

## Revising State Usury Statutes in Light of a Tight Money Market

Jack C. Merriman

James J. Hanks Jr.

Follow this and additional works at: <http://digitalcommons.law.umaryland.edu/mlr>



Part of the [Commercial Law Commons](#)

---

### Recommended Citation

Jack C. Merriman, & James J. Hanks Jr., *Revising State Usury Statutes in Light of a Tight Money Market*, 27 Md. L. Rev. 1 (1967)  
Available at: <http://digitalcommons.law.umaryland.edu/mlr/vol27/iss1/4>

This Article is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Law Review by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact [smccarty@law.umaryland.edu](mailto:smccarty@law.umaryland.edu).

# Maryland Law Review

---

---

VOLUME XXVII

WINTER 1967

NUMBER 1

© Copyright Maryland Law Review, Inc., 1967

---

---

## REVISING STATE USURY STATUTES IN LIGHT OF A TIGHT MONEY MARKET

By JACK C. MERRIMAN\* and JAMES J. HANKS, JR.\*\*

The early laws had in view this object, to prevent the powerful lender getting more from the needy borrower than — what? Six per cent.? No; there is nothing in nature that points to six per cent., — from getting more than the fair value at the time. I coincide with that entirely. I agree that if you could pass a law which should not *fix*, but *ascertain* the market value of money every day, that would be right. In early, simple times, the value could be ascertained, nearly. But as business increased, the means for ascertaining the rates failed. It was found at last that fixed legal rates could not be adjusted to the real value of money. Can it be done now?<sup>1</sup>

The law of usury is ancient. It is also statutory. Therefore, one might doubt the need for further critical analysis of this established area of the law. The fact is, however, that only sporadic attention has been given to the law of usury, perhaps because it is not an everyday problem for the general practitioner and comes before the courts only at cyclical periods. Usury laws are somewhat like a ceiling over a long, long corridor existing through time. The interest rates are the floor. Since these rates are subject to the changes of the money market, the floor of the corridor is not level but stepped up and down. The ceiling, however, is statutorily fixed in each state and so is generally level. Thus, the height of the corridor at any given time is the difference between permissible rates of interest, as set by the state legislatures, and actual rates of interest, as determined from day-to-day in the money

---

\* College of William & Mary; A.B. 1947, Luther College; J.D. 1949, State University of Iowa; Partner, Weinberg & Green, Baltimore, Maryland.

\*\* A.B. 1964, Princeton University; Member, Editorial Board, Maryland Law Review.

1. DANA, SPEECH OF RICHARD H. DANA, JR., IN THE HOUSE OF REPRESENTATIVES OF MASSACHUSETTS, FEBRUARY 14, 1867, ON THE REPEAL OF THE USURY LAWS 12 (1867). This classic speech, by the celebrated journalist while he was a member of the Massachusetts legislature, marked "a turning point in usury legislation in the United States." RYAN, USURY AND USURY LAWS 75 (1924). For the benefit of scholars, the authors have obtained and deposited a copy of this speech in the University of Maryland Law School Library, Baltimore, Maryland.

market. In periods of "easy" money, borrowers and lenders, as they move down the corridor through time, have sufficient "headroom" in which to transact business; but during "tight" money times, the floor of the corridor is stepped up and parties seeking loan money often bump their heads against the ceiling.

The law of usury becomes significant when the scarcity of money causes higher interest rates. Except in these periods of "tight money," usury statutes generally lie dormant on the books. When a tight market arrives, however, usury statutes are dusted off, re-examined, and often found lacking; a scramble among the legislatures of the states to repair, modify, or overhaul the statutes where they threaten to stifle the free course of commerce frequently ensues. In any case, the response of state legislatures, which usually meet for only a few weeks each year, lags far behind the vagaries and exigencies of the business world. The experiences of recent months should indicate that a fundamental re-appraisal of the purpose and operation of usury statutes may be long overdue.

### I. THE MONEY MARKET TODAY

The United States may at last be emerging from a tight money period in which borrowers experienced greater difficulty in obtaining money than at any other period of time since the 1920's.

A continuing surge in commercial and industrial loans at New York City commercial banks,<sup>2</sup> evidenced by the ratio of outstanding loans to deposits, has reflected the heavy demand for credit which has been straining the nation's commercial banking system. Until late 1965, a loan-deposit ratio of 55 per cent was considered to be "tight." Among all major U.S. commercial banks, the loan-deposit ratio for the end of 1965 was 60.8 per cent;<sup>3</sup> during the third quarter of 1966, it rose to 70.1 per cent.<sup>4</sup> At major New York commercial banks, the average loan-deposit ratio at the end of 1965 was 69.7 per cent.<sup>5</sup> By August, 1966, this ratio had risen to 77.0 per cent;<sup>6</sup> and at the largest of these banks, the ratio hovered between 80 and 85 per cent.<sup>7</sup> By February, 1967, the ratio for the major New York banks had only eased to 74.7 per cent.<sup>8</sup>

The daily average of net borrowed reserves for member banks of the Federal Reserve System, normally a rough indicator of credit demand and current monetary policy, exceeded \$200 million in only four

---

2. This article discusses lending from the perspective of commercial banks. Other important lenders, such as first borrowers, rely upon commercial banks, while still others, such as insurance companies, are indirectly affected by the situation of the commercial banks. Virtually all lenders, therefore, are subject to the operations and effects discussed herein. For example, when interest rates from commercial banks exceed 6 per cent, individuals and businesses borrow against the cash values of their life insurance policies at a guaranteed 5 per cent, forcing their insurance carriers to borrow at more than 6 per cent from the banks.

3. Computed from figures in 1967 FED. RESERVE BULL. 108, 110.

4. Computed from figures in 1966 FED. RESERVE BULL. 1486, 1488.

5. Computed from figures in 1967 FED. RESERVE BULL. 108, 110.

6. Computed from figures in 1966 FED. RESERVE BULL. 1366, 1368.

7. Wall Street Journal, Aug. 9, 1966, p. 1, col. 6.

8. Computed from figures in 1967 FED. RESERVE BULL. 414, 416.

weeks in 1965, when a less restrictive monetary policy prevailed.<sup>9</sup> In the second and third quarters of 1966, net borrowed reserves for all member banks continually reached a daily level in excess of \$300 million.<sup>10</sup>

For five years, from 1960 until the end of 1965, another indicator of the current situation in the money market, the rate available to a bank's most credit-worthy customer, remained steady at 4½ per cent. Between late 1965 and August, 1966, the prime rate moved forward four times to 6 per cent, the highest level which the prime had reached since it first came into wide use in the 1930's. In January, 1967, however, the Chase Manhattan Bank touched off a ragged retreat by reducing its prime rate from 6 per cent to 5½ per cent. Other banks failed to follow the leader's move with their usual alacrity. When they did lower their rates, it was generally to 5¾ per cent at first and to 5½ per cent only after a delay of more than two months.<sup>11</sup>

Whether events which have unfolded since the beginning of 1967 have initiated a sustained period of easier money, it is probably too early to say.

The underlying causes for tight credit conditions in this country are bound up, of course, in the current economic boom, now in its seventh year, which represents the longest sustained period of prosperity in this country since the decade following World War I. Large-scale government spending in the Kennedy and Johnson administrations, the tax incentives in the 1954 and 1962 Revenue Acts, and the tax reduction in 1963 have probably been the major stimulants for this economic growth. Increased personal income and rising corporate profits have encouraged individuals and companies to undertake major investment and expansion programs, creating the present needs for money. As a result, the demand for capital rapidly closed in on the supply. This capital shortage persisted despite the fact that many banks generated additional cash inventory through sale of securities (even at a loss<sup>12</sup>) and through issuing certificates of deposit at rates up to 5½ per cent.<sup>13</sup>

---

9. Wall Street Journal, Aug. 5, 1966, p. 5, col. 2. Each Federal Reserve Member Bank is required by law to maintain certain percentages of its time and demand deposits on reserve. The exact figures are established by the Federal Reserve Board within statutory limits. Federal Reserve Act § 19, 38 Stat. 270-71 (1913), 12 U.S.C.A. § 461 (Supp. 1967). In order to meet these requirements, banks with a substantial percentage of their deposits on loan or otherwise invested will frequently borrow money from other banks. "Net borrowed reserves," also know as "minus" or "negative" reserves, represent the extent to which commercial banks have borrowed from other Federal Reserve Member banks in order to meet their legal reserve requirements.

10. Computed from figures in 1966 FED. RESERVE BULL. 988; and 1967 FED. RESERVE BULL. 90.

11. Many bankers stated that the loan demand at the time still justified a 6 per cent rate and that they cut back on their primes only because Chase forced their hands. Wall Street Journal, Feb. 3, 1967, p. 1, col. 6. Moreover, there is a widespread suspicion that Chase may have acted less in response to then-prevailing market factors than out of a desire to win favor with the Johnson Administration. *Id.* at p. 1, col. 6; p. 16, col. 1. In addition, the authors have discovered that many Chase customers who were prime borrowers at the 6 per cent rate were not permitted to borrow at the 5½ per cent rate.

12. Wall Street Journal, Aug. 9, 1966, p. 1, col. 1.

13. The shortage of funds in the United States has inevitably affected nations abroad. Although there is probably no likelihood of a repeat of the debacle of the

Moreover, at a time when general economic growth has spurred demand for lendable funds, the supply of money available has been decreased not only by record-high levels of commercial and industrial loans, but also by heavy government borrowing,<sup>14</sup> the sale of government securities and obligations,<sup>15</sup> deferred payment by the government of its bills,<sup>16</sup> accelerated tax collections,<sup>17</sup> and the Participation Sales Act of 1966.<sup>18</sup>

Current economic thinking seems to favor solving the demand-supply dilemma by discouraging demand rather than by increasing the supply.<sup>19</sup> In this context, government and private money managers have undertaken a number of measures designed to ease the present money situation.

In late 1965, the Federal Reserve Board boosted its rediscount rate, the rate at which it lends its funds to member banks, from 4 per cent to 4½ per cent, where it remained until April, 1967. Increasing the rediscount rate makes money more expensive to member banks, who, in turn, raise their own interest charges, the basis for which is the prime rate.<sup>20</sup> Wall Street observers acknowledge, however, that the

1930's, there are threats to individual countries. In particular, a chronic lack of funds in less than industrialized nations has historically kept interest rates high. However, now that even economically advanced countries, such as the United States, are experiencing increased money charges, underdeveloped nations are having even greater difficulty obtaining capital, at least until the other major banks lowered their prime rates.

The Johnson Administration has officially encouraged U.S. companies to borrow abroad, which drives up interest rates in foreign nations still further. The current high lending charges in the United States were in part responsible for the failure in October, 1966, of the Intra Bank in Beirut, Lebanon, the largest central bank in the Middle East. Intra Bank's chief depositors, Saudi Arabian and Kuwaiti oil sheiks, steadily withdrew their funds during the first three quarters of 1966, in order to loan their money at higher rates in the United States. Finally, in October, a run on the bank precipitated its collapse and forced the Lebanese government to declare a three-day holiday for all other banks in the country.

14. Wall Street Journal, Aug. 18, 1966, p. 11, col. 2.

15. Wall Street Journal, Aug. 26, 1966, p. 4, col. 3.

16. Business Week, Aug. 13, 1966, p. 29.

17. Tax Adjustment Act of 1966, 80 Stat. 38.

18. 80 Stat. 164 (1966). Under this Act, private lenders are being offered participation in pools of government paper priced low enough to yield competitive returns. The Federal Government will pay the difference between the actual interest rates on the loan and the market rates prevailing at the time of sale. This program will, of course, draw funds from an already tight money supply. Money managers have charged that this Act will, in effect, establish a floor under, rather than a roof over, already record-high interest rates. See also Barron's, May 23, 1966, p. 3.

19. In the face of a demand-supply dilemma, some sectors, principally the banks and frequently the Federal Reserve Board, have favored "tight" money, that is, discouraging demand for money by making it more expensive to borrow; other factions, principally political elements descended from the Populist movement, have favored "easy" money, that is, increasing the money supply, generally by making it less expensive to borrow and sometimes simply by printing more of it. Tight money advocates oppose increasing the money supply because it contributes to inflation, at times when inflation is usually a problem, and because it weakens and may eventually lead to devaluation of the dollar. Easy money adherents dislike making money more expensive because it hits hardest the small businessman who is a poorer credit risk than larger businesses and who, therefore, will be less likely to be able to borrow money when it is scarce.

20. Administration officials have been apprehensive about the genuine effect of prime rate increases during tight-money periods. The feeling in some Washington circles seems to be that the banks, rather than trying to discourage borrowing in the face of increased demand for credit, have actually been trying to exact additional profits for the use of their funds. In August, 1966, when the First National City Bank

prime rate increases in late 1965 and 1966 may have been largely ineffective in mitigating the money squeeze.<sup>21</sup>

In addition, the Board has not hesitated to increase the percentage of time deposits which banks must set aside in cash at their district Federal Reserve Banks. In June, 1966, the Board boosted the reserve requirements from 4 per cent to 5 per cent, and, in August, from 5 per cent to 6 per cent. These reserve funds are completely unavailable to member banks for any lending purposes whatever. Removing them from circulation reduces the supply of money, thereby increasing its cost to member banks and thus to borrowers from the banks. The Fed can also adjust the rates which member banks may pay on negotiable certificates of deposit.<sup>22</sup>

The Federal Reserve has also been actively dealing in government securities on the open market. By selling long- and short-term<sup>23</sup> government bonds, the Fed can soak up large amounts of funds as buyers draw on their accounts at member banks.<sup>24</sup> Conversely, when the Fed buys government obligations, it injects cash into the system.<sup>25</sup>

Congress also has acted to alleviate the present situation. More flexible powers have been granted to federal supervisory agencies to regulate savings rates paid by banks and savings and loan associations, thus indirectly contributing to a leveling-off of loan interest rates.<sup>26</sup>

---

of New York precipitated an increase in the prime rate from 5¾ per cent to 6 per cent, Secretary of the Treasury, Henry Fowler, stated that banks should simply refuse to make loans when the funds are not unavailable. The banks, however, contend that as a practical matter, it is exceedingly difficult to turn down prospective borrowers who have been long time customers, and who might take their business elsewhere. Therefore, it is more expedient in such a situation for all banks to raise their lending charges in the hope of thereby discouraging some of these borrowers.

21. Wall Street Journal, Aug. 9, 1966, p. 12, col. 2.

22. Certificates of deposit, or CDs, are receipts for funds deposited in a bank for a specified period. Negotiable certificates of deposit were introduced in 1961 to lure back non-interest-bearing checking deposits which had been increasingly diverted into short-term, interest-paying obligations. Banks generally sell CDs to large corporations who then draw on the deposits which the CDs represent. At present, the Federal Reserve permits member banks to pay no more than 5½ per cent on CDs in the amount of more than \$100,000.00. In their money-gathering efforts through CD sales, commercial banks compete for funds, first, with commercial paper and, second, with finance companies' IOU's. Recently, the rates of return available to investors in commercial paper and finance company notes have crept above 5½ per cent. Thus, huge amounts of money, once available through certificates of deposit to commercial banks for business loans, have been increasingly drawn away. The pinch on banks has encouraged corporate borrowers to fill their short-term credit in the commercial paper market, often with the banks' blessing.

23. Short-term (90-day) government bonds are more widely known as "Treasury bills."

24. Dealers in government obligations will not reveal the names of their customers, but they can be reliably presumed to be insurance companies, large business firms, and commercial banks.

25. In addition, the Federal Reserve Board exercises very effective "moral suasion" over the credit policies of member banks. In particular, the Board has authority to refuse to lend its funds to any member bank which it determines is pursuing imprudent credit policies. 12 C.F.R. § 201.0(e). On September 1, 1966, the Board sent a letter to member banks stating that future Federal Reserve loans would depend in part upon efforts of individual banks to moderate the extension of business credit. Board of Governors of the Federal Reserve System, Press Release, September 1, 1966, pp. 2-3. Later in the same month, Governor Brimmer disclosed that the Board had recently decided against further raising the discount rate, and would, for the present, rely on openly urging banks to restrain their loans to business customers. In January, 1967, the Board in effect rescinded its September 1 letter.

26. Act of Sept. 21, 1966, 80 Stat. 823.

The Eighty-Ninth Congress also withdrew some of the tax incentives for major expansion by suspending the most rapid methods of accelerated depreciation<sup>27</sup> and the seven per cent investment tax credit for 18 months.<sup>28</sup>

The measure for reducing credit demand which has been most widely espoused in the business and banking communities has been drastic reduction in government spending. The *Wall Street Journal* has stated that cutbacks in defense spending "would diminish if not curb the present shortage of marketable funds."<sup>29</sup> Other commentators have urged reductions in subsidy and welfare programs, federally-financed construction, Export-Import Bank loans, "and the whole wasteful apparatus of Socialism known as the Great Society."<sup>30</sup>

Money managers recognize, however, that there may be "some conflict between the objective of limiting business investment through restriction of bank credit and the aim of supplying sufficient money to permit business volume to grow in line with expanding activity."<sup>31</sup> Interest rates may, therefore, remain at relatively high levels; and borrowers in desperate need of funds may continue to be willing to pay premium prices for the use of money.

Thus, the money market is, as the discussion thus far suggests, an intricate structure. Nevertheless, both government and private sectors have devices available to them with which they can influence it. These devices — such as the rediscount rate, activity in government securities, and the prime rate — are of necessity instruments which are designed to be employed with considerable precision. They can be exercised on a day-by-day, or even minute-by-minute, basis; and their effects can be measured out in fine degrees. Clearly, any device which is not so precise, but which significantly affects the market — whether by design or only as a collateral effect to some other policy or purpose — should be carefully scrutinized and evaluated.

## II. EVOLUTION OF THE LAW OF USURY

Although factors are at work which will increase the supply of lendable funds, relatively high interest charges are likely to persist unless the economy suddenly ceases to expand at its present rate. At the same time, however, most of the states, through their usury laws, forbid the payment of interest in excess of a prescribed rate. If the free enterprise system and governmental "guiding" of this system drive interest rates higher, is there a counter public policy or purpose which demands that an absolute limit on interest rates retard the otherwise normal operation of commerce?

---

27. Act of Nov. 8, 1966, 80 Stat. 1508(b).

28. Act of Nov. 8, 1966, 80 Stat. 1508(a).

29. *Wall Street Journal*, Oct. 3, 1966, p. 1, col. 5.

30. Editorial, *Barron's*, April 4, 1966, p. 1.

31. First National City Bank of New York, *Monthly Economic Letter*, Aug., 1966, p. 92.

### A. *The Genesis of Usury*

Ancient laws concerning the exaction of interest for the use of money reflect a strong public sentiment against usury. Although Babylonian farmers frequently borrowed money to tide them over until the next harvest,<sup>32</sup> the Hammurabi Code limited interest on loans of corn or silver.<sup>33</sup> The Bible frequently inveighed against usury,<sup>34</sup> and so strictly did the Medieval church adhere to these injunctions that frequently the charging of any interest at all was prohibited.<sup>35</sup> The Middle Ages embraced the Aristotelian notion<sup>36</sup> that money, as opposed to land or chattels, was "contrary to nature."<sup>37</sup> In 1179, the Third Lateran Council declared that usury was condemned by both the Old and New Testaments and that usurers would be excommunicated and denied Christian burial.<sup>38</sup>

Nevertheless, by the early Thirteenth Century, usury was common in channels of trade and commerce. Although Dante relegated usurers to the seventh circle of Hell,<sup>39</sup> Pope Nicholas III threatened to excommunicate an English archbishop who tried to renege on usurious interest which he owed to certain Italian bankers.<sup>40</sup> Florentine banking families, such as the Bardi, the Peruzzi, and the Frescobaldi, lent money at blatantly usurious rates to rulers of Italian city-states and secured their loans with monopoly grants in vital commodities and with rights to coin money, gather taxes, and quartermaster armies.<sup>41</sup>

Finally, during the Reformation, leading religious leaders, such as John Calvin, recognized that money did have an income-producing capability and that it was proper, within limits, to charge fees for its use. Calvin, often regarded as a father of capitalism, regarded rents, profits, and interest as entirely normal unless abused.<sup>42</sup> Thus, the rise of commerce forced modification of the ancient concepts of usury. The recognition of the commercial convenience of credit and a reassessment of the moral aspects of usury led to English statutes permitting interest at controlled rates.<sup>43</sup>

Massachusetts, in 1661, was the first American colony to enact a usury statute;<sup>44</sup> Maryland was second in 1692.<sup>45</sup> By the outbreak of the Revolution, all of the colonies had usury laws patterned after the English statutes. Although Eighteenth Century legislators approved

32. HEILBRONER, *THE QUEST FOR WEALTH* 70 (1956).

33. DRIVER & MILES, *THE BABYLONIAN LAWS: LEGAL COMMENTARY* 173 (1956).

34. See, e.g., *Exodus* 22:25; *Leviticus* 25:36; *Ezekiel* 18:8; and *Luke* 6:35; but see *Deuteronomy* 23:19-20.

35. HOMER, *A HISTORY OF INTEREST RATES* 70 (1963).

36. ARISTOTLE, *POLITICS* 51 (Rackham ed. 1951).

37. COLE, *ECONOMIC HISTORY OF EUROPE* 69 (1952).

38. NOONAN, *THE SCHOLASTIC ANALYSIS OF USURY* 19 (1957).

39. DANTE, *DIVINE COMEDY, Inferno: Canto VII*.

40. COLE, *op. cit. supra* note 37, at 82.

41. HEILBRONER, *op. cit. supra* note 32, at 73. See also CHEYNEY, *THE DAWN OF A NEW ERA* 47-51 (1936).

42. COLE, *op. cit. supra* note 37, at 152.

43. 37 Hen. 8, c. 9 (1545); 13 Eliz. 1, c. 8 (1571); 12 Anne, c. 16 (1713).

44. MURRAY, *A HISTORY OF USURY* 76 (1866).

45. *Ibid.*



the exaction of money for money's use, they provided stiff penalties for excessively high charges.

England abolished its statutory limits on interest rates in 1854;<sup>46</sup> and, within a few years, Denmark, Spain, Holland, Norway, Sweden, and Belgium did likewise.<sup>47</sup> In 1867, Massachusetts repealed its usury laws.<sup>48</sup> Other states maintained but revised their usury statutes. In 1845, Maryland enacted a statute which provided for the enforcement of usurious contracts to the full extent of the legal interest rate, 6 per cent.<sup>49</sup> This statute is representative of legislation in force in most states today.<sup>50</sup>

Thus, from earliest times to the present, lending money for profit has been the subject of control. Today, however, the early moral stigma against charging interest for the use of money has largely disappeared. Modern controls on usury survive primarily to protect the naive borrower,<sup>51</sup> as reflected by the fact that the borrower in a usurious transaction is not *particeps criminis*<sup>52</sup> or *in pari delicto*<sup>53</sup> with the lender. Furthermore, it is clear that the defense of usury is personal to the borrower<sup>54</sup> and cannot be asserted in behalf of a general public interest.<sup>55</sup> Finally, legislatures have not been reluctant to modify usury statutes when such statutes impede the normal forces of commerce.<sup>56</sup>

### B. *The Misguided Corporate Exception*

In the period between the Jackson Administration and the Civil War, the corporation became an increasingly popular form of doing

46. Usury Laws Repeal Act, 17 & 18 Vict., c. 90 (1854).

47. PALGRAVE, 2 DICTIONARY OF POLITICAL ECONOMY 433-34 (1925).

48. LAWS OF MASS. ch. 56, § 2 (1867).

49. LAWS OF MD. ch. 352 (1845); MD. CODE ANN. art. 49, § 4 (1964).

50. Maximum permissible rates of interest generally range from 6 per cent [see, e.g., DEL. CODE ANN. tit. 6, § 2301 (1953); PA. STAT. ANN. tit. 41, § 3 (1954); VA. CODE ANN. § 6.1-318 (Replacement vol. 1966)] to 12 per cent [see, e.g., CONN. GEN. STAT. ANN. § 37-4 (1960); WASH. REV. CODE ANN. § 19.52.020 (1961)]. Rhode Island, however, has a maximum interest rate of 30 per cent. R.I. GEN. LAWS ANN. § 6-26-2 (1956). In some states, the parties may agree to any rate of interest, provided that they do so in writing. See COLO. REV. STAT. § 73-1-3 (1954); ME. REV. STAT. ANN. tit. 9, § 228 (1964); N.H. REV. STAT. ANN. ch. 336, § 1 (1955).

51. First Nat'l Bank of Opp v. Cotton, 231 Ala. 288, 164 So. 371, 374 (1935); "Usury laws are for the protection of the borrower against the cupidity of the lender."

52. National Amer. Life Ins. Co. v. Bayou Country Club, 16 Utah 2d 417, 403 P.2d 26, 30 (1965).

53. See, e.g., Plitt v. Kaufman, 188 Md. 606, 612, 53 A.2d 673, 676 (1947); Lloyd v. Gutsell, 175 Neb. 775, 124 N.W.2d 198, 202 (1963).

54. See, e.g., Peterson v. Modjeska, 256 Iowa 152, 125 N.W.2d 751, 753 (1964); Community Savings and Loan Association v. Fisher, 400 S.W.2d 927, 931 (Tex. Civ. App. 1966).

55. Cf. Sosin v. Richardson, 210 Cal. App. 2d 258, 266, 26 Cal. Rptr. 610, 614 (1962).

56. In some states, for example, there is no limitation on the interest chargeable on corporate bonds. See, e.g., N.C. GEN. STAT. § 24-2 (Replacement vol. 1965); ORE. REV. CODE ANN. § 82.120(4) (1953). Also, some states exempt from the usury statutes loans in excess of a certain amount which are secured by commercial paper. See, e.g., N.Y. GEN. OBL. LAW § 5-523 (1964); PA. STAT. ANN. tit. 41, § 1 (1954). In addition, usury laws are now being frequently evaded by means of excessive service charges, or point, by sales with repurchase options, and by tie-in sales. Moreover, although usury laws have historically been designed to protect small borrowers, they have now been superseded in this area by consumer loan legislation. Cf. Uniform Small Loan Law, MD. CODE ANN. art. 58A (Repl. vol. 1966). Thus, "the scope of general usury statutes has been increasingly restricted to the area of commercial lending." Note, 65 YALE L.J. 105, 106 (1955).

business;<sup>57</sup> and, in the rapidly expanding industrial economy of that era, borrowers naturally were no longer only individuals, but larger and larger business concerns. In 1850, New York, the nation's financial hub, was casting about for a method which would emancipate legitimate business borrowers from usury restrictions. The device chosen by the state legislature was an amendment to the usury statutes which precluded corporations from asserting usury as a defense to an action on a loan.<sup>58</sup> In effect, New York concluded that the borrowers least likely to need the protection of usury statutes are corporations and that borrowers most in need of this protection are not corporations, but individuals. Several jurisdictions, including Maryland,<sup>59</sup> have emulated New York with statutes which either preclude corporations from defending on the ground of usury<sup>60</sup> or which authorize corporations to borrow at any mutually agreed upon rate.<sup>61</sup> Here again, public policy in limiting interest charges yielded to the convenience of commerce.

Once the corporate exception was statutorily enshrined, the natural inclination of lenders who wanted to charge interest in excess of the statutory limit was to force the borrower to form a corporation in order to furnish a corporate borrower. When such cases come before the courts, the primary question, although not always so stated, is whether the usury statute is being followed or evaded.<sup>62</sup> In an early New York case, *Jenkins v. Moyse*,<sup>63</sup> the court decided that the borrower's incorporation did not purposefully evade the statute but that, indeed, the statute had been "followed meticulously in order to accomplish a result which all parties desire and which the law does not forbid."<sup>64</sup> In *Rabinowich v. Eliasburg*,<sup>65</sup> where a husband and a wife created a corporation at the lender's insistence, the court upheld the corporation as borrower even though the "object" of incorporation was to enable the lender to charge interest "lawfully against a corporate borrower capable of legally contracting such a liability."<sup>66</sup> Such cases as these are correctly decided only if it can be shown from the record that the borrower was familiar with commercial and lending transactions.

57. WILLIAMSON, *THE GROWTH OF THE AMERICAN ECONOMY* 282-83 (1951).

58. LAWS OF N.Y. ch. 172, § 1 (1850); N.Y. GEN. OBL. LAW § 5-521 (1964).

59. MD. CODE ANN. art. 23, § 125 (1957).

60. See, e.g., D.C. CODE tit. 29, § 904(h) (Supp. IV, 1965); PA. ANN. STAT. tit. 41, § 2 (1954); VA. CODE ANN. tit. 6.1, § 327 (Repl. vol. 1966).

61. See, e.g., IND. STAT. § 19-12-101(c) (1964); TEX. BUS. CORP. LAW art. 2.02A(9) (1956). For a discussion of the interpretation of corporate exceptions in the courts, see Comment, 23 MD. L. REV. 51, 56 (1962).

62. *Gelber v. Kugel's Tavern*, 110 N.J. 191, 89 A.2d 654, 657 (1952).

63. 254 N.Y. 319, 172 N.E. 521, 74 A.L.R. 205 (1930).

64. 172 N.E. at 522. See also *Rosen v. Columbia Savings & Loan Ass'n*, 29 Misc. 2d 329, 213 N.Y.S.2d 765 (1961). In that case, a partnership (composed of the plaintiffs) conveyed land to a corporation for the purpose of borrowing to pay for the land. The corporation borrowed the money, and then defendant re-financed this land and made an additional loan to the corporate borrower. The corporation paid the lender a bonus which would have been usurious as to an individual borrower. The court held that "it is fundamental that a corporation used for the sole purpose of borrowing money at a rate of interest which would be usurious if an individual were the borrower is nevertheless prohibited from raising the defense of usury." 213 N.Y.S.2d at 768. (Emphasis added.)

65. 159 Md. 655, 152 Atl. 437 (1930).

66. *Id.* at 660, 152 Atl. at 439.

Requiring borrowers to incorporate in order to obtain a loan at a rate exceeding the level set in the particular usury statute can obviously lead to abuses; it can injure those who most need the statute's protection by qualifying them for the exception. The scheme became so popular in New York that the state legislature enacted a statute restoring the defense of usury to a corporation which was established in order for a home owner to obtain a mortgage loan.<sup>67</sup> This amendment was necessary to re-establish protection for borrowers in at least some of the many transactions which met the literal requirements of the exception but violated its purpose by forcing unknowledgeable borrowers to incorporate.

### C. *Inadequacy of the Corporate Exception*

Excepting corporations from the borrowers who may set up the defense of usury does not adequately do the job. It is an inartful attempt to provide that commercially knowledgeable borrowers cannot plead usury to defeat a loan contract mutually agreed upon by equal parties. On the one hand, a corporation may be no more than the alter ego of a small borrower unfamiliar with general transactions in the commercial marketplace. On the other hand, the exception for corporations is unrealistic in presuming that only corporations do not need the protection afforded by the usury statutes. In today's commercial world, there are many businesses operated as partnerships or proprietorships which are every bit as familiar with commercial and borrowing transactions as any corporation.

There is, however, no exception in the typical usury statute for a partnership or for any form of business other than the corporate form. Although the corporation may once have been the form in which most commerce was transacted, its hegemony in the business world has steadily faded. Today, certain statutes forbid some types of businesses from incorporating; tax laws have encouraged many to do business in the partnership form; and insurance is available to limit liability in a partnership to the same extent that liability is limited in a corporation.

At the heart of commercial intercourse, investment banking and securities brokerage houses are familiar with every nuance of debt financing. Furthermore, they represent large and prime borrowers from commercial banks. Yet, many investment banking houses are not incorporated. Until recently, 1953, as members of the New York Stock Exchange, they were not allowed to do business in corporate form. They would, therefore, not qualify for the corporate exception in the typical usury statute, although unquestionably such businesses do not need the protection of such statutes. In the present money market, with rates sometimes exceeding those prescribed in the usury statutes, a lender must either refuse to lend to such businesses, resort to compensating balances, or run the risk of whatever sanctions the particular statute prescribes for a usurious loan.

---

67. N.Y. GEN. OBL. LAW § 5-521(2) (1964). See also KY. REV. STAT. § 360.025 (1962).

Just as the federal income tax laws have a marked effect upon the economy and an important role in causing the present tight money situation, they also have a significant effect upon the form in which business is conducted. Tax laws encourage the use in certain industries of business forms other than the corporate form.<sup>68</sup>

Much of the business of real estate development and real estate improvement, which is heavily dependent upon financing from commercial banks and insurance companies, is carried on in partnerships and joint ventures.<sup>69</sup> The increased preference in the real estate field for the partnership form of business rather than the corporate is based upon the tax treatment of three major characteristics of the real estate business: (1) depreciation; (2) gain from sale of capital assets; and (3) refinancing of appreciation in value.

An increasingly popular tax shelter for large investors, particularly those in high personal income tax brackets, is the purchase or construction, mainly with borrowed funds,<sup>70</sup> of depreciable real estate improvements. The rent income from such improvements is largely offset by depreciation taken on an accelerated basis, together with interest on the loan and taxes on the property. For many years, the investor, if he has not incorporated the project, can receive cash flow which is offset either entirely or in large measure by deductible items and, most importantly, by the non-cash deduction for depreciation. At the end of this period, if the depreciation does not shelter the rent income, the property is often sold and any gain realized therefrom is treated as long-term capital gain.<sup>71</sup> Whatever the legislative wisdom of the depreciation tax shelter, it does provide a great inducement for such investors to use a partnership, joint venture, or sole proprietorship rather than the corporate form of doing business.

In some instances, when the depreciation deductions have decreased (*e.g.*, under the double-declining-balance method of depreciation) to the point where the rent income is not offset, the existing mortgage on the property has been substantially amortized. In a normal mortgage market, refinancing is available. If the refinancing is done while

---

68. For example, the Internal Revenue Code permits utilization of depreciation losses to individual partners or proprietors outside of their business entity and in their personal tax brackets, but does not permit such utilization by individual stockholders of a corporation. The Internal Revenue Code further discourages abuse of the corporate form through punitive Code sections such as INT. REV. CODE OF 1954, §§ 531-35 (taxing unreasonable accumulations of surplus by corporations) and §§ 541-45 (taxing undistributed income of personal holding companies).

69. See generally, Westfall, *Corporate Analogues in Partnership Taxation*, 80 HARV. L. REV. 765 (1967).

70. Losses, including depreciation losses, in, for example, the partnership form of doing business cannot exceed the adjusted basis of the individual partner's capital interest. INT. REV. CODE OF 1954, § 704(d). However, this basis is increased, to the extent of a partner's proportionate share of partnership liabilities, where the partner is liable for a proportionate share of loans to the partnership or where no partner is liable for such loans. INT. REV. CODE OF 1954, § 752.

71. An important exception is represented by INT. REV. CODE OF 1954, § 1250, which was added to the Internal Revenue Code in 1964 to check the use of the tax shelter device. Under § 1250, a certain portion of the gain on sale, varying with the length of the holding period of the property and improvements made to the property, is recaptured as ordinary income if any of the accelerated methods of depreciation were employed.

in the corporate form, the proceeds of the loan are locked in the corporation and can be obtained by the stockholders only upon payment of dividends or liquidation. Even then, because of the collapsible corporation problem, the proceeds may be taxed not as long-term capital gains but as ordinary income.<sup>72</sup> If, on the other hand, refinancing is done when the property is held and operated in the form of a partnership, joint venture, or sole proprietorship, the refinancing mortgage proceeds come through to the owners tax free.

Financing such unincorporated real estate businesses in a tight money market where the going rate of interest exceeds the statutory rate again presents the lender with a dilemma. Does he make a loan risking the defense of usury, or does he refuse to make the loan? Of course, the lender may solve the problem by requiring the borrower to incorporate. But why should commercially knowledgeable businessmen have to indulge in such a device? Why should a businessman have to tailor the form of his business to the usury law when other salient factors favor operation in another form?

It can no longer be assumed that most of the nation's commerce is carried out in corporate form, that all who do business in corporate form are knowledgeable, or that all who do business in non-corporate form are so lacking in knowledge that they need to be protected by the usury statutes. Certainly, it is illogical to conclude that a prospective borrower who selects a non-corporate form of doing business for sound business reasons nevertheless needs the protection of the usury statutes and must be bound by a statutory level of interest in obtaining a loan.

### III. THE NEED FOR REFORM

The present tight money market and increasingly high rates of interest have now driven the available funds to the point where the interest which must be charged by the lender violates many state usury statutes. In most jurisdictions, valid loans can be made only to corporate borrowers. In view of these factors, many state legislatures are being urged to revise their usury laws at their next sessions. In most cases, the legislatures are being asked only to increase the statutory interest rate, for example, from 6 to 8 per cent.

#### A. *Need for New Approach*

There is an undeniable need for legislative revision of state usury legislation. Merely raising the statutory rate for non-corporate borrowers, however, will not solve the problems inherent in most of the pres-

---

72. A "collapsible" corporation is defined in the Internal Revenue Code as a corporation whose stockholders formed or use it "principally" to produce property or to purchase inventory with a view toward selling or exchanging their stock or causing distribution before the corporation realizes "a substantial part of the taxable income to be derived" from its property. INT. REV. CODE OF 1954, § 341(b)(1). Where a corporation meets these tests, the gain to its stockholders on a redemption, sale or exchange of stock is treated as ordinary income rather than as capital gain. INT. REV. CODE OF 1954, § 341(a).

ent usury statutes. First of all, an increased rate which a legislature may adopt at its next session may be as unrealistic five years from now as the currently popular 6 per cent or 7 per cent rates are today. Second, whatever rate is set and however much it may be increased, it will apply only to non-corporate borrowers, and the fiction and artificiality of the corporate exception will continue.

There is no justification for discriminating against knowledgeable non-corporate borrowers who desire to pay the higher interest rate, but who, because only corporations are excepted from the operation of usury statutes, cannot persuade lenders to make the loan. Nor is there any justification for allowing a knowledgeable businessman who has been able to obtain a loan at today's going rates to assert a defense of usury in a suit on the loan merely because he is doing business in non-corporate form.

Legislatures should not merely patch up existing laws, but should take the present opportunity to completely revise usury statutes to conform to the following criteria:

- (1) Usury statutes should be uniform among the states.<sup>73</sup>
- (2) The defense of usury should not be available to borrowers who are conversant with general commercial transactions.
- (3) The defense of usury should be available to borrowers who are not conversant with general commercial transactions.
- (4) Limitations on chargeable interest should be flexible so that they can reflect the changing interest rates resulting from supply and demand interactions.

### B. *Proposed Model Statute*

While the need for re-examination of the entire field of lending and finance legislation is obvious, the unhappy memories of the recent tight money market indicate that the most pressing problem today is to insure that businessmen are not arbitrarily restricted by state usury legislation in their efforts to acquire funds for business purposes. Nevertheless, any proposal in this area must be viewed and evaluated in the framework of a general usury statute. Moreover, even borrowers and lenders of funds for non-business purposes should be permitted a certain amount of independence in negotiating a rate of interest which will take into account the current state of the market, rather than a rate which is arbitrarily limited by statute. With these considerations and

---

73. Uniformity is necessary to facilitate an "increasing nationalization of commerce" in which many business transactions affect parties and interests in more than one state. *McGee v. International Life Ins. Co.*, 355 U.S. 220, 223 (1957). Under one view, a contract to which the defense of usury is asserted will be upheld if it would be valid under the laws of any state with which it has "a substantial relationship." *RESTATEMENT (SECOND), CONFLICT OF LAWS* § 334(d) (Tent. Draft No. 6, 1960). In a tight money market, non-uniformity in usury statutes encourages a borrower to shop for a loan having a situs in the state with the more liberal usury statute. On the other hand, this situation discourages loans by lending institutions in those states having stricter usury statutes.

the criteria outlined above in mind, the following model statute is proposed:

A. General Rule

(1) In all contracts made within this state and not governed by \_\_\_\_\_,<sup>74</sup> it shall be lawful for the parties to agree that there shall be paid, charged, and/or received, for money loaned to or in any manner due and owing from any person, interest at an annual rate not exceeding six per cent, or two times the Federal Reserve Rediscount Rate in effect at the time such contract is made in the Federal Reserve district in which the principal place of business of the lender is located, whichever is greater.<sup>75</sup>

(2) It shall be unlawful for the parties to agree, in any such contract, that interest shall be paid, charged, and/or received in excess of that specified in paragraph (1) hereof, except as provided in subsection B.

B. Business Loans

In all written contracts involving loans of not less than \$10,000.00 made within this state and not governed by \_\_\_\_\_,<sup>76</sup> it shall be lawful for the parties to agree to pay, charge, and/or receive any rate or amount of interest for money loaned to any person solely for the purpose of carrying on a business in which he shall be then engaged or for the purpose of acquiring a business in which he shall immediately upon acquisition become engaged, provided that such written contract shall separately state and clearly designate all charges for interest.

C. Definitions

As used in this section, the following terms shall have the following meanings:

(1) "Person" shall mean an individual, a corporation, a business association, a co-partnership, a limited partnership, a joint venture, a trust, an estate, a partner, trustee or executor thereof, or any combination of the foregoing.

(2) "Interest" shall mean the total amount of money and the fair value of property and services paid, conveyed, or per-

---

74. Here list statutes applicable to specific transactions such as small loans, retail installment sales, etc. The Commissioners on Uniform State Laws are presently considering a uniform retail installment sales act.

75. Six per cent and two times the Federal Reserve Rediscount Rate, which would presently amount to 8 per cent, are figures which are fairly representative of present statutory rates. Perhaps slightly different figures are more appropriate. In any case, the most important consideration is that the two figures be uniform from state to state. Coordination in establishing uniform figures could be facilitated through a group such as the Commissioners on Uniform State Laws.

76. Here re-list the statutes listed in A(1), note 74 *supra*.

formed or to be paid, conveyed, or performed, as consideration or compensation for the loan of money whether stated as a percentage of the loan, a percentage of the balances of the loan outstanding, or otherwise.

(3) "Rate" shall mean a percentage of the principal amount of the loan from time to time outstanding and unpaid.<sup>77</sup>

(4) "Federal Reserve Rediscount Rate" shall mean the rate which the Federal Reserve district bank for the district in which the principal place of business of the lender is located charges for loans which it makes to its member banks.

(5) "Business" shall mean any transaction or transactions in which a person is regularly engaged, or upon such person's acquisition thereof will be regularly engaged, for the production of income.

The model statute abandons any distinction between corporate and non-corporate borrowers. Instead, it distinguishes between "business" and "non-business" borrowers based on the premise that a borrower of funds for business purposes is, or should be, generally familiar with the fundamental commercial transactions, such as borrowing money, which are part of engaging in business.<sup>78</sup> Basically, as the discussion of the corporate exception points out, there is really no reason why someone should not be able to borrow money in the course of business at any rate of interest which he feels the state of his business will permit him to pay.

Borrowing money, like purchasing raw materials, acquiring office or factory space, or hiring and paying employees, is just one of many transactions which someone must expect to encounter in the course of carrying on a business for profit. While a business borrower of particularly poor judgment might well agree to repay a loan at a rate of interest which his business cannot afford, such a businessman might also purchase inferior materials, sign a particularly disadvantageous lease, or employ dishonest employees. All of these transactions necessarily involve matters of business judgment. In most cases, successful businessmen will realistically assess the factors involved in

---

77. Obviously, any new statute in this area should specify the method by which interest will be calculated. The model statute adopts the "simple interest" method of calculation, which most clearly discloses to the borrower the price which he will be paying for the borrowed money. Under this method, the borrower is charged interest only on the unpaid balance of the principal. Thus, he pays interest for the borrowed money only as long as he has its use.

Some states, however, statutorily authorize the "flat interest" method of calculation. See, *e.g.*, MD. CODE ANN. art. 49, § 1A (1957); MISS. CODE ANN. art. 4A, § 5590 (Supp. 1964). Under this method, the interest on the entire principal is computed in advance for the complete period of the loan, then added to the principal, and the total of principal and interest is divided by the number of payments to be made in order to reach the amount of each payment. Thus, a borrower at a stated rate of 6 per cent may end up paying almost 12 per cent.

Wisconsin provides by statute one rate of interest, 6 per cent, when interest is computed by the "simple" method, and another rate, 12 per cent, when it is computed by the "flat" method. WIS. STAT. ANN. § 115.05(1) (Supp. 1967).

78. See Note, 30 ST. JOHN'S L. REV. 126, 132 (1955).



each transaction, especially those involving borrowing substantial amounts of money. There is no reason to take from these successful and knowledgeable businessmen the unlimited right to obtain money, even at high rates of interest, merely in order to protect businessmen who are probably making poor business decisions in other contexts as well. Furthermore, it is reasonable to presume that an interest rate which a knowledgeable business borrower agrees to pay has been fairly negotiated between equal parties in the same manner as a businessman negotiates other contractual provisions.

Perhaps the ideal manner of determining whether to apply the protection of a usury statute would be to distinguish between borrowers who knew and understood the consequences of what they were doing at the time of the loan and those who did not. Unfortunately, a true distinction between "knowledgeable" and "unknowledgeable" borrowers is probably unworkable. Even if the courts were able to deal with such an elusive standard after a borrower had agreed to and then defaulted on a loan, it would be almost impossible for a prospective lender, before the loan is transacted, to be certain whether his borrower "knows" what he is doing or not. The number of factors which would be involved in such a determination are virtually innumerable.

A distinction between loans for business purposes and loans for non-business purposes, however, establishes a substantially ascertainable standard, one which is adopted by the new Illinois usury statute.<sup>79</sup> To be sure, knowledgeable individual borrowers will still borrow some money for non-business purposes, and will, therefore, under the model statute, be protected and afforded the defense of usury. By the same token, some business loans may involve unsophisticated borrowers. In this respect, however, the minimum loan provision of \$10,000.00 will protect many such borrowers. Small loan laws in most jurisdictions give additional protection. In the final analysis, the model proceeds on the sound proposition that a businessman should not be allowed to negate his contract to pay an agreed upon and clearly stated rate of interest any more than he should be allowed to rescind any other of the many contracts he must frequently and regularly enter into in the course of his business.

In considering a statute which would protect the naive but not the sophisticated borrower, one solution might appear to be a waiver provision. The present case law, permitting the borrower to incorporate solely for the purpose of bringing the loan within the statute's corporate exception, is based upon the borrower's exercising an option, and this is essentially equivalent to a waiver. Nevertheless, it is clear that contractual waivers are not recognized in the field of usury.<sup>80</sup> The borrower, by incorporating, may elect not to have the statute apply; or, by voluntarily paying the usurious interest<sup>81</sup> or by failing to plead usury specifically,<sup>82</sup> he may waive the defense which the statute affords him.

79. ILL. STAT. ANN. ch. 74, § 4(c) (Supp. 1966).

80. See, *e.g.*, *Ostiguy v. A. F. Franke Constr., Inc.*, 55 Wash. 2d 350, 347 P.2d 1049, 1053, 81 A.L.R.2d 1271 (1959). See also 6A CORBIN, CONTRACTS § 1515, at 731 (1962).

81. See, *e.g.*, *Hawthorne v. Walton*, 72 Nev. 62, 294 P.2d 364, 365-66 (1956).

82. See, *e.g.*, *Ionic Petroleum, Ltd. v. Third Finance Corp.*, 411 P.2d 492, 497 (Okla. 1966).

He may not, however, promise in advance that he will not raise the defense of usury. Allowing such a contractual waiver in the case of the naive borrower would eliminate the statute's protection where it is most needed. If the law must protect the unknowledgeable borrower from his contract to pay usurious interest, it must also protect him against a contract waiving his defense against performing his original contract. On the other hand, there is no justification for paternalistically protecting a knowledgeable borrower or even allowing him the choice through election or waiver of being able to negate his contract to pay the interest mutually agreed upon.

In addition, the model statute provides a flexible interest rate for non-business loans. Flexibility could also be realized by establishing a less objective standard than the fixed percentage rates commonly employed in today's usury statutes. By the Moneylenders Act of 1900,<sup>83</sup> for example, England, not having a usury statute as such, empowered the equity courts to set aside interest charges which were "excessive" or loan transactions which were "harsh and unconscionable."<sup>84</sup> Obviously, this has led to judging each case "by its particular facts,"<sup>85</sup> so that lenders act at their peril or at least without sufficient objective standards for them to know in advance of litigation whether their loans are valid.<sup>86</sup> The model statute is designed to provide for flexibility without sacrificing the certainty which lenders need.

---

83. 63 & 64 Vict. c. 51.

84. *Id.* at § 1(1).

85. Blair v. Buckworth, 24 T.L.R. 474 (C.A. 1908).

86. In Blair v. Buckworth, 24 T.L.R. 474 (C.A. 1908), the court concluded that the lender "took advantage" of the borrower by exacting a 6 per cent rate of interest. *Id.* at 476. However, in Carrington's, Ltd. v. Smith, [1906] 1 K.B. 79, the court upheld a loan of £150 at 75 per cent where the borrower had agreed to the lender's terms "without ever intending to comply with them, but intending all along to set up . . . the Moneylenders Act and to try to get off on paying some small rate of interest, knowing well that the plaintiff never would have made him the advance on such terms." *Id.* at 82-83.

Although the courts concluded that no particular rate of interest was per se excessive since Parliament had intentionally avoided a maximum rate of interest, Carrington's, Ltd. v. Smith, [1906] 1 K.B. 79, 88, it soon became apparent that some sort of upper limit had to be established. Accordingly, in 1927, Parliament passed a second Moneylenders Act, 17 & 18 Geo. 5, c. 21, which not only required moneylenders to take out excise licenses, but also established a presumption that interest of more than 48 per cent is "excessive" and renders the entire transaction "harsh and unconscionable." *Id.* § 10-(1). Since then, the courts have held that it is for the lender to prove that a rate of more than 48 per cent is reasonable. B. S. Lyle v. Pearson, [1941] 2 K.B. 391, 397. In Reading Trust, Ltd. v. Spero, [1930] 1 K.B. 492, the court upheld a lender who proved that the borrower had sought funds to provide working capital for a "speculative business," and had given no security, only promissory notes; that two of the loans were for short terms, "when the rate of interest per annum is deceptive"; and that there was no evidence of any misrepresentations or undue pressure by the lender, or of any weakness or lack of understanding by the borrower. *Id.* at 503-04.

However, the English courts have been especially ready to strike down loans with inordinately high interest charges where the lender has not scrupulously adhered to other provisions of the statute. See Edgware Trust Ltd. v. Lawrence, [1961] 1 W.L.R. 1354 (60 per cent); J. W. Grahame (English Financiers) Ltd. v. Ingram, [1955] 1 W.L.R. 563 (80 per cent).

Thus, the problems which England has faced in interpreting the "harsh and unconscionable" standard are similar to the problems which would be encountered in attempting to delineate a distinction between "knowledgeable" and "unknowledgeable" borrowers. In addition, it should be noted that the English courts have concluded that the fact that the borrower "knew all about" the transaction into which he was entering is only one element in considering "whether the transaction [is] harsh and unconscionable." Blair v. Buckworth, 24 T.L.R. 474, 476 (C.A. 1908).

Tying the maximum permissible interest rate for non-business loans to the Federal Reserve rediscount rate will insure that, even in a tight money situation, borrowers and lenders will be able to agree upon a legal rate of interest without recourse to subterfuge. Providing for the statutory rate to ride up and down with the rediscount rate assumes, of course, some sort of nexus between the rediscount rate and the money market itself. While there is not a demonstrably precise one-to-one relationship, long experience has shown that the rediscount rate responds to, and frequently initiates, changes in the money market. Although each Federal Reserve district bank establishes its own rediscount rate for member banks within its district, its decisions are subject to the approval of the Federal Reserve Board in Washington,<sup>87</sup> which seeks to promote as much uniformity within the system as possible. Thus, the rediscount rates for all Federal Reserve districts have been uniform almost 96 per cent of the time in the last 25 years.<sup>88</sup>

There is a good argument that if a statutory interest rate is to be tied to some particular money rate, it should be the prime rate. To be sure, the prime rate more faithfully reflects alterations in the money market largely because it is such an integral factor in the market. However, each bank has in effect its own prime rate; and while in the past the prime rates of almost all major banks have been the same, recent months have shown that a "split" prime rate can persist for a substantial period. Moreover, to tie a statutory interest limit to the prime rate would permit the nation's largest lenders to establish their own limit on the interest they charge.

#### IV. CONCLUSION

Now is the time to recognize that, in general, our usury laws are archaic and badly in need of fundamental overhaul. The moral premises on which they were originally based are no longer valid. They have been patched and repatched time and again like an old quilt and then shot through with exceptions whenever they threatened to inhibit commerce. They are inadequate in times of tight money and discriminatory in their operation. They vary from state to state at a time when many borrowers and many lenders are engaged in multi-state activity. With legislatures throughout the nation considering amendments to their usury statutes in light of the recent monetary situation, a timely opportunity is presented to furnish borrowers, lenders, and commerce in general with enlightened, equitable, and modern usury legislation.

---

87. Federal Reserve Act § 14(d), 38 Stat. 265 (1913), 12 U.S.C.A. § 357 (1945).

88. Computed from figures in 1967 FED. RESERVE BULL. 399.