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STUDENT NOTES

Usury Laws as Applied to Credit Sales — The Need for Revision

The system of installment buying has constituted a revolution in American economic thinking and behavior, and credit sales have raised legal issues which now touch a large segment of the population. One of these issues concerns the application of state and federal usury statutes to this form of business transaction.

Usury, in Biblical times, encompassed any transaction in which interest was charged. It did not matter whether interest was charged in money or in kind.¹ The first English statutes concerning the matter had substantially the same effect.² As the English economy began to evolve into a more complex system to meet the expanding

¹ *Deuteronomy* 23:19.

² An Act Against Usury 13 Eliz. c. 8, § IX (1570).

needs of a growing, centralized, urban population, it became necessary for the usury laws, like many others, to undergo certain changes. As a result of the industrial revolution they were repealed and new statutes fixed the rate of interest on a loan or forbearance of money.³ One of the first English cases seemed to say that these statutes would apply to a sales transaction;⁴ however, this tendency was nipped in its embryonic stages when, in 1821, *Beete v. Bidgood*⁵ held that the sale of real estate was a bona fide credit sale, rather than a loan or forbearance of money, and therefore that the usury statutes were inapplicable. This case had a definite influence on early American cases which were also concerned with the sale of real estate,⁶ and on later cases involving the sale of personal property.

Generally, statutes throughout the country have language stating that the lawful rate of interest for the loan or use of money shall be six per cent per annum. The courts are generally in accord, in interpreting these statutes, as to the elements necessary to constitute a violation thereof, the criteria usually being: 1. A loan or forbearance of money; 2. an agreement to return money absolutely; 3. an agreement to pay in excess of the lawful rate, and 4. an unlawful interest.⁷ Most courts also state that they will prevent any sham or device to be used to evade the usury statutes.⁸ In direct contrast to the position taken by the courts, against the use of sham or device to evade usury laws, it is surprising to find that the courts seldom find usury lurking behind the cloak of a sale. Although the statutory language of the usury laws sounds strongly protective, a credit buyer will be fortunate if the sales agreement with which he is presented does not provide on its face for a finance charge far in excess of the established statutory lawful rate. Does the seller violate the usury laws by charging the excess amount? With very few exceptions the federal⁹ and state¹⁰ courts have held that he does not. The courts merely say that no one has loaned the buyer any money and he is not paying

³ An Act to Reduce the Rate of Interest Without Prejudice to Parliamentary Securities, 12 Anne c. 16 (1714).

⁴ *Dewar v. Span*, 3 Term Rep. 425, 100 Eng. Rep. 656 (1789).

⁵ 7 Barn & Cress 435, 108 Eng. Rep. 792 (1821).

⁶ *Hogg v. Ruffner*, 66 U.S. (1 Black) 38 (1861); *Dry Dock Bank v. American Insurance Co.*, 3 N.Y. 344 (1850).

⁷ *In re Bibbey*, 9 F.2d 944 (8th Cir. 1925); *Equitable Credit and Discount Corp. v. Geir*, 342 Pa. 445, 21 A.2d 53 (1941).

⁸ 55 AM. JUR., *Usury* § 21 (1946).

⁹ *Hogg v. Ruffner*, 66 U.S. (1 Black) 38 (1861).

¹⁰ 55 AM. JUR., *Usury* § 23 (1946).

interest. He is only paying a higher price than the one paid by a cash purchaser.¹¹

These holdings are results of two basic ideas which have been carried over from *Beete v. Bidgood*, *supra*: first, that the time differential is a part of the credit price;¹² and second, that a bona fide sale does not come within the meaning of the term loan or forbearance of money.¹³ If the transaction, alleged to be usurious, is cast in the form of a sale rather than a loan most courts will allow the seller to evade usury restrictions.¹⁴ Courts, in distinguishing between interest and finance charges, take the view that a seller in a free economic society has the right to charge whatever he pleases for his goods.¹⁵ The difference between the cash price and the higher credit price represents the increased cost of servicing a credit account rather than compensation for forbearance or the use of money.¹⁶ They circumvent what on the surface has the appearance of charging excess interest by holding that the legislature's intent in passing the usury laws was not to protect the credit purchaser but rather to safeguard the needy who lack available cash for necessities.¹⁷

These distinctions, between a loan or forbearance and a credit sale, seem to be completely lacking in reason when the problem is one of determining whether usury is present in a contract. For example: if a party, X, needs a given article to perform his work he may buy it on credit or pay cash. If he borrows the money from a bank, in order to pay cash, he must pay interest to the lender; if he buys it by a credit sale he must pay a finance charge to the dealer. In both instances X has an added cost in acquiring a necessity. Under the distinction drawn by the courts, the lender is limited in the amount of interest he may charge by the usury law but the dealer is not limited in the extent of the finance charge. This result is often upheld by showing in scholarly works, though not generally in the decisions,

¹¹ *Cobb v. Baxter*, _____ Okla. _____, 292 P.2d 389 (1956).

¹² *Richardson v. C.I.T.*, 60 Ga. App. 780, 5 S.E.2d 250 (1939); *Yeager v. Ainsworth*, 202 Miss. 247, 32 So.2d 548 (1947).

¹³ *Commercial Credit Co. v. Tarwater*, 215 Ala. 123, 110 So. 39 (1926); *Underwriters Acceptance Corp. v. Dunkin*, 152 Neb. 550, 41 N.W.2d 885 (1950).

¹⁴ *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403 (1927); *Commercial Credit Co. v. Tarwater*, 215 Ala. 123, 110 So. 39 (1926).

¹⁵ *Fisher v. Hoover*, 21 S.W. 930 (Tex. Civ. App. 1893).

¹⁶ *Hare v. General Contract Purchase Corp.*, 220 Ark. 601, 249 S.W.2d 973 (1952).

¹⁷ *General Motors Acceptance Corp. v. Weinrich*, 218 Mo. App. 68, 262 S.W. 425 (1924).

that a lending company requires more collateral than a finance company and therefore since the latter's risk is greater so should its return be greater. This would indicate the desirability of legislative adjustments of interest rates proportionately to the security received, but it does not justify limiting interest on a direct loan while exempting *altogether* a finance charge.¹⁸

Courts often state that they will look beyond the form and into the substance of the transaction to determine whether usury is present;¹⁹ however, they fail to make clear the test to determine if the substance to which they look is usurious. There have been cases where the form of the sale was so inadequate that the most reluctant court could not fail to detect usury.²⁰ Once again, even the most reluctant courts admit the vulnerability of credit sales to usury laws when a vendor's action clearly shows a criminal intent and where strong evidence supports a finding of usury.²¹ This is a decided fallacy in the usury area which requires the extreme degree of certainty before the contract will be termed usurious. As a result of this many courts find themselves paying only lip service to their belief that substance not form should be controlling.²²

The courts generally have shown no tendency to extend the applicability of usury statutes to credit sales or interpret them to meet the conditions existing in the world today. In a small minority of lower court cases, decisions have favored the extension of such laws and though they were not upheld by the higher courts their reasoning should be noted. In *Failing v. National Bond & Investment Corp.*,²³ the court stated:

"If it is the needy 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."

One decision that may bring about eventual change is *Dellard*

¹⁸ 2 LAW & CONTEMP. PROB. 173 (1935).

¹⁹ *Dunn v. Midland Loan Finance Corp.*, 266 Minn. 550, 289 N.W. 411 (1939).

²⁰ *Seebold v. Eustermann*, 216 Minn. 556, 13 N.W.2d 739 (1944).

²¹ *Powell v. Edwards*, 162 Neb. 11, 75 N.W.2d 122 (1956).

²² *Brooks v. Auto Wholesalers Inc.*, 101 A.2d 255 (D.C. Mun. App. 1953).

²³ *Failing v. National Bond and Investment Corp.*, 168 Misc. 617, 6 N.Y.S.2d 71, 72 (1938).

v. Bank of Birmingham,²⁴ in which the federal usury statutes were held applicable to national banks participating in installment programs. The majority noted that usurious contracts were condemned by state and national policy and such policy should not be defeated by the ingenious drafting of a sales contract.

West Virginia law, as regards usury, is not noticeably different from the laws of the rest of the country. As elsewhere, all contracts and assurances made directly or indirectly for the loan or forbearance of money at a greater rate of interest than six per cent are void as to any interest in excess of that rate,²⁵ and the cases have defined usury as interest exceeding the lawful rate for the loan or forbearance of money.²⁶

In West Virginia there is no usury in a bona fide sale but only where there is a loan or forbearance of money. The courts will only apply the usury statute to a sale when it is shown that it is a mere cover for a loan or forbearance.²⁷ In essence, the courts are saying it is substance not form that is controlling but as in the other jurisdictions the test, to determine when such substance is usurious, is not shown.

The usury statutes today do not meet the requirements of society as they did a hundred years ago. In our economy today the real party to be protected is the consumer who finds it necessary to purchase merchandise on credit. He is the counterpart of the needy referred to in earlier decisions. Credit sales are no longer limited to parties who may select their vendor. The courts could, if they saw fit, adapt the existing laws to the factual situations and thereby alleviate the hardships flowing from the abuses of the finance charge. Since the trend very obviously is not in that direction, it seems the only solution is for the legislatures to enact remedial legislation. There would probably be fewer abuses of a usurious nature if the public were made aware of the cost of credit. A simple law requiring that there be a listing of all charges in a credit sale could go far in counteracting this evil. Utah and California have progressive laws embodying such a provision. Also, if the maximum interest rates do not provide for the cost of consumer credit then the legislature

²⁴ 227 F.2d 354 (5th Cir. 1956).

²⁵ W. VA. CODE ch. 47, art. 6, § 6 (Michie 1955).

²⁶ *Reger v. O'Neal* 33 W. Va. 159, 10 S.E. 375 (1889).

²⁷ *Swayne v. Riddle* 37 W. Va. 291, 16 S.E. 512 (1892).

1960]

STUDENT NOTES

47

and not the courts should remedy it. The purpose of the usury statutes has been lost through court modification and deletion. If they are no longer valid then they should be repealed but if they are still meant to protect the consumer, let us allow sufficient safeguard.

Michael Joseph Foley