

1971

Commercial Law: The Penny Decision and Revolving Charge Accounts

Ronald Wawrzyn

Follow this and additional works at: <https://scholarship.law.marquette.edu/mulr>



Part of the [Law Commons](#)

Repository Citation

Ronald Wawrzyn, *Commercial Law: The Penny Decision and Revolving Charge Accounts*, 54 Marq. L. Rev. 223 (1971).

Available at: <https://scholarship.law.marquette.edu/mulr/vol54/iss2/7>

This Article is brought to you for free and open access by the Journals at Marquette Law Scholarly Commons. It has been accepted for inclusion in Marquette Law Review by an authorized editor of Marquette Law Scholarly Commons. For more information, please contact elana.olson@marquette.edu.

NOTES

THE PENNEY DECISION AND REVOLVING CHARGE ACCOUNTS

The Wisconsin Supreme Court in *State v. J. C. Penney Co.*¹ held that Penney's revolving charge account interest rate of 1½% per month was in violation of the state's usury law. In the past, credit sales had always been exempt from the usury statute on the basis of the time-price doctrine. In recent years, however, a few jurisdictions have severely limited the time-price doctrine and have thus made credit sales subject to the usury statutes. In following these courts, the Wisconsin court has left the revolving charge account rate structure in a precarious position. Most observers agree that because revolving credit has high operating costs and a high risk of default, it needs an interest rate structure higher than the usury rate. The revolving charge account dealer can, therefore, anticipate a large deficit, unless legislation is passed that is in tune with present day consumer credit rate structures.

Before considering the *Penney* decision, a discussion of the history of credit sales and the applicability of usury statutes to such sales is appropriate. The characteristics of the revolving charge account and the merits of this form of credit will also be treated. After considering the *Penney* decision and its ramifications, the future of revolving credit in Wisconsin will be discussed, along with suggestions for appropriate legislation.

Consumer Credit Under the Usury Statutes

Do not exact interest from your countryman either in money or in kind, but out of fear of God let him live with you.²

This quotation from the Old Testament of the Bible is indicative of man's historic distrust of any charge for the use of money. Civilizations have always had difficulty regulating extensions of credit. In their early years, both the Roman and British Empires absolutely forbade any charge for the use of money. Later, however, they found that unless they granted lenders some return, they were reluctant to make loans and a needy borrower was forced to borrow from illegal sources. However, even when they did invoke statutory regulation of rates, they were faced with the burden of establishing a reasonable rate.³ Thus, although the problem has been readily identifiable, proper regulation of lending has proven a difficult task.

¹ *State v. J. C. Penney Co.*, 48 Wis. 2d 125, 179 N.W.2d 641 (1970).

² For other Biblical recognitions of usury see: Leviticus XXV, 35-37; Deuteronomy XXIII, 19-20; Psalms XV, 5.

³ For more on the history of usury, see Del Sesta, *Should Usury Statutes Be Used to Solve the Installment Problem?* 5 B. C. IND. AND COMM. L. REV. 389 (1964).

As early as the nineteenth century, the English courts determined that credit sales not be covered by the dictates of the usury statutes.⁴ This exception to the usury statutes became known as the "time-price" doctrine and was rationalized on the following basis. The credit price was an alternate price that could be chosen by the buyer if he wished to postpone payment. Thus, the term cash-price was adopted to refer to immediate payment, while the deferred payment was labeled the time-price. The courts did not find the difference between the two prices to be an interest charge,⁵ but rather identified the difference in price as merely a fee to account for the added risk of selling on credit. These courts had little difficulty explaining the reason for this exception to the usury statutes. The policy behind the usury statutes was to protect the needy borrower who found himself in a disadvantageous bargaining position.⁶ Historically, the credit buyer clearly was not in that position since he could always refuse to purchase the goods or save enough money to buy the goods at the cash price.

Although this policy distinction *has been* accepted by most critics, the legal basis for the exemption of the credit sale from usury laws has been difficult to justify. Most courts have held that the credit sale lacks one of the four essential elements of usury.⁷ Namely, the credit sale is not a loan or forbearance of money. However, a close analysis of the definition of "forbearance" reveals that the term can be made to apply to a credit sale.⁸ Did not the buyer incur a money debt by his purchase? Did not the seller-creditor refrain from collecting the money debt for a specified time? Therefore, the courts could have categorized a credit sale as a forbearance by the seller to collect the cash-price from the buyer.

The courts' reasoning would have conformed more to reality had the time-price differential been recognized as a charge for the use of money,⁹ rather than an alternate price that covered the risk of selling on

⁴ As Lord Tenterden stated in the landmark case of *Beete v. Bidgood*, 7B and C. 453, 108 Eng. Rep. 792 (K. B. 1827), "The only difficulty (in exempting a credit sale from the usury statutes) has been occasioned by calling the differences between these two prices [the cash price and the time-price] interest . . ."

⁵ See note 4, *supra*; This difference between the cash price and the credit price has been termed the time-price differential.

⁶ *G. M. Accept. Corp. v. Weinrich*, 218 Mo. App. 68, 77-78, 262 S. W. 425, 428 (1924).

⁷ 55 AM. JUR. *Usury* § 12. The elements of usury are stated as (1) a loan or forbearance, either express or implied, of money, or of something circulating as such; (2) an understanding that the principal is repayable absolutely; (3) the exaction of a greater profit than allowed by law, (4) an intention to violate the law.

⁸ *Black's Law Dictionary* (4th ed.) defines forbearance as follows: "Within usury law, term (forbearance) signifies contractual obligation of lender or creditor to refrain, during given period of time, from requiring borrower or debtor to repay loan or debt then due and payable."

⁹ Littlefield, *Parties and Transactions Covered By Consumer Credit Legislation*, 8 B. C. IND. AND COMM. L. REV. 463 (1967). "An economist might argue that the time-price differential is a charge for the use of the cash price during the

time. Such logic, however, would have weakened the time-price doctrine and forced the courts to rely more on the aforementioned policy argument. It is therefore quite clear that the time-price doctrine was not a well-carved legal exception to the usury statutes, but rather was a legal fiction that was predicated on the policy distinctions that separate a loan from a credit sale. The "time-price doctrine" was only as strong as the policy that led to its creation. In fact, a jurist who found an individual credit buyer in a disadvantageous position, could easily avoid the doctrine and hold that the charge was within the usury law.

Historically, the courts have adhered to the "time-price doctrine" rather strictly and have thus continually exempted credit sales from the usury laws. But with an increase in the use and abuse of consumer credit¹⁰ several courts viewed the traditional policy distinction between credit sales and loans with increased skepticism. The argument was that our once simple society had evolved into a complex mechanical structure. The credit buyer no longer could refuse to pay the credit price, since many of the items that were luxuries in the past were now necessities.¹¹ Consequently, the credit buyer found himself in the same disadvantageous bargaining position as the nineteenth century borrower. No doubt this argument has some merit, but courts seemed to respond to it on a case-by-case basis. In other words, where the court found nefarious practices it relied on the credit-need argument for support.

Unethical dealers took advantage of the consumer's ignorance of finance charges and the buyer's unfamiliarity with other commercial practices. One such device which was used by the shady vendor was the holder-in-due-course doctrine.¹² This doctrine enabled the seller to effectively separate the buyer's right to withhold payment from the seller's obligation to deliver a merchantable product. The seller could simply sell the buyer's promissory note to a finance company and refuse to deliver or service the product that was the subject of the note. The debtor-buyer was left with no defenses against the finance company and could not afford or was not sophisticated enough to bring an action against the seller. More frequently, vendors charged exorbitant rates for buying merchandise on credit because the uneducated buyer was not equipped to recognize these charges as noncompetitive. It was clear that as the consumer-credit business grew the abuses also increased. Although the injustices may have been meager on a per capita basis, they were substantial enough to elicit widespread calls for reform.

term of the contract and thus the difference between the cash and credit price is interest."

¹⁰ Comment, *Retail Installment Sales—History And Development of Regulations*, MARQ. L. REV. 555 (1962).

¹¹ *Consumer Credit Symposium*. See 55 N.W. L. REV. at 303-04 (1960).

¹² Although some critics have recently called for the complete abolition of this doctrine in the name of consumerism it must be noted that this doctrine is based on strong policy considerations; namely, the smooth transferability of commercial paper.

The call for reform, as is often the case, was misguided at its inception. Consumer credit as a whole was labeled as unfair to the consumer. The likely vehicle for regulation was the legislature, but prior to legislation several courts began regulation on a case-by-case basis.¹³ These courts did not abrogate the time-price doctrine, but rather found certain exceptions to the doctrine. The exceptions fell into two general classes. First, if a finance company was in any way connected with the credit sale, such as by furnishing forms to the seller,¹⁴ the court held the transaction an exception to the "time-price doctrine" and thus subject to the usury laws. Since many credit sellers dealt exclusively with one finance company, a great number of sellers were likely to have these forms on hand. Many credit sales were therefore suddenly subject to the usury laws even though their interest rates were reasonable. Second, other courts required that before the seller closed the deal, he had to negotiate with the buyer on the basis of a cash-price and time-price. Furthermore, in no case was the time-price considered genuine unless it was arrived at through some means other than affixing a finance charge to the cash-price.¹⁵ Since the time-price in reality had always been calculated by adding a finance charge to the cash price, this was tantamount to saying that the only genuine time-price is the one that is not a time-price. In short, although these courts paid lip service to the time-price doctrine, for all intents and purposes the doctrine no longer existed.¹⁶

In an attempt, therefore, to regulate consumer credit on a case-by-case approach, these courts were very harsh on the bulk of consumer credit transactions. Had these courts paid deference to credit transactions as a whole, they still could have relieved the instant aggrieved buyer on the basis of an unconscionable contract. It is therefore difficult to understand why these courts chose the usury standard with which to regulate consumer credit. There was a welter of evidence favoring other forms of regulation. It was obvious to most observers that if extension of consumer credit was to be encouraged, a fair return had

¹³ See notes 14, 15, and 29, *infra*.

¹⁴ *Hare v. General Contract Purchase Corp.*, 220 Ark. 601, 249 S. W. 2d 973 (1952);

¹⁵ See *Daniel v. First National Bank*, 227 F.2d 353, 357 (5th Cir. 1955). This view produced a startling dichotomy in the finance industry. While these courts held that a genuine time-price could not be determined by adding a finance charge to the cash price, other states had passed laws requiring full disclosure of the finance charge. Thus, for complying with the law in one state, a credit seller could be held to be in violation of the usury law in another state.

¹⁶ Wm. D. Warren, *Regulation of Finance Charges in Retail Installment Sales*, 68 YALE L. J. 849 (1959). See above for summary of what courts have done in this area; "...it appears that the courts which has purported to look through the form of a credit sale to determine whether it is in substance a loan have based their findings of usury on factors that are largely unrelated to the policies underlying usury law. In short, these courts look through form not to substance but merely to another kind of form."

to be provided for the creditor. In credit selling, not only are the risks of non-payment great, but the bookkeeping costs are also very high.¹⁷

The small loan acts were one indication that consumer credit transactions needed a higher rate structure. Small loans are often defaulted and thus, the risk of non-payment is high. It was recognized at an early date¹⁸ that consumer-sized loans would be discouraged unless the lender could obtain a reasonable rate of interest commensurate with the risk of non-payment. Nonavailability of small loans left the borrower looking to illegal sources for his money. The legislatures responded to this shortage of legal lending with licensing requirements for small loan agencies.¹⁹ The net effect of the statutes was to allow interest charges in excess of the usury rates to the licensed agencies. Like the Romans who found that legal recognition of reasonable rates made it possible for the borrower to avoid prohibitive interest rates, so too, small loan agencies gave the consumer an opportunity to avoid these exorbitant interest charges.

Numerous retail installment acts further indicated an appreciation of the need for special rate structure for consumer sized credit. This legislation came in response to widespread abuses in installment selling, particularly in the automobile business. Some jurisdictions only required full disclosure of the credit terms. Others required full disclosure and actually regulated the rates of interest. The regulatory rate structures were always liberally drawn in favor of the financier.²⁰

However, no matter how compelling this evidence may have seemed, a few courts bypassed the rationale of the small loan acts, the retail installment acts and the "time-price doctrine." Most of these courts did so while considering only retail installment sales. The Wisconsin Supreme Court in *J. C. Penney* was only the second court to limit the time-price doctrine as it applied to revolving credit. The Wisconsin Court, however, treated retail installment credit as if it were interchangeable with open-end credit (e.g. revolving charge accounts). There are some striking differences between the two. In order to analyze the *Penney* decision it will be necessary to describe the revolving charge account and differentiate it from closed-end credit (e.g. retail installment sales).

¹⁷ Kripke, *Secured Transactions Financing the Seller*, 76 BANKING L. J. 185, 191-192 (1959). "It costs just as much to collect and to do the ledger work on the installments of a refrigerator contract with payments of eleven dollars a month as it does to handle a bank loan of \$50,000 . . . So the simple fact is that installment selling cannot be done on the basis of a rate structure derived from traditional thinking as to usury."

¹⁸ The Uniform Small Loan Law was proposed in 1916.

¹⁹ These licensing requirements again reflected the long standing notion that only the "good" lender could charge for the use of money. For Wisconsin Small Loan Act see WIS. STAT. ch. 214.

²⁰ See note 16, *supra* at p. 853.

The Revolving Charge Account

Most full line department stores make this type of credit available to their customers. The operation of this credit plan may be divided into three parts. The first is a pre-contractual stage in which the retailer explains the terms of the plan and the customer supplies the retailer with credit references. If both are satisfied, they enter into an agreement.²¹ The second stage relates to the purchase of merchandise and the third stage is the billing stage. If a debt exists at the time of the billing date,²² all purchases are itemized and a bill of the balance due is sent to the customer. If, however, the customer has paid cash for any item, has returned an item or has later paid for an item, this item does not appear on the bill. Furthermore, if the customer pays the balance due before the next billing date, he avoids all interest charges. However, if the balance is unpaid at the time of the second billing following any purchase, a service charge is assessed. The customer then must pay a specified part of the debt due. There is usually a limit on the amount of debt a customer may accumulate so that the credit extension is kept on a consumer-sized level only. Thus, the term open-end credit is somewhat of a misnomer since the credit is open only so long as a maximum debt is not exceeded.

This credit plan offers advantages to both the customer and the retailer. The customer has a ready and reliable source of credit for any unexpected expenses. His payments and record keeping are simplified because all his debts are combined and paid with one monthly check. In addition, there is no need for continued re-appraisal of his credit rating each time he wants to buy on credit. Fewer credit investigations benefit the retailer also by keeping the operating cost at a lower level. Moreover, the retailer will probably be rewarded with increased sales due to the customer's tendency to patronize the store with the most convenient method of payment.

Although this credit plan, on balance, is a convenience to both buyer and seller, it has its drawbacks. Consumer protectionists have attacked the plan on three grounds. It has been claimed that the rate charges are too high and that they dilute the buyer's real purchasing power.²³ Further, revolving credit has been said to lead to overcommitment by the buyer with continued indebtedness and personal bankruptcy being

²¹ For a typical revolving charge account agreement see 55 N.W. L. REV. at 352 (1960).

²² The billing date is established by the retailer, approximately thirty days after the agreement is signed, and then thirty days after the first billing date is the subsequent billing date.

²³ From The Chicago Daily News, March 25, 1960, p. 3, col. 1, comes some rough statutory estimates on maximum yearly rates on unpaid balances of consumer loans: credit unions—12%; commercial banks 12-42%; small loan co., 24-48%; retail installment financing of a new car over one year, 12-120%; of a used car, 19-275%. These figures seem to demonstrate that revolving credit is one of the cheapest forms of credit available to the consumer.

the ultimate result.²⁴ Finally, it is claimed by some that the buyer is not made fully aware of the terms of the agreement. He may, therefore, be saddled with credit charges that he knew nothing about.

Sellers complain about the high operating costs of revolving charge accounts.²⁵ The bookkeeping costs and the expense of the initial credit investigation makes the seller's administrative costs substantial. In addition, a certain percentage of the accounts are regularly defaulted. To operate the plan efficiently, therefore, it must be run on a fairly large volume basis.

The retailer's cardinal goal is to maximize the number of customers using the plan, while minimizing the revenue lost through default in payment. Thus, if the plan is reaping a net profit, the retailer will be more likely to extend credit to marginal credit risks, but if the plan is losing money, only the prime credit risks will be allowed to buy merchandise on credit. It might be argued that since the revolving charge plan does tend to increase total sales, the retailer would always try to maximize the number of customers using it. If there was a deficit, he could pass his loss off to the consumer in the form of an increased cash price. However, this thesis is weak because it assumes that all buyers purchase merchandise on credit. If the cash price was raised, the revolving charge account dealer would lose customers to cash-only stores since these stores could sell competing items at a lower cash price.²⁶

Considering these facts, how will a revolving charge account dealer react to regulation of his credit charges? Assuming that the regulated rate is too low,²⁷ the retailer may eliminate the plan completely, run the plan at a loss, or alter the plan so that it is once again profitable. To gain more insight into the effects of a controlled rate structure, let

²⁴ It is difficult to attribute overcommitment by the purchasing public to revolving credit only. We live in a system where credit is prevalent and if revolving credit was eliminated, other forms of credit would be available to the extravagant buyer.

²⁵ Credit costs for J. C. Penney Co. in 1969 amounted to \$102 million, including interest of \$44 million to finance customer receivables; provision for bad debts totaling \$16 million, and \$12 million to administer customer credit. Since the company collected only \$79 million in revenues this left them with a \$23 million deficit for 1969. *The Milwaukee Sentinel*, February 5, 1971, pt. 2, p. 4.

²⁶ See Warren and Jordan, *A Proposed Uniform Code For Consumer Credit*, 8 B. C. IND. AND COMM. LAW REV. 451 (1967). As credit selling becomes more prevalent it becomes easier for the credit seller to allocate his credit costs to the cash price since he does not have to compete with cash sellers. To the extent a retailer is forced to pass off credit costs through a higher cash price, the cash purchaser is in essence paying for the customer who buys on credit. This is a most unfair and undesirable consequence of a too low rate structure.

²⁷ What a low rate is can only be considered as an abstract question. However, there are two concrete indicators we can look to: (a) the legislatures that have regulated these accounts have set a figure between 1 and 2% in all cases. (The most frequent statutory rate has been 1½%.) (b) the workings of our free market has led retailers, in the absence of legislation, to arrive at the 1½% rate most often.

us consider a case in point, the Wisconsin Supreme Court's enjoining of the J. C. Penney Company's 1½% per month interest charge.

The Penney Case and Its Ramifications

The Wisconsin Supreme Court in *State v. J. C. Penney Co.*, held that Penney's revolving charge account was in violation of the state's usury statute.²⁸ The court reached this result by adopting a very legalistic approach to the subject of usury. The four elements of usury were stated, and the revolving charge account was found to have all four elements present. Although prior courts had held that a credit sale was not a forbearance of money, this court abandoned that viewpoint and found the plan usurious. Furthermore, they deemed the "time-price doctrine" not applicable to the revolving charge account because there was no genuine time price submitted to the buyer. As stated earlier, the time-price doctrine has not been a well-carved legal exception to the usury statutes, but only a legal fiction used by the courts to exempt credit sales from usury statutes.

Conspicuously absent from the court's opinion was an examination of the merits of the revolving charge account. There was no discussion of the many social and economic problems that presently exist in the area of consumer credit. There was no mention of whether the determination of a proper rate for revolving credit is a function of the legislature. In short, it is most difficult to glean from the opinion any concrete basis for the court's decision. When the court strictly construed the usury statute it ignored the realities of the outside world.

The court's decision, which took the cue from a few jurisdictions who had made the same error several years before, disregarded current trends in consumer credit. The evidence was clear that if consumer credit sales were to be encouraged, they needed a separate rate structure. The National Conference of Commissioners on Uniform State Laws after many years of deliberation and preparation, drafted the Uniform Consumer Credit Code (UCCC), which endorsed the revolving credit system in the name of convenience to the consumer. Furthermore, numerous states had enacted statutes creating separate rate structures for retail-installment credit. Other legislatures had overruled courts which had made credit sales subject to the usury statutes.²⁹ The Wisconsin Legislature had passed a bill specifically endorsing the instant

²⁸ 48 Wis. 2d 125 at 155.

²⁹ Note the Nebraska experience, *McNish v. General Credit Corp.* 164 Neb. 526, 83 N.W.2d (1957), in which a court found a bona fide credit sale to be a device to avoid usury law. In 1959 the Nebraska legislature passed a retail installment act allowing a greater time price differential than that of the usury statute. Neb. Rev. Stat. 45-305 (Cum. Supp. 1959). *Elder v. Doerr*, 122 N.W.2d 528, 535 (Neb. 1963) declared the above statute unconstitutional in light of a provision in the Nebraska constitution forbidding special laws regulating the interest on money. The battle ended with an amendment to the Nebraska constitution permitting a separate structure for credit sales.

rate structure and credit system that was before the court.³⁰ Nevertheless, the court chose to ignore all these facts and found that the credit rate structure should be subject to the usury statute.

One can only speculate on the reasons for this illogical choice.³¹ It seems that in the past decade the mood of the country had a strong turn in favor of the consumer. This trend toward greater consumer protection may have been a factor influencing the court's interpretation of the usury statute. The court's humanitarian concerns for the consumer may have clouded the more cogent economic and social issues. The Wisconsin Judicare Society further alerted the court to consumerism with an amicus curiae brief which stressed social concepts more heavily than legal concepts. The tenor of their brief portrayed The Penney Company as a corporate giant who ruthlessly fed on the unsophisticated consumer.³² This plea took on an even more appealing tone, in light of the respondent's (J. C. Penney Company) brief. The respondent's principle argument was that its charge plan should be exempt from the usury statute on the basis of the "time-price doctrine." Because this doctrine has merely been a legal fiction, it was easy for the court to be persuaded by an emotional appeal. The respondent gave only a cursory treatment to the need for a separate rate structure in consumer-sized transactions. Although the Uniform Consumer Credit Code provides comprehensive evidence favoring respondent's charge account, it was relegated to a footnote in the Penney brief. Perhaps the court's decision can be explained on the basis of superior advocacy and general compassion for the "underdog." However, we are still faced with the question of what effect the *Penney Case* will have on revolving credit.

Wisconsin's revolving charge account dealers immediately complied with the mandates of the court's injunction and lowered their interest

³⁰ It is most interesting to note that the Wisconsin legislature passed a bill in 1959 that regulated revolving charge accounts at 1½% per month. The bill never became law however because it was vetoed by Gov. Nelson (see Wis. Senate Journal, Veto of Bill 256 S. October 28, 1959). Nelson had no quarrel with the rate structure in general, but thought that perhaps we should follow other states, such as New York, who put only 1% charge on a balance of \$500 and over. These declining interest charges on high principal accounts are little impediment to the retailer. His net return will be high enough to offset his operating costs. See note 17, *supra*.

³¹ The court's interpretation could be rationalized on the basis that the decision would encourage legislative action in this area. This rationale, however, is unsound since the court did not even tacitly point to the legislative character of the problem.

³² These emotional appeals in the name of social reform raise interesting policy questions. To what extent should these groups, through exaggeration and emotionalism, be allowed to controvert the real function of the judiciary? For example, on p. 2 of the Judicare brief, the 1959 Yale Law Journal article by Warren (see note 16 *supra*) is cited as authority for abrogating the time-price doctrine. That same author's viewpoint on consumer credit rate structure is diametrically opposed to Judicare's ideology. Warren's efforts have been directed at correcting consumer abuses where they really exist, while tactics such as Judicare's make great headlines but have a negative effect on the social welfare.

rate to 1% per month. Thus, one might reason that the court's decision will benefit the needy consumer by lowering his interest charge. However, the workings of our free enterprise system make this view highly unrealistic. Assuming that the lowered rate will cause a substantial loss of revenue,³³ the dealer will seemingly try to recoup his losses. This goal will likely be achieved through either raising the cash price or decreasing the risk of non-payment. As has been mentioned before, the former choice is unlikely due to competition from cash-only stores.³⁴ Thus, the dealer will presumably choose the latter method and extend credit to fewer but more trustworthy customers. By limiting the extension of credit the dealer hopes to cut his operating costs by reducing the number of default payments.³⁵ But how will this shrinking of available credit ultimately affect the needy consumer?

First, it must be recognized that persons classified as poor credit risks, even before the decision, were not allowed to open these revolving charge accounts. They were simply too great a credit risk. Furthermore, after the decision, the number of consumers who will not be able to qualify as acceptable credit risks will presumably increase. This group of ineligible consumers will then be faced with two choices regarding credit. They can either forego credit purchases altogether,³⁶ or they can seek other available sources of credit. Whether the other sources of credit are legal (e.g. retail installment or small loan agency), or illegal (e.g. loan sharks), these creditors will demand a much higher fee for the use of their money than the revolving creditor had charged.³⁷ This consumer will be forced from a convenient, reasonable, and forthright type of credit to a cumbersome, more expensive, and possibly prohibitive kind of credit. In short, the court's decision (if allowed to stand) will lower already reasonable interest fees for wealthier consumers, while seemingly closing off one of the cheapest sources of consumer credit to poorer consumers. Perhaps the end result of these misplaced efforts, will be an increase in consumer credit abuses since the rapacious dealer will be supplied with a larger group of unsophisticated consumers in search of credit.

³³ See note 27, *supra*.

³⁴ See note 26, *supra*.

³⁵ In 1969, before Penney's charge was forced to 1% per month, their credit costs exceeded their service charge revenues by \$23 million. Credit costs according to Penney's are made up of financing customer receivables, provision for bad debts and administration costs. Thus, it seems that to cut these credit costs increased selectivity of credit customers would produce the best result.

³⁶ If this is, in fact, what happens, the decision would have merit. Many critics of consumer credit have pointed to overcommitment as one of the principle hardships to the debtor. In practice, however, an individual who is apt to place himself at a debt level he cannot meet, will do so without regard to the kind of credit available. For this reason, the second alternative seems more likely.

³⁷ See 55 N.W. L. REV. at 334, "Revolving credit ... is usually the cheapest form of consumer credit available to the small borrower."

In light of these facts, in what way should the legislature respond to the *Penney Case*? More specifically, should the legislature regulate the revolving charge account at a rate other than the usury rate or should they merely enact permissive legislation that allows the revolving charge account to function unregulated?

The Future of Revolving Charge Accounts

Before considering the question of what legislation is proper, it is essential that open-end credit³⁸ be distinguished from closed-end credit. The Penney Court frequently cited cases that dealt with closed-end credit abuses as though they were interchangeable with open-end credit.³⁹ This failure to categorize open-end credit as a separate entity made it impossible for the court to consider the merits of revolving credit. Let us first look at closed-end credit transactions.

The standard installment sales contract is a typical example of a closed-end transaction. Usually, the seller parts with certain goods in exchange for the buyer's promise to pay. The promise is ordinarily made in the form of a note and the debt is most commonly divided into a specified number of equal payments. These payments are spread over an agreed period of time. The term closed-end credit is derived from the limited nature of the credit extended. The seller extends credit only to the extent of the buyer's indebtedness.

The nature of the closed end credit transaction presents the dishonest dealer with many opportunities for abuse. The system itself and the circumstances surrounding the system place the creditor in a favorable position.

The closed-end creditor typically handles one product line⁴⁰ of fairly high-priced durable goods. Furniture stores and car dealers are typical examples of businesses that may make closed-end credit available. Since the closed-end creditor deals in durable items, his customers will probably be making only an occasional purchase. Therefore, good-will is not as important a factor for him as it is for the seller of a wide variety of products.

³⁸ The scope of this paper is limited to the retail store revolving credit plans. Other forms of open-end credit, such as "Master Charge", have become increasingly popular in recent years. These plans usually consist of smaller retailers who bind together and pay the credit company a fee for collecting their customer's debt.

³⁹ The Wisconsin Supreme Court cited only one previous case that held revolving charge accounts subject to the usury statutes. It is interesting to note that in that case (*Sloan v. Sears Roebuck and Co.*, 228 Ark. 464, 308 S.W. 2d 802 1957) the Arkansas court tacitly absolved the revolving credit dealer from any wrongdoing, but held the plan to be usurious in an attempt to control other dishonest dealers (presumably in closed-end credit). See *State v. J. C. Penney Co.* 48 Wis. 2d at page 151.

⁴⁰ Perhaps the most common closed credit dealer is the used car dealer. Other examples include sellers of snowmobiles, lawnmowers, televisions, washing machines, and generally all large appliances.

Since the closed-end credit transaction is usually financed through the buyer's promissory note, the seller can discount this note to a finance company and refuse any demands to repair or deliver the merchandise.

Closed-end creditors deal in high priced goods, thus the principle amount on which interest is computed will ordinarily be large. Consequently, the dollar-amount paid for credit will be much higher than that paid for less expensive items. The buyer's ignorance of finance charges can further encourage the vender to collect exorbitant interest charges. This all leads to an environment that is most suitable for a rapacious credit dealer.

To make the setting even more conducive to unethical business practices, this market has an abundance of uneducated and unsophisticated consumers. Because this form of credit is more available to low-income consumers, a greater percentage of these credit buyers will come from the lower economic class. These credit buyers have difficulty identifying inferior merchandise and many have a tendency to overcommit themselves when credit is made available. The low-income consumer is no match for a smooth talking salesman. Consequently, the closed-end creditor can take advantage of many consumers, not only because the system favors the creditor, but also because he frequently deals with indiscriminating buyers.

The characteristics of open-end credit, on the other hand, render it a convenient method of buying for most consumers. These stores carry a wide variety of merchandise and depend on continued patronage to prosper. Goodwill is clearly a valuable asset and the customer can expect to be treated with a sense of fairness. As has been mentioned, the interest charges are kept at a level that will assure the seller reasonable operating expense, without allocating too great a burden on the credit buyer. Since the primary function of this credit is to increase total sales volume, too high a credit charge would defeat the purpose of the credit plan. In fact, the average credit charge is kept quite low due to the relatively small principle and time figures used to compute interest.⁴¹ In addition, separation of the consumer's duty to pay from his right to performance is not a source of friction in open-end credit systems. The credit buyer does not issue a note to create the debt and thus the buyer's obligation can not be transferred to a finance company. In short, open-end credit does not provide the seller with an oppor-

⁴¹ In a study conducted by Prof. Robert W. Johnson, using a leading retailer who was selected at random, it was found that equating the monthly charge of 1½% with an 18% per year figure is very misleading. Of the accounts studied, 25.8% of the purchasers paid no interest charge whatsoever and 80.2% of the purchasers were below the theoretical 18% mark.

In connection with this note the comment of a Penney's executive: "Even the financially sophisticated" think retailers make a handsome profit on service charges by charging 1½% per month on revolving charge account balances... the formula does not equal 18% a year because of payment options which charge customers have each month. . . ."

tunity to take advantage of the consumer. On the contrary, since open-end credit is extended to only the better credit risks, the consumer is more likely to be on equal footing with the seller.

It is therefore predictable that both courts and legislatures have addressed themselves to the problems of closed-end credit more frequently than open-end credit. Nevertheless, in light of the increased use of open-end credit, more legislatures have enacted laws directed to this area of credit. Most of the statutes deal with standardized disclosure of terms and regulation of the rate of interest.⁴²

Let us next consider what the appropriate response of the Wisconsin Legislature should be in view of the *Penney* decision. Focusing on disclosure requirements, it must be recognized that disclosure serves two separate functions. The first is to compel the seller to adequately inform the buyer in advance about the terms of the credit agreement. This should show how the credit charges will be computed, a statement of previous balances, amounts debited and credited, the current balance, and the amount presently payable.⁴³ Although it appears that most revolving creditors already meet these requirements, the legislature ought to make disclosure of these items mandatory. Awareness on the part of the consumer is essential if he is to choose the credit plan that best suits his needs.

The second function of disclosure is to provide the consumer with a time-rate charge in order that he may compare one seller's cost of credit with another's.⁴⁵ This time-rate charge should be expressed in the same manner by all credit sellers so that the consumer can easily select the most competitive credit charge. It must be noted, however, that disclosure of a time-rate is not possible in open-end credit agreements. This is so because a time-rate cannot be computed when either the time of outstanding indebtedness or the total credit extended is undeterminable. For example, a buyer who purchases an item one day after the billing date and pays for the item twenty-nine days after his

⁴² Note Maleson, *Consumer Credit Regulation* 23 ALB. L. REV. 312 for a discussion of the New York law dealing with open-end credit.

⁴³ In brief form, these are the items that are required to be disclosed under the UCCC.

⁴⁴ This concept of full disclosure, generally, is the theme of the UCCC. It is thought that with full disclosure of terms and a vigorous competition, consumers can determine for themselves the most convenient and the best forms of credit. For this to occur, however, the credit market must not be bogged down with technical licensing requirements. A vigorous competition relies on an easy entry into the market. Furthermore, the consumer must be educated and encouraged to familiarize himself with the terms of the many forms of available credit.

⁴⁵ This cost of credit disclosure is related to the first function in that theoretically both should aid the consumer in shopping for the best credit package. However, cost of credit seems to be more directly related to competition while the disclosure of terms functions more as a method of making the buyer aware of the bargain he will enter into. In light of consumer apathy to contract terms and finance charges, both functions of disclosure may be purely academic questions.

subsequent bill, will pay no interest. Another buyer with a shorter period of indebtedness may pay an eighteen per-cent interest charge or higher. Because of these variables, it appears that disclosure of a time-rate in revolving credit would serve only to mislead the consumer,⁴⁶ rather than inform him. However, once a charge for credit is certain, the dollar amount the buyer will pay should be stated in his monthly bill. Further, the rate of interest used to compute the credit charge should always be disclosed in the original agreement.

Turning to the question of regulation of revolving charge account rates, it is important to consider whether the rates are currently oppressive or whether they have a potential for abuse if left unregulated. If we conclude that control of rates is desirable, it will still be necessary to examine what impact regulation will have on the whole of consumer credit. In other words, even if legislation is necessary from a theoretical standpoint, legislation should be enacted only if the benefit derived from control of rates outweighs the harm done to the total credit picture.

It is a formidable task to determine what an oppressive credit charge is. It is somewhat akin to establishing what the poverty income level is in the United States. It seems, however, that when one envisions an oppressed consumer, one gets the picture of a buyer who has been taken advantage of, either due to his ignorance or his inferior bargaining position. Just like the needy borrower who came before him, the credit buyer can find himself in a position where he needs to purchase certain items⁴⁷ to function as a viable unit in society. The question then is whether the revolving charge account buyer is in this disadvantageous bargaining position?

As previously stated, the revolving charge account, for the most part, is not made available to high credit risks. It is therefore most difficult to picture a revolving-credit buyer in an unfair bargaining position. He can always refuse to purchase if the interest charge is too high. But assuming, *arguendo*, that the buyer is needy it does not follow that he is subservient to the seller for all credit purchases. If the item to be purchased is a necessity he may have no choice but to pay the interest rate demanded. However, if the merchandise can be classified as less than a necessity, the needy buyer can always refuse to purchase the item if he finds the interest rate too high. Many items sold under the revolving charge plan are not needed to function in our society. This

⁴⁶ See note 41, *supra*.

⁴⁷ This is precisely the point where many of the critics of our present day system of credit have failed to be discriminating. They reason that since our society has become highly mechanized, articles that were luxuries in the past are now necessities. It therefore follows that credit charges must be kept at a minimum by government in order to give the needy credit buyer these necessities at the lowest cost. But have all items sold on credit become necessities? It is difficult to understand why credit charges on an item such as a snowmobile should be controlled given this rationale.

is even more true of the higher-priced merchandise. The interest charge on this expensive purchase is the most significant since the dollar-amount paid for credit is highest in these cases. The rates are further kept at a reasonable level by a working competition for the buyer's continued patronage. It must be remembered that the cardinal aim of the credit plan is to maximize sales. A non-competitive credit charge would be self-defeating, since it would decrease total sales. In brief, the revolving-creditor's interest charges are kept at a reasonable level by two intermingled forces, the prerogative of the credit-buyer to refuse to purchase most items and the seller's struggle on the competitive level to maximize his sales. It is, therefore, clear that in most circumstances, the revolving credit buyer does not find himself in this disadvantageous bargaining position.

In light of these facts, legislative control of open-end credit rates would not seem to be indicated. Assuming, however, that a need for such regulation was demonstrated,⁴⁸ the question then is whether this policy would ultimately benefit the people of the State.

There is no question that the selection of the ideal credit rate is a delicate task. Since the 1½% per month rate is currently the most popular, both with legislatures and the free market, one might look to this level as an ideal standard.⁴⁹ However, even if this is the optimum rate today, an inflationary economy can render the choice inappropriate in the future. Our free enterprise system is too dynamic and it gives the seller too much mobility to allow an administered rate to function efficiently. If the legislature chooses a rate that is below the market level what will be the ultimate effect? As stated previously a low interest rate will either cause the seller to limit his credit accounts, (driving the ousted consumers to more expensive kinds of credit), or to pass off credit charge to his cash customers in the form of a higher cash price. In either case legislation designed to benefit the consumer will ultimately have a deleterious effect on the consumer. Given this hypothesis, it becomes clear that unless regulatory legislation is an indisputable necessity the choice of an ideal credit rate ought to be left to free market forces. The market can adjust to the interests of both the consumer and the seller with greater ease than the legislature. Only in the face of clear-cut malfunctioning of the market⁵⁰ should government tamper with interest rates.

⁴⁸ The economic and social climate could be pictured differently than my previous description. Instead of a working competition, there could be present a combination between all dealers in revolving credit whose aim it is to maintain credit charges at an artificially inflated level. The social conditions could be such that most products sold under the credit plan would be necessities, and most buyers no longer would have the power to refuse to purchase at high interest rates.

⁴⁹ See note 27, *supra*.

⁵⁰ See note 48, *supra*.

In concluding, legislative action of a limited nature is recommended to overrule the *Penney Case*. This could be accomplished through some type of permissive legislation that would identify the revolving charge account and allow it to exist unencumbered.

Conclusion

In recent years, some courts have seen a need to regulate interest charges on credit sales. They have accomplished this, for the most part, by limiting the "time-price doctrine" so that credit sales no longer enjoyed their historical exemption from the usury statutes. Since it is not feasible for the seller to extend credit at the usury rate, the consequence of this action has been a decrease in the availability of credit. In the absence of corrective legislation, this scarcity of credit will presumably drive the consumer to more expensive forms of credit, with the net result being that the consumer will pay interest fees many times that charged by the vendor.

The Wisconsin Supreme Court in *State of Wisconsin v. J. C. Penney Co.*, all but abolished the time-price doctrine as it applied to revolving charge accounts in Wisconsin. This being so, some Wisconsin consumers can anticipate being turned away from this relatively inexpensive form of credit.⁵¹ This tighter credit market at a time when people are demanding more open-end credit should, hopefully, serve to move the law-makers to action. To best fit the interests of the state of Wisconsin, it is suggested that permissive legislation be enacted which will call for mandatory disclosure of the terms of the agreement and will permit the revolving charge account to function subject only to the mandates of the market.

RONALD WARZYN

⁵¹ Unless "realistic laws are enacted," retailers no longer will be able to extend credit, Kenneth S. Axelson, vice president and director of Finance and Administration at Penney's, told the New York Society of Security Analysts. The Milwaukee Sentinel, February 5, 1971, part 2, p. 4, col. 1.