefore, their demands for consumer credit differ much less than they did in the years prior to 1950. *Id.*

19. NATIONAL COMMISSION REPORT, *supra* note 1, at 6; DEPARTMENT OF COMMERCE, *Special Studies,* Series P-23, No. 40 at 7 (1972). Between 1950 and 1971 the number of people between 18 and 24 years of age increased by 50% as compared to an increase of only 33% in the number of persons of all other ages. *Id.*

20. DEPARTMENT OF COMMERCE, *Consumer Buying Indicators,* Series P-65, No. 40 at 8 (1972); *see* Fed. Res. Bull. May, 1979.

Although the credit used to acquire homes is not statistically a part of consumer credit outstanding, with government support of housing the percentage of owner occupied houses rose from 55% of total housing in 1950 to over 64% in 1970, and the percentage of "two car families" rose by almost 14% in the 1960's. *Id.; see also* Fed. Res. Bull., May, 1979.

21. CONSUMER BUYING INDICATORS, *supra* note 20, at 8; NATIONAL COMMISSION REPORT, *supra* note 1, at 6.

22. NATIONAL COMMISSION REPORT, *supra* note 1, at 6.

laundry room for recreation and employment which necessitated the use of labor-saving devices in the home.[23]

There are basically two types of consumer credit outstanding: (1) installment credit (that which is scheduled to be repaid in two or more payments), and (2) non-installment credit (that which is scheduled to be repaid in a single, lump sum). Over the last thirty years installment credit has grown much more repidly than non-installment credit,[24] and this is reflected by the shift to asset ownership — the purchase of consumer durables. During the same period, consumer installment credit outstanding has risen more rapidly than monthly installment payments.[25] This is due in part, to the

23. *Id.* at 7.

24. *Id.* at 8; Fed. Res. Bull., April, 1979.

CONSUMER CREDIT OUTSTANDING
End of Year, billions of dollars

Year	Total Consumer Credit	Installment Credit	Noninstallment Credit
1955	38.8	28.9	9.9
1960	56.1	43.0	13.2
1961	58.0	43.9	14.1
1962	63.8	48.7	15.1
1963	71.7	55.5	16.3
1964	80.3	62.7	17.6
1965	89.9	70.9	19.0
1966	96.2	76.2	20.0
1967	100.8	79.4	21.4
1968	110.8	87.7	23.0
1969	121.1	97.1	24.0
1970	127.0	101.9	25.1
1971	138.6	111.2	27.4
1972	157.2	126.8	30.5
1973	179.0	146.4	32.5
1974	188.7	155.4	33.4
1975	197.3	162.2	35.0
1976	217.8	178.8	39.0

Note: Data are revised beginning 1970. Earlier data not strictly comparable. Later data not available through Federal Reserve Sources. Source: Fed. Res. Bull., April, 1979.

25. NATIONAL COMMISSION REPORT, *supra* note 1, at 8. Fed. Res. Bull. April, 1979. Between 1950 and 1976 consumer installment credit outstanding rose by almost six times while the annual level of repayments rose by only 4.5 times. Fed. Res. Bull. April, 1979.

long debt maturities that have become available and, to a smaller degree, to the development of various forms of revolving credit often used as a substitute for non-installment credit.[26]

Consumer credit has always been an economic fact of life in the United States. The growth of consumer credit has naturally accompanied the growth of other forms of debt, both public and private. The rising amount of discretionary income has undoubtedly encouraged the use of credit by consumers. Although there has been a large increase in consumer credit outstanding, a study of available data in no way indicates a dangerous situation of overindebtedness. A small portion of the total consumer population resorts to bankruptcy each year, but the majority of consumers are able to meet their obligations.[27]

II. Virginia Interest Rate Statutes

While a majority of the states have active legislation regulating interest rates which fix a legal or conventional rate to be applied in the absence of contract interest and also fix a general maximum contract rate, in many states there are so many exceptions that the general contract maximum actually applies only to exceptional cases.[28] Such is the case in Virginia where, by statute, interest rates and regulations vary depending upon the particular type of credit transaction and the creditor involved.[29]

26. National Commission Report, *supra* note 1, at 8.

27. During the early 1960's the rate of nonbusiness bankruptcies per 100,000 of population rose from 73 to 85. However, since 1965 there has been a stabilization of bankruptcies in the nonbusiness sector.

NONBUSINESS BANKRUPTCIES PER
100,000 OF POPULATION
(Fiscal year ending in June)

1961 - 73	1966 - 90	1972 - 79
1962 - 72	1967 - 98	1973 - 74
1963 - 75	1968 - 92	1974 - 80
1964 - 82	1969 - 85	1975 - 105
1965 - 85	1970 - 88	1976 - 98
	1971 - 88	1977 - 84

28. Banfield, *Money, Mortgages and Migraine - The Usury Headache,* 19 Case W. Res. L. Rev. 819 (1968).

29. Va. Code Ann. §§ 6.1-330.6 to -330.48 (Repl. Vol. 1979). The legal rate of interest in Virginia is 6% per annum, while the general maximum contract rate in Virginia is 8% per

Statutory interest rates range from 5 to 7 percent, and the general interest laws in most states set a maximum rate of between 8 and 12% per year.[30] Loans to corporations are frequently exempt from such interest regulations and are subject to a higher maximum, and in recent years it has been common to provide special rates for home mortgage loans.[31] Special statutes in many states permit industrial loan companies and banks to charge interest and fees without regard to installment payments which yield 1.5% per month or more.[32]

Although courts have held that installment sale charges are not interest, many states have limited installment sale charges by statute.[33] Charge accounts are usually regulated by laws which generally permit charges of up to 1.5% per month.[34]

Many consumer finance loan statutes, attempting to legislate small loans to wage earners under protective regulations, were based on early models drafted by the Russell Sage Foundation in the early 1900's.[35] Since 1969, the model has frequently been the Uniform Consumer Credit Code (U.C.C.C.) which applies to credit sales and loans for consumer purposes up to $25,000.00.[36] The U.C.C.C. will be examined in more detail below.

---

annum (§§ 6.1-330.9 and -330.11). The exceptions to the general contract maximum rate allowed include statutory provisions for add-on rates (§§ 6.1-330.12 to -330.16), revolving and monthly rates (§§ 6.1-330.18 to -330.21), other charges on real estate loans (§§ 6.1-330.23 to -330.25), transactions not subject to usury (§§ 6.1-330.37 to -330.42) and borrowers not entitled to plead usury (§§ 6.1-330.43 and -330.44). Also interest rate regulations for small loan companies provide an exception to the general contract maximum rate. (§§ 6.1-244 to -310). These exceptions cover the vast majority of credit market opportunities.

30. THE WORLD ALMANAC AND BOOK OF FACTS 1978, 72.

31. *Id.* Virginia provides for home mortgage loan rates depending upon the rate of interest contracted for and stated within the contract secured by a first deed of trust or first mortgage on real estate. By statute this transaction is not subject to usury or subject to any special limitations as to usury. VA. CODE ANN. § 6.1-330.37 (Repl. Vol. 1979).

32. *Id.* Virginia allows any seller or lender engaged in the extension of credit under an open-end credit plan to charge a service charge not to exceed 1.5% per month on any unpaid balances not paid in full within 25 days. VA. CODE ANN. § 6.1-330.20 (Repl. Vol. 1979).

33. *E.g.*, VA. CODE ANN. § 6.1-330.21 (Repl. Vol. 1979).

34. *E.g.*, VA. CODE ANN. § 6.1-330.20 (Repl. Vol. 1979).

35. I. MICHELMAN, CONSUMER FINANCE: A CASE HISTORY IN AMERICAN BUSINESS at 78-82 (1970). In the early 1900's the Russell Sage Foundation studied illegal loan companies in large cities throughout the United States and disclosed annual rates of charge of well over 200% which were often accompanied by "harsh collection tactics." *Id.*

36. The U.C.C.C. was promulgated by the National Conference of Commissioners on Uniform State Laws which also prepared the widely accepted Uniform Commercial Code (U.C.C.).

While Virginia statutes define most interest rate ceilings in terms of "charge in advance" or what is more commonly known as add-on interest,[37] lenders and providers of credit are required by truth-in-lending statutes and Regulation Z to quote the cost of consumer credit in terms of an annual percentage rate.[38] The statutes which define interest rates are in conflict with annual percentage rate disclosure and undoubtedly create confusion among both creditors and consumers of credit alike.[39]

Virginia has a substantial body of legislation which regulates interest rates.[40] While these laws fix a legal or a conventional rate which applies in the absence of a contract interest rate, they also fix a general maximum contract rate as well as a judgment rate of interest.[41] But Virginia's interest rate legislation does not end there. There are many exceptions to the general contract maximum rate allowed, and, in fact, the general contract maximum rate applies

---

37. VA. CODE ANN. § 6.1-330.12 (Repl. Vol. 1979).

38. VA. CODE ANN. § 6.1-330.17 (Repl. Vol. 1979); *see also* 15 U.S.C. § 1606 (1976); *see generally* U.C.C.C. § 3.301(2).

The Federal Truth in Lending Act refers to Title I of the Consumer Credit Protection Act (Pub. L. No. 90-321, 82 Stat. 146 (codified at 15 U.S.C. §§ 1601 *et seq.* (1976) (as amended)). Prior to Truth-in-Lending it was virtually impossible for a consumer to compare costs of credit offered by competing creditors. Interest rates were calculated on diverse bases because of a bewildering variety of state laws, differing by types of creditor and category of credit. Truth-in-Lending provides one standard measure of interest rates applicable to all credit transactions that would include all the costs of credit in a single calculation. This concept is called annual percentage rate (APR). Accurate computation of APR is vital to banks under control of the Federal Reserve Bank due to Regulation Z, a regulation issued by the Board of Governors of the Federal Reserve System.

39. Certain creditors in Virginia are regulated by rate ceilings which allow them to "charge in advance" a legislated rate of interest per centum per annum. VA. CODE ANN. §§ 6.1-330.13 to -330.15 (Repl. Vol. 1979). "Charge in advance" when applied to installment loans means that the interest may be added to the principal amount of the note but may not be deducted from the amount. VA. CODE ANN. § 6.1-330.12 (Repl. Vol. 1979). Since the interest charged is added to the principal amount of the loan the actual interest paid (APR) for such a loan is somewhat higher than the statutory rate depending upon the amount, duration and payment requirements of the particular loan. Virginia law, in compliance with Truth-in-Lending, requires that the cost of consumer credit be quoted in terms of APR. VA. CODE ANN. § 6.1-330.17 (Repl. Vol. 1979). Therefore, creditors in Virginia must calculate their interest charges in at least two different manners in order to assure compliance with Virginia law as well as Truth-in-Lending.

40. VA. CODE ANN. §§ 6.1-330.9 to -330.48 (Repl. Vol. 1979).

41. VA. CODE ANN. §§ 6.1-330.9 to .11 (Repl. Vol. 1979). The legal rate of interest is 6%, the judgment rate of interest is 8% and the maximum contract rate of interest is 8%, all on an annual basis.

only to exceptional cases.[42] Such interest rate legislation provides different maximum allowable rate charges depending upon the type of creditor.[43] Types of creditors specifically spelled out in Virginia interest rate legislation range from banks and savings and loan associations to credit unions and industrial loan associations.[44] Such legislation also limits the charges allowable for small loans and charges by sellers and lessors of consumer goods.[45]

Virginia interest rate legislation is at best confusing. It also restrains competition by interest rate ceilings which restrict the amount of available credit for all types of consumers.[46]

III. U.C.C.C., The Economics of Rates and Availability of Credit

The U.C.C.C. advocates abolishing the "patchwork welter of prior laws on consumer credit" and replacing it with a single, comprehensive law with a modern, theoretical and pragmatic structure "designed to provide an adequate volume of credit at reasonable cost under conditions fair to both consumers and creditors."[47] "[S]eparate, uncoordinated statutes governing the activities of dif-

---

42. Va. Code Ann. § 6.1-330.11 (Repl. Vol. 1979). *Supra* note 29.

43. Va. Code Ann. §§ 6.1-330.13 to .16, .18 to .21, .23 and .24 (Rel. Vol. 1979). Banks and savings and loan associations charge in advance at a rate of 7% per annum while industrial loan associations and lendors other than those licensed by the State Corporation Commission or the federal government may charge in advance at a rate of 8% per annum. Credit unions may lend to their members at a rate not to exceed 1% per month, computed on unpaid balances, as compared with revolving credit rates of 1.5% per month. Sellers of consumer goods may charge a rate not to exceed 2% per month on the balance at the end of the billing period next preceding each successive payment. *Id.*

44. Va. Code Ann. §§ 6.1-330.13 to -330.16, -330.18, -330.21, -330.23 and -330.24 (Repl. Vol. 1979).

45. Va. Code Ann. § 6.1-330.21 (Repl. Vol. 1979).

46. *See supra* notes 39 and 45.

Because capital is so mobile, thus providing an effective method of shifting resources in the economy to their utmost potential, it is difficult to insulate that part of the capital market which comprises consumer credit from other segments of the market. Attempts to reduce interest rates in one part of the market are likely to drive funds out of that segment and into more rewarding uses, thereby showing the effect which will be produced given interference with the free market system. Rate ceilings tend to produce "savings" for the small number of debtors who will be served in the "protective" portion of the market. However, any "savings" is at the expense of those who can no longer be provided credit at the reduced rates. I. Friend, et. al., Study of the Savings and Loan Industry (Federal Home Loan Bank Board, 1969).

47. U.C.C.C., *supra* note 4, Prefatory Note at viii.

ferent types of creditors in disparate ways . . ." would be eliminated.[48]

The National Conference of Commissioners on Uniform State Laws followed several basic assumptions in drafting the U.C.C.C. Its members believed that consumer credit legislation should be contained in one uniform law to provide quick and effective interpretation from a legal viewpoint.[49] They also believed it would perpetuate the successful American philosophy of permitting competition to determine prices of non-monopoly commodities and services. This philosophy was thought to be applicable to the pricing of money market rates determining consumer credit interest rates.[50] The National Conference realized, however, that in order for competition to exist and effectively determine the pricing of money and credit, there was a need to avoid any monopoly in the consumer credit market.[51] Relatively easy entry into the market was necessary.[52] There was also a need to make all credit recipients as equal as possible. An attempt was made to eliminate or minimize controls by knowledgeable and sophisticated credit recipients while at the same time providing protection for less sophisticated credit recipients by requiring uniform disclosure of credit costs and terms. Usury laws were not believed to be an effective means of fixing all prices in the various interest rate markets.[53]

48. *Id.*
49. *Id.*
50. *Id.* at x to xii.
51. *Id.* at xii to xiii.
52. *Id.* at xii.
53. *Id.* at xi.
The U.C.C.C. has been adopted in the following jurisdictions:

Jurisdiction	Effective Date	Statutory Citation
Colorado	10-1-1971	C.R.S. '73, §§5-1-101 to 5-9-103.
Idaho	7-1-1971	I.C. §§28-31-101 to 28-39-108.
Indiana	10-1-1971	I.C. 1971, §§24-4.5-101 to 24-4.5-6-203.
Iowa	6-3-74*	I.C.A. §§537.1101 to 537.7103.
Kansas	1-1-1974	K.S.A. 16a-1-101 to 16a-9-102.
Maine	3-27-1974*	9A M.R.S.A. §§1-101 to 6-415.
Oklahoma	7-1-1969	14A Okl. St. Ann. §§1-101 to 9-103.
South Carolina	1-1-1975	Code 1962, §§8-800.101 to 8-800.541.

Interactions of suppliers of credit and potential borrowers must be free from all restrictions. In general, any kind of imperfection in the credit market can have a potential effect on credit availability. The most common imperfections are legal constraints, regardless of intent, and the most significant legal constraints are rate ceilings, restrictions on other credit terms (such as loan size and maturity), restrictions on the entry into the market of new suppliers of credit, and limitations on creditors' remedies. The legal factors which have perhaps the greatest effect on the availability of credit are restrictive rate ceilings which limit the number of borrowers who qualify for legal credit and reduce the amount of credit supplied.[54] Ease of market entry for new suppliers is a basic principle of any free competition system, and any barriers to entry in the consumer credit market will lessen competition.[55]

The U.C.C.C. was drafted on the premise that credit availability could be defined as the degree to which creditors are willing to provide credit at the free market rate in a world without imperfections.[56] Although that is somewhat unrealistic, the ideal market (one without imperfections) can be successfully used to assess the relative availability of credit under market conditions that deviate from the ideal. The U.C.C.C. strives for a truly competitive market in which rates reach competitive equilibrium levels through a series of adjustments by suppliers of various credit offers to various risk

---

* Date of approval.

. Kansas, Maine and Iowa adopted the major provisions of the 1974 U.C.C.C., but their adoptions contain numerous variations, omissions and additional matter. Most other states that adopted the U.C.C.C. did so with only minor variations, e.g., provisions relating to billing errors, credit card sales and credit discrimination. All of the adoptions referred to above were made before the final version of the U.C.C.C. as promulgated by the National Conference of Commissioners on Uniform State Laws at its 1974 meeting. 7 U.L.A. BUSINESS & FINANCE LAWS 583 (1978).

54. NATIONAL COMMISSION ON CONSUMER FINANCE, AN ECONOMETRIC ANALYSIS OF CONSUMER CREDIT MARKETS IN THE UNITED STATES (D. Greer & R. Shay eds. 1972) [hereinafter cited as Greer & Shay]. Interest rate ceilings often lead to increased market concentration which forces less sufficient credit suppliers out of the market because they cannot compete at the restricted rate. As a result, the remaining creditors control a larger share of the market. If the degree of market concentration is sufficient to induce noncompetitive behavior, credit availability will be further reduced. Sales credit rate ceilings, are usually nonexistent or very high. If the rate is set too low, creditors are often forced to shift a portion of the finance charge into the cash price, thereby forcing cash buyers to subsidize credit buyers.

55. U.C.C.C., *supra* note 4, Prefatory Note at xii.

56. NATIONAL COMMISSION REPORT, *supra* note 1, at 112.

classes of consumers.[57] These equilibrium levels allow creditors to cover cost and to earn a normal return on invested capital. Then creditors are willing to extend any amount of credit to qualified borrowers at such profitable rates. This can be characterized as full credit availability.[58]

Economic historians have developed two conflicting views as to how reasonable rates for consumer credit transactions can be assured. One view is that the price of credit should be established by the market, unhindered by direct government interference ("free rates").[59] The other view is that there should be price ceilings on consumer credit ("decreed rates").[60]

The position of the drafters of the U.C.C.C. approaches the free rates view and is perhaps best stated by noted economist Milton Friedman:

> I know of no economist of any standing . . . who has favored a legal limit on the rate of interest that borrowers could pay or lenders received—though there must have been some . . . . Bentham's explanation of the "mischief and the anti-usurious laws" is also as valid today as when he wrote that these laws preclude "many people, altogether from getting the money they stand in need of, to answer their respective exigencies." For still others, they render "the terms so much the worse . . . While, out of loving-kindness, or whatsoever other motive, the law precludes a man from *borrowing*, upon terms which it deems too disadvantageous, it does not preclude him from selling, upon any terms, howsoever disadvantageous." His conclusion: "The sole tendency of the law is to heap distress upon distress."[61]

While many reasons have been advanced to justify placing upper limits on interest rates charged for the use of credit, the most often

57. *Id.* In an imperfect credit market, many creditors set a "base rate" for potential debt customers and accept only those sufficiently creditworthy to meet the "base rate". Whereas under perfectly competitive conditions, a credit grantor would have to give a rate consistent with the debtor's risk or else lose the business to another more willing creditor.

58. Greer & Shay, *supra* note 54.

59. NATIONAL COMMISSION REPORT, *supra* note 1, at 91. Milton Friedman and Jeremy Bentham are two noted economists who espouse this view. *Id.*

60. *Id.* Economist Leon Keyserling is a supporter of this viewpoint. *Id.*

61. Friedman, *Defense of Usury*, NEWSWEEK, April 6, 1970, at 79 (emphasis added).

voiced justification stresses that the unequal bargaining power of debtors versus creditors would allow the creditors to charge what the credit market will bear: the ceiling rate. Advocates of interest rate ceilings assume that most consumers are not knowledgeable about the complexities of finance charges, are incapable or unwilling to use Truth-In-Lending information and do not shop for credit.[62] The drafters of the U.C.C.C., on the other hand, believe that only when the interest rate price ceiling is set at or below the market rate for the particular form of credit placed under price control, will rates rise to the ceiling.[63] Persuasive evidence that rates do not inevitably rise to the ceiling was significantly reinforced in the study by the National Commission on Consumer Finance of rates prevailing for various forms of consumer credit.[64] If a rate is set above the market rate, the market rate will prevail and average rates of charge will not rise to the statutory ceilings. However, if rate ceilings are set at or below the market rate, rates will generally be at the ceiling.[65]

Credit consumers are certainly not wholly knowledgeable about finance charges, nor do they appear to shop as intensely as they do for the financed goods. Ignorance and inertia among borrowers, combined with the absence of competition among suppliers, can often lead to higher interest rates in some consumer credit markets.[71] "As a result, unequal bargaining power may exist, and in the

62. Fritz, *Would the Uniform Consumer Credit Code Help the Consumer?*, BUSINESS LAW, January, 1970, at 512.

Economist Leon Keyserling testifying before the Congressional Subcommittee on Consumer Affairs of the Committee on Banking and Currency stated:

> I find it deplorable that we feel bound to set an 18 percent interest rate ceiling for these people, which is three times the rate at which a powerful corporation can borrow money on bonds while many of our greatest corporations finance themselves and do not have interest costs of large significance. I think the ceiling shouuld be very much lower . . . I am not going to take the position that even 12 percent is a conscionable interest rate for the kind of people borrowing money for these kinds of purposes. They ought to be able to borrow for much less, even if this requires new public programs.

NATIONAL COMMISSION REPORT, *supra* note 1, at 91.

63. U.C.C.C., *supra* note 4, Prefatory Note at xi.

64. M. SCHOLER & R. SHAY, STATE & REGIONAL ESTIMATES OF THE PRICE AND VOLUME OF THE MAJOR TYPES OF CONSUMER INSTALLATION CREDIT IN MID-1971 (NCCF, 1972); R. SHAY, THE IMPACT OF STATE LEGAL RATE CEILINGS UPON THE AVAILABILITY AND PRICE OF CONSUMER INSTALLMENT CREDIT (NCCF, 1972).

65. R. SHAY, THE IMPACT OF STATE LEGAL RATE CEILINGS UPON THE AVAILABILITY AND PRICE OF CONSUMER INSTALLMENT CREDIT (NCCF, 1972).

absence of alternate credit sources, leads to higher rates, or restricted credit availability (or both) . . . ."[66]

Perfect knowledge and intense shopping behavior are not, however, prerequisites to a workably competitive maket. In order for a market to offer opportunities for credit at reasonable rates, there need only be some consumers who are willing to shift to lower rate or price sources in a market where existing competitors compete and where new competitors enjoy ease of entry.[67] "[T]he use of (inter est) rate ceilings to correct instances of unequal bargaining power and an absence of alternative credit sources is largely ineffective."[68] The philosophy of the U.C.C.C. lends itself to competition and ease of entry by new competitors into the consumer credit market, thereby enabling consumers to shift to lower rate or price sources.[69]

On balance, consumer credit rate ceilings are undesirable when credit markets are reasonably competitive. Perhaps economist Jeremy Bentham best summarizes the futility and improbabilities associated with credit rate ceilings. It was his position that rate ceilings on consumer credit transactions do not assure that most consumers will pay a fair price for the use of credit and do not prevent overburdening them with excessive debt. Ultimately, Bentham noted, rate ceilings restrict the supply of credit and eliminate credit from consumer credit markets.[70] This situation can be changed by eliminating rate ceilings and relying on competition to ensure that borrowers pay reasonable rates for the use of credit. But rate ceilings cannot be eliminated until workably competitive credit markets

66. NATIONAL COMMISSION REPORT, *supra* note 1, at 96.

67. *Id.*

68. *Id.* at 99.

69. U.C.C.C., *supra* note 4, Prefatory Note at xii.

> In advocating primary reliance on the market place to control the price of credit, the National Conference has recognized the fundamental importance of competition to permit market forces to operate most effectively, a recognition consistent with the conclusions of the National Commission on Consumer Finance. In moving away from the segmented controls of particular types of credit grantors in consumer credit laws prior to the U.C.C.C. to a single comprehensive statute dealing with consumer credit generally, it is believed that competition has been and will be enhanced.

Id.

70. J. BENTHAM, DEFENCE OF USURY SHEWING THE IMPOLICY OF THE PRESENT LEGAL RESTRAINTS ON THE TERMS OF PECUNIARY BARGAINS; IN LETTERS TO A FRIEND TO WHICH IS ADDED A LETTER TO ADAM SMITH, ESQ., LL.D. ON THE DISCOURAGEMENT OPPOSED BY THE ABOVE RESTRAINTS TO THE PROGRESS OF INVENTIVE INDUSTRY, at 29 (3d ed. 1816).

exist. Policies designed to promote competition should be given first priority, with adjustment of rate ceilings used as a complement to expand the availability of credit. Then, as the development of workably competitive markets decreases the need for rate ceilings to combat market power in concentrated markets, those ceilings may be raised or removed. The U.C.C.C. is promulgated in accordance with these ideas and goals.

While the drafters of the U.C.C.C. strove to provide for competition within the consumer credit market to allow for lower interest rates, they were not unaware of problems which could arise within the consumer credit area. Perhaps the most compelling of such problems is whether credit rate ceilings assure that debtors pay fair rates for money borrowed. Are credit rates fair for some or for all, and fair for whom, if not for all? There is also a problem in judging the fairness of rates without judging the associated terms under which credit is granted; without doubt, the entire credit package — the credit offer function — is complex with features that have differing values to different debtors.[71] There exists no generally acceptable standard for which a fair rate of interest can be determined.

Consumers' eagerness to acquire goods and services financed with credit and a desire of creditors to provide credit create a climate conducive to the growth of excessive use of credit. Forces exist and operate within the credit system, however, to counteract excessive use of credit. Creditors hesitate to extend credit if they doubt that the consumer can repay the loan. Every extension of credit becomes a debt, and as the consumer becomes progressively burdened with the debt, the odds against repayment increase, and the likelihood that the creditor will accept the applicant decreases.[72]

Although it is suggested that credit grantors and consumers have been cautious in arranging obligations, some individual consumers have problems repaying their debts. Since 1965, there has been a stabilization of bankruptcies in the non-business sector.[73] A survey

71. NATIONAL COMMISSION REPORT, *supra* note 1, at 103. The credit offer function is made up of such ever changing variables as (1) amount borrowed, (2) credit duration, (3) repayment schedule, (4) debtor risk class, (5) type of security, if any, (6) interest rate charged and (7) class of credit transaction (i.e., cash credit v. sales credit).

72. *Id.*

73. M. Ryan & E. Maynes, *The Excessively Indebteded. Who and Why*, J. CONS. AFF. 107-26 (1968). *Supra* note 27.

conducted by the National Commission on Consumer Finance showed that unemployment and illness were the first and third most important reasons, respectively, for debtors' failures to meet their obligations, which supports a basic assumption of our economic system that most consumers and creditors are rational.[74] The basic principles underlying the U.C.C.C. are good for the consumer and for the consumer credit market. The problem, if any, of excessive use of credit does not reflect on the basic assumptions underlying the U.C.C.C.

IV. Automobile Financing: An Illustration[75]

Over fifty-eight percent of automobile consumer installment credit in the United States is held by commercial banks, and over fifty-five percent of that debt is held by way of "indirect paper."[76] In Virginia, as elsewhere, there are basically two types of automobile consumer credit: that which originates with the dealer (and is available to become indirect paper held by commercial banks) and that which originates with a bank or some other financial institution as a direct lending contract.[77]

Most indirect automobile consumer credit or third-party loans are "bought" from the automobile dealer by either commercial banks or the automobile dealer's credit corporation, e.g., Ford Credit, Chrysler Credit and G.M.A.C. The interest rate on these indirect loans is governed by statute and yields a maximum rate of 2% per month.[78] The indirect loans are capable of yielding interest income of 24% per annum on annual percentage rate ("APR") basis, while direct loans made by commercial banks or other financial institutions can yield only in a range of from 7% add-on to 8% add-on[79] plus

---

74. National Commission Report, *supra* note 1, at 101.

75. Much of the data contained in this section was obtained by means of interviews with local commercial bank officers and automobile dealers and from surveys of existing interest rates across the state. The other sources cited herein bear out the findings from such interviews and surveys.

76. Fed. Res. Bull., May, 1979. Indirect paper or third-party loans are loans made by one creditor (i.e., automobile dealer) and then "bought" from the first creditor by a second creditor such as a commercial bank.

77. National Commission Report, *supra* note 1, at 114-15.

78. Va. Code Ann. § 6.1-330.21 (Repl. Vol. 1979).

79. Va. Code Ann. §§ 6.1-330.13 to .16 (Repl. Vol. 1979).

a one time, 2% service charge.[80] The typical 7% add-on loan for $3,000.00 with a 2% service charge yields an APR of 10.47% if paid over a three month period and 12.88% if paid in thirty months. This is quite a bit less than the 24% APR possibility for dealer financing of consumer goods directly.[81]

As previously demonstrated, however, such differences in interest rate ceilings, based solely upon where the consumer seeks to obtain the necessary credit, are not as important as the amount of competition in a particular credit market in Virginia. In the city of Richmond, for example, a very competitive automobile consumer installment credit market exists, and indirect consumer installment credit loans and direct consumer installment credit loans are made at basically the same rate, i.e. between 5.5% and 6.5% add-on.[82] The interest rate for indirect financing is often the same or lower than the rate for direct financing in such a competitive market. There is less cost involved to the ultimate supplier of the credit funds — usually the commercial bank[83] — because there is little overhead involved in its processing of indirect paper.

Because the bank sets the dealer's rate and buys the paper from the dealer, there is little need for costly advertising. The automobile dealer does essentially all the paper work, and the bank, which works very closely with the dealer, thereby acquires a new "branch" which specializes in the installment credit lending business.[84] The benefits to the consumer are abundant under such circumstances, and therein lies the major virtue of the highly competitive consumer installment credit market.[85]

In most of the state, especially in rural areas with a heavy market concentration by a particular creditor, the automobile consumer installment credit market is not competitive. Forty to sixty percent of the consumer installment credit portfolios of commercial banks doing business in those areas consist of indirect or third-party lend-

80. VA. CODE ANN. § 6.1-330.13 (Repl. Vol. 1979).
81. VA. CODE ANN. § 6.1-330.21 (Repl. Vol. 1979).
82. *Supra* note 75.
83. *Id.*
84. *Id.*
85. NATIONAL COMMISSION REPORT, *supra* note 1, at 3.

ing contracts.[86] But this does not reflect the total magnitude of indirect or third-party lending contracts in the state because of the large number of indirect loans purchased from dealers by the automotive credit corporations.

In such rural areas, where competition for loans is not keen, the automotive credit corporations and other financial institutions demand and get any interest rate that the market will bear: 1.5% to 2.5% add-on higher than rates in the competitive market areas of Virginia, or, expressed as APR, 2% to 4.5% higher.[87]

The inequities of the automobile consumer credit market in Virginia clearly illustrate that the competitiveness of credit markets has a tremendous influence on the interest rate which consumers will have to pay for installment credit. Interest rate ceilings have only limited competitiveness in certain consumer installment credit markets, and do not benefit the consumer. To alter this unhealthy situation, new lenders must be allowed to generate a fair rate of return on their capital funds or they will lack the incentive to become competitors in the market.[88] To have unequal interest rate ceilings for dealers and non-dealer lenders is harmful to the consumer. A change is needed so that all consumer installment credit lenders will be able to obtain a fair return. The result will be that over the long-term, competition among creditors will keep interest rates at as low a level as possible in light of the overall money and capital markets.

Simply stated, using the automobile financing example outlined above:

1. Virginia automobile dealers, unlike non-dealer suppliers of consumer credit, are permitted by statute[89] to charge interest on credit extended to the consumer at a rate which could reach 24% APR.

2. In most of the state the automobile consumer credit market is not competitive. The dealers, induced by their creditors to do so, often demand and get whatever rate the market will bear, limited

86. *Supra* note 75.
87. *Id.*
88. *Supra* notes 55 and 67.
89. VA. CODE ANN. § 6.1-330.21 (Repl. Vol. 1979).

only by a statute which is really no limit at all. The dealers sell such high interest paper only to their creditors, presumably in return for concessions as to the dealers' own financing needs.

3. In the Richmond area, on the other hand, where competition is keener in the automobile consumer credit market, financing is at much lower interest rates.

4. In order to treat the other citizens of the state to Richmond-area-rates, the solution is simple: allow non-dealers to enter the consumer credit market presently protected by statute for that special class of creditor, the dealer. Eliminate the distinction between lenders made by that statute. The resulting increase in competition will undoubtedly provide lower interest rates in the automobile consumer credit markets throughout much of the state.

V. Conclusion

The primary roles of legislation and regulation in the consumer credit area should be to promote and assure the maintenance of real competition in the form of numerous alternate sources of supply of a variety of forms of consumer credit and to provide, so far as is possible, for informed consumer credit decisions. Virginia, as most other states, has developed a complex pattern of exemptions from the usury and interest rate laws. The Virginia General Assembly should remove impediments to competition and segmentation of consumer credit suppliers to achieve the broadest penetration by all creditors in all fields of consumer credit. Such legislative action would assure the consumer of a "variety of credit sources and types of credit and, consequently . . . the benefits of a competitive marketplace."[90] To assure that competition is meaningful, legislators and regulators must also be vigilant in providing the basis for the consumers' "right to know."[91] Perhaps the General Assembly should follow the cue of the U.C.C.C. and act in a positive manner to provide consumer credit laws in a single, well-ordered code, easily understandable to all concerned — creditors, consumers and their lawyers. This would contain realistic interest rate ceilings that will foster legitimate credit markets and allow the forces of competition

90. National Commission Report, *supra* note 1, at 3.
91. *Id.* at 4.

to seek natural and reasonable levels of interest rate charges — equilibrium levels — while providing full disclosure of credit transactions to all consumers. At the very least, the arbitrary distinction between financing by retail sellers of consumer goods (dealers) and other lenders should be immediately abolished by legislative amendment so that there can be an increase in the number of suppliers of credit to Virginia consumers.

Although relatively few states have adopted the U.C.C.C., Virginia would be well advised, in the face of an ever expanding economic environment, to adopt legislation based upon the principles underlying the U.C.C.C. This would provide its citizens with a reasonable balance between the interests of consumers and the interests of the consumer credit industry.