A Federal Usury Law — Uniformity At Any Rate

As interest in new consumer protection measures has been increasing, the most ancient of consumer protection laws, the historic usury statutes, has continued to erode in the face of modern consumer and commercial needs.[1] In the past, American usury statutes have generally been within the exclusive jurisdiction of the states, but the evolution of the economy and the revolution in consumer credit buying have largely rendered continued state control, at least in the diverse fashion presently pervading the field, obsolete and illogical.[2] Uniform usury rates can be realized in two ways, uniform state action or federal legislation. Uniform state action has been pending for several years in the form of the Uniform Consumer Credit Code.[3] However,

[1]For a general history of usury in the United States *see, e.g.*, B. CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965); Bernstein, *Background of a Gray Area in Law: The Checkered Career of Usury*, 51 A.B.A.J. 846(1965); Horack, *A Survey of the General Usury Laws*, 8 LAW & CONTEMP. PROB. 36 (1941); F. RYAN, USURY AND USURY LAWS (1923).

[2]The scope of this article is limited to the exploration of the need for uniform usury laws, which, in the absence of uniform state action, must be realized through federal legislation. It is not a defense of usury laws and their resulting economic and social implications. The question of uniformity is also separate from that of the specific rate chosen. For an article attacking the economic justifications of usury *see*, Kawaja, *The Case Against Regulating Consumer Credit Charges*, 5 AM. BUS. L. J. 319(1967).

[3]National Conference of Commissioners on Uniform State Laws, UNIFORM CONSUMER CREDIT CODE (Official Text, Sept., 1968) [hereinafter cited as UCCC]. The rates for consumer credit sales and consumer credit loans are found in §§ 2.201 and 3.508 respectively. For various discussions of the UCCC *see*, Jordan & Warren, *The Uniform Consumer Credit Code: An Economist's View*, 54 CORNELL L. REV. 491 (1969); *Symposium, Consumer Credit Reform*, 44 N.Y.U.L. REV. 1 (1969); *Symposium, Consumer Credit Reform*, 33 LAW & CONTEMP. PROB. 639 (1968); *Symposium, Toward a Uniform Consumer Credit Code*, 23 J. FIN. 303(1968); *Symposium, The Uniform Consumer Credit Code*, 24 BUS. LAW. 183(1968).

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uncertainty of the future of the UCCC may ultimately leave the possibility of uniform usury laws in the hands of the federal government. Although a viable and general national usury law does not appear to be a present or impending likelihood, hints of possible federal action in the future make it necessary to explore the shortcomings of the present diverse system, the benefits of a federally imposed usury law, and the constitutional justification for such action.

I. PROBLEMS OF THE PRESENT DIVERSE USURY SCHEME

A. GENERAL EFFECTS OF USURY STATUTES

It is necessary to preface a discussion of the ramifications of the diversity in usury statutes caused by state control with a short statement about the most basic effects of usury laws in general. The most immediate and widely recognized effect of usury laws is to determine which potential borrowers will have access to the credit market.[4] Basically the theory is grounded in the assumption that if money is available to loan, the credit industry will lend at a rate which covers the fixed costs of the business and includes a profit margin commensurate with investments in other branches of the industry.[5] However, the cost of lending to different people, or more precisely the cost of lending to different classes of people, varies because of differences in the size of the loan, risk factors, and administrative and follow-up costs.[6] It would appear that there is a rate of return at which a lender can profitably loan money to nearly every person, but traditionally societies have set rigid interest rate ceilings.[7] When the cost of lending to certain classes of people exceeds the maximum rate allowable under the controlling statute, the lender is economically prohibited

[4]*See, e.g.*, Felsenfeld, *Consumer Interest Rates: A Public Learning Process*, 23 BUS. LAW. 931(1968); Kripke, *Consumer Credit Regulation: A Creditor-Oriented Viewpoint*, 68 COLUM. L. REV. 445 (1968); Johnson, *Regulation of Finance Charges on Consumer Instalment Credit*, 66 MICH. L. REV. 81(1967); Braucher, *Consumer Credit Reform: Rates, Profits and Competition*, 43 TEMP. L. Q. 313(1970).

[5]"But even if usury statutes applied to the entire money market from a geographical point of view, they would still be unable to control the market price for money unless the return on alternative forms of investment were also controlled." Shanks, *Practical Problems in the Application of Archaic Usury Statutes*, 53 VA. L. REV. 327, 329(1967).

[6]CHAPMAN & SHAY, THE CONSUMER FINANCE INDUSTRY, 22-24 (1967).

[7]Kawaja, *supra* note 2, at 321.

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from making the loan. Therefore, at least theoretically, the lower the statutory interest ceilings, the fewer high-risk borrowers which can be served by the industry. One recent study supports this conclusion.[8] The standards of credit-worthiness in Arkansas, which has one of the most restrictive interest rate ceiling schemes in the country, were found to be significantly higher than those of Illinois or of two states bordering Arkansas, Texas and Tennessee. For example, one of the strict standards imposed by the industry in Arkansas to exclude supposedly less credit-worthy customers was that the borrower have a telephone. This requirement was not found in the other states studied. Another example of the differences between states caused by disparate usury laws is found in the metropolitan area of Texarkana, one-half located in Texas governed by the more liberal Texas usury statute and other half located in Arkansas. Of the total of twenty-one loan companies in the area, twenty were located on the Texas side. From these examples, it appears that some people in Arkansas who otherwise could be served by the credit industry are denied access to it while people of like status and economic condition in other states are not so restricted.

An analysis of the credit industry also supports the proposition that low interest ceilings restrict credit market access to low risk borrowers. A study of the industry revealed that the profit margins of various companies lending within different exceptions to usury laws, thus permitted to charge higher rates of interest, and of companies lending in different states did not vary significantly.[9] In effect, the study found that higher ceilings did not result in excessive profits. "In short, companies adjust their costs to the rate ceilings in order to produce the level of profits received by the freely competitive capital markets for this type of business."[10] It would appear that because profits remain fairly constant as ceilings are raised, the difference in rates must be attributed to the increase in costs incurred by serving increased numbers of high-risk borrowers. The corollary of this proposition is that as the interest ceilings are lowered, fewer and less credit-worthy borrowers will be allowed to participate in the advantages of specific types of credit transactions.

Of course, this brief and didactic view of the effects of usury is much oversimplified. There are obviously many other factors that affect interest rates and determine which members of society will have access to the credit market. Some of these factors are: the cost

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[8]*An Empirical Study of the Arkansas Usury Law: "With Friends Like That . . .",* 1968 U. ILL. L. F. 544 [hereinafter cited as *Arkansas Study*].

[9]CHAPMAN & SHAY, *supra* note 6, at 85.

[10]*Id.* at 143.

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and availability of money to the lender, the number of lenders in the market and the resulting effects of possible competition,[11] creditor remedies for various types of breaches, the size of average loans (larger and longer term loans having significantly lower administrative costs), and the types of clientele served. But after these and other factors have been generally defined, the ultimate effect of the usury laws is to exclude certain people from the market. And obviously, with different states setting different limits, the groups excluded vary somewhat from state to state.

B. EXTENT OF DIVERSITY IN STATE USURY LAWS

The history of local control of usury statutes in the United States dates back to before the Revolution when each of the thirteen colonies enacted its own laws. The importance of the history of general usury laws is that the setting rates ceilings was left to the discretion of individual states. No single rate was adopted by all or even a majority of the states. As credit became increasingly important to the economy of the nation, the restrictive nature of the general usury laws required that exceptions be created especially for small loans with high administrative costs. At the prompting of the Russell Sage Foundation, many states adopted the Uniform Small Loan Act;[12] other statutory exceptions were also enacted and were supplemented with the common law exception of the time price doctrine. But these exceptions were neither uniformly accepted by all of the states nor were the rates adopted necessarily the same throughout the country. An example of the present number and diversity of possible exceptions can be found in California. The general usury law of the state is found in the California Constitution which sets an interest rate ceiling at ten per cent.[13] However, the constitutional provision specifically exempts banks, savings and loan associations, industrial loan banks, small loan companies, personal property brokers, pawnbrokers, and similar institutions. The statutory ceilings for these institutions are, except for banks and savings and loan associations which are not governed

[11]The free entry of creditors into the market is a much discussed area of consumer credit regulation. *See, e.g.*, Felsenfeld, *supra* note 4, at 940; Kawaja, *supra* note 2, at 333; Hubachek, ***Progress and Problems in Regulation of Consumer Credit***, 19 LAW & CONTEMP. PROB. 4, 17 (1954); CHAPMAN & SHAY, *supra* note 6, at 112.

[12]Hubachek, *supra* note 11, at 6.

[13]CAL. CONST. art. XX, § 22 (West 1964). For a discussion of the history of California interest rate ceilings *see*, ***California's Model Approach to Usury***, 18 STAN. L. REV. 1385, 1392 (1966).

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by any ceiling in the state, found in the California Financial Code.[14] In addition to the ceilings imposed on interest rates of direct loans, California also has a retail installment sales act which limits the permissible time-price differential in certain consumer transactions and an automobile sales act governing the credit sales of motor vehicles.[15] At the other end of the spectrum, Arkansas has but one interest rate ceiling and does not recognize the time price doctrine.[16]

The diversity of interest rate ceilings within some states is more than matched by the diversity of laws between the states. Forty-nine states have small loan laws, forty-one have laws regulating installment sales of motor vehicles, thirty-one have laws governing the credit sales of other consumer goods, and thirteen regulate revolving credit accounts.[17] A national consumer finance company lending in all of the states is faced with over seventy different statutes controlling loans and fifty more statutes if the company acquires installment sales contracts.[18] Now in addition to state laws, credit transactions may also be governed by the federal Consumer Credit Protection Act, which in part requires the disclosure of specific rate information and related facts surrounding certain loans.[19] Although the CCPA contains provisions allowing the return of disclosure regulation to states meeting Federal Reserve Board approval,[20] the myriad of state laws governing credit transactions were not invalidated by the CCPA and must be considered somewhat of a burden on the industry which is increasingly becoming a national enterprise operating across state lines.[21]

The diversity of interest rate ceilings throughout the country creates many collateral problems most important of which is limited credit shopping outside of overly-restrictive states. Such shopping, in a sense analogous to forum shopping, may be either a conscious or

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[14]For California laws governing Industrial Loan Companies, Pawnbrokers, Personal Property Brokers, and Small Loan Companies, *see*, CAL. FIN. CODE §§ 18000-18996, §§ 21000-21209, §§ 22000-22653, and §§ 24000-24651 (West 1954), respectively.

[15]Unruh Credit Sales Act, CAL. CIV. CODE §§ 1801 *et seq.;* Rees-Levering Motor Vehicle Sales and Finance Act, CAL. CIV. CODE §§ 2981 *et seq.* (West 1954).

[16]ARK. CONST. art. XIX, § 13 (1854). Hare v. General Contract Corporation, 229 Ark. 610, 249 S.W. 2d. 973 (1952).

[17]Proxmire, *Consumer Credit and the Law,* STUDENT L. J. 5, 6 (Sept. 1967).

[18]Felsenfeld, *Uniform, Uninformed and Unitary Law Regulating Consumer Credit,* 37 FORDHAM L. REV. 209, 212 (1968).

[19]Consumer Credit Protection Act, Pub. L. 90-321, 82 Stat. 146 [hereinafter cited as CCPA].

[20]15 U.S.C. § 1633 (Supp. V, 1970).

[21]Proxmire, *supra* note 17, at 11; Felsenfeld, *supra* note 18, at 228; Merriman & Hanks, *Revising State Usury Statutes in Light of a Tight Money Market,* 27 MD. L. REV. 1, 18 (1967).

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unknowing evasion of local usury laws. Examples of conscious evasion can be found in one of the studies previously mentioned. Residents of Arkansas living near the borders of states with more liberal usury statutes often seek and find credit in the adjacent states. This would explain in part the reason for the large number of loan companies on the Texas side of the border in the coterminous cities of Texarkana.[22] Although the out-of-state lenders were found to place geographical limits on the scope of their incursions into Arkansas, many residents near the borders of the state were able to obtain credit outside the state.[23] Another example of conscious evasion of local law is the advertising in pulp magazines by lenders who claim to deny credit to no one.[24] Often the lenders advertising in such magazines are located in states with liberal usury laws and are thereby able to extract very high interest charges. But there are also less knowing examples of borrowing from out-of-state lenders. Credit purchases made from foreign vendors would fit within this category including purchases made from many mail-order houses. Some purchases made within the state may even raise some problems. For example, purchases from drummers are made without knowledge of the domicile of his company. Moreover, contracts can easily be discounted in other states.[25] The extensive use of bank and other credit cards, though not generally used to evade local usury laws, can have that effect especially in the case of travelling credit card users, are further complicating the problem.[26]

C. CONFLICT OF LAWS PROBLEMS

Whenever people do business outside of the state of their residence, the possibility of conflict of laws problems immediately arises. Of course, the conflicts problem is as old as the country and one of the inherent disadvantages of a federal system having separate lawmaking bodies somewhat autonomous in their respective territories. But the issues have become increasingly complicated and numerous

[22] *Arkansas Study, supra* note 8, at 581.

[23] *Id.*, at 582.

[24] *Usury in the Conflict of Laws: The Doctrine of Lex Debitoris*, 55 CALIF. L. REV. 123, 124 (1967) [hereinafter cited as *Usury in Conflict of Laws*].

[25] Caplovitz demonstrates one of the possible problems in an example of a Puerto Rican, new to New York, who bought some pots and pans from a drummer and later discovered that he was required to make payments to a remote New Jersey bank. D. CAPLOVITZ, THE POOR PAY MORE 154 (1963).

[26] For the diversity in control of interest rates on credit cards see, Article, *Bank Credit Cards and Usury Laws*, this volume.

[27] *Usury in Conflict of Laws, supra* note 24, at 137.

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with the new mobility, technology, and communication within the country. The credit field is in no way immune from increasing conflicts problems. The technology and mobility arguments are often overstated in justifying incursions of the federal government into areas previously controlled by the states. But the new rapid credit rating services, quick telephone and mail service between lenders and borrowers in different states, and the fast and inexpensive transportation between states are important when there are gross disparities between the availability of credit in various states. The least that can be said about the problem in the credit field is that it cannot decrease in scope and "with the growing mobility of the population, the future of conflicts between laws of the states will inevitably increase in both frequency and complexity."[27]

The manner in which the conflicts problems arises can be seen in some of the transactions previously mentioned. The diversity of approaches to the conflict of usury law problems can be seen in passing to accent the variety of policies found among the states. In examining some of these policies, it should be kept in mind that even though the usury laws may be the controlling factor in a private party's choice of law, the availability and number of various creditor's remedies may also be an important factor.[28] Allowing the usury law of the most lenient state having significant contacts with the transaction to govern a specific loan is probably the most common policy.[29] A second policy, used in some states, makes the law of the state where payment is to be made controlling.[30] This can be viewed as one of the recent attempts of some states to protect their citizens[31] from the morally corrupt lenders of other states.[32] Thirdly, the conflicts issue may be clouded by a traditional policy accepted by many states that the parties may choose the law which they want to control a given transaction.[33] Thus, within limitations, the parties to a loan can avoid the usury laws of a particular jurisdiction by

[28]*See, e.g.*, California's Unruh Credit Sales Act, *supra* note 15, which prohibits deficiency judgments if the financed goods are repossessed.

[29]Fahs v. Martin, 224 F.2d 387, 397-98 (5th Cir. 1955).

[30]*Arkansas Study*, *supra* note 8, at 558.

[31]Felsenfeld, *supra* note 18, at 218.

[32]The moral and religious notions surrounding usury are perhaps the main reason for the continued application of such laws. The flavor of this moralism can be sampled in the following:

". . . [D]ebt—or at least voluntary debt—was a sin. Righteous people went to the money lenders only when forced to. The 'borrowing class' consisted for the most part of the destitute and the oppressed who, either from calamity of nature or ungodly foolishness, were driven to borrowing in order to save themselves, their families, and, as often as not, their farms. In this condition, they were at the mercy of the

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stipulating the place of execution as distinct from the place of performance.[34]

With the multitude of state laws governing interest rates, the differences of approach in saving conflict of usury laws situations is merely an added factor in a consumer's inevitable quandary about which rate ceiling will govern any, let alone a specific, transaction. "Largely because of the existing varieties of state law, not only among, but also within most individual states, there is no valid consumer folklore, or instinctive understanding, of what one's rights, benefits, and problems are in obtaining credit."[35] Comprehension and instinctive understanding of the law are obviously two important factors in a person's sense of justice, but each is exceptionally important in the usury area. In light of the fact that usury laws are often designed to be self-enforcing by creating civil causes of action against illegal lenders, understanding usury laws is necessary merely to enforce the law. Of course, uniformity could not completely fill the existing void but it might provide greater understanding or "folklore" about one's rights while developing a general sense of justice about interest rate ceilings in a modern commercial society. In that sense, uniformity can do much to increase respect for the law.[36]

D. SOME OF THE ECONOMIC EFFECTS OF DISCONFORMITY

Much like the conflict of laws problem is inherent in the federal scheme, the effects of diverse usury statutes on the credit markets of individual states is inherent in local control. Variations in usury statutes not only force borrowers to seek credit in states with higher ceilings but also force available money out of low-ceiling states into

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unscrupulous moneylender who dealt with them without conscience or compassion." Shanks, *supra* note 5, at 327.

"It seems to me that high interest rates are one of the social evils in this country. . . . Arkansas has been as oasis in this desert, and I say let's keep it that way." *Hearings Before the Arkansas Constitutional Revision Study Commission*, 129 (August 1967) quoted in *Arkansas Study*, *supra* note 8, at 585.

"But, largely because of political and religious overtones of the usury question, the desirability of repealing the general usury laws is hardly ever considered, although the distortive effects of these laws are so widely recognized." Kawaja, *supra* note 2, at 328.

[33]Seeman v. Philadelphia Warehouse Co., 274 U.S. 403, 407 (1927).

[34]*See* R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 378-466 (1971).

[35]Felsenfeld, *supra* note 18, at 223.

[36]*Id.* at 225.

states where possible profits are more equitable.[37] This effect of higher ceilings drawing more capital into the money market was observed in Arkansas where increased capital funding of the small loan companies was apparent during a short experiment with liberalized ceilings.[38] On the other hand, the combination of low interest rate ceilings and the shortage of capital funding result in the exclusion of some marginal borrowers as well as the failure or absence of many marginal credit companies.[39] This can be seen in Arkansas where there are few small loan companies. Thus the ultimate effect of low ceilings is not only to force funds into states which encourage lending but also to force money into states that encourage lending to a broader segment of the market.[40] And when the conditions within the money market change, the low-ceiling states would appear to be the first and ultimately the most dramatically affected. During the recent tight money situation, the cost for available capital drove interest rates to the point where they violated many state usury laws, and in many jurisdictions valid loans could be made only to corporate borrowers.[41] For example, loans for new homes could hardly be made within the statutory usury limit in Virginia.[42]

There is a general body of opinion in the consumer finance industry that interest rate ceilings must be raised in general because of decreasing profits in the industry.[43] But the need for higher interest rates in times of tight money is especially great due to the rising cost of money to the lending institutions. Within the industry, the small loan companies have traditionally paid a higher price for money than larger companies.[44] The larger loan companies have lower costs per loan than smaller companies because of the types of financing available, access to the market, and the term or length of loans made. These larger companies can rely on senior long-term issues and can

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[37]". . . [U]sury laws cannot limit the rate of interest when the economic laws of supply and demand dictate a higher rate. This is easy enough to see when there are money markets in nearby jurisdictions which are uncontrolled by a usury statute or where a maximum rate is so high that it does not conflict with the rate set by supply and demand. If the usury laws of one jurisdiction prevent the lending of money at the prevailing market rate for that particular kind of loan, money will simply go to another jurisdiction where this obstacle does not exist." Shanks, *supra* note 5, at 329.

[38]*Arkansas Study, supra* note 8, at 574.

[39]CHAPMAN & SHAY, *supra* note 6, at 145.

[40]*Id.*, at 152.

[41]Merriman & Hanks, *supra* note 21, at 12.

[42]Shanks, *supra* note 5, at 329.

[43]CHAPMAN & SHAY, *supra* note 6, at 161.

[44]*Id.* at 146.

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place a greater emphasis on commercial paper for their short-term financing.[45] On the other hand, the smaller companies often must rely on commercial banks, having a cheaper source of money, for much of their financing.[46] The banks can afford to lend to the small companies because the overall reliability of the companies, as opposed to the more marginal reliability of the clients of such companies, and because of the longer terms and larger amounts of the loans.[47] Thus, in tight money situations, small loan companies, relying heavily on other credit institutions for capital while traditionally setting interest rates at or near the maximum allowable by law, will be the first to be caught in the profit squeeze between rising costs and the statutory limit on interest. In most other businesses, when costs increase, the businessman will pass along the added overhead to the consumer or go out of business. But in the credit industry, price controls require the lender to either absorb a decrease in profits or alternatively decrease the possibility of defaults by limiting his customers to more credit-worthy clients thereby excluding a larger group from the market.[48] Of course, he can always choose to go out of business.

If the problems created by the lack of uniformity of usury laws are as pervasive and far reaching as they appear to be on the surface in light of the conflicts issue and the inherent discrimination of such laws, continued state control of interest rate ceilings would seem to be neither practical, logical, nor equitable. A rationalization for discriminating between people of like status but in different states must be grounded in something more substantial than the traditional claim of states' rights. Certain differences in laws are to be expected under the federal system but the compounding effects of usury make these laws almost unique. Not only do they drive people to markets in other states and drive money into or out of the state, but also such laws create conflicts problems which are compounded by the variety of ways states treat credit transactions. In the long run, if the states are to retain control, some rational justification for continued state control must be found which outweighs these difficulties.

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[45]*Id.* at 136. *See generally* Chapter V.

[46]*Id.* at 125.

[47]*Arkansas Study, supra* note 8, at 561.

[48]". . . [T]he lender will not lend unless the rate he receives exceeds the 'pure' rate by enough to cover the risk of defaults, voluntary and involuntary." R. LEKACHMAN, KEYNES' GENERAL THEORY 104 (1964).

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II. JUSTIFICATION FOR STATE CONTROL?

Any discussion of state as opposed to federal control will often revolve around the democratic right to participate in the decision making process. Because the states are more local and supposedly more accessible, they are assumed to be more democratic. In theory, such a conclusion may be self-evident, but in practice the nature of the area of concern is often important. Thus, a discussion of usury statutes must be prefaced with an understanding that the groups victimized by usury laws are often the groups excluded from influencing governmental decisions. By and large, those excluded from the credit market are the persons to whom the credit industry cannot lend money with a profitable return at a rate within that allowed by law. Such persons are usually the poor and marginal poor in society. This is important because these are the very people who historically have had little or no access to the governmental decision-making bodies and are often not effectively represented. If the purpose of usury laws is to protect the poor, they should at least have their interests represented especially when protection results in exclusion. In any event, it must be remembered that the democratic process might not be functioning properly at either the state or federal level when considering the victims of the disparities in present state law.

A. OPPOSITION TO THE CCPA

There was extensive opposition to the CCPA and to federal entry into the field of consumer credit regulation. To a certain extent, the same arguments against federal control of disclosure provisions can and probably would be employed to counter a federal usury law. The arguments of opponents of the CCPA center around the basic concept that consumer credit regulation is simply not a proper field for federal participation.[49] They point out that the major segment of the credit industry and of loans in general is small and local in its nature and operation[50] with the great mass of transactions taking place on the local level. These local problems are seen as being too diverse, numerous, and complex for a remote government to apply one rule to all of them.[51] This line of argument is concluded with the statement

[49]*Hearings on S. 1740 Before a Subcommittee of the Senate Committee on Banking and Currency*, 87th Cong. 2nd Sess., at 66 [hereinafter cited as *Hearings on S. 1740*].

[50]*Hearings on S. 750 Before a Subcommittee of the Senate Committee on Banking and Currency*, 88th Cong., 1st and 2nd Sess., at 1060 (1963) [hereinafter cited as *Hearings on S. 750*].

[51]*Hearings on S 1740, supra* note 49, at 66.

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that previous legislation had been exclusively state law and that the states were experienced and better able to deal with the problems.[52]

Whatever the force of these arguments may have been with respect to disclosure, they are less convincing with respect to usury. The local nature of the industry and of consumer transactions in general is weakening and national consumer finance systems are increasing.[53] But whether usury is the proper field for the federal government to control is ultimately a political decision. In making such a decision, the diversity, complexity, and multiplicity of credit transactions would not be of as much importance as in the fight against the CCPA for several reasons. First, a national usury law could be modelled after state laws which are largely self-enforcing thus placating those who fear the enlarging of the federal bureaucracy. Second, the federal government has already decided that such arguments were not sufficient to outweigh the national need for uniform rate disclosure. However, one of the sponsors of the CCPA favors state control of interest rate ceilings which implies that the theoretical justification for the shift in control from the state to the federal level with respect to usury laws is substantively different than the shift with respect to disclosure provisions.[54] Third, a major reason for the CCPA was the deceptive practices of the credit industry employed to evade the restrictive nature of state usury laws.[55] Thus, although the federal government was not attempting to set price controls, one of the goals of the CCPA was to prevent practices designed to evade restrictive state usury statutes. Rate disclosure, creditor competition, and usury laws, therefore, would appear to be intimately connected. The inference seems fairly strong that substantive justifications for the CCPA and a federal usury statute would not vary greatly. Even if a consumer credit transaction is viewed as small and local in nature, the discriminatory effects of usury laws goes far beyond a single transaction or groups of transactions. Disclosure, on the other hand, though designed to meet a national problem, would seem to have its most important function within groups of local transactions by requiring the statement of certain numerical figures and encouraging local competition. While there is continuing doubt as to the efficacy of disclosure in affecting consumer behavior, the certainty of the direct effect of a federal usury law on consumer credit transactions is obvious.

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[52]*Id.*

[53]Felsenfeld, *supra* note 18, at 228.

[54]Proxmire, *supra* note 17, at 11.

[55]*Hearings on S. 750, supra* note 50, at 4.

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B. TRADITIONAL ARGUMENTS FOR STATE CONTROL

In addition to the opposition to federal intervention into an area previously controlled by the states, other arguments have been tendered to support state control. Traditionally, people have looked to the states for control because the states were supposedly more responsive, better able to cope with sudden and unexpected changes, more concerned about pockets of economic hardship, better informed about fashions in creditor greed, and more capable of employing local procedure and enforcement.[56] Moreover, some of those people believe that the state is the most appropriate level of government in which to experiment with new approaches, that the states are more flexible, and that change when necessary is easier to accomplish at the state level.[57] But in the field of usury laws, the traditional arguments do not hold up; the flexibility and responsiveness, let alone experimentation, are often not in evidence. Even if they were, innovation short of uniform state action cannot alleviate the inequities inherent in state control of interest rate ceilings. Furthermore, in the field of consumer credit regulation, the initiative for certain types of consumer protection has already shifted to the federal level and away from state governments.[58]

The proponents of continued state control of consumer credit regulation counter federal intervention arguments by claiming that economic conditions vary throughout the country and that the states are more capable of determining local conditions and needs.[59] In effect, they would view the country as having fifty local economies, as opposed to one national economy, and would set interest rates according to local conditions. Economic conditions obviously do vary throughout the country as does the standard of living, capital wealth, and other important economic and social factors. Several responses can be made to such an argument. First, creditors have found the types of security and standards of credit-worthiness are essentially the same throughout the country.[60] Second, the states have not necessarily demonstrated the capacity or the desire to determine local needs and set interest rate ceilings accordingly. In fact, some states have demonstrated much intransigence in light of changing conditions. Third, the variations throughout the country of the cost of money

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[56]Felsenfeld, *Competing State and Federal Roles in Consumer Credit Law*, 45 N.Y.U.L. REV. 487, 509-511 (1970).

[57]*Id.*

[58]*Id.* at 487.

[59]Johnson, *supra* note 4, at 103.

[60]Felsenfeld, *supra* note 18, at 232.

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may be as much a reflection of added costs resulting from differences in regulations as evidence of natural variations in economic conditions.[61] Fourth, the geographical differences in the cost of money have long been recognized by the federal government as manifested in the power of individual federal reserve banks to set regional standards. However, the economic realities of a closely integrated national economy have resulted in the continuous use of a single national standard with little regional variation.[62] Fifth, perhaps the continued treatment of local credit transactions as being purely local in impact is one of the major factors in cost variations throughout the country. For example, Arkansas, basically a capital poor state, was able for a short time to attract capital to its money market by liberalizing its usury law for small loans.[63] When the experiment was terminated, the money conditions returned to their former condition. Thus there would appear to be a possibility that uniform ceilings might have the effect, merely by recognizing the nationally integrated economy, of more evenly distributing capital funding throughout the country.

Generally, much of the credit industry has opposed any federal regulation in the consumer credit field and preferred state and local control. This has led to many of the disparities and complexities of state law now present in the field as well as the demonstrable lack of understanding on the part of the consumer.[64] This preference is obviously not a desire for continued disparity but rather an interest tantamount to states' rights. One reason for the desire for local control is that many state administrators have credit industry backgrounds and are believed to see business needs more clearly than would a remote bureaucracy.[65] Uniformity, however, if proper considerations are given both to consumer needs and commercial realities would not necessarily be detrimental to the industry. Credit is increasingly a national enterprise operating across state lines and concerned with the laws of many states. On the surface, it would appear to be to the advantage of the national companies to have only one statute controlling, or at least have fewer than now dominate the field. In fact, there have been indications that the industry may be drifting away from its strong demand for state control.[66] Apparently, this drift has increased since the enactment of the CCPA

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[61]Kawaja, *supra* note 2, at 322.

[62]Approximately 96 per cent of the time the rediscount rate has been uniform. Merriman & Hanks, *supra* note 21, at 18.

[63]*Arkansas Study, supra* note 8, at 587.

[64]See, Article, *Impact of Truth in Lending in Automobile Financing*, this volume.

[65]Murphy, *Lawyers for the Poor View the UCCC*, 44 N.Y.U.L. Rev. 298, 323(1969).

[66]Felsenfeld, *supra* note 56, at 500.

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largely because the new federal law has not proved to be a burden but may even be beneficial.[67] It would be anomalous to justify future federal legislation imposing uniformity merely because of the possible benefit to the industry if the industry prefers state control. But a shift in power from the states to the federal government with respect to usury laws would not appear to infringe upon the changing interests of the credit industry.

C. INHERENT STATE INTEREST IN USURY LAWS

The foundations for state control of usury are also losing their power. The major foundation is the historic reliance on the states in the absence of federal control to enact usury laws. But this basis is being submerged by the evolution of the economy and increased federal action. The second foundation is more powerful. Supposedly there is a point at which interest rates become prohibitive and unconscionable resulting in economic injury to the community.[68] When the unconscionable rates cause too many of the borrowers to default on their debts and increased numbers of insolvencies, the state is said to have ample justification for determining at what point (i.e., rate) persons should no longer be allowed to borrow, thereby protecting the economic life of the community.[69] The corallary of this argument is that the state must assume the responsibility of providing necessities to its citizens who, as a result of the usury limit, can no longer obtain them on credit.[70] And when the state does in fact provide such necessities, it would seem to have adequate justification for determining the manner in which those assisted spend their money at least to the extent of preventing the recipients from mortgaging their future welfare payments.[71] Although these arguments still carry weight, the economy has become a national concern in which insolvencies, constitutionally under federal control, affect more than the local community. Furthermore, increased federal participation in the welfare programs of the states, especially in the areas of financing and setting standards, has given the federal government added interest in usury law regulation.

Ultimately the level of government chosen to impose usury laws is a reflection of how broadly "community" is defined. If the term is

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[67]*Id.*

[68]*Arkansas Study, supra* note 8, at 562.

[69]*Id.*

[70]*Id.* at 563.

[71]*Id.*

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given a restrictive meaning, the states is probably the more suitable level of government to judge the nature of the communities' needs and the protection required. On the other hand, if the impact of usury statutes ranges beyond state borders and if the economy is in fact a unitary system hamstrung by local control, federal control would be a more rational choice.

III. JUSTIFICATION FOR FEDERAL USURY LAW

The CCPA is a significant attempt to unify the field of consumer credit regulation while attempting to introduce new understanding and justice into the law. The federal government has often been reluctant to preempt areas previously within state dominion. The adoption of the CCPA was no exception. This was evident in the repeated failure of truth in lending during the early 1960's and the codification of a provision for return of disclosure regulation to the states.[72] In fact, one of the arguments employed to delay enactment of the CCPA was the request of the Commissioners of Uniform Laws that the UCCC should first be presented to the states before the federal government made its final determination that federal action was necessary.[73] Obviously, such a determination was finally made. With the new federal law, the national government effectively preempted part of the consumer credit regulation field leaving to the states continued control over interest rates, many contract provisions, industry practices, qualifications of lenders, and many other areas of regulation.

Federal experience with usury laws is very limited. There has been a federal usury statute governing national banks, savings and loan associations, and credit unions,[74] but this law was rendered partially ineffective by an early and strained court interpretation.[75] The only portion of that statute which continues to have much effect is that which limits the governed institutions to a charge of one percent above that allowable under state law for similar state governed institutions. The general sever percent limit is no longer of any effect.[76] The other federal experience with usury laws is found in the CCPA, and the applicable portion of that act is not even designed to be a

[72]15 U.S.C. § 1633 (Supp. V, 1970).

[73]*Hearings on S. 750, supra* note 49, at 1064.

[74]12 U.S.C. § 85 (1964).

[75]Daggs v. Phoenix National Bank, 177 U.S. 549 (1900).

[76]*Id.*

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viable usury law.[77] Instead, the Act sets an interest rate forty-five percent as presumptive evidence of an extortionate credit transaction which is made a federal crime.[78] Basically, these provisions were made to combat organized crime by aiding states in enforcing their own laws.[79]

A. FEDERAL RESPONSIBILITIES

The national importance of consumer credit is self-apparent. The two most important functions are financing the purchase of consumer goods and financing family emergencies, which enable people to cope with temporary financial difficulties.[80] Adequate financing of consumer goods is necessary to create and maintain a market which can sustain mass production, low unit costs, and prices within the average family budget.[81] Thus, limiting consumer credit obviously affects the production of goods. But the importance of consumer credit goes far beyond its economic impact. ". . . [M]uch of the indebtedness of workers and families is for the purchase of needed articles which are practical necessities under today's standard of living."[82] The sociology of the credit and usury issues is important when considering the groups excluded from the credit market, the poor and marginally poor. "If credit laws were such that the poorest of Americans could *never* hope to enjoy some of the luxuries of life, the resultant increase in helplessness, frustration and despair already existing among this segment of the population might lead to even greater social problems for the nation as a whole."[83] Thus the availability of consumer credit to the entire nation cannot be underestimated in importance.

On a more specific level, the federal government has the duty to protect the nation from the harmful effects of inflation and recession, to promote full employment, and to provide economic stability.[84]

[77]18 U.S.C. §§ 891 *et seq.* (Supp V, 1970).

[78]18 U.S.C. § 892 (Supp V, 1970).

[79]"Extortionate credit transactions are carried on to a substantial extent in interstate commerce and foreign commerce and through the means and instrumentalities of such commerce. Even where extortionate credit transactions are purely intrastate in character, they nevertheless directly affect interstate and foreign commerce." Pub. L. No. 90-321 § 201, 82 Stat. 159.

[80]Hubachek, *supra* note 11, at 28.

[81]*Id.*

[82]Statement of Secretary of Labor Goldberg, *Hearings on S. 1740, supra* note 49, at 139.

[83]Miller & Kopp, *Abuse of Consumer Credit—A View from the Bankruptcy Court,* 4 AM. BUS. L. J. 241, 248 (1966).

[84]Statement of Deputy Attorney General Katzenbach, *Hearings on S 1740, supra* note 49, at 113.

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Each can best be provided for at the national level. When the economy is viewed as a tightly integrated national marketing system in which consumer credit transactions perform a vital role, the federal government has the responsibility of controlling such transactions at least to the extent that its duties extend to the stabilization of the value of the money supply.[85] Rate disclosure, in part, was designed to curb the inflationary tendencies of the economy by introducing an added anti-cyclical factor into the consumer credit market.[86] When combined, all of the factors demonstrate the national importance of federal control of consumer credit. Congress has specifically recognized this importance not only by enacting the CCPA but also in two other provisions. Under the first of the two provisions, the President is given the power to instruct the Federal Reserve Board to control any credit transaction which may cause undue inflationary pressure and thereby be considered dangerous to the national economy.[87] Under the second, the Commission on Consumer Finance was created which may be a warning that more federal legislation is in the offing.[88]

Until further legislation is enacted or until the present power is employed, the federal regulation of interest rates must be found in the indirect powers exerted by the federal government over the credit market. One of the most important of these indirect powers is exercised by the Federal Reserve Board which has long been able to control the money supply by requiring an increase or allowing a decrease in the reserves which member banks must maintain.[89] The most immediate effect of this type of action is the determination of the supply of money and volume of a given bank's loanable funds. When banks are forced to allocate a larger portion of their funds to reserves, money otherwise available to loan companies and other borrowers is re-

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[85]*Id.*

[86]"The Congress finds that economic stabilization would be enhanced and the competition among the various financial institutions and other firms engaged in the extension of consumer credit would be strengthened by the informed use of credit. The informed use of credit results from an awareness of the cost thereof by consumers. It is the purpose of this Title to assure a meaningful disclosure of credit terms so that the consumer will be able to compare more readily the various credit terms available to him and avoid the uniformed use of credit." 15 U.S.C. § 1601 (Supp V, 1970).

[87]Federal Credit Control Act § 205, Pub. L. No. 91-151: 83 Stat. 371.

[88]Felsenfeld, *supra* note 18, at 229.

[89]This, of course, is not the only power of the Board but serves to demonstrate the point. Other powers include control of the rediscount rate, which may be more important, the power to buy government securities on the open market, and the power to refuse to lend to member banks using improvident credit policies. *See* Merriman & Hanks, *supra* note 21, at 4-5.

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duced and the resulting cost to the borrower is probably increased.[90] By this indirect pressure, the Federal Reserve Board act on one of its primary responsibilities, ". . . to regulate the availability and supply of credit in accordance with the overall needs of the economy.[91]

The national importance of consumer credit and the need for constant indirect federal control demonstrate the need for more direct and general control. The power of the government to effect its monetary policy is, in part, dependent upon the action of the states. For example, if the Board desires to slow the expansion of money, it may increase the reserve requirements for member banks, thus raising interest rates generally. However, the state usury laws put a ceiling on interest rates thereby limiting the effect of federal action. There are three general ramifications of the conflict between federal law and state policy. First, the raising of reserve requirements will, in state with low interest rate ceilings, have the effect of raising credit costs but without the escape valve of allowing higher interest rates. Therefore, it would appear that a larger segment of the population would necessarily be excluded from the credit market. Secondly, and perhaps most important, the effects of the general monetary policy will have different and disproportionate impacts upon different companies and upon different states because of the diversity of usury laws. Third, important measures must be taken by the loan companies when money is less available because of Board action or other forces within the market. Several necessary measures include the restricting of the volume of higher-risk loans, limiting total loans, restricting larger and longer term loans, and generally resorting to higher return investments.[92] Thus the conflict between state law and federal policy creates at least two problems: first, the federal policy is partially thwarted and, second, consumer options among different sources of credit are limited.

B. CONSTITUTIONAL GROUNDS

The constitutional justification for a viable and broad federal usury law does not suffer from a lack of constitutional provisions on which it might be based. Rather, constitutional difficulties are inherent in the fact that many credit transactions really are local in nature. The

[90]*Id.* at 4.

[91]Statement of William McChesney Martin, Jr., Chairman, Board of Governors, Federal Reserve System, ***Hearings on S 1740, supra*** note 49, at 32.

[92]NATIONAL CONSUMER FINANCE ASSOCIATION, THE CONSUMER FINANCE INDUSTRY 88 (1962).

commerce clause is obviously the most important of the constitutional grounds and will be discussed in some detail. However, there are other grounds which may prove equally important, especially if the local nature of some credit transactions render the commerce clause inapplicable. First, the bankruptcy powers of the federal government as used to justify the CCPA would apparently extend to a usury statute. Federal bankruptcy power might even be of added importance to the latter since such a law would have the effect of excluding some marginal borrowers from the market, thereby limiting their possible debts. In a recent case concerning the constitutionality of the extortionate credit transaction provisions of the CCPA,[93] the court said, "Furthermore, the statute dealing with collection of extensions of credit by extortionate means can be sustained as falling within Congress' power to make uniform laws concerning bankruptcy.[94]" There would seem to be no reason why such grounds would not be equally applicable to a federal usury law. Second, a federal law based on the economic health of the country might even be sustained under the general welfare powers of the federal government.[95] Third, the power of the federal government to control the supply and value of money, as well as full employment and economic stability, might also serve as justification for federal action.[96] On the face of the matter, it would appear that the federal government could justify a national usury law as part of a scheme to better effect the general monetary policy, to control inflation, and to limit the unnatural forces within the money market created by state control.

The most likely and most forceful grounds, however, are found in the constitutional power of the federal government to regulate interstate commerce. There is little doubt that the federal government could set a usury limit for companies operating in interstate commerce.[97] That situation would be analogous to federal regulation of insurance companies. Originally the Supreme Court allowed only state regulation[98] but later reversed its stand.[99]

> We may grant that a contract of insurance, considered as a thing apart from negotiation and execution, does not itself constitute interstate commerce. [Citations omitted] But it does not follow from this that the Court is powerless to examine the entire trans-

[93]18 U.S.C. §§ 891 *et seq.* (Supp V, 1970).

[94]United States v. Biancofiori, 422 F.2d. 584, 586 (7th Cir. 1970).

[95]Felsenfeld, *supra* note 18, at 229.

[96]Katzenbach, *Hearings on S. 1740, supra* note 49, at 114.

[97]*See,* Heart of Atlanta Motel, Inc. v. United States, 379 U.S. 241 (1964).

[98]Paul v. Virginia, 8 Wall. 168 (1848).

[99]United States v. South-Eastern Underwriter's Association, 322 U.S. 533 (1944).

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> action, of which that contract is but a part, in order to determine where there may be a chain of events which becomes interstate commerce.[100]
>
> But its [commerce clause] purpose is not confined to empowering Congress with the negative authority to legislate against state regulations of commerce deemed inimical to the national interest. The power granted Congress is a positive power.[101]

The major problem in sustaining a general federal usury law is extending it to purely intrastate transactions. Of course, if the federal government set a low interest rate ceiling on interstate transactions, the local companies might chose to lower their rates to remain competitive. On the other hand, if the federal government set high ceilings, the states might later be forced to comply so as not to discriminate against interstate transactions. The uncertainty is whether credit transactions would be considered interstate commerce. Even if they were not, the commerce clause could still be the controlling factor. "The availability of credit also has a direct and intimate effect upon the flow of interstate commerce."[102] The affectation doctrine would assume added importance.

> . . . [M]any of the more recent cases interpreting the commerce clause clearly demonstrate that Congress can regulate what might be considered local activities, if those activities in any substantial way affect interstate commerce.[103]

Another recent case in which part of the CCPA was challenged uses similar language.

> So long as a class of intrastate transactions considered as a whole has a substantial effect on interstate commerce, Congress can regulate a particular intrastate transaction in the class even though in that instance the effect on interstate commerce is minimal or non-existent.[104]
>
> The crucial question instead is whether there is a rational connection between the class of such intrastate activities, sensibly defined, and interstate commerce.[105]

Whatever of the reach of the commerce clause, the need to discuss its force with respect to a federal usury law may be made moot by a favorable holding on the CCPA. The two types of laws are similar in effect and in reach. Both have national importance and national im-

[100]*Id.* at 546.

[101]*Id.* at 551.

[102]Katzenbach, *Hearings on S. 1740, supra* note 49, at 115.

[103]United States v. Biancofiori, *supra* note 94, at 585.

[104]United States v. Perez, 426 F.2d. 1073, 1078 (2nd Cir. 1970) (appeal pending).

[105]*Id.* at 1078.

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pact yet both regulate matters which appear on their face to be purely local. In fact, disclosure may even have less national importance with respect to constitutional justification than would a federal usury law. Therefore, it would appear that if the disclosure provisions a lesser degree the criminal extortionate credit transaction are held constitutional, there would be little question that a national usury law could be upheld.

IV. CONCLUSION

If the economy of the nation and of each of its parts is to continue to grow, the indispensable need for consumer credit must also grow. Usury laws, which by their nature restrict credit in a questionably discriminatory manner, must be reexamined in light of modern conditions. When the intransigence and unresponsiveness of other states become detrimental to the national economy, perhaps a substantial shift of regulatory power is necessary for the general good. The failure of state control is best evidenced in the conclusion of an empirical study of Arkansas.

> All available evidence indicates that the Arkansas ten percent usury rate is doing more harm than good. People in Arkansas are being denied credit available elsewhere. The usury rate discourages risk capital for investment from entering Arkansas unless it is disguised in out-of-state contracts. The Arkansas usury provision generates a society of illegal lenders who must resort to deceptive devices to perform what most agree to be a valuable and necessary social function, that of making credit available to high risk borrowers. . . . [I]t clearly demonstrates that the present Arkansas ten percent usury rate is truly a malignant benefactor.[106]

The ultimate discriminatory social and economic effects are clear. But the question remains whether the nation will continue to be seen as a conglomerate of fifty or more separate economies or whether it will be seen as a single tightly integrated national economy. If the answer is the latter, a national usury rate would seem to be inevitable. Unfortunately, no matter how responsive some or most of the states may be to the changing economic conditions, anything short of uniform state action or a federally imposed standard will continue the inequitable and unjust nature of the present system of diverse control.

Scott L. Gassaway

[106]*Arkansas Study, supra* note 8, at 588.

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