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Fraudulent Installment Sales in Chicago

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FRAUDULENT INSTALLMENT SALES IN CHICAGO

By G. J. ALEXANDER*

Fraudulent sales¹ were made long before the advent of the conditional sales contract and are now made, one can be sure, in many varying forms. When coupled with installment contracts, however, they assume a new dimension of viciousness, since the conditional sales instrument enables the seller to deprive his customers not only of present wealth, but, also, to obtain a commitment of future earnings. Depending on the generosity of the legislature in providing devices to secure credit for the seller's legitimate competitors, it may place unscrupulous sellers in an almost impregnable financial position vis à vis those of his victims who are for financial or educational reasons incapable of asserting their legal remedies, the most objectionable facet of this capability being the fact that it depends for its success on judicial enforcement of the contract.²

This paper will attempt to present a brief glimpse of the magnitude of the problem as it exists in the Chicago area and to suggest methods of attack independent of new legislation.

For the former purpose, the author interviewed: Miss Agnes C. Ryan, attorney in the Economic Division of the Chicago Legal Aid Bureau, Mr. Carl D. Dalke, Manager of the Automobile Division of the Chicago Better Business Bureau and Miss Barbara A. Davis, Assistant State's Attorney in the Fraud and Complaints Department.

Regrettably, none of them was able to provide a complete picture, since all dealt with other types of cases as well, and no records were available which segregated the phase herein discussed.

Miss Ryan is assigned cases concerning collections, wage assignments and garnishments in the downtown,³ and larger, offices of the Chicago Legal Aid Bureau. A great preponderance of these cases, ac-

ording to her are based on conditional sales, and almost two-thirds of them, about 800 cases a year, by her estimate, contain allegations of fraudulent misrepresentation in conditional sales contracts. Surprisingly, most of the complaints are lodged against no more than twenty merchants, with the more prominent among them having a lion's share. Also, perhaps not so surprisingly, the laments tend to be quite similar. Thus, for a while, there were a rash of cases against a certain company charging that used televisions, often in bad repair, were delivered in place of new ones purchased,⁴ while at another time, a company was charged with obtaining signatures on sales contracts for freezers on the pretext of selling food plans in which the use of the freezer was included.⁵ The complainants relating such grievances, seem to Miss Ryan to fall within a sub group of the generally impecunious clientele,⁶ representing a lower income and less intelligent group with a leaning toward recent immigrants to the area.

At the Chicago Better Business Bureau, Mr. Carl D. Dalke described the organization's experience with fraudulent representations in the sale of automobiles, which, according to him, represents a majority of complaints based on conditional sale abuse considered by the Bureau. In 1958, 1,146 complaints were processed by the Automobile Division, of which 604 alleged misrepresentations in the sale of cars as to the price, terms or conditions of sale.⁷

The fraud complained of in this area seems less imaginative than in sales of other consumer goods, centering on practices called "bushing" and "packing" by the trade, which involve writing the contract to indicate payments greater than those agreed by the parties.⁸ Apparently the process is facilitated by having formal documents signed in the office of a person called a "closer," at which signing, Mr. Dalke states, everyone but the customer

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and "closer" are excluded. How signatures are obtained on contracts, inconsistent with the verbal understandings, is interesting but tangential to the scope of this paper; suffice it to say, that again there is a discernible mode of operation which varies between individual "closers." As was true of grievances reported to Legal Aid, the bulk of complaints heard by Mr. Dalke's department were lodged against a relatively small portion of the trade.

As might be expected, the State's Attorney's office dwarfs the other two agencies in the number of cases heard. In the period January through September, 1959, the Cook County office heard roughly 6,000 complaints in the Fraud and Complaints Division,⁹ over half of which, Miss Davis estimates, concern instances of fraud in connection with installment sales. Apparently, the cases she bears are not dissimilar from the ones related by Miss Ryan and Mr. Dalke. She agreed that comparatively few companies were involved in repetitive fraudulent acts, that the successful ruses were usually exploited and that the victims tended to be poor and uneducated.

A precise study of the abuse indicated would undoubtedly be beneficial, but even the fragmentary opinions reported here seem somewhat astonishing.

It is interesting to speculate what the incidence of fraudulent sales must be, considering that the cases reported were based on personal interviews or written complaints and that independent repetition of the same scheme vouches for the complainant's substantial veracity. If the aggrieved buyers are as untutored as they seem to the interviewers, one might suspect that the number registering grievances does not represent more than a fraction of those who could.

Most surprising was the fact that there was substantial agreement on the identity of the offending companies. Despite this information, the apparent offenders, with few exceptions, were still prospering. Their continued existence may be easier to understand if the progress of complainants in attempting to extricate themselves is followed.

The Better Business Bureau, while actively engaged in investigation and disclosure, does not ordinarily seek relief for individual complainants. Unless they can afford an attorney, these buyers are probably limited to remedies made available by the Legal Aid Bureau or the State's Attorney's office.

At Legal Aid, according to Miss Ryan, clients with complaints of the type considered, cannot hope for substantial relief in most cases. Usually, a contract has been signed which does not disclose fraud on its face; often no proof of fraud other than their own word is available. With limitations of time and funds, the Bureau policy seems to emphasize obtaining settlements, limited in many cases to payment of the purported debt over an extended period of time. Only cases containing an element other than fraud, which can be urged to defeat the contract (forgery or minority, for example) have a bright prognosis, it apparently being felt that allegations of fraudulent representations are difficult to establish in individual cases.

Lately, a master filing system for reported sales fraud cases has been established by Mr. Arthur K. Young, Director of the Chicago Legal Aid Bureau, grouping such complaints by companies. Hopefully, sufficient information will be generated to suggest warnings to offending dealers and to indicate the desirability of bringing suit to terminate contractual obligations in certain cases. Should sufficient suits materialize, the position of the guilty traders will deteriorate since, like other businessmen, they cannot afford the loss of their profits, and fraud, in its legal sense, would certainly be a sufficient ground for avoiding contracts.¹⁰ Furthermore, Legal Aid's proof problem may have been exaggerated, for, despite the difficulty faced by any single plaintiff in establishing the false representation, there may be safety in numbers, as to the issue of the representations at least, because Illinois practice would seem to allow a number of persons similarly defrauded to join as plaintiffs in the same suit.¹¹

At the State's Attorney's office, the complainants find some succor. According to Miss Davis, there is a strong emphasis on settlement rather than prosecution,¹² despite the criminal nature of many reported grievances.¹³ Victims, understandably, are primarily concerned with restitution and only secondarily with retribution. Since criminal prosecution does not necessarily accomplish the former¹⁴ and the victim's chances for recovery may be severely damaged by acquittal (thus removing the leverage of the State's Attorney in effecting settlement) it is not surprising that they primarily press for financial adjustment and tend to be poor witnesses in the event of prosecution. While neither the reticence of potential witnesses nor the desires of victims prevent prosecution, they are factors to be considered in weighing chances of success.

Another problem in this area concerns the ability to convict the dealer. Since the crimes involved all require intent to commit the act, proof against the dealer is more difficult than it is against the employees consummating the sales, which tends to spare the probable prompter whose conviction would be the most likely to prevent repetition.

Unfortunately, settlements avoid the deterrent effect of the laws and probably explain the continued operation of the offenders who, at most, lose their expected profit and often are able to settle with the complainant by offering a mere reduction of the contract price. The loss thus incurred seemingly is insufficient motivation to alter conduct or to dissuade others from a similar course. Prosecution, on the other hand, despite the fact that sentences on conviction may not be severe,¹⁵ would probably effectuate some reform.

The actual sentence in a criminal case is only a segment of the total discomfort and expense involved. Other considerations include the unpleasantness of arrest, detention with suspected criminals and the expenses of bail and counsel. The conviction may itself have a sobering effect, regardless of the sentence, since absent condemnation the offender could

consider his practice merely "good business."

These considerations indicate the desirability of increasing prosecutions even in face of apparent problems.¹⁶ Should such increase fail to terminate the offending conduct, a fortifying remedy suggests itself in the doctrine of public nuisance.

Without undertaking a definition of "public nuisance" for the moment, it seems clear that the state has the power to have such nuisance abated. At common-law this could sometimes be accomplished by an order following conviction for the misdemeanor of creating or maintaining a public nuisance,¹⁷ a remedy which, of course, is still available in those states which have adopted the common-law in this respect and in those where it has been codified. Irrespective of its existence, however, there was and is a remedy in equity to enjoin continuation of nuisances.¹⁸

To the extent that the equitable remedy is applicable to acts which also constitute crimes, other than the crime of public nuisance, there has been unfavorable comment.¹⁹ Since equity has no jurisdiction to restrain crimes, as such,²⁰ writers urge circumspection in extending chancery remedies in this area. Of primary concern is the lack of traditional criminal safeguards, of which denial of jury trial, the presumption of innocence and burden of proof beyond reasonable doubt are the most discussed. Actually, the denial runs to all of the protections that distinguish our criminal procedure from civil procedure. Furthermore once an injunction issues, continuation of the act can be dealt with summarily as contempt of court while otherwise it would be merely the basis of another prosecution, and it is urged that, since equity's jurisdiction is premised on the inadequacy of the legal remedy, it should not in any event hear cases which could be disposed of by criminal trial.²¹ Despite these objections, courts of equity have found the power to abate such nuisances.²² To the objections concerning criminal safeguards, the courts have answered that they are not concerned with the crimes,

as such, but are merely suppressing the nuisance or punishing contempt of their orders.²³ Faced with the objection of the adequacy of prosecution, they have found the remedy to be impracticable due to surrounding circumstances or insufficient protection for the public.²⁴

It would, perhaps, be less difficult to overlook the entire controversy if one could delimit "public nuisances." Relying on ancient precedent, one could then relegate "nuisance" cases to chancery with a clear conscience despite litigation concerning criminal issues. On examination, however, circumscription becomes impossible. The term "public nuisance" appears to be so broad that it merely expresses the conclusion of the court's will ingness to hear a given case or class of cases.²⁵ Some courts have gone to the extreme of classifying all continuous criminal acts as "public nuisances"²⁶ while other decisions are sufficiently erratic to make it impossible to predict which acts will be considered within the class,²⁷ nor will reference to the definition prove very helpful. Blackstone defines common (public) nuisance as, "a species of offenses against the public order and the economical regimen of the state; being either the doing of a thing against the public order and the economical regimen of all the king's subjects, or the neglecting to do a thing which the common good requires."²⁸

Despite criticism,²⁹ using the label "public nuisance", courts of equity have invoked the injunctive remedy in those areas where sufficient danger to public interests was apprehended.³⁰ One area analogous to fraudulent conditional sales has already been the subject of such judicial scrutiny.

At least ten states have considered whether a continuous usurious loan business constitutes a "public nuisance" abatable in equity (not including those states where injunction is specifically prescribed by statute). Of these, six have held it does,³¹ four have held otherwise.³² The cases are, of course, not parallel. Usury, where proscribed, is the subject of a specific statute making the legislative intent

clear, despite failure to provide equitable remedies. Fraudulent acts, to the extent that they are illegal, are so due to general criminal provisions, which provide no indication whether the legislature finds such acts more offensive in a continuous business setting than in a back alley transfer. Such an argument, however, presupposes a lesser exertion of independent judgment on the part of equity courts than the cases indicate. In the final analysis, the courts, not the legislatures, decided usury was a menace to the "public welfare", sufficiently grave to call forth an injunction; the legislatures merely enacted proscriptions. No reason suggests itself why chancery should be more inhibited respecting a phase of generally prohibited conduct.

A court might alternatively find that usury has a greater impact on "public welfare" than fraudulent conditional sales. A vivid picture of destitution suggests itself when the victims of "loan sharks" are considered. Persons able to purchase appliances or an automobile on installment credit seem less in need of protection. Such distinctions have been voiced in connection with application of usury laws to conditional sales,³³ but may be questionable today because of the growth of the installment market in recent years. In 1925 there were approximately two and a half billion dollars in outstanding installment paper.³⁴ By September of 1958, the Federal Reserve reported the volume at over 33 billion.³⁵

The class of persons protected by usury laws, passed many years ago, may now swell the ranks of installment buyers. In 1956, twenty percent of all "spending units" in the United States with incomes under \$1,000 were installment debtors, as were thirty four percent of those with incomes under \$2,000 and forty five percent of those with incomes under \$3,000.³⁶ The median amount owed by indebted "spending units" with incomes between \$2,000 and \$3,000 was \$250,³⁷ and a large proportion of such units, especially those with incomes under \$3,000, had no other liquid assets than currency on which to draw.³⁸

Even if the problem of usury is equated with current fraudulent practices in installment sales, and if there is agreement that both sufficiently harm the "public welfare" to earn the title "public nuisance", little authority exists to support the adoption of the injunctive remedy in fraud cases. In three of the six states where such relief was granted against usury, usury was not a criminal offense.³⁹ In three of four states where the remedy was denied, it was a crime, and this factor may have influenced the court, despite disclaimer of such influence in the decisions, which focused instead on determining whether the acts were "nuisances."⁴⁰ Furthermore, extension of the equitable remedy into the criminal area is, probably, by the better view, undesirable.⁴¹

Adverse comment about expanding equitable intervention into frontier "public nuisance" cases does not, however, apply to the other common law remedy against such nuisance: abatement following criminal conviction.⁴² Current ardor for the swifter proceedings in chancery has greatly eclipsed utilization of the criminal remedy, despite the fact that prosecution was apparently the usual method at common law,⁴³ that the crime was adopted in this country along with its remedial abatement order,⁴⁴ as part of the common-law, and is still in effect in some states.⁴⁵

There would appear little reason why criminal "public nuisance" should be more restricted than the equitable counterpart. Both are based on the same broad definition, essentially considering the adverse effect on "public welfare."⁴⁶ In usury cases, an indictment charging public nuisance has been found proper in at least one state.⁴⁷

If courts were to apply the criminal "public nuisance" doctrine to businesses which repetitively use fraud as a sales device, criminal safeguards, deemed vital to many writers considering the nuisance area, would be preserved in litigation determining the underlying illegal conduct. Being predicated on conviction, the remedy would be slower than injunction in

application. For the same reason, however, courts might find criminal abatement less offensive and be readier to apply it. Furthermore, as the "keeper" of property on which a nuisance is committed is indictable therefor, the owner of an offending business, presumptively the principal offender, could be prosecuted without proof of actual intent to defraud or fraudulent acts on his part.⁴⁸

Following conviction, an abatement order can be expected to make continuation of the "nuisance" perilous. Of course, not all methods of abating nuisances would be applicable to fraudulent sales cases. For example, committing the defendant until the nuisance is removed, while permissible at common-law,⁴⁹ may be more effective to remove an obstruction of a public highway than to cause termination of fraudulent conduct.⁵⁰ It seems better in sales fraud cases to order the defendant to abate the nuisance, and if he persists in his illegal operations after the order, command the sheriff to accomplish the abatement.⁵¹ Having given the defendant opportunity to reform, it would not seem too harsh to order the premises padlocked. Another alternative is to order the defendant to abate and treat non compliance as contempt of court.⁵²

Illinois appears to be one of the states in which common-law criminal nuisance is recognized. While a specific statute deals with public nuisances⁵³ it has been held that the conduct therein proscribed, not including any act applicable to the instant problem, is merely declaratory of the common law⁵⁴ and does not exclude unenumerated common-law nuisances.⁵⁵

Unsettled as yet is the question whether the statutory remedy, providing for abatement by the sheriff at the defendant's expense,⁵⁶ has superseded the common law remedy. In *People v. Livingston*,⁵⁷ the Illinois Appellate Court reversed a County Court's order that the defendant abate the nuisance of which he had been convicted. The opinion held the lower court's jurisdiction limited and, therefore, bound to the statutory prescription of abatement by the sheriff.⁵⁸ No indication is

given how the appeal would have been decided had a criminal court of general jurisdiction rendered judgment, except that stress placed on jurisdictional limitations would seem to be premised on a recognition of the existence of common-law remedies.

If Illinois courts are limited to the statutory remedy, it would seem that they might still order the sheriff to padlock the premises of offenders with previous similar convictions.

Another group, aside from the defrauded buyers, would seem to suffer rather directly from the offending conduct: the legitimate competition. Not depending on deception for their profit, they may be unable to match the "offers" made by fraudulent sellers, while sharing the resultant bad publicity. Less directly, perhaps, these dealers are harmed by legislative action designed to curb the abuses which may also result in limiting the scope of their operations or their remedies.

By applying "public nuisance" doctrines some courts have enjoined illegal conduct in suits by such competitors. Despite the fact that "public nuisances" are primarily the concern of the state, an exception has long been made for persons who suffer substantial injury distinct from that suffered by the public.⁵⁹ Competitors have sometimes been found to fall within that exception.⁶⁰

From the standpoint of the defendant, an equitable action presents the same problems whether initiated by an individual or the state. Perhaps in suits by competitors, chancery is more justified in its intervention. The criminal remedy, which might seem a reasonable ground for denying the state an injunction, is not in any true sense available to the private plaintiff. Normally, prosecutions are conducted by the government, which has a considerable amount of discretion in the timing of cases and choice of defendants.⁶¹ Furthermore, if the plaintiff has suffered damage by the illegal act of his competitor, there is an independent ground for invoking civil jurisdiction, not present in suits by the state.⁶² It would seem that, denied an injunction,

the legitimate dealer is helpless against illegal acts by a competitor, since they are not a legally recognized tort. Absence of alternative remedies is itself a strong argument for equitable intervention.⁶³

One would suspect that the hardest part of the plaintiff's case would be proof of damages. Except in rare cases,⁶⁴ difficulties arise in showing deprivation of trade by the defendant's actions. While customers, absent the illegality charged, might not have dealt with the culprit, they might well have gone to another illegal operator, thus equally depriving the plaintiff. Alternatively, they might have dealt with a legitimate competitor or have abstained from buying entirely. Arguably, they might have dealt with the offender on a legitimate basis.

In practice, however, courts may not require a rigorously logical demonstration,⁶⁵ though some have been meticulous.⁶⁶

Tied to the same problem is the question whether injury to trade is a recognized "damage" at law. Many courts analyze the damage requirement in terms of the plaintiff's "property right" in his business operation and consider interference therewith "property damage." Accordingly, courts have granted injunctions against unlicensed professional practitioners, relying on the "property right" or "franchise" inherent in the license, while others have refused such relief finding no "property right."⁶⁷ Courts have also enjoined unlicensed competitive transportation services finding "property" in the franchise,⁶⁸ but have refused to enjoin a barber's competitor who cut hair on Sunday in violation of a Sunday Closing law,⁶⁹ and architects' unlicensed competitors,⁷⁰ since the plaintiffs, in these cases, did not have "property rights" to protect. A number of courts, however, find a broader "property right" in the conduct of a lawful business, thereby enabling the proprietor to enjoin illegally operating competitors.⁷¹

The term "property right", as used in cases of business competition, would seem to express a conclusion, of which perhaps the clearest demonstration exists in the case of trademarks. Some courts call

trademarks "property rights" in invoking injunctions against competitive abuses,⁷² yet the primary "property" in the right would seem to be the ability to enjoin others from their use.⁷³ In other cases of commercial competition, the property concept is equally elusive. Certainly, a businessman has a "property right" in his lawful business, in the sense that it cannot be expropriated, in most cases, without compensation; but this is not the question. The question is whether there is a sufficient "property" interest for a court to protect against illegal competition.

In the professional license cases, as an other example, many courts have struggled over the question whether the licensing statutes were designed to protect the profession or the public in determining the sufficiency of the "property interest" involved.⁷⁴ Even assuming that the legislature was protecting members of the profession, however, it does not follow that they included a "property right" secured by equitable remedies, since had they considered this one of the privileges of the license, their intent could well have been articulated in the statute. Undeniably, licenses become "property rights" as soon as equity enjoins unlicensed practice, but such reasoning is circular.

The rule that any person engaged in lawful business has sufficient standing to enjoin competitors from continuing illegal acts, having a reasonable relationship to loss of his customers, has much to commend it, probably providing the only remedy for this class of victims and bolstering standards of the trade by giving dealers a palatable alternative to joining in marginal practices to keep their share of profit. Since the competitive commercial setting provides more than average temptation to abuse remedies, one might expect competitors to eagerly denounce each other as "fraudulent" dealers, or threaten such action unless their complaint is "settled." Perhaps, for this reason, it would be more desirable to have suits initiated by associations of the class of dealers affected by the illegal acts. Organizations of this type would not

only be less suspect of harassment but better able to compile and present salient facts concerning the damage caused by the offending conduct. Regrettably, since associations are heirs to their members' faults, the only guaranteed virtue in having them appear as parties is the reduction in the number of potential plaintiffs. Coupling the problems inherent in setting such a group in motion with the difficulty of proving the defendant's continuous illegal conduct, however, may be a sufficient deterrent to abuse in light of the discretionary nature of the injunctive remedy.

The Illinois position on injunctions against "illegally" operating competitors is unsettled, having been given only cursory attention when considered. In *Excelsior Steel Furnace Co. v. F. Meyer & Brothers Co.*,⁷⁶ the court was asked to end a patent infringement and to enjoin the defendant from stamping certain competitive items as patented, contrary to fact. The court said: "In so far as appellee is manufacturing articles like those that appellant manufactures and has falsely stamped upon them that they are patented, we are of the opinion that equity will not interfere in the way and manner indicated in this bill. We do not believe equity has jurisdiction at the suit of one trader in an article to enjoin another trader in a similar article from telling falsehoods about his own article. It is not charged as to these articles that appellee is telling any falsehoods about appellant's articles, but merely that he is telling falsehoods about the articles which appellee manufactures."⁷⁶ That was the entirety of the opinion on point.

In *Edelman Bros. v. Charles Baikoff*,⁷⁷ the court considered the propriety of an injunction against certain persons who allegedly violated Chicago municipal ordinances prohibiting solicitation of trade on public sidewalks as an unlawful nuisance, subject to fine, and forbidding related acts. The suit was brought by persons claiming to represent "most of the merchants" in said neighborhood⁷⁸ alleging that the defendants were molesting prospective customers. Essentially, the

complaint stated that the defendants were continuously engaged in hawking wares and doing other acts on the sidewalk in front of their own stores to induce passers by to enter, hurting the plaintiff's trade both in that customers were induced to deal with the violators, and in that they avoided the neighborhood because of the annoyance.

The court affirmed the denial of a demurrer, finding the acts a nuisance and a "property right" in the continuation of lawful business. Unexcused acts which interfered with lawful business were held sufficient damage to sustain the injunction and "special damage" was found in the loss of trade. Finally, the court specifically rejected the argument that the available criminal remedy prevented equitable intervention. In short, said the court, the "gist of [the allegations] is that the defendant's daily and continuous acts . . . are especially injurious to complainants in their trade and business and in the established good will of their customers; i.e. in their property rights."⁷⁹ This was sufficient, the court held, to enjoin the nuisances.

Illinois has sustained the right of a single attorney to enjoin the unlicensed practice of law.⁸⁰ An injunction has also been upheld against the unlicensed practice of three chiropractors by five of their licensed competitors.⁸¹

Finally, *Jones v. Smith Oil and Refining Co.*⁸² should be noted. In that case, the plaintiff was a retail oil service station operator, whose complaint alleged that his competitor was using an illegal lottery to attract customers. The court, in an opinion affirming the injunction, mainly considered the lottery question, and, after finding the acts constituted lottery, gave short shrift to the remaining problems: "It is argued strenuously by the appellant that the courts have no jurisdiction to

grant an injunction to restrain a person from committing a crime, and this is, in effect, what the granting of an injunction is doing in this case. The injunction in this case was not issued on the theory that it was to restrain the appellant from committing a crime, but on the theory that the contemplated plan was a violation of law and the same would be unfair competition of trade against the appellee, and if permitted to continue would seriously interfere with the business of the appellee, and for this reason the injunction was issued. Under such conditions it is our opinion that the injunction was properly issued."⁸³

The Illinois cases seem to indicate a recognition of the right to protect one's business from continuous illegal competitive acts. The earlier pronouncements of the *Excelsior Steel* case appear contrary but there is no indication that the court had been asked to consider the issue of illegality in the sale of misbranded goods and, without that element, they may have correctly found that no action lay. Read broadly, the assertions cannot be reconciled with later cases.

With the ever increasing impact of conditional sales on our economy and with legislative concern focused on the problems involved,⁸⁴ now is a good time to attempt to eliminate the unscrupulous element from the group. Whether the best road to this end lies in massing civil actions, as Legal Aid might, or bringing prosecutions, cannot be forecast. At any rate, prosecutions can be expected to prove more effective, without sacrifice of criminal jurisprudential concepts, by the rejuvenation of abatement orders on conviction. Possibly, competitors are in the best position to proceed. It is not necessary to decide the question of priority; a combination of the remedies will certainly do the job.

LECTURE REMINDER

Tuesday, March 22, 1960, 3:30 P.M.

TAX PROBLEMS OF LAWYERS — Edmond S. Sager

Tuesday, March 29, 1960, 3:30 P.M.

TAX ASPECTS OF AMOUNTS RECEIVED OR PAID AS DAMAGES, PENALTIES AND AWARDS (Including Amounts Paid as Attorneys' Fees) — James R. Wimmer

FOOTNOTES

1. "Fraudulent sales," as used in this paper, is intended to be a loose description of a class of wilful, deceptive acts on the part of the seller designed to result, and resulting, in a "contract." It is meant to correspond with the layman's concept "being defrauded."

2. This is especially evident in states which enforce confession of judgment clauses, as does Illinois. Ill. Ann. Stat. c. 110 §50 (4) (1956). Such clauses enable the seller to obtain a judgment in essentially *ex parte* proceedings, a remedy frequently utilized by at least some unscrupulous dealers. Of a list of ten companies named by a Chicago Legal Aid Bureau representative as being those against whom the most allegations of fraudulent sales were made, A had filed 1,107 suits in the Chicago Municipal Court in 1958; B, 1,085; three others over 250 each. A spot check of these complaints failed to disclose any cases other than confessions of judgment in this group.

3. 123 W. Madison Street, Chicago, Ill.

4. Orders were taken from catalogs. The installment contracts uniformly had the word "recond," inserted inconspicuously in the description of the set sold.

5. Almost any issue of *The Report* (a publication by the Chicago Better Business Bureau) reveals other schemes. Sometimes they are relatively elaborate. In order to sell furnaces, for example, one company allegedly had employees pose as government or utility inspectors, who on being admitted to homes to "check the furnace," would warn the homeowner of mortal danger if the unit was not replaced. Alternatively, salesmen would offer to check furnaces, invariably finding "small" leaks which they would offer to fix. The furnace would then be promptly dismantled, whereupon the salesman would find it hopelessly defective and incapable of reassembly without risking the life of the family and neighbors. In at least one case, a public utility representative, called by the homeowner to verify the diagnosis, was unable to find any defect. Chicago Better Business Bureau, *The Report*, March 10, 1958, p. 4.

6. The Chicago Legal Aid Bureau limits its assistance to persons whose incomes are less than maximal amounts, determined by the application of a rather complex formula to economic data obtained from prospective clients.

7. Letter from Mr. Carl D. Dalke to the author, August 10, 1959, on file.

8. "Bushing" is defined, by Mr. Dalke, as the practice of indicating a sales price, in a written contract, exceeding the agreed price. "Packing" accomplishes a price increase by adding insurance or service charges, in excess of those agreed, to the cash sales price. These practices often account for substantial differences. For example, a certain car lot advertised a car at \$445, but indicated the price on the purchase order as \$495. The "cash price" entry on the bill of sale for the same car was \$655. Chicago Better Business Bureau, *The Report*, Jan. 27, 1958, p. 7.

9. This figure is based on the complaint number in use at the end of the period, complaints being consecutively numbered.

10. 1 Corbin, *Contracts* 11, 12 (1950).

11. *Weigend v. Hulsh*, 315 Ill. App. 116, 42 N. E. 2d 146 (1942). But see *Gombi v. Taylor Washing Machine Co.*, 290 Ill. App. 53, 7 N. E. 2d 929 (1937). See a discussion of these two cases in *Opal v. Material Service Co.*, 9 Ill. App. 2d 433, 133 N. E. 2d 733 (1956); and see *Parties and Joinder of Actions Under the Illinois Civil Practice Act*, 43 Ill. L. Rev. 41 (1948).

12. Miss Davis remembered only three prosecutions, within the last two years, in which dealers were charged with multiple violations of the penal code. A small number of single complaints were also prosecuted in the same period.

13. See Ill. Ann. Stat. c. 38 §253 (1953) (false pretenses); Ill. Ann. Stat. c. 38 §256 (confidence game); Ill. Ann. Stat. c. 38 §140 (1953) (conspiracy); Ill. Ann. Stat. c. 38 §277 (1953) (forgery); Ill. Ann. Stat. c. 38 §249a (1953) (untrue, misleading, deceptive advertising).

14. The false pretenses statute specifically provides for restitution as part of the sentence. Ill. Ann. Stat. c. 38 §253 (1953). None of the other statutes listed in note 11 has similar provisions.

15. In the three prosecutions charging multiple violations, mentioned by Miss Davis, *supra*, note 12, one resulted in the conviction of two of three defendants, the convicted persons being fined \$200 each. Chicago Better Business Bureau, *The Report*, August 25, 1958, p. 1. The other two, according to Assistant State's Attorney Davis, resulted in a similarly light sentence in one, and acquittal in the other.

16. Miss Davis stated, in a conversation subsequent to the initial interview, that her office was in the process of accelerating prosecutions.

17. 9 *Halsbury's Laws of England* 231 (2d ed. 1933); 2 Wood, *Nuisances* 1305 (3rd ed. 1893).

18. 4 Pomeroy, *Equity Jurisprudence* 953-955 (5th ed. 1941).

19. Caldwell, *Injunctions Against Crime*, 26 Ill. L. Rev. 259 (1931); Dunbar, *Government by Injunction*, 13 Law Q. Rev. 347 (1897); Gregory, *Government by Injunction*, 11 Harv. L. Rev. 487 (1898); Mack, *The Revival of Criminal Equity*, 16 Harv. L. Rev. 389 (1903); Ralston, *Government by Injunction*, 5 Cornell L. Rev. 424 (1920); Schofield, *Equity Jurisdiction to Abate and Enjoin Illegal Saloons as a Public Nuisance*, 8 Ill. L. Rev. 19 (1913); *Injunction of Crimes Without Statutory Authority*, 23 Albany L. Rev. 361 (1959).

20. 4 Pomeroy, *op. cit. supra*, note 18, at 951.

21. See *id.* at 949, 950, 950 n. 4.

22. *Re: Debs*, 158 U. S. 564 (1895); *State v. Hines*, 178 Kan. 142, 283 P. 2d 472 (1955); *Bennington v. Hawks*, 100 Vt. 37, 134 Atl. 638 (1926); 4 Pomeroy, *op. cit. supra*, note 18, at 951.

23. A good articulation of this idea is found in *Re: Debs, supra*, note 22, where Mr. Justice Brewster stated: "The law is full of instances in which the same act may give rise to a civil and a criminal prosecution. An assault with intent to kill may be punished criminally, under indictment therefor, or will support a civil action for damages, and the same is true of all other offenses which cause injury to person or property. . . . So here, the acts of the defendants may or may not have been violations of the criminal law. If they were, that matter is for inquiry in other proceedings. The complaint made against them in this is disobedience to an order of a civil court, made for the protection of property and the security of rights." *Id.* at 594.

24. *Stead v. Fortner*, 255 Ill. 468, 99 N. E. 680 (1912); *State ex rel. Burgum v. Hooker*, . . . N. D. . . ., 87 N. W. 2d 337 (1957).

25. See Thayer, *Public Wrong and Private Action*, 27 Harv. L. Rev. 317 (1914), especially his oft quoted phrase, "Nuisance is a good word to beg a question with." *Id.* at 326.

26. *State v. Rabinowitz*, 85 Kan. 841, 118 P. 1040 (1911); *Knigh v. Foster*, 163 N. C. 329, 79 S. E. 614 (1913).

27. *State v. Barry*, 217 S. W. 957 (Tex. Civ. App. 1919) (showing motion picture on Sunday in violation of Sunday closing law not a nuisance); *Hamlin v. Bender*, 173 App. Div. 996, 159 N. Y. S. 1117 (1916) (same thing a nuisance); *People ex rel. Shephardson v. Universal Chiropractor's Ass'n*, 302 Ill. 228, 134 N. E. 4 (1922) (practice of unlicensed chiro-

practicers not a nuisance); *Burden v. Hoover*, 9 Ill. 2d 114, 137 N. E. 2d 59 (1956) (overruling *Shepardson v. Universal Chiropractor's Ass'n*, *supra*, without specifically labeling the offense a nuisance). Notes 30 and 31, *infra*, and accompanying text, indicate the disagreement between states on whether a business dealing in usurious loans is a nuisance.

28. 4 Blackstone, *Commentaries on the Law of England* 166 (7th ed. 1775).

29. "The distortion of the injunction into a weapon of the criminal law can be of no ultimate salutary effect." Note, 43 Harv. L. Rev. 499, 499, 450 (1930); see note 19, *supra*, and accompanying text.

30. In his article on this subject, Professor Caldwell after analyzing cases states, "The foregoing cases indicate that courts of equity are tending more and more toward a complete recognition of their power to protect the health and morals of the public as well as its property and to prevent threatened interference with the security and general welfare of the community as well as interference with its tangible substances." Caldwell, *op. cit. supra*, note 19, at 266, 267.

31. *Larson v. State*, 266 Ala. 589, 97 So. 2d 776 (1957); *State ex rel. Moore v. Gillian*, 141 Fla. 707, 193 So. 751 (1940); *State ex rel. Beck v. Basham*, 146 Kans. 181, 70 P. 2d 24 (1937); *Commonwealth ex rel. Grauman v. Continental*, 275 Ky. 238, 121 S. W. 2d 49 (1938); *State ex rel. Goff v. O'Neil*, 205 Minn. 366, 286 N. W. 316 (1939); *State ex rel. Burgum v. Hooker*, . . . N. D. . . ., 87 N. W. 2d 337 (1957). In Missouri a lower court concurred. The issue was specifically excluded from consideration in the opinion of the supreme court, *reversing on other grounds, Kansas City v. Markham*, 339 Mo. 753, 99 S. W. 2d 28 (1936).

32. *Stephens v. Seccombe*, 103 Cal. App. 306, 284 Pac. 725 (1930); *State ex rel. Boykin v. Ball Investment Co.*, 191 Ga. 382, 12 S. E. 2d 574 (1940); *Commonwealth v. Stratton Finance*, 310 Mass. 469, 38 N. E. 2d 640 (1941); *Ex parte Hughes*, 133 Tex. 505, 129 S. W. 2d 270 (1939).

33. *E.g., General Motors Acceptance Corp. v. Weinrich*, 218 Mo. App. 68, 262 S. W. 425 (1924).

34. Seligman, *The Economics of Installment Buying* 18 (1927).

35. 44 Federal Reserve Bull. 1324 (1958).

36. U. S. Board of Governors of the Federal Reserve: *Consumer Installment Credit*, Part 1, Vol. I, at 87 (1957). "Spending unit" is defined as "all related persons living together who pool their income." *Ibid.*

37. *Ibid.*

38. *Id.* at 92.

39. Alabama, Kansas, Minnesota. *Larson v. State*, 266 Ala. 589, 97 So. 2d 776 (1957); *State ex rel. Beck v. Basham*, 146 Kans. 181, 70 Pac. 2d 24 (1937); *State ex rel. Goff v. O'Neil*, 205 Minn. 366, 286 N. W. 316 (1939).

40. *Stephens v. Seccombe*, 103 Cal. App. 306, 284 Pac. 725 (1930); *State ex rel. Boykin v. Ball Investment Co.*, 191 Ga. 382, 12 S. E. 2d 574 (1940); *Commonwealth v. Stratton Finance*, 310 Mass. 469, 38 N. E. 2d 640 (1941).

41. See note 19 *supra*, and accompanying text.

42. See note 17 *supra*.

43. *Board of Health v. Du Pont de Nemours Powder Co.*, 79 N. J. E. 31, 80 Atl. 998 (1911). Blackstone writes discussing private wrongs, "Let us next attend to the remedies which the law has given for this injury of nuisance . . . no action lies for common or public nuisance, but indictment only . . ." 3 Blackstone, *op. cit. supra* note 25, 219. He was contrasting public and private remedies and his remarks should, therefore, not be taken literally, their significance consisting in the fact that indictment was chosen for contrast. The equitable remedy would have to be substituted in a modernization of the statement.

44. *Ehrlich v. Commonwealth*, 125 Ky. 742, 102 S. W. 289 (1907); *Bollinger v. Commonwealth*, 98 Ky. 574, 35 S. W. 553 (1896); *People v. High Ground Dairy Co.*, 166 App. Div. 81, 151 N. Y. S. 710 (1915); *State v. Prudential Coal Co.*, 130 Tenn. 275, 170 S. W. 57 (1914).

45. Miller, *Criminal Law* 416 (1934).

46. "It may be said that an indictment for a nuisance lies in all cases where the injury is general, and affects public rights . . ." 2 Wood, *op. cit. supra* note 17, at 1298, 1299. For examples of the wide range of acts which have been prosecuted see *id.* at 1299 1302.

47. *State v. Diamant*, 73 N. J. L. 131, 62 Atl. 268 (1905). *But see Commonwealth v. Mutual Loan and Trust Co.*, 156 Ky. 299, 160 S. W. 1041 (1913); *Commonwealth v. Hill*, 46 Pa. Super. 505 (1911), in which such indictment was held improper because usury was not a crime.

48. Wood states, "If any servant in the course of his employment, but without my knowledge, and even contrary to my orders, creates a public nuisance . . . I am liable therefor civilly and criminally, even though . . . I could in no sense be said to have done the act." 1 Wood, *op. cit. supra* note 17, at 52.

49. 2 Wood, *op. cit. supra* note 17, at 1305.

50. Also, at least one court has found it an improper method. *Bollinger v. Commonwealth*, 98 Ky. 574, 35 S. W. 553 (1896).

51. *People v. High Ground Dairy*, 166 App. Div. 81, 151 N. Y. S. 710 (1915); *State v. Prudential Coal Co.*, 130 Tenn. 275, 170 S. W. 57 (1914).

52. *Ehrlich v. Commonwealth*, 125 Ky. 742, 102 S. W. 289 (1907).

53. Ill. Ann. Stat. c. 38 §§466 466b (Supp. 1959).

54. *Town of Manteno v. Suprenant*, 210 Ill. App. 438 (1917).

55. *People ex rel. Dyer v. Clark*, 268 Ill. 156, 108 N. E. 994 (1915).

56. Ill. Ann. Stat. c. 38 §467 (Supp. 1959).

57. 331 Ill. App. 313, 73 N. E. 2d 136 (1947).

58. "The county court is a court of limited jurisdiction and is given certain jurisdiction by the constitution, but all other jurisdiction must be conferred by statute, and if conferred by statute the jurisdiction is limited to such cases as are specified in the statute." *People v. Livingston*, *supra* at 319, 73 N. E. 2d at 139.

59. 3 Blackstone, *op. cit. supra* note 25, at 220.

60. *Long v. Southern Express*, 201 Fed. 441 (S. D. Fla. 1912), *rev'd on other grounds*, 202 Fed. 462 (5th Cir. 1913); *Edelman Bros. v. Baikoff*, 277 Ill. App. 432 (1934).

61. Miller, *op. cit. supra* note 43, at 3.

62. Pomeroy states, "The incompleteness and inadequacy of the legal remedy is the criterion which, under settled doctrine, determines the right to the equitable remedy of injunction." 4 Pomeroy, *op. cit. supra* note 18, at 936.

63. Illegal competitive acts have been held a sufficient ground for equitable intervention, by a number of courts, even without finding them a "public nuisance." *Jones v. Smith Oil and Refining Co.*, 295 Ill. App. 519, 15 N. E. 2d 42 (1938); *Glover v. Maloska*, 238 Mich. 216, 213 N. W. 107 (1927); *Alper v. Las Vegas Motel Ass'n*, . . . Nev. . . ., 325 P. 2d 767 (1958); *Choctaw Pressed Brick Co. v. Townsend*, 108 Okla. 235, 236 Pac. 46 (1925); *Featherstone v. Independent Service Stations Ass'n*, 10 S. W. 2d 124 (Dallas Civ. App. 1928).

64. *E.g.*, where the plaintiff is the only legitimate source of an item.

65. In *Alper v. Las Vegas Motel Ass'n*, . . . Nev. . . ., 325 P. 2d 767 (1958), the proof apparently consisted of motel owners' repetition of statements made to them by motorists who said they would patronize competitors illegally advertising the cost of lodging. In *Glover v. Maloska*, 238 Mich. 216, 213

N. W. 107 (1927), the damages consisted of a decrease in the plaintiff's sales and an increase in the defendant's sales. In *Featherstone v. Independent Service Stations Ass'n*, 10 S. W. 2d 124 (Dallas Civ. App. 1928), the court found the damages in "that various prospective customers of plaintiff left his place without making purchases, on discovering that he did not distribute tickets for the automobile drawing [an alleged lottery] and that, since and during the operation of the schemes plaintiff's business declined, he lost money, whilst the defendant's business increased and they made money as the result of the scheme." *Id.* at 125.

66. *Goldsmith v. Jewish Press Pub. Co.*, 118 Misc. Rep. 789, 195 N. Y. S. 37 (1922); *MacBeth v. Gerbers Inc.*, 72 R. I. 102, 48 A. 2d 366 (1946).

67. *Competitor's Right to Enjoin Unlicensed Professional Practice*, 24 U. Chi. L. Rev. 714, 718 (1957).

68. *Wichita Transportation Co. v. People's Tazicab Co.*, 140 Kans. 40, 34 P. 2d 550 (1934); *New York, N. H. & H. Ry. Co. v. Deister*, 253 Mass. 178, 148 N. E. 590 (1925); *Union Traction Co. v. Smith*, 115 Misc. Rep. 73, 187 N. Y. S. 377 (1921); *Long's Baggage Transfer Co. v. Burford*, 144 Va. 339, 132 S. E. 355 (1926).

69. *York v. Yasaguairre*, 31 Tex. Civ. App. 26, 71 S. W. 536 (1902).

70. *Arkansas State Board of Architects v. Clark*, 226 Ark. 548, 291 S. W. 2d 262 (1956).

71. *Long v. Southern Express*, 201 Fed. 441 (S. D. Fla. 1912), *rev'd on other grounds*, 202 Fed. 462 (5th Cir. 1913); *California Gasoline Retailers v. Regal Petroleum Corporation of*

Fresno, . . . Cal. 2d . . . , 322 P. 2d 945 (1958); *Edelman Bros. v. Baikoff*, 277 Ill. App. 432 (1934); *Glover v. Maloska*, 238 Mich. 216, 213 N. W. 107 (1927); *Alper v. Las Vegas Motel Ass'n*, . . . Nev. . . . , 325 P. 2d 767 (1958); *Choctaw Pressed Brick Co. v. Townsend*, 108 Okla. 235, 236 Pac. 46 (1925); *Featherstone v. Independent Service Stations Ass'n*, 10 S. W. 2d 124 (Dallas Civ. App. 1928).

72. *E.g. Circle Cab v. Springfield Yellow Cab*, 73 Ohio Law Abstract 193, 137 N. E. 2d 137 (1954).

73. 4 Pomeroy, *op. cit. supra* note 18, at 962, 962 n. 20. Pomeroy states that, "the remedy does not depend upon any true *property* acquired . . . but upon the broad principle that a court of equity will not permit fraud to be practiced upon the public nor upon individuals." *Ibid.*

74. *Op. cit. supra* note 66, at 719.

75. 182 Ill. App. 537 (1913).

76. *Id.* at 539.

77. 277 Ill. App. 432 (1934).

78. *Id.* at 440.

79. *Id.* at 448.

80. *Smith v. Illinois Adjustment Finance Co.*, 326 Ill. App. 654, 63 N. E. 2d 264 (1945).

81. *Burden v. Hoover*, 9 Ill. 2d 114, 137 N. E. 2d 59 (1956).

82. 295 Ill. App. 519, 15 N. E. 2d 42 (1938).

83. *Id.* at 523, 15 N. E. 2d at 44.

84. See *Retail Installment Sales Legislation*, 58 Col. L. Rev. 854 (1958).

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