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taining high and clear standards under which they must be exercised. It is in the interest of the settlor, the trustee, and the beneficiary that a proper balance be maintained. Codification of such standards with special emphasis on the corporate trustee\(^5\) would aid in achieving such balance.\(^6\)

JOHN G. ALDRIDGE

Usury—Usury as Applied to Credit Transactions

In Biblical times\(^1\) and at the early common law\(^2\) the taking of any interest or compensation for the use of money, whether moderate or excessive, was considered usurious. Laws were later passed that allowed, but limited, the amount of interest a party could charge on a loan or forebearance of money.\(^3\) In 1821, the case of *Beete v. Bidgood*\(^4\) established the rule in England that a sale on credit was not a loan or forebearance of money and hence the laws against usury did not apply. This view was soon thereafter adopted in practically all the American courts.\(^5\) This doctrine allows a vendor to charge one price for a cash transaction and a higher price for the sale of the same goods on credit. The fact that the credit price

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\(^5\) Due to the nature of the modern corporate trustee the need to set separate and higher standards is becoming greater. This need has been recognized to some extent by those authorities that require a higher degree of care for the corporate trustee. See *Restatement (Second), Trusts* § 174 (1959). Little attempt has been made, however, to set higher standards of loyalty due to the difficulty of framing such a standard. Thus day-to-day restraints are usually imposed by the corporate trustee itself. Yet despite this difficulty it seems that the loyalty concept merits more attention by law making bodies than it has received.

\(^6\) As to the duty of care, both Tennessee and Arkansas have codified the "prudent man rule" as to investments and refer specifically to this standard in their powers acts. See *Ark. Stat. Ann.* § 58-302 (Supp. 1965); *Tenn. Code Ann.* § 35-320 (1955).

The Uniform Trustees' Powers Act in addition to adopting the prudent man rule in § 3(a), states in § 5(b) that if the duty of the trustee and his individual interests conflict in the exercise of a power, such power may be exercised only by authorization of the court. This restriction excludes, however, certain powers which are violative of fiduciary principles. For a criticism of these exclusions see Hallgring 812.


\(^3\) An Act Against Usury, 1570, 13 Eliz. 1, c. 8, § IX.


exceeds the cash price by a greater percentage than the legal rate of interest is of no consequence since the transaction is held to be outside the usury law. The courts predicated this doctrine on the basis that a vendor can charge whatever price he pleases. Furthermore, the vendee is free to accept or reject the vendor's offer. On the other hand, it is true a borrower in need of financial assistance has no choice but to accept a loan on the lender's terms.

The modern adherence to this doctrine is typified by the North Carolina Supreme Court in *Michigan Nat'l Bank v. Hanner*, where Justice Branch, speaking for the court said: "The plaintiff's pleadings make out a sale and installment credit transaction, not a loan. Thus there can be no action for usury."

In *Hanner* the defendant agreed to purchase an airplane from Graubart Aviation Inc. for a purchase price of 59,520 dollars and made a partial payment of 5,000 dollars by trading in a used plane. The defendant signed in blank a conditional sales contract and note and left them with Graubart. Later Graubart filled in the contract, raising the sales price to 69,500 dollars and adding a finance charge of 19,365 dollars. The defendant took possession of the plane in January 1963 and used it until April 1963 at which time he relinquished it to the vendor. The plane was then sold at public auction for 40,000 dollars and the plaintiff, who was an assignee of the conditional sales contract and note, sued for the remainder of the unpaid purchase price and the unpaid finance charges. The defendant

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7 *Id.* at 673.
8 There is a divergence of opinion as to whether a finance company who is an assignee of a conditional sales contract can be a holder in due course. For the proposition that it is not see Griffin v. Baltimore Savings & Loan Ass'n, 204 Md. 154, 109 A.2d 804 (1954). See also Commercial Credit Co. v. Childs, 199 Ark. 1073, 137 S.W.2d 260 (1940) discussed in 53 Harv. L. Rev. 1200 (1940) and 20 U. Cin. L. Rev. 123 (1951). These courts base their decisions on the theory that the finance company was a party to the transaction in and of itself; *cf.* Palmer v. Associate Discount Corp., 124 F.2d 225 (D.C. Cir. 1941) (relying on the agency theory). Typical of the view that a finance company under such conditions may be a holder in due course is White System of New Orleans v. Hall, 219 La. 440, 53 So. 2d 227 (1951).

A majority of the courts hold that the defense of usury is a real rather than a personal defense and even a holder in due course holds a usurious note subject to the usury defense. See Gilden v. Hearne, 79 Tex. 120, 14 S.W. 1031 (1890). This was reaffirmed in Lydick v. Stamps, 316 S.W.2d 107 (Ft. Worth Ct. Civ. App. 1958). The North Carolina Court seems to have adopted this view in Overton v. Tarkington, 249 N.C. 340, 106 S.E.2d 717 (1959) (the court spoke of *assignment* of the debt).
asserted the defense of usury in the nature of a counterclaim\(^9\) for twice the amount he alleged had been charged in violation of usury laws. The North Carolina court held that the transaction was a sale on credit and not subject to the North Carolina usury law.\(^10\)

Prior to Hanner the North Carolina court had enumerated the elements that must be present in order that there be a violation of the usury laws.\(^11\) They are: (1) A loan expressed or implied, or a forebearance of money; (2) An understanding that the money lent was to be returned; (3) A greater rate of interest than the legal rate; and (4) A corrupt intent to take more than the legal rate of interest.\(^12\) These seem to be the same essential factors that other courts look for in determining whether usury laws have been violated.\(^13\)

Courts consistently state that they will look to the true nature of a transaction and not allow a subterfuge to conceal an exaction of more than the legal rate of interest.\(^14\) The North Carolina Supreme Court found such a subterfuge in Ripple v. Mortgage & Acceptance Corp.\(^15\) There an automobile manufacturer sold automobiles to a dealer who paid for them with his own draft and the titles to the automobiles were put in the name of the dealer. A mortgage company was designated as vendor on conditional sales contracts. The

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\(^10\) 268 N.C. at 673, N.C. GEN. STAT. § 24-2 (1964) regulates the amount of interest that a party can charge. It states that the legal rate of interest in North Carolina is six per centum per annum and that the penalty for violation is the forfeiture of the entire interest and in case a greater rate of interest has been paid the person so paying may recover back twice the amount paid. N.C. GEN. STAT. § 53-43 (1964) allows commercial banks to charge interest in advance even though the debt is to be paid in installments. N.C. GEN. STAT. § 53-141 (1964) gives the same privilege to Industrial banks.


\(^12\) The corrupt intent element is satisfied by the charging of a higher interest rate than the law allows. See Associated Stores Inc. v. Industrial Loan & Inv. Co., 202 F. Supp. 251 (E.D.N.C. 1962).

\(^13\) In re Bibbey, 9 F.2d 944, 945 (8th Cir. 1925); Loucks v. Smith, 154 Neb. 597, 599, 48 N.W.2d 722 (1951); Hafer v. Spaeth, 22 Wash. 2d 378, 156 P.2d 408 (1945).

\(^14\) E.g., Dunn v. Midland Loan Fin. Corp., 266 Minn. 550, 289 N.W. 411 (1939).

\(^15\) 193 N.C. 422, 137 S.E.2d 156 (1927).
court held that since the titles to the automobiles were never in the name of the mortgage company, it could not be a vendor, and the transaction could not possibly be a sale but was a loan of the purchase price.\textsuperscript{10}

In comparing \textit{Ripple} with \textit{Hanner} it seems apparent that the North Carolina court concerns itself with form rather than substance when determining the true nature of the transaction in question. There is little substantive difference between a loan of 55,000 dollars with a charge of 30 thousand dollars interest and a sale of an item priced at 55,000 dollars and a subsequent additional charge of 30,000 dollars. No better statement concerning the lack of a substantial difference in such transactions can be found than the following by Judge Tomkins in \textit{Failing v. National Bond \\& Inv. Corp.}.\textsuperscript{17} He said:

In construing a statute, its purpose may not be ignored, its object should be the polar star of the court, when the course has become obscured by decisions where, manifestly, the port for the time, has been lost . . . If it is the needy individual whose protection usury laws are inacted to guard, is the need of him who borrows that he may buy for cash, greater than his, who purchases on credit? . . . Tweedledum and tweedledee have no place in the law today, which professes to seek the truth; whose aim is justice.\textsuperscript{18}

The attitude of the North Carolina court seems to be shared by the vast majority of the state and federal courts, which, though they state that they will examine the transaction, rarely find anything but a bona fide credit sale transaction.\textsuperscript{19}

The courts of Arkansas\textsuperscript{20} and Nebraska\textsuperscript{21} have realized the futil-
ity of attempting to distinguish between a credit sale and a loan or forebearance of money and treat the two as identical for usury purposes. Thus, any mark-up over the cash price will be treated as interest in these jurisdictions.\textsuperscript{22}

The Commissioners on Uniform State Laws have recognized the anomaly that exists in the application of the usury laws and have undertaken an exhaustive study of the entire field of consumer credit for the purpose of drafting comprehensive uniform or model state legislation.\textsuperscript{23} This study is at the request of the council of state governments. Substantial impetus for the study was provided by the bills entitled "Truth in Lending"\textsuperscript{24} introduced in Congress by Senator Douglas of Illinois. Creditors would, under this legislation, be required to tell the consumer in terms that they can understand what they are paying for credit.\textsuperscript{25} Generally speaking the Douglas Bill would require all consumer credit suppliers to state their finance charges in terms of an annual interest rate and in terms of a dollar amount. The proposed benefit to the consumer rests on the theory that there is an increasing amount of competition among creditors for consumer credit and in order for the consumer to benefit from this competition he must know which of two creditors offers the better credit price.

Conceding that a party may set one price for a cash transaction and a much higher price for the sale of the same goods on credit, it would seem, under basic contract principals, that the higher price must be agreed upon by both parties in order to consumate an enforceable contract. The decision in Hanner seems to be vulnerable

\textsuperscript{22} 220 Ark. at 607; 175 Neb. at 496. Other states have adopted a very strict view in regard to aggregation of interest which is contra to the North Carolina view set forth in note 7 supra. These states allow a bank to charge only the amount of interest which has been earned prior to the payment of each installment payment. A statement by the court in Dowler v. Georgia Enterprises, Inc., 162 Tenn. 59, 34 S.W.2d 445 (1930) is illustrative of this view. It said: "Payments are first applied to the discharge of interest accrued at the date of each partial payment." \textit{Id.} at 62, 34 S.W.2d at 448.

\textsuperscript{23} Buerger, \textit{Project On Retail Installment Sales, Consumer Credit, Small Loans and Usury}, 18 PER. FIN. Q. 110 (1963).

\textsuperscript{24} S. 2275 89th Cong., 1st Sess. (1965).

\textsuperscript{25} S. 2275 § 4 89th Cong., 1st Sess. (1965).
on this point; but on closer examination, *Hanner* can probably be justified on the theory that the use of the plane for two months operated as an acceptance of the higher price. In this factual respect *Hanner* differs from the practice indulged in by some retail stores. Under this practice a purchase is made of an item at a certain price and no mention is made of a credit price. The customer is then charged interest at rates as high as one and one-half per cent on the unpaid balance at the end of each month. This is interest at the rate of eighteen per cent per annum. The legislation proposed by Senator Douglas would require that a creditor in an open end credit transaction (1) provide to the buyer a clear statement in writing, setting forth the simple annual percentage rate at which a finance charge will be imposed on the monthly balance and (2) furnish to each person at the end of each month a statement setting forth the simple annual percentage rate at which a finance charge has been imposed on the monthly balance.

Usury statutes have, since their inception, been considered a valid exercise of the police power of the state. The traditional justification rests in the theory that a needy borrower is compelled to accept the terms of a merciless lender. Therefore, the legislature protected the needy borrower against unconscionable rates of interest. It is submitted that a needy consumer, buying a necessity of life, is just as much at the mercy of the greedy merchant as a needy borrower seeking a loan from a voracious lender.

In the modern world the volume of credit buying is much greater than in the days of *Beete v. Bidgood*. It has been estimated that the total volume of consumer credit, exclusive of home mortgage financing, approximates seventy billion dollars each year. Consumer products comprise the largest portion of the total credit buying today and most of these products fall in the category of "necessities." The need seems apparent for some form of relief against

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26 268 N.C. at 669. It should be noted that the appeal in *Hanner* was taken from the trial court's striking of the defendant's counterclaim based on usury; the enforceability of the original contract was probably not before the court.

27 This charge is usually referred to as a carrying charge.


29 State *ex rel* Ornstine v. Cary, 126 Wis. 135, 140, 104 N.W. 792 (1905), *writ of error dismissed* 204 U.S. 669 (1906).

30 See note 4 *supra* and accompanying text.

the type of credit transaction discussed herein, either from the legislature or from the courts. The statutes against usury should be extended to include credit sale transactions. Until such statutory protection is afforded, a more realistic application of the "true nature of the transaction" rule would provide some degree of protection to the consumer.

Billy R. Barr