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SMALL LOAN LENDERS EXCHANGES AND THE ANTI-TRUST LAWS

By

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The small loan business plays a vital part in the economic life of this country. Regulated small loan lenders in thirty-six states which have small loan statutes make approximately ten million loans annually. These loans total approximately three billion dollars.¹ Figures like these sound impressive, but just what do they mean? To put it on a more down-to-earth basis or in a manner showing the actual impact of the small loan industry upon the American economy, these figures mean that one out of every five families borrows from a small loan company or approximately one-fourth of the families in the United States are indebted to licensed small loan lenders at any given moment. Also it has often been said that eighty-five per cent of the people in the United States have been involved with a small loan at some time during his or her life.

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¹ The Federal Reserve Board has released the following figures on the small loan business in its broadcast G 17.1, dated April 2, 1953:

	Amount outstanding at end of period in millions of dollars	Volume
1939	448	827
1940	498	912
1941	531	975
1942	417	784
1943	364	800
1944	384	869
1945	439	956
1946	597	1,231
1947	701	1,432
1948	817	1,534
1949	929	1,737
1950	1,084	1,946
1951	1,268	2,437
1952	1,439	2,671

In April, 1953, the Board of Governors of the Federal Reserve System revised its method of compiling and reporting statistics relating to consumer credit. The following figures are taken from their report G.21:

	Loans Outstanding in Millions of Dollars			
	1952	1953	1954	1955
December	1,513.6	1,692.1	1,780.5	
January		1,529.9	1,688.7	1,776.9
February		1,515.8	1,681.9	1,775.1
March		1,530.6	1,681.7	1,787.5
April		1,545.6	1,695.2	1,803.6
May		1,551.4	1,694.7	1,809.0
June		1,574.3	1,706.6	1,830.7
July		1,603.9	1,716.8	1,845.3

A "rule of thumb" which proves to be quite accurate for most purposes is that the volume is approximately 180% of the outstandings. From these figures it can be seen that the small loan business is quite important to the American economy.

Small loan lenders require adequate credit information about the borrower before they grant such loans. One of the means of obtaining this information is through the medium of small loan lenders exchanges.

In many of the cities where there are several licensed lenders, there will be found a small loan lenders exchange. The purpose of such a lenders exchange is to assemble, pool and exchange such credit information. Organized exchanges may be roughly divided into two broad classifications: one, the "open" or unrestricted lenders exchange which acts as a clearing house of credit information and has no restrictions on the number of loans that a member may make to an individual borrower. The second classification is that which is termed the "closed" or restricted exchange. These exchanges not only act as a clearing house of credit information, but also attempt to prevent the overloading of borrowers by organizing to prevent the overextension of credit to borrowers through the medium of limiting the number of small loans that its members may have outstanding to a particular borrower at the same time. Up until the present time a lenders exchange, be it open or closed, is normally a voluntary association of lenders.

It has been alleged by some that where a closed small loan lenders exchange exists that such an exchange violates the federal anti-trust statutes. Others have alleged it is an end in the fulfillment and purposes of the applicable small loan act. The scope of this paper is limited to a discussion of the anti-trust statutes and closed small loan lenders exchanges.

The first question which naturally arises is whether an exchange and its operations are within the ambit of the federal anti-trust statutes. It may be argued that since an exchange is generally limited to a particular locality and its operations are confined to the particular community that it does not fall within the ambit. However, some exchanges, such as the one in Philadelphia, Pennsylvania, extend their operations to the city of Camden, New Jersey, and clearly this particular exchange is engaged "in commerce among the several states."

The cases dealing with the question, that the lending of money may be a business engaged in interstate commerce, are limited. In *Watts v. Mann*² the court implied that the lending of money was not interstate commerce. Counsel had called to the court's attention the fact that a federal anti-trust indictment had been returned alleging a conspiracy to fix rates of interest and made the statement that it was their belief that such was not interstate commerce. The court stated that they were inclined to go along with that belief. It should be noted that no argument was presented on this point and that the court's opinion on the point is dictum.

² 187 S.W.2d 917 (1945).

In another case, *United States v. Investors Diversified Services, Inc.*,³ the court had presented to it the question of whether a loan of money constituted a commodity as that term is used in the Clayton Act, and the court stated:

"Although a loan of money might constitute commerce or may be an article of commerce or may be subject to commerce under the Sherman Act in given situations, we are dealing here with the question of whether money is a commodity under the Clayton Act." (Emphasis added.)

Here again is another case which is obviously *dictum*. In the recent case, *Mitchell v. Household Finance Corporation*,⁴ the issue was whether the employees of a small loan company were in "interstate commerce" for the purpose of the Fair Labor Standards Act.⁵ Judge Goodrich said, in reference to the question of whether the company was engaged in interstate commerce:

"Preliminary to the three questions above stated is a broader one, namely, whether the defendant's activities constitute 'commerce' as that term is used in the Act. Defendant does not seriously contend that the sum total of its business does not make up an interstate commerce undertaking. We think that it clearly does constitute interstate business and we think that the insurance case cited for so many other propositions in the course of the argument here is a general authority for that position. See *United States v. South-Eastern Underwriters Ass'n.*, 322 U.S. 533 (1944) . . . We were much pressed in argument with the famous insurance case, *United States v. South-Eastern Underwriters Ass'n.*, 322 U.S. 533 (1944). That case held that the insurance business was interstate commerce and its activities in connection therewith came within the purview of the Sherman Act. We think that the most that case tends to establish when applied to the set of facts before us is that the small loan business, conducted as it is on a nationwide basis, is interstate commerce. That was the assumption made at the beginning of this opinion. The decision in the insurance case does not and can not give us any instruction with regard to the coverage by the Fair Labor Standards Act of individual employees of an insurance company such as those engaged in soliciting insurance, settling claims, and the like. It is simply outside the orbit of the question now before us."

An analogous field to the lending of money is the financing of automobiles. Automobile financing generally does not involve the making of loans but the buying of commercial paper, and there are certain similar aspects. A great many of the automobiles sold today are sold on a conditional sales contract. These conditional sales contracts are purchased by commercial banks or finance companies. The financing of automobiles in this manner has been held to be "in interstate commerce" within the meaning of the Sherman Act in *United States v. General Motors Corporation*.⁶

³ 102 F.Supp. 645, 649 (1951).

⁴ 208 F.2d 267 (1953).

⁵ 52 STAT. 1060 (1938), 29 U.S.C. § 201 (1947).

⁶ 26 F.Supp. 353, *aff'd* 121 F.2d 376, *cert. denied* 314 U.S. 618, *rehearing denied* 314 U.S. 710 (1939).

Banking has been held to be engaged in interstate commerce, and for that reason the bank was within the jurisdiction of the Fair Labor Standards Act according to *Lorenzetti v. American Trust Company*.⁷ Banking has also been considered to be interstate commerce for jurisdictional purposes under the National Labor Relations Act. In *National Labor Relations Board v. Northern Trust Company*,⁸ the court stated: "It cannot be said as a matter of law that no bank can be engaged in such commerce."

The underwriting of insurance has been held to be interstate commerce in the famous case of *United States v. South-Eastern Underwriter's Association*.⁹

Consent decrees have been entered against those engaged in financing on the theory that they were engaged in interstate commerce and were violating the Sherman Anti-Trust Act.¹⁰

It appears that small loan lending affects interstate commerce at least as much as fire insurance. Proceeds of small loans will be used in purchasing goods which are in the flow of interstate commerce. Further, many small loan offices are parts of a national or regional organization which does commerce among the several states and which has transactions crossing state lines. For an activity to fall within the ambit of the Sherman Act it matters not that the activity is primarily local in character, for if the activity is immediately, intimately and ultimately related to interstate commerce, then it is within the ambit of federal anti-trust statutes. In *United States v. General Motors*¹¹ it was stated:

" . . . nor does it matter that the financing is considered to be local activity *per se*. For it is well settled that the federal government may regulate under the Sherman Act local commerce which is intimately related to interstate commerce or local activity which obstructs or burdens interstate commerce . . ."

The pertinent section of the Sherman Act¹² is Section 1 which states in part:

" . . . Every contract, combination in the form of trust or otherwise, or conspiracy, any restraint of trade or commerce among the Several States, or with foreign nations is declared to be illegal. . ."

It is against this language that the question must be determined.

In examining the various cases involving anti-trust violations and such alleged violations it becomes quickly apparent that the fact situation in the particular case and industry determines whether there has been a violation of the

⁷ 45 F.Supp. 128 (1942).

⁸ 56 F.Supp. 335, 336, *aff'd* 148 F.2d 24 (1944).

⁹ 322 U.S. 533 (1944).

¹⁰ *United States v. Henry S. Morgan* (D.C.N.Y. Civil Action 45-757, filed Oct. 30, 1947); *United States v. The Mortgage Conference of New York* (D.C.N.Y. Civil Action 37-247, filed Aug. 1946); *United States v. Chicago Mortgage Bankers Assoc.* (D.C. Y11, Civil Action 48c-1826, filed Dec. 9, 1948).

¹¹ 26 F.Supp. 353, *aff'd* 121 F.2d 376, *cert. denied* 314 U.S. 618, *rehearing denied* 314 U.S. 710 (1939).

¹² 26 STAT. 209 (1890), 15 U.S.C. § 1 (1951).

federal anti-trust laws. The Supreme Court in *Standard Oil Co. v. United States*¹³ and *United States v. American Tobacco Co.*¹⁴ adopted the so-called "rule of reason".¹⁵ This rule means that before any practice will be declared violative of the federal anti-trust laws, it must appear to the court that there is a restraint-of-trade or commerce among the several states or with foreign nations and that the restraint must be unreasonable. The Supreme Court has taken the position that certain acts may result in some restraint-of-trade or commerce, but the restraint is so slight that it is not unreasonable. In order to determine whether a restraint, if any exists, is reasonable, one must examine the economic facts of life of the particular industry. It therefore behooves us to look at some of the basic facts of the small loan business.

The lending of small sums of money has many characteristics which are unique and peculiar to the business. All small loans, with the exception of those few states without a small loan statute, are made under and pursuant to a particular statute of a sovereign state. These statutes all have what is commonly referred to as a rate section or, to be more accurate, rate sections. That is to say, there are several sections which govern the rate of charge that a licensee under a particular state statute may charge a borrower of a small sum. In the first place, all these statutes provide a ceiling on the amount of money which a licensee may lend a borrower at the small loan rate. They all provide a rate of charge sometimes referred to as "interest" and other times referred to as "charges", which rates are over and above the general usury statute. Most statutes provide that a borrower may not be directly or indirectly obligated to a licensee for any amount in excess of the statutory ceiling (amount) at a rate in excess of the general usury law. Loans which are made carrying a rate in excess of the statutory rate, when below the small loan ceiling, are generally void and the lender has no right to collect any recompense whatsoever, and when above the ceiling they are subject to the penalties of the general usury law.

These statutes were enacted to remedy the loan shark evil. The small loan statutes are of a remedial nature—they are not designed for general commercial lending. States like Idaho, Nevada, and New Mexico have incorporated particular statutory declarations of legislative policy and findings of fact which point out the evils existing in the particular state at which the small loan stat-

¹³ 221 U.S. 106 (1911).

¹⁴ See note 13 *supra*.

¹⁵ It is not believed that the so-called "Per Se Violation" doctrine applies. There are none of the elements present as where the per se doctrine is applied such as price fixing, division of markets, etc. For cases applying the per se doctrine see: *United States v. Trenton Potteries*, 273 U.S. 392 (1927); *United States v. Socony-Vacuum Oil Co.*, 310 U.S. 150 (1940); *Keifer-Stewart Co. v. J. E. Segrans-Sons*, 340 U.S. 211 (1951). For a recent article with the thesis that prohibitions should be interpreted by application of the dominant yardstick of the "rule of reason" rather than by the "per se" doctrine see Oppenheim, *Federal Anti-trust Legislation: Guideposts to a Revised National Anti-trust Policy*, 50 MICH. L. REV. 1139 (1952).

A recent decision of the Federal Trade Commission indicates that agency is coming back to the "rule of reason". See *In re Maico Co.* (1953).

ute is aimed. Other states like Florida, Maryland, and Tennessee have preambles to their small loan statutes which in substance state the findings of fact and statements of policy of the legislature in enacting their small loan statute. The language used by the legislature shows clearly that the small loan statute was designed to be remedial—to correct or to minimize an evil, to provide a remedy.

The courts in some states which do not have a declaration of legislative policy and findings of fact incorporated directly in the statute or in the preamble have found the small loan act was a remedial measure.¹⁶

That cooperation among the members of an industry to correct existing evils in an industry is good is stated in *William Filene's Sons. v. Fashion Originators Guild*.¹⁷ So long as the cooperative action is wholesome the courts have approved such action when such facts have been shown and established. However, if the group action is designed to or availed of to create a single central control, i.e., a monopoly whether by an individual or a group, such action has been struck down.

The Supreme Court of the United States in *Appalachian Coals v. United States*¹⁸ stated:

"A co-operative enterprise, otherwise free from objection, which carries with it no monopolistic menace is not to be condemned as an undue restraint merely because it may effect a change in market condition where the change would be in mitigation of recognized evils, and would not impair, but rather foster fair competitive opportunities. Voluntary action to rescue and preserve these opportunities, and thus to aid in relieving a depressed industry and in reviving commerce by placing competition upon a sounder basis may be more efficacious than an attempt to provide remedies through legal processes. The fact that the correction of abuses may tend to stabilize a business, or to produce fairer price levels, does not mean that the abuses should go uncorrected or that co-operative endeavor to correct them necessarily constitutes an unreasonable restraint of trade."

In spite of such clear principles the "free enterprise" claim is asserted by young and vigorous groups who wish to avoid the restraints of public policy and who wish to increase outstanding loan balances by second and third loans to unwary borrowers.

No closed small loan lenders exchange has ever been known to use the European cartel idea of dividing the business in any manner. There are no known instances where a closed small loan lenders exchange has divided the volume of business among its members. The grouping together of members of

¹⁶ See for example: *Winneck v. Aentna Acceptance Co.*, 275 Ill. App. 438, 114 N.E. 166 (1934); *Gash Service Co. v. Ward*, 118 W.Va. 703, 192 S.E. 344 (1937); *People v. Vanderpool*, 20 Cal. App. 2d 746, 128 P.2d 513 (1942); *Domestic Finance Co. v. Williams*, 174 Misc. 227, 20 N.Y.S.2d 467 (1940).

¹⁷ 90 F.2d 556 (1937).

¹⁸ 288 U.S. 344 (1933).

a particular industry to correct evils existing in the industry has been approved by the courts in many instances.¹⁹

The Supreme Court has said in *Board of Trade of the City of Chicago v. United States*:²⁰

"The true test of legality is whether the restraint imposed is such as merely regulates and perhaps thereby promotes competition or whether, it is such as may suppress or even destroy competition. To determine that question the court must ordinarily consider the facts peculiar to the business to which the restraint was applied; its condition before and after the restraint was imposed; the nature of the restraint, and its effect, actual or probable. The history of the restraint; the evil believed to exist, the reason for adopting the particular remedy, the purpose or end to be attained, are all relevant facts. This is not because good intention will save an otherwise objectionable regulation or the reverse; but because knowledge of intent may help the court to interpret facts and predict consequences."

The question resolved itself then as to whether a closed small loan lenders exchange imposes an unreasonable restraint of trade. A closed small loan lenders exchange does not impose any unreasonable restraint upon any lender. The small loan statutes provide that the borrower may pay off the loan at any time and without the payment of interest contracted to be paid for the remainder of the term. Nor is any premium or penalty required for such prepayment. This is a unique feature in small loan statutes. Generally, the borrower in the commercial world must pay a price to pay off his loan before maturity or new expenses in connection with another loan. Under the small loan statutes and the rules of a closed small loan lenders exchange, if a borrower can make a better deal with another lender, there is no restraint upon such a transaction. It is rather a mere channeling of the business but not a restraint of the business. The small loan statutes, as stated above, were designed as a remedial correction of an abused credit situation within certain ceilings at extraordinary rates. The statutes were designed as a shield to protect the necessitous borrower and not as a sword to facilitate the exploitation of the borrower by a number of lenders. The extraordinary rate was to meet a special or a particular situation, not a series of situations for any borrower or a course of conduct for any borrower among many small loan lenders.

In one sense the ceiling limitation, the maximum rate permitted, the statutory limit as to the maximum length of a loan, such as twenty months, the control of those contingently liable as endorsers or guarantors are each and every one a restraint in and of themselves, but they are not restraints of trade. They are the result of the use of police power exercised to protect and promote the health, safety and welfare of needy borrowers.

¹⁹ See: *Sugar Institute v. United States*, 297 U.S. 533 (1936); *Maple Flooring Mfgs. v. United States*, 268 U.S. 536 (1925); *Cement Mfgs. Ass'n. v. United States*, 268 U.S. 588 (1925).

²⁰ 246 U.S. 231, 238 (1918).

We are familiar with examples of industrial action or the concerted action of competitors which are technically restraints of trade, but which are adapted for the health, safety and welfare of the public. These restraints, as are all usury statutes, are similar in nature to the police action of the states in adopting rules for the public health, safety and welfare. We recognize the need for such police action and approve, provided the actions do not become unreasonable. For example, merchants of a community may agree among themselves to remain closed on certain days. This is quite common especially during the summer months. It might be argued that such acts by the merchants are restraints of trade albeit on a local level; yet there are no cases known to the author involving the prosecution of such merchants for such closings. Other examples which readily come to mind are cases of those engaged in transportation; taxicab drivers who voluntarily agree not to carry more than certain number of persons in their vehicles, which number is less than that permitted by the authorities; or the case of the ethical drug concerns withholding a drug from the market while they thoroughly test and retest the drug even though laboratory tests indicate that it is safe, and that it would meet requirements set down in the Federal Drug and Cosmetic Act or statutes of similar nature.

The public health, safety and welfare requires temperance and, therefore, such rules have usually been held to be good. Similarly, the health, safety and welfare of the public requires temperance in credit in heavy loan charges whether such loan charges by high interest rates or numerous activity charges. Too many such loans will get the borrower into economic trouble. They will destroy trade rather than promote it.

Where closed small loan lenders exchanges exist any borrower is free to trade elsewhere among licensed lenders or other lawful lenders; and the lenders are free to trade among the borrowers as the case may be and to "pay off" any other lender in amounts within the small loan statutory limits. The statutory limits for any particular borrower are fixed by the state legislature and not by the closed small loan lenders exchange. The closed small loan lenders exchange is an aid in the fulfillment of state policy as expressed in the statute, the adjudications under the statute and the administrative rules and regulations.

New Jersey and Connecticut have regulations or practices which recognize the need of such exchanges. The National Association of State Small Loan Supervisors has recognized the need by passing a resolution on November 7, 1952 as follows:

"RESOLVED, that the National Association of State Small Loan Supervisors recommend the establishment and maintenance of an effective and efficient Lender's Exchange in each community composed of all the small loan licensees in the said community."

Closed small loan lenders exchanges have received what might be termed indirect "approval" of the federal grand jury that investigated the small loan

business and which resulted in *United States v. Rufus DeWitt King*,²¹ where indictment under Section 1 of the Sherman Act charged thirteen high-rate small loan company chains, twenty-seven other corporations and seventy-five individuals with agreeing to fix interest rates on small loans in twenty-three southern, southwestern, and western states. This is presumably the indictment counsel referred to in the *Watts* case. At that time there was made available to the Attorney General and the grand jury, the constitution and by-laws of every exchange operating in the United States, most of which were closed small loan lenders exchanges then. No action was taken against any closed small loan lenders exchange at that time. The facts were before the grand jury, and no indictment was returned nor was any suggestion made that it had any doubts about the closed small loan exchanges.

It should be noted that where a retail credit association was alleged to have entered into a combination or conspiracy to monopolize the retail credit reporting and credit information business by allotting exclusive territories to be served by member agencies by boycotting, etc., and thereby eliminating competition, a consent decree was entered in *United States v. National Retail Credit Association*.²² In connection with this case, it might be pointed out that certain discrimination in the membership of any exchange could be considered as violative of the anti-trust laws. For example, few will deny that a lenders exchange can limit its membership to small loan licensees. This is so because the small loan industry is classified as a separate and distinct business with its own statutes and constitutional classifications approved by the courts, its particular problems and objects which are not common to all businesses. However, if the exchange refuses a licensee membership solely because it is alleged to be controlled by a bank or other competitor, it would appear that such action would violate the anti-trust laws as a conspiracy to eliminate or restrain competition under the theory of the *National Retail Credit Associations* case.

A pending case, *United States v. Cincinnati Fruit and Produce Credit Association*,²³ is also of interest. Here it is alleged that the members who control eighty per cent of the distribution of fruit and produce in the Cincinnati area refuse to sell except for cash to any customer who fails to pay his accounts with any member within a prescribed time; customers disputing claims are obligated to submit to arbitration or be boycotted by all members unless they pay cash at the time of the sale; uniform credit terms are enforced by a system of fines on members who sell to black-listed buyers. The complaint seeks to prevent the association from combining with its members to fix a credit period or to force customers into compulsory arbitration of disputed claims.

²¹ U.S. Dist. Ct. of Texas, Crim. No. 13147 (1944), *The Federal Anti-trust Laws and Cases* 316.

²² Eastern Dist. Mo. Eq. No. 10420 (1933), *The Federal Anti-trust Laws and Cases* 165, *decree modf.* (1953) 1953, 1953 Trade Cases 67,608.

²³ Civil Action No. 2426, (1950), *The Federal Anti-trust Laws and Cases* 405.

Commenting on the case, Attorney General McGrath, the Attorney General at the time the case was instituted, said:

"Collusive action to fix terms of credit in sales transactions lessens competition. When sellers agree to black-list any boycott customers in order to prevent any escape from credit terms uniformly imposed, freedom of trade is curtailed, likewise by forcing customers to submit to the arbitration of claims which they dispute. In this case, the Department of Justice continues its program to prevent practices which destroy the opportunity to negotiate, buy and sell from the domination and control of a powerful group."

It would appear that if any exchange adopted rules, such as: (a) no credit to a bankrupt borrower duly discharged until he picked up the unpaid balance discharged in the bankruptcy proceedings; or, (b) no loan to a borrower by another member within four months after making or obtaining a loan from a member; or (c) no loan except on monthly installments; or (d) no loan to be made below a given rate or term of any such additional restrictions, then such exchange rule would be a violation of the anti-trust law. Such restraints would use the small loan statute as a sword for the exploitation of the necessitous borrower.

The closed small loan lenders exchange is a wholesome development on the part of the regulated small loan industry which aids in carrying out the objectives of the legislatures in passing the small loan statutes. The action of the members of the industry in forming a closed lenders exchange to combat the evil of overloading is sound judicially. See *William Filene's Sons v. Fashion Originators Guild*.²⁴

²⁴ *William Filene's Sons v. Fashion Originators Guild*, 90 F.2d 556 (1937).