Usury in California

In 1918, an initiative measure, now known as the Usury Law, became a part of the statutory law of this state. It has been the opinion of practically all economists from the time of Jeremy Bentham that general statutory maximums for loan charges, popularly known as "usury laws," are not only futile, mischievous and unnecessary, but also that they actually lead to further oppression of the very class which they are designed to protect, namely indigent persons who must borrow in order to procure the necessities of life.

It does not seem that the relative merits of usury legislation were fairly presented to the electorate in 1918, for arguments such as those which were advanced in support of the California initiative measure, will not, it is submitted, bear analysis. But, however that may be, it is not the purpose of this paper to discuss the expediency of usury statutes. By the enactment of a usury act a new and relatively large field of law has been incorporated into the law of California. It is therefore of present concern that the meaning of that act be as clearly stated, and that the extent and limits of that new field be as accurately defined, as can be done.

1 Cal. Stats. 1919, p. lxxxvii.
2 Jeremy Bentham, author of Letters in Defense of Usury, the polemic which "so effectively silenced all the arguments in favor of statutory maximums for interest rates" that usury acts were repealed in England and generally on the continent. See F. W. Ryan, Usury and Usury Laws, pp. 57, 63 et seq. (1924) for a review of the prevailing economic theories.
3 For a complete statement of the evils which usury laws are enacted to remedy; for an exhaustive and unbiased survey of usury laws, their history and their futility to effect the ends which prompted their enactment; and for a rational suggestion for obviating the evils (which usury laws only aggravate) by the adoption of the Uniform Small Loans Act, see F. W. Ryan, Usury and Usury Laws (1924). See particularly "Conclusions" III, IV, VI, VII, XXIII, XXIV, id., p. 180 et seq.
4 Mr. Ryan summarizes his reasons for stating that statutory maximums are wrong in principle as follows:
   "1. They are based upon the false assumption that it costs the same to make all loans, thus ignoring differences in kinds of loans, risks involved, duration and size of loan, and other factors.
   "2. They are powerless to control the market rate of pure interest on productive loans.
   "3. They are mischievous and detrimental in their effects upon commercial and financial relations.
   "4. They set up a rigid false definition of usury which relegates the true definition of usury to the background. This defeats the social purpose of the laws, namely to prevent moral usury."

F. W. Ryan, op. cit., p. 143.
4 See Amendments to Constitution and Proposed Statutes with Arguments Respecting Same, to be submitted to the Electors of the State of California at the General Election on Tuesday, November 5, 1918, issued by Frank C. Jordan, Secretary of State, September 23, 1918; commented on by F. W. Ryan, op. cit., p. 89.
Surprisingly few cases involving the California Usury Law have reached the appellate courts, and by these few only a fraction of the numerous mooted points have been settled. Nevertheless, it seems advisable, in a work of this nature, to first review the California adjudications which bear directly upon the subject of usury.

CONSTITUTIONALITY OF THE USURY LAW

The California Usury Act is anything but a model statute and section 3, in particular, is to say the least exceedingly ambiguous. A fair reading of this section, however, indicates that it was intended to provide therein, among other things, for the regulation of the commissions of loan brokers. In Wallace v. Zinman6 the constitutionality of the provisions relating to the charges of loan brokers was attacked successfully on two grounds.

In the first place it was contended by the defendant and conceded by the Supreme Court.6 that the provisions relating to the charges of loan brokers were not mentioned in the title to the act and were hence void under section 24 of Article IV of the California Constitution which provides: "Every act shall embrace but one subject, which subject shall be expressed in its title. But if any subject shall be embraced in an act and shall not be expressed in its title, such act shall be void only as to so much thereof as shall not be expressed in its title . . . ."

At first blush this conclusion seems sound. The California Usury Law is entitled, "An act to be known as the usury law, relating to the rate of interest which may be charged for the loan or forbearance of money, goods or things in action, or on accounts after demand, or on judgments, providing penalties for the violation of the provisions hereof and repealing" certain code sections. It is apparent that the title purports to set out specifically that to which the act relates and certainly in view of the principle, expressio unius est exclusio alterius, it can not be seriously contended that charges of loan brokers are expressly embraced in the title. However, it does appear from the title, that the act is to be known as the "usury law" and the court, in Wallace v. Zinman, not only considered the title as if it had read, "an act relating to usury," but based its decision on the premise that the regulation of the charges of loan brokers is not included in the subject "usury."7 The court's assumption as to the connotation of the term "usury" is at least questionable.

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6 (March 4, 1927) 200 Cal. 585, 254 Pac. 946.
6 200 Cal. 585, 590.
7 200 Cal. 585, 590.
It is generally said that usury is the asking, taking, receiving, or exacting, by the lender of the borrower, of a higher rate of interest or a greater profit than that allowed by law for the loan or forbearance of the use of money.\(^8\) Strictly speaking, this definition is accurate.\(^9\) It seems to follow that, since a third party broker does not lend money, but merely serves as an intermediary through whom the lender and borrower deal, his charges for negotiating a loan or forbearance are never "usury"; his charges are for procuring the loan or forbearance, not for the lending or forbearance of the use of money. But it is noteworthy that it has been the legislative practice for centuries to include within usury statutes provisions regulating the commissions of third party loan brokers. Thus in the Statute of 13 Elizabeth, c. 8 (1570), the second usury law in English history,\(^10\) there was a provision\(^11\) regulating the activities of brokers, and in the third English usury act, Statute 21 James 1, c. 17 (1623), the commissions of brokers were expressly limited to 5 shillings per £100.\(^12\) So in the Statute of 12 Anne (Stat. 2) c. 16 (1713), which constituted the English usury law until, because of the efforts of Jeremy Bentham and other economists, it was repealed by the Statute of 17 & 18 Victoria (1854) c. 90, there was an almost identical limitation on the commissions of brokers. Similarly, in the early colonial\(^13\) and later state\(^14\) acts relating to usury—and

\(^8\) Clemens v. Crane (1908) 234 Ill. 215, 84 N. E. 884.

This is the definition of "legal usury" as distinguished from "moral usury." The latter is defined as the exaction of a rate of interest or profit for the use or forbearance of the use of money for "consumptive" purposes which is unconscionable in view of the circumstances of the peculiar case and which exaction is made possible only because of the necessity of the borrower. See F. W. Ryan, op. cit., p. 14.


\(^9\) According to the definitions cited supra, n. 8, the taking or receiving must be by the lender, i.e., if any person other than the lender receives a profit because of the loan or for obtaining the loan, such profit is not technically usury because not exacted or received by the lender.

\(^10\) The first usury act which may properly be called such was the Statute (1545) 37 Henry VIII, c. 9.

\(^11\) (1575) 13 Eliz. c. 8, § 4: "And be it further enacted, that all brokers, solicitors and drivers of bargains for contracts or other doings against said statute now revived, whereupon shall be reserved or taken more than after the rate of ten pounds for the loan of one hundred pounds for a year, shall be to all intents and purposes judged, punished and used as counsellors, attorneys, or advocates in any case of praemunire."

\(^12\) (1623) 21 James I, c. 17, § 3.


\(^14\) 4 Comp. Stats. of New Jersey (1910) p. 5706, § 5; Consolidated Laws of New York (1909) Art. 25, Interest and Usury.
entitled usury acts—are to be found limitations on the charges permissible by loan brokers. Of course, when the earlier laws were enacted, no such mandatory provisions as that found in section 24 of Article IV of the California Constitution existed. Nevertheless, the only purpose of the provisions in section 24 of Article IV is to protect members of the legislature and public against fraud from deceitful and misleading titles.\textsuperscript{15} It is difficult to perceive how the people could be misled because an act entitled an usury law should contain regulations of the charges permissible by loan brokers, when historically, at least, “usury” has connoted not only illegal interest but all charges, including brokers’ commissions, exacted of a necessitous borrower. Yet, the Supreme Court, speaking through Mr. Justice Preston, says: “... it is too clear for controversy that the subject matter of the provision of the act here under consideration [regulation of loan brokers’ commissions] is nowhere referred to directly or indirectly in the title to said statute. The subject covered by the title is exclusively ‘usury.’”\textsuperscript{16} This vigorous language is hardly warranted in the light of the history of usury laws, and it seems that on this issue an opposite result might well have been reached.\textsuperscript{17}

The second reason for holding the provisions of the usury law relating to the commissions of loan brokers unconstitutional rests on well established principles. Section 3 of the act classifies loans and regulates the fees of brokers who negotiate such loans in a manner which for the purpose of clarity will be expressed as follows, viz.:

\textsuperscript{15}“If the title contains a reasonable intimation of the matters under legislative consideration, the public cannot complain.” Ex Parte Liddell (1892) 93 Cal. 633, 637, 29 Pac. 251; Abeel v. Clark (1890) 84 Cal. 226, 24 Pac. 383; In re Lake (1928) 55 Cal. App. Dec. 745, — Pac. —.

\textsuperscript{16}200 Cal. 585, 590.

\textsuperscript{17}Where the title suggests to the mind the field of legislation which the text of the act includes, the title will not be held misleading or insufficient. People v. Jordan (1916) 172 Cal. 391, 394, 156 Pac. 451.

However, judicial interpretations of § 24 of Art. IX of the California Constitution do not warrant a generalization as to its exact meaning. This constitutional provision has been construed with varying degrees of liberality. See McClure v. Riley (1926) 198 Cal. 23, 243 Pac. 429; Fleming v. Superior Court (1925) 196 Cal. 344, 238 Pac. 88 (a most liberal case); Hill v. Board of Supervisors (1917) 176 Cal. 84, 167 Pac. 514; Estate of Elliott (1913) 165 Cal. 339, 132 Pac. 439; Provident Mutual Building and Loan Ass’n v. Davis (1904) 143 Cal. 253, 76 Pac. 1034; Pratt v. Brown (1902) 135 Cal. 649, 67 Pac. 1082; In re Werner (1900) 129 Cal. 567, 62 Pac. 97; Ex Parte Liddell, supra, n. 15; Abeel v. Clark, supra, n. 15; People v. Parks (1881) 58 Cal. 624; In re Lake, supra, n. 15.
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1. Loans for periods of six months or longer:

   (a) If the loan is secured by any security except corporation bonds or municipal or other public bonds, the broker may charge a commission not exceeding five per cent of the loan if for one thousand dollars or less and not exceeding three per cent of the loan if for an amount in excess of one thousand dollars.

   (b) If the loan is secured by corporation bonds or municipal or other public bonds, or if the loan is not secured at all, the broker may charge what commission he pleases.

2. Loans for periods of less than six months:

   (a) If the loan is secured by a mortgage or pledge of real estate the broker may charge a commission of either three per cent or five per cent depending upon whether the loan is in excess of one thousand dollars.

   (b) If the loan is secured by other than a mortgage or pledge of real estate or if the loan is unsecured, the broker is forbidden to charge any commission whatever.  

A cursory examination of the foregoing classification is sufficient to convince one that it is altogether arbitrary. Consequently the Supreme Court in Wallace v. Zinman had no hesitancy in declaring that all provisions of the Usury Law relating to the commissions of loan brokers were unconstitutional and void both under sections

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18 The part of § 3 of the Usury Law here under discussion actually reads as follows:

"Any person, company, association or corporation, who shall ask, demand, receive, take, accept or charge more than twelve per centum per annum upon the sum of money actually loaned for the forbearance, use or loan thereof, when the repayment of the money loaned shall be secured by a mortgage, trust deed, bill of sale, assignment, pledge, receipt or other evidence of debt, except corporation bonds, and municipal and other public bonds, upon property, real or personal or by assignment of wages, or ask, demand, receive, take, accept or charge more than an amount equal to five per cent so actually loaned and secured in all sums of one thousand dollars or less, and three per cent on all sums over one thousand dollars in full for all examinations, views, fees, appraisals, commissions, renewals made within one year from date of loan and charges of any kind or description whatsoever, except abstracts of certificates of title charges made under the Torrens land law or otherwise, in the procuring, making and transacting of the business connected with such loans, or who shall ask, demand, receive, take, accept or charge any fee, bonus, or commission whatsoever for the use of loan or the procuring of such loan of any sum of money for a shorter period than six months when said loan is not secured by a mortgage or pledge upon real estate . . . shall be guilty of a misdemeanor."

11 and 21 of Article I of the California Constitution and under the 14th Amendment to the Constitution of the United States. Without indulging in a lengthy discussion of these constitutional provisions, it will suffice to state that generally speaking they do not require a law to apply equally to all persons or things, nor do they forbid legislation with regard to a particular class provided such classification is founded upon an extrinsic distinction which bears some relation to and furnishes cause for such particular legislation, and provided further that the law applies alike to all members of the class. If this test of constitutionality is applied to the classification made in the Usury Law with regard to loan brokers, that classification must fall as being founded upon distinctions which are palpably irrational. As far as brokers' commissions are concerned, no reasonable distinction can be made between loans secured by corporation or municipal bonds and loans otherwise secured, or between loans secured by mortgages of real property and loans secured by mortgages or pledges of personalty, nor is it rational to permit a broker who negotiates an unsecured loan for a longer period than six months to charge what commission he sees fit but to deny any fees to the broker who procures a like loan for a period less than six months.

Having determined in Wallace v. Zinman that so much of the Usury Law as pertained to loan brokers was unconstitutional, the Supreme Court in In re Washer was called upon to decide the validity of the provisions of the act relating to interest rates. Sections 1 and 2 of the California statute unequivocally deny to lenders generally the right to charge a rate of interest in excess of twelve per cent per annum. But in that part of section 3 which prescribes the penalties for the violation of the act it is provided that “any

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20 Cal. Const., Art. I, § 11: "All laws of a general nature shall have a uniform operation."
21 Cal. Const., Art. I, § 21: "No special privileges or immunities shall be granted which may not be altered, revoked, or repealed by the legislature, nor shall any citizen, or class of citizens, be granted privileges or immunities which, upon the same terms, shall not be granted to all citizens."
22 U. S. Const., Amendments, Art XIV, § 1: "... No State shall... deny to any person within its jurisdiction the equal protection of the laws."
25 (March 4, 1927) 200 Cal. 598, 254 Pac. 951.
person . . . who shall . . . charge more than twelve per centum per annum upon the sum . . . loaned . . . when the repayment . . . shall be secured by a mortgage . . . or other evidence of debt, except corporation bonds, and municipal and other public bonds, . . . shall be guilty of a misdemeanor . . . .” In other words, this particular clause of section 3 seems to permit the charging of an unrestricted rate of interest on loans which are secured by corporation or municipal bonds. It was therefore contended by the petitioner in In re Washer that the Usury Law was unconstitutional because it arbitrarily discriminated against lenders who loan upon other securities than corporation or municipal or other public bonds. The court conceded that if section 3 stood alone the act would be in violation of sections 11 and 21 of Article I of the California Constitution and of the 14th Amendment to the Constitution of the United States,” because “there is no economic, intrinsic, constitutional difference between loans secured by corporate bonds or municipal or other public bonds and loans secured by other forms of security or collateral.” But in view of the fact that sections 1 and 2 of the statute obviously apply to all loans, whether secured or unsecured, and of the further fact that violations of sections 1 and 2 are also made misdemeanors, the court, following well recognized principles of statutory construction, decided that the objectionable clause in section 3 should be regarded as surplusage and that it, together with the provisions relating to loan brokers, could be readily severed from the act, leaving the remaining portions of the Usury Law in all respects valid and subsisting.

After its disposition of the constitutional issues presented in Wallace v. Zinman, and In re Washer, the Supreme Court, in its decision in the latter case restated section 3 of the Usury Law in the light of its construction of that section. For purposes of future reference and in order that the material provisions of the Usury Law which have been declared constitutional may be visualized as a coherent statute, it seems advisable to here set out sections 1 and 2

24 See supra, notes 20, 21, 22.
27 200 Cal. 605.
28 People v. Monterey Fish Products Co. (1925) 195 Cal. 548, 556, 234 Pac. 398; School Corp. of Andrews v. Heiney (1912) 178 Ind. 1, 98 N. E. 628; 1 Lewis' Sutherland on Statutory Construction, 2 ed., § 296 et seq., p. 576 et seq. (1904); 5 Cal. Juris. § 70, p. 644; 25 R. C. L. § 244, p. 1003. See also 2 Lewis' Sutherland on Statutory Construction, 2 ed., § 376, p. 721 (1904) (quoted with approval in In re Haines (1925) 195 Cal. 605, 613, 234 Pac. 883).
29 200 Cal. 598, 605, 609.
30 200 Cal. 598, 608.
as they read in the statute, together with the court's restatement of section 3.

"Sec. 1.\textsuperscript{31} The rate of interest upon the loan or forbearance of any money, goods or things in action or on accounts after demand or judgments rendered in any court of this state, shall be seven dollars upon the one hundred dollars for one year and at that rate for a greater or less sum or for a longer or shorter time; but it shall be competent for parties to contract for the payment and receipt of a rate of interest not exceeding twelve dollars on the one hundred dollars for one year and not exceeding that rate for a greater or less sum or for a longer or shorter time, in which case such rate exceeding seven dollars on one hundred dollars shall be clearly expressed in writing.

"Sec. 2.\textsuperscript{32} No person, company, association or corporation shall directly or indirectly take or receive in money, goods or things in action, or in any other manner whatsoever, any greater sum of any greater value for the loan or forbearance of money, goods or things in action than at the rate of twelve dollars upon one hundred dollars for one year; and in the computation of interest upon any bond, note, or other instrument or agreement, interest shall not be compounded, nor shall the interest thereon be construed to bear interest unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith. Any agreement or contract of any nature in conflict with the provisions of this section shall be null and void as to any agreement or stipulation therein contained to pay interest, and no action at law to recover interest in any sum shall be maintained and the debt can not be declared due until the full period of time it was contracted for has elapsed."

"Sec. 3.\textsuperscript{33} Every person, company, association or corporation, who for any loan or forbearance of money, goods or things in action shall have paid or delivered any greater sum or value than is allowed to be received under the preceding sections, one and two, may either in person or his or its personal representative, recover in an action at law against the person, company, association or corporation who shall have taken or received the same, or his or its personal representative, treble the amount of the money so paid or value delivered in violation of said sections, providing such action shall be brought within one year after such payment or delivery. And any person, company, association or corporation who shall violate the provisions

\textsuperscript{31} Cal. Stats. 1919, p. lxxvii.
\textsuperscript{32} Cal. Stats. 1919, p. lxxxvii.
\textsuperscript{33} In re Washer, supra, n. 25, 200 Cal. 608.
of sections one and two of this act shall be guilty of a misdemeanor and upon conviction thereof shall be punished for the first offense by a fine of not less than twenty-five dollars nor more than three hundred dollars, or by imprisonment not more than six months, or by both such fine and imprisonment, and for each subsequent offense and conviction shall be punished by a fine not less than one hundred dollars nor more than five hundred dollars and by imprisonment not less than six months nor more than one year. The penalties herein provided for the violation of this section and said sections one and two shall apply to and be imposed upon each member of any unincorporated company, association, or of any copartnership and upon each officer and director of a corporation who shall violate either of said sections.”

RIGHT OF CORPORATIONS TO PLEAD USURY

When the court, in In re Washer was considering the clause of section 3, above referred to, which seems to except from the operation of the act loans secured by corporation or municipal bonds, it was urged by the respondent that this particular clause was intended to permit corporations and municipalities to sell bonds of their own issue at discounts greater than legal interest without subjecting the purchasers of such bonds to the penalties of the Usury Law. The court rejected this interpretation of the clause but nevertheless took occasion to remark that, in its opinion, the sale by a corporation or municipality of its own bonds was not a loan within the meaning of the Usury Law. In support of its opinion the court stated that the issuance, sale and disposition of corporate and municipal bonds were controlled by the Corporate Securities Act, the Public Utilities Act and other statutes, “which are the result of the best wisdom of our state and involve some of its most important and cherished functions, and it is not for a moment to be held that this system of beneficent laws was to be set awry by a poorly drafted act meant only to protect the individual necessitous borrower from the rapacity of the more fortunate lender.” While there is force in this euphonious epigram, it is not at all apparent that the beneficent laws to which the court refers would be set awry if sales by corporations and municipalities of their own bonds were held to be loans within the meaning of the Usury Law. On the contrary, it seems that the Usury Law would in no wise conflict with, or interfere with the

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34 For a statement of the clause see portion of § 3, quoted supra, n. 18.
35 200 Cal. 598, 606.
operation of, such laws as the Corporate Securities Act, the Public Securities Act and similar regulatory statutes, except in so far as it would impose an additional requirement or regulation, namely, that corporation or municipal bonds should never be sold by the issuing entity at a greater discount than that which when added to the interest provided for in the bonds would amount to more than twelve per cent per annum on the principal of such bonds.

However, if the court intended to go the length of holding that corporations, being protected and supervised by special laws applicable to them alone, can not properly be considered a part of the class which the usury law was designed to benefit, its remark, that the spirit and purpose of the usury law are to protect the individual necessitous borrower, was aptly made. Usury laws proceed upon the theory that a usurious loan is attributable to such an inequality in the relation of the lender and borrower that the borrower's necessities deprive him of freedom in contracting and place him at the mercy of the lender. "The law regards the borrower as in vinculis, and so the injury inflicted and the relief afforded as personal to the individual wronged." A corporation on the other hand is not a natural person, but an artificial legal entity, organized for commercial or other purposes that are best subserved by the advantages given through the corporate powers conferred by the state of which it is a creature. It has no sensations and cannot be coerced by its necessities into any legal obligations beyond its defined and limited corporate powers. It is primarily a creature of the law under which capital concentrates for business and other gainful ends in an amount judged sufficient for the particular undertaking. An individual may borrow from a need springing from personal necessities, but a corporation becomes a borrower voluntarily to enable it to carry forward some enterprise which affords a reasonable expectation of profits sufficient both to repay the necessary interest and to secure an ultimate emolument to those who own its stock or form its membership.

But it can scarcely be supposed that the Supreme Court intended to deny absolutely to corporate and municipal borrowers the right to plead usury. The California statute expressly gives to "any per-

33 See Carrozza v. Federal Finance & C. Co., supra, n. 38; Southern Life Insurance and Trust Co. v. Packer (1858) 17 N. Y. 53, cases sustaining constitutionality of statutes which expressly deny to corporations the right to plead usury.
son, company, association or corporation" a cause of action for the recovery of treble the amount of interest paid in violation of the act and the provisions of the law which forbid a greater rate of interest than twelve per cent per annum are not susceptible of an implied exception in cases of loans to corporations or municipalities. Rather it seems that the court meant to draw a distinction between loans to corporations or municipalities which are evidenced by bonds and loans to corporations or municipalities which rest in parol or which are evidenced by promissory notes. While this same distinction has been made in other jurisdictions the decisions which deny its existence seem to be better reasoned.

It is said by the authorities, which hold sales by corporations or municipalities of their own bonds not to be loans within the meaning of usury statute, that such bonds "are regarded as having a valid existence and transferable quality in the hands of the issuing corporation or municipality and thus subject to sale at their market value which may be at a discount much greater than legal interest." But is this explanation adequate? It is true that the sale of a negotiable instrument, or other tangible evidence of indebtedness by one other than the party primarily liable on such instrument is not usually regarded as a loan. Bonds and promissory notes, like other chattels, may be sold for what price they will bring and one who buys a $100.00 note for $50.00 cannot be charged with usury any more than can one who buys a $100.00 horse for $50.00. But bonds and notes in the hands of one primarily liable thereon can hardly be regarded as chattels if usury laws are to be given effect. Otherwise, an avaricious lender could, with impunity, require a borrower to execute bonds or notes for the amount of the loan, purchase the bonds or

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40 Usury Law, Cal. Stats. 1919, p. lxxxvii, § 3.
41 Kornegay v. City of Goldsboro (1920) 180 N. C. 441, 105 S. E. 187; Griffith v. Burden (1872) 35 Iowa 143; City of Memphis v. Bethel (1875) 3 Tenn. Cas. 205, 17 S. W. 191. For other cases see 39 Cyc. 936.
43 Unless, of course, the sale at a discount in excess of lawful interest is expressly authorized by statute. See Van Riper v. Crooks (1881) 4 N. J. L. 154; note in 35 L. R. A. (N. S.) 1106.
44 Kornegay v. City of Goldsboro, supra, n. 41, 105 S. E. 193, quoting 39 Cyc. 936. See also In re Washer, supra, n. 25, 200 Cal. 607.
notes at unconscionable discounts and thus by the form of the transaction defeat the purpose of the usury statute. To illustrate: If A, an individual, should execute a note or notes, payable to bearer, for the principal sum of $100,000 with interest at the rate of twelve per cent per annum and sell such note or notes to B, for less than $100,000 there would be no doubt but that B would be guilty of usury. Similarly if the X Company, a corporation, should execute a note or notes, payable to bearer, for the principal sum of $100,000 with interest at twelve per cent per annum, and sell such note or notes to C for less than $100,000 there would be no doubt but that C would be guilty of usury. Why, then, does the Supreme Court say that if the Y Company, a corporation, executes a bond or bonds payable to bearer, for the principal sum of $100,000 with interest at twelve per cent per annum, D may purchase such bond or bonds for less than $100,000 without being guilty of usury? If a satisfactory answer can be made to this question, that answer must be predicated upon the proposition that a bond is essentially different from a promissory note. But, of course, there is no essential difference between a bond and a promissory note; both are simply written promises to pay and neither is more representative of the assets of the obligor than is the other. If one may purchase a corporation bond, bearing the maximum rate of interest, from the issuing corporation at a discount without violating the usury law, one should also be able to purchase a promissory note, bearing the maximum rate of interest, from the corporate maker at a discount without being guilty of usury, and if the latter, it may as well be said that corporations may never plead usury for every loan may be made to take the form of a sale of a bond or promissory note. But as above observed, the California statute in no uncertain terms makes the defense of usury available to corporations as well as to individuals and the opinion in In re Washer probably should be regarded

47 See Nichols v. Fearson (1833) 32 U. S. (7 Pet.) 103, 8 L. Ed. 623; German Bank v. De Shon (1883) 41 Ark. 331; Corrozza v. Federal Finance Co., supra, n. 38; Geo. N. Fletcher & Sons v. Alpena Cir. Judge, supra, n. 42; Schermerhorn v. Talman (1856) 14 N. Y. 93, 117; 39 Cyc. 935, and cases cited; note, 43 L. R. A. (N. S.) 211, 212, p. 216.

48 See authorities cited, supra, n. 47.

49 Geo. N. Fletcher & Sons v. Alpena Cir. Judge, supra, n. 42; Schermerhorn v. Talman, supra, n. 47; Bank of Ashland v. Jones (1865) 10 Ohio St. 146; note in 43 L. R. A. (N. S.) 211, 218 (assuming, of course, that corporations may plead usury). See also 4 Cook on Corporations, 8 ed., § 766b, p. 3474 (1923).

50 In re Washer, supra, n. 25, 200 Cal. 605.

51 Kohn v. Sacramento Electric Gas & Ry. Co. (1914) 168 Cal. 1, 7, 141 Pac. 626 (assuming that both are secured or that neither is secured).

52 Sterling v. Gogebic Lumber Co. supra, n. 42.
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as doing no more than reading into the act a single exception, viz.: that a corporation may not set up usury as a defense if the corporate loan was effected by means of the sale of bonds of its own issue. In California, then, corporations may plead usury in all cases when the defense might be interposed by individual borrowers unless the loan to the corporation is in the form of a sale of its own bonds to the lender in which case the usury law has no application.

Probably the most important case decided under the California Usury Law is Haines v. Commercial Mortgage Company. While the facts of this case are not particularly significant, their statement seems necessary for a complete understanding of the court's decision. The plaintiff executed a note to the order of the defendant for $34,000 at twelve per cent interest per annum, accrued interest and principal to be paid in monthly installments of $800. This note was secured by a trust deed. The defendant advanced to the plaintiff only $32,980.00, reserving the sum of $1,020.00 from the nominal principal of $34,000.00 "for examinations, views, fees, appraisals, commissions and all charges in transacting the business of the loan." The plaintiff made monthly payments for some time, and then defaulted. The defendant threatened to have the property securing the loan sold under the trust deed. The plaintiff thereupon instituted the action to enjoin the sale under the trust deed on the ground of usury, to recover treble the amount of interest paid, and for other relief.

CHARGES PERMISSIBLE BY THE LENDER

The court had occasion to first consider the propriety of the defendant's reservation of $1,020.00 in addition to lawful interest, and determined that it was a charge made in violation of the usury law because "the manifest intent of the act is to forbid absolutely to the lender any profit whatever by way of commission, bonus or other kind of charge in excess of the maximum rate of interest declared in the act." Apparently, the defendant strenuously urged that certain clauses in section 3 of the statute expressly authorize lenders who deal directly with borrowers to charge limited commissions in addition to the maximum rate of interest. Section 3 of the act, as above remarked, is exceedingly ambiguous, but it seems that the court properly construed the clauses which appear to lend weight to the interpretation contended for by the defendant to relate ex-

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58 (March 4, 1927) 200 Cal. 609, 254 Pac. 956.
54 200 Cal. 615.
clusively to third party loan brokers. The court did state, however, that in addition to the maximum rate of interest, a lender may lawfully charge the borrower for services performed or expenses incurred in connection with the loan as long as such charges are made for specific services or expenses incident to the loan, so incurred as to absolutely preclude their being "merely a device through which additional interest or profit on the loan may be exacted."

The court's conclusion on this phase of the usury law is unquestionably sound and is supported by abundant authority. The California statute clearly forbids a greater charge than twelve per cent per annum for the loan or forbearance of money, but it does not purport to regulate charges made for any other consideration which may move from the lender to the borrower, nor does it preclude the lender from requiring the borrower to defray the expenses of the loan in order that the maximum permissible interest may be fully realized. Usury is an illegal profit which is required by the lender of a sum of money from the borrower for its use, and usury laws relate only to charges of the lender which are exacted as compensation for the loan or forbearance of money. A lender may do more than merely hire out his money; and for any additional service he is entitled to additional remuneration; whatever objection there may be to the rate of charge for such additional service cannot be based on the usury statute. For similar reasons, if a portion of the sum paid by the borrower may be allocated to expenses of the loan, such portion is not to be considered as a part of the profit reserved for the use of the money. The existence of usury, then, should be determined not by the amount of the total sum the borrower may pay to the lender, nor by the amount of compensation the lender may receive, but solely by the amount the borrower is required to pay for the loan or forbearance of the use of the money.

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55 See Wallace v. Zinman, supra, n. 5, 200 Cal. 589, and discussion, supra, text.
56 200 Cal. 616.
57 First Nat'l Bank v. Phares (1918) 70 Okla. 255, 174 Pac. 519; Fried- man v. Wisconsin Acceptance Corporation (1926) 192 Wis. 58, 210 N. W. 831; 39 Cyc. 918; 27 R. C. L. § 12, p. 211. For an exhaustive annotation and collection of cases see 21 A. L. R. 797, 807 et seq.
60 Stein v. Swenson (1891) 46 Minn. 360, 49 N. W. 55.
To attempt categorically to enumerate the services and expenses for which borrowers may be properly required to pay would be rather futile. In the last analysis the legality of charges which are imposed in addition to lawful interest depends largely upon the peculiar facts and circumstances of the particular transaction. In theory, at least,

62 Space does not permit a comprehensive treatment of the specific expenses and services for which a borrower may be required to pay. A vast number of cases are collected in the extensive annotation in 21 A. L. R. 797 et seq. See also note in Ann. Cas. 1914C 410; 2 Page on Contracts, 2 ed., § 999, p. 1758; 39 Cyc. 981 et seq. By way of illustration, however, it may be noted that the following have been held to be proper expenses: cost of drawing, acknowledging and recording papers connected with the loan, Matthews v. Georgia State Sav. Ass'n (1918) 132 Ark. 219, 200 S. W. 130; Gault v. Thurmond (1913) 39 Okla. 673, 136 Pac. 742; Testera v. Richardson (1914) 77 Wash. 377, 137 Pac. 998; note in 21 A. L. R. 797, 875; cost of investigating and appraising properties offered as security, preparing abstracts of title, searching records, etc., Matthews v. Georgia State Sav. Ass'n, supra; Iowa Sav. & L. Ass'n v. Heitd (1899) 107 Iowa, 297, 77 N. W. 1050; Hobard v. Michaud (1926) 167 Minn. 1, 208 N. W. 191; Lassman v. Jacobson (1914) 125 Minn. 218, 146 N. W. 350; Priestly v. Law (1928) 115 N. Y. S. 262 Pac. 935; Liskey v. Snyder (1904) 56 W. Va. 610, 49 S. E. 515; note in 21 A. L. R. 797, 871, 875; compare Real Estate Trustee v. Rebhan (1927) 139 Atl. 351; Miller v. Ashton (1927) Mich. 216 N. W. 448. In addition to agreeing to pay the maximum rate of interest, a borrower may agree to pay for insurance on the property given as security for the loan, Matthews v. Georgia State Sav. Ass'n, supra; Niles v. Kavanagh (1918) 179 Cal. 98, 175 Pac. 462; Friedman v. Wisconsin Acceptance Corp. (1926) 192 Wis. 58, 210 N. W. 831; note in 1 A. L. R. 834; or taxes on such property, Union Mortgage Bkg. & T. Co. v. Hagood (1899) 97 Fed. 360; Home Ins. Co. v. Danham (1884) 33 Hun. (N. Y.) 415; Deming Investment Co. v. Grigsby (1917) 65 Okla. 88, 163 Pac. 530; note in 21 A. L. R. 797, 880. Also, a borrower may properly agree to compensate the lender for any loss which the lender may incur by reason of an inopportune sale of property or a disadvantageous change in investment, necessary to raise the money to be lent. Thus if the lender sacrifices valuable stocks [Snow v. Nye (1871) 106 Mass. 413], or loses interest because of an untimely withdrawal of funds from a savings account [Washburn v. Ryder (1885) 2 N. Y. City. Rep. 127], the borrower may be required to pay for such losses. See note in 21 A. L. R. 797, 868-871.

Charges for the following services have been sustained as not usurious: legal services in clearing borrower's title to the property offered as security, Saunders v. Nicolson (1897) 101 Ga. 739, 28 S. E. 976; securing release of prior encumbrances on such property and negotiating loans from other lenders, Blanchard v. Hoffman (1923) 154 Minn. 525, 192 N. W. 352; collecting accounts assigned as security for the loan and keeping books with regard to such collections, Houghten v. Burden (1913) 228 U. S. 161, 57 L. Ed. 780, 33 Sup. Ct. Rep. 491; In re Mesibovsky (1912) 200 Fed. 562; Citizens' Bank v. Murphy (1907) 83 Ark. 31, 102 S. W. 697; note in 21 A. L. R. 797, 898; assisting in purchase of merchandise abroad, Van Dyk v. Dujardin (1925) 213 App. Div. 791, 210 N. Y. S. 737; any brokerage service not connected with the loan of money, such as selling cattle mortgaged as security for the loan, Cable v. Duke (1908) 132 Mo. App. 334, 111 S. W. 909; or agreeing to sell merchandise of borrower, M. Lowenstein & Sons, Inc. v. British-American Mfg. Co. (1925) 7 F. (2d) 51; compare Cammack v. Runyan Creamery Co. (1927) Ark. 299 S. W. 1023.

On the other hand, a borrower should not be required to pay taxes on a mortgage or debt, as such a tax is an incident of the ownership of the mortgage or debt and properly payable only by the lender, Quesner v. Novotny...
such charges, even though exorbitant are never usurious if supported by some consideration other than the loan or forbearance of money. But it is common knowledge that devices for the concealment of excessive interest are as numerous as some of them are ingenious, and "services" or "expenses" appear to be favorite means of camouflage. The courts will not tolerate any subterfuge for the evasion of the usury law; they have regard for the substance not the form of the transaction. If charges, ostensibly for services or expenses, are in fact exacted as disguised profits for the use of money, the loan will undoubtedly be held usurious.\(^3\) The intent of the parties is the material consideration\(^8\) and in ascertaining the intent the courts will attach some significance to the reasonableness of the particular charge.\(^8\) If the services or expenses alleged to have been rendered or incurred are of little value or slight consequence, and the amount agreed to be paid for them considerable, the inference to be drawn is that the compensation was for the use of the money rather than for the services or expenses.\(^6\) Nevertheless, the mere unreasonableness of charges exacted for services or expenses does not in itself constitute usury; it is only evidence of greater or less weight, according as the charges are more or less unreasonable, that such charges were reserved—in part at least—as illegal profits on the loan or forbear-

(1927) — Neb. —, 215 N. W. 796; Vandervelde v. Wilson (1913) 176 Mich. 185, 142 N. W. 553; Meem v. Dulaney (1890) 88 Va. 674, 14 S. E. 363, unless, perhaps the lender, in order to make the loan must surrender tax-exempt securities—see note in 21 A. L. R. 797, 883. The majority rule, however, seems to be that borrowers in absence of statute (see § 5 of Art. XIII, Cal. Const., repealed 1905) may be required to pay taxes on the mortgage or debt—see note in 21 A. L. R. 797, 883 and cases there cited. Nor may the lender properly charge for mere inconvenience in making the loan, or exact a commission or bonus for negotiating the loan when he deals directly with the borrower. See, generally, the annotation in 21 A. L. R. 797 et seq.; Blodgett v. Rheinschild (1922) 56 Cal. App. 728, 206 Pac. 674; 39 Cyc. 971, and cases cited.

As a caution to those who lend money in California is the remark in Haines v. Commercial Mortgage Co. supra, n. 53, 200 Cal. 616, that proper charges "must be confined to specific service or expense." In other words, it would seem that in California the practice of making a blanket charge for services and expenses will not be sustained—the charges should be for specific items. As an added precaution the borrower should be required to expressly agree to pay for the specified services or expenses. (See in this connection the note in 21 A. L. R. 797, 805-807, and cases cited.)

\(^3\) See authorities cited supra, n. 57; Haines v. Commercial Mortgage Co., supra, n. 58.

\(^4\) Douglass v. Boulevard Co. (1917) 91 Conn. 601, 100 Atl. 1067; Stein v. Swenson, supra, n. 60. See also authorities cited, supra, n. 57.


\(^6\) Douglass v. Boulevard Co. (1918) 91 Conn. 601, 100 Atl. 1067.
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The borrower and the lender may make what contract they will relating to any subject other than the price of the use of the money lent or forborne; if they stipulate in good faith with regard to specific services or expenses a court should not concern itself with the fairness of the bargain, and their agreement is not lightly to be set aside merely because it is obnoxious to some vague suspicion of being a subtle contrivance for the evasion of the law.

(To be continued)

William Tristam Coffin.

Los Angeles, California.

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Stein v. Swenson, supra, n. 60; 21 A. L. R. 797, 804, and cases cited.