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Chapter 7: Commercial Law

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C H A P T E R 7

Commercial Law

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§7.1. **Consumer credit: Credit card purchases.** Distinctions must often be drawn, for a variety of reasons, between debts arising from the borrowing of money and those arising from the purchase of goods or services on a deferred payment plan. For example, in jurisdictions having general usury laws, it is necessary to decide whether the “finance” or “service” charges are subject to the limitations imposed on interest, or whether they are simply a part of the price which may be negotiated by the buyer and seller without this control. The same determination must be made within the framework of income tax laws, which may permit deductions for interest on loans, but not for any part of the price paid for consumer goods or services. It is not surprising that the answer to the question may be different when the reason for asking the question is different.

A reason for asking the question in this Commonwealth is to determine whether the creditor must be licensed by the Commissioner of Banks on the ground that he is in the business of making loans of three thousand dollars or less with interest in excess of twelve per cent per year.¹ While the seller himself has never been held to be in the business of making loans simply because his sales are on credit, it was formerly the opinion of the courts, as shown by a decision published in 1940, that if the buyer’s payments were made to a finance company which had purchased the buyer’s notes from the seller in accordance with a prearranged plan of financing, then the finance company *was* in the business of making loans.²

This decision met with legislative disapproval, however, for in 1941 the licensing statute was amended to exempt from the concept of being in the business of making small loans “any transaction which involves any note or other instrument evidencing the indebtedness of a buyer to the seller of goods, services or insurance for a part or all of the purchase price.”³

During the 1965 SURVEY year, a new type of prearranged financing scheme was matched against the licensing requirement. In *Uni-Serv Corp. of Massachusetts v. Commissioner of Banks*,⁴ the financing plan involved the use of a credit card obtained by applicants who would

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§7.1. ¹ License is required by G.L., c. 140, §96.

² *Modern Finance Co. v. Holz*, 307 Mass. 281, 29 N.E.2d 922 (1940).

³ G.L., c. 140, §96, as amended by Acts of 1941, c. 158, §1.

⁴ 1965 Mass. Adv. Sh. 875, 207 N.E.2d 887.

then make credit purchases at any stores participating in the plan. Nothing was added to the price of the goods purchased in any individual sale. The credit card company purchased from the member stores the sales slips evidencing the indebtedness of the buyer, and the buyer received monthly bills from the credit card company. The buyer's minimum monthly obligation depended upon the total monthly balance, regardless of the number or sizes of the individual purchases. Beyond his minimum monthly obligation, the buyer could pay as much of his balance as he wished.

To any balance remaining twenty days after each billing date, a "service charge" of one or one and one-half per cent was added. The Commissioner of Banks took the understandable position that this amounted to the business of making loans, not simply financing time sales. The Supreme Judicial Court held, however, that since the customer could use his credit only when purchasing goods or services, not for securing a cash loan, and since the financing did involve, in the words of the statute, an "instrument [the sales slip] evidencing the indebtedness of a buyer to the seller," the credit card financing company could not be found to be in the business of making loans within the purview of the licensing statute.

§7.2. Consumer credit: Refunds of interest and service charges.

The Motor Vehicle Retail Instalment Sales Act, enacted in 1958, gives the noncommercial purchaser a right to prepay his debt at any time and provides for a compulsory refund of unearned interest or finance charges upon such prepayment.¹ Purchasers of other consumer goods on deferred payment plans were given similar rights by another statute in 1959,² and consumers who pay for services rather than goods in this manner have had such rights since 1962.³ With customary disregard for uniformity, the three statutes contain different descriptions of the method of computing the amount of the refund.

In *Pioneer Credit Corp. v. Commissioner of Banks*,⁴ the Supreme Judicial Court was called upon to interpret the formula required to be used when the charges arise out of the retail installment sale of motor vehicles. Since the finance charges are much like interest, the statute provides that the earned portion may depend not only on elapsed time, but also on the amount of outstanding indebtedness during that time. It does this by providing that the refund shall be "at least as great a proportion of the finance charge [after deduction for an acquisition cost] . . . as the sum of the periodic time balances after the day on which prepayment is made bears to the sum of all the periodic time balances under the schedule of instalments in the original contract."⁵ [Emphasis added.]

If a contract requires regular payments on the last day of each

§7.2. ¹ G.L., c. 255B, §16.

² G.L., c. 255, §12b. Prior to 1959, these rights did not exist if the credit was unsecured.

³ G.L., c. 255, §12d.

⁴ 1965 Mass. Adv. Sh. 789, 207 N.E.2d 51, also noted in §§3.4 *supra*, 11.10 *infra*.

⁵ G.L., c. 255B, §16.

month, and if the borrower should prepay the entire debt on such a day, then under this formula the numerator of the refund fraction must be the sum of the balances that would have existed for each subsequent month if prepayment had not been made. If prepayment is made during a month, after one regular payment day and before the next, the Court ruled that the numerator must still include the balance that would have existed at the end of that same month. In other words, the creditor earns no interest or finance charge for any part of a month if the debtor prepays at any time before the last day of the month, even the day before.

The Court reached this conclusion by comparing the formula given with the formula provided when the debt arises from the sale of consumer goods other than motor vehicles. In that formula, the numerator is "the sum of the periodical time balances *after the month in which the debt is paid in full.*"⁶ [Emphasis added.] If prepayment is made on the last day of the month, both formulas give the same result. But for prepayments at any other time during a month, it is obvious that this formula gives the lender *full credit* for interest or finance charges for the entire month. Since the wording of the two statutes is different, the Court felt, with justification, that the results would have to be different.

The refund provision for finance charges arising out of the rendering of services to consumers on time-payment plans is similar to that provided for the sale of consumer goods other than motor vehicles, except that it does not contain an additional sentence which is found immediately after the statement of the formula quoted above. That additional sentence is: "This computation of rebate to be made under the so-called sum of the digits method."⁷ The sum of the digits method is a simple method which involves numbering each installment, working backward from the last. If each installment is for an equal sum of money, then these numbers will be proportional to the balances due immediately before each installment is paid. Therefore, instead of adding the dollar amounts of the balances for each month, the numbers assigned to the months are added. When used in both the numerator and denominator of the fraction, this will give the same ratio although the additions are simpler. If the amounts of each installment are not equal, however, then this method will give a slightly different result. It is rather ambiguous, therefore, when the statute sets out one formula and then states that computations are to be made by a different method, even though that other method will generally give the same answer.

During the 1965 SURVEY year, several comprehensive retail installment sales acts were proposed. In one, proposed by the Special Commission on Laws Relative to Loans and Credit, the refund would be determined by counting the number of installments paid in advance

⁶ G.L., c. 255, §12b.

⁷ G.L., c. 255, §12d.

and comparing that with the total number of installments.⁸ Under this method, not only would the creditor get no credit for any part of a month during which an installment is prepaid, but he would not even get greater credit for the earlier months, when the debt is high, than for the later ones, when the debt is low. This "straight line" method may be simple, but it is really indefensible in legitimate financing transactions. Prepayments in the later months of contracts which have run for several years would result in grossly exaggerated refunds of "unearned" interest or charges.

In yet another proposal for a comprehensive act, reported by the Committee on Banks and Banking, the formula is spelled out, with the numerator to contain the sum of the balances which would have existed *after the date of prepayment*, but with a further clause stating, in substance, that prepayment during the first half of a month is to be deemed to have been made on the last day of the prior month, while prepayment on the second half of the month is to be deemed to have been made during the last day of the same month.⁹ This surely seems to be a sensible compromise between the extremes that result from the wording of the existing statutes. Regrettably, despite this laudable provision, the proposal does make the mistake of referring to the sum of the digits method after first spelling out the formula in terms of money balances due on each installment date.

§7.3. Consumer credit: Collection costs. While it is unusual for the losing party in a suit to be required to pay the costs, including the attorney's fee, of the winning party, clauses in promissory notes requiring such payment if suit becomes necessary because of default are common. These clauses, if reasonable, are generally upheld as compatible with usury statutes, since the additional fee is considered an indemnity for additional expenses rather than interest.¹ While such clauses have not been enforced when contained in notes taken under the Small Loan Act, the reason is that this act specifically prohibits any verdict for more than would be required to discharge the indebtedness by payment.² Provisions specifically allowing such provisions are found in the Motor Vehicle Retail Instalment Sales Act,³ as well as in the statute regulating loans secured by a security interest in consumer goods,⁴ provided in both instances that these clauses are written in the appropriate agreements.

In *American Service and Supply Co. v. Raby*,⁵ the trial court refused to grant the plaintiff's motion for allowance of counsel fees of 15

⁸ House No. 3902 (1965).

⁹ House No. 3901 (1965). For yet another statute with a provision substantially similar, see House No. 2069 (1965).

¹ See *Leventhal v. Krinsky*, 325 Mass. 336, 90 N.E.2d 545 (1950).

² G.L., c. 140, §90; *Rockland-Atlas National Bank and Trust Co. v. Murphy*, 329 Mass. 755, 110 N.E.2d 638 (1953).

³ G.L., c. 255B, §§9, 14.

⁴ G.L., c. 255B, §§9, 14.

⁵ 1965 Mass. Adv. Sh. 503, 206 N.E.2d 94.

per cent, in accordance with the terms of the consumer note involved, on the ground that no evidence had been presented in support of the motion. The Supreme Judicial Court held, however, that in the absence of a contention that the fee amounted to a penalty, it should have been allowed. In the absence of statutory control, therefore, such fees seem permissible unless clearly unconscionable.

§7.4. Sales: Medical services or goods. The implied warranties of quality recognized by the Uniform Commercial Code and the Uniform Sales Act alike arise only in contracts or agreements for the sale of goods. A sale is defined as the passing of title from the seller to the buyer for a price.¹ With rare exceptions, courts consistently have maintained a distinction between a contract for the sale of goods and a contract for work and labor or for the performance of services, although the passage of title to property may be involved in both.² Thus, while a duty of care may be imposed on the selection of property furnished under a contract for services, absolute liability under warranty concepts is not involved. The Uniform Commercial Code does provide expressly that, for the purpose of a warranty of merchantability, the service of food or drink for value does constitute a sale, although it may not constitute a sale for any other purpose.³ By stating this exception, the Code seems clearly to recognize the distinction.

The passage of title to blood given in a blood transfusion has been held universally, in all reported decisions, to be merely incidental to a contract for the performance of services rather than a sale of goods.⁴ Accordingly, liability *vel non* for the use of improper blood has always depended upon a duty other than that imposed by a warranty obligation. The legislature has now amended the Uniform Commercial Code to make certain this result.⁵ Although it is difficult to discern the reason for the amendment in view of the consistent treatment of this type of situation by courts, reputedly the amendment was sponsored by the Massachusetts Medical Association because of fears raised by a pending case in the midwestern part of the country.

The amendment itself is poorly worded, and parts of it are poorly placed in the Massachusetts version of the Uniform Commercial Code. The amendment provides first that no implied warranty shall apply to a sale of "human blood, blood plasma or other human tissue or organs from a blood bank or reservoir." (The purpose of the "sale" is immaterial, since this is not limited to transfer of these things to patients.) It then apparently provides, in rather badly stated terms, that these things are not subject to sale for any other purposes of

¹ §7.4. 1 G.L., c. 106, §2-106(1).

² *Id.* §2-314, delineating warranties of merchantability, and §2-315, delineating warranties of fitness, relate these warranties to the contract. *Id.* §2-106(1) limits "contracts" to those relating to a sale of goods.

³ *Id.* §2-314.

⁴ See the leading case of *Perlmutter v. Beth David Hospital*, 308 N.Y. 100, 123 N.E.2d 792 (1954); Annotation, 59 A.L.R.2d 768 (1958), and supplements.

⁵ Acts of 1965, c. 297.

Article 2 of the Commercial Code, either. Just what this leaves, if the transfer is not for a transfusion or a transplant, is rather uncertain. It is a pity that the Commercial Code has been tampered with in such a sloppy manner.

§7.5. Banks and banking: Conversion of co-operative banks. Conversion of co-operative banks into federal savings and loan associations may be permitted provided that the Board of Bank Incorporation determines that public convenience and advantage will be promoted by such conversion.¹ In *Massachusetts Co-operative Bank League v. Board of Bank Incorporation*² the Supreme Judicial Court held that the Board was justified in permitting conversion of a bank in Worcester over the objection of the Massachusetts Co-operative Bank League, although the bank was in no present financial danger, upon the showing of a demand for broadened services and greater opportunity for normal growth and in the absence of evidence of likely injury to the banking structure.

In the making of its determination, the statutory guides which the Board had were stated in general terms only. Future applications for this type of conversion will not be quite so indefinite, and the standards to be applied by the Board will be much easier to follow, since the legislature this year has amended the statute permitting conversion to provide full details of the contents of applications, clear restrictions on the types of evidence permissible at the hearings, and a list of factors for the Board to consider in making its determination.³ The ultimate test is still the promotion of public convenience and advantage. While this amendment on the surface would seem to represent a tightening of requirements which must be met before conversion will be authorized, it actually provides a blueprint which, if followed carefully, is more likely to assure the success of an application.

§7.6. Banks and banking: Payments to minors. Funds deposited in the name of a minor with *anyone* doing a banking business in this Commonwealth may be paid directly to the minor, unless in violation of written agreement.¹ Now three specific types of banks—national banking associations, savings and loan associations, and federal credit unions—may also pay either parent of the minor if the amount of the deposit is not over \$750.² The reason for this amendment was not discernible by this writer.

§7.7. Banks and banking: Unauthorized banking. The existing statute prohibiting unauthorized banking¹ has been expanded in its

§7.5. ¹ G.L., c. 170, §49. Although this section had been suspended for two years, the suspension did not apply to applications filed prior to January 1, 1964. See Acts of 1964, c. 386, 1964 Ann. Surv. Mass. Law §7.10.

² 1964 Mass. Adv. Sh. 1283, 202 N.E.2d 598, also noted in §13.9 *infra*.

³ Acts of 1965, c. 430.

§7.6. ¹ G.L., c. 167, §48.

² Acts of 1965, c. 197.

§7.7. ¹ G.L., c. 167, §12.

details, and in addition the use of the word “bankers” in the business name of anyone not authorized to conduct a banking business has been prohibited.² The use of the words “bank” and “banking” has long been prohibited, but the word “bankers” has not. Any domestic corporation with this word in its title may continue to use the word provided that incorporation was prior to January 1, 1965.

² Acts of 1965, c. 154.