USURY—REVOLVING CHARGE ACCOUNTS AND THE LEGALITY OF A 1½% MONTHLY CHARGE—*State v. J.C. Penney Co.*, 48 Wis. 2d 125, 179 N.W.2d 641 (1970).

The J.C. Penney Company, in the manner of countless firms engaged in the retail sale of merchandise for cash and credit, exacted a one and one-half percent monthly charge on the declining balance of its "revolving" charge accounts.[1] The state attorney general brought an action[2] to enjoin J.C. Penney from charging in excess of the twelve percent per annum maximum interest rate permitted under the usury statutes.[3]

The trial court found that the operation of a revolving account did involve a forbearance of a debt and that defendant did exact a greater profit from its forbearance than the 12% permitted under statute. However, the court also found that the defendant was not a lender of money as defined under the penalty provision of the usury statute[4]

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1 The UNIFORM CONSUMER CREDIT CODE § 2.108 defines revolving charge account as such:

> "Revolving charge account" means an arrangement between a seller and a buyer pursuant to which (1) the seller may permit the buyer to purchase goods or services on credit either from the seller or pursuant to a seller credit card, (2) the unpaid balances of amounts financed arising from purchases and the credit service and other appropriate charges are debited to an account, (3) a credit service charge if made is not precomputed but is computed on the outstanding unpaid balances of the buyer's account from time to time, and (4) the buyer has the privilege of paying the balances in installments.

2 WIS. STAT. § 280.02 (Supp. 1970) provides in part:

> An action to enjoin a public nuisance may be commenced and prosecuted in the name of the state, either by the attorney general . . . or upon the relation of a private individual . . . .

3 WIS. STAT. § 138.05 (Supp. 1970) provides in part:

> (1) Except as authorized by other statutes, no person shall, directly or indirectly, contract for, take or receive in money, goods or things in action, or in any other way, any greater sum or any greater value, for the loan or forbearance of money, goods or things in action, than:
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> (a) At the rate of $12 upon $100 for one year computed upon the declining principal balance of the loan or forbearance . . . .

WIS. STAT. § 138.09 (Supp. 1970) provides in part:

> (9)(a) No person, except as authorized by statutes, shall directly or indirectly charge, contract for or receive any interest or consideration greater than allowed in s. 138.05 upon the loan, use or forbearance of money, goods or things in action, or upon the loan, use or sale of credit. The foregoing prohibition shall apply to any person . . . who by any device or pretense of charging for his services or otherwise seeks to obtain a greater compensation than is authorized by this section.

WIS. STAT. § 214.20 (1957) provides:

> No person other than a licensee shall engage in the business of making small loans and, directly or indirectly, charge, contract for or receive a greater rate of interest or consideration upon any such loan than he is permitted by law to charge, contract for or receive without being licensed under this chapter.

4 WIS. STAT. § 138.06 (Supp. 1970) provides in part:

and therefore its credit practices, though usurious, were a concern "personal to the debtor." The court concluded that the charge agreement did not comprise a public nuisance subject to abatement at the instance of the state:

> There is no evidence in this case that the defendant caters to persons who are ignorant or necessitous; there is no evidence of general dissatisfaction of customers; the rate charged is not unconscionable as compared with a small loan; there is no evidence that the customers are not knowledgeable; the agreement makes it clear that the "service charge" is 1½% per month, so there is no evidence that the charge is concealed by any obscure computations of price; where objection is made to the charge by the customer the charge is not collected.
> . . . The imposition, if that is what it may be said to be, is upon the individuals who apply for the revolving credit. There is no evidence that they need buy on credit or that there is anything that compels them to apply for credit, except their own convenience.[5]

On appeal by both parties[6] the Wisconsin Supreme Court reversed, holding that an injunction should issue against the "usurious practices which clearly constitute a public nuisance."[7]

To decide the case, the court applied a test for usury recognized in an earlier Wisconsin case:[8]

> The definition of usury imports the existence of certain essential elements generally enumerated as (1) a loan or forbearance . . . ; (2) an understanding between the parties that the principal shall be repayable absolutely; (3) the exaction of a greater profit than is allowed by law; and (4) an intention to violate the law.[9]

The essential issue in regard to the above four criteria was whether the 1½% monthly charge was in fact consideration for forbearance of collection of the debt, or was merely a "time-price" differential that would not be subject to the statutes.[10]

Forbearance generally signifies the giving of time for the payment

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(2) Any lender or agent of a lender who violates any provisions of s. 138.05 may be fined not less than $25 nor more than $500, or imprisoned not more than 6 months, or both.

5 State v. J.C. Penney Co., No. 125-287 (Dane Cty. Cir. Ct., April 22, 1969) (the decision is unreported).

6 The state appealed the trial court's order denying injunctive relief and dismissing the complaint, and J.C. Penney Co. appealed, challenging the finding that its credit practices violated WIS. STAT. § 138.05(1). 48 Wis. 2d at 130, 179 N.W.2d at 643.

7 State v. J.C. Penney Co., 48 Wis. 2d 125, 155, 179 N.W.2d 641, 657 (1970).

8 Zang v. Schumann, 262 Wis. 570, 579, 55 N.W.2d 864, 868 (1952).

9 48 Wis. 2d at 132-33, 179 N.W.2d at 645. As was pointed out by the court, the definition was summarized in 55 AM. JUR. *Usury* § 12 (1946).

10 *See* statutes cited note 3 *supra*.

of a debt.[11] However, it does not necessarily require an actual loan of money.[12] Penney argued that in order to have forbearance, the agreement must extend the maturity date of a loan already in existence at the time the agreement was entered into.[13] This contention was based upon the premise that forbearance applies only to debts "then due and payable."[14] Under the agreement terms,[15] the customer was not bound to pay the full cash price at any certain date. Consequently, since the cash price as such would never become due, the difference between the original cash price and any subsequently paid amount could not be considered a charge for forbearance.[16]

This proposition was quickly disposed of with the observation that "the actual forbearance occurs after the purchase when the purchaser does not pay within thirty days."[17] The court would not be dissuaded by the absence in the agreement of any specific due date, and concluded that agreement subsection 2, which reads in part, "I will, within one

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11 London v. Toney, 263 N.Y. 439, 189 N.E. 485 (1934) (case involved an agreement to guarantee payment of a mortgage indebtedness in consideration for an extension of time of payment; court held the extension and guarantee agreements usurious where more than the legal rate was charged).

12 Van Schaick v. Edwards, 2 Johns. Cas. 355, 364 (N.Y. Sup. Ct. 1801):

> If a loan be necessary to constitute a usurious contract, yet it is not necessary to the creation of a loan that the money should be paid on the one hand, and received on the other; for the circumstance of a man's money remaining in another's hands, in consequence of an agreement for that purpose, will constitute a loan.

Accord, Dry Dock Bank v. American Life Ins. & Trust Co., 3 N.Y. 344 (1850).

13 48 Wis. 2d at 134, 179 N.W.2d at 646.

14 *Id.* (the phrase is from BLACKS LAW DICTIONARY 773 (4th ed. 1951), under the definition of forbearance). *See* Heilos v. State Land Co., 113 N.J. Eq. 239, 166 A. 330 (Ch. 1933) (bonus paid on mortgage for extension of due date was in excess of amount allowed by law for the loan or forbearance of money).

15 Penney's Charge Account Agreement:

> I agree that 1. I will pay the time sale price of each item charged to my account, consisting of (a) the cash sale price, plus (1) a time price differential (service charge) computed by applying the unpaid balance of the cash sale price and any unpaid service charge on each of my monthly billing dates . . . [at] the rate of 1-½%, but service charges shall not exceed the lawful maximum. 2. I will, within one month after each monthly billing date, make an installment payment in accordance with your then current payment schedule . . . . Payments will be applied to the time sale prices of purchases in the order of purchase. I understand that I may prepay my unpaid balance at any time. 3. Upon any default by me, my entire balance shall at your option become payable. I will to the extent permitted by law, pay your attorney's fees if this agreement is referred for collection to an attorney, plus court costs. 4. You may limit or terminate my account. I will upon request return my account identification, which shall remain your property.

16 48 Wis. 2d at 134-35, 179 N.W.2d at 646; Brief for Defendant at 6, 7.

17 *Id.* at 135, 179 N.W.2d at 646.

month after each monthly billing date, make an installment payment,"[18] was quite sufficient to impose an obligation on the buyer.

A "time-price" sale requires the giving to the prospective purchaser the option of two distinct prices—a cash price and a "time" price. Both prices, once arrived at between the parties, are unchanging. The concept is well illustrated in an early United States Supreme Court case:

> But it is manifest that if A proposes to sell to B a tract of land for $10,000 in cash, or for $20,000 payable in ten annual instalments, and if B prefers to pay the larger sum to gain time, the contract cannot be called usurious. A vendor may prefer $100 in hand to double the sum in expectancy, and a purchaser may prefer the greater price with the longer credit . . . . Such a contract has none of the characteristics of usury; it is not for the loan of money, or forbearance of a debt.[19]

Time-price sales have been traditionally excluded from the usury statutes in most jurisdictions,[20] and most commonly utilized in the area of motor vehicle installment sales and other high price items.[21] There is little question but that, when considering *form*, a revolving credit agreement differs substantially from a true time-price sale.[22]

In the gigantic field of modern commercial credit, general usury laws, the Wisconsin case notwithstanding, are suffering from increasing

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18 *Id.* at 136, 179 N.W.2d at 647.

19 Hogg v. Ruffner, 66 U.S. 115, 118-19 (1861), *quoted at* 48 Wis. 2d at 140, 179 N.W.2d at 649.

20 *See generally* Annot., 14 A.L.R.3d 1065, 1077-84 (1967).

21 *See, e.g.*, N.J. STAT. ANN. § 17:16C-41 (1970).

22 The *Penney* court differentiated the revolving type of account from the true time-price sale:

> 1. There is no loan as such.
> 2. The contract . . . permits the purchaser to pay cash and to lower the cost of the merchandise by payment even after the services charges have been begun.
> 3. There is a cash sales price quoted . . . so that the purchaser may, by his own will, determine the length of time he will take to pay and the extra charges that he will be compelled to pay.
> 4. There may be multiple sales with debits to the account . . . and also credits for payments.
> 5. The "service charge" is not a fixed amount, independent of the amount owed . . . .
> 6. [T]he absence of a quotation . . . of a time sale price as well as a cash price . . . is an indicia that it is not a bona fide time sale price . . . .
> 7. There is no evidence that the cost of the service . . . bears any relation to the "service charge."
> 8. The contract . . . is made prior to any sale and is not part of the sale . . . .
> 9. The contract does not differ in form from one customer to the next nor does it differ in substance.
> 10. The "service charge" is not a penalty for failure to pay on time installments as they come due . . . . Rather it is a charge for the privilege of not paying the cash price promptly . . . .
> 11. The sales tax is computed on the cash price.

48 Wis. 2d at 144-49, 179 N.W.2d at 651-54.

disuse. Principal categories in the credit industry have their own regulatory statutes; broadly included among these would be small loans, banks and trust companies, industrial and private banks, savings and loan associations, credit unions, investment companies, pawnbrokers, and installment sales.[23] The end result has been to drain the general usury statute of both potency and relevance in regard to legitimate credit transactions:

> By anachronistic legal reasoning, if a man borrowed money from a bank to buy a car, he was protected by the usury law; if he bought from a dealer "on time," the sky was the limit. The result was a plethora of statutes to cover sales of cars and other goods. But since these statutes permit much higher rates, it has been a case of dealing with usury by legalizing it. Thus usury today is largely a matter of license, for to charge more than 6 per cent may make one man a "loan shark," while another may legally exact 30 per cent.[24]

The disparity between the general usury rate and that of other transactions involving credit is clearly apparent in New Jersey law, which permits up to 8% under the usury law,[25] 10% under the conventional installment contract,[26] and a lofty 24% on loans of money under $500.[27] Though the differences in regulation are considerable, all three categories include, if not a direct extension of money, certainly a forbearance to collect it.

The New Jersey courts have not yet confronted the revolving charge account, but they have considered usury in relation to install-

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23 For an excellent discussion on usury generally, *see* Benfield, *Money, Mortgages and Migraine—The Usury Headache,* 19 CASE W. RES. L. REV. 819 (1968).

24 Bernstein, *Background of a Gray Area in Law: The Checkered Career of Usury,* 51 A.B.A.J. 846, 850 (1965).

25 N.J. STAT. ANN. § 31:1-1 (Supp. 1970) provides in part:

> (a) Except as otherwise provided by law, no person shall, upon contract, take, directly or indirectly, for loan of any money, wares, merchandise, goods and chattels, above the value of $6.00 for the forbearance of $100.00 for a year, and after that rate for a greater or less sum or for longer or shorter time; and except further, that the Commissioner of Banking and Insurance . . . may . . . provide that the value . . . shall be a value more than $6.00 but not more than $8.00 . . . .

26 N.J. STAT. ANN. § 17:16C-41 (1970); N.J. STAT. ANN. § 17:16C-1 (1970) defines "Retail installment contract" as such:

> [A]ny contract . . . between a retail seller and a retail buyer evidencing an agreement to pay the retail purchase price of goods, or any part thereof, in 2 or more installments over a period of time, and pursuant to which title to or a lien upon the goods is retained or taken by the retail seller for the payment of the retail buyer's obligation. [T]he bailee or lessee agrees to pay as compensation a sum substantially equivalent to or in excess of the value of the goods . . . .

See also note 22 *supra.*

27 N.J. STAT. ANN. § 17:10-14 (Supp. 1970).

ment sales. In *Steffenauer v. Mytelka & Rose, Inc.*,[28] the court refused to apply the statute in a case that, strictly interpreted, was in violation of the usury law. Plaintiff, interested in opening a coin operated dry cleaning business, entered into a conditional sales contract with defendant to purchase equipment valued at $18,500. After a down payment there remained $9,750 to be repaid at the rate of 7% per year for four years, divided into 48 monthly installments of $260, a total of $12,480 due.[29] Plaintiff contended that the service charge was nothing more than a "cloak to cover a usurious transaction."[30] The court disagreed, and instead adopted a "general rule"[31] that excludes *bona fide* conditional sales from the ambit of usury statutes even though the finance charge exceeds the legal rate. The Supreme Court of New Jersey was more explicit:

> For the reasons given by the trial court, we agree the transaction was a sale, and hence beyond the general usury statute, *N.J.S.A.* 31:1-1.[32]

The Wisconsin court in *Penney*, after properly concluding that the charge agreement involved a "forbearance of money and not a time

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28 87 N.J. Super. 506, 210 A.2d 88 (Ch. 1965), *aff'd per curiam*, 46 N.J. 299, 216 A.2d 585 (1966).

29 This kind of credit transaction would normally come within N.J. STAT. ANN. § 17:16C-41 (Retail installment sales) and its allowable 10% interest rate. But there is a limitation imposed by § 17:16C-1(a) as follows:

> "Goods" means all chattels personal having a cash price of $7,500.00 or less, but not including money or choses in action or goods sold for commercial or business use.

As a result, this transaction is not covered under the sales act and is thereby exposed to regulation under the usury law, which, until 1968, allowed a maximum of 6%.

30 87 N.J. Super. at 510, 210 A.2d at 90; *see* W.T. Grant Co. v. Walsh, 100 N.J. Super. 60, 241 A.2d 46 (Cty. Dist. Ct. 1968), where plaintiff store sued to recover payment due on a supposed "Retail installment sales contract," which in fact involved selling a customer a book of coupons totalling $200.00 valid for purchases in any of the chain's stores. The coupon plan obligated the customer to pay $246.01 (commencing immediately) over a 24-month period, thus imposing both interest charges for purchases not yet made and liability for full payment in the event of loss, theft, or destruction. The court held that the inducement to sign a retail installment contract whereby the customer received no goods, but only scrip to be used as money, was governed by the general usury statute and the agreement therefore was void.

31 *Id.* The rule is stated in an annotation in 143 A.L.R. 238, 242 (1943) as follows:

> It is well settled that where the contract of conditional sale is bona fide and the finance charge or other similar charge is included therein as a part of the total "time" or credit price of the chattel which the purchaser thereby agrees to pay upon a deferred payment basis, the finance charge does not constitute usury, even though such charge, if considered as interest, would be in excess of the highest lawful interest upon the cash purchase price for the time payment thereof is deferred under the contract, provided of course that the transaction was what it purported to be and not in fact a loan.

32 46 N.J. at 300, 216 A.2d at 585.

sale,"[33] felt constrained to enlist the aid of the usury statute to protect the public; but, as their own lower court cogently argued, no aid was required.[34] The court's preoccupation with the time-sale was unfounded, for it is nothing more than classifying both parts of a credit sale, *i.e.*, the cash price and the credit charge, together as a sale, and considering the entire sum charged as the price. The purpose and the result were to circumvent the usury laws. With distinctions clearly in mind, the fact remains that time-sales and revolving account sales both provide for the purchase of goods, and both involve the extension of credit and a forbearance to collect the cash price. This vital point was recognized by the *Steffenauer* court:

> *Every credit transaction partakes of a loan*, a loan by the seller to the buyer. Therefore, it is impossible to distinguish "loan" from credit per se. Where violation of a usury statute is alleged, *semantics must give way to substance*; and the question must always be whether the transaction in question was the kind of transaction which it was the intention of the legislature to prevent . . . . Frequently, the issue is formulated in terms of "credit" versus "cash" sale. . . . *In either case the real issue is the same.*[35]

Although the *Steffenauer* case was decided on the basis of a time-sale, and in a commercial rather than consumer setting, there is no indication of a different outcome had it been a revolving account. In circumstances where the buyer deals directly with the seller, and where the buyer has been advised of the charge rates, there can be no question of the existence of a bona fide credit sale. The revolving account, as struck down in *Penney*, fully satisfies the two criteria set forth in *Steffenauer* to validate an installment sale:

> First, that the facts reveal an intent between the parties to the transaction to consummate an actual purchase and sale. Second, that the purchaser be fully aware of what he is doing, and that he have an opportunity to make an intelligent choice of buying a chattel for less now rather than more later.[36]

New Jersey takes a conservative view of usury, and invokes the statute—as befits its purpose—only in cases of unconscionable con-

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33 48 Wis. 2d at 144, 179 N.W.2d at 651.

34 *See* p. 574 *supra*.

35 87 N.J. Super. at 517, 210 A.2d at 94-95 (emphasis added) (the court quoted from Langille v. Central-Penn Nat'l Bank, 38 Del. Ch. 382, 386, 153 A.2d 211, 213 (1959)).

Tennessee defines the 1½% per month charge on revolving accounts as a "Time Price Differential"; TENN. CODE ANN. § 47-11-104(c) (1964). *See* Dennis v. Sears, Roebuck & Co., — Tenn. —, 446 S.W.2d 260 (1969) (court makes no distinction between time price sale and revolving charge account).

36 87 N.J. Super. at 512, 210 A.2d at 92.

duct.[37] Today's consumer in the legitimate credit market is protected from such conduct. Through the application of comprehensive disclosure provisions within the Truth in Lending Act[38] the credit buyer enjoys substantial freedom from possible subterfuge and fraud. And when considering usury, these are the proper areas for inquiry—not the *form* of the sale. As was duly noted by the New Jersey Supreme Court, the 7% charged in *Steffenauer* actually averaged out to 14% per year on the unpaid balance.[39]

It is therefore doubtful that New Jersey will follow the course charted by Wisconsin. The *Steffenauer* court concluded their decision with the observation that "[t]o hold otherwise . . . would be to ignore the facts of everyday commercial life."[40] Indeed, other states are giving these rates their unequivocal approval. For example, Pennsylvania allows 1¼% per month;[41] California and Delaware both permit 1½% "[o]n so much of the outstanding balance as does not exceed one thousand dollars" and 1% on the excess.[42]

The proposed *Uniform Consumer Credit Code*, although presently embroiled in controversy,[43] will nevertheless exert considerable influence toward acceptance of the *Penney* rates. As stated in the introductory section, it is the purpose of the UCCC,

> (a) to simplify, clarify and modernize the law governing retail installment sales, consumer credit, small loans and usury;
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> (b) to provide rate ceilings to assure an adequate supply of credit to consumers . . . .[44]

These rate ceilings would allow, for revolving charge accounts, a

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37 *See* Paley v. Barton Sav. and Loan Ass'n, 82 N.J. Super. 75, 196 A.2d 682 (App. Div. 1964) ($10,000 charge made by defendant in consideration of holding $1,000,000 available for one year for purpose of purchasing mortgages held not unconscionable even though no mortgages were obtained for purchase; "Since no loan of money . . . existed here, usury could not be involved." *Id.* at 81, 196 A.2d at 685); Altman v. Altman, 8 N.J. Super. 301, 72 A.2d 541 (Ch. 1950) (contract requiring defendants to pay plaintiffs net profits from resale of hotel property held to be a compromise of a disputed claim and thus valid consideration; defense of usury fails unless clearly established). *See also* W.T. Grant Co. v. Walsh, 100 N.J. Super. 60, 241 A.2d 46 (Cty. Dist. Ct. 1968).

38 15 U.S.C. §§ 1601 *et seq.* (1969).

39 46 N.J. at 300, 216 A.2d at 585.

40 87 N.J. Super. at 517, 210 A.2d at 94.

41 PA. STAT. ANN. tit. 69, § 1904 (Supp. 1970).

42 CAL. CIV. CODE § 1810.2 (West Supp. 1971); DEL. CODE ANN. tit. 6, § 4337 (1969).

43 *See* Felsenfeld, *Competing State and Federal Roles in Consumer Credit Law*, 45 N.Y.U.L. REV. 487 (1970); Harper, *The Uniform Consumer Credit Code: A Critical Analysis*, 44 N.Y.U.L. REV. 53 (1969).

44 UCCC § 1.102(a),(b).

monthly charge up to "2 per cent of that part . . . which is $500 or less and 1½ per cent on that part . . . which is more than $500."[45]

"The facts of every day commercial life," as embodied in the UCCC, will influence the courts to a greater degree than widely varying and inconsistent usury statutes.[46] "1½ per cent on the declining balance" is firmly established as a fixture of American commercial life.

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45 UCCC § 2.207(3).

46 The ceiling on interest rates in general usury statutes range from 6% to 21% (Rhode Island); Maine, Massachusetts, and New Hampshire have no limit.