Usury in California

(Concluded)

Penalty for Charging Usurious Interest

The California Usury Law provides that if the parties to a contract of loan or forbearance stipulate for the payment of interest or profit in excess of an amount equal to twelve per cent per annum, on the sum lent or forborne, so much of the contract as relates to the payment of interest or profit shall be null and void "and no action at law to recover interest in any sum shall be maintained." In short, the statute clearly declares that one who charges or agrees to accept usurious interest or profit for the loan or forbearance of the use of money, forfeits one's right to recover even legal interest. The California Supreme Court in Haines v. Commercial Mortgage Company therefore held that the defendant, having made a charge of $1,020, which was in addition to the maximum rate of interest already reserved, and which could not be properly allocated to any item of expense or service, had thereby precluded itself from collecting any interest whatever on the loan.

Penalty for Accepting Usurious Interest

If a lender not only bargains for unlawful interest, but actually accepts payments of excessive interest from the borrower pursuant to the contract of loan, the borrower by the terms of the Usury Law, may recover from the lender "treble the amount of money so paid . . . in violation" of the act, provided such recovery be sought within one year after payment. In applying this part of the Usury Law to the facts in Haines v. Commercial Mortgage Company, the Supreme Court said that the plaintiffs were entitled to recover not merely treble the amount of interest paid in excess of twelve per cent, "but treble the entire amount of interest actually paid upon the loan, for the unmistakable declaration of the statute is to this effect."

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68 Usury Law, Cal. Stats. 1919, p. lxxxvii, § 2; quoted in first installment of this article, 16 California L. Rev. 281, 288 (May, 1928). In some copies of Cal. Stats. 1919, the Usury Law is found at p. lxxxiii.

69 (1927) 200 Cal. 609, 254 Pac. 956. For a statement of the facts of this case see 16 California L. Rev. 281, 293 (May, 1928).

70 For discussion of "services and expenses," see 16 California L. Rev. 281, 293 et seq. (May, 1928). In addition to the authorities there cited (n. 62), see the annotation in 53 A. L. R. 743.

71 Usury Law, supra, n. 68, § 3.

72 200 Cal. 609, 617.
But is it altogether clear that "money paid in violation of the act" means the entire amount of interest paid instead of the amount of interest paid in excess of the maximum rate? The statute reads: "Every person . . . who for any loan . . . shall have paid . . . any greater sum . . . than is allowed to be received under . . . sections one and two . . . may recover in an action at law . . . treble the amount of money so paid . . . in violation of said sections." It must be conceded that usury statutes containing similar provisions have been construed, and for sound reasons, so as to allow the borrower to recover a multiple of the total interest paid. The California law is practically identical with such usury statutes except that it contains the additional phrase, "in violation of said sections." Were it not for this phrase, the reasoning of the decisions interpreting similar acts would apply and the words "the amount of money so paid" should be held to refer back to the words "any greater sum." But does not the addition to the words "the amount of money so paid," of the modifying phrase "in violation of said sections" so qualify the words "the amount of money so paid," as to make the act mean that one who has paid "any greater sum . . . than is allowed to be received under the preceding sections," may recover not treble the total interest ("greater sum") paid, but only treble so much of the interest ("the amount of money") as is paid "in violation of the preceding sections"? If the phrase "in violation of the preceding sections" has this effect, a borrower who has paid usurious interest could recover only treble the excess of the interest paid over twelve per cent, for neither section one nor section two of the Usury Law is violated if the borrower pays and the lender accepts interest at the rate of twelve per cent per annum, even though the borrower, by charging a usurious rate, has forfeited his right to

73 Usury Law, supra, n. 68, § 3.
74 Such statutes usually read: "The taking . . . or charging a rate of interest greater than is allowed by the preceding section . . . shall be deemed a forfeiture of the entire interest . . . In case the greater rate of interest has been paid the person by whom it has been paid . . . may recover back . . . twice the amount of the interest thus paid . . ." See 13 U. S. Stats. at L. 108, U. S. Rev. Stats. §§ 5197, 5198, p. 1011. "The words 'the amount of interest thus paid' refer to the 'greater rate,' which includes . . . the same sums as are included in the words 'the entire interest,' in the first part of the section." Waldner v. Bowdon State Bank (1904) 13 N. D. 606, 102 N. W. 169, 171.
any interest. It is not intended to imply that the court's interpretation of this sentence of the Usury Law is untenable, but it is submitted that the Supreme Court's ruling that a borrower who has paid more than twelve per cent interest may recover treble the amount of the total interest paid is not "the unmistakable declaration of the statute" and it is difficult to understand the court's summary disposal of this very important issue in view of the fact that the Usury Law is a "poorly drafted act," penal in its nature, and in contravention of well established economic principles.

Sections 1 and 2 of the Usury Law are quoted in 16 California L. Rev. 281, 288 (May, 1928).

It seems clear that if the borrower has not paid more than the maximum rate of interest, the lender is not subject to the penalty of having to repay double or treble the amount of the interest received, even though the lender has charged usurious interest. Alexander v. First Nat. Bank (1903) 114 Ky. 683, 71 S. W. 883.

If the lender has charged more than 12 per cent and the borrower pays any interest up to but not more than 12 per cent, it might be thought that the borrower should be able to recover at law the amount of interest so paid. But such is not the law in California. Matthews v. Ormerd (1903) 140 Cal. 578, 74 Pac. 130; London & S. F. Bank v. Bandmann (1898) 120 Cal. 220, 52 Pac. 583, 65 Am. St. Rep. 179; Harralson v. Barrett (1893) 99 Cal. 607, 34 Pac. 342. (These cases were not decided under the present Usury Law but had reference to Cal. Const. Art. XIII, § 5, repealed in 1906, which provision was like the present Usury Law in these respects.) Probably the majority rule is contra. See annotation in L. R. A. 1918B, 585 et seq.

In re Washer (1927) 200 Cal. 598, 606, 254 Pac. 951.


The common law rule that penal statutes should be strictly construed has been expressly abrogated so far as the provisions of the California Penal Code are concerned by section 4 of that code. It has even been said that the common law rule of strict construction has no application to California penal statutes not contained in the penal code. See Ex parte Galivan (1912) 162 Cal. 331, 333, 122 Pac. 961; In re Mitchell (1905) 1 Cal. App. 396, 398, 82 Pac. 347. Nevertheless, even in California, "statutes imposing penalties are, for humane reasons, subjected to strict construction." Symmes v. Sierra Nevada Mining Co. (1915) 171 Cal. 427, 430, 153 Pac. 710. A statutory penalty is "one which an individual is allowed to recover against a wrongdoer, as a satisfaction for wrong or injury suffered, and without reference to the actual damages sustained" (Los Angeles County v. Ballerino (1893) 99 Cal. 593, 596, 32 Pac. 581, 34 Pac. 329), and statutes imposing such penalties should be strictly construed. Irvine v. McKeon (1863) 23 Cal. 472. See also Moss v. Smith (1916) 171 Cal. 777, 785, 155 Pac. 90, and Cal. Civ. Code, § 309 (concerning liability of directors of corporation for debts incurred in excess of subscribed capital stock).

See F. W. Ryan, Usury and Usury Laws, pp. 57, 63 et seq. (1924), for a review of prevailing economic theories.

The present writer does not desire to be understood as advocating judicial review of the merits of legislation. But it is well established that courts in interpreting statutes are to give effect only to such legislative intent as appears in the statute (2 Lewis' Sutherland on Statutory Construction, 2 ed., § 388, p. 745 (1904), and authorities there cited), and the writer is of the opinion that, if the legislative intent does not clearly appear in the particular statute, the court should wholly disregard the perhaps actual but unexpressed intent
But however regrettable its decision may be, the Supreme Court has unequivocally interpreted the Usury Law to mean that a borrower who pays a greater rate of interest than is permissible under the statute, may recover treble the amount of the total interest paid and it is not likely that the court will reverse itself on this point.

WHAT CONSTITUTES PAYMENT OF USURIOUS INTEREST

Usury statutes which impose upon a lender, who accepts usurious interest, a penalty of a multiple of the amount of unlawful interest so accepted, have been very generally interpreted to mean that such interest must be actually paid before the borrower may recover the penalty. The California Usury Law has been similarly interpreted. There has not been, however, a uniformity of opinion as to what constitutes a payment of usurious interest. A review of the prevailing views on the subject of payment seems advisable.

In situations where a note bearing a usurious rate of interest has matured and the lender has accepted a new note covering both the original note and the accrued but unpaid usurious interest thereon, the courts have had little hesitancy in deciding that the giving of the new note did not amount to a payment of the usurious interest accrued on the old. . . . the new note being regarded as simply a renewed promise to pay the usurious interest. Similarly, in cases where the lender has insisted that the borrower execute a note for an amount in excess of the actual loan, it has generally been held that the execution of the note for the additional sum did not amount to

of the legislators, especially if such unexpressed intent is to enact what the court considers unwise or unsound legislation, and the court should construe ambiguities in such a statute so as to effect a result which seems to the court desirable in light of economic, social and other factors—i.e. in such a situation the court should construe liberally or strictly depending upon whether in its opinion the legislation is meritorious.


7 C. J. §§ 781, 826; 27 R. C. L. §§ 78, 275.


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a payment of such additional sum.83 In view of the unanimity of opinion that such transactions do not amount to a payment of usurious interest, it was but a step to hold that the reservation of a discount, bonus or commission by the lender out of the nominal principal of the loan does not amount to a payment of such discount, bonus or commission, and the courts, almost without exception, have so decided.84 In other words, the courts have refused to distinguish between these two situations: (1) A asks B for a loan of $1,000 at the maximum rate of interest. B demands a greater profit and gives A $1,000 only after A has executed a note for $1,100 at the maximum interest. (2) A asks B for a loan of $1,000 at the maximum rate of interest. B agrees to make the loan if A will pay him a commission of $100. A assents. To avoid having to hand A $1,000 and then taking back $100 B simply hands A $900 and B executes a note for $1,000 bearing the maximum rate of interest.

But are these situations identical? It would seem not. Suppose that A and B dealt through a broker, C, and that the $100 commission was to go to C. In situation (1) A would execute a note for $100 payable to C, while in situation (2) A would hand C $100 in cash—in the first situation A would merely promise to pay but in the second, he would actually make a payment. If C drops out of the transaction and the commission goes to B, it is difficult to understand why A in situation (2) has not made a payment of $100—particularly if the question of payment of interest or profit is to be determined by the agreement understanding and intent of the parties.85 Nevertheless, the courts, with one or two exceptions,86 have held a reservation of a commission, discount or bonus out of the nominal principal of the loan not to be a sufficient payment of usurious interest to enable the borrower to recover a multiple of the

85 See infra, text and notes, for discussion of intent as the factor determining payment.
86 Boho v. Peoples' Nat. Bank, supra, n. 84; Taylor v. Shelton, supra, n. 84.
amount of such commission, discount or bonus. But in arriving at this conclusion the courts have not followed the same line of reasoning. In fact, two decidedly distinct theories have been developed, the one based on the wording of the particular statute, the other on the premise that usurious interest cannot be considered as paid until the borrower has first paid an amount equal to the principal of the loan with lawful interest thereon.

Usury statutes such as the National Banking Act may be regarded as having two penal clauses: (1) "The taking, receiving, reserving or charging a rate of interest greater than is allowed by the preceding section . . . shall be deemed a forfeiture of the entire interest . . . (2) In case the greater rate of interest has been paid, the person by whom it has been paid . . . may recover back . . . twice the amount of the interest thus paid . . ." Where such statutes are law, the weight of authority holds that the reserving of a bonus, commission or discount by the lender from the nominal principal of the loan is covered expressly and exclusively by the first penal clause and hence, that the sole penalty for so reserving is a forfeiture of the right to collect any interest. If this interpretation of the statute is sound, it of course justifies the conclusion that the reservation of a bonus or commission is not a payment within the second penal clause. But regardless of the merits of this interpretation of such statutes as the National Banking Act, a similar interpretation cannot be given the California Usury Law.

The California act, of course, also has two penal clauses: (1) providing that any contract of loan whereby the lender is to receive a greater rate of interest than twelve per cent per annum shall be void as to the agreement to pay interest; (2) providing that one who has paid a greater rate of interest than twelve per cent may recover treble the amount of interest paid in violation of the terms of the act. But "reserving" is not even mentioned in the California statute, much less is it expressly or exclusively covered by the first penal clause which provides simply for a forfeiture of the right to any interest. Consequently, for aught that is contained in the statute, a reservation of a bonus or commission out of the nominal principal

87 See authorities cited supra, n. 84.
88 "Lawful" as distinguished from "legal" interest. Any rate not in excess of twelve per cent per annum is lawful. However, the legal rate of interest in California is seven per cent per annum.
of the loan, might very well be considered a payment of usurious interest within the meaning of the second penal clause of the California law.

A second line of decisions, wherein the question of reservation of a commission or bonus has been treated, advanced, as above stated, the broad doctrine that before unlawful profit or interest could be considered as paid, an amount equal to the sum lent with lawful interest thereon must first have been paid. This theory excellently supported the conclusion that the reservation of a bonus or commission out of the nominal principal did not amount to a payment within the meaning of the double or treble penalty clauses of the usury laws. But a majority of the courts which adopted this reasoning soon decided that if carried to its logical conclusion, it would be objectionable for two reasons: (1) that it would defeat the apparent intent of the double or treble damage clauses; (2) that it would make possible the recovery by the lender of the principal sum lent, even after the borrower had paid interest in violation of the particular statute. These courts therefore concluded that the theory, that the total of the payments made by the borrower must be in excess of the principal of the loan with lawful interest before the borrower can be considered as having paid usurious interest within the meaning of the double or treble damage clauses of the usury laws, should be applied only to payments made by way of a

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91 McBroom v. Scottish Mortgage Co., supra, n. 84; Haseltine v. Central Nat. Bank, supra, n. 84; Smith v. First Nat. Bank, supra, n. 84; McCarthy v. First Nat. Bank of Rapid City (1909) 23 S. D. 269, 121 N. W. 853, and cases therein reviewed.

92 "The contract of loan not being void, except as to the excess of interest stipulated to be paid, the question arises whether the lender is liable to an action for the penalty prescribed by the statute, so long as the principal debt, with legal interest thereon, after deducting all payments, is unpaid. We are of the opinion that this question must be answered in the negative. While, under the statute, the mere charging of usurious interest may be a misdemeanor for which the lender can be fined, whether usurious interest is or is not collected or received, the borrower has no cause of action until usurious interest has been actually collected or received from him. Such is the mandate of the statute. And interest cannot be said to have been collected or received, in excess of what may be lawfully collected and received, until the lender has, in fact—after giving credit for all payments—collected or received more than the sum loaned, with legal interest." McBroom v. Scottish Mortgage Co., supra, n. 84, 153 U. S. 318, 328.

93 See particularly McCarthy v. First Nat. Bank of Rapid City (S. D.), supra, n. 91, and the cases therein reviewed; McCarthy v. First Nat. Bank of Rapid City (U. S.), supra, n. 90; Sloan v. Piedmont Fire Ins. Co. (1925) 189 N. C. 690, 128 S. E. 2; Durkee v. City Bank (1850) 13 Wis. 241. For other cases see note in 21 Ann. Cas. 446; also see note in 56 L. R. A. 673.


95 See McCarthy v. First Nat. Bank of Rapid City, supra, n. 90.
reservation by the lender from the nominal principal, and that if the borrower, subsequent to the consummation of the loan, tendered and the lender accepted money as usurious interest, the borrower's right to sue for a multiple of the money so paid should be deemed to have accrued at the time of such payment.

Unless the objections above set forth to the theory, that an amount in excess of the principal and lawful interest must first be paid, are well made, it seems that the theory should have been carried to its logical conclusion, regardless of whether the payments might be effected by way of reservation or otherwise. It is submitted that neither of the objections is sound.

If it be conceded that to require the payment of a sum in excess of the loan with lawful interest thereon before usurious interest may be considered as paid, defeats the apparent intent of the double or treble damage clauses of usury laws, it is equally true that, unless the particular statute permits a distinction to be drawn between a payment made by way of reservation and a payment otherwise made, a ruling, that a reservation of a profit out of the nominal principal does not constitute a payment of such profit, also defeats the intent of the multiple damage clauses of such statutes. But no concession need be made regarding the apparent intent of the usury laws—it is a perfectly plausible construction of the multiple damage clauses of statutes like the California Usury Act to hold that they require the payment of an excess over the principal with lawful interest thereon, before usurious interest may be considered as paid. Indeed, such statutes are wholly penal in their nature and for this reason alone should be strictly construed. Moreover, if the lender has charged usurious interest, the borrower need pay no interest. The fact that the lender, by charging an excessive rate, has committed a misdemeanor should be no concern of the borrower—he cannot be injured so long as he is not required to pay more than his lawful debt.

As to the lender's being able to recover the principal of the loan, even after the borrower has made "payments" of usurious interest it may be well to first note why this result is said to obtain: Statutes, such as the California Usury Law and the National Banking Act do not deny to the lender who has charged or accepted usurious interest the right to recover the principal sum lent, nor do such statutes

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96 See Usury Law, supra, n. 68, § 3. "Every person . . . who shall have paid . . . may . . . recover . . ." There is absolutely nothing in this language which indicates when usurious interest shall be considered as paid.
97 See n. 78, supra.
98 Usury Law, supra, n. 68, § 2.
99 As neither statute provides for a forfeiture of the principal, it seems unnecessary to cite cases on this point. However, for judicial authority, see
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give the borrower who pays usurious interest any method of redress other than a penal suit—penal although termed an action at law\textsuperscript{100}—for the recovery of a multiple of the interest paid.\textsuperscript{101} For these reasons it has been said that the borrower, when sued by the lender for the principal, cannot set off by way of counterclaim or otherwise the usurious interest “paid”\textsuperscript{102}—his exclusive remedy being an affirmative action, penal in nature, brought for the sole purpose of recovering a multiple of the usurious interest so “paid”\textsuperscript{103}—and that therefore the lender may sue for and recover the full principal regardless of how much usurious interest the borrower may have “paid.”

To completely refute so much of the foregoing ratiocination as relates to the right of the borrower to set-off against the principal the amount of usurious interest paid, it ought to be enough to point out that it involves a conclusion on the very question in issue, namely whether usurious interest can be considered as paid when the total of all payments made by the borrower is less than the sum lent with lawful interest thereon. Furthermore it seems obvious that, if usurious interest is not paid within the meaning of the multiple damage clauses of usury laws until after the borrower has first paid amounts totaling the principal with lawful interest, it is only logical to hold that usurious interest cannot be considered as paid for any purpose, until after an amount equal to the principal with lawful


\textsuperscript{100} “The remedy given by the statute is a penal suit. To that the party aggrieved must resort. He can have redress in no other mode or form of procedure.” Barnet v. Muncie Nat. Bank (1878) 98 U. S. 555, 559, 25 L. Ed. 212.


\textsuperscript{102} Cases cited, supra, n. 101.

“Assuming . . . that the bank knowingly took and was paid a greater rate of interest than that allowed by the law of the State, that did not constitute a defense to the action, either by way of set-off or payment of the primary note in suit.” Farmers’ Nat. Gold Bank v. Stover (1882) 60 Cal. 387, 392.

\textsuperscript{103} “While the plaintiff [the borrower] in such cases, upon making out the facts, has a clear right to recover, the defendant has a right to insist that the prosecution shall be brought by a suit specially and exclusively for that purpose—where the sole issue is the guilt or innocence of the accused, without the presence of any extraneous facts which might confuse the case, and mislead the jury to the prejudice of either party.” Barnet v. Muncie Nat. Bank, supra, n. 100.
interest has first been paid. If "payments" of usurious interest by way of reservation from the principal must be applied to the principal, regardless of the intent of the parties, so should all other "payments" of usurious interest be applied to the principal, notwithstanding the intent of the parties. In short, the very essence of the theory that usurious interest cannot be considered as paid before the total of the borrower's payments exceeds the principal with lawful interest, is that such payments whether made by way of reservation or otherwise and whether tendered as principal or interest, shall nevertheless be regarded as payments on the principal until that obligation is extinguished.\textsuperscript{104} If this theory is accepted, it of course follows that a borrower who has paid money to the lender, nominally as usurious interest, would never have occasion to set-off usurious interest when sued by the lender for the principal—he would set-off payments on the principal.

But assuming, for the sake of argument, that it would be possible for the lender to collect the principal after receiving "payments" of usurious interest, why would such a result be undesirable? If the lender were wise he would repent his usury and sue for only so much of the principal as would make his total receipts equal to the amount of the loan with lawful interest thereon. If he were so avaricious as to collect the entire principal after receiving payments of usurious interest, the borrower could then sue for a multiple of the interest. If it be objected that the borrower who lacked sufficient means to pay the principal could not recover the statutory penalty, it may be replied that usury laws are designed as a shield, not as a sword\textsuperscript{105}—in the event the lender has charged a usurious rate the borrower need pay no interest whatever,\textsuperscript{106} and unless he tenders payments as such, the lender cannot apply them to interest.\textsuperscript{107} In brief, if the contract of loan provides for unlawful interest, the

\textsuperscript{104} Usury laws such as the California act and the National Banking Act clearly provide that if a greater rate of interest is charged the lender may collect no interest. How then may it be said that the lender may apply payments to interest without doing violence to the terms of the statutes? See Gladwin State Bank v. Dow (1920) 212 Mich. 521, 180 N. W. 601, holding that all payments of usurious interest must be referred to the principal regardless of the intent of the parties. For other cases to same effect see the note in 13 A. L. R. 1244. It is submitted that the Michigan case states the correct view.

\textsuperscript{105} Haines v. Commercial Mortgage Company, supra, n. 69, 200 Cal. 609, 621; Gladwin State Bank v. Dow, supra, n. 104, 180 N. W. 601, 605.

\textsuperscript{106} Usury Law, supra, n. 68, § 2.

\textsuperscript{107} Second Nat. Bank v. Fitzpatrick (1901) 111 Ky. 228, 63 S. W. 459; Stout v. Ennis Nat. Bank (1887) 69 Tex. 384, 8 S. W. 808. Baker v. Lynchburg Nat. Bank (1917) 120 Va. 208, 91 S. E. 157, recognizes this general rule but holds that the borrower must object if the lender applies a payment to usurious interest.
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borrower may either refuse to pay interest or he may tender the excessive rate in the hope that the lender will accept it as interest and be thereby lured into the trap of the double or treble damage clause. The borrower who elects to pursue the latter course should not be heard to complain because he is compelled to pay an amount in excess of the principal with lawful interest before he is permitted to recover the penalty of a multiple of the usurious profit. It seems more consonant with fair play to allow the lender the full benefit of the doctrine of locus poenitentiae and thus an opportunity to escape the snare of the double or treble damage clause, particularly since such an opportunity will exist if the lender is but given until the time he seeks recovery of the principal to forego his usury and apply payments, which he may have accepted as unlawful profit, to the sum lent with proper interest thereon.

There is another argument which may be advanced in favor of the consistent application of the theory that usurious interest cannot be considered as paid until the total of the borrower's payments exceed an amount equal to the principal of the loan and lawful interest. If payment of usurious interest is so determined, the borrower's right to recover the statutory penalty depends upon the answer to a simple problem in mathematics, viz.: Is the total of all payments made by the borrower in excess of a sum equal to sum lent with lawful interest on such sum? If this question is answered in the affirmative the borrower's right to the penalty is clear, but if answered in the negative, he has no cause of action. On the other hand, if payments of usurious interest are to be determined by the intent of the parties, the right of the borrower to recover the penalty will depend upon a state of mind, a matter often difficult to prove, and at best a speculative test which cannot be applied without opening wide the door to fraud and inviting perjury. Nevertheless, comparatively few courts have consistently applied the theory that

108 It must be admitted that under this theory the borrower could ordinarily receive only treble the excess, not treble the entire interest paid. The penalty would attach only when the total of the payments of the borrower exceeded the principal with lawful interest thereon. Hence, except on short term loans, the statute of limitations (one year) would usually bar recovery of treble the entire interest. (See, however, McCarthy v. Rapid City Nat. Bank, supra, n. 91, 121 N. W. 853, 857.) But as above pointed out in the text, the California law might well have been interpreted to allow a recovery of treble only the excess of the interest paid over twelve per cent. 109 Jones v. Moore (1924) 212 Ala. 248, 102 So. 200; First Nat. Bank v. Denson (1897) 115 Ala. 650, 22 So. 518; Werner v. Lorentzen (1907) 3 Alaska, 275; First Nat. Bank v. McInturff (1896) 3 Kan. App. 536, 43 Pac. 839; Haseltine v. Central Nat. Bank (1900) 155 Mo. 66, 56 S. W. 985 (impliedly overruled in Citizens' Nat. Bank v. Donnell (1903) 172 Mo. 384, 72 S. W. 925). See also Duncan v. First Nat. Bank of Mt. Pleasant (1877) Fed. Cas. No. 4,135, Thomp. N. B. Cas. 360; Cambron v. Boldrick (1912)
usurious interest cannot be considered as paid until the total of the payments made by the borrower exceeds the principal of the loan with lawful interest. The conclusion of the majority of the tribunals which ever gave expression to the theory, has been that it can have application only to payments made by way of a reservation from the nominal principal.

The California law with regard to what constitutes payment of usurious interest is not altogether clear. In applying the usury statute to the facts of Haines v. Commercial Mortgage Company, the Supreme Court held that the plaintiff borrowers could recover treble so much of the $800 monthly payments as had been tendered and accepted as interest but denied them the right to three times the $1,020 bonus or commission reserved out of the loan. The court

147 Ky. 524, 144 S. W. 374; Smith v. Robinson (1865) 92 Mass. 130; Saunders v. Lambert (1856) 73 Mass. 484.

110 As will appear from the following illustration, the holding in Haines v. Commercial Mortgage Co., supra, n. 69, seems inconsistent on its face. The actual transaction in Haines v. Commercial Mortgage Co. was this: A asked B for a loan of $34,000. B agreed to make the loan if A would pay outright a commission of three per cent. A assented and signed a note for $34,000 at twelve per cent. As to the commission, A could have done one of three things: (1) Have handed over $1,020 from funds which he had when he sought the loan. (2) Upon receipt of $34,000 from B have handed back $1,020. (3) Have told B simply to hand him $34,000 less $1,020 or $32,980. Naturally A paid the commission in the latter fashion and it is inconceivable that a court would attach any significance to the manner in which payment of the commission was effected.

A then sought to recover treble the amount of the commission as a payment of a profit in excess of twelve per cent per annum. The court denied recovery, in effect saying this: Both A and B thought that A borrowed from B $34,000 at twelve per cent and that A paid B a commission of $1,020. But by charging more than twelve per cent A forfeited his right to any interest so the commission will be referred to the principal. A really borrowed only $32,980; by signing a note for $34,000 he merely promised to pay a bonus of $1,020. But until A has paid $34,000 the bonus will not be considered as paid, regardless of the intent of the parties.

Now let us look at the agreement between A and B as to payment of the principal and interest: A was to pay a flat rate of $800 per month. B was to apply these monthly payments first to accrued interest and then to the principal. A was to pay interest only on the unpaid balance of the principal. At the end of the first month A paid B $800. B credited A with $34 as interest and $766 as a payment on the principal. A then sued B for 3 x $34 or $102 and was allowed to recover. The court said that A tendered and B accepted $34 of the $800 as interest, therefore A paid $34 as usurious interest and may recover treble the amount so paid.

If the court had been consistent it would not have said: "Both A and B thought that A paid $34 as interest. But by charging more than twelve per cent B forfeited his right to any interest so the whole of the $800 will be referred to the principal. A really borrowed the money without interest; by his contract he merely promised to pay interest. But until A has paid more than $32,980 no interest will be considered as paid, regardless of the intent of the parties."

Suppose that instead of "reserving" the commission, B had advanced $34,000 and A had repaid $1,020 at once, after the lapse of a minute, a day, a
did not see fit to discuss the matter on principal, nor did it give any
authority other than a terse statement in Ruling Case Law.\textsuperscript{112} It is
apparent from its decision, however, that the California court did
not intend to adopt the logic of the cases\textsuperscript{113} which consistently adhere
to the proposition that usurious interest cannot be considered as paid
until the total of the payments of the borrower exceeds the principal
of the loan with lawful interest. It is possible, but not probable, that
the court based its decision on the mistaken\textsuperscript{114} assumption that the
California Usury Law, like the National Banking Act, makes for-
feiture of all interest the exclusive penalty for "reserving" a bonus
discount or commission out of the amount loaned. It might be
thought that the Supreme Court intended to adopt what may be
termed the South Dakota rule,\textsuperscript{115} namely, that a commission or dis-
count reserved out of the loan cannot be considered as paid until
the total of the payments made by the borrower exceeds the prin-
cipal of the loan with lawful interest, but that "payments" effected
otherwise than by way of reservation shall be apportioned by the
courts to principal or interest according to the intent and agreement
of the parties, regardless of whether or not the total of such pay-
ments is less than the sum loaned.\textsuperscript{116} But if the California court
intended to adopt this rule, it seems that it attached, perhaps un-
wittingly, an important modification.

It will be recalled that the note executed by the plaintiffs in Haines
v. Commercial Mortgage Company provided for flat payments of
$800 per month, part of each payment to be applied to accrued
interest and the balance to the principal. In the latter part of its
opinion that Supreme Court said that notwithstanding the usury, the
plaintiffs were absolutely bound to pay $800 per month but that "all
payments will be referred to the principal and the obligation thus
finally extinguished."\textsuperscript{117} If taken literally this statement seems
wholly inconsistent with the court's proposition that "where the parties
have by special and specific agreement, as in the case at bar,
agreed as to what portion of a given payment shall be referred to

\textsuperscript{112} See citations, supra, n. 109.
\textsuperscript{113} See supra, text, where cases cited supra, n. 90, are discussed.
\textsuperscript{114} See McCarthy v. First Nat. Bank of Rapid City (1909) 23 S. D. 269,
121 N. W. 853.
\textsuperscript{115} For citations of cases adopting this rule, see n. 93, supra.
\textsuperscript{116} 200 Cal. 609, 621.
principal and what shall be referred to interest, the court will adopt this understanding in applying the provisions of the Usury Law.\textsuperscript{118} To explain this inconsistency the court in its denial of a re-hearing declared its intent to have been that "all future or subsequent" payments would be referred to the principal.\textsuperscript{110} Evidently the court meant that all payments, made subsequent to the judgment declaring the loan usurious and that borrower need pay no interest, must be referred to the principal regardless of the intent of the parties. In other words, the court in effect held that until a borrower obtains a judicial declaration that the agreement to pay interest is void, the lender may accept as usurious interest all payments tendered as such, but that after a judicial declaration, that the agreement to pay interest is void, the lender must apply all payments to the principal, even though the borrower might be only too glad to have the lender accept payments as interest and thus become liable for the treble penalty. If the court meant to go to the extent of depriving a lender of the right to accept payments of usurious interest as such, after a judicial declaration that he had no right to any interest, it is difficult to understand why it did not deny altogether the right of a lender who has charged usurious interest to apply any payments to other than the principal. It is certainly not apparent how any significance can be attached to a judicial declaration that a lender can collect no interest, when the statute, itself, clearly declares that if the court meant to go to the extent of depriving a lender of the right to accept payments of usurious interest as such, after a judicial declaration that he had no right to any interest, it is difficult to understand why it did not deny altogether the right of a lender who has charged usurious interest to apply any payments to other than the principal. It is certainly not apparent how any significance can be attached to a judicial declaration that a lender can collect no interest, when the statute, itself, clearly declares that if the lender charges more than the maximum rate the agreement to pay interest is null and void.\textsuperscript{120}

\textbf{STATEMENT OF CALIFORNIA LAW WITH REGARD TO PAYMENT OF USURY}

If it be attempted to state the California law as to what constitutes a payment of usurious interest within the meaning of the treble damage clause, the decision in Haines v. Commercial Mortgage Company indicates that there should be included in such statement the following principles:

(1) If a commission, bonus, discount or "interest in advance" is reserved by the lender out of the nominal principal of the loan, such commission, bonus, discount or "interest in advance" shall not be considered as paid, regardless of the intent of the parties, until the total of the payments tendered by the borrower as principal\textsuperscript{121} ex-

\begin{itemize}
  \item \textsuperscript{118} 200 Cal. 609, 618.
  \item \textsuperscript{110} 200 Cal. 609, 626.
  \item \textsuperscript{120} See n. 104, supra.
  \item \textsuperscript{121} Rather than "the total of the payments tendered by the borrower as principal," it would be more accurate to say "the total of all payments made by the borrower which are not tendered and accepted as payments of interest,"
\end{itemize}
ceeds the amount actually advanced by the lender (i.e. the nominal principal less the amount reserved by way of the commission, bonus, discount or "interest in advance").

(a) The amount of such commission, bonus, discount or "interest in advance" shall be considered as effecting a reduction of the agreed or nominal principal and "in testing the transaction for usury the principal sum loaned will be held to be the amount of the loan less the interest or commission deducted in advance."

(2) If the borrower actually pays money to the lender pursuant to the contract of loan, so much of the money so paid as is tendered by the borrower and accepted by the lender as interest, shall be considered as a payment of interest, regardless of whether or not the total of all payments made by the borrower shall be less than the sum actually loaned.

(a) So much of the money as is tendered and accepted as interest shall not be referred to the principal.

(b) If the money so tendered and accepted as interest is in excess of the rate allowed by the law, the borrower may sue at once for treble the amount of such interest; the statutory limitation of one year commences to run at the time of such payment.

(3) If a contract of loan is judicially declared to be usurious, all payments made subsequent to such declaration, whether tendered and accepted as interest or principal, shall be considered as payments on the principal.

EFFECT OF USURY ON ACCELERATION CLAUSES

In Haines v. Commercial Mortgage Company the court also had occasion to construe that part of the usury law which provides that

for in case usurious interest has been charged, neither party can apply payments to other than the principal without the consent of the other. See cases cited, supra, n. 107; also Citizens' Nat. Bank v. Forman's Assignee (1901) 111 Ky. 206, 63 S. W. 454, 757; McCarthy v. First Nat. Bank of Rapid City, supra, n. 91; Bank of Cadiz v. Slemmons (1877) 34 Ohio St. 142, 32 Am. Rep. 364.

122 Haines v. Commercial Mortgage Company, supra, n. 69, 200 Cal. 609, 625.

Thus in the Haines case the nominal loan was $34,000 at twelve per cent interest plus an additional profit by way of a bonus, or commission of $1,020. The court held that in testing the transaction for usury the real principal should be considered as $34,000 less the amount of the commission or bonus, $1,020, i.e. $32,980. Under the court's theory of the transaction all payments of interest made pursuant to the transaction of loan ($34,000 at twelve per cent) were payments of usurious interest (twelve per cent on $34,000 equals over 12.37 per cent on $32,980). If the court had given effect to the intent of the parties the principal would have been considered as $34,000 and payments of interest pursuant to the terms of the contract of the loan would have not been usurious—the only payment of usurious interest would have been the payment by way of reservation of the commission or bonus, to wit, $1,020.

128 Supra, n. 69.
if unlawful interest is charged, "the debt can not be declared due until the full period of time it was contracted for has elapsed." The court held this provision to mean that an acceleration clause, providing that the lender may declare the loan to be immediately due and payable in the event that interest be not paid when due by the terms of the note, would be of no effect if an excessive rate of interest had been charged. The reason for this holding is apparent—if usurious interest has been charged the borrower need pay no interest, his only obligation being to repay the principal. The court added, however, that an acceleration clause, providing for immediate maturity in the event that an installment on the principal be not paid when due according to the terms of the note, would be valid and operative even though the loan were tainted with usury. This result also seems sound—if usurious interest has been charged, the borrower is nevertheless liable for the principal and should be required to discharge his lawful debt in the manner and at the times provided in the contract of loan. To deny the lender the benefit of an acceleration clause operative in the event of a default in the payment of an installment on the principal, would be to inflict upon such lender a penalty not expressly provided for in the act. Thus in Haines v. Commercial Mortgage Company, the clause in the note, providing for maturity, at the option of the holder, in the event that default was made in the monthly payments of $800, was declared by the court to be effective, notwithstanding the usury, because a failure to make a monthly payment would be a failure to make a payment on the principal. The court's interpretation and application of this clause of the Usury Law seems clearly correct if regard is had for the obvious meaning of the statute.

**The Nature of the Action for Recovery of the Penalty for Accepting Usury**

Since the California court has adopted the view that usurious interest may be considered as paid notwithstanding that the total of the payments made by the borrower may be less than the amount of the principal with lawful interest, the nature of the action for the recovery of treble the amount of usurious interest paid becomes rather important. The view of the federal courts with regard to the double penalty provided in the National Banking Act has been referred to above. Briefly stated, this view is that the remedy

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124 Usury Law, supra, n. 68, § 2.
125 As above pointed out in the text, the question of set-off or counterclaim of the penalty does not arise if all payments, whether tendered as interest or principal, are applied to the principal until that obligation is extinguished.
126 See text, and notes 100-103, supra.
afforded by the statute is exclusive and though termed "an action at law," is fundamentally a penal suit for the reason that the damage the borrower may have suffered because of the usury is never expressed by the penalty. As says the Supreme Court of the United States, the lender is entitled to have the question of his guilt or innocence of the offense for which the statutory penalty is punishment, determined in an action where that is the only issue before the court and jury.\(^{227}\) Under this construction of such statutes as the California Usury Law, and the National Banking Act, the penalty of a multiple of the usurious interest paid cannot be recovered by way of set-off, counter-claim or cross-complaint either in an action brought by the lender against the borrower to recover the principal or in any other action; to recover the penalty, the borrower must institute an affirmative action for that exclusive purpose.\(^{228}\)

The federal view has been adopted by practically all of the state courts\(^{229}\) which have had occasion to consider the right of the borrower to set off, or counterclaim the penalty imposed by the particular usury law. An examination of the cases\(^{230}\) which seem to lay down a contrary rule indicates that the statutes considered in such cases expressly provided for a recovery of the penalty by way of counter-claim. But even in jurisdictions where such statutes prevail, the courts have held that the penalty may be availed of as a set-off or counter-claim only in an action brought by the lender on the loan, and not in any other action which the lender may prosecute against the borrower.\(^{231}\) In Texas it seems that the statutory penalty may be recovered by way of an affirmative cross-action, but not by way of counter-claim.\(^{232}\) However, in a few cases\(^{233}\) it has been held that the penalty may be set off against the lender in an action brought by him to recover the principal.

It does not definitely appear in its opinion in Haines v. Commercial

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\(^{228}\) Cases cited supra, n. 101.


\(^{230}\) Weathersbee v. American Freehold Land Mortgage Co. (1896) 77 Fed. 523 (South Carolina statute); Waters v. Garris (1924) 188 N. C. 305, 124 S. E. 324; Smith v. Old Dominion Bldg. and Loan Ass'n. (1896) 119 N. C. 257, 26 S. E. 40; Land Mortgage Investment etc. Co. v. Gillam (1897) 49 S. C. 345, 26 S. E. 980, 29 S. E. 203.

\(^{231}\) Porter v. Jeffries (1893) 40 S. C. 92, 18 S. E. 229. See also Williams v. Little (1840) 11 N. H. 66.

\(^{232}\) Rosetti v. Lozano (1902) 96 Tex. 57, 70 S. W. 204.

Mortgage Company whether the California Supreme Court intended to hold that the penalty of treble usurious interest paid may be recovered by way of counter-claim or set-off. The court, nevertheless, remarked that the lender could set off or counterclaim the amount of the principal remaining unpaid when sued by the borrower for the penalty. If the court had in mind an equitable set-off, its dictum would not seem to be objectionable. It is common knowledge that borrowers of the class likely to be charged usurious interest are frequently on the verge of an insolvency, and it would be obviously inequitable to permit a “judgment-proof” borrower to actually collect the penalty from the lender. The amount of the penalty might well be applied pro tanto to the principal even if that obligation were not due at the time of the judgment awarding the borrower treble the amount of usurious interest he may have paid.

But it is not likely that the court was speaking of an equitable set-off when it said that the lender in an action by the borrower for the penalty could set off or counterclaim the unpaid principal. Rather it seems that the court had in mind the statutory counter-claim and because of the principle of mutuality it would seem to follow that the borrower may counterclaim the penalty when sued by the lender for the principal. While this doctrine is opposed to the federal view, which was expressly approved in an early California decision, and while it is well settled that when a statute creates a new right, the redress, afforded by the statute for the violation of that right, is exclusive, it must be born in mind that the provisions of the Massachusetts statute the penalty was by way of a forfeiture of treble the excess of the rate charged over the lawful rate, plus a forfeiture of all interest. Apparently, payment was not a prerequisite to the forfeiture. See Hart v. Goldsmith, supra; Pine v. Smith (1858) 77 Mass. (11 Gray) 38.

As to the nature of equitable set-off, see Machado v. Borges (1915) 170 Cal. 501, 150 Pac. 351; Russell v. Conway (1858) 11 Cal. 93; 23 Cal. Jur. §§ 8, 9, p. 228 et seq.


“Mutuality” as used in connection with set-off and counter-claims usually means that the debts set off must be mutual, i.e. between the identical parties in their identical capacities. See Kaye v. Metz (1921) 186 Cal. 42, 198 Pac. 1047; 23 Cal. Jur. §§ 31-37, p. 256 et seq.

“Mutuality” is used in the text above in the sense of mutuality of remedies, i.e. if the borrower may counterclaim or set off the penalty when sued for the principal, the lender should be able to counterclaim or set off the principal when sued by the borrower for the penalty.

Where a right exists at common law and a new remedy is given by statute, the latter is cumulative and either may be pursued. But where both the right and remedy are given by statute, that remedy alone can be pursued. People v. Craycroft (1852) 2 Cal. 243. Penalties for usury are enforceable.
of the California code with regard to counter-claims are very broad.\textsuperscript{142} Moreover, the California courts seem to share the popular fallacy\textsuperscript{143} that usury statutes are highly beneficial, and have evidenced an inclination to consider the usury law as remedial rather than penal.\textsuperscript{144} Apparently, then, in California the borrower who has paid usurious interest may recover treble the amount of such interest by way of counter-claim, when sued by the lender for the principal; and if the borrower seeks to recover the penalty in an affirmative action the lender may set off or counterclaim so much of the principal as remains unpaid.

**Enforcement of the Usury Law in Equity**

It is an almost universal doctrine of courts of equity that a borrower who seeks affirmative relief in equity from a usurious transaction must, as a condition precedent, do equity by tendering, or offering to pay, the principal debt with legal interest.\textsuperscript{145} In Haines v. Commercial Mortgage Company, the California Supreme Court expressly recognized the existence of this doctrine but denied that it had application to a suit by the borrower for treble the amount of usurious interest paid.\textsuperscript{146} If the action in Haines v. Commercial Mortgage Company had been one at law to recover the statutory penalty, it would seem that the court very properly denied the ap-


\textsuperscript{143} See F. W. Ryan, Usury and Usury Laws (1924).

\textsuperscript{144} See Haines v. Commercial Mortgage Co., supra, n. 69; Eaker v. Bryant, supra, n. 78.

\textsuperscript{145} This doctrine is based upon the equitable principle that he who seeks equity must do equity. When a borrower voluntarily comes into a court of conscience he should be denied relief until he tenders or offers to pay the principal debt together with a reasonable return for the use of the money. Legal interest (seven per cent in California) is such a reasonable return. Holden Land etc. Co. v. Inter-State Trading Co. (1914) 233 U. S. 536, 58 L. Ed. 1083, 34 Sup. Ct. Rep. 661; Brown v. Swann (1836) 35 U. S. (10 Pet.) 497, 9 L. Ed. 508; Pouk v. Cairo Banking Co. (1924) 158 Ga. 338, 123 S. E. 292; Liles v. Bank (1921) 151 Ga. 483, 107 S. E. 490; Tooko v. Newman (1874) 75 Ill. 215; Holden Land etc. Co. v. Inter-State Trading Co. (1912) 87 Kan. 221, 123 Pac. 733; Smith v. Meyers (1874) 41 Md. 425; Miller v. Ashton (1927) — Mich. —, 216 N. W. 448; Stiglitz v. Weinstein (1924) 227 Mich. 691, 199 N. W. 621; Olkin v. Broad & Market Nat. Bank (1921) 92 N. J. Eq. 445, 113 Atl. 139; Waters v. Garris (1924) 188 N. C. 305, 124 S. E. 334; Corey v. Hooker (1916) 171 N. C. 229, 88 S. E. 236; Moncrief v. Palmer (1921) 44 R. I. 37, 114 Atl. 181; 39 Cyc. 1010; 27 R. C. L. 264. For other cases see note, 17 A. L. R. 123. The cases which are seemingly contra are usually based upon the peculiar language of the statute which overrules the equitable principle. See the note in 17 A. L. R. 123. No such language is to be found in the California Usury Law.

\textsuperscript{146} 200 Cal. at 620.
plicability of the equitable doctrine. But of course the action in Haines v. Commercial Mortgage Company was one in equity to enjoin a sale under the trust deed, given as security for the loan, on the ground that the transaction was usurious. In fact, the court said: "The court [trial court], sitting as a court of equity at the instigation of the plaintiffs [the borrowers] . . .," should "assume full and complete jurisdiction of the premises, and state the account between the parties and make plenary disposition of all issues involved in the action." One of the issues in the action was the recovery of the statutory penalty and the unavoidable inference from the language of the opinion is that a court of equity, when asked to enjoin the foreclosure of a mortgage or trust deed because of usury, should state the account between the parties and in adjusting that account should inflict the statutory penalty of treble the amount of usurious interest paid and deduct the amount of the penalty from the principal debt. It is difficult to reconcile the rule thus laid down by the court with the principles of equity and it seems, moreover, to be opposed to practically all of the authorities.

"It is a universal rule in Equity never to enforce either a penalty or a forfeiture," and this rule has not been abrogated by the union in one tribunal of the functions formerly divided between courts of chancery and courts of law—the underlying principles of action being the same and unchanged. It must be conceded, however, that there are Mississippi cases which seem to hold that if a

147 Such was the situation in Second Nat. Bank of Richmond v. Fitzpatrick (1901) 111 Ky. 228, 63 S. W. 459, cited in 27 R. C. L. 274-5 as holding that the equitable doctrine has no application in an action to recover the statutory penalty of a multiple of the usurious interest paid. It is noteworthy, however, that in the Kentucky case, the action being at law for the penalty under the National Banking Act, no mention, much less application or refusal of application, was made of the equitable doctrine that the borrower must tender the principal with legal interest—that doctrine relates to actions in equity not to actions at law.

148 200 Cal. at 619.

149 In spite of some statements in its opinion to the effect that the plaintiffs only sought to enforce a forfeiture of interest and prevent a premature sale under the trust deed (see 200 Cal. at 622, 626) the fact remains that the trial court permitted the plaintiffs to recover the treble penalty and this award was sustained by the Supreme Court except as to treble the amount of the bonus or commission. See 200 Cal. at 617-618.


court of equity acquires jurisdiction properly for one purpose, it may proceed to dispose of all issues, legal and equitable, and enforce "in a proper case," statutory penalties. But these Mississippi cases had to do with forfeitures of penal sums to the state and have been distinguished on that ground from cases involving penalties imposed in favor of individuals.\(^{153}\) It is very generally held that penalties such as those imposed by usury statutes may never be inflicted by a court of equity regardless of how the court may have acquired jurisdiction of the matter of the loan.\(^{154}\) The soundness of this conclusion can hardly be questioned if for no other reason than that a lender is entitled to a jury trial\(^{155}\) before he can be convicted of the offense of usury and adjudged liable for treble the amount of usurious interest he may have accepted, and a court of equity is not a proper tribunal to try the guilt or innocence of a party before a jury. But, of course, when a borrower comes into a court of equity, the equitable doctrines relating to penalties are unquestionably applicable to penalties imposed for receiving usurious interest. "One seeking equity must do equity, and be content with full indemnity for actual loss sustained." Thus a debtor charged with usurious interest will be as a condition of relief required to pay the debt he owes with legal interest, . . . he must forego his demand for the penalty, and be satisfied with such compensation as measures his loss, or is the just amount of his claim."\(^{156}\) In brief, both principle and the overwhelming weight of authority\(^{157}\) indicate that a court of equity, sitting as such at the instigation of a borrower, should refuse injunctive, declaratory, and all other forms of relief, unless the borrower tender or offer to pay the principal obligation with legal interest thereon, and relinquish any claim he may have for the statutory penalty of a multiple of the amount of usurious interest which he may have paid.

Nevertheless in Haines v. Commercial Mortgage Company, the Supreme Court of California impliedly held\(^{158}\) that the borrower may recover in a court of equity the statutory penalty of treble the amount of usurious interest paid, and expressly declared\(^{159}\) that a

\(^{153}\) Meredith v. Lyon (1902) 3 Neb. (Unof.) 485, 92 N. W. 122.


\(^{155}\) See Ex parte Wong Yon Ting (1895) 106 Cal. 296, 39 Pac. 627; 35 C. J. § 26, p. 156, and cases cited.


\(^{157}\) See authorities cited supra, n. 145.

\(^{158}\) 200 Cal. at 619.

\(^{159}\) 200 Cal. at 626.
borrower may come into a court of equity and, without tendering or offering to pay either the principal or legal interest thereon, may obtain both an injunction against a sale under a trust deed, securing the loan, until the "full maturity of the loan," and a declaration that all interest is forfeited. It therefore seems that in California the equitable doctrine that the borrower who seeks affirmative relief from the chancellor must first tender the principal with legal interest, can be applied only in the situation where the borrower seeks to enjoin a sale under a trust deed or mortgage for an amount in excess of the principal and legal interest. Even this application is doubtful for if equity may enforce the penalty of treble the amount of usurious interest paid, and declare the right to any interest forfeited, it is difficult to see why it may not also grant the borrower affirmative relief by way of enjoining a sale of security for an amount in excess of the principal, and this without requiring that the borrower tender either principal or legal interest.260

In its denial of a rehearing in Haines v. Commercial Mortgage Company,621 the Supreme Court answered several questions relating to the Usury Law in what may be termed a "shot-gun" fashion, neither giving reasons nor citing authorities for its answers. The court excused its hasty treatment of these questions by a statement to the effect that the California Usury Law is not identical with any statute to be found elsewhere. While this statement may be true, it is equally true that a goodly part of the law of usury is never expressed in, and rarely depends upon the wording of the particular statute.262

**INTEREST PAYABLE AT FREQUENT INTERVALS**

One of the matters summarily treated in Haines v. Commercial Mortgage Company concerned agreements for the payment of interest at intervals more frequent than annually. While the Usury Law designates the maximum rate as twelve per cent per annum, there seems to be no reason why interest may not be charged by the month, quarter or half year provided that the rate so charged is not greater than twelve per cent per annum. If interest may be charged by the month, quarter or half year, it of course follows that interest may be paid monthly, quarterly or semi-annually without violating the usury statute. The court so held in the Haines case, and added that

260 The Supreme Court in Haines v. Commercial Mortgage Co. nevertheless declared the equitable doctrine, requiring a tender of principal and lawful interest, to be the general rule. 200 Cal. at 620.

261 200 Cal. at 622.

a clause providing for immediate maturity of the loan in case interest be not paid at the terms specified in the note would be in all respects proper.\textsuperscript{169} The court's conclusion on this point is supported by practically all of the authorities.\textsuperscript{164}

**Provision for Interest on Unpaid Installments of Interest**

A second question briefly answered in Haines v. Commercial Mortgage Company related to the validity of provisions in contracts of loan whereby the borrower is required to pay interest on unpaid installments of interest. The court said that if the maximum rate had been charged such a provision would render the transaction usurious, because an agreement to pay interest on unpaid installments of interest can be made "only after the date of maturity of such installments and upon a new consideration."\textsuperscript{165} While this statement of the law is supported by a few cases,\textsuperscript{166} an eminent authority\textsuperscript{167} has characterized such decisions as "absurd" and an analysis of the situation seems to justify the epithet.

When an installment of interest becomes due, the lender can institute an action for its recovery if it is not paid. Accrued interest is a debt due and owing.\textsuperscript{168} The borrower admittedly\textsuperscript{169} could pay the accrued interest and immediately borrow the amount of such accrued interest and agree to pay the maximum rate of interest on such new loan without violating the Usury Law. Why the parties should not be permitted to anticipate and provide for such a transaction by stipulating that unpaid interest should bear interest is quite beyond comprehension. The California court seems to confuse interest on unpaid installments of interest with compound interest. But of course an agreement to pay interest on installments of interest, which are not paid when due, is not strictly speaking an agreement to pay compound interest.\textsuperscript{170} There is a decided difference between

\textsuperscript{163}200 Cal. at 625.
\textsuperscript{166}Bowman v. Neely (1891) 137 Ill. 443, 27 N. E. 758; Drury v. Wolfe (1890) 134 Ill. 294, 25 N. E. 626; Rogers v. Rivers (1924) 135 Miss. 756, 100 So. 385.
\textsuperscript{167}2 Paige on Contracts, 2 ed., p. 1737 (1920).
\textsuperscript{168}Jones v. Nossaman (1923) 114 Kan. 886, 221 Pac. 271.
\textsuperscript{169}200 Cal. at 625.
a loan of $1,000 for ten years at twelve per cent interest payable annually with a provision that if interest is not paid when due it shall bear interest, and a loan of $1,000 for ten years at twelve per cent interest compounded annually. The borrower under the first loan can pay interest annually and avoid any payment of "interest on interest." The borrower under the second loan must pay interest on interest—he has no option to pay the interest annually. Again, assuming that neither borrower paid until the end of the ten year period, the first would pay less than the second.\(^7\) In short, both reason and the overwhelming weight of authority\(^7\) are against the California Supreme Court’s terse statement, that a note, bearing the maximum rate of interest in which is a provision that unpaid interest installments shall bear interest at the maximum rate, is tainted with usury.

**Compound Interest as Usury**

Also in its denial of a rehearing in Haines v. Commercial Mortgage Company, the Supreme Court held an agreement for the compounding of interest at the maximum rate to be usurious.\(^7\) If "compounding" is used in its strict sense,\(^7\) this holding seems unobjectionable. When the borrower cannot escape paying interest on interest, i.e. when the payment of interest on interest cannot be avoided even if the borrower performs his obligations according to the terms of the loan, there is no question but that the lender receives more than simple interest\(^7\) and, if the maximum rate is charged, compounding interest is probably usury.\(^7\)

**Collecting Interest in Advance**

The last question answered in Haines v. Commercial Mortgage Company involved the propriety of collecting interest at the maximum rate in advance, i.e. computing the interest for the full term of the loan and deducting the same from the amount actually ad-

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\(^7\) The second borrower pays interest on interest on interest. This is true compounding. See 33 C. J. § 3, p. 179, n. 6.


\(^7\) See authorities cited supra, n. 170.

\(^7\) E.g. $100 at twelve per cent per annum simple interest equals $12 for the first year. But $100 at twelve per cent interest compounded semi-annually ("compounded" net due and payable semi-annually) equals $12.36 for the first year.

\(^7\) See note in 37 A. L. R. 325 et seq.

The cases which seem to permit the compounding of interest at the maxi-
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vanted to the lender. The court decided\textsuperscript{177} that interest at the highest lawful rate could not be received in advance without violating the Usury Law. This conclusion is logically sound,\textsuperscript{178} but for practical and historical reasons\textsuperscript{178} it has been held in several cases\textsuperscript{180} that the deduction of interest in advance on short term loans is not usury. If the California court had considered these authorities it might not have so summarily declared this very common practice to be usurious.

**SALES AT ENHANCED CREDIT PRICE AS USURY**

One of the most recent cases decided by the Supreme Court under the Usury Law is Verbeck v. Clymer.\textsuperscript{181} While there are some rather significant dicta\textsuperscript{182} in the opinion, the point therein decided concerned the effect of the usury statute on transactions whereby a vendor sells at one price for cash and at a greatly enhanced price on credit. It was contended by the defendant purchaser in Verbeck v. Clymer that if the difference between the cash price and credit price amounted to more than twelve per cent of the cash price, the transaction must be usurious. The court very properly denied this contention on the ground that usury laws relate exclusively to loans of money and can have no application to sales of land or chattels. One may sell one's property for what price one sees fit and it is wholly immaterial, mum rate use the term "compounding" loosely to mean interest on accrued interest installments which remain unpaid. See authorities cited supra, n. 110. However if interest may mature at intervals more frequent than annually, may not the borrower agree to borrow the amount of such accrued interest and pay interest thereon? If so, even strict compounding would not be usury. \textsuperscript{177} \textsuperscript{178} \textsuperscript{180} Fowler v. Equitable Trust Co. (1891) 141 U. S. 384, 35 L. Ed. 786, 12 Sup. Ct. Rep. 1; Cain v. Stacy (1920) 146 Ark. 55, 225 S. W. 18; Cobv v. Guyer (1908) 237 Ill. 516, 86 N. E. 1071; Federal Nat. Bank v. Wilhelm (1926) 118 Okla. 23, 246 Pac. 478; Independent Lumber Co. v. Gulf State Bank (1927) 299 S. W. 939 (Tex. Civ. App.). For many other cases see 39 Cyc. 948; notes in L. R. A. 1915D, 1195; 29 L. R. A. 761.

\textsuperscript{181} It has been the custom of bankers for centuries to deduct interest in advance on short term loans. For a review of the decisions holding that it is not usury to take interest in advance, see Bank of Newport v. Cook (1895) 60 Ark. 288, 30 S. W. 35, 29 L. R. A. 761 and note.

\textsuperscript{182} E.g. A borrows $100 from B for six months at twelve per cent. The interest amounting to $6.00 is deducted in advance; A received only $94.00 and agrees to repay $100. But $6.00 equals 12.78\% per cent on $94.00. Hence to deduct the interest in advance really decreases the principal and increases the rate of interest—if the maximum rate is deducted in advance the rate of interest on the amount actually advanced is, of course, usurious. 

It is impossible to determine what part of an obligation is principal and what part is interest, there might be substance in a contention that no part of such obligation, even if agreed to be paid in installments, would be due until the expiration of the full time allotted for its discharge. See 74 Cal. Dec. at 612-613.
as far as the usury act is concerned, whether one's credit price be greatly in excess of one's cash price. The rule thus enunciated by the California Supreme Court is that sanctioned by practically all of the authorities.\footnote{183 Hogg v. Ruffner (1861) 66 U. S. 115, 17 L. Ed. 38; In re Bibbey (1925) 9 F. (2d) 944; Davis v. Elba Bank & Trust Co. (1927) 216 Ala. 632, 114 So. 211; Commercial Credit Co. v. Tarwater (1926) 215 Ala. 123, 110 So. 39; Rose v. Howell (1926) 171 Ark. 529, 284 S. W. 776; Berger v. Lodge (1928) 55 Cal. App. 1034, 265 Pac. 515; Atlas Securities Co. v. Copeland (1927) 124 Kan. 393, 250 Pac. 659; Holland-O'Neal Milling Co. v. Rawlings (1925) 217 Mo. App. 466, 283 S. W. 683; Commercial Credit Co. v. Shelton (1925) 139 Miss. 132, 104 So. 75; Brooks v. Avery (1850) 4 N. Y. 225. For other cases see 27 R. C. L. 214; 39 Cyc. 926. But contra, if property is sold for cash price and exorbitant interest is charged on deferred payments thereof. E. Tris. Napier Co. v. Trawick (1927) 164 Ga. 781, 139 S. E. 552. However, such a practice would seem to be lawful in California. See Verbeck v. Clymer, supra, n. 181, 74 Cal. Dec. at 613. Most of such other California cases are mentioned in the proper footnotes. The writer has not intentionally omitted a single California decision.}{\footnote{184 Most of such other California cases are mentioned in the proper footnotes. The writer has not intentionally omitted a single California decision.}}

There are other California cases\footnote{184} which have touched upon the question of usury but they have not added substantially to the law declared in the decisions hereinabove reviewed. Until our appellate courts pass upon the remaining mooted questions, the profession will continue to be perplexed by the ambiguities of the Usury Law. It may not be amiss, however, to mention and briefly discuss a few of the annoying problems which sooner or later the courts will be called upon to decide.

**Requirement that Rate of Interest be Expressed in Writing**

Section 1 of the California Usury Law provides that the legal rate of interest shall be seven per cent per annum but that the parties may contract for a greater rate, not exceeding twelve per cent per annum, "in which case such rate exceeding seven dollars on one hundred dollars shall be clearly expressed in writing."\footnote{185 Supra, n. 68, § 1, set out supra, 16 California L. Rev. 281, 288 (1928).} This provision gives rise to two very important questions: (1) When is a rate clearly expressed in writing? and (2) What are the consequences of taking and receiving a greater rate of interest than seven per cent, but not more than twelve per cent, without clearly expressing such rate in writing? These questions will be considered in order.

It is the custom of many lenders, particularly those who loan upon real estate security, to partially express a high rate of interest on the face of the note. Thus, if $1,000 is to be loaned at twelve per cent for two years, the note will be made to express an obligation of approximately $1,085 at seven per cent. This practice is primarily for the benefit of the borrower as it enables him to more readily dispose of his land and obligation. Few buyers will assume a debt bearing twelve per cent interest but the same buyers very frequently
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will assume a slightly higher debt at seven per cent interest. But if a note for $1,085 at seven per cent interest is given for a loan of $1,000, is the rate of interest on the $1,000 clearly expressed in writing within the meaning of the Usury Law? An affirmative answer to this question seems the only proper one. This provision of the Usury Law is substantially a re-enactment of Civil Code sections 1917 and 1918, which required an agreement for a greater rate of interest than seven per cent to be in writing. The object of such requirements is to remove any ambiguity which would otherwise exist regarding the rate of interest. But where the sum of money to be paid is expressed, there is no ambiguity, and if the total profit exacted does not exceed the maximum rate of interest on the amount loaned, the rate charged is readily ascertainable and the note should be enforced according to its terms. It is to be noted, however, that the California Usury Law requires a rate in excess of seven per cent to be "clearly expressed in writing." For this reason it is conceivable that the courts may hold that the exact rate must be explicitly set forth in the contract; but such a construction of the clause would be extremely harsh, and unnecessary to the accomplishment of its obvious purpose.

The only consequence of charging more than seven per cent interest, but less than twelve per cent, without expressing the rate in writing, would seem to be inability to collect more than seven per cent. In other words, a parol contract for the payment of more than seven per cent but less than twelve per cent interest cannot be

386 "The object of the statute [usury law] was evidently to require the writing to remove the ambiguity that would otherwise exist on the face of an instrument calling for interest, and mentioning no rate. It was to conform to the rule rejecting parol explanations of writings. But where the sum of money to be paid is expressed, there is no ambiguity, and if it included no more than ten per cent interest it is valid." Cameron v. Merchants, etc. Bank (1877) 37 Mich. 240, 244.


387 Usury Law, supra, n. 185, § 1.

388 So held under similar statute in Rosenbluth v. Dunn (1874) 41 Conn. 619. See also Vermont Loan, etc. Co. v. Whithed (1891) 2 N. D. 91, 49 N. W. 318.

389 If the exact rate of interest must be explicitly designated in the written contract of loan, all loans will be usurious wherein the lender stipulates for a share of the profits or wherein for other reasons the amount of the profit to be paid the lender for the use of his money depends upon some contingency.

390 Staughton v. Simpson (1898) 72 Minn. 536, 75 N. W. 744; Rosen-
enforced except as to seven per cent. It is not a misdemeanor to charge more than seven per cent but less than twelve per cent interest without expressing the rate in writing.\footnote{191} Neither does failure to express the rate of interest in writing work a forfeiture of all interest, if less than twelve per cent is charged.\footnote{192}

**Collection of Interest for Full Term of Loan When Principal Repaid Before Maturity**

Another practice which has been questioned by some is the collection of interest for the full term of a loan when the loan is paid off before maturity. To illustrate—a loan of $1,000 is made for five years at twelve per cent interest; the borrower desires to repay the money at the end of the first year and the lender demands interest for the full five years. On principle, such a practice is in no sense usurious. The lender has made what he may consider a good investment and if he gives up that investment he has a clear right to be compensated for foregoing his expected profits. Furthermore, while payment of the unearned interest may be an exorbitant charge for the privilege of repaying the principal debt before maturity, it is in no sense a charge made for the loan or forbearance of money and hence is not within the purview of the usury statutes.\footnote{193} Lastly, it may be noted that a contract of loan which is not usurious in its inception, i.e. if the profits of the lender will not exceed the maximum permissible interest in the event that the loan is repaid according to its terms,\footnote{194} it is not rendered usurious by any subsequent trans-

\footnote{191}{bluth v. Dunn, supra, n. 188. For other cases see 33 C. J. 223, n. 50. See also First National Bank v. Messner, supra, n. 186.}

\footnote{192}{The Usury Law reads: "And any person . . . who . . . shall violate the provisions of section one and two of this act, shall be guilty of a misdemeanor . . . ." Usury Law, supra, n. 68, § 3. (Italics added.)}

\footnote{193}{The use of the conjunction implies that one must violate both section one and section two—the mere violation of either alone is not enough to make one guilty of a misdemeanor. While "and" is sometimes construed to mean "or," this construction should never be resorted to, particularly in penal statutes, unless absolutely necessary to give effect to the legislative intent. Williams v. U. S. (1906) 17 Okla. 28, 87 Pac. 647. See also Robinson v. Southern Pacific Co. (1895) 105 Cal. 526, 38 Pac. 96; 2 C. J. §§ 2-5, p. 1338 et seq.}

\footnote{194}{No valid reasons exist for construing "and" to mean "or" in this provision of the Usury Law.}

\footnote{195}{The requirement that the rate be expressed in writing is in the first section of the usury act. The forfeiture clause is found in the second section and reads: "Any agreement or contract of any nature in conflict with the provisions of this section shall be null and void as to any agreement or stipulation therein contained to pay interest . . . ." (Italics added.)}

\footnote{196}{Usury statutes relate only to charges for the use of the money lent or forborne. See supra, 16 California L. Rev. 281, 294 et seq. (1928), and cases cited infra, n. 219.}

\footnote{197}{The test of usury is this: Will the contract of loan, if performed according to its terms, yield to the lender more than the maximum rate of
action between the parties. Consequently it is very generally held that a lender cannot be considered guilty of usury merely because he collects interest for the full term of the loan when it is repaid before maturity. It is not probable that the California courts will reach a contrary result.

**INTENT AS AN ELEMENT OF USURY**

Some little confusion also exists with regard to the intent necessary to make one guilty of exacting usury. The proper view of this part of the law seems to be that the necessary intent will be inferred from the mere taking of more than the maximum rate of interest for the loan or forbearance of money. Of course, if the exorbitant charge results from a mistake of fact such as an honest error in calculation or expression, i.e. if the contract either does not express the true intent of the parties or if the facts of the loan are not those contemplated by the parties, there is no intent to exact the rate of interest stipulated for and there can be no usury—the mistake or error should be rectified and the real agreement given effect.

interest? If not, there is no usury. E.g. if a bonus is exacted, it undoubtedly would make the rate of interest for the first year usurious. But the bonus and interest should be apportioned for each year of the loan and if when so apportioned the rate is not unlawful, there can be no usury. See Smith v. Brokaw (1927) 174 Ark. 609, 297 S. W. 1031; Garland v. Union Trust Co. (1917) 63 Okla. 243, 165 Pac. 197.

Huntsman v. Longwell (1925) 4 F. (2d) 105; Strickland v. First St. Bank (1925) 165 Minn. 235, 202 N. W. 727; Conservative Loan Co. v. Whittington (1926) 120 Okla. 137, 250 Pac. 485. See also 27 R. C. L. § 51, p. 248.

E.g. where a borrower, subsequent to the consummation of the loan, agrees to perform services gratuitously for the lender, the contract of loan is not thereby rendered usurious. Carder v. Knippa Mercantile Co. (1927) 1 S. W. (2d) 462 (Tex. Civ. App.).


There are, generally speaking, four elements of usury: (1) A loan or forbearance of money, either express or implied; (2) upon an understanding that the principal shall be or may be returned; (3) and that for such loan or forbearance a greater profit than is authorized by law shall be paid or agreed to be paid; (4) entered into with an intention to violate the law. The fourth element may be implied if all the others are expressly shown upon the face of the contract. Planter's National Bank v. Wysong & M. Co. (1919) 177 N. C. 380, 99 S. E. 199, 12 A. L. R. 1412, 1416; Fielder v. Darrin (1872) 50 N. Y. 437; Burden v. Unrath (1926) 47 R. I. 227, 132 Atl. 728; Washington Fire Ins. Co. v. Maple Valley Lumber Co. (1914) 77 Wash. 686, 138 Pac. 553; Grant v. Merrill (1874) 36 Wis. 390.

However, there are situations where the intent of the parties is an all-important factor in determining the existence of usury. Principal among such situations are those in which the transaction does not purport to be a loan of money. Thus, if the parties make a sale with an agreement to repurchase, or merely a sale, the question of usury will turn upon whether or not the parties in reality made a loan, which in turn will depend upon the intent of the parties.\footnote{199} Again, if the parties expressly make a loan and the lender exacts a fee, nominally for services or goods, the question of usury will depend upon the intent with which such fee was exacted and paid, i.e. whether it was a disguised charge for the use or forbearance of money.\footnote{200} In brief, it may be stated that the element of intent is important only in those instances where it is necessary to determine (1) whether there has been a mistake of fact or whether for other reasons the contract does not express the real agreement of the parties;\footnote{201} (2) whether a purported sale, joint venture or other transaction was in reality a disguised loan; (3) whether a charge by the lender, nominally for something else, was in fact a charge for the use or forbearance of money.

\textbf{USURY AS A DEFENSE AGAINST A HOLDER IN DUE COURSE}

To attempt in this work to adequately discuss the effect of usury upon the rights and liabilities of persons other than the original parties to the contract of loan, is quite out of the question. It may be noted in passing, however, that usury is generally said to be a defense which is personal to the borrower and which he is at liberty to waive.\footnote{202} It may likewise be noted that whatever rights a borrower


\footnote{199} The apparent usury may be due to the fact that a bond or mortgage is made in excess of the amount actually loaned for the purpose of security. See Brown v. Champlin (1876) 66 N. Y. 214, where upon such facts it was held that no usury existed.

\footnote{202} For a general discussion of this phase of the law of usury see 39
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may have against a lender because of usury, usually are enforceable
against the lender's assignee unless such assignee takes without
notice of the usury. Even in case an assignee of the lender takes
without notice of the usurious nature of the transaction, it seems
that the borrower may, nevertheless, avail himself of usury as a
defense, except, perhaps, in the event that the contract of loan is
evidenced by a negotiable instrument which the assignee has pur-
chased before maturity for value and without notice of its usurious
character. This latter proposition, namely that usury may not be
set up against a holder in due course of a negotiable instrument, is
of such importance as to warrant a more extended discussion.

The effect of usury on negotiable instruments, which are not
usurious on their face, depends primarily upon the wording of
the particular usury statute. If the usury act provides that usurious
contracts are absolutely void, in whole or in part, the weight of
authority holds that the negotiation of the written evidence of

Cyc. 1062 et seq.; 27 R. C. L. 281 et seq. For collection of cases see American

E. g. an automobile dealer, sued by a finance company for falsifying
amount of cash down payment under a conditional sales contract, cannot set
up alleged usury in the finance company's contract with the purchaser of
the automobile. The conditional vendee alone can complain of usury. Standard
Motors Finance Co. v. Mitchell Auto Co. (1927) 173 Ark. 875, 293 S. W.
1026.

A vendor of land subject to a usurious mortgage cannot plead usury to
defeat a foreclosure. Matthews v. Ormerd (1903) 140 Cal. 578, 74 Pac. 136;
Eq. 608, 131 Atl. 526.

203 See generally, 39 Cyc. 1077 et seq.; id. 1090.

E. g. a transferee who takes a note with knowledge of facts which made
it usurious and who collects the face balance due, is liable to the borrower
for the excessive interest (no multiple penalty under the then New Hamp-

If an assignee of the lender, knowing that the note is usurious, accepts
payments of unlawful interest, he is liable for the statutory penalty of a
multiple of such interest. Schlesinger v. Lehmann (1908) 191 N. Y. 69, 83
N. E. 657 (dictum); Anderson v. Tatro (1914) 44 Okla. 219, 144 Pac. 360
(did not appear whether transferee had knowledge of usury); Western

204 Brown v. Fletcher (1917) 244 Fed. 854; Hirsch v. Arnold (1925)
318 Ill. 28, 148 N. E. 882; Gladwin State Bank v. Dow (1920) 212 Mich. 521,
180 N. W. 601. For other cases see 39 Cyc. 1077 et seq.

However, if the borrower represents to the lender's assignee that the
obligation is in all respects valid, he thereby estops himself to plead usury.
First Nat. Bank v. Rambo (1915) 143 Ga. 665, 85 S. E. 840; Henry v. McAl-
listen (1896) 99 Ga. 557, 26 S. E. 469; Blades v. Newman (1897) 19 Ky. L.

205 Obviously if an instrument is usurious on its face, one cannot be a
holder in due course. The usury must have been effected by antedating the
note, reserving a bonus or discount, etc.

206 In re Hotel Equipment Co. (1924) 297 Fed. 842; Peoples' Savings
Bank v. Raines (1928) — Ark. —, 2 S. W. (2d) 20; note in L. R. A. 1918C,
such contracts cannot give them validity. On the other hand, if the usury act provides that usurious contracts are merely voidable, both reason and authority indicate that usury should not be considered as a “real defense,” but that a negotiable instrument, although tainted with usury in its inception, should pass to a holder in due course free from the defense of usury as well as free from other “defenses available to prior parties among themselves.”

The California Usury Law reads that any usurious contract “shall be null and void as to any agreement or stipulation therein contained to pay interest, and no action at law to recover interest in any sum shall be maintained . . . .” While the language of this provision is rather strong, “null and void” have frequently been construed as meaning “voidable,” not absolutely void. Moreover, it is well established in California that contracts supported by an illegal consideration are not mere nullities, but, if negotiable in form, are enforceable in the hands of a holder in due course, and this, even though the California code sections declare illegal contracts

773; 39 Cyc. 1079. See also Brannan, Negotiable Instruments Law, 4 ed., p. 440 (1926).

Some cases hold that if the Negotiable Instruments Law were adopted subsequent to the usury act, the latter would be impliedly repealed insofar as it made usury a real defense. Wood v. Babbit (1907) 149 Fed. 818. See notes in 5 A. L. R. 1447; L. R. A. 1918C, 773, 779. Contra: Sabine v. Paine (1918) 223 N. Y. 401, 119 N. E. 849. See Brannan, Negotiable Instruments Law, 4 ed., p. 440 (1926), for other cases.

Such a ruling cannot be made in California because the N. I. L. (1917) was adopted prior to the Usury Law (1918).


Supra, n. 68, § 2.


Cal. Civ. Code, § 1607: “The consideration of a contract must be lawful within the meaning of section sixteen hundred and sixty-seven.”

Cal. Civ. Code, § 1608: “If any part of a single consideration for one or more objects, or of several considerations for a single object, is unlawful, the entire contract is void.” (Italics added.)

Cal. Civ. Code, § 1667: “That is not lawful which is: (1) Contrary to an express provision of law; (2) Contrary to the policy of express law, though not expressly prohibited; or, (3) Otherwise contrary to good morals.”
to be "void." Consequently, the California courts have repeatedly
held that notes given for gaming debts may be enforced against the
maker by a purchaser before maturity for value and without notice
of the infirmity. In fact, the California courts for decades have
recognized and furthered the trend of the law to facilitate the free
circulation of commercial paper. It would be a backward step,
indeed, for the California tribunals to declare the meaning of the
Usury Law to be that usurious contracts are wholly void as to agree-
ments therein contained for the payment of interest. Certainly, if "it
is not for a moment to be held that" the system of beneficent laws
relating to corporations "was to be set awry by a poorly drafted act
meant only to protect the individual necessitous borrower from the
rapacity of the more fortunate lender," it should never be held
that the Uniform Negotiable Instruments Law, the result of cen-
turies of legislative and judicial study, the codification of the im-
memorial customs and practices of merchants, and the law so
peculiarly essential to the stability of credit in a business world of
ever increasing complexity, is to be thwarted in its primary pur-
pose by the same ill couched act. Nevertheless, it must be con-
ceded that the California Usury Law is susceptible of a construc-
tion which will make the defense of usury available against a holder in
due course of an instrument not usurious on its face. In fact, if the
decisions of the California appellate courts furnish any criterion
of the policy of the judiciary in applying the Usury Law, it seems
safe to predict that "null and void" will be construed as meaning
totally void rather than merely voidable.

RULES DETERMINATIVE OF EXISTENCE OF USURY

Of course there are many more very important phases of the law
of usury, but space does not permit of their treatment here. It does

213 Union Collection Co. v. Buckman, supra, n. 211; Himmilmann v.
Hotaling, supra, n. 211; Haight v. Joyce (1852) 2 Cal. 64, 56 Am. Dec. 311;
Meyer v. Lovdal (1907) 6 Cal. App. 369, 92 Pac. 322.

214 See the cases cited, supra, n. 211, 213. As to the history of the Law

215 For an excellent statement of the reasons for construing "void" and
"illegal" to mean void only as to the original parties and others not holders
in due course, see Union Trust Co. v. Preston Nat. Bank (1904) 136 Mich.
460, 99 N. W. 399.

216 In re Washer (1927) 200 Cal. 598, 606, 254 Pac. 951.


218 The primary purpose of the Negotiable Instruments Law, of course,
is to effect the circulation of commercial paper, free from personal defenses
and latent equities.

219 Particularly Haines v. Commercial Mortgage Co. (1927) 200 Cal. 609,
254 Pac. 956.
seem appropriate, however, to enumerate a few rules which to a large extent determine the existence of usury.

1. There must be a loan or forbearance of money.\(^{219}\)

(a) The amount of money lent or forborne must be a sum certain or at least readily reducible to a certainty.\(^ {220}\)

(b) Usury cannot be predicated upon a loan of credit\(^ {221}\) or of chattels,\(^ {222}\) regardless of how exorbitant the charge exacted for the use of such credit or chattels may be.

(c) A promissory note or other evidence of a chose in action in the hands of one other than a party primarily liable thereon is a chattel and may be sold for any price,\(^ {223}\) and it is immaterial that the price be very much less than the face of the note, even if payment is guaranteed by the seller.\(^ {224}\)

(d) One may have a cash and a credit price for the sale of any commodity and such one cannot be charged with usury


This statement becomes material only when a debt is forborne; if money is loaned the sum, of course, is certain. There is little express authority upon this subject. See Webb on Usury, pp. 18, 19 (1898); Rust v. Chisolm (1882) 57 Md. 376. However, the proposition seems too sound for controversy. If the claim forborne is unliquidated, the rate of interest cannot be ascertained and it is therefore impossible to determine whether or not the legal maximum has been exceeded.\(^ {222}\)


\(^{222}\) There are five views as to the effect of an indorsement on a note or other commercial paper which is the subject of sale by the indorser at a larger discount than the maximum rate of interest: (1) That the indorsee has no remedy on the paper; (2) That the indorsee may not recover against the indorser; (3) That the indorsee may recover from the indorser the amount paid for the paper without interest; (4) That the indorsee may recover from the indorser the amount paid with interest; (5) That the indorser is liable for the full amount of the face value of the paper. These views and the
even though the credit price exceeds the cash price by more than the maximum charge permitted for the forbearance of an amount equal to the cash price.225

(e) One who embarks on a joint venture and advances money for such purpose is not guilty of usury even though guaranteed a profit in excess of the maximum interest permissible for the loan or forbearance of an amount of money equal to that advanced.226

2. There must be a binding contract or agreement to pay in any event a profit which is in excess of the maximum return permitted by law for the loan or forbearance of money.227

(a) If the profit is contingent, the fact that it may or actually does exceed the maximum permissible interest does not make the transaction usurious.228

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225 See authorities cited supra, n. 183.

A few of the older cases and 27 R. C. L. (Usury), § 21, lay down a contrary rule. See 2 Page, op. cit., § 971.
(b) If a third person pays the lender a bonus as an inducement for the loan, there is no usury.229

(c) If the borrower voluntarily pays more interest than he is required to pay by the contract of loan or forbearance, the lender is not guilty of usury.230

(d) If the lender agrees to make a loan of a certain amount at the maximum rate of interest and then without the consent of the borrower refuses to advance the full amount of the loan, he breaks his contract but he is not guilty of usury.231

3. While courts, in deciding whether or not a transaction is usurious, will disregard its form and look to its substance and will condemn it if all the requisites of usury are found to be present,232 there are plenty of transactions which are exactly what they purport to be,233 and “when the parties have deliberately adopted one code to govern their relations, the law will not lightly subject them to a different code, even though similar in many respects.”234

(a) If a contract is for other than the loan or forbearance of money, it cannot be usurious,235 and it has been said that he who seeks to prove such a contract to be a disguised loan at usurious interest carries a heavy burden.236

(b) When a contract is in fact for the loan or forbearance of money and it is alleged that charges, nominally for services or expenses, are disguised usurous interest,237 that "inter-

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231 Lanier v. Trust Co. (1897) 64 Ark. 40, 40 S. W. 466; Auble's Adm'r v. Trimmer (1895) 17 N. J. Eq. 242.


233 Healey v. Hotaling (1871) 41 Cal. 22, 27.


235 See cases cited supra, n. 227. See also, supra, 16 California L. Rev. at 294-297 (1928).


237 See supra, 16 California L. Rev. 294-297 (1928).
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pretation which would make lawbreakers of the parties to the transaction should be rejected, if there is another and reasonable interpretation.”

Conclusion

In conclusion it may be well to reiterate the thesis that usury laws are economically unsound and of worse than no avail to effect the ends which prompt their enactment. The price for the use of money, like the price for the use of any other commodity, is necessarily determined by supply, demand, risk, custom and other economic factors. For the legislature to attempt to regulate the rental value of money or of any other commodity is for it to attempt the impracticable and to invade a sphere in which statutory law can serve no useful purpose. These facts are almost universally recognized by economists and it is altogether unnecessary to endeavor here to establish them. Moreover, legislative enactments which restrict interest charges cannot be reconciled with the principles of our fundamental law. Indeed, were it not for the fact that usury laws are older than the Constitution it is probable that such laws would be held unconstitutional, as being unwarranted interferences with the liberty of contract. For these reasons alone usury statutes


"The wrongful act of usury will not be presumed or imparted to the parties, and it will not be inferred, where the opposite conclusion can be reasonably and fairly reached." Cammack v. Runyan Creamery Co. (1927) Ark. —, 299 S. W. 1023, 1029.

239 See F. W. Ryan, Usury and Usury Laws (1924).

240 There is no question but that general usury laws add to the burdens of borrowers who are really "necessitous." The risk involved in loaning small amounts of money for consumptive purposes (e.g. to buy necessities of life, to pay the expenses of an illness or a funeral, etc.) is very great, and it has been demonstrated that persons engaged in making such small loans cannot remain in business unless they charge at least two or three per cent interest per month. General usury laws rarely permit any lender to charge more than one per cent per month. Consequently, lenders either refuse to make small consumptive loans or, because of the added risk of being prosecuted under the usury laws, charge the necessitous borrower more than they would charge were it not for such usury laws. See F. W. Ryan, Usury and Usury Laws (1924).

241 For a statement and review of the theories of all prominent economists from the time of Bentham, see F. W. Ryan, Usury and Usury Laws (1924).

242 "I deny the power of any legislature under our government to fix the price which one shall receive for his property of any kind. If the power can be exercised as to one article, it may as to all articles, and the prices of everything from a calico gown to a city mansion, may be the subject of legislative direction." Mr. Justice Field, dissenting in Munn v. Illinois (1877) 94 U. S. 113, 24 L. Ed. 77, 93.

243 See dissenting opinion of Mr. Justice Field in Munn v. Illinois, supra, n. 242, 94 U. S. 153, 24 L. Ed. 94.

244 See Adkins v. Children's Hospital (1923) 261 U. S. 525, 67 L. Ed. 785, 43 Sup. Ct. Rep. 394, holding minimum wage laws to be unconstitutional as unwarranted interference with the liberty of contract which is guaranteed by the Fourteenth Amendment. If minimum wage laws impair the liberty
should be construed as strictly and narrowly as it is possible to construe them without disregarding the mandates of the legislature. But usury laws are essentially penal as well as basically unsound and for this additional reason should never be given any but a strict construction. However, it is not for the judiciary to concern itself with the wisdom of legislation and usury laws must, in proper cases, be given effect. But courts, in applying a usury statute, can and should be guided by the principle that the only purpose of such legislation is to protect the necessitous borrower against extortion which he is deemed powerless to resist. "To adopt the usury laws to any other purpose is to distort them; and to carry them beyond their self-declared limits, through some vague thought of their spirit, is to take undue liberty. They select the rate with no regard to specific benefits or burdens, and they select their beneficiary by using the word ‘loan.’" If there is neither a loan nor forbearance of money there can be no usury.

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of contract, certainly usury laws also impair the liberty of contract. See dissenting opinion of Mr. Justice Holmes in Adkins v. Children's Hospital, supra, 261 U. S. 567, 568. Again, it has been held that laws fixing rentals are valid only as temporary measures. See Adkins v. Children's Hospital, supra, 261 U. S. 525, 552, explaining the Rent Cases (Block v. Hirsh (1921) 256 U. S. 135, 65 L. Ed. 865, 41 Sup. Ct. Rep. 458; Mareus Brown Holding Co. v. Feldman (1921) 256 U. S. 170, 65 L. Ed. 877, 41 Sup. Ct. Rep. 465). It is submitted that the public health, morals and welfare are infinitely more subserved by laws prescribing minimum wages and rents and by laws limiting the price of shelter, food and other necessities of life than by laws regulating the rate of interest on money. If none of the former can be sustained because they interfere with the liberty of contract, how can the latter be upheld?

245 See n. 79, supra.
246 See n. 78, supra.
247 Usury statutes set an arbitrary rate of interest without regard to risk, supply and demand, or other economic factors, nor do they distinguish between consumptive and productive loans. See F. W. Ryan, Usury and Usury Laws (1924). "Usury laws are purely arbitrary. They do not belong to foro conscientiae." Webb on Usury, § 16, p. 14 (1898).
249 See cases cited supra, n. 219.