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Call Loans and the Usury Laws

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Recent Legislation

CALL LOANS AND THE USURY LAWS

The Illinois Legislature has by a recent amendment to the interest law, incorporated into it, almost word for word, a provision of the New York interest statute, authorizing unlimited interest rates on loans of indefinite duration.[1] This provision of the New York statute is unique but has resulted in a relatively small amount of litigation in that state.[2] This fact lends itself to the conclusion that although it was a departure from the type of interest statute generally provided for in other states, the New York statutory provision was accepted without question as to its constitutionality, and was apparently very easily interpreted by those persons whom it affected.

At the time of the adoption of the foregoing amendment, the Illinois interest law provided in effect that in all written loan contracts the parties could agree upon seven per cent interest per annum or less, provided, however, with respect to money loaned to or due from a corporation, the parties might agree upon any rate of interest whatsoever, and take and pay the same.[3] The provision excepting corporations from the limitation as to the amount of interest that could be taken from them was found in paragraphs 4, 5, 6, and 8 of the then existing interest law,[4] to which the new provision of 1929 was added. The amendment reads as follows:

> ". . . that in any case hereafter in which advances of money, repayable on demand, to an amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, if evidenced by a writing, it shall be lawful to receive or contract to receive and collect, as compensation for making such advances, any sum to be agreed upon by the parties to such transaction."[5]

[1] Ill. Laws 1929, p. 535; similar New York provision, Consol. Laws N. Y. (Cahill, 1923) c. 21 sec. 379.

[2] "While the statute has been in force since 1882, apparently it has not been fruitful in litigation." Wright v. Toomey (1910) 137 App. Div. 401, 121 N. Y. S. 721.

[3] Ill. Stat. (Cahill, 1925) c. 74 par. 4.

[4] An act passed in 1925 had repealed an earlier statute which specifically denied the defense of usury to corporations. Ill. Laws 1925, p. 452.

[5] Ill. Laws 1929, p. 535. The similar New York provision found in Laws

The taking of the defense of usury from corporations by statute is not a new feature in interest laws.[6] Such statutes have been held to be constitutional by judicial decision.[7] Some states discriminate as to the amount of interest that can be charged by classifying loans by the amounts loaned. The Small Loans Laws allowing a greater amount of interest to be charged on small loans than on larger ones is a typical example of this discrimination. These laws are generally regarded as excepted from the application of the general usury law of the state.[8] Such classification and discrimination by statute in the matter of taking interest has been held constitutional.[9]

The new provision of the Illinois interest law, insofar as it places no limitation on the amount of interest that may be charged on demand loans of $5,000 or more secured by the type of security named in the provision, is probably a just and con-

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N. Y. 1882, c. 237 sec. 1, provides: "In any case hereafter in which advances of money, repayable on demand, to an amount not less than five thousand dollars, are made upon warehouse receipts, bills of lading, certificates of stock, certificates of deposit, bills of exchange, bonds or other negotiable instruments pledged as collateral security for such repayment, it shall be lawful to receive or contract to receive and collect as compensation for making such advances, any sum to be agreed upon in writing, by the parties to such transaction."

[6] The defense of usury has been withheld from corporations in many states by statute. Md. Gen. Laws (1924) art. 23 sec. 131; Consol. Laws N. Y. (Cahill, 1923) c. 21 sec. 374; Mich. Pub. Acts (1927) no. 335, pt. 2 c. 1 sec. 1; N. J. Pub. Laws (1902) p. 459; Rev. Code Del., sec. 2621, amended Acts 1915, c. 213.

Some cases under such statutes are: Buchholz v. Granite Sav. Bank (C. C. A. 4, 1911) 261 F. 75; Mazarin v. Hudson County Real Estate & Bldg. Co. (1910) 80 N. J. Law 35, 76 Atl. 322; Scheidell v. Llewellyn Realty Co. (1918) 177 N. Y. S. 529; Honey v. Ward-Gilbert Co. (1929) 248 Mich. 502, 277 N. W. 543; In re Bernard & Katz (C. C. A. 2, 1930) 38 F. (2d) 40; Thomas v. Union Trust Co. (1930) 251 Mich. 279, 231 N. W. 619; Curtis v. Leavitt (1857) 15 N. Y. 2.

[7] Griffith v. State (1910) 218 U. S. 563 (Connecticut statute); Carroza v. Fed. Finance & Credit Co. (1925) 149 Md. 223, 131 Atl. 332 (Maryland statute); Shriver v. Druid Realty Co. (1926) 149 Md. 385, 131 Atl. 815; Danville v. Pace (1874) 25 Gratt. (Va.) 1.

[8] Ill. Laws 1925, p. 452, provides in effect that nothing in the general statute on interest is to affect or alter the Small Loans Act of 1917 which allows a higher rate of interest than seven per cent to be charged on loans not amounting to $300.

[9] State v. Sherman (1909) 18 Wyo. 169, 105 Pac. 299; State v. Hurlburt (1909) 82 Conn. 232, 72 Atl. 1079; Ex parte Lichtenstein (1885) 67 Cal. 359, 7 Pac. 728. In 27 R. C. L. 204 the law on the constitutionality of these discriminations is summed up: "It is generally considered that the state may deal with different classes of money lenders in different ways, without offending the constitutional provisions, so long as the classification is reasonable, and all those who bring themselves therein are treated uniformly."

stitutional discrimination. This would seem to be a reasonable implication from the fact that the provision has survived in New York since 1882.[10] The policy of the usury laws has been stated as a desire on the part of the state to protect borrowers, especially poor borrowers, from the greediness of money lenders, but it would seem that one who owned collateral to the amount of $5,000 which he is willing to pledge for a loan of cash does not need the protection that the usury laws were designed to give.[11]

The provision in question was enacted in New York for a very definite purpose. It was an economic necessity if transactions on the stock market were to continue on a large scale. The necessity for a different interest law to be applied to call loans from that applied to ordinary loans is brought out very well by J. E. MEEKER in his recent book, THE WORK OF THE STOCK EXCHANGE, in which he says on page 559:

> "Only the excess of loanable funds which the banks may have from time to time are available for the collateral call money market or for the purchase of commercial paper in the open market. The excess of loanable funds available for employment in the securities market varies, therefore, according to the commercial requirements of the country. It has long been recognized that for an assurance of a sufficient amount of money to finance the volume of business in securities, reliance cannot be placed on a rate of interest

[10] This provision was enacted in New York by Laws N. Y. 1882, c. 237 sec. 1. It is now found in Consol. Laws N. Y. (Cahill, 1923) c. 21 sec. 379. When it has been called to the attention of the courts of that state it has been upheld. Brumley v. Robinson (1923) 120 Misc. 799, 200 N. Y. S. 460; Wright v. Toomey (1910) 137 App. Div. 401, 121 N. Y. S. 721; In re Wilde's Sons, (D. C. S. D. N. Y. 1904) 133 F. 562. One decision stretches the principle of the law so far as to prevent a forfeiture, under the usury law, of money loaned on an oral contract, holding that even an oral contract providing for more than the maximum rate of interest was not usurious if it met the other requirements of the statute, but that more than the maximum rate of interest could not be collected unless there was a written contract so specifying. Hawley v. Kountze (1896) 6 App. Div. 217, 39 N. Y. S. 897.

[11] In Caldwell Co. v. Lea (1925) 152 Tenn. 48, 272 S. W. 715, the court was called upon to determine the constitutionality of Tenn. Acts 1925, c. 69, which authorized a higher rate of interest on long term secured bonds and notes in amounts of $50,000 or more than was authorized on other loans in the state. The court held this law constitutional in spite of a provision of the Tennessee Constitution that required the interest rate to be uniform throughout the state, and gave as its reason: "Usury laws are passed to protect the borrower, especially the poor, from the rapacity of money lenders. The statute before us deals only with loans made to borrowers having property of the value of fifty thousand dollars or more. Such persons do not require the same protection as do others less fortunately endowed."

> limited to the rates which obtain or are permitted in commercial transactions whose prior claim on banking accommodations is universally conceded."[12]

Thus the real necessity for such a provision exempting these loans from the operation of the usury statute was to enable brokers to borrow funds at times when money was scarce and lenders would rather risk their principal at maximum legal interest rates in other fields than the stock market. In times when money is not scarce the system of call or demand loans on security collateral allows utilization of a great amount of the nation's capital collected in New York banks which would otherwise remain idle.[13] When great amounts of money remain idle the call loan interest rate is low, but when money is scarce a very high interest rate must be paid by brokers in order to get money with which to trade on the market, and this provision of the law allows them to pay such interest. Thus the provision is progressive and fair in recognizing that the usury law should not apply where its application is not in accord with sound economic principles.

Since the stock exchange in New York City is really the money market of America it is easily understood why the State of New York should be the first to alter its usury law in this regard. Those who have studied the commercial and economic development of the City of Chicago are aware of the fact that it is rapidly becoming the money market of the Middle West. It is not strange then that Illinois should be the second state to adopt this exception to the usury law in recognition of the law of supply and demand of loanable funds.

The Illinois amendment of 1929, although primarily passed to facilitate stock market transactions, is not restricted in operation to that field alone. It applies to all demand loans of $5,000 or more made on certain types of security collateral. The borrower who contracts to give a very high rate of interest will not suffer unduly under this provision, for it applies only to demand loans, which mature within a reasonable time.[14] Borrowers on call loans on the New York Stock Exchange need not suffer the high interest for more than a day.[15] The provision of a minimum of $5,000 to remove loans from the operation prevents the exception from applying to everyday commercial loans where the al-

[12] See also *Rates of Interest on Collateral Call Loans,* Sen. Doc. 262, 66th Congress, 2d Session, pp. 4-6.

[13] MEEKER, *op. cit.* 177.

[14] Negotiable Instruments Law, Ill. Stat. (Cahill, 1929) c. 98 par. 91.

[15] "Unlike other interest rates, these high call rates remain in force for a single day only, the loans to which they apply being either paid off the next day or renewed at a lower renewal rate." MEEKER, *op. cit.* 194.

lowance of any agreed rate of interest would put the small business man in the grasp of the money lender. Persons owning collateral of the amount that would have to be pledged in order to borrow sums as large as $5,000 are not of the class which needs the protection of the usury laws.[16]

The fact that stock brokers are not able to obtain loans at times when money is scarce without paying a higher rate of interest than other borrowers are then paying for ordinary commercial loans lends itself to the conclusion that lenders consider loans to brokers on collateral security more hazardous than ordinary commercial loans. Hazard to principal has been recognized as a ground for denying the application of the usury law.[17]

The development of important call loan markets in other cities besides New York and Chicago will doubtless result in the extension of similar legislation to other states.

NOEL F. DELPORTE, '31.

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[16] See n. 11, *supra.*

[17] Provident Life & Trust Co. v. Fletcher (C. C. A. 2, 1919) 237 F. 104; Curtis v. Le Mayne (1929) 248 Ill. App. 99.