

REVOLVING CREDIT AND CREDIT CARDS

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The tide of the future seems likely to carry with it ever increasing waves of revolving credit in the sea of consumer credit extensions. Already revolving credit represents more than a ripple in that sea.¹ The reasons are primarily economic. For a creditor who extends credit on a mass basis and has computer facilities, clerical and record-keeping costs are much lower for revolving credit extensions than for separate, one-shot credit extensions. Cost savings for revolving credit will be increased by simpler, less burdensome statutes governing extensions of revolving credit. Where enacted, the Uniform Consumer Credit Code (UCCC)² will be such a statute.

This article summarizes the treatment of revolving credit in the UCCC and comments briefly on the background and the workability of the solutions to problems that the Code would accomplish. Consideration is also given to the federal Consumer Credit Protection Act of 1968 (CCPA),³ which will apply in states where the UCCC has not been enacted or where it differs substantially from the form in which it was promulgated.

I

TERMINOLOGY

Various terms are used to refer to revolving credit. The CCPA uses the terms "open end credit plan"⁴ and "open end consumer credit plan."⁵ The UCCC uses the terms "revolving charge account" and "revolving loan account," terms having parallel definitions differing only in the terminology appropriate to the context of sales credit and lender credit, respectively. Thus, a revolving charge account is defined as an arrangement between a buyer and a seller whereby (1) the seller

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¹ See FEDERAL RESERVE SYSTEM, BANK CREDIT-CARD AND CHECK-CREDIT PLANS 47-48 (1968).

² On the text of the UCCC, see *Foreword*, in this symposium, p. 639 n.1.

³ 82 Stat. 146 [hereinafter cited as CCPA]. It is probable that the Board of Governors of the Federal Reserve System will approve the UCCC as meeting CCPA standards for state legislation sufficient to exempt credit transactions within the state from coverage of the CCPA. See CCPA § 123.

⁴ CCPA § 103(i).

⁵ CCPA § 127.

may permit the buyer to purchase on credit, (2) the unpaid balance and charges are debited to an account, (3) a credit service charge is computed on the basis of the outstanding balance from time to time, and (4) payment may be made in installments.⁶ The definition of "revolving loan account" is the same in substance but speaks of a "lender," a "debtor," "loans," and a "loan finance charge."⁷

The parallel definitions of "revolving charge account" and "revolving loan account" reflect the UCCC's deliberate separation of the treatment of sales credit and loan credit into two separate articles, articles 2 (sales) and 3 (loans). These two articles employ a different terminology and provide for some but not many substantive differences in the treatment of the two types of credit. The basic purpose of the decision to treat the two types of credit separately was to avoid encouraging the courts of a state which did not enact the UCCC to rely on the Code's provisions as a basis for rejecting the time-sale-price doctrine.⁸ This article will occasionally refer to the parallel sections of the Code incorporating substantially identical rules governing sales credit and loan credit.

The federal CCPA makes no express reference to credit cards. The UCCC uses the terms "lender credit card or similar arrangement" and "seller credit card," again reflecting the deliberate separation in the UCCC of the treatment of sales credit and loan credit. The definition of "lender credit card or similar arrangement" treats as a loan debt arising from the use of a lender credit card for the purchase of goods or services.⁹ A revolving loan account may thus include both debt arising from sales transactions and debt arising from check-credit or other cash loans.

In contrast, when the holder of a seller credit card uses it to make purchases of goods or services from a person other than the issuer of the card, the transaction is treated as a sale governed by the article on credit sales (article 2) and not as a loan governed by the article on loans (article 3), and the issuer of the credit card is treated as a seller and not as a lender. Examples of such a use include the familiar use of an oil company credit card for the purchase of gasoline products from an independent dealer in the oil company's products and the less familiar but growing use of the seller credit card issued by a department or chain store for the purchase of goods or services from another seller or merchant doing business in the same shopping plaza as the card's issuer.

II

WHAT LAW GOVERNS?

The Uniform Commercial Code provided a conflict of laws rule for transactions governed by it,¹⁰ allowing with certain exceptions the parties to a transaction to

⁶ UCCC § 2.108.

⁷ UCCC § 3.108.

⁸ UCCC, Prefatory Note.

⁹ UCCC § 1.301(9).

¹⁰ UNIFORM COMMERCIAL CODE § 1-105.

specify which affected state's law is to govern. A comparable rule was considered but rejected by the Special Committee which drafted the UCCC. Reasons for the rejection included the following:

1. Permitting the parties to a consumer credit transaction to select the governing law would allow the creditor to include in consumer credit agreements form clauses depriving the consumer debtor of the protections afforded him by the UCCC in the state of his residence.
2. Requiring the law of the state of the consumer debtor's residence to apply would place an undue burden upon the mass operations of creditors operating in more than one state: special computer programming would be required for transactions with consumer debtors depending upon the states of their residences.

Accordingly section 1.201 of the UCCC establishes rules of territorial application to avoid both these results.

Section 1.201(2) provides in substance that the Code applies to sales made pursuant to a revolving charge account—including sales pursuant to a seller credit card—if, in the enacting state, the seller either receives the buyer's application for the account or, absent such an application, mails or personally delivers to the buyer notification of the privilege of using the account. Similarly, section 1.201(3) provides that the Code applies to loans made pursuant to a lender credit card or similar arrangement if, in the enacting state, the lender either receives the debtor's application for the card or, absent such an application, mails or personally delivers to the debtor the card or notification of the privilege of using the card or arrangement.

Sections 1.201(4) and (5)(b) of the UCCC enable the enacting state to protect its consumer residents by providing that the part on limitations of creditors' remedies (part 1) of the article on remedies and penalties (article 5) applies to actions or other proceedings brought in the enacting state to enforce rights arising out of consumer credit sales or consumer loans, wherever made. Similarly, section 1.201(5)(b) protects residents of the enacting states against enforcement of agreement terms violative of the Code's "limitations on agreements and practices."

In addition, Code section 1.201(5)(a) limits a creditor's recovery of charges, through actions or proceedings in the enacting state against a consumer who was a resident when an out-of-state transaction was entered into, to the charges which would have been permitted had the transaction been entered into in the enacting state. This subsection protects a defaulting consumer debtor without serious adverse effects on the creditor. In the relatively rare instances when enforcement of a consumer debt through actions or proceedings is undertaken against a resident of a state other than that in which the creditor has a place of business or maintains its records, it will not be an arduous task for the creditor to reconstruct the debtor's account using the rate ceilings of the state of the debtor's residence.

In general section 1.201 offers a pragmatic and perhaps not ideal solution to a

difficult problem. It avoids the uncertainties which would result from leaving questions of application of the UCCC to hazy, general conflict of laws rules. It also avoids the difficulties referred to above which would result from adoption of a provision similar to that in the Uniform Commercial Code. Admittedly, like existing law, it provides no protection to the consumer holder of a credit card who pays his consumer credit bills without waiting to be sued, since no state enforcement powers are available against out-of-state creditors. However, this problem, if a problem it is, would disappear with the general enactment of the UCCC. Absent its general enactment, the Code's disclosures of the rate of credit service or loan finance charge in terms of an "annual percentage rate"¹¹ or "corresponding nominal annual percentage rate,"¹² and the similar requirements of the CCPA¹³ should encourage debtors to use credit facilities of creditors providing consumer credit at lower rates than some out-of-state seller or lender.

III

CEILING RATES

A. Sales Credit

UCCC section 2.207 prescribes ceiling rates of credit service charge¹⁴ for revolving charge accounts. Section 2.207(3) fixes these ceiling rates at two per cent per month on balances up to \$500 and one and one-half per cent per month on balances over \$500.

Section 2.207(2) permits these ceiling rates to be applied to either the average daily balance of the account or the unpaid balance of the account on the same day of the billing cycle; in either case the rate of charge may be applied to the median amount of balances within a range so limited that the charge resulting from applying the ceiling rate of charge to the median amount within the range does not exceed, by more than eight per cent of the charge on the median amount, the charge resulting from applying the ceiling rate of charge to the lowest amount within the range.

¹¹ UCCC §§ 2.304(2), 3.304(2).

¹² UCCC §§ 2.304(3), 3.304(3).

¹³ CCPA §§ 107, 126-29.

¹⁴ UCCC § 2.109 defines "credit service charge" to mean the sum of

"(1) all charges payable directly or indirectly by the buyer and imposed directly or indirectly by the seller as an incident to the extension of credit, including any of the following types of charges which are applicable: time price differential, service, carrying or other charge, however denominated, premium or other charge for any guarantee or insurance protecting the seller against the buyer's default or other credit loss; and (2) charges incurred for investigating the collateral or credit-worthiness of the buyer or for commissions or brokerage for obtaining the credit, irrespective of the person to whom the charges are paid or payable, unless the seller had no notice of the charges when the credit was granted. The term does not include charges as a result of default, additional charges (Section 2.202), delinquency charges (Section 2.203), or deferral charges (Section 2.204)."

B. Loan Credit

Section 3.201 prescribes the Code's generally applicable ceiling rate of loan finance charge.¹⁵ Section 3.201(1) fixes the generally applicable ceiling rate for consumer loans at eighteen per cent per year calculated according to the "actuarial method"¹⁶ on the unpaid balance of the principal.

However, section 3.201(4) permits a creditor to extend revolving loan credit at the usual one and one-half per cent per month rate without requiring him to make a daily balance computation, a computation for which computer facilities would be required. Subsection (4) does this by "deeming" as not exceeding eighteen per cent per year a loan finance charge of one and one-half per cent per month applied to an amount determined in the same manner that section 2.207(2), discussed above, permits for the application of the ceiling rates of credit service charge with respect to revolving charge accounts.

Moreover, section 3.508 permits loans, including a loan pursuant to a revolving loan account, to be made at a rate exceeding eighteen per cent per year by a "supervised lender," that is, either a supervised financial organization, as defined in section 1.301(17),¹⁷ or a person licensed to make such loans under the part on regulated and supervised loans (part 5) of the article on loans (article 3) of the UCCC. The maximum rate of loan finance charge which may be charged by such a supervised lender is the equivalent of the *greater* of (a) the total of (i) thirty-six per cent per year on that part of the unpaid principal which is not more than \$300, (ii) twenty-one per cent per year on that part of the unpaid principal which is more than \$300 but not more than \$1,000, and (iii) fifteen per cent per year on that part of the unpaid principal which is more than \$1,000, or (b) eighteen per cent per year on the total unpaid principal.

Under Code section 3.109(2), any discount charged to a seller by the issuer of a lender credit card is not part of the loan finance charge, but this provision may have to be superseded by the rules of the administrator to conform to the Federal Reserve Board Regulation Z, section 226.4(a)(8).^{17a}

¹⁵ The definition of "loan finance charge" in UCCC § 3.109 parallels that of "credit service charge" in UCCC § 2.109 set out in note 14 *supra*.

¹⁶ " 'Actuarial method' means the method, defined by rules adopted by the Administrator, of allocating payments made on a debt between principal or amount financed and loan finance charge or credit service charge pursuant to which a payment is applied first to the accumulated loan finance charge or credit service charge and the balance is applied to the unpaid principal or unpaid amount financed."

UCCC § 1.301(1).

¹⁷ " 'Supervised financial organization' means a person, other than an insurance company or other organization primarily engaged in an insurance business,

(a) organized, chartered, or holding an authorization certificate under the laws of this State or of the United States which authorize the person to make loans and to receive deposits, including a savings, share, certificate or deposit account, and

(b) subject to supervision by an official or agency of this State or of the United States."

UCCC § 1.301(17).

^{17a} 34 Fed. Reg. 2004 (1969).

IV

FORMAL REQUIREMENTS

Under the UCCC, formal requirements with respect to revolving credit accounts, whether revolving charge or revolving loan accounts, and with respect to credit cards, whether lender credit cards or seller credit cards, are minimal. No signature of the debtor to an application or agreement is required for the establishment of the account or for the issuance to him of a credit card. No provision is included to prohibit mass mailings of unsolicited credit cards, a policy decision consistent with the conclusion of the Federal Reserve System Task Group on Bank Credit-Card and Check-Credit Plans.¹⁸ Formal requirements are limited to disclosure and are discussed under that heading.

A. Disclosure

The UCCC requires advance and periodic disclosures with respect to revolving charge accounts and revolving loan accounts similar to those prescribed by section 127 of the federal CCPA for "open end consumer credit plans." The code's disclosure requirements are set forth in the parallel provisions of section 2.310, applying to revolving charge accounts, and section 3.309, applying to revolving loan accounts. These provisions apply to revolving charge accounts and revolving loan accounts entered into, arranged, or contracted for before the UCCC takes effect in an enacting state.¹⁹

The required advance disclosures are essentially a detailed statement of the amounts and methods of calculating charges, the periodic percentage rate or rates of credit service or loan finance charge, and the corresponding nominal annual percentage rate or rates.

The required periodic disclosures with respect to each billing cycle include a detailed statement of the outstanding balance at the beginning of the billing cycle, the debits and credits during the billing cycle, the amounts and methods of calculating charges, the periodic percentage rate or rates of credit service or loan finance charge, the corresponding nominal annual percentage rate or rates, and the date when or period within which payment must be made to avoid additional credit service or loan finance charges.

Section 105 of the CCPA contemplates that the disclosure requirements of section 127 of the act with respect to open end consumer credit plans will be supplemented by regulations of the Board of Governors of the Federal Reserve System. The UCCC requires the state Administrator to adopt disclosure rules not inconsistent with the CCPA, and the regulations issued thereunder.²⁰ At this writing

¹⁸ FEDERAL RESERVE SYSTEM, *supra* note 1, at 73-76.

¹⁹ UCCC § 9.101(4).

²⁰ UCCC §§ 6.104(2), 1.302. Final regulations under the CCPA have now been issued. 34 Fed. Reg. 2002 (1969).

the final regulations of the Board of Governors pursuant to the CCPA have not been issued. Consequently, no useful purpose would be served by a further discussion in this article of the disclosure requirements of either the CCPA or the UCCC.

In addition, UCCC sections 3.310 and 3.311, respectively, prescribe the required advance disclosures and content of periodic statements with respect to a consumer loan other than one made pursuant to a revolving loan account. Section 3.310 applies, however, only when the consumer loan is made pursuant to a lender credit card.

B. Security

The UCCC specifically contemplates that a seller may take a security interest in property sold and, subject to limitations, in goods on which services are performed or in or to which goods sold are installed or annexed, or in land which is maintained, repaired, or improved as a result of the sale of goods or services.²¹ It also permits a seller to secure debt arising from a sale by contracting for a security interest in other property in which the seller has an existing security interest as a result of a prior sale and, in addition, permits the seller to contract for, as security for a previous debt, a security interest in property sold.²²

These provisions apply to a consumer credit sale made pursuant to a revolving charge account. However, subsection (2) of section 2.409 provides that, for the purpose of determining the amount of debt secured by the various security interests, payments received by the seller upon a revolving charge account are deemed to have been applied first to the payment of credit service charges in the order of their entry to the account and then to the payment of debts in the order in which entries thereof are made to the account.²³

The article on loans (article 3) of the UCCC contemplates that a lender may take a security interest in property to secure a consumer loan, including one made pursuant to a revolving loan account or a lender credit card. It does this in section 3.309(1)(g) by requiring advance disclosure of the "conditions under which the lender may retain or acquire a security interest in property to secure the balances resulting from loans made pursuant to the revolving loan account, and a description of the interest or interests which may be retained or acquired" and in section 3.306 (2)(k) by requiring, with respect to a consumer loan not made pursuant to a revolving loan account, disclosure of a "description of any security interest held or to be retained or acquired by the lender in connection with the extension of credit, and a clear identification of the property to which the security interest relates." However,

²¹ UCCC § 2.407.

²² UCCC § 2.408.

²³ The practice of crediting payments to each purchase in proportion to the unpaid balance on each, with the result that no item is paid for in full until all are paid for in full, is eliminated by UCCC § 2.409(2). See also *Williams v. Walker-Thomas Furniture Co.*, 350 F.2d 445 (D.C. Cir. 1965), which indicates that a consumer sales contract containing such a pro rata payment clause may be unconscionable under UNIFORM COMMERCIAL CODE § 2-302.

section 3.510 prohibits a lender from contracting for a security interest in land with respect to a supervised loan, *i.e.*, a consumer loan in which the rate of loan finance charge exceeds eighteen per cent per year when the principal is \$1000 or less.

Unlike the code article on credit sales (article 2), the article on loans (article 3) makes no provision for release of security interests as debt is paid.

Whatever the provisions of the UCCC with respect to security for revolving charge accounts or revolving loan accounts, the author questions the feasibility of creditors' generally requiring such security. The Uniform Commercial Code requires, for a security agreement to be enforceable, that it be signed by the debtor.²⁴ In addition, it requires the filing of a financing statement to perfect such a security interest unless it is a purchase money security interest in consumer goods.²⁵ Moreover, the Commercial Code requires that a filed financing statement be signed by the debtor.²⁶ In general, state laws impose similar requirements for the creation and perfection of a security interest in or lien on land. These requirements are not readily adaptable to the kind of mass operation typical of revolving charge accounts or revolving loan accounts. Only when a relatively large purchase is involved will it be feasible for a seller or lender to require and obtain the buyer's signature to a security agreement and a financing statement.

V

CHANGE IN TERMS OF REVOLVING CHARGE AND REVOLVING LOAN ACCOUNTS

New developments in consumer credit practices may require changes in the terms of revolving charge accounts and revolving loan accounts. A national chain department store may have hundreds of thousands of customers with revolving charge accounts, and a bank may have hundreds of thousands of credit card customers with revolving loan accounts. An insurmountable problem would confront the store or bank if it were necessary to obtain from each customer his signed consent to a change in terms. Experience indicates that only a minority of customers take the trouble to return an express approval or disapproval of a change in terms proposed as a condition of the future use of revolving accounts. Nevertheless, creditors should not be able to take advantage of customers by a change which is unfair, unanticipated, or inadequately communicated.

The parallel provisions of the UCCC, sections 2.416 and 3.408, are intended to enable creditors to change the terms of revolving accounts in a manner which is feasible for creditors yet safeguards the interests of revolving account customers. Subsection (2) of both sections provides to the creditor a means of making a proposed change effective as to customer balances in a revolving account both before and

²⁴ UNIFORM COMMERCIAL CODE § 9-203(1)(b).

²⁵ UNIFORM COMMERCIAL CODE § 9-302.

²⁶ UNIFORM COMMERCIAL CODE § 9-402.

after notice to the customer of the change. To comply with these provisions the creditor must give the customer written notice at least six months before the change is to take effect and repeat the notice twice during the six-month period. If the customer disapproves the change he may avoid any liability predicated on it (a) with respect to future charges to his account, by refraining from making further purchases or loans under the account, and (b) with respect to the balance in the account at the time of the notice of change, by paying it in full within six months.

By further provisions the six-month notice requirement of subsection (2) of both sections is inapplicable in these circumstances:²⁷

- (a) if the customer, after notice to him of the change, agrees in writing to it;
- (b) if the customer elects to pay an amount designated on a billing statement as including a new charge for the change in terms, but only if the billing statement also states the amount payable if the new charge is excluded;
- (c) if the change involves no substantial cost to the customers;
- (d) if the buyer has previously consented in writing to the kind of change made, and notice of the change is given to the customer in two billing periods prior to the effective date of the change, and
- (e) if notice of the change is given to the customer in two billing cycles prior to the effective date of the change and the change applies only to purchases made or debt incurred after the effective date of the change.

VI

GENERAL PROVISIONS

Some general provisions of the UCCC also apply to revolving charge accounts and revolving loan accounts. An enumeration of some but not all of them follows.

The UCCC provides for selection by an enacting state between alternative provisions with respect to attorneys' fees. Thus, alternative version A of sections 2.413 and 3.404 would make unenforceable any agreed provision for the payment by the debtor of attorneys' fees with respect to a consumer sale, consumer lease, or consumer loan. Alternative version B of those sections would permit an agreed provision for the payment by the debtor after default of attorneys' fees up to fifteen per cent of the unpaid debt with respect to a consumer sale, consumer lease, or consumer loan but only if the attorney is not a salaried employee of the creditor. Suit is not required for the enforceability of such an agreed provision. If alternative A of section 3.404 is not selected by the enacting state, section 3.514 would make unenforceable an agreement for attorneys' fees with respect to a supervised loan—*i.e.*, one as to which the loan finance charge exceeds eighteen per cent per year—when the principal is \$1,000 or less.

The UCCC article on insurance (article 4) and the parallel provisions of sections

²⁷ UCCC §§ 2.416(3)(a)-(e), 3.408(3)(a)-(e).

2.202 and 3.202, applying generally to consumer credit sales and consumer loans, impose certain restrictions on insurance practices and charges.²⁸ These would protect the debtor against excess charges,²⁹ provide limits on the term and amount of insurance,³⁰ require disclosure of terms and charges,³¹ specify when refunds are required,³² and, when the creditor requires insurance, give the debtor his choice of insurer.³³

CONCLUSION

In the author's opinion, general enactment of the UCCC will materially facilitate extensions of credit under revolving charge accounts, revolving loan accounts, and credit cards.

Creditors will benefit from the following:

1. Resolution of any doubt whether extensions of credit under revolving charge accounts are subject to usury laws or escape from them under the time-sale-price doctrine.

2. Elimination of formal requirements burdensome to creditors yet of little or no value or meaning to their customers, such as those for:

- debtor's signatures to agreements for revolving charge and loan accounts;
- notice to buyer or to borrower legends in such large size type as to preclude or limit the use of forms adaptable to computer or other automated procedures;
- different treatment of and different ceiling rate structures for purchase credit and loan or cash advance credit; and
- forms of sales slips and cash advance memos which vary from state to state and preclude or hamper interstate use of credit cards and revolving charge accounts or revolving loan accounts.

Consumers, in turn, will benefit from:

1. Increased competition among credit grantors, encouraged by

- elimination of segmentation of credit grantors under existing laws arbitrarily limiting the kinds of consumer credit each type of credit grantor may extend;
- requirements for full advance disclosure of credit terms including the com-

²⁸ On credit insurance generally, see Davis et al., *The Regulation of Consumer Credit Insurance*, in this symposium, p. 718.

²⁹ UCCC §§ 4.104, 4.107.

³⁰ UCCC §§ 4.201, 4.202. For revolving accounts, the term need extend only until payment of the debt, UCCC § 4.201(2)(a), and the amount of insurance "may be reasonably commensurate with the amount of debt as it exists from time to time." UCCC § 4.202(2). This constitutes a limited exception to the general requirement that the amount of insurance not exceed the amount of the debt.

³¹ UCCC §§ 4.105, 2.202(2), 3.202(2).

³² UCCC § 4.108.

³³ UCCC § 4.109.

mon denominator of an annual percentage rate (which the CCPA will also require on and after July 1, 1969); and

—less restricted access by potential creditors to the consumer credit market.

2. Their improved ability, at least for the more knowledgeable consumers, to elect from alternative sources of consumer credit those which best fulfill their needs or provide them credit at least cost.

3. Increased use of revolving charge account and revolving loan account credit at (because of lower costs to the creditor) lower rates than the formerly more general, separate, one-shot credit extensions.

4. Greater protection resulting from improved administration of consumer credit laws and increased powers in the Administrator.