

# Bank Credit Cards And The Usury Laws

## I. INTRODUCTION

The bank credit card has played an increasingly important role in the consumer credit field in the last ten years. Cardholder accounts have grown to over 24,000,000 at the beginning of 1970.<sup>1</sup> Over 500 banks are now issuing credit cards and approximately 5,000 banks are participating in the transactions.<sup>2</sup> Bank credit cards are one of the most available and most commonly used methods of consumer credit in this country.<sup>3</sup> While the development of this type of con-

<sup>1</sup>Abouchar, *Bank Charge Cards in the 1970's*, 62 BANKING 34 (1969) [hereinafter cited as Abouchar]. Total dollar volume for bank charge card programs in the U.S. approached four billion compared to about one hundred million in 1959. *Id.*

<sup>2</sup>*Id.* This was an increase from an estimated 50 banks in 1960.

<sup>3</sup>Approximately 50% of all the users of bank charge cards use them as a "convenience card." A recent Lou Harris Poll indicated that 54% of households use credit cards. In 1970, in Phoenix Arizona, 60% used department store credit cards and 55% used bank cards. From an address by Mr. Carl D. Labell at a Practising Law Institute seminar on Credit Cards - Legal and Business Problems, held on Dec. 7, 1970, in Los Angeles. Open-end credit represents approximately 10% of all outstanding consumer credit, that is, about 12 billion of the total of 120 billion dollars. This 12 billion dollar figure is broken down among the six major economic business groups utilizing credit cards:

Bank Credit Cards.....	800 million
Oil companies.....	1 billion
Department stores revolving credit.....	3.5 billion
Retail charge accounts.....	6.5 billion
Travel and Entertainment cards.....	100 million
All others.....	100 million
	<u>12 billion</u>

From an address by Basil J. Mezines, Executive Director, Federal Trade Commission, before the Practising Law Institute, Barbizon Plaza Hotel, New York, New York, Oct. 23, 1970.

sumer credit has been phenomenal during the past decade, it is expected to quadruple during the next five years.<sup>4</sup> One of the results of this rapid growth and the seeming uniqueness of the tripartite aspect of bank credit cards has been uncertainty as to the legal framework within which the bank credit card should be fit.

Of primary concern in the consumer credit field is the cost to the consumer, the interest charged for this credit. These rates or costs to the consumer are regulated primarily by use of Retail Installment Sales Acts, Revolving Credit Acts, Small Loan Acts, and Usury Statutes. This article will consider whether one of the oldest of consumer protection devices, the Usury statutes, can be used to regulate interest charges on this new type of consumer credit, where other rate regulation is non-existent or inapplicable.

## II. USURY - THE GENERAL RULE AND RECENT APPLICATION TO CREDIT SALES

Usury may be defined as contracting for or receiving something in excess of the amount allowed by law for the loan or forbearance of money.<sup>5</sup> The taking of interest for the loan of money or at least excessive interest has been regarded with abhorrence from the earliest times. During Biblical times and at early common law, the taking of any interest or compensation for the use of money, whether excessive or not, was generally considered usurious and forbidden. This prohibition was lifted in England as early as 1545 when contracts for interest not exceeding ten per cent were expressly authorized by Parliament.<sup>6</sup> The early colonial usury acts were modeled after the English acts,<sup>7</sup> and today almost all states have statutes controlling legal maximum interest rates.<sup>8</sup>

An attempt to apply usury laws to credit sales was made in England in the 19th century. In the case of *Beete v. Bidgood*<sup>9</sup> the court held that a credit sale was not a loan or forbearance of money and

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<sup>4</sup>Abouchar, *supra* note 1.

<sup>5</sup>1 C.J.S. *Usury* § 1.

<sup>6</sup>Stat. 37 Hen. VIII c.9 (1545).

<sup>7</sup>In England the lawful rate was set at five percent in 1714, where it remained until 1854, when all restrictions on interest charges were removed. - Stat. 17 § 18 Vict. c 90.

<sup>8</sup>See 1 CCH CONSUMER CREDIT GUIDE ¶ 510 for tables on state usury rates.

<sup>9</sup>7 Barn & Cress 453; 108 Eng. Rep. 792 (K.B. 1821).

was excepted from the purview of the usury statutes. This view was subsequently adopted in this country.<sup>10</sup> A loan is considered to be an agreement by which one party transfers a sum of money to another who agrees to repay that sum and usually an additional sum (interest) for the use of the money borrowed.<sup>11</sup> This last sum (interest) is limited by usury statutes. Forbearance of debt is illustrated by an extension of time for payment of a matured obligation.<sup>12</sup> The consideration changed for this forbearance is covered by the usury statutes.<sup>13</sup> In contrast, it is argued, the amount charged in a credit sale that exceeds the cash price is not interest but compensation for the increased risk incurred in a credit sale. The vendor in a credit sale will be allowed to have one price at which he will sell for cash and a higher price at which he will sell on credit.<sup>14</sup> Neither was it considered forbearance of debt under the common law definition as the credit price is not due at the time the bargain is made but at some time in the future. This difference between the cash price and the credit price, commonly called the "time price differential" was, therefore, not covered by the usury statutes, and the parties to the transactions were left to make their own bargain.

There are, however, three primary factual situations in which courts have removed credit sales from the protection of the time price doctrine and have found the agreement subject to the usury statutes. First, usury has been found when the buyer and the finance agency have agreed prior to the sale that the latter will finance the sale by purchasing the contract from the seller.<sup>15</sup> The courts have found this transaction to be a loan, even if there is an assignment of the installment contract from the seller to the financing agency.

Secondly, the transaction has been found usurious when there has been close contact between the finance agency and the seller.<sup>16</sup> This

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<sup>10</sup>*E.g.* *Hogg v. Ruffner*, 66 U.S. (1 Black) 115 (1861).

<sup>11</sup>*See In re Grand Union Co.*, 219 Fed. 353 (2d Cir. 1914); *Milana v. Credit Discount Co.*, 27 Cal.2d 335, 163 P.2d 869 (1945); *Brem v. Cook*, 147 Tex. 374, 216 S.W. 2d 179 (1949).

<sup>12</sup>*See Herlos v. State Land Co.*, 113 N.J. Eq. 339, 166 A. 330 (1933), *Moseley v. Brown*, 76 Va. 419 (1882); *Hafer v. Spaeth*, 22 Wash. 2d 378, 156 P.2d 408 (1945).

<sup>13</sup>*Id.*

<sup>14</sup>*General Motors Acceptance Corp. v. Weinrich*, 218 Mo. App. 68, 262 S.W. 425 (1924). *Accord*, *Commercial Credit Co. v. Torwater*, 215 Ala. 123, 110 So. 39 (1926); *Atlas Securities Co. v. Copeland*, 124 Kan. 393, 260 P. 659 (1927); *Commercial Credit Co. v. Sheldon*, 139 Miss. 132, 104 So. 75 (1925).

<sup>15</sup>*See Jackson v. Commercial Credit Corp.*, 90 Ga. App. 352, 83 S.E.2d 76 (1954); *Nazarion v. Lincoln Fin. Corp.*, 77 R.I. 497, 78 A.2d 7 (1951).

<sup>16</sup>*See Hare v. General Contract Purchase Corp.*, 220 Ark. 601, 249 S.W.2d 973 (1952); *White v. Disher*, 232 N.C. 260, 59 S.E.2d 798 (1950).

may be found by the seller's use of forms and rate charts furnished by the finance agency<sup>17</sup> and rebates of part of the finance charge to seller.<sup>18</sup> The third exception to the protection of the time price doctrine has been the seller's failure to establish a truly valid time price. To qualify for the exemption some courts have held that both a cash price and a time price must be quoted before the agreement to purchase is made.<sup>19</sup>

During the past two decades some courts have looked at the transaction as a whole to see whether there was a valid time price or whether the transaction was a scheme to defeat the usury statutes. The Arkansas courts have been especially active in this area. In 1952, the Arkansas Supreme Court stated in *Hare v. General Contract Purchase Corp.*<sup>20</sup> that credit transactions would be closely scrutinized to determine whether they were merely a disguise of usury. One of the indicia that the court stated would be used to make this determination was prior agreement between the seller and a finance company on transferring commercial paper. If the seller charged more than the allowable interest rate under the usury laws with the intention and assurance of transferring the commercial paper to a finance company, the transaction would be treated as a loan instead of as a credit sale involving a time price differential and would be subject to the usury statutes. The Arkansas courts went even further in 1958 in *Sloan v. Sears, Roebuck and Company*<sup>21</sup> when they eliminated the time price doctrine altogether. The court held that any difference between the cash price and the credit price amounted to interest paid by the buyer for the seller's forbearance on the debt and that this interest was governed by the states usury statutes.<sup>22</sup>

In a 1957 decision, *McNish v. General Credit Corp.*,<sup>23</sup> the Nebraska Supreme Court held that if the buyer was not quoted a cash price and a definite credit price and given a choice between the two, the difference between the prices would be treated as interest and the

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<sup>17</sup>See *Daniel v. First Nat'l Bank*, 227 F.2d 353 (5th Cir. 1955).

<sup>18</sup>*State ex rel. Beck v. Associates Discount Corp.*, 162 Nebr. 683, 77 N.W.2d 215 (1956).

<sup>19</sup>See *Powell v. Edwards*, 162 Nebr. 11, 75 N.W.2d 122 (1956); *Daniel v. First Nat'l Bank*, 227 F.2d 353 (5th Cir. 1955).

<sup>20</sup>220 Ark. 601, 249 S.W.2d 973 (1952).

<sup>21</sup>228 Ark. 464, 308 S.W.2d 802 (1958).

<sup>22</sup>*But see* *Dennis v. Sears, Roebuck & Company*, 446 S.W.2d 260 (1969) where the Supreme Court of Tennessee held that a Tennessee statute authorizing a time price differential under a retail charge agreement not exceeding 15 cents per \$10 per month did not violate the Tennessee constitutional prohibition against interest rates in excess of 10 percent per annum and that the Sears contract involved a valid time price.

<sup>23</sup>164 Neb. 526, 83 N.W.2d 1 (1957).

usury limitations would apply. In a later case, *Lloyd v. Gutsell*,<sup>24</sup> the court found a credit charge usurious when the seller had computed the credit price by applying a rate chart to the cash price. The credit charge was found to be interest paid for forbearance from collecting the debt.

The United States Court of Appeals, District of Columbia Circuit, in *Beatty v. Franklin Investment Company*,<sup>25</sup> also refused to exempt a credit sale from the usury statutes. The court found the transaction, in which the buyer signed a conditional sales contract and a promissory note which a finance company purchased at a discount from the seller after prearranging the credit terms, to be a cash sale accompanied by a note bearing a usurious rate of interest.<sup>26</sup> The court held that due to the prearrangement of the credit terms between the seller and the finance company there was no valid time price.

During the past few months courts of two states, Wisconsin and South Dakota, have handed down decisions on department store credit card plans, the reasoning in which might be applied as well to three party bank credit card transactions. In the first of these the Wisconsin Supreme Court considered the J. C. Penny revolving credit card plan in *State v. J. C. Penney Co.*<sup>27</sup> The court found the one and one-half percent monthly charge on the unpaid balance of the revolving charge account not to be a "time price differential" and that the transaction was subject to the state's usury statutes.

Indicia for determining that the transaction was not a true time price sale were as follows and would appear to be equally applicable to bank credit card plans:

1) There was no definite time price involved in the transaction. The contract allows the purchaser to pay cash or to determine his credit price dependent on when the unpaid balance is paid. He "may by his own will determine the length of time he will pay and the extra charges that he will be compelled to pay."<sup>28</sup> Since no definite credit or time price is established at the time of sale but will instead be

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<sup>24</sup>175 Neb. 775, 124 N.W. 2d 198 (1963).

<sup>25</sup>319 F.(2d) 712 (D.C. Cir. 1963).

<sup>26</sup>The amounts involved in the transaction were as follows:

After a down payment and a trade-in, Beatty owed the vendor a cash balance of \$301. To cover this balance and a finance charge on that amount of \$150, Beatty executed a promissory note for \$451 payable in monthly installments over a period of twelve months. A conditional sales contract was executed simultaneously. On the same day Franklin, which had furnished the forms on which the note and contract were executed and which had approved Beatty's credit application, paid Auto Discount the cash balance of \$301 and received from it the note and contract.

<sup>27</sup>48 Wisc. 125, 179 N.W.2d 641 (1970).

<sup>28</sup>*Id.* at 651.

determined by the buyer, no time price differential is available to remove the credit sale from the purview of the usury statutes.

2) The service charge is not a fixed amount, independent of the amount owed. Instead it is a percentage of a balance of indebtedness. "When a time sale price is determined by applying a certain schedule or rates or charges to the cash price, the resulting product is interest. This is merely a sale for a cash price, with the difference between the money the buyer has and what he needs being financed."<sup>29</sup>

3) The service charge bore no relation to the cost of the service necessary, or the expense incident to the operation of the account, such as bookkeeping, billing, etc.

4) The contract was made prior to the sale and was not part of the sale, except by reference if the buyer elects not to pay cash. The only price at which the goods are offered at the time of the sale is the cash price and the actual total time price is neither calculated or quoted at the time of the sale.

5) The contract did not differ in form from one customer to the next nor did it differ in substance. Instead of being a charge dependent on the risk involved in a credit sale it is based on the amount of the debt and a standard rate application. This standard rate is applied regardless of the risk involved in extending credit to a particular buyer.

6) The contract did not contemplate a single sale only. The court stated that it had found no cases which had held that a contract covering more than a single sale was a true time credit sale.

7) The sales tax was computed on the cash price.

In December 1970, a circuit court of South Dakota, in *Rollinger v. J. C. Penney Company, Inc.*<sup>30</sup> and companion cases against Sears, Roebuck and Company and Montgomery Ward and Company, followed the reasoning of the Wisconsin court and rejected the time price argument. The court found the one and one-half percent per month charge on the declining balance of a revolving charge account to be subject to and in violation of the state's usury laws.<sup>31</sup> Judgment was awarded plaintiff of all interest paid by him since July 3, 1966, two years prior to the filing of the action. This case is of particular interest in that the court also found the action to be a proper class

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<sup>29</sup>*Id.* at 653.

<sup>30</sup>Circuit Court of South Dakota, Second Judicial Circuit, Civ. No. 69-479, opinion letter to counsels, November 23, 1970, order and summary judgment, Dec. 9, 1970.

<sup>31</sup>SDCL 54-3-7 (1967), provides: "Highest lawful rate of interest. The highest rate of interest which it shall be lawful for any person to take, receive, detain, or contract for in this state shall be eight percent per annum, and at the same rate for a shorter time, and in the computation of interest, the same shall not be compounded."

action and ordered procedures initiated for public notice of the judgment to be given all residents of the state who had paid service charges under the revolving charge account agreements since July 3, 1966.

However, not all states have been as ready to narrow the time price doctrine. In 1965 the Supreme Judicial Court of Massachusetts in *Uni-Serv Corporation of Massachusetts v. Commissioner of Banks*<sup>32</sup> refused to hold that a three party credit card plan involved interest on a loan or forbearance on a debt and found that the credit card transaction was a valid time sales financing arrangement. The court rejected the commissioner's argument that the existence of prior agreement between the cardholder and Uni-Serv changed the character of the transaction.

### III. THE BANK CREDIT CARD TRANSACTION - A LOAN OR FORBEARANCE?

#### A. A LOAN?

Although the Uni-Serv case involved a tripartite credit card, there has been a general absence of judicial consideration of the bank credit card specifically. In those states such as California, which specifically exempt banks from the usury laws,<sup>33</sup> the bank credit card transaction has been tailored to the form of a loan with immunity. In many of the states having revolving credit acts, the bank credit card has been set up to fit within their scope. The banks have voluntarily limited the "service charges" on their credit cards to meet the requirements of state usury statutes in some states such as Minnesota, Wisconsin, and West Virginia. However, in a number of states the banks have in the past and are continuing to rely on the time price doctrine and the argument that the transaction itself is not a loan or forbearance.

In the *Uni-Serv* case the Massachusetts court disregarded the prior agreement between the cardholder and the issuer and the issuer and the merchant and defined the transaction as an assignment of an

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<sup>32</sup>349 Mass. 283, 207 N.E.(2d) 906 (1965).

<sup>33</sup>CAL. CONST. art 20, § 22 provides that "any bank as defined in and operating under that certain act known as the 'Bank Act' approved March 1, 1909, as amended, or any bank created and operating under and pursuant to any laws of this state or of the United States of America \* \* \*" shall be exempt from the usury statute.

account receivable and not a loan. Uni-Serv's sales slip that was furnished to the merchant and signed by the purchaser at the time of sale provided that the cardholder would pay to either the seller or his assignee in accordance with the "consumer's agreement" on the reverse side. The merchant-issuer agreement provided that the merchant would assign and that Uni-Serv would purchase accounts receivable created by the cardholder's purchase. The court stated that the delivery of the sales slip constituted an assignment of the account receivable evidenced by the slip and obligates Uni-Serv to pay to the member store the amount of such account less on agreed discount. Uni-Serv as assignee of the account, acquires the rights of the member store set forth in the consumer agreement.

The Attorney General of Oregon in 1967 rejected this accounts receivable argument in an opinion on whether the BankAmericard system was in violation of the Oregon usury statutes.<sup>34</sup> First National Bank of Oregon and the United States National Bank of Oregon had inaugurated the BankAmerica credit card system in Oregon the previous year, and an opinion had been requested by a state senator on the applicability of the state usury law.

Under the Oregon BankAmericard holder agreement, the credit card holder agreed to "assume responsibility for credit extended by this bank on the basis of this card" and to "waive and release Bank from all defenses, rights and claims holder may have against any merchant or company honoring this card."<sup>35</sup> Upon purchase of an item the credit card was imprinted on a "sales draft" furnished by the bank. On this sales draft was printed the following language. "25 days from demand purchaser-acceptor shall pay to First National Bank of Oregon, or order, the sum shown above."<sup>36</sup> Pursuant to the agreement between the merchant and the bank, the merchant's account with the bank is given credit for the amount of the sales draft, less a discount of from three to five percent, when the merchant presents the sales draft to the bank.

The banks involved in the case conceded that the cash advance aspect of the BankAmericard constituted a loan but argued in effect that the use of the credit card for purchases, permitting the cardholder to extend the period of payment over a number of months, did not constitute a loan within the meaning of ORS 708.480<sup>37</sup> and

<sup>34</sup>OP. ATT'Y GEN. OREGON No. 6250, March 8, 1967.

<sup>35</sup>*Id.* at 160.

<sup>36</sup>*Id.*

<sup>37</sup>ORS 708.480(1) (1953) authorizes a maximum charge.

"\* \* \* at a rate not exceeding \$8 per annum per \$100 of the original principal amount of the loan not exceeding \$500 and at a rate not exceeding \$6 per \$100 per



that they were purchasing receivables when they "purchased" the sales draft. The banks relied in this argument on the Oregon Supreme Court holding in *General Electric Credit Corporation v. Oregon State Tax Commission*:<sup>38</sup>

"The purchase of conditional sales contracts is not a loan of money either in ordinary or legal understanding. This court has twice held that the purchase of such instruments does not constitute lending money for purposes of the usury laws, an area where the definition of a loan is most often in controversy. *Coast Finance Corp. v. Ira F. Powers Furniture Co.*, 105 Or. 339, 209 P. 614 (1922); *Starker v. Heckart*, 200 Or. 573, 267 P.2d 219 (1954). It was decided in these cases that the transaction is a sale of a chose in action and does not involve a loan of money. 200 Or. 573, 575. In this Oregon follows the general rule. To bring the discounting of negotiable or commercial paper within the usury law, proof must be made that the transaction is merely a facade for what is actually a loan. Anno., 165 ALR 626, 663".

First the Attorney General was of the opinion that the BankAmericard transaction did not involve the merchant selling paper to the bank as the merchant had no proprietary interest in the sales draft to sell to or assign to the bank. The sales draft was payable to the bank or its order, not to the merchant. Thus the merchant had no interest in the instrument that he could transfer to the bank by his endorsement or assignment, particularly since under his contract with the bank the merchant had no right to sue or make collections on the sales draft. Thus the presentation by the merchant of the sales draft was compliance by the merchant with his contract with the bank. The Attorney General stated that in these respects he disagreed with the court's holding in *Uni-Serv* but noted that the instrument in that case was made payable to the merchant or the merchant's assignee.

Secondly, in characterizing the transaction as a loan the Attorney General felt that the transaction should be looked at as a whole, disregarding the form which it might take. To constitute a loan it is not necessary that manual delivery of the money be made by the lender to the borrower. The agreement to advance money as a loan, and application of it as directed by the borrower, creates the relation of debtor and creditor, vests title to the money in the borrower, and stamps the transaction as a loan.<sup>39</sup> The credit card agreement re-

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annum of the original principal amount of the loan in excess of \$500, not exceeding \$1,000 \* \* \*".

<sup>38</sup>231 Or. 570, 590-91, 373 P.2d 974 (1962).

<sup>39</sup>*Hirschfeld v. Howard*, 59 S.W. 55, 58 reh. den. 60 S.W. 806 (1900).

quires the holder to pay all obligations evidencing credit extended by the bank on the basis of the card. Implicit in the agreement is the undertaking by the bank to extend credit to the cardholder when the card is presented to a merchant participating in the plan. Thus, the Attorney General reasoned, when the purchaser of goods in the context of his credit card agreement signs the sales draft he (1) advises the bank, through his signature confirming the sale and accepting the draft, that he has purchased the goods or services shown on the sales draft for the indicated sum; (2) requests the bank to extend him credit for the purchase of these goods or services, that is, for the bank itself to make payment thereof to the merchant; and (3) promises to pay the bank the sum shown on the sales draft. In short, the sales draft is essentially a note which evidences a debt owing directly from the cardholder to the bank for the bank payment to the merchant of the purchase price.

The Attorney General quoted from a syllabus prepared by the court in *United Tire & Inv. Co. v. Trone*,<sup>40</sup>

“Whether a transaction constitutes a loan of money is a question of fact and not one of form. If money is loaned to a borrower to enable him to purchase or to complete the purchase of merchandise the transaction remains one for the loan of money and this is so even though the evidence of debt may be made payable to the vendor and by him endorsed and delivered to the person lending the money.”

Noting that in that case a loan was found even when the evidence of debt was payable to the seller rather than to the lending institution as in the Oregon situation, the Attorney General was of the opinion that the BankAmericard transaction constituted a loan by the bank to the cardholder and that the rates of interest chargeable therefore are controlled by the Oregon usury statutes.

The Oregon courts have not had the opportunity to consider this transaction as the banks involved voluntarily dropped their interest rates to comply with the Oregon statute shortly after the above Attorney General opinion.

In 1969 the Idaho Attorney General considered the bank credit card transaction and stated that in his opinion it included a loan under Idaho law and that the banks administering the credit card plans were in violation of the Idaho Usury statutes.<sup>41</sup> Quoting *Corpus Juris Secundum*<sup>42</sup> that

<sup>40</sup>189 Okla. 120, 113 P.2d 977 (1941).

<sup>41</sup>OP. ATT'Y. GEN. IDAHO, Sept. 16, 1969.

<sup>42</sup>54 C.J.S. 654.

"A loan of money is something more than a mere delivery of money by the owner to another. In order to constitute a loan there must be a contract whereby in substance one party transfers to the other a sum of money which the other agrees to repay absolutely, together with such additional sums as may be agreed on for its use. A loan is made when the borrower receives money over which he exercises dominion, and which he expressly or impliedly promises to return, and in a loan the initial transaction creates a debit and credit relationship which is not terminated until replacement of the sum borrowed with agreed interest.", (footnotes omitted),

the Attorney General was of the opinion that the necessary elements of a loan were present. There is a contract between the cardholder and the bank whereby in substance the bank transfers to the cardholder a sum of money which the cardholder agrees to repay, along with an additional sum for its use. The cardholder exercises dominion over the money loaned in that he is able to purchase goods and services with the card and in so doing is directing the bank to pay to the merchant the amount of the loan. A debit and credit relationship is created by use of the card which is not terminated until the sum borrowed, the purchase price, and the agreed upon charge for its use, are repaid.

Looking at the mechanics of the transaction, the cardholder determines the amount he wishes to borrow and who the recipient of the money borrowed is to be when he charges a purchase or service with his card. The loan is made when the bank receives the 'sales draft' and pays the merchant. The 'sales draft' constitutes a note which the cardholder signs when he makes his purchase. The bank, therefore, is loaning the cardholder money with which to make the purchase.

The Attorney General stated that when the "substance" of the transaction was looked at rather than the "form", it constitutes a loan, not a sale of property to which the time sales doctrine would apply. He further argued that "a bank could not seriously contend that the credit card agreement would fall within the above [latter] definition. The bank is in no manner of speaking a seller of property."<sup>43</sup>

## B. A FORBEARANCE OF A DEBT?

In contrast, the Wisconsin court in defining the transaction in *State v. J. C. Penney Company*,<sup>44</sup> saw the "service charge" as a charge for the forbearance of a debt. While this case dealt with a two-

<sup>43</sup>OP. ATT'Y. GEN. IDAHO, *supra* note 41.

<sup>44</sup>48 Wisc. 125, 179 N.W. 2d 641 (1970).

party department store credit card, the courts reasoning could be applied to the bank credit card.

Respondent in that case argued that the definition of forbearance required refraining from collecting a debt due and payable and that to constitute forbearance, an agreement must extend the maturity date of a debt in existence at the time the extension agreement is entered into. Respondent contended that "there is no debt payable at the time of purchase" but under the agreement the decision to charge the purchase "creates the debt that is payable under the credit terms of the plan agreement. There simply is no forbearance because of the absence of a prior debt."<sup>45</sup>

Agreeing with the trial court, the Wisconsin Supreme Court rejected this argument as without substance. They concluded that when a sale is completed, there results a debt created to pay money, and the merchant and purchaser then assume the relationship of debtor and creditor. The purchase of goods creates an obligation to pay for them. Upon failure to pay for the goods received at the time of purchase, a debt is created. The prior agreement to a financing plan does not change this legal relationship.<sup>46</sup> In the agreement the parties merely agree to forbear. The court said that the actual forbearance occurs after the purchase when the purchaser does not pay within thirty days. Another theory, the court indicated, was that the creation of the debt (purchase) and the effective agreement to forbear from immediate collection are "coterminous". In substance the customer is making a new contract with respondent every time he makes a new purchase. The customer at each purchase agrees to apply the terms of the agreement to that particular transaction. The court stated "to sustain respondent's contention that the method of handling all the details changes the effect of the transaction is merely to sustain form over substance."<sup>47</sup> If the agreement stated that "this debt becomes due and payable in thirty days from the date of purchase" and then provided for additional charges for payment after that time, the court felt that this came clearly under the definition of forbearance. The Penney's agreement provided:

"2. I will, within one month after each monthly billing date, make an installment payment in accordance with your loan current payment schedule. . . ."<sup>48</sup>

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<sup>45</sup>*Id.* at 646.

<sup>46</sup>The court cited *Dry Dock Bank v. American Life Ins. & Trust Co.* 3 N.Y. 344, 358 (1850) which stated: "upon the sale of property on time, the purchase money becomes a debt which is forborne for the period limited by the credit." *Id.*

<sup>47</sup>*Id.*

<sup>48</sup>*Id.* at 647.

The court held that this made no difference in effect and in substance was the same. If the purchaser pays within thirty days or within "one month after each monthly billing date" he pays no charge but if he does not, he pays an additional charge at the rate of one and one-half percent on the unpaid balance due and this is a charge for forbearance on a debt due.

The Wisconsin court discussed the bank credit card transaction in that state in support of its holding in *Penney's*. The bank credit card companies in that state have apparently voluntarily complied with the usury statutes.

"Similarly with the distinction between bank charge cards and department store charge cards. It seems universally accepted that the bank can charge no more than one percent per month on the unpaid balance. Yet, what is the practical distinction between the two? On oral argument respondent dismissed this question by stating that one (bank) was a loan of money to make a purchase, the other was the extending of credit on a credit purchase. This begs the question, the question of whether there is involved here a true credit sale or a charge for a forbearance. The assumption that the agreement constitutes a true "credit sale" or "time price sale" as it has come to be defined in the law, is incorrect."<sup>49</sup>

Respondent argued that the terms interest and forbearance cannot be predicated on any other than a loan of money, actual or presumed. The court stated that where there is a forbearance of money as in this case a loan will be presumed for so much of the purchase money as is equivalent to the cash value of the commodity sold.<sup>50</sup> Thus there is a forbearance which will place the transaction under the usury statutes.

Applying the reasoning of these cases and opinions to bank credit cards in general, in those states where credit card transactions are not covered by retail installment legislation and banks are not specifically exempt from the usury laws, the banks might be wise not to rely on the time price doctrine to exempt their credit card transactions from the usury statutes. In some form, this credit card transaction includes all the primary exceptions to this doctrine.

There is a prior agreement between the cardholder and issuer that the issuer will finance the purchase by purchasing the "sales slip" from the merchant. This can be found from the credit card application, the cardholder agreement signed on obtaining the card, and the provisions printed on the credit card.

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<sup>49</sup>*Id.*

<sup>50</sup>*Id.* at 648.

There is the necessary close contact between the finance agency (bank) and the merchant. The issuer-merchant agreement provides for the purchase of the "sales slips" at a discount by the bank. Bank furnished forms are used by the merchant. Standard rate tables are applied to the outstanding balance by the bank.

Most importantly, no time price is quoted the buyer at the time of sale. In effect the purchaser is able to determine his own time price dependent upon how long he wishes to refrain from paying the outstanding balance. Thus there is no definite time price differential determined at the time of sale.

Looking at the substance of the transaction instead of at its forms the courts may be willing to classify it as a loan. In those cases where the cardholder agreement and sales slip provide for payment to the bank or to order, following the Oregon and Idaho Attorney General's reasoning, the transaction can be seen as a loan evidenced by a note. Even in those cases where payment is to the seller or his assigns, if the transaction is looked at in light of the pre-existing cardholder agreement and the merchant-bank contract requiring assignment of the sales slip, there would seem to be little difference in substance. Instead of the cash for the purchase being transferred to the merchant through the buyer's hands after a direct loan from the bank, it is transferred to the merchant directly from the bank, minus a discount. In both cases the purchaser has obtained the merchandise or services through financing from the bank and makes payments to the bank. Without the protection of the time sales doctrine the transaction can be seen to be a loan, regardless of its form.

Applying the Wisconsin reasoning, elements of forbearance can be seen whether the payment is made to the bank or order, or to seller or his assigns. The purchase price can be viewed as due at the end of the period that is free from additional charges, usually 30 days or a billing cycle. Whether the bank is a lender under the note or direct obligation theory or an assignee under the accounts receivable theory, the debt is due the bank at this time. Charges made for extensions of this due date can be viewed as forbearance on the collection of this due debt, thus subjecting the transaction to the usury statutes.

#### **IV. NATIONAL BANKS AND STATE USURY LAWS**

Assuming that the courts are willing to find a bank credit card transaction to be a loan or forbearance and assuming that the bank administering the plan is charging a higher rate than is allowed by

state usury statutes, is the bank, if it is a national one, subject to the state usury laws? The National Bank Act contains a federal usury statute which exclusively governs the rates of interest which national banks may charge.<sup>51</sup> This usury statute in the National Bank Act incorporates by reference the usury limit of the state where the national bank is located. The national bank “may . . . charge . . . interest at the rate allowed by the laws of the state, territory, or district where the bank is located . . . and no more.”<sup>52</sup> In *Tiffany v. National Bank of Missouri*,<sup>53</sup> the Supreme Court in interpreting the original version of this statute, which was substantially identical, stated in part that:

“It was to allow national associations the rate allowed by the state to national persons generally, and a higher rate, if state banks of issue were authorized to charge a higher rate.”

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<sup>51</sup>12 U.S.C. §§ 85 & 86 (1969) provide:

“§ 85. . . . any association may take, receive, reserve, and charge on any loan or discount made, or upon any rates, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal Reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any state a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum, or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank in the Federal reserve district where the bank is located, whichever may be greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run. The maximum amount of interest or discount to be charged at a branch of an association located outside of the states of the United States and the District of Columbia shall be at the rate allowed by the laws of the country, territory, dependency, province, dominion, insular possession, or other political subdivision where the branch is located. And the purchase, discount, or sale of a bona fide bill of exchange, payable at another place than the place of such purchase, discount, or sale, at not more than the current rate of exchange for sight drafts in addition to the interest, shall not be considered as taking or receiving a greater rate of interest.”

“§ 86. . . . “The taking, receiving, reserving or charging a rate of interest greater than is allowed in the preceding section, when knowingly done, shall be deemed a forfeiture of the entire interest which the bill, note, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom it has been paid, or his legal representatives, may recover back, in an action in the value of debt, twice the amount of the interest thus paid from the association taking or receiving the same; Provided, that such action is commenced within two years from the time the usurious transaction occurred.”

<sup>52</sup>The alternative of a rate 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank in the Federal district where the bank is located would not appear to be useful, as the rate thus computed would be less than the usury rate in most states.

<sup>53</sup>85 U.S. 409, 413, 21 L.Ed. 862 (1874).

In *Daggs v. Phoenix National Bank*<sup>54</sup> the court wrote,

“The meaning of these provisions [in the federal statute] is unmistakable. A national bank may charge interest at the rate allowed by the laws of the state or territory where it is located; and equality is carefully secured with local banks.”

“The intention of the national law is to adopt the state law, and permit to national banks what the state law allows to its citizens and to the banks organized by it.”

The U. S. Court of Appeals, Ninth District, stated in 1966 in *Hiatt v. San Francisco National Bank*,<sup>55</sup>

“Our conclusion must necessarily be that the language of 12 U.S.C. § 85 which reads “any association may . . . charge . . . interest at the rate allowed by the laws of the state . . . where the bank is located . . .” should be construed as meaning that a national association located in a particular state may charge as much interest as may be legally charged by the state’s banks under the state’s existing laws.”

Thus it would seem that the national banks administering credit card plans that are found to be loans or forbearances are limited to the rates allowed state banks under the state usury laws unless the state has additional legislation such as revolving credit statutes under which the plans can be fit.

However, an argument has been made that this statute allows the national banks to charge interest rates equal to those charged by any lender in the state. In the Oregon Attorney General’s opinion discussed *supra*,<sup>56</sup> the national banks involved argued that they may charge the rate of interest allowed by state law to small loan companies, which, under state law, were permitted to charge up to 36 percent per annum. In support of this argument was a view expressed by letter from the Comptroller of the Currency, the administrative officer charged by the Congress of the United States with the duty of supervising national banks. These views had been solicited by the Oregon Attorney General.

Although Section 85[12 U.S.C.A. § 85], to some extent, incorporates state law as a measuring rod in determining maximum interest rates, national banks in making loans and charging interest thereon do so exclusively under the authority of Federal legislation. Therefore, as is stated in paragraph 7310 of the *Comptroller’s Manual for National Banks*, a national bank may charge interest

<sup>54</sup>177 U.S. 549, 555, 20 S.Ct. 732, 44 L.Ed. 882 (1900).

<sup>55</sup>361 F. 2d 504, 507, (9th Cir. 1966), *cert. denied*, 385 U.S. 948 (1966).

<sup>56</sup>OP. ATT’Y GEN. OREGON, *supra* note 34, at 162.

<sup>57</sup>*Id.* at 166.



at the maximum rate permitted by applicable state law to any competitive state institution. Where state law permits a higher rate on specified classes of loans, a national bank which makes loans at such higher rate is subject only to such limitations relating to the classifications of loans as are material to the determination of a rate of interest.

“Accordingly, a national bank may lawfully charge the highest rate permitted to any competitor in the state, including a small loan company, even though a state bank may not similarly do so. Any provision in such state law which purports to exclude a national bank from its rights under Federal law (12 U.S.C. 24 and 85) is inoperative and ineffective.”<sup>57</sup>

In other words, the banks and the Comptroller would seem to be arguing that state usury limitations are inapplicable if any lending organization in the state is allowed to exceed them.

The Attorney General of Oregon rejected this argument stating that small loan companies do not engage in banking business and may make loans only as authorized by Oregon statutes. For that reason, small loan companies cannot qualify as “similar state institutions” mentioned by the Supreme Court in the *Tiffany* case and as to which national banks are entitled to charge the same rate of interest.<sup>58</sup> Secondly, it was not the legislative intent that small loan companies compete with banks, otherwise there would be no justification for allowing small loan companies the right to charge substantially higher interest rates than banks. Third, the authority to exact the interest rates permitted under the small loan law has been granted to only a limited number of small loan companies and, therefore, is not in the category of “the rate allowed by the state to natural persons generally” referred to by the Supreme Court in *Tiffany*. Fourth, because state banks have no statutory authority to charge interest at small loan rates or engage in the small loan business,<sup>59</sup> and one of the purposes of §85 is to insure equality, national banks should not be permitted to charge this higher interest rate. Similarly, national banks should not be allowed to charge the interest rates permitted industrial loan companies<sup>60</sup> or the so-called “industrial banks.”<sup>61</sup> Therefore, the Attorney General reasoned, national banks would be held to the same interest rates of state banks and any rates exceeding this allowable figure would be usurious.

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<sup>58</sup>See *United States v. Palmer*, 28 F. Supp. 936, 937-38, (D.C. S.D. N.Y. 1939).

<sup>59</sup>ORS 707.310 (1953).

<sup>60</sup>See ORS chapter 724 (1953).

<sup>61</sup>See *United States v. Palmer*, *supra* note 58, which pointed out that a national bank could not engage in practices permitted “industrial banks” under New York law.

In the Idaho Attorney General's opinion discussed *supra*,<sup>62</sup> similar reasoning was followed. The Attorney General based this part of his opinion on the interpretation in *Hiatt v. San Francisco National Bank* that a national bank doing business in an individual state is subject to the usury laws of that state prescribed for state banks. The court had indicated that it was the congressional intent to put both the national bank operating within a certain state and the state banks doing business in the particular state on a competitive basis. Banks doing business in Idaho are expressly excluded from charging small loan industry rates and are unable to obtain licenses to do business as small loan companies.<sup>63</sup>

However, in a 1970 opinion, the Kentucky Attorney General felt that no definite answer could be given on the question of whether a national bank can take advantage of the maximum interest rate permitted by state law to any class of lenders on specified types of loans until the courts speak further on the subject.<sup>64</sup>

The answer to this question remains to be clearly answered by the courts, but until such time as the courts rule that the national banks may charge rates allowed to any lender, the national banker might be prudent to restrict himself to the rates allowed the state banks of the particular state in which he is operating.

#### A. NATIONAL BANKS IN STATES THAT EXEMPT BANKS FROM USURY STATUTES

In California and similar states where banks are specifically exempted from the usury limitations and where they seemingly are immune from other state legislative interest rate regulation, 12 U.S.C. §85 provides "when no rate is fixed by the laws of the state, or territory, or district, the bank may take, receive, reserve, or charge a rate not exceeding seven percentum."<sup>65</sup> Where the state does not fix a maximum rate, as California does not, the Federal statute clearly seems to fix a maximum rate of seven percent applicable to national banks.

This has not, however, been the court's interpretation of the seemingly clear meaning of the statute. In 1900, in *Daggs v. Phoenix*

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<sup>62</sup>OP. ATT'Y GEN. IDAHO, *supra* note 41.

<sup>63</sup>IDAHO CODE 26-2029 (1957).

<sup>64</sup>OP. ATT'Y. GEN. KENTUCKY 70-332 (1970).

<sup>65</sup>The bank has the alternative method of computing the applicable maximum legal interest rate - 1 percent above the discount rate on ninety-day commercial paper by the Federal Reserve Bank. See footnote 51.

*National Bank*<sup>66</sup> the U.S. Supreme Court interpreted the words “when no rate is *fixed* by the laws of the state, territory, or district . . .” to mean “when no rate is *allowed* by the laws of the state, territory, or district.” In other words the seven percent limit is applicable only when the state law forbids the taking of *any* interest. Although this seems clearly not what Congress meant when it passed the seven percent limit, that is what the Supreme Court said it meant and in doing so read the seven percent limit out of the law. The fallacy of the court’s reasoning can be seen by looking at the provision contained in the first half of §85 discussed previously. If a state prohibits all interest, allowing a national bank to charge seven percent interest would conflict with the provision limiting national banks to the rate allowed by local statute—zero percent in this case. The court, in attempting to reach a decision in light of the realities of the commercial market place, seems to have strained to the ultimate their interpretation of this usury law.

In addition to the *Daggs* ruling in 1900, the inapplicability of the seven percent provision was followed in *Hiatt v. San Francisco National Bank*<sup>67</sup> in 1966. Plaintiff attempted to distinguish the *Daggs* case on the ground that California had not spoken in any manner with respect to her loan whereas in *Daggs* the territory of Arizona had specifically provided that the parties may contract for any rate. Although the Ninth Circuit Court of Appeals recognized that plaintiff’s argument that the seven percent limit was applicable to her loan was “technically forceful,” they nevertheless followed the *Daggs* holding and rejected the argument. Certiorari was denied by the Supreme Court.<sup>68</sup> It would seem then that the seven percent limitation in the National Bank Act may be ignored and is of no threat to national banks operating in states such as California.

It would appear that the only way the bank credit cards could be brought under existing usury limitations in California and similar states would be to convince the courts of these states that when banks were excluded from the usury restrictions, the legislatures did not envision such transactions as the bank credit cards, and they are not as such included within the meaning of banks in the statutes.<sup>69</sup> Such organizations as BankAmericard have structured the transaction as a loan, payment being made to the bank or its order, in California. However, to argue that the transaction was not a loan or lending,

<sup>66</sup>177 U.S. 549, 20 S.Ct. 732, 44 L.ED. 882 (1900).

<sup>67</sup>361 F.2d 504 (9th Cir. 1966).

<sup>68</sup>385 U.S. 948 (1966).

<sup>69</sup>CAL. CONST. art. 20, § 22, which exempts banks from the California usury statutes was added Nov. 6, 1934.

would seem to directly conflict with the necessary finding of a loan or forbearance if the usury statutes are to apply, absent the bank exclusion. Unless the courts could be convinced that the credit card transaction was a loan or forbearance, but not one envisioned by the legislature in exempting banks and similar lending institutions from the usury statutes, the usury statute limitations would be of no use in controlling interest charges.

Absent a holding of this type, the banks in states such as California would appear to have complete freedom in setting interest rates in their credit card systems. It is noteworthy that although the bank credit card systems in California appear immune from all rate regulations systems such as BankAmericard in this state have set their rates to match those allowed under the state's revolving credit statutes.<sup>70</sup>

## V. CONCLUSION

With the increased emphasis on consumer protection and with the continuing phenomenal growth of bank credit card use, more and more judicial and legislative action on this subject can be expected.<sup>71</sup> While in substance the transaction is basically the same in all states, its regulation is by no means uniform. In those states in which the bank credit cards do not come within the scope of other legislative control, they may be vulnerable to the state's usury statutes. However, finance charge control through usury statutes in many of these states should be thought of as only a stop-gap measure and as an incentive to the legislatures to deal directly with the bank credit card problem. Application of low interest rate ceilings could dry up a source of credit to the higher risk customer, in many cases the class which may need this credit the most. More of the total price (cash price plus credit charge) might be allocated to the price of the goods or services to all consumers. Higher discount rates might be charged the mer-

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<sup>70</sup>California revolving credit statutes (CAL. CIVL. CODE § 1810.2 (West 1954)) allow one and one-half percent per month not over \$1000, and one percent per month over \$1000. BankAmericard rates are one and one-half percent up to and including \$1000, one percent over \$1000 up to and including \$2,500, eight tenths of one percent over \$2,500.

<sup>71</sup>*Sliger v. R. H. Mary and Company, Inc. et.al*, a class action suit in which two bank charge card plans are defendants, is now pending in New Jersey. (Superior Court, Chancery Division: Essex County). One of the plans is relying on the time price doctrine as a defense.

chant who will in turn pass this along to the consumer through increased prices. In effect, the non-credit purchaser of these goods or services could find himself financing part of the cost to the credit purchaser.

On the other hand, freedom from any regulation other than that of the market place could lead to credit charges totally out of perspective to their actual costs. It can be questioned whether there is any effective competition through credit charges between the various bank credit card systems. Although credit rates vary with a system from state to state, there appears to be little rate competition between systems within a given state.

Thought should be given towards legislation specifically dealing with credit card financing, either on the state or federal level, especially in light of their even greater expected use in the future. Attempts to fit these transactions under preexisting legislation that was passed previous to their growth would seem to be a stop-gap measure. The transactions involve features unique from previous credit financing that could be better handled by specific legislation tailored to meet these features. Possibly this could be accomplished through legislation similar to the credit card regulation provisions of the Uniform Consumer Credit Code or by the addition of an article to the Uniform Commercial Code.

In the meantime increased applications of the usury laws can be expected to be applied to the bank credit card transaction following the reasoning of the Oregon and Idaho Attorney Generals and that of the Wisconsin and South Dakota courts. The distinction originally drawn between the purchaser and the borrower in justification of the time price doctrine no longer seems as clear as it did in the early part of this century.

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