Maurer School of Law: Indiana University
Digital Repository @ Maurer Law

Indiana Law Journal

Volume 30 | Issue 3 Article 2

Spring 1955

Another View on the Origin of Dealer Participation In Automobile Finance Charges

Russell Hardy

Follow this and additional works at: http://www.repository.law.indiana.edu/ilj

Part of the Banking and Finance Law Commons

Recommended Citation

Hardy, Russell (1955) "Another View on the Origin of Dealer Participation In Automobile Finance Charges," *Indiana Law Journal*: Vol. 30 : Iss. 3 , Article 2.
Available at: http://www.repository.law.indiana.edu/ilj/vol30/iss3/2

This Comment is brought to you for free and open access by the Law School Journals at Digital Repository @ Maurer Law. It has been accepted for inclusion in Indiana Law Journal by an authorized editor of Digital Repository @ Maurer Law. For more information, please contact wattn@indiana.edu.

JEROME HALL LAW LIBRARY
INDIANA UNIVERSITY
Maurer School of Law
Bloomington

COMMENTS

ANOTHER VIEW ON THE ORIGIN OF DEALER PARTICIPATION IN AUTOMOBILE FINANCE CHARGES

RUSSELL HARDY*

A note in the *Indiana Law Journal* relative to automobile dealers' participation in installment sales financing charges, in which valuable and interesting material on the subject is collected, contains one very important statement which can be challenged in the light of other sources.[1] The statement is:

> The Big Three has been instrumental in disinfecting the entire industry of many abusive practices. Partially because of the nationals, the average finance charge has been maintained at a reasonable level.[2]

The truth is, those companies have the largest part of the responsibility, probably the entire responsibility, for so "infecting" the business. They, and they alone, aside from public officials, possess the means of effectually "disinfecting" the business.

General Motors Acceptance Corporation originated the practice of adding to the finance charge a part to be collected from the purchaser and paid to the dealer.[3] Although the company began business on January 24, 1919, it was not until about the middle of 1925 that the dealer participation practice was put into effect. During the first five or six years of the GMAC existence, the methods used by it for the acquisition of wholesale financing of General Motors dealers, and of the notes which the dealers had taken from retail purchasers, included no effort, or at least no systematic and appreciable effort, to force the dealers to patronize GMAC. In that period the notes taken by dealers in retail transactions were simple promissory notes, in a principal amount equal to the balance due by the purchaser, bearing a percentage rate of interest. Generally, the dealers retained the notes or transferred them variously to GMAC, other finance companies, or banks, according to their own interests. The principal advantage to the dealer of the transfers was the conversion of his notes into cash, in effect making the sales of his cars cash transactions. Profit to the dealers in the sale of notes was not expected and was virtually

---

* Member, District of Columbia and Maryland Bars, formerly Special Assistant to the Attorney General of the United States in antitrust cases.

1. *Is Control of Dealer Participation a Necessary Adjunct to Regulation of Installment Sales Financing?*, IND. L.J. 641 (1953).

2. *Id.* at 659.

3. United States v. General Motors, 121 F.2d 376, 391 (7th Cir. 1941).

non-existent. The profit to GMAC and other finance companies during these first years was represented by the interest paid by the note makers. The volume of the GMAC wholesale and retail business increased from 1919 to the end of 1925 at a uniformly gradual rate—from about $1,760,000 at the end of 1919 to about $246,113,000 at the end of 1925.[4] Sales of General Motors cars fluctuated during the same period, indicating the absence of any strong influence connecting the volume of GM sales with the volume of GMAC business.[5]

By 1925 it was clear that much of the GM dealers' financing business was getting away from GMAC.[6] In equal competition against independent finance companies and others, GMAC had proven incapable of attracting all of the General Motors trade. The GMAC officials felt that it was a melancholy hardship that up to that time "we had to fight our own way" against the small and scattered competitors who were taking the business away from the young but ineffectual financing giant.[7] In this emergency GMAC called upon General Motors to help them stay in business.

An early, official "Confidential Report" of GMAC declared that the purpose for which it had been organized was to acquire and keep within its control, to the greatest extent possible, the business of financing the sales of General Motors cars.[8] Results of the first seven years, however, convinced the GMAC management that the business acquisition methods then being used were not effective to secure the business to the "greatest extent possible."

Two new methods to accomplish the purpose were, accordingly, inaugurated in the latter part of 1925: namely, dealer profit participation in the finance charge, and exercise of control by General Motors of the wholesale and retail financing part of the dealers' business.[9] In another "Confidential Report," GMAC declared on December 3, 1925, "[t]he factory will hereafter exercise control of the dealer's time selling practices," and "[t]his corporation . . . will work hand in hand with the factory divisions in the development of the dealer's credit merchandizing along sound lines."[10]

---

4. MOODY'S MANUAL OF INVESTMENTS 2415, 2417 (1927); MOODY'S MANUAL OF INVESTMENTS 1099 (1926); MOODY'S MANUAL OF INVESTMENTS 2012 (1924).
5. *Ibid.*
6. United States v. General Motors, 121 F.2d 376, 392 (7th Cir. 1941).
7. *Id.* at 392-393.
8. *Id.* at 382; Transcript of Record on Appeal, pp. 2636, 3072.
9. "GMAC finances approximately 65% of the General Motors cars sold to dealers on time and around 75% of the cars sold to retail purchasers on time." United States v. General Motors, 121 F.2d 376, 391 (7th Cir. 1941).
10. *Ibid.*, Transcript of Record on Appeal, pp. 3141-3146.

The effect of the new acquisition methods was powerful and instantaneous. In 1926 the GMAC business rose at the stupendous ratio of 245 percent. Whereas its business for the whole preceding seven years amounted to about $968,000,000, it amounted to about $607,000,000 in 1926.[11] The Seventh Circuit Court of Appeals said the GMAC volume of business and net earnings for 1926 increased about 225 percent over 1925.[12] The increase was almost five times greater than the General Motors sales increase of about forty-eight percent for the same period.[13] At the same instant, the dealer participating practice was permanently fastened to a large part of the automobile business (the GM proportion of the business was about forty percent at that time), and at the expense of the retail time purchasers of GM cars.

GM and GMAC gave the dealer participation the euphemistic label of "repossession loss reserve," on the pretense that it served solely to compensate the dealers for losses on defaulted finance notes.[14] In 1933 Alfred P. Sloan, Jr., then president of General Motors, candidly stated that any "appreciable excess" over actual repossession losses was "unfair" to other finance companies.[15] Sloan's candor was probably caused by a lack of knowledge that his own companies were the worst offenders. It is notoriously known that from 1926 to the present time, repossession losses have amounted to but a small fraction of one percent (in bad times a little more), while the payments to dealers have been enormously disproportionate to the default and repossession deficiencies.

Not only is the "reserve" intrinsically a powerful business acquisition method, but the GMAC ingenuity soon devised a special manipulation which multiplied its intrinsic force. This device is to remit no reserve payments to dealers as individual installments are paid or as individual notes are fully satisfied but to credit and accumulate the amounts for periodic distribution. The funds thus due to dealers were held virtually as bond money posted to assure dealer obedience to the GM-GMAC financing law.[16]

The enormous and sudden increase of the GMAC business meant an abrupt and almost complete disappearance of the business of independent finance companies who had been serving the GM dealers. They were confronted with the choice between bidding a fond and permanent fare-

11. See note 4 *supra*.
12. United States v. General Motors, 121 F.2d 376, 397 (7th Cir. 1941).
13. See note 4 *supra*.
14. *Ibid.* Also see generally NRA records and hearings on proposed automobile finance code, Department of Commerce, Washington, D. C.
15. NRA records and hearings on proposed automobile finance code.
16. For illustrative examples see United States v. General Motors, 121 F.2d 376, 395, 396 (7th Cir. 1941).

well to that important body of customers or recovering the business by matching or increasing the participation offered by GMAC. They chose to contend with the GMAC giant and adopt their dealer participation acquisition practice. But it was not sufficient for the independents merely to offset the participation accorded dealers by GMAC. Dealers demanded more from the independents to compensate them for resisting the efforts to confine their patronage to GMAC. As the economic life or death of a dealer depends on the pleasure and will of General Motors, only a substantial additional amount would induce him to transfer his time sales notes to an independent company.

The original exposure of GMAC during 1919-1925 to free enterprise competitive conditions—the same conditions under which independent finance companies have had to live and survive—was the first real competitive experience of GMAC, and it has not been repeated since GMAC grasped the GM apron strings, which GMAC has ever since firmly held. Its most vigorous business acquisition effort has been to receive, almost automatically, the enormous amount of business driven into its waiting net by the GM power and influence.

Knowledge of the invention and stupendous effect of the new business acquisition methods used by GM and GMAC, spread at once throughout the automobile business. Chrysler and Commercial Credit immediately formed an affiliation to use similar methods for procurement of the Chrysler dealer financing by Commercial Credit, and Commercial Credit began making substantial payments to Chrysler for "causing" its dealers to confine their financing patronage to Commercial Credit.[17] Ford and Universal Credit, then already affiliated by stock ownership, also promptly applied the participation-coercion technique to the time sales financing of Ford cars.[18] The Commercial Credit-Chrysler arrangement for payments to Chrysler added to the dealer participation the practice of splitting the charge with the dealers' master as well.[19] The corporate ownership by General Motors of GMAC gave GM a similar interest in the finance charges collected by GMAC. As Ford and Chrysler represented about fifty percent of the automobile business, the independent finance companies were again confronted with the choice of abandoning a large part of their business or of matching the Ford and Chrysler dealer participation and coercion. Thus the acquisition methods were originated and permanently fastened upon ninety percent of the auto-

17. United States v. Chrysler, Crim. No. 1041, N.D. Ind., May 27, 1938; Civil No. 9, November 7, 1938; THE FEDERAL ANTITRUST LAWS 179, 186 (CCH 1952).

18. United States v. Ford, Crim. No. 1041, N.D. Ind., May 27, 1938; Civil No. 8, November 7, 1938; THE FEDERAL ANTITRUST LAWS 179, 187 (CCH 1952).

19. MOODY'S MANUAL OF INVESTMENTS 775 (1928).

mobile business by the Big Three companies. Whether those methods are pernicious or wholesome, the credit or blame for their invention and use belongs almost wholly to those companies.

The Big Three have sought to control and limit the dealer participation but, it seems, only when practiced by the independent finance companies.[20] By a variety of methods, they have sought to prevent dealers from yielding to the competitive bidding of the independents against the favored finance companies, such as threatening to cancel their contracts for a supply of cars and so forth. In the case of General Motors and GMAC, the factory affiliation with the finance company is obviously the major cause and motive for coercion of dealers as to financing. It would seem logical that disaffiliation would end the pressure on dealers. Also the necessity would end for increasing the dealer participation in an amount sufficient to pay him for the risk involved in displeasing GM.

Statements in the note to the effect that the Big Three finance companies have maintained their finance charges at a low level and have always maintained lower rates than the independent finance companies[21] are gravely misleading if not incorrect. The truth is that the associations which have long existed between the Big Three factory and finance companies and the manufacturers' performance of acquisition services for the finance companies without cost make any invidious comparison of independent finance rates meaningless to the public and unfair to the independents. In the case of GM and GMAC, a high actual finance cost to the purchaser can always be concealed behind a low finance rate merely by placing in the basic cost of the car any amount of additional finance revenue which may be desired, thus leaving the car buyer happy in the illusion that he has paid a modest finance rate. As GM has always owned all of the stock of GMAC, the finance corporation is in reality but another cash register of General Motors. As a machine for acquiring the financing business ostensibly at the lowest possible rates, the combination of the two corporations could hardly be more perfect.

These acquisition methods have a two-fold effect which makes comparison of rates unfair. First, they relieve the Big Three finance companies of normal acquisition efforts and thereby reduce their acquisition cost; second, because it is necessary for independent companies not only to make conventional acquisition efforts but also to make efforts to offset the influence exerted against them in favor of the Big Three companies, the acquisition cost of the independents is abnormally in-

20. United States v. Ford, 68 F. Supp. 825 (N.D. Ind. 1946), 335 U.S. 303 (1948); Chrysler v. United States, 316 U.S. 556 (1942); United States v. General Motors, 121 F.2d 376, *cert. denied,* 314 U.S. 618 (1941).

21. Note, *supra* note 1, at 649, 656.

creased. Moreover, no matter what may be the true significance of any comparison of rates, it is unmistakably clear that the fact that the automobile finance business is ninety percent monopoly and ten percent free competitive enterprise not only conceals the true financing cost but abnormally increases the total automobile financing bill for all time sales purchasers as well. It follows that the position taken in the note that the ownership of GMAC by General Motors has been an important factor in reducing the finance charge to consumers[22] is precisely the opposite of the fact.

For the same reasons it appears further that the attitude in the note that CIT, CC, and GMAC have caused the average finance charge to be maintained at a reasonable level,[23] to say the least, takes in a lot of debatable territory. If the GMAC charges had been in fact maintained at a "reasonable level," then GMAC profits would also stand at reasonable levels, but, as the appellate court, speaking of the period, 1926-1938, said, "The statistical data in the record indicates clearly that GMAC does have a tremendous amount of business and makes huge profits."[24]

The idea that the GMAC competition against the independent companies has been on the basis of rates, that GMAC has given the car purchasers lower rates of its own, and that this has brought down the rates of independents is contrary to the findings of the court of appeals. The court held that GMAC had refused to adopt a recommendation of one of its own principal officials to meet rate and nonrecourse competition of independents and instead determined to maintain its rates and recourse policy by the dealer's cut and by coercion of non-conforming dealers.[25]

The assertions in the note that Commercial Investment Trust, Commercial Credit, and GMAC have been instrumental in "disinfecting" the automobile finance business of many abusive practices[26] is merely a resurrection of an argument made in the *General Motors* case to save the monopoly-coercion system, which was thoroughly considered and fully refuted in that case.[27] The argument was the stock excuse of monopolists,[28] that is, that GMAC had been organized and had always existed, not for profit, not for procuring the business of financing GM car purchases to the largest extent possible, but solely for the public benefit. And specifically it was urged that the aim of GMAC was to permit GM dealers to patronize freely any independent finance companies, subject only to

22. *Id.* at 646.
23. *Id.* at 659.
24. United States v. General Motors, 121 F.2d 376, 397 (7th Cir. 1941).
25. *Id.* at 391, 397.
26. Note, *supra* note 1, at 659.
27. United States v. General Motors, 121 F.2d 376, 392, 397, 400 (7th Cir. 1941).
28. State v. Eastern Coal Co., 29 R.I. 254, 263, 70 Atl. 1, 5 (1908).

the condition that the dealers receive from the independent companies no part of the finance charge and make available to their customers the same low rates and superior terms said to be offered by GMAC.[29]

But the court found that the GMAC object and achievement was profit and not to disinfect the business as to rates or practices, saying, among other things,

> The evidence shows that the coercive conduct in question was not intended to discriminate against an inferior or unreliable finance service. Rather its entire force and effect was directed against any use of an independent finance service. Regardless of the quality of the independent finance service, the command to General Motors dealers was to use GMAC. And obedience to the will of the appellants resulted in additional sales of the finance service. But behind it all lay the might of GMC which had achieved a dominant position in the automobile industry as manufacturer of cars desired by dealer-purchasers and many members of the retail public.[30]

The basic cause of these conditions still exists, that is, the ownership of GMAC by General Motors, and the other less durable associations which are permitted to exist between the other large manufacturers and finance companies.

The Government filed an antitrust suit to end the GM-GMAC affiliation, based on the theory that the relationship produced an unlawful monopoly of the financing business.[31] The complaint charged that the power of those great companies had been exercised to create unlawful conditions, which could be corrected only by ending control of the finance company by General Motors. Although this case afforded an intelligent, effective remedy, it was hurriedly terminated, after many years of inaction by the Government, in the last months of the preceding national administration. A consent decree was quietly and jointly composed by General Motors and Government officials, in which the government entirely waived its demand for divorcement and the injunction of many coercive practices. The Government representatives freely admitted the inadequacy of the judgment to end the unlawful conditions but justified their action on the feeble and incredible ground that the suit was abandoned "to avoid the expense of a trial of the issues and the loss of time occasioned thereby."[32]

---

29. United States v. General Motors, 121 F.2d 376, 400, 406-407 (7th Cir. 1941).
30. *Id.* at 400.
31. United States v. General Motors, Docket No. 2177, N.D. Ill., October 4, 1940.
32. United States v. General Motors, Docket No. 2177, N.D. Ill., June 17, 1952, proceedings on entry of judgment.

The factory coercion of dealers in financing transactions, which inevitably increases finance charges, is but one aspect of comprehensive merchandising plans devised and enforced for many years by each of the Big Three. These plans differ in minor features but are alike in being based on the philosophy—not literally stated, of course, but implicit in the principles—that all of the business in and incident to the sale, repair, maintenance, and use of the cars, from the assembly line to the jalopy graveyard, belongs to them. In the *General Motors* case, GM and GMAC pressed the same view upon the court in the contention that the "commerce" in cars made by General Motors belonged to them, but the court said that when the dealers bought the cars it became the dealers' commerce.[33] Although the cars are invariably sold to the dealers only for full cash payment at the factory and before delivery, and although title, ownership, and possession is thus passed to new owners, these merchandising plans enable a systematic invasion of the rights of the new owners in the cars, which is at variance with our private property, free enterprise economy. Among other things, dealers are limited by the factory as to the prices and conditions on which the cars they own may be resold, and as to purchases, contractual and business relations with other people, principally competitors of the factory and its finance company. In a recent striking example of this false theory of perpetual ownership, the leading officials of General Motors and Ford condemned as "bootlegging," the perfectly legal and necessary action of dealers in transferring cars which had been loaded on them in great numbers by the big companies despite adverse selling conditions. These merchandising methods constitute a system of control and regulation of numerous small private businesses on a nationwide scale, which would be far in excess of the constitutional powers of the Government itself and which, if applied to the big automobile companies, would be rightfully resisted by them with rebellious indignation.

Those concerned about abuses in automobile financing, especially in dealers' participation, should turn their serious attention to those coercive merchandising schemes in their entirety. When these schemes receive the sincere, effective attention of the public authorities, then the abuses referred to in the *Indiana Law Journal* note will vanish.

---

33. United States v. General Motors, 121 F.2d 376, 401, 402 (7th Cir. 1941).