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Money, Mortgages, and Migraine—
The Usury Headache

Marion Benfield*

The usury headache, Professor Benfield asserts, results from the failure of present State usury prohibitions to operate effectively. A foundation for fully understanding the usury problem is provided by the author's discussion of the rationale for and historical development of usury regulation, which is followed by a comprehensive examination of the current statutory schemes. In his evaluation of the applicable statutes, the author emphasizes that numerous exceptions, exemptions, and avoidance techniques have the effect of nullifying many statutory provisions with the result that over one-half of our total private debt is not subject to usury regulation. To cure the headache, Professor Benfield argues that the Uniform Consumer Credit Code be adopted by the States. It is argued that Consumer Code provisions will result in realistic interest rate ceilings, increased competition in the credit marketplace, and full disclosure to the borrower of the applicable rates, thus serving to bring equity and order to this confused area.

INTRODUCTION

WEBSTER'S DICTIONARY defines migraine as a "kind of nervous headache, usually periodical, and confined to one side of the head." That description fits the usury problem in the United States in this century. It has arisen in acute form periodically, at times when the general money market interest level approaches the interest rate ceiling of many States. Further, like the migraine headache, the usury problem (because of the exemptions from the general usury statutes in various States) is confined to a part of the total lending market. Similarly, the usury headache may be characterized as a nervous or neurotic one, based upon an attachment to usury laws which does not seem to be rational and which substantially ignores the realities of money market and interest rate behavior.

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In spite of the fact that this country has never seriously considered price fixing of goods and services except in times of national emergency, all States except two impose maximum prices for the use of money; however, because of various exclusions and special higher rates for particular transactions, less than one-half of the total amount of lending is subject to the general usury statutes. Further, the usury laws often do not have the supposed effect of fixing a rate ceiling even as to loans nominally subject to them. When the general money market level or the risk or cost involved in the particular transaction makes the usury rate unrealistically low, there are many devices, some clearly approved by the courts, some clearly disapproved, and some untested but trusted, which are used to produce a reasonable return.

Even though general usury laws have substantially less impact than might be supposed, in times of "tight money" they do operate to create artificial barriers to the flow of money into States with low statutory ceilings and to entice money out of these States into States with higher rates. They also operate selectively to impose on certain borrowers, primarily the homebuilding industry, the burden of cutting back production in the face of a tight money market. Furthermore, even in times of "easy money," usury laws substitute legislative judgment for private judgment as to how credit worthy the borrower should be in order to secure a loan. For instance, in a State which applies a 6 percent maximum rate to loans to non-corporate businessmen, those whose situation calls for a higher rate to compensate the lender for greater risk may be denied access to the legal credit market.

The position here taken is that laws fixing ceilings on the price which may be charged for the use of money are no more desirable than any other form of price fixing, except in the case of consumer and small business credit where it is desirable to protect the necessitous or unsophisticated borrower against the overreaching credit supplier. Ironically, all States except Arkansas have recognized that the risks and costs of lending are such that the general usury rates

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1 The general money market interest level approached the interest rate ceiling of many States in the 1920's, the early 1950's, and several times in this decade.
2 See notes 165-90 infra & accompanying text.
3 See notes 191-237 infra & accompanying text.
are too low for consumer loans and have passed special legislation authorizing higher rates for consumer transactions.\textsuperscript{4}

As long ago as 1786, Jeremy Bentham gave rather conclusive economic arguments against general usury laws,\textsuperscript{5} and in England,\textsuperscript{6} in many European countries, and in many other countries of the world there have been no general usury laws for a hundred years.\textsuperscript{7} But in most of our States they linger on to present obstacles to the freedom of businessmen to pay appropriate prices for appropriate risks and to create artificial barriers to, and artificial channels for, the flow of money from State to State. The foregoing words are, it is realized, fighting words to many, particularly to those who have only occasional contact with the money market and who think primarily of the consumer borrower when they think of usury laws. So that the position taken in this article will not be misunderstood, it should be emphasized again that the one area in which control of rates by statute is clearly needed is that of small consumer loans. However, the general usury laws do not operate in this area except in one State and except as to home mortgage loans. The position taken herein is that in the home mortgage loan area usury statutes do more harm than good; low interest home mortgage loans, if they are to be encouraged, must be encouraged through special governmental programs directed particularly to them. The present general usury laws do not have the desired effect.\textsuperscript{8}

This article will discuss briefly the history, theory, and effect of

\textsuperscript{4}See notes 62-130 infra & accompanying text.

\textsuperscript{5}Bentham, \textit{Letters in Defense of Usury}, in 3 \textit{Jeremy Bentham's Works} 1-29 (1843).

\textsuperscript{6}The Usury Laws Repeal Act of 1854, 17 & 18 Vict., c. 90. The Moneylender's Act of 1900, 63 & 64 Vict., c. 51, § 1 as amended by the Moneylender's Act of 1927, 17 & 18 Geo. 5, c. 21, § 10 provides that, if a court finds that the interest charged is excessive or the transaction is harsh and unconscionable, the court may reopen the transaction and reduce the interest to a level deemed by the court to be fair. A rate of more than 48 percent per year is presumptively excessive.

\textsuperscript{7}Denmark, Spain, Holland, Norway, Sweden, and Belgium abolished statutory limits on interest ceilings in the mid-19th century. R. Palgrave, 2 \textit{Palgrave's Dictionary of Political Economy} 433-34 (H. Higgs ed. 1925), \textit{cited in} Merriman & Hanks, Revising State Usury Statutes in Light of a Tight Money Market, 27 Md. L. Rev. 1, 8 n.47 (1967). The current Martindale-Hubbell foreign law summaries indicate that Belgium, Denmark, Finland, Italy, The Netherlands, Spain, and Sweden presently prescribe no statutory maximum interest rate. See the "interest" entry in the digests for these countries in 5 \textit{Martindale-Hubbell Law Directory} (100th ed. 1968). Generally, in these countries the courts would be able to set aside or reduce the interest charged if the court found the rate unconscionable or unreasonably high. The digest states the present French rule to be: "Usury is defined as interest exceeding [by] 25% ... [the] ordinary rate applied by banks for similar operations." \textit{Id.} at 2949.

\textsuperscript{8}See notes 191-237 infra & accompanying text.
usury statutes, the elements involved in fixing the price for the use of money, the present general usury statutes in the United States and the statutory and judicial exceptions to them. It will then consider the present effectiveness and effect of usury statutes and will conclude with a discussion of the Uniform Consumer Credit Code provisions dealing with the usury question, which propose a treatment of interest rate limitations which the writer believes to be a sound cure for the usury headache.

A. History of Usury Laws and Interest

The lessons of history concerning legislative attempts to fix interest rates have not yet been learned. As the following short survey indicates, statutes prohibiting the taking of interest or regulating interest rates never seem to have been effective when they ignore the realities of money market behavior, but, in this country at least, they are still being tried.

Credit is almost certainly as old as organized society, and, unless human nature has changed more than seems likely, the first interest was charged at about the time the first loan was made. The charging of interest on loans in primitive societies has been noted in many cases — a not infrequently reported rate of charge being two-for-one on a loan to the next harvest (a rate of 100 percent and up). Such rates seemed severe to those who paid them, and, as might be expected, many early societies had legal provisions regulating interest rates. The Code of Hammurabi, for example, fixed maximum rates on loans of grain at 33 1/3 percent and on loans of silver at 20 percent. However, even though under the Hammurabic Code charging rates above the legal maximum re-

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9 A number of articles have been written in recent years attacking usury laws. See, e.g., Harell, Mortgage Investments and the Usury Problem, 10 CLEV.-MAR. L. REV. 343 (1961); Merriman & Hanks, supra note 7; Prather, Economics, Morality and the Real-Estate Loan, 8 B.C. IND. & COM. L. REV. 475 (1967); Shanks, Practical Problems in the Application of Archaic Usury Statutes, 53 VA. L. REV. 327 (1967). See also the excellent student note, An Ounce of Discretion for a Pound of Flesh: A Suggested Reform for Usury Laws, 65 YALE L.J. 105 (1955). For comparative purposes, see the following articles defending usury statutes: Collins & Ham, The Usury Laws of Arkansas: A Study in Evasion, 8 ARK. L. REV. 399 (1954), and Comment, Usury — Effectiveness of the General Usury Statutes in Missouri, 26 MO. L. REV. 217 (1961). For a good general discussion of usury laws and of the usual legal rules which have developed around them, see Horack, A Survey of the General Usury Laws, 8 LAW & CONTEMP. PROB. 56 (1941).


11 Id. at 22-23.

12 Id. at 30.
sulted in loss of the right to collect the principal, legal rates did not limit actual rates, and there is evidence that the highest actual rates on loans of silver were around 25 percent. 13

The Romans under the Republic and the Empire enacted usury statutes which fixed maximum interest at rates which varied from time to time from a low of 4 1/6 percent to a high of 12 1/2 percent, 14 and there were also some sporadic, unsuccessful attempts to prohibit any taking of interest. 15 There is substantial evidence that actual interest rates were often above the legal maxima. 16 With the collapse of the Roman Empire, the church-oriented society of the early Middle Ages took seriously the Biblical injunctions 17 against lending at interest and church and state prohibitions against usury became increasingly severe. 18

However, at no time were the church and state prohibitions completely successful in stamping out loans at interest, and with the beginning of the trade revival in the 11th and 12th centuries considerable thought and ingenuity went into the development of plans and theories by which compensation could be paid for the use of money without violating prohibitions against usury. One of the avoidance devices was a doctrinal distinction between gain (usury) from the loan of money and loss (interesse-interest) occasioned by the fact that the lender was deprived of the use of the money. Originally this concept was limited to initially interest-free loans for which interest might be charged if the loan was not repaid when due. However, once the principle was established it was used as a revenue-producing device in a number of ways. Loans were made payable at a date on which neither the lender nor the borrower expected repayment to take place so that interest

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13 Id. Even though Aristotle considered charging interest for the use of money unnatural because money did not beget money, the traders and moneylenders of Athens, being more realistic about the returns to be gotten from borrowed money, borrowed and lent at rates of from 6 percent to around 18 percent. ARISTOTLE, POLITICS, book 1, ch. 10. See S. HOMER, supra note 10, at 43.

14 S. HOMER, supra note 10, at 52.


16 Id. at 52-55. In 44 B.C. Senator Marcus Junius Brutus made a loan to a city in Asia Minor at a rate of 48 percent per year. Cicero criticized Brutus for the transaction, pointing out that the legal rate was 12 percent per annum. Id. at 47.

17 "Thou shalt not lend upon usury to thy brother; usury of money; usury of victuals; usury of anything. . . . Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury." Deuteronomy 23:19-20.

And from the New Testament, "lend freely, hoping nothing thereby." Luke 6:35. The original meaning of usury was interest, and the Biblical prohibitions were against any interest taking.

18 See S. HOMER, supra note 10, at 70.
might be charged after the fictitious due date. Also, the concept was extended to allow interest from the beginning in cases where the lender had to sell property to get the money to lend or where he clearly gave up income-producing opportunities by making the loan. Another device which finally gained church approval was a special "partnership contract" in which the special partner was guaranteed a fixed return on his investment. Still another device was the "annuity" or "census" which involved the sale of an obligation to pay an annual return from productive property. This arrangement, which varied in form from a modern annuity to a modern redeemable bond, generally was not challenged as usurious if the interest was set at a reasonable rate. Also, since Jews were not subject to church control, they often were permitted by church and state authorities to lend at interest to gentiles.

In the 13th and 14th centuries, commercial pressures became so great that in many parts of Europe laws were adopted permitting interest charges. In 1545, England adopted an act permitting interest charges of up to 10 percent per year, the preamble of the act stating that the "statutes . . . [prohibitory of interest altogether had] so little force . . . that . . . little or no punishment . . . ensued to the offenders . . .". Except for the years between 1552 and 1571, during which time there was an absolute prohibition against interest taking, English statutes permitting interest charges at varying rates, reduced until the rate reached 5 percent in 1713, remained in effect until all English usury statutes were repealed in 1854.

The first American colony to adopt a usury law appears to have been Massachusetts which adopted an 8 percent rate in 1641. Thereafter, all colonies and the successive States adopted usury statutes. Prior to the middle of the 19th century, there appears to have been relatively little lending to borrowers for consumption

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19 Id. at 73-74.
20 Id. at 75.
21 Id. at 76.
22 Horack, supra note 9, at 37.
23 S. HOMER, supra note 10, at 72, 78.
24 A Bill Against Usury, 37 Hen. 8, c. 9 (1545).
26 See note 6 supra & accompanying text.
27 J. MURRY, supra note 15, at 76.
28 In 1866 all existing States had usury laws, usually at 6 percent, but California had a 10 percent law and some other States had rates of 7 or 8 percent. Id. at ix.
purposes in the United States and usury laws were regarded as protection for the small businessman and the farmer against high interest rates. The statutes, however, often did not serve their professed purpose. Usury rates were often near or below the prevailing market rate for minimum risk loans and did not leave room for loan prices to include the necessary charges for costs of lending and for risk. Further, there was no organized national money market and farmers and business borrowers usually had to compete for limited local money. Because of these factors, businessmen and farmers in various areas complained that usury statutes only increased the rates they had to pay because the usury laws forced lenders to resort to inconvenient and illegal subterfuges to secure returns that were reasonable but above the usury limits. Another complaint was that the usury statutes drove from the lending market some who would have otherwise been willing to lend out their money and attracted to it the more avaricious and hardened who were willing to violate the law to lend at illegal rates.

In 1867


30 Friedman, The Usury Laws of Wisconsin: A Study in Legal and Social History, 1963 Wis. L. Rev. 515, 523-25, contains an excellent discussion of the arguments for and against usury laws put forth in Wisconsin in the years between 1848 and 1875.

31 Except for a few years in the 1830's, when yields on federal government bonds fell as low as 3.06 percent, yields on federal government obligations in the first part of the 19th century ranged above 5 percent and sometimes above 6 percent. After the Civil War, bond rates fell steadily, along with the general decline in prices, until 1900, when yields fell as low as 1.98 percent. S. HOMER, supra note 10, at 302-17. Usury statutes generally fixed the legal contract rate at 6 or 7 percent, though a few States had a higher rate.

32 Id. at 322-26.

33 In 1834, 202 businessmen of Boston submitted a petition to the Massachusetts legislature urging repeal of the usury laws. The petition described evasions of the usury laws as follows:

We would respectfully direct the attention of the Legislature to the numerous modes that have been devised for evading the laws; modes of transacting business, which, besides being circuitous and inconvenient, and besides taking away the sanction and protection of the law from those who engage in them, leaving no security but what is termed honor, thus increasing the risk, and of course the premium paid — besides these evils, which are loss of time, money, comfort and security — produce a fearful disregard of the laws, and establish a precedent of the utmost danger, while they tend to throw pecuniary negotiations in the hands of unprincipled and dangerous men. We need not specify the various methods by which the law is now evaded, and by which interest above six percent is taken, in defiance of law, under the various names of "premium," "exchange," and "commission"; for these are matters of notoriety, and need only be alluded to in order to secure the attention of the Legislature. So long as our laws remain unchanged, it is vain to hope for a better state of things. MASS. S. DOC. NO. 66 (1834), quoted in L. ROBINSON & R. NUGENT, supra note 29, at 30.

In 1859 a Tennessee legislative committee reported:
Massachusetts repealed its usury laws primarily as a result of a powerful political speech on the subject by Representative Richard H. Dana, Jr. But attempts to repeal usury statutes in other States never made any substantial headway. A number of States did repeal usury statutes for a short time, but later reenacted them. Presently, all States except two have general usury statutes.

B. Factors Involved in Determining the Price of Money

Before discussing the theory and present effect of usury laws, the factors which are involved in fixing the interest rate at which a loan will be made will be briefly examined. There are four components involved in determining the free market rate at which a particular loan will be made: (1) the cost of money; (2) the cost of administering the loan; (3) the amount of risk that the loan will not be repaid; and (4) the competition confronting the particular lender.

(1) The cost of money. —The basic factor affecting interest rate levels is the amount which borrowers are willing to pay and lenders are willing to accept for the use of money in those instances where the risk is for all practical purposes nonexistent and costs of making and administering the loan are an insignificant proportion of the total return. This “prime” rate is fixed by essentially the same factors of supply and demand which fix other market prices. Some special features of the money market, however, are worth observing. In addition to the factor of supply of money, as against demand for credit at a particular time, the duration for which the loan is requested is also a factor in setting the market rate. The longer the term of the loan, the less liquid the position of the lender and the

Comparatively . . . little money is now loaned out in Tennessee, at legal rates. In some portions of east and middle Tennessee, and occasionally by a conscientious guardian or private individual in other parts of the state, loans may be effected at the legal rate, but in these instances it is generally done more for accommodation to friends of known punctuality than for the sake of gain . . . . It is impossible to ascertain the exact amount of money used in Tennessee in note-shaving transactions. The law . . . like most other enactments guarded by heavy penalties and unjust discriminations, has defeated its own object. Id. at 31.

For a very interesting discussion of usury legislation in Wisconsin in the 19th century together with a description of actual rates charged for farm loans at various times and the devices used to secure more than the legal rate of interest, see Friedman, supra note 30.

34 F. Ryan, Usury and Usury Laws 60-61 (1924). Dana was the author of Two Years Before the Mast.

35 Horack, supra note 9, at 38-39.

36 See notes 62-99 infra & accompanying text.
less ability he has to react to changes in the money market. Because of this loss in liquidity, in most economic circumstances rates are higher for long term loans than for short term loans.

However, it is probably correct to assume that the principal factor in setting prime interest rates is the relationship between total money supply and total borrowing demand. The sources which make up the total supply of funds for investment may be placed in several classes. First, there are funds from private sources which would have been available in the market no matter what interest rates were being paid, but which are more or less sensitive to interest rates and will seek the highest possible return. Many individual savings accounts are in this class, and good institutional examples of such funds are pension funds and assets of life insurance companies. Of course, even these funds are to some extent available for loans only because interest is paid. If interest rates were zero, most of us would keep our surplus money in a sock rather than lend it out. In any event, therefore, the rate must be sufficiently higher than zero to induce the saver to give up his liquidity advantage by lending out the money. However, it is probable that an increase in the interest rate from 5 percent to, say, 6 percent has little effect on the total amount of this type of money available for loans.

The second classification of savings is that which is induced only by attractive interest rates. Some indeterminate amount of money saved and made available for lending falls in this category. Some savers who would forego present consumption at a 5 percent return would not forego present consumption if the rate of return were only 3 percent. In the case of a business saver, the situation is more complex since, in addition to the option of either paying its surplus money to the owners or shareholders or saving it and making it available for loans, the business also has the option of investing the surplus as additional capital in the business being operated.

The present money market in the major industrialized nations of the world has a peculiar source of lendable funds in a third category, the demand deposits of commercial banks. These deposits do not represent the "savings" of anyone, except in a very limited sense, but collectively they make up a huge fund from which loans can be, and are, made. These funds are generally not accumulated in response to interest rates, since they are not deposited primarily

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87 Demand deposits of commercial banks in the United States on December 27, 1967, were about $180 billion. FED. RESERVE BULL. Feb. 1968, at A-18.
to earn interest, but rather are accumulated for the convenience of the depositors.

The prime interest rate is substantially affected by the discount rate at which the Federal Reserve Board will loan money to banks and by the fiscal policies of the Federal Reserve Board. The Board, through various devices, can substantially reverse trends toward inflation or recession by increasing or decreasing the amount of money available for lending.\(^8\)

The other side of the market prime interest rate-fixing mechanism is the demand for funds. Borrowers who seek funds are of two types, those who seek the funds for productive purposes, that is, to enhance their earning capacity, and those who seek the funds for consumptive purposes, that is, to anticipate their future income. The strength of the demand for productive loans depends on the spread between the interest rates on money and the general profit levels of business. If the spread is great, the demand will be high, and if it is narrow, the demand will be smaller. Of course, the forces of the market tend to narrow the gap between interest rates and profit. The forces as to consumptive borrowing are not subject to factors as objective as the spread between profits and interest, for the rate which a consumer-borrower is willing to pay depends substantially on his subjective feeling as to the desirability of anticipating future income.

Hopefully, this brief review of the factors involved in setting market interest rates makes it clear that the money market is a complex marketplace in which interest rates are set in much the way that prices are set in other markets.\(^9\) While it is true that a large part of the lendable funds available at any particular time are not increased by higher interest rates, higher rates do attract substantial additional money into the lending market. This is particularly so in the present United States money market where equity stock purchases are an easily available alternative to investment in loans or lending institutions. Therefore, money available for lending is affected by the interest rate — higher rates do not result merely in higher prices with no expansion in supply. Further, even if


\(^9\) In addition to the citations in note 38 supra, see F. Ryan, supra note 34, at 64-75; Merriman & Hanks, supra note 7, at 1-6.
money supply were not responsive to rate changes, free market rates should efficiently apportion the available funds to the best use. This fact is of substantial importance in the consideration of the desirability of usury statutes.

As of the time this article is being written, the Federal Reserve discount rate is 5 percent,\textsuperscript{40} bank short term (less than 1 year) rates in New York City are 5\% to 6 percent,\textsuperscript{41} 5-year federally guaranteed bonds of the Federal National Mortgage Association have just sold to yield around 6.45 percent,\textsuperscript{42} and private corporate bonds are selling to yield around 6.74 percent.\textsuperscript{43} These rates may be considered to represent the prime market interest rate range presently. Therefore, States with 6 or 7 percent general usury laws are attempting to force lenders to lend at rates below or only slightly above prime rates. It is unreasonable to expect lenders in such situations to actually lend below prime rates — a more likely result is that credit will be dried up.

(2) Cost of Administering the Loan. — The second factor in determining the interest rate at which a loan will be made is the administrative cost of making the loan. This cost becomes particularly significant in smaller loans, especially installment loans, where substantial time is spent in evaluating the loan request and in handling the disbursement and bookkeeping expenses included in the loan. For example, a recent study showed the average annual operating expenses, other than bad debt reserves, of some major national finance companies to be $10.47 per $100 of average loan balance.\textsuperscript{44} Applying this average figure to a single payment loan of $100 for a year, the total operating costs apportionable to that loan would be $10.47. Assuming that the finance company borrows the money to make the loan at a prime interest rate\textsuperscript{45} of 6 percent, this is an additional cost of $6. Therefore, the total cost of this loan to the lender would be $16.47 and he would have to charge an interest rate of 16.47 percent just to break even, without taking into consideration any bad debt reserve. Although as the loan gets bigger

\begin{itemize}
\item \textsuperscript{40} N.Y. Times, Mar. 28, 1968, at 69, col. 5.
\item \textsuperscript{41} Wall Street Journal, Mar. 29, 1968, at 18, col. 5.
\item \textsuperscript{42} N.Y. Times, Mar. 27, 1968, at 1, col. 2.
\item \textsuperscript{43} Id., Mar. 28, 1968, at 74, col. 1.
\item \textsuperscript{44} J. CHAPMAN & R. SHAY, THE CONSUMER FINANCE INDUSTRY 38 (1967). The cost makeup was as follows: salaries, $5.60; occupancy costs, $.98; advertising, $.71; other, $3.18. Some other companies reported on in the study had operating expenses, excluding bad debt reserves, as high as $26.80 per $100 of loan. Id. at 100.
\item \textsuperscript{45} See discussion in text accompanying notes 37-43 supra.
\end{itemize}
the ratio of cost to loan goes down and costs go down when single payment rather than installment loans are made, the above example does serve to illustrate the effect of administrative costs on interest rates.

(3) Risk That the Loan Will Not Be Repaid. —The third factor in determining the market value of a particular loan is the risk which the lender is assuming. Since this factor is always a characteristic of the particular borrower, rather than the particular lender, loans are not at all interchangeable as to rate. The fact that X Steel Corporation sells steel to General Motors at $75 cash per ton is a good indication that it will also sell to American Motors at $75 cash per ton. However, the fact that X Bank lends money to General Motors at 6 percent is no indication that it would or should loan to American Motors at 6 percent. Similarly, the fact that X Bank lends Bill Jones $1,000 for 1 year at 10 percent does not mean that it could or should loan to his neighbor, Frank Smith, on the same terms. In each case some judgment must be made as to the risk that all or some of the loan will not be paid and the amount which is to be charged for taking this risk must be determined.

The major national finance companies previously referred to had average bad debt writeoffs of $2.27 per $100 in 1964, and some loan companies reported bad debt writeoffs as high as $6 per $100.46 These figures indicate that in some parts of the lending market, at least, the risk factor is a good deal more than negligible.

(4) Competition to the Lender. —The final factor involved in fixing the interest rate in a particular transaction is the existence of alternative sources of supply to which the borrower can turn, or of alternative borrowers to whom the lender can turn. If money markets were monopoly markets then usury statutes would have the same justification as regulation of telephone company or electric power company rates. However, this writer does not believe that the present money supply system can be characterized as a monopoly. Borrowers, large and small, generally have access to a number of different lenders who are not, by any means, acting in concert. However, competitive forces can be made to operate more efficiently by allowing lenders free access to the credit market and by requiring disclosure of the rates charged on comparable terms by all lenders if the borrower is not otherwise likely to understand rate differences.

46 J. CHAPMAN & R. SHAY, supra note 44, at 38, 100.
C. Theory of Usury Statutes

The major theoretical ground for prohibition of, or limitation on, the amount of interest which may be charged on a loan was for many centuries, and perhaps still is, a religious one. The Old Testament prohibition of interest taking on loans had an overpowering influence in the Middle Ages. The arguments in behalf of, and in explanation of, the Biblical injunction against the taking of interest was at the very core of the scholastic thinking of the Middle Ages. With the Reformation, however, the religious ground for the prohibition against interest was cut away, and the religious prohibition was shifted toward unconscionably high rates. Indeed, modern usury laws reflect the gradual modification of a medieval, religiously based theory that no interest at all could be charged for the lending of money.

While medieval attitudes on usury were no doubt based substantially on the belief that the taking of interest was prohibited by the authoritative word of God, they were also reinforced by pictures of the overreaching and hardhearted usurer who took advantage of the necessitious condition of the borrower to exact an unconscionable charge. This reason for usury limitations, which has been called the prohibition of "moral usury," has always been, and still remains, one of the strongest underlying theories for usury.

47 B. NELSON, THE IDEA OF USURY (1949) traces the impact of the Deuteronomic usury prohibition from the time of the early Christian church to its final gasp for life in the quixotic writings of Father O'Callaghan, a Catholic priest, in the early 19th century.

48 Id.

49 Surely one of the most telling bits of invective ever written is the following quotation from a 4th century sermon of St. Basil:

The gripping usurer sees, unmoved, his necessitous borrower at his feet, condescending to every humiliation, professing everything that is villifying; he feels no compassion for his fellow-creatures; though reduced to this abject state of supplication, he yields not to his humble prayer; he is inexorable to his entreaties; he melts not at his tears; he swears and protests that he has no money, and that he is under necessity of borrowing himself; he acquires credit to his lies by superadding an oath, and aggravates his inhuman and iniquitous traffic with the grossest perjury. But when the wretched supplicant enters upon the terms of the loan, his countenance is changed; he smiles with complacency; he reminds him of his intimacy with his father, and treats him with the most flattering cordiality. "Let me see," says he, "if I have not some little cash in store, for I ought to have some belonging to a friend who lent it to me on very hard terms, to whom I pay most exorbitant interest for it; but I shall not demand anything like that from you." By fair words and promises, he seduces and completely entangles him in his snares; he then gets his hand to paper and completes his wretchedness. How so? By dismissing him bereft of liberty. Quoted in Commonwealth v. Donoghue, 250 Ky. 343, 351, 63 S.W.2d 3, 6 (1933).
statutes," in spite of the fact that in only one State does a usury statute actually apply to small loan transactions of the kind in which the necessitous borrower situation practically always arises.\footnote{See F. Ryan, supra note 34, at 10-17, where the author discusses the concept of "moral usury," that is, the taking advantage of the necessitous condition or inexperience of the borrower.}

Related to the "prevention of overreaching" argument is the medieval theological concept of "just price" under which at various times and in various places the prices of essential commodities were controlled by statute.\footnote{See text accompanying notes 100-30 infra.} In this context, it was natural for the prohibition against any interest charge to be transmuted into a doctrine that the state should fix a fair price for the use of money. Free enterprise countries have long since abandoned the concept of state price fixing except in times of national emergency and in the case of monopoly enterprises, but the idea that the state can and should fix a fair price for money apparently still has a strong appeal to legislators. It has been argued that the money market is actually a monopoly market and that, therefore, price fixing is justified.\footnote{See Bonn, Price Regulation, 12 Encyc. Soc. Sci. 355 (1934); Salin, Just Price, 8 Encyc. Soc. Sci. 504 (1932).} However, in view of the variety and diverse character of lenders today this seems not to have any present foundation in fact.

A special variety of the fair price doctrine is an argument that loans for productive purposes should not be permitted at a rate higher than the average percentage of net profits which can be earned in the borrower's business.\footnote{See Friedman, supra note 30, at 520.} This argument has a ring of authenticity since it is clear that a businessman is headed for bankruptcy if he pays more for money than he is able to earn by putting it to use. Its failure is in assuming that there is a standard net profit figure applicable to businesses in general and in assuming that a legislature can discover what this figure is. A more sophisticated argument was made by Adam Smith in Wealth of Nations\footnote{A. Smith, Wealth of Nations book II, ch. IV (1784).} in which he argued that to permit high interest rates would attract too much capital to speculative ventures at the expense of more stable and more established industries which could not afford to pay speculation interest rates.

More recently, John Maynard Keynes has suggested that for many centuries interest rate ceilings were justified because an irrational thirst for land caused so many men to borrow to buy land.
that, in the absence of usury statutes, rates would have gone too high for possible productive investment in agriculture or business. Keynes also seemed to suggest that usury statutes may serve a useful purpose in establishing expectations as to returns which, as he saw it, have a substantial effect on actual interest rates charged.

Usury statutes may also indicate a social judgment as to the kind of people who should be entitled to credit. If a State has a general usury law applicable to the small businessman which sets an interest ceiling of 10 percent, it could be argued that the State has thereby stated a policy that borrowers whose credit standing does not enable them to borrow at 10 percent should be discouraged from borrowing to continue in business. That this has actually been a conscious consideration in the forming of usury statutes is doubtful though this feature of small loan legislation is well known.

In summary, it can be said that usury laws attempt either to fix the market price for money, or to fix a ceiling for conscionable transactions, based on the belief that rates higher than the ceiling are never justified from the lender's point of view, or, if they are justified, should not be permitted as a matter of social policy.

II. Usury Laws and Their Effects

Usury laws in the United States, which range from 6 to 21 percent, obviously present a mixture of motives. Six percent statutes perhaps come close to being price-fixing statutes since they are so close to actual money rates. Rates of 12 percent or 21 percent, however, do not attempt to fix the market price of money, but only set limits on the kinds of money contracts which can be made.

A. Factors Controlling the Effect of Usury Laws

To set the framework for an examination of existing usury statutes and their effect, some of the factors which are likely to affect their importance and impact on interest rates will be considered. These factors are the general usury rates, the penalty imposed for violation of usury laws, the extent of statutory exemptions and of special rates for particular kinds of lending, the judicial atti-

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66 J. Keynes, supra note 38, at 241.
67 Id. at 203.
68 For a discussion of this aspect of consumer interest rate regulating statutes, see Johnson, Regulation of Finance Charges on Consumer Installment Credit, 66 Mich. L. Rev. 81 (1967).
tude toward interest rate ceilings, the extent to which lenders voluntarily observe the statutory ceilings, and the availability and ease of access to alternative uses of capital.

(1) The Rate. —The lower the maximum rate allowed the more likely it will widely dislocate free market operations in tight money situations. The New York 6 percent usury statute, for example, is presently having a substantial effect on home mortgage loans. On the other hand, the Rhode Island 21 percent ceiling has very little effect on the general lending market.

(2) The Penalty for Violation of the Usury Statute. —If, as in nine States, the penalty is only loss of the excess above the legal rate, the deterrent effect is probably very small indeed. On the other hand, if the penalty is loss of the entire principal and interest, as it is in some States, lenders must be greatly concerned about possible violations.

(3) The Statutory Exemptions from the General Usury Statutes. —The extent to which a usury statute really interferes with free market bargaining for credit depends substantially on the various exemptions from it. Existing exemptions are of two types. Most common are exemptions based on the size and type of loan, but exemptions also are made on the basis of the character of the borrower or lender. If a State has special statutory high rates for loans of smaller amounts under small loan or installment loan legislation, and exempts loans to corporations from the general usury laws, the effect of the usury laws may be little more than to cause a large number of small loans and many incorporations.

(4) The Judicial Attitude Toward Avoidance Devices. —As will be pointed out later, at various times, courts have been liberal in allowing use of various subterfuges to avoid usury statutes. If such devices are available, usury statutes, for the knowledgeable, only result in more expensive and roundabout ways of handling transactions.

(5) The Voluntary Observance of Statutory Ceilings. —Business custom and practice often permit charges above usury limits which have not been approved by either courts or legislatures. If this happens the usury laws on the books have no impact except

59 See text accompanying notes 193-97 infra.
60 See notes 71-76 infra & accompanying text.
61 Some examples are the discount in home mortgages in many States and the charges of 1 or 1½ percent per month on cash loan revolving credit in many States. So long as borrowers do not complain, such charges are frequently made even though they possibly, or even probably, violate usury laws. See text accompanying notes 193-97 infra.
in sporadic instances when some particular borrower decides not to play by the working rules and turns to the judicial or legislative ones.

(6) The Availability and Ease of Access to Alternatives for the Use of Investable Funds. —If the holder of capital has available alternatives such as equity stock purchases, the secondary bond market, loans in areas free from usury control, or loans in other jurisdictions with a higher rate, the effect of usury laws will be substantially different from what it would be in the absence of alternatives. To the extent that alternative sources of investment are available, usury laws are not effective to produce loans at the usury rate when the general market rate is higher. In such a situation, there will probably continue to be some loans at the usury rate, but the amount of money available will be substantially reduced as funds flow to the areas where greater returns are available.

B. Present General Usury Statutes and Their Exceptions and Exemptions

Existing State legislation regulating maximum interest rates is typically a jumble of statutes fixing a basic usury rate and then exempting from the basic rate small loans, installment loans, loans by industrial banks, and perhaps totally exempting banks, savings and loan associations, or other particular types of lenders. One difficulty with existing legislation is that it is so complex and so scattered throughout the statute books that it is practically impossible, within any reasonable period of time, to develop a complete picture of interest rate regulation in all the States. The summary of the existing situation in the United States which follows, because of these difficulties, is not exhaustive in treatment, but, in general, it does draw an accurate picture of the present interest rate regulation structure.

All States except two, Massachusetts and New Hampshire, have general usury statutes or constitutional provisions fixing a general maximum interest rate. Of these 48 States, 10 have a 6 percent general usury law, six, a 7 percent law; 12 and the District of

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62 For an excellent collection and summary of the various rate regulatory statutes applicable to consumer borrowers in the United States, see B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965). CCH INSTALLMENT CREDIT GUIDE reports most State legislation in the consumer credit field and also contains a summary of general usury laws.
63 Delaware, Maryland, New Jersey, New York, North Carolina, Pennsylvania, Tennessee, Vermont, Virginia, West Virginia. Statutory citations for these States and
Columbia, an 8 percent law,\footnote{Columbia, an 8 percent law.} one, a 9 percent law,\footnote{One, a 9 percent law.} 10, a 10 percent law,\footnote{10, a 10 percent law.} and six, a 12 percent law.\footnote{Six, a 12 percent law.} New Mexico has a split general law, 10 percent with collateral and 12 percent without.\footnote{New Mexico has a split general law, 10 percent with collateral and 12 percent without.} Maine has a 16 percent and Rhode Island a 21 percent general usury statute.\footnote{Maine has a 16 percent and Rhode Island a 21 percent general usury statute.}

The impact of these usury laws depends very substantially on the penalty for violation. And, since the pressures toward evasion of usury statutes are stronger in States where the rate is lower, penalties by rate groupings will be examined. Generally, the lower the interest ceiling, the smaller the penalty imposed for a violation, though there are notable exceptions.

In five of the ten 6 percent States, the only penalty for usury is loss of the excess interest over 6 percent.\footnote{In five of the ten 6 percent States, the only penalty for usury is loss of the excess interest over 6 percent.} In three others the penalty is loss of all interest.\footnote{In three others the penalty is loss of all interest.} And in Vermont, the penalty is all interest plus one-half of the principal.\footnote{And in Vermont, the penalty is all interest plus one-half of the principal.} In straight-laced New York, usury makes the contract void.\footnote{In straight-laced New York, usury makes the contract void.} It appears, therefore, that in one-half of the 6 percent States the sting of the usury laws is very slight indeed. In only two of the 6 percent States is usury a criminal offense.\footnote{In only two of the 6 percent States is usury a criminal offense.} (A recent New York statute aimed at Mafia-type loans makes it a felony to lend at rates above 25 percent.\footnote{A recent New York statute aimed at Mafia-type loans makes it a felony to lend at rates above 25 percent.})

One of the six 7 percent States forfeits the excess over 6 percent for usury,\footnote{One of the six 7 percent States forfeits the excess over 6 percent for usury.} three forfeit all interest,\footnote{Three forfeit all interest.} Iowa forfeits all interest plus

\footnotesize{for all States listed through footnote 96 will be found in the table which appears as Appendix A.}

\footnote{Illinois, Iowa, Kentucky, Michigan, North Dakota, South Carolina.} \footnote{Id.} \footnote{Alabama, Alaska, Arizona, Georgia, Idaho, Indiana, Louisiana, Minnesota, Mississippi, Missouri, Ohio, South Dakota.} \footnote{Id.} \footnote{Nebraska.} \footnote{Id.} \footnote{Arkansas, California, Florida, Kansas, Montana, Oklahoma, Oregon, Texas, Utah, Wyoming.} \footnote{Id.} \footnote{Colorado, Connecticut, Hawaii, Nevada, Washington, Wisconsin.} \footnote{Id.} \footnote{Id.} \footnote{See id.} \footnote{Maine has no limit on the interest rate on loans under $2,000.} \footnote{Delaware, Maryland, Pennsylvania, Tennessee, West Virginia.} \footnote{Id.} \footnote{New Jersey, North Carolina (where if a violation occurs the borrower can recover back double the amount actually paid), Virginia.} \footnote{Id.} \footnote{See id.} \footnote{See id.} \footnote{TENN. CODE ANN. § 39-4602 (1955); VT. STAT. ANN. tit. 9, § 34(c) (Supp. 1967). Unless otherwise indicated, all States which make usury a crime make it a misdemeanor.} \footnote{N.Y. PEN. LAW § 2401 (McKinney 1967).} \footnote{Kentucky. See Appendix A infra.} \footnote{Illinois, Michigan, South Carolina (plus costs).} \footnote{Id.}
16 percent of the principal; 79 and in North Dakota all interest plus 25 percent of principal is forfeited. 80 Two of these States make usury a misdemeanor. 81

Of the thirteen 8 percent jurisdictions, two, Missouri and Ohio, 82 penalize usury by forfeiture of the excess interest, and one, Indiana, forfeits the excess above 6 percent. 83 Eight jurisdictions forfeit all interest, 84 while Idaho forfeits treble interest, 85 and Minnesota makes the contract void. 86 Only South Dakota of this group makes usury a misdemeanor. 87

Nebraska, the single 9 percent State, requires forfeiture of all interest for a violation of the usury law. 88 Four of the ten 10 percent States forfeit all interest, 89 and another three forfeit twice the interest. 90 Kansas requires forfeiture of double the excess over 10 percent. 91 Arkansas forfeits all interest and principal, 92 and Oregon, in a complicated scheme, forfeits the loan, less interest and payments on principal, to the school fund. 93

Of the 12 percent States, Nevada forfeits the excess over 12 percent; 94 Colorado forfeits treble the excess charge; Hawaii and Washington require forfeiture of all interest plus principal under $2,000; and in Connecticut the entire principal and interest is forfeited. 95 Four of these States make usury a misdemeanor. 96

New Mexico, a 10-12 percent State, forfeits all interest and

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79 See id.
80 See id.
82 See Appendix A infra.
83 Id.
84 Alabama, Alaska, Arizona, District of Columbia, Georgia, Louisiana, Mississippi (all interest and principal when the interest charged is above 20 percent), South Dakota. Id.
85 See id.
86 Id.
87 Id.
88 Id.
89 California, Florida (if interest charged is more than 25 percent, all interest and principal), Utah, Wyoming. Id.
90 Montana, Oklahoma, Texas (forfeit all principal and interest if the rate charged is 20 percent or more). Id.
91 See id.
92 Id.
93 Id.
94 Id.
95 Id.
96 Colorado, Connecticut, Hawaii, Wisconsin. Id.
makes usury a misdemeanor. 97 Maine, a 16 percent State, forfeits all interest and principal, 98 while Rhode Island forfeits all interest and principal for violation of its 21 percent limitation and makes violation a misdemeanor. 99 All 48 States with general usury laws except Arkansas have a series of statutory or judicial exceptions which substantially diminish the impact of the general rate limitation. The most common of these exceptions are discussed in the following sections.

(1) The Small Consumer Borrower Exemption from Usury Statutes. —Many consumer borrowers undoubtedly need legislative protection from sellers and lenders who overreach on credit transactions. A substantial portion of small loans to consumers are emergency loans to tide the borrower over a financial rough spot caused either by an unexpected expense, temporary unemployment, or by the borrower’s inability to handle his financial affairs. Such a borrower needs money quickly to protect himself from inconvenience, discomfort, or loss of property to existing creditors. This necessitous borrower usually is willing to pay almost any rate to get a loan and often would in the absence of legislative controls.

Also, it is an unfortunate fact that many consumers are unintelligent or naive in money matters and, in the absence of some legislative limits on rates, would pay very high rates without fully understanding either the rate or its effect. However, if one accepts the fact that consumers are of differing credit worthiness, he must also accept the fact that legislative ratemaking in the consumer area cannot take the form of price fixing for every class of customer without resulting in serious inequality among borrowers. Therefore, rates set by statute in the consumer area probably should be set at some outside conscionable limit with the expectation that most transactions will take place at lower rates. It is clear, however, that the present general usury rates are too low to allow any substantial amount of consumer financing to be done under them. 100

One of the most fantastic episodes of 19th century laissez faire business profit taking occurred in the small loan business between 1870 and around 1910. The general usury statute maximums then (6 to 12 percent), as now, were not high enough to permit profitable lending of small amounts at legal rates. In the large

97 See id.
98 Id.
99 Id.
100 On the costs of the consumer credit industry, see J. CHAPMAN & R. SHAY, THE CONSUMER FINANCE INDUSTRY (1967).
industrial cities, however, there were many wage earners who could not control their financial situation and who were often in desperate need of small amounts of cash to pay medical bills or to tide them over periods of unemployment. The need could not be satisfied within the usury structure, so it was satisfied outside it. Small loan lenders operated openly and advertised in nearly every city of any size in the United States in spite of the fact that in every State except Massachusetts they were lending at illegal rates.101 The interest rates charged ranged from a reasonable 3 percent per month to 33 percent per month and even higher. And it is significant that the rates in Boston, in a State with no usury laws, while high, were not as high as in many cities in States with tight usury statutes.102 In some States the penalty for usury was only loss of interest, so the high rate lender was taking only a small chance in lending at above the legal rates. However, even in States where there was a substantial penalty, illegal loans were widely made.103 Some States attempted to end illegal lending by making it a felony to charge higher than usury rates, but since the demand was present, some people were willing to meet that demand even at the

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102 Id. at 57-58. A portion of the authors' table showing rates actually charged in various cities follows:

**RATES OF INTEREST CHARGED BY LENDERS IN VARIOUS CITIES, COMPiled FROM NEWSPAPER REPORTS OF LOAN-SHARK CRUSADES, 1887 TO 1922**

<table>
<thead>
<tr>
<th>City</th>
<th>Year</th>
<th>Rate of Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>Boston, Mass.</td>
<td>1887-88</td>
<td>3 to 10 per cent a month</td>
</tr>
<tr>
<td>Boston, Mass.</td>
<td>1908-09</td>
<td>No rates reported</td>
</tr>
<tr>
<td>Boston, Mass.</td>
<td>1911</td>
<td>180 per cent a year; 200 to 300 per cent a year</td>
</tr>
<tr>
<td>Boston, Mass.</td>
<td>1915-16</td>
<td>15 per cent a month prevailing on $10 or less; 8 to 10 per cent a month; 200 per cent a year</td>
</tr>
<tr>
<td>Kansas City, Kan.</td>
<td>1893-94</td>
<td>10 per cent a month</td>
</tr>
<tr>
<td>Philadelphia, Pa.</td>
<td>1893-94</td>
<td>10 to 60 per cent a month</td>
</tr>
<tr>
<td>Philadelphia, Pa.</td>
<td>1908-10</td>
<td>20 per cent a month; 120 to 200 per cent a year</td>
</tr>
<tr>
<td>Providence, R.I.</td>
<td>1895-98</td>
<td>5 to 12 per cent a month</td>
</tr>
<tr>
<td>Toledo, Ohio</td>
<td>1897</td>
<td>10 per cent a month</td>
</tr>
<tr>
<td>Kansas City, Mo.</td>
<td>1902</td>
<td>10 per cent a month</td>
</tr>
<tr>
<td>Atlanta, Ga.</td>
<td>1903</td>
<td>3, 10, 20, and 33 per cent a month; 473 to 1,735 per cent a year</td>
</tr>
<tr>
<td>Milwaukee, Wis.</td>
<td>1905</td>
<td>120 to 400 per cent a year</td>
</tr>
<tr>
<td>Milwaukee, Wis.</td>
<td>1910</td>
<td>110 per cent a year</td>
</tr>
<tr>
<td>Detroit, Mich.</td>
<td>1906-07</td>
<td>88 per cent a year</td>
</tr>
<tr>
<td>Pittsburgh, Pa.</td>
<td>1908-09</td>
<td>72 to 300 per cent a year</td>
</tr>
</tbody>
</table>

103 Id. at 66.
risk of substantial criminal punishment.\footnote{D. GALLERT, W. HILBORN & G. MAY, SMALL LOAN LEGISLATION 27-28 (1932).}

In the early years of this century, the Russell Sage Foundation became interested in small loan problems and sponsored the development of the \textit{Uniform Small Loan Law} which attacked the problem of high rate consumer loans by (1) fixing realistic legal rates (originally $3\frac{1}{2}$ percent per month on small loans); (2) requiring small loan lenders to be licensed and subject to regulation by State authorities; and (3) subjecting lenders to criminal penalties for violation of the small loan law.\footnote{Id. at 89-94. The most recent (7th) draft of the \textit{Uniform Small Loan Law} is set out in B. CURRAN, \textit{supra} note 62, at 144-57.} Laws patterned more or less closely after the \textit{Uniform Small Loan Law} were soon adopted in a number of States and there is presently legislation in all States except Arkansas which permits small loans to be made at rates higher than the general usury rates.\footnote{1 CCH INSTALLMENT CREDIT GUIDE 41 (Aug. 17, 1966); see B. CURRAN, \textit{supra} note 62. Rates presently range from approximately 12 percent to 40 percent. Most rates range around 3 percent per month for the first $300 and generally scale down in a series of steps on larger amounts if the law covers loans higher than $300.} The original maximum loan amount under the \textit{Uniform Small Loan Law} was $300 and a number of States still have this limitation, though other States have much higher small loan law ceilings.\footnote{1 CCH INSTALLMENT CREDIT GUIDE 41 (Aug. 17, 1966); B. CURRAN, \textit{supra} note 62, at 20-21.}

The enactment of the small loan laws substantially improved the position of the consumer-borrower of small sums by supplanting low usury rates with higher rates which provided a reasonable profit for credit suppliers. Social science researchers have made it clear that such laws do lower interest rates to consumers and that, in their absence, in more recent times, rates have been five or six times higher than the small loan rates.\footnote{D. GALLERT, W. HILBORN & G. MAY, \textit{supra} note 104; L. ROBINSON & R. NUGENT, \textit{supra} note 101; see Simpson, Cost of Loans to Borrowers Under Unregulated Lending, \textit{8 LAW & CONTEMP. PROB.} 73 (1941) for a study of small loan rates in some Southern States in the late thirties.}

\textbf{(2) Industrial and Installment Loan Laws.}—In addition to the small loan laws just discussed, most States have installment or industrial loan laws or both under which rates in excess of those allowed by the usury statutes may be charged. Industrial loan acts are statutory approvals of the Morris Bank Plan which was developed around 1910 by Arthur Morris to secure a yield greater than that permitted under the usury laws. Under the Morris Plan, a

\textit{...}
borrower pays interest at the highest legal rate for the full term of the loan and, in a "separate" transaction agrees to make monthly deposits with the lender which will be sufficient to repay the loan at its maturity date. Under this scheme the borrower pays approximately double the interest he would have paid had interest been computed on the basis of the declining balances of his debt as he paid into the payoff account. A stated rate of 6 percent, under

109 The following is a description of the beginning and operation of the Morris Plan:

While Pierre Jay was proposing a credit union law for Massachusetts, Arthur J. Morris, an attorney of Norfolk, Virginia, was studying the banking law of his state in an effort to find a practical method of lending to applicants for loans on salaries and wages. Because he was counsel for several banks, he was aware that banks refused loans to many worthy applicants who could not offer the kinds of security customarily required. He considered the lack of credit facilities by these applicants to be a distinct weakness of the American banking system.

Mr. Morris worked out a plan by which he believed loans could be made profitably by a banking institution under existing legislation. He raised capital among business men of Norfolk and applied to the Virginia State Corporation Commission for a bank charter. The charter was granted, and on March 23, 1910, the Fidelity Savings and Trust Company opened its doors.

The technique of this institution was ingenious. Funds were to be acquired by the sale of three classes of certificates. Common stock was represented by class A certificates, which were entitled to the earnings of the corporation. Class B certificates, which resembled the certificates of deposit used by some banks, bore interest at a fixed rate. Class C certificates, which were to be purchased by instalment payments, bore interest after a certain amount had been paid unless hypothecated as security for a loan.

Two or more endorsements were required as security for loans. Interest was discounted in advance at the legal rate plus an investigation fee amounting usually to $2.00 for each $100 borrowed. The borrower was required to repay the loan by weekly instalments which were credited, not to the principal of the loan, but to the purchase of non-interest-bearing class C certificates. The par value of each certificate was $50. If the face value of the loan was $200, the borrower contracted to buy four certificates at the rate of $4.00 a week for fifty weeks. When the purchase was completed, the certificates were cancelled and the proceeds used to liquidate the loan. Fines were levied for delinquency at the rate of 5 per cent a week on the amount in arrears.

The purpose of this elaborate mechanism was to increase the amount of interest charged without conflicting with the usury law. The maximum interest rate in Virginia was 6 per cent a year, but the courts had occasionally allowed banking institutions to charge in addition certain expenses of investigation. Mr. Morris relied upon these decisions to validate his proposed investigation fee. The device of crediting payments to a non-interest-bearing certificate was designed to disguise the increase in the true rate of interest which results from instalment repayments of principal when interest is discounted in advance. Stripped of these technicalities, the actual interest rate on a loan discounted at $8.00 per hundred and payable in 50 equal weekly instalments amounted to 17.7 per cent if the contract was met promptly and a higher rate if the borrower was delinquent in his payments.

Although the validity of these devices for increasing interest income was doubtful in most jurisdictions, the Fidelity Savings and Trust Company organized by Mr. Morris and his associates was quite secure because of its in-
this scheme, would produce an actual yield over a year of 10.9 percent simple annual interest if the interest is added to the principal, and 11.58 percent if it is deducted from the principal. Approxi-
mately one-half of the States have laws specifically applying to in-
dustrial banks which either approve the scheme described above or fix substitute statutory rates which allow a return larger than that permitted by general usury statutes. Most of the statutes do not impose dollar limits on loans which may be made under indus-
trial loan laws, though a few do. While in most States with indus-
trial bank laws, the industrial banks could lend at their higher rates to business operations, their primary market and market expertise has been in consumer loans.

Installment loan laws which authorize lenders to charge higher than usury rates on installment loans exist in about four-fifths of the States. In all States with such laws banks may lend at the installment loan rates and in some States only banks may lend at such rates. In other States, various types of lenders, and, in a few States, all lenders, may lend at the installment loan rates.

The rate provisions usually provide that a dollar discount or add-on may be charged at the beginning of the loan. These provisions, like the industrial loan provisions, result in a simple annual interest yield on installment loans which is approximately double the stated add-on or discount rate. In 17 States there is no max-
imum on the amount which may be loaned under installment loan

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110 In a 6 percent add-on loan for a year, the borrower receives $100 and pays back $106. In a 6 percent discount loan for a year, the borrower, receives $94 and pays back $100. In the first case he gets the use of $100 for $6, while in the second case he gets the use of $94 for $6.

111 B. CurrAn, supra note 62, at 52-60, 204-19. The author lists the following States as having industrial loan laws: Arizona, Arkansas (Arkansas does not, however, permit industrial banks to charge more than the usury rate of 10 percent a year), California, Colorado, Connecticut, Florida, Hawaii, Indiana, Kentucky, Maine, Massachu-
setts, Michigan, Minnesota, Missouri, Nebraska, New Hampshire, New York, North Carolina, Oregon, South Carolina, South Dakota, Tennessee, Utah, Virginia, Washing-
ton, West Virginia, and Wyoming.

112 Id. at 57.
provisions — and in those States, the installment loan law becomes, in effect, a special general usury law applying to all loans repayable in installments.\textsuperscript{113} In the other States there are limits on the amounts which may be loaned at installment loan rates ranging from as low as $1,000 in Wyoming to $15,000 in Illinois. The installment loan rates are usually around 12 percent simple annual interest and in only two States are they higher than 15 percent on amounts larger than $1,000.\textsuperscript{114}

In addition to the small loan, industrial loan, and installment loan laws, most States have special provisions for credit unions and pawnbrokers which allow them to charge more than the general usury rates for loans. Also, many States have special statutory provisions authorizing higher rates for home improvement loans, check loans, second mortgage loans, and others.\textsuperscript{115}

The small loan, industrial loan, and installment loan laws and other special consumer lending laws, together carve out a massive area of credit which is not subject to the general usury laws.\textsuperscript{116} These statutes, not the general usury laws, are now, it should be observed, the statutes which apply to control practically all consumer borrowing except home mortgage loans. This is particularly significant since perhaps the single most influential reason given for retention of usury laws is protection of the necessitous consumer-borrower.

(3) The “Time-Price” Exception to General Usury Laws. — As just pointed out, all States except Arkansas have concluded that the best solution to the problems of consumer credit is the statutory creation of exceptions to the general usury laws permitting lenders to charge higher rates under controlled conditions. Like-

\textsuperscript{113} The 17 States and the maximum simple annual interest yield on installment loans are as follows:

<table>
<thead>
<tr>
<th>State</th>
<th>Rate</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>10.90%</td>
</tr>
<tr>
<td>Delaware</td>
<td>11.58%</td>
</tr>
<tr>
<td>Georgia</td>
<td>10.90%</td>
</tr>
<tr>
<td>Hawaii</td>
<td>26.14%</td>
</tr>
<tr>
<td>Indiana</td>
<td>15.68%</td>
</tr>
<tr>
<td>Virginia</td>
<td>11.58%</td>
</tr>
<tr>
<td>Kansas</td>
<td>10.90%</td>
</tr>
<tr>
<td>Kentucky</td>
<td>9.58%</td>
</tr>
<tr>
<td>Maryland</td>
<td>11.58%</td>
</tr>
<tr>
<td>Nebraska</td>
<td>12%</td>
</tr>
<tr>
<td>New Mexico</td>
<td>12.68%</td>
</tr>
<tr>
<td>W. Virginia</td>
<td>11.58%</td>
</tr>
<tr>
<td>N. Carolina</td>
<td>11.58%</td>
</tr>
<tr>
<td>Oregon</td>
<td>10.90%</td>
</tr>
<tr>
<td>S. Carolina</td>
<td>12.68%</td>
</tr>
<tr>
<td>Texas</td>
<td>14.45%</td>
</tr>
<tr>
<td>Vermont</td>
<td>11.58%</td>
</tr>
</tbody>
</table>

These rates are interpolated from the information given in 1 CCH INSTALLMENT CREDIT GUIDE § 48 (Aug. 17, 1966).


\textsuperscript{115} See B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965), gives an excellent general survey of the many laws creating special rates for consumer transactions.
wise, all States except Arkansas give similar treatment to credit sales of goods either through the "time-price doctrine" or through various retail installment sales acts which have replaced the time-price rules.\textsuperscript{117}

Under the time-price doctrine a seller of goods may fix one price for a sale for cash and another for a sale on credit and the difference in price is not considered to be an interest charge, but rather is considered to be merely a higher price for the goods which the merchant may charge to cover the risks of selling on credit.\textsuperscript{118}

The principle was first announced in an 1827 English case\textsuperscript{119} and the first American case recognizing the doctrine appeared in Missouri in 1856.\textsuperscript{120} From its mid-19th century beginnings, the time-price doctrine swept across the country and it was not until the 1950's that two States, Arkansas and Nebraska, overruled their prior cases, and held a credit sale of goods to be subject to usury or small loan statutes.\textsuperscript{121}

The time-price doctrine and the rule that a purchase of a note or contract obligation at less than its face value is not subject to usury laws became the twin pillars supporting the great modern

\textsuperscript{117} Id. at 83-123.

\textsuperscript{118} As stated in the leading American case, Hogg v. Ruffner, 66 U.S. (1 Black) 115, 118-19 (1861):

[It is manifest that if A propose 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 may not 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; and one who will not distinguish between things that differ, may say, with apparent truth, that B pays a hundred percent for forbearance, and may assert that such a contract is usurious; but whatever truth there may be in the premises, the conclusion is manifestly erroneous. Such a contract has none of the characteristics of usury; it is not for the loan of money, or forbearance of a debt.

\textsuperscript{119} Beete v. Bidgood, 108 Eng. Rep. 792 (K.B. 1827). The concept, however, has a long history. Mention of the "time-price doctrine" appears as early as the 12th century when Pope Alexander III rejected it and ruled that credit sales at prices above the cash price were usurious. S. HOMER, A HISTORY OF INTEREST RATES 70 (1963). However, later scholastics managed to work in a higher price for credit sales as a part of the "just-price doctrine." Salin, Just Price, 8 ENCYC. SOC. SCI. 504, 506 (1932).

\textsuperscript{120} Mitchell v. Griffith, 22 Mo. 515 (1856). The court held that the doctrine did not apply where all of the $6,289 purchase price of land was paid except $379.72 for which 2½ months credit was given.

\textsuperscript{121} B. CURRAN, supra note 116, contains a general discussion of the significance of the time-price doctrine. For a more detailed discussion, see Britton & Ulrich, The Illinois Retail Installment Sales Act — Historical Background and Comparative Legislation, 53 NW. U.L. REV. 137 (1958); Warren, Regulation of Finance Charges in Retail Installment Sales, 68 YALE L. J. 839 (1959); Consumer Credit Symposium: Developments in the Law, 55 NW. U.L. REV. 303 (1960). Nebraska has now adopted a retail installment sales act permitting higher than usury rate credit charges in installment sales. See B. CURRAN, supra note 116.
credit sale society. The dealer sold on credit at a "time-price" and then sold the resulting conditional sales contract or account to a finance company. Since neither transaction was subject to usury laws, the rate charged to customers could be sufficiently high to provide a good return for the extension of credit and the finance company could purchase at a discount big enough to give it a good profit. Through this use of the two rules, banks and sales finance companies were able to avoid usury and small loan laws. The time-price doctrine, therefore, came to be used to allow banks and finance companies to charge rates for financing which they could not have charged had they been dealing directly with the buyer.

It is difficult to understand why courts should have been convinced that a credit sale of goods did not fall within the purview of usury statutes which generally are drafted in language similar to the following: "The rate of interest upon the loan or forbearance of any money, goods, or things in action, except as otherwise provided by law, shall be six dollars upon one hundred dollars, for one year, and at that rate, for a greater or less sum, or for a longer or shorter time." While a credit sale of goods is not a loan of money, it seems to be a forbearance of money and has the same economic consequences as a loan. However, in the early and middle 19th century, sales on credit may have been so infrequent that they did not appear to the courts to fall within the areas of usury statute concern. Perhaps this conclusion was facilitated by the fact that even cash prices were often not fixed firmly and were subject to haggling between buyer and seller.

Whatever the situation when the time-price doctrine was being developed, its use in the closing years of the 19th century to cover installment sales of sewing machines and pianos and its tremendous use from the 1920's onward to cover installment sales of automobiles and all types of consumer goods created an entirely different

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122 The usury statutes apply only to extensions of credit, that is, to cases in which an obligor promises to pay money in the future in return for a present advance. However, the sale by a person to whom money is due of his right to receive the money for a sum less than the amount due is not a transaction subject to the usury laws since the seller himself does not promise to pay money in the future. Cases are collected in Annot., 143 A.L.R. 238 (1943).

123 See Britton & Ulrich, supra note 121, at 140-44; Warren, supra note 121, at 857.

124 N.Y. GEN. OBLIGATIONS LAW § 5-501 (McKinney 1964). This statute is patterned closely after the first English statute authorizing an interest charge. A Bill Against Usury, 37 Hen. 8, c. 9 (1545).

125 Professor Warren suggests that this may have been one of the reasons for the early acceptance of the time-price doctrine. Warren, supra note 121, at 842.
situation. The purchaser of a new automobile may either borrow money from a bank or finance company and pay cash for the automobile or he may buy the automobile on credit from the dealer. In either case the economic result is the same, especially in view of the fact that in most cases the dealer who finances a sale immediately transfers the paper to a bank or sales finance company which, through a different office, would probably have loaned the purchase price directly to the buyer. In determining the "time-price" the seller usually uses a chart furnished him by his financing agency which shows the price which should be charged to produce the desired yield. In such circumstances, to say that the additional charge is not equivalent to an interest charge gets very farfetched indeed.

However, the doctrine continues; one court giving as an additional rationale for the rule the argument that "a purchaser is not like the needy borrower, a victim of a rapacious lender, since he can refrain from the purchase if he does not choose to pay the price asked by the seller." In this area, as in others, it can be assumed that the courts were "doing" better than they were "saying." So long as general usury laws were the alternative to the time-price doctrine, the time-price doctrine was the better choice. Holding that sales were subject to general usury statutes would have forced sellers into illegal transactions or into various subterfuges to avoid their impact. And the small loan and installment loan laws which ordinarily involved the concept of a licensed lender and substantial State regulatory authority did not adequately fit the thousands of retailers in the various States.

In spite of the fact that the time-price doctrine continued and remains in effect presently, it is clear that there is no economic difference between buying on credit and borrowing money to buy with cash. The argument that a buyer on credit is not likely to be victimized since he can refrain from the purchase if he does not like the terms and that, therefore, there is a distinction between sales credit and lender credit, does not stand close analysis. Often, purchases are as essential as any purposes for which money may be borrowed. An automobile, a washing machine, and even a television set can be considered necessities so that purchasing them on credit should not be treated differently from a small loan. In

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126 See Britton & Ulrich, supra note 121, at 140-44.
earlier years, transportation, laundry, and entertainment services may have been purchased from others at small daily and weekly cost. Today, however, public facilities have withered as the great bulk of these services are provided within the family unit. The purchase of a washing machine or a television set will ordinarily provide laundry service and entertainment at a lower cost than use of public facilities. In this context, the justifications for regulation and control of consumer lenders would seem to apply with equal force to consumer credit sellers.\footnote{128 See the similar arguments in Warren, supra note 121, at 841-43.}

The need for regulation of installment sellers in a way similar to the regulation of consumer lenders was recognized a good many years ago; the first installment sales act took effect in Indiana in 1935.\footnote{129 See Britton & Ulrich, supra note 121, at 151 n.59; 1 CCH INSTALLMENT CREDIT GUIDE § 35 (Aug. 17, 1966).} Today 43 States and the District of Columbia have retail installment sales laws fixing the maximum finance charge which may be imposed in credit sales.\footnote{130 The States which have no statutes regulating finance charge rates in credit sales are North Carolina, Rhode Island, South Carolina, Virginia, West Virginia, and Wyoming. 1 CCH INSTALLMENT CREDIT GUIDE § 35, at 1502-27, 1553-83 (Aug. 17, 1966). In Arkansas, credit sales are subject to the general 10 percent usury law.} These acts vary in coverage, some covering only motor vehicles, some only goods other than motor vehicles, and some which are so-called "all goods acts" covering sales of all kinds of goods. Some of the statutes are limited to sales for nonbusiness purposes while others apply generally to all credit sales.

The net effect of the evolution from the time-price doctrine to regulation through retail installment sales acts is to subject credit sales to regulation and rates very similar to those provided under small loan and installment loan acts and to leave another huge area of credit free from usury statute control.

(4) Exemptions for Loans to Corporations. —The time-price doctrine and small loan, installment loan, industrial loan, and similar laws take most nonreal estate consumer credit from under the general usury statutes. The exemptions for loans to corporations exclude from the usury laws loans at the other end of the lending spectrum.

The first corporate exemption statute grew out of the use of the usury statute by a New York bank to defeat what the business community considered to be a just debt.

In 1838, the Dry Dock Bank of New York City suspended
payments and its property was placed in receivership. The directors thereupon arranged a fairly complicated note-shaving agreement with the American Life Insurance and Trust Company to secure financing to reopen the bank.\textsuperscript{131} In 1842, after the financing agreement had put the bank on its feet, it sued to have its obligations to the trust company voided because the effective rate was higher than the allowable New York statutory interest rate. The New York court ruled in favor of Dry Dock.\textsuperscript{132}

The business community was repelled by the decision, and at the next legislative session a bill was passed forbidding corporations to plead the defense of usury.\textsuperscript{133}

From this beginning, the exclusion of loans to corporations spread until today 29 States and the District of Columbia allow corporate borrowers to pay any rate agreed upon.\textsuperscript{134} The basis for the legislative exemptions would seem to be that corporations do not need the protection of usury statutes. A corporate borrower will nearly always be fully aware of the rate it is paying. It will,

\textsuperscript{131} The bank secured from the American Life Insurance and Trust Company two certificates of deposit, each for £48,000 sterling, payable in London in installments over the next 2 years. In return the bank gave the trust company its own bills of credit for £50,000. The Dry Dock bills stipulated that they were payable in London in five equal installments plus interest at 6 percent, but the bank collaterally agreed to pay them in New York at $5 to the £, (about 13 cents per £ above the actual exchange rate) and at 7 percent interest. In addition, the trust company vice-president was paid $2,500 and was sold 1,000 shares of bank stock at the depressed prerefinancing price. To get immediate cash, the bank discounted the trust company certificates of deposit to other New York bankers for about £42,000 each.

\textsuperscript{132} Dry Dock Bank v. American Life Ins. & Trust Co., 3 N.Y. 344 (Ct. App. 1850).

\textsuperscript{133} Act of 1850, ch. 172, §§ 1, 2, as amended, N.Y. GEN. OBLIGATIONS LAW § 5-521 (McKinney Supp. 1967). An annotator of the Dry Dock case has said: "The iniquitous defense taken in this case led to the passage at the next session of the legislature of the Act of 1850, ch. 172, forbidding corporations to interpose the defense of usury." 3 N.Y. at 345 (5th ed. 1888).

In Butterworth v. O'Brien, 23 N.Y. 275, 276 (1861), the court referred to the Dry Dock case as follows:

"The celebrated case of The Dry Dock Bank v. The American Life and Trust Company . . . is an instance of a corporation availing itself of the statutes to prohibit usury, for the purpose of relieving itself from its contracts. It had committed usury, and had derived a benefit therefrom, and then came into a court of equity to punish its confere in guilt by repossessing itself of the property parted with, whilst retaining for its own benefit what it had received from the opposite party. This court, in obedience to the positive mandate of the statute, had to lend its aid to the perpetration of such gross injustice. It is not surprising that an act which produced such results should have been stigmatized, by one of the learned and eminent judges of this court, as "severely penal in its provisions," that, in fact, it was a barbarous act, unworthy of the age and country where it was found."

\textsuperscript{134} See Appendix A infra. New York, by a 1965 statute, gave corporations the right to plead usury as a defense if the rate charged is 25 percent or more. N.Y. GEN. OBLIGATIONS LAW § 5-521(3) (McKinney Supp. 1967).
also, have looked carefully for the best possible terms and, if it ends up paying a very high rate, it will almost always be because its credit position does not justify a loan at a lower rate. Though some corporations may ultimately fail because of a high interest burden, others will survive on borrowed money which they could not have secured at usury limit rates. On balance, it would seem that in the corporate area it is better to let the parties make their own bargains.

These 30 jurisdictions in which usury laws are not applicable to corporations plus the two States in which there are no general usury laws make a total of 32 jurisdictions in which corporations may borrow free from any statutory limitation on interest rates. In addition, nine other States fix maximum corporate borrower interest rates which are higher than those fixed by the general usury laws. There are only nine States (Arkansas, California, Colorado, Connecticut, Hawaii, Montana, Nevada, Rhode Island, and South Dakota) in which corporations are subject to the general usury laws, and in only one of these States, South Dakota, is the general usury limit lower than 10 percent. Of these nine States, Montana, Nevada, and South Dakota cannot be considered to be important corporation States. Connecticut corporations, being geographically close to Massachusetts, can no doubt secure financing without regard to usury limitation when needed, and, in California, banks are not subject to usury laws, so there are some available suppliers for loans at above usury rate.

The corporate exception statutes fix differing qualifications for the exemption. Many of them provide blanket corporate exemptions, but in some States there are special limitations. In New York, for example, the exemption does not apply to a corporation whose principal asset is a one- or two-family dwelling if it was organized within 6 months prior to the execution of any notes or security instruments issued in connection with the loan. The Washington statute makes a corporate borrower subject to the usury law on obligations on which an individual is also liable.

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135 See Appendix A infra.
136 Id.
137 However, given the conservative lending policies of banks, probably not a substantial amount of above 10 percent money is available from banks in California.
139 WASH. REV. CODE ANN. § 19.52.030 (Supp. 1967); see Hershman, Usury and
There has been a split of authority as to whether the exemption statutes apply to a corporation organized specially for the purpose of taking advantage of them. In New York it is permissible to form a corporation for the express purpose of avoiding the usury laws, and the same result has been reached in Maryland and Illinois on an estoppel theory.

On the other hand, New Jersey has taken a very hard line, holding that the defense of usury is available where a corporation is formed in an attempt to avoid the usury statutes. In 1956, the New Jersey Supreme Court suspended from practice for a year a lawyer who had arranged an incorporation for the purpose of avoiding the usury statute. Florida also has decisions inferring that general usury statutes apply where the incorporation is for the sole purpose of avoiding them. Even in New York, there are limits to the corporate exemption rule. In a case where the husband and wife owners of a small incorporated retail hardware business borrowed money through the corporation for the purpose of making a down payment on a home they were purchasing, the court held that the corporate exemption did not apply.

The effect of the corporate usury exemption, in spite of the cases holding that it cannot be used for the sole purpose of avoiding the usury statutes and in spite of exclusions from the corporation exceptions like those in New York and Washington, is to provide a vehicle by which borrowers for a business purpose can escape

the Tight Money Market, 22 Bus. L. 333, 340 (1967) for a further listing of some of the special State requirements for corporate usury exemptions.


143 In re Greenberg, 21 N.J. 213, 121 A.2d 520 (1956). The attorney failed to advise the party incorporating that the reason for incorporation was avoidance of usury statutes, and also failed to suggest that they might take $2,000 worth of marketable securities given as collateral for the particular loan and borrow elsewhere at lower rates. Therefore, it is not clear that the attorney would have been disciplined had the transaction been more straightforward.

144 Atlas Subsidiaries, Inc. v. O. & A., Inc., 166 So. 2d 458 (Fla. 1964). Florida applies a 15 percent rate to corporations and the charge in question was above 25 percent; therefore the Florida statutes were violated independently of the question of sham incorporation. The court, however, referred to the sham nature of the transaction.

the general usury laws. Incorporation may be inconvenient and may increase the total cost of the loan, but the incorporation method can be and is used to provide financing which would not otherwise be available.

(5) Exemption of Banks and Savings and Loan Associations or Savings Banks. —A number of States exempt banks and savings and loan associations from usury laws. California, Connecticut, Colorado, and Delaware exempt banks, although Delaware exempts banks only as to loans above $5,000 for which negotiable instruments, negotiable documents of title, or investment securities are given as collateral. A larger group of States, including California, Connecticut, Florida, Illinois, Louisiana, Minnesota, Ohio, South Dakota, West Virginia, and probably some others, exempt savings and loan associations.

The reason for the exclusion presumably is that these are public investment institutions under governmental supervision and under a fiduciary duty to depositors which makes it very unlikely that any rate which they might charge would be unreasonable.

(6) Other Exemptions. —In addition to the various exemptions covered above, there are a variety of miscellaneous exemptions or special higher rates which may be found scattered through the States. Illinois and Maine, for example, impose no statutory maximum on any business loan, nor on loans of $5,000 or more secured

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140 CAL. CONST. art. 20, § 22.
149 DEL. CODE ANN. tit. 6, § 2302 (1953).
150 CAL. CONST. art. 20, § 22.
152 CONN. GEN. STAT. ANN. § 36-178(e) (1958).
153 FLA. STAT. ANN. § 665.18 (1966); see Spinney v. Winter Park Bldg. & Loan Ass'n, 120 Fla. 453, 162 So. 899 (1935).
154 ILL. ANN. STAT. ch. 32, § 800 (Smith-Hurd 1967).
156 MINN. STAT. ANN. § 334-06 (1966).
159 W. VA. CODE ANN. § 51-6-17 (Supp. 1967).
160 Research in the State statutes in this area is difficult because of the different places in which exemptions from the usury laws are placed and the failure of index systems to index some of the provisions under interest or usury. On savings and loan associations and the usury laws, see Prather, Savings Association Mortgages and the Usury Laws, 1960 UNITED STATES SAV. & LOAN LEAGUE LEGAL BULL. 125.
by warehouse receipts, or negotiable instruments or securities.\textsuperscript{161} Connecticut exempts loans of $5,000 or more secured by "bona fide" mortgages of real property.\textsuperscript{162} Some States exempt Federal Housing Authority (FHA) insured home improvement loans\textsuperscript{163} and about 30 States exempt FHA-insured home mortgage loans.\textsuperscript{164} There are, no doubt, other exemptions scattered through the statute books of the 50 States and the District of Columbia which could be forced to the surface by a skindiver willing to spend weeks poking about in the murky waters of the State laws.

C. \textit{Percentage of Total Private Debt Subject to Usury Laws}

The existence of the various exemptions from the usury laws just discussed makes it clear that a substantial portion of outstanding private debt in the United States is not subject to the general usury laws. Particularly, nearly all nonreal estate secured consumer debt is either subject to special interest rates much higher than the usury rate or is not subject to rate control at all under the time-price doc-

\textsuperscript{161} \textit{ILL. ANN. STAT.} ch. 74, § 4 (Smith-Hurd 1967) reads in pertinent part:

\[\text{It is lawful to charge, contract for, and receive any rate or amount of interest or other compensation with respect to the following transactions: (a) Any loan made to a corporation; (b) Advances of money, repayable on demand, to an amount not less than $5,000, which are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, if evidenced by a writing; (c) Any business loan to a business association or copartnership or to a person owning and operating a business as sole proprietor or to any persons owning and operating a business as joint venturers, or to any limited partnership, or to any trustee owning and operating a business or whose beneficiaries own and operate a business, transacted solely for the purpose of carrying on or acquiring the business of such business association, copartnership, joint venture, limited partnership, trustee, beneficiaries, or persons; except that any loan which is secured (1) by an assignment of an individual obligor's salary, wages, commissions or other compensation for services, or (2) by his household furniture or other goods used for his personal, family or household purposes shall be deemed not to be a business loan; and provided further that a loan which otherwise qualifies as a business loan shall not be deemed a non-business loan by the inclusion, with other security, of real estate occupied by an individual obligor solely as his residence.}\]

\textit{See also} \textit{ME. REV. STAT. ANN. tit. 9, § 229} (Supp. 1967).

\textsuperscript{162} \textit{CONN. GEN. STAT. ANN.} § 37-9 (1958).

\textsuperscript{163} \textit{See, e.g., ILL. ANN. STAT.} ch. 74, § 4(d) (Smith-Hurd 1967).

\textsuperscript{164} Hershman, \textit{supra} note 139, at 341, lists the following States as having excluded FHA-insured loans from State usury statutes: Alabama, Arizona, Florida, Hawaii, Indiana, Iowa, Kansas, Kentucky, Michigan, Minnesota, Mississippi, Missouri, Montana, Nebraska, Nevada, New Jersey, New Mexico, New York, North Carolina, North Dakota, Pennsylvania, Oklahoma, South Carolina, South Dakota, Utah, Vermont, Washington, West Virginia.
trine. Further, most corporate debt is not subject to any statutory maximum rate.

Unfortunately, debt figures by appropriate classification are not available on a State-by-State basis and it is impossible to make an exact determination as to the amount of outstanding debt which is subject to usury statutes. However, the Federal Reserve Board does report total debt figures on a national basis. Using the Federal Reserve figures plus the information set out above concerning State usury laws and the exemptions, a rough approximation as to the percentage of national private debt which is subject to general usury laws can be made. This approximation, while it is not much more than an educated guess, will be sufficiently accurate to allow the drawing of some conclusions concerning the actual effect of usury laws on the money market.

As of December 31, 1966, the last period for which the Federal Reserve Board had reported full figures as of the time this was written, the total debt in the United States, excluding federal, State, and local governmental obligations, was $659.1 billion.\(^\text{165}\)

This debt breaks down roughly as follows:\(^\text{166}\)

<table>
<thead>
<tr>
<th>Type of Debt</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Consumer debt</td>
<td>$ 94.7 billion</td>
</tr>
<tr>
<td>Household real estate mortgages (1-to 4-family dwellings)</td>
<td>$224.1 billion</td>
</tr>
<tr>
<td>Commercial real estate mortgages</td>
<td>$ 99.9 billion</td>
</tr>
<tr>
<td>Corporate bonds</td>
<td>$108.0 billion</td>
</tr>
<tr>
<td>Bank farm credit</td>
<td>$ 8.5 billion</td>
</tr>
<tr>
<td>Farm mortgage debt</td>
<td>$ 23.3 billion</td>
</tr>
<tr>
<td>Bank commercial loans</td>
<td>$ 80.5 billion</td>
</tr>
<tr>
<td>Other loans</td>
<td>$ 20.1 billion</td>
</tr>
</tbody>
</table>

Of that debt, it may be assumed that practically all of the const---

---\(^\text{165}\) FED. RESERVE BULL., Feb. 1968, at A-65.12, Table 6. These figures do not include corporate stock or financial system (for example, banks and savings and loan associations) borrowing.

---\(^\text{166}\) All figures in the following breakdown were taken from FED. RESERVE BULL., Feb. 1968. However, the various charts from which the amounts are taken sometimes show minor percentage differences. For example, id. at A-44 shows the 1-to 4-family dwelling debt as $224.1 billion while id. at A-65.12 shows it as $222.8 billion. Such differences are not significant for our purposes and no attempt has been made to determine which figure is accurate or why they differ.

---\(^\text{167}\) Id. at A-48.

---\(^\text{168}\) Id. at A-44.

---\(^\text{169}\) Id.

---\(^\text{170}\) Id. at A-65.12, Table 6.

---\(^\text{171}\) Id. at A-22.

---\(^\text{172}\) Id. at A-44.

---\(^\text{173}\) Id. at A-22.

---\(^\text{174}\) All the other items were subtracted from the total private debt to get this figure.
Consumer debt of $94.7 billion was not subject to general usury laws because of the time-price doctrine and the small loan, industrial loan, installment loan laws, and retail installment sales laws. Some part of the debt, primarily single payment loans, and Arkansas transactions, is subject to usury statutes. As a conservative estimate it is assumed that 80 percent or $75.8 billion of the 1966 consumer debt was not subject to usury statutes.

Because of the corporate exemptions from usury statutes and the bank exemptions in California, Connecticut, Colorado, and Delaware, it is estimated that a major part of the commercial real estate debt, corporate bond debt, and bank commercial loan debt, is not subject to usury statutes. Of this total of $288.4 billion, it is assumed that 90 percent of the bond debt of $108 billion was not subject to the general usury laws, that 80 percent of the total bank commercial loan volume of $80.5 billion was not subject to usury laws, and that 66.6 percent of the commercial mortgage debt of $99.9 billion was not subject to usury laws. The 80 percent estimate for bank commercial loans and the 66.6 percent estimate for commercial real estate loans reflect an attempt to take into consideration loans to unincorporated businesses, a method of operation which is particularly prevalent in commercial real estate financing. On this basis, $228 billion of the total business debt of $288.4 billion would not have been subject to usury laws.

Of the $224.1 billion in one- to four-family dwelling mortgages outstanding on December 31, 1966, $64.8 billion was held by life insurance companies. These mortgages would apparently have been subject to usury statutes in all States except the two States without usury laws and Connecticut. If we deduct 5 percent as the estimated total for loans made in those States, $61.6 billion of these loans were subject to usury statutes. At that time, commercial banks held $34.8 billion in household real estate mortgages, and by assuming that 10 percent of this amount was in those States without usury laws or where banks are not subject to usury statutes, $31.3 billion of this debt is left subject to usury statutes. As of Dec.

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176 Installment loan exemptions to the usury statutes, by definition, do not apply to single payment loans. Single payment loans might fall under some other exception to the general usury laws such as small loan laws or credit union laws, but, so that any error in the estimate made will be in favor of usury statute coverage, it is assumed that all single payment consumer credit was subject to usury statutes. As of Dec. 31, 1966, $7.8 billion of single payment consumer credit was outstanding. FED. RESERVE BULL., Feb. 1968, at A-48.

176 Id. at A-45.

177 Id. at A-44.
December 31, 1966, savings and loan associations and savings banks held $114.4 billion\textsuperscript{178} of home mortgage debt. In at least 11 States, savings and loan associations are not subject to usury statutes. Assuming that 25 percent of savings and loan loans were made in those States and the no-usury States, $85.8 billion of savings and loan and savings bank home mortgage debt was subject to usury statutes. Therefore, a total of $188.7 billion of residual real estate debt as of December 31, 1966 was, on the above estimates, subject to general usury laws and $35.4 billion was not.

Of the total farm real estate and bank credit of $31.8 billion as of December 31, 1966, it is assumed that roughly 90 percent was subject to usury statutes. The other 10 percent is attributed to (a) those States which have no usury statutes, (b) those States which exempt banks and savings and loan associations from usury laws, and (c) loans to farmers under installment loan laws. On this assumption about $28.8 billion of 1966 farm real estate and bank credit was subject to usury statutes and about $3 billion was not. For the purposes of our discussion it will be assumed that all of the $20 billion of “other loans” shown in the total debt breakdown was subject to usury statutes.

On the above estimates something like $343 billion, more than half of the total 1966 debt of $659.1 billion, was not subject to usury statutes. Even though the calculations are subject to substantial error, it is believed that the error is toward including too much of the debt within usury statute regulation and that actually at least 60 percent of private debt is not subject to usury statute control.

An unpublished study made for the National Conference of Commissioners on Uniform State Laws also supports the conclusion that most private debt in the United States is not subject to general usury statutes.\textsuperscript{179} That study, which covers 15 States considered to be representative, attempts to establish on a State-by-State basis the proportions of various kinds of debt subject to usury statutes. The study is an approximation only, depending on such sources of information as the number of under-$20,000 real estate mortgage filings in each State, the percentage of national income received by the citizens of the State, the percentage of national farm income

\textsuperscript{178} Id. at A-45.

\textsuperscript{179} H. Bailey, Analysis of Existing Debt in the United States and State by State on Basis of Existing Laws Affecting Interest Rates and Finance Charges (unpublished 1966) (copy on file in University of Illinois, College of Law library). (That study and its conclusions reflected the views and conclusions of its author and not necessarily the views and conclusions of the National Conference of Commissioners.)
reserved by the farmers in each State, and a survey of the State usury and interest laws. In spite of the necessary approximations, the study is sufficiently accurate to serve our purposes.

The study estimates that in California, which exempts savings and loan associations and banks from the general usury statutes and provides special rates for industrial loan companies, credit unions, pawnbrokers, personal property brokers, and some nonprofit cooperatives, only 38 percent of all private debt is subject to the general usury statutes. The author estimates that approximately 2 percent of household mortgage and consumer debt is subject to the general usury statutes, as is approximately 80 percent of farm credit, and 66 percent of business credit.

In Colorado, which exempts banks, savings and loan associations, and title and guarantee company loans over $1,500 from the usury laws, and provides special rates for small loans, retail installment sales, industrial banks, credit unions, and pawnbrokers, the study estimates that 45 percent of all private lending is subject to usury statutes. It is estimated that approximately 25 percent of household mortgage and consumer credit is subject to usury statutes, as is 68 percent of business credit, and 33 percent of farm credit.

Florida exempts from the general usury statutes sales of bonds, money loaned on the security of bonds, and loans by building and loan associations or pawnbrokers. There are special rates for small loans, retail installment sales, corporate borrowers, bank installment loans of $5,000 or less, and loans by credit unions and individual savings banks. The study estimates that 35 percent of total private debt in Florida is subject to the general usury statutes and that 53 percent of household mortgage and consumer debt is subject to the general usury statutes, as is 20 percent of business debt and 25 percent of farm debt.

In Indiana, which exempts corporate borrowers from the general usury law and provides special rates for small loans, installment loans, industrial loan and investment companies, credit unions, pawnbrokers, and, to a limited extent, savings and loan associ-
tions and banks,\textsuperscript{187} it is estimated that 45 percent of all private debt is subject to the usury law. It is estimated that 76 percent of household mortgage and consumer credit, 18 percent of business credit, and 83 percent of farm credit is subject to the usury law.\textsuperscript{188}

New York exempts from the general usury laws any demand loan of $5,000 or more secured by a security, document of title, or negotiable instrument and also exempts loans to corporate borrowers. It provides special rates for small loans, retail installment sales, bank and trust company loans, and loans by industrial banks, credit unions, and pawnbrokers.\textsuperscript{189} It is estimated that 23 percent of New York loans are subject to the general usury statute, and that 56 percent of household and consumer credit is subject to usury laws, as is all of farm credit and approximately 12 percent of business credit.\textsuperscript{190}

The reader will not be further encumbered with State-by-State detail, but following are estimates as to the total percentage of private debt which is subject to the general usury statutes in the 10 other States surveyed (charts for all these States are included in Appendix B): Connecticut, 41 percent; Georgia, 33 percent; Indiana, 45 percent; Iowa, 47 percent; Michigan, 44 percent; Minnesota, 34 percent; New Jersey, 39 percent; New Mexico, 36 percent; Ohio, 51 percent; Pennsylvania, 24 percent.

In summary, of the 15 States studied, it is estimated that in only one, Ohio, is 50 percent or more of the total volume of private debt in the State subject to general usury statutes. Also, it is clear from the study, as it is from the statutory material surveyed earlier, that by far the greatest impact of usury statutes is in the area of home real estate mortgages and farm finance. Other than in these two areas, usury statutes have no substantial impact in States with a corporate exemption, nor is there substantial interference with corporate finance in those States which instead have a high usury ceiling or a special high ceiling for corporate borrowers. Legislators, though so far unwilling to completely repeal usury laws, have filled the statute books with exemptions which have taken care of many of the situations in which usury laws interfered with lending operations.

\textsuperscript{187} H. Bailey, \textit{supra} note 179, at Indiana 2-3.
\textsuperscript{188} \textit{See} Appendix B, chart 7 \textit{infra}.
\textsuperscript{189} H. Bailey, \textit{supra} note 179, at New York 4-5.
\textsuperscript{190} \textit{See} appendix B, chart 13 \textit{infra}. 
D. Some Significant Effects of Usury Laws

The sections which follow discuss the effect of the present usury statutes upon (1) home mortgage finance, (2) farm lending, and (3) business loans.

(1) Home Mortgage Loans and the Usury Laws. —Home mortgage loans constitute, by far, the largest single lending area covered by general usury laws and make up a substantial portion of all debt subject to the general usury statutes of the various States. Of the $232.1 billion of one- to four-family home mortgage debt outstanding in the third quarter of 1967,\textsuperscript{191} a substantial proportion, perhaps as much as $200 billion, is subject to general usury laws.

It is submitted that the usury laws in this area do more harm than good. The fear that without usury ceilings mortgage interest rates would go higher and higher is not justified by the facts. Interest rates on home mortgages are responsive to general money market levels and do not go to usury ceiling rates unless the general market interest rates approach the usury ceiling. The chart in the footnote\textsuperscript{192} which sets out interest rates for 18 metropolitan areas

\textsuperscript{191} FED. RESERVE BULL., Feb. 1968, at A-44.

\textsuperscript{192} INTEREST RATES OF CONVENTIONAL FIRST MORTGAGE LOANS ORIGINATED ON SINGLE — FAMILY HOMES BY MAJOR TYPES OF LENDERS

<table>
<thead>
<tr>
<th>Month of December</th>
<th>1963</th>
<th>1964</th>
<th>1965</th>
<th>1966</th>
<th>1967</th>
</tr>
</thead>
<tbody>
<tr>
<td>Atlanta</td>
<td>5.87%</td>
<td>5.64%</td>
<td>5.92%</td>
<td>6.86%</td>
<td>6.92%</td>
</tr>
<tr>
<td>Baltimore</td>
<td>5.61</td>
<td>5.54</td>
<td>5.54</td>
<td>6.00</td>
<td>6.00</td>
</tr>
<tr>
<td>Boston</td>
<td>5.25</td>
<td>5.28</td>
<td>5.24</td>
<td>6.22</td>
<td>6.36</td>
</tr>
<tr>
<td>Chicago</td>
<td>5.64</td>
<td>5.42</td>
<td>5.47</td>
<td>6.38</td>
<td>6.31</td>
</tr>
<tr>
<td>Cleveland</td>
<td>5.83</td>
<td>5.74</td>
<td>5.76</td>
<td>6.52</td>
<td>6.26</td>
</tr>
<tr>
<td>Dallas</td>
<td>5.90</td>
<td>5.77</td>
<td>5.87</td>
<td>6.82</td>
<td>6.72</td>
</tr>
<tr>
<td>Denver</td>
<td>6.05</td>
<td>5.78</td>
<td>6.04</td>
<td>6.65</td>
<td>6.58</td>
</tr>
<tr>
<td>Detroit</td>
<td>5.55</td>
<td>5.53</td>
<td>5.53</td>
<td>6.43</td>
<td>6.50</td>
</tr>
<tr>
<td>Houston</td>
<td>5.87</td>
<td>6.19</td>
<td>6.10</td>
<td>6.96</td>
<td>6.57</td>
</tr>
<tr>
<td>Los Angeles-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Long Beach</td>
<td>6.05</td>
<td>6.12</td>
<td>6.07</td>
<td>6.50</td>
<td>6.58</td>
</tr>
<tr>
<td>Memphis</td>
<td>5.73</td>
<td>5.87</td>
<td>5.73</td>
<td>6.64</td>
<td>6.76</td>
</tr>
<tr>
<td>Miami</td>
<td>5.87</td>
<td>5.80</td>
<td>5.97</td>
<td>6.36</td>
<td>6.45</td>
</tr>
<tr>
<td>Minneapolis-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>St. Paul</td>
<td>5.52</td>
<td>5.63</td>
<td>5.68</td>
<td>6.77</td>
<td>6.75</td>
</tr>
<tr>
<td>New Orleans</td>
<td>5.75</td>
<td>5.67</td>
<td>5.91</td>
<td>6.63</td>
<td>6.98</td>
</tr>
<tr>
<td>New York</td>
<td>5.85</td>
<td>5.76</td>
<td>5.72</td>
<td>5.98</td>
<td>6.00</td>
</tr>
<tr>
<td>Philadelphia</td>
<td>5.52</td>
<td>5.47</td>
<td>5.54</td>
<td>6.01</td>
<td>6.05</td>
</tr>
<tr>
<td>San Francisco-</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Oakland</td>
<td>5.95</td>
<td>5.86</td>
<td>5.89</td>
<td>6.85</td>
<td>6.71</td>
</tr>
<tr>
<td>Seattle</td>
<td>5.79</td>
<td>5.77</td>
<td>5.81</td>
<td>6.94</td>
<td>6.85</td>
</tr>
<tr>
<td>UNITED STATES</td>
<td>5.80%</td>
<td>5.76%</td>
<td>5.78%</td>
<td>6.44%</td>
<td>6.45%</td>
</tr>
</tbody>
</table>

* Based on data from the Federal Home Loan Bank Board-Office of Public
as of December for the years 1963 through 1967 is very instructive in this regard. In 1963, the rates ranged from a low of 5.25 percent in Boston to a high of 6.05 percent in Los Angeles-Long Beach. Neither of these areas has or had a usury statute which had any effect on these rates. Massachusetts has no usury law at all and California exempts banks and savings and loan associations from its 10 percent general usury limit. Boston is, however, in a capital surplus area while Los Angeles is in a capital shortage area. Boston, in a State which has had no usury limitation for 100 years, also had the lowest home mortgage interest rates in the years 1964 and 1965. As general interest rates rose in 1966 and 1967 and 6 percent usury laws began to bite, the reported rates in New York, Baltimore, and Philadelphia, all in 6 percent States, fell below those of the Boston area. If this were all there is to the story, usury laws would be vindicated, for the conclusion would be that they do operate to hold down interest rates when they should operate, that is when rates are rising. However, that is not the whole story.

The home mortgage market is not insulated from other money markets and markets in 6 percent States are not insulated from the markets in States with 8, 9, 10, or 12 percent usury rates. When, in New York, for example, the general interest rate reaches such a level that general commercial and business loans are being made at above 6 percent and bond yields are above 6 percent,103 it would seem obvious that one of two things is going to happen. Either methods of evading the usury laws are going to be found or a substantial amount of money will be diverted from the local home mortgage market to other, more profitable areas. As a matter of fact, both things happen.

The practice of taking discounts or "points" is presently being used in New York to avoid the 6 percent ceilings.104 The point system operates in the following way. A builder or seller prices his

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103 The highest prime interest rates reported in this century were in 1920 when the average interest rate for that year on 4- to 6-month commercial paper was 7.5 percent. S. HOMER, A HISTORY OF INTEREST RATES 364 (1963). The highest rates presently for prime money range around 6.5 percent. See text accompanying notes 40-43 supra. However, some first mortgage home loan rates presently are above 7 percent. See NATIONAL OBSERVER, Apr. 8, 1968, at 1, col. 6.

104 "A 'point' is 1 percent of the original principal amount of the mortgage debt, to be paid in cash to the lender. The term of the debt is irrelevant. A $40,000 mortgage with two points means that the borrower (or seller) pays the lender $800 in cash at the inception of the transaction." Felsenfeld, Consumer Rates, A Public Learning Process, 23 BUS. LAW. footnote 9 (forthcoming fall 1968). N.Y. Times, Nov. 10, 1967, at 71, col. 1, reported the point operations in New York.
house at, say, $25,000. A buyer appears who is willing to pay $25,000 if he can secure a loan of $18,000. The lender, however, says he will make a loan of $18,000 at the usury limit of 6 percent only if the seller pays him $1,800, which the seller does. The effect of this transaction is that the lender is repaid $18,000 plus interest at 6 percent, even though he has actually loaned only $16,200. The $1,800 discount or 10-point deduction from the stated loan of $18,000 is, in reality, additional yield or interest payment to the lender. If the above loan is payable over a 20-year period, the actual yield received by the lender will be approximately 7.3 percent simple annual interest. The point or discount system also imposes heavy penalties on the borrower if the loan is paid off early. In that case the effective interest may rise sharply. For example, if the loan is paid off in 8 years the effective yield is increased to approximately 9 percent and if the loan is repaid in 3 years the interest rate raises to approximately 13.2 percent.\textsuperscript{106}

It might be argued that when the seller pays the points (and therefore takes less for his house than his stated price), the borrower is not really affected by the points. But, the usual result of the existence of a point system is that the seller increases the price of his house so that he can absorb the discount. The writer has not been able to find any cases dealing with the question of whether the discounts violate usury statutes. The fact is they do result in additional yield to the lender and should be treated as additional interest.\textsuperscript{106} In spite of the fact that the legality of points is ques-

\textsuperscript{105} The net effect on the interest rate of the stated discount was computed by taking the total monthly amount necessary to pay off an amortized loan of $18,000 over periods of 20, 8, and 3 years and then computing this cost per $1,000 on a loan of $16,200 for the same period of time. The cost per $1,000 was then translated into interest cost.

\textsuperscript{106} It has been pointed out by a recent writer on the subject that if the seller of a house takes a mortgage and note back himself at the highest stated interest rate and immediately transfers the note and mortgage to a lender at a price less than the face amount of the mortgage, no usury would be involved. Hershman, \textit{Usury and the Tight Money Market}, 22 BUS. LAW. 333 (1967). While this is true (see the discussion text accompanying note 122 supra) it does not necessarily follow that the same result should be reached where the mortgage runs directly to the bank or finance company.

The New York Commissioner of Banks was quoted in the \textit{New York Times} as saying: "the point is neither higher interest rates nor lower interest rates, but a realistic flexibility . . . ". \textit{N.Y. Times}, Nov. 10, 1967, at 71, col. 1.

The Uniform Consumer Credit Code, in the case of commercial sellers of houses, would treat the difference between the cash price of the house and the total time price as interest. If, for example, a developer regularly sold house model B-5 in his subdivision at $35,400 for cash and in a particular transaction extended the credit himself at a price of $37,000 at interest of 6 percent, the $1,600 difference between the cash price and the credit price would be treated as additional interest. \textit{Uniform Consumer Credit Code} §§ 2-109,-110 (Tent. Draft No. 8, 1968).
tionable, they are taken because otherwise the lender could get higher returns elsewhere.

There are at least two reasons for objecting to the point or discount system. First, since the points paid are not dependent on the length of the loan and since no part of them is refunded when the loan is prepaid, they work rather high penalties for prepayment. Second, they often result in misleading a buyer. Even if the buyer knows of the discount he may not understand its effect on the rate. However, far more serious is the fact that the home buyer will often not know that the seller is paying a discount to the lender. If the buyer knew the amount of discount and the effect on the rate, he might prefer to arrange a loan from a different lender, or use other assets of his own in the purchase, or, perhaps, forego the purchase until credit is available on better terms. \(^{106a}\)

Even though the point system is widely used to get around usury statutes, the ability of prospective home buyers to secure loans is substantially reduced when market rates go above usury ceilings. Many lenders are reluctant to lend at high discounts because of a feared adverse effect on their public image and because of doubt as to the legality of the discount system. \(^{197}\) The New York Times, on March 7, 1968, reported that the Bowery Savings Bank of New York City, with assets of $2.9 billion (more than 1 percent of total national one- to four-family dwelling mortgage credit), would lend only to persons who had been depositors for a year or more. \(^{198}\) The Times reported that the Bowery Bank thus fell in line with other New York City savings banks which had been following the same policy for some time. It also reported that in 1967 New York savings banks only invested $916 million within New York while investing $1,100 million outside the State where allowable returns were higher. While this writer does not have similar figures for other States with low usury ceilings, it is more than reasonable to assume that such States find themselves in a similar situation. That this is so is evidenced by the fact that in Pennsylvania, a 6 percent

\(^{106a}\) The recently enacted Consumer Credit Protection Act would require the disclosure of the effect on the rate of the payment of points. Consumer Credit Protection Act (as passed by Congress, May 22, 1968). The text of the act may be found in CCH INSTALLMENT CREDIT GUIDE (2d extra ed., No. 177, May 24, 1968). Therefore, this particular objection to the point or discount system should lose its force. The prepayment penalty aspects of the point system, however, remain.

\(^{197}\) Hearings on Mortgage Credit Before the Subcomm. on Housing and Urban Affairs of the Senate Comm. on Banking and Currency, 90th Cong., 1st Sess. 86 (1967).

\(^{198}\) N.Y. Times, Mar. 7, 1968, at 61, col. 4.
State, an attempt is being made to raise the home mortgage usury rate from 6 percent to 7 percent via a 1 percent "premium" which may be charged in addition to the general usury rate.\(^{199}\)

It appears that the home mortgage market suffers first and hardest when money becomes tight. In the 1966 tight money market, the seasonally adjusted annual rate of housing starts declined from 1,735,000 in April to 819,000 in October.\(^{200}\) Of course, not all the drop in housing starts can be attributed to usury laws. Even in States with usury rates which were high enough to be out of the way of the market rates, housing starts dropped.\(^{201}\) Other factors such as the hesitancy of borrowers to pay high interest rates and the preference of lenders for alternative investments were also involved.\(^{202}\) In addition, the 1966 drop was partly caused by a substantial outflow of funds from savings and loan associations because of a large differential between interest rates which savings and loans were allowed to pay and the rates which banks were allowed to pay on certificates of deposit.\(^{203}\) However, as already pointed out, low usury ceilings do result in a substantial reduction of the flow of money into the home mortgage market.\(^{204}\)

In this regard, the experience of the federal government with restrictions on interest rates for Federal Housing Administration (FHA) and Veterans' Administration (VA) insured loans is worthy of careful consideration. After World War II, FHA maximum rates were first set at 41/2 percent and VA maximum rates at 4 percent. However, the 1950's and 1960's were periods of rising interest rates and by steps, usually 1/4 percent at a time, the maximum interest rates were raised and finally reached 6 percent in October 1966.\(^{205}\) However, the maximum rates were not increased fast enough to keep pace with the general increase in interest rates and steep discounts developed many times, sometimes going as high as 10 percent of the loan.\(^{206}\) Twice, in 1950 and in 1957, Congress

\(^{199}\) Pa. Senate Bill 1239 (1967) as amended.

\(^{200}\) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, 90TH CONG. 1ST SESS., REPORT ON MORTGAGE DISCOUNTS 13 (Comm. Print 1967).

\(^{201}\) Hearings, supra note 197, at 218.

\(^{202}\) Id. at 18.


\(^{204}\) See also the testimony of Undersecretary Barr of the Treasury Department, in Hearings, supra note 197, at 49.

\(^{205}\) Id. at 41, Table C.

\(^{206}\) DEPARTMENT OF HOUSING AND URBAN DEVELOPMENT, supra note 200, at 30.
attempted to enforce the federal FHA and VA "usury laws" by controlling discounts and each time the provisions were repealed. Each time it appeared that they had the effect of driving prospective lenders from the market and, therefore, of depriving mortgage funds to the marginal borrower. From the repeal in 1958 until

Following is a part of the Senate report made in 1957 in connection with the repeal of the last discount control legislation:

**DISCOUNT CONTROLS**

In response to very forceful presentations by the Federal Housing Administration and the Veterans' Administration, section 6 of the bill would repeal certain provisions of law which require detailed regulation of discounts charged by lenders to increase the yield of FHA-insured and VA-guaranteed loans. The statement made by the Commissioner of the Federal Housing Administration reads, in part, as follows:

"• • • FHA has made every effort to administer the provisions of this section in a manner that would cause as little disruption of the normal practices of the homebuilding and financing industries as possible, while at the same time preventing any excessive charges to home buyers. In spite of these efforts this provision has created confusion and reluctance on the part of lenders toward using FHA-insured financing. This is working a hardship against prospective home buyers, particularly in the lower priced housing area where higher loan-value-ratio mortgages are most needed.

"These controls should be repealed for the following reasons also:

"1. They tend to increase costs for mortgage money because the permitted maximum discount becomes the standard charge for the best transactions.

"2. Discount controls actually have the effect of excluding from FHA programs those categories of borrowers who are most in need and whom the controls are intended to aid — low-income families, minority group families, and residents of small towns.

"3. It is not administratively feasible to establish variations in permissible discounts for all of the factors which are believed by secondary market buyers to constitute justification for variations in discounts. Furthermore, effective understanding and enforcement by both FHA and industry requires that discount controls be simplified to a maximum extent. Under these conditions, all scarcities of mortgage money for specific situations tend to be ascribed to the inadequacies of discount controls and the administration of such controls is made still more difficult.

"4. Costs of enforcing such controls are great and are unavoidable if industry's respect for FHA regulations is to be maintained.

"5. Aggregate funds for FHA-insured mortgages tend to be less under discount controls. These controls unnecessarily complicate the operations of the mortgage lending industry and as such many lenders will favor alternative investments rather than attempting to operate under such control regulations. Also, funds which would otherwise be allocated to marginal cases because of the higher yields on cases with greater than average discounts, will seek other areas of investment.

"We believe these controls, in reality, penalize those they are supposed to benefit • • • ."

Without endorsing specifically any of the Commissioner's views, the committee believes that existing law on this subject is not accomplishing the desired objectives. Consequently, this bill would repeal section 605 of the Housing Act of 1957. The committee will continue its study of this problem, however, in the hope that some more workable solution may be found. *Quoted in id.* at 33.

The discount legislation presented special problems because of the complexity of
1968, the FHA and VA administrators accepted the fact that discounts would occur whenever a discount was necessary to bring the yield on FHA and VA loans up to general money market yields. However, when in late 1967 discounts again went as high as 10 percent of the loan, a substantial belief developed that the 6 percent ceiling itself should be removed so that the point system would not be forced upon lenders. On March 26, 1968, the House of Representatives approved legislation which would allow the Veterans' Administration to fix rates above 6 percent when necessary to attract funds. This legislation, now before the Senate, would finally solve the discount problem as to VA loans.

To summarize, usury statutes in the home mortgage field have no effect until general interest rates reach a level near the usury rates; then their effect is to (1) drive lenders to more or less deceptive ways of avoiding the usury limitations, and (2) drive money out of the home mortgage market.

In the context of the present legal situation which provides prospective lenders with a very large market not subject to usury statute control, a major policy issue which should be considered in deciding whether usury statutes should be repealed or rate limits raised substantially, is whether the home mortgage market should be the first and most seriously affected area of the economy in times of tight money and higher interest rates. This does not seem to have ever been the conscious policy of either the States or the federal government, and it does not seem a justified policy. Why a consumer should be able to borrow money to buy a new automobile, but should not be able to borrow money to buy a new house, is not apparent to anyone except, perhaps, the automobile industry.

Of course, repealing the existing usury laws does leave the possibility that there will be an occasional loan by a noninstitutional lender at a rate which is much too high in relationship to the risk taken. This problem can be alleviated, however, by a maximum rate statute which fixes rates high enough above general market rates that it never has the effect of driving down the general housing market.

(2) Farm Credit. —Farm credit is another area presently sub-
stantially subject to usury controls and, therefore, any general argument in behalf of repeal of usury laws must be concerned with the possible effects of repeal on farm credit. Total farm credit on January 1, 1967, was approximately $45.7 billion of which $21.2 billion was nonreal estate secured debt. In 1965, the average interest rate on farm mortgages, a large portion of which are subject to usury laws, varied from a high of 5.98 percent in Georgia to a low of 5.37 percent in Iowa. In spite of the fact that in many of the great farming States usury statutes fix rates substantially higher than 6 percent, all States reported averages below 6 percent.

While there are apparently no accurate reported figures on the actual rates charged farmers for nonreal estate secured credit, there are some special features of farm nonreal estate finance which are significant in considering the effect of usury laws.

There are three major sources of short term farm credit: commercial banks, production credit associations (PCA), and merchants and dealers. Commercial banks provide about one-half of farm credit and on January 1, 1967, had approximately $8.5 billion in short term farm loans outstanding. Production credit associations, farmer-owned cooperatives chartered under federal laws and operating in all areas of the United States, had loans of $3 billion outstanding on January 1, 1967. While there are no accurate total figures available it seems likely that merchant and dealer credit to farmers is around $3 billion. Another government agency, the Farmer's Home Administration, also makes farm loans, but its total volume is insignificant in relation to the other sources of credit. Also, the Farmer's Home Administration is restricted by law to lending to those who cannot borrow from commercial lenders at

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211a FED. RESERVE BULL., Apr. 1968, at A-22.
213 In 1966, seven large farm machinery manufacturers alone held nearly three-quarters of a billion dollars of debt arising out of purchases from their dealers of farm equipment purchase contracts. Hamlin & Eitel, Manufacturer Financing of Farm Machinery Sales to Farmers, 1963-1966, AGRICULTURAL FINANCE REV., Nov. 1967, at 52.
214 Total Farmer's Home Administration loans as of Jan. 1, 1967 were about three-quarters of a billion dollars. Evans & Warren, supra note 210, at 5.
reasonable rates (apparently the PCA rate is considered to be the relevant reasonable rate).\textsuperscript{215}

Perhaps the most significant factor in the farm credit picture is the large percentage of farm credit which is handled by the production credit associations. The PCA's borrow from Federal Intermediate Credit banks at rates fixed by the general money market and loan at rates which are sufficient to cover the cost of money plus the administrative costs of the PCA.\textsuperscript{216} Rates on April 1, 1967, were between 7 and 8 percent for 68 percent of the associations.\textsuperscript{217} The strength of the PCA's in the farm lending market is such that commercial banks, the major source of farm operating credit, generally find it necessary to lend at rates close to PCA rates. Rates for merchant credit probably run around 12 percent.\textsuperscript{218} It appears, then, that the credit worthy farmer has available credit at reasonable prices. The fact, also, that farmer cooperatives find it necessary to charge rates between 7 and 8 percent suggests that in the present market 6 and 7 percent usury statutes are unrealistic. Further, in nearly all States, if the particular farmer's credit position is such that he is a high risk, loans may be made to him under installment loan or even small loan legislation which provides returns substantially higher than those allowed by the usury statutes. This suggests that the farmer who cannot compete in the marketplace for money at reasonable rates should perhaps be treated as a consumer or small businessman in regard to rate limitations. This, as will be seen later, is the way he would be treated under the Uniform Consumer Credit Code.

(3) Business Loans and Usury Statutes.—While the corporate, bank, and installment loan exemptions to the usury statutes detailed above remove much of the sting from, and pressure upon, usury laws in relationship to business loans, cases still occur, even in States which are most liberal in rates and exemptions, involving loans which are in areas subject to usury laws but in which the risk factor is so great that loans cannot reasonably be made within the statutory limit. An excellent example of this kind of case, and of a fairly frequent judicial response to it, is found in \textit{Martyn v. Leslie},\textsuperscript{219}

\textsuperscript{215} W. MURRAY & A. NELSON, \textit{supra} note 212, at 439-58, discusses the Farmer's Home Administration.

\textsuperscript{216} See \textit{id.} at 390-403.

\textsuperscript{217} Eighteen percent of the PCA's were charging 6 percent and under, 7 percent were charging between 6 and 7 percent, and another 7 percent were charging rates above 8 percent. Evans & Warren, \textit{supra} note 210, at 9.

\textsuperscript{218} W. MURRAY & A. NELSON, \textit{supra} note 212, at 311-15.

\textsuperscript{219} 137 Cal. App. 2d 41, 290 P.2d 58 (1955).
a 1955 California decision. Plaintiffs were partners engaged in the production of a television series of 39 weekly episodes. Plaintiffs produced three episodes under their original financing. At this point, however, they needed additional financing and borrowed enough money from various sources to produce three more episodes. But again, after producing six episodes, they were unable to proceed without additional money. It seemed at this point that they were not going to be able to secure the necessary funds and would lose their entire investment because the six episodes, by themselves, would not be saleable.

However, the partnership was saved by an arrangement with the defendants for a loan of $36,000 for 6 months. Under the arrangement, the plaintiffs signed a note for $35,500 payable with interest at 5 percent. The other $500, which made up the total of $36,000, was stated to be the purchase price of a 15 percent interest in the partnership which was being sold to the defendants. The partners were given an option to repurchase their 15 percent interest at a price of $8,000 within 6 months. Under the agreement, certain guarantors of the loan agreed to purchase the 15 percent interest from defendants for $8,000 if the plaintiffs failed to exercise their option. After the debt had been paid and the "option" to repurchase the 15 percent interest exercised, the plaintiffs attacked the transaction as usurious, claiming that the $7,500 profit earned by the defendants on the sale-compulsory repurchase agreement was additional interest. If the $7,500 profit were treated as interest, the total interest charge was $8,387.50 or a simple annual interest rate of approximately 47 percent.

The defendants argued that the transaction involved a bona fide purchase-resale agreement and gave two basic supporting arguments: (1) the transaction was set up in this way so that they could receive capital gains tax treatment as to the $7,500, and (2) the arrangement was offered to them by the plaintiffs as an inducement to enter into the transaction. These arguments amounted to assertions that there was a nonusury reason for the arrangement and that, in any event, the borrowers, not the lenders, proposed it.

In spite of the fact that the sale-repurchase agreement is a

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220 A second transaction with a different group of defendants was later entered into on similar terms, but is omitted from the discussion here.

221 The California maximum rate applying to the transaction was 10 percent. See Appendix A infra.
well-known, long-used device for evasion of usury laws, the trial court found that there was no violation of the usury statutes and the decision was affirmed by the appellate court.

The appellate court justified its affirmation of the trial court by saying that the partnership did not bind itself to repurchase the 15 percent interest and there was no evidence that the partnership agreed to reimburse the guarantors who did bind themselves to purchase it. This arrangement, said the court, was not usurious since securing a return greater than that allowed by the usury statutes through payments from third parties is not a violation. This rationale would allow any lender to avoid the usury statutes by arranging for payments through two parties. It is hard to believe that such an evasion technique would be sanctioned except in a case like Martyn where it is clear that the risk involved justified the high rate charged.

Another California case in which the court found no violation of usury laws even though a violation seemed obvious on any reasonable analysis, is Lindsey v. Campbell. Wheeler, a real estate developer and partner of Lindsey, asked Mrs. Campbell, a widow, if she were interested in receiving $14,000 in return for supplying $6,400 to the partnership for 1 year. She agreed to the proposition and was given seven notes for $2,000 each. After all were paid, the plaintiffs instituted suit for refunds and statutory damages claiming that the transaction was usurious. The trial court found for the plaintiffs, but was reversed on appeal. The appellate court stated, inter alia (in spite of the fact that there was nothing contingent about the widow's repayment right): "We do not see how the trial court could have inferred from the facts stated that any of the parties to the transaction understood that it involved a loan of money." The court thought it was clear that, instead of being a loan, the transaction was an "investment."

On reflection, the case could be written off either as incredibly bad analysis of a transaction or as an extension of the rule in the Daisy Whiffle v. Twitter Bird Seed Company case. All loans

222 Collins, Evasion and Avoidance of Usury Laws, 8 LAW & CONTEMP. PROB. 54, 65 (1941).
225 Id. at 751, 282 P.2d at 952.
226 The rule in Twitter is adequately summed up in the following instruction which was given to the jury: "If you find from the evidence that the plaintiff was a woman and the defendant was a corporation, your verdict will naturally be for the lady." As
at interest are "investments" and a loan at a high rate may be a very good (or very bad) investment, but nevertheless, both a loan and an investment. The essential requirements of a loan would seem to be the giving of the present use of money, or money’s worth, in exchange for a promise to return money, or money’s worth, at a later time. This was the situation in Lindsey and the court’s assertion otherwise does not change the realities. However, the case should be treated as one which recognizes the inexact, bludgeon nature of usury laws and refused to apply them where the total circumstances and risk taken justified the rate paid.

Obviously, if usury statutes are as easy to avoid as these two cases indicate, they have little, if any, effect. Yet, as long as usury laws remain on the statute books, cases like Martyn must be considered to involve very doubtful statutory interpretation. Such cases, however, have one outstanding virtue. They recognize, sub silentio, that the risk of nonpayment is often so great that a loan at very high rates is not unreasonable. If such decisions could be expected in cases in which, on the facts, they are called for, usury laws would be subject to much less criticism. But, of course, such judicial tailoring of concepts under the traditional usury laws cannot be depended upon. In a 1954 California case, the operative facts were essentially the same as in the Lindsey case, except that a husband and wife, rather than a widow, were involved. A construction company promised to pay $10,000 in return for a loan of $5,000 for 1 year. The agreement provided for an irrevocable assignment to the lenders of a certain amount from the sales price of each house completed, but also included a guarantee of the corporation’s principal shareholder that the full $10,000, evidenced by a note, would be paid. The appellate court reversed a lower court holding that the transaction was a joint adventure contract and held it a usurious loan.

The cases just reviewed alert one to the fact that courts sometimes try very hard to escape the impact of usury laws. There are


227 In fact in an earlier case in which a court had found usury, the California Supreme Court had said: “A loan... is the delivery of a sum of money to another under a contract to return at some future time an equivalent amount with or without an additional sum agreed upon for its use...” Milana v. Credit Discount Co., 27 Cal. 2d 335, 339, 163 P.2d 869, 871 (1945).

several fairly standard methods used to either conceal the nature of the transaction or the true rate being paid and which have fared reasonably well at the hands of courts, a few of which will now be discussed.

The first is the sale with recourse of conditional sales contracts or customer accounts. There are two basic ways of setting up the transaction by which a seller of goods or services gets present cash for his customer time-payment accounts. They are, respectively, "recourse" and "nonrecourse" assignment of the accounts. In both transactions the finance company or bank advances cash for the assigned accounts. In a nonrecourse financing arrangement, the assignee bank or finance company thereafter takes the risk that the account will not be paid and the transferor of the accounts usually has nothing further to do with them. While this transaction generates present money in place of future money, it is usually considered a sale not a loan, and properly so, since the transferor of the accounts is under no obligation to repay any part of the price paid for the accounts. The assignee in the nonrecourse transaction has simply purchased the right to payment in the future at a discount sufficient to cover the costs of the money he has paid for the accounts, the risk that some part of the accounts will not be paid, and a profit.

In recourse financing of accounts, on the other hand, the transferor of the accounts promises that if any of the accounts transferred are not paid when due he will pay them. This transaction is the equivalent of a loan. If the debt is not paid from the proceeds of the accounts, the transferor must pay any deficiency, just as in any case of deficiency after recovery on collateral given for a loan. Similarly, the transferee of accounts on a recourse basis is taking only the risk, which every secured lender takes, that the borrower will not be able to pay the debt and that the security will not cover the amount which is to be repaid.  

As just pointed out, recourse financing is indistinguishable from a loan. However, lenders often attempt to avoid usury laws which would be applicable to loans by calling the recourse transaction a sale. And courts have often seized on very flimsy facts (sometimes

228a There are business justifications for the use of either recourse or nonrecourse financing. In nonrecourse financing, the transferor gets rid of the uncertainties of collection. Recourse financing, on the other hand, will provide lower costs of "borrowing" (or a higher "sales price") since the transferee of the account is not taking the risk of nonpayment by the account debtors.
nothing more than that the parties called the transaction a sale) to find that the recourse transaction is a sale.

In a 1967 Texas case, a finance company made an arrangement with a dealer under which the finance company was to purchase the dealer's sales contracts with full recourse (under the terms of the agreement the dealer had to take back any sales contract which became 90 days delinquent and pay the finance company the amount outstanding). The court affirmed a jury verdict finding a sale.

Against the borrower-seller's contention that the court should have, as a matter of law, found a loan, the appellate court cited as supporting the jury verdict the following factors: (1) the borrower had requested that the lender "purchase" automobile paper rather than make a loan; (2) the parties called the transaction a purchase; (3) the borrower's board of directors authorized assignment of accounts without indicating that they were assigned as collateral only; (4) the lender showed the transactions on its books as a purchase.

In the course of its opinion, the court distinguished several prior Texas cases which had reached the contrary result on similar facts. All the factors relied upon by the court amount to nothing more than that the parties called the transaction a sale.

However, calling the transaction a sale does not always work. In Milana v. Credit Discount Co., the parties entered into a "sales agreement" under which the defendant would "buy" plaintiff's accounts at a 2 percent discount (later raised to 2½ percent). The agreement contained an unconditional guarantee by plaintiff that all accounts would be paid within 60 days after the assignment. Plaintiff's suit attacking the transaction under the usury statutes was dismissed, she appealed, and the California Supreme Court reversed. The court noted that usury statutes cannot be avoided by mere word forms and said:

The significant fact is that if the defendants had really purchased

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229a The issue framed for the jury was: "'Do you find from a preponderance of the evidence that the transactions between the plaintiff ... and the defendant ... , which are listed on plaintiff's Exhibit 'A', were loans of money by the defendant to the plaintiff?'" The jury answered in the negative. 421 S.W.2d at 726. There is no discussion of the charge under which the jury returned its verdict.

230 421 S.W.2d at 727-28, 730-31.

231 27 Cal. 2d 335, 163 P.2d 869 (1945).
the accounts and had taken absolute title there would be no occasion for the provision or practice relating to guaranties of payment within specified dates, or reversions of title and "re-purchase," in the event of delayed payment by the customer.233

There are other cases reaching a similar result.234

Financing a business on the basis of its accounts receivable is a fairly expensive form of financing235 because of the many individual transactions included and also because it is likely to be used by a business which has exhausted all other credit avenues; so that accounts receivable financing is comparatively high risk financing. Therefore, in States with low usury ceilings there is substantial reason to attempt to avoid the usury statutes by casting the transaction as a sale. And this is done (with varying success) as shown by the cases just discussed.

A common banking practice used to secure a return higher than that allowed by usury statutes is the requirement of "compensating balances." In a typical example, reported in a recent Louisiana case,236 the defendant borrowed $235,000 from the plaintiff bank. However, the bank required the defendant to leave $28,000 of the total in a deposit in the bank on which the bank paid no interest. Defendant paid interest at 7 percent on the total $235,000, though he actually had the use of only $207,000. The interest paid, if applied only to the money the defendant actually had the use of, would have made the interest rate 7.9 percent. The court, however, held that since the $28,000 would finally be applied to the payment of the debt, the actual interest rate was the stated 7 percent.237

232 Id. at 342, 163 P.2d at 872.
233 E.g., Sedberry v. Duffy, 158 N.C. 432, 73 S.E. 355 (1912); see Annot., 165 A.L.R. 626 (1946). See the earlier Texas cases cited in A.B. Lewis Co. v. National Inv. Corp., 421 S.W.2d 725 (Tex. Civ. App. 1967). Many of the cases involve very complicated business arrangements which are difficult to categorize. Agreements, for example, may provide that the "buyer" of the accounts will also render other services such as advice on collection techniques or credit approvals. In such a case, even though there is full recourse, the discount in excess of the usury rate may be considered to be payment for additional services. Agreements may also split the risk of customer nonpayment between the "seller" and the "buyer" of the accounts. These limited recourse agreements are also difficult to categorize as loans or sales. For a case involving both types of additional agreements, see General Motors Acceptance Corp. v. Mid-West Chevrolet Co., 66 F.2d 1 (10th Cir. 1933).
234 It is reported that interest rates on accounts receivable financing average 9 to 15 percent and occasionally go as high as 18 to 20 percent. R. Phelps, ACCOUNTS RECEIVABLE FINANCING AS A METHOD OF SECURING BUSINESS LOANS 52 (2d ed. 1961).
236 Id. The defendant argued that the withheld amounts increased the interest rate
The devices discussed above are but a small fraction of the many methods which have been tried as a means of avoiding usury laws. Among other schemes which have been used are (1) the tie-in sale, a sale of goods at a very high price as a condition to making the loan; (2) the sale of credit, which requires two lender parties, one to make the loan at the highest legal rate and the other to guarantee the loan for an additional payment from the borrower; and (3) making the loan payable only upon the nonoccurrence of a contingency like the total destruction of Manhattan Island (this has sometimes been considered to make payments above the usury statute nonusurious because they are merely compensation for the increased risk). 237

III. A CURE FOR THE USURY HEADACHE

Before taking a look at the provisions of the proposed Uniform Consumer Credit Code which, it has already been suggested, contains a cure for the usury headache, a quick review of the present usury situation is in order. First, present usury statutes have almost no operation in the nonreal estate consumer credit area because of the time-price doctrine and the many special statutes which provide innumerable special rates and special exceptions to the general usury statutes. Second, many States have so reduced the penalties for usury that lenders can afford to ignore the statute. 238 Third, usury statutes have only a limited and somewhat haphazard effect on business transactions because of the many corporate exemptions. However, the unincorporated business borrower or the corporate borrower in the few States without the exemption often may find that the usury statute stands in the way of obtaining needed capital. The cases reviewed above indicate some of the many devices used to avoid usury statutes and also indicate that such devices are sometimes successful and sometimes not. Fourth, because of the exemptions just described and other exemptions referred to earlier, more
than half of the volume of private debt in the country is not subject to usury statutes. The availability of alternative sources of investment not subject to usury laws results in a substantial flow of funds away from regulated areas whenever the free market rate goes above the particular statutory maximum rate. Fifth, the lending areas in which usury statutes presently have substantial impact are home mortgage and farm finance. In the home mortgage area, usury statutes which set rates low enough to affect actual market interest rates also have the effect of driving lenders to the use of subterfuges to avoid the statutory ceilings or of driving them from the home mortgage market, or both. Mortgage interest rate figures indicate conclusively that it is the general money market, not the statutory ceilings, which fix home mortgage interest rates. The same situation seems to prevail as to farm finance; and in farm finance the situation is also affected by the substantial portion of farm lending which is done by farmer-owned production credit associations.

It could be argued that the solution to the unregulated competition problem and the flow of money away from the home mortgage area is complete regulation of the money market by comprehensive usury statutes. Such an attempt, however, would be wrong as a matter of policy, and if history is any guide, almost certain to fail as a matter of fact. Legislatures should not make a bludgeon decision that only business which can qualify for 6 percent credit or 10 percent credit can get financing. While States should, no doubt, place controls on consumer credit, this is not presently done by usury statutes, but rather by the many exceptions to them. More important, money market interest rates in this country presently are manipulated as a matter of national policy by federal agencies, particularly by the components of the Federal Reserve System. This manipulation can and does operate rather effectively to control up and down swings in the national economy. The State legislatures, without the information or flexibility, and without the responsibility and power to control national money trends, should withdraw from attempts to fix money market rates.

Further, as a matter of fact, it has been true historically that ways to avoid usury statutes have been found, where necessary to meet market conditions, and this will almost certainly continue to

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239 For a good brief discussion of recent federal action affecting interest rates, see Merriman & Hanks, Revising State Usury Statutes in Light of a Tight Money Market, 27 Md. L. Rev. 1, 2-6 (1967). See also W. MURRAY & A. NELSON, supra note 212, at 295-307.
happen so long as usury statutes exist. The conclusion to which this writer is inescapably drawn is that usury statutes which attempt to fix the market price for money are wrong in principle and are essentially unworkable. This does not mean, however, that no statutory limits are feasible. On the contrary, statutory limits can be adopted which set the outside limits on conscionable transactions. Such limits, however, should attempt to prevent only those transactions which would almost never be justified by the risk or expense involved. It would seem, for example, that a limit of 10 or 12 percent simple annual interest is too low. Too many actual transactions take place in this range; too many of which are justified by the cost and expense involved.

Of course, any limit fixed by statute is likely to exclude some transactions which are justified on the basis of expense and risk. The job of the legislature is to choose a rate high enough that it does not interfere with the bona fide credit market but low enough to give substantial protection to the unknowing or hard-pressed debtor. Furthermore, the judgment already made by a number of States that no statutory interest rate limit should be placed on substantial business transactions seems to be justified and should be a part of any statutory scheme regulating interest rates.

A. The Uniform Consumer Credit Code

The Uniform Consumer Credit Code would restructure and simplify the total statutory framework concerning lending and selling on credit. In place of the many present statutory and time-price rules in existence in the various States it would substitute an orderly, uniform system. It establishes three categories for interest rate regulation purposes: (1) consumer and agricultural purpose loans and credit sales of not more than $25,000 (the $25,000 limitation does not apply to loans secured by real estate); (2) business purpose credit sales and loans of not more than $25,000 to individuals

240 All references herein are to Working Draft No. 8, May 1968, which has been published in CCH INSTALLMENT CREDIT GUIDE (extra ed. No. 176, 1968). Present plans are that the Consumer Code will be approved by the National Conference of Commissioners in the summer of 1968 and proposed for adoption by the various States. See the following articles dealing with the Consumer Code: Johnson, Regulation of Finance Charges on Consumer Credit, 65 MICH. L. REV. 81 (1967); Jordan & Warren, The Uniform Consumer Credit Code, 68 COLUM. L. REV. 387 (1968); Jordan & Warren, A Proposed Uniform Code for Consumer Credit, 8 B.C. IND. & COM. L. REV. 441 (1967); Jordan & Warren, Disclosure of Finance Charges: A Rationale, 64 MICH L. REV. 1285 (1966); Kripke, Consumer Credit Regulation: A Creditor-Oriented Viewpoint, 68 COLUM. L. REV. 445 (1968); Ziegel, Consumer Credit Regulation: A Canadian Consumer-Oriented Viewpoint, 68 COLUM. L. REV. 488 (1968).
or, in a very limited situation, to organizations; and (3) other (business) loans. While the Consumer Code contains separate articles on sales and on loans the maximum interest rates are the same in both articles, except for revolving credit balances under $500 where the sale credit rates are somewhat higher. The basic maximum rate fixed for consumer, agricultural purpose, and small business loans or credit sales is 18 percent simple annual interest with higher rates for portions of the debt under $1,000. The small debt rates are 36 percent on that part of the debt which is $300 or less, 21 percent on that part which is more than $300 but not more than $1,000, and 15 percent on that part of the debt above $1,000.

The Consumer Code defines a consumer credit sale as a sale of goods, services, or land by a professional seller to an individual who is buying primarily for a personal, family, household, or agricultural purpose. A consumer loan is a loan made by a professional lender

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241 In addition to its provisions relating to interest rates, the Consumer Code also fixes disclosure and advertising requirements for consumer and agricultural purpose loans, limits creditor remedies in consumer and agricultural transactions, and provides for administrative control of higher rate lenders. These aspects of the Consumer Code are beyond the scope of this article, though they should be kept in mind when considering its rate structure.

242 The Consumer Code terms for “interest” are in article 2 on credit sales: “credit service charge”; UNIFORM CONSUMER CREDIT CODE § 2-109 [hereinafter cited as C.C.C.], and in article 3 on loans, “loan finance charge.” Id. § 3-109. Under the Consumer Code, the time-price doctrine is replaced by statutory rate limitations on allowable credit service charge. However, the Consumer Code goes to some lengths to preserve the distinction between time-price differential and interest charges. Credit sales and loans are treated in separate articles and the terminology which is used to define the permissible charges for credit is different. All this is done, without creating a substantive difference in allowed rates, for the purpose of preserving the distinction between time-price differential and interest. It is believed that the reason for preserving the distinction is political. Merchant groups want the extra insurance against the possibility of being subjected to general usury laws, and the National Conference is willing to make a concession on a formal point which has no substantive effect on the Consumer Code since actual rates allowed, except for revolving charge balances under $500, are the same in both credit sales and in loans.

243 C.C.C. §§ 2-201, 2-602, 3-201, 3-508, 3-602. The rates for revolving credit loans are 1½ percent per month; credit sellers may charge 2 percent per month on that part of the balance below $500. Id. §§ 2-207, 3-201. The combination of 36, 21, and 15 percent rates evens out at 18 percent at around $2,500 and at this point the regular 18 percent ceiling comes into operation.

244 Id. § 2-104. [Definition: “Consumer Credit Sale”.] (1) Except as provided in subsection (2), “consumer credit sale” is a sale of goods, services, or an interest in land in which
   (a) credit is granted by a seller who regularly engages as a seller in credit transactions of the same kind,
   (b) the buyer is a person other than an organization,
   (c) the goods, services, or interest in land are purchased primarily for a personal, family, household, or agricultural purpose,
to an individual who borrows primarily for a personal, family, house-
hold, or agricultural purpose.\textsuperscript{245} Loans and credit sales by non-
professionals are subject to the 18 percent maximum.

\begin{quote}
(d) either the debt is payable in instalments or a credit service
charge is made; and,
(e) with respect to a sale of goods or services, the amount financed
does not exceed $25,000.
\end{quote}

(2) "Consumer credit sale" does not include
(a) a sale in which the seller allows the buyer to purchase goods
or services pursuant to a lender credit card or similar arrangement, or
(b) a sale of an interest in land if the credit service charge, how-
ever calculated, does not exceed 10 per cent per year calculated on the
unpaid balances of the amount financed according to the United States
rule; for the purpose of calculating the rate of the credit service charge,
non-periodic charges made at the inception of the sale which are included
in the credit service charge shall be amortized over the term of the sale
agreement notwithstanding that the debt is paid prior to the end of the
agreed term, and charges for the privilege of prepaying the debt shall
not be included in the credit service charge.

(3) The amount of $25,000 in subsection (1) is subject to change pur-
suant to the provisions on adjustment of dollar amount (section 1.106).

The 10 percent rate limitation as a device for exempting real estate secured consumer
and farm loans from the Consumer Code substantive provisions may be dropped in view
of the passage of the "Federal Truth in Lending Bill" which does subject all consumer
real estate mortgages to some of the disclosure provisions of that Act. Consumer Pro-
tection Act, (as passed by Congress, May 22, 1968), §§ 106, 128, 129, which can be
found in CCH INSTALLMENT CREDIT GUIDE (2d extra ed., No. 177, May 24, 1968).
Under the Federal Act, the Federal Reserve Board may exempt transactions in particular
States if it finds that the State has disclosure provisions which are substantially the same
as the federal requirements. \textit{Id.} § 123.

\textsuperscript{245} \textit{Id.} § 3-104. [Definition: "Consumer Loan"]]
The Consumer Code provisions exclude 10-percent-and-under real estate sales and loans from the definition of consumer credit with the effect of excluding such transactions (which will include practically all ordinary first mortgages) from the Consumer Code provisions as to disclosure, remedies, and special administrative controls which apply to lenders. Of course, if a real estate secured loan is made at an interest rate of more than 10 percent, it is treated in the same manner as any other consumer sale or loan and is subject to the 18 percent ceiling.

(1) Nonreal Estate Consumer Loans and the Consumer Code.—Practically all nonreal estate consumer lending and credit selling is made at an interest rate of more than 10 percent, it is treated in is not covered by general usury laws. Earlier the development of the time-price doctrine, and the small loan, instalment loan, and other special laws which take consumer transactions out from under the usury laws was discussed. Since the primary concern of this article is the general usury laws themselves, the rates adopted by the Consumer Code in the consumer area will not be dealt with in substantial detail. It is worth noting, however, that the Consumer Code would replace the present multitude of State statutes with a single statute which applies the same statutory maximums to all consumer transactions.

The Consumer Code maximum rates are, as just pointed out, a high of 36 percent simple annual interest in transactions under $300, and a low of 18 percent in portions of the debt above $2,500. The rates fixed by the Consumer Code fall at about the midpoint of existing rate limitations in the small loan area and are above most present installment loan rates in the area over $3,000. As has been noted by several writers, the policy which the legislature determines in fixing a small loan or installment loan rate is how restricted or broad should buyer or borrower access to the credit market be. The lower the statutory maximum, the less risks the lender is able to take and the more difficult it is for poorer credit risks to obtain loans. Several studies have indicated that when maximum small loan rates are raised, the volume of loans made increases but the rates of profit of small loan lenders remain the same. This means that under higher rate statutes lenders expand their market by making loans to poorer risks so that loan losses and increased costs of

246 See notes 244-45 supra.
lending, on a percentage basis, offset the increased revenue from the higher rate. This also indicates, as is the fact, that present small loan licensees usually lend at the maximum rate. However, other lenders, such as banks, industrial banks, and installment loan lenders, make loans at lower rates when the amount borrowed and the borrower’s credit rating justifies lower rates.

The legislature in fixing a maximum interest rate for consumer transactions decides what rate is too high to pay, even for borrowers who cannot otherwise obtain credit. In the case of consumption credit this seems to be a desirable and even necessary legislative judgment. A family which cannot borrow except at rates of, say, 60 or 70 percent perhaps should not be permitted to borrow. This may mean that the family will have to forego physical comforts which other families have or even that it will become a public charge when it might have tided itself over a difficult period with a high rate loan. However, it is better that a family becomes a temporary public charge than that it become involved in a loan which saps the earning power of its wage earners for months or years.

It should be noted, in considering Consumer Code consumer rates, that the Consumer Code requires all lenders and credit sellers to disclose their finance charges as a simple annual interest rate and allows free entry into the lending business. The disclosure provisions which make it easy for the borrower or buyer to compare credit rates and the free entry provisions which should give practically every borrower or buyer access to a number of credit suppliers should result in strong competition in the credit market. The careful shopper, therefore, if he is credit worthy, should be able to borrow at below the ceilings. However, ceilings are preserved to protect the careless shopper and to set an outside limit on the credit unworthiness of borrowers who can secure credit.

(2) Consumer Real Estate Loans and the Consumer Code. — The Consumer Code 18 percent maximum interest rate also applies to home mortgage loans. This maximum is intended to set the outside limit for conscionable transactions, but is not otherwise intended to affect the free operation of the real estate mortgage market. This writer believes that the Consumer Code scheme is the proper way of dealing with real estate mortgage rate limitations. It has already been pointed out that mortgage rates are responsive to general money market conditions and stay near the prime interest rate.
rate even where there are no statutory ceilings. It has also been pointed out that, when market interest rates reach or go above the general usury rates applicable to real estate transactions, lenders either use subterfuges to secure the return justified by market conditions or they withdraw from the mortgage market.

Statutory ceilings which attempt to hold down the general market interest rate are, therefore, self-defeating, and the only statutory maximums which are justified are those which attempt solely to reach the occasional individual unconscionably high rate. This is what the 18 percent limitation does. There are a substantial number of real estate secured transactions with rates of from 9 to 13 percent and a rate any lower than 18 percent would unnecessarily interfere with many routine financing situations. FHA insured home improvement loans, for example, yield 9 to 10 percent, and non-FHA insured home improvement loans are made at rates ranging from 8 to 13 percent. It may be objected that an ordinary first mortgage at 14 percent would be unconscionable. But whether that would be so as to any particular loan depends upon the credit worthiness of the borrower, the size and repayment terms of the loan, and the ratio of the loan to security. The 18 percent rate is a compromise figure which may be too low, and which will itself no doubt force some legitimate loans out of the market. On the other hand, under developing unconscionability concepts, even interest rates under 18 percent may be struck down or reduced by a court as unconscionable if the rate is not, as a matter of fact, reasonably justified on the facts.

(3) Agricultural Credit and the Consumer Code. —The Consumer Code treats agricultural credit as consumer credit.

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250 See notes 191-209 supra & accompanying text.
251 See notes 194-209 supra & accompanying text.
252 See Jung, Terms on Home Improvement Loans, 2 NAT'L BANKING REV. 51 (1964).
253 See the following recent cases in which excessively high price of goods was a substantial element in a finding of unconscionability: Frostifresh Corp. v. Reynoso, 52 Misc. 2d 26, 274 N.Y.S.2d 757 (Dist. Ct. 1966), rev'd per curiam, 54 Misc. 2d 119, 281 N.Y.S.2d 964 (Sup. Ct. 1967); American Improvement Inc. v. Mclver, 105 N.H. 435, 201 A.2d 886 (1964). The Consumer Code, section 5-107(3) states that: "For the purpose of this section [court may refuse to enforce or limit recovery on unconscionable agreements] a charge or practice expressly permitted by this Act is not of itself unconscionable." This writer takes the "not of itself" language to suggest that, taken together with other aspects of the transaction, a charge, even though authorized by the Consumer Code, may be unconscionable.
254 See note 244 supra.
fore, farm real estate mortgage debt is treated in the same way as consumer real estate mortgage debt and nonreal estate secured farm debt is treated in the same way as is equivalent consumer debt. There is, therefore, an 18 percent maximum rate with higher maximums for transactions of $2,500 or less. The special features of the farm credit market have already been pointed out, particularly the effect of production credit associations and of the installment loan safety valve for farmers who do not qualify for lower rates. These factors, plus the matters discussed elsewhere in this article on the Consumer Code and consumer credit indicate that this treatment of farm credit is justified. Here again, the purpose of the 18 percent limitation is to set an outside limit within which market forces can operate.


—The Consumer Code drafters were convinced that large business operations should be able to borrow at whatever rates they can negotiate free of arbitrary statutory restrictions. It makes no sense to impose limits on what General Motors, or more pertinently, American Motors, may pay for credit. On the other hand, the very small businessman is really in many respects indistinguishable from the consumer. The typical small small businessman, for instance the operator of a corner grocery store, is likely to be no more able than the typical consumer to negotiate carefully for credit terms, and high interest charges on a business loan to him is likely to have the same effect which a high rate loan has on a consumer. Therefore, a distinction between types of businesses is made by the Consumer Code which, while it preserves part of the corporate exemption idea, is somewhat more sophisticated. The Consumer Code establishes a category of small business credit transactions (those under $25,000) which is subject to an 18 percent rate ceiling but which is not subject to the special disclosure and limitation of remedy rules which apply to consumer transactions. This category includes loans or credit sales for nonconsumer purposes to individuals or to an organization if the loan is secured primarily by a one-or two-family dwelling occupied by a person related to the organization. However, the parties may by contract provide that the loan

255 See notes 240-43 supra & accompanying text.
256 See text accompanying notes 210-18 supra.
257 See text accompanying notes 247-54 supra.
258 C.C.C. § 2-602. [Credit Service Charge for Other Certain Sales.]
(1) This section applies to a sale of goods, services, or an interest in land
shall be treated as a consumer transaction, in which event the higher rates for under $1,000 amounts apply as do all the limitation of remedy and disclosure provisions applicable to consumer transactions.\footnote{259}  

(5) Other Loans and the Consumer Code. —The Consumer Code provides outside rate protection for smaller individual business borrowers under the provisions just discussed, but, similar to the law already in effect in a few States,\footnote{260} it imposes no statutory ceiling at all on business loans or credit sales of amounts of more than $25,000.\footnote{261} Also, there is no statutory ceiling rate on any loan or credit sale to a corporation, except for the “incorporated house” situation noted above.

In the business debt area, the only difference between the Consumer Code rules and the present law of the many States which exempt corporations from the usury laws is that noncorporate business borrowers of amounts above $25,000 may also deal free of rate regulation. As the cases reviewed above show, there are noncorporate business situations in which rigid statutory ceilings are unrealistic. The legislature cannot determine, in advance, rates which are proper

\footnote{259} Id. § 2-601. “[Sales Subject to Act by Agreement of Parties.] The parties to a sale other than a consumer credit sale may agree in a writing signed by the parties that the sale is subject to the provisions of this Act applying to consumer credit sales. If the parties so agree the sale is a consumer credit sale for the purposes of this Act.” Id. § 3-601 contains identical provisions as to loans.

\footnote{260} Illinois and Maine exempt all business loans from the general usury statutes. See text accompanying note 161 supra. Massachusetts and New Hampshire do not have usury statutes.

\footnote{261} C.C.C. § 2-605. “[Credit Service Charge for Other Sales.] With respect to a sale other than a consumer credit sale or a sale for which credit service charge ceilings are set by the provisions on credit service charge for certain other sales (Section 2.602), the parties may contract for the payment by the buyer of any credit service charge agreed to in writing.”
for a particular transaction and there does not seem to be any reason why business borrowers should not be able to go into the market and pay whatever is necessary to obtain money. Here, the Consumer Code continues the judgment presently made by most States that major business deals should not be limited by an arbitrary statute interest rate, even 18 percent. Of course, this is not to say that there will be absolutely no control upon oppressive and overreaching lenders. It is most likely that courts will apply unconscionability concepts to set aside or scale down interest payments in the unusual case in which the lender has unjustifiably overcharged. However, courts should, and no doubt will, move very cautiously because of a realization that rates which on first glance appear to be excessive may, on closer examination, appear to have been entirely justified on the facts. Both those who want courts to apply the unconscionability concept in this area and those who fear that inexpert courts will set aside bona fide lending transactions can take comfort from the recent Elkin Dell litigation. In those cases, the referee in bankruptcy held unconscionable and unenforceable two financing arrangements under which an accounts receivable financer received interest of 15.8 percent per year in one case and 18 percent in the other, and which contained other provisions which were rather lopsided in favor of the lender. Both borrowers were corporations not subject to the applicable State usury laws. On appeal, the district judge reversed and remanded the cases for a full hearing on the question of unconscionability. In the course of the opinion the court said:

We entertain grave doubts about the wisdom of declining to enforce contracts entered into under these circumstances. It would be unsound to encourage bankruptcy trustees or general creditors to attempt to escape lawful factoring debts by impassioned appeals to equity — unsound because it would be inconsistent with the scheme of the Bankruptcy Act and because it would tend to dry up the credit of businesses who need it most. There are important considerations of policy in favor of promoting the availability of funds for businesses in distress, even at unusually high rates of interest. The risks of lending are sometimes great, and the inducements may have to be commensurate.

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263 253 F. Supp. at 871. The court also said: "To hold these contracts unenforceable on their face would probably be to impose a judicially invented but economically dysfunctional morality upon knowledgeable contracting parties. It might jeopardize
In spite of its doubts, the court remanded the case for a full hearing on unconscionability, and, in its opinion, went on to point out that the factors which should be considered in determining whether a loan is unconscionable are (1) the extent to which agreements of the kind in question are customary; (2) the extent to which the lender's contracts vary with and reflect anticipated risks; (3) the availability of other funds to the borrowers; (4) whether such contracts facilitated commerce by making more funds available or whether they impeded commerce by precluding access to other sources of funds; and (5) the effects of holding the agreements unconscionable on future financing of similar businesses in need. The court's tests for unconscionability are also strong arguments against legislative price fixing in the business area. Courts can take such factors into consideration in the particular case; the legislature cannot tailor its rules finely enough to do so.

(6) Uniformity. — In addition to its effect in curing some of the ills of the present interest rate regulation system in the United States, the Consumer Code would also have even greater effect than did the Uniform Commercial Code in producing uniformity among the various States. At a time when probably most business volume is done by organizations which operate in more than one State and when millions of consumers move from State to State every year, there will be substantial advantages, both to business and consumers, from a uniform law.\(^{264}\)

B. Conclusion

The Uniform Consumer Credit Code would replace the multitudinous State laws in the consumer credit area with a single, unified treatment, providing protection for consumer, agricultural, and small business borrowers, and would leave other business transactions free of statutory rate regulation. The Consumer Code scheme of setting a maximum rate for conscionable transactions in certain areas and leaving actual rates to free market determination is, it is submitted, a very substantial improvement over the present mud-

\(^{264}\) A substantial amount of the law review writing has been directed toward the problems of counseling multistate operations on the interest laws of the various States. See, e.g., Hershman, Usury and the Tight Money Market, 22 Bus. Law. 333, 340 (1967). See also Address by Bonin, Life Insurance Company Investments: What Price Interest, to the Association of Life Insurance Counsel (1960) (copy on file in University of Illinois, College of Law library).
dled and irrational system. The Consumer Code can cure the usury headache — and reduce to simplicity and comprehension the present incomprehensible collection of State laws.
<table>
<thead>
<tr>
<th>State</th>
<th>Usury Rate</th>
<th>Penalty for Violation of Usury Statute*</th>
<th>Corporate Exemptions</th>
<th>Special Rate for Corporate Obligations</th>
<th>Savings and Loan Exemptions</th>
<th>Bank Exemptions</th>
</tr>
</thead>
<tbody>
<tr>
<td>Delaware</td>
<td>6%</td>
<td>Excess over 6%.</td>
<td>$2306</td>
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<td>$2302</td>
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<td></td>
<td>Del. Code Ann. tit. 6, § 2301 (1953)</td>
<td>$2304</td>
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<tr>
<td>Maryland</td>
<td>6%</td>
<td>Excess over 6%.</td>
<td>art. 23, § 125</td>
<td></td>
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</tr>
<tr>
<td>New Jersey</td>
<td>6%</td>
<td>All interest.</td>
<td>$31:1-6</td>
<td></td>
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</tr>
<tr>
<td>New York</td>
<td>6%</td>
<td>Contract void and unenforceable.</td>
<td>$5-521</td>
<td></td>
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</tr>
<tr>
<td>North Carolina</td>
<td>6%</td>
<td>All interest.</td>
<td>§§ 24-8, 24-9</td>
<td>8% if $30,000 or more and 5 years; any rate if secured.</td>
<td>§ 24-8</td>
<td></td>
</tr>
<tr>
<td>Pennsylvania</td>
<td>6%</td>
<td>Excess over 6%.</td>
<td>tit. 41, § 2</td>
<td></td>
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</tr>
<tr>
<td>Tennessee</td>
<td>6%</td>
<td>Excess over 6%.</td>
<td>§ 47-14-106</td>
<td>7½% for bond.</td>
<td>§ 47-14-106</td>
<td></td>
</tr>
<tr>
<td>Vermont</td>
<td>6%</td>
<td>All interest and 50% § 31</td>
<td>§ 31 (a)</td>
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<td></td>
<td>Vt. Stat. Ann. tit. 9, § 31 (a) (1964)</td>
<td>§ 34</td>
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<td>Rate</td>
<td>Statute</td>
<td>Penalty</td>
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<tr>
<td>Virginia</td>
<td>6%</td>
<td>VA. CODE ANN. § 6.1-318 (1966)</td>
<td>$ 6.1-327</td>
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<tr>
<td></td>
<td></td>
<td>All interest.</td>
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<tr>
<td>West Virginia</td>
<td>6%</td>
<td>W. VA. CODE ANN. § 57-6-5 (1966)</td>
<td>$ 47-6-10</td>
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<td></td>
<td></td>
<td>Excess over 6%.</td>
<td>$ 31-6-17</td>
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<tr>
<td>Illinois</td>
<td>7%</td>
<td>ILL. ANN. STAT. ch. 74, § 4 (Smith-Hurd 1966)</td>
<td>ch. 32, § 157.5</td>
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<tr>
<td></td>
<td></td>
<td>All interest.</td>
<td>(1954) All business loans. ch. 74</td>
<td></td>
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<tr>
<td>Iowa</td>
<td>7%</td>
<td>IOWA CODE ANN. § 535.2 (1966)</td>
<td>$ 535.2 (2)</td>
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</tr>
</tbody>
</table>
|               |      | All interest and 8% or unpaid principal at time of judgment. Additional 8%-
|               |      | amount to school fund.                 | $ 535.5             |
| Kentucky      | 7%   | KY. REV. STAT. § 360.010(1) (1967)      | $ 360.025           |
|               |      | Excess of 6% on loans over $300.        | $ 360.020           |
| Michigan      | 7%   | MICH. STAT. ANN. § 19.11 (1964)        | $ 21.78 (1963)      |
|               |      | All interest.                          | $ 19.12             |
| North Dakota  | 7%   | N.D. CENT. CODE § 47-14-09 (1959)       | $ 10-19-04(8)       |
|               |      | All interest and 25% of principal; or double interest applied on principal. §§ 47-14-10, 47-14-11 |
| South Carolina| 7%   | S.C. CODE ANN. § 8-3 (1962)             | $ 8-8               |
|               |      | All interest plus costs.               |                     |

* Many States have different provisions which provide a slightly different penalty as to sums actually paid over under a usurious contract. See CCH INSTALLMENT CREDIT GUIDE § 31 (May 12, 1968).
<table>
<thead>
<tr>
<th>STATE</th>
<th>USURY RATE</th>
<th>PENALTY FOR VIOLATION OF USURY STATUTE*</th>
<th>CORPORATE EXEMPTIONS</th>
<th>SPECIAL RATE FOR CORPORATE OBLIGATIONS</th>
<th>SAVINGS AND LOAN EXEMPTIONS</th>
<th>BANK EXEMPTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Alabama</td>
<td>8%</td>
<td>All interest. tit. 9, § 65</td>
<td>tit. 10, § 56(3)</td>
<td>(1966)</td>
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<tr>
<td>Alaska</td>
<td>8%</td>
<td>All interest. § 45.45.040</td>
<td>$ 10.05.009(8)</td>
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<tr>
<td>Arizona</td>
<td>8%</td>
<td>All interest. § 44-1202</td>
<td>12% if over $35,000.</td>
<td>$ 10.177</td>
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<td></td>
</tr>
<tr>
<td>District of Columbia</td>
<td>8%</td>
<td>All interest. § 28-3303(2)</td>
<td>$ 29-904(h)</td>
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<tr>
<td>Georgia</td>
<td>8%</td>
<td>All interest. § 57-112</td>
<td>If over $2,500 no usury defense. § 57-118 (Supp. 1967)</td>
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<tr>
<td>Idaho</td>
<td>8%</td>
<td>All interest plus twice all interest.</td>
<td>Rate of 12%. § 28-22-105</td>
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<td></td>
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<tr>
<td>Indiana</td>
<td>8%</td>
<td>Excess over 6%. § 19-12-104</td>
<td>$ 19-12-104</td>
<td></td>
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<tr>
<td>Louisiana</td>
<td>8%</td>
<td>All interest. § 9:3501</td>
<td>$ 12:603</td>
<td>§ 6:728</td>
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<tr>
<td>Minnesota</td>
<td>8%</td>
<td>Contract void except as to bona fide purchaser. § 344.021</td>
<td>$ 334.06</td>
<td>§ 334.03</td>
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<tr>
<td>State</td>
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<td>Statute/Code</td>
<td>Description</td>
<td>Rate to 15%</td>
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<tr>
<td>Mississippi</td>
<td>8%</td>
<td>MISS. CODE ANN. § 36 (1957)</td>
<td>All interest; all interest and principal over 20%.  § 36</td>
<td>$408.060</td>
<td></td>
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<tr>
<td>Missouri</td>
<td>8%</td>
<td>MO. REV. STAT. § 408.030 (1949)</td>
<td>Liable for excess and costs of suit. § 408.050. Invalidity of security agreement.</td>
<td>$1701.68</td>
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<tr>
<td>Ohio</td>
<td>8%</td>
<td>OHIO REV. CODE ANN. § 1343.01 (Page 1954)</td>
<td>No statutory provision.</td>
<td>$1151.21</td>
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<td>South Dakota</td>
<td>8%</td>
<td>S.D. CODE § 38.0109 (1939)</td>
<td>All interest.</td>
<td>$7.0414</td>
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<td>Nebraska</td>
<td>9%</td>
<td>NEB. REV. STAT. § 45-101 (1943)</td>
<td>All interest.</td>
<td>$45-102</td>
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<td>Arkansas</td>
<td>10%</td>
<td>ARK. CONST. art. 19, § 13 (1947)</td>
<td>All interest and principal. art. 19, § 13</td>
<td>$665.18</td>
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<tr>
<td>California</td>
<td>10%</td>
<td>CAL. CONST. art. 20, § 22 (1947)</td>
<td>All interest.</td>
<td>$687.04</td>
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<tr>
<td>Florida</td>
<td>10%</td>
<td>FLA. STAT. § 687.02 (1965)</td>
<td>All interest and principal when over 25%. § 687.07</td>
<td>$687.02</td>
<td></td>
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<tr>
<td>Kansas</td>
<td>10%</td>
<td>KAN. STAT. ANN. § 16-202 (1964)</td>
<td>Double excess over $17-4103</td>
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</tr>
</tbody>
</table>

* Many States have different provisions which provide a slightly different penalty as to sums actually paid over under a usurious contract. See CCH INSTALLMENT CREDIT GUIDE § 31 (May 12, 1968).
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<th>BANK EXEMPTIONS</th>
</tr>
</thead>
<tbody>
<tr>
<td>Montana</td>
<td>10%</td>
<td>Double interest charged. $47-126</td>
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<td>MONT. REV. CODE ANN. § 47-125 (1947)</td>
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<tr>
<td>New Mexico</td>
<td>10%</td>
<td>Double amount charged. $267</td>
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<td>N.M. STAT. ANN. § 50-6-16 (Supp. 1967)</td>
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<tr>
<td>Oklahoma</td>
<td>10%</td>
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<td>Double amount charged. $267</td>
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<tr>
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<td>OKLA. STAT. tit. 15, § 266 (1966)</td>
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<tr>
<td>Oregon</td>
<td>10%</td>
<td>Forfeit loan, less interest and payments on principal, to school fund. § 82.120 (5)</td>
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<td>$57.030, 82.010</td>
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<td>Texas</td>
<td>10%</td>
<td>Double interest; all interest if rate is 20% or more. art. 79, § 5073</td>
<td></td>
<td>Rate to 11% per month over $5,000. art. 1302-2.09 (1967 Supp.)</td>
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<td>TEX. REV. CIV. STAT. art. 79, § 5069 (1962)</td>
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<td>Utah</td>
<td>10%</td>
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<td>Wyoming</td>
<td>10%</td>
<td>All interest. $17-36.4</td>
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<td>WYO. STAT. ANN. § 13-476 (1957)</td>
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<tr>
<td>Colorado</td>
<td>12%</td>
<td>Three times the excess over 12%.</td>
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<td></td>
</tr>
<tr>
<td>Hawaii</td>
<td>12%</td>
<td>HAWAII REV. LAWS § 191-3 (1955)</td>
<td>All interest. §§ 191-4, 191-6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nevada</td>
<td>12%</td>
<td>REV. REV. STAT. § 99.050(1) (1957)</td>
<td>Excess over 12%. § 99.050(2)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Washington</td>
<td>12%</td>
<td>WASH. REV. CODE § 19.52.020 (1961)</td>
<td>All interest. § 19.52.030</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Wisconsin</td>
<td>12%</td>
<td>WIS. STAT. § 115.05 (Supp. 1967)</td>
<td>All interest plus principal under $2,000. § 115.05</td>
<td>$ 115.05</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Maine</td>
<td>16%</td>
<td>ME. STAT. ANN. tit. 9, § 229 (Supp. 1967)</td>
<td>Loan void. tit. 9, § 229</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>All business loans.</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Rhode Island</td>
<td>21%</td>
<td>R.I. GEN LAWS ANN. § 6-26-2 (1956)</td>
<td>All interest and principal. §§ 6-26-3, 6-26-4</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

* Many States have different provisions which provide a slightly different penalty as to sums actually paid over under a usurious contract. See CCH INSTALLMENT CREDIT GUIDE § 31 (May 12, 1968).
APPENDIX B

Charts showing estimated percentage of total private debt subject to general usury laws in 15 States. (Taken from unpublished study by Professor Henry J. Bailey, 3d, of Willamette University of College of Law, entitled, Analysis of Existing Debt in the United States and State by State on Basis of Existing Law Affecting Interest Rates and Finance Charges (1966). Professor Bailey comments on the methods used to compile his figures and charts as follows:

To develop these figures, it was found that as to certain classes of debt figures were available for some of the fifteen states. These figures were used where they were available if the source seemed reasonably reliable. In those cases where no debt figures were available, an approximation of the amount of debt in the several classes was obtained by applying percentages against . . . national figures . . . .

It is recognized that the methods used to obtain the figures . . . for each state are not ideal and the resulting figures . . . can only be estimated approximations.

While it is recognized that the methods used in developing figures are not ideal, it is believed they are reasonable under the circumstances, first, because the basic objective of this paper is to develop estimated approximations of the volume of debt in different classes . . . and, secondly, because it is believed the methods used and the figures obtained are probably as satisfactory and accurate as may be obtained in view of the limited figures available. Id. at 1-2.

Even assuming that the Bailey figures are occasionally subject to substantial percentages of error, they are undoubtedly sufficiently accurate to make it clear that a majority of private debt in the States studied is not subject to usury statutes.

CALIFORNIA — Pie chart for all types of California credit subject or not subject to usury law.

EXPLANATION OF ABBREVIATIONS:

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<thead>
<tr>
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COLORADO — Pie chart for all types of Colorado credit subject or not subject to usury law.

CONNECTICUT — Pie chart for all types of Connecticut credit subject or not subject to usury law.

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FLORIDA — Pie chart for all types of Florida credit subject or not subject to usury law.

[Diagram]

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GEORGIA — Pie chart for all types of Georgia credit subject or not subject to usury law.

[Diagram]

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ILLINOIS — Pie chart for all types of Illinois credit subject or not subject to usury law.

INDIANA — Pie chart for all types of Indiana credit subject or not subject to usury law.

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IOWA — Pie chart for all types of Iowa credit subject or not subject to usury law.

[Chart]

Not Subject to Usury Law

Subject to Usury Law

MICHIGAN — Pie chart for all types of Michigan credit subject or not subject to usury law.

[Chart]

Explanations of Abbreviations:

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MINNESOTA — Pie chart for all types of Minnesota credit subject or not subject to usury law.

NEW JERSEY — Pie chart for all types of New Jersey credit subject or not subject to usury law.

EXPLANATION OF ABBREVIATIONS:

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NEW MEXICO — Pie chart for all types of New Mexico credit subject or not subject to usury law.

![Pie chart for New Mexico credit](image)

NEW YORK — Pie chart for all types of New York credit subject or not subject to usury law.

![Pie chart for New York credit](image)

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OHIO — Pie chart for all types of Ohio credit subject or not subject to usury law.

PENNSYLVANIA — Pie chart for all types of Pennsylvania credit subject or not subject to usury law.

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