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WISCONSIN CONSUMER ACT—A CRITICAL ANALYSIS

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I. INTRODUCTION

On March 1, 1973, the Wisconsin Consumer Act ("WCA" or "Act") became effective in the State of Wisconsin and ushered in what is probably the most sweeping consumer credit legislation yet enacted in any state.¹ Although many states, including those which have adopted the Uniform Consumer Credit Code, have enacted some consumer protection provisions similar to those contained in the WCA on a piecemeal basis, the Wisconsin legislation appears to be the first code which not only includes most, if not all, of the provisions enacted in other states, but also, a variety of new controls and regulations enacted for the first time anywhere.

The provisions of the WCA regulate almost all aspects of the consumer debtor-creditor relationship, from the creation of the indebtedness to the provisions permitted in the contract itself, as well as the enforcement of the agreement through informal and formal methods of collection. Also, the Act, for the first time in Wisconsin, provides for broad regulatory powers by a state administrator over all consumer credit grantors, not just licensed lenders

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1. The WCA was originally enacted in March, 1972, Wis. Laws 1971, ch. 239 (effective March 1, 1973) and consisted of Wis. STAT. chs. 421-427. Since passage of the WCA, three sets of amendments have been enacted in Wis. Laws 1973, ch. 2 (effective March 1, 1973) which made a number of technical modifications, Wis. Laws 1973, ch. 3 (approved February 22, 1973, effective March 1, 1973) which clarified a number of provisions of the Act and contained substantial revisions to ch. 424, and Wis. Laws 1973, ch. 18, (effective April 22, 1973) which essentially substituted ch. 428 in place of the WCA to govern all first mortgage real estate loans under \$25,000 having an annual percentage rate of 12% or less. This article discusses the WCA as amended by these three session laws, and for ease of reference refers to the "February 22, 1973 Amendments" (Wis. Laws 1973, ch. 3) and "April 22, 1973 Amendments" (Wis. Laws 1973, ch. 18) where appropriate.

and other previously licensed credit grantors which have traditionally been subject to regulation.

This article will point out to the practicing attorney the substantial changes which the WCA has made from prior Wisconsin law, and provide a critical analysis of the statutory provisions and some of the problems which are presented by the language of the new legislation. Where important, the philosophies of consumer and creditor interests with respect to certain provisions are also explained.

Before discussing the particular provisions of the WCA, it may be helpful to mention the basic underlying objectives which appear to have guided the various consumer and creditor groups which contributed to drafting and promoting the legislation. The main objectives espoused by the consumer groups which have supported the "consumer protections" of the WCA were essentially to eliminate and prevent alleged harsh and abusive credit practices and to attempt to make the consumer more aware of the nature of his objections.

On the other hand, the creditor groups involved in creating the legislation claimed that their main objective was to provide legislation which would correct credit abuses without becoming so unduly burdensome on creditors as to unfairly limit legitimate extensions of credit. Also, a primary objective was to limit the possibility of exorbitant penalties for technical violations of what was known would be a highly technical act. Both groups agreed that the additional obligations imposed on creditors would result in higher operating costs, which would necessitate increased allowable interest rates and finance charges.

Perhaps the most important aspect to be noted concerning the objectives of each of the groups is that the creditors were not diametrically opposed to the consumers' purposes as has been the case in other states, but agreed to work with the consumers' main attempt to produce agreeable legislation.² This is not to say that the opposing factions did not differ on the wording of the various

2. The fact that creditors were interested in developing a comprehensive consumer credit code is evidenced by their participation from 1969-1972 on the legislative advisory committee appointed to study the Uniform Consumer Credit Code (hereinafter referred to as "UCCC"). The final version of the UCCC reported out by the committee contained substantially more "consumer protection" provisions than the official version of the UCCC. Although the UCCC was abandoned in favor of the WCA, the cooperativeness of creditors toward adopting workable consumer credit legislation was established and carried over to negotiations concerning the WCA.

provisions, since there was substantial disagreements and intense negotiations, but on the whole, the goal of both groups was to provide a workable consumer credit package for Wisconsin.³

II. SCOPE

Although the WCA covers all consumer credit transactions, it does not erase all other consumer credit legislation in effect in Wisconsin prior to its effective date. For example, section 218.01 WIS. STATS. *et. seq.*, concerning the financing of automobiles, mobile homes, etc.,⁴ section 138.09 relating to licensed lenders, section 138.12 relating to insurance premium financing, and various other sections concerning the regulation of credit transactions, continued in effect after March 1, 1973, although with some modification. However, any "consumer" credit transactions entered into by a creditor pursuant to said separate statutes, is also subject to the WCA. Therefore, consumer credit transactions may be subject to coverage under one of the above-mentioned sections as well as the WCA, although presumably conflicts will be resolved in favor of the specific statute.⁵ Thus, it may be necessary to consult not only the provisions of the Act, but also specific legislation which may exist in other parts of the Wisconsin Statutes.⁶

The provisions of the WCA apply to all "consumer transactions," essentially defined as encompassing transactions entered into by a natural person seeking property, services, money or credit for personal, family, household or agricultural purposes.⁷ Although the major thrust of the Act is certainly directed toward regulation of consumer "credit," it should be noted that the Act also extends to some non-credit consumer transactions.⁸

3. For an interesting commentary on the negotiations concerning the WCA, see Davis, *Legislative Restriction of Creditor Powers and Remedies: A Case Study of the Negotiation and Drafting of the Wisconsin Consumer Act*, 72 MICH. L. REV. 3 (1973).

4. All references to statutory sections are to the 1971 Wisconsin Statutes. Reference to "WIS. STAT." is hereinafter omitted in this article.

5. Section 138.09 (relating to licensed lenders) and § 138.12 (relating to insurance premium financing) specifically state that those sections will prevail in the event of any inconsistency with the provisions of the WCA.

6. In addition to the sections mentioned in the text, it is important to note that the usury provisions contained in §§ 138.05 and 138.06 were not eliminated by the WCA and still remain in effect for non-consumer credit transactions concerning individuals not regulated by other statutes, including those transactions specifically exempt from the WCA under § 421.202.

7. Section 421.301(13) and (17). See further discussion concerning applicability of the WCA to consumer transactions, including consumer credit transactions, *infra* text at 393.

8. In particular, the provisions governing consumer approval transactions under ch. 423

A number of transactions are specifically excluded from the WCA in section 421.202, including extensions of credit to organizations or any transaction in which all parties are organizations (except for certain cooperatives specified in section 421.301(17) and (28)), certain transactions involving late payment or discount for early payment with public utilities or common carriers, pawnbroker rates, financing of insurance by insurers (except for credit insurance subject to chapter 424),⁹ consumer credit transactions where the amount financed or cash price exceeds \$25,000, real estate transactions falling under chapter 428 and security transactions by broker dealers.¹⁰

In attempting to determine the scope of the Act, a legitimate criticism would appear to be the confusing definitions contained in section 421.301. For example, section 421.301(10) defines a "consumer credit transaction," which is the type of transaction most often subject to the provisions of the WCA, as a transaction between a "merchant" and a "customer" in which "real or personal property, services or money is acquired on credit and the customer's obligation is payable in installments or for which credit a finance charge is or may be imposed. . . ." However, to determine who is a "merchant" and who is a "customer," other provisions of section 421.301 must be consulted. The definition of "merchant," in section 421.301(25) states that he is a person who regu-

and debt collection practices under ch. 427 apply to consumer transactions as well as consumer credit transactions.

9. Although § 421.202(5) refers to "the sale of insurance by the insurer" (emphasis added), the exclusion obviously is intended to apply to the *financing* of insurance by an insurer which would otherwise be a "consumer credit transaction" no matter what financing arrangement is employed. If the exclusion were intended to be limited only to non-credit sales of insurance, the reference to the applicability of ch. 424 would not be necessary, since that chapter only applies to insurance provided in relation to credit transactions. See § 424.102. Of course, most insurance premium installment payment arrangements do not constitute "consumer credit" anyhow since the payment schedule usually is sufficient to keep the insurance paid in advance and no "debt" is created. FRB Information Letter (Mar. 18, 1970), 4 CCH CONSUMER CREDIT GUIDE ¶ 30,406 (1974) (hereinafter cited as GUIDE).

10. Subsections (7) (which excludes transactions subject to ch. 428) and (8) (which excludes certain securities transactions) to § 421.202 were added by the April 22, 1973 Amendments. The passage of ch. 428 was in response to the heavy criticism leveled at the application of the Act to smaller home loans, especially those sponsored by government agencies such as the FHA or VA loan programs. Several sections of the WCA as originally enacted contained special provisions for consumer credit transactions secured by a first lien or equivalent security interest, and to the extent that such transactions are covered by ch. 428 (*i.e.*, loans not exceeding \$25,000 secured by a first lien real estate mortgage or equivalent security interest with an annual percentage rate of 12% or less), the WCA is no longer applicable.

larly “advertises, distributes, offers, supplies or deals in real or personal property, services, money or credit in a manner which directly or indirectly results in or is intended or designed to result in, lead to or induce a *consumer transaction*.” (emphasis added) A “consumer transaction” in turn is defined as a transaction in which one or more of the parties is a *customer* in section 421.301(13). A “customer” is defined in section 421.301(17) essentially as an individual who “seeks or acquires real or personal property, services, money or credit for personal, family, household or agricultural purposes.”

The key term in the definition of “customer” is the word *credit* which is defined in section 421.301(14) as the right “granted by a *creditor* to a customer to defer payment of debts. . . .” (emphasis added) A “creditor” is defined in section 421.301(16) to mean “a *merchant* who regularly engages in *consumer credit transactions* or in arranging for the extension of *consumer credit*” (emphasis added) Looking for the explanation of the key words in the term creditor, it is seen that the definition is circular referring back to the definition of a “merchant” (which includes a “creditor”) and a “consumer credit transaction” which is a consumer transaction between a merchant and a customer. These circular definitions probably will cause far more confusion than assistance in determining precisely who falls under the coverage of the WCA and what transactions will be covered. Arguably the provisions of the Act would have been easier to understand if some of these terms had not been defined at all, or at least defined without circular references.

Nevertheless, an analysis of the interrelated definitions would appear to indicate generally that a “consumer credit transaction” is one between a person regularly in the business of extending credit (a “merchant”) and a natural person (“customer”) which constitutes either a loan of money, or a sale of real or personal property or services, or a lease of personal property,¹¹ primarily for personal, family, household or agricultural purposes,¹² and (a) in which any part of the loan is repayable or any part of the price of

11. A consumer lease subject to the WCA does not include a leasehold interest in real property. WIS. ADM. CODE Bkg. § 80.05 (hereinafter regulations promulgated under the WCA will be cited as “Bkg.”).

12. Bkg. § 80.06 states that the *primary* purpose, that is 50% or more, of the transaction must be for personal, family, household or agricultural purposes before the WCA will apply (emphasis added).

the real or personal property or rental of personal property is payable on a deferred basis for which a finance charge is imposed, or (b) in which such loan, purchase price, or rental is payable in more than four installments whether or not there is any finance charge, or payable in two or more installments (other than a down payment) if any installment is more than twice the amount of any other installment.¹³

Some of the possible confusion in determining whether a particular transaction is one which would be subject to the WCA is removed by the provision in the definition of "customer" which allows any person by agreement to become a "customer" and be governed by the Act. Therefore, for example, the fact that certain credit card users might actually be purchasing items for business or other non-consumer purposes which would not be subject to the WCA (but would still be subject to the usury limits contained in section 138.05) certainly could result in problems for retailers honoring credit cards unless the individual could agree to become a "customer" under the WCA and subject to the Act.¹⁴

One other concept contained in the definitional section of the WCA deserves particular attention since it may dramatically change the fundamental concept of the validity of written agreements in consumer transactions. Section 421.301(3) defines an "agreement" to mean the "bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance." The section also states that provisions prohibiting introduction of parol or extrinsic evidence, such as section 402.202 of Wisconsin's Uniform Commercial Code, shall be inoperative to exclude or limit the admissibility of evidence relating to agreements subject to the WCA.

Apparently the purpose of this section is to allow customers to explain in court what they were told by the creditor or seller in those circumstances where they were misled as to the content of the written contract. However, the language of section 421.301(3) goes much further and not only permits customers to introduce evidence claiming that the written contract does not express their understanding of the agreement, even where the language in the

13. Bugge and Holbrook, *Creditor's Responsibilities and Duties Under the WCA*, 46 WIS. BAR BULL. 38-39 (Feb., 1973).

14. *Id.* A more detailed discussion of the problems with regard to transactions which may include both consumer and business aspects is also discussed more fully in that article.

contract is unambiguous, but also permits challenge to such written contracts based on "implication" to the contrary from the merchant's "course of dealing" or "performance".

Elimination of the parol evidence rule and permitting challenge to written documents by implication from the merchant's course of dealing could certainly be costly for merchants since it could have the effect of encouraging specious challenges on the part of customers and subjecting merchants to the possibility of continuous harassment and delay in collection proceedings. On the other hand, the value of this section as an additional benefit to customers is certainly questionable, especially in light of the broad definition of what constitutes "unconscionable" conduct by a merchant under other provisions of the WCA, which would appear to be sufficient to protect those customers unfairly taken advantage of by merchants.¹⁵ Presumably courts will interpret this section narrowly and will set aside written provisions only when the customer has clear and convincing evidence that the "agreement" between the parties was contrary to the written contract.

Undoubtedly the most noticeable impact of the WCA will be felt in the area of consumer credit sales. Such transactions, except for automobile and mobile home financing under sections 218.01 and 218.04 respectively, for the first time will be subject to a limitation on the amount of time price differential which may be charged as well as subject to the other provisions of the WCA and regulations issued thereunder. Prior to the effective date of the Act, such consumer "time sales" were not subject to any statutory regulation and were not limited by the restrictions on interest contained in the usury statutes because of the long established court created rule that the "time price differential" in a credit sale (the difference between the cash price and the time sale price) is not "interest".¹⁶

It is interesting to note that the general approach of the WCA is to treat all credit grantors, both lenders and sellers, as "mer-

15. See §§ 425.107 and 426.108 and discussion, *infra* text at 475 for provisions concerning "unconscionable" conduct.

16. The "time-price differential" concept was first announced by the United States Supreme Court in the early case of *Hogg v. Ruffner*, 66 U.S. (1 Black) 115 (1861). In that case, the Court held that a seller could charge one price if payment was to be made at the time of sale and another higher price if payment was to be made at a later time. The difference between the time price and the cash price was not "interest" which would be subject to usury limitations, but rather a contract which was outside the scope of usury statutes. The concept, although still valid, has been increasingly narrowed in its application. *E.g.*, *State v. J.C. Penny Co.*, 48 Wis. 2d 125, 179 N.W.2d 641 (1970) and *State ex rel. Turner v. Younker Brothers, Inc.*, ___ Ia. ___, 210 N.W.2d 550 (1973).

chants" under the Act, thereby attempting to eliminate the traditional distinction between interest on loans and the "time price differential" in credit sales.¹⁷ By combining most of the provisions concerning loans and consumer sales, the WCA differs substantially from the Uniform Consumer Credit Code which has been adopted in seven states to date.¹⁸ In the UCCC, a separate chapter is provided for credit sales and for loans, apparently on the theory that each type of creditor would be able to look to those sections which applied particularly to him. However, there is considerable redundancy in the UCCC's provisions on sales and loans, and, perhaps taking a cue from the WCA, the latest UCCC working draft has adopted the approach of consolidating the provisions concerning credit sales and loans.¹⁹

It should be noted that the WCA, in addition to applying to what is typically thought of as a consumer credit transaction, (that is, credit for personal, family or household purposes), also includes extensions of credit for "agricultural" purposes as does the Truth-In-Lending Act on the federal level.²⁰ The Truth-In-Lending Act, as initially proposed, did not include agricultural credit since it was considered that such extensions of credit were more in the nature of a "business" credit extension rather than a consumer credit extension, but it was amended prior to final passage to include agricultural credit. The reasoning, although not clear from the Truth-In-Lending Act itself, apparently was a feeling that small farmers needed protection as much as individual consumers. How-

17. Despite the fact that sellers and lenders are identified as "merchants" and treated the same in most provisions of the WCA, sellers are treated differently in several significant provisions, including: § 422.303(2) (the terms evidencing the consumer credit sale must be set forth in at least 8 point standard type); § 422.406 (most negotiable instruments are prohibited in consumer credit sales); § 422.417 (restrictions on security interests differ with regard to sales and loans); §§ 425.209 and 425.210 (limitation on deficiency judgments only apply to consumer credit sales).

18. The UCCC has been adopted in one form or another in the following states: Colorado, Idaho, Indiana, Kansas, Oklahoma, Utah and Wyoming. For the official UCCC text and state variations see 1 GUIDE ¶¶ 4770-5703.

19. UCCC Working Redraft No. 5 (Nov., 1973), *National Conference of Commissioners on Uniform State Laws*. CCH INSTALLMENT CREDIT GUIDE, CONSUMER CREDIT, Issue No. 264. Part 5 of art. 2 of the Working Redraft combines many aspects of sale and loan transactions including delinquencies, deferrals, refinancing and consolidations and other items which previously were contained in separate articles of the UCCC as adopted in the states mentioned in *supra* note 16. Working Redraft No. 5 also includes many other provisions based on the WCA.

20. Title I of The Consumer Credit Protection Act of 1968, Pub. L. No. 90-321, 82 Stat. 146, 15 U.S.C. § 1600 (1968) *et. seq.* is more popularly known as the "Truth-in-Lending Act," and will be referred to as such in this article.

ever, the many basic differences between the typical credit for consumers and credit for agricultural purposes has resulted in substantial special provisions for agricultural credit under Regulation Z, the regulation implementing the federal law.²¹

Apparently, as a result of the extension of the Truth-In-Lending Act to agricultural transactions, subsequent consumer credit codes have usually included agricultural credit as consumer credit, as is the case with the WCA. However, the problems which have become apparent in attempting to treat the two types of credit identically under the Truth-In-Lending Act, which only concerns disclosure of credit terms, are magnified under comprehensive credit codes, such as the WCA, which regulate the terms of credit arrangements in addition to disclosures. In recognition of the peculiar nature of agricultural credit when compared with the more traditional types of consumer credit, the WCA treats agricultural credit differently from credit for personal, family or household purposes throughout its provisions.²²

III. TERRITORIAL APPLICATION

The territorial application of the WCA set forth in section 421.201 is extremely broad and purports to extend the WCA to any consumer transaction "made" within the state (which definition includes many types of transactions normally thought to be outside the state), to all refinancings, consolidations, or deferrals "made" in Wisconsin of any consumer credit transaction no matter where originally consummated, as well as to a variety of transactions consummated outside the borders of the state.

Section 421.201(2) states that a consumer transaction is "made" within the state if the merchant either (i) receives the customer's offer to enter into the obligation or the executed document representing the obligation within the state or (ii) "induces" a customer to enter into a transaction by "face-to-face" solici-

21. *See, e.g.*, § 226.8(0) of Regulation Z to the Truth-in-Lending Act (providing special disclosures for prompt payment "discounts," a typical agricultural credit arrangement). 12 C.F.R. § 226.8(0); 1 GUIDE ¶ 3579.

22. Thus, for example, certain aspects of agricultural credit are treated differently in the following sections: § 422.201(4) (separate rate for sellers of farm implements); § 422.203(4) (different delinquency rate for agricultural credit); § 422.402 (agricultural credit excluded from prohibition against balloon payments); § 422.412 (agricultural credit excluded from limitation on size of last rental payment in consumer leases); [§ 422.417(1)(e)] (security interest in after acquired property allowed in agricultural sales); § 423.201 (agricultural sales excluded from right to cancel a "consumer approval transaction") and § 425.103(2)(a) (separate definition for "default" in agricultural credit transactions).

tion or by "mail or telephone solicitation" directed to the particular resident within the state.²³

Under this sweeping definition, it would appear, for example, that an Indiana mail order retailer which has no contact within the state of Wisconsin other than by sending its catalogs and order solicitations to particular persons within the state and which only accepts credit orders upon receipt in Indiana, would nevertheless be subject to the WCA since such merchant could be claimed to have "induced" the Wisconsin resident to enter into the transaction by "mail . . . solicitation directed to the particular customer in this state."²⁴ Paradoxically, if the transaction were reversed and a Wisconsin mail order retailer mailed such solicitations to particular individuals in Indiana, and accepted credit orders upon receipt in Wisconsin, the WCA still would purport to apply since the "offer of the customer" would be "received by the merchant in this state."

The attempt to extend the WCA to transactions which only have a casual contact with Wisconsin under section 421.301(2)(b) could result in irreconcilable conflicts with the laws of other states. Section 1.201(a) of the UCCC, for example, provides that agreements or offers to purchase "received" in the state are subject to the UCCC, and conceivably an out of state merchant in a UCCC state, such as Indiana, could find itself not only subject to Indiana law because it "receives" the executed contract or offer in Indiana, but also subject to the WCA because it "induced" a Wisconsin resident to enter into the transaction. The dilemma for such creditors undoubtedly will have to await court solution.

Section 421.201 not only applies the WCA to transactions "made" in Wisconsin (under the expanded definition of that term), but also purports to extend certain provisions of the WCA to consumer transactions made by a Wisconsin resident while outside the state boundaries. Thus, section 421.201(6) provides that an out of state merchant cannot enforce provisions of any consumer transaction entered into with a Wisconsin resident if such provisions violate subchapter IV of chapter 422 or chapter 423, even if such provisions would not violate the laws of the state in which the

23. Presumably the phrase "*directed to the particular customer*" would only extend to mail solicitations bearing the name of the particular customer, and would not extend to general solicitations addressed to the "occupant" of the premises (emphasis added).

24. This possible extension of the WCA to such out-of-state merchants has been challenged by an out-of-state mail order creditor. See *Aldens v. Warren, Atty. Gen. and Mildenberg, Com'r. of Banking*, Case No. 72-C405, filed Oct., 1972 (W.D. Wis.).

transaction was consummated. Subsection (6) also provides that if such merchant attempts to enforce his out of state transaction in Wisconsin, he may collect charges only to the extent permitted by chapter 422. Thus, for example, if a Wisconsin resident went to Indiana and purchased an automobile, the Indiana seller would have to adhere to Wisconsin law, at least with regard to subchapter IV of the chapter 422 and chapter 423, and if he were forced to enforce the contract through legal proceedings in Wisconsin, he could only collect the charges to the extent permitted by chapter 422.

Although section 421.301(6) attempts to have certain protections of the WCA follow Wisconsin residents wherever they may travel, it is easy to visualize the confusion which would result if other states adopted similar provisions. For example, if each state adopted an identical provision, each seller throughout the country would have to determine the residence of every one of its buyers and have appropriate contract forms available to make sure he would be in compliance with the pertinent provisions of the consumer laws of the buyer's state. The burden on interstate commerce of such laws would be staggering.

In fact, subsection (6) of section 421.201 could be constitutionally deficient as a deprivation of property of the out of state creditor without due process of law, a denial of full faith and credit to the other state's statutes, or an unconstitutional impairment of the contract consummated in the foreign state.²⁵ Although it is beyond

25. The language of § 421.201(6) does not limit its application to enforcement in Wisconsin courts, but purports to apply the specified WCA provisions to contracts entered into by Wisconsin residents in other states even if the contract is valid under the laws of that state and apparently even if enforcement is sought in the courts of the other state. This application certainly could be attacked as a denial of due process. *See, e.g.,* Hartford Accident and Indemnity Co. v. Delta and Pine Land Co., 292 U.S. 143 (1934) where the Court stated that a state could not "in an action based upon such a [foreign] contract enlarge the obligations of the parties to accord with every local statutory policy solely upon the ground that one of the parties is its own citizen." *Cf.* John Hancock Mutual Life Insurance Co. v. Yates, 299 U.S. 178 (1936). Even if enforcement were sought in Wisconsin courts, the due process and full-faith-and-credit clauses of the U.S. Constitution generally appear to prohibit a state from declining to apply the law of the situs of a contract merely because enforcement is contrary to that state's public policy. *Annot.*, 92 A.L.R. 932 (1934). In fact, strict application of § 421.201(6) would virtually abolish numerous statutory provisions of other states, such as those contained in small loan or retail installment sale statutes which specifically permit the practices prohibited in the WCA sections referred to in § 421.201(6). For example, unfettered application of § 421.201(6) could prohibit an out-of-state creditor who enters into a consumer credit transaction with a Wisconsin resident in the creditor's home state from collecting rates valid in his state if they exceed the rates in ch. 422, even if such rates were permitted under a small loan statute requiring licensing.

the scope of this article to discuss such constitutional issues, constitutional challenges to this provision would not seem unlikely.

Aside from the constitutional difficulties of section 421.201(6), the difference between the restrictions contained in subsection (6)(a) and subsection (6)(b) are noteworthy. Subsection (6)(a) does not state that an out-of-state transaction with a Wisconsin resident is limited to the charges contained in chapter 422, but only that a merchant cannot collect charges in excess of those permitted rates if he attempts collection through "actions or other proceedings" in the State of Wisconsin. Thus, if the Wisconsin resident pays the charges originally contracted for without legal proceedings, there would be no violation of the WCA even if such charges exceeded those permitted in chapter 422.

By contrast, subsection (6)(b) states that a merchant may not "enforce" any rights against a Wisconsin resident to the extent that the provisions of the contract violates subchapter IV of chapter 422 or any of the provisions of chapter 423. Thus, it would appear that contractual provisions not conforming with those requirements of the WCA could not be enforced against a Wisconsin customer whether through legal proceedings or otherwise. In fact, since there is no limitation on the purported applicability of subsection (6)(b), its provisions would appear to apply to a transaction with a Wisconsin resident even if the merchant enforces the contract through legal proceedings in his own state, although it probably is unlikely that an out-of-state court would invalidate a provision of a contract legal in that state but prohibited by the WCA simply because the buyer was a Wisconsin resident.

Section 421.201(5) extends the application of the WCA even further by stating that subchapters I and II of chapter 425 apply to actions brought in Wisconsin to enforce rights arising from consumer transactions (or extortionate extensions of credit) whether originally subject to the WCA or not. If subchapters I and II of chapter 425 merely contained procedural remedies, the application of the WCA pursuant to this section would appear to be little more than a restatement of the usual conflicts of law rule

Similarly, a Wisconsin resident could claim that a valid negotiable instrument taken by an out-of-state creditor in a consumer credit sale consummated in the foreign state is void under § 422.406 or that otherwise valid security interests are nullified by the provisions of §§ 422.417 and 422.418. Such provisions and others might be prohibited in contracts with Wisconsin residents even though the contract was consummated in a foreign state which specifically permitted them and upon which the foreign creditor relied in entering into the transaction.

which states basically that the procedural requirements of the forum state control legal proceedings. However, subchapters I and II go far beyond simply stating procedural rules, and include such substantive provisions as defining when a "default" occurs which will permit commencement of legal proceedings, a requirement that merchants give customers a "right to cure" such defaults, a restriction on the deficiency which will be allowed if collateral is seized and sold, and a requirement that the merchant is to give the customer a right to "redeem" collateral once possession is obtained by the creditor.²⁶ Imposing these limitations on contractual provisions which are contrary to the WCA but were valid when made would appear tantamount to rewriting the agreement, and consequently the validity of this section to the WCA may also be constitutionally suspect.

Apparently, except for application of chapter 427 concerning debt collection procedures and subchapters I and II of chapter 425, a consumer credit transaction consummated outside the state of Wisconsin by a non-Wisconsin resident is enforceable in accordance with its terms in Wisconsin under Section 421.201(7).

Section 421.201(3) provides that open-end credit plans are subject to the WCA where the customer is a resident of Wisconsin and the merchant honoring the credit card is also a resident or furnishes, mails, or delivers the goods, services or credit to the customer while he is in Wisconsin. Although it would appear that this subsection is intended to limit the application of the WCA to the circumstances described therein, it should be noted that open-end

26. To illustrate the possible applicability of § 421.201(5), assume that an Illinois merchant sells an automobile for \$1,000 (including the finance charge) in a credit sale to an Illinois resident and takes a security interest in the automobile to secure the obligation. The contract provides that upon missing one installment, the seller has the right to repossess the car and commence legal proceedings for collection. If the Illinois resident then moves to Wisconsin (whether or not he formally becomes a Wisconsin resident) and ceases to make payment, the applicability of the WCA under § 421.201(5) would not only prohibit the Illinois seller from peacefully repossessing the automobile without court order (§ 425.206), but to commence legal proceedings in Wisconsin for collection, he would have to wait until "two" installments were in "default" (§ 425.103), give a notice of right to "cure" the default (§ 425.104), and grant a fifteen day redemption right if he repossesses the automobile after the appropriate court hearing (§ 425.208). Moreover, since the amount of the obligation would be less than \$1,000, after electing to repossess the automobile, the seller would not be permitted to sue for any deficiency if the value of the automobile would not be sufficient to repay the entire unpaid balance of the indebtedness (§ 425.209). These restrictions contained in ch. 425 purport to apply under § 421.201(5) even though they were not applicable when the contract was consummated and even though the Illinois seller had no opportunity to consider the extra expenses he would be faced with in the event of default when deciding the finance charge to charge the customer.

credit transactions are not excluded from the other portions of section 421.301. Since a consumer credit transaction includes open-end credit, it could be argued that all of the provisions of section 421.301 could apply to such transactions in addition to the special provisions of subsection (3).

Finally, subsection (4) of section 421.201 provides that chapter 427 regulating debt collection activity applies to collection of debts within the state no matter where the original transaction arose.

IV. RATES

The WCA generally provides that all persons, unless regulated under separate statutes, who extend consumer credit (whether in the form of a loan or a credit sale) may impose a finance charge not exceeding the simple annual interest rate of 18% per year on the first \$500 of credit extended plus 12% per year on any amount over \$500.²⁷

With regard to loans, the Act essentially creates an exception to the 12% per annum usury limit contained in section 138.05,²⁸ and allows lenders, such as banks, savings and loan associations, credit unions and other lenders not otherwise specifically regulated under separate statutes, to impose an increased finance charge rate of 18% per annum in consumer credit transactions on the first \$500 of the loan.

Although the 18% rate on the first \$500 may represent an increase in interest for a loan or forbearance or other debts subject to Wisconsin usury limits, it may well represent a decrease in the finance charge rate imposed by consumer credit sellers since most consumer credit sales were completely unregulated prior to the effective date of the WCA, and it was permissible to charge a time price differential equal to any annual percentage rate which the market would bear.

The Act also provides that finance companies who make loans under section 138.09 and automobile sales finance companies extending credit under section 218.01 will continue to be regulated by the rates provided in those sections.²⁹ Although the legislative

27. Section 422.201.

28. Section 138.05 sets a general usury limit of 12% per year computed on the declining unpaid balance of the loan or forbearance except for precomputed loans repayable in substantially weekly or monthly installments in which case the maximum rate is an "add-on" rate of \$6.00 per \$100 per annum which is an annual percentage rate of approximately 10.90% for a one year obligation.

29. The Administrator of the WCA (hereinafter referred to as "Administrator") has ruled that the rates permitted under § 422.201(3) for licensed lenders under §§ 138.09 or

bill containing the WCA also modified the rates allowed under those respective sections, the rates generally remain the same.³⁰

In addition, dealers who sell new or used farm equipment, implements, tractors, and the like, are now limited to the same rate which licensees under section 218.01 may charge for class 2 motor vehicles.³¹

Notwithstanding the rates in subsections (2), (3) and (4), section 422.201(8) allows a merchant to contract for a minimum finance charge of \$5.00 where the amount financed does not exceed \$75, or \$7.50 when the amount financed exceeds \$75 in transactions not pursuant to an open-end credit plan.³² Presumably the "mini-

218.01 "pre-empt" the general rate permitted in subsection (2). Bkg. § 80.231. Therefore, if a rate under subsection (3) is lower than the general rate permitted under subsection (2), the creditors specified in subsection (3) are limited to the lower rates. *See infra* note 31.

30. For a comparison between the rates permitted under the WCA and rates allowed under prior law, *see Stute, An Overview of the Wisconsin Consumer Act*, 46 WIS. BAR BULL. 9, 14-15 (Feb., 1973). Generally, § 218.01 rates for motor vehicle financing were unchanged after the effective date of the WCA except that the maximum allowable time-price differential on Class 4 motor vehicle sales defined in § 218.01(6) was lowered from \$15 per \$100 to \$13 per \$100 per year, although Class 4 was expanded to include five-year-old motor vehicles whereas before a vehicle had to be six years or older. With regard to licensed lenders under § 138.09, previously such lenders operated under § 138.07 (secured loans) and § 138.09 (unsecured loans up to \$3,000). These two statutory sections essentially were consolidated on the effective date of the Act in § 138.09, and licensees thereunder may now charge a discount rate of \$9.50 per \$100 per year on the first \$1,000 plus a discount rate of \$8.00 per \$100 per year on any remainder over \$1,000 up to \$3,000. On loans over \$3,000 of any size (or if desired, for loans under \$3,000 as well) licensed lenders are permitted to charge interest up to 18% per year.

31. § 422.201(4). The finance charge rate for the credit sale of Class 2 motor vehicles under § 218.01(6) is limited to a maximum add-on rate of \$9.00 per \$100 per year. On a one year precomputed installment sale, this rate is equal to an annual percentage rate of approximately 16 1/4%. This rate, of course, is a lower rate than the 18% allowed generally under § 422.201(2) for other credit sales where the amount financed is less than \$500. Although it would appear that the main purpose of subsection (4) was to give farm implement sellers an alternative higher rate to subsection (2) when financing sales over \$500, the Administrator has issued Bkg. § 80.24 stating that the rate for farm implement dealers under subsection (4) is an exclusive rate, and not an alternative rate. Under this regulation, farm implement dealers are limited to the \$9.00 add-on rate under subsection (4) for all sales, whether under or over \$500.

32. It would appear that subsection (8) of § 422.201 intends to provide an alternative to the rates permitted in subsections (2), (3), and (4) in the event that rates computed under those sections are less than the minimums specified in subsection (8). Thus the language states that a merchant "may" charge the minimum rate specified therein. Nevertheless, the Administrator, in Bkg. § 80.241 has ruled that the "election" provided in subsection (8) is not merely an alternative, but rather is a limitation on the rates permitted in subsections (2), (3), and (4) in the event a higher minimum would be permitted thereunder. Consequently, despite the fact that § 218.01(6)(b)(6) provides for a minimum time-price differential of \$15 in motor vehicles sales contracts, the Administrator has ruled that the minimum finance charge under § 422.201(8) is exclusive and the higher minimum provided under

num" charge is earned when the transaction is consummated, and does not have to be rebated in the event of prepayment.³³

Interestingly, section 422.201(8) does not place any limitation on the application of the minimum interest charges, and theoretically the \$5.00 and \$7.50 minimums can be applied regardless of the repayment schedule. Thus a thirty day loan of \$50 can have a minimum charge of \$5.00 even though the actual annual percentage rate would be 120%.³⁴

With regard to open-end credit transactions (credit card and other similar open-end credit) the rates are similar to the rates allowed on closed-end transactions in that a periodic rate of 1 ½ % per month may be charged on outstanding balances up to \$500 plus 1% per month on any amount over \$500.³⁵ However, the Act prohibits the so-called "previous" or "opening balance" method of computing finance charges and requires that such finance charge be computed upon either the "average daily balance" of the account during the billing cycle or the "closing balance" of the account (the amount outstanding on the last day of the billing cycle after deducting all payments, credits and refunds during the billing cycle).³⁶ Other provisions regulating open-end credit rates are also

§ 218.01(6)(b)(6) is no longer permitted in consumer credit transactions. The validity of this regulation appears questionable in the light of the direct statutory language in § 422.201(3) specifically making the § 218.01 rates applicable to licensees thereunder (the exclusivity of which is emphasized by the Administrator himself in Bkg. § 80.231) and the equally unambiguous language of § 422.201(8) permitting a merchant to elect the minimum finance charge specified therein. (Bkg. § 80.241 mistakenly refers to § 218.01(6)(a)(6) instead of § 218.01(6)(b)(6)).

33. Thus, upon prepayment of an obligation (whether the finance charge is precomputed or not), the merchant is entitled to charge an amount equal to the minimum charges in § 422.201(8) in the event the earned finance charge upon prepayment would otherwise be less than such minimums. This conclusion is supported by the fact that the language of § 422.201(8) permits the merchant to "contract for and receive" the minimum finance charge and such language is not found in the general rate language of subsections (2), (3), and (4). Furthermore, subsection (8) permits a minimum charge in both precomputed and non-precomputed transactions while the rebate provisions of § 422.209 only relate to precomputed transactions. Since the minimum charge could be contracted for and received in a non-precomputed transaction and would not have to be rebated upon prepayment, it is only logical that the minimum finance charge could also be retained in a precomputed transaction upon prepayment.

34. This subsection permits minimum charges equal to those for which § 129(a)(5) of the Truth-In-Lending Act requires no annual percentage rate disclosure. 15 U.S.C. § 1639(a)(5) (1968). Since the WCA incorporates the disclosures required under the Truth-In-Lending Act in § 422.301, the annual percentage rate of such a minimum finance charge does not have to be disclosed.

35. § 422.201(9). Compounding interest in open-end credit plans is permitted by Bkg. § 80.221.

36. § 422.201(9)(a).

contained in section 422.201(9).

In addition to the finance charge permitted by section 422.201, a credit grantor may impose certain "additional charges" outlined in section 422.202, including official fees and taxes,³⁷ charges for premiums for credit life or credit accident and sickness insurance (written in connection with the consumer credit transaction if such insurance is not required by the merchant as a condition of the loan and the customer gives affirmative written indication of his desire for such insurance), charges for property insurance (written in connection with the transaction if a specific statement is furnished to the customer stating the cost of the insurance if obtained through the merchant and stating that the customer may obtain such insurance from any person other than the merchant if he desires), and certain charges incurred in connection with extensions of consumer credit secured by a first lien or equivalent security interest in real property.

One confusing aspect of the authorization to collect additional charges under section 422.202 is that the language states that the merchant may receive such additional charges only if he "bargains for" them. Although the concept that certain provisions must be "bargained for" is contained in several sections of the WCA, it appears to make little sense in section 422.202 since all the charges permitted therein are established by statute or third parties and not by the merchant. For example, the cost of filing a financing statement to perfect a security interest in Wisconsin is set by section 409.403 and the amount cannot be negotiated or bargained for between the merchant and the customer. Similarly, since the premiums for credit life, accident and sickness or property insurance are usually set by an insurer which has filed its rates with the Insurance Commissioner, the merchant has no power or authority to bargain with the customer on the rate. The merchant must offer the insurance to the customer at the rate specified, or not offer it at all.

It might be argued that the concept of "bargaining" between merchant and customer was not intended to apply to the amount of the additional charge, but rather to whether the charge should

37. "Official Fees" are defined in § 421.301(26) to include fees actually paid to officials for determining or perfecting a security interest as well as premiums payable for insurance in lieu of perfecting. In addition, Bkg. § 80.08 makes it clear that official fees can include a termination fee for terminating an outstanding financing statement or mortgage when termination of such prior security interest or mortgage is agreed to by the customer and is necessary for the merchant to obtain the security interest or mortgage priority agreed upon by the parties.

be included in the transaction at all. However, a careful reading of the section does not support such an interpretation since the merchant is not prohibited from requiring the customer to pay the additional charges as a condition to extending the credit, except with regard to credit life and accident and sickness insurance.³⁸ Thus it would appear that a merchant may require the customer to pay for insurance and other additional charges (except for credit life and accident and sickness insurance) as a condition of the extension of credit, and the only "bargaining" which would be available to the customer concerns whether he wants the credit, with the additional charges, or does not want the credit at all.

Ironically, similar language is not found in section 422.201 which sets forth the maximum rates allowed in consumer credit transactions. Thus, a merchant is not required to "bargain for" the amount of the finance charge he may receive on an extension of credit, yet he is required to bargain for "additional" charges set by third parties which are usually beyond his power to alter. The precise meaning of the "bargain for" phrase in section 422.202 is most confusing, and appears to have no purpose. Hopefully it will be ignored by the courts or eliminated by the legislature.

V. DELINQUENCY CHARGES

Section 422.203(1) provides that a delinquency charge in an amount not exceeding \$3.00 or 3% of the unpaid amount of the installment, whichever is less, may be assessed on any installment which is not paid in full on or before the tenth day after its sched-

38. Thus § 422.202(1)(b) states that credit life or credit accident and sickness insurance cannot be "required" by the merchant. Since this subsection specifically states that this type of credit insurance cannot be "required," it follows logically that all other charges enumerated therein may be so required. Similarly § 422.202(1)(c) states that the cost of property insurance, to be considered a permitted "additional charge," must be disclosed in writing as must the fact that the customer may obtain such insurance through another insurer of his choice. It is obvious that this subsection does not prohibit the merchant from requiring the customer to purchase such property insurance as a condition of extending the credit as long as the customer is not required to purchase the insurance from the merchant himself. Provisions similar to this language contained in the Truth-In-Lending Act have been consistently interpreted to permit the creditor to require property insurance to insure collateral and excluded the premium from the finance charge provided that the customer is given conspicuous notice of his right to purchase such insurance from any person of his choice and is not required to purchase it from the creditor. *See, e.g.*, Interpretation § 226.403 to § 226.4, Regulation Z. 1 GUIDE ¶ 3518.05. The fact that § 421.302(20) defines "finance charge" as any charge payable by the customer "as a condition of the extension of credit" does not prevent the merchant from requiring the "additional" charges in § 422.202 as a condition of the extension of credit since § 421.301(20) specifically excludes "additional charges under § 422.202" from the definition of finance charges.

uled or deferred due date. This subsection also provides that only one such delinquency charge may be imposed with regard to any one installment, no matter how long that installment is delinquent.

The concept of a "one-time" delinquency charge substantially changes the law prior to March 1, 1973 with regard to consumer loans, since section 138.05(3) allowed lenders to obtain a delinquency charge equal to the maximum usury rate in all consumer loan situations.³⁹ Thus, a lender could impose a charge of up to 12% per annum (or 1% per month) until the delinquent installment was paid.

Creditors have traditionally resisted the concept of a one-time delinquency charge on the grounds that such a limitation substantially weakens the underlying premises of delinquency charges. First of all, creditors claim that delinquency charges should serve as a type "penalty" to encourage repayment on schedule in addition to compensating the creditor for the outstanding money which was not paid when due. Where only a one-time default charge will be assessed, they argue, it is obvious to the customer that once the delinquency charge is imposed, the longer he stays in default the "cheaper" his delinquency will become since he will have to pay only a one-time charge whether he pays one month or one year after the scheduled due date. Secondly, delinquency charges, at least to some extent, offset the creditors additional bookkeeping and collection costs which result from delinquent accounts and assess such additional costs to the party in default.

On the other hand, the consumer groups advocating the one-time default charge feature in the WCA claimed that the recurring delinquency charge under the usury statutes often resulted in an undue burden on customers. It was charged that many creditors allowed the delinquency to continue without attempting collection in order to build up additional delinquency charges, especially where the indebtedness was secured and the creditor knew that the value of the collateral would be enough to cover the remaining obligation plus all of the accrued delinquency charges.

In limiting delinquency charges to a one-time charge to 3% of the delinquent installment up to \$3.00, it would appear that the

39. Section 138.05(3) states:

A contract to make loans or an evidence of indebtedness may provide for a rate of interest or penalty payable upon the principal amount of an extension of a loan or forbearance or upon any amount in default under a loan or forbearance which shall not exceed the rate allowed in subsection (1)(a).

legislature responded mainly to consumer arguments, although it might be argued that the 3% charge is still a large enough amount to be a "penalty" that will encourage prompt payment.⁴⁰ On the other hand, it could be that the limitation will also have unintended repercussions for consumers. One by-product of the one-time default charge limitation undoubtedly will be that merchants will be forced to act more quickly to attempt collection in delinquency situations since they literally will not be able to "afford" to wait and see if the delinquent customer can make his payment. Consequently the consumer may be subject to swifter repossessions and formal collection proceedings.

It is submitted that a more satisfactory compromise between consumer and creditor interests would result if a continuous default charge would have been permitted up to a maximum. For example, a delinquency charge of 2% per month up to a maximum of 6% would appear to resolve consumer complaints, but would also take into consideration the basic interests of creditors, namely to encourage repayment on schedule as well as partially offset collection and bookkeeping costs. Also, merchants would not be forced to immediately initiate repossession or formal collection procedures since they could wait at least three months without giving the customer a "free" ride.

In addition to limiting delinquency charges to a one-time charge equal to the lesser of 3% of the unpaid amount of the installment or \$3.00, section 422.203(2) specifies that, for the purposes of determining delinquency charges, payments will be applied first to current installments and then to delinquent installments. To illustrate the application of payments, assume that a customer did not make a payment in a monthly installment extension of credit, (for ease of illustration, assume that the customer does not pay his January installment) and then makes sporadic payments from time to time. In such a situation, absent our statu-

40. UCCC §§ 2.203 and 3.203 grant a creditor the option of imposing a one-time delinquency charge equal to 5% of the unpaid amount of the installment or \$5, whichever is less, in consumer credit sales or loans, or in the alternative, to impose a delinquency charge equal to the permitted deferral charge. The deferral charge allowed under UCCC §§ 2.204 and 3.204 is essentially the same as the original annual percentage rate disclosed to the customer. Therefore, although a delinquency charge based on the deferral charge rate would usually result in a monthly charge which would be less than the one time 5% or \$5 delinquency charge if the delinquent installment were paid shortly after default, it could result in a greater total delinquency charge if there were an extended delinquency since the deferral charge rate could be imposed continuously on the delinquent installment until paid in full.

tory restrictions, most creditors would apply the payments received to the installments due in the order in which they were due. That is, any amounts paid by the customer would be applied to the January installment until it (and the permitted delinquency charge) was paid in full. Further payments would be applied to the February installment until it (and the permitted delinquency charge) was paid in full, and so on until the obligation was satisfied.

Although consumer groups apparently do not oppose such an application of payments in general most consumer advocates nevertheless felt that the application of payments to the order in which the installment was due would be unfair for the purposes of determining delinquency charges under the WCA because of the possible misunderstanding of the concept of a "one-time" delinquency charge. They claimed that a customer who "skipped" only one installment, but then made subsequent payments equal to a full installment on each of the remaining scheduled installment due dates, might be lulled into think that he would be liable for only one delinquency charge. Absent the restriction in section 422.203(2), of course, such would not be the case.

If, for example, the customer missed his January installment, but brought in an amount equal to a full installment on his February installment due date, the merchant could apply that payment toward the delinquent January installment (since payments would be applied to installments in the order in which they were due) and the February installment would then be delinquent. Since the February installment would be past due, the merchant would impose another one-time delinquency charge on that installment. If the January installment were the seventh installment in a twelve month contract, the customer would pay six one-time delinquency charges (one delinquency charge each for the seventh through twelfth installments) even though he brought in an amount equal to each of the remaining installments on their respective due dates after his missed January payment and believed that he was delinquent on only that one payment.⁴¹ Therefore, unless a customer brought in an amount large enough to pay both the delinquent installment and the current installment, he would be one month delinquent on the remainder of his loan or credit sale and a delinquency charge would be imposed each month.

41. Thus, the one-time delinquency charge limitation in § 422.203(1) itself does not prohibit the application of payments and imposition of delinquency charges described in the example in the text.

To prevent unwary customers from incurring such unintended delinquency charges, consumer groups demanded that a customer should be protected when he misses a payment but makes subsequent payments on time. The result was subsection (2) to section 422.203 which requires a merchant to apply payments first to current installments for the purposes of determining delinquency charges. Thus, in the above example, the payment brought in on the February installment due date (or within the ten day grace period) would be applied first to the February installment period. If the amount brought in is equal to the *full* current installment, there is no delinquency charge under section 422.203(2) for that month even though prior installments remained unpaid and were delinquent.

Note, however, that the legislature apparently intended subsection (2) to apply only to the very narrow problem area specified above, that is, where the customer brings in a *full* payment on a scheduled payment due date and believes that the payment will be applied to the installment then due. The subsection does not prevent merchants from applying payments to installments in the order they are due for *all* purposes *other than* determining a delinquency charge under subsection (2).⁴² Allowing merchants to continue the practice of applying payments to installments in the order they are due is extremely important for accounting purposes as well as for determining the rebates upon prepayment, and for determining deferral periods and deferral charges.⁴³

Also, note that subsection (2) states that a delinquency charge cannot be assessed against the current installment while earlier installments are delinquent *only if* the current installment is "paid

42. Section 422.203(2) states:

No delinquency charge may be collected on an installment which is paid in full on or before the 10th day after its scheduled or deferred due date even though an earlier maturing installment or a delinquency charge on an earlier installment may not have been paid in full. *For purposes of this subsection, payments are applied first to current installments and then to delinquent installments.* (emphasis added)

Bkg. § 80.221 specifically permits the application of payments to "the most delinquent" installment except for the "calculation of delinquency charges" under subsection (2) of § 422.203.

43. Thus, in the example used in the text, for all purposes other than the purpose of determining the delinquency charge under subsection (2), the payment brought in on the February installment due date (or within the ten-day grace period) would be applied to the delinquent January installment (and accrued delinquency charges) first. February's installment would still be due and owing (and hence technically delinquent) with the only difference from the practice prior to the effective date of the WCA being that no delinquency charge could be imposed on the delinquent February installment.

in full.” If an amount less than the full installment were received, the merchant apparently would not have to apply it to the current installment. Therefore, in the above example, if the customer is delinquent on his January installment, and on the February installment due date brings in an amount which is half of the normal required installment amount, the merchant would only have to determine whether the payment received is enough to pay the February installment in full. Since it would not be, the merchant presumably can ignore subsection (2) and could apply the amount received to the delinquent January installment for purposes of determining delinquency charges. The merchant then would be entitled to collect a delinquency charge equal to 3% of the *entire* February installment under subsection (1).⁴⁴

44. The following is submitted as an illustration of the application of the current installment rule contained in subsection (2) of § 422.203:

(a) If the first installment of \$50 of a monthly payment loan (12 equal installments of \$50 each) is due on January 1, but only \$10 is paid on that date and no further payment is made on or before January 11, a delinquency charge of \$1.20 (3% of \$40, the unpaid amount of the January installment) accrues for that installment payment as of January 12. Since no prior installment is delinquent, the payment must be applied to the January installment and a delinquency charge of 3% of the unpaid amount of that installment is assessed.

(b) If on January 15, the borrower makes a second payment of \$10, the amount may be applied to the delinquency charge and unpaid balance of the January installment. (See Bkg. § 80.221.) Thus \$1.20 may be applied to pay the January delinquency charge and \$8.80 to the unpaid balance of the January installment. The remaining unpaid overdue balance of the loan on January 15 would be \$31.20.

(c) If another \$10 payment is made on January 31, the amount in arrears would be reduced to \$21.20.

(d) If no further payment was made in January and on February 5, the borrower makes a fourth payment of \$10, the \$10 payment may be applied toward the unpaid amount of the January installment. The amount owing after application of this \$10 payment would be \$11.20 unpaid on the January installment plus \$50 unpaid on the February installment. However, the February installment would not be delinquent until February 12 and no delinquency charge may accrue until then. (Since a delinquency charge is permissible only if the installment is not paid on or before the tenth day “after” the installment due date, the borrower has until the end of February 11 to pay an amount equal to the full February installment to avoid a delinquency charge for February).

(e) If the borrower, after making the \$10 payment on February 5, pays another \$40 on or before February 11, there can be no delinquency charge for the February 1 installment since an amount equal to the “full” February installment would be made within the applicable grace period. For bookkeeping purposes, however, all payments can be applied first to the delinquent January installment and the remainder to the February installment. Thus, as of February 12, the total amount in arrears on the loan would be \$21.20. (This amount is arrived at as follows: The total due in January and February is \$100 plus the \$1.20 default charge for January. The customer paid \$80 leaving an amount unpaid of \$21.20. There is no delinquency charge for February).

Although the concept of "delinquency" charges is usually applied only to precomputed credit transactions,⁴⁵ the WCA does not contain such a limitation, and section 422.203 permits such charges in non-precomputed consumer credit transactions as well. Thus, it appears that the Wisconsin legislation allows merchants to impose a delinquency charge in addition to a simple interest rate in non-precomputed credit transactions.⁴⁶ For example, if a customer borrowed \$500 on a simple interest bearing basis (not precomputed), and the loan was repayable in 12 equal monthly installments of principal plus accrued interest, and if the customer missed his January installment, then the lender could not only continue to receive an interest charge at the annual percentage rate of the loan on the missed installment until it is paid, but in addition, he could impose the one-time delinquency charge allowed in section 422.203(1). Therefore, in a delinquency situation, a merchant with a non-precomputed loan or credit sale will have a much greater total charge upon delinquency than is permitted to the merchant under a precomputed transaction.

The fact that section 422.203 applies to non-precomputed credit transactions as well as precomputed credit transactions presents another peculiar dilemma. Subsection (4) states that "interest" after maturity shall be at the rate specified in section 138.05(1)(a) (12% simple interest per annum), provided that no delinquency charge is taken on the final scheduled installment. Does this mean that "interest" after maturity is in lieu of the finance charge rate of the original transaction or is such interest in addition to the finance charge rate?

If the "interest" after maturity is meant to be the exclusive

(f) On the other hand, if the customer made no other payment after his \$10 remittance on February 5, on February 12 the creditor would be entitled to an additional delinquency charge of \$1.50 (3% of \$50). The 3% can be applied against the full \$50 February installment because the \$10 payment made on February 5 could be applied to the delinquent January installment, and would not have to be applied to the February installment under § 422.203(2). The language of that subsection only requires application to the current installment if an amount equal to the "full" installment is remitted during the February grace period.

45. See, e.g., UCCC §§ 2.203 and 3.203. However, NCA § 2.204 does not limit the delinquency charge to a precomputed transaction but allows such charges to be imposed on any transaction whether precomputed or non-precomputed.

46. Section 422.201(2) states that the finance charges permitted therein may be imposed on the "unpaid balance" of the amount financed. Thus, the finance charge in a non-precomputed transaction may be applied on the amount financed as long as it remains "unpaid" even though the amount financed may remain unpaid beyond its originally scheduled due date.

charge after maturity, it may result in a charge after maturity which is substantially less than the original annual percentage rate, even while the merchant is prohibited from collecting the indebtedness. To illustrate, if a customer borrows \$500 at 18% on a thirty day note, and then refuses to pay the note when due on its maturity date, under the theory that the 12% is the exclusive charge, the lender could not continue to charge the agreed 18% rate after maturity, but would be forced to lower its rate to 12%. This would appear to encourage customers not to pay non-precomputed indebtedness as scheduled where the rate exceeds 12% since the interest rate after maturity (and after default) would actually be lower than the original interest rate agreed upon.

The possible unfairness to merchants extending credit on a non-precomputed basis under this theory would be magnified under the amendment to section 425.301 passed on February 22, 1973 which provides that no single payment loan is in "default" until forty days after maturity.⁴⁷ In the above example, the lender and debtor could agree to a thirty day loan of \$500.00 at 18%, but if the debtor refused to pay at the end of thirty days, the lender could then charge only 12% for the next forty days and could not proceed to collect the obligation through legal proceedings until the end of that forty days.⁴⁸

Furthermore, the theory that the interest after maturity is exclusive would have a paradoxical effect; during the term of a non-precomputed transaction a merchant could collect *both* the finance charge and delinquency charge on any installment past due, but after the maturity date, he no longer would be permitted to collect a finance charge, and the permitted "interest" after maturity could well be lower than the original annual percentage rate of the obligation.

On the other hand, if the interest is permitted as an additional charge after maturity, on a \$500.00 extension of credit, the total rate after maturity could be as high as 30% (the maximum annual percentage rate of 18% plus "interest" after maturity of 12%). Although this total rate of 30% after maturity apparently would not be in violation of the maximum finance charge rates permitted in section 422.201 because the definition of what constitutes a "finance charge" in section 421.301(20) specifically excludes delinquency charges under section 422.203, it certainly does not appear

47. See § 425.103, *as amended*, by February 22, 1973 Amendments.

48. For a discussion on the concept of "default" under the WCA, see text, *infra* at 455.

to be in conformity with the intent of the rest of section 422.203. The thrust of that section is to limit the charges imposed upon the delinquent customer.

The precise intention of the legislature here is impossible to determine, although logic seemingly would support the second theory permitting interest after maturity as a charge in addition to the finance charge rate. These inconsistencies appear to arise because the delinquency charge section has been extended to non-precomputed transactions.⁴⁹ A suggested solution would be to limit section 422.203 to precomputed transactions, and in non-precomputed transactions simply allow the merchant to apply the annual percentage rate to the unpaid balance of the obligation until paid in full, including when the obligation is delinquent.

Finally, with regard to delinquency charges on the extension of agricultural credit, whether on a precomputed or non-precomputed basis, the WCA grants the merchant the option of imposing the 3% delinquency charge permitted under section 422.203(1) or the 12% interest rate permitted under section 422.203(4)(b) although the same questions concerning the exclusivity of such charges vis-a-vis the finance charges are still present.

VI. DEFERRAL CHARGE

Turning to section 422.204 concerning deferral charges, the WCA specifically allows the customer and merchant to defer one or more installments in any precomputed consumer credit transaction. Deferral charges, of course, are not necessary with regard to non-precomputed transactions since the finance charge under section 422.201(2) may be assessed against the outstanding balance of the obligation until paid, at least until the maturity date of the transaction.

In order to understand the allowable deferral charges contemplated under section 422.204 and the effect of prepaying an obligation after it has been deferred, it should first be pointed out that there are two concepts which may be employed in "deferring" a credit transaction. One method contemplates deferring a specific installment from its due date until the end of the term of the

49. During negotiations over various provisions of the WCA between consumer groups and representative creditors, consumer advocates demanded that the delinquency charge section apply to both precomputed and non-precomputed transactions, basically because the NCA's section on delinquency charges was applicable to non-precomputed transactions as well as precomputed transactions.

contract or some other specific date. The other contemplates deferring the entire obligation, not just one installment.

To illustrate the first theory, assume that the customer wishes to defer his seventh installment to the end of his twelfth month obligation. The parties would agree to defer the seventh installment to become due one month after the last installment, and thus the seventh installment is placed at the end of the transaction. A simple interest rate would be charged from the due date of the seventh installment until it is paid one month after the last installment due date. Deferral by this method is permitted by section 422.204(1)(b), which permits a deferral rate equal to the original annual percentage rate of the transaction.⁵⁰

Under the second theory, using the same example, the seventh installment would not be deferred to one month after the end of the contract, but rather each installment remaining in the transaction would be deferred for a one month period. Thus, the seventh installment would be due on the due date originally scheduled for the eighth installment, and the eighth installment would be due on the due date of the ninth installment, and so on to the end of the contract. The twelfth installment would then be due one month after its original scheduled due date. In essence, the whole obligation (all remaining installments) is deferred one month. This method is also sanctioned by the WCA under the circumstances specified in section 422.204(1)(a).⁵¹

In calculating the deferral charge at the time of the deferral, theoretically it makes no difference which method is employed since the total deferral charge will be identical. For example, the deferral charge will be the same whether the seventh installment is deferred for six months at the original annual percentage rate or whether the seventh and all subsequent installments (a total of six installments) are each deferred one month at the same rate.⁵²

50. The theory of deferral described in this paragraph of the text appears to have been the only one permitted under § 138.05(3) which controlled deferrals of consumer loans or forbearances prior to the effective date of the WCA. The maximum deferral rate under § 138.05(3), which still applies to all non-consumer loans or forbearances subject to the usury statutes, is a rate equal to 12% per annum.

51. Although the UCCC does not spell out both of the procedures cited above in the statutory text, the Official Comments to UCCC §§ 2.204 and 3.204 also contemplate that on deferral the installment can be treated as deferred until the end of the contract or all installments may be considered deferred for the deferral period. Section 422.204(1) simply makes the alternatives statutory.

52. The statutory language of § 422.204(1)(a) and (b) contemplates that the deferral charges would be identical under either method if the merchant allocated his finance charge

However, the method of deferral does make a difference with regard to calculation of rebates of finance charges in the event of

under the so-called "flat actuarial method" based on the annual percentage rate. [See Official Comment to UCCC § 2.201 for discussion of finance charge allocation methods. When the "Flat actuarial method" is employed, basically 1/12 of the annual percentage rate of the transaction is used to determine the rate applicable to each monthly period, and the fact that the finance charge was actually calculated using graduated rates (under the WCA, 18% up to \$500 and 12% thereafter) is ignored. However, since subparagraph (a) requires use of the finance charge "attributable to the final installment" of the original transaction to be used as the multiplier to determine the deferral charge, if some method other than the "flat actuarial method" is used to allocate the finance charge, the deferral charges under the two provisions will be different.

To illustrate, assume that the customer borrows \$600 at an annual percentage rate of 10.90% (which is an add-on rate of \$6 per \$100) repayable in twelve equal monthly installments of \$53 each. (Finance charge equals \$36 and the total of payments is \$636). If the seventh installment were deferred to one month after the original maturity date of the loan, the deferral charge under § 422.204(1)(b) would be \$2.89 (\$53 deferred for six months at the annual percentage rate of 10.90%). This charge would be identical to the deferral charge resulting under subsection (1)(a) if the finance charge is allocated according to the "flat actuarial method." The finance charge attributable to the last installment would be \$.481 (1/12th of 10.90% x \$53), and the deferral charge for deferring the seventh and all subsequent installments one month each would be \$2.89 (6 installments multiplied by \$.481).

However, if the finance charge is allocated on some method other than the "flat actuarial method", such as the direct ratio method (more popularly referred to as the "sum of the digits" or "Rule of 78" allocation method), then the deferral charge under subparagraph (a) would be lower than the charge resulting under subparagraph (b). (See *infra* note 61 for discussion of "Rule of 78.") Under the "sum of the digits method", the finance charge "attributable" to the last installment would be \$.461 (1/78th of the total finance charge of \$36). Using the formula in subparagraph (a), the deferral charge in the example above would only be \$2.77 for the same period. (\$.461 x 6 = \$2.77.) It should be noted that one of the main reasons merchants would prefer to make deferrals under subsection (1)(a) even though subsection (1)(b) could yield a higher deferral charge is because of the ease in computing refunds upon prepayment under the method allowed under subparagraph (a). See discussion in text.

Despite the fact that § 422.204(1)(a) does not limit the method of finance charge allocation to determine the finance charge "attributable" to the last installment, Bkg. § 80.29 promulgated by the Administrator requires the merchant to use the "sum of the digits method" of allocation to determine the portion of the finance charge "attributable" to the last installment. Although most merchants allocate the finance charge according to the "sum of the digits" method in precomputed transactions so that the Administrator's regulation will probably have little impact, nevertheless, given the statutory language of the section, it is doubtful that the regulation would be valid if challenged by some merchant who desired to allocate the finance charge according to some other method. At a minimum, the deferral charge computation under subsection (1)(a) should permit the finance charge to be allocated to the last installment under the "flat actuarial method" since, as discussed herein, such method would result in no greater deferral charge than would be permitted under subparagraph (b). Furthermore, since the Administrator agrees that the two concepts contained in § 422.204(1) are optional alternatives, (Bkg. § 80.281), a merchant employing some finance charge allocation method other than the "sum of the digits" method could always claim that he is making a deferral under subparagraph (b) if the deferral rate does not exceed the annual percentage rate. It is difficult to see how the Administrator's limitation on the application of subsection (1)(a) can be upheld.

early prepayment of the entire indebtedness.

If the first concept described above were employed (section 422.204(1)(b)), upon prepayment before the maturity date, a merchant in a precomputed equal monthly extension of credit would probably compute the rebate of the finance charge for the installments after the date of prepayment according to the "Rule of 78,"⁵³ while the unpaid amount of the deferral charge attributable to the one installment deferred from the seventh installment due date to the end of the contract would have to be recalculated on a simple interest pro rata basis from the seventh installment due date until the date of prepayment. The necessity of two separate methods for calculating the rebate of the original finance charge and the rebate of the deferred charge proved so confusing and so likely to result in error under pre-WCA law that very few creditors deferred precomputed loans under the usury statutes prior to the effective date of the Act.⁵⁴

If the second theory is employed, the deferral charge is attributed only to the deferral period. Since the whole loan is considered deferred one month (that is, the customer has the entire use of the remaining unpaid balance for one extra month), the deferral charge is earned after that month expires. Thus, when the seventh installment becomes due one month later on its deferred due date, the entire deferral charge is earned and no portion of it would have to be rebated. If there were a prepayment later during the term of the obligation, the merchant would only have to compute the rebate based on the "Rule of 78" for the installments remaining unpaid. Section 422.209(4)(a) specifically contemplates this second theory of rebating deferral charges, while subsection (4)(b) contemplates the first theory.

It should be noted that the second theory set forth above under section 422.209(4)(a) does not "penalize" the consumer upon prepayment since the rebate would be calculated on the basis that there is one additional month in the loan period. To illustrate, using the above example, after being deferred one month when the seventh installment was due, assume that the loan was prepaid in full two months after the deferral, which would be on the date on which the ninth installment was originally due. Under the first theory, the calculation of rebate of the original finance charge

53. See discussion of rebate under § 422.209 in text, *infra* at 421.

54. Deferrals were permitted under § 138.05(3) in consumer loans prior to enactment of WCA. See *supra* note 50.

would be calculated on the basis that there would be three installments remaining after prepayment (the tenth, eleventh and twelfth installments) plus a separate calculation of pro rata rebate for the deferral charge on the seventh installment which was "deferred" until the end of the contract. Under the second concept, each unpaid installment at the time of the seventh installment would be deferred one month, and on the date of prepayment, instead of three installments remaining, the refund calculation would be based on the four installments remaining.⁵⁵

Section 422.204(1) also provides that a deferral under one of the two theories can be made "at any time" between a merchant and his customer and subsection (7) spells out what disclosures must be made at the time of the deferral. Unfortunately these disclosures presume that all deferrals will be made according to the first method described above (i.e. one installment deferred until end of contract), and the language fails to adequately take into consideration the second theory of deferral, which is the theory most often used by creditors. Thus, subsection (7)(c) required disclosure of the amount of each installment deferred, the original due dates, and the new deferred due dates. In the above illustration, if each installment remaining in the loan were deferred one month, the merchant apparently would have to disclose that the seventh installment is deferred to the due date of the eighth installment, the eighth installment is deferred to the due date of the ninth installment and so on to the end of the contract. Undoubtedly this will confuse customers rather than inform them, since the customer usually is concerned only with the total deferment charge necessary to make his loan current. It appears that the disclosures required under the Truth-In-Lending Act for deferrals or extensions are far more clear to a customer than the additional disclosures required under section 422.204(7) of the WCA.⁵⁶

55. Using the illustration in note 52, *supra*, the applied to the example in note 52, *supra*, the rebate permitted by § 422.09(4)(a) would be \$4.62 (rebate based on the "Rule of 78" method with four months remaining applied to a finance charge of \$36.00) while the rebate under § 422.209(4)(b) would be \$4.70 ("Rule of 78" rebate based on three months = \$2.77 plus pro rata rebate of the deferral charge = \$2.89 minus earned deferral charge for two months equals deferral rebate of \$1.93)). Remember that the deferral charge collected under § 422.204(1)(a) was less than under § 422.204(1)(b) so that the rebate under § 422.209(4)(a) will naturally be less than under § 422.209(4)(b). See *supra* note 52.

56. The disclosures required by § 422.204(7) of the WCA are in addition to the disclosures required by § 226.8(1), Regulation Z, Truth-In-Lending Act. 12 C.F.R. § 226.8(1). Section 226.8(1), Regulation Z, basically requires disclosure of (i) the amount deferred or extended; (ii) the date to which or the time period for which payment is deferred or extended;

In addition to allowing bilateral deferral agreements, a merchant may unilaterally defer a transaction when any installment is more than thirty days over due if such arrangement is provided for in the original contract and the merchant sends the customer the ten day notice required in subsection (8) before granting the unilateral deferral. Under section 422.204(8), only one such deferral may take place every twelve months, although the language does not limit the amount of time in the deferral period. Therefore, if a customer was delinquent on his installments due on the first of January, February, and March, but the merchant was willing to grant a unilateral deferral of these installments to make the loan current in April, the merchant could unilaterally defer the January installment to become due on April 1, and similarly defer each of the other installments remaining unpaid on the obligation to become due three months later. The whole loan would be deferred only once, although it would be a deferral for a three month period. Presumably another unilateral deferral could be made twelve months after January 1, the date of the first installment deferred.

VII. REFINANCING AND CONSOLIDATION

The refinancing of any consumer credit transaction or the consolidation of one or more consumer credit transactions are permitted by section 422.205 and section 422.206 respectively at the maximum rates allowable under section 422.201 whether or not the original contracts or notes being refinanced or consolidated were at such maximum rates.

The original version of the WCA proposed to limit the annual percentage rate on refinancing to the rate of the original transaction,⁵⁷ although there was no attempt to limit the rate on a consolidation of two consumer credit transactions. The reasoning behind the proposed limitation on refinancing, according to consumer groups, was to make sure that if an individual could not make his payments and was forced to refinance an extension of credit, the new refinanced agreement would be at no higher rate than the original agreement.

Although attractive in the abstract, the limitation on refinancing would be unrealistic in practice since its provisions could easily be circumvented simply by advancing new money to the customer

and (iii) the amount of the charge or fee for the deferral or extension.

57. See § 2.206 of original version of Wisconsin Consumer Act contained in Assembly Bill 1057, 1971 Legislative Session. A similar provision is contained NCA § 2.206.

at a higher rate than the obligation to be refinanced and then "consolidating" the original obligation with the new obligation. Since consolidations would have been permitted at the maximum rates available even under the original version of the WCA, the merchant in essence would be able to increase the rate of the original indebtedness up to the maximum allowed rates, thereby effectively avoiding the refinancing restrictions. In recognition that a limitation on refinancing rates would be meaningless, the final version of section 422.205 was changed to permit refinancing at the maximum allowable rates without the formality of extending new money.

In the consolidation situation, of course, there could be no realistic attempt to limit the new consolidated rate to a rate lower than to the allowable maximum. Since there might be a number of different rates on the various obligations being consolidated, it would simply be impossible to designate one of those rates as the maximum rate for the consolidated transaction. If the "highest" rate of the obligations being consolidated were considered the maximum, again the limitation could be circumvented simply by advancing new money at the maximum WCA rates and consolidating it with the other obligations. In addition, if a creditor were limited to a certain rate on consolidation other than the maximum rate, he might refuse to consolidate which would often times be to the detriment of the consumer.⁵⁸

With regard to consumer credit sale transactions, the consolidation provisions of section 422.206 provide new flexibility for sellers since the WCA will allow an existing consumer credit sale to be refinanced at the time of a second sale at the maximum rates permitted under section 422.201 so that both obligations can be contained in a consolidated payment schedule. Prior to the effective date of the WCA, an existing time price sale having a finance charge greater than the usury limit could not be "consolidated" with a second time price sale at a rate higher than 12% per annum. The reason was that once the first sale was refinanced, it became a "loan or forbearance," and as such, would be subject to the usury limitations of section 138.05. Thus, where the time price

58. In a consolidation, the merchant usually consolidates previous obligations with a current obligation so that the resulting single schedule of payments of the consolidated transaction is less each month than the total of the monthly payments would be if the obligations were paid separately. The resulting lower monthly or periodic payment is usually sought by the customer.

differential exceeded the usury limits, time sale credit grantors had to sell each item under a separate time price contract with its own repayment schedule, or finance all sales pursuant to a loan agreement at a rate not exceeding the usury rates. This inconvenience for creditors and consumers has been eliminated by the refinancing and consolidation provisions of the Act.

VIII. PREPAYMENT AND REBATE

Section 422.208 provides that a customer has the right to repay any consumer credit transaction without penalty, except in the circumstances of a transaction secured by first lien mortgage or equivalent security interest where the original term is ten years or more and the annual percentage rate is 10% or less.⁵⁹

Presumably the exception for certain real estate transactions originally was included to permit the typical prepayment penalty imposed by many financial institutions upon prepayment of home mortgages. In this regard, it may be questioned why the legislature decided to allow prepayment penalties for certain real estate transactions and prohibit them in all other circumstances, especially since statistics indicate that most home mortgages are prepaid in full on the average of between 6 ½ and 8 ½ years (usually through purchase of another home and obtaining another mortgage) so that the prepayment penalty is actually income to the mortgagee.⁶⁰ There would certainly seem to be little reason for distinction between such a real property creditor and any other creditor employing the same finance charge rate.

With regard to precomputed consumer credit transactions, section 422.209(1) provides that upon prepayment in full by the customer, either by cash, refinancing or consolidation, the creditor must grant a rebate of unearned interest to the customer as provided in that section. Subsection (2) provides that for transactions repayable in substantially equal successive installments at approximately equal intervals of time, the rebate of the finance charge must be at least as great as a rebate calculated according to the "sum of the digits" or "Rule of 78" method of calculating earned interest and rebates.⁶¹

59. Since the April 22, 1973 Amendments exempted first mortgage loans of \$25,000 or less having an annual percentage rate of 12% or less, the exclusion in § 422.208 only applies to indebtedness *other than loans* secured by first liens, such as land contracts.

60. This is the average life of a typical residential mortgage according to the executive director of the Wisconsin Banker's Association. Telephone conference December 14, 1973.

61. The "sum of digits" or "Rule of 78" finance charge allocation procedure for deter-

With respect to other precomputed credit transactions (ones not involving equal installments at equal intervals), subsection (3) allows the Administrator to prescribe a refund formula "consistent" with the "Rule of 78" method described in subsection (2). Pursuant to this statutory direction, the Administrator has promulgated a regulation which requires a merchant to recalculate irregular installment precomputed transactions so that only a simple rate, not exceeding the maximums allowed under the WCA, is permitted on the outstanding balances of the transaction for the period that such balances were outstanding.⁶² In other words, the merchant, in essence, must refund the entire precomputed finance charge and recalculate the obligation as if it were a non-precomputed simple interest bearing loan.

It is debatable whether the Administrator has complied with the direction contained in subsection (3) since the requirement that irregular payment loans be recalculated would not seem to be a formula "consistent" with the "Rule of 78," formula contained in subparagraph (2) in many circumstances, especially where the only

mining rebates of precomputed finance charges upon prepayment in full is widely used and accepted in the United States as a shorthand method of approximating the rebate which would be granted if the "actuarial" method were used. Essentially the procedure allocates the finance charge to each month of a monthly payment obligation in the "direct ratio" that the number of monthly installments scheduled to be outstanding on any installment due date bears to the sum of all monthly installments scheduled to be outstanding during the term of the transaction. Thus, during the first installment period of a twelve month obligation, all twelve installments would be scheduled to be outstanding; while during the second month, eleven installments would be scheduled to be outstanding and so on for each monthly period of the obligation. The sum of all such unpaid monthly installments scheduled to be outstanding during the term of the obligation is 78 ($12 + 11 + 10 + \dots + 3 + 2 + 1 = 78$). Thus, for example, the portion of the precomputed finance charge earned during the first month of the transaction would be $12/78$ since all twelve monthly installments would have been outstanding (and used by the customer) during that monthly period. During the second month of the transaction, only eleven monthly installments would be scheduled to be outstanding and $11/78$'s of the total finance charge would be attributable to that monthly period. Concomitantly, if the obligation were prepaid in full on the due date of the second installment, a total of $23/78$'s of the finance charge would be earned and the customer would receive a rebate equal to $55/78$'s of the finance charge.

Although the denominator is "78" only in a twelve-month obligation, the term "Rule of 78" is commonly used interchangeably with the term "sum of the digits" no matter what the length of the obligation. The method has long been used in Wisconsin (see § 138.05(2)) and has been recommended as the procedure to be used upon prepayment of precomputed transaction in the *Report to the President by the National Commission on Consumer Finance* (hereinafter referred to as "*Report*"). See ch. 3, "Rebates for Prepayment" of *Report*. CCH INSTALLMENT CREDIT GUIDE—*Consumer Credit*, Issue No. 215, (Jan. 15, 1973) at 40-41. The "Rule of 78" rebate method is described more fully in ch. 3. of the *Report* as well as the Official Comment to UCCC § 2.210.

62. Bkg. § 80.301.

irregularity concerns an extended first or last installment period. It is submitted that the Administrator would at least have to accept the method of determining rebates on irregular transactions permitted under the UCCC.⁶³

By requiring that unearned precomputed interest be rebated upon prepayment, the WCA basically has expanded the concept of rebate upon prepayment in effect prior to the Act for loans under section 138.05(2). That section, which only applies to loans, provides that a partial rebate of precomputed interest is required, but only if such precomputed interest exceeds \$10 per \$100 per annum. Under the WCA, rebates of precomputed finance charges must be made in all consumer credit transactions no matter what the annual percentage rate.

IX. DISCLOSURES TO THE CUSTOMER

Subchapter III of chapter 422 is designed to make customers more aware of the terms of their consumer credit obligations through required disclosures of certain credit terms and required notices, as well as to establish certain minimum standards which must be followed in consumer credit transactions.

With regard to disclosures of the terms of an extension of credit, the WCA basically builds upon the Truth-In-Lending disclosures, incorporating the federal disclosures by reference. It is important to note, however, that the disclosure requirements of subchapter III, including disclosures made pursuant to the Truth-In-Lending Act, are applicable to a broader range of transactions than are subject to the Truth-In-Lending Act itself. Thus, section 422.301 provides that disclosures under the WCA must be made for all consumer credit sales "payable in installments" as defined in section 421.301(30), even though no finance charge may be imposed. Under section 421.301(30), credit sales are considered to be "payable in installments" when there are two installments if one installment is more than twice the size of the other installment. Thus, disclosure under the WCA may be required in sales where there are only two installments even though Regulation Z only requires disclosures to be made where there are more than four

63. See UCCC § 2.210(5) (sales) and § 3.210(5) (loans) for a description of the "Rule of 78" method of rebate applied to irregular payment precomputed extensions of credit. Basically, these sections codify the established practice of using the "Rule of 78" rebate method where the first or last installment interval is longer or shorter than the other intervals, if all other intervals are equal.

installments.⁶⁴

In addition to the disclosures required under the Truth-In-Lending Act, the WCA requires every document evidencing the customer's "obligation to pay" (other than in open-end credit transactions) to contain the following "Notice to Customer" set forth in section 422.303(3):

- (a) Do not sign this before you read the writing on the reverse side, even if otherwise advised.
- (b) Do not sign this if it contains any blank spaces.
- (c) You are entitled to an exact copy of any agreement you sign.
- (d) You have the right at any time to pay in advance the unpaid balance due under this agreement and you may be entitled to a partial refund of the finance charge.

The intent of the notice obviously is to make customers aware of what consumer groups consider the more important aspects of a consumer credit transaction. The concept is laudable, and on its face, the Notice seems quite reasonable. Unfortunately, however, the Notice in many respects may be misleading to the customer, and can be criticized for adding unnecessary language to consumer credit transaction forms already overburdened with required language.

For example, the Notice informs the customer in clause (a) that he should not sign the agreement before reading the writing on the reverse side even if otherwise advised. The objection to this clause is not so much its content, but the fact that such language probably duplicates language already contained in the contract. Virtually all contracts state on the front that terms and conditions contained on the reverse side are incorporated in the agreement. Rather than having a notice to the customer telling him to read the reverse side, in addition to the incorporation language, which still will be included to make sure that such terms and conditions are part of the agreement, it would seem more reasonable simply to require the merchant to disclose "conspicuously" the fact that the terms and conditions on the reverse side are incorporated as part of the contract contained on the front side.

Also, the language of clause (a) of the Notice unnecessarily appears to reflect the consumer groups' distrust of merchants by implying that merchants would generally advise consumers not to

64. See § 226.2(k), Regulation Z. 12 C.F.R. § 226.2(k).

read the reverse portion of a contract. Interestingly, this part of the Notice actually might result in a greater benefit to merchants than to consumers since a customer would have difficulty claiming that he did not read the reverse side or was unaware of its provisions or that the merchants told him not to read the reverse side when the notice is conspicuously to the contrary.

Clause (b) of the Notice could be extremely confusing. It directs the customer not to sign if there are any blank spaces in the contract, yet it fails to inform him that, with certain exceptions, section 422.304 only prohibits blank spaces which are to be "filled in after it is signed." Moreover, section 422.304 permits blank spaces for identification numbers of goods to be filled in subsequent to consummation of the transaction where such information is not available at the time the transaction was consummated.⁶⁵

Similarly, clause (c) may be misleading to customers since the customer is not entitled to an exact copy of *every* document he signs, but only to documents which evidence his "obligations."⁶⁶

Finally, clause (d) of the Notice is repetitious and misleading to customers. It is redundant because the Truth-In-Lending Act already requires creditors to disclose the method of rebate upon prepayment.⁶⁷ In addition, it misleadingly states that the customer may be entitled to a partial refund of the finance charge any time he pays in advance. In fact, such rebate will *only be* refunded when a *precomputed* consumer credit transaction is prepaid, and then only if such transaction is prepaid in full.⁶⁸

65. Section 422.304 also requires merchants to fill in blank spaces "relating to price, charges or terms of payment which are inapplicable to a transaction . . . in a manner which reveals their inapplicability unless their inapplicability is clearly and conspicuously indicated." The Administrator, in Bkg. § 80.34, has stated that a general statement to the effect that blank spaces are inapplicable to the transaction cannot be relied upon by merchants, although the regulation does not prohibit the use of such general statements. The Administrator advances no reason for his regulation, and such a general statement, if clear and conspicuous, would seem to be in compliance with the statutory language.

66. See § 422.302(3). It should be noted that the WCA draws a distinction in this regard between documents which evidence a customer's "obligation" and documents which evidence a customer's "obligation to pay." The Notice to Customer required by § 422.303 is only required to be inserted on the customer's "obligation to pay," while the customer is entitled to receive a copy of every document which "evidences the customer's obligation" under § 422.302(3). See also Bkg. § 80.32 which acknowledges the distinction between documents evidencing the customer's "obligation" and those evidencing his "obligation to pay."

67. § 226.8(b)(7), Regulation Z. 12 C.F.R. § 226.8(b)(7).

68. Section 422.209 specifying rebates only applies to precomputed transactions. Obviously, if the finance charge is not precomputed, there is nothing to "rebate." In addition, § 422.209 specifically states that no refund is required unless a precomputed transaction is

Another disclosure requirement is found in section 422.303(2) which stipulates that the "terms" of sale contracts shall be in not less than 8 point standard type, apparently because of the feeling that more abuses result from the fine print in consumer credit sales than in loans. Presumably this section does not require the whole contract to be in 8 point type, but only the actual terms of the sale agreement (*e.g.* some state and federal required disclosures might not be considered "terms" of the sale).⁶⁹

Subchapter III also places additional requirements on creditors with regard to supplying customers and co-signers information to make sure that those persons are aware of the exact nature of their obligations. Thus, section 422.302(3) requires that the creditor furnish every customer with a copy of each agreement or document evidencing the customer's obligation. In a typical secured loan transaction, the creditor would have to give the customer copies of the loan document, any security instruments, and the required federal and state disclosures.⁷⁰ This is certainly a reasonable request since the customer has a right to know the extent of the obligations. The requirement should impose little additional hardship on most creditors, since creditors usually supply copies of such documents already.

The notice to co-signers entitled "Explanation of Co-signer Obligation" required by section 422.305 must be in at least 10 point bold face type, and delivered to and signed by each co-signer of any consumer credit transaction. The notice is intended to put the co-signer on notice of his obligations and especially of the fact that he may be liable for the consumer credit obligation even though the principal debtor may not be first pursued for collection.

Several possible pitfalls should be mentioned with regard to this co-signer notice. First of all, it is possible to interpret section 422.305 as requiring that the notice and a copy of each instrument

prepaid "in full." Fortunately, the Administrator has permitted some flexibility in the terms of the Notice to Customer in forms submitted for his approval pursuant to § 426.104(4). Thus most forms make it clear that there will only be a rebate of precomputed finance charges when there is prepayment "in full." In this regard, the Federal Reserve Board has adopted a recent amendment to § 226.8(b)(7) of Regulation Z requiring disclosure when no rebate of finance charge will be given upon prepayment in full. 1 CCH GUIDE ¶ 3566. Prior to the effective date of the amendment on January 1, 1974, disclosures were required only where the prepayment resulted in a rebate of some portion of the finance charge.

69. In addition to the disclosures and notices set forth in the text, the WCA also requires disclosures upon deferment. *See* § 422.204(7) and (8). *See* text at 418, *supra* for discussion.

70. If a document is signed by the customer but does not evidence any of his obligations, such as a loan or credit sale application, he is not entitled to a copy of the document. *See also supra* note 65.

evidencing the consumer credit transaction be supplied to each person signing a note or time sale contract (other than the customer and his spouse) even though all signatories are liable directly to the creditor on a joint and several basis.⁷¹ In other words, since each party executing the agreement may be considered a "co-signer" for every other party, all parties must receive co-signer notices and a copy of the instrument evidencing the transaction. This requirement goes far beyond Regulation Z to the Truth-In-Lending Act which requires only one copy of a disclosure statement to be furnished to the principal debtor (a debtor other than an endorser, co-maker, guarantor or similar party).⁷²

In this regard, it is suggested that such an interpretation goes too far. A careful reading of the language of the notice indicates that it is primarily intended to alert parties who are secondarily liable on the transaction, such as a guarantor or surety. Often such parties sign separate guaranty agreements without being fully aware of the terms of the specific credit transactions they are guaranteeing or the full import of the guaranty agreement. The notice correctly warns such guarantors concerning possible future liability. However, a person who signs the loan or credit sale instrument as one of the parties certainly is aware of his obligation, and the co-signer notice becomes an additional burden on creditors without any corresponding benefit to the customer. The co-signer notice should be limited to parties who are secondarily liable.

In addition, the requirement in section 422.305(3) that each co-signer also must be furnished a copy of the instrument underlying the consumer credit transaction in addition to the co-signer notice seems overly burdensome to creditors. One or the other would seem sufficient.

Ironically, although section 422.305(3) requires the merchant to furnish the co-signer with a copy of the instrument evidencing the consumer credit transaction, there is no requirement in the statute that the merchant supply the guarantor or endorser who signs a separate guaranty or endorsement with a copy of that separate agreement. However, the Administrator has issued regulations requiring that the creditor deliver to the co-signer a copy

71. Although § 422.305(2) states that the explanation of co-signer obligation "shall contain no other matter than above set forth [in subsection (1)]", the Administrator has issued regulations permitting form numbers, execution dates, instructions, union printing labels and acknowledgements of receipt to be included on the notice. Bkg. § 80.341. Also, Bkg. § 80.35 permits modification of the statutory notice for open-end transactions.

72. § 226.6(e), Regulation Z. 12 C.F.R. § 226.6(e).

of any instrument he signs.⁷³

Secondly, with regard to this section, it is possible that a creditor will not be able to obtain a valid continuing or "blanket" guaranty from an individual guaranteeing more than one indebtedness of a customer unless the co-signer signs a new co-signer notice and is furnished with a copy of the instrument evidencing the transaction each time a new obligation is undertaken by the customer.

This interpretation could arise by virtue of the introductory clause to section 422.305(1) which states that no co-signer shall be "obligated" on a consumer credit transaction unless given the required notice. Thus, without the notice, it can be argued that a guarantor would not be obligated with regard to that transaction. If such an interpretation is upheld, the concept of a continuing guaranty in consumer credit transactions would probably disappear; if the guarantor must execute a new notice for each transaction, it would be just as easy to require him to sign the document evidencing the transaction as one of the parties.⁷⁴

Finally, although originally there was no limitation on the liability of a guarantor of a consumer credit transaction in subchapter III and presumably the guarantor could have been obligated to a greater extent than the principal debtor himself could have been obligated, section 422.420 added by the February 22, 1973 Amendments, essentially limits the co-signor's liability for fees and charges so that it can be no greater than that of the primary debtor. The section also provides that the co-signer is afforded the same protections under the WCA as the original debtor himself.⁷⁵

X. LIMITATIONS ON AGREEMENTS AND PRACTICES

Sections 422.401 through 422.420 further regulate and limit the terms which may be included in the agreement between a creditor grantor and a customer in a consumer credit transaction. Because

73. Bkg. § 80.351.

74. It appears that the Administrator has accepted the concept of continuing guaranties in open-end transactions without requiring the co-signer to execute a new explanation each time a new transaction is entered into as long as the co-signer's liability does not exceed the amount originally specified on the co-signer explanation. Bkg. § 80.35. It would seem that the same concept could also be applied to a continuing guaranty for a series of closed-end transactions, although no regulation has been issued on the subject.

75. For a discussion on the possibility that a guarantor could guarantee attorneys' fees in a consumer credit transaction even though the principal written agreement between the merchant and the customer cannot contain a provision for attorneys' fees, see *supra* note 103.

of the numerous restrictions and limitations contained in these sections, it is impossible to discuss each one in detail, and the following will discuss only the more important provisions which are likely to affect creditors and consumers most frequently.

A. Balloon Payments

Consumer groups have long considered the typical balloon payment transaction abusive because the arrangement allegedly entices unsuspecting customers into low monthly payments on a transaction which then has a prohibitively large last installment often referred to as a "balloon" payment. Although the customer can make the monthly installments, it would usually be impossible for him to pay the balloon payment when it came due. Merchants might agree to refinance the balloon payment, but consumer groups claimed that such refinancings were often at a much higher annual percentage rate than the original transactions. Also, if the merchant refused to refinance the balloon payment, the customer would be forced to obtain new financing (which often times would be impossible) or to return the collateral which secured the obligation often leaving the customer with no merchandise and a possible deficiency.

The Truth-In-Lending Act attempted to negate the abuses connected with balloon payments by requiring such payments to be clearly identified.⁷⁶ However, apparently feeling that the abusive practices concerning balloon payments were still present, consumer Groups in Wisconsin insisted that legislation restricting balloon payments be contained in the WCA.

Creditors, on the other hand, pointed out that typical balloon payment transactions gave the consumer more borrowing power enabling him to make large purchases or to meet emergencies with low monthly payments which fit his budget and a balloon payment at the end. Most creditors claim that they rarely refused to refinance the balloon, and that the refinance rates did not differ greatly from the original rate.

The WCA basically agreed with consumers by prohibiting most

76. § 226.8(b)(3), Regulation Z. 12 C.F.R. § 226.8(b)(3). In fact, Regulation Z extended the concept of "balloon payment" to include any payment which is twice the size of any other payment stating that:

If any payment is more than twice the amount of an otherwise regularly scheduled equal payment, the creditor shall identify the amount of such payment by the term 'balloon payment' and shall state the conditions, if any, under which that payment may be refinanced if not paid when due.

balloon payments in section 422.402 although there was some compromise since the section excepts open-end credit plans, non-precomputed transactions on which the annual percentage rate disclosed is less than 12% and transactions involving an extension of agricultural credit.

In consumer credit transactions not specifically exempt from section 422.402, however, the restrictions extend far beyond merely limiting the typical balloon payment arrangement involving a large last installment after a number of lower equal installments. The section prohibits any consumer credit transaction which does not have substantially equal installments or is not payable in substantially equal intervals unless specifically permitted under one of the narrow exceptions contained in subsection.(2).⁷⁷

Subsection (2)(a) permits irregular payments or irregular intervals (including traditional balloon payment type arrangements) where the income of the customer is "seasonal" and the credit arrangement is "in accordance with the needs of the customer," but only if a proper "warning" concerning the irregular payment arrangement be set forth in the contract.⁷⁸ Moreover, section 422.401(3) provides that the customer shall have the right at any time to refinance any unequal or irregular (balloon) installment at an annual percentage rate which does not exceed the rate disclosed in the original transaction, although in this regard it is not altogether clear whether subsection (3) is referring to the finance charge rate of the original transaction, or whether it simply is requiring the creditor to disclose the rate at which the balloon payment will be refinanced at the time of the original transaction. Arguably, because limitations on rates at the time of refinancing are easily circumvented and because section 422.402(3) specifically permits the method of refinancing contemplated in section 422.205 (which permits refinancing at maximum rates),⁷⁹ subsection (3)

77. The language of § 422.402(1) would not appear to prohibit an interval between the date of the agreement and the first installment due date which is longer or shorter than the other payment intervals since the section only requires that intervals "between" payments be substantially the same. Since there is no payment due before the first payment, the first payment interval is not subject to the limitation.

78. Section 422.402(2)(a) requires the following warning to be stated in 12 bold type on any permitted balloon payment transaction:

WARNING

The amounts of payments or the dates on which they are payable under this agreement are not equal. Do not sign this paper unless you are certain that this payment schedule meets your needs.

79. See text at 419 *supra*, for discussion of § 422.205.

only requires the disclosure of the rate which will apply if the balloon payment is refinanced, and does not limit the refinance rate to the rate of the original transaction.⁸⁰

Subsection (2) also provides that a downpayment of any amount will not be considered a prohibited balloon payment if it is paid prior to or contemporaneously with the consummation of the transaction or if the downpayment is no more than 20% of the cash price of an item if it is paid on or before the due date of the second installment. In addition, last installments may exceed the average of all other installments by as much as 10%.⁸¹

B. Maximum Periods of Payment

Another alleged abusive practice claimed by consumer groups concerned extensions of credit with low payments stretched over a prolonged number of months or even years so that the total amount of finance charge paid became extremely large. To prevent such practices, section 422.403 limits the number of months over which consumer credit transactions can be scheduled, depending on the amount of the original transaction. Surprisingly, the limitation on the periods of repayment does not apply simply to precomputed transactions (which is the case with the statutes of most states which limit the periods of repayments) but applies to *all* credit transactions whether precomputed or non-precomputed.⁸²

80. Thus, if the original contract containing the balloon payment (as permitted by subsection (2)(a)) states that the balloon installment can be refinanced at the maximum rates under the WCA, the disclosure would appear to comply with § 422.402(3) even though the annual percentage rate of the original transaction is lower than the maximum rate.

81. Section 422.412 provides limitations on consumer leases similar to the balloon payment limitation contained in § 422.402 stating that in consumer leases other than ones for agricultural purposes, the obligation of the customer upon expiration of the lease cannot exceed the average payment allocable to a monthly period under the lease, except for damages caused to the leased property. *See also* Bkg. § 80.38 (charge for excess mileage in motor vehicle lease is considered damages and is not prohibited by § 422.412).

82. There is good reason for limiting the maximum period of payment in many precomputed transactions since the simple interest rate per year (the annual percentage rate) often increases with each year that the transaction is scheduled to be outstanding. For example, the annual percentage rate computed on a "discount" basis of 10% per annum per year would be 19.91% for a one year extension of credit repayable in equal monthly installments, while the same discounted rate over a five year obligation would result in an annual percentage rate of 31.58%. (Where the finance charge is calculated using a discount rate, it is deducted from the total amount of the obligation. For example, if the total of payments in a consumer credit transaction was \$1,000, a 10% discount rate for a one year monthly repayment loan would result in a finance charge of \$100 and an amount financed of \$900, if the \$1,000 were repayable in two years at the same discount rate the finance charge would be \$200 and the amount financed \$800; etc.). Thus, a limitation on the maximum period of payments is necessary to limit the effective annual percentage rate which may be charged

An unexpected result caused by the limitations on periods of repayment contained in the original version of section 422.403 was the prohibition of the typical government college student loan, since such transactions would often extend beyond the designated maximum period. For example, most government student loans do not require repayment until after graduation, and the period from the commencement of the loan until repayment would often be longer than the maximum periods stated in section 422.403. To correct this unintended result, subsection (4) was added to section 422.403 by the February 22, 1973 Amendments, specifically to exempt college student loans from the limitations of section 422.403. New subsection (2) was added at the same time to permit longer periods of repayment for credit used to improve the customer's real estate, provided that the annual percentage rate does not exceed 15%.

It is worth noting that with regard to non-precomputed credit transactions with an annual percentage rate of less than 12%, section 422.403 does not prevent a merchant and a customer from agreeing to a repayment schedule which substantially exceeds the stated maximum periods, since the last payment can be a large balloon payment which the parties can agree to refinance.⁸³ For example, if the total of payments is \$700 in a transaction with an annual percentage rate of less than 12%, the obligation can be repaid in twenty-four equal installments of \$10 each and a final balloon payment of \$460.⁸⁴ The balloon payment can then be refinanced and repaid in any number of installments since section 422.403 only provides a maximum period of repayment for the "initial" transaction. This technique undoubtedly will be employed by merchants who traditionally permit the cash price of an item to be repaid over an extended period of time without a finance charge, such as in jewelry sales, water softener sales, cemetery lot sales and the like.

on a transaction. However, the same rationale does not apply to non-precomputed transactions since the annual percentage rate remains the same no matter how long the period of repayment is scheduled. Thus, the WCA not only controls the maximum finance charge rates in a consumer credit transaction, but also, for the first time, limits the length of a consumer credit transaction to the extent set forth in § 422.403 even though such repayment period has no effect on the annual percentage rate.

83. Section 422.402 restricting balloon payments does not apply to non-precomputed transactions where the annual percentage rate is less than 12%.

84. The "balloon payment" must still be disclosed pursuant to § 226.8(b)(3), Regulation Z. 12 C.F.R. § 226.8(b)(3).

*C. Limitation On Holder In Due Course
And Waiver of Defense Doctrines*

One of the major changes, long advocated by consumer groups, which has been incorporated in the WCA, concerns the limitations on the rights of holders of time sales contracts or negotiable documents evidencing a time sale where the holder is not the original seller.⁸⁵

Prior to the WCA, the common practice of many sellers was to take a "negotiable" promissory note or a contract containing a clause waiving all defenses against the assignee to evidence the obligation incurred in a time sales transaction. The seller would then negotiate the note to a third party who became a "holder in due course" or sell the contract containing the "waiver of defense" clause to a third party who would be able to pursue collection of the obligation without regard to most claims or defenses that the buyer might have against the original seller, including claims for defective merchandise or failure to perform.⁸⁶ Consumer groups have long claimed that such doctrines fostered fraudulent practices by allowing sellers to obtain a negotiable promissory note evidencing the sale obligation or sales contracts containing a waiver of defense clause before the customer has a chance to discover if the merchandise sold or work performed is satisfactory. If the customer later discovered that the work or service was not as promised, the seller often had vanished or become insolvent so that no remedy was available against the party actually at fault. Since no claim would be available against the "holder in due course" or the third party to whom the contract was assigned, the customer would not only be saddled with the inferior work or merchandise, but would still be required to pay the third party holder. Even when the seller was available, if he refused to correct the customer's complaint, the customer was faced with the prospect of commencing a lawsuit for satisfaction, which probably would be more costly than the amount being claimed, while still being required to make payments to the holder of the note or contract.

Creditors defended the holder in due course and waiver of defense concepts as necessary to allow the unobstructed and easy movement of consumer paper. The argument was that third party purchasers of such paper, such as financial institutions, should be

85. §§ 422.406-422.408.

86. Under § 403.305 of Wisconsin's Uniform Commercial Code, a holder in due course takes the note free from all claims and defenses except those set forth in § 403.305(2).

able to look at the face of the note or contract and determine whether it would be subject to any claims or defenses arising out of the underlying transaction. If the assignee ascertained that the note or contract would not be subject to claims that the customer may have against the seller, he would be able to purchase the instrument without the delay which would have otherwise been necessary to check the validity of each underlying transaction. Also, creditors pointed out that the customer was the one who dealt with the seller, and therefore was in a much better position to determine the seller's trustworthiness with regard to defective merchandise or performance of services. If the merchandise or services were inferior, the customer could proceed against the seller, but he should not have the right to stop payment to the third party assignee who had nothing to do with the underlying transaction. If the seller was insolvent or could not be found, the customer should bear the loss.

In rebuttal, the consumer groups argued that the institutional assignee in today's society is in a much better position than the customer to determine the trustworthiness of the seller and the merchantability of the service or products sold by a particular merchant. They not only claim that purchasers of notes or sales contracts, such as financial institutions, can easily check on the trustworthiness of a merchant, but that all too often such purchasers know or should know that the merchant is not acting properly with regard to his sales or services. Despite this, such institutions purchase a seller's negotiable notes or sales contracts knowing that they will be protected from liability under the holder in due course doctrine or waiver of defense clause. Consumer groups argue that the elimination of the holder in due course doctrine and regulation of waiver of defense provisions would force the large financial institutions to purchase such instruments only from sellers who perform properly, thereby "policing" such merchants. Such responsibility on third party holders would cause sellers to upgrade the merchandise and service sold to customers. In addition, limitation of the protective doctrines would guarantee the customer some remedy in the event he is "tricked" into purchasing inferior merchandise or services.

The result of the conflicting arguments is that the WCA prohibits sellers from taking a negotiable instrument, other than a check, in a consumer credit sale and substantially limits the validity of waiver of defense provisions in sales contracts.

With regard to elimination of a "negotiable" note, section

422.406 prevents a subsequent holder of such a note from becoming a "holder in due course," and instead limits his capacity to that of an assignee. As an assignee, of course, the holder is subject to the same claims and defenses as the seller.

Section 422.406(4) does limit the liability of such holder to the amount owing on the instrument at the time the holder receives notice of a claim or defense against the original seller if the customer's claim is eventually proven to be valid. However, if the customer cannot obtain satisfaction against the original seller for his valid claim, the holder may be additionally liable for any amounts he has previously received from the customer. In order for the customer to obtain this additional amount, he must obtain a judgment against the seller which is uncollectible and must act against the holder within the time limits outlined in section 422.406(4).⁸⁷

It is important to note that the buyer may sue the *holder* of the instrument directly for any claim or defense he may have against the *seller*, since the holder of any note, who is not a holder in due course, takes subject to all claims and defenses which the maker of the note has against the original payee. The seller may, of course, be joined in the action.⁸⁸

Although the language contained in subsection (4) of section 422.406 purports to limit a holder's liability to the unpaid balance of the instrument at the time the holder receives notice that the customer has a claim or defense against the original payee of the note, unfortunately there appears to be confusion arising from the juxtaposition of subsection (3) with subsection (4). Subsection (3) provides that "a holder to whom an instrument [is] issued in violation of this section . . . is subject to all claims and defenses of the customer against the payee subject to the extent provided in subsection (4)". Subsection (4) then states that "such holder's liability . . . is limited . . ." as described therein. Therefore, it could be claimed that subsection (4) merely limits the liability of a holder who actually takes a negotiable instrument in violation of section

87. Section 422.406(4)(b) provides that the customer must proceed against the holder within two years after an execution with bond is returned unsatisfied against the original seller. The section also requires the customer to levy execution against the original seller within one year after judgment.

88. The right to directly sue a holder of a note taken in a consumer credit sale permitted under § 422.406 should be compared with the prohibition against such direct action where the consumer credit sale is evidenced by a retail sale contract rather than a promissory note. See text *infra*, at 438, for discussion of § 422.407(5).

422.406, but does not limit the liability of a holder of a non-negotiable instrument who attempts to comply with the WCA.

Such a result does not appear to be the legislature's intent since creditors would be encouraged to take instruments purporting to be negotiable in order to limit their liability. This certainly would be in direct contravention to the purpose of section 422.406 which is to prohibit the use of such negotiable instruments. The legislature should have been more precise and specified that the holder of any promissory instrument, whether negotiable or not, would be held liable only to the limits contained in subsection (4).

Since negotiable instruments are prohibited only in a consumer credit *sale* transaction under section 422.406, absent some restrictions, it would be possible for a seller to circumvent the limitation of section 422.406 simply by sending the customer to a lender who would loan the money to the customer using a negotiable note, but by prior arrangement with the seller, have the proceeds made payable directly to the seller. To prevent this type of circumvention, section 422.408 provides that loans which are so closely related to a credit sale that they are really "interlocking" transactions, will be treated essentially as if the seller himself took the note.

Subsection (3) of section 422.408 defines when a loan is "interlocking" with a consumer credit sale and essentially includes loans where the lender and seller are "related" or have an arrangement which indicates that the basic purpose for the loan is to circumvent the prohibition against negotiable instruments in consumer credit sales.⁸⁹ Paragraph (e) and (f) of subsection (3) are the only two extensions of the definition of "interlocking" beyond the situation of a pre-arranged relationship between the lender and seller.

Subsection (3)(e) states that if a lender has knowledge of "substantial complaints" that a seller or lessor fails or refuses to perform his contracts and fails to remedy complaints within a reasonable time then the loan will be considered an "interlocking" loan, provided, of course, that the lender knows that all or a "meaningful part" of the proceeds will be paid to such a seller as required under the introductory clause of subsection (3). However, section 422.408(3)(e) undoubtedly will be applied only to clear cut and blatant failures to perform on the part of sellers, since the customer's burden of proving that the lender had "knowledge . . . or written notice of *substantial* complaints" (emphasis added) against the seller for failure to perform, *and* knowledge of the merchant's

89. See § 421.301(32) and (33) for definition of "related" persons.

failure to remedy such complaints, would appear extremely difficult.⁹⁰

Subsection (3)(f) provides that an interlocking loan will result under lender credit card systems where a purchase is financed by a loan in excess of \$100 disbursed directly to a seller who has a direct or indirect contractual relationship with the credit card issuer permitting him to honor that credit card. Where subsection (3)(f) applies, § 422.408(5) requires the customer to notify the card issuer of his claim within twelve months after entry of the transaction on his account. Lender credit card transactions under \$100 are not considered interlocking loans unless one of the other elements of subsection (3) are applicable. The \$100 exemption also applies to seller credit card transactions which are used in the same manner as a lender credit card with parties unrelated to the issuer.⁹¹

Since section 422.408 is intended merely to avoid the circumvention of the prohibition against taking negotiable instruments in the typical consumer credit sale transaction for merchandise or services, the section as originally enacted did not extend to the financing of residential real property secured by a first lien on the property when the annual percentage rate was less than 12%.⁹² Of

90. Some consumer advocates have opined that "grapevine" information of complaints against a seller would be sufficient to give a lender knowledge under § 422.408(3)(e), or that a newspaper account of a seller's failure to perform would constitute sufficient "notice" under that section. See Davis, *supra* note 3, at 24. However, subsection (3)(e) clearly requires something more. The section was intended to require *actual* knowledge on the part of the lender of such complaints since the objective standard that the lender "should have known" of such complaints is not found in this subsection. Compare § 425.310 (which provides that corporate officers may be liable for damages in certain circumstances where he knew of, or "should have known of" violations of the WCA). The phrase stating that such "knowledge" may be obtained by a lender "from his course of dealing with other customers of the seller" simply is to make it clear that the information would not have to come from the customer who is asserting that the loan is interlocking, but can come from other customers. However, such knowledge must be actual knowledge and not third-party hearsay or "grapevine" accusations. Similarly, the "written notice" of substantial complaints "by such other customers" can only include notices directed to the lender by customers of the seller, and certainly cannot logically be expanded to include any written word concerning the seller, such as a story printed in a newspaper. Finally, as emphasized in the text, the lender must not only have knowledge of the "substantial complaints," but also knowledge that the merchant "fails to remedy such complaints within a reasonable time."

91. See § 422.408(2). Ordinarily, all seller credit transactions (such as oil company credit cards) would be considered transactions subject to the restrictions concerning waiver of defense clauses contained in § 422.407 since such transactions are not "consumer loans" as defined in § 421.301(12). However, § 422.408(2) redefines consumer loans for the purposes of § 422.408 to include seller credit card transactions except when the transaction is with the seller credit card issuer or a person related to the issuer or operating pursuant to a license or franchise under the trade name of the issuer. In those transactions not included in § 422.408, of course, the customer may assert any claim against the issuer whether under or over \$100 within the limitations of § 422.407.

92. § 422.408(6).

course, this exception becomes somewhat less important after enactment of chapter 428, which regulates all first lien mortgage loans.⁹³

The WCA also limits the effectiveness of the so-called "waiver of defense" clause in time sale contracts, although the validity of such provisions are not eliminated as are the protections granted a "holder in due course" of a negotiable instrument. Thus, section 422.407(2) states that waiver of defense clauses are not effective until twelve months after the buyer receives notice of the assignment of the sale contract from the seller to a third party.⁹⁴ In other words, the buyer has one year after notice of assignment in which to notify the assignee of possible claims or defenses.⁹⁵ Such assignment must be in good faith to an assignee not related to the seller.⁹⁶

The time period obviously represents a compromise between consumer and creditor interests. The first twelve months after the assignment of the contract was felt to be the time period during which most warranty defects or other non-performance on the part of the seller would occur and when the consumer is most in need of a defense against collection attempts by third party assignees. The effectiveness of the waiver of defense clause after twelve months meets the needs of creditors by granting them an assurance that at some definite time the sale contract paper which they have purchased will be enforceable on its face and will not be defaulted because of the underlying transaction. Most creditors feel that if claims were allowed after twelve months, false and spurious claims would be fostered simply to avoid or hinder collection by the third party assignee.

It is important to note that the twelve month period does not commence until a notice of the assignment is sent to the buyer by

93. See note 59 *supra* for discussion of ch. 428.

94. The language of § 422.407 appears to have left open a technical loop hole concerning waiver of defense clauses since subsection (1) states that the section only applies to consumer credit transactions "other than a consumer loan which is not an interlocking consumer loan." This leaves open the possibility that a seller could take a non-negotiable promissory note in a consumer credit sale containing a waiver of defense clause. Since § 422.406 only prohibits "negotiable" instruments in consumer credit sales, and since § 422.407 only applies to credit transactions other than consumer loans, arguably there is no limitation against waiver of defense clauses in non-negotiable promissory notes.

95. It is interesting to note that §§ 422.406-422.408 provides the purchaser of goods on credit with substantially greater rights than a purchaser who pays cash. Thus, these sections grant a customer who purchases on credit the right to proceed against the third-party assignee in certain circumstances as well as against the original seller for defective merchandise or services. A cash customer, of course, can only proceed against the seller.

96. § 422.407(2).

the assignee. Pursuant to section 422.409, such notice must make conspicuous reference to the customer's right to notify the assignee of any claims or defenses he may have against the seller within twelve months after receiving the notice of assignment, and warn that if no notification is given by the customer, the assignee may enforce the contract fee of such claims or defenses.

As in the case of a holder of an instrument under section 422.406, the liability of a third party assignee of a time sale contract containing a waiver of defense clause generally is limited to the unpaid balance at the time he receives notification from the buyer of a claim against the seller.⁹⁷ Similarly, if the buyer obtains a judgment against the seller which is returned unsatisfied and later proves to be uncollectible, the buyer can obtain additional recovery of all amounts aid to the holder or assignee prior to the notice of claim or defense.⁹⁸

Contrary to the rights of a customer to sue the holder of a negotiable instrument directly, section 422.407(5) states that "any claims or defenses of the customer" against the seller "can only be asserted as a matter of counterclaim, defense to, or set-off against a claim by the assignee" of a time sale contract. This means that a customer may neither sue a third party assignee directly on a claim against the seller, nor join the assignee in any lawsuit commenced against the seller. Rather, the customer only has the right to assert his claim as a "counterclaim defense to or set-off" in a lawsuit for collection by the assignee.

This provision is extremely important to creditors since it should prevent disgruntled customers who have a claim against sellers from routinely joining third party assignees in lawsuits against the seller.⁹⁹ Absent this limitation against direct action,

97. § 422.407(2)(a).

98. § 422.407(2)(b).

99. Section 422.407(5) has another important effect. Although the section permits the customer to preserve his claim or defense against the assignee, it does not give him the legal right to stop payment on the obligation. Consequently, if the customer does stop payment, which he usually will do if he has a legitimate claim against the seller, it will constitute a "default" under § 425.103 permitting the assignee to seek legal collection of the indebtedness and test the validity of the customer's claim or defense in court. If a customer were given the statutory right to cease payment if he had a valid claim against the seller, arguably the assignee would never have the opportunity to force the customer to prove the validity of his claim or defense in a legal proceeding because a default occurs under § 425.103(2) only if the customer refuses to pay the obligation "without justification under any law."

100. It should be noted that if the buyer obtains judgment against the seller for defective merchandise or other legitimate claim, and the judgment proves uncollectible, or if the seller is bankrupt or cannot be found within the state, the limitation of § 422.407(5) does not

third party assignees would probably be joined in every action commenced by a customer against a seller and thereby forced to incur litigation costs even though the customer is eventually successful in collecting his claim against the seller.¹⁰⁰ Of course, assignees of contracts or notes without waiver of defense clauses could be sued directly.¹⁰¹

D. Attorneys' Fees

Section 422.411 provides that writings evidencing a consumer credit transaction may not include a provision for the payment of attorneys' fees by the customer. The prohibition apparently is aimed at prohibiting clauses, often inserted by merchants in consumer agreements, stating that the customer will be responsible for attorneys' fees up to 15% or 25% of the unpaid balance of the obligation in the event of default. Before the WCA, some merchants would assess such fees immediately after default even if the contract were never turned over to an attorney for collection.

An exception is provided for consumer transactions in which (i) the credit is extended for the purpose of acquiring residential property, (ii) the extension of credit is secured by a first lien mortgage or equivalent security interest, and (iii) the annual percentage rate is 12% or less, although again this exception became relatively unimportant when chapter 428 was added to the WCA by the April 22, 1973 Amendments covering all first mortgage loans with an annual percentage rate not exceeding 12%. In transactions where the above elements are met, the merchant may contract for the payment of attorneys' fees with the customer not to exceed 5% of any judgment entered against the customer or \$100, whichever is less. Also, the fees must be payable only to licensed attorneys not employed by the merchant.

With regard to mortgage loans covered by chapter 428, section 428.103(1)(e) permits a lender to contract for attorneys' fees for opinions of title as well as an amount equal to 5% of the amount adjudged due a creditor on the unpaid indebtedness in the event of foreclosure. If a foreclosure action is settled prior to judgment, the creditor may recover reasonable attorney fees up to 2 ½% of the unpaid principal balance if the contract so provides.

apply and the customer can proceed against the third-party directly for the entire amount of the indebtedness under § 422.407(2).

101. See text *supra* at 438, for discussion. The possibility of waiver of defense clauses in non-negotiable notes is discussed *supra* note 94.

The reasoning of the legislature in allowing limited attorneys' fees under sections 422.411(2) and 428.103(1)(e) apparently is that an annual interest rate of 12% or less does not sufficiently compensate a first mortgagee for the substantial legal cost of foreclosing a mortgage and therefore, such creditors should not have to bear the entire legal expense of foreclosure as a cost of doing business. However, there appears to be little reason for the distinction between first lien mortgagees and all other merchants, other than an arbitrary determination on the part of the legislature. It certainly can be argued that whatever justification there is for allowing certain first mortgagees to collect attorneys' fees, although limited, also applies to all other merchants charging the same rates. Prohibiting a large group of merchants from collecting the actual attorneys' fees from defaulting customers means that the cost of collecting such delinquent accounts will be spread among *all* consumers in the form of higher finance charge rates.

The problem of protecting the defaulting customer from excessive extra charges while not forcing all customers to subsidize him appears to be more fairly approached by the recommendation of the National Commission on Consumer Finance, which reflects the status of the law in many states. The Commission proposed that the defaulting customer should bear his own attorneys' fees if in fact the contract were referred to an attorney for collection and the attorneys' expense is actually incurred, and in no event could such fees exceed 15% of the outstanding indebtedness at the time of default.¹⁰²

Finally, it should be noted that although section 422.411 prohibits any writing from containing a provision providing for the payment of attorneys' fees by customers, the section does not purport to limit the right of creditors to collect statutory fees such as those provided in section 271.04.¹⁰³

102. See *Report supra* at 25-26. The states which have adopted the UCCC have all chosen alternative B of UCCC § 2.413 which permits attorneys' fees up to 15% of the unpaid net after default as recommended by the National Commission on Consumer Finance.

103. Also it is interesting to note the curious language contained in the prohibition against the attorneys' fees in § 422.411. The section does not prohibit such attorneys' fees in a consumer credit transaction, but only prohibits a provisions for such attorneys' fees from being included in the written contract between the customer and the merchant. Theoretically, therefore, it is possible for the customer to agree to the imposition of such attorneys' fees orally as long as the provision is not included in writing. Since § 421.301(3) defines an "agreement" under the WCA as the bargain of the parties in fact and specifically states that § 402.202 concerning the prohibition against parol evidence is inoperative to

E. Multiple Transactions

Section 422.414 prohibits a merchant from dividing one transaction into two or more loans or sales in order to obtain a higher finance charge rate than would be permitted if the transaction were set up as a single sale or loan. This prohibition is necessitated by the fact that the WCA allows an 18% charge on the first \$500 financed, and only a 12% charge on amounts above \$500. Without section 422.414, a merchant could divide what is essentially a single sale or loan into two or more obligations of less than \$500 each and obtain 18% on each obligation instead of obtaining 18% on only the first \$500 and 12% on any excess.

Some critics have claimed that section 422.414 is automatically violated any time a customer owes more than one obligation to the same creditor at the same point in time. Such a narrow interpretation, however, certainly is not supported by the language of subsection (1), especially when read in conjunction with subsection (2). Subsection (2) provides that more than one loan or financed sale arising out of "substantially" the same transaction shall be *presumed* a violation of the section. There is no such presumption, however, where the multiple agreements arise out of separate transactions, indicating that multiple indebtednesses arising out of separate transactions were definitely contemplated.

A narrow interpretation prohibiting a customer from having more than one outstanding obligation from each creditor at any point in time would force a creditor to refinance all prior obligations whenever the customer desires a new extension of credit. Such refinancing might be impossible for multiple office creditors like finance companies or large retail operations, neither of which would have any way of readily ascertaining if the customer were

exclude admissible evidence of the actual bargain in fact between the parties, it is conceivable that the oral agreement to such attorneys' fees could be enforced. See text *supra* at 394. This argument is supported by the language contained in § 428.103(1)(a) concerning certain first mortgage real estate loans where a creditor cannot "contact for *or charge*" attorneys' fees except as set forth in that section, indicating that the legislature could have prohibited all attorneys' fees in § 422.411 if it desired (emphasis added). Perhaps more intriguing is the possibility that a guaranty agreement could provide that the guarantor is responsible for any attorneys' fees incurred in attempting to collect the transaction upon default by the customer if the customer agreed to such attorney fees orally. Such a provision would not be prohibited by § 422.420 (added by the February 22, 1973 Amendments) since that section only prohibits a co-signer from being obligated for the payment of fees which could not be imposed upon the customer, and § 422.411 does not prohibit the customer from orally agreeing to attorneys' fees. A similar analysis could be applied to the agreement to pay default charges orally. See § 422.413.

already obligated on another consumer credit transaction. Indeed, even if it could be discovered whether the customer had other obligations with the creditor, a rebate of the finance charge would have to be calculated on such previous transactions causing irritating delays for customers and merchants alike. Certainly the legislature intended no such result. Also, in precomputed transactions, requiring a refinancing and consolidation every time a subsequent extension of credit is sought by the customer could result in a greater total finance charge than if the transactions were kept separate.¹⁰⁴

Rather, section 422.414 only regulates the merchant's conduct; he may not "divide" an obligation to obtain a higher finance charge than would otherwise be permitted. If the customer himself obtains a \$500 loan today, and, on his own volition, comes in the following week and obtains another \$500 loan, the creditor may charge the maximum rate on both loans apparently without violating the section.

However, the section makes it clear that such multiple indebtedness can only be initiated by the customer. Thus, section 422.414 not only forbids a merchant from splitting transactions, but also

104. For example, assume that a customer purchases a washer and dryer for \$800 and finances it at the maximum annual percentage rates permitted by § 422.201 repayable monthly over a twenty-four month period. The total finance charge would be \$148.96 (the amount financed would be \$800 and the total of payments would be \$948.96 with monthly payments of \$39.54 each. The annual percentage rate would be 16.96%). If at the end of twelve months, the customer purchases another small electrical appliance for \$50 from the same merchant, the narrow interpretation of § 422.414 would require the first indebtedness to be refinanced and consolidated with the second transaction. The rebate on the indebtedness under § 422.209(2) would be \$38.73. The unpaid balance of the first purchase of \$436.05 (\$948.96 minus twelve payments of \$39.54 each equals \$474.48 minus rebate of \$38.73 equals unpaid balance of \$436.05) plus the new purchase of \$50 would be financed over the remaining period of twelve months at the maximum permissible rates, an annual percentage rate of 18%. The total finance charge on this new obligation of \$486.05 (\$436.05 plus \$50) would be \$96.00. Thus, if the two purchases were consolidated at the time of the second purchase, the customer would pay a total finance charge of \$206.23 (\$148.96 minus rebate of \$38.73 plus new finance charge of \$96.00). If, on the other hand, the customer had merely financed his new purchase of \$50 separately at the same 18% annual percentage rate over a twelve month period, the additional finance charge would have been only \$4.96 and the total finance charge of the two separate purchases would only have been \$153.92. Part of the reason for the increased total finance charge when the two transactions are consolidated is because the new amount financed on the consolidated transaction is less than \$500, permitting the merchant to charge an annual percentage rate of 18% on the consolidated transaction while the maximum annual percentage rate on the initial transaction was only 16.96%. It should be noted that a similar result would occur if the rebate of precomputed finance charge were calculated according to the flat actuarial method, instead of the "Rule of 78." See discussion *supra* note 61.

from "encouraging" a customer to become obligated on more than one loan or credit sale at the same time with the "purpose" of obtaining a higher finance charge than would be permitted if there were only one extension of credit.

Consequently, it seems clear that a customer who is multiply indebted to the same merchant may show a violation of section 422.414 only if he is able to carry either of the following evidentiary burdens: (a) prove that the separate transactions are "substantially" the same, thereby triggering the presumption that section 422.414 is violated, (although he then must be prepped to meet the creditor's rebutting evidence); or (b) prove that the creditor's "purpose" was to obtain a higher finance charge, and that his conduct "encouraged" the customer to enter separate agreements, thereby violating section 422.414(1) directly.

F. Restrictions On Security Interests

Sections 422.417 and 422.418 contain strict limitations on security interests which may be taken in the collateral for a consumer credit sale or loan transaction. With regard to consumer credit sales, section 422.417 provides that a seller may take a security interest only in (a) the property sold, (b) goods sold previously but only where the transaction is a consolidation of several credit sales or if such goods were purchased pursuant to an open end credit plan, (c) goods upon which the purchased property is installed or annexed or upon which services are performed, if the obligation is more than \$500 and (d) real property to which the property sold is affixed or which is improved by the property or services sold, if the obligation is \$1,000 or more. No security interest is permitted in after acquired property to secure a consumer credit sale, except in the financing of agricultural products or agricultural equipment.¹⁰⁵

The release of security interests after two or more credit sales are consolidated is governed by section 422.418(2). The seller must apply payments received after consolidation to the oldest transaction first. When an amount received is sufficient to pay for the oldest transaction, the security interest with regard to that transaction must be released.

The provision in section 422.418 restricting the security interest in consolidated transactions, along with the section 422.417(1) lim-

105. § 422.417(1)(e). Bkg. § 80.391 provides that a security interest may include repair or replacement parts in the property sold as well as "proceeds" of such property.

itation on security interests in consumer credit sales, regulate the use of the traditional "cross collateral" agreement. Under such cross collateral provisions, the seller could retain a security interest in all items purchased by an individual until the price of the last item purchased was paid in full.¹⁰⁶ Thus, if there were a default in the payment of the last item, a seller could seize all items of collateral even though the customer had paid the seller sufficient amounts for items previously purchased.¹⁰⁷

The WCA remedies cross collateral abuses by prohibiting a seller from taking a security interest in future property,¹⁰⁸ and by requiring allocation of payments received first to the oldest obligation of a consolidated transaction.¹⁰⁹ A seller in a consumer credit sale transaction will now be forced to look only to the merchandise most recently sold and still unpaid to secure the consumer credit sale.

The result of the restriction on cross collateral security interests undoubtedly will cause many sellers to demand larger downpayments (resulting in less credit extended) in consumer credit sales, especially where the items sold depreciate rapidly after sale (such as automobiles or furniture).¹¹⁰ Since the seller usually will only be able to secure the indebtedness with the merchandise he sells, he will attempt to make sure that the amount of the outstanding obligation never exceeds the value of the collateral upon repossession.

Subsection (2) of section 422.417 states that with respect to a consumer lease, a lessor cannot take a security interest in any property of the customer other than the leased goods to secure the

106. This procedure is permitted under § 409.204 of Wisconsin's Uniform Commercial Code which permits a secured party to retain a security interest in any item of collateral to secure all "future advances" or obligations between the parties.

107. *See, e.g., Williams v. Walker-Thomas Furniture Company*, 350 F. 2d. 445 (D.C. Cir. 1965). In that case, plaintiff purchased a number of household items during the period from 1957 to 1962 but then defaulted payment on the last item purchased. The creditor repossessed all items purchased during the five year period even though the amount in default was less than the cash price of the last item. The court ruled against the defendant creditor claiming that such repossession was unconscionable. Although this case was decided prior to enactment of the UNIFORM COMMERCIAL CODE, similar cross collateral provisions are specifically permitted under the Code and many courts have refused to set aside such cross collateral agreements in view of the specific statutory authorization. *See supra* note 106.

108. § 422.417(1).

109. § 422.418(2).

110. Larger down payments (and lower amounts financed) are further encouraged under the WCA by the limitation on deficiency judgments in consumer credit sales contained in § 425.209 when the unpaid balance is under \$1,000. *See* discussion text, *infra* at 462.

obligations under the lease. This section is extremely confusing since in a true lease, the lessor is the owner of leased property and therefore it is meaningless to allow him to take a security interest in his own property. Some consumer advocates claim that this section prohibits the taking of a security deposit in connection with a consumer lease, but it appears extremely doubtful that the legislature intended to prohibit the well established practice of taking security deposits from customers to protect against damages without specific language to that effect. Also, although such deposits are often labeled "security" deposits, generally no security interest is taken in money. The logical interpretation of subsection (2) is that it only prohibits a creditor from taking a security interest in other personal property to secure the payment of obligations due under the consumer lease, but does not prohibit the usual security deposit arrangement to protect against possible damage to the property.¹¹¹

With regard to consumer loans, subsection (3) of section 422.417 allows a lender to take a security interest in any personal property except the necessities listed in the statute, if such items were not purchased with the proceeds of the loan. Thus, only a purchase money security interest may be taken in the "clothing (of the customer's family), dining table and chairs, refrigerator, heating stove, cooking stove, radio, beds and bedding, couch and chairs, cooking utensils and kitchenware." Also, no security interest is allowed in real property if the obligation is less than \$1,000.

The reason advanced by consumer groups for exempting household furnishings from security interests other than purchase money security interests is that the value of the customer's basic necessities is not usually relied upon by creditors in determining whether they will make the loan in the first place. Therefore, creditors

111. Since the WCA specifically permits changes for damages to leased property to be assessed against the lessee under § 422.412, it would seem reasonable to assume that an advance deposit could be agreed to between the parties to protect against such damage. However, care should be taken to make sure a security interest is not taken in the money. In addition, it appears that the WCA does not prohibit a lessor from requiring advance payment of rent in a consumer lease transaction. Thus, for example, in lieu of a security deposit, a lessor could require the lessee to pay the last two months of rent in advance at the beginning of the lease term. Such advance payment would not be prohibited by § 422.412 since that section only limits the obligation of the customer upon termination of a lease (in effect, prohibiting a "balloon" type payment), and does not purport to limit the customer's obligation during the lease term. This advance payment of rent could serve the same function as a security deposit to guarantee payment of damages as long as no security interest was taken in the deposit.

should not be able to threaten seizure of such collateral, which serves only as a psychological club over the customer. Even if the collateral is actually seized, it is claimed that the creditor does not count on the collateral to liquidate the loan, but rather only to force the customer to obtain the money for repayment so that the collateral will be returned. Creditors, on the other hand, claim that a customer's collateral is a determinative factor in making loans, and that often the only collateral a customer has is his household goods.

Section 422.417(3) represents a compromise between consumer advocates and creditors by exempting certain items considered necessities, but allowing a creditor to take security interests in "luxury" items such as color television sets, boats, snowmobiles, paintings, appliances and the like.¹¹²

G. Miscellaneous Limitations

The remaining sections of subchapter IV of chapter 422 impose a number of other limitations and requirements on the relationship between creditors and their customers. Thus, section 422.404 prohibits wage assignments as security for payment of an obligation unless it is revocable at will;¹¹³ section 422.405 prohibits confession of judgment clauses;¹¹⁴ and section 422.413 limits default charges contained in the written contract to those provided in the WCA plus reasonable expenses incurred in the disposition of collateral.¹¹⁵ Changes in open-end credit plans are not allowed in most situations without proper advance notice under section 422.415.

112. An intriguing question is whether an AM-FM stereo radio, television, and record player combination console would be considered exempt as a "radio" under the language of the statute. If such a unit were considered a "radio", query whether the merchant could substitute a \$3.50 transistor radio so that the customer would have in his possession one "radio" which would be the exempt radio under the statute. In this regard, it should be noted that only one of each of the items enumerated in § 422.417(3) is exempt.

113. Wage assignments are governed by § 241.09. Although the statutory language of § 422.404, as amended by the February 22, 1973 Amendments, does not prohibit a penalty for revoking an assignment, and only requires a notice to the right to revoke if the merchant desires to renew the assignment. Bkg. § 80.361 requires substantially the following notice on any wage assignment: "The customer may terminate this assignment at any time without penalty."

114. This prohibition against confession of judgment clauses essentially repeats the prohibition already contained in § 270.69. Section 422.405, however, provides that any merchant who accepts an instrument containing a confession of judgment clause is subject to the penalties provided in § 425.305 (transaction is void and customer may retain goods, services, or money received).

115. See text, *infra* at 460 for discussion of the expenses permitted upon disposition of repossessed collateral. See also *supra* note 103 for discussion of "oral" default charges.

Also, granting or offering rebates to customers for referring other prospective customers, or upon occurrence of certain events such as a subsequent sale, are prohibited by section 422.416. Section 422.419 prohibits a contract which contains the waiver of certain rights of customers.¹¹⁶ Finally, section 422.420, added by the February 22, 1973 Amendments, grants a co-signer the same protections granted to the customer.¹¹⁷

XI. CONSUMER APPROVAL TRANSACTION

Another problem area often raised by consumer groups concerns the alleged "high pressure" tactics of door-to-door salesmen and direct solicitation sellers or lenders, especially against housewives. The theory is that the salesmen exploit the sense of security that consumers feel in the privacy of their own home. Consequently, consumer groups have consistently demanded protection for the customer against certain types of high pressured salesmanship. The UCCC and the NCA have taken opposite routes in the attempt to alleviate some of the problems, and the approach taken in subchapter II of chapter 423 might be considered as a compromise between the two Codes.

The UCCC provides a three day "cooling off" period within which the customer has a right to cancel any home solicitation consumer credit sale by sending notice of such cancellation¹¹⁸ to the creditor. However, the UCCC applies only to consumer "credit" transactions where the buyer's agreement or offer to purchase is obtained by the seller, creditor or persons acting on their behalf while personally soliciting the sale at the buyer's "residence."

The NCA goes much further and extends protection beyond just home credit transactions.¹¹⁹ First of all, the NCA provides that any sales agreement (credit or non-credit) initiated or consummated away from the merchant's regular place of business,

116. Section 422.419(1)(a) prohibits a consumer credit contract from containing a provision by which the customer authorizes the merchant to enter the customer's "dwelling" to repossess collateral. Bkg. § 80.392 defines the term "dwelling" to include "any garage, shed, barn, or other building on the premises whether attached or unattached." This expansion of the definition of "dwelling" certainly goes far beyond the normal meaning of the word, and does not appear to be supported by any statutory language of the WCA.

117. See *supra* note 103 for discussion of possibility that guarantor could agree to guarantee certain charges agreed to orally by the customer.

118. UCCC §§ 2.501-2.505.

119. NCA §§ 2.501-2.505. At least one state, Vermont, has already adopted a right of rescission statute which applies to all retail sales. See VT. STAT. ANN., Title 9, § 2454 (supp. 1967).

whether or not at the buyer's residence, would not be complete until the customer "affirmed" the sale by notifying the creditor within three days that he does indeed intend to consummate the purchase. Secondly, with regard to all other retail sales, the NCA grants a customer a three day right of rescission no matter where the sale is consummated. The drafters of the NCA rationalized as follows: since pressured door-to-door sales often lack volition, the consumer should be given a second chance to enter affirmatively into the transaction. With regard to store sales, the drafters reasoned that most retailers accept merchandise returns anyhow, in effect giving the customer the same second chance, and therefore, a consumer's chance to change his mind should be codified into a right of cancellation.¹²⁰

The WCA incorporates concepts from both the UCCC and NCA. The basic provision of subchapter II is a three day right to cancel any "Consumer Approval Transaction." A Consumer Approval Transaction is any consumer credit transaction or a cash transaction over \$25 not specifically exempted by section 423.201: (i) which is initially solicited by face-to-face contact away from the merchant's regular place of business, or by mail or telephone communication directed toward a particular customer, *and* (ii) which is consummated away from the merchant's regular place of business or in which the customer's offer to contract or other writing evidencing the transaction is received by the merchant away from his regular place of business.¹²¹

By extending coverage beyond just credit sales consummated in the home, the WCA is somewhat broader than the UCCC. Yet, by limiting coverage to transactions initiated *and* consummated (or where the offer to contract is received) away from the merchant's regular place of business, and not extending the right to cancel to transactions consummated on the creditor's premises, the WCA does not go as far as the NCA. Also, unlike the NCA, the WCA does not automatically cancel a Consumer Approval Transaction not reaffirmed; it only permits the customer to cancel if he acts within three days.

Where both elements of the Consumer Approval Transaction definition are met, the customer has until midnight of the third business day after he receives a notice of his right to cancel (specified in section 423.203) to rescind the transaction. The notice to

120. See Official Comment, NCA § 2.501.

121. § 423.201.

the customer may be included on other documents and need not be a separately typed document.¹²²

Upon any cancellation by the customer, he is not liable for any finance or other charge, and the merchant must return any down-payment within ten days of cancellation as well as take any appropriate action to terminate the transaction including termination of any security interests.¹²³ After cancellation by the customer, section 423.205 provides that he must tender the return of the property after the merchant performs his obligations under section 423.204. The customer has the duty to take reasonable care of the goods from the time of delivery until the expiration of a reasonable time after tender, not to exceed twenty days.¹²⁴

It should be emphasized that *both* elements specified in section 423.201 must be present before subchapter II to chapter 423 will apply: the transaction must be initiated away from the merchant's regular place of business (by face-to-face solicitation or direct mail or telephone solicitation) *and* consummated (or the offer to contract or evidence of transaction received) away from the merchant's regular place of business.

The most obvious example of a Consumer Approval Transaction under chapter 423 would be where a salesman visits John Smith at his home and sells merchandise to him. In fact, the sale need not actually be consummated at the Smith's residence; Smith's offer to purchase received by the seller or his agent is all

122. The notice contained in § 423.203 was substantially amended by the February 22, 1973 Amendments. The section, as amended, makes it clear that the notice need not be contained in a separate document and can be printed on the document evidencing the Consumer Approval Transaction. Section 423.203 (3)(m), also added by the February 22, 1973 Amendments, states that if the Federal Trade Commission or other federal agency adopts a notice of right to cancel different from that specified in the WCA, compliance with the federal notice will also be considered compliance with the WCA. Although not promulgated as a final regulation at the time of the printing of this article, the Federal Trade Commission has proposed a rule which would grant customers the right to cancel in substantially more circumstances than granted in ch. 423. See 37 F.R. 22934; 4 GUIDE ¶ 10,451.

123. § 423.204(1), as amended by the February 22, 1973 Amendments.

124. § 423.205 as amended by the February 22, 1973 Amendments. It should be noted that the statutory language of § 423.205(1) does not limit the customer's duty to take care of delivered property in a Consumer Approval Transaction if the merchant fails to perform his obligations under § 423.204 after the customer's cancellation. This is because § 423.205(1) states that the duty to take reasonable care of the property shall not exceed twenty days after "tender" of the property, but § 423.205(2) does not require the customer to "tender" the property until the merchant has performed his obligations under § 423.204. To correct this deficiency, the Administrator has issued Bkg. § 80.44 which states that the customer's duty to take reasonable care of goods in no event shall exceed forty days after he gives notice of cancellation.

that is needed to trigger the customer's rights. Thus, the fact that some creditors do not "accept" a contract until it is received at the home office will not affect Smith's right to cancel if the agent receives the offer at his home.

Moreover, the receipt of the offer to purchase need not take place in Smith's home, since the Consumer Approval Transaction concept extends to transactions consummated "away from the merchant's regular place of business." Thus, if the initial contact was at Smith's home, but the deal was consummated at a restaurant which was not the seller's regular place of business, the three day cancellation period would still apply.

On the other hand, if Smith had read a newspaper advertisement concerning the merchandise, called the seller who then came to Smith's home, and the sale was then consummated, it would not be a Consumer Approval Transaction. One of the elements above, namely the requirement that the transaction be initiated by "telephone solicitation *directed* to the particular customer" (emphasis added) by the merchant, would not have been met¹²⁵ In fact, Smith would be deemed to have initiated the transaction. Conversely, if the seller initiated the transaction by telephone solicitation directed to Smith, but Smith came to the premises of the seller to consummate the transaction, it again would not be a Consumer Approval Transaction, and Smith would not have a three day right of rescission.

Unfortunately, application of the three day right of rescission may be extremely difficult to determine in certain circumstances, such as where a seller or lender addresses mail to a particular customer by name inviting him to send in a postcard for information concerning a loan or the purchase of certain merchandise. If the customer executes the card and "invites" the lender or seller to his home for a presentation, and the transaction is then consummated in the individual's home, the determination as to whether the transaction is a Consumer Approval Transaction revolves on whether the first element, which requires the transaction to be "initiated . . . by mail . . . directed to the particular customer," is met. It appears that this type of transaction would *not*

125. Presumably the requirement that the mail or telephone solicitation be "directed" to the customer means that the soliciting merchant must seek out the particular individual who eventually becomes the customer. An envelope addressed to "occupant" or a telephone solicitation to anyone who answers the telephone would not be a solicitation "directed" toward that person.

fall within the scope of the chapter because the customer was not directly solicited to enter into the transaction, but only invited to make an inquiry if he felt interested. It is only the type of "pressure" exerted in uninvited solicitation that appears to be subject to the cancellation provisions.

XII. INSURANCE

Although a detailed discussion of the insurance regulation provisions of chapter 424 is beyond the scope of this article, a few points should be mentioned.

Subchapter II to chapter 424 controls the issuance of credit life and credit accident and sickness insurance including the method of determining and filing premium rates for such insurance,¹²⁶ limitations on the total amount of such insurance which can be written,¹²⁷ the maximum permitted term of such insurance,¹²⁸ and the required disclosures of insurance terms.¹²⁹

Chapter 424 also controls the issuance of property insurance written on collateral securing a consumer credit obligation in subchapter III. Section 424.301 provides that although creditors may require property insurance on collateral, a creditor may not receive a separate charge for such insurance unless the insurance covers a substantial risk of loss or damage to the property allowed as collateral, the amount, terms and conditions of the insurance are reasonable in relation to the value of the property, the term of coverage is comparable to the term of the obligation, and the value of the property and the amount financed of the credit transaction (excluding the insurance premium) is \$800 or more.¹³⁰ Section 424.301(2) provides that the "term" of insurance will be considered reasonable in relation to the term of credit if the coverage does not extend substantially beyond the scheduled maturity date of the obligation.

It is important to note that although section 424.301(3) does not permit a creditor to "contract for or receive" a separate charge for property insurance where the value of the property is \$800 or less, it does not prohibit the creditor from requiring the customer to obtain such insurance through someone other than the creditor as a condition for the extension of credit. The prohibition only

126. § 424.209.

127. § 424.208.

128. §§ 424.201(a) and 424.207.

129. § 424.203.

130. *See* § 424.301(1) and (3).

limits the "separate charge" which a creditor may receive, not the insurance he may require the customer to purchase at his own expense. The rationale of the section is to prevent a creditor from selling insurance and collecting the insurance premium (and thereby receiving a commission) on collateral which would not ordinarily be insured. However, there is no prohibition against requiring such insurance when insurance is deemed necessary to protect the value of the collateral securing the obligation. Presumably a creditor will not require unnecessary property insurance when he will receive no commission from the sale.¹³¹

Also, although subsection (3) prohibits the creditor from contracting for or receiving such a separate charge, a corporation "related to" the creditor is not so prohibited. Apparently recognizing the commercial reality that insurance companies "related to" a creditor under the broad scope of that term contained in section 421.301(33) are usually separate profit centers, subsection (3) only seeks to remove the incentive to the creditor himself from directly profiting by the sale of such credit insurance.¹³²

Section 424.302 makes sure that the benefit of property insurance is extended to the debtor where the creditor contracts for or receives a separate charge for such insurance. The risk of loss of such collateral, if not willfully caused by the customer, extends only to the portion of the collateral not covered by insurance. This section also has the effect of prohibiting contracts where by insurers are subrogated to the rights of creditors to any loss or damage not willfully caused by the debtor.¹³³

Section 424.303 prohibits cancellation of property or liability insurance unless the customer is in default under section 425.103 or unless the customer agrees in writing. In either event, at least thirty days advance written notice must be given to the customer before cancellation. Upon cancellation, any prepaid insurance premium shall be rebated or credited to the customer's account.

Subchapter IV of chapter 424 grants the Commissioner of In-

131. A typical example of the type of collateral on which a merchant would require insurance even though the merchant himself could not sell the insurance would be snowmobile financing, especially for used snowmobiles where the purchase price is often less than \$800.

132. The WCA is careful to set forth those instances in which its provisions extend to persons "related to" a merchant. Therefore, for example, § 422.408(3)(a) states that an interlocking loan occurs when the lender is "related to" the seller of merchandise and § 422.407(2) states that the agreement to waive defenses cannot be asserted by an assignee "related to" the assignor.

133. See Official Comment to UCCC § 4.302.

surance power to issue rules in connection with chapter 424 and provides for cooperation between the WCA Administrator and the Commissioner.

In general, many of the provisions in chapter 424 are the same provisions as contained in Article 4 on insurance of the Uniform Consumer Credit Code, and reference to that law and the Official Comments thereto are helpful to understanding the WCA provisions.

XIII. COLLECTION REMEDIES

The sections of the WCA discussed above concerned the regulation of the formation of the contract, the terms which may be included, and the disclosures which must be made. Chapters 425 and 427 regulate creditors' formal and informal remedies with regard to customers who default in the repayment of a consumer credit obligation or who jeopardize collateral securing the obligation. The creditors' remedies and limitations thereon and the rights of customers upon default are discussed in the sequence a merchant would normally expect to encounter them when an obligation is not paid when due.

A. Regulation of Informal Collection Remedies

As has been the case under prior Wisconsin law, the WCA permits a merchant or other "debt collector" as defined in section 427.103(3) to attempt to "collect" an installment of a consumer credit obligation through means other than legal proceedings in a court of law as soon as the installment becomes past due.¹³⁴ Upon such nonpayment, a merchant may contact the customer to determine the reason for nonpayment and urge the customer to pay immediately.¹³⁵

Chapter 427, however, for the first time imposes some statutory limitations on the activities of merchants who attempt such informal collection. Section 427.104 basically prohibits a merchant from attempting to coerce collection by threatening the customer directly with physical harm or criminal prosecution or threatening

134. Section 425.103(1) limits the commencement of legal proceedings in a court of law, but does not limit informal collection procedures. Cf. Bkg. § 80.61 (stating that the restriction against "commencing any action" under § 425.105(1) unless a notice of right to cure is sent only refers "to the commencement of legal proceedings in a court of law").

135. Only oral or written collection attempts are permitted without court action. Seizure of collateral without court proceedings is prohibited by § 425.206. See discussion in text, *infra* at 461.

to communicate or actually communicating with third parties in an attempt to force the customer to pay the overdue indebtedness through embarrassment in front of friends or neighbors, or fear of reprisal from his employer.

Most of the items contained in section 427.104 concern practices which are generally considered "unfair", although some of the rather vague language provides little guidance for merchants who desire to comply with the Act. For example, subsection (1)(h) of section 427.104 prohibits a merchant attempting to collect a debt from engaging "in other conduct which can reasonably be expected to threaten or harass the customer or a person related to him." However, the merchant is left with the task of determining what "reasonably" threatens or harasses a customer. Presumably court decisions and administrative regulations will develop to inform merchants of the extent of permissible collection practices.¹³⁶

B. Formal Collection Remedies

In addition to regulation of "informal" collection attempts of overdue payments, the WCA strictly regulates the formal or legal remedies that a merchant may take against the customer or any collateral. Thus, chapter 425 not only details the procedures which must be followed if the customer does not make payment voluntarily, but also prohibits commencement of any legal proceedings upon breach of contract unless such breach is also a "default" as defined in section 425.103.

1. *What constitutes a Default?* With regard to monthly payment transactions, the typical type of closed-end consumer credit, a default occurs when a customer has:

. . . outstanding 2 or more scheduled payments which have remained unpaid for more than 10 days after their original or deferred due dates, or the failure to pay the first payment or the last payment, or in the case of a transaction for an agricultural purpose, the failure to pay an installment within 40 days of its original or deferred due date . . .¹³⁷

136. It should be noted that ch. 427 does not apply to transactions consummated prior to March 1, 1973 even though the activity may occur after March 1, 1973. The transitional provisions of the WCA make it clear that the Act does not apply to any transaction consummated prior to March 1, 1973 except for certain specified sections. See transitional provisions. Wis. Laws 1971, ch. 239 § 39. See also discussion in text, *infra* at 479.

137. Section 425.103(2)(a)(1). Where the interval between installments is more than two months, § 425.103(2)(a)(2) provides that a "default" will occur when one payment remains unpaid for more than sixty days after its original or deferred due date. Section

Although there is some inconsistency in the use of the term "payments" and "installments," generally speaking, the section means that a merchant cannot proceed with formal collection remedies in a court of law until the customer has two or more scheduled payments outstanding and unpaid beyond their respective 10 day grace periods. As discussed subsequently, however, there are some exceptions to the two missed installments rule when dealing with the first and last installments, agricultural transactions, impairment of creditor's rights in collateral, or impairment of the customer's ability to pay.

The provision permitting customers to miss two payments before a creditor may proceed with formal remedies developed amid substantial controversy. Consumer groups argued that since creditors usually do not attempt legal collection until an account is 60 or 90 days past due, section 425.103(2) does no more than codify the practice of most creditors. In addition, these consumer advocates claimed that the extra month allows customers time to work out financial problems and resume normal payments. On the other hand, creditors argued for a retention of the right to commence legal collection immediately after a default to encourage people to pay promptly and to take possession of collateral as quickly as possible to prevent damage. Creditors claimed that delinquencies would be increased by customers' knowledge that creditors could not proceed against them when they took an additional month to repay. Despite these arguments by creditors, however, the WCA generally adopted the two missed installments approach advocated by consumer groups, although with several important exceptions.¹³⁸

The first exception, concerning a merchant's right to commence legal proceedings against a customer upon non-payment of

425.103(2)(a)(3), added by the February 22, 1973 Amendments, states that a single installment obligation is not in "default" until forty days after its scheduled or deferred due date. With regard to open-end credit plans, § 425.103(2)(b) provides that a default will occur when a customer fails to pay any two installments when due within any twelve month period.

138. It should be noted that the version of the WCA originally introduced in the Wisconsin Assembly stated that a customer would not be in "default" until he missed three consecutive payments. See § 425.103 of A. B. No. 1057, 1971 Sess. Laws. In addition, that original proposal granted the customer the right to unilaterally defer any installment which he could not pay. The language eventually contained in § 425.103 of the WCA was a compromise between the interests of creditors in retaining their rights to proceed for defaults as soon as possible after an installment is unpaid and consumers who supported the original version of the Act. See Davis, *supra* note 3 at 29-33 (1973). It should also be noted that this concept of permitting two missed installments before a creditor can proceed has been adopted in other states. See, e.g., IOWA CODE § 536.13(7)(f).

the first or last installment, has been seriously undermined by the Administrator through his rule making powers. The statutory language of subsection (2) quoted above appears to have been intended to permit a merchant to proceed for collection immediately against a customer who refuses to pay his first or last installment of a monthly consumer credit transaction. Thus, the language states that a default occurs upon "the failure to pay the first or last payment, . . ."

The first installment exception from the two missed installments rule presumably was in recognition of the experience of merchants who generally have found that individuals who do not pay the first installment of an obligation usually have no intention of making any payments and merely desire to use any collateral as long as possible before it is repossessed. Similarly, since the obligation has matured when the last payment is due, there is no reason to grant the customer additional time before permitting the merchant to proceed with legal collection if the last installment is not paid when due.¹³⁹ Nevertheless, despite the fact that the statutory language seems unambiguous in permitting immediate formal action upon non-payment of the first or last installment, the Administrator has adopted a regulation which states that no cause of action will accrue against a customer until forty days after the first or last installment remains unpaid.¹⁴⁰ The effect of the Administra-

139. Of course another reason failure to say the last installment is a "default" is because no other installment may have been missed, and only one installment would be delinquent. Consequently, to make sure the merchant can collect the last unpaid installment in such a situation, § 425.103(2)(a)(1) provides that a default occurs upon non-payment of the last installment.

140. Bkg. § 80.60 states:

For the purposes of section 425.103(2)(a), Wis. STATS., the term 'default' with respect to the first or last installment of a transaction other than one pursuant to an open-end plan shall mean to have outstanding such scheduled payment for more than 40 days after its original or deferred due date.

Apparently the Administrator based this regulation on the claim of some consumer groups that the pertinent language of subsection (2)(a) of § 425.103 meant to state that the forty day period applied to the first payment or the last payment of any consumer credit transaction as well as the failure to pay any installment in a transaction for an agricultural purpose. This interpretation, however, would appear to be directly contrary to the plain language of subsection (2)(a)(1). If the legislature had intended for the forty day period to apply to the first and last installments, it certainly would have clearly done so instead of putting the forty day phrase after the provisions concerning agricultural transactions. In fact, the legislature specifically amended subsection (2) of § 425.103 in the February 22, 1973 Amendments by adding a new subparagraph (a)(3) stating that a single installment transaction would not be in "default" until forty days after its scheduled due date. Obviously if the legislature had intended to apply this same requirement to the first or last installment of a monthly payment transaction, it would have done so when it originally passed the Act or surely when it enacted the amendment to § 425.103.

tor's regulation is particularly severe with regard to the first installment, especially where the collateral will be subject to heavy use. Thus, for example, a farmer could purchase and use a large piece of equipment until forty days after the due date of the first installment before being in "default" for non-payment. Assuming the typical thirty day period between the date of the purchase and the first installment, the equipment could be used for seventy days without any payment before the merchant could even attempt to reclaim the collateral through legal procedures. Nevertheless, although the validity of this regulation is certainly dubious, until successfully challenged, it would appear that no legal action for collection may be commenced upon default in payment of the first and last installment until the forty day period has elapsed.

Section 425.103(2)(a) also exempts agricultural extensions of credit from the two missed installment rule by providing that such obligations are in "default" if the customer fails to pay *any* installment within forty days of its original or deferred due date. This language presumably was in addition to the right of a merchant to proceed immediately for non-payment of the first or last installment in extensions of credit for agricultural purposes, and would have permitted merchants to commence legal proceedings under either exception in an agricultural transaction where collateral is likely to be subject to heavy use and substantial depreciation in value. The Administrator's regulation mentioned above, however, would appear to make the exception for first and last installments meaningless in agricultural transactions since the merchant is given the right to proceed within forty days after any payment due on the transaction is not paid.

Finally, in addition to defining defaults in terms of missed installments, a transaction may also be in "default" anytime the customer breaches a covenant of the transaction which either materially impairs (a) the condition, value or protection of the collateral, (b) the creditor's security interest, or (c) the customer's ability to pay the balance of the obligation. Thus, even if a customer has not missed any installments, but the merchant has proof that the ability of the customer to pay the remaining installments is materially impaired (*e.g.*, commencement of insolvency proceedings or loss of employment), or that the value of the collateral is impaired or the security interest is in jeopardy (*e.g.*, customer has damaged the collateral or is preparing to remove it from the state), then the merchant may commence formal collection procedures immedi-

ately.¹⁴¹

2. *Customer's Right To Cure Default.* After a "default" has occurred as specified in section 425.103, a merchant may proceed to realize upon the collateral, or otherwise collect the debt through legal proceedings, only after he gives the defaulting customer a notice of his right to "cure" such default pursuant to section 425.104.¹⁴² To cure, a customer must tender all unpaid installments (prior to acceleration) plus unpaid delinquency or deferral charges, and take whatever action is necessary to cure the default.¹⁴³ If the customer cures the default within fifteen days after the notice is sent, the obligation is reinstated as current and the merchant may not proceed further to collect the indebtedness or recover the collateral. A customer has the right to cure only twice during any twelve month period.¹⁴⁴ If the customer does not exercise his right to cure (or if the cure provisions are inapplicable), then the merchant may accelerate maturity of the obligation and either (a) replevy the collateral securing the debt and, if allowed, obtain a deficiency, or (b) waive rights to the collateral and sue the customer for the entire unpaid balance of the obligation as an unsecured creditor. Section 425.203 specifically provides that the merchant must elect his remedies; he may not sue on the entire obligation and also seize the collateral in satisfaction of the obligation.

3. *Replevin-Enforcement of Security Interest.* If a merchant decides to proceed against personal property by enforcing his security interest, he must follow the procedure outlined in subchapter II of chapter 425. To obtain possession of the collateral, if the customer does not surrender it, the merchant must institute an action for replevin in small claims court pursuant to section 425.205.¹⁴⁵ This section requires a hearing to determine whether the

141. In the event that a default occurs under § 425.103(2)(c) it presumably would still be necessary to send a "notice of right to cure default" pursuant to § 425.104. See § 425.103(3). However, if the "default" consisted of proof that the customer was preparing to remove collateral from the state, the merchant could immediately obtain a restraining order pursuant to § 425.207. Section 425.207 permits a court to enter a restraining order to protect collateral if the merchant can show that the customer is acting or about to act in a manner which substantially impairs the merchant's prospect for realization of his security interest.

142. §§ 425.103(3) and 425.105(1).

143. § 425.105(2). Bkg. § 80.62 specifies that the notice is deemed given on the "date of mailing" and concomitantly the date of "tender" of performance on the part of the customer is considered the date on which he mails or otherwise delivers the unpaid delinquent installments or otherwise performs to cure the default.

144. § 425.105(3).

145. Under § 425.205(1) such replevin action may be commenced in the small claims

customer is in default and if the merchant has the right to seize the collateral. If the merchant is successful at the hearing, a judgment will be entered ordering the customer to turn over the collateral to him. The judgment, however, determines only the right of possession; any claim for deficiency or damages to the collateral must be sought in a separate action. Unfortunately, this necessity of double judicial proceedings appears to impose a substantial burden on customers and merchants alike. The burden for merchants is obvious since now two court actions, one for possession and a separate action for any deficiency, are necessary. However, the procedure may also be an additional burden on customers, since the merchant is not prohibited from collecting the statutory attorney's fees and court costs from the customer for both proceedings if awarded by the court and the customer often will be obligated to pay such costs for two actions instead of one.¹⁴⁶ A much more satisfactory procedure would have been to allow determination of the entire claim in one court proceeding, but require actual repossession and resale of collateral before a merchant could recover damages and/or a deficiency. Handling all facets of collection in one action would be less costly for the merchant and would make the customer liable only once for statutory attorneys' fees and court costs.

To prevent undue delay in the collection enforcement procedure, the summons for the replevin action may be issued at any time after the customer is in "default", although the return date may not be set prior to the expiration of the the fifteen day right to cure period.¹⁴⁷ In recognition that the elimination of self help repossessions and the requirement of a court hearing before seizure will be more costly, section 425.205(1) attempts to minimize the

court regardless of the value of the collateral. Appropriate forms for the summons and complaint are set forth in § 425.205(2) and (3) respectively.

146. Although § 422.411 prohibits written provisions which provide for payment of attorneys' fees by the customer, award of statutory attorneys' fees are not prohibited. See text *supra* at 440.

147. § 425.205(6). This provision permits some flexibility to the merchants. Thus, for example, a merchant may send the fifteen day notice of right to cure pursuant to § 425.104 as soon as the obligation is in "default". If the merchant heard nothing from the customer for seven days, he could then serve the small claims replevin summons setting the return date for one day after the expiration of the fifteen day notice of right to cure period. (Section 299.05(3) permits the return date of a small claims action to be set from eight to seventeen days after service of the summons.) If the customer did not choose to cure the default within the fifteen day period and had no defense, the merchant could force the customer to turn over the collateral in the small claims proceedings one day later.

merchant's costs and attorneys' fees by permitting the replevin action to be commenced by an officer or agent of the merchant even though he is not an attorney.¹⁴⁸

The requirement of a hearing before replevin would appear to satisfy the constitutional requirements set forth by the United States Supreme Court in *Fuentes v. Shevin*.¹⁴⁹ In that case the Supreme Court held replevin procedures in Florida and Pennsylvania unconstitutional because the statutes did not provide for a hearing before seizure by the *sheriff*.¹⁵⁰ In fact, the WCA appears to go much further than the constitutional requirement of the *Shevin* case since a hearing is required before a *merchant* (without action by the sheriff) may seize collateral through peaceful repossession.¹⁵¹

Once the merchant has obtained judgment for possession pursuant to section 425.205, section 425.206 allows him to take possession of collateral in much the same manner as secured parties could take possession of collateral without a hearing prior to the effective date of the WCA. Consequently, any method of peaceful repossession permitted prior to the effective date of the Act under

148. Although § 425.205(1) permits a non-attorney officer or agent of a merchant to "commence" the small claims replevin procedure, the section does not appear to permit such individual to "argue" in the action without an attorney. Thus, subsection (1)(a) states that "notwithstanding §§ 299.05(2) and 299.06(2)(a), process may be issued to, and such action may be commenced by, an officer or agent of a merchant on the merchant's behalf even though such officer or agent is not an attorney authorized to practice law in this state." The two referenced sections concern only the "commencing" of small claims actions. Section 425.205(1)(a) does not make reference to § 299.06(2)(b) which states that a party, who is not appearing *pro se*, may "appear and prosecute" an action or proceeding only "by an attorney regularly authorized to practice in the circuit courts of this state but not otherwise." Nevertheless, an attorney presumably is not needed to appear in the replevin action if it is not contested and a judgment granting possession of the collateral to the merchant is entered by default.

149. 407 U.S. 67 (1972).

150. Similarly, the district court for the Eastern District of Wisconsin declared Wisconsin's replevin before judgment statute (ch. 267) unconstitutional in *Dorsey v. Community Stores Corp.*, 346 F. Supp. 103 (E.D. Wis. 1972). Although the statute was declared unenforceable in the *Dorsey* case because it did not provide for a hearing before a judgment, the defect probably can be cured by providing a hearing to the defendant prior to actual seizure.

151. At the time the WCA was enacted, the Wisconsin legislature apparently decided to follow the concept expressed in *Adams v. Egle*, 338 F. Supp. 614 (S.D. Cal. 1972) which held that collateral could not be repossessed under the Uniform Commercial Code unless there is a prior court hearing. The *Adams* case was eventually reversed in *Adams v. Southern California First National Bank*, ____ F.2d. ____ (9th Cir. 1973) 42 U.S.L.W. 2230. The case is now on appeal to the U.S. Supreme Court. For a discussion of the ramifications of abolition of self-help repossession, see White, *The Abolition of Self-Help Repossession: The Poor Pay Even More*, 1973 Wis. L. Rev. 503.

the Uniform Commercial Code is probably permitted after judgment is obtained pursuant to section 425.205.¹⁵²

4. *Customer's Surrender of the Collateral.* It is important to note that the WCA does not require a judgment in replevin in every case before a merchant can obtain possession of collateral securing a consumer credit obligation after default. Section 425.206 states that a creditor may take possession of collateral after default without the necessity of starting a replevin action if the customer consents to a "surrender" of the collateral.

The WCA has two concepts of "surrender". Section 425.204 states that a customer may "voluntarily surrender" all of his rights in collateral to a merchant at any time. A surrender is "voluntary" only if it is *not* made pursuant to a "request or demand" by the merchant.¹⁵³ If the customer "voluntarily" surrenders his collateral, presumably he will be liable for any deficiency after resale of the collateral notwithstanding the restriction on deficiencies contained in section 425.209.¹⁵⁴ However, the language of section

152. Section 425.206(2) does regulate such peaceful repossession after judgment by prohibiting a merchant from committing a "breach of the peace" or entering a "dwelling used by a customer as his residence" except at the voluntary request of the customer, although such activities would probably be prohibited by existing law without the statutory language.

153. The fact that § 425.204 gives a customer the right to voluntarily surrender his collateral "at any time" does not mean that the merchant is compelled to accept unreasonable surrender. The customer cannot "surrender," for example simply by abandoning the collateral on the merchant's premises without a reasonable delivery to the merchant.

154. Subsection (2) to § 425.204 states that "the rights and obligations of the merchant and customer with respect to collateral voluntarily surrendered as defined in this section *shall be governed by §§ 409.504 to 409.507 and are not subject to his subchapter.*" (emphasis added). Thus by the express language of the statute, the deficiency limitation provisions of § 425.209 do not apply when collateral is "voluntarily" surrendered. Unfortunately, last minute amendments to the WCA on the floor of the Wisconsin Senate has resulted in unnecessary confusion with regard to the application of the deficiency limitations contained in § 425.209 to "voluntary" surrenders of collateral. Originally the deficiency limitations of § 425.209 applied only to repossessions other than "voluntary surrenders." Just before passage, however, the Senate amended § 425.209(2),(3) and (4) so that the section purports to prohibit deficiencies under \$1,000 where "the merchant repossesses or *accepts voluntary surrender of goods*" (emphasis added) which were the subject of a consumer credit sale and in which the merchant had a security interest. This amendment created an inherent conflict with § 425.204(2) which, as quoted above, specifically states that rights and obligations with respect to collateral voluntarily surrendered are not subject to the provisions of subchapter II of ch. 425, and instead are governed by §§ 409.504-409.507, which permit deficiencies. Apparently the Senate confused the concepts of "voluntary" surrenders and "non-voluntary" surrenders. Interestingly, as § 425.409 is now worded, it does not purport to apply to "non-voluntary" surrenders at all, and unless such a non-voluntary surrender is a "repossession," it may be argued that § 425.209 does not apply when collateral is surrendered pursuant to a request or demand. Such an interpretation, however, would appear to defeat the purpose of the section.

425.204 does not prohibit a merchant from "requesting or demanding" surrender of collateral, but only provides that if he does make a request or demand, such surrender is no longer "voluntary".¹⁵⁵

If a merchant does "request or demand" surrender of collateral when the customer is in default, and the customer complies, the surrender would be valid under section 425.206(1)(a). When the customer submits his collateral to the merchant in a "non-voluntary" surrender, however, the merchant is prevented from proceeding for any deficiency if prohibited under section 425.209.¹⁵⁶ In this regard, promulgated regulations of the Administrator state that a non-voluntary surrender of collateral will not be valid unless the customer is notified of his right to contest the merchant's claim to the collateral in a replevin hearing.¹⁵⁷

5. *Customer's Right of Redemption.* Upon the issuance of process under section 425.205 or when the merchant obtains possession of the collateral pursuant to judicial action or surrender, section 425.208 grants the customer the right to "redeem" the collateral within fifteen days by (1) paying all installments due and unpaid on the date of repossession (prior to any acceleration) plus any unpaid delinquency or deferral charges, (2) taking any necessary action to cure non-monetary defaults, (3) paying the court costs incurred by the creditor including filing and service fees and bond costs, and (4) tendering a "performance deposit" equal to three scheduled installments (or three minimum payments in open-end plans) or 1/3 of the remaining unpaid obligation, whichever is less. If a customer exercises his right to redeem, the collateral must be returned to him and the agreement will be reinstated as though payments had been made as scheduled.¹⁵⁸

Section 425.208(4) and (5) provides that the performance deposit, may, but need not be applied to future delinquent install-

155. § 425.204(3). Notification sent to the customer informing him of his right to voluntarily surrender collateral is *not* a "request or demand". See Bkg. § 80.67.

156. Section 425.209, discussed *infra*, text at 465 only prohibits deficiencies in credit sale transactions. Therefore, in consumer loan transactions (other than interlocking loans under § 422.408), whether the collateral is surrendered voluntarily or surrendered pursuant to request or demand makes no difference since a deficiency can be sought in either case.

157. Bkg. § 80.68. However, no notice is required under the provisions of the statute for an effective surrender and, arguably, a non-voluntary surrender would be effective under § 425.206(1) even without such notice. Bkg. § 80.68 also states that collateral will not be deemed surrendered if the merchant misrepresents any material fact or the state of the law, or if the merchant violates the debt collection provisions of ch. 427.

158. § 425.208(2). In addition, subsection (3) provides that any process under which the collateral had been held shall be vacated, and the pending action dismissed.

ments until the unpaid balance of the obligation equals the deposit. Therefore, until such amount is reached, a merchant may proceed with his legal remedies against the collateral or the customer immediately upon occurrence of another "default" as defined in section 425.103.

At least three points deserve special mention with regard to section 425.208. First of all, subsection (1) states that the right of redemption continues for fifteen days after the taking of possession of the collateral *or* after "issuance of process" under section 425.205. Literally interpreted, the subsection appears to mean that the right to redeem *commences* on the date that the merchant serves the summons to recover his collateral in a replevin action even though this could mean that the customer's right of redemption will expire before a hearing is held in the replevin action and before the merchant even obtains possession of the collateral.¹⁵⁹

Furthermore, under this language a merchant who mails a notice of "right to cure" under section 425.105 and simultaneously commences a small claims action under section 425.205(6), will cause the customer's "right to redeem" and "right to cure" to run concurrently. Although the statute is clear in this procedure, it certainly will result in confusion and probable litigation. Thus, when a merchant causes the concurrent running of rights, which one actually applies? Does the customer merely have to "cure" pursuant to section 425.105, or must he "redeem" according to section 425.208? Presumably he must "redeem", since section 425.208(1) clearly provides that the right to redeem commences when process is issued under section 425.205, but the procedure is certainly confusing and should be clarified by legislation.

The second point to note is that the WCA does not require a merchant to notify the customer of his right to redeem unless a small claims action for replevy is commenced.¹⁶⁰ Thus, although the customer has a right to redeem, he may never be given any notice of his right.

Finally, to redeem collateral under section 425.208, a customer

159. The conclusion that the customer's right to redeem commences on the date that the merchant issues process is buttressed by the fact that § 425.205(3)(d) states that a notice of the customer's right of redemption must be included in the complaint itself. There is no other requirement that a notice of the right of redemption be given to the customer, and apparently the legislature required the notice to be put in the complaint to make sure that the customer was aware that the right of redemption was running even though the customer had not yet relinquished possession of the collateral.

160. § 425.205(3)(d). *See also supra* note 159.

must pay "any court costs, filing and service fees, and bond premium charges incurred by the creditor," but it appears that the customer need not pay the expenses incurred by the merchant in the repossession. In this regard, the WCA is inconsistent in that it allows a merchant to obtain reimbursement for all costs of disposition of the collateral (which includes the cost of retaking the collateral) to the extent provided in the contract if the sale is actually consummated, but does not allow recovery of the cost of taking possession of the collateral if the customer elects to redeem the collateral.¹⁶¹ Consequently, although the merchant may have incurred the same expenses in obtaining the collateral for disposition, reimbursement for such expenses depends entirely on whether the customer decides to "redeem."

If the collateral is not redeemed by the customer within the fifteen day period, the merchant may then proceed under section 425.208(6) to dispose of it pursuant to the provisions of sections 409.504 through 409.506 of Wisconsin's Uniform Commercial Code subject to the deficiency limitations of sections 425.09 and 425.10.

6. *Deficiency Judgments.* Once the merchant disposes of the collateral, different rules apply concerning his rights to a deficiency depending on whether the original transaction was a sale or loan. If the original transaction was a consumer loan, other than an interlocking loan, the creditor may proceed to collect any deficiency in much the same manner as allowed under prior law. Under the WCA, however, as discussed above, the deficiency will not be set in the replevy hearing. If the customer refuses to acknowledge and pay the deficiency, a new court action would have to be commenced.¹⁶²

If the transaction is a consumer credit sale (or an interlocking loan), the merchant may proceed only for a deficiency as allowed by sections 425.209 and 425.210. Subsection (2) of section 425.209 states that the customer is not personally liable for the unpaid balance of an indebtedness when the amount owing at the time of

161. Section 422.413 permits a contract to provide for reimbursement of reasonable expenses incurred by a merchant in "disposition of collateral" and § 425.408(6) permits collection of such expenses upon sale of the collateral pursuant to § 409.504. Section 409.504(1) permits a secured party to apply proceeds of disposition first to "the reasonable expenses of retaking, holding, preparing for sale, selling and the like." However, no reimbursement for any expenses incurred by the merchant in retaking the property is permitted under § 425.208(1)(c) if the customer exercises his right to redeem the collateral.

162. See § 425.206(1)(e) and discussion in text, *supra* at 461.

default is \$1,000 or less. If \$1,000 or more, section 425.210 states that the collateral must be valued at its "fair market value" to determine the amount of the deficiency.

The valuation requirement in section 425.210 apparently is an attempt to prevent the merchant from selling repossessed collateral to a related company or friend at a price below its actual value to establish a large deficiency. For example, a retail furniture outlet could assign a time sales contract to an affiliated sales finance company, which, upon default, would repossess the collateral and resell it back to the retail furniture outlet at a very low price. The sales finance company could then sue the buyer for the large deficiency thus established, while the retail outlet could resell the furniture at an inflated price. To prevent such practice, the WCA requires that the fair market value of the collateral be deducted from the unpaid balance of the obligation.¹⁶³

It is important to note that sections 425.209 and 425.210 are specifically limited to consumer credit *sales* and interlocking loans, and do not apply to non-interlocking loans. Limiting the deficiency judgment sections only to credit sales and interlocking loans apparently is based on the belief of consumer groups that most alleged abuses occurred in the repossession of collateral by retail sellers, especially in the automobile field.¹⁶⁴ As explained above, some sellers would attempt to establish large deficiencies. Also, consumer groups claimed that not infrequently the cost of repossessing and disposing of collateral would be extremely excessive when compared to the actual value of the collateral. Thus, they claimed, customers would not only lose their collateral after repossession, but also face an artificially high deficiency plus the often exorbitant expenses of repossession and sale of the collateral.

Although the same argument might be made with regard to consumer loans, the difference appears to be that consumer lenders usually do not own retail outlets to resell repossessed collateral, and consequently are not likely to sell collateral at artificially low prices because their main purpose is to satisfy as much of the unpaid obligation as possible. Also, lenders rely on a variety of collateral, while sellers usually rely only on the item sold to secure the obligation.¹⁶⁵ Therefore, a limitation on deficiencies for con-

163. After extensive research, the *Report*, *supra* note 61, concluded that very few creditors geared their operations to repossess and resell collateral at a low price in an attempt to establish a large deficiency. See *Report*, at 28.

164. *Cf. Report*, at 30.

165. In fact, under § 422.417(1), subject to the narrow exceptions stated therein, a seller

sumer loans would probably be meaningless since consumer lenders would merely add more property to make sure that the total value of the collateral always exceeds the outstanding balance of the obligation.¹⁶⁶

One confusing point under section 425.209 is the fact that it exempts a customer from a claim for deficiency in a credit sale or interlocking loan if the amount owing at the time of default is \$1,000 or less, but it does not describe the method for computing the \$1,000.

The Administrator has issued a regulation stating that the \$1,000 should be computed by deducting any unearned finance charges from the unpaid balance on the date of default.¹⁶⁷ However, this position appears to confuse the concept of "acceleration" of maturity of installments with the right to rebate of unearned precomputed finance charges. It has long been the practice of creditors, codified in virtually all consumer credit laws, that upon default the creditor may demand payment of all unpaid installments (or "accelerate" maturity of the installments) even though the scheduled due dates (or maturity dates) of each installment would not yet have become due. Absent any statutory language, a creditor would not have to rebate unearned interest in the event of such acceleration since each installment is a combination of both principal and the precomputed finance charge and it is the entire installment which becomes accelerated and immediately due, not merely the principal portion of each installment. When rebate upon acceleration is required, the statute usually states the requirement clearly.¹⁶⁸

in Wisconsin may only take a security interest in the property actually sold. *See* discussion in text, *supra* at 444.

166. Professor Davis, in his article on the Wisconsin Consumer Act, suggests that the limitation on deficiencies contained in § 425.209 should also extend to purchase money consumer loans. Davis, *supra* note 3, at 68. However, such a limitation would simply be unworkable. All a lender would have to do to avoid the consequences of the deficiency limitation would be to take other property of the customer as collateral to secure the loan in addition to that being purchased with the loan proceeds. The fact that the loan proceeds are going to be used to purchase a particular item in which the lender expects to take a security interest does not prevent the lender from taking a security interest in other property, except as set forth in § 422.417(3). A limitation on deficiency judgments only makes sense in consumer credit sales transactions.

167. Bkg. § 80.69.

168. *See, e.g.*, Wis. STAT. § 138.09(7)(d) (1971) (which was repealed by Wis. Laws 1971, ch. 239 (effective March 1, 1973)). That section required a rebate of precomputed interest after acceleration only if the lender desired to charge a default charge after such acceleration. By analogy, it should be noted that prior to the WCA, a creditor did not have

The WCA is no exception. Section 422.209(6) clearly states that upon acceleration a merchant does not have to rebate any precomputed interest until the date on which judgment is entered. Thus, for example, if a customer is in default and has ten payments of \$100 each remaining unpaid, the merchant may "accelerate" and sue for all ten payments totalling \$1,000. The merchant is required to rebate unearned precomputed finance charges only at the time judgment is finally entered. This seems logical since the merchant does not have possession of the money owed nor the method of forcing the customer to pay such money until the date of judgment, and therefore, he should be entitled to continue to earn the finance charge at the original annual percentage rate at least until that date.¹⁶⁹

Consequently, the more logical interpretation of section 425.209(2) appears to be that the total amount of the remaining installments must be \$1,000 or less before the merchant is prohibited from obtaining a deficiency. The WCA does not state that the \$1,000 is after the "rebate" of precomputed interest, but only that the amount "owing" at the time of default is less than \$1,000. The amount "owing," at least until the required rebate on date of judgment under section 422.209(6), is the total amount of all installments. Therefore, the Administrator's regulation would appear to be of questionable validity under the Act.

It should also be noted that although the customer is not liable for a deficiency upon repossession of collateral where the unpaid

to rebate any portion of the precomputed finance charge even upon early prepayment under § 138.05(2) if the annual percentage rate was less than 10%.

169. In fact, many would argue that the merchant should be entitled to receive the precomputed finance charge until the unpaid delinquent balance is actually collected from the customer. However, this approach was rejected in the WCA because it could permit merchants to obtain judgment and then delay enforcing such judgment until the maturity of the obligation so that all precomputed interest would also be collected. By limiting interest after judgment to the judgment rate of 7%, merchants are encouraged to move promptly to collect the judgment.

It is not clear under § 422.409(6) whether a merchant would have to give a rebate of unearned interest to a customer after default and acceleration if the indebtedness is collected other than by obtaining a judgment. Since that section requires a rebate of unearned interest only on the date of judgment, presumably no such rebate would be required if no judgment were obtained. It might be argued that once the merchant collects the unpaid balance of the obligation, he would be required to give a rebate of unearned interest on that date under § 422.209 since the customer in effect has "prepaid" the obligation in advance of the originally scheduled installment due dates. Such a theory, however, would appear to run counter to the concept of acceleration which makes all installments due immediately and gives the merchant the right to collect *all* such installments without waiting for the scheduled due dates. Since all installments are due upon acceleration, there can be no "prepayment."

balance of the indebtedness is \$1,000 or less, he is responsible for damages to the collateral under subsection (5) to section 425.209.

7. *Suit for Entire Balance of Debt.* If the merchant in a consumer credit sale or interlocking loan desires to proceed against the customer for the full amount of an obligation which is less than \$1,000 at the time of default, he may do so only by waiving his right to possession of the collateral, and seeking a judgment for personal liability against the customer as an unsecured creditor.¹⁷⁰ In such event, if judgment is obtained, the merchant may not levy execution on the collateral which secured the obligation in the first instance.¹⁷¹

In addition, when a judgment is obtained in either a consumer credit loan or sale transaction, the WCA prohibits enforcement of the judgment against any property described in section 425.106 as well as the usual exempt property stated in section 272.18.¹⁷² Section 425.106 also raises the homestead exemption from \$10,000, which is the limit under section 271.20, to \$15,000 for any judgment based on a consumer credit transaction.¹⁷³

Finally, section 425.106(1)(a) limits the amount of wages which may be subject to garnishment after judgment in a consumer credit transaction. That section provides that 75% of disposable earnings or forty times the federal minimum hourly wage plus \$15 per dependent other than the customer (as reported on federal income tax returns), whichever is larger, is exempt per weekly pay period. Thus, for example, 75% of the wages of a wage earned in a family of five (after deduction of all amounts required by law to be withheld) or \$124 whichever is greater, will be exempt from garnishment under this section based on the current federal minimum hourly wage where the debtor is paid on a weekly basis.¹⁷⁴ Section

170. § 425.203.

171. § 425.209(6).

172. The items of personal property exempt from execution under § 425.106(1)(b) are the same items in which a lender is prohibited from taking a security interest under § 422.417(3)(a).

173. § 425.106(1)(c). For all other (non-consumer credit) judgments, § 272.20 continues to provide only a \$10,000 homestead exemption.

174. The \$124 minimum is computed as follows: the current federal minimum hourly wage of \$1.60 multiplied by 40 plus \$15 for each of the customer's four dependants (other than the customer himself). Note that the \$15 exemption per dependant was per pay period and not per week under the original version of the WCA, but was made applicable on a weekly basis by the February 22, 1973 Amendments. Of course the minimum exemptions will increase when the new federal law becomes effective.

Although it apparently was the intent of consumer groups to provide the same exemption under § 425.106(1) as provided under the Truth-in-Lending Act except that a higher

425.106(3) provides that a process or order issued in violation of section 425.106 is void.¹⁷⁵

It is important to note that the scope of subchapter II of chap-

minimum exemption would be provided under subsection (1)(a)(2), the language in § 425.106(1) does not accomplish that result. In fact, § 425.106(1) will often result in less of an exemption from garnishment than the federal law.

Section 303 (15 U.S.C. § 1673) of the federal law provides that the maximum earnings of an individual *subject* to garnishment may not exceed the lesser of (i) 25% of his "disposable earnings" (gross earnings minus required withholdings) per week or (ii) the amount of his weekly "disposable earnings" in excess of 30 times the federal minimum hourly wage (which means that a minimum of \$48 is exempt under current minimum hourly wage rates). Thus, for example, a person earning \$200 per week who has \$40 withheld for taxes would have a maximum of \$40 subject to garnishment (25% of \$160) by application of the first method specified above which would result in the least amount of wages subject to garnishment.

By comparison, § 425.106(1) of the WCA *exempts* the greater of (i) 75% of an individual's "earnings remaining after all deductions," or (ii) 40 times the federal minimum hourly wage plus \$15 per dependant per week other than the customer. Thus the WCA does not identify the portion of wages "subject" to garnishment as the federal law does, but rather specifies the portion of wages which are "exempt." However, the exempt portion of the wages are not required to be deducted from the net income remaining after required withholdings (which the federal law refers to as "disposable income"), and therefore the exempt portion of the income is subtracted from the *gross* wages of the customer.

Using the same example set forth above, under § 425.106(1)(a)(1) the portion of an individual's wages "exempt" from garnishment would be \$120 (75% of \$160, the customer's earnings after required withholdings), but this would leave \$80 subject to garnishment (the total wage of \$200 minus the exempt portion of \$120), not \$40 as under the federal law. Similarly, assuming a family of five, the exempt earnings under § 425.106(1)(a)(2) would be \$124 (40 x federal minimum hourly wage of \$1.60 plus 4 x \$15). Again, however, the amount subject to garnishment would not be merely \$36 (\$160 minus \$124), but rather would be \$76 (\$200 minus \$124). The only argument that might be made for the contention that the legislature intended that the difference between "disposable earnings" and the exempt portion of a customer's wage would be the amount subject to garnishment, is by inference from subparagraph (1)(a)(1) which deducts required withholdings from gross wages before calculating the 75% exemption. However, even this argument is not available with regard to subparagraph (1)(a)(2) since the calculation there makes no mention whatsoever of the "customer's earnings remaining after all deductions."

In the above example, of course, the federal law would control since it specifies that 25% of the disposable income or \$40 is the maximum subject to garnishment. However, § 425.106(1) often may not provide a greater exemption assumed by its consumer supporters.

175. Because a process issued in violation of § 425.106 is void, it could be that Bkg. § 80.63, purportedly issued to "assist" employers, may in fact result in a trap for employers not familiar with its provisions. Bkg. § 80.63 states that a garnishee summons "should" contain the legend "Consumer Credit Transaction Garnishee Summons" when a garnishment is issued in a consumer credit transaction under § 425.106. It is not altogether clear whether failure to comply with this regulation would result in a garnishee summons which would be considered in violation of § 425.106 and thus "void" under subsection (3), but if it were, an unwary employer who honored such a garnishee summons could be liable to the wage earner customer for conversion. Hopefully, the fact that Bkg. § 80.63 states that the garnishee summons "should" bear such legend means that summonses without such legend are nevertheless still proper under the WCA.

ter 425 set forth in sections 425.201 and 425.202 only applies to enforcement of a security interest in collateral which are "goods". Thus, under the language of those sections, it would appear that the provisions concerning the customer's right to surrender collateral, the requirement that the merchant sue and replevy for possession, the customer's right to redeem, the restrictions on deficiency judgments and the like will not extend to real estate or intangible property used as collateral.¹⁷⁶ With regard to these items, only subchapter I would apply, and after a default and notice of right to cure, the merchant would be able to proceed for repossession of the item as allowed under the law prior to enactment of the WCA, subject only to the restrictions of subchapter I.

The rest of chapter 425 sets forth a number of restrictions concerning specific collection practices. These restrictions include a prohibition of extortionate extensions of credit;¹⁷⁷ a specification that a complaint for collection set forth the facts constituting the default, the amount claimed by the merchant and the figures necessary to compute such amount and contain a copy of the writing evidencing the transaction (except in open-end credit plans);¹⁷⁸ and a prohibition against discharging employees who are garnished.¹⁷⁹ In addition, section 425.111 and 425.207 set forth the circumstances in which there can be an attachment of property before judgment by a merchant and section 425.112 grants the court authority to stay enforcement of a judgment by order upon "just and equitable conditions".

Section 425.113 prohibits the issuance of a warrant against the person of a customer under chapter 273 (Remedies Supplementary to Execution) in any consumer credit transaction. Note that the term "warrant" as used in this section only refers to warrants issued pursuant to section 273.05 and does not limit or effect the power of a court to issue an order or attachment pursuant to

176. Consequently, collateral such as corporate stock and bonds, real estate or real estate fixtures (which were fixtures at the time of the transaction and thus are not "goods" under § 421.301(21)) would not be subject to the procedures contained in subchapter II.

177. § 425.108. Compare the limitation on extortionate extensions of credit contained in § 201(a) of the Truth-In-Lending Act. 18 U.S.C. §§ 891-96. Section 425.108 provides substantially greater recoveries than the federal law for extortionate extensions of credit by permitting triple penalties.

178. § 425.109.

179. § 425.110. This section appears to prohibit dismissal based on a garnishment regardless of the number of garnishments. Compare § 304 of the Truth-In-Lending Act 15 U.S.C. § 1674 which prohibits dismissal by reason of the fact that an employee's earnings were subject to garnishment "for any *one* indebtedness" (emphasis added).

section 295.04 where a person has failed to appear at a supplementary examination permitted under chapter 273.¹⁸⁰ In other words, it is only the type of ex parte "body attachment" upon affidavit under section 273.05 which is prohibited by section 425.113, and not the order to show cause for contempt or attachment to arrest allowed under section 295.04 for refusal to obey a court order to appear at a supplementary examination pursuant to section 273.03.

Section 425.107 introduces the concept of "unconscionability" to consumer credit transactions on a broad basis. Under this section, a court may refuse to allow any agreement to be enforced if it determines that certain conduct is "unconscionable" as defined therein.¹⁸¹ General guidelines as to what may be considered unconscionable practices are outlined in subsection (3), but the precise application of the concept of unconscionability will have to await development through the administrative process and the courts.

XIV. CUSTOMER'S REMEDIES

The monetary civil penalties allowed against merchants for violation of the WCA range from a minimum of \$25 plus actual damages to a maximum of \$1,000 or actual damages, whichever is higher.¹⁸² Certain violations will render the entire transaction void under section 425.305 and the customer has the right to retain any goods or services received.¹⁸³ Interestingly, section 425.304 provides an alternative penalty of twice the finance charge but not less than \$100 or greater than \$1,000 or the actual damages. The other

180. Bkg. § 80.66.

181. The Administrator is granted a similar power to determine unconscionable conduct under § 426.108. See discussion in text, *infra* at 474. For a thorough comparison of the customer's rights after default contained in subchapters I and II of ch. 425 with prior Wisconsin law from a consumer advocate's point of view, see Crandall, *The Wisconsin Consumer Act: Wisconsin Consumer Credit Laws Before and After*, 1973 WIS. L. REV. 334 (1973).

182. §§ 425.302-425.304. Section 425.302 providing for a penalty of \$25 plus actual damages applies to all violations of the WCA for which no other penalty is specified.

Section 425.303 providing for a penalty of \$100 plus actual damages applies to the following sections: §§ 424.203; 424.206 and 425.107.

Section 425.304 providing for a penalty of twice the finance charge with a minimum of \$100 and a maximum of \$1000 or actual damages applies to the following sections: §§ 422.203-422.207; 422.209; 422.303-422.305; 422.402-422.404; 422.406; 422.407; 422.411; 422.413; 422.415; 422.417-422.419; 423.203; 424.204; 425.108; 427.105. See Stute, *supra* note 30, at 29-30.

183. Section 425.305 voids the transaction and permits the customer to retain all goods, services or money received without any obligation to pay for violations of the following sections: § 422.201; 422.405; 422.414; 422.416; 423.302; 425.108; 425.113 and 425.206. See Stute, *supra* at 30.

provisions providing for customer remedies allow actual damages *plus* the dollar amount of the penalty specified.

In addition to the monetary penalties, if the customer prevails in an action he may recover costs and expenses incurred in connection with prosecuting the action plus a reasonable amount of attorneys' fees. However section 425.308 specifically limits the award of attorneys' fees by stating that fees generally shall be determined by the time and labor required, and not by a percentage of the recovery. In this regard, it is difficult to understand why the Act permits consumers to recover reasonable attorneys' fees while no similar provision is contained for creditors.¹⁸⁴

Section 425.307 provides a rather complicated statute of limitation periods by providing that, except for open-end transactions, a customer may sue at any time within one year after the date of the last violation of the WCA or within two years after consummation of the agreement or one year after last payment under the agreement, whichever is later. With regard to open-end credit plans, a customer must commence an action within two years after the date of last violation.

An overall time limit of six years after the date of last violation is also provided, presumably as a limitation on the right to commence an action within one year after last payment on those transactions which are longer than six years. Thus, for example, in the case of real estate mortgages which may require payments over a twenty-five or thirty year period, the overall limitation states that no action may be commenced more than six years after the date of last violation rather than one year after the last payment on the transaction. The limitation on commencement of actions does *not* apply to defenses, set-offs or counterclaims based on a right under the Act.

A unique attempt to prevent the use of the "corporate shield" to circumvent liability for violations of the WCA is contained in section 425.310. This section provides that where a "meaningful" part of a corporation's activities are in violation of the Act, but damages or penalties awarded to a customer or the Administrator cannot be collected from such corporation by reason of its insolvency or dissolution, then the judgment shall be recoverable against the principal agents of the corporation including officers

184. Section 422.411 prohibits merchants from including a written provision in a consumer credit contract providing for recovery of attorneys' fees upon default. *See* discussion in text, *supra* at 440.

and managers who "knew" or "should have known of" the violation or "willfully participated" in the violation.

The fact that the principals of the corporation must be in a position to "have known of" or have "willfully participated" in a violation and the fact that a "meaningful part" of the corporation's activities must be in violation of the Act hopefully will limit the application of this section to alleged "fly-by-night" operators who set up corporations simply to avoid personal liability for their illegal activities. However, it is conceivable that this provision could apply to principals of a legitimate merchant where, for example, an employee knowingly violates the Act resulting in class action damages which exceed the assets of the corporation and the court determines that the principals "should have known" of the violations. Although such a possibility is greatly reduced by the fact that a class action for recovery of penalties is not allowed in most circumstances under the class action provisions,¹⁸⁵ nevertheless, principals of a corporation, especially a closely held corporation, could risk personal as well as corporate assets under this section.

In addition to the private damages and penalties granted customers under the provisions of subchapter III of chapter 425, a violator of the Act may be subject to civil penalties brought by the Administrator under section 426.301. Such penalty may be as high as \$10,000 for a willful violation. Also, section 425.401 provides for criminal penalties in certain circumstances.

XV. ADMINISTRATION OF ACT

The administration of the WCA is to be handled by the Commissioner of Banking who is granted broad powers as "Administrator" by chapter 426. Under section 426.104, the Administrator has the power to receive and act on complaints, counsel individuals and groups on their rights and duties under the WCA, make and publish results of studies under the WCA, hold public and private hearings to effectuate the purposes of the WCA, plus the power to promulgate rules to enforce the WCA or prevent circumvention of its terms.

The WCA also has incorporated protection for merchants who rely on the Administrator's rules. Section 426.104(4)(a) states that no penalty can apply under the Act if the merchant has acted in

185. For limitation of penalties in class actions, see discussion in text, *infra* at 476.

conformity with any rule, order, interpretation, opinion, or statement of the Administrator notwithstanding the fact the Administrator is later reversed by a court or other authority. In the event of such reversal, however, the merchant is still liable for actual damages. Similarly, a merchant may submit a proposed practice to the Administrator for approval under section 426.104(4)(b), and if approved, or not disapproved within thirty days, then the practice shall not be considered a violation of the Act notwithstanding later judicial reversal. In addition, under section 426.104(4)(a), the merchant will not be liable for penalties *or* damages in the event of a reversal of a practice approved or not disapproved under subsection (4)(b).¹⁸⁶

Section 426.106 provides for strong investigatory powers in the Administrator. He can investigate any person who he "has reason to believe has engaged in or is about to engage in" a violation of the Act. In any such investigation, the Administrator has broad powers to compel testimony and subpoena records.¹⁸⁷

Under section 426.108, the Administrator has the power to promulgate rules which declare specific conduct to be unconscionable and prohibit the use thereof. The guidelines provided in section 426.108 are essentially the same guidelines which are set forth in section 425.107, which grants the right to any court of law to find certain activities unconscionable. However, the rules promulgated by the Administrator concerning specific "unconscionable" conduct will not automatically be upheld as unconscionable in a case brought before a court under section 425.107, since section 425.107 (2) states that the Administrator's rules will only be "presumed" to be unconscionable in such cases.

The power granted to the Administrator to declare certain specific conduct "unconscionable" increases the authority of the Administrator substantially over the power of most administrative agency heads who are usually only given the power to promulgate rules based on statutory language. Under the WCA, he potent-

186. Section 426.104(4)(a) states that no provision of the WCA "which imposes any penalty" shall apply while § 426.104(4)(b) provides that no "violation of this Act" will result if an act, practice or procedure is submitted and approved or not disapproved.

187. Section 426.106 does not give the Administrator the right to periodically "examine" merchants as the Commissioner of Banking has the power to do with licensees under § 138.09 or ch. 218. The Administrator can investigate only if he has "reason to believe" the WCA has been or is about to be violated, or upon the filing of a complaint verified by five persons under subsection (2). Presumably the Administrator would have to state the facts upon which he relies to trigger his investigation rights, and these facts could be challenged by the merchant at the outset pursuant to ch. 227. See § 426.107.

ally has the power to prohibit conduct which may not be specifically prohibited under the statutory language of the Act. In recognition of this fact, the language of section 426.108 carefully proscribed the limits of the Administrator's authority. Presumably the Administrator can only declare certain "specific" conduct unconscionable on a case by case basis upon determination that such conduct violates the guidelines set forth in that section. The elements of what constitutes "unconscionable" conduct specified in section 426.108 all contemplate existence of and application to a specific set of facts or transaction. Consequently, section 426.108 does not grant the Administrator unlimited authority to "legislate" new substantive consumer protective provisions simply by designating unfavored conduct as "unconscionable". Unless such limitation of authority is carefully observed, the provisions granting the Administrator authority to promulgate rules of unconscionability could well be considered unconstitutional as an improper delegation of legislative power by the legislature.¹⁸⁸

To prevent violations of the WCA or the rules promulgated thereunder, as well as to restrain use of any false, misleading, deceptive or unconscionable conduct, the Administrator may seek temporary restraining orders or temporary or permanent injunctions under section 426.109. Ex parte restraining orders may be issued for up to thirty days.¹⁸⁹

XVI. CLASS ACTIONS

The WCA contains extensive class action provisions which per-

188. The Administrator, after some consideration, apparently acknowledges the limited power granted under § 426.108. Thus, the tentative draft of the rules first proposed by the Administrator presented for public hearing on April 16, 1973 stated that it would be "unconscionable" for a merchant "to fail to respond in writing to a specific question or dispute raised by the customer within 30 days of such inquiry" At such hearing it was repeatedly pointed out by creditors that the Administrator had no basis for declaring such conduct "unconscionable" under § 426.108 since the conduct did not fall within the preview of any of the particular elements outlined in that section. (Such elements, according to the official comments to § 6.109 of the NCA from which § 426.108 was taken, reflect "the most common factors that society would recognize as constituting probable unfairness in consumer transactions). Moreover, the subject of responding to billing statement inquiries had been the subject of considerable congressional debate with regard to the Fair Credit Billing Act then before Congress. In light of these arguments, the Administrator decided not to promulgate such conduct as being "unconscionable" in the final version of the regulations. In a maneuver which may be questionable, however, the Administrator promulgated virtually the same regulation as Bkg. § 80.36 as a general regulation, apparently basing his authority to issue the regulation under § 422.306 dealing with record keeping requirements.

189. § 426.109(2).

mit use of the class actions procedure, but takes effective steps to limit the possible abuses which may arise under such procedure.

Section 426.110(1) permits a class action by any customer "affected" (i) by a violation of the WCA or rules promulgated thereunder, (ii) by a violation of the Truth-In-Lending Act, or (iii) by false, misleading, deceptive or unconscionable conduct of a merchant in making, soliciting or enforcing consumer credit transactions.¹⁹⁰ It also permits class actions to be brought by the Administrator on behalf of a customer so affected.¹⁹¹ Such class action may only be maintained for "actual damages" and other relief to which a person may be entitled under the Act, but cannot be brought for penalties unless the conduct of the merchant is shown by a preponderance of the evidence to be a "willful and knowing" violation of the Act.¹⁹² The prayer for relief may also include a request for "reasonable" attorneys fees which are specifically limited to "the value of the time reasonably expended by the attorney rather than by the amount of the recovery on behalf of the class."¹⁹³

Restricting class actions recoveries to actual damages (except where there are willful and knowing violations of the Act) is an effective response to one of the particularly abusive characteristics of class actions which has become prevalent under the Truth-In-Lending Act. Under the Truth-in-Lending Act an inadvertent error by the creditor permits the customer to sue for an amount equal to double the finance charge (or for an amount not less than \$100 nor more than \$1,000) even if no actual damages are sustained. If such error were committed on forms used by the creditor with all its customers, a class action for the Truth-in-Lending Act penalties could result in astronomical civil liability if the class is upheld.¹⁹⁴

190. Under § 426.110(2), a class action for "false, misleading, deceptive or unconscionable conduct" is permitted only in consumer *credit* transactions.

191. Section 426.110(1) provides that if a customer files such action, he must give notice to the Administrator who has the option to join within thirty days of such notice.

192. § 426.110(1) and (14).

193. § 426.110(15).

194. See, e.g., *Ratner v. Chemical Bank New York Trust Company*, 329 F.Supp. 270 (D.C. N.Y. 1971). In the *Ratner* case, the court refused to uphold the class. Although cases brought under the Truth-In-Lending Act have split on whether class actions should be upheld, generally cases decided since the *Ratner* decision have refused to permit such classes. See, e.g., *Rogers v. Coburn Finance Corp.*, 54 F.R.D. 417 (N.D. Ga. 1972); *Hoffman v. Charnita Inc.*, 58 F.R.D. 86 (N.D. Pa. 1973); *Gerlach v. Allstate Insurance Co.*, 338 F.Supp. 642 (S.D. Fla. 1972); *Shields v. Valley National Bank of Arizona*, 56 F.R.D. 442 (D. Ariz. 1972); *Rodriguez v. Family Service Publications Inc.*, 57 F.R.D. 189 (C.D. Cal. 1972); *Alsup v. Montgomery Ward and Co.*, 57 F.R.D. 89 (N.D. Cal. 1972); *Goldman v. First National Bank of Chicago*, 56 F.R.D. 548 (N.D. Ill. 1972); *Kruger v. European*

Section 426.110 eliminates the specter of this enormous liability for penalties under the WCA except for willful and knowing violations. Also, the limitation of attorney's fees to actual time expended in the event of recovery should cause attorneys to assess the validity of the class action with somewhat greater care since the allure of potential recovery of tremendous attorney's fees for technical violations has been removed.

Furthermore, a class action for unconscionable or false, misleading or deceptive conduct cannot be brought unless the act or practice has been found to constitute a violation of the Act and is specified with "particularity" in a rule promulgated by the Administrator or in a case decided by an appellate court of the state. In addition, the violation must occur at least thirty days after the decision or promulgation of the rule.¹⁹⁵

Since one of the fundamental purposes of a class action is to provide a vehicle to force merchants to correct violations of the WCA as well as to compensate individuals sustaining damages because of such violations, subsection (4)(a) requires a customer to give the merchant an opportunity to correct any mistake by requiring that prior to the commencement of the class action, the customer must give at least thirty days notice to the merchant specifying the particular alleged claim or violation and demanding that such violation be corrected. If the merchant remedies the alleged error or agrees to remedy such violation in a reasonable time within thirty days after receipt of such notice, no class action may be maintained by that customer.

Furthermore, no action for damages may be maintained if, at any time during the class action proceeding, the merchant complies with subsection (4)(d). This subsection states that if a merchant ceases the alleged violation and notifies or makes a reasonable effort to notify all customers in the class that upon their request they will be given the appropriate remedy, and gives such remedy

Health Spa Inc., 56 F.R.D. 104 (E.D. Wis. 1972); *Kenney v. Landis Financial Group Inc.*, 349 F.Supp. 939 (N.D. Ia. 1972); *Evoldi v. First National Bank of Chicago*, 55 F.R.D. 134 (N.D. Ill. 1972).

195. Section 426.110(3) specifically provides that alleged violations of § 426.110(2) (false, misleading, deceptive or unconscionable conduct in the making, soliciting or enforcing of consumer credit transactions), § 423.301 (false, misleading or deceptive advertising consumer credit), § 425.107 (unconscionable conduct decided by a court), § 426.108 (unconscionable conduct under rules promulgated by the Administrator) or § 427.104(1)(h) (conduct reasonably expected to threaten or harass a customer in debt collection activity) cannot be sustained as a class action unless the conduct is specifically defined in an administrative rule or appellate court decision.

to customers who so request it within a reasonable time, no damages will be granted in the class action. This provision is particularly helpful to merchants since after notification, the remedy will only have to be given to those customers who request the remedy or "opt in" to the class. On the other hand the procedure should also satisfy consumer groups since the merchant must cease the alleged violative activity and compensate customers who have sustained damages and request payment.

Subsection (4)(e) does permit injunctive action to prevent an alleged violation without the necessity of the notification to the merchant under subsection (4)(a).

Section 426.110(5) and (6) basically repeat the provisions of Federal Rule 23 of the Federal Rules of Civil Procedure concerning the determination of maintenance of class actions.

The remaining portions of section 426.110 are mainly procedural provisions with regard to maintenance of the class action.¹⁹⁶

XVII. TRANSITIONAL PROVISIONS AND EFFECTIVE DATE OF ACT

The WCA became effective on March 1, 1973, and will apply to all consumer transactions or modifications of consumer credit transactions entered into on or after that date. The transitional provisions included with the bill containing the provisions of the WCA, however, provide that, with certain exceptions, all "rights, duties and interests" flowing from consumer transactions entered into before the effective date of the WCA may be terminated, completed, consummated or enforced as required or permitted by any statute, rule of law, or other law modified or repealed by the Act as though such repeal, amendment, or modification had not occurred.¹⁹⁷

196. In the case of *Eisen v. Carlisle & Jacqueline*, 479 F.2d 1005 (2d Cir. 1973) cert. granted 94 S.Ct. 235 (1973), the court indicated that notice in class actions would have to be given to the class at the expense of the plaintiff which expense could be recovered upon ultimate victory of the plaintiff. Section 426.110(16) provides that in class actions, the Administrator shall bear the costs of all notices although the Administrator may recover all costs if eventually judgment is entered for plaintiff. The cost of notification in class actions could be substantial, but subsection (16) removes one of the obstacles to maintaining class actions under the WCA which could be presented by the *Eisen* case if eventually upheld. Note that the Administrator must bear such costs whether or not he is a party to the action.

197. Wis. Laws 1971, ch. 239, Section 39. That section states:

TRANSITIONAL PROVISIONS (1) Except as otherwise provided in this section, this act takes effect at 12:01 a.m. on March 1, 1973.

(2) Consumer transactions entered into before the effective date of this act and the rights, duties and interests flowing from them thereafter may be terminated,

The only exception to the above rule is that (i) any refinancing, consolidation or deferral, (ii) any open-end credit plan and (iii) the enforcement provisions contained in chapter 425 of the WCA, except for sections 425.103, 425.203, and 425.209, will apply to any transaction regardless of the original date of consummation.

In this connection, it is important to note that transactions entered into prior to the effective date of the WCA may be enforced under the status of the law as it existed prior to said effective date unless otherwise provided. Therefore, for example, the limitations on merchants contained in the WCA, any rules or regulations promulgated by the Administrator and the prohibited debt collection practices under chapter 427 do *not* apply to consumer transactions and the enforcement of consumer transactions consummated prior to March 1, 1973.

XVIII. CONCLUSION

On the whole, the WCA would appear to be a reasonable compromise between consumer and creditor interests. The Act responds to many of the long standing complaints of consumer groups, but usually attempts to do so without placing unrealistic limitations on Wisconsin creditors. This is not to deny that some of the language in the statute is confusing and contradictory, but to some extent such problems are inherent in any new law, especially when new and untested provisions are adopted. Such problems were undoubtedly magnified in the passage of the WCA because many of the provisions were compromises resulting from intense negotiations between consumer and credit groups conducted over an extremely abbreviated period of time. Hopefully, however, the legislature will respond to the technical problems,

completed, consummated or enforced as required or permitted by any statute, rule of law or other law amended, repealed or modified by this act as though the repeal, amendment, or modification had not occurred, but this act applies to:

(a) Refinancing, consolidation and deferral agreements made after the effective date of this act, of consumer transactions whenever made;

(b) Consumer transactions made after the effective date of this act pursuant to open-end credit plans entered into, arranged or contracted for before the effective date of this act; and

(c) All consumer transactions made before the effective date of this act insofar as ch. 425 of the statutes on remedies and penalties limits the remedies of merchants, except that the provisions of §§ 425.103, 425.203 and 425.209 of the statutes shall not apply to consumer transactions made before the effective date of this act and as to all matters governed by said provisions such transactions shall be governed by the law of this state in effect before the effective date of this act.

many of which were mentioned in this article, so that creditor compliance will be facilitated and unintended violations kept to a minimum.

However, despite these imperfections, the WCA would certainly appear to be a worthwhile experiment in consumer credit protection. Consumer groups have long protested that credit laws simply do not provide adequate protection for consumers, and the WCA does provide comprehensive protection against those practices which national consumer groups have long deemed most oppressive. The fact that most major Wisconsin creditor groups supported the Act and have diligently attempted to implement its provisions, makes the WCA an ideal testing ground for determining the workability of these consumer created solutions.

In all fairness to creditors, it should be remembered that the WCA was the result of considerable compromise on the part of creditor groups, and consumer advocates, as well as those obligated to enforce the law, should be willing to abide by the provisions of the law as drafted. They should not seek expansion of the WCA beyond its boundaries in an attempt to regulate activities which are not specifically covered by the statutory language of the Act.

After some experience is gained under the law, the legislature will have the opportunity to determine the effects of the "experiment" and review the substantive provisions of the Act as well as the effect such provisions have had in accomplishing the purposes of the Act. In those instances where creditor abuses are shown to still exist, certainly appropriate additional provisions should be adopted to eliminate such activities. Concomitantly, where such additional provisions are adopted, consumer groups must be willing to recognize the increased expenses to creditors and be willing to support increased finance charge rates to creditors to cover those expenses where necessary.

On the other hand, the legislature should also take a critical look at the consumer protection provisions to determine if the benefits of the provisions are worth the cost to the public. It must be remembered that the consumer groups which proposed and negotiated the WCA emphasized the problems of lower economic level consumers. Because of this fact, it may well be found after some experience is gained under the WCA, that many of the "protection provisions", while purporting to represent the best interests of all consumers, in fact only reflect the interests of a relatively minor segment of the borrowing public. Since most of the "protec-

tions" of the Act are aimed at protecting debtors who do not make their payments when due or otherwise breach terms of contracts so that creditors are forced to resort to collection through court proceedings or seizure of collateral, the legislature must determine if the increased finance charges paid by all consumers, many of whom pay on time and never are in a default situation, are worth the protection provided to the few.

Also, the legislature should review the provisions of the WCA to determine if the "consumer protection" provisions which limit creditors activities are being used by some consumers to harass or avoid payment of legitimate obligations, thereby unduly increasing delinquencies. Such additional delinquencies can only be reflected in higher finance charges, again with the effect that the majority of consumers who pay on time must bear the increased cost of collection against individuals who intentionally use the provisions of the Act to delay or avoid paying their indebtednesses.

Finally, the legislature should review the effect that the WCA has on the availability of credit, especially on the availability to lower economic level borrowers. Since the WCA provisions make it more costly and more difficult for creditors to obtain payment of obligations from recalcitrant borrowers, it is natural to assume that creditors' standards for extending credit will be raised. This in turn could result in the elimination of credit to many marginal borrowers, who are often low income consumers. If this is the case, the WCA provisions would have the paradoxical effect of cutting off substantial availability of credit to the very group of people that most of the provisions are intended to protect.

These questions and others, however, can be determined only after substantial experience is gained under the WCA. For the present, the legislature should permit both consumers and creditors to gain experience under the Act to determine exactly where the problem areas are.