

Constitutional clamor in Arkansas

By Ed Winn

You shall not lend upon interest to your brother; interest on money, interest on victuals, interest on anything that is lent for interest. To a foreigner you may lend upon interest, but to your brother you shall not lend upon interest, that the Lord your God may bless you in all that you undertake in the land which you are entering to take possession of it.” — DEUTERONOMY 23:19–20

Given its location deep in the Bible Belt, it should perhaps be no great surprise that Arkansas treats the notions of money lending, interest and usury differently from most other states. In Arkansas, the regulation of the loaning of money is contained in the state's constitution, whereas almost everywhere else, it is entirely a legislative matter. ¶ California, Oklahoma, Tennessee and Texas all have constitutional provisions relating to usury, but have left regulation of interest to their respective legislatures. In these other states, there is a sort of default provision in the state constitutions that regulates usury if the legislature fails to do so. In Arkansas, the constitution sets the rate and the legislature has no say in the matter short of amending the constitution. Therefore, the situation in Arkansas via-a-vis usury limits is unique in the country.



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With this environment doubtless in mind, plaintiffs' attorneys have recently launched a frontal assault on the rental industry in Arkansas. They have sued the country's three largest rental chains in three separate class-action lawsuits alleging that all rental-purchase transactions entered into in these companies' stores during the past five years violate the state's constitution.

Until 1982, the Arkansas Constitution limited interest rates in the state to a flat 10 percent per year. In 1982, when the prime lending rate approached 20 percent in the United States, the state amended its constitution to provide some flexibility to interest rates. The amendment pegged the maximum interest rate to no more than 5 percent per year above the Federal Reserve discount rate or in the case of consumer transactions, 17 percent per year. However, a year later, the Arkansas Supreme Court read the amendments language in peculiar fashion and concluded that interest rates on consumer transactions in the state are also limited to the lesser of the floating rate or 17 percent. Today the floating rate is 10 percent.

Over the years, various legislative enactments have been challenged as violating the constitutional limit on interest rates. The courts have jealously guarded their right to decide what is and what is not usury in the state. From time to time, the Arkansas Supreme Court has knocked down some legislative pronouncement that the court deemed as infringing on the constitutional limit on interest rates. It did so most recently in 2001 in a case which held that the state's Check-Casher's Act was unconstitutional.

It is likely that the result in this case has emboldened plaintiffs' attorneys to take on the rental-purchase industry. Therefore, some understanding of the payday loan case is important to explain why the Arkansas rental-purchase industry has suddenly come under legal attack.

In the 1990s, the payday loan industry was successful in getting the Check-Casher's Act enacted. The statute specifically authorized merchants to charge a fee of up to 10 percent of the face amount of a personal check for providing the service of cashing it. The statute further authorized merchants to charge a fee of \$10 per check for offering a deferred presentment option, requiring the merchant to hold the check for a agreed period of time before cashing it in exchange for this fee. The statute had the following language:

The fee, when made and collected, shall not be deemed interest for any purpose of law, and a check-cashing transaction, including one (1) with a deferred presentment option, shall not be deemed to be a loan, loan contract, or a contract for the payment of interest notwithstanding any disclosures required by this chapter.

Payday lenders used this statute as protection from the constitutional limit on interest charges, as payday loans

often carry triple-digit interest rates. Even so, payday lending paperwork disclosed annual percentage rates for the transactions, primarily not to run afoul of the federal Truth-In-Lending Act, which views payday loans as loans without attempting to regulate their interest rates.

In the lawsuit, *Luebbers v. Money Store Inc.*, it was undisputed that the defendant payday lender was in full compliance with the Check-Casher's Act. Plaintiff Luebbers had written a check for \$400 to the Money Store on September 3, 1999 and received \$350 in cash. The Money Store charged a \$40 check-cashing fee and a \$10 deferred presentment fee, promising to hold the check until September 17.

The question raised in the lawsuit was whether the

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Check-Casher's Act was constitutional and the state Supreme Court ruled that it was not. The defendant argued that the legislature intended to exempt the payday loan business from the usury strictures in the state. The court ruled that the legislature does not have the power to determine that a certain kind of transaction is not a loan or that a certain fee is not interest. The court viewed the Check-Casher's Act as "a patent attempt by the legislature to usurp a judicial function." The court went on to offer fairly standard judicial dross to the effect that courts must look to the substance, not merely the form, of a transaction to determine if it is usurious. This decision in *Luebbers* was immediately followed by a spate of lawsuits against other payday lenders in the state.

The argument in the three new rental-purchase lawsuits is whether rental-purchase transactions are really disguised conditional sales bearing interest at a rate in excess of the constitutional limit. Without more, the Arkansas rental-purchase industry might have cause for real concern.

However, the good news for the industry is that the

Arkansas Supreme Court has already ruled on the true nature of rental-purchase transactions. It did so in 1989 in a case called *Crumley v. Berry*, which held that traditional rental-purchase transactions with consumers for electronics and furniture of the type in use then and still in use today are true leases and not sales. The court made this ruling without resorting to the then-newly-enacted Arkansas rental-purchase statute. The court based its ruling on the established case law, not only in Arkansas, but also around the country and on the sound reasoning of the best legal scholars.

The court's holding in *Crumley* was that when the lessee has an option to terminate the lease at any time, the transaction is a true lease and cannot be a conditional credit sale. The court agreed to follow what it acknowledged in the opinion as the majority legal view in the country. The court acknowledged that there was a minority view that did not consider a terminability option as dispositive of the characterization of the transaction, but rather as merely one factor among anywhere from five to 14 factors to be considered when making the lease/sale distinction.

Of course, the rationale for the majority rule is that without an obligation to pay, there can be no debt as a logical matter and without a debt, there can be no interest. The logic of the majority rule also has the practical marketplace effect of providing legal certainty to lease transactions that will in turn foster commerce. This is one of the oft-stated goals of the all-mercantile law—to provide legal certainty. If merchants knew that every time they entered into a lease that the transaction might be scrutinized by a court and recharacterized for any one of as many as 14 reasons, there would be fewer leases written because of the risks involved.

There was a dissenting judge in the *Crumley* case. The dissenter thought that the rental-purchase transaction was a sale and clearly usurious and declared, with no analysis, that the lessee had in fact agreed to pay a set amount. The judge simply ignored the fact that the consumer had the unqualified right to return the property and terminate the agreement at any time with no further obligation.

Plaintiffs in the three new rental-purchase lawsuits have an uphill battle. They will have to persuade the Arkansas Supreme Court to overrule itself, as the facts in the *Crumley* case are substantially the same as current industry practices in the state today. In the intervening 14 years, the majority rule—no obligation is dispositive of the lease/sale issue—has continued to be followed in bankruptcy courts around the country and most state courts when the issue occasionally arises. There is no reason to suppose that the Arkansas Supreme Court will be persuaded to reverse itself and adopt this minority, cumbersome-to-apply, anti-business view. ■

Copies of the cases cited in this article are available to APRO members upon request to the APRO home office. Ed Winn III is APRO's general counsel. His e-mail address is edwinn@e-by-law.com.

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