

January 1957

## Does the Texas Credit Insurance Act Legalize Usury

Harvey L. Davis

---

### Recommended Citation

Harvey L. Davis, *Does the Texas Credit Insurance Act Legalize Usury*, 11 Sw L.J. 139 (1957)  
<https://scholar.smu.edu/smulr/vol11/iss2/2>

This Article is brought to you for free and open access by the Law Journals at SMU Scholar. It has been accepted for inclusion in SMU Law Review by an authorized administrator of SMU Scholar. For more information, please visit <http://digitalrepository.smu.edu>.

# DOES THE TEXAS CREDIT INSURANCE ACT "LEGALIZE" USURY?†

*by*

*Harvey L. Davis\**

THE 51st Legislature of the State of Texas in 1949 passed an act detailing comprehensive regulation of the writing and solicitation of credit life insurance and credit health insurance in connection with loans of money not exceeding \$1,000.00. This act, which will be referred to throughout this article as the "Credit Insurance Act," is now Article 3.53 of the Insurance Code.<sup>1</sup> The emergency clause reads as follows:

The facts that many thousands of Texas citizens who are borrowers of moderate sums of money are now required by many lenders as a condition for making the loans that the borrower purchase from the lender policies of life insurance and health and accident insurance; that the premium rates charged in many cases are exorbitant and bear no reasonable relation to benefits provided by such policies; that in many cases the policies so purchased are never delivered to the insured borrowers; that frequently such borrowers never know that they are entitled to any insurance protection notwithstanding the premiums for such insurance have been included in the amount of their loans; that there is no such general law prohibiting coercion of insurance and preserving to each citizen the right to choose his own insurers and insurance agent; that there is no general law prescribing for the regulation of the sale of such insurance and providing for the protection of Texas citizens from such unscrupulous practices, create an emergency and an imperative public necessity that the Constitutional Rule requiring bills to be read on three consecutive days in each House shall be, and said Rule is hereby suspended, and this Act shall take effect and be in force from and after its passage, and it is so enacted.<sup>2</sup>

The Credit Insurance Act in its various sections sets up in detail the scope of regulations to be administered by the Board of Insurance Commissioners for the purpose of eliminating the abuses, coercion and unscrupulous practices described in the emergency clause. No question is raised in this article as to the constitutionality of any of the sections of the Credit Insurance Act designed to pro-

---

† This article is the first of a series of articles considering Texas laws pertaining to the regulation of the loan and consumer finance business.

\* A.B., University of Akron; LL.B., Southern Methodist University; Professor of Law and Director of Moot Court Activities, School of Law, Southern Methodist University.

<sup>1</sup> TEX. INS. CODE ANN. (Supp. 1956).

<sup>2</sup> Texas Acts 51st. Leg., 1949, c. 81, §17.

tect Texas citizens as set out in the emergency clause. But there is one section of the Credit Insurance Act that does not lend itself to the protection of Texas citizens. That section is Section 6, which is worded as follows:

Commissions received by lenders, lender agents and insurance agents from insurers for the writing of credit insurance complying with the terms of this Act, the maximum rates promulgated by the Board, and rules and regulations of the Board of Insurance Commissioners, shall be considered for all purposes as compensation for services rendered to such insurer and shall not be taken to be an interest charge on the money borrowed; provided, however, should such commissions be in excess of any maximum fixed hereunder, then such commissions shall be deemed to be an interest charge on the money borrowed. No agreements by insurers with any of its agents shall permit contingent commissions based on loss experience.<sup>3</sup>

It is the thesis of the writer that this section permits "legalized usury" in the sense that as long as small loan lenders comply with the other sections of the Credit Insurance Act, they remain immune from the usury laws under Section 6 even though said lenders in fact and intent are committing usury. This situation will prevail as long as Section 6 remains unchallenged as to its constitutionality.<sup>4</sup> The purpose of this article is to reveal Section 6 as unconstitutional.

#### SCOPE OF THE ARTICLE

This article deals with only one very important aspect of the tremendous small loan problem in Texas. It deals specifically with the constitutionality of Section 6 of the Credit Insurance Act. It does not go into any of the many other aspects of our unregulated small loan situation.<sup>5</sup>

<sup>3</sup> TEX. INS. CODE ANN. art. 3.53, §6 (Supp. 1956).

<sup>4</sup> A subsequent article will consider in detail the case of *Hatridge v. Home Life & Accident Ins. Co.*, 246 S.W.2d 666 (Tex. Civ. App. 1951), which held the Credit Insurance Act constitutional on "stipulated" facts that did not really raise the issue of its constitutionality.

<sup>5</sup> Texas has been labeled too many times for it to be coincidental, as the leading loan shark state. See the pamphlet *STOP BRAGGING TEXAS* compiled under auspices of State Junior Bar of Texas in 1952. Also Morehead, *Loan Shark State*, Dallas Morning News, 9-article series, April 11-19, 1952. Operation under the Texas Credit Insurance Act apparently has had no effect on Texas leadership in this field. See WESTERN RESERVE UNIVERSITY BUREAU OF BUSINESS RESEARCH, *SMALL LOAN LAWS OF THE UNITED STATES* 13 (11th ed. 1955); Mors, *Small Loan Laws and Credit Insurance*, 1954 INS. L. J. 784; Chrisby, *Credit Life, Health and Accident Insurance and the Small Loan Industry in Indiana*, 1954 INS. L. J. 466. See also Morehead, *Drive Starts for Legislation to Curb State's Loan Sharks*, Dallas Morning News, Dec. 21, 1956, §1, p. 17, where it is reported that Morris Brownlee, Commissioner of Insurance, called for legislation to stop the tie-in of insurance sales with loans and financing because that practice had cost Texans "millions of dollars." See also STATE BAR OF TEXAS, *REPORT OF SPECIAL COMMITTEE ON SMALL LOAN LAWS* (July 3, 1952).

This article does not deal with the many facets opened by the passage of the Credit Insurance Act. It does not deal with the numerous abuses of the borrower by the lender under this Act.<sup>6</sup> It does not deal with the widespread belief that the Credit Insurance Act has led to the almost universal tie-in of credit insurance sales with small loans as a cloak for usury.<sup>7</sup> It does not deal with statistics indicating flagrant abuses and violations of the Credit Insurance Act.<sup>8</sup> It does not deal with the void existing with respect to policing of lenders operating under the Act.<sup>9</sup> It does not consider the merits or demerits of credit insurance itself or its use in the small loan and consumer financing field.<sup>10</sup>

This article will not consider constitutional questions of usurious interest that might be raised by statutes concerned with banks,<sup>11</sup>

<sup>6</sup> A reading of the statements recorded in the *Transcript of Proceedings, Public Hearing on Credit Insurance before the Board of Insurance Commissioners*, Austin, Texas, April 3, 1956, indicates that after seven years under the Credit Insurance Act, the abuses are greater than ever and that none of the purposes of the Act as set out in the emergency clause of the Act have been achieved. For some specific examples where the abuses have been proved see jury findings in *Harned v. E. Z. Finance Co.*, 151 Tex. 641, 254 S.W.2d 81 (1953); *Duty v. General Finance Co.*, 159 Tex. 16, 273 S.W.2d 64 (1954); See also *Industrial Finance Service Co. v. Riley*, 295 S.W.2d 498 (Tex. Civ. App. 1956) *error granted*; *Advance Loan Service v. Mandik*, No. 78519-C, 68th District Court, Dallas (now pending appeal). See also MAJOR MILTON W. SWETT, JR., *OPERATION OF THE LOAN SHARK CREDIT INSURANCE RACKET AMONG MILITARY PERSONNEL IN TEXAS* (1955), a brochure distributed to military commanders in Texas. See also testimony of James Danheim, *Transcript of Proceedings, Public Hearing on Credit Insurance*, Austin, Texas, Sept. 4, 1951, p. 41-45. See statements of various Texas leaders quoted in article *Credit Insurance and the Money Lenders*, *The Texas Observer*, Jan. 25, 1956.

<sup>7</sup> *Ibid.* See also Commissioner Brownlee's statement quoted note 5 *supra*.

<sup>8</sup> See Testimony, *Transcript of Proceedings, Public Hearing on Credit Insurance*, Board of Insurance Commissioners, Austin, Texas, April 3, 1956, pp. 10 to 54. See also authorities cited note 6 *supra*. Also *Texas Finance & Thrift Assn. v. State*, 224 S.W.2d 522 (Tex. Civ. App. 1949); *Ware v. Wright*, 266 S.W.2d 188 (Tex. Civ. App. 1954).

<sup>9</sup> See STATE BAR OF TEXAS, REPORT OF SPECIAL COMMITTEE ON SMALL LOAN LAWS 3 (July 3, 1952); remarks of former Chairman of Board of Insurance Commissioners, George Butler, *Transcript of Proceedings, Public Hearing on Credit Insurance*, Austin, Texas, Sept. 4, 1951, p. 2. See also Morehead, *Credit Insurance Will Get Review*, *Dallas Morning News*, Feb. 2, 1956: "... One commissioner [Board of Insurance Commissioners] declared that he never understood whether the Legislature intended for him to regulate the insurance or fix maximum charges on the loan."

<sup>10</sup> The following writings present various shades of views on credit insurance. Dunbar, *Credit Insurance — Use by Licensed Lenders*, 1956 INS. L. J. 443; Mors, *Consumer Installment Credit Insurance*, 1956 INS. L. J. 299; Cade, *The Fundamental Issues of Consumer Credit Insurance*, 1955 INS. L. J. 76; Mors, *Small Loan Laws and Credit Insurance*, 1954 INS. L. J. 778; Vernon, *Regulated Credit Life and Disability Insurance and the Small Loan*, 29 N.Y.U. L. REV. 1111 (1954); Report of the Subcommittee on Antitrust and Monopoly Legislation, *The Tie-in Sale of Credit Insurance in Connection with Small Loans and other Transactions*, S. Doc. No. 57921, 83rd Cong., 2d Sess. (1955). Chrisby, *Credit Life, Health and Accident Insurance and the Small Loan Industry in Indiana*, 1954 INS. L. J. 465. But for a record of how it is operating in Texas, the reader is again referred to *Transcript of Proceedings, Public Hearing on Credit Insurance*, Board of Insurance Commissioners, April 3, 1956.

<sup>11</sup> Arts. 342-508, TEX. REV. CIV. STAT. ANN. (1947).

building and loan associations,<sup>12</sup> insurance companies<sup>13</sup> (other than those selling credit insurance), pawn brokers,<sup>14</sup> loan brokers or lending companies,<sup>15</sup> or with cash and time prices in sales of motor vehicles.<sup>16</sup>

In none of these other statutes has the Legislature undertaken to assert that money received by lenders from borrowers "shall be considered for *all* purposes" as something other than interest. Therefore, assuming all of these other statutes are constitutional, the further assumption does not necessarily follow, that the Credit Insurance Act is constitutional.

### CONSTITUTION AS SELF-EXECUTING

In order to test the constitutionality of Section 6 of the Credit Insurance Act, an examination of the pertinent provision of the Texas Constitution and of the principles that apply to it must be made. Section 11 of Article XVI of the Constitution of Texas provides:

All contracts for a greater rate of interest than ten per centum per annum, shall be deemed usurious, and the first Legislature after this amendment is adopted, shall provide appropriate pains and penalties to prevent the same; but when no rate of interest is agreed upon, the rate shall not exceed six per centum per annum.

Of first importance is the fact that this section is self-executing to the extent that it renders all contracts for a greater rate of interest than ten per cent per annum illegal.<sup>17</sup>

In *Watson v. Aiken*,<sup>18</sup> the Supreme Court considered a case where a loan was made after the earlier constitutional prohibition against usury was adopted but before the Legislature had met in its first session and so had not yet provided for "appropriate pains and penalties to prevent and punish usury" as required by the Constitution. The court held:

When this loan was made the usury was illegal by virtue of the constitutional prohibition; and although it was left to the legislature

<sup>12</sup> Arts. 852-881b, TEX. REV. CIV. STAT. ANN. (1953).

<sup>13</sup> Art. 3.39, TEX. INS. CODE ANN. (1952).

<sup>14</sup> Arts. 6146-6161, 6165a, TEX. REV. CIV. STAT. ANN. (1949).

<sup>15</sup> Art. 1524a, TEX. REV. CIV. STAT. ANN. (1949), held constitutional in *Reams v. Fianace & Thrift Corp.*, 236 S.W.2d 185 (Tex. Civ. App. 1951). Condemned as unconstitutional in 31 TEXAS L. REV. 345 (1953).

<sup>16</sup> Art. 5074a TEX. REV. CIV. STAT. ANN. (Supp. 1956).

<sup>17</sup> *Hemphill v. Watson*, 60 Tex. 679 (1894); *Watson v. Aiken*, 55 Tex. 536 (1881); *Watts v. Mann*, 187 S.W.2d 917 (Tex. Civ. App. 1945) *error ref.*

<sup>18</sup> *Supra* note 17.

to prescribe pains and penalties to prevent and punish usury a contract for usurious interest was a contract in violation of law.<sup>19</sup>

*Hemphill v. Watson*<sup>20</sup> confirmed the decision of *Watson v. Aiken* and declared that Section 11, Article XVI of the Constitution is self-executing. The loan involved was made after the adoption of said section, but before the act of August 21, 1876 was passed, which prescribes certain penalties for usurious contracts.<sup>21</sup> The lender contended that since the loan was previous to the passage of this act there was no law against usury in force. The court rejected this argument, stating that the Constitution made usury a "quasi offense" which the Legislature was charged with suppressing and punishing. The court said:

This provision is prohibitory in its nature and self-executing so far as to render all contracts of the kind immediately illegal; and it left to the legislature the only remaining duty of saying what penalties should be imposed upon offenders against this clause of the constitution.<sup>22</sup>

*Watts v. Mann*<sup>23</sup> discussed in detail below, confirms the law in these decisions.

The law is conclusive that the Constitution itself prohibits usury and makes usurious contracts illegal regardless of legislative action. And the constitutional prohibition against usury being self-executing, it is conclusive that the Legislature is powerless to pass a constitutional statute that would make contracts for a greater interest than 10% per annum legal contracts rather than usurious contracts. The Legislature is powerless to pass a valid statute attempting to do this either directly or indirectly. Section 6 of the Credit Insurance Act is a statute that permits, indirectly, contracts for more than 10% interest per annum.

#### CONSTITUTIONAL MEANING OF "INTEREST"

Section 11, Article XVI of the Constitution is very clear. Its words are simple and specific; its meaning and intent apparent. *All* contracts for more than 10% interest per year are usurious and the Legislature has the duty to prevent usurious contracts. Section 6 of the Credit Insurance Act says commissions received by lenders

<sup>19</sup> 55 Tex. at 542.

<sup>20</sup> *Supra* note 17.

<sup>21</sup> This act is in part our present Art. 5071, TEX. REV. CIV. STAT. ANN. (1947), which prescribes certain penalties for usurious contracts.

<sup>22</sup> 60 Tex. at 681.

<sup>23</sup> *Supra* note 17.

shall not be "interest." The key word is "interest." As will appear, the only basis on which Section 6 of the Credit Insurance Act could be constitutional is that the commissions received by the lender can not constitute "interest." What is "interest?" It is not defined in the Constitution. But there is no doubt as to its meaning as used in the Constitution. The Constitution was framed with reference to the common law, and in judging what the Constitution means in using an undefined term, the common law definition applies.<sup>24</sup> "Interest" as known to the common law is defined as "a compensation usually reckoned by a percentage for the loan, use or forbearance of money."<sup>25</sup> The common law, at the time of writing and adoption of the Constitution of 1876 and at the time of its amendment in 1891 has included in the definition of "interest" any compensation for the use of money.<sup>26</sup> That this was the essential element in the definition of "interest" at common law is verified by the fact that all of the statutes defining interest have included the fundamental principle that it is compensation for the use of money.<sup>27</sup> The constitutional meaning of "interest" is therefore properly defined in our present-day statute.<sup>28</sup> Interest means today what it meant when the Constitution was adopted. Our Supreme Court has definitely approved the constitutional principle that the meaning which a constitutional provision had when it was adopted remains fixed. Its intent does not change with time nor with conditions. While it operates upon new subjects and changed conditions, it operates with the same meaning and interest which it had when formulated and adopted.<sup>29</sup>

#### ATTEMPTED LEGISLATIVE CHANGE

The constitutional meaning of interest today, as in the past, is that it is compensation for the use of money. And the Constitution, by a self-executing declaration, makes usurious all contracts which yield more interest than 10% per year as compensation for the use of money. And the Constitution by mandate casts upon the Legislature the duty to prevent such usurious contracts by pains and

<sup>24</sup> *Great Southern Life Ins. Co. v. City of Austin*, 112 Tex. 1, 243 S.W. 778 (1922).

<sup>25</sup> *Parks v. Lubbock*, 92 Tex. 635, 51 S.W. 322 (1899). The element of "detention" of money first appeared in Revised Statutes of 1879 so the later constitutional provisions against usury adopted the element of "detention" in the definition of interest.

<sup>26</sup> *Ibid.*

<sup>27</sup> Art. 2972, TEX. CIV. STAT. (1879); Art. 3097, TEX. CIV. STAT. (1895); Art. 5069, TEX. REV. CIV. STAT. ANN. (1947).

<sup>28</sup> Art. 5069, TEX. REV. CIV. STAT. ANN. (1948).

<sup>29</sup> *Cramer v. Sheppard*, 140 Tex. 271, 167 S.W.2d 147 (1943); *Travelers Insurance Co. v. Marshall*, 124 Tex. 45, 76 S.W.2d 1007 (1934).

penalties.<sup>30</sup> Yet in the face of the above, Section 6 of the Credit Insurance Act has attempted to remove from the meaning of "interest," premiums and commissions for credit insurance which may be received by the lender from the borrower, in fact and intent, as compensation for the use of money. It attempts to do this by saying that such commissions "shall not be taken to be an interest charge on the money borrowed" and that such commissions "shall be considered for all purposes as compensation for services rendered to such insurer." By these words, the Legislature has attempted to change the constitutional meaning of "interest" contrary to the constitutional principle that that meaning shall remain the same as when adopted. By these words, the Legislature has not only attempted to avoid the constitutional mandate to *prevent* usurious contracts by pains and penalties; it has actually gone conversely to such mandate by *permitting* usurious contracts. These things the Legislature has no power to do under the Constitution and the law as declared by the Supreme Court.<sup>31</sup>

In *Snyder v. Baird Independent School District*, it was stated:

It is insisted that the Legislature and the officers of the state have construed the Constitution different to our interpretation, therefore that construction should prevail; but neither the Legislature nor any officer of the state has the power to annul a provision of the Constitution and thereby deprive the citizen of this state of the protection guaranteed to them by that instrument.<sup>32</sup>

In *Cramer v. Sheppard*, the Supreme Court declared:

By the adoption of the foregoing amendments to the Constitution the people of this state clearly expressed their will on this question, and those who are called upon to construe the Constitution are not authorized to thwart the will of the people by reading into the Constitution language not contained therein, or by construing it differently from its plain meaning. The people have the sole power to change or modify the plain language adopted by them. Until that is done, it remains the supreme law of the land, and should be obeyed.<sup>33</sup>

In *Jones v. Ross*, the question involved was whether Section 26 of Article XVI of the Constitution, creating an action for exemplary damages for survivors of one killed by willful act or omission or gross neglect, was affected by subsequent statutes enacted for the protection of workmen on buildings. The Supreme Court held that legislative enactments could not change the constitutional cause of

<sup>30</sup> *Carder v. Knippa Mercantile Co.*, 1 S.W.2d 462 (Tex. Civ. App. 1927) *error dismissed*.

<sup>31</sup> See *Thompson v. Kay*, 124 Tex. 252, 77 S.W.2d 201, 214 (1934).

<sup>32</sup> 102 Tex. 4, 111 S.W. 723, 725 (1908).

<sup>33</sup> 140 Tex. 271, 167 S.W.2d 147, 154 (1943).



action and used the following language appropriate to the subject matter of this article:

It is the settled law of this State that the provisions of our State Constitution mean what they meant when they were promulgated and adopted, and their meaning is not different at any subsequent time. Constitutional provisions must be construed in the light of conditions existing at the time of adoption, and it does not lie within the power of the Legislature to change their meaning, or to enact laws in conflict therewith. *Travelers Ins. Co. v. Marshall*, 124 Tex. 45, 75 S.W.2d 1007, 96 A.L.R. 802; *Cramer v. Sheppard*, Tex. Sup., 167 S.W.2d 147. It follows that Section 26 of Article 16 of our Constitution only operates to allow exemplary damages for homicide by wilful act or omission, or gross neglect, in the classes of exemplary damage cases in existence at the time it was adopted. At such time Articles 1582 and 5182 of our Statutes had never been enacted. They therefore cannot affect such cases one way or the other.<sup>34</sup>

Actually there are stronger reasons for applying these constitutional principles to outlaw Section 6, Credit Insurance Act, for not only is Section 6 in conflict with the meaning of Section 11 of Article XVI of the Constitution, it is also counter to the duty cast upon the Legislature by that section of the Constitution, to prevent usurious contracts by pains and penalties.<sup>35</sup>

This is a legislative attempt to change the clear meaning of the constitutional provisions on usury. The Legislature can no more set such provisions aside than it could the constitutional provisions involved in *State v. Hatcher*<sup>36</sup> which provided that payment under oil and gas leases on university land should go to the "permanent university fund." The Legislature passed a statute providing that such funds should go to the "special building fund." The Supreme Court held the statute to be void, declaring that neither the Legislature nor the courts can set aside clear constitutional provisions; the people alone through constitutional amendments have power to change the Constitution.

#### CONSTITUTIONAL DUTIES AND RESTRICTIONS UPON THE LEGISLATURE

There is a further constitutional principle that mitigates against the validity of Section 6 of the Credit Insurance Act. Our Constitution is not a grant of power by the people to the Legislature, but operates as a limitation of power whereby all power not limited by the Constitution inheres in the people, and acts of the Legislature

---

<sup>34</sup> 141 Tex. 415, 173 S.W.2d 1022, 1024 (1943).

<sup>35</sup> *Supra* note 30.

<sup>36</sup> 115 Tex. 332, 281 S.W. 192 (1926).

are legal when the Constitution contains no express or implied prohibition against them.<sup>37</sup> Our constitutional provisions are also mandatory, not merely directory, so it is incumbent on the Legislature, in exercising its power within the limitations of the mandatory provisions of the Constitution, to enact such legislation as might be necessary to carry out the purposes set out in such provisions,<sup>38</sup> but not to enact legislation that is implicitly prohibited by the mandatory provisions, or contrary to the purposes set out in such provisions.<sup>39</sup>

*Watts v. Mann*<sup>40</sup> is squarely in point. A little history will serve to give better insight to the meaning of Section 11, Article XVI of the Constitution as a limitation of power on the Legislature. Prior to 1943 there was no legislation giving the state power to enjoin money lenders from charging usurious rates. Nevertheless, the Attorney General in 1939 filed a civil suit against numerous money lenders seeking to enjoin them from collecting usurious interest, on the theory that their activities constituted a public nuisance. The Supreme Court held that the state did not have the power to enjoin money lenders from charging usurious rates.<sup>41</sup>

The basis for the decision was that the constitutional provision of Section 11 places upon the Legislature the duty to provide appropriate pains and penalties to prevent usury; that the same constitutional provision did not constitute the charging or collection of interest a nuisance of any kind, much less a public nuisance, and therefore there was no jurisdiction for an injunction since charging usurious interest is not a public nuisance. The case was further based on the fact that the Legislature had provided a penalty for charging usurious interest under Article 5073 and had also provided that usurious interest shall be void under Article 5071 and that all rights, penalties and remedies provided for had been given exclusively to the borrower and no effort had been made to award the state any remedies. It was concluded that the court had no power to add to or take away from such legislative pains, penalties and remedies.

As a direct consequence of that decision, the Legislature in 1943 passed Article 4646b<sup>42</sup> (popularly known as the Loan Shark Act)

<sup>37</sup> *Watts v. Mann*, 187 S.W.2d 917 (Tex. Civ. App. 1945) *error ref.*

<sup>38</sup> *Hunt v. State*, 22 Crim. App. 396, 3 S.W. 233 (1886); *San Antonio & A.P. Ry. Co. v. State*, 79 Tex. 264, 14 S.W. 1063 (1891). *City of Denison v. Municipal Gas Co.*, 257 S.W. 616 (Tex. Civ. App. 1923), *aff'd*, 117 Tex. 291, 3 S.W.2d 794 (1928).

<sup>39</sup> *Supra* notes 28, 30, 32 and 33.

<sup>40</sup> 187 S.W.2d 917 (Tex. Civ. App. 1945) *error ref.*

<sup>41</sup> *Ex parte Hughes*, 133 Tex. 505, 129 S.W.2d 270 (1939).

<sup>42</sup> TEX. REV. CIV. STAT. ANN. (Supp. 1956).

giving the Attorney General and District and County Attorneys the right to institute suits to enjoin habitual money lenders from contracting for, demanding or receiving usurious interest. Walter Watts and twenty-nine other money lenders brought a suit against the Attorney General and others seeking a declaratory judgment that the Loan Shark Act was invalid and asking an injunction against its enforcement. The Attorney General by cross-action asked for the injunctive relief afforded by the Loan Shark Act. Watts *et al.* appealed the trial court judgment against them.

Watts attacked the validity of the Loan Shark Act on five different grounds, the first of which is the only one important to this discussion. It was argued that under Section 11, Article XVI of the Constitution, the Legislature is authorized to prevent usury only by providing "pains and penalties" which does not include injunctions.

The theory advanced was that the constitutional reference to "pains and penalties" was a grant of power to the Legislature and that the Legislature could exercise its power only within the exact words of the grant. Therefore, it was argued, the Legislature could enact laws prescribing "pains and penalties" exclusively and hence had no power to pass laws to permit injunctions. The court held, however, that the Constitution is not a grant of power, but operates as a limitation of power whereby all power which is not limited by the Constitution inheres in the people, and the action of the Legislature is legal when the Constitution contains no prohibition, express or implied, against it. It was concluded that Section 11 of Article XVI imposed no inhibitions against the enactment of the Loan Shark Act since there was no prohibition, expressed or implied, against permitting injunctions to prevent usury as well as other "pains and penalties." Such use of injunctions clearly follows the intention of the Constitution that the Legislature prevent and penalize usurious contracts.

The clear and definite basis for the holding in *Watts v. Mann* is that Section 11, Article XVI of the Constitution operates as a limitation of power on the Legislature under which the Legislature can pass a valid statute giving the state injunctive powers to prevent usury, there being no constitutional prohibition expressed or implied against such means to prevent usury. Further, the statute tends to carry out the expressed purpose of the Constitution that the Legislature pass laws to prevent usury. Implicit in the holding is that there is a constitutional prohibition against the Legislature passing a

statute that will permit usury rather than prevent it contrary to the expressed purpose of the Constitution.

That the Legislature cannot restrict the constitutional mandate to prevent usury in any way is exemplified by *Dunman v. Harrison*,<sup>43</sup> where it was argued by the lender that what is now Article 5071, in using the term "written contracts," meant that only written contracts for more than 10% interest were usurious and therefore the contract involved, being partly written and partly oral, was not usurious. The court rejected this argument because the Constitution applies to *all* contracts, so if the statute restricted the constitutional declaration to written contracts "the restrictive feature of the statute should be held to be in violation of the more comprehensive and emphatic declaration of the constitution."<sup>44</sup>

#### EFFECT OF SECTION 6

Section 6 declares that commissions received by lenders "shall be considered *for all purposes* as compensation for services rendered to such insurer and *shall not be taken to be an interest charge on the money borrowed.*" (emphasis supplied) This forecloses any inquiry as to whether the credit insurance is written for the bona fide purpose of giving security to the lender or for the illegal purpose of securing additional interest beyond that allowed by the Constitution for the use of money. Even though such lender swears under oath that he is by this means extracting usurious interest, Section 6 says it is not interest but it is "for all purposes" compensation for services rendered to the credit insurance company. Even though it be proved as an unquestioned fact that thousands of small loan lenders in Texas receive millions of dollars each year<sup>45</sup> in the form of credit insurance commissions for the illegal purpose of securing additional compensation beyond that allowed by the Constitution, Section 6 says these millions of dollars "shall not be taken to be an interest charge on the money borrowed" and it declares that these millions of dollars "shall be considered for all purposes as compensation for services rendered" to the credit insurer. This analysis reveals that Section 6 has the effect of saying that black is white; that bad is

<sup>43</sup> 41 S.W. 499 (Tex. Civ. App. 1897).

<sup>44</sup> 41 S.W. at 500.

<sup>45</sup> Premiums reported to the Board of Insurance Commissioners are set out in "Texas Earned Premiums and Paid Losses for Credit Life, Health and Accident Insurance, Five Years Experience Ending December 31, 1955," Exhibit A to *Transcript of Proceedings, Public Hearing on Credit Insurance*, April 3, 1956, as follows: 1951: \$4,103,695; 1952: \$10,593,865; 1953: \$12,333,266; 1954: \$16,263,202, and 1955: \$22,513,464 — a total of the five years of \$65,807,592. The paid losses for the five years were \$5,642,969, for a loss ratio of 13.2%.

good; that interest is not interest. It thus seems beyond question that Section 6 is patently unconstitutional because it attempts to make contracts for a greater rate of interest than 10% per annum legal by declaring certain compensation not interest, which in fact and under the Constitution is interest.

Section 6 further provides that should such commissions "be in excess of any maximum fixed hereunder, then such commissions shall be deemed to be an interest charge on the money borrowed." Under this provision, the maximum commission could be fixed so high—or not fixed at all—that the lender could extract well over the 10% interest allowed by the Constitution and yet not exceed the maximum.

In actual practice, the latter situation exists, for the Board of Insurance Commissioners has never fixed a maximum charge for commissions. A lender can receive 100% of the premiums as commissions and such commissions would not be excessive under the Credit Insurance Act and the regulations as they now stand. The usual commission retained by the small loan lender is 85% of the premiums.<sup>46</sup> There can be no argument that the lender's main purpose in retaining said commission is to secure more compensation for the use of his money.<sup>47</sup> And although such commission is in addition to the 10% interest the lender also charges, such commission, not being in excess of a nonexistent maximum, can't "be deemed to be an interest charge on the money borrowed" under Section 6. So again Section 6, along with the nonaction of the Board of Insurance Commissioners, has the effect of declaring that which is in fact interest, not interest.

Section 6, in declaring "shall be considered *for all purposes* as compensation for services rendered to such insurer and *shall not be taken to be an interest charge on the money borrowed*" (emphasis supplied), is in effect an attempt to refute the many decisions and assertions by the Texas courts that in deciding whether the loan

---

<sup>46</sup> A typical case reflecting proof of such percentage of commissions is *Advance Loan Service v. Mandick*, No. 78519-C, 68th District Court, Dallas (now pending appeal), where the records of Home Life & Accident Ins. Co. were introduced. See also *Ware v. Paxton*, 266 S.W.2d 218, 223 (Tex. Civ. App. 1954) *error ref. n.r.e.* See testimony of James Donhain, *Transcript of Proceedings, Public Hearing on Credit Insurance*, Sept. 4, 1951, p. 43.

<sup>47</sup> Authorities cited notes 6 and 46 *supra*, and jury findings of lenders' purposes in the following cases: *Clanton v. Community Finance & Thrift Corp.*, 262 S.W.2d 252 (Tex. Civ. App. 1953); *Ware v. Wright*, 266 S.W.2d 188, 190 (Tex. Civ. App. 1954); *Ware v. Paxton*, 266 S.W.2d 218, 223 (Tex. Civ. App. 1954) *error ref. n.r.e.*; *Industrial Finance Service Co. v. Riley*, 295 S.W.2d 498, 506 (Tex. Civ. App. 1956) *error granted*.

was usurious, the courts will disregard the form and look to the substance of the transaction.<sup>48</sup>

Likewise, it refutes the many decisions that all devices conjured by lenders to conceal usury will be disregarded.<sup>49</sup> Further, it refutes the many decisions that the courts look to the intentions,<sup>50</sup> because the intent to take usury constitutes the offense.<sup>51</sup>

Section 6 would seem to preclude the submission to the jury of a special issue as to whether credit insurance premiums were charged to the borrower for the purpose of obtaining usury.<sup>52</sup>

Section 6 of the Credit Insurance Act also has the effect of attempting to refute those decisions which take the realistic view of the transactions involved and if it is found that the contracts, business arrangements and practices constitute a mere disguise under ostensible legal forms to conceal the business of charging and collecting usurious interest, the element of the actual intent of the parties is not essential.<sup>53</sup> Proof of actual intent is no more essential under these circumstances than it is where the loan contract on its face expressly shows that more than the legal rate of interest is being charged.<sup>54</sup> The law laid down in the cases supporting the above statement is especially applicable to the tie-in sales of credit insurance with small loans. Such transactions are strictly analogous to the "tie-in" of required brokerage or bonus ar-

<sup>48</sup> *Graham & Locke Investment Co. v. Madison*, 295 S.W.2d 234, 243 (Tex. Civ. App. 1956) *error ref. n.r.e.*; *Autocredit of Ft. Worth, Inc., v. Pritchett*, 223 S.W.2d 951 (Tex. Civ. App. 1949) *error disp.*; *Schmid v. City National Bank*, 132 Tex. 115, 114 S.W.2d 854 (1938); and cases cited in 42 TEX. JUR., *Usury* §8 (1936).

<sup>49</sup> *Glenn v. McCarty*, 130 S.W.2d 295 (Tex. Civ. App. 1939), *aff'd*, 137 Tex. 608, 155 S.W.2d 912 (1941); *Glover v. Bushman*, 104 S.W.2d 66 (Tex. Civ. App. 1937) *error disp.*; *Standard Supply and Hardware Co. v. Christian-Carpenter Drilling Co.*, 183 S.W.2d 657 (Tex. Civ. App. 1944) *error ref.*; and cases cited in 42 TEX. JUR., *Usury* §8, note 19 (1936).

<sup>50</sup> *Graham & Locke Investments v. Madison*, 295 S.W.2d 234, 243 (Tex. Civ. App. 1956) *error ref. n.r.e.*; *Temple Trust Co. v. Sewell*, 133 Tex. 417, 126 S.W.2d 943 (1939); and cases cited in 42 TEX. JUR., *Usury* §8, note 19 (1936).

<sup>51</sup> *Henry v. Sanson*, 21 S.W. 69 (Tex. Civ. App. 1893); *Walker v. Temple Trust Co.*, 124 Tex. 575, 80 S.W.2d 935 (1935); and cases cited 42 TEX. JUR., *Usury* §18, note 15 (1936).

<sup>52</sup> But apparently such an issue was permitted in *Industrial Finance Service Co. v. Riley*, 295 S.W.2d 498 (Tex. Civ. App. 1956) *error granted*.

<sup>53</sup> *Sledge v. Murphy*, 284 S.W.2d 938 (Tex. Civ. App. 1955); *Donoghue v. State*, 211 S.W.2d 623 (Tex. Civ. App. 1948) *error ref. n.r.e.*; *Federal Mortgage Co. v. State Nat. Bank of Corsicana*, 254 S.W. 1002 (Tex. Civ. App. 1923) *error disp.*; *Joy v. Provident Loan Society*, 37 S.W.2d 254 (Tex. Civ. App. 1931) *error disp.*; *Commerce Trust Co. v. Best*, 54 S.W.2d 1037 (Tex. Civ. App. 1932), *judgment reformed and aff'd*, 124 Tex. 583, 80 S.W.2d 942 (1935). And see *Graham & Locke Investments v. Madison*, 295 S.W.2d 234, 243 (Tex. Civ. App. 1956) *error ref. n.r.e.*

<sup>54</sup> *Hemphill v. Watson*, 60 Tex. 679 (1894); *Walker v. Temple Trust Co.*, 124 Tex. 575, 80 S.W.2d 935 (1935); *Joy v. Provident Loan Society*, 37 S.W.2d 254 (Tex. Civ. App. 1931) *error disp.*

rangements,<sup>55</sup> coupon arrangements,<sup>56</sup> collateral contract arrangements,<sup>57</sup> and investment certificate arrangements,<sup>58</sup> all of which have been struck down when the facts revealed that the arrangements resulted in the lenders receiving a greater compensation than 10% per annum for the use of their money.

#### STATISTICS SHOWING INTENT

Official figures issued by the Board of Insurance Commissioners of earned premiums and paid losses for credit life, health and accident insurance for five years ending December 31, 1955, are very revealing.<sup>59</sup> These are the companies' own figures as reported to the Board of Insurance Commissioners. They indicate quite conclusively that the purpose of most lenders in writing credit insurance is not for the security of their loan but for the added compensation obtained thereby.

During 1951 and 1952 the Board set the highest maximum rate for premiums to be charged for health and accident insurance on the "6 day retroactive" policy. Consequently almost all health and accident policies written by the lenders were the "6 day retroactive" policies.

In 1951 out of \$3,545,716 in premiums reported for writing health and accident policies, \$3,032,524 was for the "6 day retroactive" type. This amounts to 85.53% of the total.

In 1952 out of \$8,774,559 in premiums for health and accident policies, \$7,697,350 was for the "6 day retroactive" type, or 87.72% of the total.

In 1953 out of \$9,438,686 in health and accident premiums \$7,701,089 was for "6 day retroactive," or 81.59% of the total.

On December 2, 1952, new regulations were issued setting forth maximum premium rates to be charged for credit insurance, and these regulations provided that "3 day retroactive" health and accident policies could also contain hospitalization and confinement benefits with the right to charge higher premiums for such benefits.<sup>60</sup> These

---

<sup>55</sup> *Donoghue v. State*, 211 S.W.2d 623 (Tex. Civ. App. 1948) *error ref. n.r.e.*

<sup>56</sup> *Glover v. Buchman*, 104 S.W.2d 66 (Tex. Civ. App. 1937) *error dism.*

<sup>57</sup> *Waxahachie Loan & Trust Co. v. Turner*, 74 S.W. 792 (Tex. Civ. App. 1903).

<sup>58</sup> *Citizens Industrial Bank of Austin v. Schmidt*, 112 S.W.2d 513 (Tex. Civ. App. 1937) *error dism.*

<sup>59</sup> Exhibit A, *supra* note 45.

<sup>60</sup> *Official Minutes of Meeting, Board of Insurance Commissioners*, Austin, Texas, Dec. 2, 1952. This regulation itself may be illegal under Sec. 5 of the Texas Credit Insurance Act, which permits only one policy of life and one policy of health and accident insurance, or both, on one loan. See *Hartridge v. Home Life & Accident Ins. Co.*, 246 S.W.2d 666, 670 (Tex. Civ. App. 1951).

regulations permitted lenders to charge the highest premiums for "3 day retroactive" instead of "6 day retroactive." These regulations did not become effective until March 1, 1953, and consequently the lenders could not take advantage of their provisions during 1953.

In 1954 out of a total of \$11,088,263 in health and accident premiums, \$9,265,273 was for the writing of "3 day retroactive." Thus the now highest maximum premium, "3 day retroactive," comprised 83.56% of the total premiums collected, while the former highest premium insurance had dropped to only 3.84% of the total.

In 1955 out of a total of \$14,614,850 in health and accident premiums, \$12,774,266 was for the "3 day retroactive" policies, for 87.41% of the total, while the "6 day retroactive policies amounted to only \$616,286 for a percentage of 4.22% of the total.

There can be little doubt that most of the lenders followed the practice of arbitrarily writing the insurance for which they could charge the highest premium and thereby secure the greatest compensation. Security for the loan cannot be the intent of such lenders. Why were they more secured in their loans in 1951, 1952, and 1953 with "6 day retroactive" insurance rather than "3 day retroactive" insurance, and then more secured in their loans in 1954 and 1955 with "3 day retroactive" insurance rather than "6 day retroactive" insurance? The necessitous borrower would not invariably purchase on his own volition the insurance that cost him the most.

The figures for the five-year period are also very significant with regard to the amounts of premiums received for "level life" credit insurance and the premiums received for "reducing life" credit insurance. If security of the loan was really the purpose of the lender in selling credit life insurance, a reducing life credit insurance policy would give him complete security, and in the case of the necessitous borrowers of small loans it would seem that the lender would want to write such a policy for him, since it costs only half as much as the "level life" insurance policy. However, throughout the five-year period premiums collected for "level life" policies have been consistently and substantially greater than those for "reducing life."<sup>61</sup>

That added compensation for the use of their money is the real motive of the lenders is also revealed by the loss ratio figures. Invariably the lowest loss ratio each year during the five-year period is on the type insurance for which the highest premiums were charged. In 1951 the loss ration for "6 day retroactive" insurance was 12.99%; in 1952 it was 8.78%; in 1953 it was 7.93%. In 1954 the

---

<sup>61</sup> Exhibit A, *supra* note 45.



loss ratio for "3 day retroactive" insurance was 8.20% and in 1955 it was 8.84%.<sup>62</sup> This low loss ratio also explains how the small loan offices are able to retain 85% of the premiums as commissions and the credit insurance companies, even those who do not own the loan company, are still able to make a profit.

The official records of the Board of Insurance Commissioners also reveal the admitted purpose behind the Credit Insurance Act as expressed by Frank Cain, a strong sponsor and vigorous defender of the act. Mr. Cain stated to the Board:

Now, what has come about is simply this, had to make a choice, couldn't go before the people of Texas and we have got a constitution I would never advocate be changed, too many abuses when you don't have a constitutional limitation on interest (sic). So, as we came along here, here was a means by which we could give the people of Texas a loan insurance properly regulated *at a rate where the yield through the commission to the lending agent together with the interest that be charged would not exceed that which is recommended by everybody as not being more than 40 per cent.* And that we would still be giving the people of Texas something for their money and yet providing a means for keeping the independent lending agent in business. (Emphasis supplied).<sup>63</sup>

The real purpose behind this act is emphasized by the following question by former Insurance Commissioner Paul B. Brown and Mr. Cain's answer thereto:

[Commissioner Brown] Well now, isn't this scheme of this credit insurance partially lying behind the fact that the lender can't make enough money at 10 per cent and he wants to get a high rate commission paid on insurance so he can get the insurance instead of lending money?

[Mr. Cain] No, sir. Let me say this, it is a universally recognized thing, uncontroverted, that you cannot loan money of \$250.00 on down for any 10 per cent simple interest and stay in business. Nobody can do that, not even the great Household Finance Corporation. Either depart from the constitution prohibition or got to supplement that income with something. That is logical, beneficial and a welfare to the public itself, and that's what a credit insurance is.<sup>64</sup>

#### SIMILAR ARKANSAS ACT HELD UNCONSTITUTIONAL

The case of *Stricker v. State Auto Finance Co.*,<sup>65</sup> decided by the

<sup>62</sup> *Ibid.*

<sup>63</sup> *Transcript of Proceedings, Public Hearing on Credit Insurance*, Board of Insurance Commissioners, Austin, Texas, Sept. 4, 1951, p. 36. Frank Cain's law firm has represented small loan lenders and he formerly was chairman of the board of one of the largest credit insurance companies in Texas.

<sup>64</sup> *Ibid.* at 39.

<sup>65</sup> 220 Ark. 565, 249 S.W.2d 307 (1952).

Supreme Court of Arkansas, substantiates the analysis and conclusions reached in this article. Arkansas has a constitutional prohibition against usury similar to that of Texas.<sup>66</sup> In 1951 the Arkansas Legislature passed the "Arkansas Installment Loan Law"<sup>67</sup> which authorized lenders to make and collect certain service charges and collect premiums from borrowers for credit life and credit health and accident insurance as additional profit on loans. The court ruled unconstitutional those sections of the act purporting to authorize the collection of charges of more than 10% per annum, regardless of the definition given or the label attached to the particular charge by the Legislature. The following observations by the court are particularly pertinent to the subject matter of this article:

It is further provided in subsection (c) that "such charges shall not be considered to be interest or compensation for the use or forbearance or detention of money." Contracts including this and similar provisions have been repeatedly condemned by this court as ineffectual devices to evade the Constitution . . . .

When these sections are considered [together] there arises in our opinion a legislative intent to authorize the collection of more than 10 per cent interest in violation of the Constitution. Even if we are wrong in this conclusion and there was only the intent to allow charges that have been approved by this court, still these sections would so handicap a necessitous borrower as to render impotent his constitutional right to invalidate as usurious a contract made pursuant to the Act. The Constitution directs the enactment of laws to prohibit, and not to permit, usury. The invalidity penalty is designed to protect borrowers from imposition and usurious oppression at the hands of rapacious lenders. An attempt by the Legislature to take from the borrower this constitutional shield is just as effective as a direct authorization to the lender to make usurious charges in the first instance. While the Act is ingeniously drawn, the fact remains that the above-mentioned subsections would nullify rights of a borrower which the framers of our fundamental law intended to preserve.<sup>68</sup>

The Court then discussed the credit insurance aspect as follows:

We next consider the insurance charges of \$28.20. The evidence disclosed that these charges, as well as the \$24 service charge, were made after consultation and advice with those officials who sponsored Act 203 and are charged with its enforcement. Appellee's insurance operations were fully sanctioned as being authorized by and in conformity with §27(f) of the Act. Although appellant apparently

<sup>66</sup> ARK. CONST. art. 19, § 13 provides: "All contracts for a greater rate of interest than ten percent per annum shall be void, as to principal and interest, and the General Assembly shall prohibit the same by law; but when no rate of interest is agreed upon, the rate shall be six per centum per annum."

<sup>67</sup> ARK. STAT. ANN. §§1301-37 (Supp. 1951).

<sup>68</sup> 249 S.W.2d at 312, 313.

furnished ample security for the loan by a mortgage on her household furniture, which could have been insured for a small premium, she was required to purchase both life and health policies which she did not want, or need, and which she could ill afford to purchase. We cannot agree with appellee's contention that this requirement represents a proper charge made under a valid collateral agreement. . . .

Section 35 of Act 203 attempts to authorize registrants to receive commissions on insurance premiums as a profit on a loan in addition to the various other charges authorized by the Act. The facts in the instant case demonstrate the abuses that are bound to arise when such authority is exercised by a lender in connection with the further authority to require life and health insurance in all cases under §27(f) without regard to the needs of the borrower. We conclude that the insurance charges made in this case were usurious and unauthorized under the Constitution and that said §§35 and 27(f) are invalid insofar as they purport to validate such charges.<sup>69</sup>

#### SUMMARY AND CONCLUSIONS

Does the Texas Credit Insurance Act "legalize usury"? The answer is *no*. But it attempts to do so. The answer is no because our Constitution contains a self-executing mandatory prohibition against usury; therefore the Legislature has no power to "legalize" usury in any manner. Section 6 of the Texas Credit Insurance Act attempts to legalize usury by indirectly changing the constitutional meaning of "interest" in such a way as to permit usury. Such attempt is unconstitutional because the Legislature has no power to so change the meaning of interest; it has the mandatory duty to prevent usury and consequently is prohibited from permitting usury by any indirect means. Any argument that the Legislature has the constitutional power to change the meaning of interest as has been attempted by Section 6 of the Texas Credit Insurance Act, must necessarily lead to the indefensible conclusion that the Legislature has the power to nullify Section 11, Article XVI of the Constitution. It is the writer's opinion, based on collateral research in writing this article, that Texas is in desperate need of a comprehensive, modern and effective small loan law. But it is also the writer's opinion, based on the obvious conclusions to be drawn from the analysis made in this article, that there must be a constitutional amendment of Section 11, Article XVI in order for such small loan law to be valid.

For all Texans who are interested in our small loan problems and especially for those who have the responsibility of carrying out the will of the citizens of Texas as expressed in the constitutional provision on usury, the following is quoted from United States Senator

---

<sup>69</sup> 249 S.W.2d at 313.

William Langer's subcommittee report on "The Tie-in Sale of Credit Insurance in Connection With Small Loans and Other Transactions":

To those individuals who abhor the thought of Federal interference with the business of insurance, who desire the continued regulation of the industry by the several States, the subcommittee has this final admonition:

This subcommittee will not allow itself to be blinded by subterfuge. Neither will it turn a deaf ear to those of our citizenry oppressed by the coercive practices related in this report. The citizens of Kansas and the other several States likewise are citizens of the United States. While these abuses here related continue, this subcommittee will not forever accept "attempts" at regulation as a substitute for regulation of the business of insurance by the States. The patience of the Federal Government with those who would abuse the good name of insurance some day may come to an end.<sup>70</sup>\*

---

<sup>70</sup> S. Doc. No. 57921, 83rd Cong., 2d Sess. 14 (1955).

\* The author acknowledges with appreciation assistance in the form of a research grant from the Southwestern Legal Foundation.