

## IS CONTROL OF DEALER PARTICIPATION A NECESSARY ADJUNCT TO REGULATION OF INSTALLMENT SALES FINANCING?

Exorbitant charges have long been a serious abuse of installment sales financing. In the early 1930's a rash of complaints about high finance charges prompted state agencies to institute studies of consumer financing.<sup>1</sup> These surveys uncovered many factors which contributed to imposition of excessive financing costs upon installment purchasers.<sup>2</sup> One major element augmenting the finance charge was dealer participation.<sup>3</sup> As a result of these investigations, two states attempted to regulate both the finance charge and dealer participation;<sup>4</sup> eleven other

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1. Complaints filed with the Wisconsin Interim Committee to Investigate Finance Companies are representative of those received by agencies of other states. See REPORT OF THE STATE BANKING COMMISSION AND INTERIM ADVISORY LEGISLATIVE COMMITTEE TO INVESTIGATE FINANCE COMPANIES 65-89 (1935) (hereinafter cited as WISCONSIN INTERIM REPORT). Both the Indiana Department of Financial Institutions and the Better Business Bureau received with regularity complaints of high installment sales financing charges. See REPORT OF INDIANA DEPARTMENT OF FINANCIAL INSTITUTIONS ON INDIANA CONSUMER FINANCE AGENCIES 1 (1935) (hereinafter cited as INDIANA REPORT).

2. Such practices of finance companies as refusing to refund the unearned portion of the finance charge upon prepayment by consumers, imposing excessive additional charges for delinquencies or repossessions, "finance kiting," and insurance misrepresentations, serve to drive the finance charge upward. For explanation of these and other methods of extracting higher payments from installment buyers, see WISCONSIN INTERIM REPORT 33-49. More recently, other states have conducted the same sort of investigations, with similar findings. See RETAIL INSTALLMENT SELLING, RESEARCH REPORT No. 6, RESEARCH DIVISION, MARYLAND LEGISLATIVE COUNCIL (1940) (hereinafter cited as MARYLAND REPORT); INTERIM REPORT OF THE JOINT LEGISLATIVE COMMITTEE ON INSTALLMENT FINANCING (New York) (1948).

For a complete bibliography of writings about installment sales financing, including citations to all relevant state reports, see BARRETT AND ULRICH, LEGAL INDEX TO CONSUMER INSTALLMENT LENDING AND USURY 113-116 (1948).

3. Cavers, *The Consumer's Stake in the Finance Company Code Controversy*, 2 LAW AND CONTEMP. PROB. 200, 210-212 (1935); see also INDIANA REPORT 45, n.1.

"Dealer participation" may be defined as that amount paid to a dealer by a purchaser of installment contracts over and above the retail cash price of the item sold; it manifests itself in several forms. The "dealer's reserve," for example, is the type used by a finance company which purchases paper from a dealer on a repurchase agreement whereby the dealer promises to buy back any items which the finance company repossesses. The finance company establishes a reserve intended to absorb the dealer's loss. This method is relied upon primarily by the large national companies. A "rebate," used mainly by the small companies, which purchase contracts on a non-recourse basis, is a specific amount paid by the finance company to a dealer for each contract sold to that finance company. A "pack" is that amount added by the dealer to the finance charge specified by the finance company, and is retained by the dealer as profit. For the best practical discussion of the part dealer participation plays in raising finance charge, see WISCONSIN INTERIM REPORT 33-38.

4. The Indiana Retail Installment Sales Act expressly empowered the Department of Financial Institutions to establish maximums. IND. ANN. STAT. §§ 58-906, 58-910, 58-926 (Burns 1951). The Wisconsin State Banking Commission, under its authority

states have since enacted installment sales legislation.<sup>5</sup> Analysis of the types of regulation adopted indicates the chaos prevailing in the area today.

Some states rely entirely upon disclosure-type statutes to prevent exorbitant finance charges by eliminating hidden contract provisions, thereby acquainting consumers with the exact charges being imposed.<sup>6</sup> Others have established rigid limits upon this charge.<sup>7</sup> Still other jurisdictions have attacked the very roots of the dealer participation issue by limiting dealer participation itself.<sup>8</sup> Utah adopted the unique method of subjecting the finance charge to its statutory usury limits.<sup>9</sup> The majority of courts, however, distinguish the purchase of items to be paid for at a later time from simple money-borrowing, thus excluding installment sales credit from the operation of usury statutes.<sup>10</sup> If the problem began and ended with elimination of exorbitant finance charges, perhaps it could be said that those states which merely limit the finance charge have found the correct approach. But the very presence of discord among the states indicates a much broader problem.

Although most of the states which have legislated in the area attempt to curb abuses in installment sales of all consumer goods<sup>11</sup> several confine their installment regulation to motor vehicle financing.<sup>12</sup>

to revoke, suspend, or deny licenses on the grounds of unconscionable practices, has established a maximum on dealer participation. Being without power to set rates, the Commission requires the filing of rate charts, from which it determines the industry rate, and labels any rate above that average "unconscionable." WIS. STAT. § 218.01(3) (11) (1951). For a complete discussion of the Wisconsin Motor Vehicle Sales Finance Act, including a review of the manner in which the Banking Commission limits finance charges and dealer participation, see Holz, *The Regulation of Consumer Credit*, 1943 WIS. L. REV. 449, 529-550.

5. California, Connecticut, Maine, Maryland, Massachusetts, Michigan, New Jersey, New York, Ohio, Pennsylvania and Utah. See statutes collected in Note, 101 U. of PA. L. REV. 530, 533, n.11 (1953).

6. *E.g.*, N.Y. PERS. PROP. LAW § 64a, 80b, 81.

7. *E.g.*, PA. STAT. ANN. tit. 69, § 619 (Purdon Supp. 1951).

8. Besides Indiana and Wisconsin (see note 4 *supra*), Ohio and Michigan have enacted legislation placing upper limits on dealer participation. MICH. STAT. ANN. § 23.628 (31) (c) (Supp 1951); OHIO GEN. CODE ANN. § 6346-22 (Supp. 1952).

9. UTAH CODE ANN. § 15-1-2 (1953).

10. A continuing battle has been waged over judicial treatment of installment credit in regard to the usury statutes. For a good presentation of the case for inclusion of installment sales credit in usury regulation, see Berger, *Usury in Installment Sales*, 2 LAW AND CONTEMP. PROB. 148 (1935); and see Ecker, *Commentary on "Usury in Installment Sales,"* 2 LAW AND CONTEMP. PROB. 173, criticizing Mr. Berger's position, and supporting the position of the majority of the courts, who refuse to apply usury statutes to installment sales credit.

11. Only the Massachusetts and Ohio statutes apply to all installment sales, regardless of dollar amount. MASS. ANN. LAWS c. 255, §§ 11-13H (Supp. 1952); OHIO GEN. CODE ANN. §§ 6346-15 to 27, 9589-5 (Supp. 1952). The other states, with the exception of those regulating only automobile sales, place a limit upon the dollar value of sales included in the coverage of their statute. *E.g.*, N.Y. PERS. PROP. LAW § 64-a (\$1500).

12. California, Maine, Michigan, Pennsylvania, and Wisconsin.

The automobile industry, with its assembly-line production depending upon mass distribution, provokes abuses differing substantially from those arising in diversified financing.<sup>13</sup> Furthermore, the automobile industry is most dependent upon sales financing—approximately one-half of all retail installment sales financing stems from sales of motor vehicles,<sup>14</sup> and more than sixty per cent of retail auto sales are handled through installment-plan instruments.<sup>15</sup> An analysis of this industry clearly underlines the complications implicit in the control of installment sales financing and the regulation of dealer participation.

In order to retain some degree of liquidity, automobile dealers sell their installment paper for the cash price of the item sold; the purchaser of the paper collects from the consumer and imposes a finance charge upon the transaction.<sup>16</sup> Although commercial banks purchase some dealer paper, the most important outlets for these contracts are sales finance companies.<sup>17</sup> Every finance company issues rate charts to the dealers

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13. One major difference between automobile and diversified financing is in the bases upon which contracts are purchased by finance companies. Most installment sales contracts of items such as electrical appliances and furniture are sold by dealers on a recourse basis; dealer reserves are in common use and the pack is not a major problem. Furthermore, far more manufacturers are involved in diversified financing, but none conducts a business as large as Chrysler, Ford, or General Motors, who comprise the Big Three of motor vehicle manufacturing. For a description of the competitive situation in diversified financing, see PLUMMER AND YOUNG, SALES FINANCE COMPANIES AND THEIR CREDIT PRACTICES 283-85 (1940).

14. Over the ten-year period from 1929-1938, automobile installment credit averaged 51.6% of all installment sales credit. Furniture store installment credit ran an outdistanced second with an average of 15.5% of total installment sales credit. These figures are extracted from data in MARYLAND REPORT 11, Table 5.

15. FTC REPORT ON MOTOR VEHICLE INDUSTRY 920 (1940) (hereinafter cited as FTC REPORT).

Installment sales credit played a vital role as a catalytic agent in the mass distribution of assembly-line manufactures. Especially in the production of automobiles did it serve a valuable function. Commercial banks shied away from installment financing in untried industries such as automobile manufacturing; finance companies filled the breach. For a panoramic view of sales financing through the years, including a discussion of its importance to the automobile industry, see PHELPS, THE ROLE OF THE SALES FINANCE COMPANIES IN THE AMERICAN ECONOMY (1952), published by and supplied to the INDIANA LAW JOURNAL by Commercial Credit Company, Baltimore, Md.

16. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 36.

17. Finance companies have proven a necessity to automobile retail dealers. In 1937 approximately 60% of total automobile sales were made on the installment plan; of these, dealers financed only a small portion themselves, while of the large remainder, 96% was handled by finance companies with only 4% going to commercial and small-loan banks. FTC REPORT 920-923. Since then, the proportion received by banks has grown rapidly, until, in February, 1953, banks purchased more than 20% of all installment paper originating with automobile dealers. COX, THE ECONOMICS OF INSTALLMENT BUYING 340 (1948); see also REVISION OF CONSUMER CREDIT STATISTICS, FED. RES. BULL. 336, 351-53, Tables 4, 5, 6 (April 1953). Since manufacturers demand cash for automobiles delivered to retailers, the finance companies step in with ready cash to finance the dealers' requirements—the "floor plan"—to the extent that today they provide from 90 to 100% of cash required by retailers for this purpose.

The Wisconsin Interim Committee cited as an evil of installment sales financing

from whom that company purchases paper, specifying the finance charge which is to be added to the cash price.<sup>18</sup>

Theoretically, finance companies appear to have three methods by which to obtain dealer business. Utilization of all three by any one company should assure an advantageous competitive position. The first and foremost of these is dealer participation.<sup>19</sup> Since the dealer is primarily interested in profiting from automobile sales, the finance company offering him the highest participation which will not decrease his

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an unfair trade practice concerned with floor plan financing. This type of financing is rendered primarily as a service to the dealer, with a very small interest charge. "The evil of floor plan financing is the general tendency to coerce dealer into financing sales through the finance company who does the floor planning." This deprives the consumer of an opportunity to choose his own finance company, and may be a factor in lessening competition or creating a monopoly in favor of the large national companies. WISCONSIN INTERIM REPORT 38-39.

18. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 197. Some unscrupulous finance companies furnish dealers with more than one rate chart, one specifying the amount the company demands, and another to show the customer, indicating the charge to him; the difference is kept by the retailer as his "pack"—the consumer, of course, believes the total charge to him is that called for by the finance company. WISCONSIN INTERIM REPORT 36.

"[P]acking—the term for that part of the finance charge which exceeds the amount called for by a rate chart—is almost universally condemned as unethical." Mors, *State Regulation of Installment Financing—Progress and Problems II*, 24 J. BUS. OF U. OF CHI. 43 (1951). Mr. Mors makes the point that "[c]ompetition is virtually helpless in eliminating packing. . . ." because (1) ". . . consumer demand for installment credit is inelastic with respect to changes in interest (or finance-charge) rates. . . ." and (2) ". . . retail dealer demand for credit is elastic. . . ." with respect to the participation allowed by finance companies. *Id.* at 44. Although his second contention seems valid, the first one may be questioned. Evidence that many more buyers have financed their purchases through installment loans in recent years indicates that buyers are becoming more and more aware that commercial banks, through installment lending, may provide their cheapest method of financing; in other words, demand for consumer credit may be inelastic, but it is flexible for any particular type of consumer credit, such as installment credit. Until 1943, installment sales credit was by far the most important source of consumer credit. In that year, installment loans took the lead, and by 1947, the volume of sales credit outstanding approximated only three-fifths of the loan credit outstanding. Cox, *op. cit. supra* note 17, at 485-489, Table B-3. Although in 1948 and 1949, installment credit recaptured the lead, installment lending was in a much stronger position than at any time before 1943. Legis., 63 HARV. L. REV. 874 (1950).

In 1935, General Motors Acceptance Corporation instituted its "6% Plan," which sought to teach the public to compute finance charges. The FTC issued a "cease and desist" order, thus halting this program on the grounds of deceptive advertising. However, the Commission declared that this plan, if comprehended by prospective purchasers, would enable them to detect any overcharge or pack. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 201-203. Since consumer demand for credit appears to be flexible, perhaps education of the public by statewide or nationwide advertising campaigns, sponsored by government agencies or Better Business Bureau, would help to eliminate the dealer's pack. Or perhaps disclosure-type statutes, making the contract terms and charges succinct and concise, will rid installment sales financing of the increment called "pack." See N.Y. PERS. PROP. LAW § 64-a, which prescribes the types of information to be disclosed.

19. "Today, when a dealer makes arrangements to finance his paper, his first question is, 'How much do I get and when do I get it?'" WISCONSIN INTERIM REPORT 35.

sales will probably win his business.<sup>20</sup> The dealer may lose customers because of increased participation if the finance company which supplies him with rate charts demands a high finance charge.<sup>21</sup> Therefore, coupling a high kickback with low finance charges will lure many dealers. Competition for the dealer's business is also affected by the degree of risk which will be accepted on the paper, so that a finance company may be forced to purchase some comparatively high-risk paper as an aid to the dealer's auto sales in order to obtain his desirable paper.<sup>22</sup> Under perfect competitive conditions, these factors should determine which company will handle the largest amount of installment contracts, but what applies in theory does not always rule in actuality.

Although more than five hundred companies purchase automobile installment paper,<sup>23</sup> three of these firms, General Motors Acceptance Corporation, Commercial Investment Trust Corporation, and Commercial Credit Company, purchase about seventy per cent of all installment paper sold by dealers to finance companies.<sup>24</sup> These enterprises, often referred to as the Big Three, differ from the smaller companies in that each of them can attribute its growth to tremendous size to its kinship with one of the Big Three of automobile manufacturing.<sup>25</sup>

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20. Moralists might state the proposition that "the sincere businessman will not gouge the consumer, but will accept a reasonable profit from the sale of goods and be proud of the service he has rendered to his community." This premise may be questioned even under inflationary business conditions, but when automobiles are hard to sell, the dealer must, for his own sake, appreciate the presence of the "little extra" which may carry him safely through a depression. Cavers, *supra* note 3, at 211.

That "little extra" can be a very large item to the dealer. Assume the sale of a \$2000 automobile, with \$500 down payment. A 6% finance charge on the \$1500 unpaid balance amounts to \$90. If the dealer receives a 2% participation, his kickback is \$30. An FTC study disclosed an average gross profit of under 17% for dealers, with a net average of less than 2%. FTC REPORT 875-876. Giving the dealer the benefit of doubt in accord with the inflationary conditions existing today, assume a 25% gross, 5% net. His dollar gross on that auto would then be \$500, his net \$100. The \$30 kickback amounts to 30% of his net profit on the sale of the auto, and his profit from both the sale and the financing transactions is \$130.

21. See note 18 *supra*.

22. This factor has become virtually stable, since finance companies seldom refuse paper offered them by dealers. This may be attributed to two factors: (1) dealers have learned to refuse poor risks, and (2) the competitive situation requires each company to accept even that paper whose terms are out of line with those that are customary. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 107.

23. The exact number of individual sales finance companies operating in the United States has long been a mystery. The National Association of Finance Companies and the Census of Business have made estimates ranging from about 1,000 to 2,300. *Id.* at 34. The FTC estimated that about 500 sales finance companies are engaged in financing the distribution of motor vehicles. FTC REPORT 921.

24. A survey of 424 sales finance companies disclosed that these three companies, classified as factory-related in the survey, supplied 67.66% of retail credit, and 78.70% of wholesale credit extended by sales finance companies to dealers in 1937. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 264, Table 67.

25. For discussion of the part played by the manufacturers in the growth of

That the augmentation of General Motors auto sales is a distinctive objective of the competitive policy of GMAC, the only completely factory-controlled finance company,<sup>26</sup> is indicated by the fact that its services are available only to GM dealers<sup>27</sup> to whom it extends low cost financing facilities.<sup>28</sup> This unique policy has been an important factor in reducing the finance charge to consumers, since other companies were forced to lower their finance charges in order to compete with GMAC.<sup>29</sup>

The participation, primarily in the form of dealer reserve, offered by GMAC to its dealers has always been as low as or lower than that extended by its competitors,<sup>30</sup> yet GMAC has always managed to receive almost all GM dealers' paper.<sup>31</sup> Evidence of coercion upon dealers prompted a government anti-trust action against General Motors, which resulted in a consent decree enjoining GM from compelling its dealers to sell all of their installment paper to GMAC.<sup>32</sup> Although Ford and

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the Big Three of installment financing, see *Id.* at 261-275. On an average, each of the Big Three, in 1937, received about twelve hundred times as much automobile dealer business as the average for each of the small companies. *Id.* at 263.

26. FTC REPORT 922. For a number of years Chrysler Corporation owned 55,000 shares of stock in CCC; it has since released all ownership interest. Ford Motor Company formed Universal Credit Corporation in 1928, and in 1933 sold its proprietary interest to Commercial Investment Trust Corporation. *Ibid.* See also GRIMES, THE STORY OF COMMERCIAL CREDIT COMPANY 59-60 (1946).

27. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 269.

28. In order to enable dealers to pay cash before shipment of motor vehicles, GMAC finances floor plans of these dealers, at little or no profit to it; the purpose is to facilitate a large turnover of automobiles by dealers. To aid the consumer public in buying cars in volume, GMAC extends low cost credit to installment buyers. General Motors, realizing that sharp practices and high finance charges by finance companies and dealers reflect on automobile sales volume, has attempted to prevent these practices through the efforts of its own finance company. FTC REPORT 941, 944.

29. The perfect example of the influence GMAC's price policies have upon the whole industry is that company's initiation of its "6-percent plan." See note 18 *supra*. In 1935, GM and GMAC announced and advertised their new program. Before commencement of this plan, GMAC finance charges averaged 8% on one-year installment contracts. This program reduced them to 6%. Shortly thereafter, other manufacturers instituted similar plans for their preferred finance companies, thus reducing their rates. By the time the FTC issued a "cease and desist" order against the "6-percent plan," GMAC had made substantial gains. FTC REPORT 941-945. In 1936, GMAC's volume of obligations purchased increased more than two hundred million dollars, larger than any former increase from one year to the next. Whether this is directly attributable to GMAC's "6-percent plan" may be questioned, but some significance may be attached to that increase in respect to GMAC's new program. *Id.* at 935, Table 151.

30. A 1938 study disclosed, for example, that GMAC allowed an average kick-back on 12-month installment contracts of 1.2 percent, while CIT and CCC averaged 1.86, and the independent finance companies offered kickbacks averaging 1.65. *Id.* at 959, Table 160.

31. "GMAC finances approximately 65% of the General Motors cars sold to dealers on time and around 75% of the cars sold to retail purchasers on time." *United States v. General Motors Corp.*, 121 F.2d 376, 391 (7th Cir. 1941).

32. Independent finance companies instigated the movement that resulted in the indictment in 1938 of both the Big Three of automobile manufacturing and the Big

Chrysler had disposed of all proprietary interests in CIT and CCC respectively,<sup>33</sup> similar actions were instituted against these companies to enjoin them from certain coercive acts they had committed in favor of these finance companies which they were now related to only by agreement;<sup>34</sup> these companies, however, averted litigation by signing consent decrees.<sup>35</sup> The manufacturers' coercive practices had played a major role in enabling the related finance companies to secure dealer business; since the decrees allow the automobile manufacturers to take certain steps short of actual coercion and discrimination, it may be naive to believe that these decrees have deprived the factories of all their dealer control.<sup>36</sup>

Even if the consent decree were completely successful, GMAC has other effective weapons which it can and does use without sacrificing

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Three of automobile financing. FTC REPORT 935. General Motors elected to defend against the charge, under the Sherman Act, of "conspiracy in restraint of trade." General Motors was accused of such practices as: (1) requiring a promise to use GMAC services as a condition for receiving a GM franchise; (2) discriminating against GM dealers not using GMAC, by refusing to deliver cars; (3) giving favors to dealers using GMAC. *United States v. General Motors Corp.*, 121 F.2d 376 (7th Cir. 1941). Finally, in 1952, the case against General Motors was concluded with entry of the consent decree. *United States v. General Motors Corp.*, CCH TRADE REG. REP. (9th ed.) ¶ 67,324 (S.D. Ill. 1952).

33. See note 26 *supra*.

34. The indictments against Ford and Chrysler and their related finance companies were nol-prossed on November 15, 1938, upon the entry of consent decrees by them. For an excellent discussion of the consent decrees, see Birnbaum, *The Auto-Finance Consent Decree: A New Technique in Enforcing the Sherman Act*, 24 WASH. U.L.Q. 525 (1939).

35. One important provision restrained the manufacturers from acquiring ownership interests in finance companies. Because it would be inequitable to bind Ford and Chrysler and allow GMAC to continue its coercive practices, the decree provided that if, by January 1, 1941, a final decree were not entered requiring GM to divest itself of all ownership and control of GMAC, the court would modify the present decrees to allow the manufacturers to acquire holdings in finance companies. Haberman and Birnbaum, *The Auto-Finance Consent Decree, An Epilogue*, 1950 WASH. U.L.Q. 46.

The General Motors case rode the trail of appeal until 1952. Year after year, Ford consented to an extension of its consent decree, until 1945, when it asked relief. The Supreme Court finally, in 1948, released Ford from the restraints upon it. *Ford Motor Co. v. United States*, 335 U.S. 303 (1948). It is unlikely that Ford will revert to its coercive practices of pre-consent decree days, since ". . . [t]he lifting of the restraints imposed by the consent decree does not, of course, affect the liability of Ford for any violations of the Sherman Law that the Government may establish in court. . . ." *Id.* at 320.

The consent decree finally entered against General Motors resembles the two earlier decrees against the other manufacturers; however, General Motors is not required to dispose of proprietary interests in GMAC. *United States v. General Motors Corp.*, CCH TRADE REG. REP. (9th ed.) ¶ 67.324 (S.D. Ill. 1952).

36. The General Motors decree, for example, allows that company to: (a) adopt plans of financing sales; (b) recommend such plans to dealers; (c) advertise these plans to the public; (d) mention GMAC in institutional advertising; and (e) advertise GMAC in connection with sales made by factory owned retail stores. *United States v. General Motors Corp.*, CCH TRADE REG. REP. (9th ed.) ¶ 67,324-5 (S.D. Ill. 1952).

its ultimate objective of keeping costs low to the consumer. To enhance their security interest in the autos financed, dealers and finance companies usually require installment buyers to purchase certain types of insurance.<sup>37</sup> GMAC encourages dealing with General Exchange Insurance Corporation and Motors Insurance Corporation, both owned by GMAC.<sup>38</sup> The rates which these two corporations file with state insurance commissions average twenty-five per cent lower than manual rates.<sup>39</sup> Although an estimated eighty per cent of the total volume of insurance premiums from installment sales transactions flows through insurance companies owned and controlled entirely by finance companies, only the GMAC-owned companies offer this saving to the consumer.<sup>40</sup> In states in which auto dealers may easily qualify as insurance agents, Motors Insurance Corporation's rates are manual and the twenty-five per cent is rebated to the dealer as commission on the insurance.<sup>41</sup> The public still benefits in these states, however, in that the saving which is made in other states from low insurance rates manifests itself in the form of reduced finance charges.<sup>42</sup>

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37. Insurance misrepresentations have long been a major abuse in sales financing. Dealers ordinarily require installment buyers to purchase property damage, theft, and collision insurance. Since the dealer usually secures the insurance for the purchaser, the charge is included in the installment contract. Not infrequently does the buyer later discover that he has received insurance with a lesser value than that for which he has paid. Mors, *State Regulation of Retail Installment Financing—Progress and Problems*, 23 J. BUS. OF U. OF CHI. 211 (1950); WISCONSIN INTERIM REPORT 47. Contract disclosure provisions of installment legislation usually require itemization of all charges, including insurance, thus allowing purchasers to protect themselves against insurance misrepresentations. See IND. ANN. STAT. § 58-904-4 (Burns 1951).

38. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 269.

39. *Ibid.*

40. *Ibid.*

41. The practice of rebating insurance commissions to dealers has presented a problem in Wisconsin and Indiana. In Wisconsin, GMAC asked for a declaratory judgment of invalidity of that rule of the State Banking Commission defining dealer participation as including any amount retained by the dealer which was collected from an automobile buyer, including insurance commissions. The court looked through the corporate veil to see that GMAC owns Motors Insurance Corporation, and held that any insurance commission rebated is an element of dealer participation, and therefore, that the totals of any reserves or rebates plus insurance commissions could not legally rise above the two percent established maximum. *General Motors Acceptance Corp. v. Comm'r of Banks*, 258 Wis. 56, 45 N.W.2d 83 (1950), *rehearing denied*, 46 N.W.2d 328 (1951).

An Indiana automobile dealer sued the Department of Financial Institutions to enjoin enforcement of a general order disallowing any participation on a sale in which the dealer receives an insurance commission. The Supreme Court held this order to be an arbitrary invasion of private property under the guise of the police power. *Department of Financial Institutions v. Johnson Chevrolet Co.*, 228 Ind. 397, 92 N.E.2d 714 (1950).

42. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 269.

In addition, GMAC maintains liberal credit policies to augment GM dealers' auto sales, although extremely bad-risk paper is discouraged and often refused by GMAC. While General Motors coerced dealers to use the services of GMAC, many dealers were refused financing by this company if their financial condition was unsound.



While CIT and CCC both maintain insurance company connections, neither rebates insurance commissions to the retail dealer nor secures lower insurance rates for the public.<sup>43</sup> However, these companies have followed GMAC's price policies very closely, and so have maintained their finance charges at a low level.<sup>44</sup> The major difference in operating procedure between these two companies and GMAC is that, while GMAC maintains a low-level dealer reserve, CIT and CCC seem to channel their competitive efforts into increased dealer participation.<sup>45</sup> Furthermore, the large companies have diversified their investments, directing their resources into many profitable businesses;<sup>46</sup> the small companies have always had to rely upon installment sale financing as a primary source of profit.<sup>47</sup>

Despite the fact that dealer participation is an obvious increment to the finance charge<sup>48</sup> and a powerful, oft-abused competitive weapon

Furthermore, while dealers were compelled to sell installment paper to GMAC to the exclusion of all other finance companies, many prospective customers were declared ineligible under GMAC terms. *United States v. General Motors Corp.*, 121 F.2d 376, 389, 399 (7th Cir. 1941).

43. "Many other sales finance companies own their own insurance companies . . . but the general practice is to quote only manual rates. Thus the other finance companies . . . must offset the disadvantage. . . ." PLUMMER AND YOUNG, *op. cit. supra* note 13, at 269.

44. A study of selected finance companies for the years 1935-38 indicates that the national companies consistently maintained lower finance charges than the smaller companies. For example, in 1938, GMAC averaged, on twelve-month contracts, a finance charge of 6.1%, CIT and CCC averaged 6.4%, and the smaller companies averaged 6.8%. *Id.* at 211, Table 55.

45. A 1938 study disclosed that CIT and CCC offered participations larger than either GMAC or the independent companies. See note 30 *supra*. More conclusive evidence of the larger companies' eagerness to elevate kickbacks in order to secure dealer business is CIT's admission that, prior to the case of *Department of Financial Institutions v. Holt*, which contested Indiana's dealer participation limitation, CIT had contracted with certain dealers to raise the amount of participation if the *Holt* decision legalized higher participations. Brief for Appellees, p. 10, *Department of Financial Institutions v. Holt*, 108 N.E.2d 629 (Ind. 1952).

46. Both CCC and CIT have acquired holdings in many profit-making businesses. CCC, for example, provides five types of financing services, owns insurance companies supplying three kinds of insurance services, and operates manufacturing companies in eight different fields. See PHELPS, *op. cit. supra* note 15, at 85-86; *C.I.T.*, *Fortune*, Sept., 1947, p. 86.

47. Finance companies have three main sources of income: interest from wholesale financing; finance charges from retail financing; insurance commissions received from placing consumers' insurance with certain insurance companies. FTC REPORT 946. GMAC owns its own insurance companies. CIT and CCC have investments in insurance and manufacturing companies. Small companies though, are not able to acquire such dispersed holdings, and so have not received substantial profits from sources other than the three listed above.

48. Under the guidance of the National Recovery Administration, all finance companies met to compile a code of practice for the industry. Twice they convened and twice the meeting ended in failure, because of differences over dealer participation. The small companies seemed to favor outright abolition of any form of participation, claiming they were "commercial bribery." The Big Three wanted the reserve retained,

in the automobile industry, only four states have attempted to control it.<sup>49</sup> Only in Indiana has the constitutionality of dealer participation regulation been tested in court.<sup>50</sup> An action is now pending in Wisconsin which will test the validity of its method of limiting kickbacks.<sup>51</sup>

The Indiana Retail Installment Sales Act<sup>52</sup> established a Department of Financial Institutions, which was empowered to promulgate both maximum finance charges<sup>53</sup> and maximum allowable dealer participation.<sup>54</sup> But, in 1952, the Indiana Supreme Court wrote *finis* to In-

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and packs and bonuses eliminated, asserting that the reserve merely protected the dealers from losses, but evidence showed that the reserve was often excessive, and, therefore, a source of unearned profit to the dealers. Cavers, *op. cit. supra* note 3. Mr. Cavers points out that, in the depression, "... many dealers would have gone to the wall . . ." had it not been for the income derived from participation. *Id.* at 211. But is it proper, when the dealer renders no services, to reimburse him out of the finance charge paid by the consumers? The Michigan legislature thought not when, in 1950, it declared illegal any participation paid, unless in return for services; when paid for services, any amount over two percent is illegal. MICH. STAT. ANN. § 23.628(31)(c) (Supp. 1951). The services referred to in that statute specifically include only those rendered in preparing "... the credit information, contract, note, mortgage and application for title. . ."

An analogy may be drawn between the retail dealer and a middleman in any other industry. The job of middleman, such as a broker, is to secure customers, and the middleman is reimbursed for his services. If the dealer is likened to a middleman for securing credit customers, he may be entitled to compensation for these services to the finance company. Continuing the comparison, the kickback may then be likened to the broker's commission. If this analogy is proper, a reasonable amount of participation is easily justifiable.

49. See note 8 *supra*.

50. Department of Financial Institutions v. Holt, 108 N.E.2d 629 (Ind. 1952), declared Indiana's dealer participation regulation unconstitutional.

51. "I do believe that we have a better chance of winning the test case that is pending in Wisconsin on the constitutionality of the Rules and Regulations of this department relating to dealer participation than we would . . . under Indiana's law.

" . . . [T]he major objection raised by the dealers [is] that if it is unconstitutional to regulate dealer participation in Indiana, the Wisconsin regulation is unconstitutional." Communication to the INDIANA LAW JOURNAL from John F. Doyle, Supervisor, Consumer Credit Division, Wisconsin State Banking Department.

52. IND. ANN. STAT. §§ 58-901 through 58-934 (Burns 1951).

53. Under the authority granted by § 26 of the Retail Installment Sales Act, the Department is empowered to classify retail installment sales arising from retail installment contracts, and to fix by general order the fair maximum finance charge in each class. Class I includes *new* motor vehicles, airplanes, trailers, tractors, and motorcycles; Class II includes *used* motor vehicles, airplanes, etc., less than two years old; Class III includes the used vehicles in Class II, if more than two years old; Class IV includes all other goods. The maximum set for each class is comprised of a sum equal to a stated percentage of the unpaid balance, in effect a discount, plus an amount equal to simple interest at a stipulated rate per month on the declining unpaid balance. The discount for Class I is 2%, Class II, 3%, Class III, 5%, and Class IV, 2%. The simple interest rate used is 1¼%, 1.875%, 2.3%, and 1.875% for the four classes respectively. IND. ANN. STAT. §§ 58-906, 58-926 (Burns 1951), and Rule 58-926-1 thereunder, see HORACK, 2 IND. ADMIN. CODE 4403 (1941). For a comparison between Indiana's method of computing the maximum finance charge and those of California, Ohio, and Pennsylvania, with a discussion of the merits of each method, see Mors, *supra* note 18, at 49-57.

54. The maximum allowable dealer participation established under the authority

diana's method of limiting dealer participation; in *Department of Financial Institutions v. Holt*,<sup>55</sup> the court characterized that portion of the Act which authorized rebate regulation as an arbitrary invasion of property rights under the guise of protecting the public interest by use of the police power. Universal CIT Credit Corporation<sup>56</sup> intervened on behalf of the plaintiff, an automobile dealer, who was seeking to enjoin enforcement of the dealer participation limitation, claiming that the buying public is fully protected against unfair and exorbitant finance charges by the maximum placed upon finance charges. The Department insisted that the regulation does operate in the public interest, sufficiently so to justify its imposition. The court agreed with the plaintiff that dealer participation regulation was a form of legislative price-fixing, and therefore was governed by its earlier decisions on price-fixing statutes.<sup>57</sup> Applying the principles of substantive due process,<sup>58</sup> the court declared

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of § 10 was adapted to the finance charge classification. For Class I, the maximum was 2%, Class II, 3%, Class III, 5%, Class IV, 2%. IND. ANN. STAT. § 58-910 (Burns 1951), and Rule 58-926-1 thereunder, see HORACK, 2 IND. ADMIN. CODE 4403 (1941).

55. 108 N.E.2d 629 (Ind. 1952). A source of wonderment is the fact that the dealer participation limitation was not contested earlier. Possibly, dealers and finance companies had no idea that such a regulation might be declared unconstitutional. Their cue to test its validity may have come from the gratuitous dicta rendered by the Supreme Court in the *Johnson Chevrolet* case. That case concerned a prohibition against a dealer receiving a commission on insurance sold in connection with an installment contract. See note 41 *supra*. The Court indicated how it would treat a future action testing dealer participation regulation with these words: ". . . The cost to the retail buyer cannot be affected, because both the finance charges and the insurance rates are controlled. . . . Whether or not dealer's participation is paid would not affect the cost to the retail buyer. . . ." *Department of Financial Institutions v. Johnson Chevrolet Co.*, 228 Ind. 397, 406, 92 N.E.2d 714, 717 (1950).

56. An Indiana corporation, and a subsidiary of CIT.

57. The court admitted that it has "consistently refused to follow the 'pattern' or 'drift' apparent in the decisions of other courts which approve mere legislative price-fixing." *Department of Financial Institutions v. Holt*, 108 N.E.2d 629, (Ind. 1952). To illustrate its point, the court cited the following cases in which the Indiana Supreme Court had struck down price- or wage-fixing legislation: *Street v. Varney Electrical Supply Co.*, 160 Ind. 338, 66 N.E. 895 (1903); *State Board of Barber Examiners v. Cloud*, 220 Ind. 552, 44 N.E.2d 972 (1942); *Kirtley v. State*, 227 Ind. 175, 84 N.E.2d 712 (1949).

The *Kirtley* case placed reliance squarely upon *Ribnik v. McBride*, 277 U.S. 350 (1928), which is "dead for federal constitutional purposes." FRANK, *CASES ON CONSTITUTIONAL LAW* 690 (1952). The United States Supreme Court would probably uphold the constitutionality of legislation similar to that questioned in the *Holt* case ". . . [C]ourts may not declare a legislative judgment invalid unless, viewed in the light of facts made known or generally assumed, it is of such a character as to preclude the assumption that the classification rests upon some rational basis within the knowledge and experience of the legislators." *Metropolitan Casualty Ins. Co. v. Brownell*, 294 U.S. 580, 584 (1935). The presumption of constitutionality accorded price-fixing legislation in the United States Supreme Court is best illustrated by *United States v. Carolene Products*, 304 U.S. 144 (1938).

As a result of these cases, substantive due process is virtually a "dead letter" in the United States Supreme Court, although some state courts prize it dearly.

58. Paulsen, "*Natural Rights*"—*A Constitutional Doctrine in Indiana*, 25 IND. L.J.

that the means of regulation were not "reasonably related to the purpose sought to be accomplished."<sup>59</sup>

The Department placed equally-distributed emphasis upon two contentions.<sup>60</sup> First, it predicted that delimitation would adversely affect the public. In fixing a fair maximum finance charge, the Department bases its determination upon what it considers to be the fair cost of conducting the sales finance business, including amounts paid for installment contracts as an item of cost.<sup>61</sup> The Department therefore contended, with seemingly sufficient evidence, that with removal of dealer participation limits, the big companies will bid for dealer business by offering larger participations.<sup>62</sup> The higher prices paid for paper will then reflect as an item of cost which the Department must recognize, the Department will have to raise the finance charge maximum, and as the maximum increases, actual finance charges will follow this upward trend. In rejecting this assertion, the court pointed out that the Department can resist any pressures to raise the maximum if it does not consider a larger participation a legitimate item of cost.

Secondly, the Department contended that the nationals, financially stronger, can corner the installment paper market by outbidding the small companies, and thereby destroy them. The court asserted in answer that Section 10 had no anti-monopolistic purposes, although other sections of the act admittedly do.<sup>63</sup> The court found no reason to believe that if monopoly or oligopoly ever seems imminent, and existing anti-trust legislation fails to remedy the situation, the legislature would not act to solve the problem.

The Department, in arguing that the nationals would request an increased maximum finance charge, neglected to mention that the locals would inevitably be forced to raise their kickbacks to retain the dealer business they now hold, and certainly to acquire additional customers.<sup>64</sup>

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123 (1950); Paulsen, *The Persistence of Substantive Due Process in the States*, 34 MINN. L. REV. 92 (1950).

59. Department of Financial Institutions v. Holt, 108 N.E.2d 629, 635 (Ind. 1952).

60. *Id.* at 636.

61. "The Department, in determining the fair maximum finance charge . . . shall take into consideration . . . the finance charge which will be necessary in order to induce sufficient amounts of efficiently operated capital to enter into the business of making and purchasing retail installment contracts." IND. ANN. STAT. § 58-926 (Burns 1951) (emphasis added). "In fixing a fair maximum finance charge the Department can determine what the fair cost of conducting the business of licensees ought to be, including the amounts paid for these contracts as an item of costs. . . ." Department of Financial Institutions v. Holt, 108 N.E.2d 629, 637 (Ind. 1952).

62. See note 46 *supra*.

63. Section 21 of the Act prohibits contracts to prevent competition, Sections 22 and 23 prohibit coercive practices tending to prevent competition, and Section 24 makes illegal subsidies paid by manufacturer to licensees if those subsidies tend to lessen or eliminate competition. IND. ANN. STAT. §§ 58-921, 58-922, 58-923, 58-924 (Burns 1951).

64. As indicated by CIT's planned program of increased participations upon a

It is reasonable to assume, in light of the Big Three's long-range low-charge policy, that they would probably maintain low financing costs as long as possible.<sup>65</sup> On the other hand, the small companies, perhaps both unwilling and unable to accept a smaller profit on the finance charge, may elevate the finance charge correspondingly with the increase in participation.<sup>66</sup>

In either event, it is unlikely that the Department could resist the pressure for a change placed upon it by companies financing a substantial segment of all installment sales.<sup>67</sup> It hardly seems possible that the Department must grant increases *ad infinitum*, but with the very first increase the consumer will have been damaged.

The very heart of the Indiana Act would be endangered by the Department's refusal to grant an increase. The group denied an increase probably would sue the Department to enjoin enforcement of the maximum finance charge limitation, as a violation of its liberty to contract.<sup>68</sup> As evidenced by the *Holt* case, the Indiana Supreme Court adheres to the principles of substantive due process.<sup>69</sup> It is conceivable that the court would treat the finance charge as a price of services and the regulation as a type of price-fixing legislation; the court may then strike the maximum finance charge down as unconstitutional.<sup>70</sup> Thus, by causal

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declaration of invalidity of § 58-910 of the Indiana Retail Installment Sales Act, dealer participation is the most successful method of securing dealer business. See note 19 *supra*. Unquestionably, dealers welcome, and often demand, that item of profit. See note 20 *supra*.

65. See note 29 *supra*. High finance charges have been a factor in the increased volume of installment lending; furthermore, high charges will drive automobile customers away from dealers doing business with companies demanding these high rates. See note 18 *supra*.

66. A study of selected sales finance companies for the years 1928-39 disclosed that the national companies annually received a larger proportion of net profits to gross income, and, conversely, incurred a smaller percentage of expenses, than local companies. In 1939, for example, the nationals showed a 30.5% net profit on gross income, while the locals netted 22.6% of gross income. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 251, Table 64.

Assuming those figures to represent the existing situation, obviously any simultaneous increase in the cost to the nationals and the locals of purchasing contracts would reduce profits of both. The net profits of the locals would decrease to the point of bearing a loss sooner than the profits of the nationals. Therefore, a likely step by the small companies would be to increase a source of profit, probably the finance charge.

67. In determining a fair maximum finance charge, the Department must also take into consideration the "finance charge which will be necessary in order to induce sufficient amounts of efficiently operated commercial capital to enter into the business." Investors will not enter a field when the origination of a new enterprise is extremely risky. IND. ANN. STAT. § 58-926(c) (Burns 1951).

68. This contention would be similar to the one asserted by the plaintiffs in the *Holt* case. In that case, the plaintiffs claimed that the dealer participation regulation interfered with their right to sell contracts at a price determined by them. Brief for Appellees, p. 12, Department of Financial Institutions v. Holt, 108 N.E.2d 629 (Ind. 1952).

69. See notes 57 and 58 *supra*.

70. See note 57 *supra*.

sequence, Indiana's Installment Sales Act could be emasculated by removal of dealer participation control.<sup>71</sup>

In contemplating unreasonable demands by finance companies for an increased allowable finance charge, it must be remembered that, while attributing too much prudence and frugality to the installment buyer may be a mistake, the finance companies realize that eventually a point will be reached at which the buyer becomes cognizant of mistreatment and retreats for cover behind the protective doors of the commercial bank.<sup>72</sup> In recent years banks have become powerful competitors of sales finance companies.<sup>73</sup> Not only have they gained ground upon finance companies in volume of installment sales contracts purchased,<sup>74</sup> but from 1942 to 1947 the volume of installment loans extended by banks was larger than the total amount of installment sales credit extended to buyers.<sup>75</sup> Since the Big Three are aware of this source of danger to their business, a plausible assumption is that the large companies will attempt to maintain their charges at "bank rates" or thereabout.<sup>76</sup> And, if the small companies raise their charges, they stand to lose much dealer business.

71. The dealer participation provision has been declared unconstitutional. Without the maximum finance charge, the statute, for all practical purposes, becomes merely a disclosure-type statute with anti-trust provisions. The legislative intent seemingly will have been frustrated.

72. As recently as 1935, the consumer's ignorance made him the whipping-boy for both dealer and finance company. The situation that existed seemed to be "[e]veryone for himself and the Devil take the hindmost," the consumer of course being the "hindmost." WISCONSIN INTERIM REPORT 35; see also Mors, *supra* note 37, at 201-2. The situation has changed since that time. Bank advertising, disclosure statutes, uniformity of contract provisions, the "6% Plan," and a general increase in the education of installment buyers has made them wary of finance charge abuses. See PLUMMER AND YOUNG, *op. cit. supra* note 13, at 261. Evidence of the rapid growth of installment lending of money indicates that the consumer will no longer accept high finance charges attached to an installment sale. See note 18 *supra*.

73. Proof that finance companies recognize and fear bank competition is offered by the companies themselves, in their attempts to augment their reputation at the expense of the banks. CCC, for example, in its publications, makes subtle but continued references to banks' refusals to enter the field of consumer credit early in the century, while finance companies were more than willing to help finance the consumer's needs. See PHELPS, *op. cit. supra* note 15, at 33-45. Again, in pointing out the financial stability of sales finance companies, Mr. Phelps, quoting an unidentified authority, says: "It has been said that during the depression many finance companies lost money through bank failures but no bank lost money through finance company failures." *Id.* at 66. Anomalously, while finance companies attempt to discredit banks, they have tried to associate themselves with the prestige of banking houses. "It is as a banking house serving its community in the best traditional sense that Commercial Credit Company has had its great success." LILLY, HELPING AMERICA BUY WHAT IT WANTS 45 (1952), published by and supplied to the INDIANA LAW JOURNAL by Commercial Credit Company, Baltimore, Md.

74. See note 17 *supra*.

75. Cox, *op. cit. supra* note 17, at 489, Table B-3.

76. ". . . The sales finance company differs from . . . other finance companies . . . in its lower rates of charge, which in the purchasing of retail paper are competitive

Assumptions must be made and their probable effects considered, and the conflicting evidence must be weighed carefully before it is possible to determine whether or not to regulate the installment sales finance industry. The Indiana Supreme Court felt that regulation of dealer participation was unnecessary.<sup>77</sup> In 1935 the Indiana Legislature decided that such a limitation was essential;<sup>78</sup> the legislative attitude apparently has not changed. At the session immediately following the *Holt* decision, the General Assembly enacted a statute patently directed at monopolistic practices but with the express purpose of controlling dealer participation.<sup>79</sup> No attempt was made to conceal the fact that this new act is merely a substitute for the invalid Section 10.<sup>80</sup>

Was the change in tenor of dealer participation regulation from a direct attempt to hold finance charges at a minimum to an anti-monopoly measure justified? In the interim between the *Holt* case and the passage of the new act, several complaints were lodged with the Department of

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with the 'low bank rates' advertised by commercial banks." PHELPS, *op. cit. supra* note 15, at 47.

77. Department of Financial Institutions v. Holt, 108 N.E.2d 629 (Ind. 1952).

78. IND. ANN. STAT. § 58-910 (Burns 1951).

79. The purpose of House Enrolled Act No. 430, 1953, is stated in § 3 of the Act: "It is declared illegal for any licensee under the provisions of the Retail Installment Sales Act to enter into any contract, agreement or arrangement with any person, firm or corporation, or to engage in any practice which would tend to lessen competition or tend to create a monopoly in such business field."

Political pressures played a large part in the passage of this act. One newspaper correspondent describes the fight over the bill thusly: "I became intrigued by this behind-the-scenes battle in the legislature because it represented a situation where two business groups were battling without, seemingly, the general public interest being immediately involved. . . . So here was a situation where the big money lenders and the smaller money lenders were embattled. . . ."

"That a real battle was on was apparent when the bill failed three times to win House passage by a constitutional majority—but finally squeaked by on a fourth try. . . . [I]n the Senate, where the bill passed easily, [one senator], speaking in support, said the issue simply was the protection of Indiana finance companies against the large, widely operating companies.

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"So far as I am aware no lobbyists registered to battle for the small finance companies. However, some important leaders in the finance and small loan field are being credited in rumor with having operated rather diligently as lobbyists without official portfolio for the bill. It also seems to be pretty generally accepted by some well-informed people . . . that the car dealers sat in the game when it became apparent their enlightened self-interest was involved." Communication to the INDIANA LAW JOURNAL from A. Brown Ransdell, Indianapolis Correspondent for the Louisville Courier-Journal.

80. Although the Department of Financial Institutions intends to limit dealer participation through the new act, its method is as yet undetermined. ". . . [W]e have no definite program pertaining to dealer participation. . . ."

". . . [T]he industry will probably set the rate . . . and . . . we may decide that the prevailing rate established by the industry should be a proper basis for all concerned. . . . [The feeling in the Department is that] the practice of paying dealer participation in excess of the prevailing rate would have a tendency to lessen competition." Communication to the INDIANA LAW JOURNAL from Joseph McCord, Director, Department of Financial Institutions.

Financial Institutions by small companies which had begun to experience a loss of business to out-of-state firms.<sup>81</sup> Although the nationals probably anticipated the introduction of new anti-dealer participation measures and so withheld any extensive program of raising rebates, in some instances they had elevated the kickbacks to certain dealers with a resultant decrease in the locals' business.<sup>82</sup> In light of Indiana's recent enactment, a consideration of the necessity and propriety of dealer participation regulation to prevent threats of monopoly is in order.

The apprehension of the small companies which prompted the new Indiana statute may well be justified.<sup>83</sup> Many reasons can be advanced to explain the small companies' fear of kickback competition with the nationals. The locals must maintain low finance charges to secure dealer business. Therefore, the larger the participation they must allow, the smaller their return. All evidence points to the fact that the nationals are financially better able to accept a smaller return upon each transaction than are the small companies.<sup>84</sup> The very fact that the members of the Big Three have always maintained lower rates than the locals creates an inference of their financial superiority.<sup>85</sup> The large companies received their impetus for growth from manufacturer relationships, and with expansion came the desire for the safety and increased earnings accruing from diversification.<sup>86</sup> CIT and CCC have entered such related fields as accounts receivable financing, factoring, and, of course, insurance, as well as acquiring outright ownership of certain manufacturing companies.<sup>87</sup> Furthermore, simple administrative expenses, such as advertising and printing, can be shared by numerous branch offices,<sup>88</sup> whereas a local firm usually has but one office.

81. *Ibid.*

82. *Ibid.*

83. Dire results have been predicted for small companies, in the absence of dealer participation regulation. ". . . [T]he local and independent finance companies will, in all probability, be forced out of business for lack of clientele. They will be unable to pay the higher dealer participation under the prevailing rates for installment financing." *Ibid.*

". . . With money costs increasing and the tremendous increase in operating expenses, the small company will have to close its doors as it will not be profitable for it to operate and give the major portion of the finance charge . . . back to the dealer." Communication to the INDIANA LAW JOURNAL from John F. Doyle, Supervisor, Division of Consumer Credit, Wisconsin State Banking Department.

84. See note 66 *supra*.

85. See note 44 *supra*.

86. With the imposition of Regulation W, which tightened up installment credit terms, the volume of installment sales credit decreased. In 1946, most of CCC's profit resulted from its participation in industries other than sales credit. GMAC that same year lost more than four million dollars due to its lack of diversification. *C.I.T.*, *Fortune*, Sept., 1947, p. 87, col. 2.

87. See note 46 *supra*.

88. CCC, for example, maintains more than 300 sales finance offices located in



The nationals' pecuniary advantages may operate in many ways to improve their competitive position to the detriment of the small companies. Ordinarily, finance companies rebate a fixed percentage of the unpaid time balance to dealers.<sup>89</sup> However, evidence of the competitive situation in Pennsylvania, where only the finance charge is limited, indicates that, in a market where companies are heatedly vying for dealer business, these companies may cease to state a definite percentage, but rather will quote a net rate to the dealer, allow him to tailor the total charge on each sale to suit the individual buyer, and pocket any amount he receives above the net rate.<sup>90</sup> Where this practice prevails, the big companies have made large gains; reportedly many small companies have been absorbed by larger companies, have left sales financing and entered other phases of credit, have had to exist on substandard risk paper, or have failed completely.<sup>91</sup> Finance charges supposedly have risen to the maximum and the small companies have not been able to quote as low a net rate as the nationals.<sup>92</sup> It is not unlikely, then, that regulation of the finance charge in absence of dealer participation limits can prove an almost outright grant of dealer business to the large companies.

But the nationals, with their low-charge policy, seem more likely to select an alternate mode of competing—one which would allow them to offer a total charge to the public lower than the small companies can, while at the same time rebating larger amounts to the dealer. Taking advantage of their geographical dispersion, they can afford to take losses

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46 states. *PHELPS, op. cit. supra* note 15, at 87. Both CIT and GMAC are dispersed similarly.

89. The dealer's reserve, the rebate, and the bonus are stated percentages. Only the pack is not a predetermined percentage of the unpaid balance. *WISCONSIN INTERIM REPORT* 34-38.

90. ". . . [O]ne of the main purposes of the legislation in this state was never accomplished because our law makes no reference to dealers reserves or kickbacks. This has created a situation whereby the financial institutions are still paying substantial kickbacks to dealers at the expense of the consumer. Reserves as high as 5% and 6% . . . are being paid to the dealer. The consumer pays the full legal rate—6%, 9% and 12% discount depending on the age of the car.

"Many of the larger financial institutions have established a flat rate of 3%, 4% and 5% to the dealer. The difference is pocketed by the dealer. There is no legal protection of any kind for the consumer." Communication to William L. Schloss, President, Indianapolis Morris Plan Bank, from Cyrus S. Gorson, President, Philadelphia Automobile Finance Association, and supplied to the *INDIANA LAW JOURNAL* by Mr. Schloss.

91. "Actually these large organizations have been able to offer to the better and more substantial dealer kickback propositions which the local independent companies could not meet and continue in business. They were left with the alternative of doing business with the second rate dealers or handling sub-standard risks.

"Many of these companies have discontinued their automobile finance business and are concentrating on personal loans, home improvement loans, appliances, etc. . . ." *Ibid.*

92. *Ibid.*

in any one area long enough to woo all desirable business, to the exclusion of the small companies, either recouping their losses in other areas or allowing their tremendous volume to absorb the loss.

As previously indicated, small finance companies have three methods of enticing dealers. These firms must offer participation at least equal to that granted by their larger competitors. It is entirely possible that the small companies may not be able to survive by offering the same types and quantities of services and receiving a smaller share of the finance charge. In order to reduce expenses so that they may compete with rebates, they will, of necessity, change one of their other dealer-lures. Finance charges apparently cannot be increased any appreciable extent without a loss of business. Therefore, the first move of a small company may be to reduce its risk of loss by raising its credit standards; it may not accept contracts of persons whom investigation shows to be sub-standard risks. If the dealer, under these circumstances, were to continue selling his paper to that company, those members of the public who were refused credit would have suffered immeasurably. The dealer will more than likely transfer his business to a larger firm—one which can offer large kickbacks, maintain the same services, and continue to extend liberal credit, without increasing finance charges. Small companies, after much experimentation with the various dealer lures, will realize that, in order to retain or secure dealer business, dealer participation remains the pièce de résistance.

If locals are not able to compete individually with the Big Three, cooperative efforts may be attempted. But fewer weapons are available for organized efforts in this industry than in others. There is no way for small companies to combine for cooperative buying, because there is nothing to buy.<sup>93</sup> They could pool investigation services, perhaps even cooperatively maintain a credit and collection bureau, but the saving would be negligible. They could team capital to borrow at lower rates by floating larger loans, but it is doubtful that small companies united within one geographical area could borrow quantities large enough to render an appreciable saving.<sup>94</sup>

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93. In the food distribution industry, to combat the chain-store influence, small grocers have formed "voluntary" chains, which are ". . . group[s] of retail grocers in a wholesaler's territory who voluntarily affiliate themselves with him while preserving their individual ownership. . . ." In this way the corner grocer is able to make a saving comparable to one made by a chain owning its own warehouses. Fulda, *Food Distribution in the United States, The Struggle Between Independents and Chains*, 99 U. OF PA. L. REV. 1051, 1061 (1951).

94. Cost of borrowing is a larger part of total operating expense for the local than for the national. In 1937, for example, this cost to the small companies amounted to 15% of gross income, while for the nationals, cost of borrowing was only 10% of gross income. PLUMMER AND YOUNG, *op. cit. supra* note 13, at 249, Table 63. This means that

Despite the apparent economic advantages held by the large companies, a bare possibility of oligopoly in the sales financing industry exists; oligopoly certainly is not imminent. The very nature of credit makes difficult the acquisition of a monopoly in the financing of sales of a particular make of automobile. Credit being an amorphous substance, with any one segment of it homologous to any other, it is a product which is not associated with trade names; like the grain sold by farmers, it is fungible and homogeneous. Although the Big Three, through extensive advertising, has attempted to brand-name the credit extended by them, few consumers would knowingly and willingly pay more money to deal with GMAC than a commercial bank. The very presence of many small finance companies indicates that competition with the big firms is possible. Furthermore, the deep inroads which commercial banks have made into the business of sales finance companies, large and small, illuminate the possibilities of growth of any small company, and tend to dispel the idea that the large companies can increase their volume at will.

Were an oligopoly to develop, numerous benefits may accrue to the public. The Big Three has been instrumental in disinfecting the entire industry of many abusive practices. Partially because of the nationals, the average finance charge has been maintained at a reasonable level. Their policies toward public education have made consumers alert to mistreatment and conscious of fair treatment. But, given an oligopolistic situation, it is readily foreseen that the members of the Big Three may feud within their exclusive Utopia. A plausible first move by one of these companies would be an increase in dealer participation coupled with a decrease in finance charges, but a likely eventuality in this battle of the behemoths is that, amid their thrashings, consumers' interests would be crushed underfoot. Finance charges conceivably could rise at a rate comparable to the increase in dealer participation. However, the loss of consumer business to banks via the installment loan should prove an effective brake upon rising finance charges.

If impartial analysis discloses threats of monopoly which competition has failed to check, it may be necessary for governmental forces to intervene. Is state regulation of the single element of dealer participation an adequate method of combatting monopoly? GMAC has succeeded in procuring a large percentage of GM dealer paper without entering into participation competition. Presumably the other two large companies could conduct their business in a fashion comparable to

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in order for the small companies to borrow at rates comparable to those received by the nationals, banks which usually supply the funds for finance company activities would have to reduce their rates 33.3%, an extremely large reduction.

GMAC. State anti-trust statutes may be considered, although application of these statutes in the past has been ineffective.<sup>95</sup>

Certainly the federal government, armed with many anti-trust weapons, has the authority to prevent monopoly. The government can invoke the Sherman Act in any instance of a firm monopolizing or attempting to monopolize an area.<sup>96</sup> The Robinson-Patman Act can be used against firms discriminating in price.<sup>97</sup> The Clayton Act stands ready for use against practices which may tend to lessen competition or to create a monopoly.<sup>98</sup> But federal action is often slow and burdensome, as is evidenced by the suit against GM for coercive practices, which originated with indictments in 1938, and after much litigation, resulted in a consent decree in 1952.<sup>99</sup>

The existence of a variety of statutory schemes for regulating retail installment sales financing among states which have some type of regulation, the paucity of accurate evidence as to the effect of the plans adopted, and the laissez faire attitude of most states, illuminates the pressing need for a systematic and detailed study of the industry. Since that data which is available shows that the installment finance

95. Many factors have caused state anti-trust laws to fall into disuse, including expansion of the concept of interstate commerce, thereby broadening the application of federal anti-trust laws, expense and time involved in anti-trust prosecution, and difficulty of obtaining evidence. The impression received upon examination of previous use of state anti-trust statutes is that "these laws raise more smoke than fire." Legis., 32 COL. L. REV. 347, 364 (1932). See also Comment, 43 ILL. L. REV. 205 (1948), which discusses the inactive status of Illinois anti-trust legislation.

96. 26 STAT. 209 (1890), as amended, 15 U.S.C. § 2 (1946).

97. 38 STAT. 730 (1914), as amended, 15 U.S.C. §§ 13, 13a (1946).

98. 38 STAT. 731 (1914), 15 U.S.C. § 14 (1946).

99. The Federal Trade Commission recently entered the area of automobile sales financing with the promulgation of its Auto Pack rules, which impose contract disclosure requirements upon auto retailers. TRADE PRACTICE RULES RELATING TO THE RETAIL INSTALLMENT SALE AND FINANCING OF MOTOR VEHICLES, 16 FED. REG. 1059 (1951). The ultimate objective of these regulations is to protect the installment buyer from unfair or deceptive practices in the sale of motor vehicles.

These rules are intended to serve as a guide for the industry; without state and private cooperation they will not necessarily eliminate abuses. "Compliance with these rules is expected to be widespread and to the greatest possible extent on a voluntary basis of cooperative effort and not by 'policing. . .'" From a summary of an informal opinion expressed by PGad B. Morehouse, Chief, Trade Practice Conference Division, and Assistant Director, Bureau of Industry Cooperation, Federal Trade Commission in *FTC "Auto Pack Rules Interpreted"*, 5 QUARTERLY REPORT OF THE CONFERENCE ON PERSONAL FINANCE LAW 35 (Spring 1951).

The Chairman of the Commission openly encourages the states to promulgate controls also. "When instances of probable violation are brought to the attention of the Commission in respect of which the requisites of commerce and public interest appear to be present and to which the Federal Trade Commission Act is applicable, reference for state attention shall be made when the state in which the transaction occurs has legislation applicable to the practices and when, in the opinion of the Commission, such legislation is adequate and is being enforced by the state. . ." From an opinion expressed by William A. Ayres, Acting Chairman, Federal Trade Commission, *ibid.*

picture differs from state to state or area to area, perhaps the inquiry should be conducted by state commissions rather than a federal agency. Even if there is a need, as some writers have suggested,<sup>100</sup> for a uniform consumer credit code embracing not only installment sales financing, but all forms of credit extended to consumers, research prior to drafting such a code should elicit the peculiarities in the conditions in each state.

In contemplating regulation, various factors must be recognized and considered. The legislative process must resist political pressure from groups active in the industry, who may obscure the welfare of the consumer in the shadow of their interests. At the outset, a basic approach must be determined—that is, whether the consumer is most benefited by legislation dealing with matters affecting him directly or by legislation attacking monopolistic practices and promoting competition. The latter tack probably will be advantageous to the small finance companies as well as the consumer.

Some features of present legislation seem almost essential to successful regulation of installment sales financing. Nobody will object to disclosure requirements which will enable consumers to be informed of contract terms; these requirements should include disclosure of insurance rates and coverage and a uniform method of setting forth the finance charge. And little difficulty should arise from an attempt to limit the allowable finance charge. But the *Holt* case forewarns that there may be obstacles in the path of dealer participation control. The situation in Indiana suggests the necessity of establishing a maximum dealer participation. The Michigan statute, which limits the kickback to the dealer to compensation for services rendered, appears to embody the most just and reasonable approach. It would be premature to evaluate the effectiveness of the new Indiana act, which is couched in anti-monopoly language. Whatever type regulation is chosen, its effectuation by an administrative agency would provide desirable flexibility which cannot be achieved by rigid statutory rates and rules of practice. Thorough consideration of all relevant factors should result in legislation bringing order out of chaos.

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100. “. . . [I]t seems inevitable that our legislative processes will continue to work toward the imposition of a systematic plan of regulation covering all consumer installment credit agencies in a manner which holds them to uniform standards of conduct consistent with the public interest. . . .” Hubachek, *The Drift Toward a Consumer Credit Code*, 16 U. OF CHI. L. REV. 609, 634 (1949).