

Michigan Law Review

Volume 53 | Issue 1

1954

Contracts - Usury - Dual Contracts Designed to Evade Usury Prohibitions

Richard W. Young S.Ed.
University of Michigan Law School

Follow this and additional works at: <https://repository.law.umich.edu/mlr>



Part of the [Banking and Finance Law Commons](#), and the [Contracts Commons](#)

Recommended Citation

Richard W. Young S.Ed., *Contracts - Usury - Dual Contracts Designed to Evade Usury Prohibitions*, 53 MICH. L. REV. 138 (1954).

Available at: <https://repository.law.umich.edu/mlr/vol53/iss1/14>

This Recent Important Decisions is brought to you for free and open access by the Michigan Law Review at University of Michigan Law School Scholarship Repository. It has been accepted for inclusion in Michigan Law Review by an authorized editor of University of Michigan Law School Scholarship Repository. For more information, please contact mlaw.repository@umich.edu.

CONTRACTS—USURY—DUAL CONTRACTS DESIGNED TO EVADE USURY PROHIBITIONS—Plaintiff applied to the defendant finance company for a loan of \$100. The lender agreed to advance this amount and accordingly required the plaintiff to execute a note in the sum of \$114.04 payable in one year and secured by a chattel mortgage on an automobile, but insisted in addition that plaintiff purchase an investment certificate in the amount of the note, issued by the defendant company and bearing 2 percent interest, which certificate was to be paid for in twelve monthly instalments. Contending that the interest thus exacted was usurious, the plaintiff brought suit for cancellation of the note and mortgage.¹ On appeal from a judgment that the loan was not usurious, *held*, affirmed with a caveat. The sale of the investment certificate was essentially a part of the loan transaction, so that monthly instalments on the certificate were in effect repayment of the loan and the totality of the arrangement was usurious.

¹ ARK. CONST., art. XIX, §13 provides: "All contracts for a greater rate of interest than ten percent per annum shall be void, as to principal and interest, and the General Assembly shall prohibit the same by law. . . ." Although this mandate is self-executing, it has been implemented and amplified by statute. See *Strickler v. State Auto Finance Co.*, 220 Ark. 565, 249 S.W. (2d) 307 (1952).

But prior holdings to the contrary² which had become a rule of property could not be overruled retrospectively, and the judgment in the principal case was therefore affirmed with a caveat that a similar course of dealing would henceforth be considered a single transaction and subject to the constitutional mandate against usury. *O'Brien v. Atlas Finance Co.*, (Ark. 1954) 264 S.W. (2d) 839.³

It is well settled that where the purpose of a lender is to frame a series of transactions devised to cloak an intent to exact excessive interest, courts will frustrate such evasion and ascribe to the scheme its contemplated illegal purpose.⁴ But the Arkansas court has consistently held that good faith collateral contracts will not invalidate a contemporaneous loan of money as usurious, although the practical effect of the aggregate of transactions might be to collect more than a legal rate of interest,⁵ even though the loan is made only on condition of the borrower's assent to the collateral agreement.⁶ The system of dual contracts used in the principal case, a loan contract and simultaneous purchase of an investment certificate, is a most palpable means of evading the constitutional limitations on interest,⁷ although it bears substantial similarity to approved systems used by building and loan associations⁸ and Morris Plan banks.⁹ The

² *Simpson v. Smith Savings Society*, 178 Ark. 921, 12 S.W. (2d) 890 (1929); *Hickingbotham v. Industrial Finance Corp.*, 192 Ark. 429, 91 S.W. (2d) 1023 (1936). In these cases the Arkansas court found the note and the instalment investment certificate were separate and distinct obligations, and when thus viewed and construed did not separately disclose usury.

³ In a vigorous dissent, Griffin Smith, C.J., objected to the use of this "delightfully convenient judicial sedative spoken of as a caveat" to suspend the constitutional proscription against usury. Principal case at 841. Parties to similar contracts executed before the caveat became final were held to have no constitutional right to have the new rule applied to their transactions in *Crisco v. Murdock Acceptance Corp.*, (Ark. 1953) 258 S.W. (2d) 551, cert. den. 346 U.S. 910, 74 S.Ct. 239 (1953). On the propriety of the caveat when employed to announce a prospective departure from past holdings, see Lobingier, "Precedent in Legal Systems," 44 MICH. L. REV. 955 (1946); Snyder, "Retrospective Operation of Overruling Decisions," 35 ILL. L. REV. 121 at 130 et seq. (1940); Kocourek and Koven, "Renovation of the Common Law through Stare Decisis," 29 ILL. L. REV. 971 (1935); Stimson, "Retroactivity in Law," 38 MICH. L. REV. 30 (1939); Moschzisker, "Stare Decisis in Courts of Last Resort," 37 HARV. L. REV. 409 at 426 (1924).

⁴ See 2 CONTRACTS RESTATEMENT §529 (1932); 6 WILLISTON, CONTRACTS, 2d ed., §1687 (1938); 6 CORBIN, CONTRACTS §1501 (1951); 55 AM. JUR., USURY §14 (1946).

⁵ *Simpson v. Smith Savings Society*, supra note 2; *Hogan v. Thompson*, 186 Ark. 497, 54 S.W. (2d) 303 (1932). See also 6 ARK. L. REV. 26 at 31 (1951).

⁶ *Leavitt v. Marathon Oil Co.*, 186 Ark. 1077, 57 S.W. (2d) 814 (1933). Cf. 6 CORBIN, CONTRACTS §1501, p. 946 (1951): ". . . if the loan is made only on condition that the other transaction shall accompany it, a finding of usurious intent may be justified."

⁷ This practice was held usurious in *State v. Whaley*, 176 Tenn. 170, 139 S.W. (2d) 255 (1939).

⁸ The court in the principal case made clear that its caveat did not apply to loans made by "true" building and loan associations, as upheld in *Reeve v. Ladies' Bldg. and Loan Assn.*, 56 Ark. 335, 19 S.W. 917 (1892); *Farmers' Savings and Bldg. and Loan Assn. v. Ferguson*, 69 Ark. 352, 63 S.W. 797 (1901).

⁹ *Mesaba Loan Co. v. Sher*, 203 Minn. 589, 282 N.W. 823 (1938); *Columbus Industrial Bank of Miller*, 125 Conn. 313, 6 A. (2d) 42 (1940). For a rather comprehensive treatment of the entire area, see Collins, "Evasion and Avoidance of Usury Laws," 8 LAW AND CONTEMP. PROB. 54 (1941).

device consists of a loan at a stipulated rate for the entire term and a requirement that the borrower purchase a certificate having a nominal value equal to the amount of the loan, the purchase price being payable in periodic instalments. Since these payments are not credited on the loan, the effective rate to the borrower is practically doubled since he has the use of the full face amount of the loan only until the first instalment on the investment certificate is payable, yet interest at the contract rate is collected for the entire term on the original sum lent. Surely, the Arkansas court is right, though somewhat tardy, in declaring this arrangement a single contract at usurious interest and clearly within the constitutional prohibition.¹⁰

Richard W. Young, S.Ed.

¹⁰The Arkansas court has recently struck down a number of collateral devices as designed to exact excessive interest: *Commercial Credit Plan, Inc. v. Chandler*, 218 Ark. 966, 239 S.W. (2d) 1009 (1951) (stock subscriptions); *Strickler v. State Auto Finance Co.*, 220 Ark. 565, 249 S.W. (2d) 307 (1952) (special charges), noted 31 *TEX. L. REV.* 345 (1953); *Hare v. General Contract Purchase Corp.*, 220 Ark. 601, 249 S.W. (2d) 973 (1952) (credit sale).