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NOTES

APPLICABILITY OF USURY LAWS TO CREDIT INSTALLMENT SALES

INTRODUCTION

During the past fifty years the economy of the United States has become geared to and based upon the mass production of consumer goods. An integral part of this new system of economy is the installment credit system of financing retail sales. In the early stages of development of this consumer credit system, there were many who doubted whether such widespread credit extension would lead to a healthy economy. Arguments based on these doubts have become largely academic, however, for installment credit is now embedded too deeply in the American economy to be extracted without, at the same time, dealing a serious blow to the economy as a whole. In 1948, total installment consumer credit was in excess of eight billion dollars.¹

There remains, however, the question whether the retail installment credit system is being properly regulated and policed in order to adequately protect the public. During the earlier stages of development of this system, there were some practices initiated which were certainly not to the best interest of the public. Foremost among these was the charging of excessive "finance charges". The fact that many fields of installment credit are free from serious abuses of this nature today does not alleviate the problem of finding a method of regulation of the credit system as a whole in order to eliminate the remaining evils.

It is readily understandable that a retailer cannot sell as cheaply on a credit basis as he can for cash. The amount of increase in price between a cash and a credit sale is, however, a subject of the greatest public concern. There certainly would be few consumers who would deny the need for some limit to be placed upon the amount charged as a "finance charge" or "time differential", but the real controversy arises over whether the limitation should be imposed through the application of usury laws to sales transactions.

1. 35 Fed. Reserve Bulletin 300 (March 1949).

HISTORICAL PROCEDURES

In Biblical times, usury embraced any transaction in which interest was charged, whether the interest was taken in money or in kind; as such, usury was the subject of the severest public condemnation.² The earliest statutes on the subject in England included a prohibition of interest taking of substantially the same effect as the Biblical laws.³ Due to the difficulty of enforcement during the early part of the industrial revolution, these statutes were repealed and replaced by statutes allowing a limited amount of interest to be taken. These replacement statutes purported to fix the maximum rate of interest allowable "on a loan or forbearance of money".⁴ The applicability of these statutes to a sales transaction remained unsettled, despite an indication by *dictum* to the affirmative in the case of *Dewer v. Span*,⁵ until the precedent-setting case of *Beete v. Bidgood*,⁶ decided in 1821. The case arose as a consequence of the sale of real estate. It appeared from the accounts in evidence that the purchase price was £25,000, of which £9,000 was paid cash. To the balance, £16,000, was added £4,800, leaving £20,800 to be paid in installments. The defendant vendee gave notes for each of the installments and the plaintiff sought recovery in this action on one of these notes which was due and unpaid. The defendant entered a plea of usury, contending that the £4,800 added to the credited balance was in the nature of interest at an illegal rate. The Court, without citing authority, held that the transaction in question was a *bona fide* credit sale, with the credit price being higher by £4,800 than the cash price; since the transaction in substance appeared to be a sale, and not a "loan or forbearance of money", the statute was inapplicable.

INFLUENCES ON AMERICAN COURTS

Although *Beete v. Bidgood* has not been specifically cited in a large number of American cases, its influence is ob-

2. "Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of anything that is lent upon usury." Deuteronomy 23:19.

3. 13 Eliz. c 18 § IX (1570).

4. 12 Anne c 16 (1714).

5. 3 Term Rep. 425 (Eng. 1789).

6. 7 Barn & Cress. 435, 1 Man. & Ry. 143, 108 Eng. Reprint 792 (1821).

vious to this day. Two theories derived therefrom and often applied today are, first, that the "time differential" is a part of the credit price⁷ and secondly, that a *bona fide* sale does not come within the meaning of the term "loan or forbearance of money".⁸ Further, following the pattern set in *Beete v. Bidgood*, there is a noticeable tendency of the courts to refrain from setting and following any clearly definable rules, but rather to decide each case on its factual merits, with the obvious result that the decisions in a given jurisdiction are often difficult, if not impossible, to reconcile. In this regard, it is often stated by the courts that they will look beyond the form and into the substance of the transaction to determine whether usury is present.⁹ Unfortunately, the courts seldom make clear the test which they use to determine whether the "substance" to which they look is usurious.

Another factor that influences both our present and past decisions, and undoubtedly present in *Beete v. Bidgood*, is the judicial abhorrence of forfeitures. Usury statutes are almost invariably armed with the teeth of forfeiture, the earlier and more harsh often providing for forfeiture of principal, and the later providing for forfeiture of interest or multiples thereof.¹⁰ Throughout the decisions, therefore, there is a noticeable reluctance to find usury present in a given transaction. At times this reluctance is openly discussed by the court,¹¹ but more often it is evident from the strained reasoning of the opinion.¹²

The early cases in this country in which the law was developed on the point under discussion were concerned primarily with the sale of realty,¹³ as was *Beete v. Bidgood*. Gradually, the cases presented have increasingly raised the

7. *Richardson v. C.I.T.*, 60 Ga. App. 780, 5 S.E. 2d 250 (1939); *Commercial Credit Co. v. Shelton*, 139 Miss. 132, 104 So. 75 (1925); *Yeager v. Ainsworth*, 202 Miss. 247, 32 So. 2d 548 (1947).

8. *Commercial Credit Co. v. Tarwarter*, 215 Ala. 123, 110 So. 39 (1936); *Underwriters Acceptance Corp. v. Dunkin*, 152 Neb. 550, 41 N. W. 2d 885 (1950).

9. *Dunn v. Midland Loan Finance Corp.*, 266 Minn. 550, 289 N. W. 411 (1939); 27 R.C.L. 211, Usury § 12.

10. ALA. CODE, tit. 9, § 65 (1940); ARIZ. CODE, tit. 36, § 104 (1939); MINN. STAT., § 334 (1941); GEN. STAT. OF N. C., tit. 24, § 2 (1943); S. C. CODE, § 6740 (1942); VA. CODE, tit. 6, § 350 (1950).

11. *Seeman v. Philadelphia Warehouse Co.*, 274 U. S. 403, (1927); *Yeager v. Ainsworth*, 202 Miss. 747, 32 So. 2d 548 (1947).

12. *Munson v. White*, 309 Ky. 295, 217 S. W. 2d 641 (1949).

13. *Hogg v. Ruffner*, 66 U. S. 115 (1861); *Van Shaick v. Edwards*, 2 Johns 335 (N. Y. 1801); *Dry Dock Bank v. American Insurance Co.*, 3 N. Y. 344 (1850).

issue in connection with the sale of personal property, the transition paralleling the growth of the value and importance of personal property in our economic system.

In considering the early cases, it is important to keep in mind the basic transaction to which the courts have to apply most frequently the law developed earlier. Greatly simplified, the usual situation is this: In a purported sale on credit, the "finance charge", or "time differential" between the cash and the credit prices, if considered as interest on the cash price, or possibly on the credited part of the price, as principal, is in excess of the highest legal rate of interest.

There is one principle laid down by our early decisions over which there seems to be no dispute, for it was early settled that a vendee could fix one price for a cash sale and a higher price for a credit sale. The United States Supreme Court expressed this principle as follows:

But it is manifest that if A propose to sell to B a tract of land for \$10,000 in cash, or for \$20,000 payable in ten annual installments, and if B prefers to pay the larger sum to gain time, the contract cannot be called usurious. A vendor may prefer \$100 in hand to double the sum in expectancy, and a purchaser may prefer the greater price with the longer credit; and one who will not distinguish between things that differ, may say, with apparent truth, that B pays a hundred per cent for forbearance, and may assert that such a contract is usurious; but whatever truth there may be in the premises, the conclusion is manifestly erroneous. Such a contract has none of the characteristics of usury; it is not for the loan of money, or for the forbearance of a debt.¹⁴

LOAN OR FORBEARANCE

Usury statutes of the several states vary in form, but a large majority are worded to regulate *loans and forbearances of money and things*. Many courts hold that a sale does not come within the terms of the statute and that therefore, there can be no usury in a sale.¹⁵ In some of these jurisdictions,

14. Hogg v. Ruffner, 66 U. S. at 116 (1861).

15. G.M.A.C. v. Swain, 176 So. 636 (La. 1937); Archer Motor Co. v. Relin, 255 App. Div. 333, 8 N.Y.S. 2d 469 (1938); Hendrix v. Harry's Cadillac Co., 220 N. C. 84, 16 S. E. 2d 456 (1941).

the courts seem to rely almost solely on this strict and literal interpretation of the terms "loan" and "forbearance" to reach their decisions. The case of *Hafer v. Spaeth*¹⁶ illustrates the application of this reasoning. The transaction before the court was evidenced by a conditional sale contract specifying that the purchase price for the goods sold be paid in monthly installments of five dollars each "with \$3.50 handling charges per month or fraction thereof." The Court asserted initially that the usury statute was applicable only if there was a loan or forbearance, for which terms it gave the following much used definitions:

The word "loan" imports an advancement of money or other personal property to a person, under contract or stipulation, express or implied, whereby the person to whom the advancement is made binds himself to repay it at some future time, together with such other sum as may be agreed upon for the use of the money or thing advanced.¹⁷

The term "forbearance" * * * signifies a contractual obligation of a lender or creditor to refrain, during a given period of time, from requiring the borrower or debtor to pay a loan or debt then due and payable.¹⁸

The court then held that "manifestly" the transaction in question did not come within the definitions given.

Although there are few courts that do not at least pay lip service to the theory that there can be no usury in a *bona fide* sale, all of the courts recognize that the form of a sale may be used as a cloak behind which to hide a usurious loan. Since the courts profess to look at the substance of the transaction and not the form, the courts leave the way open to find the presence of usury in any form of contract where the court decides the facts so warrant. It is not surprising, however, that the courts seldom find usury lurking behind the cloak of a sale. Occasionally the veil by the form of a sale is so transparent that even the most reluctant of courts cannot fail to detect usury. Such was the case of *Seebold v. Emstermann*,¹⁹ in which the defendant vendor testified: "I

16. 22 Wash. 2d 378, 156 P. 2d 408 (1945).

17. 156 P. 2d at 412.

18. *Id.* at 411.

19. 216 Minn. 566, 13 N.W. 2d 739 (1944).

quoted him the price * * * * * and that the *interest* for 12 months was \$142.16. That (with the cost of insurance) made up the total that went into the contract."²⁰ As the Court admitted, in view of this candid admission, they could hardly avoid finding that the sum of \$142.16 was added for interest and for no other purpose.

The technical distinction made by the courts between a "loan or forbearance" on the one hand, and a retail credit installment sale on the other, lacks the support of reason when used for the purpose of determining whether usury is present in a given contract. If A, a salaried worker without reserve capital, needs a car to perform his work, he may have two alternatives. He may borrow money from a bank or private lender, and thereby be enabled to buy a car for cash, in which case he must give the lender a mortgage on the car (and perhaps other security); or secondly, he may purchase the car on credit under a conditional sale contract or a similar instrument. In either case a down payment is necessary. In the first alternative, A must pay interest to the lender; in the second, he must pay a "finance charge" to the dealer (which actually accrues to a finance company who furnishes the capital). In either case there is an added cost to A because he does not have the accrued capital to pay cash. Yet under the technical distinctions drawn by the courts, the lender would be limited in the amount of interest charged by the usury statute, but the "finance charge" would not be limited.

These distinctions, and the results reached thereby, are often justified, although seldom in the decisions, by pointing up the difference in the amount of security required for a loan from a bank or private investor and that required by the finance company which accepts the contract of sale from the dealer. It is undoubtedly true that a finance company takes less security than many lending institutions would require. This fact would justify an argument that interest rates should be adjusted by law to the security taken, but fails as a valid reason for limiting interest on a direct loan, and exempting altogether the "finance charge" on a credit installment sale.²¹

20. 13 N. W. 2d at 744.

21. See 2 Law & Contemp. Prob. 173 (1935), where this argument is strongly advanced.

FINANCE CHARGE AS A PART OF THE CREDIT PRICE

The courts of many jurisdictions, theorizing that a vendor may charge one price for cash, and a higher credit price, reach the conclusion that the "finance charge" or "time differential" is an integral part of the credit price.²² Among the jurisdictions reaching this conclusion, however, there is conflict as to the circumstances under which the "finance charge" will be considered a part of the credit price.

There is substantial authority holding that the "finance charge" is a part of the credit price of the goods sold, even if the finance charge is stated separately in the contract of sale,²³ provided, of course, the sale is *bona fide*. This rule borders on the inflexible, as illustrated by the case of *Munson v. White*.²⁴ A finance charge was added to the maximum price set by the Office of Price Administration. The Court held the finance charge to be a part of the credit price nevertheless, reasoning that there could be no interest in a *bona fide* sale. The Court held further that Congress, in establishing the Office of Price Administration, could not have intended to allow the fixing of credit prices, but only cash prices.

Texas courts have reached opposite results in quite similar factual situations,²⁵ by holding that the "finance charge" is considered as interest if stated separately in the contract of sale. The Texas view is well expressed by Justice Hughes of the Texas Court of Civil Appeals:

We cannot agree with appellant that the finance charge is a part of the credit price. It would be most unusual for a cash sale contract to specify the credit price or for a credit sale contract to specify the cash price. The contract would be for one price or the other, unless the buyer is given an option which is usually in the form of a discount, if paid within a certain time. The contract here specified but one sale price and whether it be a

22. Cases cited note 7, *supra*.

23. *Harper v. Futrell*, 204 Ark. 822, 164 S. W. 2d 995 (1942); *Failing v. National Bond & Investment Corp.*, 258 App. Div. 778, 14 N. Y. S. 2d 1011 (1938); *Dunn v. Midland Loan Finance Co.*, 206 Minn. 550, 296 N. W. 911 (1939).

24. 309 Ky. 295, 217 S. W. 2d 641 (1949).

25. *Associates Investment Co. v. Thomas*, (Tex. Civ. App.), 210 S. W. 2d 413 (1948); *Associates Investment Co. v. Hill*, (Tex. Civ. App.), 221 S. W. 2d 365 (1949); *Gifford v. State*, (Tex. Civ. App.), 229 S. W. 2d. 949 (1950).

cash or credit price is not material. The amount of the down payment is plainly stated and so is the amount of the unpaid purchase price. That the \$197.50 was not a part of the purchase price is obvious unless we ignore the contract which states that this amount was for the "total finance charge and insurance premium for which credit is extended." Omitting insurance, this language is a fair definition of interest.²⁶

Texas courts have held further that the failure to pay the state sales tax on the finance charge indicated that such finance charge was interest and not a part of the credit price.²⁷

In determining whether the finance charge is a part of the credit price, a distinction based solely on the manner of stating the finance charge in the contract does not seem well founded. This belies the unanimous rule that the court will look to the substance rather than the form of the contract. In addition, it discourages the practice of itemizing the account, which should be encouraged in order for the purchaser to be able to fully understand the premium he pays for buying on credit, whether this premium be called "finance charge" or "interest".

However, a rigid application of the rule that the finance charge is always a part of the credit price provided the sale is *bona fide* can be just as onerous, as illustrated by the result reached in *Munson v. White*.²⁸ Where the price charged prior to the addition of the finance charge is the maximum allowed by the Office of Price Administration (or today by the Office of Price Stabilization), or where the state sales tax is paid on an amount exclusive of the finance charge, better reasoning indicates that these are matters of substance showing the finance charge is not a part of the purchase price.

There is an additional factor bearing on the substance of the transaction, which, judging from the expressed reasoning of the courts, is seldom given the weight it deserves, if indeed it is given any weight at all. The fact that a retailer negotiates the sales contract immediately subsequent to the sale to a finance company, coupled with the use by the re-

26. *Associates Investment Co. v. Ligon*, (Tex. Civ. App.), 209 S. W. 2d 218, 219 (1948).

27. *Gifford v. State*, (Tex. Civ. App.), 229 S. W. 2d 949 (1950).

28. Note 24, *supra*.

tailer of forms and schedules of rates furnished by the finance company, is a strong indication that the transaction is in fact and substance a loan by the finance company to the purchaser, made in the form of a sale by the retailer to avoid the limitation of the usury statutes.

RECENT TRENDS OF DECISIONS

The courts generally have shown no tendency to increase the applicability of usury statutes to installment sales or to adapt them by judicial interpretation to meet the contingencies of changing economic conditions. There are some notable attempts, however, by the lower appellate courts of New York to make broad application of the usury statutes to conditional sales transactions.²⁹ Since the Court of Appeals of New York does not share their views, these cases are notable chiefly for their reasoning:

May the vendor make legal the unconscionable charge of \$130 for deferring the payment of \$530 of the cash purchase price for one year by smoothly sugar coating it with phraseology? A sale on credit incurs risk, of course. Likewise, there is risk in every loan, yet the law allows but 6 percent, secured or unsecured. Here is the security of the thing purchased, protected by insurance against collision, fire, and theft. Perhaps the security will have to be realized on, may be urged. True, but the contract provides in that event for a 15 per cent attorney fee. If the dealer may not legally charge \$130 interest on a \$530 note secured by a chattel mortgage, why should he be allowed to charge the same sum for the forbearance of \$530 of the cash purchase price secured by a conditional contract of sale, under the guise of calling it a "differential"? Does calling it a "differential" instead of interest save it from illegality? May interest masquerade as a "differential" and so escape the penalty? May a fancy name cloak an offense beyond recognition? "The shifts and devices of usurers to evade the statute against usury have taken every shape and form that the wit of man could devise, but none have been allowed to prevail".

29. *Universal Credit Co. v. Lowell*, 166 Misc. 15, 2 N. Y. S. 2d 743 (1938); *Failing v. National Bond & Investment Corp.*, 168 Misc. 617, 6 N. Y. S. 2d 67 (1938), *rev'd* 14 N. Y. S. 2d 1011 (1938).

Quackenbos v. Sayer (1875), 62 N. Y. 344, 346. It is for the court to scrutinize the transaction, discover the real facts and the actual intent and then apply the law . . .³⁰

And in a later decision by the same court, we find:

If it is the needy individual whose protection the usury laws are enacted to guard, is the need of him who borrows that he may buy for cash greater than he who purchases for credit? Where lies the difference . . . Tweedledum and Tweedledee have no place in the law today, which professes to seek the truth; whose aim is justice.³¹

Although these decisions did not meet with the higher court's approval, the practical reasoning advanced seems unanswerable by logic. The fact that decisions based on such practical reasoning are in a small minority is a questionable tribute to the judicial reluctance to change in order to keep step with progress.

STATUTORY PROVISIONS

Until recent times, usury statutes of the several states conformed largely to the pattern set by the early English statutes. Variances were mostly limited to degrees of forfeiture and amounts of interest allowable. Today, however, some of the more progressive states in this field have sought to meet the current problems with legislation designed specifically to remedy the existing evils. The scope of this article will not permit any exhaustive treatment of the many statutes of the several states, but different types of legislation will be briefly considered.

The most comprehensive effort to regulate the retail installment sale is probably embodied in the Utah statute enacted in 1935:

No contract for the purchase of any goods, wares or merchandise or loan or forbearance of money, shall contain any provision providing for a handling or service charge on any said contract, or any commercial charge on said contract, or any charge whatsoever, which when

30. *Universal Credit Co. v. Lowell*, 166 Misc. 15, 2 N. Y. S. 2d at 750 (1938).

31. *Failing v. National Bond & Investment Corp.*, 168 Misc. 617, 6 N. Y. S. 2d at 71, 72 (1938).

taken together with the interest charged on such contract for the sale of goods, wares or merchandise, or for loan or forbearance of money, exceeds ten per cent per annum of the unpaid principal sum of said loan or contract, except; (a) a contract may specifically provide for a service charge, which charge shall not exceed four per cent per annum of the unpaid balance of the said principal sum, such service charge to be applied but once on any transaction and shall not be again applied in case of refunding or renewal of the contract between the parties concerned with the original transaction; nor shall such service charge be subject to any additional service charge, interest charge or penalty; (b) a reasonable attorney's fee in case of collection by attorney; and (c) such exceptions as are otherwise provided by law.³²

Despite the comprehensive language of such statutes as quoted above, there remains a wide latitude of effectiveness to be determined by judicial interpretation. Consider a North Dakota statute construed in *Saylor v. Brady*.³³ The statute, as amended, read in part:

. . . provided, further, that any evasion of this act by charging more for goods or chattels when sold on credit or on deferred payments, or when sold on monthly or installment payments, shall be deemed usury whenever the total payments shall exceed the cash selling price, plus eight per cent interest . . .³⁴

The Court, in construing this statute, (and we quote from the Court's syllabus) held:

(a) That the statute as amended is not a price fixing statute.

(b) That sales of personal property on credit or on deferred payments, or upon monthly or installment payments, are not prohibited by this statute, though the total payments exceed the cash selling price, plus 8 per

32. Utah Rev. Stat. § 44-0-1, § 44-0-2, as amended by Utah Laws 1935, c 42.

33. 63 N. D. 471, 248 N. W. 673 (1933).

34. N. D. House Bill No. 93, 1933 Legislative Assembly.

cent interest, unless made in order to evade the prohibition against usury as defined in it.

This well illustrates the profound effect which judicial interpretation can have on comprehensive, clear and unambiguous statutes. As was said in a partial dissent to the majority opinion: "It may well be doubted whether the construction (of the amendment quoted) adhered to by the majority of the court adds anything to the statute."³⁵

There are some statutes which seek not only to regulate the amount of the charges made, but to further remedy the evil by revealing to the purchaser the exact composition of the total charge. The *California Conditional Sales Law*³⁶ is very comprehensive in this respect. This Act requires a recital in the contract of the cash sale price; buyer's down payment, and whether made in cash or by trade in; cost to the buyer of insurance; itemization of fees to be paid by seller or buyer to any public officer; amount of the unpaid balance; time price differential; contract balance; and number, amount and due date of installments. Omission of these items makes the contract unenforceable except by a holder in due course for value.³⁷ Further, this act provides maximums for the various charges. It is to be noted that the charges permitted are somewhat higher than the average maximum interest limitations.

Although they may not accomplish all that could be desired in this field, these progressive legislative acts are certainly strides in the right direction. It is evident, however, that the courts are reluctant to strictly enforce a broadly worded statute which purports to set maximum differences between cash and credit prices on an indiscriminate basis.³⁸ In order to increase the probability of enforcement, legislatures should make the statute detailed and as unambiguous as possible. Also a statute regulating finance charges should be based to some extent on the type of security taken by the seller. Requirements for itemization of all charges, prices and expenses incident to the sale undoubtedly serve their in-

35. 63 N. D. 471, 248 N. W. 673, 676 (1933).

36. CALIFORNIA CIVIL CODE, §§ 2981, 2982.

37. *Carter v. Seaboard Finance Co.*, 33 Cal. 2d 564, 203 P. 2d 758 (1949).

38. *Saylor v. Brady*, 63 N. D. 471, 248 N. W. 673 (1933).

tended function well, especially where combined with a limitation of charges.

SOUTH CAROLINA VIEWS

The problems of usury in a credit sale seems to have been first considered in South Carolina in the case of *Coleman v. Garlington*.³⁹ The transaction over which this action arose was a sale by one partner to another of the seller's interest in a mill owned by the partnership. To determine the selling price, the parties added ten per cent to the value of the stock and seven per cent to borrowed money. The purchaser gave five promissory notes in payment, totaling an amount reached by the above described process, with each note bearing interest at ten per cent. The Court, citing *Beete v. Bidgood*,⁴⁰ held that the adding of ten per cent to the value of the stock, and seven per cent to borrowed money, was a legal method of arriving at a credit price; but the ten per cent charged on the notes was interest and constituted usury.

In reaching this decision, the Court subscribed to the view that there may be both a cash and a credit price for property; and an adoption of the latter will not make the contract usurious although the credit price is made up by the cash price plus interest higher than the legal rate fixed by statute. The court reasoned further, however, that once the purchase price is reached, interest above the legal rate reserved upon this purchase price will constitute usury although such interest is provided for in the contract of sale.

The problem arose again a few years later in the case of *Thompson v. Nesbit*,⁴¹ an action brought on a note executed and delivered by defendant in payment for a slave purchased from plaintiff. The testimony indicated that the purchase price for the slave was \$1,000. The body of the note read as follows:

Three years after date, I promise to pay H. Thompson, or bearer, thirteen hundred dollars, to be paid at such times as I please, and to deduct ten per cent per annum off the amount paid at each payment.^{41a}

39. 2 Speers 238 (S. C. 1843).

40. Note 6, *supra*.

41. 2 Rich. 73 (S. C. 1845).

41a. *Ibid*.

The Court stated that it would look not at the form of the transaction, but at the substance, and in this instance the form of a sale was but a veil behind which there was an attempt to hide usury. The Court also held that once the contract had been determined, the question of the existence of usury was one of law.

Some forty-five years later, the Supreme Court affirmed the judgment of the Circuit Court in the unreported case of *Wheeler v. Marchbanks*.⁴² The facts of the case, as found by the Circuit Court, were as follows: Mrs. Marchbanks desired to purchase a tract of 72 acres, but was unable to meet the seller's price of \$1,045, payable one-third cash, one-third in one year, and the balance in two years. Mrs. Marchbanks applied to plaintiff, Wheeler, for assistance, and Wheeler purchased the property for \$1,045 cash. Then Wheeler sold the property to Mrs. Marchbanks for \$400 cash, and notes for \$906 to be paid over a period of six years, for a total price of \$1,306. The defendant, Mrs. Marchbanks, pleaded usury to an action on the note. The judgment, as affirmed, held that there was no usury in the sale, but a just profit of \$251 on a sale in consideration for indulgence.

*Peoples Bank v. Jackson*⁴³ followed shortly thereafter, in which usury was raised as a defense to an action on a note given by the defendant to the plaintiff in payment for land purchased. The note bore interest at a greater rate than allowed by statute, and the Court found the note to be usurious, basing the judgment on the earlier case of *Thompson v. Nesbit*.⁴⁴ It is interesting to note that Mr. Chief Justice McIver, in a concurring opinion, points out that the citation of *Beete v. Bidgood*⁴⁵ in the case of *Coleman v. Garlington*⁴⁶ for the principle that the usury law did not apply to a contract to secure the payment of the purchase money of property sold was in his opinion dictum and further was controlled by the late case of *Thompson v. Nesbit*.⁴⁷

The question next arose in the case of *Milford v. Milford*,⁴⁸ in which it was sought to foreclose a mortgage given to secure

42. 32 S. C. 594, 10 S. E. 1011 (1890).

43. 43 S. C. 86, 20 S. E. 786 (1895).

44. Note 41, *supra*.

45. Note 6, *supra*.

46. Note 39, *supra*.

47. Note 41, *supra*.

48. 67 S. C. 553, 46 S. E. 479 (1903).

payment of six promissory notes executed and delivered by defendant to plaintiff on the purchase price of land. Each note reserved interest at ten per cent, and the mortgage was for the amount equaling the principal and interest in the notes. The plaintiff contended that the amount recited in the mortgage was in fact the purchase price, but the Court pointed to the consideration stated in the deed, which was the amount of the principal of the notes, and held the notes to be usurious without citing authorities.

In *Osborn v. Fuller*,⁴⁹ a plaintiff sought to recover double the amount of alleged usurious interest collected from plaintiff by defendant. Defendant, plaintiff's landlord, made advances to plaintiff by giving him written and verbal orders on merchants for goods. Defendant paid the merchants, and then charged and collected from plaintiff the amount he had paid the merchants plus twenty per cent. The Court did not hesitate to affirm a judgment for the plaintiff and a finding that the form of a sale in this instance was but a cloak behind which to hide a usurious loan.

A purported sale of wages, by an instrument assigning \$16.50 worth of wages to be earned for a consideration of \$15, was held to be a loan and usurious, despite the fact that the instrument was entitled "Bill of Sale" in *Martin v. Pacific Mills*.⁵⁰

A situation very similar to that raised in *Wheeler v. Marchbanks*⁵¹ was presented by *Cohen v. Williams*.⁵² An action was brought by Cohen to foreclose a mortgage, in which the defendant Williams raised the defense of usury. When certain lands were advertised for sale by a Master and Probate Judge, defendant Williams expressed to Cohen his desire to own the lands advertised for sale. Cohen told Williams that he, Cohen, might buy the land for speculation. Cohen bid in the land at the auction, but had the deeds made to Williams as grantee. After Williams had executed the mortgage and bond in suit, Cohen delivered the deeds to Williams. The price Cohen charged Williams was \$300 above the auction price paid by Cohen, and eight per cent interest was reserved on the bond. The Court relied strongly on *Wheeler v. March-*

49. 92 S. C. 338, 75 S. E. 557 (1912).

50. 160 S. C. 453, 158 S. E. 831 (1931).

51. Note 42, *supra*.

52. 164 S. C. 499, 162 S. E. 758 (1932).

*banks*⁵³ in holding the transaction to be a sale at a profit without usury.

From this line of decisions there can be drawn certain principles to which the Supreme Court of South Carolina has uniformly adhered. The Court throughout the years has recognized that a seller could charge a higher price for a credit sale than for a cash sale and no usury would be present although the difference in prices, if considered as interest on the cash price, would be above the lawful rate. But the Court subscribed just as strongly to the idea that charges for forbearance for the part of the purchase price for which credit was extended would constitute usury of higher than the legal rate. This principle was asserted first in *Coleman v. Garlington*⁵⁴ and followed invariably through *Milford v. Milford*.⁵⁵ It will be noticed from a careful scrutiny of the cases that where an increment was added to and based on the part of the purchase price for which credit was extended, such increment has been held to constitute usury if higher than the legal interest rate.

The recent case of *Brown v. Crandall*⁵⁶ presented to the South Carolina Supreme Court for the first time a "time price differential" as such. An action of claim and delivery was brought to recover property covered by a chattel mortgage given by defendant to plaintiff to secure payment of a purchase money note. The defendant interposed a defense of usurious interest in the form of a "time price differential". The case was submitted on the following agreed statement of facts:

On or about April 16th, the defendant contracted the plaintiff in regard to the purchase of a sawmill and other incidental items named in the original claim and delivery papers, and in the complaint. The plaintiff gave the defendant a cash price of \$1,875.00 including delivery charges, and advised the defendant that if he wanted to buy the sawmill on a time basis, that there would be a time price differential of \$120.00. The defendant paid \$675.00 down and gave the plaintiff a note and chattel mortgage on the sawmill and incidental equipment for

53. Note 42, *supra*.

54. Note 39, *supra*.

55. Note 48, *supra*.

56. 218 S. C. 124, 61 S. E. 2d 761 (1950).

\$1,320.00 which covered the remaining \$1,200.00 of the original cash price plus \$120.00 as time price differential. This total was to be paid in 12 installments of \$110.00 each with interest at 7% after maturity.⁵⁷

The bill of sale for the credit purchase was as follows:

Brown Equipment and Supply Co

Walhalla, S. C.

April 16th, 1948

Sold to Prof. W. G. Crandall

Clemson, S. C.

1 Turner Ball and Roller bgr. saw mill \$1,825.00

Delivery ----- 50.00

\$1,875.00

Less cash ----- 675.00

\$1,200.00

Time price differential ----- 120.00

\$1,320.00

Note due May 16th ----- \$1,320.00

Payable \$110.00 on the 16th day of May, 1948,
and \$110.00 on the 16th day of each and every
month until paid.⁵⁸

The trial court found a *bona fide* sale at a *credit price* of \$1995.00, and that the note for the unpaid portion was not usurious. This judgment was affirmed by the Supreme Court.

Thus the South Carolina Supreme Court in effect turned decidedly in the direction of the pattern set by the more conservative jurisdictions. Prior to this decision, the way was open and the foundation laid by previous decisions for the courts of this State to curb the evils of the "finance charge" system. Now the door is closed.

An examination of the agreed statement of facts will show many features of the case that indicate that an opposite result might logically have been reached. First, there

57. *Id.* at 125, 126, 61 S. E. 2d at 762.

58. *Id.* at 125, 61 S. E. 2d at 762.

is no mention in the agreed statement of facts of the sum of \$1995.00, either as credit price or otherwise. Nor does this sum appear on the bill of sale, \$1,875.00 being the only price specified anywhere. In addition, there is no mention of a credit price existing. Second, it is obvious from the bill of sale that the down payment was based on the first item stated in that bill of sale. The third, and probably the strongest indication, is the fact that the time price differential is a flat ten per cent of the amount for which credit or forbearance was extended, as a look at the bill of sale will show. This is not to suggest that the form of the transaction should be relied on in lieu of the substance, but the facts shown by the form should not be ignored where, as in this instance, there is nothing in the substance of the transaction to contradict the terms shown by the form.

It is true that there is no ground for an assertion that the result reached in *Brown v. Crandall* is in conflict with any case previously decided on the subject in this State. Neither did the Court in that case purport to lay down any new hard and fast rule that would bind them to such a result in the future. Nevertheless, the result reached on this agreed statement of facts, which are unequivocal, will bind the court in the future to an identical result where "time price differentials" are concerned; for the finance companies and retail installment sellers have an approved pattern to which they can conform without variation, and within which they may frame their charges to their heart's desire.

SOUTH CAROLINA USURY STATUTES

South Carolina statutory provisions generally applicable to the question under discussion are found in Sections 6738 and 6740 of the *Code of Laws* (S. C. 1942). Section 6738 provides for the maximum rate of interest to be charged . . . "for the hiring, lending or use of money or other commodity, either by way of straight interest, discount or otherwise . . ." Section 6740 is what is commonly referred to as the "penalty" section of the statute, and it provides for forfeiture of double the usurious interest paid by the usurer.

There are many arguments to be advanced to the effect that the courts could adapt the existing statutes to the factual situations in such a manner as to remedy many of the

evils inherent in the finance charges; but since the courts have indicated their intention not to do so, such arguments are now academic. Therefore, it remains for the Legislature to pass such laws as are necessary to remedy the situation.

By using the experiences of other states in applying their more progressive usury laws as a guide, one may recognize certain features which should be considered in designing new legislation in this field.

Forfeiture provisions, embodied in a statute, tend to decrease the likelihood of strict application of the statute by the courts, due to the judicial abhorrence of forfeitures. Forfeitures should therefore be kept to a minimum, that is confined to forfeiture of the interest alone and not multiples thereof.

Another feature found to be effective when incorporated in modern usury statutes is that of compulsory itemization of all charges included in a credit sale. This feature is utilized to full advantage in the *California Conditional Sales Law*.⁵⁹ The instances of usury will be much fewer where the public is made aware of the cost of credit when the purchase is made on the installment plan.

Probably the most progressive and effective step would be the fixing of legal rates of interest or finance charges, and basing the limitation, at least to some extent, on the amount of security taken by the seller. This, in itself, would nullify the most substantial argument for not applying the existing statutes to credit sales transactions.

Both the *California Conditional Sales Law*⁶⁰ and the Utah usury statute⁶¹ are excellent examples of practical, progressive legislation in this field, and would serve as the best existing guide to the legislatures of this and other states where the need for new laws in this field is acute.

JOSEPH F. BUZHARDT, JR.

59. Note 36, *supra*.

60. Note 36, *supra*.

61. Note 32, *supra*.