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December 30, 1987

Administrative Interpretation No. 2.110-8701

IN CONSUMER CREDIT SALES OF MOTOR VEHICLES, BONA FIDE CHARGES FOR OPTIONAL EXTENDED SERVICE CONTRACTS MAY PROPERLY BE CONSIDERED PART OF THE AMOUNT FINANCED BOTH FOR PURPOSES OF DISCLOSURE UNDER THE TRUTH IN LENDING ACT AND FOR RATE LIMITATION PURPOSES UNDER THE CONSUMER PROTECTION CODE.

The Department has been asked whether an extended service contract must be disclosed and charged as part of the credit service charge in connection with consumer credit sales of new and used automobiles. With this service the seller agrees to perform repairs or other services on the automobile subject to the sale at some future time as repairs are needed (such as, for example, when the manufacturer's warranty has run out). The extended service contract is optional and is offered to both cash and credit customers.

I. DISCLOSURE

The Federal Truth in Lending Act [15 U.S.C. §1601 et seq.] disclosure provisions are made a part of South Carolina law by S. C. Code Ann. §§ 37-2-301 and 37-3-301 (1976 as amended), both of which state:

> A person upon whom the Federal Truth in Lending Act imposes duties or obligations shall make or give to the consumer the disclosures, information and notices required of him by that act and in all respects comply with that act.

For purposes of determining what disclosures are to be made and what transactions are subject to the Truth in Lending Act pursuant to South Carolina law, the Federal Act does not acquire any new provisions or meanings nor does it lose any provisions or meanings simply because of the incorporation of its disclosure provisions into South Carolina law. One must evaluate the Truth in Lending Act independently to determine what disclosures are required and how those discloses are to be made in order to ascertain whether the Consumer Protection Code likewise requires those same disclosures. See South Carolina Department of Consumer Affairs Administrative Interpretation 3.301-7803; See also Administrative Interpretation 3.301-7915 (appraisal fee disclosed as part of amount financed pursuant to Truth in Lending Act even though those fees were considered part of the finance charge for rate maximum purposes under the then existing Consumer Protection Code). A short if oversimplified way of understanding this dichotomy is to recognize that the Truth

in Lending Act generally deals with disclosures of rates and charges, whereas the Consumer Protection Code deals with substantive issues of whether and how such charges may be assessed and earned. Even so, disclosures must be made in the manner that the Truth in Lending Act directs.

The Federal Truth in Lending Act defines "finance charge" as follows:

> Except as otherwise provided in this section, the amount of the finance charge in connection with any consumer credit transaction shall be determined as the sum of all charges, payable directly or indirectly by the person to whom the credit is extended, and imposed directly or indirectly by the creditor as an incident to the extension of credit. The finance charge does not include charges of a type payable in a comparable cash transaction. . . . Federal Truth in Lending Act Section 106(a), 15 U.S.C. § 1605 (1980) (emphasis added).

Regulation Z, the implementing regulation for the Federal Truth in Lending Act, provides a similar definition at 226.4(a) [12 C.F.R. §226.4(a)]. The Federal Reserve Board staff in its Official Staff Commentary indicates that charges in comparable cash transactions include "[c]harges for a service policy, auto club membership, a policy of insurance against latent defects offered to or required of both cash and credit customers for the same price." Commentary at 4(a)-1

The United States Supreme Court has indicated that because the Federal Reserve Board has the statutory duty to interpret and enforce the Federal Truth in Lending Act, the opinions of the Board and its staff should be given great weight and should be followed unless "demonstrably irrational." Ford v. Millhollen, 444 U. S. 555 (1980). The staff commentary does not appear to be "demonstrably irrational" with regard to its assessment of this type of charge. It seems clear that the Truth in Lending Act requires the extended service contract charge to be part of the amount financed as long as it is bona fide and offered to both cash and credit customers.

II. MAXIMUM RATES

The related question is the extent to which the disclosure of maximum rates pursuant to Section 37-2-301 might differ because of any required separate treatment of the extended service contract. The Department believes a result similar to that discussed above applies with regard to maximum rate schedules. Section 37-2-305(2) provides:

> The rate schedule required to be filed and posted by subsection (1) shall contain a list of the maximum rate of credit service charge (§ 37-2-109) stated as an annual percentage rate, determined in accordance with the Federal Truth-in-Lending Act and Federal Reserve Board Regulation Z, that the creditor intends to charge for consumer credit transactions. . . . (emphasis added)

This provision in some ways seems contradictory in that the credit service charge as set forth in 37-2-109 might include certain elements which would differ with a calculation of the annual percentage rate under the Federal Truth in Lending Act. For example, under certain circumstances brokerage fees and appraisal fees might be considered part of the credit service charge under the Consumer Protection Code but under the Federal Truth in Lending Act the annual percentage rate would be calculated by leaving those elements out of the finance charge. Nevertheless, the Section explicitly indicates that the annual percentage rate will be determined in accordance with the Federal Truth in Lending Act. Thus the Federal Truth in Lending Act determines how rates will be calculated both for purposes of ascertaining and disclosing maximum rates under Section 37-2-305 and for disclosure purposes.

III. CASH PRICE

Finally, it is necessary to determine whether the extended service contract charge is among those charges which might be considered part of the credit service charge under the Consumer Protection Code even though they would be considered part of the amount financed under the Federal Truth in Lending Act. The Department has long held the opinion that any charge assessed to a buyer in connection with a credit sale must be considered either part of the amount financed or part of the credit service charge. "Credit service charge" is defined in Section 37-2-109: "'Credit service charge'" means the sum of (1) all charges payable directly or indirectly by the buyer and imposed directly or indirectly by the seller as an incident to the extension of credit. . ."

The term "amount financed" is defined in Section 37-2-111. With the exception of certain limited specific charges, it is comprised of the "cash price" of the goods, services or interest in land less any downpayment or trade in, and the additional charges permitted by Section 37-2-202. Section 37-2-202 does not address extended service contracts or any like product. Thus, the charge for such a product may not be assessed as a permissible additional charge. If the charge for such products is not part of the cash price, it must be considered part of the credit service charge.

The sale of an extended service contract is a sale of services as that term is contemplated in Section 37-2-105(5) under the circumstances described. The services are being sold in connection with a sale of goods. "Cash price" is defined in Section 37-2-110:

> Except as the Administrator may otherwise describe by rule, the "cash price" of goods, services, or an interest in land means the price at which goods, services, or interest in land are offered for sale by the seller to cash buyers in the ordinary course of business, and may include . . . (2) the cash price of accessories or related services such as delivery, installation, servicing, repairs, alterations and improvements. . . .

This provision indicates that mixed sales of services and goods, services and land, or land and goods may be treated as part of the cash price. Otherwise, the Code would have the absurd result of requiring, for example, that in a sale in which the seller took back a second mortgage on a lake lot, an unattached mobile home also subject of the sale would have to be treated as part of the credit service charge. The Code is clearly not so limiting. In the opinion of the Department the sale of an extended service contract is a service so closely related to the sale of the automobile that it qualifies as part of the cash price of the sale and therefore need not be treated as part of the credit service charge as set forth in Section 37-2-109.

It is possible to envision a sale of goods or services that bear so remote a relationship to the actual subject of the sale that they would not fit under this definition. It is also possible to envision the sale of goods or services in connection with the true object of the sale where the goods or services are supposedly sold to cash customers but are not actually offered to cash customers, or the business is so arranged that cash sales are never or very seldom made. This could potentially raise the issue that such charges are actually "incident to" the extension of credit as contemplated in Section 37-2-109. The Department will approach such matters on a case by case basis and will always attempt to determine the substance rather than the form of the transaction.

Finally, the Department is aware there are certain similar products which may be considered "motor club services" under the Motor Club Services Act, S. C. Code Ann. §§ 38-50-10 et seq. (1985). This interpretation is limited in scope to the permissibility of extended service contract charges as part of the cash price of automobile sales. It should not be construed to validate charges for such services where the seller is not in compliance with the Motor Club Services Act.

In conclusion, it is the opinion of this Department that bona fide and optional charges for extended service contracts sold in connection with consumer credit sales of motor vehicles and offered for the same price in cash sale transactions are properly considered part of the cash price of the transaction and are therefore properly part of the amount financed in such a transaction.

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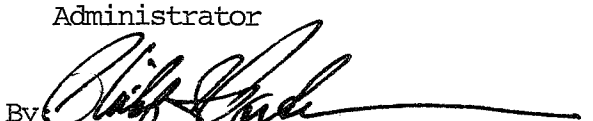
By 
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