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USURY—COMMITMENT FEES—MAYBE YES, MAYBE NO, BUT NOT THIS TIME. *Arkansas Savings & Loan v. Mack Trucks of Arkansas*, 263 Ark. 264, 566 S.W.2d 128 (1978).

On March 1, 1974, Mack Trucks of Arkansas, Armond Smith, and Shirley G. Smith executed a note secured by a mortgage to the Arkansas Savings and Loan Association of North Little Rock, Arkansas. The principal amount of the note was \$340,000 with interest thereon at the rate of nine percent per annum. On March 5, 1974, Arkansas Savings, by way of a bookkeeping entry, credited this amount to Mack Trucks and the Smiths.¹ Arkansas Savings then made certain disbursements out of the loan proceeds. Among these was a \$3,400 charge labeled a "service charge" credited to Arkansas Savings on March 6, 1974.

Mack Trucks and the Smiths defaulted on the note, and Arkansas Savings brought suit in the Pulaski County chancery court to foreclose the mortgage. The Smiths asserted the defense of usury. They offered testimony that in March of 1974 Arkansas Savings & Loan was charging one percent in addition to the quoted interest on almost every loan it made.² They further argued that the \$3,400 labeled a "service charge" amounted to additional interest and when added to the stipulated rate of nine percent, the interest on the note exceeded the ten percent Arkansas constitutional limitation.³ Despite the fact that it was recorded in several places in the lender's records solely as a service charge, Arkansas Savings contended that the \$3,400 fee was a legitimate "commitment fee"⁴ charged to Mack Trucks and the Smiths for its \$340,000 loan commitment.⁵ The Chancellor sustained the usury defense and dis-

1. Abstract and Brief of Appellant at 42-43, *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark. Inc.*, 263 Ark. 264, 566 S.W.2d 128 (1978).

2. Abstract and Brief of Appellant at 56, *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 566 S.W.2d 128 (1978).

3. The parties stipulated that Arkansas Savings charged interest in the amount of \$13,653.74. This amount did not include the \$3,400 fee. If the \$3,400 was interest, then the total interest charged for the year was \$17,053.74 or \$2,028.92 above 10%. *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 267, 566 S.W.2d 128, 130 (1978).

4. Abstract and Brief of Appellant at 55-56, *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 566 S.W.2d 128 (1978).

5. See Prather, *Mortgage Loans and the Usury Law*, 16 BUS. LAWYER, 181 (Nov., 1960); Mitchell, *Usury in Arkansas*, 26 ARK. L. REV. 263 (1972). A commitment fee in its purest form works as an option. The borrower reserves money for a certain period of time at a certain rate of interest. For this "option", the lender charges a fee. The borrower is free to seek financing elsewhere if he can find better terms. On the other hand, a service charge represents a somewhat broader concept. Extra charges for money or forbearance might include anything from a fee for a credit report as in *Winston v. Personal Finance Co.*, 220 Ark. 580, 249 S.W.2d 315 (1952), to fees paid to a broker if that broker is acting as the borrower's agent, *Altschul*

missed the complaint with the exception of \$3,429.65. Arkansas Savings had paid this amount for taxes and hazard insurance and the Chancellor found these payments had benefited all parties.

The Arkansas Supreme Court affirmed, citing an earlier decision which held that a "moneylender cannot impose upon the borrower charges that in fact constitute the lender's overhead expenses or costs of doing business."⁶ The court considered the \$3,400 charge to be interest and the transaction of March 6, 1974, to be no more than a discount or the taking of interest in advance. *Arkansas Savings & Loan Association v. Mack Trucks of Arkansas*, 263 Ark. 264, 566 S.W.2d 128 (1978).

Basic to understanding usury law in Arkansas is a grasp of the terminology and canons that surround the law. One writer has concluded that perhaps the most frequent statement to be found in usury cases is that a court will look beyond the device or label in determining whether a transaction is in fact usurious.⁷ In making such a determination, Arkansas courts rely on the facts and circumstances existing at the instant the contract is consummated.⁸

While the word "interest" is not statutorily defined in Arkansas, it has been fairly well established that interest is the price paid by a borrower to a lender for the use of what he borrows.⁹ The term "usury" is ordinarily defined as an excessive charge for a loan or forbearance of money.¹⁰ Article 19, Section 13 of the Arkansas Constitution declares: "All contracts for a greater rate of interest than ten percent per annum shall be void as to principal and interest" If interest exceeds ten percent, a lender cannot collect either principal or interest. The General Assembly has, under this constitutional mandate, prohibited usury.¹¹

Some money lenders in Arkansas have tried to avoid the penalty mandated by the 1874 Constitution by attempting to find loopholes in the constitutional declaration and its supporting statutes¹² rather than by restricting the interest they charged.¹³ Courts

v. Martin, 227 Ark. 816, 301 S.W.2d 571 (1957). Mitchell, in his article, reports that Arkansas law has always allowed lenders to make certain extra charges without having them added to and computed as interest.

6. *Sosebee v. Boswell*, 242 Ark. 396, 400, 414 S.W.2d 380, 382 (1967).

7. Collins & Ham, *The Usury Law of Arkansas: A Study in Evasion*, 8 ARK. L. REV. 399, 419 (1954).

8. *Sloan v. Sears, Roebuck & Co.*, 228 Ark. 464, 469, 308 S.W.2d 802, 806 (1957).

9. *Miles v. Gordon*, 234 Ark. 525, 529, 353 S.W.2d 157, 160 (1962).

10. *Mid-State Homes, Inc. v. Knight*, 237 Ark. 802, 803, 376 S.W.2d 556, 557 (1964).

11. ARK. STAT. ANN. § 68-601 et. seq. (1957).

12. Collins & Ham, *supra* note 7, at 401.

13. Shortly before the adoption of this constitutional provision of 1874, a reasonable

for a time were reluctant to construe the ten percent limitation strictly¹⁴ and, because the penalty was so severe, undertook to soften its impact by sanctioning a number of evasion techniques.¹⁵ Lenders were able to exclude from interest such items as inspection fees¹⁶ and compulsory insurance.¹⁷ The Arkansas Supreme Court also refused to apply the usury limitation to a bona fide sale of goods on credit.¹⁸

It is important to note that even during this period of leniency, the court never permitted sham transactions as an avoidance device.¹⁹ For example, in *Cammack v. Runyan Creamery*,²⁰ the borrower was required to hire the lender as an "advisor" on financial affairs. The evidence showed that the lender did nothing to earn its fee and the court invalidated the borrower's obligation.²¹

During the 1950's, this "leniency" trend was reversed in a series of cases wherein the Arkansas Supreme Court invalidated as usurious practices it previously had sanctioned. In the first of these decisions, *Schuck v. Murdock Acceptance Corp.*,²² the seller of an automobile and a loan company which financed the sale attempted to charge the purchaser a principal amount in excess of the quoted price, in addition to interest. The practice of allowing a seller to charge a greater price for a credit sale than for a sale made for cash had been one of the earliest devices used by Arkansas lenders to avoid the usury limitation.²³ The Arkansas Supreme Court found no fault with the right of a seller to ask one price where cash was paid, and a higher price if credit was extended.²⁴ In *Schuck*, however, the seller had not informed the buyer of the difference between the cash price and the price to be extracted through time payments. In addi-

rate of interest was considered to be about 24% per annum and it was not unusual to find borrowers paying 60% per annum. Penick, *The Impact of Usury Law on Banks in Arkansas*, 8 ARK. L. REV. 420, 423 (1954) (citing W.B. WORTHEN, *EARLY BANKING IN ARKANSAS* (1906)).

14. Mitchell, *Usury in Arkansas*, 26 ARK. L. REV. 263 (1972).

15. *Id.*

16. Lyttle v. Matthews Inv. Co., 193 Ark. 849, 103 S.W.2d 47 (1937).

17. Matthews v. Georgia State Sav. Ass'n, 132 Ark. 219, 225, 200 S.W. 130, 132 (1918).

18. General Contract Purchase Corp. v. Holland, 196 Ark. 675, 119 S.W.2d 535 (1938); Harper v. Futrell, 204 Ark. 822, 164 S.W.2d 995 (1942).

19. Collins & Ham, *supra* note 7, at 418.

20. 175 Ark. 601, 299 S.W. 1023 (1927).

21. Collins and Ham in their article cite to a case that reaches an opposite result—Cain v. Stacy, 146 Ark. 55, 225 S.W. 18 (1920) (contract of employment as prerequisite to loan held valid where these services were actually needed and performed). *Cain*, however, is clearly distinguishable from *Cammack* in that the fee was earned.

22. 220 Ark. 56, 247 S.W.2d 1 (1952).

23. Collins & Ham, *supra* note 7, at 401.

24. *Schuck v. Murdock Acceptance Corp.*, 220 Ark. 56, 61, 247 S.W.2d 1, 4 (1952).

tion, there was evidence that the seller was not an independent actor, but rather the agent of the finance company. The Arkansas Supreme Court concluded upon these facts that the failure to disclose a credit price was fatal to any "time-price differential" defense that the lender might raise. The court viewed the difference between the two prices as an add-on which was an unauthorized charge devised to evade usury and as such made the contract usurious.

The Arkansas Supreme Court clarified *Schuck* in *Hare v. General Contract Purchase Corp.*²⁵ Recognizing that a long line of cases had held it permissible to charge a greater price for goods in a credit sale, the court stated that these precedents could no longer be relied upon.²⁶ The court pointed out that any valid distinction between buying at a credit price and buying at a cash price had largely disappeared and such time-price differentials were only serving as a cloak for usury in many cases. The court issued a caveat:

(1) We leave unimpaired the doctrine that a seller may, in a *bona fide* transaction, increase the price to compensate for the risk that is involved in a credit sale. But there may be a question of fact as to whether the so-called credit price was *bona fide* as such, or only a cloak for usury.²⁷

In the next decade, the Arkansas Supreme Court made it clear that the court had initiated a policy of strictly construing the Arkansas usury law. *Strickler v. State Auto Finance Co.*²⁸ turned back a legislative attempt to allow specific charges to be excluded from interest. The court held Act 203 of 1951, the Arkansas Installment Loan Law,²⁹ unconstitutional because it would permit illegal interest to be extracted in the form of a service charge. In 1954 and 1957 the courts broadened its prohibitions to include more than just commercial lenders.³⁰ Strict construction, however, did not mean that all charges imposed by a lender would be considered interest.³¹ In

25. 220 Ark. 601, 249 S.W.2d 973 (1952).

26. *Id.* at 609, 249 S.W.2d at 977.

27. *Id.* at 609, 249 S.W.2d at 978.

28. 220 Ark. 565, 249 S.W.2d 307 (1952).

29. In 1951, the legislature passed what purported to be a model small loans act allowing certain lenders, if qualified, to make loans up to \$2,500 and to extract charges for interest, various types of insurance, and service fees. The act authorized the lender to require the purchase of life and health insurance to protect the loan, and permitted the lender to charge to each borrower his proportionate amount of the lender's overhead. Collins & Ham, *supra* note 7, at 412-13.

30. See *Sloan v. Sears, Roebuck & Co.*, 228 Ark. 464, 308 S.W.2d 802 (1957); *O'Brien v. Atlas Finance Co.*, 223 Ark. 176, 264 S.W.2d 839 (1954).

31. *Lockhart v. General Motors Acceptance Corp.*, 252 Ark. 878, 481 S.W.2d 350 (1972).

Lockhart v. General Motors Acceptance Corp.,³² the Arkansas Supreme Court identified certain collateral charges that would not be considered interest. The court recognized the propriety of such charges as property inspection fees,³³ expenses for an abstract of title,³⁴ insurance premiums paid to a third party,³⁵ recording fees,³⁶ and title insurance premiums.³⁷ These charges benefit the lender, but the Arkansas Supreme Court characterized these transactions as being reasonable in amount, made in good faith, and representing reimbursements made to third persons.³⁸ In *Sosebee v. Boswell*,³⁹ the court identified two principles it would consider in determining whether charges amounted to interest. "First, any profit extracted by the lender must be treated as interest if it depends upon a contingency not within the control of the debtor."⁴⁰ And second, the money lender could not impose upon the borrower charges that in fact "constitute[d] the lender's . . . costs of doing business."⁴¹

In *Harris v. Guaranty Financial Corp.*,⁴² the court defined other factors relevant to a determination of whether a charge amounted to interest.⁴³ One factor was whether a particular charge was for the sole benefit of the lender or for the mutual benefit of both the lender and the borrower. Another element was whether the charges received by the lender were disbursed to a third party for services rendered in the loan procedure or were pocketed by the lender and applied to his business overhead.⁴⁴

The first of these elements was present in *Key v. Worthen Bank & Trust Company, N.A.*⁴⁵ The holder of two bank credit cards brought suit to void as usurious contracts which required the cardholder to pay an annual membership fee in each credit plan. The

32. *Id.* at 880, 481 S.W.2d at 351.

33. *Winston v. Personal Finance Co.*, 220 Ark. 580, 584, 249 S.W.2d 315, 317 (1952).

34. *Brown v. Fretz*, 189 Ark. 411, 414, 72 S.W.2d 765, 766 (1934).

35. *Ragge v. Bryan*, 249 Ark. 164, 171, 458 S.W.2d 403, 408 (1970).

36. *Brown v. Fretz*, 189 Ark. 411, 414, 72 S.W.2d 765, 766 (1934).

37. *Harris v. Guaranty Financial Corp.*, 244 Ark. 218, 224, 424 S.W.2d 355, 358 (1968).

38. *Lockhart v. General Motors Acceptance Corp.*, 252 Ark. 878, 880, 481 S.W.2d 350, 351 (1972).

39. 242 Ark. 396, 414 S.W.2d 380, *cert. denied*, 389 U.S. 953 (1967).

40. *Id.* at 399, 414 S.W.2d at 382.

41. *Id.* at 400, 414 S.W.2d at 382.

42. 244 Ark. 218, 424 S.W.2d 355 (1968).

43. *Harris* also held that whether a particular charge was proper depended upon the facts and circumstances of each case. The court found determinations of this nature were questions of fact.

44. *Harris v. Guaranty Financial Corp.*, 244 Ark. 218, 223, 424 S.W.2d 355, 357-58 (1968).

45. 260 Ark. 725, 543 S.W.2d 496 (1976).

cardholder claimed that the twelve dollar annual charge when added to the ten percent interest on her balance exceeded the constitutional limitation. The court, in holding that the charge was not interest, relied on the fact that the plaintiff was not a necessitous borrower, who, as a prerequisite to a loan, was forced to purchase something.⁴⁶ More importantly, the charge was incidental to the extension of credit and provided the cardholder with a number of collateral benefits such as check-cashing and identification, and also obviated the necessity of carrying large amounts of cash. Relying on two earlier decisions,⁴⁷ the court held that: "contracts or fees collateral to the lending or borrowing of money, if in themselves lawful and made in good faith, do not infect the 'borrowing transaction' with usury, although their effect may be to increase the sum payable from the borrower to the lender."⁴⁸

The question of whether commitment fees are non-usurious collateral charges has not been decided by the Arkansas Supreme Court⁴⁹ or by many courts in other states.⁵⁰ One writer views this absence of cases as an indication that few courts would hold that a fee paid for an advance commitment to make a mortgage loan should be considered as interest in the calculation of whether the

46. The court stated that the fee was not imposed in connection with receiving a loan from Worthen or with any specific extension of credit. Mrs. Key had come to the bank voluntarily seeking membership in specific bank plans. Further, the applications for the cards stated that the applicant understood the fee was required whether or not she used "the bank card for the purpose of obtaining credit." *Key v. Worthen Bank & Trust Co., N.A.*, 260 Ark. 725, 730, 543 S.W.2d 496, 499 (1976).

47. *Commercial Credit Plan v. Chandler*, 218 Ark. 966, 239 S.W.2d 1009 (1951) and *Leavitt v. Marathon Oil Co.*, 186 Ark. 1077, 57 S.W.2d 814 (1933).

48. *Key v. Worthen Bank & Trust Co., N.A.*, 260 Ark. 725, 730, 543 S.W.2d 496, 499 (1976).

49. The subject of a commitment fee was abruptly treated in *Sosebee v. Boswell*, 242 Ark. 396, 414 S.W.2d 380, *cert. denied*, 389 U.S. 953 (1967), in which a commitment fee was charged and dicta indicated it would be interest. It was stipulated, however, that upon the facts there involved the charge was interest and the Arkansas Supreme Court did not decide whether commitment fees were to be considered additional interest or not.

50. *Amicus Curiae Brief for Appellant by Central Arkansas Bank Clearing House Association at 10-11, Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 566 S.W.2d 128 (1978), lists seven cases which touch upon the subject: *Altherr v. Wilshire Mortgage Corp.*, 104 Ariz. 59, 64-65, 448 P.2d 859, 864-65 (1968); *Daily Mines Co. v. Catalina Consol. Copper Co.*, 59 Ariz. 149, 155-57, 124 P.2d 320, 323 (1942); *Financial Fed. Sav. & Loan Ass'n v. Burleigh House Inc.*, 305 So.2d 59, 62-63 (Fla. Dist. Ct. App. 1974), *cert. denied*, 429 U.S. 1042 (1977); *D & M Dev. Co. v. Sherwood & Roberts, Inc.*, 93 Idaho 200, 457 P.2d 439, 445-46 (1969); *Pivot City Realty Co. v. State Sav. & Trust Co.*, 88 Ind. App. 222, 229-30, 162 N.E. 27, 29 (1928); *Paley v. Barton Sav. & Loan Ass'n.*, 82 N.J. Super. 75, 81, 196 A.2d 682, 685 (1964), *cert. denied*, 41 N.J. 602, 198 A.2d 446 (1964); *Gonzales County Sav. & Loan Ass'n v. Freeman*, 534 S.W.2d 903 (Tex. 1976). In all of these cases, the decision or dictum has stated that the commitment fee in question was not interest.

total charges were usurious.⁵¹

The Arkansas Supreme Court in *Mack Trucks* held that the \$3,400 Arkansas Savings disbursed to itself on March 6, regardless of the label that was placed upon it, amounted to no more than the taking of interest in advance. The court reasoned that the charge was made on all Arkansas Savings loans regardless of the type of loan involved or whether the lender provided a benefit collateral to the extension of credit. The practice represented no more than the collection from the borrower of a part of the lender's expense of doing business. *Sosebee* had explicitly condemned a charge of this kind as usurious. The court reasoned that if the charge was not a payment for overhead, then it had no basis.⁵² The court decided that because there was no legitimate basis, the fee was an unjustified service charge which the lower court properly included as interest under the note.

In *Mack Trucks*, the Arkansas Supreme Court has placed a cloud over the charging of commitment fees in the State of Arkansas. The court declined to distinguish the fee charged by Arkansas Savings from a true commitment fee. This affects the ability and willingness of lenders within the state to commit themselves to loan money at a future date for a fixed rate of interest, a commitment collateral to the actual transfer of funds.⁵³

It is significant to note that the court did not rule out valid commitment fees, but rather condemned the particular transaction that was involved.⁵⁴ However, by using broad language and failing

51. Prather, *Mortgage Loans and the Usury Law*, 16 BUS. LAWYER 181, 188 (1960).

52. Abstract and Brief of Appellant at 59, *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 566 S.W.2d 128 (1978). In the lower court, Arkansas Savings' senior vice-president had testified that none of the \$3,400 charge could be attributed to services other than the setting aside of funds.

53. Loan commitments play an essential role in the construction industry. The commitment assures the interest parties of the availability and the cost of long term financing. The commitment of funds also may play a vital role in a wide variety of business arrangements. The importance of commitment fees was underscored by the conclusion drawn in the Amicus Curiae Brief for Appellant by the Central Arkansas Bank Clearing House Association at 16: "[t]he loan commitment is such an accepted and vital ingredient in major commercial transactions that it is difficult to list every type of transaction in which loan commitments could be involved."

54. Abstract and Brief of Appellant, vol.II, at 5, *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 566 S.W.2d 128 (1978). On August 23, 1974, Mack Trucks and the Smiths paid Arkansas Savings by check another \$3,400 for a certain commitment letter. The parties stipulated that this payment with its surrounding circumstances was not an interest charge on the note. The court pointed out that this second payment was apparently for permanent financing, but would make no ruling as to whether this charge was interest or not. It is significant to note that this second charge more accurately represented a true commitment fee.

to distinguish the charge in this case from a true commitment fee, the court has caused confusion.

To clarify its decision, the court might have pointed to various factors that would distinguish the charge made by Arkansas Savings from a true commitment fee. Mack Trucks had no option as to whether to take out or forego the loan and received no collateral benefit for the charge.⁵⁵ In addition, there was no evidence that the borrower was ever advised of the charge until closing. Moreover, the charge was paid after the transfer of funds to Mack Trucks' account and not in advance of the time of closing. And although the court has held that labels will not rule the transaction,⁵⁶ the charge appeared in the lender's records as a service charge and not a commitment fee.

The court in the past has recognized that lenders who confer additional benefits could charge fees separate and apart from interest paid for the use of money. It would appear that a true commitment fee would fit within this classification. The fee in *Mack Trucks* was a charge that was extracted from almost every borrower and did not support any legitimate collateral benefit. Although a true commitment fee was not involved, the court nevertheless missed an opportunity to clarify for lenders some of the necessary characteristics of true commitment fees. The court might thus have prevented unnecessary future litigation.

One member of the Arkansas Supreme Court has shown an awareness of the problem created by *Mack Trucks*. Note should be taken of the concurring opinion of Chief Justice Carleton Harris upon denial of a petition for a rehearing in the case.⁵⁷ In his opinion, the Chief Justice recognized a distinction between the fee in *Mack Trucks* and a true commitment fee and emphasized that important questions had been left unanswered by the majority opinion. He issued a caveat, however, that lenders should not rely on the opinion of a single justice.

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55. Abstract and Brief of Appellant at 60, *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 566 S.W.2d 128 (1978).

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

57. *Arkansas Sav. & Loan Ass'n v. Mack Trucks of Ark., Inc.*, 263 Ark. 264, 271, 566 S.W.2d 128, 132 (1978).