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## Protection Afforded the Borrower by the California Usury Law—An Interpretation of Recent Cases

The California Usury Law, meant "to protect the individual necessitous borrower from the rapacity of the more fortunate lender,"<sup>1</sup> was enacted in 1919.<sup>2</sup> An analysis of the subject of usury in California, published in the REVIEW four years ago, dealt with cases decided prior to 1928.<sup>3</sup> Since then, many questions, formerly unanswered, have been settled by decisions which have helped to make more certain the actual effect and application of the Usury Law. This paper concerns itself with an examination of these recent decisions to determine whether the so-called "poorly drafted act"<sup>4</sup> has proved effective in furnishing the borrower with adequate protection against the oppression occasioned by lenders who would exact exorbitant rates for the use of money.

Usury laws are applicable solely to loans or forbearances of money,<sup>5</sup> and certain other elements are indispensable.<sup>6</sup> The absence of some one of these elements in many cases has led to undesirable results similar to those against which the Usury Law is aimed. Also, there have followed multitudinous devices attempting to evade the penalties and restrictions of the law.<sup>7</sup> These unfortunate consequences are to be explained by the nature and history of usury laws and conditions leading to their enactment.<sup>8</sup>

<sup>1</sup> *In re Washer* (1927) 200 Cal. 598, 606, 254 Pac. 951, 955.

<sup>2</sup> Cal. Stats. 1919, lxxxiii.

<sup>3</sup> Coffin, *Usury in California* (1928) 16 CALIF. L. REV. 281, 387.

<sup>4</sup> *In re Washer*, *supra* note 1.

<sup>5</sup> *Verbeck v. Clymer* (1927) 202 Cal. 557, 261 Pac. 1017; (1927) 1 So. CALIF. REV. 304; WEBB, LAW OF USURY (1899) §§19-23; 27 R. C. L. 213, 215.

<sup>6</sup> The elements generally said to be essential in order that a transaction be usurious are: (1) a loan or forbearance of money; (2) an understanding that the principal shall be or may be returned; (3) that for such a loan a greater profit than authorized by law shall be paid or agreed to be paid; (4) that the transaction be entered into with the intent to violate the law. *Planters National Bank of Virginia v. Wysong & Miles Co.* (1919) 177 N. C. 380, 99 S. E. 199, 12 A. L. R. 1412. WEBB, LAW OF USURY (1899) §18; 39 Cyc. 918 (claiming the principal absolutely, not contingently, must be repaid).

<sup>7</sup> See, as an example, *Jones v. Dickerman* (1931) 65 Cal. App. Dec. 810, 300 Pac. 135.

<sup>8</sup> WEBB, LAW OF USURY (1899) §§1-17; RYAN, USURY AND USURY LAWS (1904) 37-85.

## I. SALES ON CREDIT

If the transaction is a sale the buyer on credit receives no protection from usury laws. It is well settled that a vendor may name any price he wishes as the credit price, and as long as the sale is *bona fide* the courts will not interfere.<sup>9</sup> Several cases in California have held that there is no usury in a conditional sale contract although the credit price exceeds the cash price by more than the permitted rate of interest on a loan.<sup>10</sup> Yet, where the total purchase price has been agreed upon, a subsequent transaction with the seller at excessive rates for the unpaid balance under a conditional sale contract offends the statute as a contract for the forbearance of money, in the absence of a further consideration to the buyer.<sup>11</sup> It becomes important, therefore, to determine whether the transaction is a *bona fide* sale or simply a means of evading the restrictions imposed upon loans and forbearances. Wisely, the courts have not limited themselves to an examination of the form of the transaction, but look to its substance as well.<sup>12</sup> The intention of the parties becomes significant in this investigation, and the circumstances surrounding the case are considered to discover that intention.<sup>13</sup>

Intent is material not only in determining the nature of the transaction, but also in finding whether the contract expresses the real agreement of the parties, and whether a so-called charge was in fact merely additional profit on the loan or forbearance.<sup>14</sup> But intent to do

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<sup>9</sup> Blackmore Investment Co. v. Johnson (C. C. A. 9th, 1929) 32 F. (2d) 433; Lagorio v. Yerxa (1929) 96 Cal. App. 111, 273 Pac. 856; Lamb v. Herndon (1929) 97 Cal. App. 193, 275 Pac. 503; see Baker v. Butcher (1930) 106 Cal. App. 358, 289 Pac. 236; 39 Cyc. 926, n. 86; WEBB, LAW OF USURY (1899) §§63-74; cases *infra* note 10; cf. McCarthy v. Mellinkoff (1931) 67 Cal. App. Dec. 534, 4 P. (2d) 595 (holding that it was not a usurious transaction where an amount equivalent to the remaining interest was charged the plaintiff who desired to pay the unpaid balance before its due date).

<sup>10</sup> Verheck v. Clymer (1927) 202 Cal. 557, 261 Pac. 1017; Wilson v. J. E. French Co. (1931) 82 Cal. Dec. 599, 4 P. (2d) 537; Berger v. Lodge (1928) 90 Cal. App. 19, 265 Pac. 515; Pacific Finance Corp. v. Lauman (1928) 95 Cal. App. 541, 273 Pac. 48; Ricker v. Fay Securities Co. (1931) 110 Cal. App. 750, 294 Pac. 732; (1929) 2 So. CALIF. REV. 502; cf. Blodgett v. Rheinschild (1922) 56 Cal. App. 728, 206 Pac. 674.

<sup>11</sup> San Joaquin Finance Corp. v. Allen (1929) 102 Cal. App. 400, 283 Pac. 117.

<sup>12</sup> Wallace v. Zinman (1927) 200 Cal. 585, 254 Pac. 946, 62 A.L.R. 1341; Terry Trading Corp. v. Barsky (1930) 210 Cal. 428, 292 Pac. 474; Connor v. Minier (1930) 109 Cal. App. 770, 288 Pac. 23; Smith v. Cavaglier Mortgage Co. (1931) 64 Cal. App. Dec. 195, 295 Pac. 366; Jones v. Dickerman, *supra* note 7; Wood v. Angeles Mesa Land Co. (1932) 68 Cal. App. Dec. 506, 7 P. (2d) 748.

<sup>13</sup> Terry Trading Corp. v. Barsky, *supra* note 12; Coley v. Wolcott (1930) 103 Cal. App. 140, 284 Pac. 241; Jones v. Dickerman, *supra* note 7; see Baker v. Butcher, *supra* note 9.

<sup>14</sup> Terry Trading Corp. v. Barsky, *supra* note 12; Jameson v. Warren (1928) 91 Cal. App. 590, 267 Pac. 372; Van Noy v. Goldberg (1929) 98 Cal. App. 604, 277 Pac. 538; Davis v. Westphal (1929) 102 Cal. App. 148, 282 Pac. 800; Graybeal

what was actually done should not be confused with intent to violate the law.

## II. INTENT TO VIOLATE THE LAW

A corrupt intent to violate the law has been listed many times as an element which must be present before a contract is usurious.<sup>15</sup> But it is said that an intent to violate the law may be implied when all the other elements of usury are present.<sup>16</sup> That is, if the true intent of the parties is to do what actually has been done, ignorance of the fact that it is forbidden by the usury law is of no avail.<sup>17</sup> The meaning is, then, that an intent to violate the law is unnecessary; to say that an intent is necessary, but that it is implied is raising a criterion merely to destroy it. In accordance with the general rule, *Martin v. Kuchler*<sup>18</sup> decided that lack of an intent to violate the law was immaterial. The action was to recover treble damages and enjoin foreclosure of a deed of trust securing a promissory note which called for payment in advance of the maximum rate of interest. Neither party was aware that the provision for payment in advance of the maximum rate was in contravention of the Usury Law. The court considered that the act would have been practically nullified by permitting evidence of lack of an intent to violate it, when the instrument was clearly usurious on its face. *Lamb v. Herndon*<sup>19</sup> was distinguished, for the intent considered there was not the intent to violate the law. A provision of the Code of Civil Procedure,<sup>20</sup>

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Co. v. Cook (1931) 64 Cal. App. Dec. 463, 295 Pac. 1088; (1928) 2 So. CALIF. REV. 195; see Coffin, *op. cit. supra* note 3, at 416; DEXTER, SECCOMBE, BLEDSOE, CALIFORNIA USURY LAW (1930) 15.

<sup>15</sup> *Supra* note 6.

<sup>16</sup> *Planters' National Bank of Virginia v. Wysong & Miles Co.*, *supra* note 6; *Burdon v. Unrath* (1926) 47 R. I. 227, 132 Atl. 728; *Washington Fire Insurance Co. v. Maple Valley Lumber Co.* (1914) 77 Wash. 686, 138 Pac. 553; see *Jupiter Finance Corp. v. Hess* (1930) 157 Wash. 29, 288 Pac. 226.

<sup>17</sup> "Innocent ignorance is just as fatal to their contract as conscious wrongdoing." 39 Cyc. 920. "The voluntary taking or reservation of more than the legal rate of interest is *per se* usurious, and the offense is not condoned by a want of intent to violate the law." 27 R. C. L. 222. See *New England Mortgage Security Co. v. Gay* (C. C. S. D. Ga., 1888) 33 Fed. 636; *Fiedler v. Darrin* (1872) 50 N. Y. 437; PAGE, *THE LAW OF CONTRACTS* (2d ed. 1920) §966 and cases cited; *Notes* (1890) 9 L. R. A. 292; (1910) 23 L. R. A. (N.S.) 391. On the other hand, obviously, the intent to violate the Usury Law is not alone sufficient to make the contract usurious. *Low v. Sutherlin, Barry & Co.* (C. C. A. 9th, 1929) 35 F. (2d) 443.

<sup>18</sup> (1931) 81 Cal. Dec. 778, 299 Pac. 52, *rev'd* (1930) 62 Cal. App. Dec. 1325, 290 Pac. 892. See also the recent case of *Wood v. Angeles Mesa Land Co.*, *supra* note 12, affirming the rule of *Martin v. Kuchler*.

<sup>19</sup> (1929) 97 Cal. App. 193, 275 Pac. 503. The question here arose whether the transaction was a loan or forbearance to which the Usury Law applied, and the court in holding that there was no loan of money, but only an agreement for the payment of services, said that a corrupt intent is one of the necessary elements of usury.

<sup>20</sup> Section 1962 is labelled, "Specification of Conclusive Presumptions," and reads, in part: "1. A malicious and guilty intent, from the deliberate commission of an unlawful act, for the purpose of injuring another."

to the effect that a malicious and guilty intent is conclusively presumed from the deliberate commission of an unlawful act for the purpose of injuring another was relied upon in the *Martin* case. It has been argued that, since an offense against the Usury Law is a crime,<sup>21</sup> to hold the defendant guilty of a violation of that law would be to make a criminal of one who had no intent to do any wrong whatever. But it hardly need be recalled that, "It is an emphatic postulate of both civil and penal law that ignorance of a law is no excuse for a violation thereof."<sup>22</sup> While the reasoning of the district court,<sup>23</sup> that a judgment such as the supreme court later rendered makes the law a sword in the hands of a crafty borrower rather than a shield for the innocent, as was intended, is not to be passed over lightly, the result will tend to carry out the aforesaid purpose of the Usury Act, protection of the borrower.

### III. NATURE OF THE LENDER

Cases where the Usury Law does not apply due to lack of some element or elements essential to a usurious contract have been considered.<sup>24</sup> There also is a class of cases in which, even though all of the elements of usury are present, the Usury Law may be held not to apply because of the nature of the lender.

Off hand, in view of the general language of the act, it might be thought that twelve per cent per annum, the maximum profit permitted by the Usury Law, would be all that any lender could lawfully exact.<sup>25</sup> But, prior to the enactment of the Usury Law, the rates which Industrial Loan companies, pawnbrokers, and personal property brokers

<sup>21</sup> Cal. Stats. 1919, lxxxiii, §3.

<sup>22</sup> *People v. O'Brien* (1892) 96 Cal. 171, 176; 31 Pac. 45, 46; see *Newby v. Times-Mirror Co.* (1916) 173 Cal. 387, 160 Pac. 233; *Keedy, Ignorance and Mistake in the Criminal Law* (1908) 22 HARV. L. REV. 75; Note (1910) 23 L. R. A. (N.S.) 384. The extension of this principle may work great hardship in particular cases as in *Martin v. Kuchler*.

<sup>23</sup> (1930) 62 Cal. App. Dec. 1325, 290 Pac. 892, *rev'd* (1931) 81 Cal. Dec. 778, 299 Pac. 52. Query, whether a borrower could enter into a transaction knowing it violated the Usury Law and then receive the protection and benefit of that law.

<sup>24</sup> In *Lagorio v. Yerxa*, *supra* note 9, where the transaction was not a loan or forbearance, but a sale, the provision for payment by the other party of two per cent per month on unpaid installments toward taxes, rents, and installments was considered not to make the transaction usurious. The court quoted from 39 Cyc. 953: "When an excessive rate of interest is made payable only in case of default in payment of the principal, the higher rate is not for the use of the money, but imposed as a penalty for non-performance of the contract." But the application of this sentence must be limited. Surely it does not follow that one could loan money at lawful rates, payable in a very short time, knowing the borrower could not repay in that time, with a provision for excessive interest as a "penalty for non-performance." A borrower might be forced to accept such a contract, and the result would be as oppressive as excessive rates at the outset. The courts will not countenance an evasion of the law, and, if an intent to evade it is proved, this type of transaction would certainly not be sanctioned.

<sup>25</sup> Section 2 begins, "No person . . ." and section 3, "Every person . . ."

might charge were controlled by special statutes.<sup>26</sup> Also, since 1919, the legislature has amended each of these statutes.<sup>27</sup> The effect of the Usury Law upon former legislation and the validity of the recent amendments is practically undecided. Inasmuch as only two California cases, these decided by superior court appellate departments, have dealt directly with these questions, and since there now is pending before the supreme court a case<sup>28</sup> involving the problem with regard to personal property brokers, it is enough at this time merely to present the controversy.

The Usury Law reads, in part: ". . . all acts and parts of acts in conflict with this act are hereby repealed."<sup>29</sup> Furthermore, as mentioned above, the language throughout the act is general and in no way self-restricting. Concerning the Industrial Loan Companies Act, *Connor v. Minier*<sup>30</sup> had held that insofar as that act was repugnant to the Usury Law it was invalid, but on rehearing it was held that the question was not properly raised by the defendant's pleading. It would seem that the two acts are not necessarily in conflict.<sup>31</sup> Considering the Personal Property Broker's Act, the court, in *Crooks v. People's Finance & Thrift Company of Pomona Valley*,<sup>32</sup> held that it was repealed *pro tanto* by the Usury Law. The two features of the Usury Law referred to above may justify the conclusion that in no case whatever may one legally be charged more than twelve per cent per annum. However, a reasonable argument is that the earlier acts are special statutes, whereas the Usury Law is a general statute; a general statute does not repeal a special statute by implication; and there was no express repeal of these acts.<sup>33</sup>

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<sup>26</sup> Industrial Loan Companies Act, Cal. Stats. 1917, 658; Pawnbrokers Act, CAL. PEN. CODE, §§338-344; Personal Property Brokers Act, Cal. Stats. 1909, 969, 1911, 978.

<sup>27</sup> Industrial Loan Companies Act, Cal. Stats. 1921, 729; Pawnbrokers Act, CAL. PEN. CODE §340; Personal Property Brokers Act, Cal. Stats. 1931, c. 273.

<sup>28</sup> Beneficial Loan Society Ltd. v. Haight, S. F. No. 14405.

<sup>29</sup> Section 4.

<sup>30</sup> (1930) 109 Cal. App. 770, 288 Pac. 23. See Note (1930) 18 CALIF. L. REV. 542, stressing the fact of which the court in the Crooks case took judicial notice: that the argument was presented to the people that the Personal Property Brokers Act would be repealed by the Usury Law.

<sup>31</sup> If the amounts authorized to be deducted under the Loan Companies Act be considered merely as limits on charges which may be made for actual expenses incident to a loan, since the lender may incur expenses incident to a loan under the Usury Law, there is no conflict. If the provision of the Loan Companies Act that the lender may compel the borrower to subscribe to an investment certificate pledging it as collateral security be considered as permitting additional interest, the act is inconsistent with the Usury Law. On the subject of expenses, see *Lloyd v. Girola Bros.* (1931) 65 Cal. App. Dec. 1089, 300 Pac. 889; *Notes* (1922) 21 A. L. R. 797; (1928) 53 A. L. R. 743.

<sup>32</sup> (1930) 1 Cal. Supp. 86, 292 Pac. 1065; (1931) 19 CALIF. L. REV. 213.

<sup>33</sup> Cases supporting this view are: *McNeil v. Kingsbury* (1923) 190 Cal. 406, 213 Pac. 50; *Riley v. Forbes* (1924) 193 Cal. 740, 227 Pac. 768; *Ohlson v. Jerome* (1929) 102 Cal. App. 635, 283 Pac. 862.

Contrary to the tendency, demonstrated in the above cases, toward a broad application of the Usury Law are the recent expressions of the legislature in amending the earlier statutes to allow an even greater rate to be charged. The Usury Law is an initiative measure. The Constitution of California provides that this type of legislation may be amended only by a vote of the electors, in the absence of a provision in the act, itself, for its alteration.<sup>34</sup> No such provision is present in the Usury Law. In view of these facts, if the amendments of the other laws be considered as attempted amendments to the Usury Law they must be construed as invalid. It is urged by some that the recent amendments are not amendments to the Usury Law and so are valid.<sup>35</sup>

Many of those who hope that the earlier statutes were not repealed by the Usury Law and that the amendments to them are valid, feel that by being able to charge three and one-half per cent per month, companies may be established which will loan at that rate and no more. It is claimed that this rate is small when compared to charges now exacted by "loan sharks."<sup>36</sup>

The case now pending in the supreme court<sup>37</sup> will help to settle many of these questions involving the applicability of the Usury Law.

#### IV. RIGHTS AND REMEDIES OF THE BORROWER

When all the elements of usury are present so that the transaction is clearly usurious, what are the borrower's remedies? Has he the right to recover usurious interest voluntarily paid? If he has, when can it be said that there has been a payment of usurious interest sufficient to permit a recovery?

In California, before the Usury Law, a mortgagor who had paid a mortgage tax could not recover the amount, though Article XIII, Section five of the Constitution of California, which was held to be in its essence a usury law,<sup>38</sup> made an agreement to make such payment invalid.<sup>39</sup> This state was classed with those which hold that "there is no remedy at common law for the recovery back of usurious payments voluntarily made; at least, where the statute in relation to usury, while

<sup>34</sup> Art. IV, §1.

<sup>35</sup> See argument presented in brief of *amicus curiae*, in support of petitioner in *Beneficial Loan Society Ltd. v. Haight*, *supra* note 28.

<sup>36</sup> To the Russell Sage Foundation must go most of the credit for the establishment of small-loan legislation in many states. The rate of three and one-half per cent per month is small as compared with the one hundred and twenty per cent per year obtained by "loan sharks," and it is the former rate which the foundation seeks to establish throughout the states. For a brief outline of the work of the foundation, see RYAN, *op. cit. supra* note 8, 133 *et seq.*

<sup>37</sup> *Supra* note 28.

<sup>38</sup> *Matthews v. Ormerd* (1903) 140 Cal. 578, 74 Pac. 136. The section was repealed in 1906.

<sup>39</sup> *Harralson v. Barrett* (1893) 99 Cal. 607, 34 Pac. 342. The mortgagor was said to have waived his right to object to the agreement.

prohibiting recovery of usury, does not declare the contract void in whole or in part upon that ground."<sup>40</sup>

However, the borrower now receives more protection than did the mortgagor under the former act. The Usury Law declares that the provision for interest is null and void.<sup>41</sup> It specifically provides for recovery of a statutory penalty based upon the amount of usurious interest paid.<sup>42</sup> And, furthermore, the supreme court, in *Westman v. Dye*,<sup>43</sup> refused to extend the doctrine formerly applied in the mortgage cases to those involving violations of the Usury Law. In addition, payments of usurious interest are not regarded as voluntary payments, but rather as payments exacted under restraint.<sup>44</sup> The law has given to the borrower the right to recover usurious interest, but it must have been paid.<sup>45</sup> It is sometimes difficult to determine when usury has been paid, and the question arises whether payments under a usurious contract are considered payments of interest or payments of principal.

If a layman borrower were asked whether he had paid usury, in all probability his reply would be based upon his understanding with the lender. But many acts which might seem to him sufficient to constitute a payment are not so considered.<sup>46</sup> For example, where there is a reservation of a bonus, discount, or commission out of the nominal principal

<sup>40</sup> Note, L. R. A. 1918B, 585, 589: "By weight of authority, both in this country and in England, an action at common law, in the nature of an action for money had and received, will lie for the recovery back of usurious payments; at least, where the statute in relation to usury declares usurious contracts void in whole or in part."

<sup>41</sup> Cal. Stat. 1919, lxxxiii, §2. That the lender may recover the principal loaned in an usurious contract is well established in California. In *Haines v. Commercial Mortgage Co.* (1927) 200 Cal. 609, 254 Pac. 956, 53 A. L. R. 725, it is said that "even a casual reading of the statute itself shows that the legislative intent was not to declare the whole contract void, but only the portion thereof relating to interest." This view is followed in *Rice v. Dunlap* (1928) 205 Cal. 138, 270 Pac. 196, discussed in (1928) 17 CALIF. L. REV. 73 (the case further affirms the rule in California permitting the defendant to set up treble damages as a counterclaim); *Thomson v. Mortgage Investment Co.* (1929) 99 Cal. App. 205, 278 Pac. 468; *Worsley v. Seelig* (1930) 103 Cal. App. 621, 284 Pac. 970; *Gregg v. Phillips* (1930) 105 Cal. App. 132, 286 Pac. 1071. The nominal principal less the amount reserved is considered the principal which may be recovered. *Haines v. Commercial Mortgage Co.*, *supra*.

<sup>42</sup> Cal. Stats. 1919, lxxxiii, §3.

<sup>43</sup> (1931) 82 Cal. Dec. 475, 4 P. (2d) 134. In *Douglas v. Klopfer* (1930) 107 Cal. App. 765, 288 Pac. 36, the superior court had already decided similarly.

<sup>44</sup> *Babcock v. Olhasso* (1930) 109 Cal. App. 534, 293 Pac. 141.

<sup>45</sup> Section 3 of the Usury Law reads in part: ". . . who . . . shall have paid or delivered a greater sum . . ." *Haines v. Commercial Mortgage Co.*, *supra* note 41; *Conlter v. Collins* (1925) 71 Cal. App. 381, 235 Pac. 465; *Welder v. Director* (1931) 67 Cal. App. Dec. 613, 4 P. (2d) 793.

<sup>46</sup> See *Low v. Sutherland, Barry & Co.* (C. C. A. 9th, 1929) 35 F. (2d) 443 (unauthorized demand by creditor which debtor refuses to pay held not to be payment); *Duke v. Levy* (1929) 208 Cal. 376, 281 Pac. 496 (giving promissory note

of the loan, usury is not considered as paid, regardless of the intent of the parties, until the total of all the payments exceeds the actual amount loaned.<sup>47</sup> On the other hand, the case of *Haines v. Commercial Mortgage Co.*<sup>48</sup> has been thought to mean that where payments have been made to be applied to interest as evidenced by the intent of the parties, such payments are treated as payments of interest without regard to whether the amounts total more than the sum loaned, but payments made after a judgment declaring the contract to be usurious are to be considered payments on the principal regardless of the parties' wishes.<sup>49</sup> This conclusion was not unreasonable in view of the language of the *Haines* case, but *Westman v. Dye*<sup>50</sup> shows that it is only partially correct. It was there held that, with the qualification noted below, all payments made upon an usurious transaction are allocated to the principal, and until it is satisfied, there can be no payment of interest. This is the view of many courts which, recognizing that the parties are not in *pari delicto*, apply all payments, regardless of the intention of the parties, to the principal<sup>51</sup> or to the legal interest.<sup>52</sup> Some incorrectly

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held not to be payment, but simply evidence of debt); *Connor v. Minier* (1930) 109 Cal. App. 770, 288 Pac. 23, followed by *People v. Campbell* (1930) 110 Cal. App. 783, 291 Pac. 161 (mere signing and delivery of usurious instruments are not payment); *Liebelt v. Carney* (1931) 82 Cal. Dec. 156, 2 P. (2d) 144 (receipt of benefit by lender indirectly by assigning a non-negotiable instrument to another to whom payments are made is not payment to the lender); *Smith v. Cavaglier Mortgage Co.* (1931) 64 Cal. App. Dec. 195, 295 Pac. 366 (entry of a charge upon the books of the lender as against the borrower for interest due is not payment).

<sup>47</sup> *Haines v. Commercial Mortgage Co.*, *supra* note 41. But see *Libert v. Unfried* (1907) 47 Wash. 186, 91 Pac. 776. A question arises whether amounts paid must exceed not only the principal, but also lawful interest, in order that usurious interest be considered paid. See *McBroom v. Scottish Mortgage & Land Investment Co.* (1894) 153 U. S. 318, 14 Sup. Ct. 852; cases *infra* note 53.

<sup>48</sup> *Supra* note 45.

<sup>49</sup> *Coffin, Usury in California* (1928) 16 CALIF. L. REV. 281, 387, 400; DEXTER. SECCOMBE, BLEDSOE, CALIFORNIA USURY LAW (1930) 34.

<sup>50</sup> (1931) 82 Cal. Dec. 475, 4 P. (2d) 134.

<sup>51</sup> *Fowler v. Equitable Trust Co.* (1891) 141 U. S. 384, 12 Sup. Ct. 1; *Nicrose v. Walker* (1903) 139 Ala. 369, 37 So. 97; *Davis v. Elba Bank & Trust Co.* (1927) 216 Ala. 632, 114 So. 211; *Gilbert v. Clark & Co.* (1919) 186 Iowa 904, 173 N. W. 104; *New Hampshire Banking Co. v. Walker* (1897) 5 Kan. App. 881, 47 Pac. 543; *Cambron v. Boldrick* (1912) 147 Ky. 524, 144 S. W. 374; *Estey v. Capital Investment Building & Loan Ass'n.* (1902) 131 Mich. 502, 91 N. W. 753; *Gladwin State Bank v. Dow* (1920) 212 Mich. 521, 180 N. W. 601, 13 A. L. R. 1233; *Jones v. Brewer* (1926) 146 Miss. 142, 110 So. 115; *The International Building & Loan Ass'n. v. Biering* (1894) 86 Tex. 476, 25 S. W. 622; *People's Building, Loan & Savings Ass'n. v. Bessonette* (Tex. Civ. App. 1898) 48 S. W. 52; *American Building & Savings Ass'n. v. Daugherty* (1901) 27 Tex. Civ. App. 430, 66 S. W. 131; *Sugg v. Smith* (Tex. Civ. App. 1918) 205 S. W. 363; *Libert v. Unfried* (1907) 47 Wash. 186, 91 Pac. 776; see *Yonack v. Emery* (Tex. Com. App. 1929) 13 S. W. (2d) 667, 70 A. L. R. 684.

<sup>52</sup> *Crenshaw v. Duff's Ex'r.* (1902) 113 Ky. 912, 69 S. W. 962; *Cambron v. Boldrick*, *supra* note 51; *Taulbee v. Hargis* (1917) 173 Ky. 433, 191 S. W. 320 (gives



assume that the parties to the transactions are in *pari delicto*, and the intention of the parties is accepted.<sup>53</sup> It is argued that the former view defeats the purpose of the act, for if usury is not considered as paid, it cannot be recovered.<sup>54</sup> But the California courts, without relying on the above incorrect assumption, adequately protect the borrower in this respect.

In the *Haines* case it was held that the intention of the parties would be followed so far as the application of the provisions of the Usury Law is concerned.<sup>55</sup> This means that the amount paid as interest will be used for figuring the sum which may be recovered as the statutory penalty.

In *Westman v. Dye*,<sup>56</sup> the lender sued to recover the balance of the principal due. The defendant borrower was permitted to "set-off" not only treble the amount of interest paid within the year preceding the action, but also all interest paid even though paid more than two years before.

At least two grounds exist for criticizing these cases. In the first place, under the common law, there existed in the borrower the right to recover the excessive interest paid after the contract was completely performed.<sup>57</sup> The additional remedy provided by the Usury Law has

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debtor the election as to application); *Lawler v. Vette* (1912) 166 Mo. App. 342, 149 S. W. 43.

Where the parties intend a payment as interest, there is a conflict as to the application. See 39 Cyc. 1078; 27 R. C. L. 277. 39 Cyc. 1035 says that as a general rule one cannot recover usury paid as long as amounts due on the principal remain unpaid. See Note (1921) 13 A. L. R. 1244 and cases cited to the effect that even though the rule in the jurisdiction is that payments made voluntarily cannot be recovered, they may be applied to the principal. See Note L. R. A. 1918B, 585.

<sup>53</sup> *Dickey v. Permanent Land Co.* (1885) 63 Md. 170; *McCarthy v. First National Bank of Rapid City* (1909) 23 S. D. 269, 121 N. W. 853, 23 L. R. A. (N.S.) 335, *aff'd* 223 U. S. 493, 32 Sup. Ct. 240; see 39 Cyc. 1028; Note (1901) 56 L. R. A. 673, 702. To the effect that by the great weight of authority parties can by express agreement make application to interest, see 27 R. C. L. 276.

<sup>54</sup> 39 Cyc. 1028.

<sup>55</sup> *Supra* note 45. See *Sugg v. Smith* (Tex. Civ. App. 1918), 205 S. W. 363, 373, saying, "the right of action given by the statute is not a recovery of the money paid . . . but it is an action to recover a penalty, and the fact that the amount of the penalty is measured by the amount of interest does not change the fact that the recovery is a penalty," and holding that the borrower has the election to sue for the penalty or have the amount paid as interest applied upon the principal. The court reasoned that to hold otherwise would mean that after the period for recovering the penalty had passed the borrower would be helpless, and the creditor would get his usurious interest.

<sup>56</sup> *Supra* note 43. The usury consisted in a charge of \$125 every six months to renew a note for \$2500 at 8% per annum. That usury present in one note attaches to all renewals thereof, see *Gladwin State Bank v. Dow*, *supra* note 51.

<sup>57</sup> WEBB, LAW OF USURY (1899) §§460, 466.

not abrogated that right,<sup>58</sup> and, accordingly, *Douglas v. Kloppe*<sup>59</sup> held that only the excess, and not all of the interest, could be recovered. On the other hand, it was held in *Babcock v. Olhasso*,<sup>60</sup> where the contract had been completely performed, that all interest might be recovered. But no California case holds that there is a cause of action to recover usury unless the contract has been completely performed, except the action to recover the penalty. In spite of this, it was said in the *Westman* case that there existed a right of set-off of all amounts paid as interest.<sup>61</sup> Inasmuch as it is essential, in order that there be a right of set-off, that a cause of action exist,<sup>62</sup> it is difficult, if not impossible, to understand how the court found a right of set-off of all amounts paid. It is submitted that this application of funds with the exception of the amount paid as interest within the year preceding the action, is not a set-off, and should not be so termed. It is merely an application of the payments to the principal.<sup>63</sup> When the plaintiff in the *Westman* case attempted to set up the Statute of Limitations in bar of the right of set-off, the court said that since all payments were applied on the principal there had been no payments of interest against which the statute

<sup>58</sup> *Haines v. Commercial Mfg. Co.*, *supra* note 45; *Douglas v. Kloppe*, *supra* note 43; Note L. R. A. 1918B, 585; see WEBB, LAW OF USURY (1899) §465.

<sup>59</sup> *Supra* note 58. See *Murphy v. Citizens' Bank of Junction City* (1907) 82 Ark. 131. 100 S. W. 894; *Lawler v. Vette* (1912) 166 Mo. App. 342, 149 S. W. 43; *Sugg v. Smith*, *supra* note 51; Note L. R. A. 1918B, 585.

<sup>60</sup> *Supra* note 44. The Statute of Limitations was not mentioned here, as opposed to *Douglas v. Kloppe*, *supra* note 43, where the court said that the Statute of Limitations relating to contracts applies, citing section 339 of the Code of Civil Procedure.

<sup>61</sup> See *Fay v. Lovejoy* (1886) 20 Wis. 403, where there is a dictum to the effect that only the excess could be set off because that was all that could be recovered. There, the intention of the parties as to application was adopted. It follows that had the court not given effect to the intention of the parties, and had allocated the payments to the principal, the situation where there is a set-off of payments made over a year before the action was brought would never arise.

In *Wood v. Cuthbertson* (1884) 3 Dak. 328, 21 N. W. 3, where a fifteen per cent usury charge was all paid, but the principal was not, it was held that since the statute provided for the recovery only of the excess, only the excess could be set off. See *Yancy v. Teter* (1872) 39 Ind. 305; *Holcroft v. Mellott* (1877) 57 Ind. 539; 39 Cyc. 1021.

<sup>62</sup> *Rackley v. Pearce* (1846) 1 Ga. 241; *Irish v. Snelson* (1861) 16 Ind. 365; *Trabue's Ex'r v. Harris* (1858) 1 Metc. (Ky.) 597; *Naylor v. Smith* (1899) 63 N. J. Law 596, 44 Atl. 649; see *Story & Isham Commercial Co. v. Story* (1893) 100 Cal. 30, 34 Pac. 671; *Terry Trading Corp. v. Barsky* (1930) 210 Cal. 428, 292 Pac. 474 (describing the right of counterclaim in this state). See definition of "set-off" in WORDS AND PHRASES. In Note L. R. A. 1918B, 585, 594, it is said that set-off is a different thing from application of payments upon the principal. See 24 R. C. L. 792. In order for one to have a right of counterclaim, he must be able to secure a several judgment. CAL. CODE CIV. PROC. §438. And a counterclaim is broader than set-off. POMEROY, CODE REMEDIES (5th ed. 1929) §672.

<sup>63</sup> Cases permit the payments to be applied on the principal though there is no cause of action to recover them. See cases collected in Note L. R. A. 1918B, 594.

could run. That is, the court said that there was no cause of action against which the statute might run, and, therefore, the right of set-off was not barred. This reasoning appears replete with contradiction and can be explained only by saying that the court did not mean set-off in the strict sense. It has been said that "most of the courts regard the debtor's right to have usurious payments applied in reduction of the principal as in the nature of a set-off of his right to recover such payments in a direct proceeding, and therefore subject to the same time limitation as such action to recover usury. But in other courts a contrary view is held, based upon these two reasons: (1) the right to recover usurious payments does not accrue until the principal debt is wholly paid, and hence the Statute of Limitations could not in any event begin to run so long as any part of the principal remains unpaid; and (2) because usurious interest payments are to be deemed payments of principal as of the date when made, and the statutes of limitation have no application to [such] payments."<sup>64</sup> Consistency demands that either one position or the other be assumed by our courts. If we are to allow all payments to be applied to the principal, as was done in the *Westman* case, set-off and the Statute of Limitations are not pertinent.

Secondly, if the payments are to be treated as payments on the principal so that there can be no payment of usury until first the principal, at least, has been repaid, on what grounds can it be said that treble damages can be recovered before the principal has been repaid, as in the *Haines* case?<sup>65</sup> There it was said, that for the purpose of applying the provisions of the Usury Law, the intention of the parties as to the application of payments will be adopted.<sup>66</sup> A payment, then, may be a payment of interest for a year after it is paid, but after that time it becomes a payment upon the principal. This arrangement is highly advantageous to the borrower, but, from the legal point of view, is it not rather anomalous?

Now, applying the law as laid down by these cases, under what conditions will our courts consider that usury has been paid? If the usurious contract has been completely performed, principal and all interest having been paid, then, obviously, usury has been paid. If only part of the principal has been repaid, and the parties have intended some of the payments to be applied as interest, usury has been paid only so far as recovery of the statutory penalty is concerned.<sup>67</sup> But for other purposes, it has not, even though, considering the intention of the parties, more than twelve per cent has been paid. All payments are

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<sup>64</sup> 39 Cyc. 1030.

<sup>65</sup> (1927) 200 Cal. 609, 254 Pac. 956, 53 A. L. R. 725.

<sup>66</sup> See *supra* note 55.

<sup>67</sup> *Haines v. Commercial Mortgage Co.*, *supra* note 65.

allocated to the principal.<sup>68</sup> If, regardless of whether the payments were intended to be of interest or principal, the amounts paid total the principal plus seven per cent or more, only in the latter case will usury be considered as paid in a common law action to recover it.<sup>69</sup>

In California the question of whether usury has been paid is important mainly in determining the right of the borrower to the statutory penalty and the right to sue to recover the excessive interest at common law. If he defaults and thus forces the lender to sue to recover the balance of the principal, he can "set-off" all payments.<sup>70</sup>

The borrower's remedies may be summarized as follows:

1. He may sue to recover treble the amount paid as interest if he sues within a year after it is paid.
2. He may sue to recover the excess paid over the principal and legal interest, seven per cent, if he sues before two years have elapsed since payment.<sup>71</sup>
3. In defense to an action by the lender, the borrower may apply on the principal treble the interest paid within the preceding year.
4. In defense, he may also have applied on the principal all payments made, whether or not they were intended as interest.

#### V. EFFECT OF TRANSFER OF EVIDENCE OF INDEBTEDNESS<sup>72</sup>

The borrower has the remedies listed when his controversy is with the lender, providing the lender is still the other party in interest. However, cases are frequent where the lender has assigned the instrument of indebtedness to some third party; in these it becomes import-

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<sup>68</sup> Westman v. Dye (1931) 82 Cal. Dec. 475, 4 P. (2d) 134.

<sup>69</sup> Douglas v. Klopfer, *supra* note 43; see *infra* note 71.

<sup>70</sup> Westman v. Dye, *supra* note 68; see Richlin v. Schleimer (1932) 68 Cal. App. Dec. 317, 7 P. (2d) 711.

<sup>71</sup> His right to this seems certain in view of the common law, but if the opinion in Babcock v. Olhasso (1930) 109 Cal. App. 534, 293 Pac. 141, be accepted then the borrower may recover all interest paid after the principal has been repaid.

<sup>72</sup> The question as to what parties may raise the defense of usury or recover the penalty is outside the scope of this article. See WEBB, LAW OF USURY (1899) §§467, 468; 39 Cyc. 999, 1062, 1064. The right to recover usury is in the nature of a statutory penalty and is not assignable. Esposti v. Rivers Bros. Inc. (1929) 207 Cal. 570, 279 Pac. 423; Scott v. Hollingsworth (1931) 66 Cal. App. Dec. 588, 2 P. (2d) 571. That a statutory penalty is not assignable, see Pardoe v. Iowa State National Bank (1898) 106 Iowa 345, 76 N. W. 800; Lloyd v. Russell First National Bank (1897) 5 Kan. App. 512, 47 Pac. 575. But see Lasater v. First National Bank (1903) 96 Tex. 345, 72 S. W. 1057. See Ames v. Occidental Life Insurance Co. (1930) 210 Cal. 271, 291 Pac. 182 (dictum to the effect that the purchaser of an equity of redemption in real property who took expressly subject to the encumbrance cannot raise the question of its usurious character); Note Ann. Cas. 1916D, 893. It may be noted that a receiver appointed by a federal court to settle the question of ownership of stock in a corporation is not the "personal representative" within the meaning of section 3 of the Usury Law, and so is not entitled to recover on behalf of the corporation the statutory penalty. Scott v. Hollingsworth, *supra*.

ant to know whether any rights the borrower possessed because of the usury have been affected by the assignment. What rights has the borrower against the assignee? What rights has he against the original lender? The effect of the transfer depends largely upon whether the law makes the transaction void *in toto* or merely as to interest, whether the instrument evidencing the debt is negotiable or non-negotiable, whether or not the transferee had notice of the usury, and whether any circumstances of estoppel are present. Only a few cases pertinent to these problems have reached the appellate courts of California. What the borrower's rights are under many circumstances can be determined only from an examination of the authorities from other jurisdictions.

Let us consider the defense of usury against an action by the transferee of the instrument. If the debt is evidenced by negotiable paper such as a promissory note, and the transferee is a holder in due course for value without notice, the general rule is that he takes the note free of the defense of usury.<sup>73</sup> Some cases which take the contrary view have been explained by the fact that the local statutes declare the transaction void.<sup>74</sup> From this it is reasoned that if the statute provides that only the provision for interest is void, then the holder may sue to recover only the principal.<sup>75</sup> In California, the Usury Law provides that the provision for interest in an usurious contract is void.<sup>76</sup> While it seems logical then to suppose that the defense of usury exists in the borrower to the extent that the holder is not entitled to any interest, our courts do not so hold. In *Community Lumber Co. v. Chute*<sup>77</sup> the court said:

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<sup>73</sup> *Orr v. Sparkman* (1898) 120 Ala. 9. 23 So. 829; *Richter v. Burdock* (1913) 257 Ill. 410, 100 N. E. 1063; *Ernst Oeser & Co. v. Behrend* (1915) 89 Misc. 391, 151 N. Y. Supp. 873; *Lynchburg National Bank v. Scott* (1895) 91 Va. 652, 22 S. E. 487; see *Colby v. Parker* (1892) 34 Nebr. 510, 152 N. W. 693; *Bradshaw v. Van Valkenburg* (1896) 97 Tenn. 316, 37 S. W. 88; WEBB, LAW OF USURY (1899) §§159-163; 39 Cyc. 1078, n. 30.

<sup>74</sup> *Crusins v. Siegman* (1913) 81 Misc. 367, 142 N. Y. Supp. 348; *Sabine v. Paine* (1918) 223 N. Y. 401, 119 N. E. 849, 5 A. L. R. 1444; *Eskridge v. Thomas* (1916) 79 W. Va. 322, 91 S. E. 7, L. R. A. 1918C, 769. It is reasoned that a transaction void in the inception cannot be made valid by a transfer to an innocent holder for value.

<sup>75</sup> *McCormick v. Fallier* (Ala. 1931) 134 So. 471; *Note* (1931) 18 VA. L. REV. 79; see *Saltmarsh v. Planters & Merchants Bank* (1848) 14 Ala. 668; *Pearson v. Bailey* (1853) 23 Ala. 537; *Laramore v. Bank of Americus* (1882) 69 Ga. 722; *Perry Savings Bank v. Fitzgerald* (1914) 167 Iowa 446, 149 N. W. 497; *Kendall v. Robertson* (1853) 12 Cush. (Mass.) 156; *Cheney v. Campbell* (1889) 28 Nebr. 376, 44 N. W. 451; WEBB, LAW OF USURY (1899) §159; *Note* L. R. A. 1918C 773.

<sup>76</sup> Cal. Stats. 1919, lxxxiii, §2, reading in part, "Any agreement or contract of any nature in conflict with the provisions of this section shall be null and void as to any agreement or stipulation therein contained to pay interest . . ." Construed in *Haines v. Commercial Mtg. Co.*, *supra* note 45 and in *Babcock v. Olhasso*, *supra* note 71.

<sup>77</sup> (1930) 80 Cal. Dec. 537, 292 Pac. 1069; (1930) 18 CALIF. L. REV. 436. The case also raised again the problem of the necessity to plead the defense of usury.

"... the defense of usury . . . cannot be availed of against the purchaser of a promissory note in due course and for value."<sup>78</sup> While this may be called mere *obiter*,<sup>79</sup> inasmuch as the borrower himself was not bringing the action and the statement was unnecessary to the decision, the case was relied upon in *Baker v. Butcher*<sup>80</sup> in stating the same proposition. Here, again, however, additional facts<sup>81</sup> make this declaration by the court mere dictum. But it is safe to say that in California, despite the Usury Law making void the provision for interest, a borrower may not set up the defense under these circumstances.

If the holder of the negotiable instrument took with knowledge of the usury, then, generally, the maker of the note has not lost his defense.<sup>82</sup> It seems that no case concerning this problem has reached the appellate courts in California.

When a non-negotiable instrument is assigned to a third party who knows nothing of its usurious character, in the absence of circumstances of estoppel,<sup>83</sup> it would seem that the holder could be in no better posi-

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In *Wallace v. Zinman* (1927) 200 Cal. 585, 254 Pac. 946, 62 A. L. R. 1341 and *English v. Culley* (1927) 85 Cal. App. 291, 259 Pac. 355, the California courts said that in cases where the instrument is usurious on its face the defense need not be pleaded. This view has been followed by *Curtis v. Thaxter* (1929) 204 Cal. 439, 268 Pac. 630; (1928) 16 CALIF. L. REV. 553. But from the *Community Lumber Co.* case we find that when the note on its face is not usurious, "those who seek to take advantage of the latent fact of usury against the transferees [in this case] of the obligation must affirmatively plead that the transaction is usurious." In *Terry Trading Corp. v. Barsky* (1930) 210 Cal. 428, 434, 292 Pac. 474, 476, the court made the broad statement that, "Moreover, usury as a defense need not be pleaded; the court will as in other cases of illegality, deny the recovery of usurious interest on its own motion." Inasmuch as the transaction was not usurious on its face, it would seem that this statement is inconsistent with that above.

The federal courts require that the essential elements of usury be set out where the defendant seeks to recover treble damages in cross complaint. *Commercial Credit Co. v. Semon* (D. C. N. D. Cal. 1928) 33 F. (2d) 356.

<sup>78</sup> (1930) 80 Cal. Dec. 537, 541, 292 Pac. 1069, 1071.

<sup>79</sup> While unnecessary to the decision, the problem was put in issue and a definite stand seems to have been taken. The point was stressed that the defense was personal to the borrower, and from this it must follow, it was argued, that the word "void" in the act meant only "voidable," or otherwise anyone could set up the defense.

<sup>80</sup> (1930) 106 Cal. App. 358, 289 Pac. 236. Here it was said that it is only when the note is void is the defense available, and our law does not so provide, citing 29 Am. & Eng. Enc. of Law, 521.

<sup>81</sup> Elements of estoppel were sufficient to decide the case similarly; see *infra* note 83.

<sup>82</sup> *Tucker v. Wilamouicz* (1874) 8 Ark. 157; *Brown v. Wilcox and Sawyer* (1863) 15 Iowa 414; *Bruck v. Lambeck* (1909) 63 Misc. 117, 118 N. Y. Supp. 494; *Kass v. Blumberg* (1913) 142 N. Y. Supp. 544; *Kass v. Maisel* (1915) 155 N. Y. Supp. 217; *Schlesinger v. Lehman* (1908) 191 N. Y. 69, 83 N. E. 657; *Keene v. Behan* (1905) 40 Wash. 505, 82 Pac. 884; 39 Cyc. 1078.

<sup>83</sup> The borrower may by his words or actions in inducing a third person to rely upon the validity of the contract estop himself to set up the defense of usury.

tion with regard to the defenses which the borrower might set up than was the original lender.<sup>84</sup> While there is no unanimity of opinion, the courts generally hold that the borrower has a good defense against even the innocent purchaser.<sup>85</sup>

*A fortiori* if the holder of the non-negotiable instrument had knowledge of the usury, the borrower can set up the defense against him as he could against the lender, for the holder cannot rely on the Negotiable Instruments Law or on ignorance of the usury. In *San Joaquin Valley Finance Corp. v. Allen*,<sup>86</sup> the defense of usury was permitted against an assignee where the contract itself gave notice that the charge was usurious. The defendant paid an amount equal to the actual principal and the plaintiff assignee was permitted to recover no more.

Regarding the recovery of the statutory penalty the Usury Law provides that one may recover "... against the person, ... who shall have taken or received the same [the greater sum or value than is allowed to be received] ... treble the amount of the money so paid. ..."<sup>87</sup> It is generally held that the borrower may sue to recover the penalty from the party who received the usurious interest.<sup>88</sup> But a general exception is made if the instrument is negotiable and is held

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WEBB, LAW OF USURY (1899) §439 *et seq*; see Note 50 L. R. A. (N.S.) 1031; 39 Cyc. 1081. In *Baker v. Butcher*, *supra* note 80, the court found an estoppel *in pais* when the contract was not usurious on its face and the plaintiff gave the defendant at the time the latter purchased the note a written warranty that he had received consideration for the full face value of the note. The court felt that this constituted an assurance that the note was free from the taint of usury. In *San Joaquin Finance Corp. v. Allen* (1929) 102 Cal. App. 400, 283 Pac. 117, despite that fact the contract provided that in the event of an assignment then all moneys payable thereunder should be paid to the assignee without recoupment, set-off, or counterclaim whatsoever, estoppel *in pais* was held not available. The court based its decision on the ground that the usury was apparent on the face of the instrument.

<sup>84</sup> As a general rule the holder of a non-negotiable instrument takes subject to the defenses of the maker against the assignor. *Bacot v. South Carolina Loan & Trust Co.* (1925) 132 S. C. 340, 127 S. E. 562; *Austin v. Wallace* (1921) 117 Wash. 61, 200 Pac. 566; *State v. McDowell County Court* (1924) 98 W. Va. 703, 128 S. E. 925.

<sup>85</sup> See the inference made by the court in *Liebelt v. Carney* (1931) 82 Cal. Dec. 156, 159, 2 P. (2d) 144, 146: "The plaintiff could at any time have set up usury in defense of an action [by the assignee] upon said contract . . ." See *Gates v. Merchants Banking & Storage Co.* (1901) 11 Ohio Cir. Div. 721, 22 Ohio Cir. Ct. 724; *Doll v. Hollenbeck* (1886) 19 Neb. 639, 28 N. W. 286; 39 Cyc. 1081.

<sup>86</sup> *Supra* note 83. On the issue of estoppel raised in this case, see *supra* note 83.

<sup>87</sup> Cal. Stats. 1919, lxxxiii, §3.

<sup>88</sup> *Anderson v. Tatro* (1914) 440 Okla. 219, 144 Pac. 360; *First National Bank of Wellston v. Sensbaugh* (1916) 58 Okla. 462, 160 Pac. 455; *Webb v. Galveston & Houston Investment Co.* (1903) 32 Tex. Civ. App. 515, 75 S. W. 355; *Western Bank & Trust Co. v. Ogden* (1906) 42 Tex. Civ. App. 465, 93 S. W. 1102; 39 Cyc. 1038. See *Liebelt v. Carney*, *supra* note 85, where a non-negotiable contract was assigned and the borrower sued the original payee, the court saying, "He has simply sued the wrong party. He could have maintained against the assignee the cause of action provided for under said section 3." 82 Cal. Dec. at 159, 2 P. (2d) at 146.

by a holder in due course for value.<sup>89</sup> Knowledge on the part of the holder of the note renders him liable for the penalty.<sup>90</sup>

Since the borrower is practically compelled to pay the holder in due course without knowledge where the instrument is negotiable, the courts have considered it just that the borrower have recourse against the original lender.<sup>91</sup> Where, however, the holder's claim rests on a non-negotiable instrument it is questionable whether the lender can be held. It has been decided in California that the lender is not liable for the penalty in this situation. In *Liebelt v. Carney*,<sup>92</sup> the defendant advanced a sum to the General Motors Finance Corporation to discharge the final payments due the corporation from the plaintiff. To secure reimbursement from the plaintiff, the defendant took an assignment of the conditional sale contract and issued another, greatly inflated, to the plaintiff. The latter contract the defendant assigned to another, to whom the payments were made. On default in the last payment the process was repeated, and finally the plaintiff completed his payments to the assignee of the defendant. Plaintiff then brought an action against the assignor for treble the interest paid, but the appellate court said that since the plaintiff might have set up the Usury Law as a defense, as the contracts were non-negotiable, but instead had voluntarily paid the interest, he could not recover from the respondent.<sup>93</sup> In affirming the decision of the appellate court the supreme court stressed the fact that the payments were made to the assignees, and concluded therefore that no recovery from the defendant could be permitted because of the wording of the act.<sup>94</sup> On rehearing,<sup>95</sup> the court adopted its former opinion, relying upon additional authorities,<sup>96</sup> the

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<sup>89</sup> *Culver v. Osborne* (1907) 231 Ill. 104, 83 N. E. 110, 121 Am. St. Rep. 302; *Harbough v. Tanner* (1904) 163 Ind. 574, 71 N. E. 145; *Taulbee v. Hargis* (1917) 173 Ky. 433, 191 S. W. 320, Ann. Cas. 1918A, 762; *Koch v. Black* (1876) 29 Ohio St. 565; see *Fredin v. Richards* (1895) 61 Minn. 490, 63 N. W. 1031. This exception is in keeping with the general principle of negotiable instruments, enabling instruments to pass more freely from hand to hand. This is not the rule in jurisdictions which make the transaction void, such as New York. *Sabine v. Paine*, *supra* note 74.

<sup>90</sup> *Atwell v. Gowell* (1868) 54 Me. 358; *Moffie v. Slawsky* (1915) 77 N. H. 555, 94 Atl. 193; 39 Cyc. 1035.

<sup>91</sup> See *supra* note 89.

<sup>92</sup> (Cal. 1930) 295 Pac. 815, *aff'd*, (1931) 82 Cal. Dec. 156, 2 P. (2d) 144.

<sup>93</sup> (1930) 62 Cal. App. Dec. 669, 289 Pac. 872. But see *Westman v. Dye*, *supra* note 43, where the fact that payments were voluntary was held immaterial. Kentucky provides for recovery in this situation. Kentucky Stats. (1892) §§2219-2.

<sup>94</sup> *Supra* note 46.

<sup>95</sup> *Supra* note 92.

<sup>96</sup> *Fredin v. Richards*, *supra* note 89; *Snyder v. Crutcher* (1909) 137 Mo. App. 121, 118 S. W. 489; 39 Cyc. 1038. The first case must be construed in the light of the Minnesota statute which allows recovery from the original payee only where the transferee is a bona fide indorsee. The second case, upon which is based the



applicability of which may well be questioned. A second rehearing of the case was denied.<sup>97</sup> The lender, then, is under no liability to the borrower, but he may well be liable to the assignee if the latter is forced to pay.<sup>98</sup>

On the basis of the few California cases and cases from other jurisdictions which pertain to the effect of a transfer or assignment of the usurious instrument upon the rights of the borrower, a summary may be suggested as follows:

1. He may defend on grounds of usury against: (a) a holder with notice of the usury, whether the note be negotiable or not; (b) an innocent holder of a non-negotiable instrument.

2. Having completed all payments to the holder of the instrument, he may recover the penalty from: (a) the original lender, only when the instrument is negotiable and the holder is one in due course and without knowledge of the usury; (b) the transferee, if the note is non-negotiable, or if he took the negotiable instrument with notice.

#### VI. USURY AS A MISDEMEANOR

To shield the borrower, the Usury Law provides that the agreement for interest in an usurious contract is null and void, and imposes a penalty upon the lender which the borrower may recover. As an added deterrent, violation of the act is made a misdemeanor punishable by fine and imprisonment.<sup>99</sup> To judge from the few cases which have reached the appellate courts in this state since 1927,<sup>100</sup> the latter pro-

quotation from *Cyc.*, does not seem to be in point but is explained by its material facts, the third party being a mere dummy used to evade the law and the note given to him being a renewal note.

<sup>97</sup> August 27, 1931.

<sup>98</sup> See CAL. CIV. CODE §1774 prior to 1931 change, warranting lack of knowledge of facts rendering the paper worthless.

<sup>99</sup> Section 3.

<sup>100</sup> There have been only three cases involving criminal action. This may be explained by the fact that a certain provision of the criminal feature of the Usury Law has been declared unconstitutional. *In re Washer* (1927) 200 Cal. 598, 254 Pac. 951; *Wallace v. Zinman* (1927) 200 Cal. 585, 254 Pac. 946, 62 A. L. R. 1341.

In *People v. Seccombe* (1930) 103 Cal. App. 306, 284 Pac. 725, the people sought to enjoin defendant from practicing usury, but the injunction was refused. A note in (1930) 18 CALIF. L. REV. 328, discussing this case, explains that the decision was based upon a point of pleading, since there was no statement of facts to show an intention to commit further crimes of the same nature.

In *People v. Campbell* (1930) 110 Cal. App. 783, 291 Pac. 161, the prosecution was for receiving usurious interest, and establishing the acceptance of the contract was held not sufficient. The fact that the defendant was secretary of a corporation when it received interest did not make him criminally liable, as the Usury Law requires conscious participation in the violation, it was held.

In *People v. Adams* (1931) 1 Cal. Supp. 100, 295 Pac. 511, the court found that charges of \$0.75 to \$1.25 per week for loans of from \$15 to \$25 were usurious, and that the papers purporting to be assignments of wages signed in blank were mere attempts to evade the law.

vision seems not to have been very effective, especially when is considered the great number of cases in which borrowers have sought to take advantage of the other two provisions. Still, if making usury a crime prevents some from charging excessive rates, the provision is justified.

#### CONCLUSION

Usury laws have been the objects of criticism ever since they were enacted. Even today their wisdom is a subject of much debate. New Hampshire's recent repudiation of her old usury law, so that persons may contract at any rate, causes existing acts to be scrutinized still more closely. Unquestionably, there are many devices for evading the restrictions imposed by the acts. Nevertheless, our Usury Law has helped to do away with open oppression of borrowers, to provide them with certain remedies, and to disclose many attempted evasions. It is certain that borrowers within this jurisdiction are by no means unprotected.

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