Usury: Utilitarian or Useless?

Jarret C. Oeltjen
Florida State University College of Law

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JARRET C. OELTJEN

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USURY: UTILITARIAN OR USELESS?

JARRET C. OELTJEN

I. INTRODUCTION

The amount of credit in our economy is staggering, and its growth has been phenomenal. Outstanding consumer credit, which alone amounted to $180 billion in 1973, has doubled since 1965.1 Increases in the rates charged for the lending of these funds have accompanied the volume growth. This is exemplified by the increase in rates

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1. NATIONAL CONSUMER FINANCE ASSOCIATION, 1974 FINANCE FACTS YEARBOOK 46. See also FED. RES. BULL. (Jan. 1975).
charged the most creditworthy customers, appropriately called the "prime rate." During the 1966-67 period of "tight money," the prime rate rose from its prior five year level of 4.5 percent to a hefty 6 percent. In many jurisdictions this new level was at or near the then-current interest rate (usury) ceilings. Then came the tight-money market of 1969, about which one writer commented: "With the prime rate at this writing having reached the dizzying level of 7 percent, it is obvious that even institutional first mortgage lending must go to 8 percent or better." The current period of tight money has seen the prime rate peak at 12 percent to 12.25 percent. This current peak, following the terminology of the above author, could aptly be described as "astronomical."

As interest rates move up, lenders are caught in a squeeze between their cost of capital and the rate they can legally charge to their borrowers. This squeeze, which occurs in every segment of the lending industry, forces lenders to adopt more selective lending practices. Such practices are to be expected because of the decreased profit margin available to cover risk of nonpayment. But as lending standards are tightened to lower risk, sources of credit dry up for the less creditworthy, those with lower incomes or poor credit histories. Thus a lender might be forced to discontinue certain types of loans that it would otherwise make, simply because it cannot afford to lend money to certain borrowers at the ceiling rate.

In periods of tight money, moneylenders of all types resort to diverse methods to avoid restrictive interest rate (usury) ceilings. Lenders use mandatory credit life, health and accident insurance; service fees; recording fees; and a system of points to extract more money from borrowers. In view of these increased costs and the current uncertainty about the economy, consumers are repaying their loans at a record pace. In November, 1974, consumer borrowing dropped by a record $402 million. This was followed in December by a drop of $877 million. This was the first time credit dropped for two consecutive months since 1958. Moreover, it dropped in rapidly...

2. Hershman 333.
4. Tallahassee Democrat, Feb. 6, 1975, § B, at 1, col. 5.
6. Id.
7. Newsweek, Nov. 11, 1974, at 102-03.
9. Id.
increasing amounts. During this same period there had also been a "sharp decline in business loans."

In addition to these more direct costs, debtors pay for the indirect costs of administering the complex usury statutes. Since each segment of the credit industry is regulated at a different rate, which varies from jurisdiction to jurisdiction, a myriad of regulations result. One finance company reported it had to stock 126 different forms merely to comply with the various statutes and regulations concerning consumer credit. This complexity is additionally detrimental to the borrower because it makes it difficult for even seasoned observers to understand whether what they have been charged is legal, or even competitive. It is to this system of regulations that this article is devoted. It is hoped the reader will gain a true understanding of the rationale, or lack thereof, of this system.

II. History

A. General History

Even in primitive society private property, which is essential to a credit economy, existed as personal ornaments, weapons, and dress. Lending had a different connotation than it has today; it was done easily and naturally, and the common understanding typically was that the borrowed item should be returned. There was, of course, no charge for the item lent. As society became less nomadic and more complicated, and land became susceptible of private ownership, the concept of lending for a charge came into being.

Throughout history few classes of transactions have so evoked the emotions of men as the lending of money for interest. It has been condemned as sinful, oppressive, or just wrong; it has been both legislated against and denounced by monarchs. But loans were still made, and interest was taken despite severe penalties. Even after the legalization of moderate interest charges by the enactment of usury laws, those who charged for the use of money were not thought well of by society. Dante described the fate of usurers as permanent residence in the Seventh Circle of Hell. Jews historically have been maligned as moneylenders and usurers, as in Shakespeare's The Mer-

10. Tallahassee Democrat, Feb. 6, 1975, § B, at 1, col. 5.
11. Id.
15. See Robinson & Nugent 15-16.
17. Dante, Divine Comedy, The Inferno: Canto VII.
chant of Venice. Ironically the Italian story on which Shakespeare based his play had as its usurer a Christian, and a Jew as the one who pledged his "pound of flesh." 18

Usury, then defined as the taking of any interest, was virtually prohibited in Old Testament times. 19 The Old Testament is quite explicit on interest taking; 20 the New Testament, however, offers no definite guidance, although the parable of the talents 21 shows at least a tolerance of lending money at interest. 22

Other ancient cultures reacted similarly to moneylending for profit. 23 Although the ancient Greeks had no prohibition against taking interest, nor statutes regulating the rate, social and commercial practice operated to keep the rates within reasonable bounds. 24 Aristotle thought that payment for the use of money was not natural since money was barren and could produce nothing, 25 but his position had scant effect on moneylending in his time. 26 In Republican Rome, charging interest for the use of money was prohibited, but, because of the realities of growing commerce, interest taking was a normal practice during the time of the Empire. 27

The general attitude of the Church in early Christendom was that usury (interest taking) simply was wrong. 28 Later, in medieval and

19. See, e.g., Exodus 22:25; Leviticus 25:35-37; Psalms 15:2-5. But interest taking on loans to foreigners was allowed. Deuteronomy 23:19-21. Roman law did not recognize usury as the taking of excessive interest, for "interest . . . meant the compensation for damage or loss suffered by the creditor resulting from the debtor's failure to return the loan (itself gratuitous in principle) at the date specified by the contract"; rather, usury was "a payment for the (use) of money itself." T. Divine, Interest 3-4 (1958). The standard modern definition of usury is the taking of interest above the lawful rate. Black's Law Dictionary 1714 (4th ed. rev. 1968).
20. See note 19 and accompanying text supra.
21. For those who are unfamiliar with this parable and would be unlikely to refer to it: "Thou oughtest therefore to have committed my money to the bankers, and at my coming I should have received my own with usury." Matthew 25:27. One may interpret this parable as more than mere tolerance.
24. Johnson 5, 7-9. Different rates were charged according to whether the loan was a personal or commercial transaction. See M. Neifeld, supra note 16, at 19.
25. Aristotle's view of the unnaturalness of interest taking was based on his belief in the barrenness of money itself, not on the social effect of the practice. Johnson 9.
Renaissance Europe, the Church and the State joined to prohibit interest taking. Thomas Aquinas' views on usury (interest taking) fairly well represented the prevailing anti-interest stand. His views have been summarized in a most interesting way: "When one demands over and above the return of the original sum loaned, an added amount purely for the use of the money, it is the same thing as charging a man the market price for a glass of beer and then charging him again simply for the privilege of drinking it."  

The rise of trade and commerce during the late Middle Ages, coupled with exceptions to the absolute prohibition against interest taking, weakened but did not eliminate this strong adverse reaction to usury. It was during this period that the Church itself, through the Franciscan order of monks, created in certain locations in Italy the montes pietatis, a fund from which loans could be made to the poor at a low rate of return. Indeed, by 1730 the Pope had disclaimed any right to interfere in the question of usury.  

During the middle 1500's the opinion of Protestant leaders wavered. Martin Luther generally was against the taking of interest; Melancthon, on the other hand, saw the necessity of allowing interest taking to stimulate trade. Calvin, although by no means a proponent of interest taking, distinguished moderate interest taking from usury (the excessive taking of interest, as it was later defined). He approached the subject of moneylending as both a theologian and a man of business.  

England, in 1545 under Henry VIII, was the first of the European countries to establish a "legal" rate of interest. This forerunner of all usury laws recognized the legal right to take interest but reserved the regulation of rates to the state. Interest rates continued to be regulated in England, and the target of criticism shifted from the total prohibition of interest to the necessity or reason for any usury limitation.  

In the eighteenth and nineteenth centuries the "liberal" laissez-faire opinions of such men as Adam Smith, Jeremy Bentham, Ben-
jamin Franklin, and Thomas Jefferson created a feeling that freedom from restrictions was the “natural order.” This belief in freedom set the stage for the questioning of the concept of usury. Jeremy Bentham’s superbly written *Letters in Defence of Usury* is known as one of the most adept arguments against laws setting rate ceilings. Most articles concerning usury written since Bentham’s time have been basically restatements of Bentham’s view. Turgot, Bentham’s French counterpart, shared Bentham’s views and carried on the resistance to usury laws in France.

Due largely to the atmosphere created by philosophers such as Bentham, England repealed its usury law in 1854. For 46 years, England existed without a usury law of any type. Then, in 1900, the English Parliament established the Money-lenders Act which did not specify an absolute lawful rate of interest but prohibited unconscionable rates; rates above a set maximum were presumed to be unconscionable.

During American colonial times, legislation was patterned after English statutes, specifically the Statute of Anne. The early Americans brought with them the prevailing attitudes toward interest, including the 6 percent lawful rate. Although Massachusetts in 1661 adopted a legal rate of 8 percent, most of the colonies followed the lead of Maryland and adopted a 6 percent rate. The 6 percent pattern was well set, and by 1776 all the former English colonies had

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40. *Id.*
41. Bentham’s position on the advantages of a laissez-faire economy is articulated well in Letter I:

... [N]o man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from making such bargain, in the way of obtaining money, as he thinks fit: nor (what is a necessary consequence) anybody hindered from supplying him, upon any terms he thinks proper to accede to.

3 THE WORKS OF JEREMY BENTHAM 3 (J. Bowring ed. 1962).
42. Johnson 14.
43. HOLDSWORTH 112; Collins & Ham 400.
44. HOLDSWORTH 112.
46. Hershman 335.
48. *Id.*
49. The statute was established in the form of a general order stating “that no man shall be adjudged for the mere forbearance of a debt above eight pounds in the hundred for one year.” Address by Walter D. Malcolm, Esq., Consumer Credit Project of the Nat’l Conference of Commissioners on Uniform State Law, June 19, 1968, at 3.
usury laws similar to England.\textsuperscript{51} After independence, the courts found
that where there were no statutory prohibitions, no interest was illegal
unless it was unconscionable and oppressive.\textsuperscript{52}

During the period from the end of the Revolutionary War to the
Civil War, penalties for usury were gradually decreased. By the Civil
War the laws of most states provided only for a forfeiture of interest
if usury were proven.\textsuperscript{53} Interest rate ceilings, however, were generally
retained, and many businessmen believed that the usury laws set
rates which were unrealistic in the commercial world.\textsuperscript{54} Because of
this attitude, there was widespread evasion of usury provisions.

The discontent with the relatively low interest ceiling prodded
many businessmen to lobby vehemently for relief in their state legis-
latures.\textsuperscript{55} In 1866 the Florida Legislature recognized the oppressive
effect of usury laws on commerce and enacted a statute\textsuperscript{56} repealing all
previous usury laws. To loan or borrow money above the “legal” rate
of interest of 8 percent (8 percent had been set in a previous law
enacted that year) was no longer usurious.\textsuperscript{57} These provisions remained
in effect until at least 1881.\textsuperscript{58}

In 1891 the Florida Legislature provided business opportunities
for illegal lenders by enacting a usury statute declaring “all contracts
for the payments of interest . . . at a higher rate of interest than ten per
centum per annum” usurious.\textsuperscript{59} This law was replaced in 1909; the

\textsuperscript{51} Merriman & Hanks 7.
\textsuperscript{52} Houghton v. Page, 2 N.H. 42 (1819), as cited in McConlogue, supra note 23, at
255.
\textsuperscript{53} ROBINSON & NUGENT 29.
\textsuperscript{54} Id. at 30.
\textsuperscript{55} In 1867 Harmer Gilmer, Jr. was persuaded to author a dissertation against
usury laws. He described in scholarly terms the ill effect that these laws had on
the economy of the state of Virginia. However, unlike the effect of Jeremy Bentham’s Letters,
this treatise failed to convince the Virginia legislature. Shanks, Practical Problems in the
\textsuperscript{56} The title and Preamble of the 1866 act stated:
AN ACT to untrammel Capital and to repeal all laws on Usury.
WHEREAS money, or its representatives, like other property and commodities
thrown upon market for sale or loan, should no more than these be trammeled
by law, but that an enlightened policy makes it judicious that its loan should
be left to the laws of demand and supply and to the sense of the mutual interest
of loaner and borrower;
Fla. Laws 1866, ch. 1562.
\textsuperscript{57} Fla. Laws 1866, ch. 1562. See Fla. Laws 1866, ch. 1483.
\textsuperscript{58} L. McCLELLAN, A DIGEST OF THE LAWS OF THE STATE OF FLORIDA 585 (1881).
\textsuperscript{59} The penalty for taking, reserving, or charging interest over 10\% per annum
was forfeiture of the interest. Therefore only the principal could be recovered by
the lender. Certain associations and holders of negotiable instruments under specified
circumstances were exempted from the application of this act. Fla. Laws 1891, ch. 4022.
new law was similar but had two major additions: to be usurious, the charging or reserving of a rate of interest had to be "willful," and a taker of more than 25 percent interest forfeited principal as well as interest. Since 1893 savings and loan associations have been exempted from the usury laws.

In other states the usury laws continued to unbalance the money market system. About 1870 the first truly professional, small loan lenders appeared in Chicago and other midwest cities. This advent of small loan lenders corresponded to the development in large cities of a class of wage earners who needed additional money for emergency and other expenses and who had enough earning potential eventually to pay back the lender, whether he be legal or illegal. The usury laws of this era, by placing an unreasonably low ceiling on rates, drove those seeking small loans to illegal sources.

The growth of small loan lending continued; by 1900 nearly every large city in the United States harbored loan companies briskly loaning money at illegal rates. These loans, although usurious in character, did perform a necessary economic function—usurious loans were better than no loans at all. In Wisconsin, for example, around 1900 the "loan shark" (an excessive usurer) became a considerable emotional and economic problem. The usurer was condemned as a "scoundrel," and the good citizens were morally outraged. In the face of this, the usury law was strengthened, but, as usual, it had no real effect on the "loan shark."

60. Fla. Laws 1909, ch. 5960.
61. Fla. Laws 1909, ch. 5960, § 3. Under the previous usury law the fact of taking over 10% interest constituted a per se violation. Under the 1909 statute unless it was "willfully" taken, the interest would not be a violation, i.e., the lender could show that interest over 10% was charged due to inadvertence or mistake. However the lender could not escape the penalties by pleading no intent to "exact usury" or "violate the statute." The lender was charged with knowledge of the law, Coe v. Miller, 77 So. 88 (Fla. 1917). Caraballo, Discussion of the Usury Laws in the State of Florida Before the Hillsborough County Bar Association, Fla. St. B. Ass'n L.J., June, 1929, at 7.
64. ROBINSON & NUGENT 38, 42.
65. MICHELMAN 106, 107.
66. MICHELMAN 108.
68. Id.
Except for remedial loan societies, the field of small loan lending was preempted by the "loan sharks" until the early 1900's. In reaction to this "loan shark" monopoly, the Provident Loan Society, a "semi-philanthropic remedial loan society," was organized in 1894 in New York City. The motives behind its establishment were basically charitable, but a reasonable profit was allowed and its interest rate was set by law. New York soon permitted other remedial loan societies to be established. The purpose of these societies was to drive "loan sharks" out of the market by providing a reputable group of lenders for those who needed financial assistance. It was presumed that a legal, low-rate lender would drive out the "loan sharks." While this did not happen, Provident still survives today as the leader of the pawnbroking business in New York.

Studies of the "loan shark" problem were initiated by the Russell Sage Foundation shortly after its incorporation in 1907. 1910 marked the end of an era during which small loan legislation was a nearly organic reaction to the stimulus of loan sharking, and during which lending to small borrowers was looked upon as anti-social if not illegal. A new attitude toward consumer loans was dawning, and between 1911 and 1915 six states passed small loan laws. Utilizing information gathered by its earlier studies, the Foundation promulgated and recommended a uniform law in 1916.

Ancillary to the small loan legislation movement, the first cooperative credit society (credit union) was organized in New Hampshire.

69. See CONSUMER CREDIT 15.
70. Friedman, supra note 67, at 563.
71. Id. at 563-64.
72. Id. at 563.
73. See D. GALLERT, W. HILBORN & G. MAY, SMALL LOAN LEGISLATION 22 (1932).
74. MICHELMAN 113, 114.
75. The two main studies were WASSAM, THE SALARY LOAN BUSINESS IN NEW YORK CITY (1908) and HAM, THE CHATTLE LOAN BUSINESS (1909), as cited in Gisler, Legal and Historical Background of Missouri Small Loan Problem, 16 Mo. L. Rev. 207, 211 n.18 (1951).
76. The Foundation's title is somewhat of a misnomer. Mrs. Margaret Olivia Sage actually founded the Russell Sage Foundation after Mr. Sage's death. Russel Sage himself could hardly have been called a philanthropist; Fiorello H. La Guardia called him "one of the meanest skinflints who ever lived." MICHELMAN 17-28.
77. D. GALLERT, W. HILBORN & G. MAY, supra note 73, at 58. Massachusetts was an exception, in degree, to the general rule; in 1888 it enacted an inclusive small loan act. Id. at 19.
78. ROBINSON & NUGENT 95.
79. ROBINSON & NUGENT 118 (Massachusetts (1911), Oregon (1913), New Jersey (1914), Ohio (1915), Pennsylvania (1915), and Michigan (1915)).
80. See note 75 supra.
81. For a thorough discussion of small loan laws and their development see ROBINSON & NUGENT 113-17; Hubachek, The Development of Regulatory Small Loan Laws, 8 LAW & CONTEMPP. PROB. 108 (1941).
in 1909.82 The idea was not quickly accepted and the movement faltered until E. A. Filene took up the cause.83 Thereafter, due in great part to Mr. Filene's effort, many states passed credit union acts, and in 1934 the Federal Credit Union Act was enacted.84 By 1943, 41 states had provisions for the establishment of credit unions.85

Various other methods of small loan lending were yet to be tried. Around 1910 a Norfolk, Virginia, attorney, Arthur L. Morris, originated the concept of lending that became known as the Morris Plan.86 Understandably, the institutions using the plan were usually dubbed "Morris Plan banks." But they were also called industrial or industrial savings banks, which are misnomers because the banks were consumer credit oriented. They were intended to fill the consumer void left by commercial banks which at that time did not make personal loans.87 To operate within the confines of the traditional 6 percent rate limitation, Morris formulated an ingenious scheme:88 by discounting the interest and by requiring the borrower to deposit with the lender in a noninterest-bearing savings account one-twelfth of the original principal per month, or to purchase the equivalent amount of investment certificates from the lender, the effective interest rate was nearly doubled.89 Florida began regulating industrial banks by statute in 1929 and allowed a maximum effective interest rate of 20 percent.90

A reaction to the general usury laws by savings and commercial banks began as a specialized loan service around 1928 at the National City Bank of New York.91 Florida in 1941 authorized special loans not in excess of $1,500 to be made by non-Morris Plan banks at a 6 percent per annum discount rate computed on the total amount of the loan.92

82. CONSUMER CREDIT 37. But see Johnson, Regulation of Finance Charges on Consumer Installment Credit, 66 Mich. L. Rev. 81, 84 (1967) (citing Massachusetts as the first).
83. CONSUMER CREDIT 37.
85. CONSUMER CREDIT 37. Florida enacted its credit union statute in 1929 authorizing 1% per month to be charged. Fla. Laws 1929, ch. 14499.
86. Holz, The Regulation of Consumer Credit, 1943 Wis. L. Rev. 449, 454.
87. CONSUMER CREDIT 31.
88. MICHELMAN 197-98.
89. Id. See also Collins & Ham 405-06; Danforth, Usury: Applicability to Collateral Fees and Charges, 16 S. Dak. L. Rev. 52, 69-70 (1971); Gisler, supra note 75, at 217-20; Pearce & Williams 254-58; Penick, The Impact of Usury Law on Banks in Arkansas, 8 Ark. L. Rev. 420, 437, 450-51 (1954).
91. CONSUMER CREDIT 45. For an interesting anecdote see Dellmuth, Banking's Opportunity To Service the Small Loan Needs of the Public, 19 Law & Contemp. Prob. 115, 116-17 (1954).
92. Fla. Laws 1941, ch. 20940, §§ 1-3. This limitation has been raised to $5,000. Fla. Stat. § 659.18 (1973).
Since the payments could be made in monthly installments and additional charges up to 2 percent were authorized, a return of about 15.25 percent was possible.93

By 1938 the Uniform Small Loan Law with some modifications was enacted in 24 states; three other states used the uniform law as a model but almost modified it to death.94 In 1925 Florida adopted the fourth draft of the Uniform Small Loan Law with an added exemption for bonafide purchasers of choses in action. The Florida statute was not applicable in counties with populations less than 40,000,95 and no mention was made of wage purchasing.96 These weaknesses were eliminated by amendment in 194197 after a vicious battle between the organized, syndicated, unlicensed lenders and the advocates of effective small loan legislation.98 After the 1941 amendments, the Act remained basically unchanged99 until the 1973 legislative session, except for an increase in the maximum allowable loan100 and a change in the rate structure.101

In 1949 the Florida Consumer Finance Law was enacted,102 creat-

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94. CONSUMER CREDIT 16.
95. Fla. Laws 1925, ch. 10177, § 19. The population limitation further encouraged the loan shark to operate in the less populous areas where enforcement of usury laws would seemingly be lax and where legitimate sources of loans would be scarce.
96. Section 16 of the Uniform Small Loan Act was omitted from the Florida act. The wage buying technique, which offered a way to extract high rates of interest without violating loan laws, evolved as the result of delayed payments of earned wages. The delayed payment created a chose in action which could easily be discounted and not fall within the confines of the Florida act. Hubachek, supra note 81, at 121. For further discussion of wage buying see pp. 189-90 infra.
97. The population limitation was excluded by Fla. Laws 1941, ch. 20728, § 6. The inclusion of wage buying within the sphere of the Small Loan Act was accomplished by Fla. Laws 1941, ch. 20209. This law stated:
[T]he laws of the State relating to the regulation of the business of lending money and to interest charges and usury are being evaded . . . by the guise of purchasing the wages [and] salaries . . . at discounts far exceeding the rates of interest permitted by law . . . [and] such transactions in substance and effect amount to loans for all practical purposes and the evil of such exorbitant discounts is equivalent to the evil of usurious interest charges.
98. Kilgore, Legislative Tactics of Unregulated Lenders, 8 LAW & CONTEMP. PROB. 173, 174 (1941). "[A] moral stigma attached to any small loan and to both parties to it. As for the lender, the public did not know the difference between licensed lender and loan shark . . . . As for the borrower, public opinion generally condemned any borrowing by him as immoral." Smith, What Lies Ahead in the Field of Small Loans, 19 LAW & CONTEMP. PROB. 120, 121 (1954).
102. Fla. Laws 1949, ch. 25343. For additional commentary on the Consumer Finance Law, see Oeltjen 378-79.
ing a dual system of small loan laws in Florida. The Consumer Finance Law was almost identical to the original Small Loan Act except for the method utilized to compute interest and charges.\textsuperscript{103} The effective interest rate which could be charged under the Consumer Finance Law, however, was several percent less than that authorized by the Small Loan Law.\textsuperscript{104} When both acts were amended in 1957 some of the discrepancy was eliminated.\textsuperscript{105}

The most recent revisions of the Florida small loan laws occurred during the 1973 legislative session. After a heated and drawn-out process,\textsuperscript{106} on June 1, 1973, the bill amending the Small Loan Act was finally forwarded to the Governor's office where it became law without his signature.\textsuperscript{107} With the 1973 amendments, Florida again has only one small loan statute, the 1949 Consumer Finance Law having been repealed.\textsuperscript{108} The new, all inclusive statute, named the "Florida Consumer Finance Act,"\textsuperscript{109} adds several consumer protections and provides for a maximum rate of 30 percent.\textsuperscript{110}

\textbf{B. Sales Credit and Credit Cards}

Retail credit is not a new phenomenon. Since colonial days\textsuperscript{111} farmers have been extended credit from crop to crop, and, as is still done in many rural and urban areas today, the finance charge was built into the price of the goods sold. This method of extending credit is usually termed book, or open account, credit, and is based mainly on the creditors' experience with the borrower. Installment buying also existed in the colonies.\textsuperscript{112} Commodities were sold on the installment plan as early as 1807. Singer widely sold sewing machines using this method beginning in the middle 1800's.\textsuperscript{113} Volume of sales credit increased with the advent of selling automobiles on the installment plan around 1910.\textsuperscript{114}

\begin{itemize}
  \item \textsuperscript{103} See Oeltjen 379-87.
  \item \textsuperscript{104} Compare Fla. Laws 1949, ch. 25343, § 8, with Fla. Laws 1949, ch. 25343, § 14.
  \item \textsuperscript{105} Compare Fla. Laws 1957, ch. 57-164, § 5, with Fla. Laws 1951, ch. 26484, § 10.
  \item \textsuperscript{106} FLA. S. JOUR. 569 (1973). See also Oeltjen 378.
  \item \textsuperscript{107} Fla. Laws 1973, ch. 73-192, § 16.
  \item \textsuperscript{108} Fla. Laws 1973, ch. 73-192, § 15.
  \item \textsuperscript{109} Fla. Laws 1973, ch. 73-192, § 1.
  \item \textsuperscript{110} For a comprehensive discussion of the Florida Consumer Finance Act see Oeltjen.
  \item \textsuperscript{111} CONSUMER CREDIT IN THE U.S. 5.
  \item \textsuperscript{112} For example, a colonial cabinet maker, David Evans, sold over 9/10ths of his goods on credit. M. NEIFELD, NEIFELD'S MANUAL ON CONSUMER CREDIT 16 (1961), as cited in CONSUMER CREDIT IN THE U.S. 5.
  \item \textsuperscript{113} CONSUMER CREDIT 58. For a short history of installment buying see R. BAISON, THE FOLLY OF INSTALLMENT BUYING 18-22 (1938).
  \item \textsuperscript{114} CONSUMER CREDIT IN THE U.S. 5.
\end{itemize}
As previously shown, creditors throughout this period felt hampered by usury laws, and much of their history is a chronicle of how to avoid the usury laws—legally or illegally. Those who granted credit through the sales of goods, however, were not as restricted by usury laws. The "time price doctrine," discussed later in this article, allowed retail merchants to avoid usury laws and extract a greater return than allowed by law. Nonetheless, certain aspects of retail credit were successfully challenged as usurious practices.

In reaction to consumer discontent concerning the use and abuse of the time price doctrine in installment selling of automobiles, the Florida Legislature in 1957 enacted the comprehensive Motor Vehicles Sales Finance Act. The Act specified maximum rates for automobile finance charges that ranged from 14.5 percent to 30 percent, depending on the model year of the automobile. In 1959, the legislature passed the Retail Installment Sales Act which limited the rate of finance charge on installment sales contracts for other consumer goods and services and revolving charge accounts to an effective rate of 18 percent per year.

The use of credit cards and revolving charge accounts is a fairly recent phenomenon. Certain department stores, petroleum distributors, and retail gasoline outlets used this form of credit as early as the 1910's, but the introduction of modern revolving credit is usually attributed to Wanamaker's of Philadelphia in the 1930's.

116. See pp. 186-87 infra.
121. Fla. Laws 1959, ch. 59-414, § 2(7) defined retail installment contract as "an instrument or instruments reflecting one or more retail installment transactions entered into in this state pursuant to which goods or services may be paid for in installments. It does not include a revolving account or an instrument reflecting a sale pursuant thereto." Currently this is Fla. Stat. § 520.31(7) (1973).
122. Fla. Laws 1959, ch. 59-414, § 5(4)(a): "ten dollars ($10.00) per one hundred dollars ($100.00) per year." Fla. Laws 1959, ch. 59-414, § 6(3): "a time price differential which shall not exceed fifteen cents (15¢) per ten dollars ($10.00) per month . . . ."

Revolving account was defined as:

an instrument or instruments prescribing the terms of retail installment transactions which may be made thereafter from time to time pursuant thereto, under which the buyer's total unpaid balance thereunder, whenever incurred, is payable in installments over a period of time and under the terms of which a time price differential is to be computed in relation to the buyer's unpaid balance from time to time.

Fla. Laws 1959, ch. 59-414, § 2(8) (§ 520.31(8)).
In the 1960's banks entered the credit card field. In response to this, the Florida Legislature enacted in 1969 a 1.5 percent per month (18 percent per year) rate ceiling for bank cards.\(^{124}\)

\section*{C. Recent Developments}

The exceptional growth of credit has resulted in and from hodgepodge legislation and judicially recognized exceptions to the usury laws.\(^{125}\) The resulting confusion stimulated studies, such as the American Bar Foundation's in-depth study of consumer credit in the 1960's,\(^{126}\) and proposed model legislation, such as the Uniform Consumer Credit Code\(^{127}\) and National Consumer Act.\(^{128}\)

The Uniform Consumer Credit Code (hereinafter referred to as the UCC) is proposed uniform legislation first presented for adoption by the states in 1968. It is the result of approximately five years of concentrated study by a special committee, a substantial staff of draftsmen and experts, and advice from numerous advisers and consultants drawn from both industry and consumer interests. The UCC, intended to provide a comprehensive, integrated law in the area of credit,\(^{129}\) was molded in the pattern of the Uniform Commercial Code. Its coverage includes both consumer and non-consumer credit sales and loans.\(^{130}\)

The UCC, financed in large part by the credit industry, has been strongly lobbied by the credit industry as a whole and some national small loan companies in particular.\(^{131}\) However, it has been opposed by segments of the banking and small loan industries. Opposition to the UCC by consumer groups has been vehement.\(^{132}\) Much of the consumer unrest emanates from the presence of industry financing and support;\(^{133}\) the code is alleged to be pro-creditor, complicated, and excessively bulky.\(^{134}\) Because of the heavy criticism and scant enactment—only

\begin{itemize}
\item \(^{124}\) Fla. Stat. § 659.181 (1973).
\item \(^{125}\) See pp. 184-96 infra.
\item \(^{126}\) Graham, The UCC: A Perspective and a Summary, 42 Fla. B.J. 1043, 1044 (1968).
\item \(^{127}\) See generally Uniform Consumer Credit Code, Prefatory Note.
\item \(^{128}\) See generally National Consumer Act, Prefatory Note.
\item \(^{129}\) Uniform Consumer Credit Code, Prefatory Note.
\item \(^{130}\) Id.
\item \(^{131}\) Shick, Storm Warnings: A "Revised" UCCC, 6 Clearinghouse Rev. 463 (1972). See also National Consumer Act, Prefatory Note.
\item \(^{133}\) Shick, supra note 131; A Consumer Credit Code . . . for lenders, supra note 132. See also St. Petersburg Times, March 8, 1972, § B, at 1-B.
\item \(^{134}\) Shick, supra note 131; A Consumer Credit Code . . . for lenders, supra note 132.
\end{itemize}
seven states have adopted it to date—it is now in its fifth redraft. The redrafts are more consumer oriented, less complex, and more concise.\textsuperscript{135}

In Florida, the U3C was first introduced in the House in 1969, where it died in committee. It was reintroduced, in either or both the Senate and House, in each succeeding year through 1973, but never reported out of committee.\textsuperscript{136} In 1974 it was informally considered by a House committee but never introduced.

In response to the U3C the National Consumer Law Center produced a model code entitled the National Consumer Act (hereinafter referred to as the NCA).\textsuperscript{137} The NCA is considerably more consumer oriented than the older drafts of the U3C,\textsuperscript{138} but its future is uncertain, especially in light of the U3C redrafts. Many provisions of the NCA were considered by Florida legislative committees as alternatives to the U3C, and they directly influenced some provisions of Florida's Consumer Finance Act.\textsuperscript{139}

Although at one time usury was defined as the charging of \textit{any} interest,\textsuperscript{140} today charging interest is considered usurious only if it exceeds set limits and fulfills certain other requisites.

Usury is an affirmative defense which must be proven by clear and satisfactory evidence. The Florida courts on more than one occasion have stated that there are four elements in a usurious transaction, each of which must be established. First, there must be a loan, express or implied; second, an understanding between the parties that the money loaned is to be returned; third, payment or agreement to pay a greater rate of interest than is allowed by law; and, finally a corrupt intent to take more than the legal rate for the use of the money loaned.\textsuperscript{141}

\textsuperscript{135} Uniform Consumer Credit Code, Prefatory Note to Working Redraft No. 4 (Dec. 1972).


\textsuperscript{138} Shick, supra note 131; National Consumer Act, Prefatory Note, supra note 131.

\textsuperscript{139} See generally Oelten.

\textsuperscript{140} See note 19 supra.

\textsuperscript{141} Anderson, Tight-Money Real Estate Financing and the Florida Usury Statute,
Each requisite provides an opportunity for innovation in methods of avoidance or evasion. Several examples of these "innovations" follow.

III. METHODS USED TO AVOID USURY LAWS

To counter restrictive rates mandated by most state laws, debtors and creditors, courts and legislatures created or countenanced what one author has referred to as "escape valves." Those created by the parties to the transaction are catalogued as either evasions or avoidance. The only difference I can discern between the two categories is that an avoidance is an evasion that succeeded, or an evasion is an avoidance that failed. One of the least successful attempts to avoid the usury laws was by contract. Contractual waivers have not been recognized in the field of usury. The most successful and widespread avoidances are the corporate exception and the time price doctrine.

A. The Corporate Exception

Volume-wise, the largest exception to the general usury laws is the "corporate," or "commercial," exception. This may include,

142. Shanks, supra note 55, at 331.
143. Merriman & Hanks 16 n.80; Penick, supra note 89, at 436.
144. The case most often cited as the beginning of the time price doctrine is Bette v. Bidgood, 108 Eng. Rep. 792 (K.B. 1827). The American counterpart is Hogg v. Ruffner, 66 U.S. (1 Black) 115 (1861). For Florida cases discussing and upholding the doctrine see, e.g., Dillon v. J. W. Walter, Inc., 98 So. 2d 391 (Fla. 1957); Nelson v. Scarritt Motors, 48 So. 2d 168 (Fla. 1950); Midstate Homes v. Stairres, 161 So. 2d 569 (Fla. 2d Dist. Ct. App. 1964). The doctrine has also received more than adequate treatment in the journals. See, e.g., Berger, Usury in Installment Sales, 2 LAW & CONTEMP. PROB. 148 (1935); Collins & Ham, 401-05, 408-12; Ecker, Commentary on "Usury in Installment Sales," 2 LAW & CONTEMP. PROB. 173 (1935); Penick, supra note 89; Robertson, Myth and Reality in Consumer Credit Rate Regulation, 43 MISS. L.J. 429, 437-38 (1972); Note, Judicial and Legislative Treatment of "Usurious" Credit Sales, 71 HARV. L. REV. 1143 (1958); Note, Retail Credit Sales and Usury, 24 LA. L. REV. 822 (1964); Note, Credit Sales At a Price in Excess of the Cash Sale Price as a Violation of the Usury Laws, 12 NEB. L. BULL. 370 (1934); Note, Applicability of Usury Laws to Credit Installment Sales, 4 S CAR. L.Q. 290, 290-93 (1951); Note, Usury and Revolving Credit: The Old Law and the New Economics, 15 S. DAK. L. REV. 304 (1970); Note, Protection of Borrowers in Distribution Finance, 60 YALE L.J. 1219 (1951); Note, Usury Statutes and Installment, 48 YALE L.J. 1102 (1939); Comment, Credit Sales at a Price in Excess of the Cash Sale Price as a Violation of the Usury Laws, 39 YALE L.J. 408 (1930); 49 MICH. L. REV. 1087 (1951).

145. States where there is no law allowing corporations the right to use the defense of usury are: Alaska, Arkansas, Colorado, Connecticut, Indiana, Maine, Massachusetts (no limit on contract rate of interest), Montana, Nevada, New Hampshire (no
or be in addition to, an exemption for transactions in excess of a certain amount; Florida, for example, applies its 15 percent corporate rate to all loans exceeding $500,000. The rationale behind such exceptions is quite simple: the exemption is granted where the debtors are thought quite able to protect themselves. "The need for regulation is much more apparent in the consumer field, and in the writer's opinion, problems in commercial and consumer lending are inherently different."  

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. . . . 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.

Finally, "by releasing the corporation, which is the prime vehicle of industry and commerce, from this restraint lenders are more willing

146. See Harrell, supra note 141, at 353-54; Hershman 339-40; Hershman, supra note 3, at 1152-34; Katz, Usury Laws and the Corporate Exception, 23 Md. L. Rev. 51 (1962); Loiseaux, Some Usury Problems in Commercial Lending, 49 Tex. L. Rev. 419, 438-41 (1971); Merriman & Hanks 8-12; Podell, The Application of Usury Laws to Modern Real Estate Transactions, 1 Real Estate L.J. 136, 138-42 (1972); Prather, Mortgage Loans and the Usury Laws, 16 Bus. Law. 181, 194-95 (1960); Note, Incorporation to Avoid the Usury Laws, 68 Colum. L. Rev. 1390 (1968).


148. Loiseaux, supra note 146, at 420. See Katz, supra note 146, at 55.

149. Merriman & Hanks 15-16.
to risk their capital on corporate ventures and commerce is increased." But "corporate borrowers are not really different from noncorporate borrowers. . . . After all, if it is ipso facto wrong and oppressive—as a matter of legislative policy—to charge a necessitous borrower more than six percent, it is no better to charge a sophisticated corporation more."

Once the constitutionality of such an exemption was established, attention and litigation focused on whether the corporation was for a "business purpose" or was in substance only an illegal method or device for circumventing the usury restrictions on loans to individuals. In light of this line of cases it would seem reasonable to revise the corporate exemption to make it a business exception. "[T]here 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." In this regard it should make little difference if the debtor is incorporated or not.

**B. The Time Price Doctrine**

The time price doctrine is a very simple device by which the parties can avoid the application of usury laws. The seller of a piece or item of property quotes two prices to the buyer—one contemplating cash and one envisioning payment over a period of time. The difference between the two is known as the time price differential. The usury laws are frequently inapplicable because the transaction is a sale, not a "loan or forbearance of money" to which usury laws traditionally apply. In defense of the doctrine it is said that it "was not deviously

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155. *E.g.*, in the sale of an automobile the seller would quote a cash price of $2,000 but if the buyer wanted to pay for it over two years he could do so for a price of $2,400 at the rate of $100 per month. The time price differential would then be $400 ($2,400-$2,000).
156. See, *e.g.*, Note, *Applicability of Usury Laws to Credit Installment Sales*, 4 S. Car. L.Q. 290, 293 (1951), and cases cited therein. See also Morrison v. McKinnnon, 12 Fla. 552 (1869) (compensation for loan or forbearance of other than money is not regulated by usury statute—an exaction of 100 bushels of beans for loan of 30 bushels, not usury).
invented for use in installment sales of the new forms of personal property, but had originated respectably in 19th-century cases related to land sale.”

As one can see with a casual perusal of the cited articles, the merits of the doctrine have already been thoroughly debated; this article, therefore, will not address them further.

In two collateral areas, the time price doctrine has not been faring well of late. The first is the situation where the seller “discounts,” or sells, the buyer’s obligation—chattel paper—to a bank, sales finance company, or other financier. The other area of recent concern is the revolving charge account.

The merits of the time price doctrine are evident. First, it provides a method by which property can be sold on credit where strict adhesion to the usury limitation would make such sales highly uneconomical. Second, it is a gray market, a substitute for loan sharks, “whenever the urgency of the borrower’s needs requires the purchase of durable goods.” And third, criticism of its abuses cleared the way for adoption of the retail installment acts.

C. Option To Repurchase, Sale-leaseback, and “Wrap-around” Mortgage

Other avoidances (or evasions) utilizing sales, found mostly in business contexts, are a sale with option to repurchase and a sale-


159. See, e.g., State v. J. C. Penney Co., 179 N.W.2d 641 (Wis. 1970), commented on in 2 CUMBERLAND-SAMFORD L. REV. 234 (1971) (revolving charge not within time price doctrine); State ex. rel. Turner v. Younker Bros., 210 N.W.2d 550 (Iowa 1973), commented on in 7 CREIGHTON L. REV. 419 (1974) (revolving charge accounts fall under Iowa usury law); Note, Service Charges for Revolving Charge Accounts: A Time Price Doctrine or Usury?, 71 COLUM. L. REV. 905 (1971); Note, Interest Incognito—Usury Statute Applied to Revolving Charge Agreement, 34 U. PITT. L. REV. 54 (1972) (discussing Rollinger v. J. C. Penney Co., 192 N.W.2d 699 (S. Dak. 1971) (nonapplicability of time price doctrine to revolving accounts). See generally Driver, Retail Revolving Credit and the Usury Statutes, 20 PERS. FINANCE L.Q. 24 (1965), advocating applying the time price doctrine even to revolving charge accounts. (At the time he wrote the article, Mr. Driver was assistant general counsel of the J. C. Penney Company.)

160. See Kripke, supra note 157, at 452-53. See generally, Shanks, supra note 55.


162. Kripke, supra note 157. For a discussion of Florida’s retail installment act, see notes 261-63 and accompanying text infra.

leaseback transaction. Both allow a higher return than that permitted by the usury limitation. In both situations, the borrower "sells" property to the lender and is either given an option to buy it back at a price slightly above what the seller received plus the highest legal contract rate of interest, or the borrower leases the property back at rates which, when added to the lease redemption charge, will be above the price received plus the highest legal contract rate of interest.

The "wrap-around" mortgage is another technique that the seller or lender may utilize to increase revenue.

The "wrap-around" mortgage is a subsequent and subordinate mortgage secured by real property upon which there exists a first mortgage which remains outstanding and unsatisfied. The wrap-around mortgage differs from a conventional second mortgage in that it entails a special agreement between the parties for payment of the first mortgage obligation by the lender, and consequently, the principal of the wrap-around loan is the sum of the outstanding indebtedness on the first mortgage and the new funds advanced. When the wrap-around mortgage is executed at an interest rate which exceeds the contractual rate of the first mortgage, it becomes possible for the lender to increase his effective interest yield from the overall transaction. The benefits to be derived from the use of wrap-around financing, therefore, can be realized primarily in a period of rising interest rates.

D. Discounting Negotiable Paper

Discounting negotiable paper or other obligations is another method of avoiding usury limitations. One author describes the procedure and problems as follows:

Where the original borrower absorbs a discount of such [an] amount that the maximum legal rate is exceeded when the discount is added to the contract rate, usury results. Where, however, the original borrower receives the proceeds of the loan at par (or at such lesser amount which translated into a rate of interest and then

164. See Anderson, supra note 141, at 648-58, Podell, supra note 146, at 145-47.
165. See, e.g., Zmistowski v. Oxley, 161 So. 2d 706 (Fla. 2d Dist. Ct. App. 1964) (deed absolute with option back found to be sale not loan, hence not within usury prohibitions). See also Hadlow & Legler, supra note 153, at 573-74, for a recent discussion of these transactions.
167. See Collins & Ham 419; Danforth, supra note 89, at 66; Hershman 347-51. For a good summary of the problems in computing the rate of interest charges, see Pearce & Williams 297-38.
added to the contract rate does not exceed the maximum legal rate) and the loan is then purchased at a discount, no usury results because the transaction is not a loan but a purchase. Unfortunately, the factual situations in which these principles are applied are not so easily placed into the different categories.\(^{168}\)

A Florida example of this problem is *Dante v. Givens*,\(^ {169}\) where plaintiff held a $6,800 note and mortgage. He agreed to assign it to the defendant for $3,000 and a promise that the defendant would, after a period of time, assign it back upon payment of $3,600. The court held that the transaction was not the sale of a mortgage but was a loan and subject to the usury laws.\(^ {170}\)

**E. The Wage Purchase**

One of the most prevalent methods used to skirt the usury laws as they applied to consumers was a salary or wage purchase.\(^ {171}\)

The “salary purchaser,” so called, advances the employee a sum of money and takes in return only an assignment of a portion of the employee's wages covering the advanced amount and usually ten percent in addition. The “purchaser” takes no obligation from the seller of the wage—only the assignment. The device is obvious and it is believed that most courts would declare the transaction no matter what its form a loan of money.\(^ {172}\)

A common practice in unregulated territory in the South takes the form of a sale by the borrower to the lender of his next pay check, which he agrees to buy back at [the] next pay day with a premium. If he cannot pay the whole amount on the appointed day he must sell another pay check. This process goes on from week to week, often for years on end. Salary buying was especially flagrant in Georgia. The charge there was usually $1 on each $10. The borrower must go on renewing his agreement and paying his premium until such time as he could find enough cash to discharge the principal with the premium.\(^ {173}\)

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168. Hershman 347.
The purchase or assignment of "wages, salary, commissions or other compensation for services" of $600 or less has been brought under Florida's usury provisions. Furthermore, the legality of such a sale or assignment, even for security, in Florida is open to question.

F. The Collateral Advantage Doctrine

The collateral advantage doctrine was designed to deal with another series of contrived variances to usury restrictions. "The general rule is that a collateral transaction between the borrower and lender under which the lender may earn a profit will not render the transaction usurious, if entered into in good faith and without an intent to exact usury." This rule might be applied, for example, where, in addition to legal interest, (1) the lender was "hired" by the borrower as a financial advisor but did no work; (2) the debtor was required to lease unneeded space from the lender; or (3) the borrower was required to buy a $10 merchandise coupon good for face value on all purchases over $40 made from the lender.

A prevalent form of this "tie-in" arrangement in consumer transactions is the sale of credit life, accident and health, or other forms of insurance. Among cash lenders it is not unusual to find that 95 to 98 percent of the borrowers have purchased insurance from or through the creditor. This saturation coupled with the belief that insurance is an improper method of raising lender revenues has brought near condemnation by many writers. The practice is said to be bad for several reasons, not the least of which is the tendency to mask the true cost of the credit transaction. Unlike many prices

176. Pearce & Williams 252. See generally Loiseaux, supra note 146, at 434-35.
177. Collins & Ham 418.
178. Id. at 419.
179. Penick, supra note 89, at 437.
181. Consumer Credit in the U.S. 86.
183. "[E]ven . . . informed debtors have no real alternatives in selecting coverage and are in a vastly inferior bargaining position vis-a-vis the creditor. In addition, the
which are virtually unregulated, insurance premiums are not subject to competition but are influenced by a type of "reverse competition": the creditor sells the brand of insurance which carries the highest legal price because he profits in direct proportion to the size of premium collected.184

Because of the potential for coercion in a situation where the creditor can both "sell" insurance and require its purchase,185 certain protective measures have been legislatively enacted. For example, under Truth in Lending if the creditor requires the purchase of credit life or disability insurance as a prerequisite to the granting of credit, it must be included in the "finance charge."187 In Florida the sale by a creditor-seller of certain types of insurance is subject to the anti-coercion statute that, while reinforcing the right to require insurance, prohibits the specification of any particular agent, solicitor, or insurer.188 However, a Consumer Finance Act licensee "can sell credit life and disability insurance . . . and can condition the grant of credit on the purchase of such insurance from an employee or associate of the licensee."189 While the National Consumer Act would forbid the creditor any advantage from the insurance sale other than having the risk insured,190 the Uniform Small Loan Act prohibits any charge in addition to the permitted interest.191

Proposals to prevent the creditor from profiting on the sale of insurance have been criticized on two fronts. First, if the profit incentive is removed, fewer creditors may sell insurance and unit costs will probably rise—credit insurance may well be more expensive on a nonprofit basis than it is on a profit basis.192 Second, without the revenue from credit insurance operations, consumer finance companies would have a reduction in profit.193 Reductions of profit would in turn

relatively insignificant cost of the added insurance service discourages debtors from engaging in intense price shopping." CONSUMER CREDIT IN THE U.S. 86.

184. Id. at 85-86; Copenhaver, The Uniform Consumer Credit Code, 71 W. VA. L. REV. 1, 14-15 (1968).

185. See, e.g., FLA. STAT. §§ 626.321(1)(a), (c) (1973).


188. FLA. STAT. § 626.960 (1973).

189. Oeltjen 993.

190. NATIONAL CONSUMER ACT § 4.110(11).

191. Seventh Draft of the Uniform Small Loan Law § 13(c) in B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION 153 (1965).

192. CONSUMER CREDIT IN THE U.S. 86.

193. "[T]he revenue from credit insurance accounts for 15 percent of the net operating profit of consumer finance companies and that almost 40 percent of premiums on credit insurance are returned to the lender in the form of commissions and dividends . . . ." Goudzwaard, The Economic Impact of Credit Insurance Charges, 36 J. RISK & INS. 515, 522 (1969). See CONSUMER CREDIT IN THE U.S. 86.
prompt a cutback in expenses, which would take the form of a re-
duction of credit extended to borrowers in the marginal risk
category. 194

A study done in the State of Washington following the enactment
of a law lowering interest rates from 18 percent to 12 percent reported
that "[r]etailers, and particularly automobile dealers, also compensated
for their decline in income on credit transactions by selling more of
their customers credit life, credit health, and accident insurance
policies." 195 There was an increase of 23 percent in credit health and
life insurance from automobile sales in 1969 in Washington, while
the rise in other states was negligible. 196

The cited article discusses other reasons for the increase in sales
of insurance. First, if the consumer who has credit health in-
insurance becomes sick or disabled, the insurance company will make
the payments. By ensuring the repayment of more loans, the creditor
can offer more credit on better terms because of his lower risks of de-
fault. Second, insurance makes the contract "between the merchant
and the consumer more salable to financial institutions." It allows
the creditor to get more money when he discounts the note. The
secondary effect is, of course, an increase in the availability of credit
at lower terms. 197

Arkansas also provides an example of this problem.

The Little Rock lenders, especially the loan company officials,
were quick to point out their need to employ the credit insurance
sale as a revenue-producing device—either for the lender's com-
mission as agent for an independent insurer or for the profit on
the premium in cases where the lender is its own insurer. On the
other hand, many of the Champaign-Urbana lenders, particularly
the banks, regard insurance simply as added security for payment.
Not only are the insurance charges higher in Arkansas, but the
Little Rock lenders to some extent use property insurance solely
as a revenue producing device. For example, several of the Little
Rock loan companies often attempt to acquire a security interest

194. "If insurance were eliminated or if the premiums were reduced sharply, then
in order to maintain credit availability at present levels, it seems likely that rate ceilings
would have to rise or other solutions must be sought, such as loans guaranteed by
government agencies." Goudzwaard, supra note 193, at 523. "Indeed it might be that
cash lenders, under such circumstances, would not only discontinue offering insurance
services but cease or severely restrict offering financing services as well." CONSUMER CREDIT
IN THE U.S. 86.
195. Wheatley & Gordon, Regulating the Price of Consumer Credit, 35 J. MARKET-
ING 21, 24-25 (1971).
196. Id.
197. Id.
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in the household furnishings of the borrower simply in order to justify imposing an insurance premium which varies among the lenders from $1.00 per thousand valuation to $2.50 per hundred valuation.198

G. Choice of Laws

Nonuniformity among state laws that define and penalize usury creates an advantage for the parties who can "forum shop."199 Discussions of the cases involving whether debtors and creditors may choose their forum and what criteria should be used to govern or invalidate their choice are commonplace.200 Where parties have not specified a forum but have "contacts" with two or more jurisdictions, the courts may be called upon to decide the choice of laws problem.201

H. Profit Sharing

Another arrangement subject to question is one in which capital is advanced in exchange for a return of principal and perhaps interest plus a share of the profits.202 It has been suggested that "[a]lthough

199. A recently discussed example of this is the situation where the Arkansas constitution as interpreted by the state supreme court limits any and all finance charges to 10% simple interest. "Despite the fact that one-third of the Texarkana urban population is located on the Arkansas side, 20 of 21 loan companies are operating in Texas. According to our interviews, this concentration can be specifically attributed to the Arkansas usury law. Lenders find it much more profitable to operate under the higher Texas ceilings. Our research indicates that the lenders on the Texas side deal extensively with Arkansas residents." Comment, supra note 198, at 582-83.
202. Strangely enough a similar problem faced the French Tosafists, French Jews of the Twelfth Century, similarly troubled by interest restrictions—in their case by reason of biblical injunctions against the charging of interest. The device they invented and called "Hetter Iske" was a partnership or joint venture in which the man who supplied the capital joined in the venture with a working partner who employed the capital in his discretion but guaranteed the investment against loss plus a minimum yield. The partnership agreement recited an acknowledgment by the working partner that he had been paid for his work and an agreement for the sharing of losses. The latter provision was, however, negated by rules of evidence which made it impossible to prove the losses. Under this agreement the debt lawfully owed was the principle plus the "profit" and was payable at the end of a defined "trading" period.
there are no Florida cases analyzing this problem, Florida's treatment of disguised loans makes it almost a certainty that the value of an equity position will be treated as additional interest."

I. Additional Fees Charged by Lenders

Commissions, brokers' fees, handling charges, service charges, "points," origination fees, appraisal fees, filing fees, attorney fees, investigation fees, closing charges, bonuses, premiums, etc., are all means by which the cost to the borrower is increased. With all of these charges, "[t]he key question in each case is whether the assessment represents a reasonable fee for an identifiable service rendered or is only an additional charge for the use, detention or forbearance of money." This straightforward statement of the question understates the complexity of the issue. Substantial litigation and commentary has been devoted to this very question, albeit in varying contexts. The problem of the credit broker has been especially troublesome.

While the courts generally hold that the payment of a commission to one acting as agent for the borrower in negotiating a loan will not render the loan usurious, they hold different views as to the effect on the loan when the borrower's agent shares his commission with the lender. Most courts hold that if a part of the commission is paid to the lender as an inducement to grant the loan, the transaction will be deemed usurious.

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203. Hadlow & Legler, supra note 153, at 573. For additional discussion on this point, see Anderson, supra note 141, at 660 & n.61.

204. See Fla. Stat. § 687.05 (1973) (provision for attorney's fees will not render transaction usurious); Va. Code Ann. § 6.1-319 (1950) ("points" included in interest. See also Danforth, supra note 89, at 61-64; Harrell, supra note 141, at 348-51; Hershman 342-44; Loiseaux, supra note 146, at 422-28, 426-29; Pearce & Williams 240-42, 249; Penick, supra note 89, at 440-41; Prather, supra note 146, at 188-91.

205. Loiseaux, supra note 146, at 428. If the assessment were not merely an "additional charge" for the use of money, the Florida courts would probably permit its exaction even though if added to the interest charge it would render the transaction usurious. See, e.g., Crompton v. Smith, 192 So. 186 (Fla. 1939). See also Comment, Evasion and Avoidance of Florida Usury Laws, 5 Miami L.Q. 493, 499 (1951), and cases cited therein.

206. See, e.g., Birkhead, Murray & Lochmoeller, supra note 180, at 268-69 (broker employment form); Note, California's Legislature Faces the Small Loan Problem, 27 Calif. L. Rev. 286 (1939).

207. Harrell, supra note 141, at 348. Florida is in accord with the general rule as stated. See Investment Funds Corp. v. Bomar, 303 F.2d 592 (5th Cir. 1962), citing
As one commentator has pointed out, even where the brokers “pur-
port to act as the agent for the borrower in ‘arranging’ loans, it is
interesting to note that the borrower is seldom aware of this alleged
relationship.”208

J. Computational Differences

A group of problems very closely tied to the computation of the
amount of “interest” used to determine compliance with the usury
laws is presented by prepayment209 or other penalties, delinquency
fees,210 and acceleration provisions. Any extra fee charged for early
payment or otherwise should probably be prorated over the term
that the loan is outstanding to determine whether the transaction
is usurious, especially in light of the all-inclusive nature of Florida’s
usury statute.211 But it has been argued that “[t]here is no reason why
the lender should be required to accept repayment of his money before
the agreed term expires. It, therefore, appears perfectly legal to require
additional compensation, not for the loan but for the release before
the time agreed upon.”212 The underlying rationale of this argument
could be extended to other penalties as well: they should be con-
sidered as compensation to the lender for variances, the benefit of
which inures to the debtor.

Acceleration and its effect upon usury has been the subject of
much litigation and commentary.213 The main conflicts focus on

Shaffran v. Holness, 102 So. 2d 35 (Fla. 2d Dist. Ct. App. 1958) (fee paid by borrower
to agent not to render transaction usurious); Applebaum v. Laham, 161 So. 2d 690 (Fla.
taken by lender’s agent made transaction usurious).

208. Birkhead, Murray, & Lochmoeller, supra note 180, at 257.

209. All of the consumer credit acts provide for prepayment rights and specify the
method of refund if the interest is precomputed. FLA. STAT. § 516.15(3) (1973) (Con-
sumer Finance Act); FLA. STAT. § 520.09 (1973) (Motor Vehicle Sales Finance Act);
FLA. STAT. § 520.34(10) (1973) (Retail Installment Sales Act); FLA. STAT. § 520.84 (1973)
(Home Improvement Sales and Finance Act); FLA. STAT. § 659.18(2)(f)(1) (1973) (bank loans
under $5,000). For a discussion of the Consumer Finance Act provision, see Oeltjen 395-97.

210. A delinquency charge is an additional assessment made on credit transactions
because payment is made later than the due date specified in the contract or loan
agreement. Delinquency charges are specifically authorized by several Florida statutes.
See FLA. STAT. §§ 516.031(2); 520.07(5), .37, .85; 627.841(1); 656.17(5); 659.18(2)(a) (1973).
For a discussion of the problems under the Consumer Finance Act, see Oeltjen 389-91.

211. See FLA. STAT. § 687.03 (1973). See generally Danforth, supra note 89, at 64;
Loiseaux, supra note 146, at 431-32; Pearce & Williams 242; Prather, supra note 146, at 191.

212. Comment, Evasion and Avoidance of Florida Usury Laws, 5 MIAMI L.Q. 493, 503
(1951).

213. For a discussion of the Florida statutes, cases, and problems that they raise,
see Anderson, supra note 141, at 658-60; Boyer & Berger, supra note 169, at 321-22;
Boyer & Berger, Usury and the Viruliferous Acceleration Clause in Florida, 21 U.
MIAMI L. REV. 215 (1966); Hadlow & Legler, supra note 153, at 575-76; Hardaway,
situations where the unearned interest is collected upon acceleration, where the interest is precomputed, or where "interest" and other charges are deducted from the principal sum before being turned over to the debtor. In such situations, the shortened or "accelerated" term should be used to compute the actual rate for usury purposes.\textsuperscript{214} Although there are contractual and other methods to avoid such a result, much of the problem has been obviated in Florida by a recent statutory enactment which includes an "assumption that the debt will be paid according to the agreed terms."\textsuperscript{215}

IV. Finance Charges

We may define the rate of interest as the per cent of premium paid on money at one date in terms of money to be in hand one year later.\textsuperscript{216}

A. Composition

A thorough understanding of the various components of a "finance" or "interest" charge is necessary to understand any plea for changed usury ceilings. Built into the charge authorized by each of the usury provisions are several components: 1) "pure" interest; 2) inflationary offset; 3) cost of operations; 4) risk; and 5) profit.\textsuperscript{217}

"Pure" interest generally is the rate of return for a riskless venture that has no administrative costs. In the absence of inflation, the closest example might be the return on a U.S. government bond.\textsuperscript{218} If this were the only component of the finance charge, interest rates from year to year and across the economy would be substantially similar.\textsuperscript{219}
The second component, inflationary offset, accounts for the decreased value of the loan principal when it is repaid.\textsuperscript{220} For example, if we assume an inflationary rate of 10 percent, an interest-free loan of $100 that you made to your neighbor for the upcoming year is actually going to cause you to lose $10 while your neighbor profits by the same amount. With the 10 percent decrease in buying power it will take $110 to buy at the end of the year what you could get for $100 today.

The third factor, cost of operations, is especially significant in setting an appropriate rate of finance charge.\textsuperscript{221} Many types of credit are much more expensive to administer per dollar extended than others. For instance, it would cost little more to record a $100,000 payment on a $2 million loan than it would to record a $5 payment on a $50 stereo.\textsuperscript{222} Costs of operation can be divided into several subparts: acquisition, servicing, termination, and general overhead.\textsuperscript{223} The acquisition costs are those incurred to open the loan, including costs of advertising, credit investigations, legal complications of drafting and recording, and establishment of the “account.” Servicing would include the acceptance and recording of payments, followup of delinquencies, collection of overdue accounts, etc. Termination would include closing out the file on final payment or charge off and perhaps refinancing and consolidations. The overhead category would include items such as rent, depreciation, interest, taxes, and insurance.\textsuperscript{224}

The risk component is likewise very significant in determination of a finance charge.\textsuperscript{225} Lower risk operations have fewer bad debts and customers with a higher average “credit rating” than those institu-

\textsuperscript{220} This component is discussed and explained in A. Alchian & W. Allen, University Economics 193-94 (3d ed. 1972).

\textsuperscript{221} See generally Consumer Credit in the U.S. 139-47; Chapman & Shay.

\textsuperscript{222} Kripke, supra note 157, at 447. “Within reasonable limits there is a fixed overhead cost of every loan which varies only slightly with the size of the loan.” Hubachek, supra note 180, at 650. See Chapman & Shay 20; Murphy, supra note 182, at 351; Upton, supra note 217, at 280; Testimony of Robert P. Shay in Report to the California Senate Subcommittee on Judiciary of the Advisory Commission on the Uniform Consumer Credit Code, January 18, 1972, at 273-76.

\textsuperscript{223} Upton, supra note 217, at 276-77.

\textsuperscript{224} Id.

\textsuperscript{225} Each time a creditor provides credit, he is making a bet. Through credit judgment and credit scoring systems a creditor estimates the probability that a given applicant will be willing and able to repay the debt. If he guesses correctly, the revenue he receives for the credit service provides a return on invested capital. If he guesses wrong, he loses up to his entire investment in the account, as well as the costs involved in its processing. Thus, operating costs associated with the assumption of risks are reflected both in bad debt losses and in costs of collection efforts.

Consumer Credit in the U.S. 140.
tions which have a relatively high rate of bad debt charge off and whose clientele have marginal "credit ratings." Factors which may influence risk include age of debtor, his health, assets in excess of liabilities, credit and repayment experience, size of loan, length of term, repayment provisions, security taken, income potential, and family situation. Since these factors influence not only bad debt charge off but also the cost of debt collection, the risk component also influences the cost of operations.226

The final component is that of profit. Profit for this purpose would be defined as that return which would compensate the lender for his ingenuity in combining the necessary human and capital resources to form a successful lending operation.227 If the lender is inefficient or unimaginative compared to his competitors, he may not be entitled to any profit.

B. The Charge

The representations with reference to charges now being made by banks, discount companies, and sales finance companies constitute a veritable babble of tongues.228

There are a variety of methods utilized in stating the maximum permissible rate of interest. Statutes contain such references as "discount,"229 "payable in periodic installments,"230 "ten dollars per one hundred dollars per year,"231 or "simple interest,"232 each of which is either a form of stating interest or influencing it. The Federal Truth in Lending Act requires disclosure of these rates in all "consumer credit transactions" in terms of the annual percentage rate (APR) of finance charge.233

226. Id.
227. The profits to which I here refer are entrepreneurial profits as opposed to the receipts of an asset owner. These latter receipts are compensated through other components. For a quite recent and thorough discussion of the entrepreneur and his role in society, see I. KIRZNER, COMPETITION & ENTREPRENEURSHIP (1973).
228. Hubachek, supra note 81, at 132.
233. 15 U.S.C. §§ 1601-65 (1970). "Annual percentage rate" is defined (1) in the case of any extension of credit other than under an open end credit plan, as (A) that nominal annual percentage rate which will yield a sum equal to the amount of the finance charge when it is applied to the unpaid balances of the amount financed, calculated according to the actuarial method of allocating payments made on a debt between the amount financed and the amount of the finance charge, pursuant to which a payment is applied first to the ac...
The term "discount," when used to describe the interest charge, simply means that the interest is deducted from the loan proceeds before they are turned over to the debtor. For example, a $100 loan at an interest rate of 6 percent discount means that the debtor will receive $94 in loan proceeds. The debtor would thus get the use of $94 for a charge of $6. Since APR is computed on the basis of dollars of interest charge per $100 principal per year, the ratio 94:6 can be utilized to determine the APR. To carry the computation further, $94x = 600$ or $x = 6.4$. Thus the APR of a 6 percent discount would be 6.4 percent.

If the loan is to be repaid at the above rate in monthly installments, the APR must again be recomputed. If the loan is being repaid in installments, at any one point in time the debtor only has the use of approximately one half of the principal—the outstanding balance declines from $100 at the beginning of the term to $0 at the end. This has the effect of nearly doubling the APR.\(^{234}\) To determine the exact rate in such circumstances involves complex mathematical computations which are beyond the scope of this article. Since the computations are so complex, I would strongly suggest that frequent reference be made

\[ 15\text{ U.S.C. § 1606(a) (1970).} \]

\[ \text{234. It is frequently said that a rate of so many dollars per$100 per year should be} \]
doubled to find the true interest rate per annum. Then why is not the true interest rate here 13\% (2 \times 6\%\%) instead of 12\%? The answer is that the installment payments do not quite reduce the average term of the obligation to one-half the nominal term. The average term of an obligation payable in installments over 12 months is 6\(\frac{1}{2}\) months, not 6 months. Thus, the rate does not quite double, because the average term is always one-half month more than one-half the nominal term. This one-half month factor diminishes in importance as the overall term lengthens to several years.


The following formula can be used to approximate the true interest rate.

\[
\text{TRUE INTEREST RATE} = \frac{2 \ M \ I}{P \ (N + 1)}
\]

\(P = \) Amount borrowed
\(I = \) Dollar amount of interest
\(M = \) Pay periods in year
\(N = \) Total pay periods in contract
to annual percentage rate tables, available from many sources. In the above example, the APR would be 11.5 percent.

A rate of charge of 10 percent simple interest would be the same as a finance charge of 10 percent APR. The only apparent difference between the two terms is that the scope of APR is broader than "simple interest," since the former term can also be used to describe such non-"interest" charges as insurance and other service charges.

Thus in a particular situation, a finance charge at the APR of 15 percent may consist of interest at the rate of 10 percent "simple interest," insurance of 3 percent and a service charge of 2 percent.

Stating that a loan is made at the rate of $10 per $100 per year is the same as stating the charge for the loan is 10 percent APR. But if the loan is repaid in installments, for the reasons stated above the rate would be 18 percent APR.

If, in addition to a finance charge stated in one of the manners discussed above, the parties utilize points, origination fees, bonuses, interest in advance, compounded interest, or "wrap-around" mortgages, it becomes a nightmare to determine whether the resulting charge is in violation of the usury laws. First it must be determined if the charge is properly includable in "interest," and if it is, how the charge is computed. Then one must determine the maximum permissible charge for the particular transaction, which may be no easy chore. This is confusing to creditors and debtors alike. Federal Truth in Lending has created an "incentive" for creditors in consumer credit transactions to properly determine and state the charge as an annual

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235. Annual percentage rate tables can be acquired from the Federal Reserve System at a cost of $1 a volume for a two volume set. Volume 1 is the most useful. Volume 2 contains the factor tables for irregular transactions.


237. There is also a possibility of "interest on interest," which is to be distinguished from "compound interest." "Interest on interest is the interest paid on the interest due upon the original sum. Compound interest is the interest paid when the unpaid interest due is added to the principal and the resulting sum is the basis for the next computation." Comment, Legality of Agreements To Pay Interest on Interest in New York, 15 Fordham L. Rev. 269, 270-71 (1946) (footnotes omitted). This comment includes a chart that illustrates the difference between the two different forms of computation. Id. at 271.

Another commentator has described compound interest as "a potent mathematical formula which, if allowed to operate to its full extent, would within a relatively short time bring about intolerable conditions." Note, Compound Interest and the Law, 6 Temple L.Q. 357 (1932). "If instead of throwing a dollar across the Potomac George Washington had set it aside in a 6 percent fund to be accumulated for the benefit of some heir living in 1932, the lucky person would today receive $36,000." Id.

238. See explanation of "wrap-around" mortgages at pp. 187-88 supra.
percentage rate, but the businessman is still at the mercy of the terminology and computations.

V. Survey of Statutory Usury Law in Florida

A. General Usury—Chapter 687

Under the current Florida statutory scheme, it is illegal to charge more than 10 percent per annum "either directly or indirectly, by way of commission for advances, discounts, exchange, or by any contract, contrivance or device whatever," except where a greater rate is authorized by another statute. This is one field where the exception entails more cases than the rule. The following pages set forth the various rates that may be charged in each of the many segments of Florida's financing industry. In addition to the charges set forth herein, in many instances "other charges" and insurance may be added.

B. Consumer Finance Act—Chapter 516

Under the Consumer Finance Act (CFA) licensees may loan up to $2,500 at rates computed according to a graduated scale. Since the rates of interest are stated to be "simple interest, and not add-on interest or any other computations," the stated percentage rates are equal to the APR. For the first $300 the licensee may charge up to 30 percent, for the second $300 ($300-$600) the rate is 24 percent, and for that portion of the loan which exceeds $600 the rate is 16 percent.

239. [A]ny creditor who fails in connection with any consumer credit transaction to disclose to any person any information required under this part to be disclosed to that person is liable to that person in an amount equal to the sum of

(1) twice the amount of the finance charge in connection with the transaction, except that the liability under this paragraph shall not be less than $100 nor greater than $1,000; and

(2) in the case of any successful action to enforce the foregoing liability, the costs of the action together with a reasonable attorney's fee as determined by the court.


240. FLA. STAT. § 687.03 (1973). The maximum rate which may be charged corporations is 15% per annum. However, this rate does not apply to sales of bonds in excess of $100 and mortgages securing the same, or money loaned on bonds. Id. Where the contract does not specify the rate of interest to be charged, interest accrues at the rate of 6% per annum. FLA. STAT. § 687.01 (1973).

241. See pp. 194-95 supra.

242. For a thorough discussion of the Consumer Finance Act, see Oeltjen.

243. FLA. STAT. §§ 516.02, .031 (1973).

244. FLA. STAT. § 516.031(1) (1973).

245. FLA. STAT. § 516.031(1) (1973).
The above rates are to be applied to the "original principal amount," which is the equivalent of "amount financed" as defined in the Federal Truth in Lending Act.246

C. Industrial Savings Banks (Morris Plan Banks)—Chapter 656

Industrial savings banks may lend money

at a discount not to exceed eight percent per annum upon the total amount of the loan from the date thereof until the maturity of the final installment, notwithstanding that the principal amount of such loan is required to be repaid in installments, plus an additional charge not to exceed two percent of the principal amount of any loan, which additional charge shall be for investigating the character of the individual applying for the loan, the security submitted and all other costs in connection with the making of such loans, all which charges and discounts may be collected at the time the loan is made.247

Because this section authorizes deduction of the interest at the time the loan is made,248 even if the loan is being repaid in installments, the maximum authorized APR is 20 percent. If the 2 percent service charge were not included, the resulting APR would be 15.75 percent.

Unlike many such service charges,249 the creditor apparently does not have to show that he expended such amounts; he may assess the additional charge regardless of whether he can prove he incurred such costs.

D. Credit Unions—Chapter 657

Credit unions may loan money at an interest rate not to exceed 1 percent per month on the unpaid balance.250 This rate is equivalent to an annual interest rate of up to 12 percent.

E. Bank Loans Under $5,000—Chapter 659

For loans less than $5,000, banks may charge a maximum interest rate of 6 percent per annum computed on the total amount of the

246. The "amount financed" is "[t]he amount of credit . . . which will be paid to the customer or for his account or to another person on his behalf, including all charges, individually itemized, which are included in the amount of credit extended but which are not part of the finance charge . . . ." Reg. Z, 12 C.F.R. § 226.8(d)(1) (1974).
loan for its entire duration. The interest may be deducted in advance from the proceeds of the loan, and the loan may be made repayable in substantially equal periodic installments. Thus the maximum APR is 11.5 percent.

In addition to the interest charges, the debtor may be charged for the actual cost of credit investigations and appraisal of offered security. Such costs may not exceed 2 percent of the principal amount of the loan. If the maximum is charged, the APR total would be 15.25 percent.

For loans which would otherwise be uneconomical to grant, the bank is authorized to make a minimum interest charge of $3 on any single payment loan or $5 on any installment loan notwithstanding the fact that these would exceed the statutory 6 percent rate.

**F. Bank Credit Card Loans—Chapter 659**

Banks are given the power to make loans or extend credit, not exceeding $5,000, on a credit card or overdraft financing arrangement and to charge interest of not more than 1.5 percent per month on the unpaid balance of such extension of credit computed on a monthly cycle. This allows an APR of 18 percent.

**G. Premium Finance Companies—Chapter 627**

A premium finance company may collect a service charge for financing insurance premiums. The charge, which is to be computed on the balance due after subtraction of the down payment, shall be a maximum of $9 per $100 per year. This rate may be charged from the inception of insurance coverage to the date of final payment. Thus the maximum APR is 16.25 percent.

In addition to the above finance charge, the financier is authorized to charge an additional $10 per premium finance agreement which charge need not be refunded upon prepayment. If, however, the premium is financed by the insurer or an agent or subsidiary thereof, the charge is limited to $1 per installment, not to exceed $6 per year, on premiums of $120 or less. For premiums of $120 to $220, the charge may not exceed $9 per year. For premiums of over $220, the charge shall not exceed $12 per year. Since the charge is to be applied to

251. FLA. STAT. § 659.18(1) (1973).
255. FLA. STAT. § 627.840(3) (1973).
256. FLA. STAT. § 627.840(3) (1973).
257. FLA. STAT. § 627.901, 902 (1973).
a range of potential principals, it is not possible to state the APR. In lieu of the above charges, interest not exceeding 10 percent "simple interest per annum" may be assessed on the unpaid balance.\textsuperscript{258} This equals an APR of 10 percent, which is also the general usury rate.\textsuperscript{259}

**H. Policy Loans on Insurance—Chapter 627**

The insurer may make a loan on an insurance policy at an interest rate not to exceed 6 percent per annum on the amount loaned, which amount is not to exceed the cash transfer value of such policy.\textsuperscript{260}

**I. Retail Installment Sales—Chapter 520**

The seller under a retail installment contract may exact a finance charge on the amount financed not exceeding $10 per $100 per year.\textsuperscript{261} The amount financed is equal to the cash price of the goods, minus the amount of the buyer's down payment, plus the amount included for insurance and other benefits (if not included in the finance charge), plus the amount of the license taxes and official fees.\textsuperscript{262} This means that a maximum APR of 18 percent is authorized. Notwithstanding the above, the creditor may assess a minimum finance charge not exceeding $12 on any retail installment contract involving an initial amount financed of $50 or more, $7.50 on a contract of more than $25 and less than $50, and $5 on a contract of $25 or less.\textsuperscript{263}

**J. Revolving Charge Accounts—Chapter 520**

The seller under a revolving account may charge a finance charge which shall not exceed 15 cents per $10 per month, computed on the unpaid monthly balances.\textsuperscript{264} This computes to a maximum APR of 18 percent. A $1 minimum charge per month is allowed.\textsuperscript{265}

**K. Motor Vehicles Sales Financing—Chapter 520**

For financing the sale of a motor vehicle, the finance charge, exclusive of insurance, shall not exceed:

(a) Class 1. Any new motor vehicle designated by the manufacturer

\begin{itemize}
\item \textsuperscript{258} FLA. STAT. § 627.901, .902 (1973).
\item \textsuperscript{259} See note 240 and accompanying text supra.
\item \textsuperscript{260} FLA. STAT. §§ 625.321, 627.458 (1973).
\item \textsuperscript{261} FLA. STAT. § 520.34(5) (1973).
\item \textsuperscript{262} FLA. STAT. § 520.34(2)(f) (1973).
\item \textsuperscript{263} FLA. STAT. § 520.34(5) (1973).
\item \textsuperscript{264} FLA. STAT. § 520.35(5) (1973).
\item \textsuperscript{265} FLA. STAT. § 520.35(3) (1973).
\end{itemize}
by a year model not earlier than the year in which the sale is made—$8 per $100 per year.

(b) Class 2. Any new motor vehicle not in Class 1 and any used motor vehicle designated by the manufacturer by a year model of the same or not more than two years prior to the year in which the sale is made—$11 per $100 per year.

(c) Class 3. Any used motor vehicle not in Class 2 and designated by the manufacturer by a year model not more than four years prior to the year in which the sale is made—$15 per $100 per year.

(d) Class 4. Any used motor vehicle not in Class 2 or Class 3 and designated by the manufacturer by a year model more than four years prior to the year in which the sale is made—$17 per $100 per year.  

Such finance charge is to be computed on the amount financed, which is the “unpaid balance of cash price” (the cash price of the vehicle minus the down payment), plus insurance costs if not included in the finance charge, plus the amount of license, taxes, and official fees. For Class 1, the maximum APR is 14.5 percent; for Class 2, 19.75 percent; for Class 3, 26.75 percent; and for Class 4, 30 percent. In lieu of these charges, a minimum charge of $25 may be assessed.

L. Home Improvement Sales—Chapter 520

Under this part of chapter 520, a finance charge is defined as the “amount by which the time sale price exceeds the total of the cash price and the amounts, if any, included for insurance premiums and official fees.” Such finance charge is not to exceed $10 per $100 per year and is to be computed on the principal amount financed on the contract. The rate of interest allowable computes to 18 percent APR. Under this section a $25 minimum finance charge is permitted.

VI. Proposals for Change

A. Introduction

The provisions that regulate the price of credit in Florida have

counterparts of one form or another in every state and jurisdiction. Although this is simple to verify, it is difficult to determine why so many such restrictions remain. We have gone from a time when one was scorned by his neighbors for being so improvident as to need to borrow money, to an era where one must have something quite sinister locked away in his credit file if one does not have and use a charge card. With the change of attitude toward credit, why has there not been a corresponding change in attitude toward its regulation? One answer may be that “[u]sury laws imposing inflexible price ceilings on money and credit are historical vestiges of the erroneous supposition that emperors, kings and governments could effectively fix all prices.”

There must be more to usury limitations than the quote suggests, because in most other sectors of our economy we disdain price controls except in emergency situations and for utilities, which are state-granted monopolies. Perhaps, as one author suggests,

[a] theoretical distinction is possible between two kinds of usury laws—a price-fixing variety, and a “moral” variety, which does not fix the price of money, but outlaws fraudulent trade practices. Before the Civil War, American usury laws were obviously price-fixing laws, or tried to be; but rhetoric appropriate to “moral” laws was often used to defend them. The laws themselves made no distinction between big and small borrowers, weak and strong ones, secured or unsecured debt.

But with the legislative “innovations” of the post Civil War period, the complexity and segmentation of today’s regulatory scheme arose. And even today, “[m]any businessmen, politicians, and consumers . . . (even those who favor free market prices as a general policy), tend to favor legal limits on the price (interest rate) which may be paid or received for money or credit.”

Moral and religious grounds, together with the theory that capital is nonproductive, which historically prompted usury restrictions, produced the present hodgepodge of regulations and exceptions. These laws remain, but the rhetoric has changed. Today’s arguments are

273. UNIFORM CONSUMER CREDIT CODE, Prefatory Note xix (1968).
274. Friedman, supra note 67, at 521.
275. Wheatley & Gordon, supra note 195, at 22.
276. See discussion of history of usury pp. 171-84 supra.

That arbitrary rate ceilings have little to do with morality is demonstrated by their across-the-board applicability and their general failure to make any exception based upon the ability or willingness to pay. A man who borrows not
phrased in such terms as "economics," "unconscionability," and "bargaining disparity".

[Most important] is the striking disparity in bargaining power between the two parties to a typical consumer credit transaction of any magnitude, coupled with the average consumer's almost total lack of understanding of the legal implications of the transaction.278

Proposals to increase rates or to sustain current levels which may be unpopularly high are met with such arguments as:

The tragedy is that, as with most of the pro-creditor provisions of the draft, the brunt of these high rates will be borne most heavily by low to moderate income consumers.279

It is also to be remembered that he [the person who would borrow money at these higher rates] is the man who can least afford to pay ....280

Let there be no mistake about it; the Code [U3C] would impose a rigid interest rate structure which will fan the fires of inflation and have the greatest impact on those who can afford it least.281

These arguments are not to be taken lightly, but neither is the constricting effect that reduced or low usury limitations have on the availability of certain types of credit.282 A recognition of this conflict prompted Senator Douglas to present an even more complicated issue:

At what point does a rate become so high that society expresses the judgment that it is unconscionable and that the individual must do without the credit rather than pay the unconscionably high rates?283

What, then, is an unconscionable rate of interest? At one extreme

from need but from an incentive to accumulate more money has the same rate ceiling applied to his loan as the unemployed man who borrows to buy food.

279. Shick, supra note 131, at 465.
282. See note 318 infra.
is the "6 percent myth"—6 percent is "the proper rate." On the other extreme are those who would abrogate all limitations and find no charge "unconscionable." In narrowing the parameters we find statements such as the following:

The most unbelievable part of this whole story is the fact that the Russell Sage Foundation was able to sell many legislatures in the United States an interest rate of 3½ percent per month, or 42 percent per annum, as a reasonable rate of interest. The only explanation which can be given for that salesmanship is that the proposal came from a charitable trust and was offered as the solution for a sociological problem. . . . If the rate of interest proposed had been suggested without "benefit of clergy," to-wit, the charitable front, it would not have been entertained for a single moment by any legislature. . . . As one writer put it, "It was from social agencies that the small loan companies learned the trick of immunity by legislating unconscionable rates under the guise of serving the forgotten man, the necessitous borrower."285

I also believe an interest rate ceiling of 42% on credit transactions under $300 is entirely too high and borders on the unconscionable.286

In discussing the rate ceilings of the UCC it has been suggested that

[rate ceilings [maximum ceiling under the Code for a consumer transaction is 36 percent] are provided to nip the unconscionable transactions which result from a joining of an unwary or desperate consumer with an avaricious credit grantor.287

To give persons a right to charge 36 percent-plus interest (or finance charge) shocks at least my conscience and I do not believe that I am unduly sensitive.288

284. "A '6% myth' is found by many investigators to be the basis of consumers' expectations about the normal charge for credit. [T]he type of state legislator who is always ready to defend motherhood and the American flag has a field day with any effort to breach visibly the 6% ceiling." Kripke, supra note 157, at 447. "That almost no consumer credit is handled at six percent seems to make little difference. Six percent remains almost as fundamental a standard as the Golden Rule." Felsenfeld, supra note 217, at 931.


Those who would keep a low ceiling on the cost of credit are hopefully not so simplistic as to believe that lower rates merely mean that consumers will save money at the expense of lenders’ profits. It must be realized and remembered that advocates of a low ceiling are making a conscious decision to deny credit to a segment of society.289

The basic question is, therefore, what rate is too high for a borrower to pay although he is not able to obtain credit otherwise? No doubt, some such rate does exist. An interest rate of 100 per cent certainly seems too high for anyone to pay. A person who can satisfy his debts or needs only by borrowing at 100 per cent perhaps should be left to the bankruptcy courts and public assistance.290

These views by no means aid us in finding the boundary of unconscionability. Because each transaction is unique, perhaps no meaningful maximum can be determined. Rather the very nature of usury dictates that rates be set by our present very subjective and arbitrary process.

What additional rationale can be presented to bolster the belief that the cost of credit should be subject to price control while other staples, such as a loaf of bread, usually are not? A simplistic, but unsatisfying, answer could be that “[m]oney [is] unique because it [has] no substitutes. If wheat were the only known food, ‘without which we must famish and die,’ its price too would surely be regulated.”291

Professor Johnson has suggested two possible economic rationales for the imposition of rate limitations such as ceilings.292 First, he argues that the “credit market is so imperfect that consumers seldom pay a ‘fair’ price for their use of credit.”293 His second argument is that “within each given credit market, suppliers of credit may have monopoly power, so that even with perfect knowledge consumers may be overcharged for their use of credit.”294

One market imperfection is that consumers cannot effectively shop for credit because of their lack of meaningful knowledge. Furthermore, this imperfection cannot be cured through disclosure provisions such as Truth in Lending295 because confusion and complexity are inherent

289. See note 318 infra.
291. Friedman, supra note 67, at 520, citing N.Y. ASSEMBLY DOCS., VOL. IV., DOC. No. 118, at 3 (1858).
292. Johnson, supra note 82, at 90.
293. Id.
294. Id.
in the nature of credit. Disclosure appears to raise the consciousness of debtors as to the price (interest charge) of credit.\textsuperscript{296} But a potential debtor not only shops for the best \textit{price} of credit, he also is concerned with such \textit{nonprice factors} as size of required down payment, terms for repayment (including amount of periodic payments), security requirements, and collection policies.\textsuperscript{297} Indeed, in many instances the size and duration of the payments may be the determinative factor.\textsuperscript{298} If the credit is sale credit, as opposed to loan credit, the prime consideration probably will be the product which the consumer seeks to purchase.\textsuperscript{299} This "grocery store" choice of credit combinations arguably makes rate competition virtually meaningless to the consumer.\textsuperscript{300} In fact, several studies have shown this, and have sought to explain why

\textsuperscript{296} Studies commissioned by the National Commission on Consumer Finance indicated that "[i]n the 15 months after TIL [Truth in Lending] became effective substantial increases were found in levels of APR awareness." \textit{Consumer Credit in the U.S.} 176.

In spite of this improvement [after Truth in Lending as compared with before], however, borrowers are still largely unaware of the rate of interest they are paying, even though this rate has, by law, been imparted to them. Only one tenth of borrowers can estimate the rate of interest they are paying on a car loan with a 10 per cent margin of error and nearly half of all borrowers miss the mark by 50 percent or more.


Disclosure was also found to have done little for the poorly educated, low income consumer. \textit{Consumer Credit in the U.S.} 176-82.

[O]ur survey has shown strong indications that for one, rates of interest on installment credit are less available to the general public since the truth-in-lending legislation came into effect than they had previously been; that consumers had shown little, if any, additional concern over the costs of their borrowing, despite the disclosure of additional information to them; and that finally, the cost of providing credit to the consumer sector has risen appreciably as a result of the costs involved with complying with the new law, and that, as a result, such loans have become less profitable for many institutions and retailers.


\textsuperscript{298} \textit{See, e.g.,} Shay, \textit{The Price of New Automobile Financing}, 19 J. Finance 205, 220 (1964) ("To the consumer, the price of credit to finance his purchase of a car is a joint product with the car itself. He has been primarily concerned with the combined cost of the product and credit as reflected in the size and duration of his monthly payments.").

\textsuperscript{299} \textit{See Consumer Credit in the U.S.} 181-82.

\textsuperscript{300} \textit{But cf. Consumer Credit in the U.S.} 177 ("Even though only 38 percent of all consumers using closed end credit may be aware of the APR, and even though relatively few of them use it in comparison shopping, these may be enough to bring about price competition . . . .")
the consumer has a high degree of insensitivity to the level of interest rates.\textsuperscript{301}

A second imperfection is the monopolistic tendency of the credit market.\textsuperscript{302} For the most part, the consumer credit market is localized; that is, there is no national credit market. Very few consumers will shop for credit outside of their city, and many will not go out of their neighborhood.\textsuperscript{303} The only exceptions—mail order and borrowing against the cash surrender values of insurance policies—constitute a very small proportion of the market.\textsuperscript{304} This situation creates monopoly power in the local credit grantors. Such power is manifested most often in the common cry that at whatever point rate ceilings are set, that is what the credit grantors will charge.\textsuperscript{305} Support for this common complaint can be readily found. If one were to call all of the finance companies in a given location and request, for example, the finance charge on a $325 loan for the maximum repayment term that they would grant, the answers received would vary little from each other or from the ceiling rate. To obtain further proof, one could seek a $1,000 consumer bank loan. "Competing" banks would likely quote substantially the same rate, which would be near or at the statutory

\textsuperscript{301} See, e.g., Juster, \textit{Consumer Sensitivity to the Price of Credit}, 19 J. Finance 222 (1964); White & Munger, supra note 296, at 1222 ("Is it not remarkable that a majority of the new car buyers [in the authors' sample] have [sic] been paying 25\% more interest than they had to pay?").

\textsuperscript{302} Johnson, supra note 292, at 95-97.

\textsuperscript{303} See \textit{Consumer Credit in the U.S.} 11. "Not only do the poor pay more for money, they are also caught in the net of neighborhood credit monopolies. To tighten a lucrative hold on their customers, many stores and loan companies refuse to trade information with credit bureaus. Consequently, many low-income consumers who have never missed a payment to the local furniture store or loan shop nevertheless cannot get credit elsewhere." \textit{A Consumer Credit Code . . . for lenders}, 1969 \textit{Consumer Reports} 131. "The inadequacy of competition in the inner city marketplace is well known." Johnson, \textit{Rate Competition}, 26 Bus. Law. 777, 780 (1971).


\textsuperscript{305} Examples of this "cry" can be found in Ripley, \textit{Proposed Consumer Credit Code Stirs Conflict}, Christian Science Monitor, Feb. 18, 1969, at 10, col. 2; Statement of Blair C. Shick before the Florida Legislature, March, 1972, at 11; Statement of the Consumer Federation of America on the Uniform Consumer Credit Code before the Virginia Consumer Credit Study Commission, May 24, 1971, at 5: "It is common knowledge, especially in disadvantaged areas where there is such a disparity of economic strength, that legal maximums quickly become the accepted norm. Once those rates are cloaked with the legitimacy of law, no creditor or seller will hesitate to impose the maximum whether warranted by competitive economic conditions or not." See Statement of Richard A. Elbrecht, \textit{Hearings on the Uniform Consumer Credit Code Before the Advisory Commission on the Uniform Consumer Credit Code to the Subcommittee on Judiciary of the Senate General Research Committee of the California Senate}, in \textit{Advisory Commission on the Uniform Consumer Credit Code, Report to the Subcommittee on Judiciary of the Senate General Research Committee} 305 (1972).
maximum. The same thing would be found for credit unions, which are both owned by and established for the benefit of their member depositors and debtors. The dearth of rate competition within the various segments of the credit industry is paralleled by the lack of competition among the various classes of our segmented credit industry: banks do not compete for the business of the consumer finance companies, consumer finance companies do not compete with retail installment sellers, etc. Even though prices vary, finance companies usually extend credit only to those borrowers who present too high a credit risk to be advanced credit by a bank or by a major retail establishment. Each segment of the credit industry caters to a particular group of borrowers classified by type (consumer or commercial) and risk. These classes are distinguished by the rate ceiling permitted each segment. For example, consumer loans made by banks at 15 percent APR are necessarily made to lower risk borrowers than comparable loans made by consumer finance companies at 30 percent. Debtors can move up the interest scale; one who is entitled to a 15 percent bank loan can also borrow at a finance company which is authorized to charge up to the 30 percent maximum. But the debtor whose credit standing only entitles him to a 30 percent loan has few sources from which to borrow.

But you might reasonably ask, isn't this natural? Shouldn't borrowers with less capacity to repay debt have fewer credit sources to borrow from? My reply would be no! Borrowers with less capacity to repay debt should not be able to obtain as much debt as borrowers with greater capacity to repay, but they should have as many sources to choose from. Why argue that higher risk borrowers should face fewer credit sellers each of whom has a correspondingly greater monopoly position in the market?306

An additional problem, which can be couched either in terms of unconscionability or economics, is oversupply or overextension of credit.307 This situation is encouraged by our system of successful, convincing product and service advertising and offers of "easy credit." Because of this pressure and "[t]he ready availability of credit . . . some families . . . overextend themselves by borrowing more than they can really afford."308 In many situations this overextension can have detrimental social costs.

306. Shay, supra note 161, at 774.
The unwarranted inducement to bite off more credit than one can chew (or possibly repay) is causing more divorces among young people in South Carolina than alcohol or adultery.\footnote{309}

The social costs of overextension are categorized by Professor Wallace as (1) public subsidization of the credit regulatory system; (2) lost productivity due to "court appearances, meetings with creditors, and general psychological stress"; (3) loss of respect for government; and (4) extreme hardship for the debtor and his family.\footnote{310}

It would seem reasonable to assume, though, that any creditor who wishes to remain in business will not extend credit to one he knows is going to default. Nor is the creditor lying in wait for innocent debtors to overextend themselves so that he may exercise unconscionable harassment.\footnote{311} Assuming that the debtor has the "willingness to pay,"\footnote{312} his default is going to be based on an inability to pay. This inability may arise in several ways—loss of employment, loss of ability to work, or unexpected drains on family budgets such as illness. Only a small percentage of the cases of inability to pay are caused by voluntary overextension—borrowing more than the debtor is able to pay at the time.\footnote{313}

But what about rate ceilings? Do we really need them?\footnote{314} Do they

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\footnote{310} Wallace, \textit{The Logic of Consumer Credit Reform,} 82 YALE L.J. 461, 470-71 (1973). \textit{See CHAPMAN AND SHAY} 25-27. In a survey to determine the causes of personal bankruptcy and the underlying financial difficulty, 

\textit{[t]he leading reason, given by 31 percent, was poor debt management—too many debts, unwise refinancing, overspending. Their decisions about borrowing or buying depended only on whether or not they thought their current income could support another monthly payment. All too seldom did they evaluate the total cost involved or their future prospects.}

\textit{Next as underlying causes were family health reasons (sickness, injuries, babies, death), 28 percent, and job problems like layoffs, strikes, and loss of overtime, 20 percent. Then 13 percent cited threats of legal action or hounding by creditors, followed by 10 percent who mentioned actual legal action—suit, garnishment, repossession.}

\textit{D. STANLEY \& M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 47} (1971).

\footnote{311} \textit{See Kawaja, The Economics of Statutory Ceilings on Consumer Credit Charges, 5 W. ECON. J. 157, 160} (1967).

\footnote{312} "Willingness to pay" includes such factors as personal integrity and the breakdown of creditor-debtor relationships, the latter caused by such practices as consumer fraud. Caplovitz, \textit{Breakdowns in the Consumer Credit Marketplace,} 26 BUS. LAW. 795, 796 (1971).

\footnote{313} \textit{Id.} at 796-97. \textit{See CONSUMER CREDIT IN THE U.S.} 101.

\footnote{314} "[T]he need for rate ceilings lies more in the realm of philosophy and politics than in economics." Johnson, \textit{supra} note 292, at 97.
really serve their intended purpose of preventing citizens of the particular jurisdiction from being overcharged for credit or forced to pay an unconscionable price for credit?315 Who is protected by the rate ceilings316 The person who is now able to obtain credit at rates below the ceiling (all persons who obtain bank credit could be included in this class because they pay at rates below those permitted the consumer finance companies) is not protected by the ceiling. The person who is now unable to obtain credit from any source except illegal loan sharks hardly seems "protected," and surely does not appreciate being "protected against his own improvidence." The debtor who is in the no-person's land between 15 and 30 percent, the one who cannot get a bank loan and is overqualified for a consumer finance loan, is not benefited. The only person the rate ceiling really protects is the debtor who is entitled to a rate which approximates the legal ceiling and who would have paid, in a free market system, a higher rate because of careless shopping.317 It should be added that loan sharks probably profit from rate ceilings because low ceilings increase the pool of credit risks who cannot obtain credit318 and are thus prime targets for "easy" loans from their friendly shark.319

315. See Consumer Credit in the U.S. 103-07.
316. "[L]ow rate ceilings do provide protection for consumers, but only some consumers. In the sales credit field they protect credit buyers at the expense of cash buyers. In the cash loan field they protect affluent borrowers at the expense of less affluent borrowers." Statement by Professor Robert W. Johnson, Hearings on the Uniform Consumer Credit Code Before the Subcommittee on Consumer Affairs of the House Committee on Banking and Currency, February 26, 1969.
317. E.g., "Some people, of course, are oblivious to competitive prices and will pay whatever they are charged . . . ." Jordan & Warren, The Uniform Consumer Credit Code, 68 COLUM. L. REV. 387, 393 (1968).
318. The Washington experience demonstrates that interest ceilings affect credit availability. In the year following a rate reduction from 18 to 12%, credit extensions dropped significantly (25% in the number of personal loans), both in number and dollar volume, despite an increase in retail sales. Wheatley & Gordon, supra note 195, at 24. In addition, "[v]irtually all financial institutions and retailers tightened their lending policies by increasing downpayment requirements and by shortening loan maturities." Id. at 23. For a discussion of the effect on small loan companies of a drastic reduction in Missouri's interest rate in the mid 1940's, see Spiva, Operations of Lenders in the Small Loan Field from 1939 to the Present, 16 Mo. L. REV. 234, 239-41 (1951). Nugent, Three Experiments with Small-Loan Interest Rates, 12 HARV. BUS. REV. 35 (1933), shows that lowering the small loan rate in two states greatly restricted the volume of loans compared with those states which did not lower rates. See also Shay, Factors Affecting Price, Volume and Credit Risk in the Consumer Finance Industry, 25 J. FINANCE 503, 513 (1970), and studies discussed therein (Shay's "research suggests that when rate ceilings are higher, licensed small loan lenders do accept poorer credit risks . . . ."); Goudzwaard, Price Ceilings and Credit Rationing, 23 J. FINANCE 177, 185 (1968); "[P]rice controls have important economic and credit rationing effects on credit availability at consumer finance companies."; Chapman & Shay 144; Separate Statement
History is replete with cases where loan sharks have lobbied in legislatures for unrealistic minimum rates, knowing that such meaningless ceilings would permit them to charge much higher rates.\(^{320}\)

[M]ost consumers forced from the legal cash loan market into the hands of loan sharks are represented in no statistical sample, pay rates that are unreported and undisclosed, and must remain mute when legislatures lower price ceilings on consumer credit in well-intended efforts to afford greater "protection" to some other borrowers.\(^{321}\)

In the realm of sales credit, rate ceilings seem to have even less meaning. In most instances the credit and the sale are a single package—if the seller cannot legally charge more for the credit he merely raises the price of the goods to be sold.\(^{322}\) In these situations the cash buyer, including both the person who voluntarily shuns credit and the person who is not creditworthy, subsidizes the credit buyer.\(^{323}\)

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of Robert Shay in Consumer Credit in the U.S. 249-59 ("Rate ceilings were found to be significantly related to both availability and price (APR) in the personal loan market, to availability only in the new auto market, and to neither availability nor price (APR) in the other consumer goods market." Id. at 259).

But see Goudzwaard, Rate Ceilings, Loan Turndowns, and Credit Opportunity, 6 W. Econ. J. 404 (1968) (findings suggest that high rate ceilings do not expand credit availability); Sartoris, The Effect of Regulation, Population Characteristics, and Competition on the Market for Personal Cash Loans, 7 J. Financial and Quantitative Analysis 1931, 1951 (1972) (rate increase would have more effect on segmentation of market than on its size); Separate Statement of Senator Proxmire in Consumer Credit in the U.S. 228 ("An increase in rate ceilings will simply increase a lender's total revenues, and like Parkinson's law, the lender's total costs will rise to absorb the additional revenues. More money will be spent on staff, salaries, travel, advertising, office fixtures and space, convention going and lobbying. Profits may also increase. However, the net amount of credit extended will not appreciably change.").

319. Murphy, supra note 182, at 331.

320. Statement by Dr. Paul A. Samuelson before the Committee on the Judiciary of the General Court of Massachusetts in Support of the Uniform Consumer Credit Code, January 29, 1969.


322. See, e.g., Comment, An Empirical Study of the Arkansas Usury Law: "With Friends Like That . . . ", 1968 U. Ill. L.F. 544, 588 (discussing the Arkansas situation under a 10% usury limitation); Lynch, Consumer Credit at Ten Percent Simple: The Arkansas Case, 1968 U. Ill. L.F. 592, 599, 606, 618-19; Wheatley & Gordon, supra note 195, at 24 (the authors report that, in response to a lowering of the interest limitation from 18% to 12%, "Fifty-six percent of nonautomobile retailers said that they raised prices an average of 5% on all merchandise in their stores . . . ."); Federal Trade Commission, Economic Report on Installment Credit and Retail Sales Practices of District of Columbia Retailers xiii (1968) (the costs of "easy credit" to high risk debtors are usually reflected in the form of higher merchandise prices).

323. This latter situation prompted Professor Johnson to point out: "[Y]ou require those who are less affluent and less creditworthy—those who cannot get credit and
At this point it should be obvious to the reader that the law governing usury has been, is, and may continue to be a complex social and economic problem; that any attempt at additional piece-meal legislation similar to what we have had to date is highly unsatisfactory; that changing economic and societal conditions prompt changes in the usury laws; that the arguments for the present scheme are emotionally charged and perhaps deceptively convincing; and that an immense amount of effort expended on this issue by courts, legislators, lawyers, economists, and other academics has produced little except volume, complexity, and perhaps a touch of the absurd. Assuming that these observations are obvious and suggest the need to study alternatives to the present scheme, there are several proposals for action to be considered. These proposals can be grouped into the following models: (1) organized inaction; (2) loan sharking plus; (3) public utility; (4) free market; and (5) compromise, including but not limited to unconscionability, variable or sliding scale, or any other mix of the various models.

B. Organized Inaction

The organized inaction model includes measures designed to improve operation of our existing structure without fundamentally altering the present scheme. Basically, pursuit of organized inaction would involve increasing current interest ceilings to relieve some of the present stress caused by two-figure inflation and enacting piece-meal legislation aimed at prohibiting or regulating the worst abuses of the usury statutes. Additional legislation could be enacted to overrule those court cases which have relaxed or misinterpreted the usury limitations.

The most ideal solution within this classification would be a comprehensive, voluminous statute, with comments, that would put all of the rate ceilings, rules, exceptions and resulting complexities im-

who must buy for cash—to subsidize the credit purchases of more fortunate citizens. This is class legislation at its worst." R. Johnson in National Conference of Commissioners on Uniform State Laws, Statements in Support of the Uniform Consumer Credit Code Filed with the Sub-Committee on Consumer Affairs of the Banking and Currency Committee of the House of Representatives, Wash., D.C., Feb. 26, 1969, at 21 (emphasis added).

324. "Our industry [consumer credit lenders], if it is to prosper and survive in this world of change, cannot be shackled with obsolete loan maximums. It cannot operate in a straightjacket of regulatory requirements designed to protect the necessitous borrower of 1916. It cannot continue to do the same type of business in the same old way if it is to meet the changing trends of consumer demand." Robinson, The Uniform Consumer Credit Code, A New Way of Life for the Consumer Loan Industry, 22 Personal Finance L.Q. 118 (1968).
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mediately at the regulators' and lawyers' fingertips.\textsuperscript{325} Organized inaction could thus postpone dealing with some of the pressing and obvious problems and could make it easier (possible?) for lawyers and judges to function in the area. Nonetheless, as soon as economic or societal conditions change, pressure groups may again force a reorganization.

Another stopgap plan would be the enactment of a small, small loan law which would make small amounts of credit available to the necessitous borrower\textsuperscript{326} at rates which would cover the lender's expenses and permit him a fair measure of profit.\textsuperscript{327}

C. Loan Sharking Plus

The second model is one in which rates and structure remain basically unchanged, but in which there is an option to lower rate ceilings and place additional nonprice restrictions on lenders, the restrictions being carefully designed to lessen competition. In so doing, a conscious decision would be made to allow the loan sharking industry to operate essentially as it does now. One author has suggested that society could adopt this position without being amoral.\textsuperscript{328}

\textsuperscript{325} Though using the rhetoric of a freemarket system, the U3C provided an opportunity for many state legislatures to lower certain rates and collect various credit laws in one statutory location. The enacted versions have little resemblance to a free market approach. "Rate ceilings are provided to nip the unconscionable transactions which result from a joining of an unwary or desperate consumer with an avaricious credit grantor." Johnson, \textit{Economic Rationale of the Uniform Consumer Credit Code}, 23 J. Finance 303 (1968).

\textsuperscript{326} "This—this particular type of loan goes to somebody who is—I claim to be a necessitative borrower. He borrows for rent. He borrows for a bottle of whiskey. He borrows to get into a crap game. And I think there are things about this loan money that must be taken care of in a very regulated manner or else he will rob a filling station or else you give it to him. And somebody had to make the judgment. And this is just simply an area that has to be recognized." Statement of Richard L. Wheatley, Jr., \textit{Hearings, supra} note 305, at 288.


\textsuperscript{328} Seidl, \textit{Let's Compete with Loan Sharks}, 48 Harv. Bus. Rev., May-June, 1970, at 69, 75. Loan sharking and other extortionate extensions of credit are, however, illegal both under federal and state law. The Consumer Credit Protection Act, recognizing the problem involved in extortionate extensions of credit, states:

An extortionate extension of credit is any extension of credit with respect to which it is the understanding of the creditor and the debtor at the time it is made that delay in making repayment or failure to make repayment could result in the use of violence or other criminal means to cause harm to the person, reputation, or property of any person.

18 U.S.C. § 891(6) (1970). Such an extortionate extension of credit can be punished by fines of up to $10,000 or a maximum of 20 years imprisonment or both. 18 U.S.C. §
this model, the legitimate sources would deal with borrowers they could afford to serve profitably within the established structure. Loan sharks would service those who could not receive the desired service in the upper world.\textsuperscript{329}

The loan shark is an effective and efficient means for controlling high risk loans. While other creditors worry about such matters as security, collection efforts, and form dunning letters to insure payment, the loan shark relies on his reputed connections with organized crime, a universal belief that he will resort to physical violence to collect his due, and the borrower's expected need for future services.\textsuperscript{330} Normal lending practices are formal, complicated, and time consuming procedures that usually involve the posting of collateral. Many borrowers want the secrecy, informality, speed, convenience, and availability the loan shark offers. Legitimate lending institutions are precluded from offering equivalent services because of low interest ceilings.\textsuperscript{331}

The usual loan sharking procedure starts with the lending of a lump sum from a "boss" to a "lieutenant" at 1 percent interest (called "vig" or "vigorish") per week. The lieutenant loans it to the street worker—the person we call the "loan shark"—at 1.5 to 2.5 percent interest per week. The money is then lent to borrowers at 5 percent


\textsuperscript{330} Loan Sharking: The Untouched Domain of Organized Crime, 5 \textit{Colum. J.L. & Soc. Prof.} 91, 95 (1969). One loanshark described a first meeting with a borrower, in which the borrower couldn't understand why the loan shark did not need collateral, as follows: "'The borrower couldn't understand this too well. He was simply told in no uncertain terms that 'Your body is your collateral.'"—Miller, \textit{The Impingement of Loan Sharks on the Banking Industry}, 149 \textit{The Bankers Magazine}, Winter 1966, at 84, 85.

\textsuperscript{331} Seidl, \textit{supra} note 328, at 72.
per week\textsuperscript{332} (260 percent per year) to 20 percent per week (1,040 percent per year).\textsuperscript{333} It has been estimated that $1 million loaned by a "boss" can generate over $4 million in interest for all persons in the chain,\textsuperscript{334} and up to $1.3 million for the "boss" alone.\textsuperscript{335}

The loan sharking business of today has little resemblance to the friendly village noteshaver of yesterday. Today's system not only forces people who are desperate for loans to suffer the web of entanglement a loan shark weaves, but also grants organized crime a continuing source of income approaching $1 billion per year.\textsuperscript{336} The hazards to both the individual borrower and society from the involvement of organized crime in loan sharking are numerous. First, there are no practical limits on the lender's practices—no state or federal officials conduct internal audits or enforce Truth in Lending. Second, since the guiding principle of loan sharking is to maximize profit, all available money must be kept out in loans to the various lenders at very high interest rates. By discouraging the repayment of principal—by refusing to accept payment in installments, for example—the loan shark generates additional interest. In one case, a $1,900 loan led to payment of $14,000 in interest over a three-year period, with $5,800 still unpaid; this is not unusual.\textsuperscript{337} Third, loan sharking leads to increases in criminal activity by forcing borrowers to commit crimes to repay their loans.\textsuperscript{338} Exacerbation of crime rates is particularly evident among the urban poor, who have high demands for money but few legitimate sources from which to obtain it.\textsuperscript{339}

In addition, "[s]mall businessmen who need working capital; speculators, promoters, and producers who need venture capital; and in-

\textsuperscript{332} Seidl, \textit{supra} note 328, at 71; \textit{Loan Sharking: The Untouched Domain of Organized Crime, supra} note 330, at 94.

\textsuperscript{333} \textit{Loan Sharking: The Untouched Domain of Organized Crime, supra} note 330, at 94. The quoted rate stems from the traditional "six for five racket" in which a loan of five dollars required the paying of $1 per week in "juice" as long as the principal was outstanding.

\textsuperscript{334} Miller, \textit{supra} note 330, at 85.

\textsuperscript{335} \textit{Loan Sharking: The Untouched Domain of Organized Crime, supra} note 330, at 93 n.20.


\textsuperscript{337} \textit{Loan Sharking: The Untouched Domain of Organized Crime, supra} note 330, at 96. \textit{See generally} Seidl, \textit{supra} note 328, at 72.

\textsuperscript{338} \textit{Loan Sharking: The Untouched Domain of Organized Crime, supra} note 330, at 97.

\textsuperscript{339} \textit{Id.} at 100. Historically loan sharks focus on urban areas. \textit{See generally} Nugent, \textit{The Loan Shark Problem}, \textit{8 Law & Contemp. Prob.} 3 (1941). \textit{See also} \textit{Consumer Credit in the U.S.} 46.
dividends who need personal funds to satisfy spending habits or correct illegal business activities" constitute a large loan market for the loan shark.\textsuperscript{340} Through such loans, loan sharks gain access to legitimate businesses,\textsuperscript{341} which provide depositories for illegally gained money. Taking over a legitimate business gives the loan shark an opportunity to perform a "bankruptcy caper." This scheme involves borrowing as much as possible on the good will of the business from legitimate sources, milking the business of funds, and then allowing it to go bankrupt.\textsuperscript{342}

The modern loan shark and his syndicated "bosses" are also infiltrating the banking system. They use tellers and loan officers as contacts for borrowers, as a means of getting large-volume loans at standard bank rates, and as a means of exchanging for cash the checks that the loan sharks receive, without endorsement or without depositing them in an account.\textsuperscript{343} There also are reports that organized crime is attempting to enter the management of banks.\textsuperscript{344}

The social costs of loan sharking are high, and traditional usury laws foster rather than inhibit its growth. For this reason Capt. John M. Seidl proposes to compete with the loan shark in the marketplace for high risk loans.\textsuperscript{345} The heart of his proposal is the establishment of legitimate high risk lending institutions that offer the same secrecy, informality, speed, convenience, and availability of loans that a loan shark offers.\textsuperscript{346} He points out that though these firms will be at a competitive disadvantage because they will not be able to use criminal

\begin{itemize}
  \item \textsuperscript{341} Loan Sharking: The Untouched Domain of Organized Crime, supra note 330, at 99. For examples of loan sharks working in banks, see Miller, supra note 330, at 86, 90.
  \item \textsuperscript{342} Loan Sharking: The Untouched Domain of Organized Crime, supra note 330, at 99.
  \item \textsuperscript{343} Miller, supra note 330, at 88-89.
  \item \textsuperscript{344} Id. at 90.
  \item \textsuperscript{345} Seidl, supra note 328.
  \item \textsuperscript{346} This is illustrated by stories of just how accommodating loan sharks are. In one case an antique dealer needed a continuing line of credit. Banks would only offer him a standard $10,000 loan with regular paybacks. The dealer did not want this, so he refused. "'One day I met Ed. He offered me $2,000 in a pinch—no questions asked. From then I did business with him.'" Seidl, supra note 328, at 72.
  
  In another case an automobile salesman ran out of cash just before Christmas while at a bar. "'I called Jimmy and told him I needed a couple of hundred until the first. Thirty minutes later Jimmy arrived. He'd driven from South Philly through the snow that had been falling since early afternoon. He handed me $200 and left. Where else could I get that kind of service? I'd gladly pay extra for the couple hundred, wouldn't you?'" Id. at 69.
\end{itemize}
means to collect loans, the duplication of the loan shark’s informal services, together with lowering risks to the borrower and reducing his need for future loans, will offset any advantages the loan shark has. “The key is to duplicate the service elements in loan shark transactions while eliminating the threat of physical violence in the collection process.”

Seidl’s proposal is, in reality, an extension of the Uniform Small Loan Laws developed by the Russell Sage Foundation. Both proposals stem from one underlying and controlling fact—it is impossible to destroy the loan shark by means of the criminal laws alone. If society wishes to curtail the harmful effects of loan sharking, it must challenge the economic base on which loan sharking rests by providing legitimate competition to the loan sharks.

D. Public Utility

The public utility approach contemplates greater, more complete, and more careful regulation of the credit industry than we presently have. The goals in regulating credit as a public utility would be to give the public the best service at the lowest cost and assure “fair” profit to creditors, assuming we did not wish to operate the system publicly. To insure an “equitable” system, we would first have to decide whether we wanted to establish a single rate of credit charge applicable to all borrowers regardless of intended use, need, or credit-worthiness or whether we should establish a series of rates applicable to various groups of the borrowing public. Groups would be defined by reference to such factors as loan purpose and borrowers’ wealth, age, and credit experience.

If the single rate approach were chosen, a subsidiary question is whether the service would be open to all borrowers or only to those whose personal criteria show a repayment probability above a pre-established cutoff point. The repayment probability and cost of servicing eligible borrowers would determine the “raw” rate. To this would be added (or subtracted) a differential for inflation (or deflation) and the prescribed “fair” rate of profit. The main drawback of this scheme is that it could never happen. A wealth transfer of this form, where “good” credit risks who are economically entitled to a

347. Id. at 76.
348. Seidl, supra note 328, at 75. See also Loan Sharking: The Untouched Domain of Organized Crime, supra note 330, at 125-26.
349. But even the existing system wherein “[t]he privilege of lending to the poor was granted by the state to a few lenders who had to meet prescribed standards of character and fitness ... [i]s similar to a public utility franchise . . . ." Jordan & Warren, The Uniform Consumer Credit Code, 68 COLUM. L. REV. 387, 390 (1968).
10 percent rate are forced to subsidize "poor" risks who cannot borrow money except at rates which approach or even exceed 50 percent, would and probably should not be permitted to exist. Furthermore, under such a system careful supervision would be required to ensure that each licensee financed a proper mix of high and low risk debtors—an excess of one or the other could give it more or less than a "fair" return. The complexity and inequity of such a system is, hopefully, obvious.

The second alternative, that of carefully dividing borrowers into several classes, each class having a different cost structure and resulting rate, would be highly complex but surely not beyond the capacity of modern computer technology. Such a system would be equitable to the majority. But the poor—those who can least afford high rates—would still have to pay a premium for loans, since the higher probability of default and the fact that the small loans the poor are likely to seek occasion a higher operating cost per dollar loaned. Furthermore, once placed in a high rate classification, it may, as a practical matter, be difficult to make timely progressions to lower plateaus. The cost of instituting such a scheme probably would be high when compared to the advantages gained.

To attempt to regulate credit as a public utility would be a major error. In the first place, public utilities are usually industries with heavy investment in fixed capital equipment so that competition among them is wasteful and inefficient. The consumer credit industry has relatively few fixed costs and few of the other economic characteristics which would favor the establishment of regulated monopolies in this field. Under the public utility approach there would be constant pulls and tugs from consumer groups resisting rate increases, requesting lower rates and greater service while industry groups would argue for higher rates to offset higher costs and elimination of unprofitable service.

Most economists would agree that such a policy would be undesirable.

E. Free Market System

The third model is many an economist's dream—the free market system.

350. This differs from the present system in which the lenders are divided into several classes, each with a different rate structure. Cf. notes 240-72 and accompanying text supra.
351. See Consumer Credit in the U.S. 102-03.
I know of no economist of any standing . . . who has favored a legal limit on the rate of interest that borrowers could pay or lenders receive—though there must have been some. I know of no country that does not limit by law the rates of interest—and I doubt that there are any.\textsuperscript{353}

Those who oppose interest rate restrictions view credit markets as relatively efficient when left alone to operate freely. According to this position free competitive markets lead to an optimum allocation of resources and maximum individual satisfaction. Consequently, interferences with normal credit flows by use of imposed ceilings on lending or deposit rates can only create inefficiencies in financial markets which hamper production and exert an adverse influence on the distribution of goods and services.\textsuperscript{354}

Since this is one of the more seriously contended proposals I will devote proportionately more space to its exploration.

A system with few government controls could boast many initial benefits: (1) the very costly process of regulation, which surely feeds the fires of inflation and fuels bureaucratic waste, could be eliminated; (2) the whole area could rapidly become less complex as the need to devise schemes to increase revenues by skirting usury laws evaporates; (3) through competition, debtors would be charged only what their risk class dictates; (4) merchants of debt would be limited to a marginal rate of return; and (5) credit would be made available to a wide spectrum of potential borrowers. The basic theory of this system is that competition among sellers (creditors) for the buyers' (debtors') business (loans) will keep the price (interest charge) at the lowest sustainable level—equilibrium, in economic jargon. If the price drops below this level, sellers will leave the business, and the price will rise. Conversely if the price is above this level additional sellers will enter the market, and the price will fall. Buyers' (debtors') behavior will also be influenced by the price. Less credit will be purchased when the price is high than when it is low, and conversely, more credit will be purchased when the price is low. So far, this explanation is but a simplified version of a textbook definition of a competitive market. To apply this definition to the credit picture, various prerequisites to a functioning market must be examined.

In order to have a viable market system it is important that there be competition. "A highly competitive market exists when the number of sellers is so large and entry is so easy that no seller has


\textsuperscript{354} Bowsher, \textit{supra} note 27, at 17.
power over price." But will competition work to bring credit charges into perspective? Those who argue for lowered ceilings base their arguments on the "fact" that creditors most always charge the ceiling rate and that "creditors seem unwilling to compete on the basis of rates."

It can be shown, however, that lack of competition is not inevitable. Those states that have enacted corporate exceptions to the usury statutes have not experienced non-competitive practices in this particular area. Creditors in those states that authorize interest in excess of 18 percent for revolving charge have maintained the 18 percent limit. In the past, banks have usually charged below the ceiling limit, and competition has been quite common in the financing of automobiles, major appliances, and homes.

That many interest charges today hover at the legal ceiling probably indicates that current rates are too low. "In earlier years when interest rates and operating costs had not generally pressed rates to the ceiling, the maximum permitted was not the prevailing rate." This was true not only of banks but also of finance companies and credit unions. An examination of the 1974 economy, when increased interest rates froze up sources of credit for all but the corporations, strongly suggests that rates at the maximum permitted level resulted primarily from

355. Consumer Credit in the U.S. 109. The basic requirements for a perfectly competitive market are summarized and applied to the consumer credit market in Johnson, Rate Competition, 26 Bus. Law. 777 (1971).

356. Statement of Richard A. Elbrecht, Hearings, supra note 305, at 305: "[C]reditors have refused to advertise the rates they charge and seem intent, instead, on hiding them in the fine print . . . . This is proof that there is relatively little, if any, rate competition at present. The spirit of competition is simply not present." But cf. Prather, supra note 146, at 181: "Rates in the money market are not set by any diabolical collusion among banks, savings associations, or other lenders; when the nation as a whole decides to spend more money on goods than can be financed out of the current flow of savings, interest rates go up." See also Harper, The Uniform Consumer Credit Code: A Critical Analysis, 44 N.Y.U.L. Rev. 58 (1969).

357. For a discussion of evidence that competition works, see Johnson, Rate Competition, 26 Bus. Law. 777, 783-84 (1971), and authorities cited therein.


359. A study of automobile financing in Oklahoma after the adoption of the USC found that 75% of the "contracts were in the effective rate area of between 11 percent and 16 percent, annual percentage rate . . . . [T]hese figures are significant because they represent over 100 million dollars in automobile installment contracts, bargained by individual dealers with individual buyers from small towns to cities, across the State of Oklahoma." Statement of Richard L. Wheatley, Jr. to the Florida House Committee Studying Uniform Consumer Credit Code, February 21, 1972, at 9. See also, Benfield, supra note 290, at 947-48; Shay, The Price of New Automobile Financing, 19 J. Finance 205, 219-20 (1964).

economic conditions. For example, few home loans were being made, and those few were made with down payments of 20-30 percent, whereas a few months earlier, rates of at least 2 percent below the usury limitation with merely 5 percent down were common.

These are not isolated examples of competition; they show that competition is possible and does work. But the question remains whether we are going to trust the market on the basis of these observations when common experience provides numerous examples of non-competitive behavior: charging ceiling rates, offering identical credit packages, grouping debtors into classes to be served only by certain segments of the finance industry, and take-it-or-leave-it prices. Many of these symptoms can be readily explained. One reason for the uniformity of rates among the various credit grantors in a particular segment is the complexity of the total credit package. Apart from the subjective risk factors concerning each debtor, the creditor needs to consider legal maximums on rates and sometimes on maturities, and the amount of security available. Most creditors have found it easier and more profitable to establish a credit package, which they then offer to all potential debtors who meet certain minimum qualifications. In Florida, a person who wishes to borrow $300 and does not qualify for the banks' 15 percent package, but is overqualified for the finance companies' 30 percent package, must choose between the 30 percent package or no loan at all. If he "buys" the loan, then the finance company has improved its overall risk and can expect either an improved profit picture or can increase volume by extending credit to debtors who may be underqualified.

The rigidity of credit offerings is due in part to the graduated rate ceiling. It is nearly impossible to compute the interest charges and resulting APR for Truth in Lending disclosure purposes without access to a programmed computer or rate chart. Most creditors use a single chart based on the set of rates which is currently the statutory maximum, and others already have the maximum rate pre-printed on their standard disclosure and obligation forms.

The prevailing statutory maximums further explain the lack of competition: when one financial institution—a bank—may legally charge less than one half as much as another type of institution—a consumer finance company—it is not difficult to understand why they do not actively compete for the same type of business. Why should a

361. It has been said that the laws of economics may be frustrated by the acts of legislatures, but they cannot be repealed.
364. See, for example, the Florida rate structure discussed pp. 201-05 supra.
consumer finance company compete for the bank's business when it has the whole higher-risk, personal finance business to itself? Conversely, how can a bank be expected to effectively compete for the personal finance business if it can charge only half as much?

[U]niformity requires either raising the existing ceiling for one or lowering it for the other, or both; and it is less disruptive to allow banks to lend at the higher small loan rates than to limit small loan companies to lower bank rates. Once it is decided to set legal maxima above the existing ceilings for some creditors, the consumer interest requires that there be some incentive to charge less than the maximum and the policy of encouraging competition responds to this need.365

A uniform ceiling . . . would encourage credit grantors to experiment with different rates of charge in order to penetrate new markets and to adjust to changing economic conditions. This would reinforce the present trend toward diversification, discourage consumer segmentation, and bring increased competition into the field as a whole.366

Intra-industry competition, however, is not the only factor affecting rate structures and credit availability. If the rate of interest which an industry can profitably pay for its supply of capital is below the market rate, that industry will be outbid by users of capital who can afford to pay more.367 A recent example of this is the home and

365. Braucher, Consumer Credit Reform: Rates, Profits and Competition, 43 Temple L.Q. 313, 318 (1970). One misguided advocate of competition suggests that the way to insure that there is adequate competition is to repeal all of the exceptions to the usury law, so that all lenders can compete at the same level, that of the general usury law. McReynolds, supra note 280, at 317-18.

366. Johnson, supra note 82, at 101. The drafters of the NCA recommend that states adopt a "unified and consistent rate which applies across the board to all creditors" because discrimination often results in hardship to consumers. They left blanks for interest rate ceilings, however, saying that existing rate ceiling statutes in a state should provide the basis for these amounts. NATIONAL CONSUMER ACT § 2.201, Comment 2.

367. "[E]ffect of the rate of interest on the supply of funds . . . rather than on the demand . . . implies that changes in the rate of interest will not affect the demand for funds as much as the supply, and that lenders will have to use other methods, i.e., credit rationing, to cope with the excess demand." Catt, "Credit Rationing" and the Keynesian Model, 75 Econ. J. 358 (1965). The author goes on to explain why this "is not merely a frictional imperfection of the money market but is a chronic condition arising out of the essentially rational behavior of lenders, especially the larger institutions who lead the market." Id.

"[M]any legislatures have exempted loans to corporation [sic] from the usury statute, no doubt in partial recognition of the convertibility of the capital market between equity stock and interest bearing investment." Statement of Marion Benefield in SOUTH CAROLINA COMMITTEE TO STUDY THE UNIFORM CONSUMER CREDIT CODE AND FEDERAL CON-
personal mortgage market. In many locations, loans of this type could not be made because the rate which savings and loan associations and similar lending institutions had to pay for their capital was either above the legal limit that could be charged the mortgagor or so close to it as not to permit a margin for cost of operations, risk, and profit.

Another question is whether the price of credit actually influences the amount of credit purchased. Obviously, one will use more credit when it is free than when there is a service charge. This fact explains the massive growth of bank cards and other revolving charge systems utilizing 30-day "free" accounts. But if rate ceilings were removed and the average rate of charge were to significantly increase, would the volume of credit be reduced? If rates went down, would volume increase so as to duplicate traditional market theory? Several of the studies that have been conducted in this area suggest that the change in demand for credit does not keep pace with the change in rate. Thus, it is said, the demand for credit is relatively inelastic.

Most consumers are in fact unresponsive, but only because they are constrained to accept shorter contract maturities than they would prefer. By implication, if credit institutions were to offer longer maturities at finance rates commensurate with the added risks, consumers would become rate sensitive because they would no longer be rationed. . . . In short, consumers appear to be unresponsive to finance rates because they do not have access to anything like a perfectly competitive capital market. The closer capital markets come to this analytical ideal, the more sensitive will consumers be to the cost of funds.868


"It was the general opinion of those involved in commercial lending that the ten percent ceiling had a very restrictive effect on the flow of risk capital into the state and that it was in large measure responsible for Arkansas' status as a capital-poor state." Comment, An Empirical Study of the Arkansas Usury Law: "With Friends Like That . . . .", 1968 U. Ill. L.F. 544, 584. "The nationally recognized small loan companies have generally avoided Arkansas because of the unlikelihood of a profitable operation under the ten percent ceiling." Id. at 574. But cf. Separate Statement of Congresswoman Leonor K. Sullivan, Consumer Credit in the U.S. 238 ("[I]n a period of tight money, unrestricted rates for business credit siphon off vast amounts of money from housing and from other essential purposes. I do not subscribe to the philosophy that we should permit investment funds, willy-nilly, to go to those credit purposes which bring the highest return.").

868. Juster, Consumer Sensitivity to the Price of Credit, 19 J. Finance 222, 233 (1964). In their econometric studies of consumer sensitivity to finance rates, Juster and Shay found it a necessity to qualify the widely held view that consumer borrowing decisions are wholly unresponsive to changes in finance rates, aside from the effect of rate changes on monthly payments. This generalization appears to be valid for rationed consumers—
The degree of inelasticity would vary, however, among different types of debtors. Those who use credit only as a convenience will show a much greater elasticity of demand than those who are credit rationed, those who because of lack of creditworthiness cannot obtain as much credit as they desire. In fact, as the legal rate increases, the creditor can afford to extend credit to those who were not creditworthy at the lower rates. As to this group, an increase in the price of credit could result in an increase in volume.

The expected increased volume of credit for the affected class of borrowers could be cited as justification for maintaining lower rates. Increased availability would, it could be argued, foster debtor overextension and its resulting “evils.” In answer to such a charge, Professor Kripke in a different context has suggested:

If society determines to make the decision for the poor that they shall not have what they want to purchase, the result can be achieved in a far better fashion . . . . If society determines to deny these [credit] purchases, the solution is a re-enactment of the wartime Regulation W of the Board of Governors of the Federal Reserve...
System . . . In war-time the goal was to cut down the civilian pressures on scarce materials; but the technique could be used to accomplish the result desired by our informal social planners of denying [credit] to the poor . . . .

Lastly, in order for a market system to work, participants need options for which to cast their market "votes." In an area where creditors are highly segmented but concentrated and borrowers have little choice, the rates would tend to be higher and more noncompetitive practices could be expected. The present segmentation of the finance industry, in which various subgroups of creditors operate under different statutory authority, ceiling rates, capital requirements, and licensing standards, substantially restricts movement of capital within the industry and prevents much intra-industry competition for borrowers.

The key to reforming the credit industry is a change of emphasis. Today, we stress reducing competition by imposing loan size and maturity limits, low ceiling rates, licensing, and such artificial

372. Kripke, supra note 132, at 34. In the article, Kripke goes on to explain how such a return to Regulation W could work. Id. at 34-36. "That some people are excluded from obtaining credit at a lower maximum interest rate than at a higher rate does not tell us whether the exclusion of such persons from credit sources is good or bad. Judgment as to that must be formed by use of one's philosophy about freedom and paternalism, rather than from empirical information." Dunham, Research for Uniform Consumer Credit Legislation, 20 Bus. Law. 997, 1000 (1965).

373. E.g., "[L]imiting the number of lenders enhances the practicability of their arriving at a tacit understanding among themselves to fix volume and finance rate[s]." Kawaja, The Economics of Statutory Ceilings on Consumer Credit Charges, 5 W. Econ. J. 157, 164 (1967).

374. See Johnson, Economic Rationale of the Uniform Consumer Credit Code, 23 J. Finance 303, 307-08 (1968). But cf. Harper, The Uniform Consumer Credit Code: A Critical Analysis, 44 N.Y.U.L. Rev. 53, 58-59 (1969) (retain the segmentation rather than scrap 50 years of experience); Statement of Senator Jack Lindsay, supra note 309, at 109 ("By continuing to segment our consumer laws and making them consistent and compatible, we can better build upon our reasonably good foundation of consumer laws, without abandoning the stability that we find generally existent today.").

375. See CONSUMER CREDIT IN THE U.S. 163-64.

376. "How would industry structure be changed if ceilings on consumer finance charges were lowered? The evidence . . . indicates that the industry would be more heavily concentrated in the hands of the large lenders." CHAPMAN & SHAY 146. Accord, CONSUMER CREDIT IN THE U.S. 136-37.

377. See generally Moore, The Purpose of Licensing, 4 J. Law & Econ. 93 (1961). "Practitioners of licensed occupations usually support licensing on the ground that it is in the public interest; many economists, on the other hand, feel that such licensing is designed to give monopoly power to members of the occupation." Id. In answer to these two viewpoints, Moore found that "[a] survey of occupations and businesses regulated and the requirements for entry imposed indicates that the least restrictive types of regulations were imposed for the public welfare while the most restrictive types appear to have been established to benefit practitioners of the regulated occupations and businesses." Id.
controls as character and fitness, minimum capital, and "convenience and advantage" requirements. We should instead stress active competition and rigid enforcement of the antitrust laws.

Though regulation may be necessary to protect depositors, there is no comparable reason to protect debtors from having creditors compete for their business. On the other hand, some of those who argue for limitations on competition suggest that there is some efficiency in size, and by limiting entry into the field we protect debtors from harsh and abusive collection practices of creditors barely making a go of it.


381. One way to foster competition is to eliminate or greatly decrease restrictions on entry. But it may be questioned whether restrictions on entry really work. In an econometric study of entry into the banking industry it was estimated that in the absence of legal restrictions on entry, about twice as many banks, approximately 2,200, would have been chartered in the years 1936-62. Peltzman, Entry in Commercial Banking, 8 J. Law & Econ. 11, 48 (1965).


383. "Unbridled entry would promote overselling by some lenders, especially by those without experience in the consumer lending field; many ill-informed or financially irrational borrowers would succumb to the blandishments of easy credit and become overcommitted; duplication of facilities and inefficiency would result; the increased competition would tend to lead to wild credit practices to the detriment of all; and the effect of such a concept on the monetary and fiscal policies of the United States was an unknown quantity, the ramifications of which had not been fully explored." Harper, The Uniform Consumer Credit Code and Freedom of Entry, 24 Bus. Law. 227 (1968).

"Over-zealous competition will eventually result in loan abuses, and the sheer magnitude of numbers of lenders will result in the inability of proper supervision and regulation of the lenders, and will bring new catastrophe and heartache to many South Carolinians." Statement of Senator Jack Lindsay, supra note 309, at 106.
Such reasoning cannot be sustained. If credit practices are unhealthy, the solution is not to regulate credit, but to outlaw the particular offending practices. Such practices may even be self-defeating for the creditor. 384 Furthermore, studies on efficiency find few cost differences between large lenders and small lenders—although, to be efficient, offices must do the amount of business for which they were designed. 385

F. Compromise

The last model consists of several proposals which have common elements: they do not have rigid ceilings nor do they adopt an absolute free market system. The most flexible system of this type would permit the parties to agree on any interest rate, but allow courts to declare a loan transaction usurious if the interest rate were excessive and the loan, taken as a whole, were harsh and unconscionable. 386


I have confidence that in a truly free market, one in which lenders would not be ashamed to advertise their rates, the mechanism of competition would insure reasonable rates, and would sort debtors according to their ability to pay. In this market system, I would approve of creditors charging higher interest rates to the poor than to the rich. But, by the same token, I would demand that interest rates be determined by past performance rather than by arbitrary criteria. Thus if a poor person has demonstrated that he is a good risk in that he pays promptly, he should be entitled to the same low interest rate as the more affluent debtor. To present this proposition in a dramatic form, I am prepared to entertain the following rule: any person who reaches the age of 21 and is ready to enter the world of consumer credit, should be issued credit at the highest rate, irrespective of his wealth or job security, perhaps a rate as high as 100 per cent. Should he prove to be a reliable debtor, the rate of interest charged him should be reduced accordingly. If over the years, some debtors prove to be extremely reliable by paying promptly and thus freeing their creditors of all collection costs, then they should be accorded such premium rates as 9 or 10 per cent.

Id. (emphasis added).

385. Upton, The Economics of Fair Charges for Consumer Loans, 16 Mo. L. Rev. 274, 282 (1951). "Perhaps the most striking finding in our exploratory studies is that there is customarily a fairly wide range of optimum sizes—the long run marginal and average cost curves of the firm are customarily horizontal over a long range of sizes. This finding could be corroborated, I suspect, by a related investigation: if there were a unique optimum size in an industry, increases in demand would normally be met primarily by near proportional increases in the number of firms, but it appears that much of the increase is usually met by expansion of the existing firms." Stigler, The Economies of Scale, 1 J. LAW & ECON. 54, 71 (1958). Cf. Zwick, A Cross-Section Study of Industry Costs and Earnings in CHAPMAN & SHAY 55. "Companies which make comparatively larger numbers of loans per average office are more profitable and, as the analysis also indicates, there is a significant tendency for large companies to achieve higher degrees of loan office utilization." Id. at 56.

386. Note, An Ounce of Discretion for a Pound of Flesh: A Suggested Reform for
Another approach is enactment of a usury law similar to the English Money-lenders Act of 1900, which declares unconscionable interest charges to be illegal. The act sets an unconscionability rate of 48 percent. This is not an absolute rate; charges on either side of this percentage give rise to certain rebuttable presumptions. All charges over 48 percent are presumed unconscionable, but the creditor may prove otherwise by showing that the particular charge was justified in the circumstances. Charges under 48 percent are presumed conscionable, but the debtor is permitted to prove otherwise by showing that the charge was not justified and thus was unconscionable. The main drawback of such a system is that it would seem to encourage litigation. However, that does not appear to be a common English complaint, and the English courts have decided the unconscionability question on a sufficiently wide range of rates and situations to provide guidance in the future determination of rates.

Furthermore, the unconscionability tool seems to be an effective tool in the credit realm where presently used.

The [Oklahoma U3C] administrator has this terrible tool called the law suit regarding unconscionability. And what we found is that, any time you have a credit-connected abuse, that by use of this tool you can . . . go direct to the person granting the credit . . . [and break] up almost any kind of credit abuse practices . . . . The consumers are happy. You know, we don’t have anybody in Oklahoma complaining, except the creditors.

Another possibility would be to tie the rate of charge to a flexible

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388. Consumer Credit in the U.S. 94. Most of the Canadian Provinces utilize an unconscionability standard for credit which five provinces limit to loan credit, there being no limit on sales credit. Also Germany and Australia rely primarily on unconscionability to limit credit charges. Id. at 94-95. For a more extensive discussion of the Canadian situation, see Ziegel, Consumer Credit Regulation, A Canadian Consumer-Oriented Viewpoint, 68 Colum. L. Rev. 488, 493-97 (1968).

389. In Meston, Rate of Interest in Moneylending Transactions, 1953 Scots L.T. (News) 133, the author discusses the English cases on what constitutes an unconscionable rate of interest. Toward the end of the article there is a summary of the cases suggesting that the rate would begin at about 10% for loans secured to as high as 177.7%. Id. at 137.

standard, such as the Federal Reserve Rediscount Rate or some other presently existing index. Recently it has been suggested that Florida interest limits be permitted "to rise and fall quarterly with the money market. The suggested limit would be 150 percent of the average interest charged on a particular type of loan the previous quarter." Regardless of the index used, if it reflects the market, when capital becomes scarce the ceiling rates could freely move upwards. When the contingency passes and the indicator responds, the rates would readjust.

Like the unconscionability scheme, a sliding scale system could be subject to the charge of being difficult to administer. Over a period of time, the same types of loans would be subject to varying regulations. When the "transaction" took place could well become a subject for litigation. For example, on a rewriting or consolidation of existing loans, do we apply the original rates pro rata or do we apply the rate as of the day of the change in the account after crediting the debtor with the proper rebate of unused interest? Furthermore, to eliminate the problems of segmentation which have been so detrimental to competition, whichever standard is adopted should utilize a single standard rather than adopt provisions of the Florida proposal that perpetuate segmentation through use of a standard based on past transactions of a particular class or type.

The policy of adopting unconscionability or a sliding scale as our norm is to prevent those few transactions in which we believe the rate charged is so far beyond what we deem reasonable that it cannot be sanctioned, while permitting the market to operate in a relatively unfettered fashion. Unconscionability offers additional flexibility over the other alternatives. It permits the creditor to show why he needs to charge more than the established rate. It would then be left to a trier of fact, whether in an administrative or court proceeding, to determine if his reasons are sufficient.

391. This is the standard suggested in a model statute proposed in Merriman & Hanks 15-15.

"In Germany in some consumer credit legislation the maximum finance charge for some types of consumer credit is geared to the central bank discount rate . . . ." Dunham, Research for Uniform Consumer Credit Legislation, 20 BUS. L. 997, 1002 (1965).

392. Shaw, Floating Ceilings on Interest Rates Proposed in State, St. Petersburg Times, January 14, 1975, § B, at 5, col. 5 (proposed before Florida House of Representatives Commerce Committee). This proposal could also have been noted in the section on organized inaction because apparently it still has vestiges of a segmented rate—"average interest charged on a particular type of loan." Id. (emphasis added).

"In France the general usury laws define as usurious any loan whose interest is more than 1 1/4 times the interest charged generally in the credit market for loans of similar cost and risk." CONSUMER CREDIT IN THE U.S. 95.
VII. CONCLUSION

The usury regulations of today have been enacted piecemeal and in an ad hoc fashion, and have often been based upon myopic views of society and its needs. Examples and hypotheticals accompanied by intense emotion have been used to justify usury legislation that, in many instances, proved detrimental to our financial and societal structures. In such cases the hard evidence was less than convincing and highly unreliable. If this emotion could be removed from the policy-making process and the situation viewed objectively and in perspective, uniform solutions would be forthcoming. The goal is not insurmountable.

The first task in drafting uniform solutions is to isolate the causes of the highly charged emotions. The group always singled out as needing our consideration is that composed of the uneducated and economically disadvantaged. The viability of any proposal should not be questioned solely because of its influence on this class; the law should be directed to the majority of society. Let us eliminate this class, at least momentarily, from our consideration. If there are similar groups in the consumer or business communities, they should also be eliminated from consideration when formulating an overall policy toward usury.393

If these eliminated groups constitute a significant segment of society, we need to develop innovative programs for them, not more or new forms of regulation.394 Groups so disadvantaged in the bargaining and market process as to need special protection and assistance are unlikely to benefit from complicated and unaccessible regulatory protections. Several innovative programs aimed at providing credit to the poor, the young and other inexperienced debtors, the less creditworthy, and others who are classified as "eliminations" have been proposed and discussed, but few have ever been tried.395 Even the most

393. See generally CONSUMER CREDIT IN THE U.S. 151-60.
394. See Dunham, Research for Uniform Consumer Credit Legislation, 20 BUS. LAW. 997, 1002-03 (1965); Engman, How Government Regulation Has Become the Curse of Consumerism, 2 BARRISTER 58 (1975).
395. See, e.g., CONSUMER CREDIT IN THE U.S. 156-60; Caplovitz, Breakdowns in the Consumer Credit Marketplace, 26 BUS. LAW. 795, 799 (1971) (quoted supra note 384); High, Consumer Credit Regulation in Texas—A Rejoinder by an Economist, 50 TEXAS L. REV. 463, 472 (1972). Examples given include limited-income credit unions, governmental consumer loan fund, government insured consumer loans, development of credit scoring systems to better predict repayment frequency than present systems which are based mostly on financial and educational status. If adequate scoring systems could be developed, for example, many of the poor could cease to be "eliminations" and could safely be included in whatever system was adopted for the remainder.
successful trial to date, the Uniform Small Loan Act, has outlived its evolutionary usefulness.

It makes little sense to subject those who survive the elimination process to the high costs of intense regulation. Of the five models presented, the free market approach should best fulfill the needs of, and be totally acceptable to, the members of this group. There are few who would argue that a free market approach to usury would be unworkable in our system. Any such free market approach must facilitate competition; all institutions should be free to enter and compete in the lending arena with little governmental interference and restriction. Furthermore, the tack of any type of regulation should be to improve and stimulate competition among lenders.\textsuperscript{396} If some marginal protection is deemed essential, the unconscionability concept with a high presumptive limit could be established without doing great violence to the market approach.

If it takes governmental support to stimulate and insure innovation and an adoption of workable proposals, it will be well worth the price to the taxpayers. The resulting savings to society from a revamping of the present system would be immeasurable.

\textsuperscript{396} E.g., antitrust legislation and enforcement.

Raising rate ceilings is another method of stimulating competition. "Somewhat paradoxically the inclusion of finance charges in advertising copy occurred more frequently in states with highest ceiling rates than in those with lower ceilings. This probably reflects price competition for the more desirable types of loans as this practice was also related to the differentials in rates . . . ." Smith, \textit{Pricing Policies on Consumer Loans at Commercial Banks}, 25 J. Finance 517, 520 (1970).

Another possibility for new legislation would be . . . to require lenders who advertise to disclose in their advertisements the rates at which they make various loans. . . . [Under current law] lenders remain free to ignore rates entirely in their advertising. Indeed, a recent GMAC television advertisement features a heavy-breathing jogger. The point of the ad is that it is much more convenient to come to GMAC to buy the car and borrow in one spot than it is to run to one place for insurance, to another place for a loan, and to a third place for the car. Perhaps GMAC should be required in such an advertisement to disclose the rate at which it will lend against new cars.