

Debt and usury case usury assignment

Business



History and Background To begin my research, I wanted to get a clear understanding of just exactly what usury was and how it came about. The word usury is derived from both the Medieval Latin word *usura*, meaning “interest” or “excessive interest”, and from the Latin word *usura*, which simply means “interest”. At that point in time, the definition of usury meant the charging of interest on loans, but over time after the legislation of countries to limit the rate of interest on loans, the definition of usury came to mean the interest above the lawful rate.

As it stands today, usury would be found to mean the charging of unreasonable or relatively high rates of interest. The practice of usury can be traced back over four thousand years ago (Jain, 1929), and during its subsequent history it has been repeatedly condemned, prohibited, scorned and restricted, mainly on moral, ethical, religious and legal grounds. Among its most visible and vocal critics have been the religious institutions of Hinduism, Buddhism, Judaism, Islam and Christianity.

Other critics also included ancient Western philosophers and politicians, as well as various modern socio-economic reformers. In regards to the religious institutions of Hinduism and Buddhism, the oldest known references to usury were found in ancient Indian religious manuscripts (Jain, 1929). The earliest reference was found in the Vedic texts of Ancient India (2,000-1,400 BC) in which the word “usurer” was mentioned several times and interpreted as meaning “any lender at interest.” More frequent and detailed references to interest payment are to be found in the later Sutra texts (700-100 BC), as well as the Buddhist Jatakas (600-400 BC). It was during these times when the condemnation of usury was first expressed. Usury in Islam became well

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

known through the teachings in the Holy Quran[i] by the Prophet Mohammed, dating back to around 600 AD. The word they used for usury was riba which means “ excess or addition”.

This referred directly to interest on loans so that the prohibition of interest was a well established working principle integrated into the Islamic economic system and also what was described by a couple of Islamic economists as “ a gradual evolution of the institutions of interest-free financial enterprises across the world” (Choudhury and Malik, 1992). Usury in Judaism has its roots in several Biblical passages in which the taking of interest is either forbidden, discouraged or scorned. ii]?? The Hebrew word for interest is neshekh, which means “ a bite” and is believed to refer to the exaction of interest from the point of view of the debtor. In the Exodus and Leviticus texts of the Bible, neshekh applies only to lending to the poor and destitute, while in Deuteronomy, the prohibition of it is extended to include all money lending, excluding only business dealings with foreigners. Usury in Christianity was derived heavily from the usury in Judaism, however, a new reference to usury was introduced in the New Testament of the Bible. iii] Based on the texts in the New Testament, the Roman Catholic Church had by the fourth century AD prohibited the taking of interest by the clergy. In the eighth century under Charlemagne, they took it a step further and declared usury to be a general criminal offence. This movement continued to gain momentum during the early Middle Ages and perhaps reached its peak in 1311 when Pope Clement V made the ban on usury absolute and declared all secular legislation in its favor, null and void (Birnie, 1952).

Usury was denounced by a number of Ancient Western philosophers, including Plato, Aristotle, the two Catos, Cicero, Seneca and Plutarch. For instance, both Plato and Aristotle viewed usury as being immoral and unjust. Evidence that these sentiments found their concurrent manifestation in the civil law of that period can be seen, for example, from the Lex Genucia reforms in Republican Rome (340 BC) which outlawed interest altogether. (Birnie, 1958). There were a couple of notable modern reformists who also criticized usury.

Adam Smith, who was considered the “ Father of the Free-market Capitalism” and known for his general advocacy of laissez-fair economics, however, was strongly in support of controlling usury (Jadlow, 1977; Levy, 1987). While he didn't want to completely exclude interest, he was in favor of the imposition of an interest rate ceiling??(Smith, 1937). Another reformist was Silvio Gesell, a successful nineteenth century merchant in Germany and Argentina, who condemned interest on the basis that his sales were more often related to the pride of money than people's needs or the quality of his products??(Gesell, 1904).

His proposal of making money a public service subject to a use fee led to widespread experimentation in Austria, France, Germany, Spain Switzerland, and the United States under the banner of the so-called “ stamp script movement”, but these initiatives were all squashed when their success began to threaten the national banking monopolies (Kennedy, 1995). Usury Law Generally, usury law is used for the most part in the handling of consumer credit cases that involve the statutes and regulations which limit the charges that creditors may assess when extending credit to consumers.

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

There are many statutes and regulations which restrict credit charges. The oldest of these are referred to as general usury statutes which are established to set the maximum rate of interest that can be charged in any loan transaction in a jurisdiction. Then there are more recent statutes and regulations referred to as special usury laws, which are usually structured as exceptions to a general usury ceiling, and which govern interest charges only in connection with specified kinds of loans. Finally, there are numerous laws which regulate charges for credit, however, they are not necessarily called usury laws (Brown, 1987, p. 3).

General Usury Statutes The English usury statutes were adopted by the American colonies prior to U. S. independence. With very few exceptions, general usury laws were the only statutes regulating interest in the United States prior to the twentieth century and have had a major influence on modern credit regulation (Brown, 1987, p. 20)

Special Usury Statutes The structure of credit statutes in most states today primarily consists of special usury laws. Also today, the average credit transaction that is governed is by a special usury statute.

Each statute, when originally adopted or when subsequently amended, was aimed at problems associated with a particular type of creditor, a particular type of transaction, or some combination of these. Three common variety of special usury statutes are small loan laws, industrial loan laws, and installment loan laws, which I will further cover later (Brown, 1987, p. 21).

Laws Governing Loans Consumer credit as we think of it today did not exist, for practical purposes, prior to the twentieth century. Yet the vast majority of credit transactions were commercial.

The total amount of credit available in the nineteenth century United States was limited, and most of it was directed towards industrial development where the profits available were higher, and the risks lower, than for individual loans. Furthermore, demand for individual credit was lower than it is today. Not only was individual borrowing socially frowned upon, but the economy was not oriented toward the production of consumer durable goods. In the days before automobiles, televisions, radios, refrigerators, etc. , there was less for an individual to buy on credit (Brown, 1987, p 21).

This is not to say, of course, that individual Americans had no need to borrow for personal expenses prior to the twentieth century, or that there was no demand for goods, but the official credit system simply did not extend to the average wage-earner. Given interest ceilings under general usury statutes in the neighborhood of six percent, and the proportionately higher administrative expense in small personal loans than in large commercial loans, banks could make more money lending to businesses, and individuals in need of personal loans had to resort to loan sharks (Brown, 1987, p. 1).

The problem of loan sharking was pervasive in the nineteenth century,[iv] and both the financial plight of wage earners and their need for a legitimate source of credit was increasingly recognized. Attempts for reform were, especially at first, small-scale, informal, and uncoordinated but seemed to follow one of three basic strategies. First, cooperative societies were formed, generally following models pioneered in Europe, in which individuals pooled their money for their mutual benefit.

The earliest of these societies took the form of mutual savings banks which were organized under existing banking laws but which, catered to and were

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

owned by small depositors. As their name implies, however, mutual savings banks were primarily concerned with encouraging thrift rather than providing credit. Building and loan associations, on the other hand, were cooperative organizations established primarily to provide mortgage money to members.

Both of these institutions, which were the precursors of modern savings banks and savings and loan associations respectively, were widespread by the turn of the century, 35 A later model of the cooperative society, which did not emerge in the United States until the first decade of the twentieth century, was the credit union which, as did its predecessors, emphasized the pooling of resources, but which also required the existence of some common bond among the members, typically a common employer (Brown, 1987, p. 1). A second response to the loan shark problem was more strictly philanthropic. Organizations supported by donated funds made small loans at no charge except administrative expenses. Some employers apparently followed the same route. However, the money available through such organizations does not appear to have been sufficient to make much of a dent in the demand for small loans (Brown, 1987, p. 22).

The third and, chronologically, last strategy adopted to combat loan sharking was to attract credit, which had previously been extended to businesses, to the consumer credit market by making consumer lending a profitable prospect* While the philanthropic organizations and, at least in their early stages, the cooperative credit organizations had posed no challenge to the existing general usury laws, the essence of this third strategy was to create exceptions to the general usury law for small, unsecured loans and thereby to make them attractive investments for legitimate creditors.

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

The concept of making small loans available by increasing their yield is most clearly manifested in the small loan laws and the industrial bank laws, both of which were first adopted in the early twentieth century (Brown, 1987, p. 22). The small loan laws, pioneered by the Russell Sage Foundation[v] and the research that it supported, took a direct approach to attracting capital to the consumer market.

The Uniform Small Loan Law, the first draft of which was issued in 1916, created a licensed class of small loan lender which, in return for accepting regulation, the risk involved in personal lending, and the higher administrative expense of small loans, was authorized to charge rates significantly in excess of the general usury ceilings. For example, the fourth draft of the uniform law[vi] allowed the charging of 3 1/2 percent monthly on loans of \$300 or less. This rate was obviously much higher than the general usury ceiling, but was nevertheless vastly lower than the rates charged by the loan sharks (Brown, 1987, p. 2). The industrial banks, which were first organized under regular state banking laws early in the twentieth century, took a less direct approach to increasing the yields on consumer credit. [vii] These institutions accepted individual deposits and made loans secured by those deposits. Under a plan devised by Arthur Morris, loans were treated as repayable in a single lump sum at the end of the agreed term and interest was computed accordingly- However, the borrower was required to make regular “ deposits” in the bank which were calculated to equal the total amount of principal and interest due at the end of the term.

Essentially, the Morris Plan allowed industrial banks to increase yields by charging interest on sums the borrower had already repaid (i. e. by ignoring <https://assignbuster.com/debt-and-usury-case-usury-assignment/>

the declining principal balance on the loan). This device was really an evasion of existing general usury laws, rather than a clear-cut legal exception to them, but statutory exceptions to general usury laws in many states were adopted to validate the practice, and industrial banks came to serve a market of consumers seeking loans somewhat in excess of the \$300 limits set for small loan licensees (Brown, 1987, p. 22).

Carving out statutory exceptions to the general usury laws proved to be an effective means of expanding the amount of available consumer credit. Not surprisingly, it also proved to be a trend which, once started, was very difficult to limit. Although the development of the credit laws in each state was different, statutory usury exceptions were soon given not only to small loan lenders but also to industrial banks, as mentioned previously, to credit unions, to mortgage lenders such as the savings banks and building and loan associations, and eventually to banks^[viii] making installment loans to finance consumer purchases (Brown, 1987, p. 2). Laws Governing Sales

Since the effective interest rate (technically, the “time-price differential”) which a seller could impose in a credit sale was not limited by the general usury laws, there was no need to loosen the regulatory reins through special legislation as there was with loans. Consequently, the subject of consumer credit sales was largely unregulated by state legislatures until after the Second World War, and was governed instead by regular contract law (Brown, 1987, p. 23).

When the attention of state legislatures did turn to credit sales transactions, the motivation was significantly different from previous special usury laws; the idea was to tighten controls rather than to loosen them. ^[ix] The retail

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

installment sales acts (RISAs) and motor vehicle retail installment sales acts (MVRISAs) adopted after the war frequently imposed limits on finance charges where none had previously existed, and they universally emphasized consumer protections such as disclosure of credit terms and limitations on creditor remedies. x] There is, of course, a sense in which the special lending laws were also protective; they allowed regulated lenders to charge high rates so that small borrowers might be saved from the even greater ravages of the loan sharks. Moreover, many of the subjects treated by RISAs are also addressed by special lending statutes, which is not surprising because a credit sale is merely a secured loan in different legal clothing. For these reasons, this manual treats RISAs and MVRISAs as just a subclass of special usury law.

Yet, it is important to remember that the law has historically treated credit sales and loans distinctly, and these historical distinctions still occasionally crop up in modern consumer credit cases (Brown, 1987, p. 23). Small Loan Laws Small loan laws were first adopted in the early twentieth century as a response to the widespread problem of loan sharking, which is what the crime committed for lending money at usurious rates is referred to as. They were largely the product of the research and promotional efforts of the Russell Sage Foundation which, between 1916 and 1942, published seven drafts of a Uniform Small Loan Law.

This uniform law was widely adopted by the states and language from the uniform statute appears in numerous consumer finance statutes today even though these statutes may no longer be called small loan laws. Because small loan laws were based on a uniform statute, the terminology employed <https://assignbuster.com/debt-and-usury-case-usury-assignment/>

in the modern small loan and consumer finance statutes, of different states may be similar or identical (Brown, 1987, p. 31). The concept behind the small loan law was to drive the people engaging in loan sharking, also known as loan sharks, out of business by making it profitable for regular business enterprises to make small loans to individuals.

The uniform law created a class of licensed lender which, in return for compliance with the limitations of the statute on bookkeeping, security interests, and collection practices, were authorized to issue loans of less than \$300 at interest rates in the neighborhood of 3% or 3 1/2% per month. The uniform law strictly limited the charges or fees other than interest that a lender could assess, and provided harsh penalties, including loss of principal, for statutory violations (Brown, 1987, p. 31).

The original small loan laws have been substantially modified in many states. Most significantly, the size of the loan to which small loan laws or their successors may apply has been greatly increased, in some states to as much as \$25, 000. Other states have authorized discount or add-on interest calculation methods which were prohibited by the uniform law. Finally, small loan laws have sometimes been combined with industrial loan laws and other credit statutes, and have been renamed " consumer finance" laws (Brown, 1987, p. 31). Industrial Loan Laws

Industrial loan laws were first enacted to attract credit to a consumer market dominated by loan sharks, however, instead of simply raising interest rates for licensed lenders as the small loan laws did, the industrial loan laws raised yields on consumer loans by authorizing mathematical subterfuge. In

particular, industrial loan laws adopted what came to be known as “ Morris Plan” banking, under which a prospective borrower and a lender authorized to issue industrial loans would enter into supposedly separate loan and investment contracts.

The loan would be repayable in one lump sum at the end of an agreed term, and interest would be deducted in advance. Simultaneously, the borrower would make periodic deposits, pursuant to the investment agreement, which would total the amount of the lump sum when the loan came due. Industrial banks were thus authorized, in effect, to charge discount interest at the general usury ceiling. Separate service charges, apart from the stated interest, were also permitted by most industrial loan laws (Brown, 1987, p. 2). Industrial bank acts were adopted in only about half of the states. The development of industrial banks was limited by competition from small loan lenders and, especially in states which did not authorize industrial banks to accept demand deposits, commercial banks. Nevertheless, industrial banks became established in many states as consumer lenders could offer loans above the small loan limits (Brown, 1987, p. 32). Industrial loan act provisions differ among the states which recognize these transactions.

Many states abolished the dual loan and investment contracts, which originally characterized industrial loans, and instead authorized licensed industrial loan lenders to issue installment loans at a stated discount interest rate. Other states opened industrial lending terms to commercial banks and, often, allowed industrial banks to issue commercial loans under the standard banking provisions. Finally, a few states combined industrial loan and small

loan regulations into consumer finance acts which covered most, if not all, non-depository consumer lending (Brown, 1987, p. 32).

Installment Loan Laws Installment loan laws are a diverse collection of statutes which authorize banks, and frequently other lenders, to issue standard installment-payment loans at high interest rates. The idea behind most of these statutes seems to have been to put banks on an equal or comparable footing with small loan lenders, industrial banks, credit unions, or other lenders with statutory authority to lend at rates above the general usury ceiling. Thus installment loan laws have usually been constructed so that they apply to loans which these competing lenders might make.

Installment loan statutes also focus on interest calculation methods which might give competing lenders undue advantages. Although installment loan laws may be seen primarily as a special usury law for banks, in many states other lenders may invoke their terms as well. Typically, these other lenders will be savings and loan associations, mutual savings banks, or other state-regulated creditors which do not have their own special usury statute. Yet, in a few states, installment loan laws may be used by any lender to avoid the general usury ceiling, and they thus represent a very significant usury exception.

The general usury ceiling in these states would, however, still apply to otherwise unauthorized loans that did not satisfy any installment loan act requirements for equal periodic payments, rebates upon prepayment, disclosure, etc (Brown, 1987, p. 32). **Second Mortgage Laws** I wanted to include the information I came across on second mortgage laws because as

with usury and most of what I have found with my research, there could be a good case about usury today having played a key role in the current situation of the economy.

The most explosive consumer credit market in recent years has been the market for second mortgages on residential real estate. The growth in these loans has a number of causes: the increase in real property values and, consequently, in the amount of equity held by homeowners; the desire of finance companies to lower the risks associated with their loans by obtaining real estate collateral; and the deregulation of the mortgage market in the early 1980's. Regardless of the precise causes, second mortgages have become a minefield for unwary consumers. The risks take many forms.

Variable interest rates on many mortgages put the homeowner at the mercy of future market rate fluctuations. Nonamortizing mortgages with final balloon payments can prove difficult to pay off and can leave the borrower either in default or in perpetual debt. Credit cards associated with home equity lines of credit can lead to unnecessary borrowing, and the presence of real estate security can lead also to unnecessary lending to over-extended homeowners. Finally, the bottom line risk is always that a defaulting borrower may lose his or her home (Brown, 1987, p. 3). An increasing number of states have reacted to the second mortgage problems by adopting special usury laws which govern only second mortgages. These statutes frequently set interest ceilings for second mortgage loans, and many regulate the closing costs such as points and appraisal fees that may be charged to the borrower at the outset of a transaction. Nevertheless, the ability of states to regulate the structure of second mortgage loans has

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

largely been preempted by federal law (Brown, 1987, p. 33). Comprehensive Consumer Credit Codes

Several states have rewritten and consolidated all or parts of their various special usury statutes in the form of consumer credit codes. Among these jurisdictions are: Colorado, Idaho, Iowa, Indiana, Kansas, Maine, Oklahoma, South Carolina, Texas, Utah, Wisconsin, and Wyoming. The codes adopted by some of these states are unique to the adopting state. However, most of the jurisdictions which have enacted comprehensive consumer codes have adopted some form of the Uniform Consumer Credit Code (UCCC) (Brown, 1987, p. 34).

The UCCC is a model statute which has been approved by the National Conference of Commissioners on Uniform State Laws and the American Bar Association. Two basic versions of the UCCC exist. The original 1968 draft was funded and written predominantly by representatives of the consumer credit industry. It relied primarily on competition rather than rate ceilings to restrain excessive charges for credit, although the statute did contain ceilings which vary with the class of loan or credit involved. The adoption of this draft was opposed by many consumer groups on the ground that it contained insufficient consumer protections.

The 1968 draft has been adopted to varying degrees by seven states. As a response to the deficiencies of the UCCC, the National Consumer Law Center issued an alternative consumer credit code, the National Consumer Act in 1970. This statute and a subsequent abbreviated draft of the NCA, known as the Model Consumer Credit Act (MCCA), included significantly more

consumer protections than the 1968 UCCC. For example, among other changes, the NCA abolished the traditional distinctions between loans and credit sales, restricted security interests and credit insurance commissions, and addressed credit bureau abuses and deceptive trade practices.

The NCA was not adopted in its entirety by any state. Yet many states incorporated individual NCA provisions in their credit laws. In general, the NCA served as a counterpoint to the 1968 UCCC, and it significantly influenced the second draft of the UCCC which was issued in 1974. The 1974 draft went farther than its predecessor towards abolishing unnecessary distinctions among types of credit. It also improved the consumer protection of the 1968 draft and, accordingly, received much less industry support (Brown, 1987, p. 4). Usury Laws and the Federal Truth in Lending Act By the 1960's, many of the general and special usury laws were firmly in place, but the problem with many of those special usury statutes in particular was that in most states the credit terms employed by the different statutes were inconsistent, and that this inconsistency extended not only to the setting of interest railings, but to the most fundamental credit issues such as the definitions of principal, interest, and interest rate in a transaction.

Even for the same kind of transaction, different creditors might use different interest rate calculation methods. As a result, it was extremely difficult for a consumer to compare the credit terms being offered by different lenders or credit sellers. The situation encouraged deceptive and anti-competitive credit practices (Brown, 1987, p. 35). The Federal Truth in Lending Act (TILA) M was adopted in 1968 with the goal of providing a mandatory, uniform set

of consumer credit disclosures which a buyer or borrower could use to make an informed choice in the credit marketplace.

The primary mechanism by which the Act sought to achieve this goal was a standardized disclosure statement which creditors of consumer credit transactions are required to give a consumer before a transaction is carried out. Among other disclosures, this statement must contain the amount financed, the finance charge, and annual percentage rate (APR). All of these figures must be calculated according to detailed regulations set forth by the Federal Reserve Board (Brown, 1987, p. 35). The TILA did contain some consumer protections beyond its required disclosures.

Most importantly, the TILA gave a consumer a three-day period to rescind any transaction giving a creditor a security interest in his home, and this three-day period may be extended to as much as three years if disclosures are not properly made. Yet, at its core the TILA was and is a disclosure statute whose purpose is not to replace state law, but to provide a separate, standardized mechanism which a consumer can use to shop for credit. With some very limited exceptions related to the terminology which may be employed in credit contracts, the TILA does not preempt state usury laws.

It does not alter state usury ceilings, nor does it affect the way that interest rates are calculated for the purposes of state usury law. Indeed, many consumer credit contracts currently state two interest rates??? one on the contract or note which is calculated as required or permitted by state law, and one on the TILA disclosure statement which contains the APR and other disclosures as calculated under federal law. Thus the TILA and state usury

laws are best regarded as separate statutory schemes, and compliance with one in no way guarantees compliance with the other (Brown, 1987, p. 6).

Penalties for Usury Violations The penalties for violation of usury statutes vary among the statutes but can be quite severe. Small loan laws and some general usury statutes provide that the creditor loses all interest and principal on a usurious loan. Other statutes allow the creditor to recover the principal advanced, but deny recovery of any interest. Still other statutes combine an interest forfeiture with some penalty, such as an award to the debtor of twice the usurious charges paid.

At the very least, usury statutes compel lenders to credit debtor's accounts with the amount of any overcharge. Almost always, the debtor can recover attorneys' fees and costs incurred in challenging a usurious contract (Brown, 1987, p. 14). **Basic Issues in a Usury Case** Usury law is generally a matter of statutory interpretation, and because the typical state has several statutes regulating interest rates in particular kinds of transactions, the first issue in many usury cases is which statute applies.

Deciding whether a statute with a low interest ceiling or another statute with a higher ceiling should apply can, and often does, determine whether usury is present. Similarly, deciding whether a federal statute preempts the otherwise applicable state statute essentially can decide a whole case (Brown, 1987, p. 14). If the controlling usury statute is obvious, the next issue is whether it has been violated. The provisions of usury statutes vary, especially among modern consumer credit statutes which do much more than merely set interest ceilings.

However, centuries of case law interpreting the provisions of English and American general usury statutes have established that there are four elements which a borrower must prove to show usury in the average case: (1) a loan of money; (2) an absolute obligation to repay the principal of the loan; (3) an interest overcharge; and (4) the intent of the lender to assess the excess charges. These four elements can be restated as a set of questions which are the basis of most usury cases, and which any attorney considering a usury action should ask (Brown, 1987, p. 14).

The first question is does the transaction involve an extension of credit and, if so, what kind? Usury statutes have traditionally applied only to loans which are absolutely repayable, not to leases, not to investments in which repayment is contingent on the success of some enterprise, and not to sales of goods on credit, although modern installment sales acts obviously do cover sales credit. Creditors have often attempted to disguise loans as non-credit transactions to avoid usury ceilings, and the validity of such attempts is one focus of usury litigation (Brown, 1987, p. 5). The second question is what is interest? Not all payments to a creditor under a loan contract are interest subject to usury ceilings. Obviously, some payments are attributable to the repayment of principal. Yet, under most usury statutes, creditors may assess fees for the services of third parties, or even for services of the creditor itself, without those charges being treated as interest. The extent to which the exclusion of charges from interest is valid is another focal point of usury litigation (Brown, 1987, p. 15).

The third question is what rate of interest was charged, and did that rate exceed the statutory ceiling? The answer to this question requires that the

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

total interest charges under the contract have already been determined. Yet even once the principal and interest charges are known there are still several ways to calculate an interest rate. Many usury statutes state their interest ceilings in terms of simple interest rates, but others are stated as “ add-on” or “ discount” rates (Brown, 1987, p. 15). The fourth question is whether the lender intended to assess any overcharge which may exist?

Almost all usury statutes have been interpreted as requiring some showing of intent, but despite the frequency with which this issue is raised in usury litigation, it is usually not as difficult to establish intent as might be expected. In most states, the borrower need not show that the creditor intended to violate a usury statute, only that the creditor intended to charge what it did in fact charge. Since this intent is often presumed from the contract, the only serious issue sometimes raised by the intent requirement in usury statutes is whether the creditor can establish that an overcharge was imposed by honest mistake (Brown, 1987, p. 5). There are some issues which are not common to most usury cases but which should nevertheless always be considered in conjunction with usury. For example, many consumer credit statutes impose conditions other than interest limitations on credit contracts. They may set a maximum term for loans they cover; they may require equal monthly payments; they may prohibit specified kinds of charges; they may set disclosure requirements; they may require lenders to be licensed. Depending on the particular statute, the penalties for violation of such non-usury provisions may be the same as those for interest overcharges.

On the other hand, violations of these provisions may make the whole statute inapplicable to the transaction and thereby subject the creditor to a different statute with a lower interest ceiling (Brown, 1987, p. 15). Finally, an attorney in a usury case should not limit his or her attentions to usury issues. Other theories of recovery frequently apply to potentially usurious contracts. Some charges assessed by creditors may be unauthorized by contract and may constitute breach of contract. Proper disclosures may not have been made under the state or federal truth-in-lending statutes.

Frequently, price-gouging in credit contracts is susceptible to attack under statutes prohibiting unfair or deceptive practices in consumer transactions. Last, but not least, basic contract defenses such as failure of consideration may be appropriate in some cases which also involve usury (Brown, 1987, p. 15). Common Credit Overcharges There are a few common types of credit transactions, and a few situations which often arise in consumer credit transactions, for which a consumer advocate should keep an eye open, because they frequently involve the exploitation of unwary consumers.

These include rebates, credit insurance, and refinancing transactions.

Rebates The interest in many if not most consumer credit transactions is already precomputed. In other words, the total interest payable over the term of the contract is computed when the contract is filled out, and the consumer signs a promissory note obliging him or her to repay principal plus this precomputed interest amount. If the loan is paid off early, or if the borrower defaults and the lender accelerates the note, demanding full payment of the debt, the borrower has not had the use of the loaned money for the full anticipated term of the loan.

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

Most consumer credit statutes require the lender to credit the debtor's account with the amount that the debtor has, in effect, overpaid due to the shortened term of the loan. This credit is called a rebate. The failure to give any rebate, or the failure to calculate it properly, is a common usury violation that consumer's attorneys should check for whenever a precomputed credit agreement is, for some reason, terminated prematurely (Brown, 1987, p. 16). Credit Insurance Credit insurance is sold in conjunction with most consumer credit transactions.

It is sold by the creditor as an agent for an insurance company, and depending on the particular policy, the coverage guarantees that the insured debt will be repaid in the event of the borrower's death or disability or sometimes in the event of damage to the security which has been given by the debtor in connection with the credit transaction. The sale of credit insurance is one of the most widespread and generally unrecognized rip-offs in the entire field of consumer finance.

Much of the exploitation stems from the fact that credit insurance policies are almost invariably sold through creditors who, for their efforts, receive large percentage commissions which frequently exceed fifty percent of the premium of the policies sold. Thus creditors have a great incentive to sell consumers the most expensive available policies. Simultaneously, they are either in a position to require a prospective borrower to purchase the insurance in order to get a loan, or they are in a position to talk otherwise preoccupied and inexperienced borrowers into spending sums that are relatively small compared to the entire credit transaction. The result of these incentives is not only over-pricing and strong-arm tactics, but sales of <https://assignbuster.com/debt-and-usury-case-usury-assignment/>

duplicative policies to the same borrower, and sales to borrowers who do not qualify for the insurance and whose claims will be rejected if they are ever filed. (Brown, 1987, p. 16). Refinancing Transactions

A special kind of credit transaction in which creditors often exploit the inexperience of consumers is refinancing. A refinancing occurs when a borrower who already owes money to a creditor agrees to renegotiate the terms of the debt. Frequently this renegotiation takes place when the borrower has fallen behind in payments, and it takes the form of a new loan. The borrower signs a new promissory note for an amount which slightly exceeds the outstanding debt, including unpaid interest and late fees.

Most of the proceeds of the new note are used to pay off the old debt, and the borrower frequently gets a small cash payment. The new loan is generally more expensive than the old. Finance companies often buy outstanding credit contracts with relatively low interest rates and convince the debtor to refinance at a higher rate by offering a cash advance or lower monthly payments over a greatly extended loan term. Refinancing is deceptive.

A creditor emphasizes the lower monthly payments a borrower will obtain, never hinting that the total payments that the borrower will owe under the new contract may be double the previous debt. Also, the refinancing provides unscrupulous creditors with golden opportunities to overcharge borrowers, often by adding fees for deceitful services to the outstanding debt or by neglecting to give the borrower a proper rebate upon the prepayment of the old debt.

Finally, repeated refinancing tends to leave consumers in a state of perpetual debt, a condition which benefits nobody except the lender which receives the ongoing interest payments and profits. (Brown, 1987, p. 16).

Usury in Texas The usury law of Texas can currently be found in Subtitle 4 of the Texas Financial Code adopted in 1997. Unlike the law in most states where usury is strictly a statutory creature, Texas law addresses usury ceilings both by statute and by the Texas Constitution (Nicewander, 2005, p.). The Texas Constitution addresses the issue of usury as follows: “ The Legislature shall have authority to define interest and fix maximum rates of interest; provided, however, in the absence of legislation fixing maximum rates of interest all contracts for a greater rate of interest than ten per centum (10%) per annum shall be deemed usurious; provided, further, that in contracts where no rate of interest is agreed upon, the rate shall not exceed six per centum (6%) per annum. “[xi]

In reality, very few credit transactions are actively constrained by the constitutional interest rate limits of ten percent and six percent because state statute provides higher interest limits for most lenders and loans. Most usury laws are codified in Title Four of the Texas Finance Code, also called the Texas Credit Title. Consumer and commercial loan transactions are governed by separate credit law provisions in the Credit Title. Subtitle A typically applies to commercial loans, as well as consumer loans with interest not exceeding ten percent annually.

In general, Subtitle B regulates consumer loans with interest in excess of ten percent annually (Nicewander, 2005). Commercial Loans in Texas A commercial loan is defined as a loan made primarily for business,
<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

commercial, investment, agricultural, or similar purposes. [xii] Commercial loans are authorized by Chapter 306 of the Texas Finance Code. They are subject to a commercial usury ceiling of 18 percent annual interest, which may float with inflation to 24 percent (or 28 percent for loans exceeding \$250, 000). xiii] For specific types of large commercial loans, called qualified commercial loans, Texas statute allows for equity participation in addition to the allowable interest rate. Equity participation agreements occur typically with small business loans and allow an interest rate under the legal limit plus a specified percentage of profits from the transaction the loan finances. In these agreements, the lender subjects part of his return to the future profits of the venture.

Equity participation agreements are seen as a viable way to encourage business investment and strengthen the economy especially during times of inflation (Hackerman, 1970). Texas statute defines qualified commercial loans as loan transactions valued at or exceeding \$250, 000 if non-real estate secured or three million dollars if secured by real estate. [xiv] The statute was written in 1997 in response to an ambiguity in law as to whether equity participation was considered interest and thus subject to usury determinations.

Equity participation contracts were being successfully employed to procure a return greater than otherwise allowed by law prior to 1997, however, the agreements had to be carefully constructed in such a way to avoid usury taint, and even then still contained a small element of Risk (Hackerman, 1970). The statutory definition of interest in Texas is broad, covering all

compensation for the use, forbearance, or detention of money. [xv] This is true both for commercial and consumer loans.

Penalties for Subtitle A violations apply to a contract for, charge, or receipt of usurious interest. The basic penalty formula is the greater of either three times the amount computed by subtracting the amount of allowable interest from the total amount of interest, or the lesser of two thousand dollars or 20 percent of the principal. [xvi] If the interest on a Subtitle A loan is charged and received in excess of twice the allowable amount, additional liability is assessed.

This additional amount is forfeiture of principal along with all interest and other amounts charged and received. [xvii] Subtitle A penalties for commercial loan violations are civil penalties. Creditors subject to Subtitle A have the opportunity to correct or cure violations under certain circumstances. [xviii] Texas is one of very few states that regulates interest rates for commercial loans among sophisticated parties. Most states have no effective commercial usury laws for large commercial loans. Only five other states cap interest rates for these loans.

Of those states that do cap large commercial transaction interest rates, Florida and Colorado have a cap of 45 percent; Arkansas commercial usury laws are similar to those in Texas, however Arkansas commercial usury laws have been effectively federally preempted through provisions of the Gramm-Leach-Bliley Act, also known as the Financial Service Modernization Act, enacted in November 1999 (Nicewander, 2005). Consumer Loans The Texas Finance Code has a relatively complicated system of determining maximum

allowable interest rates for various consumer loan products in Subtitle B. For consumer loans to exceed the constitutional interest ceiling of ten percent, they must comply with licensing or registration requirements. Lenders must follow regulations for permissible interest rates, specific fees and charges that maybe assessed, insurance rules, consumer protection practices and disclosures, and late charge requirements. (Nicewander, 2005). Civil penalties for violating consumer loan provisions of Subtitle B are prescribed in Chapter 349 of the Finance Code, along with criminal misdemeanor penalties for certain violations.

Contract for, charge, or receipt of interest in violation of Subtitle B results in a basic penalty of twice the amount of interest and attorney's fees.

Additional penalties exist for excessive charges other than interest or time price differentials, for charging twice the allowable interest rate, and for certain non-interest related violations. Subtitle B violations can be corrected by creditors under limited circumstances (Nicewander, 2005). Recent Usury Court Cases in Texas I ended my research with trying to find recent court cases involving usury law particularly here in Texas.

I was able to find one recent case here that took place in 2005. This case dealt with the issue of the Texas Finance Code providing creditors with a chance to cure an alleged usury violation. [xix] In *Sotelo v. Interstate Financial Corporation (IFC)*, borrower (" Sotelo") who executed a deed of trust giving a creditor (" IFC") a lien on real property brought an action against IFC, following a foreclosure sale of the property, asserting claims of wrongful foreclosure and usury. On January 10, 2005, the trial court abated the case to allow Sotelo to send IFC notice of her usury claim.

<https://assignbuster.com/debt-and-usury-case-usury-assignment/>

Upon receipt of Sotelo's notice, IFC's counsel sent Sotelo a reply on February 16, 2005 releasing her from all obligations, except the amount of principal which was her own individual obligation. As such, IFC moved for summary judgment on the grounds that it corrected any usury violation by releasing and discharging Sotelo's liability by responding to her notice. The trial court granted IFC's summary judgment. Sotelo appealed claiming that summary judgment was not proper because IFC's correction was not timely under Texas Finance Code Section 305. 03, which states that a creditor will not be held liable if a violation is corrected not later than the 60th day after the date the creditor actually discovered the violation. Further, Sotelo argued that IFC had actual knowledge of the usury claim on March 17, 2004 when she filed her first amended petition, but that IFC did not give her notice of its intent to correct the violation until December 22, 2004, more than nine months later. In response, IFC argued that Sections 305. 006(b) and (c) of the Texas Finance Code provide an alternative method for a creditor to correct a violation and avoid liability.

Sections 305. 006(b) and (c) of the Texas Finance Code provide a creditor sixty days " beginning on the date the notice is received" in which to effect a correction. The Legislature's goal in enacting these provisions was to encourage creditors to amend usurious contracts in the borrower's favor. The Court stated that it was unpersuaded by Sotelo's argument that since IFC acquired knowledge of her contentions regarding the usury cause of action at the time she filed her first amended petition, the correction letters were untimely under section 305. 03, because it ignores the Legislature's intention under section 305. 006 of providing a safe harbor method for

correction before a debtor files suit. Sotelo failed to send IFC notice of her usury claim before she filed her first amended petition. Further, the Court concluded that if a claimant can maintain an action by abating the case and sending the required notice after the suit has been filed, there is no reason why the abatement and subsequent notice should not also give the creditor an opportunity to use section 305. 06(c) to correct the violations. Here, IFC made its correction on February 16, 2005 which was less than sixty days after Sotelo sent her notice under section 305. 006(b). IFC proved its statutory defense to usury and therefore, the trial court did not err by granting summary judgment on Sotelo's usury claim. So basically from this court case, the lesson to be learned about Texas usury law is that the Texas Finance Code provides creditors a 60-day window to correct or cure any alleged usury violation and avoid liability to borrowers on a usury claim.

Conclusion In conclusion, I think it's fair to say that just for about the majority of the areas of the laws, usury is definitely one of the areas that is very complicated and can be confusing. Transactions that a person would not consider to be affected by usury often are, for example, repurchase agreements, or sales with an option to repurchase are often found to be loans. Before trying to lend someone money or invest with a guaranteed return, I think it would be very beneficial to see an attorney to make sure not to run afoul of the usury laws.

Also, in closing, as I mentioned before, based on my understanding of usury now, I think it could be easily argued by many that at the brink of the this financial crisis, people engaging in usurious acts could have a lot of blame for the way things are. The reason being is that at the heart of this crisis I <https://assignbuster.com/debt-and-usury-case-usury-assignment/>

think is the issue of lending money to people whose credit history and ability to repay such a loan that they receive was very doubtful. Historically, Americans were supported by a large number of institutions that encouraged savings and cautious spending.

It used to be where if you wanted to buy a house, you had to first accumulate savings, apply to a local lender, document your creditworthiness, subject yourself to the bank's scrutiny, and usually make a down payment. Instead, now the market is now flooded with institutions who prey on the naive, desperate, and irresponsible. As I think I will continue to gain an understanding of usury and how it has evolved but yet changing over the years, I'm interested to see how it will maybe possibly play into the economy in the very near future.