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Usury Law in California: A Guide Through the Maze

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INTRODUCTION

Almost every attorney occasionally represents a creditor or a debtor. Competent representation of such clients requires a knowledge of the usury laws. Unfortunately, California usury law is not easily accessible. The relevant legislative provisions are scattered throughout various sections of the Civil Code, the Financial Code, the Insurance Code, and the California Constitution. Federal statutes and regulations are also pertinent. Criminal penalties are printed in the Civil Code rather than the Penal Code. The time-price doctrine, an important exception to the interest rate limits, is based mainly on decisional law. Thus, attorneys must grope their way through a labyrinth of constitutional, statutory, administrative, and decisional law. We offer this study as a guide through the maze.[1]

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We would like to thank Professor John Ayer for his many useful suggestions.

[1] Earlier helpful articles include Bosko & Ackerman, *California's Diminishing Usury Law*, 4 CAL. LAW. No. 7, 12 (1984); and Note, *A Comprehensive View of California Usury Law*, 6 SW. U.L. REV. 166 (1974).

I. Maximum Interest Rates For Nonexempt Loans

A California statute is officially designated "the usury law."[2] Despite this designation, the statute is partly obsolete, as is discussed below. When we refer to this statute, as opposed to the general body of usury law, we will put "the usury law" in quotations.

"The usury law" passed as an initiative measure in a general election in 1918. It has never been amended or repealed. "The usury law" established the legal rate of interest as seven percent per year.[3] This legal rate is "[t]he rate of interest upon the loan or forbearance of any money, goods or things in action or on accounts after demand or judgments rendered in any court of this state . . . ."[4] In plain English, it is the interest rate that will apply if the parties fail to stipulate an interest rate in the loan contract. Under the California "usury law," the maximum interest rate that parties may contract for in writing is twelve percent per year.[5] As indicated below, subsequent events have made this "maximum interest rate" obsolete.

In 1934, a voter initiative added article XX, section 22 to the California Constitution. It established the legal interest rate as seven percent per annum and the maximum interest rate that parties may contract for in writing as ten percent per annum.[6] This section also exempted several classes of lenders from its interest rate restrictions.[7]

In 1976, California voters added article XV, section 1 to the California Constitution by an initiative, and repealed article XX, section 22. Article XV was amended in 1978 and 1979. As currently written, Article XV defines two separate classes of loans. First, it distinguishes loans primarily for personal, family, or household purposes, but excludes loans primarily for the purchase, construction, or improvement of real property.[8] For convenience we will call these "consumer loans." For a consumer loan the parties may contract for an interest rate as high as ten percent per annum, provided the agreement is in writing.[9] All other loans, or "nonconsumer loans," have a more complex maximum per-

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[2] Cal. Civ. Code §§ 1916-1-1916-5 (West 1985). These sections may be found following Cal. Civ. Code § 1916.12 (West 1985). They are also reported in Deering's Uncodified Initiative Measures.

[3] Cal. Civ. Code § 1916-1 (West 1985); *see also* Cal. Const. art. XV, § 1.

[4] Cal. Civ. Code § 1916-1 (West 1985); *see also* Fowler v. Smith, 2 Cal. 568, 570, *aff'g on rehearing*, 2 Cal. 39 (1852).

[5] Cal. Civ. Code § 1916-1 (West 1985).

[6] Cal. Const. art. XX, § 22 (1934, superseded 1976).

[7] *Id.*

[8] Cal. Const. art. XV, § 1(1).

[9] *Id.*

mitted interest rate. For nonconsumer loans, the parties may contract in writing for an interest rate that is the higher of (1) ten percent per annum, or (2) five percent over the San Francisco Federal Reserve Bank's rate for advances made to member banks under sections 13 and 13a of the Federal Reserve Act prevailing on the twenty-fifth day of the month prior to the date of the loan contract or the date the loan was made, whichever is earlier.[10]

Article XV retains the seven percent per annum legal interest rate and the scheme of exempting several classes of lenders set by article XX, section 22.[11] However, article XV's list of exceptions is longer.[12] Article XV also gives the legislature the power to designate additional classes of persons who are exempt from the interest rate restrictions, and exempts any successor in interest to a loan made by a member of an exempt class.[13] These and other exemptions will be discussed below.

This survey began by referring to "the usury law." "The usury law" is at odds with the California Constitution on the most important issue in usury law, the maximum interest rate that the parties may legally designate. "The usury law" establishes a maximum interest rate of twelve percent, while the constitution establishes a maximum rate of ten percent for consumer loans, and for other loans the higher of ten percent or five percent over the rate charged member banks for advances by the San Francisco Federal Reserve Bank. The courts have resolved this discrepancy by ruling that the constitution controls in a conflict with "the usury law," but otherwise "the usury law" remains

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[10] CAL. CONST. art. XV, § 1(2). To obtain the rate on advances to member banks under sections 13 and 13a of the Federal Reserve Act one can call (415) 974-2230. This number provides a recording giving the current rate, how long it has been in effect, and the previous rate. For earlier rates or more information one can call (415) 974-2265. The rate for advances under sections 13 and 13a is often referred to as the "discount rate."

[11] However, article XV permits the legislature to set the rate of interest on judgments at not more than 10%. The current rate of interest on judgments is 10%. *See* CAL. CIV. PROC. CODE § 685.010 (West Supp. 1987).

[12] [N]one of the above restrictions shall apply to any obligations of, loans made by, or forbearances of, any building and loan association[s] [now called savings and loan] . . . industrial loan companies . . . credit unions . . . pawn broker[s] . . . personal property broker[s] . . . real estate broker[s] . . . bank[s] . . . nonprofit cooperative association[s] organized under Chapter 1 of Division 20 of the Food and Agricultural Code . . . federal intermediate credit bank[s]. . . .

CAL. CONST. art. XV, § 1.

[13] "However, none of the above restrictions shall apply to . . . any other class of persons authorized by statute, or to any successor in interest to any loan or forbearance exempted under this article . . . ." *Id.*

in full force and effect.[14] Thus, California usury law is found in the constitution, in the so called "usury law," and, as will be explained below, in numerous other statutes.

II. Exemptions to the California Usury Law

The maximum interest rates specified in the constitution and in "the usury law" are subject to many exemptions or exceptions. The three basic classes of exemptions are: (1) federal statutory exemptions; (2) the time-price doctrine; and (3) California constitutional or statutory exemptions.

A. Federal Exemptions

Federal law exempts from state usury laws any "federally related" loan secured by a first lien on residential property.[15] Preempting state usury laws ensures that the availability of federally related residential loans, mortgages, credit sales, and advances is not restricted by state interest rate ceilings.[16] "Federally related loans" are defined as loans

> (1) Made by any lender whose deposits or accounts are insured by any Federal agency[17] (*e.g.*, Federal Deposit Insurance Corps.; Federal Savings and Loan Insurance Corp.);
> (2) Made by any lender regulated by any Federal agency[18] (*e.g.*, Federal Reserve System Board of Governors; Federal Home Loan Bank Board);
> (3) Made by any lender approved by the Secretary of Housing and Urban Development (HUD) for participation in any mortgage insurance program under the National Housing Act;[19]
> (4) Made in whole or in part by HUD; insured, guaranteed, supplemented, or assisted in any way by HUD or any Federal agency or development program administered by HUD

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[14] Nuckolls v. Bank of Cal., 10 Cal. 2d 266, 74 P.2d 264 (1938); *see also* Penziner v. West Am. Fin. Co., 10 Cal. 2d 160, 74 P.2d 252 (1938); Barnes v. Hartman, 246 Cal. App. 2d 215, 54 Cal. Rptr. 514 (1966); Shirley v. Britt, 152 Cal. App. 2d 666, 313 P.2d 875 (1957); Brown v. Cardoza, 67 Cal. App. 2d 187, 153 P.2d 767 (1945).

[15] 12 C.F.R. § 590.3(a) (1986) (implementing section 501 of Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 161 (1980)).

[16] 12 C.F.R. § 590.1(b) (1986).

[17] *Id.* § 590.2(b)(1).

[18] *Id.* § 590.2(b)(2).

[19] *Id.* § 590.2(b)(3).

or other Federal agency;[20]
(5) Eligible for purchase by Federal National Mortgage Association, Government National Mortgage Association, or Federal Home Loan Mortgage Corp. (FHLMC), or made by an institution from which the loan could be purchased by FHLMC,[21] or which invests a total in excess of $1,000,000 per year in residential property loans.[22]

To qualify for exemption from state usury laws the loan must be secured by a first lien[23] on residential property,[24] on stock in a residential housing corporation when the loan is used to finance the stock's acquisition,[25] or on residential manufactured (*e.g.*, mobile) homes.[26] The loan contract must comply with certain consumer safeguards.[27] "Loans which are secured by first liens on real estate" include loans secured by first mortgages or first trust deeds.[28] The interest in real estate that is subject to the first lien may be a fee, or a leasehold or subleasehold for a period of at least five years beyond the loan's maturity.[29] Certain time-share interests also qualify as interests in real property.[30]

"Residential real property" is "real estate improved or to be improved by a structure or structures designed primarily for dwelling, as opposed to commercial use."[31] Thus, property acquired with the intent to develop for residential use is considered residential real property.[32] Multifamily dwellings, such as apartment buildings, are included in the definition of residential real property.[33] The traditional single family

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[20] *Id.* § 590.2(b)(4).
[21] *Id.* § 590.2(b)(5).
[22] *Id.* §§ 590.2(b)(6)(i), (ii).
[23] *Id.* § 590.3(a)(2).
[24] *Id.* § 590.3(a)(2)(i).
[25] *Id.* § 590.3(a)(2)(ii).
[26] *Id.* § 590.3(a)(2)(iii).
[27] *Id.* § 590.4.
[28] *Id.* § 590.2(c).
[29] *Id.*
[30] Ewing & Vickers, *Federal Pre-emption of State Usury Laws Affecting Real Estate Financing*, 47 MO. L. REV. 171, 174 (1982).
[31] 12 C.F.R. § 590.2(f) (1986).
[32] *Id.*
[33] "The limitation described in section 527(b)(1) [12 U.S.C. § 1735f-5(b)(1)] of the National Housing Act that property must be designed for the occupancy of from one to four families shall not apply . . . ." The Depository Institutions Deregulations and Monetary Control Act of 1980, Pub. L. No. 96-221, § 501(a)(C)(i) (codified at 12 U.S.C. § 1735f-7, note "State Constitution or Laws Limiting Mortgage Interest, Dis-

residence, condominium, townhouse, and multiplex are all, of course, considered residential real property.[34]

B. Time-Price Doctrine

When the seller finances the purchase of real or personal property by extending payments over time, usury laws do not apply.[35] This type of transaction is regarded as a bona fide credit sale, not a loan. Thus, usury laws do not apply because there is no loan or forbearance of money or other thing of value.[36] A bona fide credit sale is characterized by the transfer of property in exchange for a price.[37] The doctrine applies even if the seller assigns the contract to a third party, such as an institutional lender.[38] It also applies even if the expressly specified interest rate exceeds the maximum interest rate otherwise legally permitted.[39]

Applying the time-price doctrine creates problems when a seller sells property on account and does not charge the buyer interest unless the buyer fails to satisfy the account within a specified time.[40] This arrangement applies quite frequently to nonretail sales on account and to sales on retail revolving charge accounts. The question presented is whether to characterize the transaction as a sale and subsequent forbearance,[41] as a bona fide credit sale,[42] or as liquidated damages for breach of a sales contract.[43]

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count Points, and Finance Charges; Exemption for Obligations Made After March 31, 1980." (1982)).

[34] 12 C.F.R. § 590.2(f) (1986).

[35] Verbeck v. Clymer, 202 Cal. 557, 563, 261 P. 1017, 1019 (1927). *But see* Glaire v. La Lanne-Paris Health Spa, Inc., 12 Cal. 3d 915, 528 P.2d 357, 117 Cal. Rptr. 541 (1974). In *Glaire*, a unanimous court held that in certain circumstances an apparent credit sale may actually involve a concealed interest bearing loan and thus be subject to the usury laws.

[36] Boerner v. Colwell Co., 21 Cal. 3d 37, 45, 577 P.2d 200, 205, 145 Cal. Rptr. 380, 385 (1978).

[37] *Id.* at 47, 577 P.2d at 206, 145 Cal. Rptr. at 386.

[38] *Id.* at 50-54, 577 P.2d at 208-11, 145 Cal. Rptr. at 388-91.

[39] *Id.* at 45-46, 577 P.2d at 205, 145 Cal. Rptr. at 385.

[40] *See* Hogan, *Is There a Cap on Service Charges?*, 7 CAL. LAW. No. 1, 30 (1987).

[41] *See* Crestwood Lumber Co. v. Citizens Sav. & Loan Ass'n, 83 Cal. App. 3d 819, 825, 148 Cal. Rptr. 129, 132 (1978).

[42] *See* Fox. v. Federated Dep't Stores, Inc., 94 Cal. App. 3d 867, 873-81, 156 Cal. Rptr. 893, 898-903 (1979).

[43] *See* Loomis, Crestwood Lumber Company v. Citizens Savings & Loan Association: *The Usury Law and Liquidated Damages in Sale of Goods Transactions*, 10 GOLDEN GATE U.L. REV. 553 (1980). The author suggests that usury considerations

The issue as applied to consumer goods apparently was settled in *Fox v. Federated Department Stores, Inc.*[44] The *Fox* court characterized a transaction involving a retail revolving charge card or account as a bona fide credit sale.[45] The court held that the Unruh Act[46] was intended to make the time-price doctrine applicable to retail installment sales and revolving accounts.[47] Since retail charge cards and accounts fall within that class of transactions, the Unruh Act applies to them.[48] Thus, the time-price doctrine's usury exception is applicable.[49] Since the Unruh Act applies only to consumer goods,[50] the *Fox* holding probably will not apply to similar purchases and sales of nonconsumer goods.

The leading case for transactions involving nonconsumer goods is *Crestwood Lumber Co. v. Citizens Savings & Loan Association.*[51] *Crestwood* involved the sale of lumber to a contractor. The sales orders stated that the "payment [was] due within 10 days from date of invoice — less 2% . . . [and] a finance charge of 1½% per month (annual percentage rate of 18%) will be made on all overdue accounts." When the contractor failed to satisfy the account, Crestwood Lumber sued for the money owed, including the interest as stipulated by the sales order. *Crestwood* granted recovery of the principal, but denied recovery of the interest because it exceeded the usury limits.[52] The court said that, "the finance charges in question would unquestionably be permitted if this transaction were a retail installment sale. . . . However, the [Unruh] act is inapplicable . . . , since it only applies to sales of consumer goods."[53] The court rejected the argument that the transaction was a bona fide credit sale, because "the finance charge was added on after maturity of the debt . . . [as] an assessment made by the seller in con-

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could be avoided by characterizing the "interest" on overdue accounts as "liquidated damages."

[44] 94 Cal. App. 3d at 873-81, 156 Cal. Rptr. at 898-903.

[45] *Id.*; *cf.* Peterson v. Wells Fargo Bank, 556 F. Supp. 1100, 1110 (1981) (Bank credit cards fall within an exemption provided to banks, *see infra* note 80 and accompanying text, and thus are not subject to interest rate limitations).

[46] *Fox*, 94 Cal. App. 3d at 878, 156 Cal. Rptr. at 901; *see infra* notes 58-61 and accompanying text (discussing the Unruh Act).

[47] *Fox*, 94 Cal. App. 3d at 878, 156 Cal. Rptr. at 901.

[48] *Id.*

[49] *Id.* at 880, 156 Cal. Rptr. at 902.

[50] CAL. CIV. CODE §§ 1802.1, 1802.2, 1802.6 (West 1985 & Supp. 1987).

[51] 83 Cal. App. 3d 819, 148 Cal. Rptr. 129 (1978).

[52] *Id.* at 827, 148 Cal. Rptr. at 133.

[53] *Id.* at 823, 148 Cal. Rptr. at 131.

sideration for his 'waiting to collect a debt' . . . ."[54] Thus, the court held that the transaction was a sale and subsequent forbearance.

Although the *Crestwood* decision has been criticized,[55] it has withstood the criticism and stands with *Fox* as the law in this area.[56] Therefore, transactions involving nonconsumer goods are subject to the constitution's usury limits, while transactions involving consumer goods are regulated by the Unruh Act.[57]

Although the general law of usury does not apply to credit sales, many credit sellers are regulated by specific statutes such as the Unruh Act[58] and the Automobile Sales Finance Act.[59] The Unruh Act regulates the financing of retail installment sales contracts.[60] A retail installment contract is a contract between a buyer and a seller for the payment for consumer goods and services in installments, in which the buyer agrees to pay a service charge.[61] The seller or holder of a retail installment contract may not impose a finance charge that exceeds (1) 1.6% per month on any outstanding balance not exceeding $3,000 and (2) 1% per month on the outstanding balance exceeding $3,000.[62] Beginning January 1, 1988, the permissible rates will be 1.5% on the first $1,000 and 1% on the excess.

The Automobile Sales Finance Act regulates conditional sales con-

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[54] *Id.* at 825, 148 Cal. Rptr. at 132. The court went on to hold that the finance charge did not represent a liquidated damages charge, because there was no agreement between the parties that the finance charge would represent fair compensation for the failure to make timely payments. *Id.* at 826-27, 148 Cal. Rptr. at 132-33.

[55] Hogan, *supra* note 40, at 30-31; Loomis, *supra* note 43, at 558-68. The criticism has been directed at the decision's inconsistency with *Fox*, the lack of logic in applying a stricter limitation upon business creditors than consumer creditors, and the improper finding that there was a forbearance.

[56] Peterson v. Wells Fargo Bank, 556 F. Supp. 1100, 1111 (N.D. Cal. 1981) ("[Defendants in *Fox*] were subject to the Unruh Act, and not the usury laws of the California Constitution."); *In re* Pillon-Davey & Assocs., 52 Bankr. 455, 460 (Bankr. N.D. Cal. 1985) (following *Crestwood*'s finding that forbearance could be inferred from sales agreement imposing finance charge for late payments).

[57] Other commentators have suggested that the usury limitations may be avoided in nonconsumer transactions by characterizing a late charge as a "service charge" or "liquidated damage charge" and avoiding referring to the charge as a "finance charge" or "interest." *See* Hogan, *supra* note 40, at 35; Loomis, *supra* note 43, at 568-85.

[58] CAL. CIV. CODE §§ 1801-1812.41 (West 1985 & Supp. 1987).

[59] *Id.* §§ 2981-2984.4 (West 1974 & Supp. 1987). This act is also sometimes called the Rees-Levering Act.

[60] Op. Leg. Counsel, 4 J. OF THE ASSEMBLY, CAL. 5429 (1959).

[61] CAL. CIV. CODE §§ 1802.1, 1802.2, 1802.6 (West 1985 & Supp. 1986).

[62] *Id.* § 1810.2 (West Supp. 1987).

tracts between buyers and sellers of motor vehicles.[63] The maximum finance charge for such contracts is based on the unpaid balance on an annual basis.[64] Civil Code section 2982(j) contains the maximum finance charge formula.[65] However, this Act does not cover many financing arrangements offered by automobile dealers. Automobile dealers will often attempt to procure financing for their customers from a third party, usually a bank or other institutional lender. Such third party financing arrangements obtained by the seller of a motor vehicle on the buyer's behalf are not governed by the Automobile Sales Finance Act.[66]

C. Lenders or Loans Fully Exempt by California Constitution or Statute

The California Constitution exempts several classes of lenders from the law of usury and gives the legislature the power to create new exempt classes.[67] Any successor in interest to any exempt lender is also exempt.[68] The constitution also authorizes the legislature to prescribe the maximum annual interest rates that exempt classes may charge.[69] In this section we describe the classes of lenders and loans not restricted by any interest rate ceilings. In the next section we discuss lenders or loans subject to at least some interest rate ceilings.

1. Real Estate Brokers

The California Constitution was amended in 1979 to exempt any loans "secured in whole or in part by liens on real property," and "made or arranged" by licensed real estate brokers.[70]

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[63] *Id.* § 2981.

[64] *Id.* §§ 2981(n)(1), 2982(j).

[65] *Id.* § 2982(j).

[66] *Id.* § 2982.5.

[67] CAL. CONST. art. XV, § 1.

[68] "However, none of the above restrictions [the usury limits] shall apply to . . . any successor in interest to any loan or forbearance exempted under this article . . . ." *Id.* § 1(2).

[69] "The legislature may from time to time prescribe the maximum rate per annum . . . or any other compensation which all or any of the said exempted classes of persons may charge or receive from a borrower. . . ." *Id.*

[70] The real estate broker exemption was enacted as part of an initiative measure, Proposition 2, which amended article XV of the California Constitution at the November 1979 special election.

a. Loans "Made By" Real Estate Brokers

Loans secured by real estate and made by licensed real estate brokers are exempt from usury laws regardless of whether the broker acted within the scope of the license.[71] Loans "made by" a licensed real estate broker are those loans that the broker actually funded.[72] The loan in *In re Lara*[73] was partially funded by a licensed real estate broker and partially funded by the broker's friend. The part funded by the broker was borrowed from a bank. The entire loan was secured by a deed of trust, but it was not otherwise connected with any real estate transaction involving the broker. Mr. and Mrs. Lara claimed that the loan was usurious; the interest was 43.57% per year. The Ninth Circuit held that the portion of the loan funded by the broker was exempt from usury laws, because the Civil Code exempted loans made by licensed real estate brokers.[74] However, the portion of the loan funded by the broker's friend was not exempt, because it was not made by the broker, nor properly arranged by him in his capacity as a licensed broker.

In *Garcia v. Wetzel*[75] the court of appeal held that a loan made by a licensed real estate broker was not usurious, even though the interest rate exceeded 250 percent and even though the loan was unsecured. In effect, the court held that in passing Civil Code section 1916.1, the legislature had created a new class of exempt lenders — real estate brokers. Apparently the court overlooked the first sentence of Civil Code section 1916.1, which limits the usury law exemption to loans made or arranged by real estate brokers that are "secured . . . by liens on real property."[76] It is unlikely that other courts will follow this position.

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[71] CAL. CIV. CODE § 1916.1 (West Supp. 1987). The exemption of loans made by brokers not acting within the scope of their licenses has been strongly criticized. *See* Comment, *The Usury Exemption: Should it Apply to Real Estate Brokers Making Loans?*, 26 SANTA CLARA L. REV. 403 (1986) (arguing that the exemption is unfair, unwise, and unconstitutional).

[72] *In Re* Lara, 731 F.2d 1455 (9th Cir. 1984); Garcia v. Wetzel, 159 Cal. App. 3d 1093, 206 Cal. Rptr. 251 (1984); Merrifield v. Edmonds, 146 Cal. App. 3d 336, 194 Cal. Rptr. 104 (1983).

[73] 731 F.2d 1455 (9th Cir. 1984).

[74] *Id.* at 1461.

[75] 159 Cal. App. 3d 1093, 206 Cal. Rptr. 251 (1984).

[76] It is possible that the decision was correct, but for the wrong reason. The court assumed that the loan was unsecured. If this assumption was correct, then, we submit, the decision was wrong. However, in fact it appears that the loan was secured. The lender received a deed to certain real property. However, at the same time the lender gave the borrower an option to "repurchase" the property for $22,239.45 — about $4000 more than the lender paid for it. It seems likely that the transaction was a disguised or concealed secured loan and would be treated as such in California. *See*

A loan is "made by" a real estate broker even if the broker borrowed the funds it subsequently loaned.[77]

b. Loans "Arranged By" Real Estate Brokers

Civil Code section 1916.1 defines a loan "arranged by" a licensed real estate broker as a loan in which the broker:

> (1) Acts for . . . or in expectation of compensation for soliciting, negotiating or arranging [the] loan for another, or (2) acts for . . . or in expectation of compensation for selling, buying, leasing, exchanging, or negotiating the sale, purchase, lease, or exchange of real property or business for another and (A) arranges a loan to pay for all or any portion of the purchase price of, or of an improvement to, that property or business or (B) arranges a forbearance, extension, or refinancing of any loan in connection with that [transaction], or (3) arranges or negotiates for another forbearance, extension, or refinancing of any loan secured by real property in connection with a past transaction in which the broker had acted for . . . or in expectation of compensation . . . .[78]

Thus, a broker arranging but not making the loan apparently must do so within the scope of her broker's license. This means the broker must expect compensation, or have received or expected compensation in connection with a transfer of some real property or business interest.

The exemption for loans made or arranged by a licensed real estate broker does not apply when the broker is the borrower.[79]

2. Banks and Savings and Loan Associations

Banks operating under the Bank Act or any bank operating under the laws of California or the United States are exempted by the constitution from the law of usury.[80] However, the California Constitution provides that the legislature can limit or remove this exemption.[81] The Financial Code applies this exemption to state banks and any national bank whose principal place of business is in California.[82] The Financial Code also exempts certain foreign banks with assets of at least

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CAL. CIV. CODE §§ 2924, 2925 (West 1974 & Supp. 1987).

[77] Orden v. Crawshaw Mortgage & Inv. Co., 109 Cal. App. 3d 141, 167 Cal. Rptr. 62 (1980).

[78] CAL. CIV. CODE § 1916.1 (West Supp. 1987).

[79] Winnett v. Roberts, 179 Cal. App. 3d 909, 225 Cal. Rptr. 82 (1986); Green v. Future Two, 179 Cal. App. 3d 738, 225 Cal. Rptr. 3 (1986).

[80] CAL CONST. art. XV, § 1.

[81] *Id.*

[82] CAL. FIN. CODE § 1504 (West Supp. 1987).

$100 million.[83] Banks from other states are also exempt from the constitution's interest rate ceilings.[84] Finally, bank holding companies and their nonbank subsidiaries are exempted by the Financial Code.[85]

The constitution exempts any building and loan association operating under the Building and Loan Association Act.[86] Building and Loan Associations are now known as mutual or stock savings associations, savings and loan associations, or savings banks.[87] The Building and Loan Association Act is now known as the Savings Association Law.[88] The Savings Association Law exempts from interest rate restrictions any "association," "federal association," savings and loan holding company, "non-association" savings and loan association holding company subsidiary, or any subsidiary service corporation for any "association" or "federal association."[89]

3. Credit Unions

The constitution exempts credit unions operating under "an act defining credit unions, providing for their incorporation, powers, management, and supervision."[90] The Financial Code states that "the interest rate on obligations from the members of the credit union shall be determined by the board of directors from time to time," but does not specifically state that credit unions are exempt from the usury law.[91] However, the statute's legislative history shows that it is intended to eliminate interest rate limitations on credit unions and to allow credit union boards of directors to set the rates charged.[92]

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[83] *Id.* § 1716.

[84] *Id.*

[85] *Id.* § 3707.

[86] CAL. CONST. art. XV, § 1.

[87] CAL. FIN. CODE § 5102 (West Supp. 1987). The Financial Code refers to mutual or stock savings associations, savings and loan associations, and savings banks as "associations." *Id.* However, federal savings and loan associations and federal savings banks are referred to as "federal associations." *Id.*

[88] *Id.* § 5000.

[89] *Id.* § 7675.

[90] CAL. CONST. art. XV, § 1.

[91] CAL. FIN. CODE § 15,000 (West Supp. 1986).

[92] Cal. Legis., 1981-82 Regular Session, 1981-82 First Extraordinary Session, Summary Digest of Statutes Enacted and Resolutions (Including Proposed Constitutional Amendments) Adopted in 1982 and 1979-82 Statutory Record C.219, p. 86 (1982).

4. Nonprofit Agricultural Cooperative and Federal Intermediate Credit Banks

The constitution exempts any nonprofit cooperative association organized under Chapter 1 of Division 20 of the Food and Agricultural Code.[93] The constitution also exempts any qualifying business or corporation securing money or credit from any federal intermediate credit bank.[94] Qualifying businesses or corporations are those that engage exclusively in the business of marketing agricultural, horticultural, viticultural, dairy, livestock, poultry and bee products on a cooperative nonprofit basis.[95]

5. Insurance Companies

In 1981, the legislature exercised the power granted under the constitution to create new classes of exempt lenders. It exempted all insurance companies incorporated under article 3 of the Insurance Code.[96]

6. Physicians' and Surgeons' Cooperative Indemnity Corporations

In 1982, the legislature exempted funds held in trust by physicians' and surgeons' cooperative indemnity corporations for indemnifying members for medical malpractice claims.[97]

7. Pension Funds

Pension funds and retirement systems subject to the Employment Retirement Income Security Act of 1974 are exempt from interest rate restrictions.[98] State or local public retirement systems are also exempt from interest rate restrictions.[99]

8. Business and Industrial Development Corporations

Business and industrial development corporations are California corporations licensed to provide financial and management assistance to business firms in accordance with the Small Business Investment Act of

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[93] CAL. CONST. art. XV, § 1.
[94] *Id.*
[95] *Id.*
[96] CAL. INS. CODE § 1100.1 (West Supp. 1987).
[97] *Id.* § 1280.7.
[98] CAL. CIV. CODE § 1917.220 (West 1985).
[99] CAL. GOV'T CODE § 7509 (West Supp. 1987).

1958 and the federal Small Business Administration.[100] Their purpose is to promote the establishment, growth, and expansion of business firms in California, thus increasing job opportunities.[101] Business and industrial development corporations are exempt lenders.[102]

9. Securities

Certain evidences of indebtedness issued pursuant to the Corporate Securities Law, and the purchasers thereof, are exempted from the California Constitution's usury provisions.[103] An evidence of indebtedness is any contractual obligation to pay in the future for presently received consideration.[104] The qualifying evidences of indebtedness are:

> (1) Those rated by Standard & Poor's Corporation as AAA, AA, A, BBB, or investment grade commercial paper, or by Moody's Investors Service, Inc. as Aaa, Aa, A, Baa, or investment grade commercial paper, including any such ratings with "+" or "−" designation or other variations . . . , or (2) the issuer thereof either (A) has any security listed or approved for listing upon notice of issuance on a national securities exchange certified by the commissioner [of Corporations] pursuant to subdivision (o) of Section 25100 [of the Corporations Code], or (B) meets each of the following requirements: (i) The issuer is a corporation which is subject to Section 13 of the Securities Exchange Act of 1934 [12 U.S.C. § 78m (1982)] (ii) The issuer had total shareholders' equity of at least one million dollars ($1,000,000) at the end of its most recent fiscal year, and had consolidated net income . . . of at least five hundred thousand dollars for three of its last four fiscal years . . . .[105]

10. Commercial Finance Lenders

Commercial finance lenders are licensed to engage in the business of making commercial loans.[106] Commercial loans are defined as loans of $5,000 or more, which the borrower intends to use primarily for other than personal, family, or household purposes.[107] These lenders are fully exempt from the usury law.[108]

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[100] CAL. FIN. CODE § 31,401 (West 1981).
[101] *Id.* § 31,020 (West Supp. 1987).
[102] *Id.* § 31,953.
[103] CAL. CORP. CODE § 25,116 (West Supp. 1987).
[104] Hamilton Jewelers v. Department of Corps., 37 Cal. App. 3d 330, 334, 112 Cal. Rptr. 387, 389 (1974).
[105] CAL. CORP. CODE § 25,117 (West Supp. 1987).
[106] CAL. FIN. CODE §§ 26,009, 26,200 (West Supp. 1987).
[107] *Id.* § 26,007.5.
[108] *Id.* § 26,000.2.

11. Bottomry Contracts

Some readers may not be familiar with "bottomry." Bottomry is a contract pledging a vessel or its cargo as security for a loan, which is paid only if the vessel survives a particular risk, voyage, or period.[109] The parties to a bottomry contract may stipulate an interest rate higher than what is lawfully allowed for other contracts.[110] However, a court may reduce the stipulated rate if it appears unjustifiable and exorbitant.[111]

12. Shared Appreciation Loans

Shared appreciation loans are secured loans that give the lender a right to receive a share of the appreciation in the value of the security property.[112] There are three classes of shared appreciation loans: (1) shared appreciation loans of Employment Retirement Income Security Act (ERISA) pension funds;[113] (2) normal shared appreciation loans;[114] and (3) shared appreciation loans for seniors.[115] Shared appreciation loans for seniors are discussed below as partially exempt loans.

ERISA shared appreciation loans may be made for the purchase of real property with one to four family dwelling units.[116] These dwellings include attached single family units, single family mobile home units on permanent foundations, residential condominium units, and dwelling units within a planned unit development.[117] At least one of the units must be owner-occupied, with the borrower being the owner.[118] The borrower must certify in writing that she will occupy the security property.[119] If the borrower fails to occupy the security property, the lender may accelerate the loan according to its terms.[120] Lenders making shared appreciation loans from ERISA pension funds are exempt from the constitution's usury provisions.[121]

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[109] CAL. HARB. & NAV. CODE § 450 (West 1978).
[110] *Id.* § 455.
[111] *Id.*
[112] CAL. CIV. CODE §§ 1917.020(i), 1917.120(j) (West 1985).
[113] *Id.* §§ 1917.010 - .075.
[114] *Id.* §§ 1917.110 - .175.
[115] *Id.* §§ 1917.320 - .714.
[116] *Id.* § 1917.030.
[117] *Id.*
[118] *Id.*
[119] *Id.*
[120] *Id.*
[121] *Id.* § 1917.067.

Normal shared appreciation loans may be made for the same types of property as ERISA shared appreciation loans.[122] However, if the borrower certifies in writing at the time the loan is made that she will occupy the security property, the security property is conclusively deemed owner-occupied.[123] A normal shared appreciation loan's fixed contract interest rate must comply with the constitution's usury provisions.[124] However, if the payment of contingent deferred interest makes the actual interest paid exceed the usury limits, the loan will not become usurious.[125] Contingent deferred interest is the lender's share of the security property's appreciated value.[126] Lenders already fully exempt from usury laws are also fully exempt when making shared appreciation loans.[127]

D. Partially Exempt Lenders

"Partially exempt" lenders may charge interest rates that exceed the maximum rates allowed by the constitution. However, these lenders may not charge a higher interest rate than what is permitted by the specific statutes regulating the lender. The constitution exempts three classes of partially exempt lenders from interest rate limitations: industrial loan companies, licensed pawnbrokers, and personal property brokers.[128] However, the legislature has prescribed the maximum rates that these lenders may charge.[129] The remaining classes of partially exempt lenders derive their status from the legislature.[130]

Partially exempt lenders seem to share the common trait that they are likely to lend to the most vulnerable borrowers. Examples include

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[122] *Id.* § 1917.130.

[123] *Id.* It is not clear whether the conclusive presumption prohibits the lender from effectively providing in the loan that the loan will accelerate if the property ever becomes nonowner occupied. Due on sale clauses, however, are generally enforceable. *See id.* § 1917.162 (West 1985).

[124] *Id.* § 1917.167.

[125] *Id.*

[126] *Id.* § 1917.120(c).

[127] Friend, *Shared Appreciation Mortgages*, 34 HASTINGS L.J. 329, 348-49 (1982).

[128] CAL. CONST. art. XV, § 1.

[129] "The Legislature may from time to time prescribe the maximum rate per annum of, or provide for the supervision, or the filing of a schedule of, or in any manner fix, regulate or limit, the fees, bonuses, commissions, discounts or other compensation which all or any of the said exempted classes of persons may charge or receive from a borrower in connection with any loan or forbearance of any money, goods or things in action." *Id.*

[130] "However, none of the above [interest rate] restrictions shall apply to . . . any other class of persons authorized by statute. . . ." *Id.*

borrowers who go to a consumer finance lender or personal property broker for a loan to purchase a refrigerator; borrowers who go to an industrial loan company or pawnbroker for a personal loan; college students applying for student loans; and senior citizens refinancing their homes. These borrowers seem to have less relative bargaining power with their lenders than do borrowers who go to banks, savings and loan associations, or securities brokers. These are the borrowers that modern usury laws are designed to protect or should be designed to protect.[131] The partially exempt lenders are described below.

1. Consumer Finance Lenders

A consumer finance lender is an entity engaged in the business of making consumer loans.[132] A consumer loan is a loan, either secured or unsecured, that the borrower intends to use primarily for personal, family, or household purposes.[133] For licensed consumer finance lenders, the maximum allowable interest rates for such loans are (1) 2.5% per month on that part of the unpaid principal balance on any loan up to and including $225.00;[134] (2) 2% per month for $225.01 to $900;[135] (3) 1.5% per month for $900.01 to $1,650,[136] and (4) 1% per month for the amount over $1,650.[137] Alternatively, the lender may contract for and charge up to 1.6% per month on the unpaid balance[138] or 5/6 of 1% over 1/12 of the discount rate charged by the San Francisco Federal Reserve Bank on the twenty-fifth day of the second month of the quarter preceding the quarter in which the loan was made.[139] If the bona fide principal amount is $2,500 or more, the loan is totally ex-

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[131] Usury laws are enacted for the protection of borrowers. Such laws are intended as a bulwark to protect the needy from the greed of the rapacious. It is the theory of such enactments that those in distress might be plunged into deeper distress if the law did not come to their relief and protect them from the money lender, who would prey upon misfortune and wring from the needy borrower, in his endeavor to tide over present difficulty, the utmost farthing as compensation for what is often an evanescent benefit — merely the putting off of an evil day.

In re Washer, 78 Cal. App. 759, 771-72, 248 P. 1068, 1073 (1926), *aff'd*, 200 Cal. 598, 254 P. 951 (1927).

[132] CAL. FIN. CODE § 24,009 (West Supp. 1987).

[133] *Id.* § 24,007.5.

[134] *Id.* § 24,451(a).

[135] *Id.* § 24,451(b).

[136] *Id.* § 24,451(c).

[137] *Id.* § 24,451(d).

[138] *Id.* § 24,451.1(a).

[139] *Id.* § 24,451.1(b).

empt from the usury law.[140]

2. Personal Property Brokers

Personal property brokers are persons in the business of lending money and receiving as security a contract or obligation calling for a forfeiture to the lender of rights in personal property.[141] The schedule of maximum legal rates for licensed personal property brokers is identical to the schedule for licensed consumer finance lenders.[142] The preferential treatment given personal property brokers has been upheld against constitutional attack.[143]

3. Pawnbrokers

Any person in the business of receiving goods as security for a loan is a pawnbroker.[144] The rates a pawnbroker may charge depend on the loan's amount and its term. This schedule of maximum rates is codified in the Financial Code.[145]

4. Industrial Loan Companies

Industrial loan companies operate under the provisions of the Industrial Loan Law, California Financial Code sections 18000-18704.[146] They are also known as thrift and loan companies.[147] Industrial loan companies specialize in making small short term loans that are unsecured by real or personal property.[148] This class of lenders grew out of Morris Plan banks that made loans to borrowers who could not offer the kinds of security customarily required.[149] Under the Financial Code an industrial loan company may not charge more than (1) 2% per month on the unpaid principal balance up to and including $1,000[150]

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[140] *Id.* §§ 24,000.2, 24,451, 24,451.1.
[141] *Id.* § 22,009 (West 1981).
[142] *Id.* §§ 22,451, 22,451.1 (West Supp. 1987).
[143] Carter v. Seaboard Fin. Co., 33 Cal. 2d 564, 203 P.2d 758 (1949).
[144] CAL. FIN. CODE § 21,000 (West 1981).
[145] *Id.* §§ 21,200 (West Supp. 1987), 21,200.5 (West 1981).
[146] *Id.* § 18,003 (West Supp. 1986).
[147] *Id.*
[148] Comment, *The Mortgage Banking Act: A New Way Around California Usury Laws*, 26 HASTINGS L.J. 460, 464-68 (1974) [hereafter Comment, *Mortgage Banking*].
[149] Benfield, *Money Mortgages, and Migraine — The Usury Headache*, 19 CASE W. RES. L. REV. 819, 841 n.109 (1968).
[150] CAL. FIN. CODE § 18,212(a)(1) (West 1981).

and 1% per month of the unpaid principal balance over $1,000;[151] or (2) if the lender contracts for it, 1.6% per month on the unpaid principal balance;[152] or (3) if the lender contracts for it, 5/6 of 1% over 1/12 the discount rate charged by the San Francisco Federal Reserve Bank.[153]

5. Mortgage Bankers

Mortgage bankers are covered by the Industrial Loan Law.[154] Mortgage bankers make loans to corporations or partnerships secured by a lien on real property.[155] The minimum loan principal for a mortgage banking loan is $100,000.[156] Although they are incorporated under the Industrial Loan Law, mortgage bankers are totally exempt (rather than partially exempt) from usury laws when making mortgage banking loans.[157] Mortgage bankers were included in the Industrial Loan Law before the legislature had the power to create an exempt class, thus providing them with an exemption to the usury laws without amending the state constitution.[158]

6. College Loans

The interest rate for loans made by colleges to students for educational purposes may not exceed the rate allowed by article XV, section 1, part 2 of the California Constitution. In addition, it may not exceed one percent more than the rate the institution is paying for the money.[159] Loans made by educational institutions to faculty and staff that are secured by a residential dwelling are totally exempt from interest rate limitations.[160]

7. Shared Appreciation Loans for Seniors

A "shared appreciation loan" is a secured real property loan that gives the lender a right to receive a share of the appreciation in the

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[151] *Id.* § 18,212(a)(2).
[152] *Id.* § 18,212(b).
[153] *Id.* § 18,212.1 (West Supp. 1987).
[154] *Id.* §§ 18,680-18,705 (West 1981).
[155] *Id.* § 18,683.
[156] *Id.* § 18,683.
[157] *Id.* § 18,705.
[158] Comment, *Mortgage Banking*, *supra* note 148, at 468.
[159] CAL. FIN. CODE § 28,000(a)(b) (West Supp. 1987).
[160] *Id.* § 28,000(c).

security property's value.[161] To qualify for a shared appreciation loan for seniors, the borrower must be at least sixty-five years old.[162] These loans may be made to refinance real property improved with one to four dwelling units, including attached single family dwelling units, single family mobile home units, residential condominium units, and dwelling units within a planned unit development.[163] At least one unit must be owner-occupied, with the owner being the borrower.[164] The unit will be deemed owner occupied if the borrower certifies in writing to the lender that she will occupy the property.[165] Shared appreciation loans for seniors are exempt from the constitution's usury limits.[166] However, the fixed interest rate stipulated in the loan contract must comply with the constitution's usury limits. Further, the payment of actual contingent interest plus the contract rate cannot exceed 1.5 times the applicable usury rate found in the constitution, when all of that interest is applied over the loan's actual term.[167] Actual contingent interest is the lender's share of the security property's net appreciation.[168] The actual term of the loan terminates on the occurrence of a maturity event.[169] A maturity event is the earliest of the death of the borrower or surviving spouse, date of sale, or the date the loan is repaid in full.[170]

While no case or authority exists on this point, it would probably be incorrect to presume that a lender already fully exempt from the usury laws need not comply with the interest rate restrictions for shared appreciation loans for seniors, just as previously exempt lenders are exempted from the interest rate restrictions of normal shared appreciation loans.[171] This conclusion is drawn from the differences between the statutory scheme for normal shared appreciation loans and that for shared appreciation loans for seniors.

Only Civil Code section 1917.167 concerns usury and normal shared appreciation loans in the law governing normal shared appreciation

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[161] CAL. CIV. CODE § 1917.320(h) (West 1985).

[162] *Id.* § 1917.320(d).

[163] *Id.* § 1917.330.

[164] *Id.*

[165] *Id.*

[166] *Id.* § 1917.619.

[167] *Id.* § 1917.616.

[168] *Id.* § 1917.320(a).

[169] *Id.* § 1917.331(a)(1).

[170] *Id.* § 1917.320(i).

[171] *See supra* notes 112-27 and accompanying text (discussing shared appreciation loans).

loans.[172] Section 1917.167 restricts the initial contract interest rate on shared appreciation loans to that allowed by article XV, section 1 of the California Constitution. However, this Civil Code section does not restrict contingent deferred interest.[173] (The ability to charge and receive contingent deferred interest is one of the distinctive features of shared appreciation loans.) Thus, the legislature has authorized an exempt class of lenders for the contingent deferred interest on normal shared appreciation loans. Previously exempt lenders (*e.g.*, licensed real estate brokers) do not need Civil Code section 1917.167 legally to make a normal shared appreciation loan or any other loan that exceeds the usury limits. Thus, this statute was not intended to apply to them, but to lenders not previously exempt.[174] Therefore, previously exempt lenders probably do not need to comply with the restriction on the initial contract rate for normal shared appreciation loans.[175]

In contrast, the law governing shared appreciation loans for seniors has two statutes concerning usury. Civil Code section 1917.619 exempts all lenders making shared appreciation loans for seniors from article XV, section 1 of the California Constitution;[176] Civil Code section 1917.616 limits the maximum interest rates that lenders may charge on a shared appreciation loan for seniors.[177] Civil Code section 1917.616 states:

> *[I]n no event* may the amount of actual contingent interest received by the lender, plus the stated interest received by the lender, result in an annual percentage rate in excess of 1.5 times the applicable usury rate calculated pursuant to Article XV of the California Constitution, when all of such interest is applied over the actual term of the loan.[178]

The intent of this section, governing shared appreciation loans for seniors, cannot be the same as Civil Code section 1917.167, covering other types of shared appreciation loans. Civil Code section 1917.616 is intended to limit the maximum interest rate that an exempt lender may charge because all shared appreciation loans for seniors lenders are exempt. Civil Code section 1917.616 is similar in effect to the statutes that limit the interest that may be charged by other exempt lenders, such as industrial loan companies, licensed pawnbrokers, and personal property brokers. Furthermore, given the nature of these loans, there

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[172] CAL. CIV. CODE § 1917.167 (West 1985).
[173] *Id.*
[174] Friend, *supra* note 127, at 349.
[175] *Id.*
[176] CAL. CIV. CODE § 1917.619 (West 1985).
[177] *Id.* § 1917.616.
[178] *Id.* (emphasis added).

are good policy reasons for protecting the borrower. Therefore, lenders previously exempt from usury restrictions should not be exempt from the interest rate restrictions for shared appreciation loans for seniors.

E. Exempt Lenders as Borrowers

Most lenders are borrowers as well. Lenders borrow the funds that they lend to others. Depositors of all types and bondholders lend to lending institutions. This raises the issue of whether exempt lenders can use the usury laws against their creditors.[179] For example, can a bank legally refuse to pay its "high money market rates," because the rate is usurious and the depositors are not exempt?

Article XV, section 1 of the California Constitution provides that "none of the above restrictions shall apply to *any obligations of*, loans made by, or forbearances of . . . [the exempt classes of lenders]."[180] The term "obligations of" can logically only refer to those situations in which the exempted classes are acting as debtors.[181] Debtors have an "obligation" to repay their debts with interest. Creditors are not "obligated" to receive repayment of a debt with interest. Thus, under the California Constitution, it appears that exempt lenders are also exempt borrowers.

However, a recent case, *Green v. Future Two*,[182] held that real estate brokers are exempt lenders, but not exempt borrowers. The *Green* court reached its conclusion by paraphrasing article XV as, "the restriction shall not apply to loans *made* by building and loan associations, credit unions, banks, pawn-brokers, and other identified lending institutions."[183] The court then defined "loan" as "the act of lending" and argued that "lend" means "to make a loan."[184] It continued, "[a] borrower does not make a loan; he receives or obtains a loan from a lender."[185] The court concluded that only loans made by a real estate broker, as a lender, are exempt.[186] Then, in dicta, the court tried to

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[179] *See* Harroch & Frasch, *The New California Usury Law in Light of the Monetary Control Act of 1980*, 35 BUS. LAW. 1053, 1066 (1980).

[180] CAL. CONST. art. XV, § 1 (emphasis added). The reference to "obligations of" was added in 1979.

[181] Harroch & Frasch, *supra* note 179, at 1066.

[182] 179 Cal. App. 3d 738, 225 Cal. Rptr. 3 (1986); *accord* Winnett v. Roberts, 179 Cal. App. 3d 909, 225 Cal. Rptr. 82 (1986) (borrower-broker neither makes nor arranges loans).

[183] *Green*, 179 Cal. App. 3d at 741, 225 Cal. Rptr. at 4.

[184] *Id.* at 742, 225 Cal. Rptr. at 4.

[185] *Id.*

[186] *Id.*

strengthen its argument by noting that, "[s]uch institutions [referring to the other exempt lenders] are in the business of lending money, not borrowing it."[187]

The court reached the right conclusion for real estate brokers, but its reasoning seems faulty and overbroad when it includes other exempt lenders as nonexempt borrowers. First, paraphrasing article XV, the court only cites the portion declaring that loans made by the listed lenders are exempt. It overlooks the portion declaring that "obligations" of the listed lenders are exempt as well. Second, the court fails to recognize the reality of the market for money when it states that lending institutions are in the business of lending money, not borrowing it. The only way a lending institution can stay in the business of lending money is by borrowing it. Otherwise, the institution will run out of loanable funds. Lending institutions borrow money by accepting passbook deposits, selling certificates of deposit, offering money market accounts, and selling their own bonds. With these borrowed funds, lending institutions attempt to make loans at a higher rate than the rate at which they are borrowing. This reality, that institutional lenders are also borrowers, gave birth to adjustable rate mortgages. Savings and loan institutions in the latter part of the 1970's were locked into mortgages they made ten years earlier at eight percent rates and had to pay out to their depositors at fifteen percent rates on money market accounts. If these institutions were not exempt borrowers, they could have legally used the usury laws to avoid paying interest to their depositors.

The *Green* court could have concluded that real estate brokers are not exempt borrowers by looking to Civil Code section 1916.1. Section 1916.1 limits the real estate broker exemption to loans made or arranged by real estate brokers.[188] The constitution gives the legislature power to statutorily limit its exemptions.[189] For many of the other exempt lenders, the legislature included the phrase "obligations of" in codifying the exemption.[190] For other exempt lenders, the legislature created an exempt class of lenders, without limiting the exemption to

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[187] *Id.*

[188] CAL. CIV. CODE § 1916.1 (West Supp. 1987).

[189] *See supra* note 129.

[190] Exempt classes of lenders using the phrase "obligations of" in the statutory codification include banks, *see* CAL. FIN. CODE § 1504 (West Supp. 1987); savings and loan associations, etc., *see id.* § 7675; bank holding companies, *see id.* § 3707; insurance companies, *see* CAL. INS. CODE § 1100.1 (West Supp. 1987); physicians and surgeons cooperatives, *see id.* § 12,807(a)(4); and ERISA pension funds, *see* CAL. CIV. CODE § 1917.220 (West 1985).

"loans made or arranged by" the lender.[191] By closely examining the statutory scheme of codifying the usury exemptions, one can conclude that real estate brokers are only exempt lenders, not exempt borrowers, without concluding that all exempt lenders are nonexempt borrowers.[192] Thus *Green*'s holding was correct; the dicta in *Green*, suggesting that most lenders other than real estate brokers are not exempt borrowers, is not likely to be followed.

III. Hidden Interest

The Civil Code defines interest as "the compensation allowed by law or fixed by the parties for the use, or forbearance, or detention of money."[193] Interest is presumed in all loans of money, except when the loan contract expressly states that interest will not be charged.[194]

The popular notion of "interest" is that it is compensation for the use of money. However, interest can also take the form of compensation for the forbearance to sue a person for a debt owed.[195] A forbearance is "the act by which a creditor waits for the payment of a debt due him by the debtor after it has become due."[196] When a lender releases the borrower from liability on a debt, the release is a forbearance.[197] A forbearance is an independent obligation.[198] In order to determine if a forbearance is usurious, the consideration received for the forbearance and the amount of time the lender forbears is calculated against the amount owed.[199]

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[191] Classes of lenders exempted without stating, "obligations of, loans made by, or forbearance of," in codification include credit unions, *see* Cal. Fin. Code § 15,000 (West Supp. 1987); and commercial finance lenders, *see id.* § 26,000.2. The remaining exempt classes of lenders either omit the phrase "obligations of" or their code sections do not make specific references to Cal. Const. art. XV, § 1.

[192] This approach was followed in the well-reasoned case of Winnett v. Roberts, 179 Cal. App. 3d 909, 225 Cal. Rptr. 82 (1986).

[193] Cal. Civ. Code § 1915 (West 1985).

[194] *Id.* § 1914.

[195] *Id.* § 1915.

[196] Eisenberg v. Greene, 175 Cal. App. 2d 326, 330, 346 P.2d 60, 63 (1959) (quoting Murphy v. Agen, 92 Cal. App. 468, 469, 268 P. 480, 481 (1928)); *see* Upton v. Gould, 64 Cal. App. 2d 814, 818, 149 P.2d 731, 733 (1944) (same); *see also* Calimpco, Inc. v. Warden, 100 Cal. App. 2d 429, 440, 224 P.2d 421, 429 (1950).

[197] *Calimpco*, 100 Cal. App. 2d at 440, 224 P.2d at 429.

[198] Crestwood Lumber Co. v. Citizens Sav. & Loan Ass'n, 83 Cal. App. 3d 819, 824, 148 Cal. Rptr. 129, 132 (1978).

[199] Buck v. Dahlgren, 23 Cal. App. 3d 779, 786, 100 Cal. Rptr. 462, 467 (1972). "Thus for the sum of $500, appellant was given one month further in which to pay the matured loan. Respondent therefore received .99 percent of the $50,560 debt for the

Other charges, not designated as interest, may be treated as interest in a usury action, and thus used as an offset against the principal amount the lender can recover.[200] The constitution not only forbids charging usurious interest, but also forbids charging any fee, bonus, commission, discount or other compensation that would make a loan usurious.[201] Therefore, under the usury law, interest is any compensation or benefit received by the lender as part of a loan or forbearance, other than specific charges for services or expenses that are incidental to making the loan.[202] However, a lender may charge an extra reasonable amount for investigating, arranging, negotiating, brokering, making, servicing, collecting, and enforcing its obligation.[203]

The maximum rate allowed by the usury law refers to simple interest.[204] Thus, loans that involve compounding interest or installment payments need careful attention. Compounding interest is permitted only if the parties clearly express in writing that interest will be compounded.[205] However, the total interest paid may not exceed the maximum rate allowed by law.[206] If the interest is compounded annually at

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one month forbearance, or an annual usurious rate of 11.88 percent." *Id.* However, there are two situations in which contingent interest will not render a loan usurious. First, if the obligation to repay the principal is contingent on uncertain events, then there is no loan for usury purposes. Thus the contingent interest is free from usury claims. *See* Miley Petroleum Corp., Ltd. v. American Petroleum Corp., 18 Cal. App. 2d 182, 189, 63 P.2d 1210, 1214 (1936). Second, if, at the time the loan is made, the principal is absolutely payable, but the interest is not, then the subsequent collection of interest will not render the loan usurious. *See* Thomassen v. Carr, 250 Cal. App. 2d 341, 346, 58 Cal. Rptr. 297, 301 (1967).

[200] Haines v. Commercial Mortgage Co., 200 Cal. 609, 255 P. 805 (1927); Blodgett v. Rheinschild, 56 Cal. App. 728, 206 P. 674 (1922).

[201] CAL. CONST. art. XV, § 1. These fees, bonuses, commissions, or other compensations are added to the charges designated as interest. Otis v. I. Eisner Co., 7 Cal. App. 2d 496, 499-500, 46 P.2d 235, 236 (1935). This total is then calculated against the loan principal for the full term of the loan to determine if the loan is usurious. Hoffman v. Key Fed. Sav. & Loan Ass'n, 286 Md. 28, 416 A.2d 1265 (1979).

[202] 59 OPS. CAL. ATT'Y GEN. 452 (1976). Discount points and seller points are not considered to be a specific charge, incidental to making a loan. Thus, they are added to interest and may make a loan usurious.

[203] Klett v. Security Acceptance Co., 38 Cal. 2d 770, 242 P.2d 873 (1952); Forte v. Nolfi, 25 Cal. App. 3d 656, 102 Cal. Rptr. 455 (1972).

[204] Warren, *Regulation of California Housing Finance: A Forgotten Consumer*, 8 UCLA L. REV. 555, 562 (1961).

[205] "[I]n the computation of interest upon any bond, note or other instrument or agreement, interest shall not be compounded, . . . unless an agreement to that effect is clearly expressed in writing and signed by the party to be charged therewith." CAL. CIV. CODE § 1916-2 (West 1985).

[206] Penzner v. Foster, 170 Cal. App. 2d 106, 109, 338 P.2d 533, 535 (1959).

the maximum rate, after a default, the loan is not usurious.[207] If, however, the interest is compounded more frequently at the maximum rate, the loan is usurious.[208] In any case, to determine if the loan is usurious, the interest is calculated against the loan's full term, between the date of execution and the date of maturity.[209]

Loans are often repaid in equal monthly or other periodic installments. Such an equal payment loan may appear legal yet actually be usurious. Suppose, for example, a loan of $1000 is made at a purported annual rate of seven percent. The loan is repayable in 36 equal monthly installments over a three year period. The lender adds the three years of interest, $210 (3 times $70) to the principal amount of $1000 to obtain the sum of $1210. The lender then divides this amount into equal installments of $33.61 ($1210÷36 = $33.61). If the maximum permitted interest rate is ten percent, the loan as structured is usurious. The true rate of interest (the "annual percentage rate") is 12.83%.[210] This is because the lender is charging interest for the use of the entire $1000 for three years, but most of the money is repaid in less than three years.

If interest is deducted in advance, a loan that appears to be legal may actually be usurious. The case of *Taylor v. Budd*[211] provides an interesting illustration. In *Taylor*, 12% per annum was the legally permitted interest rate. The parties agreed on a 12% per annum rate, ***payable monthly in advance***. The court held the transaction usurious. Consequently, the plaintiff borrower was permitted to recover: (1) three times the interest paid in the year preceding the action, and (2) all other interest paid in the two years preceding the action. Thus, the defendant forfeited the equivalent of four years interest for charging an annual rate of twelve percent payable monthly *in advance*, rather than an annual rate of twelve percent, payable at the end of each month. The fact that the defendant's violation of the law was probably inadvertent did not reduce his penalty.

Fees paid to a lender's agent may be treated as interest charged by the lender. These payments will be treated as interest if the payment is

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[207] Heald v. Friis-Hansen, 52 Cal. 2d 834, 840, 345 P.2d 457, 461-62 (1959) (overruling, on the compound interest issue, Haines v. Commercial Mortgage Co., 200 Cal. 609, 254 P. 956 (1927) (holding that compounding interest annually at maximum rate, after default, was usurious.)).

[208] *Id.* at 840, 345 P.2d at 461-62.

[209] *Penzner*, 170 Cal. App. 2d at 109, 338 P.2d at 535.

[210] 12 C.F.R. pt. 226, app. J(b)(l) (1986).

[211] 217 Cal. 262, 18 P.2d 333 (1933).

known to and authorized or ratified by the lender.[212] This rule does not apply to specific charges for services or expenses that are incidental to making a loan.[213] Fees paid to the borrower's agent will not be treated as interest.[214]

Conversely, when the payment does not benefit the lender, it is not treated as interest paid to the lender. For example, when a trustee personally receives a commission or bonus for her sole benefit and the trust neither knew about, ratified, nor profited from the commission or bonus, courts do not treat the amount received as interest on a loan made by the trust.[215] Similarly, courts will not treat a bonus or commission received by a corporate agent for her own benefit without the corporate lender's knowledge, consent, authorization, or ratification as interest charged by the corporation.[216]

Contingent interest is another form of "hidden" interest. "The determination whether [a loan specifying contingent interest] was usurious depends upon the factual question whether the parties acted in good faith and without intent to avoid the usury laws, or merely gave the transaction this form as a colorable device to obtain a greater profit than was permissible under said laws."[217] A variable interest rate loan may legally exceed the usury limits if the parties contracted for a variable interest rate in good faith and without the intent to evade the usury law.[218]

Prepayment penalties that are specified in the loan contract and that are triggered when the borrower exercises her option to repay the principal sooner than the term contracted will not render an otherwise legal

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[212] Niles v. Kavanagh, 179 Cal. 98, 100, 175 P. 462, 463 (1918); Clarke v. Horany, 212 Cal. App. 2d 307, 310, 27 Cal. Rptr. 901, 903 (1963); Penziner v. West Am. Fin. Co., 133 Cal. App. 578, 589, 24 P.2d 501, 506 (1933).

[213] *See supra* text accompanying notes 202-03.

[214] Forte v. Nolfi, 25 Cal. App. 3d 656, 682, 102 Cal. Rptr. 455, 472 (1972).

[215] Hobbs v. Buck, 115 Cal. App. 3d 176, 182, 171 Cal. Rptr. 258, 261 (1981).

[216] Thunderbird Inv. Corp. v. Rothschild, 19 Cal. App. 3d 820, 830, 97 Cal. Rptr. 112, 118 (1971).

[217] Arneill Ranch v. Petit, 64 Cal. App. 3d 277, 289, 134 Cal. Rptr. 456, 464 (1976).

[218] McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 21 Cal. 3d 365, 377-78, 578 P.2d 1375, 1382, 146 Cal. Rptr. 371, 378 (1978). This case was reheard to consider whether parol testimony and written communications may also be considered in determining whether a written agreement provides for compounding. *See* McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 33 Cal. 3d 816, 662 P.2d 916, 191 Cal. Rptr. 458 (1983). For variable interest rate loans in general, see CAL CIV. CODE §§ 1916.5-1916.7 (West 1985).

loan usurious.[219] This rule is based on the principle that "a debtor cannot by his voluntary act [of shortening the loan term] render a transaction usurious which, but for such circumstance, would be entirely free from a claim of usury."[220] "[I]n determining whether the loan was usurious the full term of the loan should be considered rather than a shorter period created when the loan was prepaid."[221]

IV. Defenses to a Claim of Usury

In response to a usury claim, a lender may assert several defenses. These defenses can be broken down into four classes: (1) usury exemptions; (2) procedural defenses; (3) mistake of fact; and (4) borrower culpability defenses.

A. Usury Exemptions

The most effective and probably most common defense to a usury claim is an exemption. As discussed above, a fully exempt lender may charge any interest rate without violating the usury law. A partially exempt lender may charge rates that exceed the usury limits established in the constitution, but must conform to its particular interest rate limitations.[222]

B. Procedural Defenses

As in any civil action, the litigants may assert a number of defenses based on civil procedure and due process requirements. Of these defenses, the statute of limitations and *res judicata* warrant particular attention in usury litigation.

The statute of limitations for a usury claim is two years.[223] Further,

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[219] French v. Mortgage Guar. Co., 16 Cal. 2d 26, 33, 104 P.2d 655, 659 (1940).

[220] *Id.*

[221] White v. Sweeney, 138 Cal. App. 2d 199, 201, 291 P.2d 77, 78 (1955).

[222] However, violating interest rate limitations established for a partially exempt lender may result in penalties that are harsher than the penalties for violating the usury law. Some partially exempt lenders forfeit the right to collect the principal on a loan that exceeds its particular interest rate limit. *See infra* notes 284-86 and accompanying text.

[223] Cal. Civ. Proc. Code § 339 (West Supp. 1987) is the two year statute of limitations on an "obligation or liability not founded upon an instrument of writing . . . ." Actions to recover usurious interest payments have been held to come within this statute. *See* Stock v. Meek, 35 Cal. 2d 809, 817, 221 P.2d 15, 20 (1950); Baruch Inv. Co. v. Huntoon, 257 Cal. App. 2d 485, 65 Cal. Rptr. 131 (1967); Simmons v. Patrick, 211 Cal. App. 2d 383, 27 Cal. Rptr. 347 (1962); Shirley v. Britt, 152 Cal.

only the interest paid within that two year period is recoverable.[224] However, the statute of limitations has two important exceptions. First, the statute does not begin to run until after the borrower repays the loan.[225] Thus, if the borrower brings a usury action on an unsatisfied loan, the borrower may recover as an offset all of the interest paid on the loan without regard to the two year statute of limitations. Second, if a lender sues to enforce a usurious loan contract, the borrower may assert a usury cross-complaint for all of the interest paid on the loan as an offset without regard to the two year statute of limitations.[226]

The statute of limitations for recovering treble damages on a usurious loan is one year.[227] The borrower may recover triple the interest paid within one year of bringing the action. The treble damages statute of limitations is not subject to the exceptions applicable to the statute of limitations for an action to recover interest paid.[228] Thus, a borrower may only recover triple the interest paid within one year of bringing the action, regardless of whether the loan has been satisfied or whether the lender is attempting to enforce a usurious loan.

The borrower's remedies, recovery of interest paid and treble damages, are cumulative.[229] The borrower's right to collect interest paid is not affected by the grant or denial of treble damages. The borrower can choose to seek both remedies or one without the other.

If the borrower brings an action to recover interest paid, then subsequently brings a separate action to recover treble damages, the doctrine of *res judicata* will bar the treble damages action.[230] Although the ability to recover treble damages and the ability to recover interest paid are considered separate and cumulative remedies, both arise from the violation of the same substantive right. Thus, they both give rise to only one cause of action. Therefore, a valid final judgment on the merits between the same parties will bar a subsequent claim on the same cause of action.

Res judicata will also bar a borrower's usury claim after a court has

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App. 2d 666, 313 P.2d 875 (1957).

[224] CAL. CIV. PROC. CODE § 339 (West Supp. 1987).

[225] Westman v. Dye, 214 Cal. 28, 4 P.2d 134 (1931); Harris v. Gallant, 183 Cal. App. 94, 6 Cal. Rptr. 630 (1960); Janisse v. Winston Inv. Co., 154 Cal. App. 2d 580, 317 P.2d 48 (1957); Shirley v. Britt, 152 Cal. App. 2d 666, 313 P.2d 875 (1957); *see infra* notes 258-60 and accompanying text.

[226] *Westman*, 214 Cal. 28, 4 P.2d 134.

[227] CAL. CIV. CODE § 1916-3 (West 1985).

[228] Taylor v. Budd, 217 Cal. 262, 266, 18 P.2d 333, 334 (1933).

[229] *Id.*

[230] Alston v. Goodwin, 174 Cal. App. 2d 16, 343 P.2d 993 (1959).

rendered judgment against her on the loan.[231]

C. Mistake of Fact

When a written instrument fails to reflect the true intent of the parties who executed it, the party harmed by the mistake of fact may bring an action to reform the contract to reflect their true intent.[232]

In *First American Title Insurance & Trust Co. v. Cook*,[233] the parties were allowed to reform the promissory note when a mistake of fact made it usurious. First American inadvertently used a loan form for a loan written at the maximum rate that called for compounding of interest on late payments, with the interest compounding more frequently than once a year. Neither party was aware of the compounding clause, and neither party intended the interest to be compounded. An action to foreclose on the loan security was brought twelve months after executing the loan because Cook failed to make the required installment payments. The compound interest clause was discovered at that time. First American included a prayer for reformation in its complaint for foreclosure. Cook's cross-complaint included a cause of action for usury and a prayer for reformation. The trial court granted First American both foreclosure and reformation. Accordingly, the loan was reformed to reflect the parties' true intent by deleting the compound interest provision. Deleting the compound interest provision removed the usurious taint from the loan. Thus, the trial court allowed First American to foreclose. Cook appealed on the grounds that reformation could only be granted for the party harmed by the mistake. The appellate court upheld the judgment for foreclosure, reversed First American's reformation judgment, and entered a reformation judgment in favor of Cook. Reformation precluded Cook from asserting his usury claim, because the loan was rendered nonusurious. Thus, he could not recover interest paid for treble damages.

First American held that a loan made usurious by a mistake of fact may be reformed to be nonusurious. However, mistake of fact is not really a lender defense, because the borrower must ask for reformation. Normally, a borrower would not ask for reformation, because she would then lose her usury claim. Therefore, a borrower on a usurious

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[231] Andrews v. Reidy, 7 Cal. 2d 366, 370-71, 60 P.2d 832, 834-35 (1936). "The ground upon which this rule is based is that the borrower should have interposed his defense of usury in bar to the [previous] judgment, and that having failed to do so he is barred by his neglect." *Id.* at 371, 60 P.2d at 835 (citations omitted).

[232] CAL. CIV. CODE § 3399 (1970).

[233] 12 Cal. App. 3d 592, 90 Cal. Rptr. 645 (1970).

loan should not ask for reformation, and a lender's best hope is that the borrower will ask for reformation.

Mistake of law is not a defense to a usury claim. "The conscious and voluntary taking of more than the legal rate of interest constitutes usury and the only intent necessary on the part of the lender is to take the amount of interest which he receives; if that amount is more than the law allows, the offense is complete."[234]

D. Borrower Culpability Defenses

Lender defenses to usury charges that are based on borrower fault will not succeed absent fraud. These lender defenses are *pari delicto*, implied and express waiver, and estoppel. The successful assertion of these by the lender, absent fraud by the borrower, would defeat the fundamental policy of usury law — protecting unwary borrowers.[235] However, the level of the borrower's fault or guilt in the transaction is considered in awarding treble damages.[236]

Since borrowers are the class protected by the usury law, they are not considered as in *pari delicto* with those who violate the usury law.[237] "[The] [p]roper enforcement of the law of usury precludes the blanket application of the in *pari delicto* doctrine."[238] If lenders could invoke the in *pari delicto* doctrine, it would be nearly impossible for a borrower, as a party to an illegal contract, to maintain a usury cause of action.

Similarly, "voluntary" payments of usurious interest do not constitute a waiver of the borrower's right to maintain a usury action.[239] Courts have found that borrowers feel compelled by the loan contract to make such payments; therefore the payments are not "voluntary."[240] Thus, since waiver requires the voluntary relinquishment of a known right, the borrower's right to maintain a usury action cannot be implied

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[234] Thomas v. Hunt Mfg. Corp., 42 Cal. 2d 734, 740, 269 P.2d 12, 16 (1954).

[235] White v. Seitzman, 230 Cal. App. 2d 756, 761, 41 Cal. Rptr. 359, 362 (1964); Wooton v. Coerber, 213 Cal. App. 2d 142, 148, 28 Cal. Rptr. 635, 638-39 (1963); Aitken v. Southwest Fin. Corp., 131 Cal. App. 95, 102-03, 20 P.2d 1000, 1003 (1933); *In re* Washer, 78 Cal. App. 759, 771-72, 248 P.2d 1068, 1073 (1926), *aff'd*, 200 Cal. 598, 254 P. 951 (1927).

[236] Golden State Lanes v. Fox, 232 Cal. App. 2d 135, 141-42, 42 Cal. Rptr. 568, 572 (1965).

[237] Carter v. Seaboard Fin. Co., 33 Cal. 2d 564, 574, 203 P.2d 758, 765 (1949).

[238] Stock v. Meek, 35 Cal. 2d 809, 818, 221 P.2d 15, 21 (1950).

[239] Taylor v. Budd, 217 Cal. 262, 266-67, 18 P.2d 333, 334 (1933) ("Payments of usury are not considered voluntary but are deemed to be made under restraint.").

[240] *Id.*

from the borrower's compliance with the loan terms. In addition, the borrower's express waiver of the usury defense will not defeat a usury claim.[241]

"[N]o borrower is estopped from asserting usury merely because he has knowingly met the usurious exactions of the lender."[242] Estoppel does not arise simply because the borrower knew of the transaction's usurious nature, took the initiative in seeking the loan, and paid usurious interest without protest.[243]

If there is fraud by the borrower, the above defenses are more likely to be effective. The courts have not allowed usury to be used as a vehicle for borrowers who deliberately cheat lenders.[244] When the facts show that the borrower is attempting to defraud a lender, the borrower will be estopped from claiming that the transaction is usurious.[245]

Buck v. Dahlgren[246] is a good example of estoppel in usury. The plaintiff in *Buck* was a real estate developer. He borrowed money from a recent immigrant from Sweden who could not write, and barely spoke, English. The plaintiff initiated the transaction and suggested the terms and conditions. He offered security that he knew was worth far less than the loan principal. He had no intention of repaying the loan and anticipated foreclosure on the secured property. After the property was sold in foreclosure, the plaintiff brought an action against the lender for return of usurious interest and treble damages. The court found that the plaintiff knowingly made false representations to the defendant, with the intent of inducing the defendant to rely on the repre-

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[241] Baruch Inv. Co. v. Huntoon, 257 Cal. App. 2d 485, 496, 65 Cal. Rptr. 131, 138 (1967): "A 'voluntary' payment of excessive interest does not waive the usury laws, which are designed for the protection of society. *A fortiori* a general waiver of rights executed before usurious interest was paid, could not defeat the respondent's cross-complaint." (citation omitted).

[242] Martyn v. Leslie, 137 Cal. App. 2d 41, 57, 290 P.2d 58, 67 (1955).

[243] Janisse v. Winston Inv. Co., 154 Cal. App. 2d 580, 587, 317 P.2d 48, 53 (1957).

[244] Baker v. Butcher, 106 Cal. App. 358, 364-65, 289 P. 236, 238 (1930). The makers of a note provided written assurance to the note's purchaser that it was not usurious. The makers then brought an action against the lenders for usury. The court held:

> To permit the plaintiffs to now deny the validity of this note or assert that they did not receive the full face value of the note from the payee, would sanction fraud and convert the wholesome purpose of the usury law into an engine of injustice and deceit. This may not be done.

[245] Lakeview Meadows Ranch v. Bintliff, 36 Cal. App. 3d 418, 111 Cal. Rptr. 414 (1973); Buck v. Dahlgren, 23 Cal. App. 3d 779, 100 Cal. Rptr. 462 (1972); White v. Seitzman, 230 Cal. App. 2d 756, 41 Cal. Rptr. 359 (1964); Baker v. Butcher, 106 Cal. App. 358, 289 P. 236 (1930).

[246] 23 Cal. App. 3d 779, 100 Cal. Rptr. 462 (1972).

sentation. It also found that the defendant detrimentally relied on the plaintiff's representation. Thus, the court held that the plaintiff was estopped from claiming that the transaction was usurious.

V. Penalties for Usurious Loans

The maker of a usurious loan is subject to both civil and criminal penalties.

A. Civil Penalties

Civil penalties for usurious loans are substantial. Generally speaking, although the lender normally retains the right to collect the loan's principal, it forfeits its right to collect the interest.[247] In addition, under the circumstances described in the following paragraphs, it may have to pay triple the interest it collected in the year before the borrower brought suit.[248]

The California Supreme Court in *Burr v. Capital Reserve Corp.* held that "[t]he granting of treble damages upon a finding of usury is a matter within the trial court's discretion."[249] The court followed two earlier decisions from the second District Court of Appeal, *White v. Seitzman*[250] and *Golden State Lanes v. Fox.*[251] The borrowers in *Burr*, *White*, and *Golden State Lanes* were sophisticated businessmen who devised schemes allowing their respective lenders to evade the usury law while loaning them money at usurious rates.[252] Each of these bor-

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[247] Williams v. Reed, 48 Cal. 2d 57, 68, 307 P.2d 353, 358-59 (1957); Stephans v. Herman, 225 Cal. App. 2d 671, 37 Cal. Rptr. 746 (1964).

[248] Cal. Civ. Code § 1916-3(a) (West 1985) ("Every person . . . who for any loan . . . shall have paid or delivered any greater sum or value than is allowed [by "the usury law"] may . . . recover in an action at law against the person . . . who shall have taken or received the same, . . . treble the amount of the money so paid or value delivered in violation of said [law], providing such action shall be brought within one year after such payment or delivery."). The maximum interest rate allowed by "the usury law" has been supplanted by the maximum interest rates allowed by the California Constitution article XV, § 1. *See supra* note 11.

[249] *Burr*, 71 Cal. 2d 983, 994, 458 P.2d 185, 192, 80 Cal. Rptr. 345, 352 (1969).

[250] 230 Cal. App. 2d 756, 41 Cal. Rptr. 359 (1964).

[251] 232 Cal. App. 2d 135, 42 Cal. Rptr. 568 (1965).

[252] *See Burr*, 71 Cal. 2d 983, 458 P.2d 185, 80 Cal. Rptr. 345 (plaintiff owned ice-skating rink and wanted to open billiard parlors; used sale and lease back transaction); *Golden State*, 232 Cal. App. 2d 135, 42 Cal. Rptr. 568 (corporate plaintiff operated bowling alley; used sale and lease back transaction to borrow funds for remodeling); *White*, 230 Cal. App. 2d 756, 41 Cal. Rptr. 359 (1964) (plaintiff created, operated, and maintained 55 corporations and 26 trusts; through three of his corporations, plaintiff gave lender, construction company, two notes and deeds of trust at large discounts).

rowers defaulted on their respective loans and attempted to recover treble damages under usury law. This raised a conflict between two legal principles. Civil Code section 1916-3(a) states that every person who has paid usurious interest may recover treble the amount of interest paid within one year of bringing the action.[253] Civil Code section 3517 states that "[n]o one can take advantage of his own wrong."[254] A later case, cited with approval by the supreme court in *Burr v. Capital Reserve Corp.*,[255] resolved this conflict. The court of appeal in *White* held that: (1) The purpose of the usury law is to protect unwary borrowers and that the plaintiff was not such a borrower; (2) The purpose of the usury law's penalty provision is to "penalize sharp operators taking advantage of unwary and necessitous borrowers," but that was not the situation in the case before it; and (3) "No one can take advantage of his own wrong;" therefore, the plaintiff could be denied treble damages.[256] The California Supreme Court reaffirmed and refined the *Burr* rule in *McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, which held that "[i]n awarding treble damages, however, the court does not exercise an abstract discretion, but must base its ruling on the facts of the transaction at issue."[257]

Civil penalties for making usurious loans are best understood through examples. In each example, assume that the maximum permitted interest rate is ten percent per annum.

> EXAMPLE 1. Lender makes a $10,000 loan at an interest rate of eleven percent. All interest and principal is due at the end of the year. At the end of the year, borrower pays $11,100 to lender in full satisfaction of the loan. Six months later borrower brings an action seeking a return of three times the $1100 interest, or $3300. The court has the discre-

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[253] CAL. CIV. CODE § 1916-3(a) (West 1985).

[254] *Id.* § 3517 (West 1970).

[255] 71 Cal. 2d 983, 458 P.2d 185, 80 Cal. Rptr. 345 (1969). *Burr* does not cite *White*, but cites *Golden State Lanes*. *Golden State Lanes* attributes the rule to *White*: "[i]n keeping with the views expressed in *White v. Seitzman*, 230 Cal. App. 2d 756, [41 Cal. Rptr. 359,] the granting of treble damages is discretionary with the trial court and depends upon the relative guilt of the parties in initiating the transaction." 232 Cal. App. 2d at 142, 42 Cal. Rptr. at 572.

[256] *Seitzman*, 230 Cal. App. 2d at 761-65, 41 Cal. Rptr. at 362-64.

[257] *McConnell*, 21 Cal. 3d 365, 379, 578 P.2d 1375, 1383, 146 Cal. Rptr. 371, 379 (1978). This case was reheard to consider whether parol testimony and written communications may also be considered in determining whether a writtent agreement provides for compounding. *See* McConnell v. Merrill Lynch, Pierce, Fenner & Smith, Inc., 33 Cal. 3d 816, 662 P.2d 916, 191 Cal. Rptr. 458 (1983).

tion to award $3300, triple the amount of interest charged. It must award borrower at least $1100, the amount of interest actually paid.[258]

EXAMPLE 2. Same facts as Example 1, except borrower pays the $1100 interest in advance and repays the principal at the end of the period. The maximum that the court can award is $1100. The treble damage action must be brought within one year after the interest is paid.[259] Since the interest was paid more than one year before the action was brought, an action for treble damages is time-barred. Borrower must bring the action for recovery of the $1100 interest paid at the beginning of the loan within two years after the interest is actually paid.[260] However, a court might view the principal actually loaned as only $8900 ($10,000 minus $1100 simultaneously "repaid"). So viewed, the interest of $1100 would be considered paid at the time the $10,000 was paid. In such a case, triple damages would be available.

EXAMPLE 3. Same facts as Example 1, except borrower brings her action before paying off the loan. The court will excuse borrower from paying any part of the interest, but borrower will have to pay the principal.[261] Borrower cannot

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[258] *See* Stock v. Meek, 35 Cal. 2d 809, 221 P.2d 15 (1950).

[259] *See* Fox v. Peck Iron & Metal Co., 25 Bankr. 674, 692-93 (S.D. Cal. 1982) (treble damages denied when usurious transaction was negotiated by experienced and sophisticated businessmen); *see also* Taylor v. Budd, 217 Cal. 262, 18 P.2d 333 (1933). CAL. CIV. CODE § 1916-3(a) (West 1985) limits treble damages to the amount of interest paid within one year prior to bringing the action.

[260] CAL. CIV. PROC. CODE § 339 (West Supp. 1987), which is the two year statute of limitation, does not explicitly refer to actions for the recovery of usurious interest. It merely refers to an "obligation or liability not founded upon an instrument of writing." *Id.* § 339.1. It has been held that an action to recover usurious interest payments comes within this statute. *See Stock*, 35 Cal. 2d at 817, 221 P.2d at 20; Baruch Inv. Co. v. Huntoon, 257 Cal. App. 2d 485, 65 Cal. Rptr. 131 (1967); Simmons v. Patrick, 211 Cal. App. 2d 383, 27 Cal. Rptr. 347 (1962); Shirley v. Britt, 152 Cal. App. 2d 666, 313 P.2d 875 (1957).

[261] CAL. CIV. CODE § 1916-2 provides in part: "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. . . ." Although section 1916-2 literally refers to a 12 percent interest rate, that rate has been impliedly superceded by CAL. CONST. art. XV, § 1. Thus, section 1916-2 in effect covers any unlawful interest rate rather than a rate over 12 percent. *See* Heald v. Friis-Hansen, 52 Cal. 2d 834, 838-39, 345 P.2d 457, 461 (1959) (same principle applied to a predecessor of article XV, § 1); *see also* Haines v. Commercial Mortgage Co., 200 Cal. 609, 623, 255 P. 805, 806 (1927) ("[T]he legislative intent was not to declare the whole

get treble damages for the interest that she has contracted to pay, but has not in fact paid. She can only get such damages for interest that she has actually paid.[262] Here, since no interest has actually been paid, the court cannot impose treble damages.

EXAMPLE 4. Lender lends $10,000 to borrower for five years at eleven percent per year. Borrower agrees to pay the interest of $1100 at the end of each year and also to pay the principal at the end of the fifth year. Borrower makes all payments when due. Shortly after paying off the interest for the fifth year and the principal amount, borrower brings an action against lender based on usury. The court has the discretion to award $3300 (three times the interest for the fifth year) since the borrower brought the action within one year of making the payment. A one year statute of limitations governs the triple damage action.[263] In addition, the court must award $1100 based upon the interest paid at the end of the fourth year.[264] It can award nothing for previous interest payments since the two year statute of limitations bars a refund of these payments.[265]

EXAMPLE 5. Same facts as in Example 4, except that the controversy arises before borrower makes the final payment of interest and before the borrower pays off the principal. The court has the discretion to award three times the last interest payment, made at the end of the fourth year, or $3300. In addition the court will set-off, as against the $10,000 principal amount owed by borrower, the first three years of interest that borrower paid, or $3300.[266] Thus, the

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contract void, but only the portion thereof relating to interest."); Harris v. Gallant, 183 Cal. App. 2d 94, 99, 6 Cal. Rptr. 630, 633-34 (1960) (trial court's decision to declare usurious note null and void reversed: "Under our usury laws interest is uncollectable and penalties are provided, but the principal is not forfeited.").

[262] Heald v. Friis-Hansen, 52 Cal. 2d 834, 839, 345 P.2d 457, 461 (1959); Haines v. Commercial Mortgage Co., 200 Cal. 609, 618, 254 P. 956, 958 (1927).

[263] CAL. CIV. CODE § 1916-3(a) (West 1985).

[264] Taylor v. Budd, 217 Cal. 262, 266, 18 P.2d 333, 334 (1933).

[265] In a usurious loan the agreement for the payment of interest is "void." CAL. CIV. CODE § 1916-2 (West 1985). Consequently the borrower who pays such interest has a common law action for money had and received. Such an action is governed by the two year statute of limitations for contracts, liabilities, and obligations not based on a written instrument. CAL. CIV. PROC. CODE § 339 (West Supp. 1987); *see* Stock v. Meek, 35 Cal. 2d 809, 817, 221 P.2d 15, 20 (1950).

[266] *See* Westman v. Dye, 214 Cal. 28, 4 P.2d 134 (1931); Shirley v. Britt, 152 Cal.

total set-off as against the $10,000 principal that was due is $6600, assuming the court awarded discretionary treble damages. Notice that the result is startlingly different if borrower paid the loan principal and all interest. As noted in Example 4, borrower would be barred from recovering any interest payments made more than two years before the filing of suit. Therefore, the maximum that she could recover would be $4400 ($3300 in treble damages for the fourth payment of interest plus $1100 for the third payment). In contrast, in the present example, borrower recovers, through set-off, $6600.

EXAMPLE 6. Lender makes a loan of $10,000 for eleven percent, with principal repayable at the end of twenty years. Interest of $1100 is payable annually at the end of each year. Borrower fails to make the first payment, and in accordance with the loan agreement, lender claims that the entire loan, principal and accrued interest, is now due. A court will not accelerate the loan. Borrower will not have to pay any interest for the twenty year period of the loan. At the end of the twenty year period, borrower will have to pay the principal amount of $10,000 but will not have to pay any interest.[267]

EXAMPLE 7. Lender makes a $10,000 loan to borrower at eleven percent interest. The loan is secured by commercial real estate, and is fully amortizing, repayable in equal monthly installments over twenty years. Each installment is applied first to accrued interest and then to reduction of principal. Borrower stops making payments after five years. In accordance with the terms of the acceleration clause contained in the loan documents, lender declares the entire loan due. Borrower makes no attempt to redeem the property or reinstate the loan. The entire unpaid principal amount of the loan is due. However, borrower may offset against the principal amount three times the amount of interest borrower paid within a year before lender brought an action to enforce the loan, provided that the court exercises its discretion to

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App. 2d 666, 313 P.2d 875 (1957); *see also* Janisse v. Winston Inv. Co., 154 Cal. App. 2d 580, 317 P.2d 48 (1957).

[267] *See* Harris v. Gallant, 183 Cal. App. 2d 94, 99, 6 Cal. Rptr. 630, 633-34 (1960); Shirley v. Britt, 152 Cal. App. 2d 666, 313 P.2d 875 (1957).

award triple damages.[268] In addition, borrower may offset as against the principal all of the other interest that she actually paid.[269]

EXAMPLE 8. Same facts as Example 7. However, borrower does not stop making payments until the sum of all monthly payments actually made equals the loan's principal amount. The loan will then be deemed paid in full. All payments, including that portion of each payment designated as interest by the parties, will be applied against the principal.[270] If borrower sued immediately upon making the last payment, borrower could possibly recover triple the amount of interest paid in the year before bringing the action.[271]

From the above examples, several generalizations can be drawn. First, among loans deemed usurious, little distinction exists between those in which the interest greatly exceeds the legal limit, and those in which the interest only slightly exceeds the legal limit. In both cases the borrower's obligation to repay the principal is unaffected. In both cases the borrower's obligation to pay any unpaid interest is nullified. Similarly, in both cases the borrower can recover any interest actually paid within two years of bringing the action. However, a court might be more likely to impose the discretionary treble damages in the case of a

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[268] CAL. CIV. CODE § 1916-3(a) (West 1985), which provides for treble damages, envisages the debtor bringing an action to enforce the penalty. When the lender brings an action to enforce the debt, it has been held that the debtor may use the treble damage statute to reduce the principal amount owed to the creditor. *See* Westman v. Dye, 214 Cal. 28, 4 P.2d 134 (1931). *Westman* held that the debtor could offset three times the amount of interest that was paid in the year before the creditor brought the suit. *Id.* at 36-37, 4 P.2d at 137-38. Presumably, if the creditor had waited a year before bringing her action, and if the debtor had not brought an action to enforce the treble damage remedy, the treble damage remedy would have been barred both as an offset and as a cause of action.

[269] Haines v. Commercial Mortgage Co., 200 Cal. 609, 621, 254 P. 956, 960 (1927).

[270] *Id.*

[271] If the borrower recovered such treble damages, it could not, of course, also receive an offset against principal for the interest paid within a year before bringing suit. All payments, even those designated as interest by the parties, are treated as principal payments for purposes of set-off, under the doctrine of *Haines*, 200 Cal. 609, 255 P. 805. However, for purposes of calculating treble damages, payments designated as interest by the parties are treated as interest. In Westman v. Dye, 214 Cal. 28, 4 P.2d 134 (1931), the loan was not an amortizing loan and the borrower was using the usury law solely as a defense to an action brought by the creditor. The court held that both treble damages and all interest payments (excluding those covered by the treble damage remedy) could be used as an offset.

gross breach of the usury laws than it would in the case of a relatively minor breach. Thus far, however, the courts that have refused to impose triple damages have emphasized the borrower's lack of innocence rather than the degree to which the interest rate exceeded the legal limit.[272]

Second, existing law recognizes a somewhat illogical distinction between cases in which a borrower has already paid the principal and interest in full, and cases in which a borrower has not yet paid the principal. When the borrower has already paid principal and interest in full, she can only recover the interest paid during the two years before the bringing of the action.[273] When the borrower has not yet paid the principal the borrower will, in effect, recover all interest paid by setting this off as against the principal sum owed.[274] California courts treat all payments of usurious interest as payments in reduction of principal, thus reducing the size of the principal amount.[275] The courts do this even if the parties designate the payments as interest and despite a statute that seems to bar such treatment.[276]

Although applying interest payments against principal may seem

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[272] *See* White v. Seitzman, 230 Cal. App. 2d 756, 761-65, 41 Cal. Rptr. 359, 362-64 (1964); *see also*, Buck v. Dahlgren, 23 Cal. App. 3d 779, 789-91, 100 Cal. Rptr. 462, 469-70 (1972) (borrower who initiated and induced usurious transaction by fraudulent representations was denied treble damages and estopped from recovering interest paid); Golden State Lanes v. Fox, 232 Cal. App. 2d 135, 141-42, 42 Cal. Rptr. 568, 572 (1965) ("[T]he granting of treble damages is discretionary with the trial court and depends upon the relative guilt of the parties initiating the transaction.").

[273] In the discretion of the court, the interest paid for the first year may be tripled. *See supra* text accompanying notes 249-57.

[274] Westman v. Dye, 214 Cal. 28, 39, 4 P.2d 134, 138 (1931) ("[T]he instant a payment is made of usurious interest it is applied to the principal, and the principal indebtedness at the time of such payment is reduced to the extent thereof."); Harris v. Gallant, 183 Cal. App. 94, 6 Cal. Rptr. 630 (1960); Shirley v. Britt, 152 Cal. App. 2d 666, 313 P.2d 875 (1957); *see also* Janisse v. Winston Inv. Co., 154 Cal. App. 2d 580, 317 P.2d 48 (1957).

[275] *Westman*, 214 Cal. 28, 4 P.2d 134; *see also* Shirley v. Britt, 152 Cal. App. 2d 666, 313 P.2d 875 (1957); CAL. CIV. PROC. CODE § 431.70 (West Supp. 1987) (permitting defense to be used by way of set-off even if time-barred as individual cause of action).

[276] CAL. CIV. CODE § 1479 (West 1982) provides, in effect, that if the parties designate a payment as interest it will be treated as such, and if no such designation is made the payment will be applied first to interest and then to principal. The courts get around this statute by reasoning as follows: All obligations to pay usurious interest are void; therefore, payments made in purported satisfaction of such obligations should be applied to principal instead. Section 1479 does not suggest the contrary since it addresses only the case in which both obligations, the one to pay principal and the one to pay interest, are valid.

anomalous, it avoids other anomalies. Suppose, for example, that the courts did in fact bar any recovery of interest paid more than two years before bringing the action, whether by set-off against principal or otherwise. In such a case a borrower who refused to make the first interest payment on a twenty year loan would be excused from making any interest payments for the full twenty years. In contrast, if the borrower made all of the payments except for the principal, the borrower could recover only the interest payments made within the last two years. This, too, is anomalous.

Perhaps existing law, despite its inconsistencies, is more desirable than a rule barring the application of past usurious interest payments against the principal. Existing law, at least, more fully protects the borrower than would the opposite rule. Any inconsistencies result from the fact that the statute of limitations bars affirmative recovery of interest payments made more than two years before the bringing of the action. Until the legislature abolishes or modifies the existing two year statute of limitations, the existing law seems a reasonable accommodation between conflicting policies.

B. Criminal Penalties

A lender who willfully receives interest or compensation in excess of the rate allowed by law is guilty of loan sharking.[277] Loan sharking is a felony, punishable by imprisonment for up to five years.[278] Thus, if the state can prove that a person willfully or intentionally made a loan exceeding the legal interest rate, and received that interest, that person is guilty of loan sharking.[279] The lender need not consciously intend to violate the usury law. The only intent that matters is the intent to make a loan at a usurious rate.[280]

However, not every loan that is made with a usurious interest rate leads to prosecution and conviction of loan sharking. It seems that any person who makes a loan at a usurious rate will meet the requisite criminal intent. It is difficult to imagine a lender recklessly or negligently making a usurious loan. The only reported case of loan sharking in California since the 1930's involved a real estate salesman.[281] The

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[277] *Id.* § 1916-3(b) (West 1985).

[278] *Id.*

[279] *In re* Washer, 200 Cal. 598, 254 P. 951 (1927).

[280] Golden State Lanes v. Fox, 232 Cal. App. 2d 135, 42 Cal. Rptr. 568 (1965).

[281] People v. Asuncion, 152 Cal. App. 3d 422, 199 Cal. Rptr. 514 (1984). Other cases reported since 1930 include People v. J.M. Adams & Co., 112 Cal. App. Supp. 769 (1931) (resulting in conviction of real estate broker that was affirmed); People v.

real estate salesman made a loan and received interest at an annual rate of 288%.[282] He was found guilty of loan sharking because, as a licensed real estate salesman, he did not fall under the licensed real estate brokers exemption.[283]

C. *Forfeiture of Principal*

Lenders licensed under the Industrial Loan Law, the Personal Property Brokers Law, or the Consumers Finance Lenders Law who make loans exceeding the legal interest rate forfeit the right to receive any principal, charges, or recompense in connection with the transaction; and the loan contract is void.[284] The provision that principal is forfeited by a violation of these laws sharply contrasts with the usual usury penalties. Normally, a finding of usury will not affect the lender's right to collect the loan principal, nor will it invalidate the entire loan contract.[285] Violation of these laws is a misdemeanor.[286]

VI. TRUTH-IN-LENDING ACT

Although it is beyond the scope of this Article, lenders must consider whether the Truth-in-Lending Act[287] applies to them.[288] Truth-in-

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Campbell, 110 Cal. App. Supp. 783 (1930) (reversing the conviction and ordering new trial). The extent of CAL. CIV. CODE § 1916-3(b)'s actual use cannot be determined because statistics on loan sharking are not recorded in the standard statistical compilations for the years of 1965 to the present. *See, e.g.*, Dep't of Justice, Div. of Law Enforcement, Criminal Identification and Information Branch, Bureau of Criminal Statistics and Special Servs., *Crime and Delinquency in California, 1984* (1984); U.S. Dep't of Justice, Bureau of Justice Statistics, *Sourcebook of Criminal Justice Statistics—1984* (1985).

[282] *Asuncion*, 152 Cal. App. 3d 422, 199 Cal. Rptr. 514.

[283] *Id.* at 426.

[284] CAL. FIN. CODE § 18,349 (West 1981) (industrial loan companies); *Id.* § 22,651 (personal property brokers); *Id.* § 24,651 (West Supp. 1987) (consumer finance lenders).

[285] Wolpert v. Gripton, 213 Cal. 474, 2 P.2d 767 (1931); Haines v. Commercial Mortgage Co., 200 Cal. 609, 254 P. 956 (1927).

[286] CAL. FIN. CODE § 18,435 (West 1981) (industrial loan companies); *Id.* § 22,653 (personal property brokers); *Id.* § 24,653 (West Supp. 1987) (consumer finance lenders).

[287] 15 U.S.C. §§ 1601-1666j (1982 & Supp. III 1985).

[288] For more detailed discussions of the Truth-in-Lending Act, see Abraham, *Some Rescission Problems in Truth-in-Lending*, 87 BANKING L.J. 867 (1970); Clontz, *The Evolution in Truth-in-Lending and Regulation Z*, 87 BANKING L.J. 963 (1970); Garwood, *Truth-in-Lending — Real Estate Transaction*, 87 BANKING L.J. 985 (1970); Griffith, *Recent Developments in the Effort to Simplify Truth-in-Lending: Caveat Via-*

lending law resembles usury law in two respects. First, the exceptions to its applicability are significant. Second, failure to comply with the truth-in-lending requirements can be costly to the lender.

The Truth-in-Lending Act's purpose is to "assure a meaningful disclosure of credit terms" and "to protect the consumer against inaccurate and unfair credit billing and credit card practices."[289] The Act applies to creditors who regularly extend consumer credit payable in more than four installments and to creditors who issue or honor credit cards.[290] It covers all forms of financing arrangements, loans, consumer leases,[291] and credit sales.[292]

The Act does not include (1) credit extensions primarily for business, commercial, or agricultural purposes;[293] (2) credit extensions primarily to government or governmental agencies;[294] (3) credit extensions primarily to organizations;[295] (4) transactions in securities or commodities by broker-dealers registered with the Securities and Exchange Commission;[296] (5) credit transactions, other than those secured by real property, or personal property used or expected to be used as the consumer's principal dwelling, in which the total amount financed exceeds

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tor, 56 CHI.-KENT L. REV. 893 (1980); Warren & Larmore, *Truth-in-Lending: Problems of Coverage*, 24 STAN. L. REV. 793 (1971-72).

[289] 15 U.S.C. § 1601 (1982); 12 C.F.R. § 226.1 (1986).

[290] 15 U.S.C. § 1602 (1982); 12 C.F.R. § 226.1(c) (1986).

[291] 15 U.S.C. §§ 1601, 1667-1667e (1982). "The term 'consumer lease' means a contract in the form of a lease or bailment for the use of personal property by a natural person for a period of time exceeding four months, and for a total contractual obligation not exceeding $25,000, primarily for personal, family, or household purposes . . . ." *Id.* § 1667(1).

[292] The term "credit sale" refers to any sale with respect to which credit is extended or arranged by the seller. The term includes any contract in the form of a bailment or lease if the bailee or lessee contracts to pay as compensation for use a sum substantially equivalent to or in excess of the aggregate value of the property . . . and it is agreed that bailee or lessee will become . . . the owner . . . .

Id. § 1602(g). However, the seller must qualify as a "creditor." Griffith, *supra* note 288, at 900. Thus, the credit sale must include a finance charge. 15 U.S.C. § 1602 (1982); 12 C.F.R. § 226.2 (1986). For a comparison with the usury law, see *supra* text accompanying notes 35-39.

[293] 15 U.S.C. § 1603 (1982); 12 C.F.R. § 226.3 (1986).

[294] *Id.*

[295] *Id.* "The term 'organization' means a corporation, government or governmental subdivision or agency, trust, estate, partnership, cooperative, or association." 15 U.S.C. § 1602(c) (1982).

[296] 15 U.S.C. § 1603(2) (1982); 12 C.F.R. § 226.3(d) (1986).

$25,000;[297] (6) charges for public utility services;[298] and (7) loans made, insured, or guaranteed pursuant to a program authorized by Title IV of the Higher Education Act of 1965.[299]

To effectuate the purpose of the Truth-in-Lending Act, Congress authorized the Board of Governors of the Federal Reserve System to prescribe regulations.[300] These regulations are known as "Regulation Z."[301] Regulation Z defines creditor duties and consumer rights, and provides model disclosure forms.

Creditors must make written disclosures before the credit transaction is made.[302] The creditor must disclose the finance charge as a dollar amount along with the corresponding annual percentage rate; all other related fees or charges that are or may be imposed; the amount financed; the payment schedule; the total amount financed and the finance charge; any repayment penalties; and any late payment charge.[303]

The consumer has a right to rescind any credit transaction secured by the consumer's principal dwelling until midnight of the third day following consummation and delivery of all material disclosures.[304] However, loans to acquire or construct real or personal property are exempt.[305] "All material disclosures" includes two copies of a notice to the consumer of the right to rescind.[306]

A creditor willfully and knowingly violating the Truth-in-Lending Act or Regulation Z is subject to fines of up to $5000, imprisonment up to one year, or both.[307] The Truth-in-Lending Act also provides civil remedies for consumers damaged by a creditor's failure to comply with the Act.[308] The damage award may include twice the amount of any

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[297] 15 U.S.C. § 1603(3) (1982); 12 C.F.R. § 226.3(b) (1986).

[298] 15 U.S.C. § 1603(4) (1982); 12 C.F.R. § 226.3(c) (1986).

[299] 15 U.S.C. § 1603(6) (1982); 12 C.F.R. § 226.3(f) (1986).

[300] 15 U.S.C. § 1604 (1982); 12 C.F.R. § 226.1(a) (1986).

[301] 12 C.F.R. §§ 226.1-.29 (1986).

[302] *Id.* §§ 226.6, 226.17.

[303] *Id.* In addition, open-end credit plans require a statement of billing rights and periodic disclosure statements. 12 C.F.R. §§ 226.6-226.7 (1986). Model disclosure forms for closed-end credit sales and loans are found in 12 C.F.R. § 226, app. H (1986).

[304] 12 C.F.R. §§ 226.15, 226.23 (1986).

[305] *Id.* §§ 226.15(f), 226.23(f); *see also* 12 C.F.R. pt. 226, supp. I (1986) (official staff interpretations).

[306] 12 C.F.R. §§ 226.15(b), 226.23(b) (1986).

[307] 15 U.S.C. § 1611 (1982).

[308] *Id.* § 1640. Section 1640 authorizes individual and class action suits.

finance charge in connection with the transaction.[309] However, a creditor will not be held liable if it can show by a preponderance of evidence that noncompliance resulted from a bona fide error notwithstanding the maintenance of procedures reasonably adapted to avoid any such error.[310]

The Truth-in-Lending Act preempts state law to the extent that state law conflicts with the Act.[311] The Act does not preempt state usury laws.[312] However, the Act directs that discounts offered by sellers to consumers for paying cash instead of using open-end credit plans or credit cards shall not be considered finance charges under the usury laws of any state.[313]

CONCLUSION

The California Constitution purports to establish maximum interest rates for loans. Most lenders, however, are either totally or partially exempt from these maximums. Among the few lenders not exempt is the individual or corporation making an occasional loan. Perhaps this class of lender lacks the political organization and strength to obtain an exemption. Perhaps the legislature properly fears that this type of lender is especially likely to charge unconscionable rates unless restrained. Whatever the explanation, it is clear that the current usury law does not seriously inconvenience most lenders and offers very little protection to most borrowers. The law in this area has a loud bark but rarely bites. However, its rare bite can be painful indeed. This may be good politics, but it makes for complex law.

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[309] *Id.* § 1640(2)(A)(i).
[310] *Id.* § 1640(c).
[311] *Id.* § 1666j.
[312] *Id.*
[313] *Id.* §§ 1666f, 1666j (1982 & Supp. III 1985).