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USURY. USURY IN VENDOR CREDIT TRANSACTIONS

Suppose that *B*, Buyer, wants to purchase an automobile from *S*, Seller for a purchase price of \$1,500 but *B* has only \$500 cash to pay down; *B* may finance the remaining \$1,000 balance one of two general ways: (1) He may borrow the \$1,000 directly from *F*, Finance Company or Bank at say a charge of \$100, loan to be repaid in twelve equal monthly installments of \$91.67 each; or (2) he may execute a note and security agreement with *S* and pay directly to *S* the \$91.67 per month. The first transaction is clearly within the usury statutes because it involves a "loan or forbearance of money".¹ The second, however, is not subject to the usury statutes because the transaction was one of sale rather than a loan of money.² It is this second transaction that is the subject of this paper.

Oklahoma has exempted this second transaction - - - the credit sale - - - from the usury statutes by invoking the doctrine that a seller may offer an article at two different prices, a cash price and a time and/or credit price.³ The fact that the time price exceeds the cash price by an amount representing interest greater than the statute allows is deemed immaterial on the theory that the credit sale is merely a sale at a higher price which the seller is entitled to charge to cover the risks of selling on time.⁴ The non-loan nature of the credit sale is not altered by the fact *S*, to avoid having his working capital tied up, may transfer his interest to *F* at a discount.⁵ However, if *B* attempts to borrow money from *F* and *F* has *B* finance the purchase through *S* by means of an installment contract which is later assigned to *F*, the transaction will then be subject to the usury laws.⁶

Since the lender credit laws⁷ are inapplicable to vendor credit and the absence in Oklahoma of any legislation specialized to the regulation of

¹ OKLA. STAT. tit. 15, § 264 (1961): "Interest is the compensation allowed for the use or forbearance or detention of money, or its equivalent."

² *Cobb v. Baxter*, 292 P.2d 389 (Okla. 1956); *Henry v. P. & E. Fin. Co.*, 197 Okla. 676, 174 P.2d 373 (1946); *GMAC v. Mid-West Chevrolet Co.*, 66 F.2d 1 (10th Cir. 1933).

³ *Henry v. P. & E. Fin. Co.*, *supra* note 2; *Mondie v. GMAC*, 178 Okla. 584, 63 P.2d 708 (1937); *Huseman v. Universal Credit Co.*, 178 Okla. 168, 62 P.2d 485 (1937).

⁴ The pioneer case expounding this theory is the early English case of *Beete v. Bidgood*, 7 B&C 453, 108 Eng. Rep. 792 (K.B. 1827). The backbone of the United States cases is the early *Hogg v. Ruffner*, 66 U.S. (1 Black) 115 (1861). Most of the leading cases are collected in 143 A.L.R. 238 (1943).

⁵ See *Carolina Industrial Bank v. Merrimon*, 260 N.C. 335, 132 S.E.2d 692 (1963), citing similar holdings in a number of jurisdictions.

⁶ *Jackson v. Commercial Credit Corp.*, 90 Va. App. 352, 83 S.E.2d 76 (1954); *McCalister v. Columbia Credit Co.*, 84 A.2d 108 (Munic. Ch. App. D.C. 1951); *Nazarian v. Lincoln Fin. Corp.*, 78 A.2d 7 (R.I. 1951).

⁷ Small Loan Act, OKLA. STAT. tit. 15, § 280.1—29 (1961); Credit Unions, OKLA. STAT. tit. 6, §§ 395.1—18 (1961); Pawnbrokers, Okla. Stat. tit. 21 §§ 1091—1093 (1961); Savings and Loan, OKLA. STAT. tit. 18, §§ 233, 244 (1961).

vendor credit,⁸ the only prescriptions applicable to consumer credit sale transactions are those which are applied to commercial sales transactions generally. In Oklahoma these prescriptions are generally within the *Uniform Commercial Code*.⁹ But the adoption of the *U.C.C.*, has no effect on the usury laws.¹⁰ Since the courts have denied relief under the usury statutes by their application of the time price doctrine, Oklahoma is without a regulatory scheme of management regarding vendor credit transactions.

The inequalities in Oklahoma vendor credit transactions are apparent. The commercial buyer is put on an even plane with the consumer buyer. The commercial buyer with his knowledge, experience and resources is in a much better bargaining position to negotiate for results which he can, at least, predict. But when the same general commercial laws are applied to the consumer buyer, the results are, more often than not, unexpected and disappointing. It may be true that the consumer buyer can find it quite simple to obtain credit, but he has virtually no bargaining position as to the terms of such credit. A large number of states have recognized just such inequalities and have passed laws dealing exclusively with consumer credit sale transactions.¹¹

The need for such legislation is made more apparent as we watch the court struggle with the problem of determining whether a particular credit transaction is one of loan or of sale. In two states, Arkansas¹² and Nebraska¹³ the court has given up trying to distinguish the loan transaction from the sale transaction, at least for the purpose of apply the usury laws. As a result, the two transactions discussed before are both considered loans in those two states. In the rest of the states, Oklahoma included, the time-price doctrine has been affirmed.¹⁴

To better understand this doctrine, we quote the North Carolina Supreme court directly from a recent case:

In interpreting [usury] laws in relation to [vendor credit] trans-

⁸ Oklahoma has no major legislation resembling an Installment Sales Act.

⁹ OKLA. STAT. tit. 12A, § 1-9 (1961), hereinafter referred to as the *U.C.C.*

¹⁰ *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 364 S.W.2d 158 (1963).

¹¹ OKLA. STAT. tit. 12A § 9-201 (1961) (The Secured Transaction section of the *U.C.C.*): "Nothing in this Article validates any change or practice illegal under any statute or regulation thereunder governing usury . . . or extends the application of any such statute or regulation." It should be noted that this exemption is specifically stated in the Secured Transaction Article of the *U.C.C.* Usury is still a valid defense to one other than a holder in due course of a negotiable instrument under Article 3 of the *U.C.C.* OKLA. STAT. tit. 12A, §§ 3-305 & 06 (1961). Presumably usury will not be disregarded in striking down "unconscionable" bargains under the Sales Article of the *U.C.C.* See OKLA. STAT. tit. 12A, § 2-302 (1961).

¹² CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION, 254-55 (1965).

¹³ See text accompanying notes 25-27 *infra*.

¹⁴ See text accompanying notes 28-34 *infra*.

¹⁵ See text accompanying notes 2 & 3 *infra*.

actions . . . there have been declared by the great weight of authority, the following principles:

- (1) Usury can only attach to a loan of money or to forbearance of a debt.
- (2) A vendor may fix on his property one price for cash and another for credit, and the mere fact that the credit price exceeds the cash price by a greater percentage than is permitted by the usury laws is a matter of concern to the parties and not to the courts, barring evidence of bad faith.
- (3) Usury cannot be predicated upon the fact that property is sold upon a credit at an advance over what would be charged in case of a cash sale so long as it appears that the price charged is in fact fixed for the purchase of goods on credit with no intention or purpose of defeating the usury laws even though the difference between the cash price and the credit price, if considered as interest, amounts to more than the legal rate.
- (4) A *bona fide* credit sale upon an installment payment basis does not involve a loan of money or a forbearance of a debt within the meaning and application of the usury laws.
- (5) A finance company is not precluded from enforcing a credit sale contract according to its terms, if valid between the original parties, although the credit price exceeds the cash price by more than the legal interest. And such transaction is not converted into a loan by reason of the fact that the finance company solicited such business from the dealer and furnished forms for the contract, and if the seller computes the finance charge in accordance with a Table or schedule furnished by the finance company.¹⁵

The questions now arises: Why the time-price doctrine at all? Historically, the doctrine was predicted on the basis that a seller has an inherent right to charge whatever price he pleases. Further, the buyer under a credit sale contract is free to accept or reject the seller's offer; whereas, the needy borrower subject to the loan acts, has no choice but to borrow the money.¹⁶ This stagnant approach has been carried forward by the blind principles of *stare decisis* to today's modern world of big volume consumer buying. The approach is typified by the Missouri court in a 1960 case where they say:

The statute against usury is striking at forbidding the exaction of receipt of more than a specified rate for the hire of money and not anything else. And a purchaser is not like the needy

¹⁵ Carolina Industrial Bank v. Merrimon, *supra* note 5, at _____, 132 S.E.2d at 698. (Citations, *op. cit. supra* note 11, at 2-3.

¹⁶ CURRAN, *op. cit. supra* note 11, at 2-3.

borrower, a victim of a rapacious lender, since he can refrain from the purchase if he does not choose to pay the price asked by the seller.¹⁷

It is submitted that in today's modern world, one can be just as "needy" of an automobile, washing machine, or various other consumer commodities, as one can be "needy" of a loan.¹⁸

Further, to *B* in our two hypothetical situations set out above, there is no economic difference between the interest charge and the credit charge, both represent charges for buying on credit rather than paying cash.¹⁹ In the first situation; *B* borrowed the money and used the proceeds to buy merchandise. The entire money-use charge is interest and goes to the benefit of *F*. This charge is intended to cover *F*'s expenses plus yield a fair return on his investment. In the second situation - - - the credit sale contract - - - the amount paid by *B* to *S* as a credit charge is the same as the interest collected by *F* in the first example. The situation is not the same, however, where *S* has transferred his interest to *F* at a discount.²⁰ That portion that has been received by *F* can properly be regarded as interest since such payments are nothing more than charges for the use of money.²¹ Any portion of the credit charge paid to *S* should also be regarded as interest. There appears no justifications for treating *S*, who finances his own sale, differently. *S* is adding a credit charge to the cash price in order to cover credit losses for *B*'s non-payment and to provide a charge for the use of his money. This is the same function of the interest charged by *F* in the first situation and should be treated as such. Assuming that in the second situation, *S* sold the note to *F* at a discount "with recourse" (thereby guaranteeing payment to *F*), *S* is still receiving payment for the credit charge to the benefit of *S* and this should likewise be regarded as part of the total interest charge to *B*. To treat the credit charge as interest no matter who receives it is more in keeping with the spirit and purpose of the usury laws - - - protection of the borrowing public - - - than to say that the credit charge paid to *S* is merely an increase in his selling price.

The decisions in Nebraska²³ and Arkansas²⁴ bear out this approach. An examination of these decisions against each states' statutory requirements

¹⁷ Wyatt v. Commercial Credit Corp., 341 S.W.2d 348, 352 (Mo. 1960).

¹⁸ For an expansion of this viewpoint see Warren, *Regulation of Finance Charges in Retail Installment Sales*, 68 YALE L.J. 839 (1959).

¹⁹ *Id.* at 842.

²⁰ *Project*, 7 U.C.L.A.L. REV. 618, 659 (1960).

²¹ Technically a finance company can never be anything but a lender because the very nature of the finance company business is to "sell" money.

²² But in this situation, *S* is probably increasing his price, not for the purpose of compensating himself for the credit risk he is taking, but to assure the sale of the paper to *F*.

²³ See text accompanying notes 25-27 *infra*.

²⁴ See text accompanying notes 28-34 *infra*.

may give some insight into the possible course of future Oklahoma action in the field.

In 1952, the Arkansas Supreme Court decided the case of *Hare v. General Contract Purchase Co.*²⁵ In that case *B* executed a security agreement and note to *S* for face amount of \$1,439.13. *S* immediately thereafter discounted the note and security agreement to *F* for \$1,150.00. The cash price of the item was \$1,150.00 so that the difference between the cash price and the time price was \$289.13. The court said that since the \$289.13 *i.e.*, the time price differential, exceeded the constitutional maximum interest rate of 10%, the contract was usurious. The court did not abolish the time-price doctrine retroactively but did so by means of a *caveat*. The court said that in the future if *S*, subsequent to his agreement with *B*, transfers his interest to *F* and such transfer permits *F* to obtain more than a 10% return of its investment, then a question of fact arises as to whether *S* increased his cash price with the reasonable assurance that he could so discount the paper to *F*. The court, in overruling much of the time-price doctrine, gave as its reason: "What we are trying to do is to keep the spirit of the constitutional mandate against usury abreast of present day commercial transactions."²⁶

In 1957, Arkansas extended the *Hare* doctrine in *Sloan v. Sears, Roebuck & Co.*²⁷ The situation in that case was essentially the same as in the second hypothetical set out at the beginning of this paper. The court said that the constitutional prohibition against excessive interest charges applied not only to direct loans of money but also to any contract on which a charge for credit was made, and therefore applied to a credit sale contract.

In Nebraska, the decisions are basically quite different from those of Arkansas. Nebraska's decisions arose under a retail Installment Sales Act. In 1963, the Nebraska Supreme Court, decided the case of *Elder v. Doerr*.²⁸ In this case it was stipulated that the facts showed a perfect time sale at common law. It was further stipulated there was no misrepresentation, that *B* was offered two prices, no finance company was involved, etc., so that the transaction would qualify anywhere as a valid time sale.

The court held that finance charges made in compliance with the Installment Sales Act were interest and that the provisions authorizing such charges were unconstitutional under the Nebraska constitution.²⁹

²⁵ 220 Ark. 601, 249 S.W.2d 973 (1952).

²⁶ *Id.* at _____, 249 S.W.2d at 978.

²⁷ 228 Ark. 464, 308 S.W.2d 802 (1957).

²⁸ 175 Neb. 483, 122 N.W.2d 528 (1963), *appeal dismissed*, 377 U.S. 973 (1964).

²⁹ The Nebraska Installment Sales Act referred to is set out in NEB. REV. STAT. ch. 45, § 114-158 (1960).

In this case the court upheld the time-price doctrine but refused to apply it in this case because the time sale had not been made in good faith, i.e., a contract made under a void statute.³⁰ This decision along with two decisions immediately following³¹ only muddied the water as far as any concrete determination of the status of the time-price doctrine in Nebraska was concerned.

In *Lloyd v. Gutzell*³² the court perhaps made its position clear. The court said:

There seems to be an impression that if a cash price is quoted and the buyer is unable to pay cash, it is then possible to apply a certain schedule of rates or charges to the cash price in order to determine the time sale price, the difference being denominated a time price differential. It is possible to do so if the resulting charge does not exceed 9% simple interest. If it does, we have a usurious transaction . . . When we look through the form, can we come to any other conclusion but the one that the difference between the price and what the buyer finally pays is the cost of carrying the balance of the cash price? To put it another way, the charge is for the forbearance to collect the full cash price, or for the use of money. A rose is still a rose though we may label it a violet.³³

One would think then, that Nebraska vitiated the time-price doctrine. But the court's refusal in the *Lloyd*³⁴ case to specifically overrule, by name, the case which first established the doctrine in Nebraska, *Grand Island Fin. Co. v. Fowler*,³⁵ leaves some doubt yet. At least one writer thinks that the doctrine is still in force, at least as to two individuals who want to bargain at arms length.³⁶ It is only when the right of the seller and the buyer to agree has been completely submerged by mass financing from frozen rate tables that the court feels this use of fixed tables of charges is such a close resemblance to interest rates as to amount to the same thing.³⁷

³⁰ *Elder v. Doerr*, *supra* note 28, at _____, 122 N.W.2d at 532-33.

³¹ *GMAC v. Mackrill*, 175 Neb. 631, 122 N.W.2d 742 (1963); *Stanton v. Mattson*, 175 Neb. 767, 123 N.W.2d 844 (1963), 16 STAN. L. REV. 1113 (1964)

³² 175 Neb. 775, 124 N.W.2d 198 (1963).

³³ *Id.* at _____, 124 N.W.2d at 203-04.

³⁴ *Lloyd v. Gutzell*, *supra* note 32.

³⁵ 124 Neb. 514, 247 N.W. 429 (1935).

³⁶ *Davis, Nebraska Installment Sales "Latest Installment"*, 18 PERSONAL FIN. L. Q. 4 (1963). Mr. Davis was counsel for the defendant in the *Elder* case, *supra* note 28.

³⁷ *Id.* at 6.

In comparing the decisions in Arkansas and Nebraska as to any effect they may have on future Oklahoma vendor credit law, it would appear that Arkansas rulings are to be the most closely scrutinized. In Arkansas, the decision as to the nature of credit charges made for time payment sales was made in the context of constitutional provisions specifying the maximum rate of interest allowable for loan contracts in Arkansas.³⁸

This is nearly identical with the Oklahoma Constitutional provision.³⁹ The Arkansas legislature had no power to enact legislation which conflicted with the maximum prescribed in the constitution.⁴⁰ The Oklahoma legislature may very well be subject to the same prohibition.⁴¹

In addition, prior to the *Hare*⁴² decision in Arkansas vendor credit contracts in Arkansas were subject only to general commercial laws. As discussed previously, this is exactly the situation in Oklahoma today. In short, it would appear that the compelling reasons for the *Hare*⁴³ decision in Arkansas⁴⁴ are present in Oklahoma.

By contrast, it seems the only real statutory similarity between Oklahoma and Nebraska is the constitutional provision in each state regarding

³⁸ ARK. CONST. art. 19, § 13. "All contracts for a greater rate of interest than (10%) per annum shall be void . . . but when no rate of interest is agreed upon, the rate shall be (6%) per annum."

³⁹ OKLA. CONST. art. XIV, § 2: "The legal rate of interest shall not exceed (6%) per annum, in the absence of any contract rate of interest, and, by contract, parties may agree upon any rate not to exceed (10%) per annum"

⁴⁰ See *Strickler v. State Auto Fin. Co.*, 220 Ark. 565, 249 S.W.2d 307 (1952), wherein provisions of the Arkansas Small Loan Act which provided for service charges and insurance charges was held to be in contravention of the Arkansas Constitution. The court stated in the opinion: "We conclude that the service charge of 24 dollars is illegal and an attempt to burden the necessitous borrower with excessive interest under another name. The legislature was therefore powerless to validate the charge." *Id.* at _____, 249 S.W.2d at 312. The court also held that insurance charges collected from the borrower were also illegal. The lender had required the borrower to purchase life, accident and health insurance even though the borrower had already given the lender a chattel mortgage on household furniture. The court said: "The act . . . attempts to authorize registrants to receive commissions on insurance premiums as a profit on a loan in addition to the various other charges authorized by the Act." *Id.* at _____, 249 S.W.2d at 313.

In *Winston v. Personal Fin. Co.*, 220 Ark. 580, 249 S.W.2d 315 (1952), the court held that service charges which included travel expenses and inspection fees as within the provision prohibiting usury.

Because of these decisions the Arkansas Small Loan Act was repealed. ARK. STAT. tit. 67, ch. 13, § 1303-37. (1947) repealed by Ark. Acts 1953, no. 391, sec. 1.

⁴¹ Oklahoma Small Loan Act, OKLA. STAT. tit, 15, §§ 280.1-29 (1961), is quite similar to the Arkansas Act. The constitutionality of the Oklahoma Act has never been tested.

⁴² *Hare v. General Contract Purchase Co.*, *supra* note 25.

⁴³ *Ibid.*

⁴⁴ See text accompanying note 26, *supra*.

the passage of special legislation dealing with interest laws.⁴⁵ This is of no concern in Oklahoma at present because there is currently no major special legislation in the field of vendor credit on the state statute books.⁴⁶ But should Oklahoma decide special legislation is needed in this area, a constitutional amendment may very well be the only answer.⁴⁷

On June 22, 1964, the National Conference of Commissioners on Uniform State Laws announced that it had commenced ". . . an exhaustive study of the entire field of consumer credit for the purpose of drafting comprehensive uniform or model state legislation."⁴⁸ The impetus for this study was provided in part by the Nebraska decisions,⁴⁹ and in part by the bills entitled "Truth in Lending," introduced in Congress by Senator Douglas of Illinois.⁵⁰ Let us hope that the Conference can come up with a realistic program for solving the needs of the consumer as well as the needs of financiers. It is a fact that much of today's "American way of life" is being paid for on the installment plan.⁵¹ The reliance upon the installment plan by the buying public has pointed up the need for effective consumer protection.

The type of legislation necessary to grant effective protection has not been discussed, but it seems clear that the usury statutes have not brought the protection needed. The time price doctrine has been more than efficient in its blocking of effective enforcement of the usury laws. This is not to say, however, that rigid enforcement of the usury statutes, *i.e.*, a complete

⁴⁵ OKLA. CONST. art. V, § 46: "The legislature shall not . . . pass any local or special law authorizing: . . . fixing the rate interest."

⁴⁶ But, according to traditional doctrine, the "special laws" provisions of state constitutions (Oklahoma's special laws provision is set forth in note 45) require that a reasonable basis be shown to sustain economic legislation which distinguishes among members of a class. See *Ferguson v. Skrupa*, 372 U.S. 726 (1963), where the federal rule was restated that acts of the legislature respecting economic legislation are not in violation of the equal protection clause of the fourteenth amendment unless shown to be arbitrary and "evincing invidious discrimination."

The Oklahoma court could sustain a time sale regulation which permits a higher rate of interest than for others types of loan transactions on the rationale that our economic system demands such treatment. *But see* *Turney v. Goldberg's Loan Office*, 135 Okla. 147, 274 Pac. 464 (1929), where the court struck down a pawnbroker's statute on the grounds that any statute attempting to authorize pawnbrokers to charge over 10% interest is invalid under both art. V, sec. 46 (see note 45 *supra*) and art. XIV, sec. 2 (see note 39 *supra* of the Oklahoma constitution) There was no determination in this case whether service charges were to be considered interest.

⁴⁷ This was the answer that Nebraska finally came up with. In November of 1964, the voters of Nebraska passed a constitutional amendment which gave the legislature authority to separately define and classify loans and installment sales and to establish maximum rates within the classifications of loans or installment sales which it establishes. See Thone, *Nebraska Installment Sales "Voter Installment"*, 19 PERSONAL FIN. L. Q. 21 (1964).

⁴⁸ Buerger, *Project on Retail Installment Sales*, 18 PERSONAL FIN. L. O. (1964).

⁴⁹ Discussed in text accompanying notes 28-34 *supra*.

⁵⁰ Buerger, *op. cit. supra* note 48 at 110.

⁵¹ Warren, *op. cit. supra* note 18.

dismanteling of the time-price doctrine, is the answer. This would only serve to threaten the flow of capital into installment credit.⁵² What is needed is a realistic installment sales act aimed at establishing a balance between the need of protecting consumers against exorbitant finance charges and the need of the finance companies to be recognized as a necessary element of today's consumer world. And, as previously discussed, the first step in Oklahoma to effective consumer credit legislation must be a constitutional amendment to allow the Oklahoma Legislature to enact the "special" legislation which is required.

Should the Oklahoma courts "take the ball" from Arkansas and repudiate the time-price doctrine, then the constitutional interest provision in the Oklahoma Constitution would also need amending. Without the time-price doctrine, the constitutionality of an Installment Sales Act in Oklahoma is extremely doubtful and may even be *per se* unconstitutional.

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⁵² This may not be a true statement because following the *Hare* decision in Arkansas there was a significant increase in the automobile "paper" held by the banks of that state. The four years following the decision saw the "paper" increase from \$9,662,000 to \$19,344,000. This is surprising since the decrease in rates was substantial. The reason for this rise is due probably to the fact that the lowering of rates caused there to be more consumers ready to buy. It also cut down the losses suffered by finance companies since from the bigger volume of buyers they could select better credit risks. See 32 *FORDHAM L. REV.* 587, 591 n.29 (1964).