Usury-Applicability of State Usury Laws to Installment Sales

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USURY—APPLICABILITY OF STATE USURY LAWS TO INSTALLMENT SALES—Plaintiff sued a vendor and a finance company to cancel a conditional sales contract and note, for return of payments made, and to obtain an unencumbered certificate of title to a house trailer. The trailer's cash price was 5,000 dollars and plaintiff had paid 1,250 dollars down. Charges of 1,569 dollars were added, making the total time-price 6,569 dollars and leaving a time-balance of 5,319 dollars, payable in sixty monthly installments.[1] The contract and note were immediately assigned to the finance company. Plaintiff based his claim on Nebraska's Installment Loan Act,[2] alleging that the difference between the cash price and the time-price was usurious in exceeding nine percent.[3] Defendants denied that the time-price

[1] Charges of $1,569 on $5,000, payable in sixty monthly installments, amount to a time-price differential in excess of 12% per annum.

[2] NEB. REV. STAT. § 45-138(1) (Supp. 1961) provides: "No licensee shall directly or indirectly charge, contract for, or receive a greater rate of interest than nine per cent per annum upon any loan. . . ." NEB. REV. STAT. § 45-155 (1960) provides: "Violations of 45-114 to 45-155 in connection with any indebtedness, however acquired, shall render such indebtedness void and uncollectable."

[3] For the purposes of usury laws, a man who borrows $100 and pays back $109 one year later has paid 9% interest. If, however, the same man borrows $100 and pays back

differential constituted interest within the meaning of the act. On appeal by the finance company from a judgment for plaintiff, *held*, affirmed, two judges concurring. A time-price differential in an installment sale, computed by applying a schedule of rates to the cash price, constitutes interest subject to the nine-percent limitation of the Installment Loan Act. *Lloyd v. Gutgsell*, 175 Neb. 775, 124 N.W.2d 198 (1963).

The decision in the principal case has attracted considerable national attention.[4] In holding that the time-price differential in a credit sale is interest within the meaning of the state's usury law,[5] and thereby effectively emasculating the traditional application of the time-price doctrine, the Nebraska court has called into question the validity of the vast majority of conditional sales contracts executed in Nebraska during the past four years.[6] According to the time-price doctrine,[7] the fact that the difference between the credit price and the cash price is in excess of the percentage allowed by the usury laws does not render a sales transaction usurious if the parties have acted in good faith.[8] This position found early acceptance in the United States in the leading case of *Hogg v. Ruffner*.[9] In asserting the right of the vendor to name one price for cash and another for credit, courts normally advance the rationale that the position of a purchaser and that of a borrower are not analogous. It has been suggested that while the borrower has little choice but to borrow, the purchaser has merely to refrain from buying, with no real need for the protection afforded by the usury laws.[10] Hence, the applicability of the usury laws traditionally has

$109 in twelve monthly installments, the interest rate is 18%, since he has had the use of the principal for only one-half the time.

4 See, *e.g.*, Time, Nov. 8, 1963, p. 76.

5 Prior to the principal case, Nebraska followed the policy of looking to the substance of each transaction to determine whether a particular sale was bona fide and therefore exempt from the usury laws, or merely a cloak for usury. See, *e.g.*, Elder v. Doerr, 175 Neb. 483, 122 N.W.2d 528 (1963); Wood v. Commonwealth Trailer Sales, Inc., 172 Neb. 494, 110 N.W.2d 87 (1961); Robb v. Central Credit Corp., 169 Neb. 505, 100 N.W.2d 57 (1959); Curtis v. Securities Acceptance Corp., 166 Neb. 815, 91 N.W.2d 19 (1958); State *ex rel.* Beck v. Associates Discount Corp., 162 Neb. 683, 77 N.W.2d 215 (1956); Powell v. Edwards, 162 Neb. 11, 75 N.W.2d 122 (1956); Grand Island Fin. Co. v. Fowler, 124 Neb. 514, 247 N.W. 429 (1933). See generally Note, 40 NEB. L. REV. 433 (1961).

6 Judge Boslaugh, commenting on the court's failure to limit the decision to prospective application, said, "The effect of the language in the majority opinion is to destroy the validity of all time sale contracts which were made in good faith in reliance upon previous decisions of this court." Principal case at 785, 124 N.W.2d at 205 (concurring opinion).

7 The time-price doctrine was first enunciated in Beete v. Bitgood, 7 B. & C. 453, 108 Eng. Rep. 792 (K.B. 1827). This case did away with apparently contradictory language in Dewar v. Span, 3 Term Rep. 425, 100 Eng. Rep. 656 (1789).

8 In its earliest application, the good faith limitation on the doctrine consisted of nothing more than a requirement that there be an actual sale, as distinct from a disguised usurious loan.

9 66 U.S. (1 Black) 115 (1861).

10 An often quoted statement to this effect is found in General Motors Acceptance Corp. v. Weinrich, 218 Mo. App. 68, 77-78, 262 S.W. 425, 428 (1924).

been limited to transactions involving a loan of money or forbearance to enforce a debt.[11]

The time-price doctrine was firmly entrenched in the United States before the rapid transition to a credit-oriented economy which commenced after World War I.[12] With this development, the time-price doctrine assumed a new vitality. It was held applicable to the classic situation wherein the vendor, after quoting a cash price which the buyer is unable to pay, applies a schedule of charges to the cash price, thereby determining the higher time-price. After a conditional sales contract is negotiated, the vendor assigns his rights under it to a finance company, which collects from the buyer in monthly installments.[13] Decisions which deny the applicability of the usury laws to such a credit sale comprise the majority rule today,[14] and, as such, they constitute a curious anomaly. If a person borrows money from a finance company to purchase an automobile, the maximum rate of interest chargeable is strictly regulated by usury laws, which have been enacted in all but four states.[15] If, however, the purchase is made on time, the purchaser may pay up to six times as much in carrying charges to the very same finance company, as assignee of the vendor, since the usury laws are held inapplicable to the transaction. Cognizant of the increasing popularity of the credit sale and the opportunities it afforded for subverting the policy underlying the usury laws, some courts began to whittle away at the time-price doctrine.[16] Generally, this took the form of limiting

11 See, *e.g.*, Brooks v. Auto Wholesalers, Inc., 101 A.2d 255 (D.C. Munic. Ct. App. 1953); Bryant v. Securities Investment Co., 233 Miss. 740, 102 So. 2d 701 (1958); General Motors Acceptance Corp. v. Weinrich, *supra* note 10; Carolina Industrial Bank v. Merrimon, 260 N.C. 335, 132 S.E.2d 692 (1963).

12 For a review of the startling rise of credit sales in the United States, see Comment, 45 MARQ. L. REV. 555 (1962).

13 See, *e.g.*, Commercial Credit Co. v. Tarwater, 215 Ala. 123, 110 So. 39 (1926); Rose v. Wheeler, 140 Cal. App. 217, 35 P.2d 220 (1934); Zazzaro v. Colonial Acceptance Corp., 117 Conn. 251, 167 Atl. 734 (1933); Robrock v. Ditzler, 113 Ind. App. 332, 47 N.E.2d 613 (1943); Henry v. P & E Fin. Co., 197 Okla. 676, 174 P.2d 373 (1946); Hafer v. Spaeth, 22 Wash. 2d 378, 156 P.2d 408 (1945).

14 See, *e.g.*, Brooks v. Auto Wholesalers, Inc., 101 A.2d 255 (D.C. Munic. Ct. App. 1953); Newkirk v. Universal C.I.T. Credit Corp., 93 Ga. App. 1, 90 S.E.2d 618 (1955); Bell v. Idaho Fin. Co., 75 Idaho 560, 255 P.2d 715 (1953); Black v. Contract Purchase Corp., 327 Mich. 636, 42 N.W.2d 768 (1950); Van Asperen v. Darling Olds, Inc., 254 Minn. 62, 93 N.W.2d 690 (1958); Bryant v. Securities Investment Co., 233 Miss. 740, 102 So. 2d 701 (1958); Thomas v. Knickerbocker Operating Co., 202 Misc. 286, 108 N.Y.S.2d 234 (Sup. Ct. 1951); Carolina Industrial Bank v. Merrimon, 260 N.C. 335, 132 S.E.2d 692 (1963); Luchesi v. Capitol Loan & Fin. Co., 83 R.I. 151, 113 A.2d 725 (1955). In addition, the time-price doctrine has been enacted into statute in Texas and Colorado. TEX. REV. STAT. ANN. art. 5074a (Supp. 1959); COLO. REV. STAT. ANN. § 13-16-1(8) (Supp. 1957).

15 Colorado, Maine, Massachusetts and New Hampshire.

16 See Seebold v. Eustermann, 216 Minn. 566, 13 N.W.2d 739 (1944). In Hare v. General Contract Purchase Corp., 220 Ark. 601, 249 S.W.2d 973 (1952), the court prospectively overruled, by caveat, cases upholding the unqualified application of the time-price doctrine. The court held it a question of fact whether the seller increased his cash price with reasonable assurance that he could discount his paper to a loan company. When that assurance is found and the time-price differential exceeds 10%, the transaction is a usurious loan. For Arkansas cases subsequent to the caveat in *Hare*, *supra*, see Crawford

its applicability in certain cases by an examination of the substance of the transaction, rather than its form, to determine whether it was a mere cloak for usury.[17] Typical of these situations were those in which the buyer actually contracted with the finance company,[18] or where there was an inordinate degree of cooperation between the vendor and the finance company.[19] Usury has also been found where the vendor failed to quote an actual time-price[20] and where the original contract obligation was later refinanced by the finance company.[21] Nevertheless, credit sales have generally remained exempt from the strictures of the usury laws, and cases holding that such a transaction is tainted are relatively few in number.

The decision in the principal case is significant not only in breaking with the traditional application of the time-price doctrine to credit sales, but in doing so retroactively.[22] The effect on vendors and finance companies which have relied on the validity of the doctrine in executing conditional sales contracts is likely to be unduly harsh, since a finding of usury in Nebraska results in a loss of the property sold, as well as the principal and interest paid and owing.[23] Implicit in the decision is the premise that little, if any, distinction exists between the borrower and the time-payment purchaser in an economy where credit sales have become a way of life. This court recognized, as have others, the need for extending protection to consumers whose bargaining power is most often inconse-

v. General Contract Corp., 174 F. Supp. 283 (W.D. Ark. 1959); Universal C.I.T. Credit Corp. v. Lackey, 228 Ark. 101, 305 S.W.2d 858 (1957); Thompson v. Murdock Acceptance Corp., 223 Ark. 483, 267 S.W.2d 11 (1954); Murdock Acceptance Corp. v. Clift, 22 Ark. 313, 259 S.W.2d 517 (1953).

17 "The theory that a contract will be usurious or not, according to the kind of paper bag it is put up in . . . is altogether erroneous. The law intends that a search for usury shall penetrate the substance." Pope v. Marshall, 78 Ga. 635, 640, 4 S.E. 116, 118 (1887).

18 Jackson v. Commercial Credit Corp., 90 Ga. App. 352, 83 S.E.2d 76 (1954); Nazarian v. Lincoln Fin. Corp., 77 R.I. 497, 78 A.2d 7 (1951).

19 Factors which have been considered significant are the finance company's providing the forms, setting the rates, furnishing rate tables, or conducting the credit check; immediate assignment by the vendor; and joint ownership of the sales agency and finance company. See Crawford v. General Contract Corp., 174 F. Supp. 283 (W.D. Ark. 1959); Universal C.I.T. Credit Corp. v. Lackey, 228 Ark. 101, 305 S.W.2d 858 (1957); Powell v. Edwards, 162 Neb. 11, 75 N.W.2d 122 (1956). *But cf.* Luchesi v. Capitol Loan & Fin. Co., 83 R.I. 151, 113 A.2d 725 (1955), where the time-price doctrine was applied despite the fact that one man was president of both the sales agency and the lending organization.

20 Daniel v. First Nat'l Bank, 227 F.2d 353 (5th Cir. 1955); Robb v. Central Credit Corp., 169 Neb. 505, 100 N.W.2d 57 (1959); Curtis v. Securities Acceptance Corp., 166 Neb. 815, 91 N.W.2d 19 (1958).

21 Wood v. Commonwealth Trailer Sales, Inc., 172 Neb. 494, 110 N.W.2d 87 (1961); State *ex rel.* Beck v. Associates Discount Corp., 162 Neb. 683, 77 N.W.2d 215 (1956); Associates Discount Corp. v. Ruddock, 244 Miss. 533, 81 So. 2d 249 (1955).

22 Cases following Hare v. General Contract Purchase Corp., 220 Ark. 601, 249 S.W.2d 973 (1952), applied its caveat only to transactions occurring subsequent to the decree in *Hare.* See, *e.g.*, Murdock Acceptance Corp. v. Clift, 222 Ark. 313, 259 S.W.2d 517 (1953).

23 NEB. REV. STAT. § 45-155 (Supp. 1961).

quential.[24] While the inconsistency inherent in providing protection for one class of debtors and withholding it from another may be conceded, it is questionable whether the most prudent solution lies in judicial extinction of the time-price doctrine. The primary advantage of the doctrine is its beneficial effect in encouraging a sufficient supply of risk capital to finance installment credit. Financial concerns, however, contend that the statutory interest rates for money loans in the majority of states are inadequate to compensate for the costs involved in financing credit sales.[25] The lack of ready financing would necessarily force the vendor to reduce his volume of credit sales to a level which he could carry personally, a result which hopefully is to be avoided. It is pertinent to note that since the decision in the principal case, several large finance companies have suspended operations in Nebraska, and sales of new and used automobiles have slumped from lack of financing.[26]

Specific legislation suggests itself as an alternative to application of the usury laws in an area where they were not intended to operate. Such legislation, embodying the premise that money loans and credit sales are dissimilar in some aspects, would have to balance protection of the credit purchaser against the necessity of maintaining a climate conducive to the profitable financing of installment credit. Unfortunately, this path seems to be blocked in Nebraska, where a statute purporting to fix the maximum time-price differential in installment sales was held to violate the Nebraska Constitution as establishing a special interest rate applicable to only a specific type of transaction.[27] Another alternative would be to raise the statutory maximum interest rates provided by the usury laws, but this has the objectionable feature of increasing those rates beyond what has been found to be necessary and equitable for money loans. Moreover, such an alternative would require constitutional amendment in some states.[28] Despite these drawbacks to a legislative solution, the courts should await the determination of the legislature, rather than overruling the traditional application of the time-price doctrine to credit sales. Even under this

24 See *Consumer Credit Symposium: Development in the Law*, 55 NW. U.L. REV. 301, 304 (1960).

25 See Ecker, *Usury in Installment Sales*, 2 LAW & CONTEMP. PROB. 173, 185 (1935). At present the statutory limits on interest rates for larger loans in most of the states range between 6% and 10%. See Note, 8 ARK. L. REV. 420, 428-31 (1954).

26 Time, Nov. 8, 1963, p. 76.

27 The Nebraska Installment Sales Act, NEB. REV. STAT. § 45-305 (1960), was held unconstitutional in Elder v. Doerr, 175 Neb. 483, 122 N.W.2d 528 (1963). The statute was found to be an unreasonable classification, violative of NEB. CONST. art. 3, § 18, which prohibits the passing of special laws regulating the interest on money. The *Elder* decision is a precursor of the principal case in equating the time-price differential with interest, thus bringing the act under the constitutional prohibition against special interest rates. However, the parties stipulated to this identity, and the court assumed the point without discussion.

28 Maximum interest rates for money loans are constitutionally fixed in Arkansas (ARK. CONST. art. 19, § 13), California (CAL. CONST. art. 20, § 22), Oklahoma (OKLA. CONST. art. XIV, § 2), Tennessee (TENN. CONST. art. 11, § 7), and Texas (TEXAS CONST. art. 3, § 56).

view, the purchaser has some protection, in that the transaction is voidable if it may be construed as usurious in substance. Certainly, if a court is constrained to act, its ruling should not be applied to those transactions entered into prior to the decree.[29]

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29 That the principal case was a proper one for a prospective overruling only would seem to be evident from the number and importance of contracts executed in reliance on the validity of the time-price doctrine. See Note, 60 HARV. L. REV. 437, 441-42 (1947), where the writer discusses the frequent prospective application of judgments overruling a prior decision in situations where contracts have been formed in reliance on that decision.