



UNC
SCHOOL OF LAW

NORTH CAROLINA LAW REVIEW

Volume 70 | Number 1

Article 13

11-1-1991

No Longer Bending to the Purposes of the Money Lenders: Prohibiting the Bank Method of Interest Calculation

Allan W. Vestal

Follow this and additional works at: <http://scholarship.law.unc.edu/nclr>



Part of the [Law Commons](#)

Recommended Citation

Allan W. Vestal, *No Longer Bending to the Purposes of the Money Lenders: Prohibiting the Bank Method of Interest Calculation*, 70 N.C. L. REV. 243 (1991).

Available at: <http://scholarship.law.unc.edu/nclr/vol70/iss1/13>

This Article is brought to you for free and open access by Carolina Law Scholarship Repository. It has been accepted for inclusion in North Carolina Law Review by an authorized administrator of Carolina Law Scholarship Repository. For more information, please contact law_repository@unc.edu.

NO LONGER BENDING TO THE PURPOSES OF THE MONEY LENDERS: PROHIBITING THE “BANK METHOD” OF INTEREST CALCULATION

ALLAN W. VESTAL*

For nearly two centuries, American banks have employed the little known but highly lucrative “bank method” of calculation to determine interest charges on many loans. The method, which computes yearly interest charges by dividing the annual interest rate by 360 and multiplying the result by 365, effectively increases the charges by a fraction of a percent. For individual borrowers the increase is often nominal. For banks, however, the method nets millions of dollars in annual interest gains. In this Article, Professor Allan Vestal explores the American judicial treatment of the “bank method” of interest calculation. Professor Vestal concludes that although courts have penalized banks for employing the procedure, its use remains widespread because case law treating the subject has often failed to provide a meaningful avenue for relief. To correct the problem, Professor Vestal proposes modifications in the National Bank Act, along with parallel changes in related statutes.

This Article explores a failure of the American legal system. Unsupported by convincing legal or logical justification, banks are diverting perhaps in excess of one billion dollars annually from their customers into their own coffers by simply redefining what constitutes a year. By calculating per diem interest rates using a 360-day year, and then calculating interest charges using those per diems and a year of 365 days, banks are able to overcharge their customers. As early as 1824, in one of the first reported American cases on point, an attorney for a borrower identified the fundamental issue: Was it true, he asked, that “the laws of nature and of man must bend to the purposes of the money lender[?]”¹ For many banks, the answer is clearly yes.

* Assistant Professor of Law, Washington and Lee University School of Law. B.A. 1976, J.D. 1979, Yale University. The assistance of the Frances Lewis Law Center, Washington and Lee University, is gratefully acknowledged.

1. New York Firemen Ins. Co. v. Ely & Parsons, 2 Cow. 678, 686 (N.Y. 1824) (attorney Wells arguing for the defendant). At least one earlier American case had noted, but not resolved, the issue. See Bank of Alexandria v. Mandeville, 2 F. Cas. 607, 613 (C.C.D.C. 1809) (No. 850).

Legal challenges to the bank method of interest calculation present a story of chronic failure to eliminate this patently unfair banking industry practice. Although over 150 years ago borrowers prevailed in suits challenging the bankers' practice,² subsequent outcomes have been mixed; the banks have prevailed in odd cases as a result of unusual statutes, judicial acceptance of transparently false arguments, the reluctance of courts to impose penalties greatly disproportionate to the offense, and a misplaced freedom-of-contract analysis.³ More important, while the practice has been frequently condemned by reviewing courts, banks have not abandoned the procedure. Generalized regulations and attempts at class action litigation have in large measure failed to curb the practice and protect the public.⁴ Therein lies the story and, perhaps, a broader lesson.

The question is simple: Should banks be allowed to use a method of interest calculation that surreptitiously, systematically, and deliberately charges interest over the course of a calendar year in excess of the stated annual rate? If not, how should the legal system correct its long-standing failure to protect borrowers from this practice? To answer these questions, this Article begins by outlining briefly the procedure in question. The Article then considers various defenses the banking industry traditionally has offered to support the practice. The Article concludes that the banks' practice is unjustifiable, considers the litigative and legislative options for redress, and proposes a legislative solution.

I. GOD ISN'T A BANKER

Had God been a banker, the year might have had 360 days. A 360-day year divides nicely into four ninety-day quarters and twelve thirty-day months. Calculating interest is easy at the historically customary interest rates of six percent, twelve percent, and eighteen percent per annum using a 360-day year.⁵ But God did the start-up phase of the universe without outside financing and, lacking the counsel of bankers, caused a year to be 365 days, 5 hours, 48 minutes, and 46 seconds long.⁶

2. See, e.g., *Ely*, 2 Cow. at 704; *Bank of St. Albans v. Stearns*, 1 Vt. 430, 431-32 (1829); *Bank of St. Albans v. Scott & Raymond*, 1 Vt. 426, 429 (1829); *Bank of Burlington v. Durkee*, 1 Vt. 399, 404 (1829).

3. See *infra* notes 31-111 and accompanying text.

4. See *infra* notes 112-54 and accompanying text.

5. Using a 360-day year made up of 12 months of 30 days each, the monthly interest at 12% per annum is simply 1% of the balance, ½% for a 6% obligation and 1.5% for an 18% obligation.

6. DANIEL J. BOORSTIN, *THE DISCOVERERS* 9 (1983). This is a solar year, the period during which the earth makes a complete orbit around the sun. Although a calendar based on a sidereal month initially appears attractive to bankers because it uses months of a constant 28-

Historical responses to the odd length of a year are adverse from the bankers' perspective. The Egyptians adopted a calendar of 365 days, including twelve months of thirty days each and five interstitial days of celebration.⁷ This result is attractive to banks in that the months are of equal length, but it is unfavorable because the odd interstitial days are outside of the months. Julius Caesar took the Egyptian "Nile year" and rearranged it to have twelve months of twenty-eight, thirty, or thirty-one days, with no interstitial days, but with leap years.⁸ Julius Caesar's year had the advantage of eliminating the interstitial days, but the disadvantage of having odd-length months and uneven-length years. Pope Gregory XIII made a minor adjustment of the leap-year cycle to correct the Julian calendar—not terribly important from the bankers' perspective, but yet another complication.⁹ America adopted the Gregorian calendar in 1752, leaving bankers to ponder the calculation of interest for months of twenty-eight, thirty, or thirty-one days in years of either 365 or 366 days.¹⁰

At first, bankers attempted to reconcile the divergent goals that arose from the uneven calendar. On the one hand, they wanted to collect every penny of interest possible, and thus wanted to charge interest for 365 days in an ordinary year and 366 days in a leap year. On the other hand, bankers wanted a system that was easy to administer, both in terms of simplifying the calculation of interest and in standardizing monthly payments across months of different length. These two goals proved impossible to accommodate in one interest calculation scheme, so the bankers developed two.

The first objective of the bankers—collecting every penny of interest due—was achieved by a method of calculating interest that takes the annual interest rate, divides it by the number of days in the year to produce a per diem interest rate, and then levies interest for each day based on the per diem rate. This form of computation is called the "365/365"

day length, the lunar cycle is not precisely 28 days. Indeed, the sidereal calendar would be even worse for bankers, for it uses a 19-year Metonic cycle, in which all of the months have 28 days, but 7 years have 13 months and the remaining 12 years have only 12 months. *Id.* at 5. Of course, a calendar with years differing in length by a full month of 28 days would give new meaning to the term "per annum."

7. *Id.* at 7.

8. *Id.* at 9.

9. *Id.* at 9, 303. Under the Julian calendar every fourth year was a leap year. The Gregorian formula for leap years is somewhat more complex: a leap year is any year evenly divisible by 4, unless the year ends in "00" and is not divisible by 400. Thus 1898 was not a leap year (not divisible by 4), 1900 was not a leap year (divisible by 4, but ends in "00" and is not divisible by 400), but 2000 will be a leap year (divisible by 4, ends in "00" but is divisible by 400). *Id.*

10. *Id.* at 9.

method.¹¹ It enables banks to collect every penny due, but requires somewhat difficult calculations and produces different amounts of interest for months of different length, since interest is charged for each day and collected for months of different length.¹²

The second goal, ease of calculation and level monthly payments, was achieved by a method of calculation that takes the annual interest charge, divides it by the number of days in a hypothetical 360-day year to produce a per diem interest rate, and then levies interest based on a hypothetical thirty-day month. This form of computation is called the "360/360" method.¹³ The 360/360 method has the virtue of producing constant payments for months of different length. Its virtue, however, is also its flaw; when loans cover only parts of years, this formula does not always collect precisely what would be assessed under the 365/365 formula because the 360/360 method ignores the variations between months of different length and the 365/365 method does not.¹⁴ Of course, over the period of a year, the 360/360 and 365/365 methods produce identical total amounts of interest.¹⁵

At this point, some banker got creative. As between the two methods, the 360/360 method produced a higher per diem interest rate, since banks divide the same annual interest rate into a smaller number of pieces (360 as opposed to 365). The 365/365 method, however, provided more days for which interest could be charged. What would happen, one can imagine this creative banker asking, if the higher per diem figure of the 360/360 method was combined with the full daily-count feature of

11. The 365/365 method is also called "exact simple interest." *Silverstein v. Shadow Lawn Sav. & Loan Ass'n*, 51 N.J. 30, 38, 237 A.2d 474, 478 (1968); Robert T. Daunt, Note, *When Statutory Maximum Interest Rate Becomes Usury: Interest Formulas*, 6 U. TOL. L. REV. 541, 541-42 n.5 (1975).

12. For example, given a principal obligation of \$10,000 and a 12% per annum interest rate, the 365/365 method will generate \$92.0548 in interest for February ($\$10,000 \times 12\% \times 28/365$), \$101.9178 in interest for March ($\$10,000 \times 12\% \times 31/365$), and \$98.6301 in interest for April ($\$10,000 \times 12\% \times 30/365$).

13. The 360/360 method is also called "exact simple interest," *Silverstein*, 51 N.J. at 38, 237 A.2d at 478; "ordinary interest," Daunt, *supra* note 11, at 541-42 n.5; and "the pure 360-day year method," Dick West, *A Primer on Interest Rate Calculation Methods—Part I: Single Payment Loans*, 9 AM. BANKERS ASS'N BANK COMPLIANCE J., Winter 1988, at 11, 14.

14. For example, given a principal obligation of \$10,000 and a 12% per annum interest rate, the 360/360 method will yield a constant monthly interest payment of \$100 ($\$10,000 \times 12\% \times 30/360$), compared to \$92.0548 in interest which the 365/365 method would yield for February, \$101.9178 in interest which the 365/365 method would yield for March, and \$98.6301 in interest which the 365/365 method would yield for April. See *supra* note 12.

15. Given a principal obligation of \$10,000, no principal repayments and a 12% per annum interest rate, for example, the 360/360 method will yield an annual interest payment of \$1,200 ($12 \times \100), as will the 365/365 method (with one month of 28 days, four months of 30 days and seven months of 31 days the total will be $(1 \times \$92.0548) + (4 \times \$98.6301) + (7 \times \$101.9178)$, or \$1,200).

the 365/365 method? Banks would lose the administrative convenience of the 360/360 method's constant monthly payments and easy calculations, but would maximize interest income.

Thus was created the 365/360 method, or "bank method," of interest calculation.¹⁶ To derive the interest cost for any period, the 360-day per diem interest charge is multiplied by the actual number of days. Obviously, over the course of a year the 365/360 method produces more interest than the 365/365 method or the 360/360 method since it takes the higher 360/360 per diem charge but multiplies it by the 365-day time period.¹⁷ The increase in the amount of interest charged is a constant factor of slightly less than 1.4%.¹⁸

Absolutely no conceptual justification exists for the 365/360 method.¹⁹ No logic supports dividing the annual interest rate by 360 and

16. The 365/360 method is also called "the bankers' customary short year," *Commercial Nat'l Bank v. Connolly*, 176 F.2d 1004, 1010 n.2 (5th Cir. 1949) (Holmes, J., dissenting) (referring to "the bankers' customary short year of 360 days, which only applies in figuring interest that is charged as compensation for the use or detention of money"); "ordinary simple interest," *Silverstein*, 51 N.J. at 38, 237 A.2d at 478; "bank interest," Daunt, *supra* note 11, at 541-42 n.2; and "a bob-tailed, 360-day calendar," 117 CONG. REC. 18,538 (1971) (statement of Rep. Patman). The 365/360 method "is sometimes erroneously referred to as the 360-day year [method]." West, *supra* note 13, at 14.

17. For example, a \$10,000 principal obligation at 12%, with no principal repayment, will generate \$1,200 in interest using either the 360/360 or 365/365 method, *see supra* note 15; using the 365/360 method it will generate \$1,216.6667 ($\$10,000 \times 12\% \times 365/360$).

18. The percentage increase is calculated by multiplying the nominal rate using the 365/365 method by 365/360 (or 1.0138889). Thus, for a 6% nominal rate (365/365), the 365/360 method yields an effective rate of 6.08333%; for 9% nominal, 9.125% effective; for 12% nominal, 12.1667% effective; for 15% nominal, 15.2083% effective; and for 18% nominal, 18.25% effective. At least one commentator has gotten it wrong: "[t]his hybrid [the 365/360 method] results in a substantial distortion of the nominal interest rate, particularly when it is used to compute interest for extended payment periods." Richard J. Bronstein, Note, *Legal Aspects of the Use of "Ordinary Simple Interest,"* 40 U. CHI. L. REV. 141, 141 (1972) (emphasis added). In actuality, the rate distortion is a constant and does not vary over time.

19. It should be noted that the financial community uses both a 365-day year and a 360-day year in other contexts, often for no obvious reason. Examples are in daily and continuous compounding, *see* Beaton Wallace, *Little Difference in Daily and Continuous Compounding*, BOSTON GLOBE, Jan. 8, 1989, at 76 (observing that "[d]aily compounding . . . is based on a 360-day year, while continuous compounding is based on a 365-day year or, in a leap year, 366 days"); repo rates, *see* William Baldwin, *Margins for Error*, FORBES, Mar. 12, 1984, at 184, 188 (noting that "repo rates are calculated on a 360-day year"); and banker acceptances, bonds, and bank notes, *see* Lynn G. Lindsay, *Bankers Acceptances Come into Their Own as Trade Instruments*, AM. BANKING ASS'N BANKING J., Mar. 1984, at 104, 110 (noting that discount interest on banker acceptances is calculated on 360-day year, while bonds and bank notes are calculated on 365 days).

Sometimes an obvious reason does exist; some banks collect interest on loans using the 365/360 method and pay interest on deposit accounts using the 365/365 method. *American Timber & Trading Co. v. First Nat'l Bank*, 511 F.2d 980, 983-84 (9th Cir. 1973), *cert. denied*, 421 U.S. 921 (1975).

The controversy over use of a 365/360 day method is not limited to esoteric questions of

then multiplying the result by the actual number of days in a year, if the goal is to calculate payments that add up to the stated annual interest rate. One banking industry expert has candidly noted as much in an official American Bankers Association journal:

The 365/360-day year method . . . combines elements of the 365/365-day year and the 360/360-day year. But, unlike the 365/365-day year, this method's goal is not accuracy in approximating the exact length of a calendar year. Unlike the 360/360-day year, its goal is not simplicity in calculation. The goal of this method is, quite simply, to maximize the amount of interest charged.²⁰

A Congressional critic was more direct: "[T]his practice could be described in many ways, but it comes down to just plain old-fashioned greed."²¹

If the banks' goal is in fact to increase interest income, the 365/360 method is simply a surreptitious way to do so. The same result can be obtained in every case by using the 365/365 method with a marginally higher interest rate.²² The only reason to use the 365/360 method is that it allows banks to cozen their borrowers and charge higher-than-agreed-upon amounts of interest.²³ Borrowers think they are borrowing at a specified rate, but actually they pay nearly 101.4% of the agreed-upon interest.²⁴

interest calculation. State prisoners in Wisconsin have unsuccessfully sued the State, claiming that the use of a 365/360 calculation for the determination of release dates is constitutionally infirm. It comes as no surprise that the trial court denied their claims, reasoning that "using a standard 360-day year calendar rather than the Gregorian calendar simplifies sentence computation" and actually worked to the inmates' benefit. *Martinez v. Gudmanson*, 125 Wis. 2d 92, 93, 370 N.W.2d 814, 815 (Ct. App. 1985). Interestingly, there is no consistency between prison systems: federal prisons use a 365/365 method of calculation. See FEDERAL BUREAU OF PRISONS, SENTENCE COMPUTATION MANUAL 7612.1 (1972).

20. West, *supra* note 13, at 14.

21. 117 CONG. REC. 18,538 (1971) (statement of Rep. Patman).

22. In every case the result using $x\%$ under the 365/360 method can be duplicated using an interest rate of $1.0138889 \times x\%$ under the 365/365 method. For example, an 18% nominal interest rate using the 365/360 method of interest calculation can be expressed as an 18.25% nominal interest rate using the 365/365 method.

23. One banking industry representative confirmed the obvious:

Despite the problems inherent in using the 365/360-day year method, bankers cling to it tenaciously. I used to suggest that a bank merely raise its interest rates slightly to generate the additional income the method produces without dealing with all the attendant problems. The response I invariably got was that, if one could raise the interest rate to get yet more interest, one could get even yet more interest by applying the 365/360-day year to that higher rate. And, of course, that response is correct.

West, *supra* note 13, at 16.

24. See *infra* note 59 and accompanying text.

The lack of a conceptual or mathematical justification for the bank method of interest calculation has not stopped the banking industry from seeking to legitimize the practice. In early litigation challenging the 365/360 method, bankers argued that the method is consistent with the quotation of a "per annum" interest rate,²⁵ that the difference between interest calculated under the 365/360 method and interest calculated using the other methods of calculation is de minimis and thus not judicially cognizable,²⁶ that industry custom and usage authorize the practice,²⁷ and that administrative convenience justifies the practice.²⁸ More recently, banks have argued that the use of the 365/360 method is simply a contractual term, either express or implied,²⁹ and that claims of borrowers are barred when banks have complied with disclosure statutes.³⁰ Upon closer examination, each of these defenses is found wanting.

II. JUSTIFICATIONS OFFERED BY THE BANKS

A. *"A year has 365 days . . . and no amount of juggling the figures or resorting to rhetoric can change the facts"*

The first rationale banks offer for the 365/360 method is both elegantly simple and remarkably audacious. The banks argue that use of the bank method is proper because the phrase "interest at x% per annum" in their advertising and loan documentation does not necessarily refer to a year of 365 days. It is the type of argument that is plausible only when uttered in the soothing and solemn voice of an impeccably dressed senior partner.

Courts typically have addressed this argument in the context of usury cases, where use of the 365/360 formula with a nominal interest rate at the legal maximum is alleged to be usurious because over the course of a calendar year the borrower will pay interest in excess of the product of the legal maximum rate and the outstanding principal.³¹ In the early cases the question often was framed with regard to loans out-

25. See *infra* notes 31-52 and accompanying text.

26. See *infra* notes 53-68 and accompanying text.

27. See *infra* notes 69-87 and accompanying text.

28. See *infra* notes 88-97 and accompanying text.

29. See *infra* notes 98-111 and accompanying text.

30. See *infra* notes 144-50 and accompanying text.

31. For example, a \$10,000 principal obligation at the legal maximum rate of 18% per annum is supposed to generate \$1,800 per calendar year in interest ($\$10,000 \times 18\%$). Calculated using the 365/360 method, however, the obligation will result in a five dollar per diem interest charge ($\$10,000 \times 18\% / 360$) and thus will generate \$1,825 in interest over the calendar year ($\$5 \times 365$). If the \$1,800 figure is the maximum interest permissible, then the interest charged under the 365/360 method is usurious.

standing for less than a year, a customary borrowing pattern earlier in our history.³² Thus, in *New York Firemen Insurance Co. v. Ely & Parsons*,³³ the defendant bank charged one-fourth of the statutory maximum annual interest for a period of time, a fictionalized bankers' quarter of 90 days, which is less than one-fourth of a year.³⁴ Attorney Wells properly framed the argument in 1824:

But is 90 days a quarter of a year? It is so only on the principle with which the plaintiffs set out, that 30 days make a month. By what rule of law is this? We have lunar and calendar months; the one 28, the other a different number of days. If 30 days be the twelfth of a year, then 12 times 30 days are the year; if not to any other intent, yet the laws of nature and of man must bend to the purposes of the money lender.³⁵

Wells's position that use of the 365/360 method was improper was consistent with past English practice³⁶ and was adopted by the court.³⁷

The conclusion of one commentator that "[t]hroughout the remainder of the nineteenth century . . . the position taken in *Ely* was uniformly rejected"³⁸ simply does not withstand a critical examination of the cases.³⁹ One must differentiate between analyses of whether use of the

32. See Bronstein, *supra* note 18, at 143 (The Bank of North America "limited the maturities of notes to sixty days in order to avoid risk.").

33. 2 Cow. 678 (N.Y. 1824).

34. *Id.* at 686-87. The interest for a 90-day period should equal the product of the principal, the annual interest rate, and 90/365. In this case, the bank charged the product of the principal, the annual interest rate, and 90/360.

35. *Id.* at 686 (attorney Wells arguing for the defendant).

36. *Id.* at 686 & n.(a). Attorney Wells argued for the defendant:

The 3d Dyer, 345 a, pl.5.(a) tells us that the legal year is 365 days; the half year, 182, and the legal quarter, 91 days. . . . (a) . . . by the opinion of the court, the fourth part of the days of a year, which are 91 days, make a quarter, and to the 6 hours over, the law pays no regard. And Bendlowes showed an extract from an old book of the Exchequer, to this end: *s.* Note, that every quarter of a year contains in it ninety and one days, which make thirteen weeks; and half a year contains 182 days, but the year 365 days, and 52 weeks

Id.

37. *Id.* at 704. The court wrote:

Was it usurious in consequence of the interest having been calculated upon the supposition that 90 days were the fourth of a year, and 3 days the 10th of a month? The effect of this mode of calculation is to give to the lender interest for 365 days, upon a forbearance of 360; and where the interest is seven *per cent.* the amount received, upon this principle of calculation, will exceed the rate allowed by law.

Id.

38. Bronstein, *supra* note 18, at 145.

39. The cited commentator, *see* Daunt, *supra* note 11, at 549, does acknowledge one case in which the court explicitly approved and followed *Ely*. See *Haas v. Flint*, 8 Blackf. 67, 68 (Ind. 1846) (charging interest equivalent to one-fourth of a year on a 90-day note is usury). The other cases either do not relate to the 365/360 method of calculation or do not approve

365/360 method in conjunction with a per annum interest rate at the legal maximum comports with the statutory limit on interest and analyses of whether such a practice, by itself, can constitute usury. While it is true that loans using the 365/360 method were routinely found non-usurious—a departure from the result in *Ely*—it is not true that the intervening courts “effectively condoned”⁴⁰ the use of the 365/360 method in conjunction with the statutory maximum rate. Rather, some courts imposed a more stringent test of intent as an element of usury.⁴¹ These holdings merely show that the use of the 365/360 method was not, alone, dispositive for all courts on the question of usury.

The intent-sensitive approach to the usury determination in this

the use of the 365/360 method as a substitute for the 365/365 method, but stop short of the sanctions imposed in *Ely*. See *infra* note 43.

40. Bronstein, *supra* note 18, at 146.

41. The modified intent analysis was basically a question of whether the operational decision to use the 365/360 method was a sufficient indicium of corrupt intent. *Ely* and its progeny answered this question in the affirmative. See, e.g., *Utica Ins. Co. v. Tilman*, 1 Wend. 555, 556 (N.Y. 1828) (interest retained on principal calculated with 360 days equalling a year was prima facie usury); *Bank of Utica v. Smalley & Barnard*, 2 Cow. 770, 779 (N.Y. 1824) (intent to “receive interest for 91 days, upon a forbearance of 90, under an erroneous impression that 90 days were the legal fourth of the year . . . must be considered usurious”); *Bank of Utica v. Wager*, 2 Cow. 712, 769 (N.Y. 1824) (365/360 interest calculation “is a direct violation of the . . . Statute against Usury”); *Ely*, 2 Cow. at 705-07 (stating that intent to take interest at a rate higher than allowed by statute is sufficient for presumption of corrupt intent); *Childers v. Deane & Page*, 25 Va. (4 Rand.) 406, 412 (1826) (dictum) (“If a mode of calculating interest, which gives the creditor more than legal interest, is adopted, and the creditor knows it will have that effect, he is guilty of usury, although he may not suspect he is violating the law . . .”).

A majority of the reported cases, including at least one case that predates *Ely*, answered in the negative. In *Bank of Alexandria v. Mandeville*, 2 F. Cas. 607, 613 (C.C.D.C. 1809) (No. 850), for example, the court wrote:

[One party argues] that sixty-three days is not two months and one tenth of a month, but is sixty-three three hundred and sixty-fifths of a year, that is, they do not allow that a month is to be considered as the twelfth part of a year, nor a day the thirtieth part of a month. . . . It is for the jury to say what is the usual mode of calculation in such cases, and to calculate accordingly. If, however, it were a matter of law, and not a matter of fact, I should most certainly calculate it according to the mode in which the clerks in the bank calculated it, because I know that to be the general, I may almost say the universal, mode of calculation, not only among bankers and merchants, but in our courts of justice. But if it were an error, I should leave it to the jury to say whether it were not a mistake; and not done with an intent to make more than the lawful discount.

Id.; see also *Bank of St. Albans v. Stearns*, 1 Vt. 430, 431-32 (1829) (intent to violate statute may not be inferred when a bank calculates interest from tables in common use for over 20 years); *Bank of St. Albans v. Scott & Raymond*, 1 Vt. 426, 429 (1829) (365/360 calculation “an invariable rule of the bank, [which is] uniformly and publicly followed . . . [and] affords a strong presumption that the plaintiffs [intended to conform] to the statute”); *Bank of Burlington v. Durkee*, 1 Vt. 399, 404 (1829) (365/360 interest calculation is “scarcely intended to create usury, it has been so long sanctioned by judicial adjudications”); *infra* note 43 (discussing further the interest element).

context was introduced in a series of cases decided by the Vermont Supreme Court five years after *Ely*. The Vermont court followed *Ely* and rejected the calculation of interest on the 365/360 basis, but refused to invoke the statutory penalty for usury—forfeiture of the interest and principal. Instead, the court merely ordered an adjustment of the interest paid.⁴² The bank in each case was saved by an absence of corrupt intent.⁴³

Only one reported case held that the 365/360 method of computa-

42. *Durkee*, 1 Vt. at 404 (“[T]he taking of the twenty-nine cents, as above mentioned, is a taking of more than the six per cent. allowed by the statute; and that sum ought at least to be deducted in making up the judgment.”); accord *Stearns*, 1 Vt. at 432; *Scott*, 1 Vt. at 430.

43. *Durkee*, 1 Vt. at 403 (additional interest resulting from the 365/360 method of calculation taken as excessive interest, corruptly and against the statute, constitutes usury and avoids note); accord *Stearns*, 1 Vt. at 431-32; *Scott*, 1 Vt. at 429.

The absence of corrupt intent was a factor in each of the cases cited by one commentator, see Bronstein, *supra* note 18, at 145 & n.25, who has suggested there was “uniform rejection” of *Ely*. In *Bradley v. McKee*, 3 F. Cas. 1156 (C.C.D.C. 1837) (No. 1,784), although it is not clear from the report whether the case focused on the method of interest calculation or the addition of a premium for “eastern paper,” the intent element was clearly present in the jury instruction. Over the defendant’s citation of *Ely*, the court instructed the jury

that if from the evidence they shall be of opinion, that, in the years 1833 and 1834, and for a long time before, it was the usage and custom of the banks and exchange-brokers, in that part of the state of Virginia in which the town of Wheeling is, to discount paper at and after the rate of one per cent. for sixty days; and, in addition thereto, to charge a premium for exchange on eastern paper, varying from an [sic] half to one per cent. when eastern paper was loaned; and also to charge the same discount and premium for the renewal of the notes given therefor; and that the said transaction was *bona fide*, and not intended as a cloak for usury, this case was not usurious.

Id. at 1157 (emphasis added). But the court refused to instruct the jury in a way that omitted the intent component, and did not charge the jury

that, if . . . the consideration given . . . was a loan negotiated by . . . any . . . person acting on behalf of the said company; and that the terms of the said loan were one per cent. for sixty days’ discount for forbearance, and one half per cent. for exchange on eastern funds; and that such was the usage and custom of the banks and exchange-brokers in that part of the country where the said loan was made, in the years 1833 and 1834; and that the same rate of discount and premium, or commission, was charged upon each renewal of such loans, then the said contract was *bona fide*, and not usurious.

Id. Thus, to the extent the court even addressed the calculation method issue, it did not repudiate the basic *Ely* analysis.

In *Agricultural Bank v. Bissell*, 29 Mass. (12 Pick.) 586, 588-89 (1832), for example, the court held that if a computational method giving “more than the legal rate” was employed “in good faith . . . [it] would not be warranted, from the mere fact that the interest thus computed slightly exceed[ed] the legal rate, to infer a corrupt and usurious agreement.” *Id.* A similar rationale was employed in *Planters’ Bank v. Snodgrass*, 5 Miss. (4 Howard) 573 (1840), where a majority of the court found no usury in the absence of corrupt agreement, *id.* at 620-22, and the absence of intention to violate the law, *id.* at 625-26. See *Planters’ Bank v. Bass*, 2 La. Ann. 430, 437 (1847) (apparently adopting the *Snodgrass* majority’s corrupt agreement and intent analysis); *Lafayette Bank v. Findlay*, 1 Ohio Dec. Reprint 49, 50 (1844) (including

tion did not violate the standard for excessive interest, without regard to the corrupt intent element of usury, or without a statutory justification.⁴⁴ In contrast, courts routinely have found interest assessments at the statutory rate based on a 365/360 formula to violate the statutory maximum rate.⁴⁵ Thus, the 365/360 method of calculation finds no support in the usury cases.

Nor does the bankers' initial rationale, that reference to a per annum rate does not require the use of a 365-day year, find support in the cases that depend upon a statutory intention or permission to use other than a 365-day year. On rare occasions a statute will express a clear legislative intention to allow the 365/360 method of interest calculation.⁴⁶ In a small number of cases courts have been able to divine less

element of intent), *cited in* 47 AM. DIG. *Usury* § 107 (1904); *Parker v. Cousins*, 43 Va. (2 Gratt.) 372, 386 (1845) (citing *State Bank v. Cowan*, 35 Va. (8 Leigh) 238 (1837) and *Bissell*).

In *Cowan*, the court divided on theory. 35 Va. (8 Leigh) at 246-63. Judge Brockenbrough declared that "[m]y own opinion always has been that by the calculation the law is violated, and the contract founded on it . . . is usurious," but, bowing to custom and usage, allowed the calculation. *Id.* at 253. The panel's presiding member, President Tucker, declared that Rowlett's tables "were founded upon the false postulate that the year contained only 360 days instead of 365," but found no intent and thus no usury. *Id.* at 257-59. Judge Brooke found no "corrupt intent to commit usury." *Id.* at 255.

The only other case cited, *see Bronstein, supra* note 18, at 145 n.25, apparently does not involve the 365/360 method of calculation, but rather approves the use of the 360/360 method. *See Pool v. White*, 175 Pa. 459, 474-75, 34 A. 801, 803 (1896) (Although the 365/360 calculation is not the "strict legal rule" unless a particular method of calculation was "specially agreed upon by the parties, it was not error . . . to assume that the mode usual with bankers was to be pursued.").

44. *Merchants & Planters' Bank v. Sarratt*, 77 S.C. 141, 144-45, 57 S.E. 621, 622 (1907). The court wrote:

The law does not stickle over fractional parts of a day in the calculation of interest. . . . We, therefore, do not rest our conclusion upon the fact that plaintiff did not intend to take usurious interest, nor upon the fact that it is the custom of banks to so compute interest, but upon the ground that such standard and reasonably correct method of calculation for less periods than a year is not unlawful, and was not intended to be overthrown by the usury statute.

Id.

45. *See Mohr, Inc. v. Bank of California, N.A.*, 443 F. Supp. 370, 371 n.6 (D. Or. 1978) (court without comment recomputes from 365/360 to 365/365 for usury determination); *American Timber & Trading Co. v. First Nat'l Bank*, 334 F. Supp. 888, 889 (D. Or. 1971), *aff'd*, 511 F.2d 980 (9th Cir. 1973), *cert. denied*, 421 U.S. 921 (1975), *aff'd on rehearing*, 690 F.2d 781 (9th Cir. 1982); *Ellis Nat'l Bank v. Davis*, 359 So. 2d 466, 469 (Fla. Dist. Ct. App.), *cert. denied*, 365 So. 2d 711 (Fla. 1978), *cert. denied*, 440 U.S. 976 (1979); *Ditmars v. Camden Trust Co.*, 10 N.J. 471, 497-98, 92 A.2d 12, 25 (1952); *Ely*, 2 Cow. at 704; *First Am. Nat'l Bank v. Hunter*, 581 S.W.2d 655, 659 (Tenn. Ct. App. 1978) (awarding borrower \$0.70), *cert. denied*, 581 S.W.2d 655 (Tenn. 1979); *Lawler v. Lomas & Nettleton Mortgage Investors*, 691 S.W.2d 593, 596 (Tex. 1985); *O'Brien v. Shearson Hayden Stone, Inc.*, 90 Wash. 2d 680, 691-92, 586 P.2d 830, 836 (1978) (en banc).

46. *See Holisak v. Northwestern Nat'l Bank*, 297 Minn. 248, 250, 210 N.W.2d 413, 414 (1973) (en banc) (noting that statute allows maximum agreed interest of "\$8 on \$100 for one

straightforward indications of legislative intent to allow the 365/360 method.⁴⁷ But there is no support for the argument that the statutes themselves evidence a general acceptance by the legislatures of the 365/360 method of calculation.⁴⁸

Indeed, it is remarkable that parties have even litigated the meaning of the words "per annum" in this context. After all, "the words ['per annum'] mean, in Latin, 'by the year.' The ordinary person assumes that a year, except leap year, has 365 days."⁴⁹ A number of courts have adopted this simple analysis, either consciously⁵⁰ or without acknowl-

year" and provides that "[i]nterest at the rate of one-twelfth of eight percent for every 30 days shall not be construed to exceed eight percent per annum"). Of course, that some jurisdictions have adopted statutes which specifically allow the use of a nonstandard year in some limited contexts simply indicates that the standard year consists of 365 days.

47. See *Voitier v. First Nat'l Bank of Commerce*, 514 F. Supp. 585, 593 (E.D. La. 1981) (en banc) (noting that Louisiana statute allowed a day to be counted as one-thirtieth of a month and concluding that the Louisiana Supreme Court would, "in accordance with [the state's] civilian tradition . . . give greater weight to the probable intent of the Louisiana legislature" and uphold use of the 365/360 method); *THC Fin. Corp. v. Managed Inv. Corp.*, 64 Haw. 491, 495, 643 P.2d 549, 552-53 (1982) (noting that statute made contracting for, not collecting, excessive interest illegal, and holding use of the 365/360 method not to violate the statute); *Cotton v. Commonwealth Loan Co.*, 206 Ind. 626, 630, 190 N.E. 853, 855 (1934) (noting that variable number of days in a month requires conclusion that "to construe the word 'month' as meaning calendar month is plainly repugnant to the intent of the Legislature and the context of the statute, and we must seek the true intent when the provision is considered in the light of the purpose of the act and its practical application").

Typical of these holdings is *State Securities Co. v. Corkle*, 191 Neb. 578, 583, 216 N.W.2d 879, 882-83 (1974), in which the court wrote:

Appellee used a 360-day year, relying upon section 8-441, R.R.S.1943, which states: 'For the purpose of computing charges, . . . a month shall be any period of thirty consecutive days, and the rate of charge for each day shall be one-thirtieth of the monthly rate.' Appellants' testimony establishes that the daily interest factor achieved by use of a 360-day year, when charged for 365 days, produces a return in excess of 12 percent simple interest. Is such a charge within the contemplation of the statute? We believe that it is. The term 'year' in section 8-435, R.R.S.1943, is not further defined in the statute. However, section 8-441, R.R.S.1943, requires that the daily interest rate be one-thirtieth of the monthly rate. Since interest computed in accordance with section 8-441, R.R.S.1943, at 12 percent a year, or 1 percent a month, would divide that monthly rate into thirty equal parts for the purposes of a daily interest figure, one must assume either that the term 'year' in section 8-435, R.R.S.1943, contemplates a 360-day year, or that section 8-441, R.R.S.1943, could allow, on a 365-day year, interest in excess of the stated maximum. Reading the two sections together, we find that the 360-day method of computing interest used by appellee, under these statutes, was not usurious.

Id.

48. Any argument that the statutes evidence such a general acceptance is ultimately unavailing because of a lack of uniformity in use of the 365/360 method of calculation. See *infra* text accompanying notes 76-80.

49. *American Timber & Trading Co.*, 334 F. Supp. at 889.

50. *Chern v. Bank of Am.*, 15 Cal. 3d 866, 876, 544 P.2d 1310, 1316, 127 Cal. Rptr. 110,

edgement.⁵¹ One must sympathize with Arkansas Supreme Court Justice Purtle, who observed that “[t]en per cent per annum means 10% per year. A year has 365 days, except for a leap year, and no amount of juggling the figures or resorting to rhetoric can change the facts”⁵²

B. *“The avidity with which a half cent is watched and pocketed shows no want of care”*

A second rationale banks offer for the 365/360 method is that, although the practice of using the 365/360 formula may generate interest in excess of the nominal per annum figure, the difference is so insignificant as to be beneath the dignity of the courts. This argument invokes the legal maxim, *de minimis non curat lex*, thus adding a patina of legitimacy to an otherwise bald position.⁵³

The *de minimis* argument has worked,⁵⁴ but only rarely.⁵⁵ Of course, on one level the argument is attractive: the individual’s losses as a result of the bank method of interest calculation are often insubstantial.⁵⁶ Even on the individual level, however, the use of the 365/360 method can have a significant impact. One published report notes that

116 (1976) (en banc); *O’Brien v. Shearson Hayden Stone, Inc.*, 90 Wash. 2d 680, 691, 586 P.2d 830, 836 (1978) (en banc).

51. *Lawler v. Lomas & Nettleton Mortgage Investors*, 691 S.W.2d 593, 596 (Tex. 1985) (although statute provided a 10% usury maximum, defendant charged 10% using a 360-day year; “[i]n other words, interest was charged at the rate of 10.139 per cent per annum”).

52. *Martin v. Moore*, 269 Ark. 375, 379, 601 S.W.2d 838, 841 (1980) (Purtle, J., dissenting).

53. The phrase may be translated: “The law does not care for, or take notice of, very small or trifling matters. The law does not concern itself about trifles.” BLACK’S LAW DICTIONARY 482 (6th ed. 1990). See *Lastlow v. Thomlinson*, 80 Eng. Rep. 237 (1484) (affirming judgment in assumpsit despite three-farthing variation “because it was not possible in effect to mince the measure so, as it shall hit the just sum, as the odd hours are not accounted in the year”).

54. See *Koos v. First Nat’l Bank*, 358 F. Supp. 890, 892 (S.D. Ill. 1973), *aff’d*, 496 F.2d 1162 (7th Cir. 1974); *Cotton v. Commonwealth Loan Co.*, 206 Ind. 626, 633, 190 N.E. 853, 856 (1934) (citing *Broce v. Master Loan Serv., Inc.*, 171 Ga. 22, 25, 154 S.E. 324, 325 (1930)).

55. See, e.g., *Ellis Nat’l Bank v. Davis*, 359 So. 2d 466, 468 (Fla. Dist. Ct. App.) (rejecting *de minimis* defense), *cert. denied*, 365 So. 2d 711 (Fla. 1978), *cert. denied*, 440 U.S. 976 (1979); *New York Firemen Ins. Co. v. Ely & Parsons*, 2 Cow. 678, 704 (N.Y. 1824) (“Whether [the] excess [from use of a 360 day year] be great or small is unimportant; for the least excess is as much usury as the most enormous.”).

56. See *First Am. Nat’l Bank v. Hunter*, 581 S.W.2d 655, 659 (Tenn. Ct. App. 1978) (awarding borrower \$0.70), *cert. denied*, 581 S.W.2d 655 (Tenn. 1979); *Bank of St. Albans v. Scott*, 1 Vt. 429, 430 (1829) (“The case shows the taking of about eight cents too much”); *Bank of Burlington v. Durkee*, 1 Vt. 399, 404 (1829) (awarding borrower \$0.29). In a slightly different context, the calculation of interest on investments, one author reports that “[a] Cambridge banker informs me that the only difference between daily [360-day year] and continuous [365-day year or, in a leap year, 366-day year] compounding is the cost of a package of cigarettes.” Wallace, *supra* note 19, at 76.

when dealing with a loan amortized over twenty-five years, the use of the 365/360 method adds approximately one year to the time required to fully amortize the principal.⁵⁷ At a nominal rate of 18% per annum, the use of the 365/360 method adds a full 1/4% to the effective interest rate, making the effective yield 18 1/4% per annum.⁵⁸

Furthermore, the *de minimis* argument loses much of its force when the matter is viewed from the banks' perspective and individual loans are aggregated. Use of the 365/360 method results in a windfall to banks equal to slightly less than 1.4% of interest income—not a trifling sum.⁵⁹ The bank involved in the amortization situation above, for example, "ended up with \$90,000 in interest it was not entitled to," according to the Solicitor General.⁶⁰ Even more dramatic are the prayers for relief in class actions that have been filed.⁶¹ In one case from the United States Court of Appeals for the Eleventh Circuit, the class of potential plaintiffs numbered some 8,600, and a reasonable estimate of the potential liability of the bank on the 365/360 issue was in excess of \$3,500,000 annually.⁶²

The sums involved are anything but trifling when translated to the national plane. Twenty years ago, Representative Wright Patman, then chair of the House Committee on Banking and Currency, noted the "massive overcharges to consumers, homeowners, and businessmen throughout the Nation" caused by the use of the 365/360 method, and

57. See *Bank Board Asks Supreme Court for Power to Stop S&L Overcharges*, WA. FIN. REP., Apr. 5, 1982, at B-3.

58. At 18% per annum the effective interest rate using the 365/360 method is $0.18 \times 365/360$, or 0.1825.

59. The windfall equals $5/360$, or $1/72$ (1.3889%) of the interest-income stream.

60. *Bank Board Asks Supreme Court for Power to Stop S&L Overcharges*, *supra* note 57, at B-3.

61. See *Kleiner v. First Nat'l Bank*, 751 F.2d 1193, 1196 (11th Cir. 1985) (approximately 8,600 potential class plaintiffs); *Fletcher v. Security Pac. Nat'l Bank*, 23 Cal. 3d 442, 446, 591 P.2d 51, 54, 153 Cal. Rptr. 28, 30 (1979) (plaintiff class numbered over 50,000); *Chern v. Bank of Am.*, 15 Cal. 3d 866, 871, 544 P.2d 1310, 1312, 127 Cal. Rptr. 110, 112 (1976) (en banc) (aggregate claims in excess of \$100,000); *Perlman v. First Nat'l Bank*, 15 Ill. App. 3d 784, 788, 305 N.E.2d 236, 242 (1973) ("thousands of individual claims"), *appeal dismissed*, 60 Ill. 2d 529, 331 N.E.2d 65 (1975) (dismissed on recusal of two supreme court justices); *Bernard v. First Nat'l Bank*, 275 Or. 145, 148, 550 P.2d 1203, 1207 (1976) ("Plaintiffs estimate that the borrowers within the class in combined cases number 70,000 and seek a total recovery of \$8,000,000 . . .").

62. *Kleiner*, 751 F.2d at 1196. Of 8,600 in the plaintiff class, approximately 2,800 having \$694,997,218 in loans were induced to opt out of the class. *Id.* at 1198. Assuming the typicality of the borrowers induced to opt out, the average loan at issue was about \$250,000 ($\$694,997,218 / 2,800 = \$248,213.29$). Calculating on the basis of a 12% per annum interest figure, each loan would generate \$30,000 per annum in interest ($\$250,000 \times 0.12 = \$30,000$). Using the 1.4% adjustment figure for excess interest charged using the 365/360 method, the average loan would be subject to \$420 in excess interest charges each year; in the aggregate, the 8,600 class members would be overcharged \$3,612,000 each year.

conservatively estimated the unearned annual wealth transfer from the public to banks at \$145,000,000⁶³—a figure that would be in excess of \$465,000,000 per annum in 1990 dollars.⁶⁴ If the same methodology used by the congressional authority is applied to current commercial loan balances, the annual estimated loss is more than \$940,000,000.⁶⁵ The estimate rapidly exceeds one billion dollars when adjustment is made for contemporary interest rates.⁶⁶

Thus, perhaps the best reason to reject the *de minimis* argument is that the issue is anything but *de minimis* to banks.⁶⁷ Attorney Wells

63. 117 CONG. REC. 18,538 (1971) (statement of Rep. Patman). Rep. Patman noted that assuming

only one-half of the more than \$300 billion of loans outstanding by all the commercial banks as of the end of 1970, had the 360-day method applied to them—a quite conservative figure—the overcharge to the bank borrowers of the country would now amount to approximately \$145 million a year.

Id. The \$145,000,000 overcharge figure is calculated using an assumed 50% figure for the incidence of the 365/360 method, an assumed interest rate of 7%, and the 0.0139 factor for use of the 365/360 method. *See supra* note 18. Thus, the calculation is $\$300,000,000,000 \times 0.50 \times 0.07 \times 0.0139 = \$145,950,000$.

64. The congressional estimate of \$145,000,000 was made in June of 1971, when the consumer price index (CPI) was 40.8 (1982-84=100). [3 Labor Relations] Lab. L. Rep. (CCH) ¶ 6627, at 15,010 (Mar. 8, 1991). The CPI for September of 1990 was 131.1. *Id.* ¶ 6605. Using a conversion factor of 3.21323529 (calculated by dividing 131.1 by 40.8), the \$145,000,000 in June of 1971 would equal \$465,919,000 as of September 1990. In fact, there is some reason to believe that the practice is more widespread than a CPI calculation would suggest. The 1971 Federal Reserve study indicated that larger banks tended to use the 365/360 method more than smaller banks. 117 CONG. REC. 18,539 (1971). One of the questions from the study suggested by Representative Patman was “whether there is any relationship between the increasing concentration in banking through various means and the use of questionable practices which cost the public many millions of dollars a year.” *Id.* To the extent there is a correlation between bank size and the use of the 365/360 method, one would expect the practice to be more widespread after the last decade of reckless deregulation, savings and loan thievery, holding company expansion, and interstate banking.

65. *See supra* note 63. The corresponding commercial bank loan figure for 1988, the most recent year for which the information is available, is \$1,932,300,000,000. BUREAU OF THE CENSUS, U.S. DEPT. OF COMMERCE, STATISTICAL ABSTRACT OF THE UNITED STATES: 1990 table 805, at 496 (110th ed. 1990) (combining line items for real estate loans, commercial and industrial loans, loans to individuals, farm loans, and other loans and leases). Using the same 50% incidence assumption, the same 7% assumed interest rate, and the constant 0.0139 factor, the present loss is estimated at \$940,064,000 ($\$1,932,300,000,000 \times 0.50 \times 0.07 \times 0.0139 = \$940,064,000$).

66. An interest rate assumption of 7%, *see supra* note 65, is probably too conservative an estimate for the current mix of bank loans. Using a conservative 10% average, the loss is \$1,342,950,000 ($\$1,932,300,000,000 \times 0.50 \times 0.10 \times 0.0139$). A 12% figure yields \$1,611,540,000 ($\$1,932,300,000,000 \times 0.50 \times 0.12 \times 0.0139$), while 14% results in a \$1,880,130,000 loss ($\$1,932,300,000,000 \times 0.50 \times 0.14 \times 0.0139$).

67. In *Kleiner v. First National Bank*, 751 F.2d 1193 (11th Cir. 1985), the importance of the use of the 365/360 method to banks was demonstrated by the lengths to which one bank and its counsel went to quash the claims. In this class action litigation involving a claim based on the use of the 365/360 method, the federal district court adopted an opt-out provision for

identified the crux of the issue in 1824: "The plaintiffs may here again claim the benefit of the maxim *de minimis non curat lex*, in protection of their rights, but the avidity with which a half cent is watched and pocketed by them, shows no want of care on their part."⁶⁸

C. *"It received the universal approbation of mankind . . ."*

The third justification banks proffer for the 365/360 formula is that the method has gained legitimacy through custom and usage. This argument has been flatly rejected by some courts,⁶⁹ partially accepted by others,⁷⁰ and embraced without apparent difficulty by still others.⁷¹

approximately 8,600 potential class members. *Id.* at 1196. After the district court issued an order severely limiting contacts with potential class members, counsel for the bank organized a campaign to contact and convince bank clients to opt out of participation. *Id.* at 1197-98. The stakes apparently were high; in fact, one bank loan officer who was an attorney was forced to resign when he would not participate in the campaign. *Id.* at 1198 n.90. The campaign was successful: of approximately 3,000 customers reached, the bank got opt-out commitments from 2,800 customers, whose loans totalled \$694,997,218. *Id.* at 1198. The district court found the tactics both coercive and in direct violation of the court's order:

The use of a customer's personal loan officer to solicit an exclusion request from him is inherently coercive. This does not mean that *all* customers would be coerced by such a call from their loan officer. However, many would be. These customers would include, for example, those who anticipated seeking a note "roll-over," new loans, extension of lines of credit, or any type of discretionary financial indulgence from their loan officers, and who did not have convenient access to other credit sources. To these customers, Defendant's statement that it would not "call" their loans if they elected to participate in the case is hardly reassuring. Failure to opt out of a class action is not an event of default under Defendant's note forms. Thus, injecting the idea of retaliation served no purpose other than to coerce.

Kleiner v. First Nat'l Bank, 102 F.R.D. 754, 768 (N.D. Ga. 1983) (citations omitted), *aff'd in part and rev'd in part*, 751 F.2d 1193 (11th Cir. 1985). Because of the intervening settlement, the Eleventh Circuit was not called upon to rule on attorneys' fees, costs, voidable opt-out exclusions and cessation of contacts remedies ordered by the district court. *Kleiner*, 751 F.2d at 1199. The circuit court did uphold the fines and disqualification of lead bank counsel ordered by the district court. *Id.* at 1210. The court also agreed with the district court that "the high number of exclusion requests was witness to the inherent coercion of the Bank's machinations." *Id.* at 1202.

68. *New York Firemen Ins. Co. v. Ely & Parsons*, 2 Cow. 678, 687 (N.Y. 1824) (attorney Wells arguing for the defendant).

69. *Perlman v. First Nat'l Bank*, 15 Ill. App. 3d 784, 795, 305 N.E.2d 236, 245 (1973) (holding that "under no circumstances could the affirmative defense of custom and usage be maintained"), *appeal dismissed*, 60 Ill. 2d 529, 331 N.E.2d 65 (1975) (dismissed on recusal of two supreme court justices).

70. In *Bank of St. Albans v. Stearns*, 1 Vt. 430 (1829), the court used custom and usage in part to avoid the intent element necessary to find usury, thus allowing an adjustment of the interest without forfeiture of the principal. *Id.* at 432. The court wrote:

How numerous must have been the Bank suits, in all the states in the union, where a similar defence might as well have been interposed as here! Yet, who ever heard of such a defence, till the case reported in 2 Cowen? A man would as soon be apt to doubt the correctness of his printed law book, as of his printed interest tables, till

One can easily understand the frustration of banks that are sued for following what they thought to be a common industry practice.⁷² The custom and usage defense has two central weaknesses, however. First, no universal custom and usage exist approving the use of the 365/360 formula. Second, banks were put on notice over 160 years ago that the practice is improper.

Use of the 365/360 formula is not universal. Apparently an American invention, it is contrary to the English rule.⁷³ Is it a rule of general

some incorrectness be shown to him. I have seen Rowlett's [sic] tables much used, and have no recollection of ever knowing, or suspecting, them incorrect, till on the present circuit. Many others may have been alike unsuspecting. What should excite suspicion? We may be jealous of a new invention or an innovation in practice, and be led to examine its correctness. But, when we are told, and that with truth, that the tables presented have been in general, and well approved use, for 25 or 30 years, why go about to correct them? Why refuse to trust them as a guide?

Id. Barely 150 years later, a Florida court rejected reliance on Rowlett's tables, perhaps indicating that the element of surprise had worn thin. *Ellis Nat'l Bank v. Davis*, 359 So. 2d 466, 468 (Fla. Dist. Ct. App.) (holding it a usury violation for bank knowingly to charge 10% off of Rowlett's tables using 360-day year when usury limit is 10%), *cert. denied*, 365 So. 2d 711 (Fla. 1978), *cert. denied*, 440 U.S. 976 (1979).

71. *See, e.g., Martin v. Moore*, 269 Ark. 375, 376, 601 S.W.2d 838, 839 (1980) ("We have no hesitancy in holding, for practical, legal, and historical reasons, that the use of the 360-day year is lawful even when the interest rate is [the constitutional usury rate]."). The court in *Martin* never explained precisely how the payments were calculated, and the method is not at all clear from the facts presented.

72. The banks' exasperation was shared as early as 1829 by the Vermont Supreme Court:

If a bank commences and carries on its operations in a way pursued by all the banks in the country, and in the way that has been pursued by them for thirty years, and even from the first establishment of banks in this country; and uses the same tables for casting interest, or, to speak more properly, takes the interest from those tables already cast, for any sum and any term of time, those same being printed tables, and kept for sale for the accommodation of banks and business men; and, during all this time, this mode of casting and taking interest has been acquiesced in as correct, and no resistance made to it in any of the numerous actions, in which the defence might be made if good in any case—under all these circumstances it cannot be presumed that they acted with any intention to oppose or violate the statute. In such a case, the bank would have reason to believe, that the statutes of usury had received a construction from the bench that sanctioned this mode of casting interest, or at least, that it received the universal approbation of mankind. The going in a path so well understood, so long in use, and in such general use, precludes all presumption of any intention to evade the statute, or do any wrong whatever.

Bank of Burlington v. Durkee, 1 Vt. 399, 403 (1829).

73. *New York Firemen Ins. Co. v. Ely & Parsons*, 2 Cow. 678, 688 (N.Y. 1824) (attorney Wells arguing for the defendant). Counsel for defense in *Ely* argued that

the manner of casting interest, disclosed by the case, is peculiar to this country. In England the rule is the same in all banks, public and private. In the last edition of *Chitty on Bills*, 608, 609 and 610, the Court will see the English tables of interest for years, months and days, which make a distinction between a note payable at 30, 60 and 90 days, and a note payable at 1, 2 and 3 months. The contrary practice, then, must have originated in this country; and we ask whether it is of such an age as to

application in the United States? As recently as 1980, the Arkansas Supreme Court, without any citation or apparent evidence, determined that "the 360-day year is so uniformly used in the commercial world that no one has thought to question it."⁷⁴ In the mid-1930s the Indiana Supreme Court, based on third-party calculation aids, found that there was general agreement on the 365/360 method in one limited segment of the financial services industry.⁷⁵ The weight of modern authority, however, is clearly to the contrary—that no custom and usage legitimize the 365/360 formula. In the leading modern case, *American Timber & Trading Co. v. First National Bank*,⁷⁶ the United States Court of Appeals for the Ninth Circuit found on the basis of nationwide surveys that "although the 365/360 method is used there is no definite, uniform, long-established custom."⁷⁷ The court relied upon the opinion of Representative Wright Patman, an acknowledged authority in banking affairs:

[Use of the 365/360 method] is not standard or uniform in any way. It varies among banks with respect to the types of loans or maturities of loans subjected to the practice. It varies even in many instances within the same bank with respect to the type of loans and maturity of loans to which the practice is applied, and it varies significantly from one part of the country to another.⁷⁸

Similarly in the landmark case *Kleiner v. First National Bank*,⁷⁹ the court held that the evidence supplied by the defendant bank also failed to establish a trade meaning for "per annum."⁸⁰

sanction a violation of law? There is no doubt of the intent to swell the amount of interest beyond what is strictly legal, and the court cannot relieve against a mistake of the law.

Id. (attorney Wells arguing for the defendant).

74. *Martin*, 269 Ark. at 377, 601 S.W.2d at 839.

75. *Cotton v. Commonwealth Loan Co.*, 206 Ind. 626, 630, 190 N.E. 853, 855 (1934) ("It is a well-known fact that in commercial circles certain recognized tables are used in the computation of interest, and that in these tables 360 days are treated as a year.")

76. 511 F.2d 980 (9th Cir. 1974), *cert. denied*, 421 U.S. 921 (1975).

77. *Id.* at 984 n.3. The court explained: "The bank contends it relied upon industry custom. . . . [W]e doubt the existence of such custom. . . ." *But see* Bronstein, *supra* note 18, at 143 ("The 365/360 method has been the standard method of interest calculation in the banking industry for the last two centuries.")

78. *American Timber*, 511 F.2d at 984 n.3 (citing 117 CONG. REC. 18,539 (1971) (statement of Rep. Patman)).

79. 581 F. Supp. 955 (N.D. Ga. 1984).

80. *Id.* at 962. Affidavits of nonparty Atlanta bankers offered by defendant bank indicated "that the 365/360 method of interest calculation is one of several generally recognized, customarily accepted methods of computing interest in the banking industry." *Id.* The court found that

the affidavits tendered by the bank fail to support any conclusion that the term "per annum" has a trade meaning or that any trade custom applies which would reveal

In actuality, different types of financial institutions have adopted different methods of interest calculation and handle different types of loans differently.⁸¹ Even banks involved in litigation are not internally consistent, often treating one class of commercial loans differently from another.⁸² Interest accruing on loans is also treated differently from interest accruing on deposit accounts.⁸³ One bank attorney has even reported that his bank used different methods for calculating interest on identical loans; the treatment the customer got depended on which computer was used to calculate the interest.⁸⁴

Finally, to the extent custom and usage were ever a viable argument, it ceased to be compelling early on. The custom and usage defense was unambiguously rejected in New York in 1824.⁸⁵ In 1829 the Vermont

the true meaning of the phrase "per annum." Indeed, the affidavits suggest the absence of a common meaning for the term "per annum," rather than the existence of a common meaning.

Id.

81. 117 CONG. REC. 18,539 (1971). Even within a single bank, there are often variations in the use of the 365/360 practice. See *Federal Reserve Bank Survey on Calculating Interest Charges on Loans*, 117 CONG. REC. 18,540-45 (1971) (among 191 banks using the 365/360 method, none apply method for all types of loans and maturities). In *Silverstein v. Shadow Lawn Sav. & Loan Ass'n*, 51 N.J. 30, 237 A.2d 474 (1968), the court noted surveys showing that an overwhelming number of commercial banks, savings banks, and insurance companies used the 360/360 or 365/365 method for computing interest on long-term monthly payment mortgage loans. *Id.* at 37, 237 A.2d at 478. The court also acknowledged, however, that the 365/360 method was the "general practice of banks with respect to short-term and demand loans, construction mortgages, and commercial loans secured by mortgage." *Id.* at 38, 237 A.2d at 478.

82. *Perlman v. First Nat'l Bank*, 15 Ill. App. 3d 784, 794, 305 N.E.2d 236, 244 (1973) (finding "manifestly unacceptable" assertion that interest statute means 360-day year when applied to commercial loans and 365-day year when applied to other loans), *appeal dismissed*, 60 Ill. 2d 529, 331 N.E.2d 65 (1975) (dismissed on recusal of two supreme court justices).

83. *American Timber & Trading Co. v. First Nat'l Bank*, 511 F.2d 980, 983-84 (9th Cir. 1974) (365/365 method used to compute interest to depositors), *cert. denied*, 421 U.S. 921 (1975); see also 117 CONG. REC. 18,539 (1971) (noting that banks borrow short-term funds from the Federal Reserve System and pay interest to their depositors on basis of 365-day year).

Interestingly, prior to deregulation, some thrift institutions used the 365/360 year in the deposit context when such use favored the customer, "to make the Regulation Q [governing maximum interest rates on deposit accounts] differential over what banks could pay as large as possible." Paul S. Nadler, *Cost-Cutters Look at Banks' 'Small' Expenses*, AM. BANKER, Aug. 25, 1986, at 4.

84. *West*, *supra* note 13, at 12. The bank attorney stated that he entered a sample loan on each of several calculators and found that "for the same loan, the seven calculators gave me six different payment amounts and finance charges. . . . Bank officials had no explanation for the disparity. In fact, they were not even aware a disparity existed. The difference, of course, was that each calculator used a different interest calculation method." *Id.*

85. *New York Firemen Ins. Co. v. Ely & Parsons*, 2 Cow. 678, 707 (N.Y. 1824). The court observed:

That the principle of calculation adopted by the plaintiffs, was the one in general or universal use among banks, cannot alter the law of the case. A statute cannot be

Supreme Court found that the use of the 365/360 method was "the uniform course of business" at least at the defendant bank, required an adjustment of the interest paid to conform to the usury statute, and concluded: "[W]e wish it fully understood, that the bank must change their mode in the future, or they will act with their eyes open."⁸⁶ The banks have been operating for over 160 years with their eyes purposely closed. The defense of custom and usage should not be given continued effect.⁸⁷

D. "The intention only of expediting the computation"

The next rationale banks have offered to justify the bank method is that interest is made easier to calculate by using this method. This argument proved persuasive in some of the earlier cases.⁸⁸ The clear weight of modern authority rejects the ease-of-computation argument, because the evaluation should be made on the basis of the effect on the borrower and not on inconvenience to the lender, and because any computational benefit to banks from the use of the 365/360 method has been eliminated by the use of computers.⁸⁹

abrogated by custom or usage of a particular trade. In *Dunham v. Gould*, (16 John. 367 (1819)), which was also a case of usury, Chancellor Kent says, "The custom of merchants is not applicable to such a case. It is not a matter of trade and commerce within the meaning of the law merchant; and if there were such a local usage, it would be null and void, and could not be set up as a cover or pretext to trample down the law of the land. The money lenders throughout the country might as well set up a custom of their own, and then plead it in bar of the Statute."

Id. (quoting *Dunham v. Gould*, 16 Johns. 367, 374-75 (N.Y. 1819)).

86. *Bank of St. Albans v. Scott*, 1 Vt. 426, 429-30 (1829).

87. The Hawaii Supreme Court has found that although "[t]he 365/360 method of computing interest has been a standard method of the banking industry for the past two centuries" and "[t]he majority of early cases . . . held that computational convenience and banking custom justified the use of the 365/360 method," because of changes in the industry, including the use of computers, "the rationale of the earlier cases is no longer persuasive to all courts." *THC Fin. Corp. v. Managed Inv. Corp.*, 64 Haw. 491, 494, 643 P.2d 549, 551-52 (1982) (citing *Bronstein*, *supra* note 18, at 145-50).

88. See, e.g., *Martin v. Moore*, 269 Ark. 375, 376, 601 S.W.2d 838, 839 (1980) ("We have no hesitancy in holding, for practical, legal, and historical reasons, that the use of the 360-day year is lawful even when the interest rate is [the constitutional usury rate]."); *Cotton v. Commonwealth Loan Co.*, 206 Ind. 626, 633, 190 N.E. 853, 856 (1934) (holding that when the computational method is used with "the intention only of expediting the computation or following a convenient business practice, the contract will not be held usurious").

89. *THC Fin. Corp.*, 64 Haw. at 494, 643 P.2d at 551-52. The *THC* court noted:

The 365/360 method of computing interest has been a standard method of the banking industry for the past two centuries. The majority of early cases refused to hold that interest resulting from the use of the 365/360 method at the maximum legal rates is usurious. These cases held that computational convenience and banking custom justified the use of the 365/360 method. But interest is now calculated by computers, and the rationale of the earlier cases is no longer persuasive to all courts. In

The fundamental flaw in this rationale for the 365/360 method is that the ease or difficulty of calculation is not in any sense a legal defense.⁹⁰ Banks seem to muddle through complicated calculations when it is in their interest to do so,⁹¹ and it does not seem appropriate to allow a bank to structure the transaction and then plead that it is unable to fulfill its clear commitment because of internal bookkeeping difficulties.

In support of the ease-of-calculation argument, banks have asserted that the published, standardized charts used by the banking industry are based on the 365/360 method of calculation.⁹² Thus, banks argued that they were faced with two alternatives: either use the standardized charts—and with them the 365/360 method—or use another method of calculation and be forced to do the individual computations by hand without the assistance of standardized charts. This attempt to justify the bank method is unavailing for three reasons. First, the argument finesses the certainty that new charts could have been published using a different formula. Second, recent investigation has revealed that “almost all banks used *Rowlett's Tables* to compute interest, and the *Tables* were not designed to yield interest readily on the 365/360 basis.”⁹³ Third, the proper reading of the standardized charts is moot, because the use of

American Timber & Trading Co. v. First National Bank of Oregon, the United States Court of Appeals for the Ninth Circuit, applying Oregon law, found that the bank's use of the 365/360 method of computation was usurious and agreed with the district judge's determination that the usury statute “should be construed with regard to its net effect upon the borrower rather than upon the bookkeeping burden, custom, or convenience of the lender.” *American Timber* has been followed by most courts who have subsequently considered this issue.

Id. (citations omitted) (quoting *American Timber & Trading Co. v. First Nat'l Bank*, 511 F.2d 980, 983 (9th Cir. 1974), *cert. denied*, 421 U.S. 921 (1975)).

90. *American Timber & Trading Co. v. First Nat'l Bank*, 334 F. Supp. 888, 889 (D. Or. 1973) (“The legislative intent in enacting usury laws is to protect borrowers from paying excessive interest. Usury legislation is a form of consumer legislation. It should be construed with regard to its net effect upon the borrower rather than upon the bookkeeping burden, customs, or convenience of the lender.”), *aff'd*, 511 F.2d 980 (9th Cir. 1974), *cert. denied*, 421 U.S. 921 (1975).

91. *American Timber*, 511 F.2d at 983-84 (“The bank contends that the use of a 365/365 method creates difficult computations and, therefore, for reasons of convenience the banking community considers it proper to use the simpler 365/360 method. . . . The court noted that the bank used the 365/365 method to compute interest it paid to its depositors.”).

92. *Bank of St. Albans v. Stearns*, 1 Vt. 430, 432 (1829).

93. Bronstein, *supra* note 18, at 143-44. In a more benign reading, another commentator observes:

Rowlett's tables used two methods of calculating interest; the first, which Rowlett called the “bank interest,” was based on the 365/360 method, but in his 1831 edition of the tables he also included what he called the “lawful, or statute interest.” This latter interest was based on the 360/360 method and the 365/365 method. . . . [A] bank made an active policy decision to increase its returns for any given rate of interest when it selected the bank interest method of using the tables. The tables

computers in banking operations has made charts obsolete. Although one nimble lender alleged that the use of computers made it harder to calculate interest to avoid usury limitations,⁹⁴ the advent of computers has removed whatever force remained in the ease-of-calculation argument.⁹⁵

Even beyond the adoption of computers, the ease-of-calculation argument is rightly dismissed because it simply is not true. The 360/360 method has computational advantages over both the 365/360 and 365/365 methods because of the use of fictional months of even length. But the use of an actual-days numerator—as is the case with both the 365/365 and 365/360 day formulas—makes computations using these formulas equally difficult because interest is calculated by multiplying the number of days in the period by the per diem interest charge. It does not matter significantly whether the daily interest charge is 1/365 or 1/360 of the per annum interest amount.⁹⁶ Indeed, it is this fact that stands behind a remarkable New Jersey case in which the bank unsuccessfully

themselves provided both methods in an easily accessible form . . . [and] they supplied the banking industry with the information it wanted.

Daunt, *supra* note 11, at 554-55.

94. *O'Brien v. Shearson Hayden Stone, Inc.*, 90 Wash. 2d 680, 683, 586 P.2d 830, 832 (1978) ("Later . . . all accounts of the two entities were integrated into one computer system. Defendant alleges that the system could not practically be programmed to extend different rates of interest to Washington residents.").

95. *American Timber*, 511 F.2d at 984 ("Any claim by the banking industry that ease of calculation is justification for exacting higher interest is of dubious validity in this age of computer technology."). In fact, the results of a Federal Reserve System study in the early 1970s lead one to question whether the justification ever had any force.

As a practical matter, the larger banks are in a much better position to do away with such a questionable practice than smaller banks because of the greater availability to them of sophisticated data processing and computer equipment. It is ironic, therefore, that the smaller banks in the country are taking advantage of the public far less in this matter than the larger banks.

117 CONG. REC. 18,539 (1971) (reporting results of informal survey of American banks by Rep. Wright Patman and the Federal Reserve System).

96. One commentator came to the fallacious conclusion that "[m]annual calculation for the 365/365 method is more difficult than for the 365/360 method." Bronstein, *supra* note 18, at 143 n.13. The problem with the argument is that it is wholly dependent on the nominal interest rate selected. The commentator conveniently chose a nominal annual rate of 12%. *Id.* If one selects a nominal annual rate of 9.125%, another commercially standard rate, the results are reversed; the 365/360 method results in a per diem rate of 0.00025347 (0.09125 / 360) while the 365/365 method results in a per diem rate of 0.00025 (0.09125 / 365), obviously a much easier figure with which to calculate. Of course, neither mode of calculation has an advantage at the vast majority of possible interest rates, because they are equally cumbersome to use. Moreover, whatever calculation advantages occur at a few points on the continuum are eliminated by the use of computers.

Indeed, in one case the bank witness testified (and the court found) that there was no advantage in terms of ease of calculation with either the 365/365 or 365/360 method (true) or with the 360/360 method (untrue for a fixed principal, amortizing loan). See *Voitier v. First*

argued that it was justified in moving from a 360/360 method to a 365/360 method, and thereby increasing the amount of interest charged to its customers, because with the introduction of computers it could do the more complicated computations required by the 365/360 formula.⁹⁷

E. "The parties have contracted"

The final justification banks offer for the 365/360 method is that the meaning of the phrase "x% per annum" is a matter of contract negotiation and can be made consistent with the use of the 365/360 method; in other words, a year does not have to have 365 days if the parties prefer that it have fewer.⁹⁸ The contract analysis requires the critical factual assumption that the adoption of a formula for interest calculation is a point of contract negotiation.⁹⁹

Nat'l Bank of Commerce, 514 F. Supp. 585, 592 (E.D. La. 1981). Perhaps the witness meant that with the use of computers the calculation is equally easy for all the humans involved.

97. *Silverstein v. Shadow Lawn Sav. & Loan Ass'n*, 51 N.J. 30, 36, 237 A.2d 474, 478 (1968).

98. *First Empire Bank v. Federal Deposit Ins. Corp.*, 634 F.2d 1222, 1225 (9th Cir. 1980), *cert. denied*, 452 U.S. 906 (1981). In *First Empire*, the court found that "the use of the 360-day basis was an advantage to the lender, secured by special provision of the letters of credit." *Id.* Absent such a provision, the court held, "interest would ordinarily be computed on the basis of the physical fact that a 'year,' for the purposes of interest or otherwise, is an actual year of 365 days." *Id.*

A slight variation is to assume that the 365/365 method and the plain meaning of the term "per annum" are to be used absent a contrary contract provision. See *Shadow Lawn Sav. & Loan Ass'n*, 51 N.J. at 39, 237 A.2d at 481. The *Shadow Lawn* court wrote:

It is elementary that interest as compensation for the use, detention or forbearance of money is a matter of contract. The contract includes the method of computation, expressed or legally implied. Where the obligation is to extend for more than a year and the instrument sets forth nothing more than that the debt shall bear interest at a specified rate—with or without the addition of the phrase "per year," "per annum" or the like, we hold that the intention of the parties must legally be taken to be that interest shall be computed only by either the 365/365 or the 360/360 method.

Id. (citations omitted).

99. A variation on the pure contractual analysis is the argument that the context in which the term "per annum" is found alters its meaning—in effect, a finding that a year does not have 365 days if the context requires otherwise:

[T]he method of interest calculation envisioned by the parties is not revealed in the "usual and common signification," of the phrase. The dictionary meaning of "per annum" is "in or for each year," WEBSTER'S NEW COLLEGIATE DICTIONARY (1979); "by the year; annually; yearly," BLACK'S LAW DICTIONARY (5th ed. 1979). Thus, a promise to pay interest "per annum" is simply a promise to pay at an annual interest rate. This does not obligate the lender to use any particular method of interest computation. Nor does it restrict the amount of interest that can be charged to the amount that accrues when interest is calculated daily for 365 days. Although "[w]hen the period of a 'year' is named [in a contract], a calendar year is generally intended . . . the subject-matter or context . . . in which the term is found or to which it relates may alter its meaning." BLACK'S LAW DICTIONARY (5th ed. 1979).

In *First American National Bank v. Hunter*,¹⁰⁰ for example, the Tennessee Court of Appeals, without any supporting evidence, indulged in the speculation that "there is no reason why a borrower could not induce the bank to make his loan by agreeing that interest be computed upon a 360-day year."¹⁰¹ It is theoretically possible that a borrower could seek to induce a bank to make a loan based in part on the method of interest calculation. As a predictor of human behavior, however, such an assumption is wildly counterintuitive for at least five reasons. First, as at least one court has found, one fairly may assume that when negotiating for a loan borrowers focus on the monthly payment amount rather than on the complex calculations required to calculate the payments.¹⁰² Second, even if the interest-formula language is included in the note, and often it is not,¹⁰³ it is unlikely to be adequate to specify the 365/360 method, because of either the obscure location¹⁰⁴ or the imprecise content of the disclosure.¹⁰⁵ Third, even if the language does provide sufficient notice, typical borrowers do not understand the significance of the

Kleiner v. First Nat'l Bank, 581 F. Supp. 955, 962-63 (N.D. Ga. 1984).

100. 581 S.W.2d 655 (Tenn. Ct. App. 1978), *cert. denied*, 581 S.W.2d 655 (Tenn. 1979).

101. *Id.* at 659.

102. See *Gulf Fed. Sav. & Loan Ass'n v. Federal Home Loan Bank Bd.*, 651 F.2d 259, 267 (5th Cir. 1981), *cert. denied*, 458 U.S. 1121 (1982) ("In a transaction of this nature, it defies common sense to believe that the parties were more intent on specifying one method under which interest was to be calculated than they were on agreeing on the amount of monthly payments . . .").

103. 117 CONG. REC. 18,539 (1971). A Federal Reserve System study of the issue has disclosed that

[a]s many as 86 of the 191, or almost 45 percent of the responding banks who use this practice, do so without disclosure of any kind to their borrowers. This is a shocking example of a lack of integrity among institutions who are constantly seeking the trust and confidence of their customers and Congress by advertising their honesty and reliability.

Id. (citing informal survey of American banks by Rep. Wright Patman and the Federal Reserve System).

104. *Gulf Fed. Sav. & Loan Ass'n*, 651 F.2d at 267 ("The sentence calling for the 365/360 method of calculating interest was located in the midst of complicated text of the loan agreement, and apparently was ignored by all but one borrower . . .").

105. Parties frequently are less than precise in specifying language adequate to describe the 365/360 formula. For example, the phrases "360 day annual rate of interest," *Haas v. Pittsburgh Nat'l Bank*, 60 F.R.D. 604, 610-11 (W.D. Pa. 1973), and "360-day simple interest basis," *Morosani v. First Nat'l Bank*, 703 F.2d 1220, 1221 (11th Cir. 1983), seem clearly insufficient to differentiate between the 365/360 method of calculation and the 360/360 method. *Contra Greenblatt v. Drexel Burnham Lambert, Inc.*, 763 F.2d 1352, 1355 (11th Cir. 1985) (language to effect that "[i]nterest is arrived at by the normal formula—Principal x Rate x Time on a 360 day year basis" deemed "[a]ll information necessary to calculate the margin interest").

Of course, precision occasionally is obtained. See *St. Jude Medical, Inc. v. Intermedics, Inc.*, 612 F. Supp. 958, 965 (D. Minn. 1985) ("[I]nterest . . . shall be computed on the basis of actual days elapsed and a year of 360 days.").

term designating the interest calculation method.¹⁰⁶ Fourth, even if borrowers note and understand the choice of formula, within these transactions borrowers almost always are unable to negotiate the point given their unequal bargaining power.¹⁰⁷ Finally, if the borrower truly wanted to use the prospect of increased interest to induce the bank to make a loan, a simple and mathematically indistinguishable method by which to do so would be simply to increase the interest rate.

Certainly if the interest calculation term were a point of negotiation, one would find some variation in the language employed from file to file. But these cases are remarkable for the lack of any claim of such variation. Of course there are no variations of the banks' preprinted forms; there is no negotiation on this point. Thus, as a practical matter, it is reasonable to assume that banks use the 365/360 method as a deception, not that borrowers use it as an inducement. It is used precisely because it is not an agreed-upon term.

In actuality the contract analysis is important to the banks not because it allows the banks to win on the merits; typically it does not. Instead, use of the contract analysis with respect to the 365/360 method of interest calculation creates a fundamental procedural problem for prospective plaintiffs seeking to configure the litigation as a class action. If the interest calculation method is theoretically a point of negotiation and agreement, then it must be true that the language of the agreement can vary and that the intention of the parties is relevant. Thus, individualized proof is required for each plaintiff to distinguish any variations in the language of the contract and to establish the intent of the parties.¹⁰⁸

106. See *Chern v. Bank of Am.*, 15 Cal. 3d 866, 872, 544 P.2d 1310, 1316, 127 Cal. Rptr. 110, 116 (1976) (holding that bank method of interest calculation constitutes false and misleading advertising under Business and Professions Code).

107. An anecdotal piece of evidence may be helpful on this question. I once raised the use of the 365/360 method of interest calculation while negotiating an initial credit facility in an amount well in excess of \$50,000,000 from a syndicate of large domestic and foreign banks for an extremely creditworthy and well-secured commercial borrower. I suspect that to the extent any borrower ever had leverage on this point, this client did. The response of the lenders was to state that they never vary their policy of using the 365/360 method on credit facilities of the type involved, that to do so would cause them substantial operational difficulties, and that the point was not negotiable. Although the lenders made numerous significant concessions on other points, some representing sums of money several magnitudes greater than the direct out-of-pocket cost of moving from the 365/360 method to the 365/365 method, the 365/360 method remained.

108. The procedural advantage conferred by recourse to parol evidence tempts banks to make some fairly bizarre arguments. In *Perlman v. First National Bank*, 15 Ill. App. 3d 784, 791, 305 N.E.2d 236, 242 (1973), *appeal dismissed*, 60 Ill. 2d 529, 331 N.E.2d 65 (1975) (dismissed on recusal of two supreme court justices), for example, the bank cited the Illinois Interest Act, ILL. REV. STAT. ch. 74, paras. 9-10 (1971), to argue that the statute was ambiguous, so as to allow parol evidence of each borrower's understanding. The first section provided that when a "certain rate of interest is . . . mentioned, and no period of time is stated for which such

Not even the absence of variation in loan agreements has deterred banks; they simply argue either that the standardized language is itself subject to varying interpretations on the part of the borrowers,¹⁰⁹ or that the standardized language does not mean what it says.¹¹⁰ In either event, individualized proof is required. Of course, the individualized proof requirement does not itself preclude class action litigation; it is only when the individualized issues are found to predominate over the general issues that the class action becomes inappropriate.¹¹¹ Still, the contractual

rate is to be calculated, interest shall be calculated at the rate mentioned, by the year, in the same manner as if 'per annum' or 'by the year' had been added to the rate." *Id.* para. 9. The second section provided that "[i]n all computations of time, and of interest and discounts, a month shall be considered to mean a calendar month, and a year shall consist of twelve calendar months." *Id.* para. 10. The *Perlman* court rejected the statutory argument when it noted that the bank—relying on the same statutory provision—calculated interest on commercial loans differently than other loans, a "manifestly unacceptable" conclusion. *Perlman*, 15 Ill. App. 3d at 794, 305 N.E.2d at 244.

109. See *Fletcher v. Security Pac. Nat'l Bank*, 23 Cal. 3d 442, 447, 591 P.2d 51, 55, 153 Cal. Rptr. 28, 31 (1979). The trial court in *Fletcher* found that the bank had "freely explained its method of interest computation when asked, and that the practice of computing interest on the basis of a 360-day year had been followed for many years." *Id.* at 448, 591 P.2d at 55, 153 Cal. Rptr. at 32. Given this fact, the "individual issues of knowledge predominated over the common questions of law." *Id.* Finally, "the class was not readily ascertainable, and consequently . . . the action should not be maintained as a class action." *Id.* The appellate court concluded that these findings did not constitute an abuse of the trial court's discretion. *Id.*

110. The second variation is found in *Bernard v. First National Bank*, 275 Or. 145, 154, 550 P.2d 1203, 1210 (1976). *Bernard* involved an estimated class of 70,000 borrowers seeking a total recovery of \$8,000,000. The plaintiffs contested the need for "separate adjudications as to individual class member's knowledge of the 365/360 computation practice," *id.*, asserting "that any attempt to show that 'per annum' refers to 360 days would vary the written contract and evidence thereof would be inadmissible because it would violate the parol evidence rule." *Id.* (footnotes omitted). The court explained that

[i]t is well settled that the parol evidence rule does not exclude evidence offered to aid the court in its interpretation of the language chosen by the parties. Furthermore, ORS 42.250 sets forth the principles governing the interpretation of language and expressly authorizes the introduction of evidence to show that the words employed have a 'technical, local or otherwise peculiar signification.' . . . Therefore, parol evidence would be admissible to show that individual borrowers knew of the 'technical' meaning employed by the bank

Id. at 155, 550 P.2d at 1210.

In *First American National Bank v. Hunter*, 581 S.W.2d 655, 658-59 (Tenn. Ct. App. 1978), *cert. denied*, 581 S.W.2d 655 (Tenn. 1979), the court held that while "[t]he phrase 'interest at —% per annum' does unequivocally indicate that —% of the principal shall constitute the interest charge for a year . . . the phrase does not indicate the exact manner in which interest shall be computed for less than a year." *Id.* at 658. The court concluded that "[t]his uncertainty of detail (latent ambiguity) must be resolved by inquiry regarding the actual intent of the parties as to the meaning of the words used by them." *Id.*

111. See, e.g., *Fletcher*, 23 Cal. 3d at 448, 591 P.2d at 55, 153 Cal. Rptr. at 31; *Kleiner v. First Nat'l Bank*, 97 F.R.D. 683, 691 (N.D. Ga. 1983) ("The existence of individual questions concerning class members does not necessarily defeat the commonality requirement. . . . [The applicable rule] requires only that common questions predominate, not that they be unanimous.").

myth has made the certification of class actions challenging the 365/360 method of calculation significantly more difficult.

III. "IT WOULD BE UNSOUND AS A MATTER OF PUBLIC POLICY
"

Given that banks improperly use the 365/360 method of interest calculation to cozen borrowers into paying inflated interest charges, it is clear that neither the American legal system nor the various banking regulators have effectively addressed the practice. Questions arise how these systems have failed in this regard, for fail they most assuredly have, and how the failures should be corrected.

A. *Litigation*

To be effective, a litigation-based challenge to the use of the 365/360 method must accomplish two objectives. First, it must transcend the economics of the individual claim. This strategy is necessary because the recovery for a typical borrower is insufficient to justify the costs of litigation.¹¹² Second, an effective litigation strategy must secure a broadly applicable judicial condemnation of the 365/360 method, thereby forcing an industry-wide abandonment of the practice.

The requirement of broad applicability suggests proceeding on either a common-law or federal cause of action, and not a state statutory cause of action.¹¹³ Unfortunately, federal law does not prohibit the bank method.¹¹⁴ The common law also fails to provide a clear legal basis for a

112. Another theoretical option would be to find an atypical plaintiff with an individual claim large enough in its own right to warrant litigation. This approach is rejected for several reasons. A plaintiff substantial enough to have such an individual claim presumably also would have a greater knowledge of banking procedures and thus would be open to additional defenses under some substantive theories. Such a plaintiff also would be a less sympathetic party, and would have more to risk by disrupting its existing banking relationships.

113. Given statutory differences between the states, a statutory suit might have limited applicability. See, e.g., *Chern v. Bank of Am.*, 15 Cal. 3d 866, 876, 544 P.2d 1310, 1316, 127 Cal. Rptr. 110, 116 (1976) (dealing generally with a state credit statute).

114. In *Waters v. Weyerhaeuser Mortgage Co.*, 582 F.2d 503, 506 (9th Cir. 1978), the court held that the use of a 360-day year, in at least some contexts, does not violate the federal Truth in Lending Act, 15 U.S.C. §§ 1601-14, 1631-46, 1661-65(a), 1666(j), 1667(e) (1988), because "[t]he legislative history, applicable portions of the Act, and appropriate Nevada statutes support the conclusion that the interest computation method was lawful." *Waters*, 582 F.2d at 506. For a discussion of the Truth in Lending Act, see *infra* note 143. Nor is use of the 365/360 method of calculation a violation of federal banking laws. See *infra* notes 155-59 and accompanying text.

Title IX of the Organized Crime and Control Act, 18 U.S.C. §§ 1961-1968 (1988), better known as the Racketeer Influenced and Corrupt Organizations Act, or "RICO," has been advanced with some success to provide a substantive theory allowing larger than compensatory damages. See *Morosani v. First Nat'l Bank*, 703 F.2d 1220, 1222 (11th Cir. 1983)

challenge to the 365/360 method. One common-law possibility is an action for breach of fiduciary duty or confidential relationship by a borrower being charged interest under the 365/360 method.¹¹⁵ Although to prosecute such an action successfully the plaintiff must distinguish the case from the general rule that "there is not a fiduciary relation between debtor and creditor as such,"¹¹⁶ the general rule is not without exceptions.¹¹⁷ One might argue, for example, that "special circumstances"¹¹⁸ exist in the 365/360 situation because the bank knows or has reason to know that the typical customer does not understand the calculation of interest to be anything but a purely administrative function and that the typical customer is placing trust and confidence in the bank to apply payments correctly.

A second possible common-law action to challenge the bank method is an action in fraud. There are two basic subtypes of such a claim: fraudulent misrepresentation¹¹⁹ and tortious nondisclosure.¹²⁰

An action for fraudulent misrepresentation requires proof of "a misrepresentation of fact . . . for the purpose of inducing another to act . . . in reliance upon it," justifiable reliance by the borrower, and damages.¹²¹ The fact misrepresented in this situation would be the effective interest

("Plaintiff's complaint alleged that the Bank had engaged in a scheme to obtain money by means of false or fraudulent pretenses and representations. Obtaining money by false pretenses, if proved, clearly falls within the traditional definition of criminal activity . . ." (footnote omitted)). This Article does not pursue the RICO option because of the Supreme Court's evident hostility toward the expansive use of civil RICO, and the efforts to reform RICO to narrow its use. *See, e.g.,* Geoffrey Aronow, *In Defense of Sausage Reform: Legislative Changes to Civil RICO*, 65 NOTRE DAME L. REV. 964, 966 (1990) (noting that the Supreme Court has stated that if there were defects in civil RICO, they were inherent in the statute as written and must be corrected by Congress).

115. *See* RESTATEMENT (SECOND) OF TORTS § 874 (1977) ("One standing in a fiduciary relation with another is subject to liability to the other for harm resulting from a breach of duty imposed by the relation.").

116. RESTATEMENT (SECOND) OF TRUSTS § 12 comment b (1957); *see, e.g.,* Klein v. First Edina Nat'l Bank, 293 Minn. 418, 422, 196 N.W.2d 619, 623 (1972) (finding no special duty to counsel absent special circumstances in transaction between bank and customer).

117. *See, e.g.,* Kurth v. Van Horn, 380 N.W.2d 693, 696 (Iowa 1986) ("Because the circumstances giving rise to a fiduciary duty are so diverse, any such relationship must be evaluated on the facts and circumstances of each individual case." (citation omitted)); Denison State Bank v. Madeira, 230 Kan. 684, 691-96, 640 P.2d 1235, 1241-42 (1982) (holding bank under no duty to provide customers with information not specifically requested and otherwise readily available); Klein, 293 Minn. at 421-22, 196 N.W.2d at 622-23 (holding no duty "unless special circumstances exist, such as where the bank knows or has reason to know that the customer is placing his trust and confidence in the bank and is relying on the bank so to counsel and inform him").

118. Klein, 293 Minn. at 421-22, 196 N.W.2d at 622-23; *see supra* note 117.

119. RESTATEMENT (SECOND) OF TORTS § 525 (1976).

120. *Id.* § 551.

121. *Id.* § 525.

rate. For example, a statement that an obligation accrues interest at 18% per annum would be a misrepresentation if in fact interest accrues at 18¹/₄% per annum through use of the 365/360 method.

The misrepresentation element may prove difficult when challenging the bank method under a fraudulent misrepresentation theory. When the loan is the subject of a correctly prepared Truth in Lending Act disclosure form, it may be impossible to show misrepresentation because the correct annual percentage rate will be disclosed on the form, even if the interest rate as stated on the note is deceptive.¹²² In other situations a lender may escape liability when ambiguity is based in a finding of industry custom and usage or because the wording itself is open to two interpretations. Notably, however, the ambiguous representation may still be fraudulent if the bank knows that it is "capable of two interpretations," one true and the other false, and the bank makes the representation "with the intention that it be understood in the sense in which it is false, . . . without any belief or expectation as to how it will be understood, . . . [or] with reckless indifference as to how it will be understood."¹²³

The reliance element may also prove difficult when challenging the bank method under a fraudulent misrepresentation theory. The bank could argue that in order to recover the plaintiff must show knowledge of the different methods of interest calculation and reliance on the use of the 365/365 method to the exclusion of the 365/360 method, all from the bare per annum interest statement. Such a challenge misapprehends the nature of the reliance test, however. Reliance should be viewed from the borrower's perspective, with the stated interest rate considered using the commonly held meaning of the words "per annum" to set an amount of interest due. It is not necessary for the borrower to understand the mechanics of the theoretical alternatives to rely upon the common meaning of the words. It is sufficient for the plaintiff to show reliance on the annual percentage rate stated in the note as a cap on interest in any calendar year equal to the product of the nominal rate and the principal balance without having to demonstrate a knowledge of the various alternative interest calculation methods. Thus, reliance on the stated nominal rate in a non-Truth in Lending Act transaction should be presumed.¹²⁴

The action for tortious nondisclosure is possible, of course, only if the relevant fact—in this case the use of the 365/360 method of interest

122. See *infra* note 143.

123. RESTATEMENT (SECOND) OF TORTS § 527(a)-(c) (1976).

124. The situation with respect to a Truth in Lending Act transaction is more complex because the required disclosure form presents a nominal interest rate, see 12 C.F.R. §§ 226.18 & 226 app. H (1991), which would differ from that on the note, perhaps putting the borrower on notice that further inquiry is required.

calculation—is undisclosed. Thus, it is inapplicable to cases in which the loan documents contain a disclosure. As to situations in which the bank makes no disclosure, this cause of action adds several elements of proof that may be difficult to satisfy. Specifically, the undisclosed fact must be “a fact that [the nondisclosing party] knows may justifiably induce the other to act or refrain from acting in a business transaction.”¹²⁵ It is, of course, not at all clear that the disclosure of the 365/360 method of interest calculation, which is in economic terms an increase of less than 1.4% of the nominal rate, would induce even a few borrowers to abandon transactions.

Additionally, liability may exist for tortious nondisclosure “if, but only if, [the nondisclosing party] is under a duty to the other to exercise reasonable care to disclose the matter in question.”¹²⁶ Such a duty exists if the borrower establishes “a fiduciary or other similar relation of trust and confidence.”¹²⁷ In the alternative, there is liability if the undisclosed interest calculation method was a fact “known to [the nondisclosing party] that [it] knows to be necessary to prevent [its] partial or ambiguous statement of the facts from being misleading.”¹²⁸ If the disclosed information is, for example, simply that “the principal balance will accrue interest at the rate of 18% per annum,” the fact that under the 365/360 method interest will actually accrue at an effective rate of 18¼% per annum is clearly known by the bank to be necessary to prevent its statement from being misleading. Assuming that the plaintiff credibly can argue that she would not have borrowed or would have borrowed elsewhere, if a full disclosure had been made, an action for tortious nondisclosure may lie. Unfortunately, however, this strategy requires individually particularized proof, which inhibits class litigation and raises the cost of prosecuting claims to impossibly high levels.¹²⁹

The marginal utility of federal statutory and common-law actions in

125. RESTATEMENT (SECOND) OF TORTS § 551(1) (1976).

126. *Id.*

127. *Id.* § 551(2)(a).

128. *Id.* § 551(2)(b).

129. See *infra* text accompanying notes 133-39. Both breach of fiduciary duty and fraud cases also offer the advantage of punitive damages. Such actions are particularly attractive since they contain an element of deterrence against nondefendants similarly situated to the defendant, and because the wealth of the defendant may be considered in establishing the amount of the award. RESTATEMENT (SECOND) OF TORTS § 908 (1977). The Restatement notes that

[p]unitive damages are damages . . . awarded against a person to punish him for his outrageous conduct and to deter him and others like him from similar conduct in the future. . . . Punitive damages may be awarded for conduct that is outrageous, because of the defendant's evil motive or his reckless indifference to the rights of others. In assessing punitive damages, the trier of fact can properly consider the character of

challenging the 365/360 method is aggravated by the difficulty of achieving a procedural posture that will yield broadly applicable relief. The obvious, although not the only,¹³⁰ candidate is class action litigation.¹³¹

the defendant's act, the nature and extent of the harm to the plaintiff that the defendant caused or intended to cause and *the wealth of the defendant*.

Id. § 908(1)-(2) (emphasis added).

130. A result with general applicability can be achieved short of a class action through the use of offensive issue preclusion, although the mechanism is distinctly less efficient. To qualify, the claims must not require substantial individualized proof, the fundamental issue decided must be substantively dispositive of numerous cases, and the initial case must be resolved in such a way as to permit the offensive use of the fundamental issue decided. In such a situation, subsequent litigants would be able to avoid retrying the fundamental issue and would be able to expedite their cases. In 365/360 method claims, however, the individually modest claims might not be of sufficient magnitude to justify such sequential litigation, even if the fundamental issue was conclusively decided as a matter of law.

131. Courts have recognized the practical importance of allowing class litigation in 365/360 interest calculation cases, *see, e.g.*, *Fletcher v. Security Pac. Nat'l Bank*, 23 Cal. 3d 442, 454, 591 P.2d 51, 59, 153 Cal. Rptr. 28, 35 (1979) (“[I]n the absence of [a class action] remedy, consumers who have been defrauded by a defendant's unlawful trade practice frequently would be effectively denied any realistic remedy and a wrongdoing defendant would often be totally insulated from any damage claim.”), and in cases involving analogous claims against financial institutions, *see, e.g.*, *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 33 Cal. 3d 816, 823, 662 P.2d 916, 921, 191 Cal. Rptr. 458, 463 (1983) (dealing with the practice of compounding interest); *Kronisch v. Howard Sav. Inst.*, 133 N.J. Super. 124, 131-32, 335 A.2d 587, 591 (Super. Ct. Ch. Div. 1975) (class action for recovery of interest on tax escrow funds for residential mortgages), *modified on remand*, 143 N.J. Super. 423, 427, 363 A.2d 376, 378 (Super. Ct. App. Div. 1976) (concluding that trial court's certification of a class action was premature and adopting a “test case” approach).

In *McConnell*, for example, the court held illegal a practice of compounding interest without a clear written expression of the method of calculation. *McConnell*, 33 Cal. 3d at 823, 662 P.2d at 921, 191 Cal. Rptr. at 463. The court observed that

[i]f each borrower's understanding of the language used in a lending agreement were admissible as an aid to “interpreting” its meaning, a cause of action for violation of [state usury law] would often be rendered inappropriate for prosecution as a class action. The result would be that lenders who violated [state usury law] would be shielded from liability to a very substantial number of borrowers whose only practical recourse to recover for violation of the section would be their participation in a class action.

Id. And in considering a class action claim for recovery of interest on tax escrow funds, the court in *Kronisch*, 133 N.J. Super. at 131-32, 335 A.2d at 591, wrote:

The courts have been generally receptive to the class action concept. “The class action rule should be liberally construed, and such an action should be permitted unless there is a clear showing that it is inappropriate or improper.” It has been recognized as a particularly useful device in the area of consumer litigation, and has been utilized in controversies between mortgagors and their mortgagee banks. An element common to such actions is the existence of a claim too small to warrant action by the individual members of the aggrieved class. “If each victim were remitted to an individual suit, the remedy could be illusory, for the individual loss may be too small to warrant a suit or the victim too disadvantaged to seek relief. Thus the wrongs would go without redress, and there would be no deterrence [sic] to further aggressions. If there is to be relief, a class action should lie unless it is clearly infeasible.”

Borrowers have tried to bring class actions on a number of different substantive theories, with some success in surviving challenges to class certification.¹³² The high-water mark of class challenges to the bank method was the analysis of Judge Orinda Evans in *Kleiner v. First National Bank*.¹³³ Rather than allow defendants to use the extraordinarily speculative contract interpretation analysis to introduce individualized elements of proof and thereby defeat the certification of class actions, Judge Evans found a well-reasoned middle ground between allowing unwieldy class litigation of individualized claims and permitting defendants to defeat class claims based on tenuous points requiring individualized proof. Judge Evans began by noting that the presence of some individual questions will not defeat class certification if common questions predominate.¹³⁴ She then applied this basic principle of class-action litigation to the facts of *Kleiner*:

When viewed in light of Rule 23, claims arising from interpretations of a form contract appear to present the classic case for treatment as a class action, and breach of contract cases are routinely certified as such. . . . In this case, putative class members signed identical or similar form agreements, all of which present the question of the meaning of such terms as "prime rate," "best and most creditworthy commercial borrowers," "per annum," and "360-day year simple interest basis." The

Id. (quoting *Riley v. New Rapids Carpet Ctr.*, 61 N.J. 218, 225, 294 A.2d 7, 10 (1972)) (citations omitted).

132. See *American Timber & Trading Co. v. First Nat'l Bank*, 511 F.2d 980, 982 (9th Cir. 1973) (allowing class litigation of 365/360-based usury claims), *cert. denied*, 421 U.S. 921 (1975); *Fletcher*, 23 Cal. 3d at 448-49, 591 P.2d at 55, 153 Cal. Rptr. at 32 (allowing class litigation of statutory, but not contract, claims); *Perlman v. First Nat'l Bank*, 15 Ill. App. 3d 784, 804, 305 N.E.2d 236, 251-52 (1973) (holding no abuse of discretion to permit class action where statutory claim is made and "custom and usage" is not available as a defense), *appeal dismissed*, 60 Ill. 2d 529, 331 N.E.2d 65 (1975) (dismissed on recusal of two supreme court justices); *O'Brien v. Shearson Hayden Stone, Inc.*, 90 Wash. 2d 680, 688, 586 P.2d 830, 834-35 (1978) (allowing class action on usury claims against brokerage house for use of 365/360 method on margin accounts).

Courts also have indicated approval of class litigation of such claims in theory, while denying class certification for lack of a proper class representative, see *Fletcher*, 23 Cal. 3d at 454, 591 P.2d at 59, 153 Cal. Rptr. at 35 (dismissal of damage claims upheld where named plaintiff knew of use of 365/360 method prior to closing on basis of named plaintiff not being a proper class representative), or the existence of atypical defenses against the named plaintiff, see *Koos v. First Nat'l Bank*, 496 F.2d 1162, 1164-65 (7th Cir. 1974) (class action standing in 365/360 method usury case denied where plaintiffs were atypical given defense that usury statute did not apply to given loan).

A class analysis has been used as a device to permit the recovery of attorney fees. See *Silverstein v. Shadow Lawn Sav. & Loan Ass'n*, 51 N.J. 30, 45, 237 A.2d 474, 482 (1968) (case treated as spurious class action to provide counsel fee to plaintiffs' attorneys).

133. 97 F.R.D. 683, 692 (N.D. Ga. 1983).

134. *Id.* at 691-93.

meaning of these terms is the predominant issue in the case and is an issue common to all class members.¹³⁵

Judge Evans did not hold that no individualized questions were presented in the case; she merely held that those questions were not substantial enough to bar class certification.¹³⁶

Judge Evans excluded individualized proof and facilitated class consideration of the challenge to the 365/360 method in several other ways. First, she rejected the bank's offer of parol evidence on the construction of the loan agreements, holding that as a basic matter of contract interpretation parol evidence is not appropriate unless the contracts are patently ambiguous, which was not the case.

[T]o *presume* . . . that the meaning of a contract will always turn on the state of mind of the parties is inconsistent with fundamental principles of contract interpretation. Here the parties have entered standard written contracts containing terms that have an objective meaning. . . . The Court's primary task is to construe the terms of the contract as written; parol evidence of the parties' subjective intent, or of a prior course of dealings, would be inadmissible unless the contract were patently ambiguous.¹³⁷

Second, Judge Evans held that a custom-and-usage defense could be determined in a class setting, without proof of the individual plaintiffs' subjective understandings.

In any event, the inquiry into usage of trade is not inconsistent with class treatment. As stated, usage of trade is imported into a contract where it is universal to the extent that individuals are deemed to have knowledge of it. If the words in Plaintiffs' agreements have come to have a particular meaning defined by reference to their usage in the industry, that meaning would be the same regardless of any individual's subjective understanding.¹³⁸

Finally, the judge noted that the danger of inconsistent findings provided a strong policy argument in favor of determining these issues in a class action, because "it would be unsound as a matter of public policy to decide broadly that a form loan contract issued by a bank is to be interpreted differently in individual cases. Public policy dictates that such contracts be given uniform interpretation throughout a given loan mar-

135. *Id.* at 692 (citations omitted).

136. *Id.* ("That individual questions may remain after interpretation of the contract—questions of damages or possible defenses to individual claims—would not defeat the commonality requirement.")

137. *Id.* at 693.

138. *Id.* at 694 (citations omitted).

ket."¹³⁹ Predictably, given the bank's inability to prevent a decision on the merits through the use of procedural barriers to litigation, the *Kleiner* case settled.¹⁴⁰

Thus, the litigation option has not failed entirely. Some plaintiffs have been successful in individual cases before judges willing to apply procedural rules to facilitate, rather than frustrate, the adjudication of class claims. Unfortunately, such judges are few. That isolated successes have not caused widespread change in banking practice indicates that litigation does not provide a solution to the problem.

B. Disclosure Regulation

Regulatory control of the 365/360 method has been pursued only once at the federal level, indirectly and ultimately without success.¹⁴¹

139. *Id.*

140. See *Kleiner v. First Nat'l Bank*, 751 F.2d 1193, 1199 (11th Cir. 1985).

141. This section does not consider directly the state-by-state prohibition of the 365/360 method, which would have to be accomplished to make the regulatory approach workable. It should be noted that some states already prohibit the use of the 365/360 method for some transactions. See, e.g., CAL. CIV. CODE § 1802.20(a)-(b) (West 1985) (allowing only 365/365 and 360/360 as simple interest basis calculations for retail installment sales contracts, for pre-1988 loans only); *id.* § 2981(n) (West Supp. 1991) (parallel provision for automobile sales contracts); ILL. REV. STAT. ch. 17, para. 5415(d) (Smith-Hurd 1991) (allowing only 365/365 method for consumer installment loans); MINN. STAT. ANN. § 48.185(3) (West 1988) (open-end loans); *id.* § 51A.385(2)(d) ("computed on the basis of a 365-day year"); *id.* § 56.131(1)(d) (West Supp. 1991) (allowing 365/365 as alternative to 360/360 for regulated loans); MONT. CODE ANN. § 31-1-106(2) (1989) ("In the computation of interest for a period of less than 1 year, 365 days constitute a year."); NEV. REV. STAT. § 675-363.1 (1985) (allowing either 365/365 or 360/360 for installment loans); N.H. REV. STAT. ANN. § 397-A:14 (1990) (allowing use of either 365/365 or 360/360 method for nondepository first mortgage bankers); N.J. STAT. ANN. § 17:3B-17 (West 1991) (providing that a year is 365 days in closed-end credit situation); *id.* § 17:10-14 ("interest [on loans not exceeding \$15,000] shall be charged for the actual number of days elapsed at the daily rate of 1/365 of the yearly rate"); VT. STAT. ANN. tit. 9, § 41a(d)(1) (Supp. 1990) (providing a 365 or 366 day year for closed-end accounts, loans or extensions of credit); *id.* tit. 8, § 2223(b) (licensed lenders' year equals 365 days).

Furthermore, versions of the Uniform Consumer Credit Code in both 1968, see UNIF. CONSUMER CREDIT CODE §§ 3.201(3), (4)(a), 3.508(4), 7 U.L.A. 729, 773 (1968), and in 1974, see *id.* §§ 2.201(4), 2.202(3), 2.401(1), (4), 7A U.L.A. 62, 68, 79, 80 (1974), contain partial prohibitions, at least in the use of the 365/360 method, to skirt the applicable finance charge limits. These uniform codes are less than perfect vehicles, however, since they parallel the narrow scope of the federal Consumer Credit Protection Act, 15 U.S.C. §§ 1601-1693r (1988), by including within their coverage only loans that are "primarily for a personal, family, household, or agricultural purpose," made to individuals, and generally in an amount not exceeding \$25,000. UNIF. CONSUMER CREDIT CODE §§ 3.104(1)(a),(b), 1.301(11), 7 U.L.A. 722-23, 623 (1968); *id.* §§ 1.301(15)(a)(ii), 1.301(29), 1.202(1), 7A U.L.A. 43, 47, 35 (1974). The 1968 Uniform Consumer Credit Code has been adopted, with modifications, by only eight jurisdictions: Colorado, Guam, Indiana, Oklahoma, South Carolina, Utah, Wisconsin, and Wyoming. 7 U.L.A. 186 (Supp. 1991). The 1974 Uniform Consumer Credit Code has been

The Truth in Lending Act¹⁴² does not prohibit use of the 365/360 method of interest calculation; it simply attempts to standardize the disclosure of credit terms to facilitate comparisons of credit options.¹⁴³ In at least one case, Truth in Lending Act disclosures proved a barrier to a borrower challenging the bank method. In *Chern v. Bank of America*¹⁴⁴ the plaintiff noticed a discrepancy between the nominal interest rate a bank representative quoted her and the interest rate that appeared in the Truth in Lending Act disclosure form. The difference was due to the bank's use of a 365/360 method of interest calculation.¹⁴⁵ The bank officer "briefly explained" the use of the 365/360 method at the closing,¹⁴⁶ the borrower noted her objection,¹⁴⁷ and then elected to proceed with the closing.¹⁴⁸ Based on the plaintiff's knowledge prior to the closing, summary judgment was entered for the defendant bank on the borrower's breach of contract claim.¹⁴⁹ Thus, the disclosure pursuant to the Truth in Lending Act actually precluded the plaintiff from prevailing.¹⁵⁰

Banks might argue that *Chern* simply demonstrates that Truth in

adopted, with modifications, by only four states: Idaho, Iowa, Kansas, and Maine. 7A U.L.A. 1 (Supp. 1991).

One state, Maryland, has a statutory provision that must have been drafted by a lender's lobbyist with an extraordinarily perverse sense of humor; it allows the lender to select any length of year it desires, from 360 to 366 days. MD. COM. LAW CODE ANN. § 12-1003(b)(2) (1990) ("For purposes of this section [governing closed-end credit extensions and limiting interest to 24% per annum], a year may be any period of from 360 to 366 days, including or disregarding the effect of leap year, as the credit grantor may determine.").

142. 15 U.S.C. §§ 1601-1614, 1631-1646, 1661-1665a, 1666-1666j, 1667-1667e (1988).

143. *Id.* § 1601(a). Under the regulations promulgated pursuant to the Truth in Lending Act, the nominal annual percentage rate for a closed-end transaction is determined "by multiplying the unit-period rate by the number of unit-periods in a year," 12 C.F.R. § 226 app. J § (b)(1) (1991), under which either a 360/360 method or a 365/365 method might be used. The nominal interest rate under the 365/360 method could not be used in the Appendix J calculations, at least directly, although the same result could be obtained through adjustment of the nominal rate and use of the 365/365 method.

144. 15 Cal. 3d 866, 544 P.2d 1310, 127 Cal. Rptr. 110 (1976).

145. *Id.* at 870, 544 P.2d at 1312, 127 Cal. Rptr. at 112. At a 9% nominal annual rate the use of the 365/360 method will result in a 9.125% effective rate. See *infra* note 153.

146. *Chern*, 15 Cal. 3d at 870, 544 P.2d at 1312, 127 Cal. Rptr. at 112.

147. *Id.*

148. *Id.*

149. *Id.* at 874, 544 P.2d at 1314-15, 127 Cal. Rptr. at 114-15. The trial court also dismissed the plaintiff's damage claim for false or misleading statements because the applicable California statute did not provide for individual damages in such cases. *Id.* at 875, 544 P.2d at 1315, 127 Cal. Rptr. at 115.

150. Following the dismissal of the damages claims the plaintiff was no longer typical of the class. Therefore, the trial court dismissed the class action for want of a proper representative plaintiff. The trial court also dismissed the request for injunctive relief, which dismissal was reversed by the California Supreme Court. The dismissal of the damage claim and the class action were sustained. *Id.*

Lending Act disclosures work. After all, the plaintiff did notice the discrepancy at closing between the quoted nominal rate and the rate disclosed under the Act. Such a sanguine view of *Chern*, however, is unjustified. First, it was not the Truth in Lending Act disclosure that put the plaintiff on notice of the practice. The plaintiff in *Chern* came to the closing having sued another bank previously under the same theory.¹⁵¹ There is a substantial question as to whether Truth in Lending Act disclosure puts a typically knowledgeable borrower on notice of the 365/360 practice. In my practice experience of over a decade, I observed that loan officers typically responded to borrower concern over the discrepancy between the agreed upon nominal rate and the rate quoted in the Truth in Lending disclosure form by noting—quite correctly—that the Truth in Lending Act includes as part of the finance charge, which is used in calculation of the annual percentage rate disclosed, some one-time origination charges and other charges.¹⁵² If a question arose (and in my experience that was atypical) the loan officer would then give a cursory but accurate explanation of the Truth in Lending Act requirements and direct the borrower to the note, which contained the “correct” interest rate and, perhaps more importantly, the “correct” payment terms.

Second, in some cases the difference between the quoted per annum interest rate and the effective interest rate due to the use of the 365/360 method will not show up on the Truth in Lending Act disclosure. In certain instances, the magnitude of the discrepancy is within the margin of error permitted under the applicable regulations.¹⁵³

151. *Id.* at 871, 544 P.2d at 1313, 127 Cal. Rptr. at 113.

152. Included is “any charge payable directly or indirectly by the consumer and imposed directly or indirectly by the creditor as an incident to or a condition of the extension of credit [but not] of a type payable in a comparable cash transaction,” including, but not limited to, interest, service charges, some points, loan fees, appraisal fees, premiums for credit life insurance, and liability insurance premiums. 12 C.F.R. § 226.4(a)-(b) (1991).

153. Changes in the regulations have limited this problem. The applicable regulations allow for a margin of error of a fraction of a percentage point above or below the actual annual percentage rate calculated in accordance with the regulations. Until October 1, 1982, the allowable margin of error was one-fourth of one percentage point for both “open end credit accounts,” *id.* § 226.5(a) (1980) (amended by 46 Fed. Reg. 20,892, 20,900 (1981), codified as amended at 12 C.F.R. § 226.14(a) (1991)), and “extension[s] of credit, other than open end credit,” *id.* § 226.5(b)(1) (1980) (amended by 46 Fed. Reg. 20,892, 20,904 (1981), codified as amended at 12 C.F.R. § 226.22(a) (1991)). Under the present regulations for both open-end credit transactions, *see id.* § 226.14(a) (1991), and closed-end credit transactions, *see id.* § 226.22(a)(2), the annual percentage rate disclosed “shall be considered accurate if it is not more than 1/8 of 1 percentage point above or below the annual percentage rate” calculated under the regulations. An exception is made for “irregular” closed-end transactions, which include “one or more of the following features: multiple advances, irregular payment periods, or irregular payment amounts.” *Id.* § 226.22(a)(3) n.46. For such transactions, the one-fourth of one percentage point standard is retained. *Id.* § 226.22(a)(3).

The deviation between the nominal interest rate using the 365/360 and 365/365 methods

Finally, even armed with her superior knowledge and an apparently strong desire to modify the interest calculation term, Ms. Chern lacked the bargaining power to convince the bank to recast the transaction in terms of a 365/365 method of interest calculation.¹⁵⁴ If the goal of disclosure regulation is to give borrowers information so that they can act upon it to their advantage, the system is irretrievably flawed by the inability of the borrower to act once disclosure is made.

Disclosure regulation has failed to inform the public adequately of the practice of calculating interest on the 365/360 basis, much less end the practice. Indeed, the disclosure regime has provided a shield for banks in some cases. Disclosure regulation is not adequate to redress this situation.

C. Prohibition

The most direct and straightforward means of eliminating the 365/360 method of interest calculation would be a federal statutory or regulatory prohibition. Because the bank method is used by banks and savings and loans chartered by federal and state law, multiple initiatives are required.

First, Congress should amend Subchapter IV of the National Bank Act¹⁵⁵ by inserting a new section 85a that would prospectively prohibit the use of the 365/360 method of interest calculation, subject only to an exception for existing loans (including nonbank-discretionary rollovers of existing loans) for which the use of the 365/360 method was clearly and prominently disclosed in the documentation or for which the bank proved through other evidence that the borrower had understood and agreed to the term.¹⁵⁶ Additionally, an amendment of subchapter IV, section 86 is needed to define the prohibited use of the bank method of

is not greater than one-eighth of a percentage point at any nominal rate up to and including 9% per annum. At 9% the effective interest rate is $0.09 \times 365/360 = 0.09125 = 9.125\%$. The deviation is not greater than one-fourth of a percentage point at any nominal rate up to and including 18% per annum (at 18% the effective interest rate is $0.18 \times 365/360 = .1825 = 18.25\%$).

154. See *Chern*, 15 Cal. 3d at 870, 544 P.2d at 1312, 127 Cal. Rptr. at 112.

155. National Bank Act, ch. 106, 13 Stat. 99 (1864) (codified as amended in scattered sections of 12, 19, and 31 U.S.C.). Subchapter IV is found at 12 U.S.C. §§ 81-95b (1988 & Supp. I 1990).

156. The new section, Title 12, Chapter 2, Subchapter IV, § 85a would read:

85a. PROHIBITION OF USURIOUS INTEREST CALCULATION METHOD.

(a) Except as provided in subsection (d) hereof, no association may take, receive, reserve, or charge on any loan or discount made, or upon any notes, bills of exchange, or other evidence of debt, interest calculated using 365 unit-periods in a year (or 366 unit-periods in a leap year) and a unit-period rate of interest equal to 1/360th of any quoted nominal annual interest rate (the "365/360 method of interest

interest calculation as usury.¹⁵⁷ Subchapter IV of the National Bank Act

calculation"); and the taking, receiving, reserving or charging of such interest shall be considered usurious, subject to the penalties of section 86 of this title.

(b) For purposes of this section, a "quoted nominal annual interest rate" shall mean any annual rate of interest quoted to the borrower in any communication by the association, including advertisements, oral representations, written representations, or written loan documents.

(c) It shall be no defense to any action at law brought hereunder that the association conforms with the disclosure requirements of the Truth in Lending Act, 15 U.S.C. Chapter 41, and has disclosed an Annual Percentage Rate either including an adjustment for the 365/360 method of interest calculation or within the statutorily allowable margin of error for such Annual Percentage Rate disclosure.

(d) Excepted from the prohibition in (a) shall be loans, notes, bills of exchange and other evidence of debt which the association establishes are both (1) made and entered into as of the effective date of this section (including replacement or substitute loans, notes, bills of exchange and other evidence of debt which the obligee is conditionally or unconditionally required as of the effective date of this section to extend), and (2) qualify under either (A) or (B) hereof:

(A) Where such loans, notes, bills of exchange or other evidence of debt are evidenced by a writing as of the effective date of this section that gives adequate notice of the use of the 365/360 method of interest calculation. For purposes of this section "adequate notice" means a printed notice that sets forth the pertinent facts clearly and conspicuously so that a person against whom it is to operate could reasonably be expected to have noticed it and understood its meaning. A writing shall not be deemed to give adequate notice of the use of the 365/360 method of interest calculation solely by stating that "interest will be calculated on the basis of a 360 day year," that "interest will be calculated on the basis of a banker's customary short year," that "interest will be calculated according to bank rules and regulations," or that "interest will be calculated as customary," or words to such effect.

(B) Where the association and the borrower have agreed on the use of the 365/360 method of interest calculation; the agreement of the borrower under this clause cannot be shown by proof of an industry custom and usage or similar non-borrower-specific pattern of dealing.

The proposed statutory language uses the definition of "quoted nominal annual interest rate" and the provisions of new subsection (c) to broaden the inquiry beyond merely whether the association correctly calculates the annual percentage rate for the purposes of Truth in Lending Act disclosures, as required by 15 U.S.C. § 1631 (1988), and the regulations promulgated thereunder, 12 C.F.R. §§ 226.14(a), 226.22(a)(2) (1991). Fairness for lenders is assured by allowing existing obligations to be calculated using the 365/360 method of interest calculation if the lender can establish that there was adequate notice (the adequate notice definition parallels that in the Consumer Credit Protection Act, 15 U.S.C. § 1602(j) (1988)), or can in any other borrower-specific way demonstrate the agreement of the parties. Note that this exception is expanded to include non-lender-discretionary rollover or extension obligations.

157. The revised section, Title 12, Chapter 2, Subchapter IV, § 86, would read:

§ 86 USURIOUS INTEREST; PENALTY FOR TAKING; LIMITATIONS. The taking, receiving, reserving, or charging a rate of interest greater than is allowed by section 85 of this title, *or the taking, receiving, reserving, or charging of interest calculated using the 365/360 method of interest calculation, as prohibited by section 85a of this title*, when knowingly done, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid, the person by whom

is a logical legislative vehicle for prohibiting the 365/360 method because it locates this prohibition with other provisions regulating the banking business of national banks, and ties the prohibition of the bank method into existing enforcement mechanisms and penalties. Such an amendment of the National Bank Act is not alone sufficient, however, in that it would apply only to the institutions regulated by Chapter 2 of Title 12, thereby excluding state-chartered financial institutions and possibly excluding federally chartered financial institutions other than national banks.¹⁵⁸ Clearly, it would be prudent separately to prohibit state-

it has been paid, or his legal representatives, may recover back, in an action in the nature of an action of debt, twice the amount of the interest thus paid from the association taking or receiving the same: Provided, That such action is commenced within two years from the time the usurious transaction occurred.

12 U.S.C. § 86 (1988) (proposed additions in italics).

158. The sweep of the National Bank Act, ch. 106, 13 Stat. 99 (1864) (codified as amended in scattered sections of 12 U.S.C. (1988 & Supp. I. 1990)), has been the source of judicial confusion. It is provided in 12 U.S.C. § 37 that the provisions of 12 U.S.C. Chapter 2 "which are expressed without restrictive words, as applying to 'national banking associations,' or to 'associations,' apply to all associations organized to carry on the business of banking under any Act of Congress." 12 U.S.C. § 37 (1988). The sections under discussion, §§ 85 & 86, are within chapter 2 of Title 12 and are cast in terms of "[a]ny association," and "the association." *Id.* §§ 85, 86. These sections are therefore within the operation of 12 U.S.C. § 37.

It has been correctly held that the National Bank Act does not apply to state-chartered institutions. *See* *Weiner v. Bank of King of Prussia*, 358 F. Supp. 684, 687 (E.D. Pa. 1973). Yet the *Weiner* court was imprecise in its formulation: "The National Bank Act regulates national banks and only national banks, which can be identified by the word 'national' in their name," an imprecision which was not outcome determinative given the facts of that particular case. *Id.* at 687, 690-92 (basing plaintiff's lack of standing on the fact that he had not entered into any credit transaction with the state bank defendant). Unfortunately, and notwithstanding the clear language of § 37, *Weiner* has been cited for the proposition that the National Bank Act does not govern the activities of the Production Credit Associations and the Federal Land Banks. *See* *Wiley v. Federal Land Bank*, 657 F. Supp. 964, 965 (S.D. Ind. 1987) (citing *Weiner* and *Criswell v. Production Credit Ass'n*, 660 F. Supp. 14 (S.D. Ohio 1985), as support for this proposition); *Criswell*, 660 F. Supp. at 16 ("Neither PCA nor FLB are established as national banks under the National Bank Act[;] rather both are instrumentalities created under the Farm Credit Act of 1971. . . . It is well settled that the National Bank Act regulates only the conduct of national banks.") (citing *Weiner* as support). *Wiley* and *Criswell* were wrongly decided if the Federal Land Banks and the Production Credit Associations are "associations organized to carry on the business of banking under any Act of Congress," within the meaning of 12 U.S.C. § 37. The issue has been properly framed and addressed once, at the district court level, with the finding that "[t]he Production Credit Association is not engaged in general banking, but is an organization under the Farm Credit Association which is designed to serve a particular, limited purpose." *Beatrice Prod. Credit Ass'n v. Vieselmeyer*, 376 F. Supp. 1391, 1392 (D. Neb. 1973). The factual conclusion is not beyond dispute, given that the Federal Land Banks and the Production Credit Associations are part of the integrated "Farm Credit System" created under Chapter 23 of Title 12 of the United States Code. 12 U.S.C. §§ 2001 to 2279aa-14 (1988 & Supp. I 1990). However, § 2205 of Title 12, which exempts Farm Credit System institutions from state interest rate limitations, provides some inferential support. *Id.* § 2205 (1988) ("[I]nterest rates on loans from institutions of the Farm Credit System shall not be subject to any . . . limitation imposed by any state constitution or statute or other laws.").

A similar uncertainty surrounds the status of federal credit unions under 12 U.S.C. § 37.

chartered institutions, and federal financial institutions other than national banks, from using the 365/360 method of interest calculation.¹⁵⁹

An alternative federal legislative strategy would be to amend the Truth in Lending Act¹⁶⁰ to prohibit use of the bank method. Such a strategy is distinctly inferior to the comprehensive amendments proposed above. An initial objection to prohibition through the Truth in Lending Act is that, by its terms, the Truth in Lending Act institutes a disclosure regime to facilitate comparisons of credit alternatives by consumers, not a system of prohibition to regulate the credit options available.¹⁶¹ This objection is incorrect. The 365/360 method of interest calculation is mathematically indistinguishable in every case from use of the 365/365 method with a nominal interest rate slightly less than 1.4% greater than the nominal rate using the 365/360 method. The use of the 365/360 method in some cases and the 365/365 method in others requires potential borrowers to recognize the use of the different formulas and perform a reasonably complex calculation in order to make the two options comparable. Standardization on the 365/365 method removes this barrier to comparison and facilitates sound credit decisions without limiting in any way the substantive outcomes to which the parties can bargain.

A more powerful objection to prohibition of the bank method through amendment of the Truth in Lending Act is that the scope of coverage of the Act is relatively narrow. Excluded from coverage are

The usury section of the National Bank Act, 12 U.S.C. § 86, has been held applicable to federal credit unions. See *Van Pelt v. P & L Fed. Credit Union*, 39 Tenn. App. 363, 378, 282 S.W.2d 794, 800-01 (1955). It is also inapplicable by inference, since there is another section of the statute, 12 U.S.C. § 1757(5)(A)(vii) (1988), that outlines usury requirements applicable to federal credit unions. See *Knights of Columbus Fed. Credit Union v. Salisbury*, 3 Conn. App. 201, 206-07, 486 A.2d 649, 654 (1985).

159. State regulation presumably would be a matter of individual state statutory or administrative rule modification. Among the federal statutes that would require attention would be the chapters of Title 12 regarding: the Export-Import Bank, 12 U.S.C. § 635(b)(1)(b) (Supp. I 1990); Agricultural Marketing, *id.* § 1441d-1 (1988); the Federal Home Loan Mortgage Corporation, *id.* § 1454 (Supp. I 1990) (setting standards for purchasable mortgages); Federal Savings and Loan Associations, *id.* § 1464(c) (setting standards for loans and investments); Federal Credit Unions, *id.* § 1757(5)(A)(vi)-(vii) (1988); the Farm Credit System, *id.* § 2205 (system-wide exemption from state interest rate limitations); and the National Consumer Cooperative Bank, *id.* § 3018(b) (criteria for interest rates on loans made by the Bank).

160. 15 U.S.C. §§ 1601-1614, 1631-1646, 1661-1665a, 1666-1666j, 1667-1667e (1988).

161. Thus, the congressional findings and declaration of purpose for subchapter I of Chapter 41, Consumer Credit Cost Disclosure, provide that

[i]t is the purpose of this subchapter to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uninformed use of credit, and to protect the consumer against inaccurate and unfair credit billing and credit card practices.

Id. § 1601(a).

loans for business and commercial purposes,¹⁶² loans other than to individuals,¹⁶³ and loans over \$25,000 other than a mortgage loan on the borrower's principal residence.¹⁶⁴ Because of the limited scope of coverage and the arguable departure from the legislative thrust of the chapter, amending the Truth in Lending Act to prohibit the 365/360 method is a disfavored alternative that is best considered an interim or compromise measure.

A third regulatory option would be for the various federal financial institution regulators to declare the use of the 365/360 method an unsafe and unsound practice.¹⁶⁵ Such a declaration would need to be framed aggressively, given the Fifth Circuit's decision in *Gulf Federal Savings & Loan Association v. Federal Home Loan Bank Board*.¹⁶⁶ That case involved the well-publicized, but ultimately unsuccessful, effort of the Federal Home Loan Bank Board to regulate the Gulf Federal Savings and Loan Association.¹⁶⁷ The savings and loan had a pattern and practice of contracting with borrowers to charge interest on a 365/365 basis and then calculating interest based on a 365/360 method.¹⁶⁸ The Federal Home Loan Bank Board classified this as a breach of contract and an unsafe and unsound practice.¹⁶⁹ The Fifth Circuit held that the Board's cease-and-desist order was improper because the Board's ability to act on the basis of "unsafe or unsound practices" relates only to conditions that threaten an institution's financial integrity.¹⁷⁰ Further, the court held

162. Section 1603(1) of Title 15 exempts "[c]redit transactions involving extensions of credit primarily for business, commercial, or agricultural purposes." *Id.* § 1603(1).

163. Section 1603(1) of Title 15 excludes "[c]redit transactions involving extensions of credit . . . to organizations," *id.* § 1603(1) (emphasis added), which is defined to mean "a corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association." *Id.* § 1602(c).

164. Section 1603(3) excludes "[c]redit transactions, other than those in which a security interest is or will be acquired in real property, or in personal property used or expected to be used as the principal dwelling of the consumer, in which the total amount financed exceeds \$25,000." *Id.* § 1603(3).

165. Such regulations presumably would be promulgated by the Office of Thrift Supervision as successor to the Federal Home Loan Bank Board and the Federal Savings and Loan Insurance Corporation pursuant to the Financial Institutions Reform, Recovery and Enforcement Act of 1989, 12 U.S.C. § 1811 (Supp. I 1990), and the Federal Deposit Insurance Corporation, pursuant to its authority under 12 U.S.C. § 1828(g) (Supp. I 1990).

166. 651 F.2d 259 (5th Cir. 1981), *cert. denied*, 458 U.S. 1121 (1982).

167. See John D. Hawke, Jr., *Banking Regulators' Clout Increases Dramatically*, *LEGAL TIMES*, Oct. 25, 1982, at 11, 14 (noting that *Gulf Fed. Sav. & Loan Ass'n* stands for the proposition "that there is a limit to agencies' discretion to define unsafe and unsound practices"); *Bank Board Asks Supreme Court for Power to Stop S&L Overcharges*, *supra* note 57, at B-3.

168. *Gulf Fed. Sav. & Loan Ass'n*, 651 F.2d at 261-62.

169. *Id.* at 263.

170. *Id.* at 264-66 ("The breadth of the 'unsafe or unsound practice' formula is restricted . . . to practices with a reasonably direct effect on an association's financial soundness. . . .

that giving the Board general supervisory authority "to enforce the public's standard of fairness in interpreting contracts" would exceed Congress's intent.¹⁷¹ The use of the 365/360 method itself was not challenged, merely the breach of the agreements to use the 365/365 method.¹⁷² One might speculate on regulators' willingness to repeat its attempt to regulate this facet of savings-and-loan activities, and the desire of the courts to block such regulation, given the wholesale failure of financial institution deregulation in the intervening years. It does seem safe to predict, however, that the attentions of regulators will be otherwise occupied for quite a long time. The unsafe and unsound practice declaration is therefore also a disfavored alternative to comprehensive and affirmative prohibition, best considered an interim or compromise measure.

Prohibition by statute or regulation has the virtue of squarely addressing the policy question, giving clear direction to lenders, and protecting borrowers. Prohibition is the preferred avenue for redress of this situation.

IV. CONCLUSION

The bank method of interest calculation ought to offend our sense of fairness and propriety. It is simply unseemly for a bank to use such a naked artifice to cheat its customers.

Viewed in isolation, the bank method of interest calculation is a computational curiosity perhaps not worthy of great attention. After all, although many are hurt, the individual injuries are slight. Viewed in its proper context, however, this situation merits attention. In the technical debate over the calculation of interest, we find yet another frontier of the legal system's chronic abandonment of the less powerful. The fundamental policy question underlying this issue is a modest reformulation of that posed by Attorney Wells in the *Ely* case: Must the laws of nature and of humanity always bend to the purposes of the powerful?¹⁷³ If the legal system is anything more than rules of etiquette within which the powerful can plunder the weak, the answer to the question must be that the

While Gulf Federal's interest calculation provision mix-up is unfortunate, it does not threaten the association's financial well-being.").

171. *Id.* at 265.

172. *Id.* at 261 ("[A]ll parties agree that the 365/360 method is a legitimate means of calculating interest, and the Bank Board does not challenge Gulf Federal's right to choose to calculate interest in this way.").

173. *New York Firemen Ins. Co. v. Ely & Parsons*, 2 Cow. 678, 686 (N.Y. 1824) (attorney Wells arguing for the defendant) ("[I]f not to any other intent, yet the laws of nature and of man must bend to the purposes of the money lender.").

interests of the less powerful should not be so subordinate. One way, a small way, to affirm the proposition that the law exists in part to protect the less powerful would be to correct the abuse inherent in the “bankers’ customary short year”¹⁷⁴ and protect the people from the insidious bank method of interest calculation.

174. *Commercial Nat’l Bank v. Connolly*, 176 F.2d 1004, 1010 n.2 (5th Cir. 1949) (Holmes, J., dissenting) (referring to “the bankers’ customary short year of 360 days, which only applies in figuring interest that is charged as compensation for the use or detention of money”).

