Rate Regulation under the UCCC

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Rate Regulation Under the UCCC

I. INTRODUCTION

The UCCC's treatment of rate regulation, i.e., setting high rate ceilings and relying on competition to prevent the ceiling from being reached, is one of its most controversial provisions. A general public attitude exists that any charge for interest up to six percent per annum is in the legitimate area; but any charge in excess of six percent is illegitimate, usurious and simple "highway robbery." Nevertheless, interest rates often exceed six percent and, in the consumer credit market, often reach into the upper thirties.2

Politically prudent legislatures have developed a method which creates the public impression that interest rates are reasonable while allowing the lender the necessary interest to make the lending of money commercially feasible. This has been accomplished by the enactment of complex interest statutes that appear to the untrained eye to set a low rate of interest, but in reality allow rates two to three times that which the ordinary purchaser believes he is paying.3

Views differ as to what better aids the consumer. The consumer feels that lower interest rates help him in that he will have less to pay back. The consumer credit industry argues that lower interest rates mean fewer loans and that consequently only the best credit risks will be offered needed credit. A third

2. See, e.g., Minnesota's Small Loan Act, MINN. STAT. § 56.13 (1969), which allows for a rate not exceeding 2.75 percent per month on the unpaid balance of a loan not exceeding $300. This computes out at 33 percent annual interest under Regulation Z of the Truth in Lending Law, 12 C.F.R. § 226.5 (1970). See also Interest-Usury and Small Loan Charts in 1 CCH CONSUMER CREDIT GUIDE ¶ 510, 540 (1970).
3. Minnesota's usury statute, MINN. STAT. § 334.01 (1969), limits interest rates to six dollars upon $100 for a year or, if agreed to in writing, interest may be charged at a rate of eight dollars upon $100 for a year. In reality these two rates allow an annual percentage rate of approximately 10.75 percent and 14.42 percent when worked out mathematically as a pre-computed contract. This phenomenon again appears in Minnesota's Motor Vehicle Instalment Act, MINN. STAT. § 168.72 (1969), which sets limits of $8 per $100, $11 per $100 and $13 per $100 depending on the model year of the car. Converted to an annual percentage rate, the above interest limitations become 14.42 percent, 19.65 percent and 23.19 percent. It is doubtful whether this type of arithmetic magic is apparent to the ordinary consumer.
school of thought urges no limitation on interest rates whatever, with reliance upon competition to keep rates reasonable. During the formulation of the UCCC serious consideration was given to this proposition. Various authors have challenged the "protection of the consumer" argument as justifying the establishment of rate ceilings. Present legislation in Massachusetts sets no rate limitations on certain loans above $3,000; in New Hampshire there are no limitations on interest rates agreed to in writing and, at present, three states apply no usury ceilings on banks.

The proposal was, however, shelved as being politically unmarketable. The Code's draftsmen chose to formulate a rate ceiling on the cost of credit which would replace with a single legislative enactment existing state statutes relating to interest rates on both consumer loans and credit sales. The Code provides rate ceilings on all consumer credit transactions. In a consumer sales transaction, the Code's maximum rate ceilings apply to the credit service charge and in a loan transaction to the loan finance charge. The credit service charge and loan finance charge include the sum of all charges payable directly or indirectly by the debtor as an incident to the extension of credit. The terms do not include charges as a result of default, additional charges, delinquency charges or deferral charges.

4. See Felsenfeld, supra note 1, at 933.
9. See Felsenfeld, supra note 1, at 933.
11. UCCC § 2.201, Credit Service Charge for Consumer Credit Sales other than Revolving Charge Accounts; § 2.207, Credit Service Charge for Revolving Charge Accounts; § 3.201, Loan Finance Charge for Consumer Loans other than Supervised Loans; § 3.508, Loan Finance Charge for Supervised Loans.
12. UCCC § 2.109.
13. UCCC § 3.109.
17. UCCC §§ 2.204 & 3.204.
The Code's rate ceilings are similar for consumer loans and sales. The differentiation in rate treatment is the Code's distinction between revolving consumer transactions (open-end) and non-revolving transactions (closed-end). Sales under a revolving charge account have maximum ceilings of two percent per month on the unpaid balance for amounts of $500 or less and 1.5 percent per month for amounts over $500. Revolving loan accounts are limited to 18 percent per year which is 1.5 percent per month of the average daily balance of the debt. For non-revolving consumer credit sales a general rate ceiling of 18 percent per year on the unpaid balance is imposed with an alternative series of higher rates for smaller individual transactions. In these smaller transactions, the credit service charge, calculated according to the actuarial method, may not exceed the greater of the total of (a) 36 percent per year on that part of the unpaid balance of amounts which are $300 or less, (b) 21 percent per year on amounts over $300 but less than $1,000 and (c) 15 percent per year on amounts over $1000; or 18 percent per year on the unpaid balances of the amount financed. Non-revolving loans are also given the 18 percent rate ceiling with the exception that supervised loans are allowed the same alternative series of rates given smaller credit sales transactions.

II. COMPETITION AND FREE ENTRY

Competition and free entry historically have presented problems in the consumer credit field. The first small loan laws in

18. UCCC §§ 2.108 & 3.108. In the revolving transaction, whether loan or sale, three basic criteria are present: (1) the unpaid balances are debited to an account; (2) the loan finance charge or credit service charge is not precomputed but is computed on the outstanding unpaid balances of the buyer's account from time to time (usually monthly), and (3) the buyer/debtor has the privilege of paying in instalments.

19. The closed-end transaction consists of separate and independent contracts between the seller/lender and buyer/debtor for each grant of credit. See UCCC §§ 2.201 & 3.201.

20. UCCC § 2.207(3).

21. UCCC § 3.201(4).

22. UCCC § 2.201(2) (b).

23. UCCC § 1.301(1). Under the actuarial method, payment is applied first to the credit service charge, and the balance to the unpaid amount financed.

24. UCCC § 2.201(2).

25. UCCC § 3.201(1).

26. UCCC § 3.501(3). A supervised loan is one which has a loan finance charge exceeding 18 percent per year. Supervised lenders, as distinguished from other lenders, are required to be licensed by the Code Administrator. See UCCC § 3.503.

27. UCCC § 3.508(2).
corporated concepts of free entry and competition. Problems soon emerged in the practices of excessive solicitation, overlending and collection abuses. Although these were later curbed by more strict state regulation, the result showed that competition had produced an overall lowering of interest rates. The UCCC, while providing broad administrative powers to curb such abusive practices, reaffirms the concepts of free entry and competition.

A basic policy in the Code's treatment of rates is that the setting of high ceilings is intended merely to establish maximum rate parameters within which free competition will cause the actual rates to level off below such ceilings. In order to allow sufficient room for this competition to work, the Code has established a concept of relatively free entry into virtually all segments of the consumer credit market. With the exception of the licensing requirements for supervised lenders, there are no Code provisions limiting or restricting the number or type of credit institutions that may be established in the community.

This is a radical departure from present commercial statutes in the State of Minnesota. In Minnesota, the lenders of money are carefully arranged in a segmented hierarchy and limited

28. Hubachek, The Development of Regulatory Small Loan Laws, 8 LAW AND CONTEMP. PROB. 108 (1941). Hubachek stated:

A certain sequence of events had followed the enactment of many small loan laws. First, the loan sharks disappeared. Then the regulated business began to expand. Due to improved lending techniques, increased volume of business, and the availability of public capital, it had become possible to make an attractive net return. A time came when there were too many licensed lenders and too many dollars seeking to be lent. Competition so far had been effective only to a very limited extent in reducing the rates of charge. Instead, it took the form of excessive solicitation and over-lending. This in turn led to the borrower's delinquency which fostered collection abuses.

Id. at 121-22.

29. UCCC Prefatory Note XIX.

30. UCCC § 3.503. This licensing procedure is concerned only with the financial responsibility, character and fitness of the applicant and eliminates any convenience, need or number limitation tests.

31. The unlimited free entry concept of the Code does not apply to banking institutions. Their authority to open new offices at which they receive deposits and make loans is to be controlled by state statutes presently governing them. See UCCC § 3.503, Comment 3.

32. See, e.g., MINN. STAT. ch. 48 (1969), Banks, Trust Companies Act; MINN. STAT. ch. 52 (1969), Credit Unions Act; MINN. STAT. ch. 53 (1969), Industrial Loan and Thrift Companies Act; MINN. STAT. ch. 50 (1969), Small Loans Act. This segmentation is brought about by limitations on rates that may be charged and on the size, maturity and form of credit that may be granted by the various types of credit grantors.
in their financial dealings. At the present time, participants under the Minnesota Small Loans Act are required to show that their engaging in the small loan business will promote the convenience of and be an advantage to the community. The Code, in order to foster such free entry, has abandoned the "convenience and advantage" test.

This provision has been a source of controversy with many banking institutions. Banks, as deposit-holding institutions, receive their authority to open new offices or charter new banks from the present Minnesota statutes. In order to charter a bank in Minnesota a reasonable public demand must be shown and, in addition, there must be a community desire for the bank and a probable volume of business sufficient to insure the solvency of the new bank and all currently existing banks. Although banks would continue to be regulated as to the number of new charters available, the real economic effect on banks should be negligible. In mid-1968, only 10.6 percent of the outstanding personal loans were attributed to finance companies. Of these loans less than one-third were subject to strict application of "convenience and advantage" provisions, so that only about three percent of consumer instalment credit will be significantly affected by establishment of freedom of entry.

When allowed to compete with small loan companies, banks have usually held a competitive edge in that they attract the better credit risks. This reduces the number of defaults, bankruptcies and other types of loan losses which increase the cost of lending. Banks also have a competitive edge in the lending interest rate market since finance companies often obtain a large amount of their lending capital through loans from banks. Consequently, the banks, depending on the rates at which they make the loans to the finance company, have a built-in advan-

33. See, e.g., MINN. STAT. § 56.15 (1969) of the Small Loans Act which limits the size of loans to $900.
34. MINN. STAT. ch. 56 (1969).
35. MINN. STAT. § 56.04 (1969).
36. See UCCC § 3.503 and comment following.
37. See UCCC §§ 3.503 & 6.107 and comments following.
38. MINN. STAT. § 45.07 (1969).
39. Id. See also Jackson v. Valley Nat'l Bank of Eagan Twp., 277 Minn. 293, 152 N.W.2d 472 (1967); State ex rel. Dybdal v. State Sec. Comm'n, 145 Minn. 221, 176 N.W.759 (1920).
41. Id.
42. Id. at 676.
tage in the cost of capital. In states like Kansas, where free entry has long been the rule, commercial banking continues to be a strong, viable business.

Nor have banks been limited in their operations by confinement to a single charter. This is manifested in the recent trend toward banking by mail and the tremendous growth of the bank credit card. The fact of the matter is that as banks continue to expand their operations into the consumer area, it is imperative for banks that sound, comprehensive consumer laws be enacted to protect and ensure this continuing expansion.

The effect of the free entry concept on retail instalment sales in Minnesota would be limited. There are presently no statutes concerned with instalment sales charges for any goods or services, with the exception of automobiles. It is possible, therefore, that under the Code's liberal entry provisions, retailers could go into the loan business. If a retailer should become a licensed supervised lender, he would be permitted, under the Code, to operate his retail business in conjunction with his lending business on the same premises. The similarity, however, in the interest rates on loans and sales transactions appears to deny any distinct advantage for the retailer, since he may obtain the same rates in an instalment sales contract as he could as a supervised lender making a loan. Moreover, were he to become a supervised lender, he would be required to comply with a new body of administrative regulations under the Code. It is also debatable whether most retailers would be willing to set aside or tie up the cash reserves usually necessary for operating a loan venture.

The use of competition to set prices in non-monopolistic sales of goods and services is a basic element of the consumer economy. This, however, has not been the case in the money

43. Cf. Benfield, Money, Mortgages and Migraine-The Usury Headache, 19 Case W. Res. L. Rev. 819, 826-830 (1968). The most basic example of this type of competitive edge would arise as follows: The bank pays five percent per year for the use of its depositors' money. When it makes a loan to the finance company at a prime interest rate of eight percent, it would immediately have a three percent competitive edge on the borrowing finance company in the making of loans to the consumer.


46. UCCC § 3.512.

47. Compare UCCC §§ 2.201 & 3.508.

48. UCCC § 6.105.
market where statutes have long served to control the price of money. Usury laws, for example, have been enacted in various forms in virtually every state in an attempt to set limits on interest rates. In a monopolistic credit area, strong arguments can be made for the adoption and enforcement of strict limits on the cost of consumer credit, but these arguments are difficult to sustain in an open, competitive market. There is no persuasive evidence that competitive pricing will not function in the money market. The instalment credit market is broad enough, presently in excess of one hundred billion dollars and growing, and can be made competitive enough to allow prices to be set by the forces of supply and demand. One current example of relatively free entry and substantial competition is the automobile financing market, which presently is shared by virtually all forms of lending institutions. In the past forty years the availability of credit has expanded, and due to vigorous competition, the average level of credit rates has remained well below the statutory rate ceiling.

III. USURY

The general usury statutes have long been used in this country to place limits on the rates of interest in the lending of money. State usury ceilings presently range from 6 to 21 percent with the most prevalent rates being those between 8 and 12 percent. However, the costs of making loans or extending credit often exceed the return permitted by the usury statutes. In such cases, would-be creditors are economically prevented from making loans or extending credit. In response to this economic reality, both courts and legislatures have fashioned exceptions to the usury laws and have sanctioned higher rates for transactions in virtually every credit situation.

49. Jordan & Warren, supra note 5, at 391.
51. Shay, supra note 5, at 495.
54. 1 CCH CONSUMER CREDIT GUIDE § 510 (1970).
55. J. CHAPMAN & R. SHAY, THE CONSUMER FINANCE INDUSTRY, ITS COSTS AND REGULATION 57 (1967). Studies have shown that the total cost per $100 of loans outstanding in a selected number of finance companies ranged between $18 and $26.
A. JUDICIAL EXCEPTIONS

In instalment credit sales transactions the courts have formulated the "time price doctrine" to provide the means by which creditors may finesse the usury statutes. The time price doctrine is a method by which a merchant charges one price for goods or services if he is to receive immediate payment in cash of the purchase price; if the merchant must wait for payment, he may sell the goods for the cash price plus an additional charge for the credit extended. The difference between the cash price and the time price is frequently called the time price differential. A second view of the time price doctrine has been to consider the time price contract as a specific article of commerce and, like any other article of commerce, it can be sold at any price agreed upon by the parties. Since a sale involves neither a "loan," which implies an advance of money or personal property repayable in kind, nor a "forbearance," which signifies an agreement to refrain from demanding payment of a loan or debt when due, it has generally been recognized that usury statutes do not apply to sales transactions or to the amount of service charge imposed in connection with a sale of merchandise on credit.

The impact and importance to the consumer industry and the consumer of the time price doctrine as an exception to the usury statute is illustrated by the usury statute in Arkansas. Arkansas is the only state which fixes one maximum legal interest rate, ten percent, applicable to all transactions. The time price doctrine has been rejected by the Arkansas court as being contrary to Arkansas' constitutional provisions against usury. This has resulted in a significant decline in the availability of loan credit, but has proven to have little impact on sales credit.

56. The time price principle was first enunciated in an 1827 English case, Bette v. Bidwood, 108 Eng. Rep. 792 (K.B. 1827) and was reiterated in 1861 in what is considered to be the leading American case on the subject, Hogg v. Ruffner, 66 U.S. 115 (1861). It has subsequently been adopted by the courts of virtually all states in which the subject was considered.

57. See Kripke, Secured Transactions Financing the Seller, 76 BANING L.J. 185, 192-93 (1959), for a detailed explanation of the time price doctrine.

58. Id.

59. Id.


The retailers simply raised their prices to offset losses on their credit transactions, converting a potential loss of retail profits into an additional burden on the consumer's pocketbook. This action on the part of the retailers, however, did cause increased out-of-state purchasing, especially in the border areas, whose net result was a deprivation of income to the state and a slowdown in economic growth.

Minnesota courts have long accepted the time price doctrine as a means of avoiding the state usury statute. In Van Asperen v. Darling Olds, Inc., the Minnesota Supreme Court upheld the proposition that

[A] bona fide installment sale does not come within the purview of the usury statute . . . . This court has never held as a matter of law that a sale involving a cash price plus a finance charge equalling a credit price is usurious.

Although Minnesota has accepted the time price doctrine in installment sales contracts, there remains considerable doubt as to whether the doctrine will exempt revolving sales transactions from the usury rate limitations. The difficulty in placing the revolving sales concept within the time price doctrine arises from the absence of a precomputed credit price. Under a revolving account there is no way the customer can be given a specific price for the cost of the credit, as each additional transaction increases the cost of the time price payment and under the general revolving account, payment within a specified period automatically cancels the time price differential. This method of financing is not, therefore, an example of a transaction clearly protected by the time price doctrine. The critical question is whether this method of financing is to be considered a forbearance on a debt and thereby subject to usury limitations.

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62. See Lynch, supra note 60, at 596, 614.
63. Id. at 600-01. Out-of-state cities bordering on the Arkansas state line exhibited consistently lower prices for similar goods, e.g. a television which cost $100 in Little Rock, Ark., was $94.26 in Texarkana, Tex., $97.18 in Greenville, Miss., $95.37 in Memphis, Tenn., and $94.43 in Tulsa, Okla.
64. Id. at 619.
65. See Van Asperen v. Darling Olds, Inc., 254 Minn. 62, 93 N.W.2d 690 (1958); Dunn v. Midland Loan Finance Corp., 206 Minn. 550, 289 N.W. 411 (1939); In re Bibbey, 9 F.2d 944 (D. Minn. 1925).
66. Minn. Stat. § 334.01 (1969) states in part: [N]o person shall directly or indirectly take or receive in money, goods, or things in action, or in any way, any greater sum . . . . for the loan or forbearance of money, goods, or things in action, than $8 on $100 for one year . . . .
67. 254 Minn. 62, 93 N.W.2d 690 (1958).
68. Id. at 68, 93 N.W.2d at 694-95.
69. See note 18 supra.
Although the Minnesota courts have not yet ruled on this issue,\textsuperscript{70} the Wisconsin Supreme Court recently held\textsuperscript{71} that the finance charge in revolving accounts was a forbearance and subject to the usury rate limitations. Although the time price doctrine remains in force in Wisconsin,\textsuperscript{72} the court stated that a revolving account lacks certain indicia which determine when a particular transaction qualifies as a true time price sale.\textsuperscript{73} Most damaging was the failure to disclose sufficiently the existence of two prices (cash and credit price) to both parties.\textsuperscript{74} The court further stated that there seemed to be universal acceptance that bank charge cards are subject to usury limitations\textsuperscript{75} and upon careful analysis found it impossible to distinguish between the revolving account in issue and the bank charge card situation.\textsuperscript{76} The court also repeatedly stressed the importance of substance over form; in cases of alleged usury, the court would look through the form of the agreement to the substance.\textsuperscript{77} Although the Minnesota court has consistently upheld the time price doctrine, they have indicated firmly that they too will look to the substance of the transaction and not merely to form.\textsuperscript{78} If the agreements are actually a pretense to evade the usury law they probably will be found invalid.\textsuperscript{79}

It is, therefore, apparent that merchants in the state of Minnesota cannot confidently rely on the time price doctrine to exempt retail instalment sales under a revolving account. If the Minnesota courts would elect to follow the reasoning of the Wisconsin court's opinion the result may prove devastating to

\textsuperscript{70} At the time of the writing of this article, the Minnesota Attorney General has filed suit against Montgomery Ward, Inc., alleging that the 18 percent annual interest on their revolving charge accounts is violative of Minnesota's usury statute.
\textsuperscript{71} State v. J.C. Penney Co., ___ Wis. 2d ___, 179 N.W.2d 641 (1970).
\textsuperscript{72} Id. at ___, 179 N.W.2d at 649-50.
\textsuperscript{73} Id. at ___, 179 N.W.2d at 651.
\textsuperscript{74} Id. The court listed additional factors which would support the finding that a revolving account would not be a time price sale, i.e., ambiguous terms in the sales contract, seller's specific agreement to finance the purchase, credit price calculated in terms of interest or percentage or a sales tax computed on the cash price, giving the customer the option of lowering the price of the merchandise by payment even after the services have begun to run.
\textsuperscript{75} Id. at ___, 179 N.W.2d at 647.
\textsuperscript{76} Id. at ___, 179 N.W.2d at 652.
\textsuperscript{77} Id. at ___, 179 N.W.2d at 647.
\textsuperscript{78} Van Asperen v. Darling Olds., Inc., 254 Minn. 62, 67, 93 N.W.2d 690, 695 (1958).
\textsuperscript{79} Melbo v. Rinn, 280 Minn. 72, 157 N.W.2d 842 (1968); Midland Loan Finance Co. v. Lorentz, 209 Minn. 278, 296 N.W. 911 (1941).
many reputable retailers. Where a transaction is found to have violated the Minnesota usury statute, the creditor stands to lose not only the interest but also the principal. 80 In the State of Minnesota, therefore, there exists a definite possibility that millions of dollars will be lost by merchants, depending on the degree to which a court may choose to extend the time price doctrine.

B. LEGISLATIVE EXCEPTIONS

Exceptions to the usury statutes for the lending of money have developed primarily through legislative action. Prior to any attempts by the legislatures to formulate exceptions to the usury statutes, the money-lending trade was subjected to the usury statutes. A large portion of the consumer market was excluded from credit because when a lender could not make a reasonable profit on his loans and was prohibited from raising his price for credit, he adjusted by limiting his market to select credit risks. The poor credit risks, unable to obtain credit from reputable lenders, were forced to seek needed money from criminal lenders at exorbitant rates. 81 The legislatures reacted to this situation with a variety of acts designed to exempt credit transactions from low general usury statutes. These statutes include such enactments as small loan laws, industrial loan acts, bank consumer loan laws and Morris Plan Company laws. With varying terms these statutes permit lending institutions to charge rates higher than those permitted by general usury statutes. 82

The unrealistic rate limitations under the Minnesota general usury statute prompted the legislature's enactment of various usury exemption statutes. 83 The Bank Instalment Loan Act, 84

80. MINN. STAT. §§ 334.02 & 334.03 (1969).
83. The Minnesota courts consider loans of money to be governed by the usury statute unless higher rates are specifically authorized by the legislature. See, e.g., Dunn v. Midland Loan Finance Co., 206 Minn. 550, 554, 289 N.W. 411, 413 (1939).
84. MINN. STAT. § 48.153 (1969). Banks lending less than $5,000 may deduct six percent in advance for five years (this is a true annual rate of 15 percent under Regulation Z of the Federal Consumer Credit Protection Act).
Industrial Loan Act,85 Credit Union Act86 and Small Loan Act87 each provide for rates in excess of the Minnesota usury statute. In fact, the cumulative judicial and legislative actions have so emasculated the usury statute that, at the present time, the usury statute governs fewer than one-third of Minnesota's credit transactions.88

C. UCCC AND USURY

Enactment of the UCCC would effectively repeal the rate ceiling of Minnesota's general usury statute in cases of consumer credit transactions and would preempt all other statutory rate ceilings theretofore imposed on credit transactions.89 Replacing the usury rate limitations and the complex and varying particular exceptions to the usury statute would be a uniform set of rate ceilings applicable to virtually all forms of consumer credit transactions. The use of a high maximum rate ceiling would accomplish the objective of protecting the consumer against unlimited ranges in rates while at the same time providing the lender or merchant sufficient room in which to compete effectively and still make a reasonable return on his investment and services.

IV. RATE REGULATION AND LOANS

The Code's basic maximum rate on consumer loans,90 defined as the loan finance charge,91 is 18 percent per year on the unpaid balance,92 except that supervised lenders93 may, if they choose, impose annual rates of up to 36 percent on loans under $300, 21 percent on amounts between $300 and $1,000, and 15 percent on the amount of the unpaid balance in excess of $1,000.94 Uncertainty or disagreement on the method of deter-

85. MINN. STAT. § 53.04 (1969). Industrial loan companies are permitted to deduct eight percent in advance for three years (18.75 percent under Regulation Z).
86. MINN. STAT. § 52.14 (1969). Credit unions may charge 12 percent per year.
87. MINN. STAT. § 56:13 (1969). Small loan companies may charge up to 2.75 percent per month on the unpaid balance for loans up to $300 (33 percent under Regulation Z).
88. See Benfield, supra note 43, at 897.
89. UCCC § 9.103.
90. UCCC § 3.104.
91. UCCC § 3.108.
92. UCCC § 3.201(1).
93. UCCC §§ 3.501–.503. The supervised lender must be licensed by the Administrator under the UCCC.
94. UCCC § 3.508(2).
mining the interest rate is eliminated under the Code—charges may be calculated and paid on any basis provided the specified rates are not exceeded. This allows the creditor to handle his bookkeeping and nomenclature in a manner most convenient to him while the consumer remains protected and informed by the rate ceiling and disclosure provisions.

Included in the loan finance charge are all charges paid directly or indirectly by the debtor with the exception of default charges, additional charges and deferral charges which are expressly excluded from the definition of loan finance charge. These charges are treated separately for rate ceiling and disclosure purposes. A lender may contract for, in addition to the loan finance charge, official fees and taxes, charges for insurance and other benefits if such charges are reasonably related to the benefits received. In the case of an instalment not paid within ten days of its due date, the lender may contract to charge an additional five percent of the amount of the unpaid instalment not to exceed five dollars. Further charges for deferral, refinancing, and consolidation, while not included under the rate ceiling, are provided for in the Code. The debtor is allowed to make a full repayment of the consumer loan at any time without penalty. Although an acceleration penalty is prohibited, the lender does not automatically forfeit the interest altogether; the “Rule of 78” applies, assuring the lender a portion of the interest based on a relationship of the greater risk assumed in the early months and the amount of the loan. The full repayment privilege does not automatically give the debtor the right to make a partial repayment; this can be done only with the consent of the creditor.

Although the maximum rates for loans may appear unusually high, fifteen states' small loan laws presently permit certain rates which exceed the maximum Code rates.

95. UCCC §§ 2.201(3), 3.201(2) & 3.508(3).
96. UCCC § 3.508 and comment following.
97. See UCCC § 2.109 and comment following.
98. UCCC § 3.202(1).
99. UCCC § 3.203(1).
100. UCCC § 3.204.
101. UCCC § 3.205.
102. UCCC § 3.206.
103. UCCC § 3.209.
105. UCCC § 3.203.
106. UCCC § 3.209.
107. See, e.g., GA. CODE ANN. §§ 25-301 to -324 (1959); MISS. CODE
In order to determine whether rates are unnecessarily high or merely reflect the actual cost at which money may be extended in return for a reasonable profit, it is first necessary to examine some basic elements of the consumer credit business. Four basic ingredients are involved in determining the rate at which a loan will be made: (1) the cost of money, (2) the cost of administering the loan, (3) the amount of risk involved as to possible nonrepayment and (4) the amount of competition facing the lender. A recent study of a large sample group of finance companies showed the annual total costs per $100 on loans outstanding ranged from approximately $18 to $26, with the average loan running about $20 per $100 lent. This would mean that on the average the finance company must charge at least 20 percent interest to break even. Operating costs also are higher for the smaller loans and lower for the larger extensions, computed on a ratio per $100. Further studies have shown that regardless of the prevailing rate levels among lenders, the profit margins did not differ significantly. The study's conclusion was that legitimate companies adjust their rates to produce the level of profits required by the competitive capital markets for this type of business. Thus, if rates are low, the net income to the lender usually shows little change from that under a high rate; what is diminished is the level of service provided to borrowers. Where rates are too low, the high risk loans and small, unprofitable loans are not offered to the consumer.

The intended function of the UCCC's rate ceiling is to decide when rates become unconscionable, not to set the going market rate, which is the purpose of current rate ceilings. A comparison of the loan rates under state loan law rate ceilings with those under the proposed UCCC shows that the rates under the UCCC are slightly higher in almost all categories.

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109. Id. at 143.
110. Id.
111. Id.
112. See UCCC § 2.201 and comment following.
TABLE I
COMPARISON OF MEDIAN YIELDS OF SELECTED LOAN SIZES UNDER STATE SMALL LOAN LAW RATE CEILINGS, EARLY 1968, WITH PROPOSED RATE CEILINGS UNDER THE UCCC

<table>
<thead>
<tr>
<th>Cash Advanced to Borrowers</th>
<th>Number of State Small Loan Laws</th>
<th>Median Rate Early 1968</th>
<th>Effective Annual Rate Ceiling UCCC</th>
<th>Difference</th>
</tr>
</thead>
<tbody>
<tr>
<td>$100</td>
<td>47</td>
<td>36.00%</td>
<td>36.00%</td>
<td>—</td>
</tr>
<tr>
<td>200</td>
<td>47</td>
<td>34.92</td>
<td>36.00</td>
<td>1.08%</td>
</tr>
<tr>
<td>300</td>
<td>47</td>
<td>32.88</td>
<td>36.00</td>
<td>3.12%</td>
</tr>
<tr>
<td>400</td>
<td>41</td>
<td>30.96</td>
<td>34.80</td>
<td>4.44%</td>
</tr>
<tr>
<td>500</td>
<td>41</td>
<td>28.80</td>
<td>33.24</td>
<td>4.44%</td>
</tr>
<tr>
<td>600</td>
<td>41</td>
<td>27.48</td>
<td>31.80</td>
<td>4.32%</td>
</tr>
<tr>
<td>700</td>
<td>35</td>
<td>26.52</td>
<td>30.72</td>
<td>4.20%</td>
</tr>
<tr>
<td>800</td>
<td>35</td>
<td>25.44</td>
<td>29.76</td>
<td>4.32%</td>
</tr>
<tr>
<td>900</td>
<td>31</td>
<td>24.72</td>
<td>28.92</td>
<td>4.20%</td>
</tr>
<tr>
<td>1,000</td>
<td>30b</td>
<td>23.64</td>
<td>28.20</td>
<td>4.56%</td>
</tr>
<tr>
<td>1,100</td>
<td>18b</td>
<td>22.20</td>
<td>27.60</td>
<td>5.40%</td>
</tr>
<tr>
<td>1,200</td>
<td>18b</td>
<td>21.84</td>
<td>27.00</td>
<td>5.16%</td>
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<tr>
<td>1,300</td>
<td>18b</td>
<td>21.72</td>
<td>26.40</td>
<td>4.68%</td>
</tr>
<tr>
<td>1,400</td>
<td>18b</td>
<td>21.60</td>
<td>25.80</td>
<td>4.20%</td>
</tr>
<tr>
<td>1,500</td>
<td>18b</td>
<td>21.36</td>
<td>25.32</td>
<td>3.96%</td>
</tr>
</tbody>
</table>

(a) loans with 12 month maturity, January 1, 1968.
(b) dollar cost of loan computed by interpolation between states above and below median.

Source: Helmuth Miller of Beneficial Finance Corporation

In Minnesota, where loan rates presently range from 12 to 33 percent, the Code would not effect a drastic change in maximum rate ceilings. The 1969 Minnesota Legislature in considering adoption of the UCCC, made only minor changes in the recommended rate ceilings. Although the Bill failed by a narrow margin, the slight changes in the Code's rate ceilings by the Legislature would seem to indicate that such rates were not considered exorbitant or objectionable per se. It cannot be emphasized too strongly that the high interest ceilings in the Code are not intended to grant lenders a means by which they might wring extra profits from the consumer. They are, to the contrary, meant to encourage competition and still allow the lender a fair return. The critic who oversimplifies and condemns such rates as unreasonable and exorbitant exhibits a lack of comprehension as to the basic economic fact that when the lender

113. Shay, The Impact of the Uniform Consumer Credit Code Upon the Market for Consumer Installment Credit, 33 LAW & CONTEMP. PROBS. 752, 754 (1968).
114. See notes 83-86 supra.
115. H.F. No. 438, J. of the House, Tuesday, May 13, 1969 (91st day), changed the 36 percent rate for loans by supervised lenders for amounts under $300 to 33 percent (UCCC § 3.508).
cannot make a profit on his loans he either ceases to lend or seriously limits those to whom he will lend. Those especially vulnerable to this phenomenon are the consumers who most need available lending capital. If consumers are unable to procure needed credit through legitimate channels, the loan sharks are always too happy to help out.

V. INSTALMENT SALES AND REVOLVING ACCOUNTS

Instalment credit, the kind of credit for which a consumer pays a fee for the privilege of paying off the debt over a period of time, is big business. It far exceeds non-instalment credit in volume. Instalment credit in September of 1968 totalled 82.9 billion dollars as compared with 21.4 billion in non-instalment credit.\textsuperscript{116} Of this amount, the instalment credit held by retail outlets alone has increased from 755 million dollars in 1920 to almost 11 billion in 1968.\textsuperscript{117} A complex structure of largely unrelated statutes and legal doctrines, ranging from the time price doctrine and state usury statutes to the Federal Consumer Credit Protection Act and various state instalment sales acts presently regulates this growing leviathan. The UCCC has been offered as a comprehensive, uniform system to eliminate the present quagmire of instalment credit.

In the UCCC the term credit service charge\textsuperscript{118} is substituted for the term interest with respect to credit sales. It includes all charges imposed on the buyer such as time price differential, service or carrying charges, insurance charges, investigation charges and charges for commissions and brokerage fees. Charges for default, additional charges, delinquency charges and deferral charges are expressly excluded from the definition of a credit service charge.\textsuperscript{119} The types of sales to which the credit service charge applies are consumer credit sales,\textsuperscript{120} consumer leases,\textsuperscript{121} consumer related sales\textsuperscript{122} and revolving charge accounts.\textsuperscript{123}

A consumer credit sale is defined basically as a sale of goods, services or interest in land purchased for a family, household or

\textsuperscript{117} Nat'l Retail Merch. Ass'n, Econ. Characteristics of Dept Store Credit 8 (1969).
\textsuperscript{118} UCCC § 2.109.
\textsuperscript{119} Id. Comment.
\textsuperscript{120} UCCC § 2.104.
\textsuperscript{121} UCCC § 2.106.
\textsuperscript{122} UCCC § 2.602.
\textsuperscript{123} UCCC § 2.108.
agricultural purpose, and the amount financed must not exceed $25,000. The consumer lease must be a lease by a person, not an organization, for a personal, family, household or agricultural purpose for a term exceeding four months. A consumer related sale is a sale of goods, services or an interest in land which is not subject to the provisions of a consumer credit sale and is in an amount under $25,000. The consumer related sale does not apply to organizations but only to persons. This provision makes the Code applicable to numerous small business transactions which would not be for a personal, family household or agricultural purpose. The revolving charge account includes purchases of goods or services with credit cards where a credit service charge is not precomputed but is computed on the unpaid balances of the buyer’s account from time to time. The amount charged for the above sales, leases, consumer related sales or revolving charge accounts is the credit service charge.

The credit service charge has a general maximum rate of 18 percent per year, with two exceptions: (a) revolving charge accounts may carry a maximum rate of two percent per month on $500 or less but 1.5 percent on that part of the amount over $500 and (b) in place of the 18 percent rate, consumer credit sales, except revolving charge accounts, may charge up to the following maximum ceilings: (1) 36 percent per year on the unpaid balance of an amount not exceeding $300; (2) 21 percent for amounts between $300 and $1,000, and (3) 11 percent on those amounts over $1,000. A minimum charge of $5 may also be imposed if the amount is less than $75, or $7.50 when the amount exceeds $75.

The UCCC rates have often been criticized as being too high. Again it must be remembered that these rates are ceilings and under the Code's use of competition and free entry the actual rates should tend to be lower than those legally allowed. In ad-

124. UCCC § 2.104(1). It does not include a purchase with a lender credit card or, except for the disclosure provisions, a sale of land where the credit service charge is less than ten percent. The $25,000 limit does not apply to land sales.
125. Consumer lease does not include a lease pursuant to a lender credit card. UCCC § 2.107.
126. See UCCC § 2.602 and comments following.
127. UCCC § 2.108. The buyer also is given the privilege of paying the balances in instalments.
128. UCCC § 2.201(2)(b).
129. UCCC § 2.207(3).
130. UCCC § 2.201(2)(a).
131. UCCC § 2.201(9).
dition, there must be faced the reality that extending credit is a costly undertaking. A recent study, conducted by the National Retail Merchant's Association, of customer credit in department stores indicated that the total credit costs for all stores included in the study exceeded their $36.5 million total service charge revenue by $14.7 million. The average deficiency for all participants amounted to 3.41 percent of credit sales.\textsuperscript{132} Theoretically, therefore, the average department store would enhance its profits by eliminating the credit function—if it could maintain the same sales volume. In a practical sense, however, eliminating the credit function would unquestionably adversely affect sales.\textsuperscript{133} The study further indicated that the cost of extending credit has increased in recent years.\textsuperscript{134} This leaves the retail merchant in the peculiar position that if he curtails credit to eliminate losses, he compounds his losses by diminished sales. The loser in this situation turns out to be the consumer, especially the cash purchaser. The merchant, in order to cover his losses, will raise the price of his goods. By this means the cash purchaser is forced to subsidize the credit purchaser. A more reasonable approach should be to allow the merchant to reasonably raise the cost of credit, thereby charging the credit consumer rather than penalizing the cash purchaser.

In Minnesota there are no credit rate limitations on sales with the exception of the sale of motor vehicles.\textsuperscript{135} The Motor Vehicle Instalment Act sets up staggered time price differential standards depending on the model year of the car. Vehicles less than one year old may have a price differential not exceeding $8 per $100 per year (14.42 percent annual rate); vehicles older than one but newer than three years cannot exceed $11 per $100 (20.72 percent annual rate), and vehicles over three years old may not have a charge exceeding $13 per $100 per year (23.19 percent annual rate) plus a flat charge of $3 for the retail instalment contract. The time price differential, the equivalent of the Code's credit service charge, also includes all charges for investigating credit worthiness and expenses for the making of the contract.\textsuperscript{136} Delinquency charges are separate and may be in an amount not in excess of five percent of each instalment or $5, whichever is

\textsuperscript{132} Nat'l Retail Merch. Ass'n, Econ. Characteristics of Dept Store Credit 50 (1969).
\textsuperscript{133} Id.
\textsuperscript{134} Id. at 52.
\textsuperscript{135} Minn. Stat. §§ 168.66-.77 (1969).
\textsuperscript{136} Minn. Stat. § 168.72(d) (1969).
Although the Code's rate ceilings are higher than Minnesota's counterpart for instalment sales, it is doubtful that the rates would increase significantly if the Code were enacted. Furthermore, the fact remains that Minnesota's rate protections for consumer instalment sales are woefully inadequate. There are no state statutes concerning instalment sales charges for any other goods or services than automobiles. No statutory protection is afforded the consumer with regard to revolving charge account rates. The existing judicial framework for such charges, the time price doctrine, can in cases of revolving accounts be termed at best uncertain. The very fact that a multi-million dollar market in Minnesota is presently being regulated by a complex, uncertain and woefully incomplete mish-mash of statutes and judicial opinions should spur both consumer and business interest groups to demand the enactment of a comprehensive uniform system of consumer credit regulation. The Uniform Consumer Credit Code offers the balanced, rational means by which this task can be accomplished.

137. MINN. STAT. § 168.71(a) (3) (1969).