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CONSUMER PROTECTION IN CREDIT SALES—THE 1971 NORTH CAROLINA ACT

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Realistic and meaningful consumer protection in the goods and services market is an objective that cannot be achieved through legislation based upon a single concept or approach. The market is beset by at least two conceptually distinct, if factually interrelated, imperfections: the fraud and deception that is continually practiced by certain sellers and the superior knowledge and bargaining position of most sellers that results in systematic overreaching by some. These imperfections are, of course, compounded by low levels of consumer awareness and education.

The deception problem will be responsive to vigorous public enforcement of deceptive trade practices legislation.¹ The Federal Trade Commission and state officials have important functions in this sphere, and in recent years both have become more active on behalf of the consumer. But public enforcement alone is not enough; new private remedies should be created, and all private remedies should be enhanced to a degree sufficient to make their exercise a real threat and sanction to the violating seller.²

The bargaining imbalance can be corrected to some extent by expanding the concepts in long-standing legislation. The Federal Trade Commission Act and the North Carolina version thereof proscribe “unfair” practices.³ The term “unfair” can be applied to minimize the

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³Federal Trade Comm’n Act § 5, 15 U.S.C. § 45(a) (1970); N.C. GEN. STAT. § 75-1.1 (1970). The Supreme Court has recently affirmed the power of the Federal Trade Commission to “proscribe practices as unfair or deceptive in their effect upon consumers regardless of their nature
impact of overbearing, though not deceptive, sales tactics that contribute to the bargaining imbalance, or even to prohibit certain contract terms. However, more specific legislation is also required to provide more detailed and predictable results and to invalidate certain contract terms that are conclusively too unilaterally beneficial to the seller and unjustifiably burdensome or harsh on the consumer. The effect of the transaction, as well as the manner in which it is presented, should be regulated, and this could best be accomplished by specific legislation.

Specific legislation regulating consumer sale transactions has ancestry in the typical early retail installment sale act, which provided for little more than a contract form and a limitation on finance charge rates. It became apparent that such a limited approach was not an adequate legislative response to the problem. Subsequent evolution and amendment have resulted in a pattern of additional substantive proscription. However, unlike the unfair and deceptive trade practices legislation, this additional consumer protection legislation generally covers only credit transactions. The ancestry of retail installment sale acts is probably largely responsible for this restriction, but it is also probably true that most of the objectionable consequences that are not reached by the unfair and deceptive trade practices acts occur in the context of a credit sale. Also, the restriction might be rationalized on the basis that the cash buyer either does not stand to lose as much as the credit buyer.


4Acting under § 5(a), the Federal Trade Commission has proposed rules that would give buyers in door-to-door sales a three-day "cooling-off" period, and numerous orders to this effect have been issued in recent years. See note 59 infra. Also proposed are rules that would prohibit the taking of negotiable instruments or waiver-of-defense clauses in consumer transactions. See note 126 infra. Finally, the FTC has issued an order that prohibits the sale of more than $1,500 worth of dance lessons to a single customer. The limit was deemed necessary in order to "eradicate the root of the evil," the evil being the use of relentless high-pressure tactics that were found to be unfair. Arthur Murray Studio of Washington, Inc., 3 TRADE REG. REP. (1971 Trade Cas.) ¶ 19,529 (FTC 1971).

The rule-making authority of the FTC is, of course, unclear. A recent case has rendered invalid an industry-wide rule that required the posting of octane ratings by gasoline stations. National Petroleum Refiners Ass'n v. FTC, 340 F. Supp. 1343 (D.D.C. 1972). This does not, however, affect the substantive reach of the "unfair" provision.

or is better able to fend for himself in the world of commerce.

In 1969 the North Carolina General Assembly enacted comprehensive unfair and deceptive trade practices legislation to enhance consumer protection. In 1971 the General Assembly enacted North Carolina's first statute to offer substantial additional specific protection in the area of consumer credit sales. That 1971 legislation is the principal subject of this article. Following a brief discussion of the scope of the legislation, its impact on the agreement stage and performance stage of the transaction will be explored and compared with similar legislation of other states.

THE SCOPE OF THE LEGISLATION

The substantive rules and prohibitions of consumer protection legislation have no applicability to non-consumer business and commercial transactions. Consequently, the consumer legislation must be carefully delimited—a process that requires extensive elaboration. Six sections of the North Carolina legislation (hereinafter sometimes referred to as the "Act") are required to set out the basic rules governing scope. With one exception, the Act applies only to "consumer credit sales," which are sales (1) of goods or services, (2) by a seller who regularly extends or arranges for an extension of credit, (3) to a buyer who is a natural person, (4) in which the goods or services are purchased primarily for personal, family, household, or agricultural purposes, (5) which involve credit (that is, sales in which the purchase price is payable in installments or in which a finance charge is imposed), and (6) in which the amount financed is not more than twenty-five thousand dollars.

"Goods" is defined broadly to include items that are to be affixed to real property. "Services" include not only personal services but also privileges that are in the listed categories. The combined goods

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6 Id. §§ 25A-1 to -6 (Supp. 1971).
7 Id. § 25A-37 (Supp. 1971) (refused sales).
8 Id. § 25A-2(a) (Supp. 1971).
9 Id. § 25A-4(a) (Supp. 1971).
11 Id. § 25A-5(a)(2) (Supp. 1971). Insurance and public utility services are excluded.
12 "[T]ransportation, hotel and restaurant accommodations, education, entertainment, recreation, physical culture, hospital accommodations, funerals and other similar services." Id. § 25A-5(b) (Supp. 1971).
and services definitions insure that home improvement transactions are included. Likewise, contracts for construction on real property that is not to be conveyed as a part of the transaction would be included.\textsuperscript{14} On the other hand, a contract for the sale of real property is not included.

An inevitable question under statutes that do not cover all types of property is how to deal with transactions that involve included property as well as excluded property. That question is most likely to arise under the Act with respect to a contract at a single price for the sale of a lot and for construction of a house thereon. Viewed at the time of execution, the contract involves real property, services, and goods. The Act does not contain an answer to such a question. Moreover, in analogous contexts the courts have given different answers. One court has held that the transaction should be divided and then subjected in part to the statute and in part to other law.\textsuperscript{15} However, under the Act that approach would require a retrospective separation and valuation of elements that are no longer functionally divisible and would result in an obligation, probably evidenced by a single note, that would, for example, be partly enforceable without regard to the buyer's defenses and partly subject to those defenses;\textsuperscript{16} partly subject to restrictions on collateral,\textsuperscript{17} partly not. Most courts have held that the predominant feature or "main object" of the transaction is controlling.\textsuperscript{18} This approach has the virtue of unitary treatment of a single transaction, but in this context it could cause distinctions between transactions that would be difficult to justify otherwise than on grounds of expediency.\textsuperscript{19}

An alternative approach would be to assess whether the transaction

\textsuperscript{14}This conclusion appears inevitable in view of the definition of goods, which includes goods that are "used . . . in . . . construction on real property," \textit{id.} § 25A-4 (Supp. 1971), and the definition of services, which includes "work, labor," \textit{id.} § 25A-5(a)(1) (Supp. 1971).

\textsuperscript{15}Foster v. Colorado Radio Corp., 381 F.2d 222 (10th Cir. 1967). In \textit{Foster} the contract involved the sale at a single price of a radio station, including the goods used in the operation of the station. The defendant repudiated the contract and the plaintiff sold the station to another person. However, the plaintiff did not give notice of the resale to the defendant as required by § 2-706(3) of the Uniform Commercial Code. The court held that the part of the contract involving "goods" was governed by the UCC, while the remainder was governed by other law.


\textsuperscript{17}See \textit{id.} § 25A-23 (Supp. 1971).


\textsuperscript{19}For example, a contract entered into when a building was 40% complete might be covered, whereas if the building were 50% complete it might not be. Substantial rights must ultimately depend upon some distinction, but this one seems unnecessarily mechanical.
is one in which the buyer needs the protections afforded by the Act. If it is, the court justifiably could apply the Act to the entire transaction whenever there are substantial goods and services to be rendered, even though at the time of the contract construction had progressed to the point at which "real property" predominated.

At the other extreme, the courts might exclude any construction contract that included the sale of substantial and related real property. But the seller-builder of real estate who sells on the installment plan cannot be assured of an exemption at this time. It must be noted, however, that most housing purchases are financed on a direct loan basis, and such transactions are clearly not within the Act.

The requirement that the seller be engaged in arranging or in extending credit in the regular course of business is a recognition of that feature of the Consumer Credit Protection Act. The requirement serves to exclude incidental sales made by persons who are not in the business of selling goods or services.

The "primarily for personal, family, or household" statement is the now universal test for "consumer" purpose, and it has given rise to so few questions under the Uniform Commercial Code that it must be largely self-explanatory. "Agricultural" is not defined in the Act. However, Regulation Z of the Federal Reserve Board contains an extensive definition that is a useful point of reference.

"Finance charge" is defined as "the sum of all charges payable directly or indirectly by the buyer and imposed by the seller as an incident to the extension of credit." Time-price differential, carrying charge, and other euphemisms for interest are mentioned illustratively. "Loan fee" and "finder's fee" are also mentioned, but the general requirement that the charge be imposed by the seller would seem to exclude a broker's fee that is imposed by and paid to an independent third person. Permissible insurance charges, closing costs in real-property transactions, and official fees paid to record or file security interests are not a part of the finance charge.

"Payable in installments" means payable, pursuant to agreement,
in more than four installments, excluding a down payment. The inclusion in the Act of this type of credit, which has no visible finance charge, is justified for at least two reasons. First, a seller whose performance obligation is not deferred and who defers payment of the price is incurring a credit expense. It is inconceivable that this expense is not being passed on to the buyer in the form of an increased price. Secondly, there is potential for overreaching by sellers whether or not a credit expense is involved. That potential increases in proportion to the size of the transaction. When the price in a transaction reaches such a level that in relation to the individual buyer’s situation it must be spread over the future, the transaction is certainly so significant to that buyer that the protections of the Act should be available to him. One might ask why the less-than-four-installment credit was excluded. The only possible answer is that in the judgment of the General Assembly, the short-term, no-finance-charge credit did not pose sufficient potential for abuse or injury as to justify regulation at this time. There is no magic in four installments, but the test did have the virtue of conforming to Regulation Z at the time the Act was adopted.

However, it is probable that the coverage of more-than-four-installment credit has been sidetracked by an indirect source. The Act “does not apply to any party or transaction that is not also subject to the provisions of the Consumer Credit Protection Act . . . .” At the time the North Carolina Act was adopted, Regulation Z, promulgated under the Consumer Credit Protection Act, provided for coverage of more-than-four-installment credit. That regulation had been challenged but upheld by at least two federal district courts. Therefore,

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27 Id. § 25A-3 (Supp. 1971).

28 The seller is precluded from “burying” an excessive finance charge in a price increase that is applicable only to credit purchasers. “Cash price” is the basic element of “amount financed,” from which the finance charge is computed. Id. § 25A-9(1) (Supp. 1971). “Cash price” is limited to the price “at which goods and services are offered for sale by the seller to cash buyers.” Id. § 25A-7 (Supp. 1971).

However, some sellers make few if any cash sales from which a normal cash price could be determined. Such sellers can in effect bury the finance charge in a uniform high sale price. As a group those sellers are probably the worst exploiters of the low-income consumer. See D. Caplovitz, THE POOR PAY MORE 16-20 (1967). It would be ironic to enact a consumer protection statute that excluded those sellers. However, that is what may have inadvertently happened. See text accompanying note 34 infra.


30 12 C.F.R. § 226.1, 2(k) (1971) [hereinafter cited as Regulation Z].

the general statement in the Act, which was added to the bill late, appeared at the time not to be inconsistent with the other provisions of the Act.

However, in *Mourning v. Family Publications Service, Inc.*, the Court of Appeals for the Fifth Circuit held that the four-installment rule in Regulation Z was invalid because it was beyond the rule-making authority granted to the Federal Reserve Board by Congress and because it was an unconstitutional conclusive presumption that a finance charge was present in more-than-four-installment credit since the federal statute covers only transactions in which a finance charge is imposed.

Neither of the grounds for invalidity of the federal regulation has any application to the North Carolina Act. The General Assembly has expressed clearly an intent to regulate such credit, and the regulation does not proceed from a presumption that a finance charge is present; rather, it proceeds directly from a proposition that such credit should be regulated. Moreover, the North Carolina Act and the federal law do not have the same objectives. The North Carolina Act is directed primarily at regulating conduct in the market place through direct substantive rules. As previously has been pointed out, the regulation of four-installment credit is absolutely consistent with the purposes of the North Carolina Act. But in the context of the federal statute, with its emphasis on finance-charge disclosure, the four-installment rule is more questionable, and it is quite possible that the *Mourning* case will stand and will be followed elsewhere.

Thus, the general expression of limitation in section one of the North Carolina Act will have to be recognized. It might be argued that the Act refers to the federal law and regulations as they existed at the time of the enactment of the North Carolina Act. But the General Assembly was undoubtedly intending to incorporate valid federal law and regulations, and since the regulation is unconstitutional, it would in any event normally be considered void *ab initio*. The Act will not cover more-than-four-installment, no-finance-charge credit unless

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*32* 449 F.2d 235 (5th Cir. 1971), cert. granted, 92 S. Ct. 1248 (1972).

*33* The statute refers only to transactions in which a finance charge is imposed and does not mention four installments. CCPA §§ 103(f), 121(a), 15 U.S.C. §§ 1602(f), 1631(a) (1970).

*34* E.g., Stewart v. Davidson, 218 Ga. 760, 130 S.E.2d 822 (1963); Miller v. O'Malley, 342 Mo. 641, 117 S.W.2d 319 (1938); O'Brien v. Rutherford County, 199 Tenn. 642, 228 S.W.2d 708 (1956). That is not an invariable proposition, but certainly it would be applied in defense of a four-installment seller who claimed the Act did not apply to his past activities.
is reversed or the General Assembly amends section one of the Act.

THE CREDIT CARD EXCLUSION

A most significant general exclusion from the Act is a "sale in which the seller allows the buyer to purchase goods or services pursuant to a credit card issued by someone other than a seller. . . ." Thus, sales effected through an independent credit card, such as the now common card issued by bank-related companies, are not affected by the Act. This unquestionably constitutes a potentially large escape valve from the Act. A seller who is dissatisfied because of restrictions imposed on the traditional retail installment sale contract can try to shift substantial numbers of his buyers to the bank credit card. The extent to which this will occur is dependent upon a number of variables, such as the size of the transaction, the difference in net cost to the seller between the discount on credit card receivables and installment sale receivables, and the relative affluence of the seller's customers.

However, whether or not credit card buying patterns change in apparent response to this exclusion, the exclusion should be re-examined by the next General Assembly. The probable reason for the exclusion was uncertainty over whether the provisions in the Act that preserve the buyer's defenses should apply to the bank credit card. The bank credit card transaction might be analogized to a direct loan or to a letter of credit transaction, in which it has not been supposed that the buyer should be able to assert defenses in the underlying obligation against the party advancing the funds. Also, a high percentage of credit card transactions are cash or check substitutes from the point of view of the

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35 N.C. Gen. Stat. § 25A-2(c) (Supp. 1971). The exclusion is not available if the credit card issuer is (1) the seller, (2) a subsidiary or parent of the seller, (3) a "principal supplier" of the seller, or (4) related to the seller by common ownership (25% of the voting stock of the issuer and seller owned by a single shareholder). Excluded credit card transactions would be subject to id. § 24-11 (Supp. 1971).

36 The bank credit card issuers impose credit limits that typically range from $300 to $500. If the limits are enforced, they would constitute a barrier to substantial movement of the cards.

37 The discount rate for credit card transactions may not exceed 4%. N.C. Gen. Stat. § 24-11(a) (Supp. 1971). There is no comparable limit for installment paper discounts, and they are probably higher on the average than 4% per annum. However, it is impossible for a seller to compare the two without knowing what terms the buyer would have requested had he purchased under a retail installment sales contract.

38 Id. § 25A-25 (Supp. 1971).

buyer, and a buyer in a cash transaction is remitted to recourse only against the seller. However, given a limitation that would isolate and exclude the cash-substitute transactions and other reasonable limitations, the position of the bank in relation to the consumer in the remaining transactions is strikingly similar to the position of the bank as an assignee of the consumer's retail-installment-sale contract. In both situations the bank has superior expertise in selecting the merchants with whom it will deal, superior leverage in cases of dispute, and risk-spreading capability. In apparent recognition of these facts, at least one state has enacted legislation that subjects the credit card issuer to the defenses of the consumer in appropriate cases.

**Classification of Credit**

The Act divides "consumer credit sales" into two well-recognized categories: (1) revolving or open-end credit (hereinafter referred to as a "revolving charge account contract") and (2) other sale credit (hereinafter referred to as a "consumer credit installment sale"). This division is made primarily for the purpose of establishing different rate limitation structures for the two types of credit so that the rates will reflect patterns that have developed in the industry. Most other substantive provisions of the Act apply to both categories of credit, although a few provisions are specifically or inherently applicable to only one of the categories.

A "revolving charge account contract" is defined in essentially the same language that defines "open-end credit" under the Consumer Credit Protection Act. The key elements of such credit are an agreement for credit extension from time to time, the computation of a finance charge on the unpaid balance, and the debtor's privilege of paying in full or in installments. These elements describe the typical department store revolving charge account or seller-issued credit card

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40 Id. at 1059-61.
41 Cal. Civ. Code § 1747.90 (West Supp. 1972). Under this act the card issuer is subject to all defenses if (1) the purchase price is over $50, (2) the sale takes place in California, (3) the card holder makes reasonable demands for satisfaction against the retailer, and (4) the card holder gives appropriate notice to the issuer. The $50 limit excludes most cash substitute transactions; the geographical limit narrows the responsibility of the card issuer to those merchants that it has some real chance to know about and police. Both appear to be reasonable limitations.
43 Id. § 25A-11 (Supp. 1971).
44 Regulation Z § 226.2(R).
account. A "consumer credit installment sale contract" is defined simply as any other type of credit.45

THE SUBSTANCE OF THE LEGISLATION

Discussion of the substantive provisions of the Act is divided along functional lines. The transaction is viewed as moving from agreement through performance, and the provisions of the Act are discussed at the point in the development of the transaction at which each is most likely to become relevant.

The Agreement Stage

General Limitations and Requirements. All consumer credit installment sale contracts "shall be in writing, dated and signed by the buyer." This general statute of frauds extends to many transactions that were not formerly subject to a requirement of a writing. Formerly, the statute of frauds applicable to contracts for the sale of goods applied only to contracts in which the price was at least five hundred dollars;47 there was no statute of frauds for sales of services. However, security agreements were required to be in writing unless the secured party had possession of the collateral.48 The new provision neither makes any exceptions nor specifies a direct consequence of violation. However, it is probable that the courts will engraft exceptions to the extent that they have always done so with the statute of frauds and that an oral contract will be unenforceable unless it falls within such an exception.

Also, the Act contains several direct prohibitions on contract terms. Any agreement or authorization to "any person" to confess judgment for the buyer on a claim arising out of a consumer credit sale is void.49 This clearly precludes the use of the cognovit clause,50 whether

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46Id. § 25A-28 (Supp. 1971). Of course, this does not apply to revolving-charge-account contracts.
47Id. § 25-2-201 (1965).
48Id. § 25-9-203 (1965).
49Id. § 25A-18 (Supp. 1971).
50It is sometimes stated that the cognovit clause is unenforceable in North Carolina. E.g., P-H CONSUMER & COMMERCIAL CREDIT GUIDE ¶ 1405, at 1404. That may be true. However, the only direct statutory prohibition was contained in the Negotiable Instruments Law, ch. 733, [1899] N.C. Sess. L. 926-51, which was repealed on the effective date of the Uniform Commercial Code. The present N.C.R. CIV. P. Rule 68.1 provides a procedure for confession of judgment by a "prospective defendant." The procedure would be cumbersome for the seller if undertaken by the
or not the buyer is given notice and a hearing prior to entry of the judgment, but, of course, does not invalidate an entry of confession by the buyer in a pending action.

Similarly, the agreement may not contain a disclaimer of express warranty in any case in which the seller has made an express warranty. This provision should preclude the use of a boilerplate express warranty disclaimer clause in standard forms because there is always a possibility that the seller will make statements constituting express warranties during the course of individual negotiations. If this section is violated—that is, if the seller creates express warranties during negotiation and purports to disclaim them in the final writing—the written disclaimer should be disregarded with the result that the parol evidence rule would not apply to prevent introduction of the buyer's evidence of an oral warranty.

The Act restricts the property of the buyer that may be subjected to the security agreement. Basically, the seller may take a security interest only in the property that is being sold and in any property

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consumer himself. But the rule does not speak to the question of who might "represent" the consumer defendant—that is, the question whether a cognovit clause that gives the seller authority to select an "attorney" for the consumer would be valid. Therefore, it seems not inappropriate for this Act to make special provision against confession of judgment.

The cognovit clause that may operate to produce a judgment without notice and opportunity for hearing has been attacked on the ground that it constitutes a denial of due process of law under the fourteenth amendment and that there is no knowing waiver of the constitutional right by the consumer. The court in Swarb v. Lennox, 314 F. Supp. 1091 (E.D. Pa. 1969), aff'd on other grounds, 92 S. Ct. 767 (1972), held that there was not a knowing and effective waiver by persons who earn less than $10,000 per year. In Osmond v. Spruce, 327 F. Supp. 1349 (D. Del. 1971), vacated and remanded mem., 92 S. Ct. 1189 (1972), the court held that the plaintiffs were entitled to a hearing on the issue of voluntariness of the waiver prior to entry of the cognovit judgment. The Supreme Court recently refused a blanket condemnation of cognovit clauses in D.H. Overmyer Co. v. Frick Co., 92 S. Ct. 775 (1972). However, the consumer transaction received mention in the opinion: "[W]here the contract is one of adhesion, where there is great disparity in bargaining power, and whether the debtor receives nothing for the cognovit provision, other legal consequences may ensue." Id. at 783.


Id. § 25-2-202 (1965). Terms of a contract that violate an express statutory prohibition are surely not within the contemplation and protection of that section.

Id. § 25A-23 (Supp. 1971). This section applies to "consumer credit sales," a term that covers both revolving credit and other credit. Therefore, by implication it authorizes the revolving-credit seller to take a security interest within the limits of the section. Id. § 24-11 (Supp. 1971) prohibits the taking of security in a revolving-credit transaction. However, in the view of the author, § 24-11(a) has been amended as to revolving credit that is within the scope of the Act, but, of course, § 24-11(a) will continue to prohibit security in revolving-credit transactions that are not covered by this Act, such as bank credit cards.
previously sold in which the seller still has a security interest.\textsuperscript{55} Also, if
the seller sells goods that are affixed to other personal property, he may
take a security interest in the other property if the amount financed is
more than three hundred dollars; if he sells goods that are affixed to real
property, he may take a security interest in the real property if the
amount financed is more than one thousand dollars; and if he repairs a
motor vehicle, he may take a security interest in the vehicle if the
amount financed is more than one hundred dollars.

In regard to terms for repayment, the parties may not contract for
any installment payment that is more than ten percent larger than the
average of earlier scheduled payments, except where the "payment
schedule is adjusted to the seasonal or irregular income of the buyer."\textsuperscript{56}
Also, there are generous limitations upon the time during which pay-
ment may be scheduled.\textsuperscript{57}

Finance charge limits and other fee restrictions will be discussed in
a later section.

\textit{Cancellation Rights—Home Solicitation Sales.} A consumer can
be subjected to high-pressure sales tactics and induced under a variety
of circumstances to purchase something that he does not need at a price
that he cannot afford. But experience has shown that this happens with
exceptional frequency when the sales pitch is delivered at the consumer's
home. Several factors probably contribute to this heightened suscepti-
bility.\textsuperscript{58}

The consumer in the home who is subjected to high-pressure tactics
has relatively unpleasant alternatives: He can force the salesman out of
his home or he can leave the home himself. On the other hand, a
customer in a public retail establishment has the easy alternative of
walking away. Many home solicitation sellers have only one product to
sell and only one relationship with a single customer. Few restraints are
imposed by desire to build and maintain customer loyalty. Moreover,
there are fewer diversions in the home, and a skillful salesman has a
psychologically better setting in which to focus the customer's attention
than in the typical, often crowded retail establishment. Finally, the

\textsuperscript{55}Whether and to what extent a seller retains a security interest in previously sold items in
multiple-sale contexts is determined by the application of payment rules. \textit{Id.} § 25A-27 (Supp.
1971); see text accompanying notes 104-05 \textit{infra.}

\textsuperscript{56}\textit{Id.} § 25A-34 (Supp. 1971). The final payment may be 25\% larger than the previous averages.

\textsuperscript{57}\textit{Id.} § 25A-33 (Supp. 1971).

\textsuperscript{58}Most of these factors are covered in Project—The Direct Selling Industry: An Empirical
salesmen typically earn only commissions, with the result that there is greater pressure to produce sales than is present with respect to retail store employees generally.

In recent years many jurisdictions have recognized the peculiar attributes of the home solicitation sale and have enacted or enforced regulatory legislation and orders. The basic pattern of regulation proceeds from the assumption that once the salesman has gone from the house the pressures are removed and the consumer can make an objective judgment concerning the deal into which he has just entered. Therefore, adequate protection is afforded the consumer if he has the right to reflect upon the contract before becoming irrevocably committed to it. The consumer is given a "cooling-off period" during which he can rescind or cancel the obligation.

The North Carolina statute is similar to the Uniform Consumer

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Related, though dependent upon the presence of a lien on the buyer's principle residence rather than home solicitation, is the cancellation provision of the Consumer Credit Protection Act. CCPA § 125, 15 U.S.C. § 1635 (1971).

Three business days has become the virtual standard. However, the FTC has ordered a seven-day cooling-off period in relation to dance lessons. Arthur Murray Studio of Washington, Inc., 3 Trade Reg. Rep. (1971 Trade Cas.) ¶ 19,529 (FTC 1971).
Credit Code provisions, but the North Carolina version contains a few amendments that were apparently designed to make it more inconvenient for the consumer to exercise his right effectively, as well as a few that operate to the advantage of the buyer.

The statute applies only to "home solicitation sales" that are also "consumer credit sales." It does not cover any cash transactions, and, because of the implications of Mourning v. Family Publications Service, Inc., it probably will not cover credit sales in which no stated finance charge is imposed, such as certain long-term magazine subscription contracts or certain transactions in which the goods are substantially overpriced initially.

A "home solicitation sale" is a sale in which "the seller . . . engages in a personal solicitation of the sale at a residence of the buyer and the buyer's agreement . . . is there given . . . ." A sale solicited or consumated outside the buyer's home—for example, at a neighbor's residence—is not affected. However, the statute does not require that "all" solicitation must occur at the buyer's home, and a seller who enters the buyer's home without a firm agreement to purchase already obtained would be best advised to comply with the statute.

There are two types of specific exclusions: (1) those transactions in which pre-existing relations between the parties presumably indicate the existence of an atmosphere of trust that dispenses with the need for statutory protection, and (2) those transactions that are apparently the result of special interest influence. In the first category are sales to a buyer who has had similar previous dealings with the seller, sales made pursuant to a pre-existing charge account, and sales "made pursuant to negotiations between the parties on the premises of a business establishment at a fixed location where such goods or services are offered or exhibited for sale." In the latter category are exclusions of sales of personal wearing apparel, motor vehicles, farm equipment, and "goods and services utilized in connection with funeral services."

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1 Uniform Consumer Credit Code §§ 2.501-.505.
3 449 F.2d 235 (5th Cir. 1971), cert. granted, 92 S. Ct. 1248 (1972); see text accompanying note 32 supra.
4 However, the FTC has required magazine subscription sellers to grant a three-day cooling-off period. Time, Inc., 3 Trade Reg. Rep. (1971 Trade Cas.) ¶ 19,564 (FTC 1971).
6 Id. § 25A-38(1)-(3) (Supp. 1971).
7 Id. § 25A-38(5) (Supp. 1971). There is a question as to whether the "funeral services" exemption applies to prepaid funeral plans. Is there a requirement that there be a close proximity
The cancellation right may be waived by the buyer in emergency circumstances. This emergency exception first appeared in the Consumer Credit Protection Act. The federal statute applies to transactions that involve a security interest in the principal residence of the debtor, whether or not the transaction was solicited by the seller or signed at the buyer’s residence. In that context the emergency exclusion is essential; without it the debtor would not be able to obtain emergency repairs to his residence unless he paid cash.

However, in the context of the “home solicitation sale,” the need for the emergency exclusion is much less convincing. The statute requires “solicitation” at the buyer’s residence as a condition to coverage. It is difficult to see how an emergency provider of services who is called by the buyer would be deemed to have “solicited” at the buyer’s residence. On the other hand, it is difficult to envision a door-to-door salesman who calls upon the buyer having anything to sell for which the buyer would have an emergency need. Unless it is strictly limited, the emergency exclusion is an invitation for mischief by sellers of fire alarms, encyclopedias, pest control, and other similar goods and services.

To invoke the emergency exclusion the buyer must request the seller in a “separate writing to provide goods or services without delay because of an urgency or an emergency.” After signing the statement, the buyer may nevertheless cancel by giving notice prior to the time that the “seller in good faith makes a substantial beginning of performance,” provided that if goods have been delivered, they can be returned in “substantially as good condition as when received” if the buyer returns them at his expense.

Where the emergency exclusion is not invoked, the three-day period

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between the time of the death and the time of the contract? The use of the past tense “utilized” imparts a faint suggestion that there is, but more than a faint suggestion should be required to limit the statute. However, from the standpoint of the seller, uncertainty should be met with compliance. It is preferable to risk a few cancellations than to risk that all contracts might be subject to cancellation without time limit.

*aId. § 25A-39(e) (Supp. 1971).*

*bCCPA § 125(d), 15 U.S.C. § 1602 (1970); cf. Regulation Z § 226.9(e).*

*cPerhaps, in a time of natural disaster, sellers might make the first approach to the buyer and be deemed to have “solicited.” But if such circumstances provide the justification, the exclusion should be limited to them.*

*dN.C. GEN. STAT. § 25A-39(e) (Supp. 1971).*

*eId. § 25A-39(e)(1) (Supp. 1971) (emphasis added).*

*fId. § 25A-39(e)(2)-(3) (Supp. 1971). The requirement that the goods be returned at the buyer’s expense is a North Carolina addition.*
for cancellation begins to run when the buyer signs an agreement that contains the statutory form of notice to the buyer. If the seller's contract does not contain the required notice, the three-day period never runs and the buyer can cancel at any time.

Where the seller has provided the correct notice, the buyer may cancel by giving notice of intent by midnight of the third business day following the signing of the original agreement. The buyer's notice must substantially comply with the statutory statement. If the buyer mails a properly addressed, postage-prepaid notice, the cancellation is effective at the time of the deposit in the mail.

After cancellation, the seller must within ten days return any consideration given by the buyer and is obligated either to return any goods traded in in "substantially as good a condition as when received" or to pay the amount of the trade-in allowance stated in the contract. Thus, the seller has the risk of accidental loss of traded-in goods while they are in his control. That should tend to discourage the seller from prematurely taking the buyer's goods as an inducement to cause the buyer to feel more committed to the transaction.

A seller who complies with his obligation under the Act is permitted to retain a cancellation fee of one percent of the cash price, not exceeding the amount of the cash down payment.

The buyer's duties after cancellation are to tender upon demand by the seller any goods delivered by the seller. Most states require only that the buyer make the goods available at his residence. The North Carolina statute provides that the buyer's obligation of tender is limited to his residence only "if the seller does not have a place of business within 25 miles of the residence of the buyer." If the seller does have a place of business within twenty-five miles, he can presumably demand a return by the buyer of the goods to that place of business. This is unjustifiable. A buyer should not be hindered in the exercise of his cancellation rights in regard to heavy or cumbersome property simply because he has no

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71Id. § 25A-39(a) (Supp. 1971).
72Id. § 25A-40 (Supp. 1971).
73Id. § 25A-39(b)-(c) (Supp. 1971).
74Id. § 25A-41 (Supp. 1971).
75Id. § 25A-41(c) (Supp. 1971). The Uniform Consumer Credit Code provides for retention of a 5% cancellation fee. UNIFORM CONSUMER CREDIT CODE § 2.504.
77A literal reading of the provision would allow the seller to demand tender anywhere in the universe if he has a place of business within 25 miles of the buyer. This probably was not intended.
pick-up truck and strong friends. The seller was quite capable of delivering the property in the face of the known cancellation right. If that right is to be fully meaningful, the seller must also have the obligation to pick up the property at the place to which it was delivered.

The consequence of a buyer's being unable to make a proper tender is unclear. Arguably, the failure in that regard does not retroactively render the cancellation ineffective. At least the statute does not so provide. If the cancellation is still effective, the seller could not sue upon the contract; rather, his claim would be in the nature of a recovery against a bailee, and the buyer would be liable for the reasonable value as distinguished from the contract price.

If the seller fails to make a demand for tender within a reasonable time (presumed to be forty days), the goods become the "property of the buyer without obligation to pay for them."81

The buyer's general duty with respect to the seller's goods in his possession is to use reasonable care in their preservation.82 The buyer would not be liable for accidental loss of the goods, and the seller would have the risk of loss with respect to causes that were not preventable by reasonable care of the buyer.

The North Carolina statute also contains a provision that allows a buyer who has not received delivery of the goods or services within thirty days after the execution of the contract to cancel if the delay in delivery is the fault of the seller.83

Referral Sales. The Act renders "referral sales," whether or not they are "consumer credit sales," unlawful and void.84 The unqualified term "referral sale" could apply to any transaction in which the buyer receives a commission or rebate on the price for furnishing leads of prospective customers to the seller, including sales in which the Commission or rebate was conditioned upon one of the following events: (1) the buyer's furnishing names of friends who might be prospective customers to the seller; (2) the buyer's furnishing names and personally contacting each referee by telephone or letter; (3) the same as (1) or (2), except that the referee must not have been named or contacted by a previous buyer; (4) a previously unnamed referee's being contacted by the buyer or seller and agreeing to sit for a demonstration by the seller;85 or (5) the referee's

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82 Id. § 25A-42(b) (Supp. 1971).
84 Id. § 25A-37 (Supp. 1971).
85 The first four categories can be varied by the seller through the imposition of additional, often vague conditions such as that the referee must be "credit worthy."
A plan that involves one of the first two events, if honestly administered by the seller, has little potential for deceiving the buyer as to the amount of "earning potential." Most buyers would have the simple mathematical ability to evaluate the plan. However, such a plan does have an element of deception as to the price and quality of the goods or services. The acts that are required of the buyer are simple and will be performed by most persons, but at the same time they are of minimal benefit to the seller. Therefore, an item that has a price of three hundred dollars accompanied by a referral plan that enables the buyer to reduce the price to two hundred dollars with little effort and little benefit to the seller is an item that is worth about two hundred dollars. Furthermore, it would be unlikely that the seller ever receives more than two hundred dollars for it. The purported three hundred dollar price and the referral plan are just gimmicks to make it appear to the unsophisticated buyer that he is receiving a bargain because of his efforts.

Referral plans that involve the latter three types of conditions clearly have great potential for deceiving the average person as to earning capacity. In each type the individual buyer is placed at some level of a geometric progression. Unless he knows the level and appreciates the consequences of the geometric progression, he has no capability to evaluate the probabilities of earning any substantial amount under the plan. For example, assume that a plan requires the buyer to produce twenty referees to earn the maximum benefit under the plan. A buyer who is brought in at the third level is potentially competing with four hundred other buyers in his community who must find produce eight thousand new names if each third-level buyer is to receive the maximum return. The chance of the third-level buyer meeting the third type of condition is small, his chance of meeting the fourth is smaller, and his chance of meeting the fifth is virtually nil. The quantity of referees that is required to yield the maximum returns rises geometrically while the potential market remains essentially stable (and probably small). Therefore, in reality the earnings from the plan will not be sufficient to pay off the mortgage on the house to send the daughter to college or even to pay any significant part of the price of the purchased product.

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84 Some plans require 40 referees for maximum earnings; others are open-ended, but the principle remains the same.
85 That is, the buyer was referred by another buyer who in turn was referred by the first buyer.
CONSUMER PROTECTION IN CREDIT

Even if the salesman resists the temptation to boast about his plan's earning potential, the average buyer is incapable of evaluating the proposal on the basis of the information that is given him. Further, salesmen unquestionably compound the deception and emphasize the earning potential by methods ranging from inferences to gross falsehoods. These facts have caused increasing effort in recent years to regulate or curtail referral selling. In the absence of specific legislation, such plans have been attacked successfully on the ground that the chance elements are sufficient to constitute them lotteries. The Federal Trade Commission has issued complaints against pyramid distributorship plans, contending that they constitute deceptive trade practices and lotteries in violation of the public policy of the United States. One plan, which also involved numerous affirmative direct misrepresentations, was enjoined under a statute covering "persistent fraud." 

Finally, many states have enacted statutes that directly regulate referral sales. The statutes vary significantly in detail. Some apply only

\[^{93}\text{Obviously, the individual buyer's chances also depend upon the time at which he enters, in relation to other buyers at his level, since there are not going to be 8,000 qualified persons left in a community.}

\[^{94}\text{Commonwealth v. Allen, 404 S.W.2d 464 (Ky. 1966); Sherwood & Roberts-Yakima, Inc. v. Leach, 67 Wash. 2d 639, 409 P.2d 160 (1965). Contra, Yoder v. So-Soft, Inc., 202 N.E.2d 329 (Stark County, Ohio, C.P. 1963). The Yoder court held, however, that the referral selling plan was a "security"—a view that has not been followed elsewhere. See R. JENNINGS & H. MARSH, Securities Regulation 252 (2d ed. 1968).}


The 1971 General Assembly also enacted a statute that is directed specifically at "pyramid" or "chain" distribution plans. N.C. GEN. STAT. § 14-291.2 (Supp. 1971). That statute declares such plans to be lotteries subject to criminal penalties, provides for injunctive relief, a civil penalty in favor of the State, and provides that contracts for the sale of such plans are void.

\[^{96}\text{State v. ITM, 52 Misc. 2d 39, 275 N.Y.S.2d 303 (Sup. Ct. 1966).}

to plans under which the referee must purchase;95 most apply to sales in which the rebate is "contingent upon a future event."96 The range of regulation is great—a requirement that the terms of the referral sale is clearly set forth in the agreement,97 a requirement that the seller discloses his recent experience in paying rebates,98 or an absolute prohibition. The penalty range is from actual damages or a minimum penalty99 to a declaration that the sales are void or voidable.100

The precise position of the North Carolina Act in this structure is to some extent dependent upon subsequent construction. A not unreasonable construction would extend the Act to all five of the types of referral sales mentioned above. The Act condemns sales in which the "price . . . is contingent upon the procurement of prospective customers . . . ."101 There is not a requirement that the contingency relate to a "future" event, and even if "contingent" is deemed to connote future, there is no point of reference. The earning of the rebate in the first category is contingent upon or conditioned upon the furnishing of the list of names. This should be sufficient unless the "procurement of prospective customers"102 requirement is deemed to impart some additional future connotation or is restrictively construed to require more than the furnishing of names. Certainly, the latter four types listed involve "future events" and would be covered by the Act.


92E.g., the statutes of Alabama, Arizona, California, Colorado, Connecticut, Idaho, Indiana, Nebraska, Oklahoma, Oregon, Rhode Island, Utah, and Wyoming.
96This is by far the most common penalty and is incorporated in most of the statutes listed in note 94 supra. Some also include criminal penalties.
97N.C. Gen. Stat. § 25A-37 (Supp. 1971). The North Carolina statute is very similar in wording to the Iowa statute that was upheld in State ex rel. Turner v. Koscot Interplanetary, Inc., Iowa , 191 N.W.2d 624 (1971). The court there answered an imprecise contention by the defendant with an observation that the "contingency" embodies a "futuristic element," but the court also stated that "the contingency factor operated both in presenti and in futuro." Id. at ., 191 N.W.2d at 631.
Violation of the Act renders the sale void, with the necessary result that the seller is not entitled to recover any part of the purchase price. The Act also permits the buyer to recover any payments already made upon a tender to the seller of "tangible consumer goods" that are part of the transaction. This tender requirement has puzzling implications. The Act, of course, covers referral sales of non-consumer goods and services. Therefore, the tender requirement, in mentioning only consumer goods, can be read one of three ways: The buyer of non-consumer goods can recover without tendering the goods; the recovery is permitted only in consumer goods transactions, and there only upon tender of the goods; or the recovery is permitted in all consumer transactions but only upon a tender of any goods that are in possession of the buyer.

The first reading is probably the most consistent with standard construction principles since it gives full weight to the negative implication, but it is seemingly inconsistent with the basic purpose of the Act to give greater protection to the consumer. The second reading is more consistent with the probable purpose of the statute, but it gives the improbable result of not permitting recovery for services that the seller has rendered in violation of the statute and which the buyer cannot return. The third reading involves essentially the moving of the word "consumer" so that it modifies the second "buyer" in the last sentence—an extreme technique at best. But that reading seems most consistent with the general purposes. The intent of the General Assembly probably could be honored only by disregarding the word "consumer," with the result that any buyer would be required to tender back any goods in his possession as a condition to his own recovery.

The Performance Stage

In Absence of Default. If the contract is entered into in accordance with the previously discussed rules and neither party thereafter defaults on his obligation, the Act has minimal additional impact on the transaction. Basically, the seller must make a required application of payments in certain cases, provide periodic statements of account, and give a rebate on prepayment.

If the seller has previously sold an item to the buyer and retains a security interest in that first-purchased item to secure partially the pur-
chase price of the subsequently purchased item, or if the seller has consolidated two or more contracts into a single contract and payment schedule, the seller is required to make a specified application of the buyer's payments. The purpose of the application-of-payments rule is to insure that the buyer acquires the earlier-purchased items free of the security interest at some reasonable time after he has paid more than the cost of that item and before he has completely paid for both items. In other words, the rule is designed to prevent the seller from retaining a security interest in each item until all are paid for.

Basically, the rules are that the seller must apply previous payments to the previous item, the down payment to the subsequent item, and subsequent payments to both items on a pro rata basis that uses the original cash prices as the elements of the proportion. However, where the amount of the payments is increased as a result of the second sale, the seller may apply the amount of the increase to the subsequent item and the amount of the original payment on the cash price by the pro rata method. This latter provision causes a substantial creditor bias in the North Carolina statute when compared the rules in other states.

Once every twelve months and when he "repays the debt early," the buyer is entitled to receive without cost from the seller a statement of account that itemizes the various charges and remaining obligations. There is no time limit during which the seller must respond, so presumably the buyer must be patient. The buyer is also entitled to a statement of finance charges once a year, if it is requested "for income tax purposes."

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102Hence, repossessing in the event of default would not be permissible.
103States having the Uniform Consumer Credit Code provide for a type of "first in, first out" (FIFO) allocation. COLO. REV. STAT. ANN. § 73-2-509 (1 CCH CONSUMER CREDIT GUIDE (Colo.) ¶ 4280 (Sept. 16, 1971)); IDAHO CODE § 28-32-409 (Supp. 1971); IND. ANN. STAT. § 19-22-409 (Supp. 1971); OKLA. STAT. ANN. tit. 14A, § 2-409 (Supp. 1971); UTAH CODE ANN. § 70B-2-409 (3 CCH CONSUMER CREDIT GUIDE (Utah) ¶ 4280 (Sept. 18, 1969)); WYO. STAT. ANN. § 40-2-409 (Supp. 1971). Four other states have similar provisions. ALASKA STAT. § 45.10.100 (1971); CAL. CIV. CODE § 1808.2 (West Supp. 1971); HAWAII REV. STAT. § 476-29 (Supp. 1971); MASS. ANN. LAWS ch. 255D, § 18 (Supp. 1971). At least fifteen jurisdictions have rules that provide for pro rata cash price allocation payments. See, e.g., TEX. REV. CIV. STAT. ANN. art. 5069—6.02(14)(c) (1971); B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION 106-07 (1965).
104Those "cash price pro rata" states that have a provision for increased payments give the seller an option to apply the amount of the increase in payments to the subsequent sale and the amount of the original payments to the earlier sale. E.g., TEX. REV. CIV. STAT. ANN. art. 5069—602(14)(c) (1971). The North Carolina provision, of course, goes one step further and allows a division of the amount of the original payment. Thus, it defers for a longer period the release of the earlier purchased items.
The buyer has an absolute right to prepay the obligation in full at any time and receive a rebate of the unearned portion of the finance charge.\textsuperscript{10} The rebate is based upon the "rule of 78's," which gives results that are close to the product of an actuarial computation.\textsuperscript{11} The seller is entitled to retain an acquisition charge or prepayment penalty as provided.

\textit{Default by the Buyer.} In the not too distant past, sellers of consumer goods who retained security interests under properly drafted agreements had the comfort of knowing that upon feeling "insecure" they could accelerate the due date of the obligation\textsuperscript{11} and, if the buyer could not then pay it in full, declare a default, repossess the property without judicial process,\textsuperscript{12} sell the property at a public or private sale,\textsuperscript{13} and recover a deficiency judgment for any difference between the sale price and the unpaid obligation (including unearned finance charges). Today, in some jurisdictions it is questionable whether the seller can do any of the above.

The North Carolina Act restricts the seller to acceleration and repossession only in the event of a "breach by the buyer of any promise or condition clearly set forth in the agreement."\textsuperscript{14} The seller is thus limited to acceleration for those events that he had the foresight to include in the contract as defaults. From the standpoint of the buyer, this is far preferable to the vague "insecurity" standard, the exercise of which the buyer could attack only by proving that the seller was not subjectively honest in exercising it.\textsuperscript{15}

Repossession is under attack as well. The Supreme Court has held

\textsuperscript{10}Id. § 25A-32 (Supp. 1971). This is comparable to the right of prepayment under the usury laws. \textit{Id.} § 24-10(b) (Supp. 1971).

\textsuperscript{11}The prepayment right will have an as yet uncertain impact on the credit life insurance industry. There are indications that credit life insurance has paid to the creditor the full outstanding balance (including the unearned finance charge) upon the death of the debtor. If that continues, the debtor's estate should receive the amount of the "rebate" due. However, if the credit life companies take the position that their only obligation hereafter is the amount the debtor would have had to pay—that is, less rebate—the payouts by the insurance companies should be less, and premium reduction would seem to be in order.

\textsuperscript{12}See Kripke, Consumer Credit Regulation: A Creditor-Oriented Viewpoint, 68 COLUM. L. REV. 445 (1968).

\textsuperscript{13}N.C. GEN. STAT. § 25-1-208 (1965).

\textsuperscript{14}The seller had to be able to obtain possession without a breach of the peace. \textit{Id.} § 25-9-503 (1965).

\textsuperscript{15}Id. § 25-9-504 (1965).
that claim-and-delivery or replevin proceedings that take property without prior notice and opportunity for hearing are violative of the due process clause of the fourteenth amendment.\textsuperscript{116} A federal district court has held that private repossession pursuant to the Uniform Commercial Code is likewise impermissible, at least with respect to consumer goods.\textsuperscript{117} If private repossession is ultimately foreclosed, the seller will be required to obtain prior to repossession a judicial determination of default, which except in exceptional circumstances may be tantamount to a judgment against the buyer in the unpaid amount of the obligation.\textsuperscript{118}

To date a significant number of jurisdictions have adopted statutes that limit the seller's ability to obtain a deficiency judgment.\textsuperscript{119} Typically

\textsuperscript{116}Fuentes v. Shevin, 92 S. Ct. 1983 (1972). There are three possible factors affecting the constitutionality of such a procedure: (1) search and seizure by state officials without a prior showing of probable cause in violation of fourth amendment principles, (2) taking of property without notice and hearing in violation of fifth amendment principles, and (3) absence of effective waiver of the above rights by the debtor. See Blair v. Pitchess, 5 Cal. 3d 258, 486 P.2d 1242, 96 Cal. Rptr. 42 (1971). In Fuentes the Court dealt only with the latter two factors, noting that a fourth amendment objection probably would be obviated by prior opportunity for an adversary proceeding. The Court acknowledged that an effective waiver of the constitutional rights might be made in advance, but left substantially unspecified the circumstances in which the waiver would be effective. The Overmyer dictum, see note 51 supra, was repeated and inequality of bargaining power and lack of knowledge of the debtor of the alleged waiver clauses were emphasized. However, it is unclear whether the Overmyer factors are viewed in the disjunctive or conjunctive—that is, whether, for example, inequality in bargaining power alone might be a sufficient basis for invalidating a waiver provision. Development of that issue must await future litigation. In the meantime, creditors probably will rely less upon judicial repossession and more upon private repossession, at least until the utility of the former is settled. See note 117 infra. Debtors should not be gleeful about repossession effected by persons who do not operate under the restraints that are imposed by public office, minimal though such restraints may often be.


\textsuperscript{118}The Supreme Court in Fuentes v. Shevin, 92 S. Ct. 1983 (1972), indicated that a state could provide for a summary procedure to determine only the right-to-possession issue that would not involve a final judgment on the debt. But since undoubtedly most buyers are in fact in default and the debt is in fact owing, it would seem more expeditious, on the average, to combine all issues in a single proceeding that would result in judgment, usually by default on the debt.

\textsuperscript{119}The statutes typically provide that if the seller "reposesses or voluntarily accepts surrender" of the goods and the original cash price was below a specified amount, typically $1,000, the buyer is not liable for any deficiency. See Act 2052, § 9, [1971] Ala. Laws (1 CCH Consumer Credit Guide (Ala.) ¶ 6014 (Oct. 26, 1971)); Ariz. Rev. Stat. Ann. § 44-5501 (Supp. 1971) (not applicable to motor vehicles); Colo. Rev. Stat. Ann. § 73-5-103 (1 CCH Consumer Credit Guide
nally, the deficiency judgment is abolished in transactions below a specified dollar amount. The North Carolina bill originally contained a provision that would have abolished the deficiency judgment where the original price was less than one thousand dollars. However, this provision did not survive, and the Act does not contain any direct restraints on the deficiency judgment.

However, in the event that the seller obtains a judgment or repossesses the goods, he is required to credit the buyer's account with a rebate of the unearned finance charge as if prepayment had been made in full on the date of the judgment or fifteen days after repossession, whichever is applicable. Following the rebate the judgment would, of course, draw the legal rate of interest. If the repossession precedes a judgment, the same result should follow.

Default by the Seller. The consumer-buyer who receives performance that does not fulfill the promises that preceded it is all too common. The disappointment to this consumer has traditionally been compounded by the fact that he could be compelled to continue to pay for the defective performance while he located the seller, if the seller could be found, and obtained from the seller repair or restitution, if that could be coerced. This result was produced by one of two legal concepts—the negotiable instrument or the waiver-of-defense clause.

The banker, the businessman, and the consumer-buyer who signed negotiable instruments risked that the instrument would be transferred to a holder in due course, who would be entitled to enforce the instru-

(Colo.) ¶ 4310 (Sept. 16, 1971) (Uniform Consumer Credit Code, but monetary limit changed to $500); D.C. CODE ANN. § 28-3812 CCH CONSUMER CREDIT GUIDE (D.C.) ¶ 6166 (Dec. 21, 1971) (not applicable if cash price less than $2,000); IDAHO CODE § 28-35-103 (Supp. 1971) (Uniform Consumer Credit Code); IND. ANN. STAT. § 19-25-103 (Supp. 1971) (Uniform Consumer Credit Code); OKLA. STAT. tit. 14A, § 5-103 (Supp. 1971) (Uniform Consumer Credit Code); ORE. REV. STAT. § 83.830 (1971) (applies if unpaid balance at repossession is $700 or less); UTAH CODE ANN. § 70B-5-103 (3 CCH CONSUMER CREDIT GUIDE (Utah) ¶ 4310 (Sept. 18, 1969)) (Uniform Consumer Credit Code); WYO. STAT. ANN. § 40-5-103 (Supp. 1971) (Uniform Consumer Credit Code). Most of the statutes contemplate that where the seller is not entitled to a deficiency claim, he need not resell and return any surplus. However, the District of Columbia statute requires the seller to resell if 60% of the cash price has been paid and return any surplus.

122Id. § 24-5 (1965).
ment free of personal defenses, such as failure of consideration or fraud in the inducement.\textsuperscript{124} It mattered not that the banker or businessman normally received cash for the signing of a negotiable instrument whereas the consumer normally received promises that were at least in part executory, such as express or implied warranties of quality, or that this was known to the holder. It was thought that the well-being of the nation’s economy, or something equally significant, was dependent upon the maintenance of parity between bankers and consumers in regard to the consequences of execution of negotiable instruments.

If the seller chose not to extract a negotiable instrument in the transaction, results almost\textsuperscript{125} as satisfying to the ultimate assignees of the contract would be obtained by inserting into the contract a clause whereby the consumer “agreed” to “waive” as to an assignee his defenses against the seller. It was thought that if the consumer could not effectively signify unknowing assent to such boilerplate clauses his freedom to contract would be flawed.

Whatever might have been at stake in the application of these concepts to the consumer—and experience has shown that it was not the well-being of any economy—it is clear that the application resulted in a misallocation of risk and loss. The individual injured consumer was required to bear the cost of the inevitable, if few, fraudulent and contract-breaching sellers. On the other hand, the financial institutions have an expertise and sources of information that enable them to assess and guard against the risk from the undesirable seller with an effectiveness that is not even remotely possible for the individual consumer to achieve. Moreover, the negotiable instrument and waiver-of-defense clause were counterproductive to utilization of these superior resources; they tended to reward most those financial institutions which learned the least. Further, where the seller can be located, the financial institutions have an immensely greater leverage to compel a just settlement than does any consumer. Finally, losses that are not prevented or recouped through use of the expertise or leverage can be distributed throughout the credit economy by the financial institutions through increases in the costs of credit, or through insurance if that is needed. Such residual costs are properly a cost to be borne as a cost of continuing business,


\textsuperscript{125} The assignee holding a contract with a waiver-of-defense clause was generally subject to the defense of fraud in the inducement. Navin, supra note 124, at 526-27.
rather than a cost to be thrust upon the individual who is fortuitously touched by the undesirable seller.

It is thus no accident that a large number of jurisdictions have changed the underlying doctrine applicable to consumer transactions so as to permit the assertion by the consumer of his defenses against assignees and holders of his contracts. The statutes fall into two basic types: those that allow assertion of all defenses without time limit\textsuperscript{126} and those that allow assertion of defenses only if notice is given by the buyer to the assignee within a specified period of time.\textsuperscript{127} To accomplish its pur-
pose the statute must, of course, make provision for the negotiable instrument and the waiver-of-defense clause. Probably the most common techniques are either to prohibit the taking of a negotiable instrument in a consumer transaction or to render consumer notes non-negotiable and to provide for the desired degree of protection and loss-shifting through specification of the effectiveness of the waiver-of-defense clause.

In regard to negotiable instruments, it should be noted that the removal of them from the consumer world does more than subject the assignee to defenses; it denies him the ability to cut off claims of ownership, and it grants to the consumer additional assurance that the installment payments that are made by him will discharge his obligation in the transaction.

However, the North Carolina Act does not prohibit the taking of negotiable instruments in consumer transactions; rather, it provides that the "buyer may assert against the seller . . . or other holder of the instrument or instruments of indebtedness any defenses available against the original seller." Thus, the seller could take a negotiable instrument, and a holder could be a holder in due course of such instrument, but the holder would be subject to defenses in accordance with the provisions of the Act. However, notes that are executed in consumer transactions must be identified as to origin so that subsequent holders will be apprised that they are buying paper that is subject to defenses.

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128This is a right that a holder in due course of a negotiable instrument would have. N.C. Gen. Stat. § 25-3-305(1) (1965). The ability to cut off claims of ownership is of no concern to the consumer, however.

129A negotiable instrument can be discharged basically only by payment to a holder. See id. § 25-3-603 (1965). Thus, a consumer who makes installment payments without requiring production of the note is taking some risk that the payee is no longer a holder and hence that the payment would not pro tanto discharge the obligation on the instrument. It is only a slight risk because of the possibility of the court's invoking agency law to protect the payor, but it is a risk nevertheless. See Equitable Life Assurance Soc'y v. Lazarus, 207 N.C. 63, 175 S.E. 705 (1934). On the other hand, if the transferee is a mere assignee, payment made prior to notice of subsequent assignment and demand by the subsequent assignee for payment will discharge the obligation. N.C. Gen. Stat. § 25-9-318(3) (1965). Therefore, since commercial financing institutions probably do not buy paper without knowledge of its origin and hence the claim of ownership freedom is of nominal significance, on balance it is preferable to remove completely the negotiable instrument.


131Id. § 25A-24 (Supp. 1971).
The rules of the Act regarding the assertion of defenses are different for each class of property involved. These rules may be summarized as follows:

(1) If the debt is secured by a "security interest" in real property, the buyer may assert against the assignee or holder all defenses available as against the original seller.\(^{132}\)

(2) If the sale is of "personal property," the buyer is deemed to have waived all defenses against a good faith assignee who takes for value unless the buyer notifies the assignee of the defense within thirty days after delivery of the property and receipt by the buyer of "separate written notice of the waiver and the assignment . . . ."\(^{133}\) However, the defenses of fraud in the inducement and failure of consideration are never lost to the buyer.

(3) In all other cases the buyer may assert against the assignee or holder all defenses available against the original seller.\(^{134}\)

In the first and third rules, North Carolina is equal to the most advanced jurisdiction in regard to consumer protection. In the second rule, North Carolina is somewhat below the median level of protection offered among those jurisdictions that have adopted statutes on the subject.

The rules raise several unresolved questions. As to the first rule, does the term "security interest" include mechanic's and materialman's liens that arise by operation of law, or is the term to be limited to consensual liens such as mortgages or deeds of trust? Related usage of the term "security interest" clearly encompasses interests that arise by operation of law. The Uniform Commercial Code defines "security interest" broadly—"an interest . . . which secures payment or performance of an obligation."\(^{135}\) The term "security interest" in the Consumer Credit Protection Act is defined by the Federal Reserve Board to include mechanic's liens.\(^{136}\) A mechanic's lienor is a "secured

\(^{132}\) Id. § 25A-25 (Supp. 1971).

\(^{133}\) Id.

\(^{134}\) Id.

\(^{135}\) Id. § 25A-25 (Supp. 1971).

\(^{136}\) Id. § 25-1-201(37) (1965). Of course, Article 9 of the UCC basically applies only to "consensual" or contract-created interests. Id. § 25-9-102(a) (1965).

\(^{137}\) Regulation Z § 226.2(z), 12 C.F.R. § 226.2(z) (1971). However, the court in N.C. Freed Co. v. Board of Governors of the Fed. Reserve System, 4 CCH CONSUMER CREDIT GUIDE ¶ 99,356 (W.D.N.Y. 1971), held that Congress did not intend that mechanic's liens be within the concept of "security interest" in the statute CCPA § 125, 15 U.S.C. § 1635 (1970). The court relied upon two parts of that section of the statute. The first part, in subsection (a), refers to a security interest that is retained or acquired. The court found that this subsection imparts a present as distinguished
creditor" under the Bankruptcy Act. Furthermore, in the context of the North Carolina Act, the evidence before the General Assembly suggested substantial abuses in certain segments of the "home improvement" industry. Persons were threatened with the loss of their homes because of contracts for improvements that were not performed correctly or contracts that were fraudulently obtained. That evidence undoubtedly contributed substantially to the formulation of this special rule regarding real property. The potential for loss to the consumer is essentially the same whether a holder is enforcing a mechanic's lien or a mortgage. Thus, a seller who would acquire a mechanic's lien would have to waive that lien to insure that the transaction would not come within the first rule.

A second question is whether the seller of an item that is to be affixed to real property, such as a furnace for the buyer's home, who retains a security interest in that item has a security interest in "real property" with the result that the first rule applies. Or, is the seller selling "personal property" so that the second rule applies? If it can be assumed that the furnace becomes a fixture, the first part of the question probably must be answered in the affirmative. Generally, a fixture interest is considered "real property" in North Carolina. However, in this context, some earlier North Carolina cases hold that the property sold subject to a security interest does not become a fixture as between the parties. If those cases are held applicable here, the furnace seller would be deemed not to have a security interest in real property, and the goods sold would continue to be treated as personal property as between him and the buyer. Thus, such a seller would probably get the benefit of the second rule.

from future connotation. The second part, in subsection (b), refers to security interests that are "given by the debtor." The court concluded that since mechanics' liens arise if at all in the future and by operation of law rather than being given by the debtor, they are not within the section.

The first point seems an exceptionally narrow reading of the statute. But the North Carolina Act provides "is secured," and therefore the first point of the Freed court has some relevance to the North Carolina Act. However, the North Carolina Act has nothing comparable to the second problem raised in Freed.

138This assumes, of course, that an assignee can enforce a mechanic's lien. There seems to be no inherent reason why he could not.
The Act does not specify the relationship between the second rule and the third rule, with the result that there is a question as to which rule applies to transactions that involve both personal property and services. It does not appear any more feasible here to divide a transaction than it is with respect to questions of coverage of the Act. Therefore, in this context the predominant or main part of a transaction should control the entire transaction. It is not likely that the General Assembly intended that a sale of a refrigerator should be excluded from the second rule because the contract also involves a service contract or that a seller of services should be subject to the second rule because he transfers title to minor amounts of personal property in conjunction with the rendering of the services.

The second rule creates a statutory waiver of those defenses of which the assignee does not receive notice within thirty days after both of the prerequisites are met. The rule is too restrictive. First, the thirty-day period is too short; the average buyer will have difficulty in ascertaining his rights and acting upon them within such a period. Secondly, the buyer is not entitled to assert defenses that do not come to his attention, such as concealed defects, until after thirty days. Of course, the second rule provides that the buyer never loses and never will be deemed to have waived the defenses of fraud in the inducement and failure of consideration.

Fraud in the inducement is a personal defense that cannot be asserted against a holder in due course of a negotiable instrument. However, some courts have allowed fraud in the inducement to be asserted against a waiver-of-defense clause. Whether the North Carolina court would have so held is unclear. Nevertheless, the Act does change prior law in regard to negotiable instruments. The Act does not mention fraud in the execution, from which fact it might be implied that it is one of the defenses that is lost to the buyer under the general waiver provision. However, that should not be the result. The basic purpose of the section is to give added protection to the consumer and to restrict further the rights of assignees and holders. The negative implication should not be taken to give a reversal of that purpose and change prior

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141 See text accompanying notes 15 & 16 supra.
142 N.C. Gen. Stat. § 25A-25(b) (Supp. 1971). This should be contrasted with Uniform Consumer Credit Code § 2.404, Alternative B, which allows the buyer to assert defenses that arise after the ninety-day period.
143 See note 124 supra.
144 See note 125 supra.
as well so that the consumer loses the right to assert his defenses against the worst type of fraud.

The exemption of the defense of failure of consideration gives rise to the most significant question under the section. The unqualified term can apply to a wide range of circumstances that involve a defective performance of a contract. The North Carolina Supreme Court recently has referred to failure of consideration as "a defense to an action brought upon a contract against the party who has not received the performance for which he bargained." Similarly, Williston's treatise states that "[f]ailure of consideration . . . will exist wherever one who has promised to give some performance fails without his fault to receive in some material respect the agreed exchange for that performance." A breach of an express or implied warranty may constitute failure of consideration. Therefore, if failure of consideration is given its normal, broad meaning, the buyer would not lose the ability to assert by way of a claim of failure of consideration defenses that arise because of breach of warranty or other defect in performance by the seller. The problem with such a broad construction is that it goes too far. With defective performance encompassed in the proviso, there is virtually no function left for the thirty-day rule. Such a result would not accord with the usual principles of construction.

It might, on the other hand, be argued that the General Assembly intended "total" failure of consideration. But, if "total" was intended, it might easily have been added. Furthermore, in the context of a sale of personal property, a "total" failure of consideration is failure to

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148 In Swift & Co. v. Aydlett, 192 N.C. 330, 337, 135 S.E. 141, 145 (1926), the court stated: "Evidence of a breach of warranty . . . is competent, not only in an action to recover damages for such breach, or upon counterclaim for such damages as a defense to recovery of judgment for the purchase price, but also to prove failure of consideration when such failure is pleaded in defense of a recovery of the purchase price of the goods sold . . . ." (Emphasis added.) In C.I.T. Corp. v. Hetland, 143 N.W.2d 94 (N.D. 1966), the contract was for sale of an airplane. The airplane was defective and the FAA refused to issue an airworthiness certificate. The court states: "If such certificate could not be obtained because of the condition of the plane, there was clearly a breach of . . . warranty . . . . Failure of consideration in any material respect is ground for the rescission of a contract as against the seller." Id. at 98. "[T]he term 'failure of consideration' frequently is used interchangeably with damages for breach of warranty . . . ." Hargrove v. Lewis, 313 S.W.2d 594, 596 (Mo. Ct. App. 1958). There are other examples. One court has drawn but not defined a distinction between failure of consideration and breach of warranty. Unico v. Owen, 50 N.J. 101, 123, 232 A.2d 405, 417 (1967). The defect there was that the goods were never delivered.
deliver the property or goods. But, as was heretofore noted, the thirty-day period does not begin to run until "delivery of the property." Thus, if failure of consideration is limited to "total" failure, the construction suffers from much the same problem as the broader reading; it leaves a significant part of the statute without substantial function.

Perhaps the General Assembly intended some degree of failure of consideration between the two extremes, but if so that degree is difficult to identify. A line of cases in North Carolina gives the buyer a defense to a contract for sale if the goods are "worthless." This doctrine appears to be similar to the English doctrine of "fundamental breach." However, in the opinion of the author, the North Carolina cases and the English doctrine can be subsumed in the express warranty of description under the Uniform Commercial Code. Together, they simply reflect the minimal level of performance that is required of a seller who has disclaimer all implied warranties but who nevertheless purports to convey a described item. Such cases may tell us when there is a failure of consideration by a seller who has assumed only a small obligation, but they cannot tell us how to measure failure of consideration in relation to a seller who has assumed a larger initial obligation. If failure of consideration is a question of degree, that degree must be a function of the particular obligation of the seller and expectation of the buyer.

It is suggested that the concepts in the sale of goods article of the Uniform Commercial Code can be used to give content to failure of consideration as the term appears in the Act. Under the Uniform Commercial Code, the buyer has a right to reject goods when they "fail in

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10N.C. Gen. Stat. § 25A-25(b). It would seem that any degree of non-performance that would be characterized as a total failure of consideration would not constitute "delivery of the property." The delivery requirement must be measured in relation to the requirements of the contract. There would be a total failure of consideration in a contract for the sale of an automobile if the seller delivered a horse. Likewise, delivery of a horse would hardly appear to be a "delivery of the property" that would start the thirty-day period running.

11See Christenson v. Friendly Ford Sales, Inc., 6 N.C. App. 137, 140, 169 S.E.2d 542, 544 (1969): "There was a failure of consideration if, at the time of the sale, the automobile could not be used for the purposes for which it was intended." The defendant had introduced evidence that the sale was "as is-where is." See also Hall Furniture Co. v. Crane Mfg. Co., 169 N.C. 41, 85 S.E. 35 (1915).


13N.C. Gen. Stat. § 25-2-313(1)(b) (1966). The goods must conform to any description that was made a part of the basis of the bargain. This surely implies that the goods will not be "worthless" in relation to the function for which such described goods are normally used or that the unqualified description describes some minimal level of quality.
any respect to conform to the contract.\textsuperscript{153} If the presence of a right of rejection signify failure of consideration, this would be giving failure of consideration its broadest meaning—a meaning that previously has been found wanting. However, the right of rejection must be exercised by the buyer within a reasonable period of time after the tender.\textsuperscript{154} Thus, the right of rejection will have been determined or lost within a very short time after delivery and, certainly, well prior to the expiration of the thirty-day period. A buyer who fails to notify the assignee of a defect that would justify rejection has little claim to the right to assert that type defense. Thus, the mere fact that a defense would give rise to a right of rejection should not constitute that defense a “failure of consideration.”

On the other hand, a buyer who does not make a timely rejection has not necessarily lost all rights to return the goods to the seller. Where the defect is of sufficient consequence and other conditions are met, the buyer may yet “revoke his acceptance.”\textsuperscript{155} However, revocation of acceptance is limited to cases in which the “non-conformity substantially impairs” the value of the goods to the buyer and the seller has assured the buyer that the defect would be cured or the defect could not reasonably have been discovered earlier.\textsuperscript{156} Thus, for example, if a buyer is confronted with a major and theretofore latent defect several weeks after the sale, he may be entitled to revoke his acceptance; or if the buyer has accepted the goods with a known defect that the seller has repeatedly assured the buyer would be repaired and it has not been, the buyer might revoke his acceptance. On the other hand, a buyer who has accepted and used goods cannot revoke for latent defects that do not “substantially impair” the value of the goods to the buyer. In the first two examples, the buyer might be said to have suffered a “failure of consideration” within the meaning of the Act. In the latter example there would be no “failure of consideration,” and the buyer would be remitted to his rights against the seller for breach of warranty. These do not seem to be inappropriate results under the Act. The buyer who is entitled to return the goods to the seller has a stronger case for not being required to continue to pay for them than does the buyer who is compelled by the Uniform Commercial Code to retain the goods and seek compensation by way of the breach-of-warranty action. This ap-

\begin{footnotesize}
\begin{enumerate}
\item[\textsuperscript{153}] Id. § 25-2-601 (1965).
\item[\textsuperscript{154}] Id. § 25-2-602 (1965).
\item[\textsuperscript{155}] Id. § 25-2-608 (1965).
\item[\textsuperscript{156}] Id. § 25-2-608(1) (1965).
\end{enumerate}
\end{footnotesize}
proach does have the virtue of preserving meaning for both parts of the second rule, and the approach is not far removed from the context in which the failure-of-consideration claim often arises—rescission of the contract.\textsuperscript{157}

A final question that inevitably will arise under the section is whether the buyer who is asserting defenses may recover payments that were made to the assignee prior to the time of the assertion of the defense. The answer will almost unquestionably be negative, at least where the assignee had no notice of the defense at the time that he purchased the paper.\textsuperscript{158} However, any payments that are made by the buyer after he notifies the assignee of the defense and prior to resolution of the claim should be returned to the buyer if his claim proves valid.

\textbf{REGULATION OF CHARGES AND FEES}

\textit{Finance Charge Rates}

The Act refers rate determination for revolving credit in which no security interest in real property is taken to the earlier enacted statute covering revolving credit.\textsuperscript{159} The rate permitted under that statute is the familiar one and one-half percent per month, or a nominal eighteen percent per annum. The rates for non-revolving credit ("consumer credit installment sales") are directly regulated by the Act. Under it the familiar "time-price doctrine" can no longer be used to justify unlimited finance charges in contracts of sale. The permissible rates for non-revolving credit range from fourteen to twenty-two percent, depending upon the amount financed, except that twenty-nine percent is permitted in certain transactions that involve automobiles that are more than three years old at the time of the sale.\textsuperscript{160}

However, both of the rate structures are subject to the exception that where a security interest in real property is taken the rate is limited to twelve percent per annum.\textsuperscript{161} The real property exception is seemingly

\textsuperscript{157}Revocation of acceptance is a rough equivalent to rescission; however, it does not carry the election-of-remedies result that flowed from rescission. In other words, the buyer can revoke \textit{and} recover damages for breach of warranty.

\textsuperscript{158}Such a result is commonly provided for in most statutes that deal with defenses of the buyer, \textit{e.g.}, \textit{Uniform Consumer Credit Code} § 2.404, and it seems to have been the common law rule in regard to assignments.


\textsuperscript{161}\textit{id.} §§ 25A-14(b), -15(c) (Supp. 1971).
intended to equalize the installment sale transaction rates with the loan rates.\(^\text{162}\)

The computation of rates for "consumer credit: installment sale" transactions is referred to the rate that is disclosed for federal Truth-in-Lending purposes.\(^\text{163}\) Thus, the Act incorporates by reference this body of federal law and regulation in the interest of providing all persons who are affected by this Act a convenient and accurate point of reference.\(^\text{164}\) The federal statute and regulations have been in effect for over two years; the business community has long ago adapted to it; extensive tables and other information are available; and all consumers are required to receive a disclosure statement before consumation of any transaction. If an accurate computation is made pursuant to Truth in Lending, both parties can know at a glance whether the rates conform the limitations of the Act.

**Insurance Charges**

The Act does not prohibit a seller from selling insurance in connection with a credit extension and receiving a share of the premium as a "commission." The Act follows the lead of Truth in Lending and requires that the seller include the cost of any purchased insurance in the

\(^{162}\)The loan rates are set forth in id. § 24-I.2 (Supp. 1971).

\(^{163}\)Id. § 25A-15(a) (Supp. 1971).

\(^{164}\)Incorporation of federal laws has been consistently approved in challenges to state income tax laws that are based upon the federal law or return. E.g., Featherstone v. Norman, 170 Ga. 370, 153 S.E. 58 (1930); Thorpe v. Makin, 43 Ill. 2d 36, 250 N.E.2d 633 (1969); Santee Mills v. Query, 122 S.C. 158, 115 S.E. 202 (1922).

In the unlikely event that the rate computation methods in the CCPA and Regulation Z are changed in the future, N.C. GEN. STAT. § 25A-15 (1965) probably would have to be re-enacted to bring it back into conformity with federal law. The Act does not expressly attempt to incorporate future changes in the federal law or regulation, and if it did a delegation-of-power question would be presented. However, there is authority upholding state statutes that incorporate existing and future federal tax law. Alaska Steamship Co. v. Mullaney, 180 F.2d 805 (9th Cir. 1950); Hickel v. Stevenson, 416 P.2d 236 (Alas. 1966) (by implication); First Federal Sav. & Loan Ass'n v. Connelly, 142 Conn. 483, 115 A.2d 455 (1955); Anderson v. Tiemann, 182 Neb. 393, 155 N.W.2d 322 (1967). The Anderson court stated: "The adoption of a state income tax based upon present and future federal income tax law does not constitute a waiver of the sovereignty of the state, nor an abdication of its functions, nor constitute a violation of the requirements of a representative form of government." Id. at 409, 155 N.W.2d at 327. The court was also aided by a constitutional provision granting the legislature the authority to "adopt an income tax based upon the laws of the United States." Neb. CONST. art. VIII, § 1B (emphasis added).

In North Carolina the propriety of the interest rate in thousands of real estate mortgages is dependent upon N.C. GEN. STAT. § 53-45 (1965), which in effect permits the Federal Housing Administration from time to time to establish the permissible interest rate for FHA and VA guaranteed mortgage loans that are closed with respect to land located in North Carolina.
finance charge, unless the seller makes the required disclosures to the buyer at the time of the sale. Two types of insurance are recognized: (1) credit life, accident, or health insurance (credit life insurance), and (2) property damage and liability insurance (property insurance).

If the seller requires that credit life insurance be purchased by the buyer, the cost of such insurance must be included in the finance charge. However, if the seller does not require its purchase and he discloses that fact to the buyer, the cost is excluded from the finance charge and becomes a part of the amount financed.

The creditor may require that property insurance be purchased as a condition to the credit extension, but if he requires that it be purchased through him, the cost must be included in the finance charge. If the seller does not require that it be purchased from a particular source and discloses that fact to the buyer, but the buyer elects to purchase from the seller, the cost of such insurance need not be included in the finance charge.

Insofar as consumer credit installment sale contracts are concerned, these provisions of the Act are duplicative of the results that would be obtained under Truth in Lending, because the rate computation under the Act is referred to Truth in Lending. However, as to revolving credit, these rules do provide a local rule that the nonqualifying insurance charges are included in the eighteen percent maximum provided in the revolving credit statute. This was not clear heretofore.

Transfer of Equity Fee

The Act permits the seller to impose a fee where he agrees to a transfer of the collateral by the buyer to a third party. The Uniform Commercial Code provides that a debtor may voluntarily transfer his rights in the collateral. However, that provision is not clear on whether a clause in the security agreement that makes such a transfer a default is nevertheless enforceable by the seller. Professor Gilmore concludes that the seller may declare a default under such circumstances.

If that view is correct, the seller has the option, and upon sale or at-

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166 Id. § 25A-17(b) (Supp. 1971).
167 Id. § 25A-16 (Supp. 1971).
168 Id. § 25-9-311 (1965).
tempted sale by the debtor the seller is in a position to extract additional fees or charges. The Act limits those charges and in the process reinforces Professor Gilmore's view of the Uniform Commercial Code provision.

Default Charges

Whenever any payment is past due for ten days or more, the seller may impose a default charge of up to five percent of the installment past due but not in excess of six dollars. In three subsequent unclear sentences the Act apparently provides that if the defaulted payment is not made up by the buyer prior to the due date of the next installment, the seller may not apply the next payment to the previously due installment and treat the currently due installment as also being in default. For example, assume that the contract called for monthly payments that are due on the first day of each month. The buyer does not make the payment due on January 1. Ten days later the seller imposes a default charge. On February 1 the buyer makes a correct payment. Apparently, the seller may not apply the payment made on February 1 to the January 1 installment in order to create a default on the February 1 installment. If this were not the rule, the seller could in certain situations turn a single default into a default on every other payment. Also, the Act prohibits the seller from imposing more than one default charge for each default. Thus, when the buyer defaults on a single payment but makes regular payments thereafter, the seller is limited to the initial five-percent fee. The seller would, of course, have the option of accelerating where the default is not made up by the buyer.

Deferral Charges

Subsequent to the initial execution of the contract, the parties may agree to defer the due date of one or more installments, and the seller is permitted to impose a deferral fee of one and one-half percent per month for each installment deferred. For example, assume that nine monthly installments remain to be paid at the time of the deferral agreement. The parties agree to allowing the buyer to skip one month's payment and make it up at the end. This deferral may be viewed as a nine-month deferral of one installment or a one-month deferral of each

installment, and the seller may impose a fee of thirteen and one-half percent of a single installment or one and one-half percent of each of nine installments.

**Consolidation and Refinancing Charges**

There will be situations in which a more radical restructuring of the transaction is required than can be accomplished through a deferral agreement. The Act recognizes consolidation and refinancing agreements and provides that finance-charge rates under such agreements may not exceed what would be permitted if an original sale transaction were involved. At the time of consolidation or refinancing, the old debts are treated as paid in full and the seller must "rebate" all unearned finance charges under the old contract to arrive at the amount financed under the new agreement.

**Attorney's Fees**

The Act authorizes a court to award reasonable attorney's fees to a prevailing seller as plaintiff and to the prevailing buyer as defendant. But there is no provision for attorney's fees for the buyer as a plaintiff, except where the buyer is recovering excessive finance charges. The reason for not including the prevailing buyer as plaintiff in other types of cases and the prevailing seller as defendant is unclear.

The attorney's fees provisions also give rise to a question concerning their relationship to an earlier statute that allows creditors (including sellers) to recover attorney's fees as provided in the agreement, but not in excess of fifteen percent of the outstanding balance and basically, only if the debtor has been given five days' notice and an opportunity to pay the obligation. However, litigation is not a condition to recovery of the fees. The question is whether that statute is superseded by the attorney's fees provisions of the Act insofar as consumer credit sale transactions are concerned. It is possible for the two statutes to operate concurrently, with only a slight change in the effect of the earlier statute. That earlier statute could be deemed to continue to apply to pre-litigation attorney's fees for the seller, and the provisions of the Act could be deemed to apply only in the event of litigation with the result

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\[\text{1}^{\text{2}}\text{id. } \S 25A-31 \text{ (Supp. 1971)}\]

\[\text{1}^{\text{3}}\text{id. } \S 25A-21 \text{ (Supp. 1971).}\]

\[\text{1}^{\text{4}}\text{id. } \S 6-21.2 \text{ (1969).}\]
that there is no fifteen-percent limit and the amount is in the judge's discretion. However, another section of this Act must also be considered. That section restricts the "fees," "charges," and "sums" that may be received by a seller to those that are "authorized by this Chapter." It is certainly possible to read that provision in such a way that the seller's attorney's "fees" would be limited to those provided by this Act. On the other hand, that provision might be construed as referring to charges that are received and retained by the seller and not to those that would be paid over to an attorney. The answer is simply not definite.

THE BUYER'S REMEDIES FOR VIOLATION OF THE ACT

Several sections of the Act contain specific internal remedies for violation. A confession-of-judgment clause taken in violation of the Act is void. Similarly, security interests taken in property other than that permitted by the Act are void. The home solicitation sale sections provide their own remedies, and a referral sale is void. An unconscionable contract or clause may be refused enforcement or limited in application. Other sections should have specified consequences of violation but do not. For example, several types of agreements are required to be in writing, but the effect of failure to do so is not specified. Certain disclaimers of warranty are prohibited, but the effect of violation is not stated. Generally, however, where the seller has contracted for or required something that is prohibited the court appropriately could refuse enforcement of the clause or requirement. If the seller is refusing to do an act that is required, such as furnishing a statement of account, the debtor might have damages or conceivably would be entitled to a mandatory order from a court.

If the seller has imposed excessive finance charges in an amount less than two times the permissible amount, the seller is precluded from recovering any finance charge in the transaction, and the buyer may recover twice the amount of any finance charge already paid plus reasonable attorney's fees. However, if the excessive charge resulted

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17 Id. § 25A-44(3) (Supp. 1971).
18 Id. § 25A-18 (Supp. 1971).
19 Id. § 25A-20 (Supp. 1971).
20 Id. § 25A-23(b) (Supp. 1971).
22 Id. § 25A-37 (Supp. 1971).
23 Id. § 25A-43 (Supp. 1971).
24 Id. § 25A-28, -30(b), -31(b) (Supp. 1971).
26 Id. § 25A-44(1) (Supp. 1971).
from accidental or good faith error, the seller is liable only for the amount of the excess.\textsuperscript{184}

If the seller has imposed a finance charge greater than two times in excess of that permitted, the transaction is deemed void.\textsuperscript{185} The Act specifies that the buyer may retain any property received by him without obligation to pay for it, but it does not provide for the situation in which the buyer has already paid. At the very least the buyer should be entitled to tender back any goods and recover payments made by him. Further, there is no conceivable excuse for such an excessive overcharge, and since results should not depend upon the time that the buyer discovers the overcharge, the buyer should be entitled to recover payments made under such a contract without tendering back any goods received by him.

Any other excessive or not specifically permitted fee or charge of due rebate that is retained by the seller may be recovered by the buyer.\textsuperscript{186} The seller is given incentive to make prompt response to proper requests for return of such charges; if the seller does not return them within ten days after he has received a written request therefor from the buyer, the buyer may recover treble the amount owing.\textsuperscript{187}

"Knowing and willful violation of any provision" of the Act "shall constitute an unfair trade practice under [General Statutes Section] 75-1.1."\textsuperscript{188} This provision thus incorporates much of Chapter 75 and thereby grants to the Attorney General the authority to make investigations of and seek injunctions against violations of the Act.\textsuperscript{189} However, the effect of this reference upon the buyer's private remedies is unclear. In general, a person injured by an unfair trade practice may recover treble damages.\textsuperscript{190} The question is whether this Act's incorporation of Chapter 75 incorporates as well the treble damage provisions. It can be argued that section 44(4) of this Act states a different offense from the general violation of the Act—that is, a "knowing and wilful violation." Therefore, the remedy provisions in Chapter 25A should apply to innocent violations and should be supplemented by Chapter 75 as to intentional violations. For example, if a seller takes excessive security or fails

\textsuperscript{184}Id.
\textsuperscript{185}Id. § 25A-44(2) (Supp. 1971).
\textsuperscript{186}Id. § 25A-44(3) (Supp. 1971).
\textsuperscript{187}Id.
\textsuperscript{188}Id. § 25A-44(4) (Supp. 1971).
\textsuperscript{189}Id. § 75-9, -14 (Supp. 1971).
\textsuperscript{190}Id. § 75-16 (Supp. 1971).
to make a proper application of payments so that items are not properly released from the security interest and subsequently repossesses and sells the collateral in violation of the Act, he should be liable in conversion to the debtor. If the violation of the Act was committed knowingly by the secured party, treble damages in an action for conversion would not be inappropriate. Thus, with respect to most provisions of the Act, it is possible to accommodate such a dual system of remedies. However, in respect to situations in which the Act specifies a monetary recovery, it is not likely that treble damages could ever be sustained. If the seller imposes an excessive finance charge, the specific recovery of twice the amount of the finance charge is provided. It is not likely that a treble (hence sixfold) recovery was intended where the violation was "knowing," particularly in view of the fact that the same specific section provides a lesser penalty for "accidental or good faith" error.

In the situation involving more than twice the permissible finance charge, the debtor is already compensated through retention of the property and avoidance of the obligation, and it is not likely that additional damages would be called for.

Finally, the excessive fee or rebate provision has its own treble recovery provision; it is not likely that a nine-fold recovery was intended under any circumstances.