1977

Contracts

Hugh M. Hadden

Follow this and additional works at: https://scholarcommons.sc.edu/sclr

Part of the Law Commons

Recommended Citation
Hadden, Hugh M. (1977) "Contracts," South Carolina Law Review: Vol. 29 : Iss. 1 , Article 6. Available at: https://scholarcommons.sc.edu/sclr/vol29/iss1/6

This Article is brought to you by the Law Reviews and Journals at Scholar Commons. It has been accepted for inclusion in South Carolina Law Review by an authorized editor of Scholar Commons. For more information, please contact dillarda@mailbox.sc.edu.
CONTRACTS

I. RETAINAGE CLAUSES

Elk & Jacobs Drywall v. Town Contractors, Inc., decided during the survey year, involved an interpretation of a retainage clause in a contract between a subcontractor and a general contractor. The case arose out of a contract between Town Contractors, Inc., the general contractor for the construction of an apartment complex, and Elk & Jacobs Drywall, the subcontractor. The contract called for Elk & Jacobs Drywall to install the sheetrock and other incidentals in the apartment complex for the total amount of $103,000.00. A retainage of $10,300.00 was to be withheld and paid sixty days after the occurrence of the later of several events. The disputed provision, subparagraph (iv), provided for payment to the subcontractor after "[f]ull and final payment to the Contractor of all the funds due him for this project." Elk & Jacobs Drywall, having made a full and complete performance of their obligation under the contract, brought suit to recover the balance retained by Town Contractors, Inc. pursuant to the retainage clause. Town Contractors contended that since it had not received full payment from the owner, it was not yet liable on the contract. The lower court directed a verdict in favor of Town Contractors, in effect, interpreting the provision as a condition precedent to its liability. The Supreme Court of South Carolina reversed.

The basis of the supreme court's decision was that there was nothing in the contract between the general contractor and the subcontractor that evidenced an intention that the latter would assume the risk of the owner's default or delay of payments to the general contractor; in fact, the contract itself stated that the

2. Id. at 415, 229 S.E.2d at 261.
3. Id.
4. A condition precedent is an act or event, other than a lapse of time, which must exist or occur before a duty of immediate performance of a promise arises. RESTATEMENT (FIRST) OF CONTRACTS § 250(a), Comment d (1932). It is further described as "a fact or event which the parties intend must exist or take place before there is a right to performance, . . . distinguished from a promise in that it creates no right or duty in and of itself but is merely a limiting or modifying factor." 5 S. WILLISTON, CONTRACTS § 663 (1961) (quoting Lach v. Cahill, 138 Conn. 418, 421, 85 A.2d 481, 482 (1951)).
5. 267 S.C. at 416, 229 S.E.2d at 261.
6. Id. at 418, 229 S.E.2d at 262.

63
purpose of the retainage was "to insure the Subcontractors [sic] full and complete performance." This decision presupposed that it is normally the general contractor rather than the subcontractor who takes the risk of the owner’s nonpayment. Finding no intention to shift this risk, the court held that subparagraph (iv) did not create a condition precedent to payment of the retained amount, but "rather only postponed payment by Town for a reasonable time so as to afford [it] an opportunity to obtain funds from the owner." This interpretation is in accordance with decisions of other courts confronted with similar provisions.

This case illustrates the problem of determining whether a condition is intended. To further complicate the problem, the desire of courts to give substantial justice in the particular case before them has sometimes introduced difficulty where as a matter of language none would exist. Thus, if a true condition pre-

7. Id. at 415, 229 S.E.2d at 261.
8. See Thos. J. Dyer Co. v. Bishop Int’l Eng’r Co., 303 F.2d 655, 660-61 (6th Cir. 1962), where the court explained that it is normally the general contractor rather than the subcontractor who takes the risk of the owner’s nonpayment.
9. "Whether a provision in a contract is a condition the nonfulfillment of which excuses performance, depends upon the intent of the parties, to be ascertained from a fair and reasonable construction of the language used in the light of all the surrounding circumstances when they executed the contract." 5 S. WILLISTON, CONTRACTS § 683 (1961) (citations omitted). Accord, RESTATEMENT (SECOND) OF CONTRACTS § 252 (1973). Therefore, custom and usage in the particular field are given great weight in the determination of the probable intention of the parties. In light of the usual allocation of the risks between the general contractor and the subcontractor, see note 8 supra, the South Carolina Supreme Court in Town Contractors further noted that:

As a practical matter the suppliers and small contractors on large construction projects need reasonably prompt payment for their work and materials in order for them to remain solvent and stay in business. "In the absence of a clear expression in the contract papers that the credit risk of the general contractor and the delay in payment frequently attending on construction projects are meant to be shifted to such suppliers and subcontractors, the contract instruments should not be construed as intending such assumption." Schuler-Haas Elec. v. Aetna Cas. & Sur., 49 A.D.2d 60, 371 N.Y.S.2d 207 (1975).

267 S.C. at 418, 229 S.E.2d at 262.
10. Id. at 418, 229 S.E.2d at 262.
12. Williston explains this anomaly as follows:

When courts hold a promisor liable in spite of the non-performance of a condition . . ., they generally purport to reach the results which they achieve by interpretation of the contract; but they are unquestionably doing something more than ascertaining the meaning of the language which the parties use. They
II. Option Contracts

South Carolina adheres to the premise that option contracts, being unilateral, are strictly construed in favor of the optionee and against the party claiming the option.14 In Cotter v. James L. Tapp Co.15 the South Carolina Supreme Court extended this principle to require exact compliance with the terms of the option by the optionee to enforce a renewal option. The court framed the issue, upon motion for summary judgment, as whether defendant, a South Carolina corporation, had taken "adequate legal steps to exercise [a] renewal option"16 in a lease with the plaintiff to make the option a binding agreement.

The plaintiff operates as the landlord of the Dutch Square Shopping Center wherein the defendant leases space to maintain and operate a department store. The controversy arose out of the lease agreement which, among other things, granted Tapp two options: (1) An option to expand whereby Tapp was given the option to expand into two expansion areas during the first five years of its lease; and (2) a renewal option whereby Tapp was given the option to renew its option to expand for an additional three years "upon the payment by tenant (Tapp) of thirty cents per sq. ft. per year for said expansion area, payable monthly as

13. At least one writer has suggested that the law of contracts should eliminate the technicalities inherent in the law of conditions and adopt an "unequivocal statement that conditions are never effective beyond their materiality." This would replace the myth of the old law and substitute the policy of supporting and promoting good faith conduct according to reasonable standards. Childress, Conditions in the Law of Contracts, 45 N.Y.U.L. Rev. 33, 58 (1970).


16. Id. at ___, 230 S.E.2d at 716.
an option cost."\textsuperscript{17} Prior to the expiration date, March 1, 1975, Tapp had neither exercised the primary option to expand nor paid or tendered to the plaintiffs the cost of the renewal option. Tapp had, however, given notice of its desire to exercise the renewal option in a letter dated February 13, 1975, prior to the expiration date, stating: "We are very anxious to proceed with the expansion and wish to take this opportunity to notify you that we wish to exercise our option as per our contract under Article XXXII, to reserve the expansion space until such time as we do expand."\textsuperscript{18} On June 13, 1975, "the plaintiffs notified defendant that the option to expand had terminated for failure to pay the option cost."\textsuperscript{19} Tapp thereafter tendered payment on June 30, 1975, which was rejected by the plaintiff.

The lessor then filed an action for declaratory judgment to determine the rights of the parties under the lease.\textsuperscript{20} The trial judge determined as a matter of law that the defendant's letter to plaintiffs was not sufficient to exercise the renewal option without actual tender to pay the option cost, and thus granted plaintiff a summary judgment.\textsuperscript{21} The South Carolina Supreme Court, with two justices dissenting, affirmed the decision of the lower court, adopting the opinion of the trial judge as its own.

Generally, "[a]n option for which consideration is given . . . is a contract, but it is also an offer which, when accepted, creates another contract . . . ."\textsuperscript{22} The option "is a 'binding' promise, because a consideration was paid for it; it is an 'offer,' because it invites a second and different exchange of equivalents."\textsuperscript{23} The offer element of an option must be accepted accord-

\textsuperscript{17} Id.
\textsuperscript{18} Id. at —, 230 S.E.2d at 717.
\textsuperscript{19} Id.
\textsuperscript{20} Id. at —, 230 S.E.2d at 716.
\textsuperscript{21} The lower court concluded that "there exists no genuine issue as to any material fact and that plaintiff is entitled to summary judgment for the reason that payment of the option cost was clearly required by the terms of the renewal option and under the existing law in South Carolina." Id. at —, 230 S.E.2d at 717.
\textsuperscript{22} 1 S. Williston, Contracts § 25 (1957). Although there is a conceptual dispute as to whether an option is an offer to make a bilateral contract, the acceptance of which completes such contract, or whether an option is a conditional unilateral contract, and that acceptance is the performance of the condition, the result is the same. "There is no completed contract . . . until the optionee [Tapp] has accepted the offer according to its terms, or . . . has performed the condition contained in the offer. . . . No mutual agreement exists prior to the acceptance." 1A A. Corbin, Contracts § 264 n.44 (1963) (citations omitted).
\textsuperscript{23} 1A A. Corbin, Contracts § 264 (1963).
ing to its terms or conditions to complete the contract. The crux of the disagreement between the majority and minority holdings was whether the option contract was conditional upon notice (dissenting opinion) or upon payment or tender of payment by the optionee (majority opinion). 24

As with all other offers, the offeror of an option is free to specify any means of acceptance that he desires and "can make his offered promise conditional upon any facts and performances that he sees fit." 25 Corbin gives the following example regarding an option to buy:

In consideration of $100 paid, O promises B to convey Blackacre on payment of $5,000 within 30 days. In the absence of evidence showing that this language is elliptical the form of acceptance and the condition of O's duty are the actual tender of $5,000 within 30 days. Nothing is said about a notice of acceptance; and the giving of such a notice would have no effect, unless the contrary intention can be found by reading between the lines and by drawing inferences from surrounding factors. 26

The above shows that, in specifying the mode of acceptance and the condition of his duty the option giver can cause the contract either to remain unilateral as before the acceptance or to become bilateral. 27

The majority in Cotter v. Tapp held that the payment by Tapp of the sum stipulated in the lease for the second option was the method prescribed for accepting the option. 28 It is equally plausible that the provision of the contract fixed only the price for the option and not the method of acceptance, and being silent as to notice requirements, intended a reasonable time of notification before the option expired. However, the strict interpretation of options in South Carolina tipped the scales in favor of the first, more literal interpretation. 29

It is assumed that in most cases the optionor expects acceptance by the giving of notice; 30 therefore, the courts are prone to

24. "In order to make a bargain, it is necessary that the acceptor shall give in return for the offeror's promise exactly the consideration which the offeror requests. If an act is requested, that very act and no other must be given." 1 S. WILLISTON, CONTRACTS § 73 (1957) (footnotes omitted); accord, Restatement (Second) of Contracts § 61 (1973).
25. 1A A. CORBIN, CONTRACTS § 264 at 513 (1963).
26. Id.
27. Id. at 514.
28. ___ S.C. at ___, 230 S.E.2d at 718.
29. See notes 33-36 and accompanying text infra.
30. 1A A. CORBIN, CONTRACTS § 264 at 518 (1963).
interpret the agreement in such a way that the contract will become bilateral after proper notice of acceptance and operative without any tender or payment, even when such tender remains a condition of the duty to perform. However, as the majority opinion pointed out, it is well settled in this state that option contracts are strictly construed in favor of the optionor and against the optionee with time being considered of the essence. Therefore, exact compliance with the terms of the option is required, and the consideration for a renewal option must be paid or tendered before the original time limit expires unless there are express provisions to the contrary in the lease. The court recognized that this may produce harsh results in option cases, but held that these results must be tolerated to further more compelling considerations of public policy. The majority of the supreme

31. Id. at 514. The dissent took this position as to the interpretation of the option, 230 S.E.2d at 720.

32. 1A A. CORBIN, CONTRACTS § 264 at 514-15 (1963).


34. Pope v. Goethe, 175 S.C. 394, 399, 179 S.E. 319, 321 (1935). "If the option requires performance in a certain manner, time is of the essence and exact compliance with the terms of the option are required." ____. S.C. at ____, 230 S.E.2d at 717-18. See also Annot., 44 A.L.R.2d 1359, 1362-77 (1955); Annot., 51 A.L.R. 2d 1404, 1427 (1957). The defendant Tapp sought to introduce evidence that the plaintiff had waived the time limit for exercising the renewal option by its course of dealings with the defendant. The court held that this constituted new matter which should have been affirmatively pleaded in the answer; therefore, introduction of the evidence was improper and could not serve as a basis for avoiding summary judgment, ____ S.C. at ____, 230 S.E.2d at 719. In the alternative, the lower court also found that the evidence sought to be introduced failed to indicate a genuine issue as to any material fact. ____ S.C. at ____, 230 S.E.2d at 719. In any event, the court held that A.C. Tuxbury Lumber Co. v. Byrd, 131 S.C. 32, 127 S.E. 267 (1925), would be controlling since time is of the essence in option contracts unless otherwise stated.

35. A.C. Tuxbury Lumber Co. v. Byrd, 131 S.C. at 41, 127 S.E. at 270 (citing Minshew v. Atlantic Coast Lumber Corp., 98 S.C. 8, 81 S.E. 1027 (1914)). See also Gray v. Marion County Lumber Co., 102 S.C. 289, 86 S.E. 640 (1915). However, it should be noted that in these cases, the optionor never received notice of the optionee's intention to renew or extend the option until after the expiration date had passed. ____ S.C. at ____, 230 S.E.2d at 720-21 (dissenting opinion).

36. In Dargan v. Page, 222 S.C. 520, 73 S.E.2d 705 (1952) the court recognized that: [S]ound legal doctrine demands that at the option of the owner, compliance with the very letter of the option may be exacted, the basic reasons being that the contract is unilateral in character, tying up the title and rights of ownership of the optionor, and giving the optionee "a right and privilege" which only by strict compliance with the terms of the option can be transformed into a mutually binding contract of sale.

Id. at 533, 73 S.E.2d at 711. However, this case, unlike Tapp, dealt with an expression of intention to exercise the option after the expiration date.
court continued to adhere to the rigid interpretation of options in South Carolina, reaffirming past decisions and affirming dicta in those cases requiring actual payment or tender to exercise an option, regardless of notice given.37

III. INSTALLMENT SALES CONTRACTS

In Davenport v. Unicapital Corp.38 the South Carolina Supreme Court addressed two important issues: usury in an installment sales contract and the application of the holder in due course doctrine to a finance company purchaser of the contract. At the outset, it should be noted that the precise facts of this case would now be covered by the Federal Truth in Lending Act,39 Federal Trade Regulation Rule (Preservation of Consumer’s Claims and Defenses),40 the South Carolina Consumer Protection (Uniform Consumer Credit) Code,41 and the South Carolina Unfair Trade Practices Act.42

On May 30, 1968, Mr. and Mrs. Davenport, the respondents, had executed a written contract with Garden City Home Improvements, Inc., for the purchase and installation of aluminum siding and other repairs and construction work to be done on their property.43 The contract provided for an installment plan of payment wherein the Davenports would pay the sum of $2,360.00 in eighty-four equal monthly payments of $54.96 for a total price of $4,616.64;44 however, it did not mention that a time price differential or a higher credit price was included. On the same date the Davenports executed a negotiable promissory note payable to Garden City Home Improvements, Inc., which corresponded to the payment terms of the contract. Thereafter, on June 12, 1968, respondent Mildred Davenport executed a written “Completion Certificate” which in addition to acknowledging acceptable performance of the work, stated that they (the Davenports) “were offered a cash price and a higher Time Price and have agreed to

37. See cases cited at notes 33-36 supra.
43. Record at 8.
44. Id. at 52 (Exhibit 1).
accept the higher Time Price.” To secure the note, the Davenport,
on June 13, 1968, executed and gave a mortgage on the real
estate, which recited the terms set forth in the contract. On that
same date the appellant, allegedly an entity independent of the
contractor-payee, purchased the note and mortgage without re-
course from Garden City Home Improvements, Inc.

The Davenport brought suit to have the mortgage securing
the promissory note declared paid and satisfied in full and to
recover judgment for double the amount of interest paid, as san-
tioned by South Carolina law upon a finding of usury. The ap-
pellant denied that the transaction was usurious, alleged that it
was a holder in due course, and pleaded merger, waiver, and
estoppel as additional defenses. The lower court affirmed the
findings of the special referee that the transaction was in fact
usurious, that Unicapital was not a holder in due course and that
the defenses of merger, waiver, and estoppel were not applicable.
Denying Unicapital’s plea of prejudice on behalf of the trial
judge, the judgment and the referee’s fee of $500.00 were af-
Rmed by the South Carolina Supreme Court.

45. Id. at 55 (Exhibit 4).
46. Id. at 6. However, see note 48 infra.
47. S.C. Code Ann. § 34-31-50 (1976) provides:
Usury — Any person who shall receive or contract to receive as interest any
greater amount than is provided for in § 34-31-30 shall forfeit all interest and
the costs of the action and such portion of the original debt as shall be due shall
be recovered without interest or costs. When any amount so charged or con-
tacted for has been actually received by such person he shall also forfeit double
the total amount received in respect of interest, to be collected by a separate
action or allowed as a counterclaim in any action brought to recover the princi-
pal sum.

S.C. Code Ann. § 34-31-30 (1976) provided for a maximum rate of interest of seven per
cent (7%) at the time this transaction was entered into. Under the foregoing contract (see
text accompanying note 44 supra) the deferred payment price of $4,616.64 produced an
interest rate of approximately 14%. ___ S.C. at ____, 230 S.E.2d at 907. See 91 C.J.S.
Usury § 35 (1955).

48. The appellants charged bias and prejudice of the trial judge based on statements
in his order to the effect:

(1) that the rule of law, permitting evidence dehors the written agreement to
show that, though legal on its face, it was in fact illegal, was designed to
“prevent unscrupulous creditors from covering up their usurious interest by
means equivalent to that which was being used in the case at Bar;” and

(2) that the trial judge was persuaded that the appellant, instead of acting
independently, was “in league with the Home Improvement Company.”

___ S.C. at ____, 230 S.E.2d at 910. See text at note 46 supra.

49. The supreme court held that the trial judge did not abuse his discretion in award-
ing the $500.00 fee to the special referee. In so holding, the court noted “the competence
of the Special Referee, the time consumed in disposing of the case, the legal issues in-
volved, and the thorough and complete report filed.” Id.
A. Usury

The first issue considered by the supreme court was whether the transaction was usurious. The appellant argued that all of the documents should be considered as one transaction to determine whether it provided for a permissible time price differential or a charge of usurious interest. Thus, the contention was that the completion certificate, signed two weeks after the contract, which made reference to a time price, should be considered as part of the transaction to show conclusively that a time price was intended instead of interest. The supreme court rejected this argument stating only that whatever effect the completion certificate had on the determination of whether the amount was intended as a loan or as a time price differential was a question of fact; and since the finding by the referee and the trial judge that there

50. A time price differential is the difference between a quoted price for immediate payment (or cash price) and a quoted price for deferred payment (or time price). This time price differential is a well-established exception to the usury laws. See, e.g., Hogg v. Ruffner, 66 U.S. (1 Black) 115 (1861) (established the time price exception to the usury laws in the United States); Wilson v. J.E. French Co., 214 Cal. 188, 4 P.2d 537 (1931); Hafer v. Spaeth, 22 Wash. 2d 378, 156 P.2d 408 (1945). See generally 45 Am. Jur. 2d Interest and Usury § 2 (1969); Note, Judicial and Legislative Treatment of "Usurious" Credit Sales, 71 Harv. L. Rev. 1143, 1145-46 (1958).

The two-price requirement limits the exception to sales, causing the loan-sale distinction to be an important determinant in the application of the time price exception to a particular transaction. See generally Annot., 14 A.L.R.3d 1065, 1124-60 (1967). A sale of property is further excepted from the usury laws in that it is neither a loan nor a forbearance of money and, therefore, does not fit under the general definition of usury, which is "the exaction of a greater sum for the use of money than is the highest rate of interest allowed by law." Id. at 1070-71; see 45 Am. Jur. 2d Interest and Usury § 2 (1969).

The fact that the price for a sale on credit is higher than the seller would require if the sale was for cash does not necessarily indicate the existence of usury; but if the transaction is found to be "actually a device to evade the usury laws, it is not saved by any attempted differential between a claimed 'cash' price and a claimed 'credit' price." Annot., 14 A.L.R.3d at 1124; see Osborne v. Fuller, 92 S.C. 338, 341, 75 S.E. 557, 558 (1913); Brown v. Crandall, 218 S.C. 124, 127-28, 61 S.E.2d 761, 762-63 (1950). If the court does find the transaction to be a device or plan to evade the usury laws it will "disregard the form and consider the substance of the transaction." Id. at 128, 61 S.E.2d at 763. The case of Brown v. Crandall is commented upon at length in Note, Applicability of Usury Laws to Credit Installment Sales, 4 S.C.L.Q. 290 (1951), which also gives an excellent and comprehensive treatment of the development of South Carolina law on usury as well as discussing the development of the time price doctrine.

The interest/time price differential dichotomy has troubled the courts for some time. Some courts have continued to apply the time price rule despite the existence of circumstances from which other courts would infer a scheme to avoid the usury laws. See, e.g., Aglio v. Carusel, Inc., 34 Misc. 2d 79, 228 N.Y.S.2d 350 (1962); Equipment Fin., Inc. v. Grannas, 207 Pa. Super. Ct. 363, 218 A.2d 81 (1966).

51. Brief for Appellant at 16-17.
52. ___ S.C. at ___, 230 S.E.2d at 908.
was no valid time price differential was amply supported by the evidence, the determination of usury was affirmed.\(^{53}\)

The referee considered the following factors as bases for determining the contract usurious: (1) The contract made no provision which would allow the plaintiff to pay off the amount due in any other manner than eighty-four payments at $54.96;\(^{54}\) (2) the discount rate, which was mentioned in the contract,\(^{55}\) was intended to mean interest;\(^{56}\) (3) the contract mentioned neither a higher time price nor a total time price;\(^{57}\) (4) the contract provided that the contractor would select a lender and that the Davenports would comply with “all things requisite in the opinion of the contractor in securing a loan,”\(^{58}\) which “clearly indicated an intention on the part of all parties that the contract was not one for which the [Davenports] were expected to pay anything ex-

\(^{53}\) Id. The analysis of a transaction to determine if it is a usurious loan or a permissible time price differential is as follows: If the transaction is a bona fide sale, and the vendor makes it clear to the purchaser that the credit price is higher than the cash price and gives him a free choice as to which price he wants to pay, there is no usury; but if the transaction as a whole is actually a scheme or device to circumvent the statutes against usury, the mere quotation of a claimed cash price and a claimed credit price will not save it. See cases cited at Annot., 14 A.L.R.3d 1065 §§ 4 & 11 (1967).

Some factors which courts have advanced as supporting a finding of a usurious loan rather than an installment time price sale may be listed as follows:

1. That the seller did not clearly quote two distinct prices and give the buyer an actual opportunity to choose as between them, \(id.\) at § 13;
2. that the conditional sale contract, chattel mortgage, or other supporting paper signed by the buyer was immediately assigned by the seller to a person or concern engaged in the business of loaning money or discounting commercial paper, with whom the seller maintained very close relations on a more or less permanent basis, \(id.\) at § 14;
3. that the sale contract contained charges against the purchaser phrased in misleading or ambiguous language which tended to cover up the essential nature of the transaction as a sale for cash, part of the price being borrowed by the purchaser, \(id.\) at § 15;
4. that the excess of the claimed “credit” price over the claimed “cash” price was calculated in language usually reserved for computing interest on a loan, \(id.\) at § 17.

\(^{54}\) Record at 52 (Exhibit 1).
\(^{55}\) Id.
\(^{56}\) Id. at 83.
\(^{57}\) Id. at 93.
\(^{58}\) The contract provision referred to stated:

It is mutually agreed and understood by and between the parties hereto that the owner(s) will and can qualify for a loan at any agency selected by the contractor; owner further agrees to cooperate at all times with the contractor, and the owner further agrees to do all things requisite in the opinion of the contractor in securing loan.

\(id.\) at 52 (Exhibit 1).
cept the regular monthly payments,” as “stated in the contract . . . [T]herefore, . . . there was no time price differential available to the defendant.”

The trial court affirmed the report explaining that because the Davenports were not given the alternative of paying cash or accepting a higher price for deferring payment, there was no valid time price differential.

The implication of the foregoing is that a payment plan in an installment sales contract that includes a substantial time price differential, to avoid being held a mere scheme to evade the usury laws, must allow the purchaser a fair and meaningful choice as to method of payment after he has been given full disclosure in the contract of the cost of delaying payment.

In recognition of the need for meaningful disclosure of credit terms to facilitate “credit shopping,” Congress enacted the Truth in Lending Act, effective July 1, 1969. This act requires creditors to make certain disclosures in connection with consumer credit transactions, necessarily including installment sales contracts. The type of disclosure required is determined by the type of transaction. In the Davenports’ contract, an installment sale transaction for consumer goods, which was a “closed-end credit sale,” the proper disclosures would have included

the cash price; the downpayment [if any]; the “unpaid balance of the cash price” . . . ; itemized additional charges not included in the finance charge; the sum of all of these amounts . . . ; any prepaid finance charges or required compensating deposits which must be deducted from the amount financed . . . ; the “amount financed” . . . ; the “deferred payment price,” which is the amount financed plus the total finance charge; the finance charge expressed as an annual percentage rate . . . ; the repayment schedule . . . ; default and delinquency charges; a description of any security interest and a clear identification of the collateral; a description of any prepayment

59. Id. at 83.
60. Id. at 107.
61. B. CLARK & J. FONSECA, HANDLING CONSUMER CREDIT CASES § 38 at 138 (1972) [hereinafter cited as CLARK & FONSECA].
63. A sale on credit having a fixed maturity is a closed-end credit sale as opposed to open-end credit which allows further loans to be made, e.g., a revolving credit card account.
penalty; and an identification of the method of computing rebates of unearned finance charge upon prepayment.64

Effective January 1, 1975, the South Carolina Consumer Protection Code65 specifically requires compliance with the Federal Truth in Lending Act. It also sets a maximum credit service charge66 depending on the amount of the unpaid balance.67

B. Holder in Due Course Doctrine

Having determined that the contract was usurious, and since a defense of usury may not be valid against a holder in due course,68 the court next made a determination as to the status of Unicapital Corporation as the transferee of the note and mortgage. The South Carolina Supreme Court affirmed the decision of the special referee and circuit judge that the appellant was not a holder in due course, that is, (1) a holder of a negotiable instrument, (2) who took it for value, (3) in good faith, (4) without notice that it was overdue or had been dishonored or of any defenses against or claim to it on the part of any person.69 It was

64. CLARK & FONSECA § 41 at 144-45. For more information on credit transactions covered by the Federal Truth in Lending Act, see generally J. FONSECA, CONSUMER CREDIT COMPLIANCE MANUAL (1975); CLARK & FONSECA, supra note 61; CONS. CRED. GUIDE (CCH).
66. "The 'credit service charge' means the sum of (1) all charges payable directly or indirectly by the buyer and imposed directly or indirectly by the seller as an incident to the extension of credit, including . . . [a] time price differential, service, carrying or other charge, however denominated." The term also includes any "premium or other service charge for any guarantee or insurance protecting the seller against the buyer's default or other credit loss." S.C. CODE ANN. § 37-2-109 (1976).
68. The Uniform Commercial Code was enacted in South Carolina on January 1, 1968, and is now a portion of the Code of Laws of South Carolina at S.C. CODE ANN. §§ 36-1-101 to 36-10-103 (1976). Under the U.C.C., usury is a defense against a holder in due course only if the effect of the usury is to make the entire transaction null and void. S.C. CODE ANN. § 36-3-305, Comment 6 (1976). See 11 Am. Jur. 2d Bills and Notes § 679 (1963).
69. S.C. CODE ANN. § 36-3-302(1)(a)-(c) (1976) provides: "The purpose of the holder in due course concept is to allow commercial paper to flow freely by protecting a holder who takes for value, in good faith, and without knowledge, from defenses that would be good against the seller." 39 Mo. L. Rev. 111, 114 (1974); accord, Comment, Judicial Limitations on Holder in Due Course Claims, 42 U. Colo. L. Rev. 439 (1970).


https://scholarcommons.sc.edu/sclr/vol29/iss1/6
uncontested that, except for notice, Unicapital met these requirements.70 Under S.C. Code § 36-3-304(1)(b), a "purchaser has notice of a claim or defense if [he] has notice that the obligation of any party is voidable in whole or in part,"71 or that all parties have been discharged."72 Unicapital had the sales contract in its possession prior to the purchase of the note and mortgage from Home Improvements, Inc.;73 thus, the issue presented was whether Unicapital had notice sufficient to defeat its claimed status as a holder in due course. The court reasoned that the underlying executory contract was usurious and that because the appellant had notice of the contract, it had sufficient notice of defenses against the note to preclude its status as a holder in due course.

Unicapital's argument was that even though it had actual knowledge of the contract, it did not have actual knowledge of the claim of usury asserted against the note until a later time since the difference in time price and cash price could have been a valid time price differential.74 Thus, Unicapital urged upon the court a

---

70. ___ S.C. at ___, 230 S.E.2d at 908.
71. The author in 2 BENDER'S U.C.C. SERV. § 11.05[5] explains that to make sense the section must be read in a particular way. He explains that the introductory language, "notice of a claim or defense" should be read as a "phrase of art" and that the definition of notice found in § 1-201(25) is not applicable; however, the § 1-201(25) definition does apply to notice in "if the purchaser has notice." Hence, the subsection may be read as follows: "A purchaser has notice-of-a-claim-or-defense if the purchaser has (1) knowledge, (2) notification, or (3) reason to know that the obligation of any party is voidable in whole or in part, or that all parties have been discharged." BENDER'S U.C.C. SERV., supra.

The author further explains:

Instead of using the term "defenses," the subsection refers to the voidability of obligations. The only effect of the Code language is to limit the concept of defenses by excluding counterclaims or set-off that may be available as against a party but which do not go to the enforceability of the obligation. It should be noted that where there is notice of the voidability of an obligation of any party, the purchaser cannot be a holder in due course, and that this is true even if the obligation is voidable only in part.

73. ___ S.C. at ___, 230 S.E.2d at 908.
74. Brief of Appellant at 12-15. See Littlefield, Good Faith Purchase of Consumer
totally subjective interpretation of "notice" under section 36-3-304(1)(b). The supreme court rejected this argument and inferred sufficient knowledge from the fact that before purchasing the respondent’s obligation, Unicapital had received the note, mortgage, and completion certificate together with the contract, which showed on its face a charge of usurious interest. Although the court did not explain its analysis further, it can be surmised that the supreme court was interpreting section 36-3-304 with reference to the definition of notice found in section 36-1-201(25). Under the provisions of section 36-1-201(25), a person has "'notice' of a fact" when: (a) he has actual knowledge of it; or (b) he has received a notice or notification of it; or (c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists. The court may have interpreted the "reason to know" standard as requiring such notice as a reasonable man would have had from all of the facts and circumstances actually known; however, it seems more probable that the courts was imputing notice that the obligation was voidable from facts that should have been realized by Unicapital,

---


76. ____ S.C. at ____ , 230 S.E.2d at 908.


The general definition of notice contained in Section 1-201(25) is important to a discussion of the holder in due course requirement that a purchaser take without notice of adverse claims, dishonor, defenses, or overdueness, because the word "notice" appears as part of the description in sections 10.3-302 and 10.3-304 of what constitutes "notice of dishonor," "notice of adverse claims and defenses," and "notice of overdueness." When the word forms a part of these descriptions, it is used in the sense of its Section 10.1-201 definition.

2 Bender's U.C.C. Serv. at § 11.05(2). See Official Comment 1 to § 10.3-304; see also note 71 supra.

78. S.C. Code Ann. § 36-1-201(25) (1976) (emphasis added). Bender's U.C.C. Serv. explains that "subparagraph (c) includes a test of notice that involves use of something like a reasonable man standard," and refers to the Comments to § 9 of the Restatement of Agency for an explanation of when a transferee has "reason to know":

A person has reason to know of a fact if he has information from which a person of ordinary intelligence, or of the superior intelligence which such person may have, would infer that the fact in question exists or that there is such a substantial chance of its existence that, if exercising reasonable care with reference to the matter in question, his action would be predicated upon the assumption of its possible existence.

Restatement (Second) of Agency § 9, Comment 46 (1958). "It is the 'reason to know' method of obtaining notice that seems to give the most difficulty. In a sense, the test is an objective one: it clearly does not require that the purchaser have actual knowledge of the adverse claims, dishonor, defenses, or overdueness." 2 Bender's U.C.C. Serv. at § 11.05(3) (1972). See also note 71 supra.
using reasonable commercial standards as a yardstick.\textsuperscript{79}

The further argument was that section 36-3-304 Official Comment 3\textsuperscript{80} should be read to exclude notice of a claim of usury as notice of a claim or defense which would preclude a purchaser from being a holder in due course since South Carolina "does not void a usurious contract but rather imposes forfeitures and penalties" thereon; therefore, section 36-3-304(1)(b) would not apply because the obligation itself was not voidable in whole or in part.\textsuperscript{81}

The court, however, found that since the usury statute allows double recovery of interest,\textsuperscript{82} the additional interest would cut into the original obligation causing it to be voidable in part; furthermore, since a usury claim can be brought in a separate action,

\textsuperscript{79} The South Carolina Supreme Court held that:

The record sustains the conclusion that appellant received the contract (which showed on its face a charge of usurious interest) along with the note, mortgage and completion certificate (signed by only one of the makers of the note) before it decided to purchase respondent's obligation. The record therefore sustains the concurrent findings of the referee and the trial judge that appellant had knowledge of the fact that the transaction was usurious.

\textsuperscript{80} S.C. at ____; 230 S.E.2d at 908. Thus, Unicapital was deemed to have notice of the defense of usury, regardless of actual knowledge, perhaps based upon reasonable expectations of conduct of commercial institutions. In Von Gohren v. Pacific Nat'l Bank of Wash., 505 P.2d 467, 12 U.C.C. Rptg. Serv. 133 (Wash. App. 1973), the Supreme Court of Washington adopted this view noting that:

This argument [see note 78 supra and accompanying text] makes the "reason to know" method of notice an objective one, and would not require that a taker have actual knowledge of an adverse claim in order to be charged with notice of such claim, but would premise notice upon reasonable commercial standards.

This line of reasoning has the support of at least one scholar. See 2 Bender's UCC Service, F. Hart & W. Willer, Commercial Paper § 11.05(2) (1972). We agree with the logic of the argument, the code has seen fit to distinguish "good faith" and "notice" by setting them forth as two separate requirements and, in article 1, in defining them separately.


\textsuperscript{81} S.C. Code Ann. § 36-3-304 (1976) Official Comment 3 provides: "'Voidable' obligation in paragraph (b) of subsection (1) is intended to limit the provision to notice of defense which will permit any party to avoid his original obligation on the instrument, as distinguished from a set-off or counter-claim."

\textsuperscript{82} Brief for Appellant at 11. See note 47 supra. The crux of this argument was that the usury provision (§ 34-31-50) sets up only a counterclaim or set-off for double the amount of usurious interest charged and does not void either part or all of the obligation, but rather imposes penalties and forfeitures. The appellant's contention was that since only the interest is voidable under § 8-5 (now § 34-31-50 (1976)) and not the whole contract (principal must still be paid), it, therefore, did not have notice that the obligation was voidable.

\textsuperscript{82} See note 47 supra.
rather than only as a counterclaim or setoff, section 36-3-304 Official Comment 3 was inapplicable.⁸³ The further exceptions of merger, estoppel, and waiver were summarily dismissed.⁸⁵

The South Carolina Consumer Protection Code⁸⁶ and the

---

⁸³. ___ S.C. at ___, 230 S.E.2d at 908.

⁸⁴. Essentially, the third defense was that when the note and mortgage were signed by the Davenports, the contract was merged into them and that reference to the contract would be of no effect whatever in that it was now a part of the note and mortgage. The Appellant relied upon the doctrine set forth in Charleston W. Ry. v. Joyce, 231 S.C. 493, 99 S.E.2d 187 (1957), that

[all conversations and parole agreements between the parties prior to or contemporaneous with the written agreement are considered to have been merged therein so that they cannot be given in evidence for the purpose of changing the contract or showing an intention or understanding different from that which is expressed in the written agreement.

Id. at 502, 99 S.E.2d at 191 (emphasis added). However, the special referee determined that reference to the contract could be made since the contract did not change the terms of mortgage or note, but only explained what interest was being charged whereas the note and mortgage were silent as to the amount of interest charged. Record at 85–86. The South Carolina Supreme Court affirmed, holding the case of Rainwater v. Bonnette, 151 S.C. 474, 149 S.E. 254 (1929) to be controlling.

⁸⁵. The court held the findings of the referee and the trial judge concerning estoppel and waiver to be “sustained by the record” without further discussion. ___ S.C. at ___, 230 S.E.2d at 909. The contention of Unicapital was that an estoppel arose because the Davenports had signed the completion certificate which expressly mentioned a time price difference and that they had received outside advice. The special referee stated, “Estoppel arises when a party misrepresents or conceals facts and the other party relies thereon and changes his position in reliance upon it.” Record at 88. Noting that the Davenports had only meager education and little business experience, the referee decided that they should not be estopped. Furthermore, the referee determined that waiver also did not apply. Record at 88 & 89.

⁸⁶. S.C. CODE ANN. § 37-2-403 (UCCC § 2.403) (1976) provides: “With respect to a consumer credit sale or consumer lease, the creditor may not take a negotiable instrument other than a check dated not later than ten days after its issuance as evidence of the obligation of the consumer.” S.C. CODE ANN. § 37-2-404 (UCCC § 2.404) (1976) provides in part:

(1) With respect to a consumer credit sale or consumer lease, an assignee of the rights of the seller or lessor is subject to all claims and defenses of the consumer against the seller or lessor arising from the sale or lease of property or services, notwithstanding that the assignee is a holder in due course of a negotiable instrument issued in violation of the provisions prohibiting certain negotiable instruments (Section 2.403).

(2) A claim or defense of a consumer specified in subsection (1) may be asserted against the assignee under this section only if the consumer has made a good faith attempt to obtain satisfaction from the seller or lessor with respect to the claim or defense and then only to the extent of the amount owing to the assignee with respect to the sale or lease of the property or services as to which the claim or defense arose at the time the assignee has written notice of the claim or defense.

(5) An agreement may not limit or waive the claims or defenses of a consumer under this section.
Federal Trade Commission trade regulation rules\textsuperscript{87} now preserve the buyers' claims and defenses arising from the sale against the assignee of the rights of the seller with respect to consumer credit sales, notwithstanding the fact that the assignee is a holder in due course of a negotiable instrument.\textsuperscript{88} This is true even if the sales contract contains a clause that attempts to waive the defenses against the assignee.\textsuperscript{88} The South Carolina Consumer Protection Code also protects the consumer where the seller, instead of transferring the contract, refers the buyer to a finance company which then makes to the buyer a direct loan of cash to complete the purchase.\textsuperscript{89}

\textit{Hugh M. Hadden}

\begin{footnotesize}
\begin{enumerate}
\item Federal Trade Commission Regulation Rule, 16 C.F.R. § 433 (1976), provides in part:
\begin{quote}
In connection with any Purchase Money Loan (as that term is defined in § 433.1) or any sale or lease of goods or services, in or affecting commerce as "commerce" is defined in the Federal Trade Commission Act, it constitutes an unfair or deceptive act or practice within the meaning of Section 5 of that Act, for a seller or a creditor, directly or indirectly, to take or receive a consumer credit contract which fails to contain the following provision in at least ten point, boldface type:

\textbf{NOTICE}

\textbf{ANY HOLDER OF THIS CONSUMER CREDIT CONTRACT IS SUBJECT TO ALL CLAIMS AND DEFENSES WHICH THE DEBTOR COULD ASSERT AGAINST THE SELLER OF GOODS OR SERVICES OBTAINED PURSUANT HERETO OR WITH THE PROCEEDS HEREOF. RECOVERY HEREUNDER BY THE DEBTOR SHALL NOT EXCEED AMOUNTS PAID BY THE DEBTOR HEREUNDER.}
\end{quote}
\end{enumerate}
\end{footnotesize}

\begin{footnotesize}
\begin{enumerate}
\item (a) Unfair methods of competition and unfair or deceptive acts or practices in the conduct of any trade or commerce are hereby declared unlawful.
\item (b) It is the intent of the legislature that in construing paragraph (a) of this section the courts will be guided by the interpretations given by the Federal Trade Commission and the Federal Courts to § 5(a)(1) of the Federal Trade Commission Act (15 U.S.C. 45(a)(1)), as from time to time amended.
\end{enumerate}
\end{footnotesize}

\begin{footnotesize}
\item See notes 86 and 87 supra.
\item \textit{Id.}
\end{footnotesize}