

# USURY IN THE CONFLICT OF LAWS: THE DOCTRINE OF THE *LEX DEBITORIS*

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*If a man . . . hath given forth upon usury, and hath taken increase;  
shall he live? He shall not live . . . he shall surely die.—Ezekiel 18:  
5, 13.*

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In the February issue of *True Adventures*, sandwiched between advertisements for hidden treasure detectors and "Psychic Dominance" ("How to Rule Others with your Thoughts"), appeared the following solicitation:

BILL PROBLEMS?  
CAN'T MAKE ENDS MEET?  
NOBODY REFUSED UP TO \$10,000.00.  
Poor Credit, No Trouble. . . . Send Your  
Name for FREE APPLICATION . . . Providence, R.I.<sup>1</sup>

For many, a response to this or similar advertisements is their first step toward a financial obligation at interest rates they can ill afford. Located in states with high, permissive interest rates, interstate lending corporations solicit borrowers all over the country through pulp magazines. The resulting form contracts sent through the mail are easily drafted to provide that the more lenient law of the lender's state shall control the contractual rate of interest.<sup>2</sup> When such transactions find their way into court, lawyers and judges are confronted by one of the oldest conflict-of-laws problems: the choice of a law to control the validity of an interstate loan contract.

Writers on the conflict of laws state with monotonous repetition the familiar view that "the question of what law determines the validity of a contract . . . is the most confused subject in the field of Conflict of Laws."<sup>3</sup>

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<sup>1</sup> True Adventures, Feb. 1967, p. 65. The use of such advertisements in pulp magazines of broad circulation is widespread. One may safely assume they are designed to reach an audience of rather limited financial experience. See, e.g., All Man, March 1967, pp. 46, 52, 56, 68; Man's Action, April 1967, pp. 47, 52, 60, 61; Man's Adventure, March 1967, pp. 48, 50, 56; Personal Romance, March 1967, pp. 68, 71; Police Dragnet, March 1967, pp. 53, 54; Real Detective, April 1967, pp. 62, 70; Real Men, March 1967, pp. 50, 52, 56; Screen Stories, Feb. 1967, pp. 75, 79, 80, 82; Sport World, Feb. 1967, p. 76; True Action, March 1967, pp. 60, 62, 64, 75; True Danger, April 1967, pp. 50, 60, 64; True Life Confessions, April 1967, pp. 55, 65. The magnitude of the interstate lending business is illustrated by *People v. Fairfax Family Fund, Inc.*, 235 Cal. App. 2d 881, 47 Cal. Rptr. 812 (1964) (small loan legislation case), in which a Kentucky corporation in the business of making interstate loans was found to have loans of \$3,500,000 outstanding to California residents alone, and was increasing the amount of loans to them at the rate of \$90,000 a week.

<sup>2</sup> See notes 412-20 *infra* and accompanying text. It is interesting to note that Rhode Island, the home of many interstate loan companies, allows the lender to recover 30% interest per annum—one of the highest interest rates of any state. R. I. GEN. LAWS ANN. § 6-26-2 (1956) (for loans over \$50). See advertisement reproduced in text accompanying note 1 *supra*.

<sup>3</sup> GOODRICH, CONFLICT OF LAWS § 110, at 321 (3d ed. 1949) (omitted in Scoles ed. 1964). See 2 BEALE, THE CONFLICT OF LAWS 1077 (1935); LEFLAR, CONFLICT OF LAWS § 123, at 232 (1959); STUMBERG, CONFLICT OF LAWS 225 (3d ed. 1963); RESTATEMENT (SECOND), CONFLICT OF LAWS 1 (Tent. Draft No. 6, 1960). *But see* EHRENZWEIG, CONFLICT OF LAWS § 175, at 465 (1962), arguing that the vast majority of contract cases may be categorized rationally by the "rule of validation," that is, by "the principle that a contract will be upheld whenever possible . . . ."

However, many courts and other authorities have concluded, with perhaps an especial sense of relief, that at least in the area of usury, a "special," "well-established rule"<sup>4</sup> "enjoys an undisputed existence."<sup>5</sup> This special rule applicable to usury typically provides that a contract for the payment of interest will be validated, whenever possible, by applying the more lenient usury statute of any state sufficiently connected with the contract.<sup>6</sup> With minor variations in emphasis, the majority of writers<sup>7</sup> adopt this express rule of validation as descriptive of the past and present state of the American conflicts law in the field. Leflar<sup>8</sup> and Weintraub<sup>9</sup> argue a middle position: that the usury cases follow the general trend of American conflicts law and turn on factors which determine all contracts decisions. A small minority, consisting primarily of Battifol<sup>10</sup> and Ehrenzweig,<sup>11</sup> reject the majority view and contend that whatever the status of a rule of validation in general, assumption of such a rule with regard to usury "is inaccurate in the light of both existing authority and common sense."<sup>12</sup>

The disquieting task of this Comment is to argue that the so-called special conflicts rule for usury is neither well-established nor undisputed. Rather, its deceptive simplicity stands as a barrier to any intelligent appraisal of the conflicting state policies and individual economic interests

<sup>4</sup> *Fahs v. Martin*, 224 F.2d 387, 397-98 (5th Cir. 1955); *accord*, *Brierley v. Commercial Credit Co.*, 43 F.2d 724, 727-28 (D. Pa. 1929).

<sup>5</sup> Nussbaum, *Conflict Theories of Contracts*, 51 YALE L.J. 893, 912 (1942).

<sup>6</sup> See, e.g., *Fahs v. Martin*, 224 F.2d 387, 397-98 (5th Cir. 1955).

<sup>7</sup> "[T]he rule has become well settled in almost all jurisdictions, too well settled to be changed except by statute, that if a contract is made and to be performed in different states, and is usurious by the law of one of these places but not by that of the other, it is governed, according to the presumed intention of the parties, by the law of the place which makes it valid." 2 BEALE, *op. cit. supra* note 3, at 1241. For other writers in accord with this view, see 6 CORBIN, *CONTRACTS* § 1509, at 959 (1951); GOODRICH, *op. cit. supra* note 3, § 111, at 334; MINOR, *CONFLICT OF LAWS* 430-31 (1901); NUSSBAUM, *MONEY IN THE LAW: NATIONAL AND INTERNATIONAL* 167 (1950); 2 RABEL, *CONFLICT OF LAWS: A COMPARATIVE STUDY* 410-11 (2d ed. 1960); STUMBERG, *op. cit. supra* note 3, at 237; 2 WHARTON, *CONFLICT OF LAWS* § 510g, at 1200 (3d ed. 1905); 6 WILLISTON, *CONTRACTS* § 1792, at 5097 (1938); Nussbaum, *supra* note 5, at 912. The authors of the *RESTATEMENT (SECOND)*, *op. cit. supra* note 3, § 334d, at 54, have adopted this view. Compare *RESTATEMENT (SECOND)*, *op. cit. supra*, § 346k. For a statement of an English view see DICEY, *CONFLICT OF LAWS* Rule 146 (8th ed. Morris 1967).

<sup>8</sup> LEFLAR, *op. cit. supra* note 3, § 131, at 249; see GOODRICH, *CONFLICT OF LAWS* § 111, at 219 (Scoles ed. 1964).

<sup>9</sup> Weintraub, *The Contracts Proposals of the Second Restatement of Conflict of Laws—A Critique*, 46 IOWA L. REV. 713, 722 (1961).

<sup>10</sup> "[I]n an area where definitive judgment is difficult and above all where the quantity is less important than the quality, we believe we can advance the view that the law of validity is adopted by less than one quarter of all . . . cases of [interest contracts] . . ." BATTEFOL, *LES CONFLITS DE LOIS EN MATIÈRE DE CONTRATS* 198 (1938) [author's trans.].

<sup>11</sup> EHRENZWEIG, *op. cit. supra* note 3, § 182, at 485.

<sup>12</sup> *Ibid.*

involved in multistate loan transactions. The conflicts law of usury has long been tied to inflexible rules, and the cases reflect the stresses between the pull of abstract dogma in one direction, and the desire for individual justice in the other. Unfortunately, courts have developed equally dogmatic and often excessively vague exceptions to these special rules to allow them to circumvent certain undesirable results.<sup>13</sup> Now that the facade of imperative rules and mechanical doctrines has begun to crumble,<sup>14</sup> a newer, more flexible and rational edifice must be built in its place. But the temptation of courts to adopt automatically whichever theories are "current" must be resisted. Unless a conflicts theory is able to cope with the diverse and peculiar problems of usury, it will remain inadequate. For this reason, it is essential that the policy determinants underlying usury laws and decisions be re-examined, both to extract what is valuable and discard what is obsolete.

The basic inquiry of this Comment is whether a court should ever set aside the protective legislation of a borrower's state in favor of the less protective policies of another state. Part I explores the historical development of usury laws and related legislation, their contemporary functions and defects, and the problems created when the interests of citizens from different states clash. Part II analyzes the failures of courts in dealing with these problems. It is argued that prevailing conflicts doctrines are largely devoid of any logical or economic justification and are inadequate to deal with the realities of modern economic life. Part III attempts to develop a coherent and systematic approach by which the problems of usury in the conflict of laws may be resolved. As an initial point of departure, it is urged that the *lex debitoris*, or law of the debtor, must be presumed to control the validity of all interstate loan transactions, and that a borrower's protective law should not be set aside absent a valid or convincing reason. This rule is then modified by a number of qualifications designed to strike a balance between the established policies of commercial freedom and legal enforceability of contractual obligations voluntarily undertaken, and the individual protective policies of each particular state.

## I

### THE PROBLEM OF USURY

The [usury] law interferes with the only contract in which a man is not liable to imposition. . . . He always comprehends clearly what he is about in borrowing money.<sup>15</sup>

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<sup>13</sup> For a discussion of these exceptions, see text accompanying notes 238-327 *infra*.

<sup>14</sup> See Traynor, *Is This Conflict Really Necessary?*, 37 TEXAS L. REV. 657, 675 (1959).

<sup>15</sup> ANON., ON THE MISCHIEF OF USURY LAWS 5 (1852), quoted in Friedman, *The Usury Laws of Wisconsin: A Study in Legal and Social History*, 1963 WIS. L. REV. 515, 518. In

It does not do any of us much good to elaborate the obvious by stating that anyone who signs such a [usurious contract with hidden charges] has a hole in his head. The facts of the matter are that people are signing such contracts. . . . Trying to teach people to read fine print and understand it is an almost impossible job.<sup>16</sup>

Over a century separates these two remarks. Yet the conflict-of-laws doctrines used by today's courts to solve the problems posed by interstate loan contracts come from the first era, not the second. The intricacies of "adhesion contracts," "revolving-credit accounts-receivable contracts," "add-on rates," and "discount-plus-fee systems" are twentieth century problems;<sup>17</sup> but the conflicts language of "lex loci contractus," "lex loci solutionis," "party intention," and "special rule of validation" invoked by today's courts are nineteenth century solutions. This time lag becomes clear when viewed against the backdrop of history and economics.

### A. Economic History

The practice of usury is one in which people of all ages have taken exceeding interest. Its history<sup>18</sup> is narrated chiefly by its enemies: a colorful tale, rich in invective,<sup>19</sup> inflamed by religious fervor,<sup>20</sup> censured by

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a similar vein, Richard H. Dana, Jr., in a speech before the Massachusetts House of Representatives on Feb. 14, 1867, stated: "I admit it has been true in times past—I trust it is *no longer true*—that the borrowing were the feebler class, and the lending the powerful class." (Emphasis added.) Reprinted in SOCIETY FOR POLITICAL EDUCATION, *USURY LAWS, THEIR NATURE, EXPEDIENCY AND INFLUENCE* (1881), and quoted in Friedinan, *supra* at 518-19.

<sup>16</sup> *Hearings on S. 1740 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 87th Cong., 1st Sess. 1166, 1168 (1961).

<sup>17</sup> See *Hearings on S. 1740, supra* note 16, at 2.

<sup>18</sup> See generally BLYDENBURGH, *LAW OF USURY* (1844); BUCKLEY, *THE LAW OF USURY* (1817); HOMER, *A HISTORY OF INTEREST RATES* (1963); KELLY, *HISTORY AND THE LAW OF USURY* (1853); MURRAY, *HISTORY OF USURY* (1866); NOONAN, *THE SCHOLASTIC ANALYSIS OF USURY* (1957); ORD, *ESSAYS OF THE LAW OF USURY* (3d ed. 1809); RYAN, *USURY AND USURY LAWS* (1924); WEBB, *LAW OF USURY* (1899); 66 C.J. § 5, at 142 (1934); 22 *ENCYCLOPEDIA BRITANNICA* 908 (1963); 15 *ENCYC. SOC. SCI.* 193-97 (1935).

<sup>19</sup> "The usurer . . . is known by his very looks often, by his speeches commonly, by his actions ever; he hath a leane cheek, a meagre body, as if he were fed by the devill's allowance, his eyes are almost sunke to the backside of his head with admiration of money, his eares are set to tell the clocke, his whole carcass is a meere anatomy." John Blaxton, quoted in MURRAY, *op. cit. supra* note 18, at 23 n.1. For a somewhat violent judicial characterization of usury see *Dunham v. Gould*, 16 Johns. R. 367 (N.Y. 1819).

<sup>20</sup> St. Basil, the bishop of Cesarea, an influential Churchman of the 4th century, summed up his attitude thus: "The griping usurer sees, unmoved, his necessitous borrower at his feet, condescending to every humiliation, professing everything that is villifying; he feels no compassion for his fellow creatures; though reduced to this abject state of supplication, he yields not to his humble prayer; he is inexorable to his entreaties; he melts not at his tears. . . ." Quoted in *Commonwealth v. Donoghue*, 250 Ky. 343, 351, 63 S.W.2d 3, 6 (1933). For a somewhat esoteric study tracing the religious concept of "brotherhood" through the history of usury see NELSON, *THE IDEA OF USURY: FROM TRIBAL BROTHERHOOD TO UNIVERSAL OTHERHOOD* (1949).

law,<sup>21</sup> enshrined in literature,<sup>22</sup> tempered by humor,<sup>23</sup> and softened by occasional tolerance.<sup>24</sup> Despite impassioned and repeated attempts at economic vindication,<sup>25</sup> the word "usurer" has remained less a description than an epithet.<sup>26</sup>

### 1. General Antecedents

"Usury"<sup>27</sup> has been prohibited by the earliest of written laws.<sup>28</sup> The Old Testament<sup>29</sup> and the Church Fathers<sup>30</sup> condemned the taking of any

<sup>21</sup> See Byll Against Usurie, 1551-52, 5 & 6 Edw. 6, c. 20, quoted at note 39 *infra*; Commonwealth v. Donoghue, *supra* note 20; RYAN, *op. cit. supra* note 18, at 22-23.

<sup>22</sup>

Thus farther yet, the utmost verge along  
of that same Seventh Circle, did I go,  
and all alone, where sat the sorry throng [the usurers].  
Out of their eyes is bursting forth their woe:  
now here, now there, with hands they agonize  
against the flames, against the soil aglow.

DANTE, *DIVINE COMEDY, Inferno: Canto XVII* (Anderson transl. 1959). For legal analysis of literature's most famous usury trial, *Shylock v. Antonio*, see KEETON, SHAKESPEARE AND HIS LEGAL PROBLEMS 10-21 (1930).

<sup>23</sup> Dr. Johnson suggested that usury laws were for the protection of moneylenders who would otherwise be tempted by extravagant interest rates into lending money on insufficient security. KELLY, *op. cit. supra* note 18, at 92. "A moneylender serves you in the present tense, lends you in the conditional mood, keeps you in the subjunctive, and ruins you in the future." Joseph Addison, quoted in ESAR, *DICTIONARY OF HUMOROUS QUOTATIONS* 16 (1949).

<sup>24</sup> Francis Bacon felt the importance of trade and commerce required the balancing of two considerations: "The one, that the *Tooth of Usurie* he grinded, that it bite not too much: The other, that there bee left open a Meanes, to invite Moneyed Men, to lend to the Merchants, for the Continuing and Quickning of Trade." BACON, *Of Usurie*, in *ESSAYES* 171 (West ed. 1896).

<sup>25</sup> The classic argument was made by Bentham: "[N]o man of ripe years and of sound mind, acting freely, and with his eyes open, ought to be hindered, with a view to his advantage, from making such bargain, in the way of obtaining money, as he thinks fit; nor, . . . any body hindered from supplying him, upon any terms he thinks proper to accede to." BENTHAM, *LETTERS IN DEFENSE OF USURY* 6 (1796). See LOCKE, *SOME CONSIDERATIONS ON THE LOWERING OF INTEREST AND RAISING THE VALUE OF MONEY* (1692); RYAN, *op. cit. supra* note 18, at 47-57 (summarizing these views); TURGOT, *MÉMOIRE SUR LES PRÊTS D'ARGENT* (1769).

<sup>26</sup> The German word for usury, "Wucher," is a very strong term describing generally any kind of economic exploitation and profiteering. As the lending of money upon interest was primarily a Jewish practice during the Middle Ages, the word "usury" soon acquired ethnic connotations. Christians engaging in this degrading activity were branded, "Christiani Judaizantes." BUCKLEY, *op. cit. supra* note 18, at 2. The character of Shylock in Shakespeare's *Merchant of Venice* has been enshrined in the English language as a "relentless money-lender." WEBSTER, *NEW WORLD DICTIONARY* 1352 (1958).

<sup>27</sup> "Interest" must be distinguished from "usury": the former means any compensation for the use of money or other property; the latter means any such compensation which exceeds the rate of interest allowed by law. The word, "usury," is derived from the words, "usus," meaning "to use," and "aera," a mark upon money showing its value. MURRAY,

interest as a breach of brotherly love;<sup>31</sup> by the ninth century usury had become both a legal offense and a religious sin.<sup>32</sup> This was partly caused by the fact that ancient and medieval lending existed primarily for personal emergencies. The desperate borrower was willing to pay virtually anything to obtain money immediately, and the lender was able to exploit this unhappy condition.<sup>33</sup> The lender's use of money to beget even more money was further felt to be "unnatural," "sinful," or even "theft."

*op. cit. supra* note 18, at 13. It was originally defined as the price paid for the use of money. The word, "interest," is derived from the words, "intereo," meaning "to be lost," and from its substantive form, "interesse." It came to mean the damages a lender sustained in foregoing the present use of his money. It was only in the thirteenth century that the Church began to discriminate between taking any interest, and taking excessive interest or "usury." See HOMER, *op. cit. supra* note 18, at 73.

<sup>28</sup> The Code of Hammurabi set a maximum rate of 33⅓% per annum on loans of grain repayable in kind, and 20% per annum on loans of silver. HOMER, *op. cit. supra* note 18, at 4. The early laws of China and India absolutely prohibited interest. 22 ENCYCLOPEDIA BRITANNICA 908 (1963), while the Mosaic Law allowed Jews to take interest from Gentiles, 91 C.J.S. *Usury* § 2, at 559 (1955). The Greeks recognized no maximum legal rate of interest. Demosthenes, for example, is known to have charged a client interest at the rate of 12% per annum for legal advice when the client wished to defer payment. HOMER, *op. cit. supra* note 18, at 5-6. But the Greeks held in contempt anyone exacting interest above 12% per annum. 91 C.J.S. *op. cit. supra* at 559. Aristotle, speaking perhaps more from his experience as a biologist than an economist, condemned it as "unnatural": "The most hated sort [of moneymaking] . . . is usury, which makes a gain out of money itself, and not from the natural use of it. For money was intended to be used in exchange, but not to increase at interest. And this term usury, which means the birth of money from money, is applied to the breeding of money because the offspring resembles the parent. Wherefore of all modes of making money this is the most unnatural." ARISTOTLE, *POLITICS* 46 (Jowett transl. 1926). The Romans included a maximum of 8⅓% per annum in the Twelve Tables in 450 B.C. This rate was continually lowered until the reign of Justinian. HOMER, *op. cit. supra* note 18, at 4.

<sup>29</sup> "Thou shalt not lend upon usury to thy brother; usury of money, usury of victuals, usury of any thing that is lent upon usury: Unto a stranger thou mayest lend upon usury; but unto thy brother thou shalt not lend upon usury . . ." *Deuteronomy* 23:19-20. "And if thy brother be waxen poor, and fallen in decay with thee; then thou shalt relieve him . . . Take thou no usury of him, or increase: but fear thy God; that thy brother may live with thee." *Leviticus* 25:35-6.

<sup>30</sup> See remark by St. Basil, note 20 *supra*. Early Christian objections to usury were based largely on Old Testament strictures, note 29 *supra*.

<sup>31</sup> Thus, in the thirteenth century, St. Thomas Aquinas stated: "[T]o take usury from any man is simply evil, because we ought to treat every man as our . . . brother." 10 AQUINAS, *SUMMA THEOLOGICA* 331-32 (2d ed. 1920-29), quoted in NELSON, *op. cit. supra* note 20, at 14.

<sup>32</sup> In 325 the Council of Nicea prohibited the taking of interest by clerics. St. Jerome and St. Ambrose both preached against it. In the 5th century Pope Leo extended the prohibition against clerics by using it to censure lay usurers morally. By 850 laymen exacting usury faced excommunication. Charlemagne's Capitularies also prohibited the taking of interest. Finally, in 1139, the Second Lateran Council universally prohibited the taking of usury. HOMER, *op. cit. supra* note 18, at 4, 70.

<sup>33</sup> *Hearings on S. 1740, supra* note 16, at 1159.

Early usury laws, therefore, were concerned primarily with *punishing lenders* for their evil conduct, not with *protecting borrowers* from their necessity.<sup>34</sup> It was only with the Reformation that religious attitudes began to change.<sup>35</sup>

In England, the common law did not restrict the interest upon which the parties might fairly agree.<sup>36</sup> The rule that interest in excess of a certain percentage would be usurious and hence illegal was "wholly the creature of legislation."<sup>37</sup> The earliest English statutes severely punished the taking of any interest whatsoever.<sup>38</sup> Like the religious prohibitions, these enactments were designed to punish lenders, not protect borrowers.<sup>39</sup> But by 1545 the commercial needs of the Empire demanded that the taking of some interest be permitted, and Parliament allowed for the first time the taking of ten per cent per annum.<sup>40</sup> The legal rate of interest

<sup>34</sup> "The Synod of Pavia in 850 [for example] excommunicates lay usurers and prescribes full restitution to their victims if living . . . . The obligation of restitution is apparently intended as a penalty, rather than considered as a requisite of commutative justice which demands the restoration of stolen goods." NOONAN, *op. cit. supra* note 18, at 16. Usury was denounced, not as a "sin against justice" which required restitution for absolution, but rather as "a form of avarice or uncharitableness" which "required simply internal sorrow for forgiveness." *Id.* at 17, 30.

<sup>35</sup> Although Luther was strongly opposed to the taking of any interest, see NELSON, *op. cit. supra* note 20, at 29-68, Calvin thought it necessary: "[U]sury is not now unlawful, except in so far as it contravenes equity and brotherly union . . . . To exercise the trade of usury, since heathen writers counted it amongst disgraceful and base modes of gain, is much less tolerable among the children of God; but in what cases, and how far it may be lawful to receive usury upon loans, the law of equity will better prescribe than any lengthened discussions." Quoted in *id.* at 79. Interest on loans was first permitted in England during the Reformation. RYAN, *op. cit. supra* note 18, at 44-46.

<sup>36</sup> WEBB, *op. cit. supra* note 18, § 5, at 3.

<sup>37</sup> *Coleman v. Commins*, 77 Cal. 548, 554, 20 Pac. 77, 80 (1888). See *Rosa v. Butterfield*, 33 N.Y. 665, 669-70 (1865).

<sup>38</sup> Under the laws of Alfred and of William the Conqueror, usurers were censured by the Church and denied a Christian burial. They forfeited all their property to the King, were sent to the pillory, publicly whipped, and banished from the Kingdom. Horack, *A Survey of the General Usury Laws*, 8 LAW & CONTEMP. PROB. 36-37 (1941).

<sup>39</sup> See, e.g., *Byll Against Usurie*, 1551-52, 5 & 6 Edw. 6, c. 20: "Usurie is by the worde of God utterly prohibited, as a vyce moste odyous and detestable, . . . which thing by no godly teachings and perswations can syncke into the harts of dyvers gredie, uncharitable and couvetous parsons of this Rcalme, nor yet by anny terrible threatenings of Godds wrathe and vengeance that justly hangeth over this Rcalme for the great and open Usurie therein dailye used and practysed they will forsake such filthie gayne and lucre, onles some temporall punishment be provyded . . . ." Quoted in BUCKLEY, *op. cit. supra* note 18, at 4-5. The temporal punishment imposed was forfeiture of the entire debt. Horack, *supra* note 38, at 37. At the end of the thirteenth century the Jewish money lenders were banished from England, and Englishmen and Lombards began to take their place. At this time, "the church assumed jurisdiction over usurers, 'for the good of their souls,' punishing them by censures and excommunication." WEBB, *op. cit. supra* note 18, at 8, citing *Usurers*, 1287, 15 Edw. 1, c. 6. (Emphasis in original.) No mention is made of the effect of usury upon borrowers.

<sup>40</sup> *Act Against Usury*, 1545, 37 Hen. 8, c. 9, quoted in Horack, *supra* note 38, at 37.



was steadily lowered<sup>41</sup> until, by the Statute of Anne in 1713,<sup>42</sup> the rate was fixed at five per cent. Usury laws were repealed completely in 1854.<sup>43</sup> For forty-six years, until the Money-Lenders Act of 1900,<sup>44</sup> England had no interest maximum at all.

## 2. *The United States*

American colonial legislation was patterned after the usury laws of England.<sup>45</sup> By 1844 all the states had laws against usury, although the legal rates on the frontier and in the West were considerably higher than on the Eastern seaboard.<sup>46</sup> In 1850, immediately following the *Dry Dock Bank* case scandal,<sup>47</sup> New York became the first state to exclude corporations from the protection of the usury laws.<sup>48</sup> Nineteen states eventually followed suit.<sup>49</sup> Meanwhile, in consonance with the then current doctrines

<sup>41</sup> 8%: Act Against Usury, 1624, 21 James 1, c. 17; 6%: Act Against Excessive Usury, 1660, 12 Car. 2, c. 13.

<sup>42</sup> Act to Reduce Rate of Interest, 1713, 13 Anne, c. 15. See Comment, 23 MD. L. REV. 51, 52 n.11 (1963) (quoting this statute).

<sup>43</sup> Usury Laws Repeal Act, 1854, 17 & 18 Vict. c. 90.

<sup>44</sup> 63 & 64 Vict. c. 51. The Money Lenders Act allows the court to reopen any transaction it finds unconscionable and, by way of relief, allows the borrower to pay just the interest rate the court adjudges to be fair. In 1927, the act was amended to provide that interest rates in excess of 48% per annum would be presumed unconscionable unless evidence to the contrary were shown, 17 & 18 Geo. 5, c. 21. See NUSSBAUM, *op. cit. supra* note 7, at 162-63. For a description of the effectiveness of the English approach see Note, 65 YALE L.J. 105, 109-10 (1955).

<sup>45</sup> The Act to Reduce Rate of Interest, 1713, 13 Anne, c. 15, was apparently the model used, although it had been repealed by 1854, RYAN, *op. cit. supra* note 18, at 25. Before 1767 all the Colonies had laws against usury. The permissible interest rates varied between 5% and 8%, and the penalty for violation was forfeiture of the entire interest and principal. See FARNAM, CHAPTERS IN THE HISTORY OF SOCIAL LEGISLATION IN THE UNITED STATES TO 1860, at 88-91 (1931). It is possible that legal interest rates were higher in the United States than in England because capital was relatively scarce; Benjamin Franklin estimated the prevailing rates to be between 6% to 10%. WRIGHT, ECONOMIC HISTORY OF THE UNITED STATES 163 (1941).

<sup>46</sup> Typical rates in the East and South were between 6% and 8%. Missouri, Indiana, and Louisiana, however, had rates of 10%, and Illinois allowed 12%. BLYDENBURGH, *op. cit. supra* note 18, at 151-299.

<sup>47</sup> The notorious case of *New York Dry Dock Bank v. American Life Ins. Trust Co.*, 3 N.Y. 344 (1850), turned many against the usury laws and caused New York to pass its corporate exemption statute. The Dry Dock Bank had negotiated from an English lender a loan at 11%, or 5% over the legal New York rate. The court of appeals sustained the defense of usury by deciding that New York law governed the transaction, and the lender forfeited the entire interest and principal (over \$200,000) to the bank. New York papers attacked "the abominable injustice of the [usury] law" as "a standing premium for fraud, deception, ingratitude, and downright robbery." They viewed with "horror and detestation" any law enabling a "fraudulent and immoral debtor to exempt himself from the payment of a debt." RYAN, *op. cit. supra* note 18, at 58-60.

<sup>48</sup> With minor modifications, the statute is still in force. See N.Y. GEN. OBLIGATIONS LAW § 5-521.

<sup>49</sup> See note 441 *infra* for a table of state corporate exemptions.

of laissez-faire, most European nations repealed their usury laws.<sup>50</sup> Similar pressures were exerted upon American state legislatures to repeal their statutes and allow interest rates to be determined by the marketplace forces of supply and demand.<sup>51</sup> Advocates of repeal argued that the price of money simply could not be fixed,<sup>52</sup> and that attempts to do so would only lead to evasion;<sup>53</sup> that usury laws drove capital into foreign markets, restricted its circulation at home, and therefore created even higher effective rates of interest;<sup>54</sup> and that the economy would best prosper if individuals were allowed to contract freely, unhampered by paternalistic governmental restrictions.<sup>55</sup> Some even went so far as to condemn

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<sup>50</sup> England repealed her usury laws in 1854, Denmark in 1855, Belgium in 1865, Spain in 1856, Holland, Sardinia, Norway and Geneva in 1857, Saxony and Sweden in 1864, Prussia and the North German Confederation in 1867. Relief from exorbitant rates of interest was left largely to the discretion of the courts. For the English approach under the Money-Lenders Act of 1900, see note 44 *supra*. France declares as usurious interest over one-and-a-half times the normal rate charged by bona fide lenders, and imposes fines or imprisonment in cases of breach. German law punishes creditors if the interest charged is found to have been flagrantly excessive, or an exploitation of the borrower's poverty or lack of experience. See NUSSBAUM, *op. cit. supra* note 7, at 163-64.

<sup>51</sup> The most successful attack was made by Richard H. Dana, Jr., in his plea for repeal of Massachusetts' usury law delivered before the Massachusetts House of Representatives on February 14, 1867. Marshalling the arguments of Bentham and Turgot, Dana's speech was largely responsible for the abolition of that state's usury law in 1867. Reprinted in SOCIETY FOR POLITICAL EDUCATION, *USURY LAWS, THEIR NATURE, EXPEDIENCY AND INFLUENCE* (1881), and discussed in RYAN, *op. cit. supra* note 18, at 60-62. See the 1859 Joint Committee Report to both Houses of the General Assembly of Tennessee, in RYAN, *op. cit. supra* note 18, at 203. This report was less successful, and to this day Tennessee has a usury statute. For an insight into the New York businessman's mind see a letter reprinted in 4 CENT. L.J. 140 (1877), referring to a "petition, signed by names representing several hundred millions of capital," asking for the repeal of New York's usury laws.

<sup>52</sup> "I agree that if you could [even] pass a law which should not fix but [merely] ascertain the market value of money every day, . . . you would be obliged to have a commissioner at every curbstone, and a financial clock at the head of State Street [Boston] to record the changes by the minute . . ." Dana, reprinted by SOCIETY FOR POLITICAL EDUCATION, *op. cit. supra* note 51, at 44, and quoted in Friedman, *supra* note 15, at 518. An anonymous pamphleteer in 1852 argued that financial laws of interest were like the "laws of nature" which "must be obeyed." ON THE MISCHIEF OF USURY LAWS 3-4 (1852), quoted in Friedman, *supra* note 15, at 517.

<sup>53</sup> RYAN, *op. cit. supra* note 18, at 53, 56. For a general treatment of current methods of evasion of usury laws see Collins, *Evasion and Avoidance of Usury Laws*, 8 LAW & CONTEMP. PROB. 54 (1941).

<sup>54</sup> BENTHAM, *op. cit. supra* note 25, at 49-50; RYAN, *op. cit. supra* note 18, at 56. BOLLES, A TREATISE ON USURY AND USURY LAWS 49 (1837), warned that the more liberal interest rates in the West were draining the East of "incredible" amounts of capital which would "never return, for the laws smile on its use. . . . Thus is our supply of money cut off."

<sup>55</sup> "The moral effect of restrictive laws is to substitute for robust, enterprising manhood, the feebleness of conscious dependence on the State's guardianship." Lanier, *Usury As Affecting Securities for Debt* (1887), quoted in Friedman, *supra* note 15, at 519 n.14. For a

as immoral those borrowers who had the audacity to raise the protective defense of usury.<sup>56</sup> The advocates of usury laws, on the other hand, argued that such laws were necessary to restrain the powers of monopolistic banking institutions;<sup>57</sup> to check the "passions of men,"<sup>58</sup> in particular the rapacity of lenders;<sup>59</sup> and to "protect men [from] the assaults of superior wit, . . . prudence and providence."<sup>60</sup>

In light of the prevailing economic trends, the laissez-faire arguments proved more persuasive. The dramatic impact of the Industrial Revolution in the nineteenth century pushed usury laws into the background.<sup>61</sup> Mercantilism, the growth of trade and commerce, and the expanding need for investment capital created heavy demands for commercial lending and borrowing. Consumer goods were scarce, and existing credit was absorbed by the heavy requirements of industry.<sup>62</sup> In this burgeoning industrial society, committed to the ideals of governmental laissez-faire, free enterprise, and liberty of contract, "individuals . . . engaged in productive pursuits worked out mutually satisfactory arrangements from substantially equivalent bargaining positions."<sup>63</sup> Large commercial interests had no need for statutory protections; and small individual wage-earners had no capacity for credit. The working man lived at a bare subsistence level. He could neither obtain a loan, nor find consumer goods to purchase.<sup>64</sup> It was during this period in the United States that many states made their usury statutes less restrictive, repealed them altogether, or passed

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general treatment of nineteenth century laissez-faire attitudes towards freedom of contract, see Pound, *Liberty of Contract*, 18 YALE L.J. 454 (1909); Letter, 4 CENT. L.J. 140 (1877).

<sup>56</sup> "Public opinion rightly brands with infamy those who under pretext of usury resist an otherwise just claim and invoke legal penalties on those who have helped them in their need." 1 COMMERCIAL AND FINANCIAL CHRONICLE 578 (1865), quoted in Friedman, *supra* note 15, at 518.

<sup>57</sup> MILLER, *BANKING THEORIES IN THE UNITED STATES BEFORE 1860*, at 185 (1927).

<sup>58</sup> *Dunham v. Gould*, 16 Johns. R. 367, 378 (N.Y. 1819).

<sup>59</sup> See, e.g., *Commonwealth v. Donoghue*, 250 Ky. 343, 350, 354, 63 S.W.2d 3, 7, 8 (1933).

<sup>60</sup> FITZHUGH, *SOCIOLOGY FOR THE SOUTH* 133, 135 (1854). For a summary of nineteenth century arguments against usury see Friedman, *supra* note 15, at 519-21.

<sup>61</sup> For economic histories of usury laws in general see *Hearings on S. 1740*, *supra* note 16, at 1159; KEMMERER & JONES, *AMERICAN ECONOMIC HISTORY* (1959); WRIGHT, *op. cit. supra* note 45.

<sup>62</sup> In the United States, the Civil War had disrupted the entire Southern economy. Their "capital" in slaves was expropriated, and the cotton sector was severely damaged. They were forced to deal with carpet-baggers from the North to obtain capital. WRIGHT, *op. cit. supra* note 45, at 80. During this time "liquid capital was scarce and in great demand while the eastern United States was still an 'under-developed country.'" KEMMERER & JONES, *op. cit. supra* note 61, at 211. The economic conditions of the South no doubt had an impact upon conflicts decisions. Southern courts would be unlikely to invalidate interstate loan contracts by the lower maximum of forum law.

<sup>63</sup> CURRAN, *TRENDS IN CONSUMER CREDIT LEGISLATION* 2 (1965).

<sup>64</sup> *Ibid.*

corporate exemptions;<sup>65</sup> and it was this period which saw the creation of a special, laissez-faire conflicts doctrine for usury.<sup>66</sup>

By the turn of the century, however, this trend was reversed. The American economy was sufficiently advanced to shift production from industrial capital to consumer goods. The concurrent jump in real wages and mass marketing of high-cost consumer goods enabled individuals, who now could and would borrow money, to purchase on credit.<sup>67</sup> It was under these conditions that usury laws were rediscovered and took on their fundamentally protective functions. Following the First World War, the states began to impose stricter interest maximums.<sup>68</sup> At present, all but a handful have usury laws, the great bulk of which vary from six to twelve per cent.<sup>69</sup>

The most significant change in the area of interest regulation came in the 1930's, when the usury laws were supplemented by small loan legislation.<sup>70</sup> The growing need for small non-commercial loans to private individuals and the inability of larger lending institutions profitably to make these loans on insufficient security, drove small borrowers into the arms of loan sharks who often exacted highly oppressive rates of interest.<sup>71</sup> Small loan legislation allowed higher interest rates on small sums, and was designed to carve out limited exceptions to the scope of general usury laws rather than supersede them altogether.<sup>72</sup> In recent

<sup>65</sup> This was particularly true in the Western States. By the turn of the century eleven states recognized no legal rate of interest: Arizona, California, Colorado, Florida, Maine, Massachusetts, Minnesota, Montana, Nevada, New Mexico, and Utah; nine allowed interest between 10-12%: Idaho, Kansas, Michigan, Mississippi, Nebraska, North Dakota, Oklahoma, Texas, and Wisconsin. See WEBB, *op. cit. supra* note 18, at 621-88. For a detailed study of the fluctuations in one state's legal interest rate through the latter half of the nineteenth century see Friedman, *supra* note 15, at 528-60.

<sup>66</sup> For the historical evolution of this conflicts doctrine see text accompanying notes 172-203 *infra*.

<sup>67</sup> CURRAN, *op. cit. supra* note 63, at 1. A rural economy became an urban, industrial economy, and "masses of working people were drawn into the cash economy." *Hearings on S. 1740 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 87th Cong., 1st Sess. 1159 (1961).

<sup>68</sup> See note 94 *infra* and accompanying text.

<sup>69</sup> For a table of all state interest rates, see note 524 *infra*.

<sup>70</sup> See Hubachek, *The Development of Regulatory Small Loan Laws*, 8 LAW & CONTEMP. PROB. 108 (1941) (history of the Russell Sage Foundation and the first uniform small loan laws). See generally CURRAN, *op. cit. supra* note 63, at 16-44 (1965); HUBACHEK, *ANNOTATIONS ON SMALL LOAN LAWS* (1954).

<sup>71</sup> See generally *Symposium—Combating the Loan Shark*, 8 LAW & CONTEMP. PROB. 1 (1941).

<sup>72</sup> Typically, small loan legislation requires all lenders to be licensed, allows up to 33% interest on loans under \$300, and provides for a payment period of 21 to 37 months. CURRAN, *op. cit. supra* note 63, at 17. Licensing provisions and close supervision act as checks on the institutions allowed to charge higher rates of interest. *Id.* at 6. It is believed that higher rates of interest will attract reliable lenders into the market and displace the loan shark.

years this type of legislation has been used to control an expanding variety of loans and lending institutions.<sup>73</sup>

The past two decades have seen an explosion in the growth of consumer credit.<sup>74</sup> Recent legislation has been concerned primarily with controlling the interest rates paid by consumers who purchase goods and services on various time-payment plans.<sup>75</sup> Consumer credit legislation, however, must be distinguished from usury legislation for two reasons. First, the credit extended by a seller to a buyer has traditionally not been considered a loan of money; the interest payments made by the buyer, therefore, have been thought to fall outside the scope of the usury laws.<sup>76</sup> Second, it is felt that the borrower may need money—perhaps for a personal emergency—more than the buyer needs a particular consumer good. The consumer who purchases a particular commodity voluntarily is not believed to require the same kind of protection as the desperate borrower whose necessity has driven him to pay excessive interest.<sup>77</sup> Consequently, consumer credit legislation has been primarily concerned with disclosure of information to the buyer, not regulation of interest rates.<sup>78</sup>

The battle to control the creditor, fought in biblical times and beyond, continues to rage.<sup>79</sup> But the simple scriptural precept, "Thou shalt not lend upon usury to thy brother,"<sup>80</sup> has been transformed into a fantastically complex maze of rules, regulations, statutes and directives; and the primeval loan for a bushel of wheat has become a massive extension of credit upon which all economic activity turns. It is against this histor-

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Hubachek, *supra* note 70. See also Hubachek, *Progress and Problems in Regulation of Consumer Credit*, 19 LAW & CONTEMP. PROB. 4 (1954).

<sup>73</sup> For enumeration and treatment of credit union loans, industrial bank loans, savings and loan associations, installment loan laws, home improvement loans, check loan laws, and pawnbroker loans, see CURRAN, *op. cit. supra* note 63, at 45-82.

<sup>74</sup> "Since the end of World War II, mortgage credit has increased almost six times—from \$18.6 billion in 1945 to \$140 billion in 1960. Consumer credit has increased more than eightfold—from less than \$6 billion in 1945 to approximately \$55 billion by the end of 1960. At this rate, personal debt in the form of mortgage credit and consumer credit in a few years could exceed the national debt." *Hearings on S. 1740, supra* note 67, at 3. See CURRAN, *op. cit. supra* note 63, at 1 n.2; Schuchman, *Consumer Credit by Adhesion Contracts*, 35 TEMP. L.Q. 125, 281 n.5 (1962).

<sup>75</sup> See generally *Hearings on S. 750 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 88th Cong., 1st Sess. 1546-65 (1963-64); CURRAN, *op. cit. supra* note 63, at 83-130; MCALISTER, *RETAIL INSTALLMENT CREDIT: GROWTH AND LEGISLATION* (1964).

<sup>76</sup> For a criticism of the "time-price doctrine" see Schuchman, *supra* note 74, at 291-301. See also CURRAN, *op. cit. supra* note 63, at 83.

<sup>77</sup> CURRAN, *op. cit. supra* note 63, at 2.

<sup>78</sup> *Ibid.*

<sup>79</sup> See, e.g., *Hearings on S. 750, supra* note 75; *Hearings on S. 1740, supra* note 67; *Hearings on S. 2755 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 86th Cong., 2d Sess. (1960).

<sup>80</sup> *Deuteronomy* 23:19.

ical backdrop that the contemporary justifications for the laws against usurious interest rates must be understood.

### 3. *The Contemporary Rationale*

Usury laws today perform one basic function: borrower protection. This simple point cannot be overemphasized. Concern over lenders no longer takes the form of moral judgments on his conduct; the interest he takes is of concern only when taken from borrowers who cannot afford it. All usury laws are based upon the fundamental premise that the bargaining power of the two parties to a loan transaction is seriously unequal<sup>81</sup>—that “greed, on one hand, and compelling necessity, short-sightedness, or gullibility, on the other,”<sup>82</sup> deprive the debtor of the ability freely to enter such a transaction and “place him at the mercy of the lender . . . .”<sup>83</sup>

But usury statutes do more than “protect the weak, the needy, and the unwary from the rapacity of the avaricious.”<sup>84</sup> They are also enacted, as Lord Mansfield put it, “to protect men who act with their eyes open against themselves.”<sup>85</sup> Rephrased in contemporary terms, the lure of “borrow now, pay later” has proved too strong for even the provident, and a state’s interest maximum constitutes in effect a legislative judgment as to the price a borrower should be allowed to pay for money.<sup>86</sup>

Usury laws, to be sure, are open to many criticisms: they fail to discriminate between those who can and cannot sustain larger interest rates;<sup>87</sup> they are too easily evaded by loan sharks;<sup>88</sup> they often impose unprofitable interest rates on lenders;<sup>89</sup> and they contain many technical

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<sup>81</sup> See *Chandler v. Kendrick*, 108 Fla. 450, 452, 146 So. 551, 552 (1933); *Frorer v. People*, 141 Ill. 171, 185-86 (1892); *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 249, 131 Atl. 332, 342 (1925); *Ferdon v. Zarriello Bros.*, 87 N.J. Super. 124, 134, 208 A.2d 186, 191 (Super. Ct. 1965) (citing further authority); *Failing v. National Bond & Inv. Corp.*, 168 Misc. 617, 621, 6 N.Y.S.2d 67, 71 (Rochester City Ct. 1938).

<sup>82</sup> Nugent, *The Loan-Shark Problem*, 8 LAW & CONTEMP. PROB. 3 (1941).

<sup>83</sup> WEBB, *LAW OF USURY* 15 (1899). For this reason it is said that borrower and lender cannot be deemed *in pari delicto*, and that the pressure under which the borrower contracts is sufficiently great to negate the element of *particeps criminis*. *Marshall v. Beeler*, 104 Kan. 32, 37-38, 178 Pac. 245, 247, (1919). See OHIO REV. CODE ANN. § 1343.05 (1961).

<sup>84</sup> *Universal Credit Co. v. Lowell*, 166 Misc. 15, 18, 2 N.Y.S.2d 743, 746 (Rochester City Ct. 1938). See *State v. Griffith*, 83 Conn. 1, 3-4, 74 Atl. 1068, 1069, *aff'd*, 218 U.S. 563 (1910).

<sup>85</sup> Quoted in KELLEY, *HISTORY AND THE LAW OF USURY* 92 (1853). (Italics omitted.)

<sup>86</sup> “The purpose of our legislation is to protect credit users who are not capable of fending for themselves in the market place.” SPECIAL COMMITTEE, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, REPORT ON RETAIL INSTALLMENT SALES, CONSUMER CREDIT, SMALL LOANS AND USURY 13 (1965).

<sup>87</sup> *Id.* at 13-17.

<sup>88</sup> See Collins, *supra* note 53.

<sup>89</sup> *Hearings on S. 750*, *supra* note 75, at 1476; Note, 65 YALE L.J. 105, 107 (1955).

pitfalls for the unwary lender and borrower.<sup>90</sup> But there is no question that usury laws are needed more today than ever before.<sup>91</sup> Loan sharks are now conducting a \$1 billion-a-year operation by dealing in loans above most states' small loan maximums.<sup>92</sup> Preliminary investigations by the House Subcommittee on Usury have revealed that over one hundred "established loan sharks" are now operating in the nation's largest cities.<sup>93</sup> The danger posed by these lenders has always been recognized by the state legislatures, and over the past forty-five years usury laws have been made increasingly strict.<sup>94</sup> The upshot of this is clear. Usury in the area above the normal small loan maximum is, and will continue to be, a growing problem. In the absence of federal legislation, each individual state will act to counter the danger in its own way. With the growing mobility of population, the future conflicts between laws of the states will inevitably increase in both frequency and complexity.

### B. *Conflict of Laws*

The problems of usury and interstate lending are frequently said to have been adequately and conclusively settled by the special conflicts rule of validation.<sup>95</sup> This rule is typically stated as follows:

[A] provision in a contract for the payment of interest will be held valid in most states if it is permitted by the law of the place of contracting, the place of performance, or any other place with which the contract has any substantial connection.<sup>96</sup>

Consider, for example, the following hypothetical problem for which the rule of validation allegedly provides the solution. Borrower, an individual, and Lender, a lending institution,<sup>97</sup> are from different states. They contract for a loan of \$2,000.<sup>98</sup> Borrower executes and delivers, in his own state, a note to Lender for repayment over a period of four years at ten

<sup>90</sup> *Hearings on S. 1740, supra* note 67, at 1162.

<sup>91</sup> *But see* Note, 65 *YALE L.J.* 105 (1955) (usury laws an "anachronism").

<sup>92</sup> Porter, *Pulling Teeth of Loan Sharks*, *S.F. Chronicle*, Mar. 11, 1966, p. 60, col. 1.

<sup>93</sup> *Ibid.*

<sup>94</sup> Florida, for example, repealed its corporate exemption in 1953 and now imposes a total forfeiture for all loans over 25%. *FLA. STAT.* §§ 687.02-03, 687.07 (1957). Mississippi has a similar penalty for loans over 20%. 1 *MISS. CODE ANN.* § 37 (1956). New York in 1965 passed a landmark law making interest rates in excess of 25% a criminal offense. *N.Y. PEN. LAW* § 2401 makes the offense of "criminal usury" a felony, punishable by five years imprisonment, a fine of \$5,000, or both. See Meth, *A Contemporary Crisis: The Problem of Usury in the United States*, 44 *A.B.A.J.* 637, 640 (1958).

<sup>95</sup> See notes 3-6 *supra* and accompanying text.

<sup>96</sup> *Fahs v. Martin*, 224 F.2d 387, 397 (5th Cir. 1955).

<sup>97</sup> For a discussion of the relevance of a large lending institution's superior bargaining power, see text accompanying notes 412-71 *infra*.

<sup>98</sup> This figure has been picked purposely to exceed \$300.00, the typical maximum below which the small loan legislation of most states comes into effect. See note 72 *supra*.

per cent interest per annum. Payments on the loan are to be made at Lender's office in Lender's state. Therefore, under typical conflicts rules the contract is "made"<sup>99</sup> in Borrower's state, and to be "performed"<sup>100</sup> in Lender's state. Upon Borrower's subsequent default, Lender brings an action on the note in Borrower's state. The laws of Borrower's state (Borrower's law) provide for a maximum interest rate of six per cent; the laws of Lender's state (Lender's law) permit a maximum of ten per cent. If the court uses the Borrower's law as the standard to determine the legality of the interest rate, the contract will be usurious. If, on the other hand, the court uses the Lender's law for this purpose, the interest rate charged will be legal, and the contract "valid."<sup>101</sup>

The controversy over which law is determinative is quickly resolved by the special usury rule: The contract will be found valid under the interest maximum of the Lender's state. This state has a "substantial connection"<sup>102</sup> with the transaction because it is the place of the Lender's residence and the place of performance; and only under the Lender's law will the contract be valid. This result does not at first seem unfair. The proponents of the special usury rule argue that the parties intended to be bound by their agreement and validation will effectuate this intent; that an additional four per cent per annum is not such an excessive burden on Borrower as to justify imposition of the sanctions of usury on Lender; and that regular enforcement of such contracts is necessary to promote the stability and growth of interstate trade and commerce, a policy which both states share.

Vary this simple hypothetical, however, and consider whether it is sensible to apply the rule of validation indiscriminately in all of the following situations: (i) Assume that Borrower's bargaining power was greatly inferior to Lender's; that Borrower signed a standardized "adhe-

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<sup>99</sup> The concept of a contract "made" in a particular place is an elusive one. Courts have variously determined the place in which the contract is "made" as the place of negotiations, the place of the document's drafting, the place of acceptance, the place of delivery, and even the place of performance. See note 166 *infra*; text accompanying notes 343-45 *infra*.

<sup>100</sup> The "place of performance" in loan contracts is typically identified as the "place of payment." The reasons for this are obscure, as is the concept of a loan being "repaid" in a particular place. Many possibilities seem feasible: the place where the check is mailed, where it arrives, where it is cashed, or where the bank pays it. See note 166 *infra*.

<sup>101</sup> For present purposes, a contract shall be deemed "valid" if it is to be enforced in its entirety; it shall be deemed "invalid" or "void" if no part of it will be enforced. Further, a "usurious" contract shall be described as one containing a rate of interest in excess of the legally permitted maximum. In some states the lender in a "usurious" contract loses merely the excess interest over the maximum; in others he loses the entire principal and interest. The contract, therefore, is "invalid" or "void" only in the latter case.

<sup>102</sup> *Fahs v. Martin*, 224 F.2d 387, 397 (5th Cir. 1955). Compare RESTATEMENT (SECOND), CONFLICT OF LAWS § 334d (Tent. Draft No. 6, 1960) ("substantial relationship").



sion contract" without power to alter the terms; and that Lender's state enforces such contracts but Borrower's state does not. Should the court in Borrower's state still unhesitatingly apply Lender's law to validate the contract? Assume further that the contract contained a stipulation in small print that the laws of Lender's state should control the transaction. Should this clause be held to express the "declared intent" of the parties? Would it be relevant were it shown that Lender inserted this clause for the specific purpose of avoiding the usury sanctions of Borrower's states?<sup>103</sup>

(ii) Suppose that both states exempt corporations from the protection of their usury statutes, and that Lender requires Borrower to incorporate in order to strip from him the protection of the usury laws. Suppose further that while this procedure is permissible in Lender's state, Borrower's state considers such a practice a "sham" and would still allow Borrower as an individual to raise the defense of usury. Will the forum court in Borrower's state relinquish its equitable doctrine of "piercing the corporate veil" in favor of the doctrines of Lender's state, and validate the contract under the foreign law? <sup>104</sup>

(iii) Suppose the rate of interest charged is thirty per cent per annum, or even higher. Will Borrower's state allow foreign lenders to enter the state and exact such interest rates while domestic lenders are limited to six per cent? If application of the rule of validation is partially influenced by the degree to which the interest rate charged violates the interest rate permissible under forum law, how and where is the line between a permissible variation and an excessive departure to be drawn?<sup>105</sup>

(iv) To what extent should the court be influenced by the punitive sanctions of its own law? Assume that application of Borrower's law would allow Lender to recover, alternatively, (a) only the principal of the loan and the interest legal under Borrower's law, or (b) nothing, forfeiting the entire principal and interest to Borrower. Should the decision to find a contract usurious be at all influenced by the consequences to Lender of such a finding?<sup>106</sup>

(v) Assume that Borrower's court would normally apply its own law to invalidate a contract where Lender came into the state to solicit

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<sup>103</sup> For discussion of these considerations, see notes 412-37 *infra* and accompanying text. The converse hypothetical is equally interesting: assume that for some reason the provision stipulated that Borrower's law should control. Would it destroy the doctrine of "party intent," see notes 126-46 *infra* and accompanying text, to disregard this stipulation? Would it destroy the doctrine of "validation," see notes 170-237 *infra* and accompanying text, to follow this stipulation? Cf. *Jones v. Tindall*, 216 Ark. 431, 226 S.W.2d 44 (1950).

<sup>104</sup> For discussion of these considerations see notes 475-517 *infra* and accompanying text.

<sup>105</sup> For discussion of these considerations see notes 523-65 *infra* and accompanying text.

<sup>106</sup> For discussion of the considerations see notes 566-618 *infra* and accompanying text.

the loan. Would the court reach a different result if Borrower went into Lender's state to request the loan?<sup>107</sup>

(vi) Suppose that Borrower and Lender were both residents of Lender's state at the time of the loan, but that Borrower has subsequently established residence in the forum state. Will the court apply Lender's law even though the contract is severely oppressive and might force Borrower into bankruptcy? Or will it apply Borrower's law even though the lender could not have foreseen its invocation?<sup>108</sup>

This partial list of possible variables affecting a conflict-of-laws decision can be multiplied at will. Today's dramatic increase in consumer and mortgage credit<sup>109</sup> has generated a rash of new consumer finance institutions,<sup>110</sup> and the practices of these institutions have in turn required a bewildering variety of protective state laws and regulations.<sup>111</sup> Two developments in particular foreshadow the impact this multiplication of state laws will have on the problems of conflict of laws: the expansion of interstate credit transactions,<sup>112</sup> and the increased mobility of the individual debtor.<sup>113</sup> Because of the former, the laws of the lenders' and borrowers' states will increasingly come into conflict; and because of the latter, those immigration states which attract great numbers of debtors will necessarily be concerned with the dangers of "foreign debts forcing these new residents onto the relief rolls."<sup>114</sup>

Although general usury laws have, to some extent, been replaced by a wide variety of consumer loan legislation, the conflicts aspects of the pure usury cases still warrant study for two reasons: First, the \$300 to \$500 maximums in most states' small loan legislation are too low to protect the increasing number of borrowers contracting for loans of much greater amounts.<sup>115</sup> Until newer legislation is passed, only the existing usury

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<sup>107</sup> For discussion of these considerations see notes 620-38 *infra* and accompanying text.

<sup>108</sup> For discussion of these considerations see notes 639-53 *infra* and accompanying text.

<sup>109</sup> Note 74 *supra*.

<sup>110</sup> CURRAN, *op. cit. supra* note 63, at 5-13.

<sup>111</sup> CURRAN, *op. cit. supra* note 63, at 15-82. See SPECIAL COMMITTEE, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, REPORT ON RETAIL INSTALLMENT SALES, CONSUMER CREDIT, SMALL LOANS AND USURY 5-6 (1965).

<sup>112</sup> See 111 CONG. REC. 22015, 22017 (daily ed. Sept 2, 1965) (remarks of Rep. Weltner); *cf.* People v. Fairfax Family Fund, Inc., 235 Cal. App. 2d 881, 47 Cal. Rptr. 812 (1964); 32 OPS. CAL. ATT'Y GEN. 121, 122 (1958).

<sup>113</sup> See DERVIN, THE SPENDER SYNDROME: CASE STUDIES OF 68 FAMILIES AND THEIR CONSUMER PROBLEMS *passim* (1965).

<sup>114</sup> 32 OPS. CAL. ATT'Y GEN. 121, 126 (1958). See generally Brunn, *Wage Garnishment in California: A Study and Recommendations*, 53 CALIF. L. REV. 1214, 1229-38, 1243-45 (1965).

<sup>115</sup> One exception may be California's statutory structure, See Note, 18 STAN. L. REV. 1381 (1966).

laws protect these borrowers from various types of oppressive loans. Second, and of greater long run importance, the vast body of existing conflicts law concerning the protective loan legislation of various states involves general usury laws. As protective economic legislation becomes increasingly complex and the courts are confronted with conflicting interest disclosure legislation, installment loan laws, personal property broker statutes, or home improvement loan legislation,<sup>116</sup> the cases involving conflicts between usury laws will constitute the primary source of authority to guide future decisions. Because the underlying policies of usury laws are similar to those supporting most types of protective credit regulation,<sup>117</sup> the usury cases may be examined with profit before the increasing complexity of contemporary legislation makes such a study overly difficult.

## II

### PREVAILING CONFLICTS THEORY AND PRACTICE

We need a rule or principle which will declare in what circumstances a state's protective policy will be preferred to the nonprotective policy of other states. Plainly such a rule ought to prevent the protective policy from being undermined by persons seeking to avoid it, and at the same time we must not stretch it so far as to impair a free enterprise policy whether it is in our own law or in our neighbors'.<sup>118</sup>

The attempt over the last 165 years<sup>119</sup> to discover such a "rule or principle" for interstate loan contracts has failed. Although validation theories have attained special notoriety in many federal courts,<sup>120</sup> state court cases have reflected, and continue to reflect,<sup>121</sup> almost every possible type and gradation of conflicts doctrine.<sup>122</sup> Different theories have been

<sup>116</sup> See CURRAN, *TRENDS IN CONSUMER CREDIT LEGISLATION* 13 (1965).

<sup>117</sup> See CURRAN, *op. cit. supra* note 116, at 45-82.

<sup>118</sup> CAVERS, *THE CHOICE-OF-LAW PROCESS* 126 (1965) (Opinion of Chief Justice *F* of imaginary state *X*, apparently speaking for author).

<sup>119</sup> The earliest case appears to be *Van Schaick v. Edwards*, 2 Johns. Cas. 355 (N.Y. 1801).

<sup>120</sup> See, e.g., *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403 (1927); *Fowler v. Equitable Trust Co.*, 141 U.S. 384 (1891); *Cromwell v. County of Sac*, 96 U.S. 51 (1877); *Miller v. Tiffany*, 68 U.S. (1 Wall.) 298 (1863); *Fahs v. Martin*, 224 F.2d 387, 397 (5th Cir. 1955) (citing further authority).

<sup>121</sup> E.g., *De Korwin v. First Nat'l Bank*, 318 F.2d 176 (7th Cir. 1963) (place of performance); *Lyles v. Union Planters Nat'l Bank*, 393 S.W.2d 867 (Ark. 1965) (emphasis on place of contracting); *Franklin Nat'l Bank v. Feldman*, 42 Misc. 2d 839, 249 N.Y.S.2d 181 (Sup. Ct. 1964) (validation); *Pioneer Credit Corp. v. Catalano*, 51 Misc. 2d 407, 273 N.Y.S.2d 310 (Columbia County Ct. 1966) (most significant contacts).

<sup>122</sup> No case, however, has adopted Currie's "governmental interest" analysis, as proposed in, e.g., Currie, *The Constitution and the Choice of Law: Governmental Interests and the Judicial Function*, 26 U. CHI. L. REV. 9 (1958).

used by different states at the same time,<sup>123</sup> by a single state at different times,<sup>124</sup> and by a single state at the same time in a single case.<sup>125</sup>

### A. General Contract Rules

#### 1. Party Intention

According to the "party intention" or "party autonomy" doctrines of conflicts,<sup>126</sup> the validity of a contract is controlled by the law which the parties themselves subjectively intended to apply. Courts have generally used two techniques to discover this intended law.<sup>127</sup> The first is to apply the law expressly stipulated in a contractual provision. In the absence

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<sup>123</sup> Compare *McKay v. Belknap Sav. Bank*, 27 Colo. 50, 59 Pac. 745 (1899) (either place of contracting or of performance); *Thomson v. Kyle*, 39 Fla. 582, 23 So. 12 (1897) (place of contracting and of performance); *Ames v. Benjamin*, 74 Minn. 335, 77 N.W. 230 (1898) (place of performance); *Smith v. Parsons*, 55 Minn. 520, 57 N.W. 311 (1893) (party intention).

<sup>124</sup> See LEFLAR, *CONFLICT OF LAWS* § 124 (1959) (citing conflicting Arkansas cases); cf. *Lewis v. Jackson & Squire, Inc.*, 86 F. Supp. 354, 360 (W.D. Ark. 1949). Compare *Folsom v. Continental Adjustment Corp.*, 48 Ga. App. 435, 172 S.E. 833 (1934) (place of performance), with *Byrd v. Equitable Life Assur. Soc'y*, 185 Ga. 628, 196 S.E. 63 (1938) (party intent).

<sup>125</sup> See *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 364 S.W.2d 158 (1963).

<sup>126</sup> See generally EHRENZWEIG, *CONFLICT OF LAWS* § 174, at 460-61, § 176 (1962); 2 RABEL, *CONFLICT OF LAWS: A COMPARATIVE STUDY* 359-444 (2d ed. 1960); Cook, "Contracts" and the Conflict of Laws: "Intention" of the Parties, 32 ILL. L. REV. 899 (1938); Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, 53 COLUM. L. REV. 1072 (1953); James, *Effects of the Autonomy of the Parties on Conflict of Laws Contracts*, 36 CHI-KENT L. REV. 34, 87 (1959); Nussbaum, *Conflict Theories of Contracts: Cases versus Restatement*, 51 YALE L.J. 893 (1942); Yntema, *Contract and Conflict of Laws: "Autonomy" in Choice of Law in the United States*, 1 N.Y.L.F. 46 (1955); Yntema, "Autonomy" in Choice of Law, 1 AM. J. COMP. L. 341 (1952).

<sup>127</sup> A third technique is occasionally adopted by which, in the absence of any *indicia* from which intent may be determined or implied, "the court 'manufactures' or 'makes' an intent for the parties in order to arrive at what the court thinks is reasonable." James, *supra* note 126, at 35-36.

Analytically, the courts' explorations of party intention in this area may be viewed as occurring in two distinct steps: First, the court adopts one of the three techniques for discovering, implying, or manufacturing party intention. Second, it distinguishes between two types of intention: (i) the intention that the law of a *particular* state shall govern the contract's validity; and (ii) the more general intention or "expectation" that the parties will be bound by their promises and the contract enforced by *some* law. Intention (i) is typically invoked in discussions of "express" or "implied" intention.

These two steps are usually combined by courts which adopt the presumed intention technique, and which attempt to use it to validate interstate loan contracts. Thus, the court presumes the existence of either an intention (i) to contract with reference to the laws of whichever state will support the contract, *Bigelow v. Burnham*, 83 Iowa 120, 123, 49 N.W. 104-05 (1891), or an intention (ii) to have entered into a binding contract, in which case the court itself selects the validating law, *Gilbert v. Fosston Mfg. Co.*, 174 Minn. 68, 72, 216 N.W. 778, 779 (1927); see textual discussion of validation accompanying notes 214-20 *infra*.

of such a stipulation, the second technique is to imply the parties' unexpressed intentions from their actions or the provisions of the contract.

(a) *Express Stipulations of Law*.—Express stipulations of the law which shall govern a multistate transaction in commercial loan contracts<sup>128</sup> have had no substantial impact upon courts' choices of law in usury cases. They are occasionally described as a "significant element"<sup>129</sup> among many to be considered; but more often they are either disregarded completely,<sup>130</sup> or treated as indicative of a fraudulent intent to evade forum law.<sup>131</sup>

In every case found which *honored* a stipulation of a foreign lender's more liberal law,<sup>132</sup> thereby validating a contract which otherwise would be usurious by forum law,<sup>133</sup> the reasoning concerning party intent was carefully buttressed by a finding of other foreign "contacts."<sup>134</sup> These contacts alone would have been sufficient to justify the same result under other<sup>135</sup> prevailing conflicts theories. Stipulations of foreign law, therefore, are probably superfluous to a finding of validity for an interstate loan

<sup>128</sup> See generally 2 RABEL, *op. cit. supra* note 126, at 410-14; Ehrenzweig, *supra* note 126, at 1085 (criticizing Rabel's analysis); James, *supra* note 126, at 87-96; Note, *Conflict of laws: "Party Autonomy" in Contracts*, 57 COLUM. L. REV. 553, 555-58 (1957); EHRENZWEIG, *op. cit. supra* note 126, § 182, at 484 n.10 (criticizing Note).

<sup>129</sup> *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 17, 38 Cal. Rptr. 376, 380 (1964).

<sup>130</sup> *E.g.*, *Ashurst v. Ashurst*, 119 Ala. 219, 24 So. 760 (1898).

<sup>131</sup> *E.g.*, *United States Sav. & Loan Ass'n v. Scott*, 98 Ky. 695, 34 S.W. 235 (1896).

<sup>132</sup> See *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964); *Consolidated Jewelers, Inc. v. Standard Fin. Corp.*, 325 F.2d 31 (6th Cir. 1963); *Albritton v. General Fin. Corp.*, 204 F.2d 125 (5th Cir. 1953); *Andruss v. People's Bldg., Loan & Sav. Ass'n*, 94 Fed. 575 (5th Cir. 1899); *In the Matter of Leeds Homes, Inc.*, 222 F. Supp. 20 (D.C. Tenn. 1963); *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 364 S.W.2d 158 (1963); *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964); *Steinman v. Midland Sav. & Loan Co.*, 78 Kan. 479, 96 Pac. 860 (1908); *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 211 S.W.2d 831 (1948); *Castleman v. Canal Bank & Trust Co.*, 171 Miss. 291, 156 So. 648 (1934); *Goode v. Colorado Inv. Loan Co.*, 16 N.M. 461, 117 Pac. 856 (1911); *Midland Sav. & Loan v. Kuntz*, 58 Okla. 156, 158 Pac. 604 (1916); *Midland Sav. & Loan Co. v. Henderson*, 47 Okla. 693, 150 Pac. 868 (1915).

<sup>133</sup> Cases, such as the following, which involve "avoidable" conflicts, see text accompanying notes 380-93 *infra*, must be disregarded: *Meinhard, Greef & Co. v. Edens*, 189 F.2d 792 (4th Cir. 1951); *Armstrong v. Alliance Trust Co.*, 88 F.2d 449 (5th Cir. 1937); *Le Sueur v. Manufacturers' Fin. Co.*, 285 Fed. 490 (6th Cir. 1922), *cert. denied*, 261 U.S. 621 (1923) (two laws identical); *United States Sav. & Loan Co. v. Shain*, 8 N.D. 136, 77 N.W. 1006 (1898) (contracts valid under both laws). *Townsend v. Riley*, 46 N.H. 300 (1865), which involved a contract between parties who were both, at the time of contracting, residents of the foreign state, creates special problems. See text accompanying notes 639-53 *infra*.

<sup>134</sup> In every case the state of the stipulated law was also the lender's domicile or principal place of business, and the place of contracting or performance.

<sup>135</sup> *E.g.*, theories based upon the places of contracting or performance, see notes 161-69 *infra* and accompanying text, or the policy of validation, see notes 170-237 *infra* and accompanying text.

contract.<sup>136</sup> On the other hand, courts have found party intent of greater importance when the stipulated law is the law of the forum. The existence of such stipulations has been stressed in two situations: where a court wishes to validate, by forum law, a contract which otherwise would be usurious under the foreign lender's law;<sup>137</sup> and where a court, anxious to protect a forum borrower against the lender's higher rates, declares the contract usurious under forum law.<sup>138</sup> Several of the latter cases honored the stipulation and applied forum law, even though most or all of the traditionally important "contacts" were in the foreign lender's state.<sup>139</sup>

Cases *refusing to honor* a stipulation of foreign law fall into two groups: those in which yet another foreign law is applied in place of the stipulated law to validate a contract in favor of a foreign lender; and those in which the stipulation is rejected completely and the contract declared usurious in favor of a forum borrower. The former have turned on the fact that the state which was stipulated seemed insufficiently connected with the transaction.<sup>140</sup> The latter have disregarded the stipulated law for various reasons: that it constitutes "a breach of [a] legal or moral right as maintained in . . . the forum",<sup>141</sup> that "such discrimination . . . would destroy . . . home banks, and other like institutions, which faithfully

<sup>136</sup> See 2 RABEL, *op. cit. supra* note 126, at 413; Note, 57 COLUM. L. REV. 553, 558 (1957).

<sup>137</sup> See *Ashurst v. Ashurst*, 119 Ala. 219, 24 So. 760 (1898); *McDougall v. Hachmeister*, 184 Ark. 28, 41 S.W.2d 1088 (1931); *Lanier v. Union Mortgage, Banking & Trust Co.*, 64 Ark. 39, 40 S.W. 466 (1897); *Byrd v. Equitable Life Assur. Soc'y*, 185 Ga. 628, 196 S.E. 63 (1938); *New England Mortgage Security Co. v. McLaughlin*, 87 Ga. 1, 13 S.E. 81 (1891); *Arnold v. Potter*, 22 Iowa 194 (1867); *Dugan v. Lewis*, 79 Tex. 246 (1891).

<sup>138</sup> See *Jones v. Tindall*, 216 Ark. 431, 226 S.W.2d 44 (1950); *Atlas Subsidiaries, Inc. v. O. & O., Inc.*, 166 So. 2d 458 (Fla. App. 1964); *Smith v. Parsons*, 55 Minn. 520, 57 N.W. 311 (1893); *Lesser v. Strubbe*, 56 N.J. Super. 274, 152 A.2d 409 (Super. Ct. 1959), *modified on other grounds*, 67 N.J. Super. 537, 171 A.2d 114 (App. Div. 1961), *aff'd per curiam*, 39 N.J. 90, 187 A.2d 705 (1963); *Union & Planters Bank & Trust Co. v. Evans*, 8 Tenn. App. 63 (1928).

<sup>139</sup> See *Jones v. Tindall*, *supra* note 138 (place of payment and of contracting in foreign state); *Lanier v. Union Mortgage, Banking & Trust Co.*, 64 Ark. 39, 40 S.W. 466 (1897); *Arnold v. Potter*, 22 Iowa 194 (1867); *Smith v. Parsons*, *supra* note 138; *Dugan v. Lewis*, 79 Tex. 246 (1891). Under certain variations of intent theories, even "contacts" become irrelevant. The parties may, for whatever reason, stipulate any law they please. See James, *supra* note 126, at 37-59. However, this has not been accepted in the area of usurious or illegal contracts, see cases cited at note 140 *infra*. Stipulations of laws not "connected" with the transaction in some other way would probably be characterized as fraudulent or against public policy. See James, *supra* note 126, at 49-55.

<sup>140</sup> See *Brierley v. Commercial Credit Co.*, 43 F.2d 730 (3d Cir. 1930); *United Divers Supply Co. v. Commercial Credit Co.*, 289 Fed. 316 (5th Cir. 1923); *Washington Nat'l Bldg. & Loan Ass'n v. Pifer*, 31 App. D.C. 434 (Cir. 1908); *American Freehold Land & Mortgage Co. v. Jefferson*, 69 Miss. 770, 12 So. 464 (1892); *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 157 S.E. 860 (1931); *Stoddard v. Thomas*, 60 Pa. Super. 177 (1915); *Manufacturers Fin. Co. v. Johnson & Co.*, 15 Tenn. App. 236 (1931).

<sup>141</sup> *Falls v. United States Sav., Loan & Bldg. Co.*, 97 Ala. 417, 422, 13 So. 25, 27 (1892).

observe the law limiting the rate of interest";<sup>142</sup> that as the parties intended the contract to be "enforced" in the forum, it must be construed by forum laws;<sup>143</sup> that the stipulation is "a mere shift or device to escape the penalty of our usury laws";<sup>144</sup> or that the stipulation would in effect "destroy the efficacy of our statutes against usury . . .".<sup>145</sup> Except in cases involving stipulations of forum law, therefore, doctrines of party autonomy have not been used to provide conflicts solutions in usury cases. Indeed, the mere presence of a stipulation of a foreign lender's law is likely to arouse the court's suspicions concerning a possible attempted evasion of forum law, and increase the danger of invalidation.<sup>146</sup>

(b) *Implied Elections of Law*.—When a contract contains no express stipulation of a governing law, courts which use intention theories have been forced to "imply" the intended law from a consideration of the parties' behavior and the provisions of the contract.<sup>147</sup> Courts have at various times construed the place of performance,<sup>148</sup> the place of con-

<sup>142</sup> *Meroney v. Atlanta Nat'l Bldg. & Loan Ass'n*, 116 N.C. 882, 921, 21 S.E. 924, 937 (1895). See *United States Bldg. & Loan Ass'n v. Lanzarotti*, 47 Idaho 287, 274 Pac. 630 (1929); *Washington Nat'l Bldg., Loan & Sav. Ass'n v. Stanley*, 38 Ore. 319, 63 Pac. 489 (1901); *Floyd v. National Loan & Inv. Co.*, 49 W. Va. 327, 38 S.E. 653 (1901).

<sup>143</sup> *Fidelity Sav. Ass'n v. Shea*, 6 Idaho 405, 416, 55 Pac. 1022, 1025 (1899). See *United States Bldg. & Loan Ass'n v. Lanzarotti*, *supra* note 142; *Snyder v. Fidelity Sav. Ass'n*, 23 Utah 291, 64 Pac. 870 (1901).

<sup>144</sup> *Building & Loan Ass'n of Dakota v. Bilan*, 59 Neb. 458, 460, 81 N.W. 308, 309 (1899). See *United States Bldg. & Loan Ass'n v. Lanzarotti*, 47 Idaho 287, 274 Pac. 630 (1929); *United States Sav. & Loan Co. v. Scott*, 98 Ky. 695, 34 S.W. 235 (1896).

<sup>145</sup> *Locknane v. United States Sav. & Loan Co.*, 103 Ky. 265, 270, 44 S.W. 977, 978 (1898).

<sup>146</sup> In *United States Sav. & Loan Co. v. Scott*, 98 Ky. 695, 698, 34 S.W. 235, 236 (1896), the court felt that the stipulation of foreign law "only makes the intent to evade [forum law] more manifest." This suspicion is found only with respect to stipulations of foreign law. No case has been found in which a stipulation of the borrower's forum law has been held an evasion of foreign law. See *New England Mortgage Security Co. v. McLaughlin*, 87 Ga. 1, 2, 13 S.E. 81, 82 (1891). A forum state may invalidate a stipulation of its own law, however, when the forum is the domicile of neither the borrower nor the lender. *American Freehold Land & Mortgage Co. v. Jefferson*, 69 Miss. 770, 12 So. 464 (1892).

<sup>147</sup> "Indeed, in all cases [respecting the payment of interest] we are to look to the real intentions of the parties, and their acts are expressive of them." STORY, *CONFLICT OF LAWS* § 293b, at 462 (4th ed. 1852). See generally 2 RABEL, *op. cit. supra* note 126, at 432-42. For the historical development of this approach see EHRENZWEIG, *op. cit. supra* note 126, at 460-61; Nussbaum, *supra* note 126, at nn.12-21; Yntema, *Contract and Conflict of Laws: "Autonomy" in Choice of Law in the United States*, 1 N.Y.L.F. 46, 50-52 (1955). For an excellent judicial discussion of intent-implication see *George v. Oscar Smith & Sons Co.*, 250 Fed. 41, 47-55 (5th Cir. 1918) (Batts, J., dissenting). For a recent intent-implication case see *Moody v. Bass*, 357 F.2d 730 (6th Cir. 1966).

<sup>148</sup> *Dupree v. Virgil R. Coss Mortgage Co.*, 167 Ark. 18, 267 S.W. 586 (1924); *New England Mortgage Security Co. v. McLaughlin*, 87 Ga. 1, 13 S.E. 81 (1891); *Smith v. Muncie Nat'l Bank*, 29 Ind. 158 (1867); *Mueller v. Ober*, 172 Minn. 349, 215 N.W. 781 (1927); *Shannon v. Georgia State Bank & Loan Ass'n*, 78 Miss. 955, 30 So. 51 (1901).

tracting,<sup>149</sup> the forum where the contract was to be enforced,<sup>150</sup> and the state where the mortgaged property was located,<sup>151</sup> as factors indicating an implicit election of law by the parties. Intent-implication theories, however, have been found unsatisfactory,<sup>152</sup> and for several reasons have fallen into disuse.<sup>153</sup> First, such theories rest upon the highly dubious assumption that the parties actually did subjectively contemplate the application of a particular law. Courts have apparently recognized this fiction for what it is, and discarded it in favor of other, more plausible doctrines.<sup>154</sup> Second, when the places of contracting and performance are in different states, there seems no obvious reason why one particular connection and not another should be taken to represent an implicit election of law.<sup>155</sup> Third, courts have occasionally felt that the places of contracting and performance were too fortuitous or too easily manipulated by the lender to serve as a reliable guide to party intention.<sup>156</sup> And fourth,

<sup>149</sup> *Zimmerman v. Brown*, 30 Idaho 640, 166 Pac. 924 (1917); *McAllister v. Smith*, 17 Ill. 328 (1856); *William Glenny Glass Co. v. Taylor*, 99 Ky. 24, 34 S.W. 711 (1896).

<sup>150</sup> *People's Bldg., Loan & Sav. Ass'n v. Kidder*, 9 Kan. App. 385, 58 Pac. 798 (1899); *Westchester Mortgage v. Grand Rapids & I.R.R.*, 246 N.Y. 194, 158 N.E. 70 (1927).

<sup>151</sup> *Westchester Mortgage v. Grand Rapids & I.R.R.*, *supra* note 150.

<sup>152</sup> "[T]he conception . . . that the acts of performance contemplated in a contract are an index to the intention of the parties respecting the law of the contract, is a slippery path which leads in the end to a fiction and to correspondingly increased judicial discretion." Yntema, *"Autonomy" in Choice of Law*, 1 AM. J. COMP. L. 341, 352 (1952).

<sup>153</sup> *Moody v. Bass*, 357 F.2d 730 (6th Cir. 1966), is the first case found since 1927 which has adopted this doctrine. The fact that *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403 (1927), the last Supreme Court decision on conflicts and usury, appeared during 1927, may explain the unpopularity of the doctrine in the intervening years. *Seeman* emphasized the place of performance, and made no mention of party intention.

<sup>154</sup> "In a search for the actual intent of the parties when none is expressed, there is an element of legal jugglery. Usually parties to transactions of this nature . . . have no unexpressed but actual intent as to the law which shall control. The question of what law governs does not suggest itself to them." *Green v. Northwestern Trust Co.*, 128 Minn. 30, 36, 150 N.W. 229, 231 (1914). *But cf. Gilbert v. Fosston Mfg. Co.*, 174 Minn. 68, 72, 216 N.W. 778, 779 (1927).

<sup>155</sup> *Van Schaick v. Edwards*, 2 Johns. Cas. 355 (N.Y. 1801), the first case of usury and conflicts in the United States, foreshadowed the difficulties courts were to have with the notions of place-of-performance and place-of-contracting. The majority held that, although the contract for the sale of New York land was made in Massachusetts, there were sufficient contacts with New York (i.e., situs of the land, and residence of buyer) to find the "probable intent" that "the parties had an express view to our law . . ." *Id.* at 360, 363. Kent, J., dissenting, argued that, as the contract was made in Massachusetts and the contract specified no place of payment, Massachusetts law should apply: "It is not enough that the parties have a view or reference to the law of another state, in the *formation* of their contract; for if that were sufficient, the statute of usury would, in every case, at the option of the parties, become a dead letter. The rule is, that the parties must have a view to the laws of another state, in the execution of the contract, and then undoubtedly the contract is to be governed by such foreign law." *Id.* at 367. (Emphasis added.)

<sup>156</sup> *Compare Wayne County Sav. Bank v. Low*, 81 N.Y. 566, 571 (1880) (sustaining the contract by foreign law and disregarding both the place of performance and of con-



statements of these connections which had at one time been viewed as indicative of party intent came to be viewed as absolute formulas in themselves; their underlying intent rationale was forgotten.<sup>157</sup> By the time the spell of these doctrines had begun to weaken, other theories based upon broader notions of party intent had become prevalent.<sup>158</sup>

In sum, party intention theories suffer from two basic disabilities. First, the judicial search for subjective intent seems as likely of success as the hunting of the snark. The widespread use of standardized adhesion contracts between large lending institutions and individual borrowers has in most cases reduced the concept of an express choice of law to a legal fiction.<sup>159</sup> Second, party intention arguments in the area of usurious contracts beg the important question. The fundamental issue is not whether the parties actually did intend a particular law to apply, but whether they should be allowed to have that law apply. The fact that an ignorant or necessitous borrower has agreed to a contractual provision which would subject him to a less protective foreign law should not in itself serve to strip from him the protection of his own laws. Party intention, as a matter of policy, must be deemed irrelevant with respect to this kind of borrower.<sup>160</sup>

## 2. Places of Contracting and Performance

A small number of older usury cases, following the general development of American conflicts law,<sup>161</sup> phrased their choice-of-law decisions in terms of a simple alternative. The law of the place of contracting was said to control the validity of the contract; but if the place of performance was elsewhere, the law of the latter controlled.<sup>162</sup> The doctrine of party intention which Story<sup>163</sup> found to support this rule was temporarily discarded or forgotten, and during the period of Beale and the First Restatement this simple alternative was applied dogmatically.<sup>164</sup> But despite

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tracting), *with* Huchingson v. Republic Fin. Co., 236 Ark. 832, 835-36, 370 S.W.2d 185, 187 (1963) (invalidating the contract by forum law and disregarding the place of performance).

<sup>157</sup> See GOODRICH, CONFLICTS OF LAWS § 106, at 201-02 (Scoles ed. 1964); EHRENZWEIG, *op. cit. supra* note 126, at 460-62.

<sup>158</sup> See text accompanying notes 214-20 *infra* for a discussion of validation theories.

<sup>159</sup> See text accompanying notes 413-20 *infra*.

<sup>160</sup> See text accompanying notes 81-86 *supra*.

<sup>161</sup> See generally EHRENZWEIG, *op. cit. supra* note 126, at 461-63; GOODRICH, *op. cit. supra* note 157, at 201-02; Yntema, *supra* note 147.

<sup>162</sup> See, e.g., Akers v. Demond, 103 Mass. 318 (1869) (place of making); Ames v. Benjamin, 74 Minn. 335, 77 N.W. 230 (1898) (place of performance).

<sup>163</sup> STORY, *op. cit. supra* note 147, at 366-67, 431-32.

<sup>164</sup> Yntema, *supra* note 147, at 55, thus describes the evolution of the doctrine: "Beale did not accept the composite alternative rule as formulated by Story, referring to the place of contracting or the place of performance and grounded in tacit assent, as a single proposition. He . . . dissected the composite rule into three mutually exclusive rules, applying,

heavy criticism,<sup>165</sup> difficulties of application,<sup>166</sup> and the apparent rigidity of this rule, the concepts of the place-of-contracting and place-of-performance had the merit of being sufficiently vague to provide the courts with the flexibility needed to reach a just result.<sup>167</sup> Although remnants of this doctrine are still found in usury cases,<sup>168</sup> it has been generally abandoned,<sup>169</sup> and has been replaced by various doctrines of validation.

### B. Special Usury Rules

#### 1. Rules of Validation

The validity of a contract will be sustained against the charge of usury if it provides for a rate of interest that is permitted by the general usury law of any state with which the contract has a substantial relationship and is not greatly in excess of the rate permitted by the state whose local law governs the validity of the contract [under generally applicable *Second Restatement* rules]. . . .<sup>170</sup>

As the most recent and authoritative statement of an openly acknowledged or "express"<sup>171</sup> rule of validation for interstate loan contracts, this

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respectively, the law of the place of contracting, or of performance, or that intended by the parties, to foreign contracts."

<sup>165</sup> See Yntema, *supra* note 147, at 57-61, summarizing the attacks of Lorenzen, Stumberg, Cook, and others.

<sup>166</sup> The difficulties were two-fold: First, it was uncertain what act was to constitute a final "contracting" or "performance" in a bilateral contract. Regarding the former, courts at different times stressed the places of final acceptance, of negotiations, where the agreement was drafted into a final form, where the mortgage was recorded, and where the promissory note was delivered. See *e.g.*, *Deaton v. Vise*, 186 Tenn. 364, 210 S.W.2d 665 (1948). Concerning the latter, early cases had difficulty in deciding whether performance consisted of the lender's transfer of the principal to the borrower, or the borrower's repayment to the lender. See, *e.g.*, *Atwater v. Roelofson*, 2 Handy 19 (Ohio Super. Ct. 1855); *cf.* *Pritchard v. Norton*, 106 U.S. 124, 138 (1882). Second, with respect to the place of performance, it was uncertain where the required act occurred. Where, for example, does the "act of payment" occur when the borrower mails a check from his state drawn on his own bank to the lender who receives it in his state and deposits it in his bank in yet another state? The notion that a contract has a place of performance is at least comprehensible in certain areas—*e.g.*, a contract for the construction of a house. But it is conceptually unintelligible when applied to the act of repaying money by check. The courts' original error lay in adopting the place-of-performance notion in areas where it could not work.

<sup>167</sup> See, *e.g.*, *Staples v. Nott*, 128 N.Y. 403 (1891); *Wayne County Sav. Bank v. Low*, 81 N.Y. 566 (1880).

<sup>168</sup> See, *e.g.*, *Pioneer Credit Corp. v. Radding*, 149 Conn. 126, 176 A.2d 560 (1961); *Santoro v. Osman*, 149 Conn. 9, 174 A.2d 800 (1961).

<sup>169</sup> See Comment, 35 CONN. B.J. 296, 299 (1960).

<sup>170</sup> RESTATEMENT (SECOND), CONFLICT OF LAWS § 334d (Tent. Draft No. 6, 1960).

<sup>171</sup> An "express" rule of validation must be distinguished from what has been designated as merely a "rule of validation." For a statement of this unexpressed "rule of validation," see EHRENZWEIG, *op. cit. supra* note 126, at 458. An "express" rule of validation is an explicit statement by a court in the language of its opinion that, for whatever reason, it is adopting the conflicts theory of supporting contracts by some available law. An unexpressed "rule of validation" is a description, not of what courts have said, but of what

pronouncement of the American Law Institute deserves careful consideration. However, only after the historical forces that shaped this doctrine over a century ago are thoroughly understood can its usefulness as a conflict of laws theory be critically examined.

(a) *Origins*.—The first basic statement of the rule of validation was made in 1863 by the United States Supreme Court in *Miller v. Tiffany*.<sup>172</sup> The Court there found "well settled" the principle that the parties to a loan contract made in one state and to be performed in another could contract for the higher rate of interest allowed by the lender's state, even though such a contract would be usurious under the law of the borrower's state. The historical development of this doctrine is instructive, for it vividly illustrates not only the consequences of a failure to discriminate between differing factual situations, but also the impact of judicial and academic misinterpretation of early cases on the growth of the law.

The Supreme Court based its rule of validation on two cases: the 1829 Louisiana case of *Depau v. Humphreys*,<sup>173</sup> and the 1839 Supreme Court case of *Andrews v. Pond*.<sup>174</sup> In *Depau v. Humphreys*, a New York lender brought an action in Louisiana against a Louisiana borrower. The borrower's promissory note was executed in Louisiana, but was to be repaid in New York at an interest rate of ten per cent per annum. Under Louisiana law, which provided for a maximum interest of ten per cent, the contract was valid and enforceable. Under New York law, however, which allowed a maximum interest of only seven per cent, the contract would have been usurious and both the interest and principal forfeited to the borrower. The borrower raised the defense of usury under New York law. He argued that, according to the doctrine set forth by Lord Mansfield in *Robinson v. Bland*,<sup>175</sup> the contract's validity was to be governed by the laws of the place of performance, and that the designation of New York as the place of payment constituted an implicit election of New York law. The court distinguished this doctrine in *Robinson v. Bland* as being "*obiter dictum*"<sup>176</sup> and sustained the contract under Louisiana law. It held that with

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they have done. It embodies the generalization that courts will attempt to sustain contracts in conflicts situations, although they may use any number of theories to do so.

<sup>172</sup> 68 U.S. (1 Wall.) 298 (1863).

<sup>173</sup> 8 Mart. (n.s.) 1 (La. 1829).

<sup>174</sup> 38 U.S. (13 Pet.) 65 (1839).

<sup>175</sup> 2 Burr. 1077, 97 Eng. Rep. 717 (1760).

<sup>176</sup> Plaintiff had sued on a note given him in satisfaction of a gambling debt. The note was executed in France, and payable in England. The debt was unenforceable at law in both France and England. French equity would enforce it as a debt of honor, but since the defendant had been killed in a duel prior to the action, the French court could not have taken in personam jurisdiction. Because the plaintiff could not have recovered under either law, the *Depau* court, quoting *Robinson v. Bland*, viewed the case as "no case at all; no point at all; no law at all." 8 Mart. (n.s.) at 18.

respect to a note executed in the forum state, a foreign lender "may stipulate for the legal rate of . . . interest authorized by *our* law, although such a rate be disallowed in the place, at which payment is to be made."<sup>177</sup> However, in critical language which has been almost universally ignored, the court gave its reasons for rejecting the rule that the law of the place of performance should control the validity of the contract:

The principle that a contract, valid in the *locus celebrati contractus*, is void, if contrary to the law *loci solutionis*, must establish the converse of the proposition, i.e. that a contract void, according to the former, is valid, if it be so according to the latter.

If this be the case, of what use is it for any legislature to pass a law for the protection of the weak and necessitous?

[I]f parties could free themselves from the effect of the laws of their country, by stipulating for payment elsewhere, they would sap the foundation of every law . . .<sup>178</sup>

Although it is not clear which particular conflicts doctrine the *Depau* court adopted,<sup>179</sup> the reasonableness of the result, given the particular factual situation, should be emphasized. *Depau* was not a case where a forum borrower had contracted to pay the higher interest rate of a foreign lender's state. On the contrary, the interest rate was in accord with the borrower's own laws. If Louisiana's usury laws were designed "for the protection of the weak and necessitous," then its borrower had been accorded all the protection to which his state felt he was entitled. On the other hand, whether the foreign lender was receiving a rate of interest in excess of that allowed by his own laws was of no concern to the Louisiana court. To declare the contract void by applying the place-of-performance rule would serve merely to bestow upon the borrower an undeserved windfall, and impose upon the lender an unexpected forfeiture.<sup>180</sup> No convincing reason, therefore, could be given for the invalidation of the contract under New York law.<sup>181</sup>

<sup>177</sup> *Id.* at 35. (Emphasis added.)

<sup>178</sup> *Id.* at 30-32. The court expressed similar concern over the evasion of laws designed to protect minors and females from entering into binding contracts. *Id.* at 30.

<sup>179</sup> The opinion did not state the particular reason for applying the place-of-contracting rule. No mention was made of party intention, actual or implied, although it was mentioned in cases before and after *Depau*. See *Robinson v. Bland*, 2 Burr. 1077, 97 Eng. Rep. 717 (1760); *Chapmann v. Robertson*, 6 Paige 627 (N.Y. 1837). This indicates that the court believed the policy considerations involved in adopting a strict place-of-performance rule were alone sufficiently undesirable to justify its rejection.

<sup>180</sup> The total forfeiture of interest and principal required by New York law would have been \$29,654.98. 8 Mart. (n.s.) at 3.

<sup>181</sup> *Depau v. Humphreys*, in fact, posed and correctly resolved an "avoidable" conflict. See notes 356-79 *infra* and accompanying text. The failure of courts to recognize and distinguish this type of conflicts problem in subsequent opinions was largely responsible for the development of a validation rule for cases of usury. See notes 182-203 *infra* and accompanying text.

Story, commenting on *Depau* shortly thereafter, appears to have missed the point of the court's reasoning, and in so doing altered the development of the law in this field:

The Supreme Court of Louisiana decided . . . that, although the note was made payable at New York, yet the interest might be stipulated for, *either* according to the law of Louisiana, *or* according to that of New York. . . . [I]f the law of *both places* is not violated, in respect to the rate of interest, the contract for interest will be valid.<sup>182</sup>

The *Depau* court was concerned that strict adherence to a place-of-performance rule would eventually force it to support a contract valid at the foreign place-of-performance, but invalid in the forum, Louisiana. It refused, in effect, to subordinate in some future case the interests of its own borrowers to a rigid conflicts rule. Under Story's unguarded<sup>183</sup> interpretation, however, the very result which the *Depau* court feared most would be realized.<sup>184</sup> Unfortunately, the great majority<sup>185</sup> of courts<sup>186</sup>

<sup>182</sup> STORY, CONFLICTS OF LAW § 298, at 248 (2d ed. 1841). (Emphasis added.) Story may have been misled by the court's statement that there were "two places of contracting, and that the interest rate *"may be legally stipulated, according to the law of the place where the note is made . . ."* *Depau v. Humphreys*, 8 Mart. (n.s.) 1, 35 (La. 1829). (Emphasis added.) However, the court made it clear that it would certainly not have looked with favor upon a stipulation of interest according to the law of the place of payment if that rate was higher than that allowed by the forum. See text accompanying note 178 *supra*.

<sup>183</sup> Story's statement is accurate only if strictly limited to the facts in *Depau*. When the foreign interest rate is lower than the borrower's rate, validation of the contract by formal reference to the higher of the two laws will still afford the borrower the protection of his own law. However, this proposition should not be adopted when the contract rate and foreign rate are higher than that allowed by the borrower's state. Story apparently did not intend to confine the statement to the *Depau* facts. See note 184 *infra*.

<sup>184</sup> Ironically, Story later stated with approval the very proposition which the *Depau* court felt to be an obvious *reductio ad absurdum*: "It has been said, that, if the principle be, that a contract, valid in the place, where the contract is celebrated, is void, if it is contrary to the law of the place of payment, it must establish the converse proposition, that a contract, void by the law of the place, where it is made, is valid, if good by the law of the place of payment. [Citing *Depau v. Humphreys*.] *This would seem to be reasonable.*" STORY, *op. cit. supra* note 147, § 305, at 252. (Emphasis added.) Contrast *Depau*'s own commentary on this very position: "If this be the case, of what use is it for any legislature to pass a law for the protection of the weak and necessitous?" 8 Mart. (n.s.) at 31-32. See note 178 *supra* and accompanying quotation.

<sup>185</sup> See *Chapmann v. Robertson*, 6 Paige 627 (N.Y. 1837), correctly citing *Depau*, and 2 KENT, COMMENTARIES ON AMERICAN LAW 460 (2d ed. 1832), with perhaps the only accurate account of the *Depau* reasoning.

<sup>186</sup> See, e.g., *Peck v. Mayo, Follett & Co.*, 14 Vt. 33 (1842). Borrowers, residents of Vermont, executed promissory notes to the lender, a resident of Montreal, repayment to be made in New York. No interest rate was stipulated in the contract. Vermont and Montreal allowed a return of only 6% in such a case, while New York permitted 7%. Erroneously citing *Depau v. Humphreys*, the court applied New York law: "The case of [*Depau*] . . . v. *Humphreys* expressly decides, that a contract made in one country, to be performed in another, where the rate of interest is higher than at the place of entering into the contract, . . . may stipulate the higher rate of interest." *Id.* at 37. *Accord*, *Bolton v. Street*, 3 Cold. 31, 45 (Tenn. 1866).

and commentators<sup>187</sup> alike have misunderstood the force of the *Depau* reasoning.

In 1839, the United States Supreme Court forged the second link in the chain leading to its rule of validation. *Andrews v. Pond*<sup>188</sup> involved a note between a resident of New York and a resident of Alabama for a rate of interest usurious under the laws of both states. The issue before the Court, therefore, was not the validity of the contract, but which state's penalties for usury were applicable.<sup>189</sup> Despite the important distinction between the issues of validity and of sanctions,<sup>190</sup> the Court set forth the proposition that a contract's validity would be determined by the laws of the place of performance, even though that rate was higher than that allowed by the laws of the place of contracting.<sup>191</sup> Although this proposition appears to have had no support in American case law at the time, and the Court itself in *Andrews v. Pond* explicitly characterized it as *obiter dictum*,<sup>192</sup> it was to appear some twenty-five years later in *Miller v. Tiffany* as a "well settled" rule of law.<sup>193</sup> It should be noted that at this stage in the development of conflicts rules regarding usury, no American court had been forced to decide a case in which the contractual rate of interest was legal by the lender's law but usurious by the borrower's law. In the cases existing at the time, either the contract stipulated no interest rate at all,<sup>194</sup>

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<sup>187</sup> See 2 PARSONS, CONTRACTS 95 (1st ed. 1855): "[I]f a note be made, bona fide, in one place, expressly bearing an interest legal there, and payable in another place in which so high a rate of interest is not allowed, it may be sued in the place where payable, and the interest expressed recovered. Because the parties had their election to make the interest payable according to the law of either place; or to express the same thing differently, they may lawfully agree upon the largest interest allowed by the law of either place . . . . This is the result arrived at after much consideration, by the Supreme Court of Louisiana, in *Depau v. Humphreys*." ACCORD, DANIELS, NEGOTIABLE INSTRUMENTS 935 (4th ed. 1891); WHARTON, THE CONFLICT OF LAWS § 507 (2d ed. 1881).

<sup>188</sup> 38 U.S. (13 Pet.) 65 (1839).

<sup>189</sup> Under Alabama law, the lender could recover only the principal without interest; under New York law, the contract would be void and both principal and interest forfeited to the borrower. *Id.* at 77.

<sup>190</sup> The distinction between validity and remedy is important for, when the contract is invalid under either law, the borrower is "protected" no matter which law is chosen. The choice of Alabama law would have given him the compensation deemed appropriate by his own state; New York law would have given him more. The primary issue, therefore, was the extent to which the borrower was to receive a windfall, see notes 410-11 *infra* and accompanying text. By imposing the heavier forfeiture of New York law, *Andrews v. Pond* appears to reach a result contrary to the trend of later cases. See RESTATEMENT (SECOND), *op. cit. supra* note 170, § 334d, at 59.

<sup>191</sup> 38 U.S. (13 Pet.) at 78.

<sup>192</sup> "[T]his question [of the law governing the contract's validity] is not very important. . . . [And it] is not the question which we are now called on to decide." *Id.* at 77, 78.

<sup>193</sup> *Miller v. Tiffany*, 68 U.S. (1 Wall.) 298, 310 (1863).

<sup>194</sup> *E.g.*, *Peck v. Mayo, Follett & Co.*, 14 Vt. 33 (1842).

was valid under the borrower's own laws,<sup>195</sup> or was usurious under both laws.<sup>196</sup> In 1863, however, the United States Supreme Court was confronted for the first time with a usury case involving an "essential"<sup>197</sup> conflict of laws.

In *Miller v. Tiffany*<sup>198</sup> an action was brought in Indiana against an Indiana borrower upon a note executed in favor of two co-lenders, residents of New York and Ohio, respectively. The note was executed in Indiana, and was to be repaid at ten per cent interest in Ohio. Indiana and New York law allowed interest of six per cent per annum, whereas Ohio law permitted ten per cent. The borrower attempted to invoke New York's usury law to invalidate the contract. He contended that the negotiations were transacted in New York, that the lenders had formally made the contract payable in Ohio to avoid the usury laws of New York and Indiana, but that in actuality the parties intended repayment to be made in New York.<sup>199</sup> The Court rejected this argument, and enforced the contract under Ohio law. In so doing it formulated the first express conflicts rule of validation for cases of usury:

The general principle in relation to contracts made in one place to be performed in another is well settled. They are to be governed by the law of the place of performance, and if the interest allowed by the law of the place of performance is higher than that permitted at the place of contract, the parties may stipulate for the higher interest without incurring the penalties of usury." [Citing *Andrews v. Pond*.] The converse of this proposition is also well settled. If the rate of interest be higher at the place of the contract than at the place of performance, the parties may lawfully contract in that case also for the higher rate. [Citing *Depau v. Humphreys*.]<sup>200</sup>

*Miller v. Tiffany* was the first judicial statement of what the leading American commentators inaccurately believed to be the existing state of conflicts law on usury. The Court, in a decision heavily influenced by a suspicion of fraud on the part of the borrower,<sup>201</sup> combined the unsus-

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<sup>195</sup> *E.g.*, *Depau v. Humphreys*, 8 Mart. (n.s.) 1 (La. 1829); *Chapmann v. Robertson*, 6 Paige 627 (N.Y. 1837); *Van Schaick v. Edwards*, 2 Johns. Cas. 355 (N.Y. 1801). See notes 367-79 *infra* and accompanying text.

<sup>196</sup> *E.g.*, *Andrews v. Pond*, 38 U.S. (13 Pet.) 65 (1839).

<sup>197</sup> For a definition of an "essential" conflict see note 406 *infra* and accompanying text.

<sup>198</sup> 68 U.S. (1 Wall.) 298 (1863).

<sup>199</sup> *Id.* at 306.

<sup>200</sup> *Id.* at 310.

<sup>201</sup> Conflicting evidence was presented as to the reasons for designating Ohio as the place of payment. *Id.* at 301-05. The court, however, viewed the borrower's part in the transaction with great suspicion: "[W]e are by no means satisfied that it was not the deliberate purpose of [the borrower] . . . to involve [the lenders] . . . in the toils of this [usury] defense, and if possible to escape with the goods without paying anything for them." *Id.* at 310.

ported dictum of *Andrews v. Pond*<sup>202</sup> with the unqualified language of *Depau v. Humphreys*<sup>203</sup> to enforce against the borrower a contract valid by the lender's law, but clearly usurious by the borrower's. Ironically, the place-of-contracting principle which *Depau v. Humphreys* had invoked to escape the undesirable consequences of a strict place-of-performance rule, was used to enlarge the scope of that very rule. *Depau* was cited as authority for the proposition it wished most to avoid.

The express rule of validation set forth by *Miller v. Tiffany* over a century ago has never been formally abandoned. Federal courts have broadened its language, but not its impact;<sup>204</sup> and the Supreme Court's formulation has not been reviewed in forty years.<sup>205</sup> To be sure, the *Second Restatement of Conflicts* has qualified its "substantial relationship" test<sup>206</sup> to apply only where the interest permissible under the related law is "not greatly in excess" of that permissible under the law having the "most significant relationship" to the contract.<sup>207</sup> It must be emphasized, however, that this qualification is almost worthless as a means of furthering any relevant state's policy of borrower protection. First, it does not provide for application of the borrower's law whenever the borrower is paying interest greatly in excess of his maximum. It states rather that the interest maximum of the state having the "most significant relationship" to the contract will be applied. Thus, for example, when the lender's interest rate is "greatly in excess" of the borrower's, but the lender's law has the "most significant relationship" to the contract, a contract providing for the maximum interest allowed by lender's state will be validated and the protective policies of the borrower's state ignored.<sup>208</sup> Second, any lending institution wishing to charge rates "greatly in excess" of the borrower's rates can easily arrange for its state to have the "most significant relationship" to the contract.<sup>209</sup> Despite the *Second Restatement's*

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<sup>202</sup> 38 U.S. (13 Pet.) 65 (1839).

<sup>203</sup> 8 Mart. (n.s.) 1 (La. 1829).

<sup>204</sup> See *Fahs v. Martin*, 224 F.2d 387 (5th Cir. 1955), proposing a "substantial connection" test. However, no recent case has sustained a contract by any law other than the law of the lender's or borrower's residence or principal place of business. As these are invariably the places of contracting and of performance, the "substantial connection" test adds little to the *Miller v. Tiffany* formulation.

<sup>205</sup> See *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403 (1927) (repeating the *Miller v. Tiffany* rule).

<sup>206</sup> RESTATEMENT (SECOND), *op. cit. supra* note 170, § 334d.

<sup>207</sup> *Ibid.* For the "most significant relationship" test, see *id.* §§ 332-32b. A law "not greatly in excess" of another is one which exceeds the other by "a few percentage points at most." *Id.* at 54.

<sup>208</sup> The *Second Restatement's* test works to the borrower's advantage only when his law has the "most significant relationship" to the contract, and the lender's law has only a "substantial relationship" to that contract.

<sup>209</sup> The lender has merely to provide that the contract be binding only when signed



formulation, therefore, the borrower is still forced into a game of "contact-counting"<sup>210</sup> which the lender can easily manipulate in his favor.

(b) *Justifications.*—*Miller v. Tiffany* flatly stated, as a "well settled" rule, that "parties may lawfully contract . . . for the higher rate" of interest.<sup>211</sup> Apart from the fact that this rule was not at all "well settled," the Court's opinion was remarkable for its complete lack of any reasoned justification for such a rule.<sup>212</sup> Consequently, the rule of validation often became an empty formula in the hands of courts which merely repeated the *Miller* language verbatim.<sup>213</sup> A number of courts, however, subsequently evolved three broad justifications for the existence of a rule favoring validation of interstate loan contracts. They failed, nevertheless, to indicate why multistate loan transactions should be treated differently from those which were purely domestic.

(1) *Presumed Intent.*—The first justification for the rule of validation was based upon the doctrines of party intention.<sup>214</sup> Several variations were proposed. One group of cases adopted the view that the parties must be "presumed" to have contracted with specific reference to the laws of the particular state in which the stipulated interest rate was lawful.<sup>215</sup>

by him in his own state, that payments be made in his state, and include a stipulation of his law in the form contract. See, e.g., *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964). The lender's law would then necessarily apply under §§ 332a or 332b, RESTATEMENT (SECOND), *op. cit. supra* note 170.

<sup>210</sup> Weintraub, *The Contracts Proposals of the Second Restatement of Conflict of Laws*—A Critique, 46 IOWA L. REV. 713, 724 (1961).

<sup>211</sup> 68 U.S. (1 Wall.) 298, 310 (1863). (Emphasis added.)

<sup>212</sup> The Court's use of the word "may" might suggest that the rule was based on party intention, the parties themselves being allowed to choose the higher of the two permissible interest rates. This view might gain support from the Reporter's statement of facts, *id.* at 301-05. However, the opinion itself contains no reference to party intention. Subsequent Supreme Court opinions vary. *Cromwell v. County of Sac*, 96 U.S. 51, 62 (1877), discussed bonds made "with reference to the law of Iowa," possibly emphasizing party intention. But *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 407 (1927), the last Supreme Court opinion on the subject, based its holding on the general "policy of upholding contractual obligations assumed in good faith," and made no mention of party intention.

<sup>213</sup> See, e.g., *Pioneer Sav. & Loan Co. v. Nonnemacher*, 127 Ala. 521, 30 So. 79 (1900); *Pancoast v. Travelers Ins. Co.*, 79 Ind. 172 (1881).

<sup>214</sup> See notes 126-27 *supra* and accompanying text.

<sup>215</sup> The classic statement of this position was made in *Bigelow v. Burnham*, 83 Iowa 120, 123, 49 N.W. 104-05 (1891): "When a contract is made in one state, to be performed in another, and in express terms provides for a rate of interest lawful in one but unlawful in the other state, the parties will be *presumed* to contract with reference to the laws of the state wherein the stipulated rate of interest is lawful, and such presumption will prevail until overcome by proof that the stipulation was intended as a means to defeat the law against usury . . . ." (Emphasis added.) *Accord*, *Joffe v. Bonn*, 14 F.2d 50, 52 (3d Cir. 1926); *Green v. Northwestern Trust Co.*, 128 Minn. 30, 36, 150 N.W. 229, 231 (1914); *American Freehold Land & Mortgage Co. v. Jefferson*, 69 Miss. 770, 778-79, 12

Where no manifestation of actual party intention could be found, courts were forced to manufacture—in the parties' behalf—an intent to have the contract judged by a particular law.<sup>216</sup>

Although this approach has the advantage of allowing a court to reform a contract under the guise of following the parties' contractual "intention," it does not indicate the court's actual motives for validating such a contract. The question remains why a court should want to presume such a fictitious validating intent. If an answer can be given in terms of some judicial, commercial, or public policy, then in the interests of clarity that policy should be forthrightly declared. If no answer can be given, the fiction should be dropped.

A second group of cases has proposed a more general theory of party intention: The mere act of entering into a binding contractual relationship creates by itself a presumption that the parties intended in good faith to be bound by their mutual promises. Accordingly, the court itself selects the particular law which will effectuate this intent.<sup>217</sup>

This position is based upon a desirable policy—upholding contractual obligations "voluntarily undertaken."<sup>218</sup> It fails to explain, however, why and under what circumstances a statute specifically designed to overturn, in the name of borrower protection, contractual obligations voluntarily undertaken should be disregarded. When confronted with a clearly usurious domestic contract, no court would ignore its own usury statute on the ground that the presumed intention of the parties to be bound by their agreement must be given legal recognition. When such an argument is unanimously repudiated in purely domestic cases, why should it be found so persuasive in conflicts cases?<sup>219</sup>

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So. 464, 465 (1892) (presumption rejected); *Franklin Nat'l Bank v. Feldman*, 42 Misc. 2d 839, 841, 249 N.Y.S.2d 181, 183 (Sup. Ct. 1964); *Bowman v. Price*, 143 Tenn. 366, 380, 266 S.W. 210, 214 (1920). The converse of this statement is often cited: "The parties cannot be presumed to have contemplated a law which would defeat their engagements." *Pritchard v. Norton*, 106 U.S. 124, 137 (1882), quoting 4 PHILLIMORE, *INTERNATIONAL LAW* § 654 (1861). For a discussion of "evasion," see text accompanying notes 243-76 *infra*.

<sup>216</sup> See James, *Effects of the Autonomy of the Parties on Conflict of Laws Contracts*, 36 *CHI.-KENT L. REV.* 34, 35-6 (1959).

<sup>217</sup> The best statement of this theory is found in *Gilbert v. Fosston Mfg. Co.*, 174 Minn. 68, 72, 216 N.W. 778, 779 (1927): "It offends both sense and justice to prevent obligation where obligation is clearly intended. So if a contract may be . . . a nullity under the laws of state A., but valid and enforceable . . . in state B., the law refers it to that state. In no other way can the plain intent to assume contractual obligation be given effect. So if the method is a species of 'legal jugglery' . . . , it is after all an open and honest kind of legerdemain done in full view of the audience. If it be a mere trick of the law, it is at least in the interest of honesty . . . ." See also *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 404 (1927); *Franklin Nat'l Bank v. Feldman*, 42 Misc. 2d 839, 249 N.Y.S.2d 181 (Sup. Ct. 1964); *cf.* *RESTATEMENT (SECOND)*, *op. cit. supra* note 170, § 334d, at 54.

<sup>218</sup> *Kossick v. United Fruit Co.*, 365 U.S. 731, 741 (1961).

<sup>219</sup> Compare the statement made in the Minnesota case of *Gilbert v. Fosston Mfg. Co.*,

This divergence can be tolerated only if some cogent argument exists which justifies judicial deference to party intention in a multistate context. The difficulty lies in attempting to conceive of such an argument. The confusion in contemporary conflicts doctrines might lead one to argue that a lighter burden on the courts should alone justify deference to party expectations. But it is doubtful whether any court would allow the parties to circumvent an area of statutory protection merely because a conflicts decision seemed too difficult. Alternatively, one might contend that a foreign lender may find it difficult to discover and comply with the requirements of the borrower's law; thus, invalidation would unfairly surprise the lender. But no established interstate lending institution could seriously argue that it lacked the facilities to determine the nature and extent of the borrower's law.<sup>220</sup> Moreover, it would not be unduly harsh to impose such a burden on all those who engage in interstate lending. It is evasive to argue, therefore, in an area where statutes *exist* to invalidate certain contracts, that an oppressive contract should be enforced under the lender's law in the name of freedom to contract. In the field of usury that very doctrine of contractual freedom has been abrogated by legislative fiat to prevent socially undesirable consequences.

(2) "*Concessions to Trade and Commerce.*"— A small number of courts at one time attempted to justify the validation of interstate loan contracts on the economic ground of commercial necessity. The best known statement appeared in *Bigelow v. Burnham*.<sup>221</sup> The court found "that the rule as to the law of contracts, made in one state to be performed in another, is modified or softened when applied to contracts for interest, so that the intentions of the parties are effectuated, *as a concession to trade and commerce.*"<sup>222</sup> The phrase, "a concession to trade and commerce,"<sup>223</sup> has achieved a notoriety of sorts among commentators on

174 Minn. 68, 72, 216 N.W. 778, 779 (1927), *with* the Minnesota case of *E.C. Warner Co. v. W.B. Foshay Co.*, 57 F.2d 656, 659 (8th Cir. 1932), just a few years later: "Usury is a moral taint, and no subterfuge, however cunningly devised, will be permitted to conceal it. . . . [T]here is no device or shift on the part of the lender to evade the statute under or behind which the law will not look . . . ." (Quoting in part *Lukens v. Hazlett*, 37 Minn. 441, 443, 35 N.W. 265, 266 (1887).) *Gilbert* validated the contract; *E.C. Warner* declared it usurious.

<sup>220</sup> See note 232 *infra* and text accompanying notes 636-38 *infra*.

<sup>221</sup> 83 Iowa 120, 49 N.W. 104 (1891).

<sup>222</sup> *Id.* at 123, 49 N.W. at 105. (Emphasis added.) The normal rule of contracts which the court found "modified or softened" is the rule that the interest rate is controlled by the place of performance, see *Butters v. Olds*, 11 Iowa 1, 2 (1860). It should be noted that the court in *Bigelow* linked the two theories of "presumed intention" and "commercial necessity." This combination has the merit of explaining why a validating intent should be presumed, in addition to the notion of generally enforcing contracts freely entered. However, no other case combining these theories has been found. Authorities citing *Bigelow* invariably omit the phrase, "so that the intentions of the parties are effectuated." See, e.g., authorities cited note 224 *infra*.

<sup>223</sup> The phrase was taken from DANIELS, NEGOTIABLE INSTRUMENTS § 922, at 935 (4th

conflicts and usury, and has apparently been thought to supply the ultimate explanation for the courts' "desire to uphold the transaction where possible."<sup>224</sup> This explanation, however, has seemed less than persuasive to the courts. No case seriously proposing this rationale has been discovered since 1891.<sup>225</sup> On the contrary, an equal number of subsequent cases have justified finding interstate loan contracts usurious on the very ground of commercial necessity, arguing that the advantage otherwise given to out-of-state lenders would be unfair to domestic businesses.<sup>226</sup>

The argument from commercial necessity is persuasive only in cases

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ed. 1891): "There are some contracts . . . which are nevertheless recognized and enforced, if valid either in the [state of contracting or performance] . . . and of this nature are contracts to pay interest . . . . In such cases, the intention of the parties is effectuated, as a concession to trade and commerce between nations . . . ." (Emphasis added.) Although Daniels cites numerous authorities for this proposition, including *Depau v. Humphreys*, 8 Mart. (n.s.) 1 (La. 1829), see text accompanying notes 173-87 *supra*, only one case mentions trade or commerce: *Potter v. Tallman*, 35 Barb. 182 (N.Y. 1861). *Potter v. Tallman*, in turn, cites only 2 KENT, *op. cit. supra* note 185, at 454, which states: "A contract, valid by the law of the place where it is made, is, generally speaking, valid everywhere . . . . [A]nd on this broad foundation the law of contracts, founded on necessity and commercial convenience, is said to have been originally established. If the rule were otherwise, the citizens of one country could not safely contract, or carry on commerce, in the territories of another." Kent, it would appear, was merely speaking of contracts in general, and had no intention of referring to usury in particular. Further, he was cited by the court in *Potter v. Tallman*, a case decided on non-conflicts grounds. *Bigelow v. Burnham*, therefore, apparently snatched the phrase, "concession to trade and commerce," out of thin air.

<sup>224</sup> GOODRICH, *CONFLICT OF LAWS* 334 (3d ed. 1949). See NUSSBAUM, *MONEY IN THE LAW: NATIONAL AND INTERNATIONAL* 167-68 & n.58 (1950): "[T]he court will apply that state law which is most favorable to the maintenance of the transaction. . . . The underlying principle is clearly stated in *Bigelow v. Burnham* . . . ." See STUMBERG, *CONFLICT OF LAWS* 238 & n.56 (3d ed. 1963) (incorrectly citing *Arnold v. Potter*, 22 Iowa 194 (1867), an earlier Iowa case). The same conclusion was reached after a study of certain Texas cases, Stumberg, *Conflict of Laws—Validity of Contracts—Texas Cases*, 10 TEXAS L. REV. 163, 184 (1932).

<sup>225</sup> See *Bigelow v. Burnham*, 83 Iowa 120, 49 N.W. 104 (1891), and notes 222-24 *supra* and accompanying text; *Bowen v. Bradley*, 9 Abb. Pr. (n.s.) 395, 399 (N.Y. 1870) (objecting to a prior decision as "contrary to law, to sound reason, and the necessity of commerce"); *Potter v. Tallman*, 35 Barb. 182 (N.Y. 1861). See also *United States Sav. & Loan Co. v. Shain*, 8 N.D. 136, 77 N.W. 1006 (1898) (the value of funds supplied by the lender "amply compensates for the apparent exorbitancy of the . . . interest"); *Atwater v. Roelofson*, 2 Handy 19 (Ohio Super. Ct. 1855) (discussing the value of money in different states as affecting the interest rate). *But cf.* *Kinney Loan & Fin. Co. v. Sumner*, 159 Neb. 57, 65 N.W.2d 240 (1954) (relying on conflicts clause in small loan legislation).

<sup>226</sup> *Meroney v. Atlanta Nat'l Bldg. & Loan Ass'n*, 116 N.C. 882, 921, 21 S.E. 924, 937 (1895): "[S]uch discrimination . . . would destroy all our home banks, and other like institutions . . . ." See *Mirgon v. Sherk*, 196 Wash. 690, 84 P.2d 362 (1938) (foreign lender not allowed to do business on more favorable terms than domestic corporations). See also *McAllister v. Smith*, 17 Ill. 328 (1856) (admission of parol evidence on usury held "paramount" to its exclusion on grounds of protecting negotiable paper).

of "avoidable conflicts,"<sup>227</sup> such as a loan contract usurious under the foreign lender's law but valid under the borrower's law. It is significant that *Bigelow v. Burnham* involved just such a contract. Courts have quite sensibly and almost unanimously refused to invoke the penalties of a foreign law to protect a domestic borrower who, under his own law, had not been harmed.<sup>228</sup> In such a case the commercial necessity argument underlines a basic principle of contract law: that the parties' mutual expectations should be protected. The existence of such an avoidable conflict permits the implementation of this principle without the violation at the same time of a borrower's statute designed to control the abuses of absolute freedom of commerce.

The commercial necessity argument is inapplicable, however, in cases of "essential conflict"<sup>229</sup> where, for example, the interest rate is valid under the lender's law but usurious under the lower rate of the borrower's law.<sup>230</sup> No court would validate a usurious, domestic contract in the name of "trade and commerce"; and it is quite unlikely that invalidation of interstate loan contracts would adversely affect healthy interstate commerce and good interstate relations to any appreciable degree. It is therefore difficult to perceive how such an economic argument might be found persuasive with respect to an interstate loan.

Another argument might be made to distinguish the multistate from the domestic loan transaction. In a multistate context the parties are handicapped by the uncertainty of not knowing which law will be applied to their transaction. Validation will assure them of the same degree of certainty enjoyed by parties in a purely domestic context. This certainty is necessary to the furtherance of "trade and commerce." Analytically, this argument covers two situations. In the first, the parties are aware of the choice-of-law problem, but assume that the contract will be sustained under the higher rate of the lender's law or will never be challenged in court. Here the argument of uncertainty immediately breaks down. The lender can easily ensure validation, and thus obtain certainty, by simply complying with the borrower's law. The contract will be valid under all applicable laws. Placed in this light, it is clear that the lender is attempting to argue not just that he needs a measure of certainty for "trade and

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<sup>227</sup> See text accompanying notes 356-405 *infra*.

<sup>228</sup> See, e.g., *Lanier v. Union Mortgage, Banking & Trust Co.*, 64 Ark. 39, 40 S.W. 466 (1897); *New England Mortgage Security Co. v. McLaughlin*, 87 Ga. 1, 13 S.E. 81 (1891). For further authority and discussion of this "avoidable" conflict see notes 367-79 *infra* and accompanying text.

<sup>229</sup> See text accompanying notes 406-09 *infra*.

<sup>230</sup> This statement may be modified with respect to corporate borrowers in certain circumstances. See text accompanying notes 453-71 *infra*.

commerce," but that it is only his law and not the borrower's which can supply this certainty. Clearly, this argument is invalid.

In the second situation neither party is even aware of a potential choice-of-law problem; both merely assume the contract is enforceable. This example is similar to a domestic situation where the parties do not realize they have contracted for an illegal rate of interest. Despite the lender's surprise, such contracts are nevertheless declared usurious.<sup>231</sup> A lender might argue that it is more difficult for him to discover the requirements of the law of another state, and that this increased difficulty is sufficient to distinguish the multistate from the domestic case. But this argument is of dubious factual merit in view of the many convenient references and available compilations of state usury statutes.<sup>232</sup> Furthermore, as a matter of policy it does not seem unreasonable to impose this burden of discovery upon all lenders who seek to make a profit from interstate lending. Usury statutes are solicitous of borrowers, not lenders. It would be paradoxical indeed to declare a protective statute inapplicable as a restraint on the lender's freedom to engage in trade and commerce.

(3) *The Special Conflicts Rule for Usury*.—Judicial explanations for the rule of validation have finally come full circle. *Miller v. Tiffany*,<sup>233</sup> the first exponent of the rule, merely declared that it was "well settled." More recently, courts have justified the rule on the equally uninformative ground that there simply exists "a special rule applicable to usury."<sup>234</sup> These decisions lack any rigorous, policy-oriented analysis. The assumption is apparently made that the rule is either so well settled by authority as to warrant no further discussion, or so obvious that discussion would be unnecessary.<sup>235</sup> Thus, while conflicts law with respect to contracts is

<sup>231</sup> "The suggestion is not that a transaction is free of usury because the parties to it do not know that there is a usury law. The contrary is true. If they contract for forbidden interest, though without moral wrong, not knowing that there is a usury law to violate, they are subject to the penalties of usury." *Green v. Northwestern Trust Co.*, 128 Minn. 30, 36, 150 N.W. 229, 231 (1914). See Horack, *A Survey of the General Usury Laws*, 8 LAW & CONTEMP. PROB. 36, 41 (1941).

<sup>232</sup> For a current compilation, see *State Interest and Usury Laws—A Chart Setting Forth Statutory Provisions as to Legal Rates of Interest and Usurious Contracts*, 3 CCH FED. BANKING L. REP. ¶ 59,005 (Nov. 2, 1966); see notes 524, 566-67, & 569-75 *infra*.

<sup>233</sup> 68 U.S. (1 Wall.) 298 (1863).

<sup>234</sup> *Fahs v. Martin*, 224 F.2d 387, 397-98 (5th Cir. 1955). See *Kinney Loan & Fin. Co. v. Sumner*, 159 Neb. 57, 65 N.W.2d 240 (1954); *Hawkins v. Ringel*, 231 N.Y.S.2d 476 (Sup. Ct. 1962), *rev'd mem.*, 19 App. Div. 649, 242 N.Y.S.2d 616 (1963); *Columbian Bldg. & Loan Ass'n v. Rice*, 68 S.C. 236, 47 S.E. 63 (1904); RESTATEMENT (SECOND), CONFLICT OF LAWS § 334d, at 54-55, 62 (Tent. Draft No. 6, 1960).

<sup>235</sup> This has been particularly true in federal courts. See *Seeman v. Philadelphia Warehouse Co.*, 247 U.S. 403 (1927); *Bedford v. Eastern Bldg. & Loan Ass'n*, 181 U.S. 227 (1901); *Miller v. Tiffany*, 68 U.S. (1 Wall.) 298 (1863); *Fahs v. Martin*, 224 F.2d 387 (5th Cir. 1955); *Lubbock Hotel Co. v. Guaranty Bank & Trust Co.*, 77 F.2d 152 (5th Cir. 1935); *Pellerin Laundry Mach. Sales Co. v. Hogue*, 219 F. Supp. 629 (W.D. Ark. 1963);

generally becoming more flexible and pragmatic, the law applicable to interstate loan contracts appears in danger of ossification.

For several reasons the rule of validation should not become another imperative rule. First, it does not describe the true state of the law. A continually increasing number of cases have declared interstate loan contracts usurious for a variety of reasons.<sup>236</sup> Second, the rule ignores the interests of the borrower—the very person usury laws are designed to protect. Third, the rule is at best a gross oversimplification. Cases involving conflicts in usury laws can be surprisingly complex. The automatic application of a special usury rule to every decision is likely to cause courts to omit the careful factual analysis which each case deserves. Fourth, even if it were true that a relatively small number of cases require invalidation, and that automatic application of the rule of validation might lead to a just result in many situations,<sup>237</sup> the widespread adoption of an imperative approach would make it embarrassingly difficult for a court to justify, on purely theoretical grounds, the few exceptions it believed were necessary. Because the evils of usury still occur, courts must remain sufficiently flexible to deal with them. It is therefore instructive to examine the methods by which courts have declared contracts usurious in the face of their own, or a generally accepted, special rule of validation.

## 2. *Exceptions to Rules of Validation*

For early commentators, it was a cardinal rule of conflicts law that “a contract, valid by the law of the place where it is made, is . . . valid everywhere . . . .”<sup>238</sup> Confronted with contracts made in one state, but to be performed in another, courts quite early professed to apply the law of the place of performance in accordance with the implicit intentions of the parties.<sup>239</sup> This necessarily meant, however, that a state might be forced by its own conflicts rule to uphold a contract otherwise invalid under its own law.<sup>240</sup> To prevent the complete abrogation of the law of the forum in favor of another state’s laws, courts have always held in

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*Cyrion Steel Co. v. Globus*, 185 F. Supp. 757, 759 n.2 (S.D.N.Y. 1960); *Brierley v. Commercial Credit Co.*, 43 F.2d 724 (E.D. Pa. 1929) (“special rule” for usury in federal courts); *United States Sav. & Loan v. Harris*, 113 Fed. 27 (E.D. Ky. 1902) (citing federal authority and refusing to follow state authority); *Kellogg v. Miller*, 13 Fed. 198 (C.C. Neb. 1881).

<sup>236</sup> See notes 238-327 *infra* and accompanying text.

<sup>237</sup> See notes 438-653 *infra* and accompanying text for a detailed discussion of the reasons justifying validation of contracts involving essential conflicts.

<sup>238</sup> 2 KENT, COMMENTARIES ON AMERICAN LAW 454 (2d ed. 1832).

<sup>239</sup> *Cf. Robinson v. Bland*, 2 Burr. 1077, 97 Eng. Rep. 717 (1760).

<sup>240</sup> See *Depau v. Humphreys*, 8 Mart. (n.s.) 1 (La. 1829).

reserve the power to invalidate a contract by invoking certain exceptions to the more general rules of "universal validity."<sup>241</sup>

General adoption of the rule of validation for interstate loan contracts might seem to have made the development of exceptions impossible. This has not been the case. Courts have emphatically retained the power to declare a contract usurious by applying forum law, despite its validity under a related foreign law.<sup>242</sup> As the invalidation doctrines used by courts often reveal the policy determinants which influence their decisions, these doctrines warrant careful analysis. The exceptions fall into three groups: cases where there has been an attempted evasion of the borrower's law; those where there has been an attempted manipulation of the contractual provisions to disguise the fact of usury; and those where the contractual provisions, if upheld, would violate the forum's public policy.

(a) *Evasion of Usury Laws*.—Cases involving conflicts in usury laws often contain language declaring that a contract for a particular interest rate in excess of the borrower's law will be declared usurious if the lender<sup>243</sup> has tried to "evade" the restrictions of the borrower's law.<sup>244</sup> This language applies most clearly in purely domestic contract cases. Forum laws would be rendered ineffective were a state to allow two residents to stipulate the more liberal usury law of a foreign state. Difficulties arise however, when the lender is a resident of a foreign state. Confronted with this situation, courts often seem caught in the grip of a paradox. To allow a lender, on the one hand, intentionally to exact a rate of interest higher than that allowed by the borrower's state, and permit him to rely for protection on his own more liberal laws, would appear to sanction an act deliberately designed to render the forum's usury statute meaningless. But on the other hand, it seems difficult to grasp exactly how a foreign lender can be held to have "evaded" a law to which he is not subject. In fact, the forum's own conflicts doctrine may itself dictate the application of the lender's validating law. Courts have attempted to resolve this paradox in two ways: first, by examining the

<sup>241</sup> STORY, *CONFLICT OF LAWS* §§ 244(3)-245, at 369-72 (4th ed. 1852).

<sup>242</sup> "[N]o people are bound to enforce, or hold valid in their courts of justice, any contract which is injurious to their public rights, or offends their morals, or contravenes their policy, or violates a public law." 2 KENT, *op. cit. supra* note 238, at 458.

<sup>243</sup> Courts are only concerned with the lender's, and not the borrower's, intent. Usury laws "are enacted to protect the weak and necessitous from oppression. The borrower is not *particeps criminis* with the lender, whatever his knowledge or intention may be. The lender alone is the violator of the law, and against him alone are its penalties enacted." *Lukens v. Hazlett*, 37 Minn. 441, 443-44, 35 N.W. 265, 267 (1887).

<sup>244</sup> *Cf. American Freehold Land & Mortgage Co. v. Jefferson*, 69 Miss. 770, 12 So. 464 (1892).



subjective intentions of the parties; second, by determining whether the law in question has a "normal" or "natural" "relation" to or "connection" with the transaction.

(1) *Subjective Intention*.—A substantial number of courts have seized upon the notion of subjective intention to solve the problem of the malicious lender. Adopting an approach similar to the continental doctrine of *fraude à la loi*,<sup>245</sup> courts have argued that the parties cannot intentionally manipulate the terms of a contract in order to subject that contract to the laws of a foreign state.<sup>246</sup> The lender's state is normally considered to be closely connected with the transaction. But if it is discovered, for example, that in order to bring the contract under his state's more liberal law the lender has purposefully manipulated the transaction so that the act of final acceptance occurred in his state, or the repayments were made in his state, or both, he may be found to harbor an "evasive intention" and the contract invalidated.<sup>247</sup>

This view of evasive intention has several critical drawbacks. First,

<sup>245</sup> Cf. Comment, 11 U. FLA. L. REV. 384 (1958); see generally EHRENZWEIG, CONFLICTS IN A NUTSHELL § 18, at 71-72 (1965); EHRENZWEIG, CONFLICTS OF LAWS § 120, at 345-46 (1962) (citing continental authority); James, *Effects of the Autonomy of the Parties on Conflict of Laws Contracts*, 36 CHI.-KENT L. REV. 34, 53-55 (1959); Note, *Fraud on the Law—The Doctrine of Evasion*, 42 COLUM. L. REV. 1015, 1020, 1025-26 (1942).

<sup>246</sup> "It is the law that parties residing in different States may, in good faith, contract with reference to the law of either State, but would not be permitted to do so for the purpose of avoiding the force of the usury law in either one of the States." Dupree v. Virgil R. Coss Mortgage Co., 167 Ark. 18, 29, 267 S.W. 586, 589 (1924) (majority opinion). Compare the concurring opinion, quoted in note 256 *infra*. For contracts usurious under both laws, see Ringer v. Virgin Timber Co., 213 Fed. 1001 (E.D. Ark. 1914); Hutchingson v. Republic Fin. Co., 236 Ark. 832, 370 S.W.2d 185 (1963); Dupree v. Virgil R. Coss Mortgage Co., *supra*. For cases finding no "evasion" and sustaining the contract under foreign law see Clarkson v. Finance Co., 328 F.2d 404 (4th Cir. 1964); Midland Sav. & Loan Co. v. Solomon, 71 Kan. 185, 79 Pac. 1077 (1905); Berrien v. Wright, 26 Barb. 208, 213 (N.Y. 1857); Bundy v. Commercial Credit Co., 202 N.C. 604, 163 S.E. 676 (1932); Bowman v. Price, 143 Tenn. 366, 266 S.W. 210 (1920) (presenting the bizarre argument that the argument that the forum borrower, had he intended forum law to apply, would have been acting in bad faith; under this theory, forum borrowers would always lose). See also McAllister v. Smith, 17 Ill. 328 (1856); Thornton v. Dean, 19 S.C. 583 (1883) (where, oddly enough, the foreign lender must have been accused of attempting to evade the borrower's more liberal laws). For cases finding "evasion" and invalidating the contract by applying the borrower's law, see cases cited at note 247 *infra*.

<sup>247</sup> See Lyles v. Union Planters Nat'l Bank, 393 S.W.2d 867 (Ark. 1965); Atlas Subsidiaries, Inc. v. O. & O. Inc., 166 So. 2d 458 (Fla. App. 1964); Fidelity Sav. Ass'n v. Shea, 6 Idaho 405, 55 Pac. 1022 (1899); Locknane v. United States Sav. & Loan Co., 103 Ky. 265, 44 S.W. 977 (1898); United States Sav. & Loan v. Scott, 98 Ky. 695, 34 S.W. 235 (1896); Shannon v. Georgia State Bldg. & Loan Ass'n, 78 Miss. 955, 30 So. 51 (1901); Building & Loan Ass'n v. Bilan, 59 Neb. 458, 81 N.W. 308 (1899); Ripple v. Mortgage & Acceptance Corp., 193 N.C. 422, 137 S.E. 156 (1927); Building & Loan Ass'n v. Griffin, 90 Tex. 480, 39 S.W. 656 (1897); Mirgon v. Sherk, 196 Wash. 690, 84 P.2d 362 (1938); cf. American Freehold Land & Mortgage Co. v. Jefferson, 69 Miss. 770, 12 So. 464 (1892).

it penalizes the lender for knowing the law.<sup>248</sup> If the parties, in perfect innocence, agree that the contract is to be accepted or the repayments made in the lender's state, the contract will be validated. But if the parties know that the contract would be usurious under the borrower's law, and reach an identical agreement concerning the places of acceptance and repayment, the court will find the contract usurious. There seems no obvious reason why the lender's ignorance should be rewarded at the borrower's expense.

Second, courts which justify validation by a presumption of good faith party intention,<sup>249</sup> and at the same time justify invalidation by the discovery of evasive intention, are forced to adopt a highly peculiar approach to interstate loan contracts. First, they analyze the evidence for any indication of "manipulation." If none is found, they then presume the parties intended a validating law to govern the contract, and will validate it by applying that law. If, however, the parties are found to have actually intended that the same validating law should control the transaction, evasion will be found and the contract declared usurious. Thus, these courts have found themselves engaged in the absurd task of presuming the existence of a fictitious intent for the purpose of validating a contract, when they would instantly repudiate that same contract were they to find that the parties themselves had formed that identical intention.<sup>250</sup>

Third, and most important, the lender's intent has no relevance whatsoever in furthering the fundamental purpose of all usury statutes: borrower protection. The crippling effect of oppressive interest on a necessitous borrower remains the same, whether the lender has deliberately arranged the elements of the transaction for administrative convenience or to evade the borrower's law.

Subjective intention is irrelevant to domestic usurious contracts.<sup>251</sup> Its importance in interstate contracts turns on the courts' reluctance to surrender their judgment to other states whose laws will validate such contracts. The crude device of party intention has been retained, therefore, as a means of resisting the indiscriminate workings of rigid conflicts rules. If evasive intention is discarded as impracticable and theoretically

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<sup>248</sup> See Note, 21 COLUM. L. REV. 585, 589 (1921).

<sup>249</sup> See text accompanying notes 214-20 *supra*.

<sup>250</sup> Consider, for example, the absurd logic of the statement made in *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 515, 157 S.E. 860, 862 (1931): "[W]here notes are executed in one State and payable in another, the parties will be presumed to have contracted with reference to the law of the place where the transaction would be valid rather than in view of the law by which it would be illegal, provided, however, that there is no evidence of bad faith or of an intention to evade the usury law of the latter State."

<sup>251</sup> See note 231 *supra*.

unsound, some other protection for the borrower must be put in its place. Few courts at present have found such a device.

(2) *A "Normal and Natural Connection."*—The United States Supreme Court in *Seeman v. Philadelphia Warehouse Co.*<sup>252</sup> adopted a different approach to the problem of evasion. In defining "good faith,"<sup>253</sup> the Court stated that parties could themselves choose the law of any state related in certain ways to the transaction:

The . . . qualification [of good faith] is merely to prevent the evasion or avoidance at will of the usury law *otherwise applicable*, by the parties' entering into the contract or stipulating for its performance at a place which has *no normal relation to the transaction* and to whose law they would not otherwise be subject.<sup>254</sup>

Courts which adopt this test<sup>255</sup> consider as irrelevant the motives of the parties in choosing a particular state to be the place of contracting or of performance. They apparently view a contract or "transaction" as having a necessary geographical situs or location. The laws of the states within this territorial location are viewed as normally related or "otherwise applicable" to the transaction. Evasion is found only when the parties attempt to invoke the law of state outside this area—a state having "no normal relation to the transaction."<sup>256</sup>

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<sup>252</sup> 274 U.S. 403 (1927).

<sup>253</sup> For judicial use of the term, "good faith," see *Miller v. Tiffany*, 68 U.S. (1 Wall.) 298, 310 (1863); see also *Vita Food Prods., Inc. v. Unus Shipping Co.*, [1939] A.C. 277 (P.C.). The term has been used by courts to refer to two distinct types of cases. First, it has been used to refer to parties' choice of a particular law. Thus, some have described "good faith" as the absence of a subjective intent to "evade" the borrower's law; others have used it to refer to a law "normally related" to the transaction. Second, "good faith" has been used to describe the parties' attempts at disguising the real nature of the transaction. Thus, "bad faith" is often found where interest payments are disguised as "service charges," "subscription fees," and so forth. See text accompanying notes 277-89 *infra*.

<sup>254</sup> 274 U.S. at 408. (Emphasis added.)

<sup>255</sup> See, e.g., *Consolidated Jewelers, Inc. v. Standard Financial Corp.*, 325 F.2d 31 (6th Cir. 1963); *United Divers Supply Co. v. Commercial Credit Co.*, 289 Fed. 316 (5th Cir. 1923); *Washington Nat'l Bldg & Loan Ass'n v. Pifer*, 31 App. D.C. 434 (Cir. 1908); *Lyles v. Union Planters Nat'l Bank*, 393 S.W. 2d 867 (Ark. 1965); *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 364 S.W.2d 158 (1963); *Dupree v. Virgil R. Coss Mortgage Co.*, 167 Ark. 18, 267 S.W. 586 (1924) (majority opinion); *Atlas Subsidiaries, Inc. v. O. & O. Inc.*, 166 So. 2d 458 (Fla. App. 1964); *Smith v. Muncie Nat'l Bank*, 29 Ind. 158 (1867); *Big Four Mills, Ltd., v. Commercial Credit Co.*, 307 Ky. 612, 211 S.W.2d 831 (1948); *Green v. Northwestern Trust Co.*, 128 Minn. 30, 150 N.W. 229 (1914); *Stoddard v. Thomas*, 60 Pa. Super. 177 (1915); *Deaton v. Vise*, 186 Tenn. 364, 210 S.W.2d 665 (1948).

<sup>256</sup> For the best statement of this position, see *Dupree v. Virgil R. Coss Mortgage Co.*, 167 Ark. 18, 30, 267 S.W. 586, 1119 (1924) (concurring opinion): "Where . . . the parties reside in different States, they have the absolute right to contract with reference to the laws of either one of those States in which the contract is valid, and it does not constitute an evasion of the law merely because they make the election in order to take advantage of the

The primary drawback of the *Seeman* approach to the problem of evasion is the difficulty in determining which states have a normal relation to the transaction. Because evasion occurs whenever the parties attempt to maneuver the places of contracting or performance into some state *other* than the state having the normal relation to the transaction, these places or "contacts" alone cannot determine the state of the normal relation. This state must be fixed by some other set of determinants. The only such co-ordinates of importance in *Seeman* which could not have been easily manipulated by the terms of the loan contract were the places where the lender and the borrower were permanently established. *Seeman*, therefore, may be construed as holding that where the places of contracting or payment are arranged in a state or states other than those of the lender's or borrower's residence, incorporation, or principal place of business, evasion may be found. The *Seeman* test is dangerous, however, for it is misleadingly phrased in terms of the places of performance and contracting, thereby suggesting they are significant; in fact, they are totally irrelevant.<sup>257</sup>

(3) *A Hybrid Approach: The Second Restatement.*—Although the Supreme Court's "normal relation" test has been stated differently,<sup>258</sup> the variation adopted by the *Second Restatement of Conflicts* is of particular interest: A contract will be validated if it provides for interest permitted by the law of any state "with which the contract has a substantial relationship . . . ."<sup>259</sup> "Substantial relationship" is further defined as a "normal and natural connection with the contract."<sup>260</sup> Interpretation

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laws where the contract is not usurious . . . . If the contract is a lawful one, the presence of a bad motive will not invalidate it . . . ." Compare the majority opinion, quoted in note 246 *supra*. See *Huchingson v. Republic Fin. Co.*, 236 Ark. 832, 834, 370 S.W.2d 185, 186 (1963), indicating Arkansas may still follow the majority in *Dupree*.

<sup>257</sup> The argument is made in text accompanying notes 346-55 *infra* that only the states where the borrower and lender are settled or established should be considered in choosing an applicable law, and that the places of contracting and performance are totally irrelevant to this determination. The Court in *Seeman* appears to have instinctively, although implicitly, adopted this position. Notice that the concurring opinion in *Dupree v. Virgil R. Coss Mortgage Co.*, *supra* note 256, explicitly states this point in terms of the parties' residence.

<sup>258</sup> See, e.g., *Consolidated Jewelers, Inc. v. Standard Financial Corp.*, 325 F.2d 31, 34 (6th Cir. 1963) ("reasonable relationship to the transaction"); *Fahs v. Martin*, 224 F.2d 387, 397 (5th Cir. 1955): ("any other place with which the contract has any substantial connection"); *Lyles v. Union Planters Nat'l Bank*, 393 S.W.2d 867, 869 (Ark. 1965) ("reasonable relationship to the transaction"); *Hawkins v. Ringel*, 231 N.Y.S.2d 476, 478 (Sup. Ct. 1962), *rev'd mem.*, 19 App. Div. 649, 242 N.Y.S.2d 616 (1963) ("normal and important relation to [the] transaction").

<sup>259</sup> *RESTATEMENT (SECOND)*, *op. cit. supra* note 234, § 334d, at 54. This is to be contrasted with the state of the "most significant relationship," *id.* § 332, at 6. "A contract may have a 'substantial relationship' with two or more states; it can have its 'most significant relationship' with only one." *Id.* § 334d at 56.

<sup>260</sup> *Id.* § 334d, at 56. See *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 408 (1927)

of the *Second Restatement's* position, however, raises a basic problem: What test should be used to discover which state or group of states has a "substantial relationship" or "normal and natural connection" with the contract? If evasive manipulation is to occur at all, the law of these states must be evaded.

The *Second Restatement* unfortunately gives few clues. It starts by apparently adopting a version of the subjective intention test:<sup>261</sup> "The required relationship cannot be based *solely* upon contacts *purposely located* in the state by the parties in an attempt to gain the benefit of that state's usury statute . . . ."<sup>262</sup> It then states that the places where the note was drawn up and dated, where the loan contract was "made,"<sup>263</sup> and where the contract was to be "performed"<sup>264</sup> are the most easily "manipulated" and therefore "suspect."<sup>265</sup> Apparently, therefore, at least one other unmanipulated contact is necessary to fix the location of the states normally and naturally connected with the contract.

The only other "significant" contacts<sup>266</sup> offered by the *Second Restatement* are the situs of the land given as security for the loan, the place where the loan was negotiated, and the lender's and borrower's domicile or, if either is a corporation, its principal place of business.<sup>267</sup> The Reporter himself discards the situs-of-the-land contact,<sup>268</sup> and the remaining individual contacts are explicitly denied determinative status by the language of the *Second Restatement* itself: "The presence in a state of *one* of [the listed contacts] . . . will not suffice to give the state a substantial [*i.e.*, normal and natural] relationship with the contract."<sup>269</sup>

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(using the word "natural"); WEARTON, *CONFLICT OF LAWS* § 510a (3d ed. 1905) ("real and vital").

<sup>261</sup> See text accompanying notes 245-51 *supra*.

<sup>262</sup> *RESTATEMENT (SECOND)*, *op. cit. supra* note 234, § 334d, at 56. (Emphasis added.)

<sup>263</sup> "Made" in the *Second Restatement* means where "the last act necessary to make the contract binding" occurred. *Id.* at 57.

<sup>264</sup> The *Second Restatement* defines "perform" as "where the loan was to be paid." *Ibid.*

<sup>265</sup> *Id.* at 56.

<sup>266</sup> The *Second Restatement* also provides a list of "contacts of lesser importance": "the place where the note was drawn up or dated, that where the borrowed money is to be used and the state of incorporation of the lender or borrower if either is a corporation." *Id.* at 57. It does not indicate, however, why these are considered to be of "lesser importance," or what weight is to be given to them. See note 269 *infra*.

<sup>267</sup> *Ibid.*

<sup>268</sup> *Id.* at 61.

<sup>269</sup> *Id.* at 57. (Emphasis added.) On the other hand, according to the *Second Restatement* "a grouping of two or three [contacts in one state] . . . is likely to [give the state a substantial relationship with the contract] . . . ." *Ibid.* (Emphasis added.) Apparently, therefore, these contacts are sufficiently unimportant that even a grouping of two or three *may not* create the required relationship. It seems possible that a state will have a substantial relationship with the contract either when two "significant contacts," see text accompanying notes 263-68 *supra*, are located in one state; or when one such contact plus two "contacts

A state can have a "substantial relationship" or a "normal and natural connection" with a contract, therefore, if it satisfies two tests: (1) it must have at least one contact which is not "manipulated" or "purposely located in the state by the parties in an attempt to gain the benefit of that state's usury statute"; and (2) it must have at least one contact in addition to either the domicile or principal place of business of the lender or borrower if it happens that these particular contacts are used to designate the related state. The following examples clearly show that the *Second Restatement's* approach is unworkable and illogical.

First, assume that Borrower's state permits interest of six per cent, Lender's state permits eight per cent, and a third state permits ten per cent. The parties contract for interest of ten per cent. Assume further that Lender stipulates for repayment to be made at his bank in the third state, but does so for convenience, from habit, or for some other non-manipulative motive. According to the *Second Restatement's* position, test (1) is satisfied and test (2) does not come into operation. The third state therefore has a "normal and natural connection" with the contract, and the contract should be valid.<sup>270</sup> Borrower must pay interest at a rate which neither party's state permits.

Second, assume Lender locates his business in a state with very high interest maximums for the express purpose of obtaining a higher return on his loans. Assume further that the places of contracting and payment were "manipulated" by Lender to fall in his state, and that the negotiations were carried on by extensive correspondence, making it impossible to fix a situs for the negotiations. Clearly, with the exception of the Borrower's domicile, every contact is either too vague to locate or has been "purposely located" in Lender's state to gain the benefit of his usury statute.<sup>271</sup> Lender's law is therefore inapplicable under test (1). Only the law of Borrower's domicile remains; yet the presence of this contact by itself will not satisfy test (2). The inescapable but paradoxical conclusion is that *no* law governs the contract's validity.

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of lesser importance," see note 266 *supra*, fall into one state. It is uncertain, however, whether the combinations of one "significant" contact plus one "lesser" contact, or of two contacts of "lesser importance," would be sufficient. In any case, it would be overstating the obvious to point out that courts adopting the *Second Restatement's* approach are given complete freedom to stress any combination of contacts they please.

<sup>270</sup> See RESTATEMENT (SECOND), *op. cit. supra* note 234, § 334d.

<sup>271</sup> It is unclear to what extent the contacts of "lesser importance," *supra* note 266, should be included in this list. See note 269 *supra*. Assume, therefore, what is likely to be the case, that the note was drawn up and dated in the lender's state to obtain the benefit of his law; that the borrower is not a corporation; and that the borrower has not yet put the money to use, or that its use is impossible to determine, or that the money was used in other states. These contacts would thus be either manipulated by the lender, non-existent, or placed in a state other than the borrower's.

Third, assume Borrower's state permits eight per cent interest, that Lender's state permits six per cent interest, and that the parties contract for eight per cent interest. Assume further that every contact other than Borrower's domicile falls in Lender's state in a normal, non-manipulated manner. Test (2) excludes the choice of Borrower's law; test (1) permits the choice of Lender's law, but that law invalidates the contract. This classic case of a "false" or "avoidable" conflict is thus resolved improperly.<sup>272</sup>

The *Second Restatement's* test for evasion are clearly deficient. Test (1) is subject to all the disadvantages of the subjective intention test.<sup>273</sup> It forces courts to examine motives, and ignores the basic issue of borrower protection. Test (2) fails to recognize that domicile or principle place of business is the only relevant test for delimiting the states whose law should be applicable to an interstate loan transaction.<sup>274</sup> Both tests greatly increase the probabilities that courts will improperly resolve avoidable conflicts.<sup>275</sup>

(4) *Subjective Intention versus "Normal and Natural Connection."*—Interesting conflicts problems are likely to arise between states having different views of evasion. Assume, for example, that Borrower's state adopts the view that mere subjective intention to evade forum laws is sufficient for invalidation. Lender's state, however, holds that so long as the transaction naturally falls into a certain group of states the parties have the right to invoke the law of one of those states. Assume further that Lender has manipulated the transaction to evade Borrower's law, that the contract can only be sustained under Lender's law coupled with the doctrine of evasion used in Lender's state, and that Borrower's state adopts the rule of validation. Although the rule of validation in Borrower's state might be thought to indicate that the usury statute and doctrine of evasion in Lender's state should be applied, it is doubtful that any court would allow a foreign state's notion of evasion to displace its own.<sup>276</sup> Borrower's court would probably invoke its own equitable doctrine of evasion as an exception to its rule of validation and invalidate the contract without even reaching the conflicts issue.

In sum, the "evasion" exception to the rule of validation does not function well. The subjective intention version is often applied incon-

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<sup>272</sup> See text accompanying notes 367-79 *infra*.

<sup>273</sup> See text accompanying notes 245-51 *supra*.

<sup>274</sup> For development of this argument see text accompanying notes 346-55 *infra*.

<sup>275</sup> The *Second Restatement* has clearly succumbed to this danger. Illustrations 1, 2, 5, 7, 8, 9, and 10, in § 334d, are all "false" or "avoidable" conflicts. Illustrations 3 and 4 fail to provide information as to domicile or residence, and are therefore inconclusive. Only Illustration 6 poses a true or "essential" conflict. See text accompanying notes 356-411 *infra*.

<sup>276</sup> Cf. EHRENZWEIG, *CONFLICTS IN A NUTSHELL* § 22, at 87-88 (1965).

sistently and unpredictably. It represents not the discovery of an actual, but "evil," subjective intention, but rather the courts' reaction against a conflicts doctrine which would leave a borrower unprotected. The "normal relation" version is often misleadingly stated in terms of places of contracting and performance. The *Second Restatement* merely provides a list of "contacts," but gives no indication why one or more are, or should be, considered important. Because the *Second Restatement* is unwilling to recognize that the residence or principal place of business of the lender and borrower are the only contacts of importance, it makes it difficult, if not impossible, to arrive at a sensible choice of law.

(b) *Manipulation to Disguise Usury*.—"Evasion" of usury laws must be distinguished from "manipulation" of the contractual terms to disguise the fact of usury.<sup>277</sup> In the former, an attempt is made to ensure that the issue of the contract's validity will be determined by the law of a more lenient state; in the latter, an attempt is made either to cause a loan to appear as some other sort of transaction,<sup>278</sup> or to make usurious interest rates appear lower than they actually are.<sup>279</sup> In domestic as well as conflicts cases raising the issue of manipulation, courts have professed to look through the form of the transaction to the substance,<sup>280</sup> and have validated the loan contract only where "the form of the transaction is not adopted to disguise its real character."<sup>281</sup>

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<sup>277</sup> Although courts often use the words, "evasion" or "bad faith," to cover both intentional evasion of forum law and manipulation of contract terms, they have been distinguished in this Comment. For a case blurring this distinction see *Clarkson v. Finance Co. of America*, 328 F.2d 404, 406 (4th Cir. 1964).

<sup>278</sup> See, e.g., *Ringer v. Virgin Timber Co.*, 213 Fed. 1001 (E.D. Ark. 1914). The borrower sold property to the lender, who in turn re-sold it to the borrower and took his notes secured by a mortgage on the land as payment. The notes, however, were for \$75,000 in excess of the legal interest rate. The court held that the procedure employed was a device to disguise a loan and evade the usury laws.

<sup>279</sup> See, e.g., *Southern Bldg. & Loan Ass'n v. Harris*, 98 Ky. 41, 32 S.W. 261 (1895). The borrower was forced to subscribe to shares of stock in the lender's building and loan association and pay stock premiums in addition to the interest on a loan. The court held that the stock premiums were disguised usurious interest, and the contract was invalidated as a "cunningly devised scheme" to evade the usury laws. *Id.* at 45, 32 S.W. at 262.

<sup>280</sup> See, e.g., *E.C. Warner Co. v. W.B. Foshay Co.*, 57 F.2d 656 (8th Cir. 1932); *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927). An early Supreme Court conflicts case is *De Wolf v. Johnson*, 23 U.S. (10 Wheat.) 367 (1825). "Usury is a moral taint, wherever it exists, and no subterfuge shall be permitted to conceal it from the eye of the law . . . all the cases . . . only vary as they follow the detours through which they have had to pursue the money-lenders." *Id.* at 383. *Cf. Andrews v. Pond*, 38 U.S. (13 Pet.) 65, 79 (1839).

<sup>281</sup> *Miller v. Tiffany*, 68 U.S. (1 Wall.) 298, 310 (1863). In general, courts seek two factors as evidence of manipulation: an intent to disguise an otherwise usurious transaction, and, apart from intent, the mere receipt of money in an amount which the court feels is excessive. These two elements are often found together, although they may be stressed indi-



Conflicts problems arise when states differ on whether a particular transaction constitutes substantive usury. This has been particularly true in cases involving building and loan associations.<sup>282</sup> Suppose, for example, that a forum borrower negotiates a loan at six per cent from a foreign building and loan association. As a prerequisite of the loan he must subscribe to, and pay additional premiums of six per cent upon, shares of stock in the association. Both states allow a maximum of six per cent interest upon loans. But while the association's state views the transaction as two distinct contracts,<sup>283</sup> each for six per cent interest, the borrower's state considers the transaction as one contract<sup>284</sup> for usurious interest of twelve per cent. Suppose further that the contracts were finally signed, and the payments are to be made, in the association's state; that the action is brought in the borrower's state; and that the forum generally adopts a rule of validation.

Most courts have refused to accept a foreign jurisdiction's conception of when form should be distinguished from substance. Rather, they have declared such contracts usurious under forum law, thereby creating an exception to the application of their own rule of validation.<sup>285</sup> Courts have reacted in a similar fashion in cases not involving building and loan associations. Apart from a small minority of courts,<sup>286</sup> the law used to pierce through form to substance has been forum law.<sup>287</sup> It would seem that a

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vidually. *Compare* *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964) (stressing the lack of evasive intent), *with* *Southern Bldg. & Loan Ass'n v. Harris*, 98 Ky. 41, 32 S.W. 261 (1895) (stressing an excessive return).

<sup>282</sup> For laws relating to building and loan associations in general see 13 AM. JUR. 2d *Building and Loan Associations* §§ 56-65 (1964). For conflicts cases involving usury laws and building and loan associations see *id.* §§ 64-65; Annot., 1961D L.R.A. 732-60; Annot., 62 L.R.A. 33, 64-73 (1904).

<sup>283</sup> See, e.g., *Hickman v. Oklahoma Sav. & Loan Ass'n*, 169 Okla. 224, 36 P.2d 928 (1934).

<sup>284</sup> See, e.g., *Henderson Bldg. & Loan Ass'n v. Johnson*, 88 Ky. 191, 10 S.W. 787 (1889).

<sup>285</sup> See, e.g., *Fidelity Sav. Ass'n v. Shea*, 6 Idaho 405, 412-13, 55 Pac. 1022, 1024 (1899) (premium payments a "trick, artifice, or subterfuge for the purpose of extorting from the debtor a usurious rate of interest"); *Southern Bldg. & Loan Ass'n v. Harris*, 98 Ky. 41, 32 S.W. 261 (1895); *Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 21 S.E. 924 (1895); *Rowland v. Old Dominion Bldg. & Loan Ass'n*, 115 N.C. 825, 18 S.E. 965 (1894); *cf.* *Snyder v. Fidelity Sav. Ass'n*, 23 Utah 291, 64 Pac. 872 (1901) (no usury statute in either state, but forum law applied to offset stock payments against original debt).

<sup>286</sup> See, e.g., *Smith v. Western & So. Life Ins. Co.*, 87 F.2d 839 (5th Cir. 1937) (valid by foreign law despite usurious acceleration clause under forum law). *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964), *United Divers Supply Co. v. Commercial Credit Co.*, 289 Fed. 316 (5th Cir. 1923) ("services" promised by lender a disguise), and *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 211 S.W.2d 831 (1948), are distinguishable as involving a corporate borrower. See text accompanying notes 439-71 *infra*.

<sup>287</sup> See, e.g., *Le Sueur v. Manufacturers' Fin. Co.*, 285 Fed. 490 (6th Cir. 1922), *cert. denied*, 261 U.S. 621 (1923) (loan under guise of purchase plan of accounts receivable held a device to cover up usury; contract usurious under both laws); *Ringer v. Virgin Timber Co.*, 213 Fed. 1001 (E.D. Ark. 1914) (usurious under both laws); *Commonwealth Farm Loan*

court's particular conception of the form versus substance distinction is primarily an equitable doctrine,<sup>288</sup> and is therefore not likely to be displaced by that of another jurisdiction.<sup>289</sup>

(c) *Public Policy*.—Perhaps the most time-honored<sup>290</sup> and frequently invoked exception to the rule of validation is the refusal to validate when enforcement of a loan contract usurious in the borrower's state would violate that state's "public policy."<sup>291</sup> Despite the generality of the exception's usual formulation and the temptation to use it as a substitute for careful analysis,<sup>292</sup> it is possible in usury cases to distinguish four main factors which cause courts to invoke this doctrine: (1) the possible frustration of forum usury laws; (2) an unwillingness to allow foreign lenders to do that which domestic lenders cannot; (3) a reluctance to sanction interest rates which by forum standards are shocking or unconscionable; and (4) an attitude by the court toward the strength of forum policy.

(1) *Frustration of Forum Law*.—A number of courts have declared contracts, which would otherwise have been valid under foreign law, to

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Co. v. Caudle, 203 Ky. 761, 263 S.W. 24 (1924) (5% services fee held usurious); Lesser v. Strubbe, 56 N.J. Super. 274, 152 A.2d 409 (Super. Ct. 1959), *modified on other grounds*, 67 N.J. Super. 475, 171 A.2d 114 (1961), *aff'd per curiam*, 39 N.J. 90, 187 A.2d 705 (1963) (\$70,000 "premium" held usurious); Ripple v. Mortgage & Acceptance Corp., 193 N.C. 422, 137 S.E. 156 (1927) (fraudulent conditional sales contract to disguise loan held usurious).

<sup>288</sup> See, e.g., Rowland v. Old Dominion Bldg. & Loan Ass'n, 115 N.C. 825, 831, 18 S.E. 965, 967 (1894). The court stated that the party arguing for application of a foreign law, where the contract would be illegal under forum law, "must be able to show clearly and conclusively that his case is one that entitles him to make such a demand."

<sup>289</sup> Cf. EHRENZWEIG, *op. cit. supra* note 276, § 22, at 87-88.

<sup>290</sup> As early as 1834, Story declared that courts should, in accordance with basic rules of comity between nations, enforce contracts arising in other states, with the "exception, that the contract . . . should not . . . work an injury to the inhabitants of the country where it is attempted to be enforced." STORY, *CONFLICT OF LAWS* § 244 (1st ed. 1834). See Fitch v. Remer, 9 Fed. Cas. 181 (No. 4836) (C.C. Mich. 1860). An early statement of the rule of comity is *Bank of Augusta v. Earle*, 38 U.S. (13 Pet.) 519 (1839). For a rejection of comity on public policy grounds in a usury case see *Building & Loan Ass'n v. Griffin*, 90 Tex. 480, 490, 39 S.W. 656, 660 (1897), repudiating a foreign law "so contrary to the laws of [Texas] . . . as to work an injury and injustice to the people . . . or a serious interference with its own policy or laws."

<sup>291</sup> For a discussion of the "public policy" exception see generally EHRENZWEIG, *CONFLICT OF LAWS* § 120, at 342-44 (1962); Nussbaum, *Public Policy and the Political Crisis in the Conflict of Laws*, 49 YALE L.J. 1027 (1940); Paulsen & Sovren, "Public Policy" in *the Conflict of Laws*, 56 COLUM. L. REV. 969 (1956). The history of the doctrine in contract law is discussed in 8 HOLDSWORTH, *A HISTORY OF ENGLISH LAW* 54-56 (1926). For a summary of "public policy" exceptions in a usury case of conflicts see *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 517, 157 S.E. 860, 863 (1931).

<sup>292</sup> See Paulsen & Sovren, *supra* note 291, at 1016: "The principal vice of the public policy concepts is that they . . . stand in the way of careful thought, of discriminating distinctions, and of true policy development in the conflict of laws." See, e.g., *United States Sav. & Loan Co. v. Scott*, 98 Ky. 695, 698, 34 S.W. 235, 236 (1896) ("These conclusions are fundamental and require no citation of authority").

be usurious on the ground that validation of such contracts would encourage foreign lenders to contract with forum borrowers at exorbitant interest rates, thereby effectively frustrating the protection of forum law.<sup>293</sup> It is surprising that this persuasive argument has not been used more often. Outwardly it appears inconsistent to argue, on the one hand, that usury statutes exist for the protection of domestic borrowers, and yet, on the other hand, allow foreign lenders to bypass that protective statute with impunity. This apparent inconsistency is partially explained, however, by a careful analysis of those cases using the frustration of forum law argument as an exception to the rule of validation. Several consistent themes can be found to run throughout these cases.

First, in a few cases, the lender, either by having a permanent agency for the solicitation of loans in the state,<sup>294</sup> or by being domiciled and doing

<sup>293</sup> "If this court should hold that a note made in this State, but payable in . . . Massachusetts, for money advanced by . . . a person who resided in Massachusetts, could be collected notwithstanding it contained 16 per cent usurious and unlawful interest, then the law of this State . . . would be inoperative and useless; the money lenders of those States . . . could flood this State with their agents, and . . . extract the highest rates of interest." *Martin v. Johnson*, 84 Ga. 481, 486, 10 S.E. 1092, 1093 (1890). See *E.C. Warner Co. v. W.B. Foshay Co.*, 57 F.2d 656, 661 (8th Cir. 1932) (danger of forum law being "annulled by a foreign statute"); *Locknane v. United States Sav. & Loan Co.*, 103 Ky. 265, 270, 44 S.W. 977, 978 (1898) ("The contract . . . would . . . destroy the efficacy of our statutes against usury"); *Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 887, 21 S.E. 924, 926 (1895) ("a virtual abrogation" of state usury laws); *Building & Loan Ass'n v. Griffin*, 90 Tex. 480, 491, 39 S.W. 656, 660 (1897) ("the practical effect would be to annul our statutes against usury"); *Snyder v. Fidelity Sav. Ass'n*, 23 Utah 291, 299, 64 Pac. 870, 872 (1901) ("a violation of the laws of the forum"); *Mirgon v. Sherk*, 196 Wash. 690, 693, 84 P.2d 362, 363 (1938) ("contrary to the laws of the state . . . a serious interference with [our] . . . policy or laws"); cf. *Depau v. Humphreys*, 8 Mart. (n.s.) 1 (La. 1829).

The *Second Restatement* has distinguished *Martin v. Johnson*, *supra*, on the ground that Massachusetts, the foreign state, had no usury prohibition at all, and that contracts will not be validated by the law of a state with no usury law. *RESTATEMENT (SECOND), CONFLICT OF LAWS* § 334d, at 60 (Tent. Draft No. 6, 1960). Emphasis upon this distinction is faulty in several respects. First, whether the foreign state has an interest statute or not is irrelevant with respect to borrower protection. Excessive interest remains excessive whether allowed by a state with no statute or by a state with a very high maximum. Second, a substantial number of cases have used the *Martin v. Johnson* reasoning to apply forum law when the foreign state did have a usury statute. See cases cited *supra*. Third, a large number of cases have validated under foreign law contracts made with forum *corporate* borrowers, where the foreign state had enacted a corporate exemption, and therefore had no usury sanction applicable to corporate borrowers. See cases cited note 460 *infra* and accompanying text; compare *RESTATEMENT (SECOND), op. cit. supra* § 334d, Illustration 1, at 56. Fourth, the *Second Restatement's* position is likely to resolve improperly cases of avoidable conflict. Thus, where the foreign borrower's state has no usury statute, and that borrower is before a court in the lender's state attempting to invalidate the contract under forum law, the only rational solution would be to apply the borrower's law to validate the contract. See text accompanying notes 367-79 *infra*. The *Second Restatement*, however, would invalidate the contract. *Id.* at 60.

<sup>294</sup> E.g., *Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 890, 21 S.E. 924, 927 (1895) ("a local branch").

business by permit in the forum,<sup>295</sup> has been viewed as having a sufficient connection with the forum state to subject its transactions to the forum's law.<sup>296</sup> In such cases the transaction has appeared more a "domestic" than a "foreign" contract, and courts have thus seen the transaction as an unlawful attempt at evasion of forum law by two primarily domestic parties.<sup>297</sup> Second, a significant portion of cases have involved interest rates substantially above the permitted forum maximum.<sup>298</sup> The threat to forum law has been felt to grow in direct proportion to the interest charged.<sup>299</sup> Third, courts appear to have found the systematic solicitation of loans by large foreign lending institutions a greater threat to the protection given by forum usury statutes than sporadic loans from out-of-state individuals, and have accordingly declared the former usurious.<sup>300</sup> This emphasis upon the size and regularity of the lender's business has considerable merit. It emphasizes that institutions making a business of interstate loans have no excuse for charging interest in excess of the borrower's maximum. A firm with the facilities to solicit customers and extend credit on an interstate scale certainly has the facilities to ascertain the interest maximums of each borrower's state. The thrust of usury statutes is clearly aimed toward the greater protection of borrowers. The slight burden imposed upon interstate lenders by charging them with knowledge of the borrowers' laws, therefore, seems easily outweighed by the policy of borrower

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<sup>295</sup> *E.g.*, *Building & Loan Ass'n v. Griffin*, 90 Tex. 480, 487, 39 S.W. 656, 659 (1897).

<sup>296</sup> See *id.* at 489, 39 S.W. at 659. The court declared that a presumption of fraudulent evasion of forum law exists where the contract is payable at a place other than the residence of either party. Apparently, the court viewed the lender to be in effect a domestic corporation, and found the provision for foreign payments a "sham."

<sup>297</sup> See, *e.g.*, *E.C. Warner Co. v. W.B. Foshay Co.*, 57 F.2d 656 (8th Cir. 1932) (the lender was a forum corporation, and the borrower, although incorporated in Delaware, had its principal place of business in the forum).

<sup>298</sup> See *ibid.* (permitted maximum of 8%, contract for over 100%); *Martin v. Johnson*, 84 Ga. 481, 10 S.E. 1092 (1890) (permitted maximum of 8%, contract for 16%); *Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 21 S.E. 924 (1895) (permitted maximum of 6%, contract for 12%); *Building & Loan Ass'n v. Griffin*, 90 Tex. 480, 39 S.W. 656 (1897) (permitted maximum of 6%, contract for 17%); *Mirgon v. Sherk*, 196 Wash. 690, 84 P.2d 362 (1938) (permitted maximum of 12%, contract for 36%).

<sup>299</sup> A discussion of the impact variations in interest rates have had on the choice of a particular law to govern the validity of an interstate loan contract is contained in the text accompanying notes 523-65 *infra*.

<sup>300</sup> See, *e.g.*, *Mirgon v. Sherk*, 196 Wash. 690, 697, 84 P.2d 362, 365 (1938). The court stressed the foreign lender's offices and substantial advertising in the borrower's state, and distinguished other cases as involving only a "single isolated transaction" with "no corporation" making the loan. *Cf. Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 886, 21 S.E. 924, 925, 926 (1895) (noted of the lender that "the scope of its power is very extensive"); *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 22, 38 Cal. Rptr. 376, 383 (1964) (distinguishing *Mirgon* on the ground that "there the lender set up offices in the borrower's state"). *But see Martin v. Johnson*, 84 Ga. 481, 10 S.E. 1092 (1890) (the lender was an individual).

protection embodied in usury statutes. The drawback of the argument stressing the foreign lender's size is that the excessive interest paid by a forum borrower is equally oppressive whether paid to a large or small lender, or through domestic or foreign agents. Because usury laws are borrower oriented, it would be more rational to have the issue of invalidation turn on the different capacities of borrowers to repay various rates of interest than on different sizes of lenders.<sup>301</sup>

(2) *Unfair Competitive Advantage to Foreign Corporations.*—A number of courts, relying on statutory or constitutional provisions which deny to foreign corporations greater powers than those possessed by domestic ones,<sup>302</sup> have refused to sanction loan contracts which are valid in the corporate lender's home state but usurious in the forum.<sup>303</sup> This is done on the theory that validation of such contracts would allow foreign corporations "the privilege of conducting [their] . . . business upon more favorable conditions than are accorded to corporations of [the forum state] . . . ."<sup>304</sup> Resort to this argument, however, has not turned solely upon the existence of express statutory provisions; even in their absence courts have invoked similar arguments to invalidate loans made by foreign corporate lenders.<sup>305</sup>

<sup>301</sup> See suggested distinction between individual and corporate borrowers notes 412-71 *infra* and accompanying text.

<sup>302</sup> MONT. CONST. art. 15, § 11, for example, provides that "no company or corporation formed under the laws of any other country, state or territory, shall have, or be allowed to exercise, or enjoy within this state any greater *rights or privileges* than those possessed or enjoyed by corporations of the same or similar character created under the laws of the state." (Emphasis added.) Compare CAL. CONST. art. 12, § 15, which states that "no corporation organized outside the limits of the State shall be allowed to *transact business within this State* on more favorable conditions than are prescribed by law to similar corporations organized under the laws of this State." (Emphasis added.) See generally 2 BALLANTINE & STERLING, CALIFORNIA CORPORATION LAWS § 390 (4th ed. 1964); 17 FLETCHER, CYCLOPEDIA CORPORATIONS § 8344 (Rev. ed. 1960); McNULTY, BACKGROUND STUDY: CALIFORNIA CONSTITUTION ARTICLE XII: CORPORATIONS AND PUBLIC UTILITIES 70-78 (a California Constitutional Revision Commission pamphlet, 1966); 23 AM. JUR. *Foreign Corporations* § 71 (1940); 20 C.J.S. *Corporations* § 1822 (1940); RESTATEMENT, CONFLICT OF LAWS § 165 (1934).

<sup>303</sup> United States Bldg. & Loan Ass'n v. Lanzarotti, 47 Idaho 287, 293, 274 Pac. 630, 632 (1929) (relying on art. 11, § 10, of the state constitution); Shannon v. Building & Loan Ass'n, 78 Miss. 955, 30 So. 51 (1901); Mirgon v. Sherk, 196 Wash. 690, 696-97, 84 P.2d 362, 364 (1938); Floyd v. National Loan & Inv. Co., 49 W. Va. 327, 338, 38 S.E. 653, 658 (1901).

<sup>304</sup> Mirgon v. Sherk, *supra* note 303, at 696-97, 84 P.2d at 364.

<sup>305</sup> "It would be contrary to the public policy of this state to permit a foreign corporation to do what domestic corporations are not permitted to do." Continental Adjustment Corp. v. Klaus, 12 N.J. Misc. 703, 705 (Dist. Ct. 1934). *Accord*, E.C. Warner Co. v. W.B. Foshay Co., 57 F.2d 656, 661 (8th Cir. 1932); Falls v. United States Sav. Loan & Bldg. Co., 97 Ala. 417, 422, 13 So. 25, 27 (1892); Rhodes v. Missouri Sav. & Loan Co., 173 Ill. 621, 628, 50 N.E. 998, 1000 (1898); Meroney v. Atlanta Bldg. & Loan Ass'n, 116 N.C. 882, 889, 21 S.E. 924, 926 (1895); Washington Nat'l Bldg. Loan & Inv. Ass'n v. Stanley, 38 Ore. 319, 341, 63 Pac. 489, 495 (1901).

Surprisingly, this seemingly persuasive argument has been used comparatively seldom. There is no immediately apparent reason why it should not always be successful.<sup>306</sup> A few courts which have used this unfair advantage argument have distinguished between a foreign corporation which is domesticated and doing a regular business in the state, and a foreign corporation without localized contacts. The latter, but not the former, are allowed to charge interest in excess of rates allowed by the forum.<sup>307</sup> But while this argument may have some relevance to considerations of competition between domestic and foreign lenders, it ignores the fundamental policy of borrower protection which underlies usury statutes. It seems curiously backhanded to emphasize the protection of forum lending institutions, but not forum borrowers.<sup>308</sup> The protective function of usury statutes should not be denied to forum borrowers simply because the foreign lender has not sufficiently localized its business in the forum state.

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<sup>306</sup> This is particularly true in light of the view that a corporation transacting business in a foreign state "impliedly agrees to become subject to its laws and is deemed to have notice of those laws," 17 FLETCHER, *op. cit. supra* note 302, § 8339, at 155. Further, there is case law to the effect that the constitutional provisions cannot be avoided by contractual stipulations of foreign law. See, e.g., Dolan v. Mutual Reserve Fund Life Ass'n, 173 Mass. 197, 53 N.E. 398 (1899); Smoot v. Bankers' Life Ass'n, 138 Mo. App. 438, 120 S.W. 719 (1909). No case has been found which has attempted a reconciliation between these constitutional provisions and a conflicts doctrine providing for application of the law of the foreign corporation's state. Several arguments could be made against the application of the constitutional provisions in question. First, one might contend that the provision was designed to protect domestic lending institutions, and that therefore a domestic borrower had no standing to raise the issue. *But see* Martin v. Johnson, 84 Ga. 481, 10 S.E. 1092 (1890). Second, one might argue that these provisions are not self-executing, but merely prevent the legislature from enacting laws granting to foreign corporations privileges not available to domestic ones. Therefore, they should not be construed as requiring foreign corporations to comply with all the provisions of a domestic corporations law. See 2 BALLANTINE & STERLING, *op. cit. supra* note 302, § 390, at 699 n.21. In the last analysis, however, this argument is irrelevant to the issue of borrower protection, see text accompanying note 308 *infra*.

<sup>307</sup> "Foreign corporations . . . localizing . . . business without our state through local boards . . . cannot . . . enforce here . . . contracts allowed by the law of the state which created them if [they] violate our laws or our public policy. [But] this holding in no way interferes with the right of a foreign corporation whose business has not been localized here to make contracts with borrowers to be governed by the laws of . . . their domicile . . ." Shannon v. Building & Loan Ass'n, 78 Miss. 955, 974, 30 So. 51, 55 (1901). *Accord*, United States Sav. & Loan Co. v. Scott, 98 Ky. 695, 698, 34 S.W. 235, 236 (1896); *cf.* Midland Sav. & Loan Co. v. Solomon, 71 Kan. 185, 191, 79 Pac. 1077, 1079 (1905) (finding foreign corporate lender had sought no substantial advantage over forum lenders). The distinction between localized and non-localized lenders is consistent with enactments which stress the transaction of business, see CAL. CONST. art. 12, § 15, quoted in note 302 *supra*; 17 FLETCHER, *op. cit. supra* note 302, §§ 8464-8502. But this distinction seems inconsistent with the wording of those statutes which limit foreign corporations to the same "rights and privileges" as enjoyed by domestic corporations, see MONT. CONST. art. 15, § 11, quoted in note 302 *supra*.

<sup>308</sup> See, e.g., Meroney v. Atlanta Bldg. & Loan Ass'n, 116 N.C. 882, 921, 21 S.E. 924, 937 (1895) ("Such discrimination, if legal, would destroy all our home banks, and other like institutions, which faithfully observe the law limiting the rate of interest, and pay their taxes to the support of the state and county government.")

(3) *Unconscionable Interest Rates*.—Absent statutory provisions against particular interest rates, American common law allowed the taking of any interest which the court did not find “unconscionable.”<sup>309</sup> When contracts are found to contain “excessive” or “unconscionable” interest rates, courts have emphatically retained this common law right to declare a contract usurious and against public policy, and have treated it as an exception to a generally adopted rule of validation.<sup>310</sup> The *Second Restatement of Conflicts* has recognized this public policy exception in part. It concedes that its rule of validation applies “only as between states which differ slightly as to the permissible rate of interest and which therefore may be said to have a common policy.”<sup>311</sup> However, it concludes that when a state “substantially related” to the contract allows interest “greatly in excess” of the law otherwise applicable, the special usury rule is discarded and the more general rule of the “most significant relationship” is put in its place.<sup>312</sup> The apparent result is that, where the lender’s state has the “most significant relationship” with the contract, it will be validated by that law, even though the policy of the lender’s state is “substantially different” from that of the borrower’s state.<sup>313</sup> In light of existing case law, it is doubtful that a court, confronted with a domestic

<sup>309</sup> See, e.g., *Thomas v. Clarkson*, 125 Ga. 72, 79-80, 54 S.E. 77, 81 (1906).

<sup>310</sup> “[T]he interest . . . being more than five times the rate authorized under the general Georgia statute, is, as a matter of law, unreasonable and unconscionable, and therefore incapable of enforcement by the courts of this state.” *Folsom v. Continental Adjustment Corp.*, 48 Ga. App. 435, 438, 172 S.E. 833, 835 (1934). *Accord*, *Falls v. United States Sav. Loan & Bldg. Co.*, 93 Ala. 417, 13 So. 25 (1892) (contract rate of 14% “greatly in excess” of 8% forum rate); *Fidelity Sav. Ass’n v. Shea*, 6 Idaho 405, 55 Pac. 1022 (1899) (contract rate of 26%, forum maximum of 13%); *Southern Bldg. & Loan Ass’n v. Harris*, 98 Ky. 41, 32 S.W. 261 (1895) (500% interest on last payment stressed); *Personal Fin. Co. v. Gilinsky Fruit Co.*, 127 Neb. 450, 255 N.W. 588 (1934), *cert. denied*, 233 U.S. 627 (1935); *Rowland v. Old Dominion Bldg. & Loan Ass’n*, 115 N.C. 825, 18 S.E. 965 (1894) (“unconscionable”); *Building & Loan Ass’n v. Griffin*, 90 Tex. 480, 39 S.W. 656 (1897) (“as grossly usurious as any contract which has come before this court”); *Central Trust Co. v. Burton*, 74 Wis. 329, 43 N.W. 141 (1889) (“gross usury,” 14-17%).

<sup>311</sup> RESTATEMENT (SECOND), *op. cit. supra* note 293, § 334d, at 55.

<sup>312</sup> *Ibid.* The rule of the “most significant relationship” is described in §§ 332-32b. Section 332(1) provides that the law of the state having the “most significant relationship” with the transaction will control the contract’s validity. This state, according to § 332(2), is the state explicitly “chosen by the parties” in accordance with certain standards of choice set forth in § 332a. Absent such a deliberate choice of law, the state of the governing law will be the state in which falls both the place of contracting and place of performance, pursuant to § 322b(a). When performance occurs in a state other than that of contracting, then § 332b(b) provides for “additional factors” to guide the choice of law.

<sup>313</sup> *Cf. id.* § 334d, illustrations 1 and 2, at 56. For example, a lender might negotiate a contract for interest of 30%, and arrange for it to be finally signed and to be repaid in the lender’s home state—say, Rhode Island, which provides for a maximum interest of 30%. The *Second Restatement’s* conclusion would compel the borrower’s forum state, with an interest maximum of 6%, to validate the contract, see note 312 *supra*.

borrower paying interest greatly in excess of his own statutory maximum, would be inclined to adopt the *Second Restatement's* conclusion.<sup>314</sup>

(4) *The Strength of Public Policy.*—Courts wishing to invalidate an interstate loan contract often do so in the name of a strong public policy against usury; courts wishing to validate such contracts often do so by declaring that usury is not against forum public policy at all. This divergence in attitude regarding the strength of a public policy toward usury is dramatically illustrated by statements from two opinions:

Arkansas has a strong public policy [against usury] . . . , as indicated by the fact that the penalty against a seller or lender exacting usury is indeed heavy . . . .<sup>315</sup>

The mere fact that [usury] . . . is prohibited in Connecticut by a statute carrying a substantial criminal penalty . . . does not establish that such conduct is contrary to a "deep-rooted public policy" in this state.<sup>316</sup>

Despite this outwardly irreconcilable difference concerning the strength of public policy against usury, the cases adopting divergent views can be rationally distinguished.

First, cases adopting the former view declaring contracts usurious because violative of strong forum public policy have all concerned individual borrowers.<sup>317</sup> Those adopting the latter view validating similar contracts have, with one exception,<sup>318</sup> all involved corporate borrowers.<sup>319</sup> This distinction is consistent with the policies of those states denying

<sup>314</sup> See cases cited note 310 *supra*.

<sup>315</sup> *Huchingson v. Republic Fin. Co.*, 236 Ark. 832, 836, 370 S.W.2d 185, 187 (1963). For similar statements see *Lyles v. Union Planters Nat'l Bank*, 393 S.W.2d 867 (Ark. 1965) (citing *Huchingson v. Republic Fin. Co.*); *McAllister v. Smith*, 17 Ill. 328 (1856); *Personal Fin. Co. v. Gilinsky Fruit Co.*, 127 Neb. 450, 451-52, 255 N.W. 558, 559 (1934), *cert. denied*, 233 U.S. 627 (1935); *In re Gale*, 176 Misc. 277, 281-82, 27 N.Y.S.2d 18, 23 (Sup. Ct.), *rev'd on other grounds*, 262 App. Div. 834, 28 N.Y.S.2d 270, *appeal denied*, 262 App. Div. 1006, 30 N.Y.S.2d 845 (1941); *Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 922, 21 S.E. 924, 937 (1895); *Mirgon v. Sherk*, 196 Wash. 690, 694, 84 P.2d 362, 363 (1938).

<sup>316</sup> *Santoro v. Osman*, 149 Conn. 9, 12, 174 A.2d 800, 801 (1961). For similar statements see *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964); *Midland Sav. & Loan Co. v. Solomon*, 71 Kan. 185, 190-91, 79 Pac. 1077, 1079 (1905); *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 622, 211 S.W.2d 831, 837 (1948); *Kinney Loan & Fin. Co. v. Sumner*, 159 Neb. 57, 69, 65 N.W.2d 240, 249 (1954); *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 157 S.E. 860 (1931) (contract not "necessarily" contrary to public policy); *Columbian Bldg. & Loan Ass'n v. Rice*, 68 S.C. 236, 241, 47 S.E. 63, 65 (1904) (usury distinguished from "gambling and other intrinsically immoral practices").

<sup>317</sup> See cases cited note 315 *supra*.

<sup>318</sup> *Midland Sav. & Loan Co. v. Solomon*, 71 Kan. 185, 79 Pac. 1077 (1905). Two other cases are distinguishable: *Columbian Bldg. & Loan Ass'n v. Rice*, 68 S.C. 236, 47 S.E. 63 (1904) (contract usurious under both laws); *Kinney Loan & Fin. Co. v. Sumner*, 159 Neb. 57, 65 N.W.2d 240 (1954) (special conflicts provision in small loan legislation).

<sup>319</sup> See cases cited note 316 *supra*.



corporations the protection of usury statutes.<sup>320</sup> Second, courts emphasizing the strength of forum policy usually stress the severity of the penalties imposed for violation of usury statutes.<sup>321</sup> Those de-emphasizing the strength of their usury policy stress the similarity of the rates between the two states.<sup>322</sup> This distinction is unrealistic. Given identical rates of interest in two states, it would seem difficult to argue that the state whose sanctions consisted of a mere refusal to allow the lender to take interest in excess of the permissible maximum had a similar policy to the state whose sanctions declared the forfeiture of all interest and principal, and imposed criminal sanctions in addition.<sup>323</sup> On the other hand, given identical penalties, it is difficult to contend that states with rates of six and thirty per cent have similar public policies against usury. A third factor influencing courts which invoke the strength of public policy argument is the size of the loan involved. Cases declaring a contract usurious typically involve small amounts;<sup>324</sup> those validating contracts typically involve larger amounts.<sup>325</sup> Courts find it far easier to require a lender to forfeit the principal of his loan when that amount is relatively small.<sup>326</sup>

Public policy exceptions to the general rule of validation provide a court with a face-saving method to avoid what might otherwise be an unjust result. But the measurement of public policy in terms of strength is at best an uncertain task. It is far more likely that public policy is invoked, not after careful analysis of forum statutes and judicial precedent, but rather as a rationalization for conclusions reached on other factual grounds. Careful analysis will often disclose that courts make "discriminating distinctions"<sup>327</sup> between different economic realities, al-

<sup>320</sup> See, e.g., *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 622, 211 S.W.2d 831, 837 (1948). The court conceded that violation of forum interest rates is "contrary to . . . public policy," but distinguished contracts "entered into between corporations . . . ." See notes 439-71 *infra* and accompanying text for discussion of corporate exemptions.

<sup>321</sup> E.g., *Mirgon v. Sherk*, 196 Wash. 690, 694, 84 P.2d 362, 363 (1938).

<sup>322</sup> See, e.g., *Midland Sav. & Loan Co. v. Solomon*, 71 Kan. 185, 190-91, 79 Pac. 1077, 1079 (1905). The RESTATEMENT (SECOND), *op. cit. supra* note 293, § 334d, at 54, stresses only rates and largely ignores the impact of penalties as indicative of state interests. The exact opposite is the case. See notes 518-618 *infra* and accompanying text for discussion of rates and penalties.

<sup>323</sup> See Horack, *A Survey of the General Usury Laws*, 8 LAW & CONTEMP. PROB. 36, 43 (1941): "The statutory penalties imposed for usury vary in severity from state to state and . . . bear witness to the heinousness with which the particular state regards the offense."

<sup>324</sup> See, e.g., *Mirgon v. Sherk*, 196 Wash. 690, 84 P.2d 362 (1938) (loan of \$280).

<sup>325</sup> See, e.g., *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964) (loan of \$34,807).

<sup>326</sup> See discussion of penalties notes 566-618 *infra* and accompanying text.

<sup>327</sup> See Paulsen & Sovern, *supra* note 291.

though these distinctions are too often buried under the linguistic facade of "public policy."

### C. Summary

Nineteenth century principles of laissez-faire have long been discredited;<sup>328</sup> but the law of contracts and conflict of laws has never recovered from its early flirtation with the concepts of "liberty of contract."<sup>329</sup> The same is true of problems involving conflicts between usury laws. Rigid rules of validation, extracted from unrelated areas of contract law and forged during an era of economic, laissez-faire liberalism, have occasionally been sufficient to reach a just result. But too often they have been applied blindly, by rote, and in detached unawareness of the individual necessities of each case. Confronted with clear examples of injustice, courts have developed a number of exceptions to their more general rules of validation. But these exceptions, although roughly adequate to reach a required result, have often been obscure, excessively vague, and inadequate to deal with the problems of usury in conflicts.

The tensions, therefore, between "an outdated belief in 'freedom of contracts' " and the recognition that "something has to be done about usury," have been reflected in what often seem to be "hesitant, inconsistent and motley" decisions.<sup>330</sup> Although close factual analysis shows to some extent a judicial awareness of the policies against usury, and a willingness to manipulate choice-of-law doctrines to fit the equities of individual cases, the magnetism of conflicts theory has often proved too strong for the courts. The results reached are occasionally incapable of systematic rationalization.<sup>331</sup>

Insofar as they purport to solve the problems of interstate loan contracts, the traditional theories of conflicts, special rules of validation, and exceptions to these rules of validation, are bankrupt. Not only do they inaccurately reflect the existing state of American conflicts law, but they also fail entirely to focus attention upon the need for the development of policy in the area of usury and interstate lending. A new analysis is needed to balance the demands of trade and business, the particular necessities of individual borrowers, and the broad legal principles of contracts and the conflict of laws.

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<sup>328</sup> Shuchman, *Consumer Credit by Adhesion Contracts*, 35 TEMP. L.Q. 125, 281 (1962); cf. Llewellyn, *What Price Contract?—An Essay in Perspective*, 40 YALE L.J. 704 (1931); Williston, *Freedom of Contract*, 6 CORNELL L.Q. 365 (1921). See also NUSSBAUM, *MONEY IN THE LAW: NATIONAL AND INTERNATIONAL* 169 (1950).

<sup>329</sup> See Pound, *Liberty of Contract*, 18 YALE L.J. 454 (1909).

<sup>330</sup> NUSSBAUM, *op. cit. supra* note 328, at 169.

<sup>331</sup> *Whithead v. Heidenheimer*, 57 App. Div. 590, 593, 68 N.Y. Supp. 704, 706 (1901).

## III

## A PROPOSED ANALYSIS

[W]e do not like it when there is less than the appearance of intellectual integrity in the process [of using precedent in the common-law system], and we ask that the process be purified as soon as possible. That is definitely our attitude today in viewing manipulative gimmicks in choice of law. We do not in general disagree with the results that these deceptions have enabled courts to achieve in the past, but we do ask that real reasons and not cover-up devices be given now as explanations of past decisions and guides to future ones.<sup>332</sup>

Part I of this Comment set forth the rationale of borrower protection embodied in general usury statutes. Part II demonstrated the inability of prevailing conflicts doctrines to implement this rationale. This part attempts to analyze the "real reasons" and not the "cover-up devices" which underlie conflicts decisions in usury cases. It constructs a choice-of-law theory which recognizes these reasons.

The critical problem of usury in the conflict of laws arises from the premise that usury laws exist to protect the weak, the needy, and the unwary, both from the temptations of their necessity and the demands of unscrupulous lenders.<sup>333</sup> The dilemma confronting conflicts law, however, is that not all borrowers are unwary, nor all lenders unscrupulous. Courts must therefore apply essentially rigid and indiscriminating interest maximums to an enormous variety of interstate loan transactions, some of which deserve validation, and some of which do not. A successful conflicts theory must provide the courts with the flexibility to make this application in an intelligent manner.

In domestic cases, both legislatures and courts have recognized the need for flexibility: the former by enacting wide variations in rates, penalties, and exemptions;<sup>334</sup> the latter by creating presumptions against usury, imposing heavy debtor burdens of proof, and tolerating devices designed to avoid usury prohibitions.<sup>335</sup> In conflicts cases involving interstate loan contracts, the same tensions appear between fixed interest maximums and different kinds of borrowers, some of whom require protection and some of whom do not. However, more often than not courts in conflicts situations have resolved these tensions by manipulating

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<sup>332</sup> Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. Rev. 267, 300 (1966).

<sup>333</sup> See notes 81-94 *supra* and accompanying text.

<sup>334</sup> One example is California's multiple-rate statutory approach toward usury. This approach is described in Note, 18 STAN. L. REV. 1381 (1966).

<sup>335</sup> See NUSSBAUM, *op. cit. supra* note 328, at 167.

their choice of law to reach a predetermined result.<sup>336</sup> Despite the outward appearance of impartiality conveyed by a choice-of-law rule, the outcome of each case has often turned, however imperfectly, upon the particular circumstances of the transaction.<sup>337</sup>

If courts do in fact use their choice-of-law rules to modify or soften the impact of a borrower's interest maximum and penalty applied to a foreign lender, it is essential to businessmen and practicing lawyers alike that the courts carefully and openly state exactly what they are doing. A "purely conceptual analysis, . . . so often found in the Conflicts field," not only fails to explain "the subject scientifically," but "also deprives the practitioner of the most important tool of prognostication."<sup>338</sup> This part, therefore, is directed toward two audiences: practicing attorneys and courts. It describes for the former those elements of interstate loan transactions which have influenced the courts' choices of law in the past, and in so doing it provides information which should assist lawyers in drafting secure agreements. It indicates to the latter what considerations they must articulate to express clearly the policies behind the results they wish to reach.<sup>339</sup> In sum, this part presents a conflicts theory which combines the certainty and uniformity required of general choice-of-law doctrines with the flexibility required for sensitive decisions tailored to fit individual cases.

This part first develops the doctrine of the *lex debitoris*. The *lex debitoris* embodies the presumption that, as an analytical point of departure, the law of the debtor's state must be presumed to control the validity of all interstate loan transactions. Cases are then grouped into situations involving "avoidable" and "essential" conflicts. Once a court identifies a particular conflict as "avoidable," it can satisfactorily resolve that conflict simply by applying the *lex debitoris*. It need not engage in traditional conflicts analyses—weighing of interests, grouping of contacts, or otherwise. On the other hand, "essential" conflicts involve situations which may cause a court to reject the presumption of the *lex debitoris* and apply part or all of the law of the lender's state. The remainder of this part is devoted to an examination of these situations and to the

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<sup>336</sup> See Leflar, *supra* note 332, at 295-304.

<sup>337</sup> "We do not deceive ourselves: the [choice of law in usury cases] . . . is usually inspired by either the preferences of the judge in economic matters, or by personal considerations: that is whether the borrower is a man of broken affairs in relation with an honorable and prudent bank, or whether an unfortunate debtor is in the hands of a professional usurer . . ." BATTIFOL, *LES CONFLITS DE LOIS EN MATIÈRE DE CONTRATS* 140 (1938) (author's transl.).

<sup>338</sup> NUSSBAUM, *op. cit. supra* note 328, at 169 n.62.

<sup>339</sup> See Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. REV. 267 (1966); see also quotation in text accompanying note 332 *supra*.

exceptions which may be sufficiently strong to overcome the presumption of the *lex debitoris*. Generally, it concludes that all or part of the lender's law should be applied to validate the transaction only in certain well-defined situations: when the borrower has sufficient bargaining power and experience not to require the protection of his own law; when the punitive sanctions of the borrower's law are unduly harsh; or when the lender could not be expected to foresee the application of the borrower's law.

Prevailing conflicts doctrines in cases of usury have traditionally failed to provide an effective mechanism of choice between the conflicting statutes and protective policies of various states. Unless it is assumed that every interstate loan contract should be validated, no matter how ignorant the borrower or oppressive the terms, some rational line between validation and invalidation must be drawn. The following analysis attempts to draw such a line.

#### A. *The Doctrine of the Lex Debitoris*

An interest maximum embodies a legislative declaration that a particular class of borrowers, regardless of need or ability to repay, will not be allowed to contract for the loan of money above a stated price. General principles of contract law, such as the legal enforcement of contractual obligations voluntarily assumed, the promotion of stable trade and commerce, and the protection of party expectations, are subordinated to the fundamental goal of borrower protection. Courts forced to choose between the protective law of a borrower's state and the less protective law of a lender's state must therefore resolve the questions of when and why a borrower should be allowed to obtain money outside his state at interest rates in excess of those allowed by his own laws. Because no satisfactory choice-of-law doctrine should ignore these questions, the following rule of decision is proposed as a point of departure for cases posing problems of conflicts in usury laws.

##### 1. *The Rule*

*The usury law presumed to control a loan transaction between parties from different states, in the absence of an overriding policy to the contrary, should be the law of the state where the borrower has his home.*

This choice-of-law rule shall be designated the *lex debitoris*, or law of the debtor. It embodies a presumption that individual borrowers are weak, ignorant, and necessitous, and that all arrangements of "contacts" or stipulations of foreign law present in interstate loan contracts have been inserted by lenders who possess vastly superior bargaining power.

The *lex debitoris* is a revolutionary doctrine only in that it states explicitly what courts for years have held implicitly.<sup>340</sup> It adopts for usury a rule which is similar in principle to the widely accepted rule for life insurance contracts: that the "validity" of such contracts and "the rights created thereby are determined . . . by the local law of the state where the insured was domiciled at the time the policy was issued."<sup>341</sup>

Several aspects of this rule require elucidation. First, the rule does not contemplate application of the *lex debitoris* to every interstate loan transaction. Rather, it creates a rebuttable presumption that the borrower can only be protected adequately by his own law. This presumption is to be set aside, and the borrower deprived of his law's protection, solely on the basis of carefully delineated social or commercial policies declared by the courts and legislatures of concerned states. While automatic application of the *lex debitoris* would always guarantee the borrower the protection of his own law, there are many situations where the borrower either does not need this protection or other considerations are deemed of greater importance.<sup>342</sup> The burden of rebutting the presumption, however, is placed upon the lender. The lender and not the borrower will be forced to prove to the court's satisfaction that application of the lender's law will not frustrate the protective policies of the borrower's state. Thus, the presumption will force courts to focus their attention upon the basic policy of borrower protection at the start of any choice-of-law inquiry.

A second aspect of the *lex debitoris* is its complete rejection of the notion that a contract or transaction either has a location in physical space, or is governed by a rule based on geographical situs.<sup>343</sup> One should

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<sup>340</sup> See cases cited at note 421 *infra*. This thesis is given implicit support by the judicial exceptions to generally held rules of validation, discussed in notes 238-327 *supra* and accompanying text, and is developed in greater detail in the text accompanying notes 406-653 *infra*. See generally EHRENZWEIG, *CONFLICT OF LAWS* § 182 (1962).

<sup>341</sup> RESTATEMENT (SECOND), *op. cit. supra* note 293, § 346(1). The *Second Restatement* gives two basic reasons for this rule, both of which are directly applicable to usury: first, the state of the insured's domicile has the "greatest interest in the insured" and the courts desire to give him "the protection of his own local law"; second, the courts seek to protect the insured against the "obvious disparity in bargaining power between an insurance company and the individuals whose lives it insures." *Id.* at 109. *Accord*, BATTIFOL, *op. cit. supra* note 337, at 305; CARNAHAN, *CONFLICT OF LAWS AND LIFE INSURANCE CONTRACTS* 200 (2d ed. 1958); EHRENZWEIG, *op. cit. supra* note 340, § 202, at 514-17; 3 RABEL, *CONFLICT OF LAWS* 313 (1950); Lenhoff, *Conflicts Avoidance in Insurance*, 21 *LAW & CONTEMP. PROB.* 549 (1956).

<sup>342</sup> These exceptions are treated in detail in the text accompanying notes 438-653 *infra*.

<sup>343</sup> The *Second Restatement*, for example, appears to adopt the notion of geographic situs. It has proposed the following list of "significant contacts" which connect the contract to a particular state: where the contract is to be performed (the loan paid); where the contract was made (the place of the last act necessary to make the contract binding on all parties); where the land given as security is located; where the loan was negotiated; where the note was drawn up or dated; where the money was used; where the lender or borrower

not forget that the metaphor of a contract existing in geographical space is, after all, only a metaphor. Not only is the image of a geographical location for a contract conceptually unsound; it is also extremely dangerous. Courts that rely upon such an image tend to cease their analysis of the policies underlying the choice of a particular law once they have charted this fictitious location. They therefore fail to see that the search for a contract's location is totally irrelevant to the basic issue of borrower protection.<sup>344</sup> It cannot be maintained that a contract for an exorbitant rate of interest should be sustained merely because the lender signed the document in his state, or because the borrower mailed his checks to the lender's out-of-state bank.<sup>345</sup>

A third aspect of the *lex debitoris* is its emphasis on the borrower's "home." This deliberately loose term<sup>346</sup> is used to indicate a connection between a borrower and a state which may or may not meet the technical requirements of domicile or residence,<sup>347</sup> but which is sufficient to bring

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is incorporated; and where the lender or borrower has his domicile or principle place of business. The *Second Restatement* does not indicate, however, why these contacts should be considered at all "significant" for the problems of usury. See RESTATEMENT (SECOND), *op. cit. supra* note 293, § 334d, at 56-57; cf. Cavers, *Re-Restating the Conflict of Laws: The Chapter on Contracts*, XX CENTURY COMPARATIVE AND CONFLICTS LAW 349, 354-59, 361-63 (1961).

<sup>344</sup> See CAVERS, THE CHOICE-OF-LAW PROCESS 127 (1965); cf. CURRIE, SELECTED ESSAYS ON THE CONFLICT OF LAWS 100-03 (1963); note 166 *supra*. Professor Cavers has recently proposed an equally unfortunate version of the view that a transaction has a geographical location. He draws a distinction between laws designed to protect "persons" and those designed to protect "transactions." The "settled residence" of the protected person is deemed the most important contact when the law affects "persons"; but when it affects "transactions," the applicable law is that of the state in which the transaction is "centered." CAVERS, *op. cit. supra* at 182-83. Since Cavers apparently feels that general usury laws protect transactions, not persons, see *id.* at 181, interstate loan contracts are to be controlled by the law of the state in which they are "centered." The rationale given is that the parties must be presumed to have expected the law of that state to apply. *Id.* at 188. But, to quote Cavers himself in another context, "what does that circumstance have to do with the problem of protection versus no protection which is here at issue?" *Id.* at 127. Cavers not only fails to indicate why he feels that some laws protect persons, while others protect transactions; he also seems mistaken in assuming usury laws are transaction-oriented, and not person-oriented. See notes 81-86 *supra* and accompanying text. The essential question in usury is not whether the parties actually expected the law of the transaction's "center" to apply, but whether an oppressive contract should be overturned despite their expectations.

<sup>345</sup> "Our own citizens would not be permitted to make [loan] contracts here payable in another state, and then insist upon having them construed here according to the laws of such state; and it does not seem consistent with principle and reason that a foreign [lending] corporation . . . can insist upon making its contracts payable elsewhere, and then invoke the authority and process of our courts to enforce them according to laws other than our own." Washington Nat'l Bldg., Loan & Inv. Ass'n v. Stanley, 38 Ore. 319, 341, 63 Pac. 489, 495 (1901).

<sup>346</sup> The term, "home," has recently been proposed by Cavers as a convenient shorthand for "settled residence." CAVERS, *op. cit. supra* note 344, at 155 & n.21, 182.

<sup>347</sup> For an analysis of the terms "domicile" and "residence" see Reese & Green, *That Elusive Word, "Residence,"* 6 VAND. L. REV. 561 (1953).

that borrower within the "ambit" of that state's "concern."<sup>348</sup> Arguably, the justification for the use of the borrower's home as a determinative factor in the *lex debitoris* turns on the answers to two questions. First, what does it mean to say that a borrower is within a state's "concern," and what relevance does this have to a choice of law? Second, how "sufficient" must the borrower's connections with a state be for him to be viewed as having a "home" there?

One approach to the first question turns upon an analysis of that contractual reciprocity which inheres in the relationship between a person and his home state. Those who have homes in a particular state legitimize its claim to sovereignty through public elections, the payment of taxes, and acquiescence in and obedience to the laws it duly promulgates. In return, they have the *right* to expect from the state a paternal concern which manifests itself in police protection, schools, highways, welfare benefits, and other activities. Part of the sovereign's function today is to protect its citizens against predatory commercial practices. Usury laws form a part of this protection, and at the same time protect certain state interests. Because a prosperous, stable citizenry is necessary to support the state, the state seeks to keep its debtors off the public relief rolls. It also tries to protect its resident creditors from out-of-state businessmen whose commercial practices may drive resident debtors into insolvency.

A borrower, therefore, is within the ambit of a state's concern when the state owes him the duty of support in case of insolvency, when the borrower's financial difficulties would adversely affect his other creditors residing in the state, and when the state owes him the duty of protection for the performance of his duties which it has received in return. The law of the borrower's home is therefore relevant to the choice of a law to govern his transactions, not only because the state is affected by and has an interest in the outcome of the determination, but also because the borrower has earned, through the performance of his duties, the right to claim that law's protection.<sup>349</sup>

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<sup>348</sup> CAVERS, *op. cit. supra* note 344, at 182 n.2.

<sup>349</sup> "Governmental interest analysis," see Currie, *The Constitution and the Choice of Law: Governmental Interests and the Judicial Function*, 26 U. CHI. L. REV. 9 (1959), essentially rests upon a foundation of comity between states. Because certain states are affected by, and therefore interested in, the outcome of litigation, other states' courts should give the laws of the interested states respectful consideration. For this reason the proponents of "governmental interest analysis" urge courts to examine the *purposes* of certain laws in terms of what that state *intended* to accomplish by enacting them: "Frequently it is clear that the *purpose* of a law is to protect . . . one of the parties to a transaction. It is equally clear that the benefit or protection is not *intended* for all men everywhere, but only for those who by virtue of their *relationship to the state* are within the legitimate scope of its governmental concern. If the policy of such laws is to be effectuated, they must be applied



The answer to the second question of when a borrower in fact has a home within a state can be determined in light of the considerations developed in answering the first question. He must be deemed to have a home within a state whenever that mutuality of interests between borrower and state has come into existence. This will occur, for example, when a person moves into a state and becomes eligible for the benefits of veteran's bonus statutes, poor laws, and other welfare enactments.<sup>350</sup> In the area of statutory borrower protection, therefore, the home state of a borrower is an essential connection for a conflicts theory designed to fit interstate loan transactions.<sup>351</sup>

"Home" typically includes settled residence if the borrower is an individual, or principal place of business if a partnership, corporation, or other association. Problems arise when the borrower is deemed to have a "home" in several states. Thus, assume that a borrower resides in New Jersey and owns a business in New York. If the borrower obtained a loan from a California lender at a rate which exceeded the maximums of both New Jersey and New York, and the court had concluded that only New Jersey or New York laws were applicable to this loan,<sup>352</sup> how would a law be chosen? There are several possible solutions to this dilemma. First, the court could look to the use to which the funds were put. If used in the business, New York law might be applied; if used for individual purposes, New Jersey law might be selected.<sup>353</sup> Second, the

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in such a way as to protect the *intended* beneficiaries." Currie & Schreter, *Unconstitutional Discrimination in the Conflict of Laws: Privileges and Immunities*, 69 YALE L.J. 1323, 1324 (1960) (emphasis added). The analysis in this comment goes one step beyond a "governmental interest analysis." It suggests that courts should take cognizance of certain states' laws, not only because these states are "interested" in the outcome of the litigation, but also because individuals from those states have certain rights vested in them by virtue of their connections with those states. They have a *right* to the protection of their own law, a right which they do not have with respect to the laws of the states where, for example, the contract is merely "performed," or "negotiated," or "made binding."

<sup>350</sup> See Reese & Green, *supra* note 347, at 572 and cases there cited.

<sup>351</sup> This assumes, of course, that the particular borrower in question does require protection. If so, the choice of potentially applicable laws is limited to the states of the borrower's and lender's homes. The reasons stated in the text apply equally to the mutuality of interests between the lender and his state. If it is found that the borrower does not need statutory protection, see discussion of corporate borrowers notes 439-71 *infra* and accompanying text, then the parties may be allowed to stipulate that any convenient law controls their contract's validity, or the court may adopt a validation theory to implement the parties' original intent to be bound by their obligation.

<sup>352</sup> This would occur when the lender failed to overcome the presumption of the *lex debitoris*, see text accompanying note 342 *supra*. The court will therefore protect the borrower by applying his law to the loan contract. The issue, however, is which law is to be deemed the borrower's.

<sup>353</sup> Courts have used the "purpose of the loan test" in other related areas to determine whether a loan was made to a borrower in his individual or corporate capacity. See, e.g., *Dahmes v. Industrial Credit Co.*, 26 Minn. 26, 32, 110 N.W.2d 484, 488 (1961) (discussed

court might attempt to determine which state would be most strongly affected by the borrower's financial difficulties. If the borrower's creditors were all in New York, that state's law might be applied. Third, the court might consider the validity of the lender's expectations. If the borrower had used stationary with his business letterhead in contacting the California lender, and had indicated that the funds were to be used for business purposes, the court might apply New York law on the theory that the lender could not justifiably be expected to have foreseen the application of New Jersey law.<sup>354</sup> Fourth, the court might apply the more strict of the two laws on the theory that the lender, if in doubt as to the applicability of the two laws, should pick the one with the lower interest maximum, thus ensuring the validity of the contract; or it might apply the more lenient law on the theory that the lender should not be penalized by the existing uncertainty in choice-of-law rules.<sup>355</sup> This difficult aspect of the *lex debitoris* would no doubt have to await a case-by-case resolution.

## 2. *Applications of the Rule*

The presumption of the *lex debitoris* is of particular value to the law of conflicts for three reasons. First, it removes from the courts the temptation to resolve "avoidable" conflicts by gratuitous choice-of-law methods. Second, it creates in cases of "essential" conflicts a strong presumption of borrower protection against which the strength of the various policy exceptions may be measured. Third, it emphasizes the strong policy of protecting inexperienced borrowers who deal with large foreign lending institutions from a position of substantially inferior bargaining power.

(a) *Avoidable Conflicts*.—Suits involving interstate loan contracts may be grouped into a number of specific situations which pose "avoidable" conflicts. The term, "avoidable" conflicts,<sup>356</sup> is used to include all cases

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in note 510 *infra*); cf. SPECIAL COMMITTEE, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, REPORT ON RETAIL INSTALLMENT SALES, CONSUMER CREDIT, SMALL LOANS AND USURY 13-15 (1965).

<sup>354</sup> For a discussion of the problem of the lender's expectations, see text accompanying notes 636-53 *infra*.

<sup>355</sup> See e.g., *Washington Nat'l Bldg., Loan & Inv. Ass'n v. Stanley*, 38 Ore. 319, 342, 63 Pac. 489, 495 (1901). The court declined to apply the borrower's entire law to the transaction in view of the "rule that forfeitures are never enforced except when the case is reasonably free from doubt." This decision was made in a context where the court felt an uncertainty existed as to the meaning of the borrower's law.

<sup>356</sup> The concept of a conflicts problem solvable without recourse to traditional choice-of-law methods has been formulated differently by many commentators. See, e.g., CAVERS, *op. cit. supra* note 344, at 89-90 ("false conflicts"); CURRIE, *SELECTED ESSAYS ON THE CONFLICT OF LAWS* 109 (1963) ("false problems"); EHRENZWEIG, *CONFLICT OF LAWS* 310 (1962) ("pseudo conflicts"); Traynor, *Is This Conflict Really Necessary?*, 37 TEXAS L. REV. 657, 675 (1959) ("spurious conflicts"); Weintraub, *A Method for Solving Conflicts Problems*, 21

in which there is one particular law which, if chosen, will not infringe upon or diminish the effectiveness of any policy embodied in the statutory or decisional laws of the lender's or borrower's state.<sup>357</sup> In cases involving usury statutes, avoidable conflicts occur in several situations: when application of the borrower's interest rate or penalty<sup>358</sup> will promote the policies held in common by all relevant states,<sup>359</sup> when application of either law will provide an identical result,<sup>360</sup> or when the legislature has included a choice-of-law rule in its usury statute.<sup>361</sup>

The specific policies underlying usury statutes control the application of the concept of avoidable conflicts. A usury law consists of two distinct but related parts: an interest maximum,<sup>362</sup> and a sanction for its violation.<sup>363</sup> Although the overall policy of usury statutes is borrower protection,<sup>364</sup> the two parts of the statute perform their functions in different ways. An interest maximum is a standard. It sets forth a particular rate of interest below which the borrower is conclusively presumed by the legislature to be protected against economic exploitation. The sanction for the violation of an interest maximum is not a standard, but a deterrent. It does not punish lenders for taking interest per se, for such conduct is not inherently bad.<sup>365</sup> Rather, it threatens to punish any lender who attempts to take more than the permitted interest from a borrower who is protected by a particular law.

This distinction becomes significant in a multistate context. An interest maximum of a state sets a standard which is only applicable to borrowers

U. PITT. L. REV. 573, 574 (1960) ("illusory conflicts"). Strictly speaking, an "avoidable" conflict does not involve a conflict of various laws at all. It is rather a problem with respect to which traditional conflicts reasoning is unnecessary for a successful solution. See generally Comment, *False Conflicts*, 55 CALIF. L. REV. 74 (1967).

<sup>357</sup> Compare CURRIE, *op. cit. supra* note 356, at 107: Cases of avoidable conflicts "do not . . . present real problems, because they do not involve conflicting interests of the respective states. It is perfectly clear what the result should be in each. Either state, though approaching the case with no other purpose than to advance its own interests, would reach that result." CAVERS, *op. cit. supra* note 344, at 89-90, develops a similar notion.

<sup>358</sup> See text accompanying notes 518-618 *infra*.

<sup>359</sup> See text accompanying notes 367-79, 394-98 *infra*.

<sup>360</sup> See text accompanying notes 380-93 *infra*.

<sup>361</sup> See text accompanying notes 399-403 *infra*.

<sup>362</sup> See notes 523-65 *infra* and accompanying text.

<sup>363</sup> See notes 566-618 *infra* and accompanying text.

<sup>364</sup> See text accompanying notes 81-86 *supra*.

<sup>365</sup> This point is illustrated by those domestic cases in which lenders are allowed to extract interest from borrowers above the normal maximum when those borrowers are not protected by the state's usury statute. See *Central Trust Co. v. Simmons Motor Corp.*, 28 Misc.2d 826, 215 N.Y.S.2d 555 (Sup. Ct. 1961); *Dilg v. Bank of United States*, 224 App. Div. 223, 278 N.Y. Supp. 972 (Sup. Ct. 1935). These cases held that a New York bank could extract usurious interest from a New York corporate borrower on the ground that the usury laws were designed to protect individuals, not corporations.

from that state. It does not, nor could it purport to, protect borrowers in other states.<sup>366</sup> The sanction for violation of a particular state's interest maximum, however, is applicable to lenders from other states as well as those from the borrower's state. It would lose its effectiveness if it deterred only domestic lenders, yet allowed foreign lenders to undermine the protection of the borrower's law. Given this twofold function in usury statutes of protection and deterrence, the following situations may be classified as avoidable conflicts.

(1) *Contract Valid Under Borrower's Law, Usurious Under Lender's Law.*—Virtually every recent case adopting a general validation theory<sup>367</sup> for cases apparently involving conflicts in usury laws has indiscriminately cited for authority cases involving the most misleading of all avoidable conflicts.<sup>368</sup> This particular situation arises when the lender charges a rate of interest illegal under his own law, but valid under the borrower's law. With few exceptions, the scores of cases which have considered this problem have come to the correct decision, but for the wrong reason.

Assume, for example, a contract with an interest rate of ten per cent; the borrower's state allows ten per cent, the lender's only six. The borrower may attempt to argue that the lender's law should be applied to declare the transaction usurious both when suit is brought in the borrower's state and when it is brought in the lender's state.

When suit is brought in the borrower's own state, that borrower is placed in the highly untenable position of arguing to his own court that he should be released from his obligation by application of the foreign lender's more protective law. The flaw in this position is that there is no reason whatsoever for his court to overturn a contract in the name of borrower protection when that borrower is already protected by the standards of his own law.<sup>369</sup> Apart from a small minority of courts unable

<sup>366</sup> "It is . . . clear that the benefit [of a protective law] . . . is not intended for all men everywhere, but only for those who by virtue of their relationship to the state are within the legitimate scope of its governmental concern. . . . To apply [such laws] . . . for the protection of others, with whose welfare the state has no concern, may in some situations . . . constitute intermeddling so officious and unjustified as to amount to a denial of due process of law, or of full faith and credit to the laws of a sister state." Currie & Schreter, *supra* note 349, at 1324.

<sup>367</sup> For a discussion of validation theories, see text accompanying notes 170-237 *supra*.

<sup>368</sup> See, e.g., *In re Speare*, 367 F.2d 208, 211 (1966).

<sup>369</sup> "If in Georgia, where 8 per cent interest is legal, a resident of this State desires to make himself liable for that rate upon a note to be paid in another State, . . . it is difficult to conceive any good reason of morals or policy why this should not be allowed . . . . To construe this note [by Georgia law] . . . works injustice to no one . . . . The contract being under our laws perfectly legal, [the borrower] cannot and ought not to expect the courts of this State to release him from his solemn and deliberate undertakings." *New England Mortgage Security Co. v. McLaughlin*, 87 Ga. 1, 3-6, 13 S.E. 81, 82-83 (1891). See *Lanier v. Union Mortgage, Banking & Trust Co.*, 64 Ark. 39, 50, 40 S.W. 466, 470 (1897); Freund, *Chief Justice Stone and the Conflict of Laws*, 59 HARV. L. REV. 1210, 1216-17 (1946).

to shake off the hypnotic attraction of conflicts dogma,<sup>370</sup> the overwhelming majority have sustained such contracts by applying the borrower's law.<sup>371</sup>

When suit is brought in the lender's state, similar reasoning is used. Although the lender has apparently violated the laws of his state,<sup>372</sup> both legislatures<sup>373</sup> and courts<sup>374</sup> have consistently allowed him to do so—as long as the contract is valid under the foreign borrower's law. Again the result is logical. The lender might argue that his state's interest maximum is designed to protect only borrowers from his state, and no such borrower is before the court. No valid purpose of either state would be served by invalidation of the contract under the lender's law. Application of the borrower's law, however, would promote the shared policy of validating contractual obligations assumed by the parties in good faith. Alternatively, the lender might argue that since no forum borrower is involved in the controversy, the usury statute of the forum is totally inap-

<sup>370</sup> See *Pellerin Laundry Mach. Sales Co. v. Hogue*, 219 F. Supp. 629 (W.D. Ark. 1963); *Stoddard v. Thomas*, 60 Pa. Super. 177 (1915). In both cases the law of the lender's state—the place of payment—was applied to declare the contract usurious, although it was valid under the *lex debitoris*.

<sup>371</sup> *Fowler v. Equitable Trust Co.*, 141 U.S. 384 (1891); *Cromwell v. County of Sac*, 96 U.S. 51 (1877); *Kellogg v. Miller*, 13 Fed. 198 (C.C. Neb. 1881); *Fitch v. Remer*, 9 Fed. Cas. 181 (No. 4836) (C.C. Mich. 1860); *Ashurst v. Ashurst*, 119 Ala. 219, 24 So. 760 (1898); *American Freehold Land Mortgage Co. v. Sewell*, 92 Ala. 163, 9 So. 143 (1890); *McDougall v. Hachmeister*, 184 Ark. 28, 41 S.W.2d 1088 (1931); *Lanier v. Union Mortgage, Banking & Trust Co.*, 64 Ark. 39, 40 S.W. 466 (1897); *McKay v. Belknap Sav. Bank*, 27 Colo. 50, 59 Pac. 745 (1899); *Byrd v. Equitable Life Assur. Soc'y*, 185 Ga. 628, 196 S.E. 63 (1938); *New England Mortgage Security Co. v. McLaughlin*, 87 Ga. 1, 13 S.E. 81 (1891); *Bigelow v. Burnham*, 83 Iowa 120, 49 N.W. 104 (1891); *Arnold v. Potter*, 22 Iowa 194 (1867); *Butters v. Olds*, 11 Iowa 1 (1860); *Wm. Glenny Glass Co. v. Taylor*, 99 Ky. 24, 34 S.W. 711 (1896); *Mott v. Rowland*, 85 Mich. 561, 48 N.W. 638 (1891); *Van Schaick v. Edwards*, 2 Johns. Cas. 355 (N.Y. 1801); *Kilgore v. Dempsey*, 25 Ohio St. 413 (1874); *Atwater v. Roelofson*, 2 Handy 19 (Ohio Super. Ct. 1855); *Thornton v. Dean*, 19 S.C. 583 (1883); *Dugan v. Lewis*, 79 Tex. 246, 14 S.W. 1024 (1891).

<sup>372</sup> The wording of N.Y. GEN. OBLIGATIONS LAW § 5-501 is typical: "No person or corporation shall . . . take or receive in money . . . any greater sum or greater value, for the loan or forbearance of any money, goods or things in action, than is above prescribed [6% per annum]." By merely "taking" more than 6% interest, even from an out-of-state borrower, a New York lender apparently violates the law of his state. However, this statute has been construed to prohibit New York lenders from taking more than 6% interest only from borrowers protected under New York law. See *Central Trust Co. v. Simmonds Motor Corp.*, 28 Misc. 2d 826, 215 N.Y.S.2d 555 (Sup. Ct. 1961).

<sup>373</sup> See, e.g., CONN. GEN. STAT. ANN. § 37-3 (Supp. 1965); GA. CODE ANN. § 57-106 (Supp. 1965). See also text accompanying notes 591-99 *infra*.

<sup>374</sup> *Green v. Northwestern Trust Co.*, 128 Minn. 30, 150 N.W. 229 (1914); *Manhattan Life Ins. Co. v. Johnson*, 188 N.Y. 108 (1907); *Sheldon v. Haxtun*, 91 N.Y. 124 (1883); *Balme v. Wombough*, 38 Barb. 352 (N.Y. 1862); *Potter v. Tallman*, 35 Barb. 182 (N.Y. 1861); *Berrien v. Wright*, 26 Barb. 208 (N.Y. 1857); *Thorn v. Alvord*, 32 Misc. 456, 66 N.Y. Supp. 587 (Sup. Ct. 1900); *Scott v. Perlee*, 39 Ohio St. 63 (1883); cf. *Davis v. Tandy*, 107 Mo. App. 437, 81 S.W. 457 (1904).

licable to the given facts;<sup>375</sup> rather, the only law relevant to the dispute from the point of view of the forum is its residual common law doctrine of upholding valid contractual obligations.<sup>376</sup> Because this doctrine is identical to the policy of the borrower's state toward interest rates below ten per cent, the laws of the two states do not conflict.<sup>377</sup>

In either case, application of the *lex debitoris* to this avoidable conflict will, by validating the contract, protect the contractual expectations of both parties without adversely affecting the policy of the borrower's state. To be sure, the rule of validation will also ensure the same result; indeed, it has been most often and most effectively applied to this kind of conflict.<sup>378</sup> However, the rule of validation obscures the distinction between cases of avoidable and essential<sup>379</sup> conflicts, while the *lex debitoris* does not. Cases in which a contract has been validated by applying the borrower's more liberal law should not be cited as authority to support validation of transactions posing essential conflicts in which, for example, the loan is valid under the lender's law but usurious under the borrower's.

(2) *Identical Results Under Both Laws.*—When the application of either the borrower's or lender's law would not affect the ultimate outcome of the controversy, conflicts reasoning is unnecessary. This occurs in two groups of cases: those in which the contract is valid under either law;<sup>380</sup>

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<sup>375</sup> It is possible to argue, however, that the legislature in the lender's state intended its statute to apply extraterritorially to protect out-of-state borrowers who deal with domestic lenders. The usury statute would then apply to the instant controversy, and the conflict would not in fact be avoidable. This argument is unlikely to succeed. Courts would be extremely reluctant to construe any statute in a manner which might constitute an unwarranted extension of state power to those who are not within the scope of that state's governmental concern. See Currie & Schreter, *supra* note 349. It may be necessary, however, for a court to extend at least the coverage of its statute to protect an out-of-state borrower when the forum statute provides for a higher rate of interest than does the borrower's. See text accompanying notes 382-92 *infra*.

<sup>376</sup> English common law imposed no restrictions upon the taking of interest. Usury prohibitions were therefore wholly the creatures of legislation. Absent such statutory regulation, most contracts including the repayment of interest would be validated. See *Coleman v. Commins*, 77 Cal. 548, 554, 20 Pac. 77, 80 (1888); *Rosa v. Butterfield*, 33 N.Y. 665, 669-70 (1865); WEBB, *THE LAW OF USURY* § 5 (1899). "Unconscionable" contracts, however, would not be enforced at common law. See *Thomas v. Clarkson*, 125 Ga. 72, 80-81, 54 S.E. 77, 81 (1906).

<sup>377</sup> The difference between the lender's two alternative arguments becomes important only when the contract would be usurious under the lender's statutory law, or under both the lender's and borrower's statutory laws. See text accompanying notes 382-84 *infra*.

<sup>378</sup> See, e.g., *Bigelow v. Burnham*, 83 Iowa 120, 49 N.W. 104 (1891); *Arnold v. Potter*, 22 Iowa 194 (1867); *Butters v. Olds*, 11 Iowa 1 (1860).

<sup>379</sup> See text accompanying note 406 *infra*.

<sup>380</sup> *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964); *Fahs v. Martin*, 224 F.2d 387 (5th Cir. 1955); *Meinhard, Greeff & Co. v. Edens*, 189 F.2d 792 (4th Cir. 1951); *Armstrong v. Alliance Trust Co.*, 88 F.2d 449 (5th Cir. 1937); *Joffe v. Bonn*, 14 F.2d 50 (3d Cir. 1926); *Shute v. Fidelity Sav. & Loan Ass'n*, 21 Ariz. 111, 185 Pac. 646

and those in which the contract is not only usurious under both laws, but the two laws impose identical interest maximums and penalties.<sup>381</sup> In either case the borrower receives the same protection, and the lender the same treatment, regardless of which law is applied.

It does not necessarily follow, however, that because each state would independently reach an identical result in a purely domestic case, a court in a multistate context would reach that same result by applying either domestic law. Assume, for example, a case in which the borrower's and lender's law each imposed identical interest rates and penalties under which purely domestic contracts in each state would be usurious. The lender might nevertheless argue, in a suit brought in his own state, that because no forum borrower is before the court, the forum state's usury statute is totally inapplicable to the controversy. Instead, a residual forum common law applies, according to which contractual obligations properly assumed should be validated. In support of this argument the lender might cite both domestic<sup>382</sup> and conflicts<sup>383</sup> cases in which contracts granting to lenders interest in excess of that permitted by their own laws were validated. Because these cases can only be explained by the theory that the statutory law of the lender's state was not applicable, the court is confronted, not with an avoidable but an essential conflict: invalidation under the borrower's usury law versus validation under the lender's common law.<sup>384</sup>

The borrower has two arguments to prove that the only choice confronting the court is between the identical usury statutes of both states. These arguments turn upon the construction which the lender's forum state might place on its own law. First, the borrower might argue that the lender's usury statute applies, not just to forum borrowers, but to all transactions made or to be performed in the lender's state. When the lender's state possesses one of these contacts, therefore, its usury statute is one of at least two potentially applicable laws. This argument has the

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(1919); *Buerkle v. Greenlee*, 179 Ark. 674, 17 S.W.2d 882 (1929); *American Farm Mortgage Co. v. Ingraham*, 174 Ark. 578, 297 S.W. 1039 (1927); *West Side Motor Express, Inc. v. Finance Discount Corp.*, 340 Mass. 669, 165 N.E.2d 903 (1960).

<sup>381</sup> *Le Sueur v. Manufacturers' Fin. Co.*, 285 Fed. 490 (6th Cir.), *cert. denied*, 261 U.S. 621 (1922).

<sup>382</sup> See note 365 *supra*.

<sup>383</sup> For cases in which the borrower received no protection under his own state's law see cases cited note 460 *infra*; for cases in which the contract was invalid under the lender's law, but valid under the higher maximum of the borrower's law, see cases cited notes 371 & 374 *supra*.

<sup>384</sup> It should be noted that the acceptance of this argument does not determine the ultimate outcome of the case in question. If successful, the lender will have persuaded the court only that it is confronted with a choice of two dissimilar laws; he will still have to persuade the court to apply the forum's common law to validate the contract.

advantage of at least sounding like a traditional conflicts argument, and would allow the court to avoid the somewhat paradoxical result of validating a contract usurious under the domestic law of either state. It has the disadvantages of failing to explain those domestic cases in which lenders have been allowed to collect otherwise usurious interest;<sup>385</sup> of invoking a theory which is conceptually unsound<sup>386</sup> and mistakenly designed to protect transactions, not borrowers;<sup>387</sup> and of suggesting a conflicts rule which might deprive both forum and foreign borrowers of their own law's protection approximately half of the time.<sup>388</sup>

Second, the borrower might argue that the forum should distinguish between foreign states which protect their borrowers by enacting usury statutes and those which do not. If a foreign state does not give its borrowers any statutory protection,<sup>389</sup> no state's policy would be furthered by the forum's invalidation, under forum law, of transactions between forum lenders and unprotected foreign borrowers. However, if a foreign state does have a usury statute to protect its borrowers, it has an important general policy which is similar to the forum's policy: the protection of borrowers from overreaching lenders. The two states differ only in their determination of the particular interest rate at which their own borrowers should be deemed "protected," not in their determination of whether borrowers in general should be protected at all. Therefore, according to this argument, two possible grounds exist for persuading the forum to apply its statutory usury law and not its common law to the transaction: As a matter of comity between states or from sheer self-interest, the lender's state should not provide its lenders with a sanctuary from which to conduct poaching raids upon the borrowers of other states, when it refuses to sanction similar conduct toward domestic borrowers. Such an attitude on the part of the forum state would incur the hostility of other states, and might evoke retaliation in other areas. Alternatively, as a matter of constitutional law, the refusal to extend to foreign borrowers

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<sup>385</sup> See note 365 *supra*.

<sup>386</sup> See text accompanying notes 343-45 *supra*.

<sup>387</sup> See note 344 *supra*.

<sup>388</sup> In multistate cases of essential conflict in which the lender's state allowed a higher rate of interest than did the borrower's state, acceptance of the argument that the lender's usury statute covers foreign borrowers if the transaction is located in the lender's state would divert the courts' attention from the critical issue of borrower protection. Their reasoning would be framed in conceptual terms, and the probabilities of their applying the less protective lender's law would be roughly fifty per cent. See Currie & Schreter, *supra* note 349, at 1330. Alternatively, where the conflict was avoidable, the court might nevertheless he tempted to invalidate the contract under the lender's more protective law, thereby extending to borrowers a greater protection than they deserve.

<sup>389</sup> This will occur, for example, when a state either has no general usury law at all, such as Maine, Massachusetts, and New Hampshire, note 566 *infra*, or has exempted certain borrowers, such as corporations, from the protection of its usury law, note 441 *infra*.



the protection afforded domestic borrowers might be subject to attack under the privileges and immunities clause.<sup>390</sup> Guided by these arguments, the forum would apply the lender's usury statute not just to forum borrowers, but to all borrowers dealing with forum lenders who are given some measure of protection by their own state. The forum statute, therefore, will not be applied if it will conflict with the policy of another state;<sup>391</sup> but it will be applied if it will implement, albeit to a lesser degree, the policy of another state.<sup>392</sup>

Should the lender's arguments prevail, the existence of identical usury statutes in the lender's and borrower's states would pose, in the multistate context, an essential<sup>393</sup> conflict between two laws—the borrower's usury statute and the lender's common law. Should the borrower's arguments prevail, however, the conflict posed would be avoidable, for application of either law would provide identical results.

(3) *Contract Usurious Under Both Laws, Milder Penalty Under Borrower's Law.*—Avoidable conflicts arise when the contract is usurious under the laws of both the lender's and borrower's states and two further conditions are satisfied: the borrower's state permits a higher rate of interest than the lender's, and the laws of the borrower's state impose lighter sanctions upon the lender.<sup>394</sup> The *lex debitoris* should be applicable

<sup>390</sup> U.S. CONST. art. IV, § 2. The "sole purpose [of the privileges and immunities clause] was to declare to the several States, that whatever those rights, as you grant or establish them to your own citizens, or as you limit, qualify, or impose restrictions on their exercise, the same, neither more nor less, shall be the measure of the rights of citizens of other States within your jurisdiction." *Slaughter-House Cases*, 83 U.S. (16 Wall.) 36, 77 (1872). See generally *Currie & Schreter*, *supra* note 349, at 1324.

<sup>391</sup> For such instances of conflict, see cases cited notes 371 & 374 *supra*. The privileges and immunities clause does not give noncitizens of a state greater privileges than its own citizens. See *Paul v. Virginia*, 75 U.S. (8 Wall.) 168, 180 (1868).

<sup>392</sup> The argument might be made that, where the lender's and borrower's states both protect borrowers, although to a different degree, the two states have the policy of borrower protection *in common*. Therefore, the issue of whether to impose the lender's usury statute or the residual common law principle of validating contracts is an avoidable one: application of the forum's usury law would promote the policies of both states, while application of the common law would not. *Cf. Kinney Loan & Fin. Co. v. Sumner*, 159 Neb. 57, 65 N.W.2d 240 (1954) (sustaining a loan contract on the basis of a common policy between the two relevant states); M. Traynor, *Conflict of Laws: Professor Currie's Restrained and Enlightened Forum*, 49 CALIF. L. REV. 845, 857-61 (1961) (commenting on *Kinney*). The suggested argument is faulty. Although the two states have *similar* policies, they do not share a policy *in common*. Each state has its *own* policy—directed toward its *own* borrowers. Application of the lender's usury statute to a transaction involving a foreign borrower would not implement the policy of borrower protection in the lender's state, for no borrower from that state is before the court. The arguments for application of the lender's statutory law to interstate loan transactions rest upon grounds unrelated to the policy in the lender's state of protecting *its* borrowers: the threat of retaliation by other states, or the constitutional dictates of the privileges and immunities clause.

<sup>393</sup> See text accompanying note 406 *infra*.

<sup>394</sup> For an analysis of this problem in traditional terms of place-of-contracting and

to the issue of which remedy should be adopted, as well as to the issue of the contract's validity.

Assume, for example, a contract which stipulates a rate of fifteen per cent interest; the lender's and borrower's states each allow only six per cent. If the lender's law is applied, he forfeits the entire interest and principal to the borrower. If the borrower's law is applied, however, the lender loses the legal interest, but can recover the principal of the loan.<sup>395</sup> In such a case the issue of borrower protection is moot. Because the borrower will pay no more than allowed by his own law (although he may pay less under the lender's law), and because under either law he will at least receive the deterrent protection of his own sanction (although he may receive more under the lender's law), the choice-of-law issue becomes the extent to which a forfeiture should be imposed upon the lender.<sup>396</sup>

Under the facts of this hypothetical,<sup>397</sup> there seem to be no reasons which might persuade a court to impose the heavier penalty of the lender's state.<sup>398</sup> The purpose of the borrower's sanction is to protect forum bor-

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place-of-performance, see Comment, 35 CONN. B.J. 296, 303-04 (1960). For the view that the lighter penalty is always imposed see RESTATEMENT (SECOND), CONFLICT OF LAWS § 334d, at 59 (Tent. Draft No. 6, 1960). The *Second Restatement's* view is sensible with respect to avoidable conflicts, but see cases cited note 398 *infra*. It is unreasonable with respect to cases of "essential" conflict in which the borrower's law imposes a stricter penalty or lower rate, see notes 410-11 *infra* and accompanying text.

<sup>395</sup> See, e.g., *In re Speare*, 367 F.2d 208, 211-12 (2d Cir. 1966).

<sup>396</sup> The lender could argue that because his law is applicable only to borrowers from his state and no such borrower is involved in the controversy, his usury statute should not even be considered in the choice of a law; thus, he would argue, the case presents a true conflict between the borrower's usury statute and his own common law. See text accompanying notes 382-92 *supra*. If the lender's argument were successful, the conflict would be deemed an "essential" conflict, see text accompanying note 406 *infra*.

<sup>397</sup> In the instant hypothetical, the interest rates in both states were the same. Cases may arise, however, in which the interest rates as well as the sanctions vary between the states. In order to determine which state imposes the milder penalty in such cases, the strength of the sanction in each should be computed with respect to the total impact of the loss upon the lender. For example, if the lender's state imposes a forfeiture of all excess interest charged plus 50% of the legal interest, and the borrower's state only forfeits the excess interest charged, it might at first appear that the borrower's state imposes the milder penalty, and the conflict is avoidable. However, given a loan of \$1,000 at 50% interest, when the lender's legal maximum is 30% and the borrower's only 10%, the borrower's law imposes the heaviest penalty upon the lender, and the conflict is not avoidable. Under his own law the lender would lose the excess interest of 20% (\$200), plus 50% of the legal interest of 30% (50% of \$300, or \$150)—a total loss of \$350. Under the borrower's law, however, the lender would lose the entire 40% excess interest (\$400).

<sup>398</sup> "[S]ince it appears that the New York law makes a usurious contract wholly void, there can be no objection to the choice of the less drastic relief sought by defendant [borrower] under the law of California [which declares only the interest forfeited] . . ." "[T]here is, therefore, no actual conflict of laws on this point . . ." *Terry Trading Corp. v. Barsky*, 210 Cal. 428, 434, 292 Pac. 474, 476 (1930). See *In re Speare*, 367 F.2d 208, 211-12 (2d Cir. 1966) (reaching the same result with "grouping of contracts" conflicts reasoning). But see *Andrews v. Pond*, 38 U.S. (13 Pet.) 64 (1839); *Washington Nat'l Bldg. & Loan Ass'n v. Pifer*, 31 App. D.C. 434 (Cir. 1908); *Central Trust Co. v. Burton*, 74

rowers by deterring lenders from entering into illegal transactions. Application of the borrower's law fully preserves the effectiveness of the borrower's deterrent. Because the lender has not threatened any borrowers from his own state, his own courts would have no reason for imposing their stricter sanctions upon him. The interests of both states and the parties concerned are best served, therefore, by application of the borrower's law.

(4) *Statutory Conflicts Provisions*.—Although conflicts provisions are most often found in small loan legislation,<sup>399</sup> a few states have also incorporated them into their general usury statutes.<sup>400</sup> A court's own choice-of-law rules are pre-empted by legislative fiat when a forum statute<sup>401</sup> dictates the law to be applied to interstate loans.<sup>402</sup> Judicial discussion of conflicts theories found in such cases must be discarded as irrelevant.<sup>403</sup> The existence of a statutory conflicts provision may also prevent recourse by the courts to the doctrine of the *lex debitoris*.

The concept of avoidable conflicts is valuable for several reasons. First, by identifying a particular conflict as avoidable, a court can consistently reach a reasonable result without being forced to apply traditional conflicts doctrines. Gratuitous judicial reasoning is thereby avoided.<sup>404</sup> Second, it prevents a court from producing "a body of misleading dicta

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Wis. 329, 43 N.W. 141 (1889). All apply the stricter penalties of the lender's law. Imposition of the lender's heavier penalty might possibly be justified when the lender's conduct was so pernicious that a punitive sanction was in order.

<sup>399</sup> For the text of the UNIFORM SMALL LOAN ACT's conflicts provision see note 592 *infra*.

<sup>400</sup> See CONN. GEN. STAT. ANN. § 37-3 (Supp. 1965); GA. CODE ANN. § 57-106 (Supp. 1965).

<sup>401</sup> *West Side Motor Express, Inc. v. Finance Discount Corp.*, 340 Mass. 669, 165 N.E.2d 903 (1960) (the forum had no statutory conflicts provision but the applicable foreign jurisdiction did).

<sup>402</sup> See Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. Rev. 267, 271 (1966). Courts nevertheless have the opportunity to exercise great interpretative discretion with respect to construction of the statutes. *Id.* at 276-79.

<sup>403</sup> See *e.g.*, *Kinney Loan & Fin. Co. v. Sumner*, 159 Neb. 57, 65 N.W.2d 240 (1954).

<sup>404</sup> See, *e.g.*, *Fahs v. Martin*, 224 F.2d 387, 397-99 (5th Cir. 1955). The court, after extensive analysis of existing authorities, applied the corporate borrower's law to sustain the contract under Florida law by a "substantial connection" test. Since New York and Florida both had corporate exemptions at the time, see notes 440-41 *infra*, the contract was valid under either applicable law, and the conflicts question therefore avoidable, see text accompanying notes 380-81 *supra*. Even if the contract would have been usurious under New York law, as the court seems to assume, the conflict was nevertheless avoidable, for the contract was valid under the borrower's (Florida's) law, see text accompanying notes 367-79 *supra*. *Fahs v. Martin*, therefore, has been inaccurately cited for a general rule of validation. For example, GOODRICH, *CONFLICT OF LAWS* 218-19 (Scoles ed. 1964), makes this error. EHRENZWEIG, *CONFLICT OF LAWS* § 182, at 483 n.8 (1962), distinguishes *Fahs v. Martin* on another ground. To say that conflicts reasoning in cases of avoidable conflict is gratuitous, however, is not to say that the use of the avoidable conflicts concept is simple or automatic. The problem discussed in text accompanying notes 382-92 *supra*, for example, indicates that its application often involves fairly sophisticated analyses.

parading as valid choice-of-law precedent."<sup>405</sup> Third, it diminishes the danger that courts will reach a result which is inconsistent with the policies of all concerned states. Apart from cases involving statutory conflicts provisions, application of the *lex debitoris* to all avoidable conflicts will ensure that the borrower receives no more than the protection given him by his own law, and that the lender is not penalized without justification. Courts confronted with potentially usurious interstate loan transactions should always attempt first to classify them as avoidable conflicts. If this is possible, application of the rule of the *lex debitoris* will provide the correct result. If not, the conflict must be classified as "essential."

(b) *Essential Conflicts*.—A case of "essential" conflict may be defined as one in which application of any law other than the *lex debitoris* will undermine or negate the policy of the borrower's law by forcing that borrower to pay interest in excess of the protective maximum established by his own state.<sup>406</sup> Application of the *lex debitoris*, on the other hand, will overturn the probable expectations of the parties that they would be bound by their obligations, and will impose a loss upon the lender which exceeds that provided by his own law. The terminology of "essential" conflicts is adopted for convenience, and is used as a short-hand reference to only the following two types of conflict.

(1) *Contract Valid Under Lender's Law, Usurious Under Borrower's*

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<sup>405</sup> Comment, *False Conflicts*, 55 CALIF. L. REV. 74, 112 (1967). See CURRIE, *SELECTED ESSAYS ON THE CONFLICT OF LAWS* 180 (1963). An avoidable conflict is a situation in which there is one, comparatively obvious and fairly easy, correct solution. In such cases courts are not forced to resolve, case-by-case and by slowly emerging common law standards, those very difficult problems which are such that no solution will implement the policies of all states concerned. Cases posing avoidable conflicts, therefore, should not be cited as authority in cases which do not constitute avoidable conflicts. Placed in the latter cases, the former only give the false illusion of precedent. It was this mistake which bastened the development of the special rule of validation for multistate usury cases, see text accompanying notes 172-210 *supra*. The RESTATEMENT (SECOND), *op. cit. supra* note 394, § 334d, has unfortunately made this error. Illustrations 1, 2, 5, 7, 8, 9, & 10 are all avoidable conflicts, mistakenly used to support a rule proposed to solve cases presenting true conflicts. Illustrations 3 & 4 fail to provide information as to domicile or residence, and are therefore inconclusive. Only Illustration 6 poses a true conflict.

<sup>406</sup> Several writers have proposed a similar formulation of a true or unavoidable conflict, but without particular reference to the problems of usury. Professor Currie, for example, has defined such a conflict as one "in which advancement of the interest of one state results in subordination or impairment of the interest of the other. Each state has a policy, expressed in its law, and each state has a legitimate interest, because of its relationship to one of the parties, in applying its law and policy to the determination of the case." CURRIE, *op. cit. supra* note 356, at 107-08. See EHRENZWEIG, *op. cit. supra* note 356, at 311 (defining "true conflicts cases" as "those cases involving contacts with foreign laws, in which those laws differ from that of the forum"); CAVERS, *THE CHOICE-OF-LAW PROCESS* 89-90, 114-38 (1965) ("true," "unavoidable" conflicts).

*Law.*—A loan contract for thirty per cent per annum, valid under the lender's statutory or common law, but in excess of the maximum prescribed by the borrower's law, presents an essential conflict. There is no one law which could be applied to effectuate the latter state's policy of borrower protection and the former's policy of supporting contractual expectations.<sup>407</sup> The choice of any law other than the *lex debitoris* would leave the borrower without the protection of his law. But application of the *lex debitoris* would upset the parties' expectation that the contract would be valid, and quite likely impose a forfeiture upon the lender. Although a court may eventually conclude that the lender's law should be applied to a case of essential conflict,<sup>408</sup> the initial presumption of the *lex debitoris* should nevertheless be maintained. In overcoming a presumption which continually stresses borrower protection, courts will be forced to make explicit the types and strengths of those particular policy exceptions which dictate the application of a less protective law. In so doing they will be forced to construct a body of conflicts law based on rational "principles of preference."<sup>409</sup>

(2) *Contract Usurious Under Both Laws, Milder Penalty Under Lender's Law.*—Assume, for example, a contract which stipulates interest at fifteen per cent; the lender's and borrower's states each allow six per cent. According to the lender's law, the lender can only recover the principal plus the legal interest; according to the borrower's law, however, the lender forfeits the entire principal and interest. The choice of the

<sup>407</sup> Compare the concept of an avoidable conflict, *supra* notes 356-57 and accompanying text. Several arguments might be made that the situation described in the text poses an avoidable and not an essential conflict. First, the borrower might argue that the lender's usury statute was intended by the legislature to apply only in situations in which a borrower from that state was involved; if it were not so intended, the court must assume that the lender's state has no interest in having its usury statute applied. Because only the borrower's state is interested in having its law applied, therefore, the conflict is avoidable, and the *lex debitoris* should be applied. This argument is deficient. Statutes in derogation of the common law, it is frequently said, are to be strictly construed. If the lender's usury statute is construed as inapplicable to the controversy, courts will revert to the residual common law doctrine of validating contracts entered in good faith and with the proper formalities, see text accompanying notes 382-84 *supra*. Because this common law would validate a contract otherwise usurious under the borrower's law, an essential conflict is posed. Further, because imposition of the borrower's law may impose a substantial loss upon the lender, it may be assumed that the legislature of the lender's state is interested in having its common law applied to the controversy. Second, the lender might argue that the borrower's usury statute was intended to protect only small, inexperienced, necessitous borrowers, and that when such a borrower is not before the court, validation of the contract will effectuate the policies of both states by allowing experienced parties to contract without interference. This argument is considered in detail, notes 439-74 *infra* and accompanying text.

<sup>408</sup> For a discussion of various exceptions to the presumption of the *lex debitoris*, see text accompanying notes 438-653 *infra*.

<sup>409</sup> CAVERS, *op. cit. supra* note 406, at 122-23.

lender's penalty would remove from the borrower the deterrent protection his state's legislature felt necessary to restrain lenders from making illegal contracts. Application of the borrower's penalty, however, might impose a heavy forfeiture upon the foreign lender. In this and similar situations<sup>410</sup> a court might decide to reject the presumption of the *lex debitoris*.<sup>411</sup> In so doing, however, it should clearly state the policy justifications for removing from the borrower the deterrent protections of his law.

Cases of essential conflict present the greatest difficulties to the courts. In some cases application of the *lex debitoris* will provide the best result; in others, the presumption should be rejected. The initial presumption of the *lex debitoris*, however, provides a starting point for all attempts to remove from the borrower the protection of his own law. The strength of this presumption becomes important particularly in the area of adhesion contracts.

(c) *Inexperienced Borrowers and Adhesion Contracts*.—Not every borrower is unaware of his ability to repay a loan at varying rates of interest over long periods of time. However, the number of borrowers who know what they want and the price they must pay to obtain it is strikingly small. The few available studies have shown that the overwhelming majority of borrowers or credit purchasers are completely ignorant of either the dollar amount or the percentage of interest they have obligated themselves to pay.<sup>412</sup>

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<sup>410</sup> A variation of this essential conflict may also arise. Assume, for example, that the contractual interest rate is 30%; the lender's law allows 20%, and the borrower's 10%. Under both laws the penalty for usury is loss of only the excess interest charged. Application of the lender's law would impose a milder loss upon the lender than would the borrower's law, but it would force the borrower to pay 10% more interest than allowed by the *lex debitoris*. This situation is identical to the one in which the contractual interest rate is 20% and valid under the lender's law; it should therefore be given similar treatment. *But see* RESTATEMENT (SECOND), *op. cit. supra* note 394, § 334d, at 59. Existing case law is divided. For cases imposing the lighter penalty, see, e.g., *George v. Oscar Smith & Sons Co.*, 250 Fed. 41 (5th Cir. 1918); *Ringer v. Virgin Timber Co.*, 213 Fed. 1001 (E.D. Ark. 1914); *Dupree v. Virgil R. Coss Mortgage Co.*, 167 Ark. 18, 267 S.W. 586 (1924); *Gilbert v. Fosston Mfg. Co.*, 174 Minn. 68, 216 N.W. 778 (1927); *Hawkins v. Ringel*, 231 N.Y.S.2d 476 (Sup. Ct. 1962), *rev'd mem.*, 19 App. Div. 649, 242 N.Y.S.2d 616 (1963). For cases imposing a heavier penalty, see, e.g., *Huchingson v. Republic Fin. Co.*, 236 Ark. 832, 370 S.W.2d 185 (1963); *Jones v. Tindall*, 216 Ark. 431, 226 S.W.2d 44 (1950); *Tallman v. Union Loan & Trust Co.*, 161 Ark. 614, 256 S.W. 379 (1923).

<sup>411</sup> For discussion of the possible justifications for rejecting the *lex debitoris* with respect to the issue of penalties, see text accompanying notes 605-11 *infra*.

<sup>412</sup> Pennisi, *A Bird's-Eye View of the Loan Shark Problem from the Offices of the Legal Aid Society in Atlanta, Georgia*, 19 LAW & CONTEMP. PROB. 81, 95 (1954), states that of 396 borrowers investigated, only five per cent even *thought* they knew what interest rate they were paying, and of that five per cent almost no one knew the actual dollar amount he was paying. A study by Due, *Consumer Knowledge of Installment Charges*, 20 J. MARKETING 162, 164 (1955), of 136 families purchasing on consumer credit plans, found that

Furthermore, borrowers dealing with large lending institutions are typically confronted with a bewildering variety of standardized forms, printed charts, and arithmetical tables,<sup>413</sup> which are often drafted deliberately to obscure the amount of interest actually paid.<sup>414</sup> These contracts have been categorized "contracts of adhesion"<sup>415</sup> to distinguish them from transactions freely negotiated between equal and informed parties. Most of them are drafted by legal experts, incorporate a vast fund of experience gained from prior mistakes, and are meticulously phrased to resolve in favor of the dominant party all questions left unanswered by statute or judicial precedent.<sup>416</sup> "[D]ue to the disparity in bargaining power between draftsman and second party," the terms must be accepted or rejected "on a 'take or leave it' basis" so that "the 'adherer' cannot obtain the desired product or service save by acquiescing in the form agreement."<sup>417</sup> The borrower must choose between signing on the dotted line or approaching other sources for money. Should he choose the latter, he will no doubt be confronted by a similar, if not identical, form.

Adhesion contracts used by interstate lenders pose serious problems

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approximately two-thirds had no accurate idea of the amount of interest they were paying. See DERVIN, *THE SPENDER SYNDROME: CASE STUDIES OF 68 FAMILIES AND THEIR CONSUMER PROBLEMS* *passim* (1965); *Hearings on S. 750 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 88th Cong., 1st Sess. 1487-89 (1963-64); cf. Collins, *Evasion and Avoidance of Usury Laws*, 8 LAW & CONTEMP. PROB. 54 (1941). See generally *Hearings on S. 1740 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 87th Cong., 1st Sess. (1961); *Hearings on S. 2755 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 86th Cong., 2d Sess. (1960). While most uninformed borrowers are individuals, a substantial number of smaller corporations are equally inexperienced at borrowing. See text accompanying notes 463-65 *infra*.

<sup>413</sup> Shuchman, *Consumer Credit by Adhesion Contracts*, 35 TEMP. L.Q. 125, 281, 290-91 (1962).

<sup>414</sup> By law, banks in many states, in lieu of stating the actual interest rate paid, may merely show the borrower tables which state the size and frequency of the installments. Banks are quick to use this alternative, and rarely state the true interest rate. *Id.* at 290-92, nn.45, 46 & 60.

<sup>415</sup> The term was coined by SALLEILLES, *DE LA DECLARATION DE VOLONTE* 229 (1901), and was adopted by Patterson, *The Delivery of a Life-Insurance Policy*, 33 HARV. L. REV. 198, 222 (1919). See generally FRIEDMANN, *LAW IN A CHANGING SOCIETY* 103-05 (1959); FULLER, *BASIC CONTRACT LAW* 209-14 (1947); Kessler, *Contracts of Adhesion—Some Thoughts About Freedom of Contract*, 43 COLUM. L. REV. 629, 631-33 (1943); Macaulay, *Justice Traynor and the Law of Contracts*, 13 STAN. L. REV. 812, 857, 860 (1961); Shuchman, *supra* note 413; Llewellyn, Book Review, 52 HARV. L. REV. 700 (1939); Comment, *Administrative Regulation of Adhesion Contracts in Israel*, 66 COLUM. L. REV. 1340 (1966). For judicial reference to adhesion contracts, see, e.g., *Siegelman v. Cunard White Star, Ltd.*, 221 F.2d 189, 204 (2d Cir. 1955) (Frank, J., dissenting); *Steven v. Fidelity & Cas. Co.*, 58 Cal. 2d 862, 882, 377 P.2d 284, 296-97, 27 Cal. Rptr. 172, 184-85 (1962).

<sup>416</sup> Shuchman, *supra* note 413, at 129, 132-38.

<sup>417</sup> *Steven v. Fidelity Cas. Co.*, 58 Cal. 2d 862, 882, 377 P.2d 284, 296-97, 27 Cal. Rptr. 172, 184-85 (1962).

for the law of conflicts.<sup>418</sup> Buried in the body of small print are provisions for the payments to be made at the lender's bank, for the contract to be binding only when accepted by the lender at his home office, and for the contract to be governed by the law of the lender's state.<sup>419</sup> The existence of these provisions is hardly accidental. One unfortunate experience with the conflicts doctrines of the borrower's state is sufficient to cause any large interstate lending or credit institution to quickly insert such one-sided provisions into its contracts.<sup>420</sup>

Judicial treatment of interstate loan transactions involving adhesion contracts is difficult to assess because courts seldom indicate the parties' relative bargaining power or the form of the contract. However, a careful reading of those opinions which contain explicit reference to standardized or form contracts shows that a clear majority have declared the loans

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<sup>418</sup> Adhesion contracts have been discussed in only one case involving conflicts in usury laws, *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964). For adhesion contracts and conflict of laws generally see EHRENZWEIG, *CONFLICT OF LAWS* § 172 (1962); GOODRICH, *CONFLICT OF LAWS* § 107, at 203-04 (Scoles ed. 1964); RESTATEMENT (SECOND), *op. cit. supra* note 394, § 332a, at 20; Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, 53 COLUM. L. REV. 1072 (1953); Note, 57 COLUM. L. REV. 553, 575 (1957). For criticism of the adhesion contract doctrine in conflict of laws see CAVERS, *op. cit. supra* note 406, at 195; Lando, *The Proper Law of the Contract*, 8 SCANDINAVIAN STUDIES IN LAW 105, 151 n.8 (1964) (criticizing the distinction between "contracts of adhesion" and "agreements between equals" as an "oversimplification," and suggesting distinctions between various types of contracts); Yntema, *Contract and Conflict of Laws: 'Autonomy' in Choice of Law in the United States*, 1 N.Y.L.F. 46, 64 (1955) (suggesting use of the more flexible "public policy" exception).

<sup>419</sup> See, e.g., *Midland Sav. & Loan Co. v. Solomon*, 71 Kan. 185, 79 Pac. 1077 (1905); cf. *In the Matter of Leeds Homes, Inc.*, 222 F. Supp. 20 (E.D. Tenn. 1963) (corporate borrower); *Ury v. Jewelers Acceptance Corp.*, *supra* note 418 (corporate borrower). In *Leeds Homes, supra*, "forms" were supplied by the foreign lender according to which the contract was to be signed, and the payments made, in the lender's state; the contract also contained a stipulation that the law of the lender's state was to govern all aspects of the contract. While the court conceded a "strong case [was] made out" for the borrower, it helplessly validated the transaction in accordance with its conflicts rules. Recognition of the element of adhesion might have broken the spell cast by the court's conflicts doctrines.

<sup>420</sup> Representative Weltner, Chairman of the House Subcommittee on Usury, recently remarked: "[O]ne company requires all contracts to be forwarded to its home office for execution because of the favorable laws of that State. Because the law of the contract is the law of the place of execution, other State laws are evaded and totally ineffective. Federal action could remedy this situation, assuring the borrower at least the protection afforded by the law of his own State." 111 CONG. REC. 22015, 22017 (daily ed. Sept. 2, 1965). Blodgett, *Interest in Usury*, *The Wall Street Journal*, July 12, 1966, p. 1, col. 1, recently reported that "many big New York-based brokerage houses, exempted by a 1959 law from a 6% interest ceiling imposed on other types of loans . . . , encounter problems where they operate branches in states which impose a 6% ceiling. 'Their solution: Ignore the laws of other states. . . . So they have been charging over 6% in states with this ceiling—and hoping they won't be challenged. [Some] . . . apparently are taking a damn-the-torpedoes attitude. An officer of one big company says the penalty for usury is so light in most states that 'it's worth the risk' to ignore the law."



usurious in favor of the individual borrower.<sup>421</sup> With few exceptions, however, no court has openly allowed its decision to turn on the existence of a substantial disparity in bargaining power. Rather, prevalent conflicts doctrines have either been adopted when convenient, or rejected when not—in either case to the ultimate benefit of the borrower.

The Arkansas case of *Jones v. Tindall*<sup>422</sup> is a classic example of this technique. A Tennessee lender sued Jones, an "elderly Negro" Arkansas borrower, to foreclose a trust deed executed by Jones to secure a series of promissory notes.<sup>423</sup> An agent of the lender, who had been travelling through Arkansas "seeking to make secured loans to Negroes,"<sup>424</sup> contacted Jones and arranged the loan. He brought Jones to his office in Tennessee where the contract was concluded and where the payments were to be made. The contract, however, contained a stipulation that Arkansas law was to govern its terms.<sup>425</sup> At the trial Jones testified he did not know the amount of the principal or interest payments, and stated he had not even read the contract: "I was so glad [to get the money] I just signed my name."<sup>426</sup> Despite various possible grounds for decision,<sup>427</sup> the

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<sup>421</sup> "[I]t seems very manifest to us . . . that this Georgia corporation required the [borrower] . . . to declare . . . that the contract was solvable in that state . . . and, by this formal declaration inserted in the contract, compel the courts of this State . . . to adjust the rights of the parties according to the laws of Georgia . . . and in disregard of the laws of this State . . ." *Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 889-90, 21 S.E. 924, 927 (1895). See *Jones v. Tindall*, 216 Ark. 431, 226 S.W.2d 44 (1950) (borrower failed even to read loan contract); *Fidelity Sav. Ass'n v. Shea*, 6 Idaho 405, 413, 55 Pac. 1022, 1024 (1899) ("form contract"); *People's Bldg., Loan & Sav. Ass'n v. Kidder*, 9 Kan. App. 385, 391, 58 Pac. 798, 800 (1899) ("contract forms"); *Commonwealth Farm Loan Co. v. Caudle*, 203 Ky. 761, 762, 263 S.W. 24, 25 (1924) ("printed form"); *Locknane v. United States Sav. & Loan Co.*, 103 Ky. 265, 272, 44 S.W. 977, 979 (1898) ("formal declaration," citing *Meroney, supra*); *Lesser v. Strubbe*, 56 N.J. Super. 274, 280, 152 A.2d 409, 412 (Super. Ct. 1959), *modified on other grounds*, 67 N.J. Super. 537, 171 A.2d 114 (App. Div. 1961), *aff'd per curiam*, 39 N.J. 90, 187 A.2d 705 (1963) (enfeebled wife of borrower forced to sign note under duress); *Washington Nat'l Bldg., Loan & Inv. Co. v. Stanley*, 38 Ore. 319, 63 Pac. 489 (1901) (form contract); *cf. Mueller v. Ober*, 172 Minn. 349, 352, 215 N.W. 781, 782 (1927) (form contract invalidated on other grounds). *Contra*, *Smith v. Brokaw*, 174 Ark. 609, 611, 297 S.W. 1031, 1032 (1927) ("forms"); *Wayne County Sav. Bank v. Low*, 81 N.Y. 566, 571 (1880) ("form" contract).

<sup>422</sup> 216 Ark. 431, 226 S.W.2d 44 (1950).

<sup>423</sup> Jones had bought a farm on an installment basis, was behind in his payments, and was "anxious to satisfy the debt." *Id.* at 432, 226 S.W.2d at 45.

<sup>424</sup> *Ibid.*

<sup>425</sup> "[T]his deed of trust and the notes and indebtedness hereby secured shall, without regard to the place of contract or of payment, be construed and enforced according to the laws of the State of Arkansas, and with reference to the laws of which state the parties to this agreement are now contracting." *Id.* at 436, 226 S.W.2d at 47. This stipulation was probably inserted by the lender to obtain the benefit of Arkansas's 10% maximum, and avoid Tennessee's maximum of 6%.

<sup>426</sup> *Id.* at 432-33, 226 S.W.2d at 45.

<sup>427</sup> The contract was usurious under both Tennessee and Arkansas law. Although the

court based its opinion on perhaps the most unrealistic of all possible theories: party intention. The stipulation of Arkansas law was found "in evident keeping with the intent of both parties,"<sup>428</sup> and the contract was declared usurious and invalid.

It is difficult to understand how the stipulation could be in accord with the actual intent of a party so desperate for money that he neither read the contract, nor even knew the total amount of the obligation. To be sure, application of Arkansas law may have been just under the circumstances;<sup>429</sup> but the method chosen—enforcement of a one-sided contractual stipulation—clearly ignored the realities of the situation. The conflicts doctrine of party intent is demonstrably inadequate in this type of case.<sup>430</sup> Arkansas and other courts, however, apparently feel no need to emphasize disparities in bargaining power when their conflicts doctrines

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note on its face stipulated interest payments of just under 10% per annum for six years, the court found that the lender drew the notes and trust deed to specify an amount greater than that actually received by Jones. Tennessee law would have merely declared the interest over 6% forfeited, and enforced the remainder of the contract; Arkansas law, however, would have declared the contract totally void, with both principal and interest forfeited to the borrower. The case therefore posed an essential conflict, see text accompanying notes 406-09 *supra*. The court might have adopted any of several more convincing conflicts doctrines than party intention. It could have picked Tennessee's law as providing for the lesser of two penalties. RESTATEMENT (SECOND), *op. cit. supra* note 394, § 334d, at 59. *But see* note 410 *supra*. It could have applied forum law as controlling the application of sanctions, see, e.g., *Columbian Bldg. & Loan Ass'n v. Rice*, 68 S.C. 236, 47 S.E. 63 (1904); *cf. Andrews v. Pond*, 38 U.S. (13 Pet.) 65 (1839). It also could have cited the rule that the combination of place of performance and of contracting in Tennessee was controlling, see 2 BEALE, *CONFLICT OF LAWS* 1243-44 n.7 (1935), and then disregarded that rule by arguing that these contractual provisions are too easily "manipulated," *cf. Huchingson v. Republic Fin. Co.*, 236 Ark. 832, 370 S.W.2d 185 (1963). The court could have announced its general rule of validation, see, e.g., *Dupree v. Virgil R. Coss Mortgage Co.*, 167 Ark. 18, 267 S.W. 586 (1924), and then invoked the exceptions of evasion or public policy, see text accompanying notes 243-51, 290-327 *supra*.

<sup>428</sup> 216 Ark. at 436, 226 S.W.2d at 47. The court cited *Lamier v. Union Mortgage, Banking & Trust Co.*, 64 Ark. 39, 40 S.W. 466 (1897), and *McDougall v. Hachmeister*, 184 Ark. 28, 41 S.W.2d 1088 (1931). In both cases an Arkansas court dealing with Arkansas borrowers upheld a stipulation of forum law. But both cases involved avoidable conflicts since the contracts were valid under the borrower's law, although invalid under the foreign lender's law. See text accompanying notes 367-79 *supra*.

<sup>429</sup> The court may have felt that the forfeiture compensated Jones for his court fees, or that imposition of a strict forfeiture was necessary to deter Tindall or other lenders from attempting such transactions, or that Tindall was unable to prove that he had no way to obtain adequate knowledge of Arkansas's penal sanctions. See discussion of penalties, notes 605-11 *infra* and accompanying text.

<sup>430</sup> Assume, for example, a situation similar to *Jones v. Tindall*, but with a stipulation of the foreign lender's validating law. The Arkansas court would be faced with a dilemma: either apply the rule of party intention and reach an obviously unjust result, or propose an *ad hoc* exception to their own rule. Either course of action would be unfortunate. Courts should not unnecessarily place themselves in a position where they will have to choose between consistency and justice.

are adequate to reach a just result. It is only when those theories create inequitable consequences that the adhesion aspects of transactions are invoked.<sup>431</sup>

The interests of fairness, predictability, and theoretical consistency would be better served if bargaining power were openly considered in conflicts decisions.<sup>432</sup> Since usury laws are predicated upon the assumption that statutory protection is necessary to supplement the borrower's inferior bargaining power,<sup>433</sup> a lender transacting business with out-of-state borrowers should not be able to deprive those borrowers of that protection simply by inserting a few sentences in a contract of adhesion.<sup>434</sup> The presumption of the *lex debitoris* would force courts to apply the borrower's law unless the lender could show that the borrower was sufficiently wary and experienced<sup>435</sup> and did not need the protection of his law.<sup>436</sup> Invocation of the traditional doctrines of freedom to contract, party intention, and concessions to trade and commerce, should be successful only when facts are established which are sufficiently strong to overcome the presumption of borrower weakness. Unless the lender can offer adequate policy reasons for allowing him to charge protected borrowers the higher amount of interest permitted by his state, he must be forced to operate his business practice in conformity with the laws of the borrower's state.<sup>437</sup>

### *B. Possible Exceptions to the Doctrine of the Lex Debitoris*

The presumption of the *lex debitoris* should be rebutted when certain exceptions, thoroughly grounded in judicial, legislative, or commercial policy are present. These exceptions fall into three broad categories. The first exception stresses the bargaining power of the parties to the loan contract; its application turns on a distinction between corporate and

<sup>431</sup> See Ehrenzweig, *supra* note 418, at 1075.

<sup>432</sup> See *id.* at 1090; Note, 57 COLUM. L. REV. 553, 575 (1957) (suggesting that stipulations of law in loan contracts should be approached with a "presumption of adhesion," and nullified where adhesion is found); *cf.* *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964); *Locknane v. United States Sav. & Loan Co.*, 103 Ky. 265, 44 S.W. 977 (1898); *Meroney v. Atlanta Bldg. & Loan Ass'n*, 116 N.C. 882, 21 S.E. 924 (1895); note 421 *supra*.

<sup>433</sup> See notes 81-93 *supra* and accompanying text.

<sup>434</sup> See text accompanying notes 624-38 *infra*.

<sup>435</sup> There are also other grounds for departing from the *lex debitoris*. See discussion of penalties, notes 566-618 *infra* and accompanying text, and discussion of the prejudicially surprised lender, notes 639-53 *infra* and accompanying text.

<sup>436</sup> See discussion of experienced individual borrowers, notes 472-74 *infra* and accompanying text.

<sup>437</sup> For the argument that lenders engaging in interstate transactions should not be treated differently from purely domestic lenders see text accompanying notes 218-20, 229-32 *supra*, and notes 627-38 *infra*.

individual borrowers. The second exception involves a cluster of economic considerations which emphasize two primary issues: which party must bear the burden of *de minimis* variations in interest rates, and which must incur the penalties of various forfeitures. The third exception involves the problem of the expectations of the parties and the extent to which application of the *lex debitoris* will unjustly surprise the lender.

Many of these exceptions are found in existing case law—most typically, however, disguised in the language of traditional conflicts doctrine. Some exceptions have been explicitly pronounced in judicial opinions; others are to be found only in the results and not the language of the cases; and many must be discovered in analogous areas of contract law.<sup>438</sup>

### 1. *Bargaining Power*

The rationale for usury laws turns on the existence of great disparities in bargaining power between parties to a loan contract. Case law has reflected this fact by drawing a distinction between corporate and individual borrowers. The following discussion attempts to integrate existing case law and statutory policy into the doctrine of the *lex debitoris*. The first two areas of discussion concern large corporate and experienced individual borrowers. In each case the *lex debitoris* presumption may be rebutted if the lender satisfies his burden of proof. The third area involves the problems raised when inexperienced individuals are forced by powerful lenders to assume a corporate form. In this area the equitable doctrine of "piercing the corporate veil" poses special problems for the law of conflicts.

(a) *Corporate Borrowers and the Corporate Exemption.*—Corporations have occupied a special position in the law of usury that has been reflected, however imperfectly, in the law of conflicts. Although courts have exhibited a definite tendency to protect individual borrowers from foreign lenders, they have shown far less concern for corporate borrowers. Courts have traditionally felt that the latter do not need the protection of usury laws, and have allowed them to contract for interest rates in excess of

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<sup>438</sup> The following treatment of exceptions to the *lex debitoris* is directed to two audiences. First, it attempts to present for the courts a conflicts theory which is consistent with the various policy considerations which actually influence the outcome of decisions in multi-state lending transactions. It is certainly possible, however, that courts will balk at being so frank in their conflicts opinions, and will prefer to reach the results described in the exceptions by means of traditional conflicts language. See Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. REV. 267, 325-26 (1966). Second, therefore, it attempts to describe for practicing attorneys the factors which have motivated courts in the past to reach certain results in cases of conflicting usury statutes. This information should prove useful in planning future loan transactions.

those permitted for individual borrowers. This difference in attitude turns primarily on a corporation's greater bargaining power, its limited liability, and the economic policy of promoting corporate growth. Many states have enacted statutes reflecting these factors, and their impact on inter-state lending has caused several conflict of laws problems.

The first statute in the United States<sup>439</sup> denying to corporations the protection of the usury laws was passed by New York in 1850.<sup>440</sup> Nineteen states have since followed suit.<sup>441</sup> These corporate exemption statutes preclude corporations from raising the defense of usury, and therefore allow them to contract for any rate of interest.<sup>442</sup>

<sup>439</sup> In England the first statute denying to a corporate borrower the defense of usury was passed in 1716. Act for Redeeming Funds of Bank of England, 3 Geo. 1, c. 8, § 39. It allowed "that the said governor and company of the Bank of England . . . shall have power and authority . . . to borrow or take up money upon any contracts, bills, bonds or obligations . . . at such rate or rates of interest, or upon such terms as they shall think fit, although the same shall happen to exceed the interest allowed by the law to be taken . . . ." This special provision was extended to the South Sea Company in the same year by 3 Geo. 1, c. 9, § 16.

<sup>440</sup> "No corporation shall hereafter interpose the defense of usury in any action. The term corporation . . . shall be construed to include all associations, and joint stock companies having any of the powers and privileges of corporations not possessed by individuals or partnerships." N.Y. GEN. OBLIGATIONS LAW § 5-521. The distinction between individual and corporate borrowers was emphasized by the fact that the maximum interest rate for individuals in New York was lowered from 7% to 6%, thereby giving them greater protection, at the same time the corporate exemption was passed. For corporate exemptions generally see Comment, 23 MD. L. REV. 51 (1963); Note, 38 CORNELL L.Q. 93 (1952); Legislation, 30 ST. JOHN'S L. REV. 126 (1955); Annot., 63 A.L.R.2d 924 (1959).

<sup>441</sup> DEL. CODE ANN. tit. 6, § 2036 (1953); GA. CODE ANN. § 57-118 (Supp. 1965) (loans over \$2,500); ILL. ANN. STAT. ch. 74, § 4 (Smith-Hurd 1966); IND. ANN. STAT. § 19-12-104 (1964); KAN. GEN. STAT. ANN. § 17-4103 (1964); KY. REV. STAT. § 360.025 (1962); MD. ANN. CODE art. 23, § 125 (1957); MICH. STAT. ANN. § 21.78 (1963); MINN. STAT. ANN. § 334.021 (1966); MO. ANN. STAT. § 408.060 (1952); N.J. STAT. ANN. § 31: 1-6 (1963); N.M. STAT. ANN. § 51-2-34 (1953); N.Y. GEN. OBLIGATIONS LAW § 5-521; N.C. GEN. STAT. § 24-8 (1965); OKLA. STAT. ANN. tit. 18, § 1.26 (1953); PA. STAT. ANN. tit. 15, § 2852-313 (1958); S.C. CODE ANN. § 8-8 (1962); VA. CODE ANN. § 6-351 (1966); W. VA. CODE ANN. § 4632 (1961); WIS. STAT. ANN. § 115.06 (1957). For a continually current compilation, see *State Interest and Usury Laws—A Chart Setting Forth Statutory Provisions as to Legal Rates of Interest and Usurious Contracts*, 3 CCH FED. BANKING L. REP. ¶ 59,005 (Nov. 2, 1966).

<sup>442</sup> See *Yoffee v. International Co.*, 80 So. 2d 910 (Fla. 1955); *Curtis v. Leavitt*, 15 N.Y. 9 (1857); Annot., 63 A.L.R.2d 924, 935-36 (1959). An Illinois statute, similar to New York's, was first construed by Illinois courts as merely denying to corporate borrowers the right to obtain a forfeiture of all interest rather than as automatically validating all corporate loans at any interest rate. *Union Nat'l Bank v. Louisville, N.A. & C.R.R.*, 145 Ill. 208, 34 N.E. 135 (1893), *error dismissed*, 163 U.S. 325 (1896). For conflicts cases noting the Illinois interpretation see *Stack v. Detour Lumber & Cedar Co.*, 151 Mich. 21, 114 N.W. 876 (1908); *Gilbert v. Fosston Mfg. Co.*, 174 Minn. 68, 216 N.W. 778 (1927). Illinois overruled this interpretation, however, in the 1919 Illinois Corporation Act and the 1925 usury act amendments. These enactments prohibit a corporation from pleading the defense of usury at all, and declare enforceable contracts for any rate of interest. Polish Peoples

The New York statute was passed during a wave of indignation following a particularly flagrant abuse of the usury defense by a corporate borrower.<sup>443</sup> The statute was justified by courts which argued that invocation of the usury defense by corporations was immoral, unjust and conducive to fraud.<sup>444</sup> Subsequent justifications of the corporate exemption have been based largely on bargaining power and economic policy. The first justification stresses the corporation's greater bargaining power in loan transactions. In contrast with individuals,<sup>445</sup> the large corporate borrower is pictured as an artificial legal entity without sensations, incapable of being coerced by compelling necessity into loans beyond its corporate powers.<sup>446</sup> The accuracy of this position is questionable, particularly with respect to small, wholly owned corporations.<sup>447</sup> It is certainly true, however, that larger corporations have access to legal expertise,<sup>448</sup> can draw on large reserves of managerial talent, and usually have sufficient power to compel the alteration of disadvantageous terms. For these reasons it is felt that corporations are sufficiently capable of protecting themselves.<sup>449</sup>

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Home Ass'n v. Atlas, 246 Ill. App. 457 (1927); Simon v. South End Cleaners & Dyers, Inc., 246 Ill. App. 14 (1927). However, there appear to be limitations on the rates of interest even corporations may pay. A court of equity may refuse to enforce a "harsh and oppressive" contract despite the existence of a corporate exemption. *In re Chicago Reed & Furniture Co.*, 7 F.2d 885, 886 (7th Cir. 1925) (interest rate of 40%).

<sup>443</sup> For an account of *Dry Dock Bank v. American Life Ins. & Trust Co.*, 3 N.Y. 344 (1850), see note 47 *supra*.

<sup>444</sup> *Curtis v. Leavitt*, 15 N.Y. 9, 154 (1857). See *Brierley v. Commercial Credit Co.*, 43 F.2d 724, 729 (E.D. Pa. 1929), *aff'd*, 43 F.2d 730 (3d Cir. 1930), *cert. denied*, 282 U.S. 897 (1931); *Butterworth v. O'Brien*, 23 N.Y. 275, 277 (1861); *cf. Rosa v. Butterfield*, 33 N.Y. 665 (1865).

<sup>445</sup> Individual borrowers, it is said, are deprived of the freedom to contract by their necessitous condition and are "placed . . . at the mercy of the lender," *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 249, 131 Atl. 332, 342 (1925). The lender thus has the power of "extorting harsh and undue terms in the making of loans," *Chandler v. Kendrick*, 108 Fla. 450, 452, 146 So. 551, 552 (1933). See cases cited notes 81-83 *supra*.

<sup>446</sup> *Carozza v. Federal Fin. & Credit Co.*, *supra* note 445, at 249, 131 Atl. at 342.

<sup>447</sup> See text accompanying notes 463-65 *infra*.

<sup>448</sup> See *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964) (stressing the fact that the corporate borrower had legal counsel to analyze the terms of the loan contract).

<sup>449</sup> "Doubtless, the legislature considered that individuals and partnerships were generally more likely than corporations to yield to the pressures of necessity and agree to unwarranted rates of interest, and that corporations generally when borrowing would have bargaining power more nearly equal to that of lenders." *Country Motors, Inc. v. Friendly Fin. Corp.*, 13 Wis. 2d 475, 485, 109 N.W.2d 137, 142 (1961). In *Bock v. Lauman*, 24 Pa. 435, 448 (1855), the court phrased its comment on the New York corporate exemption in terms of bargaining power: "[P]erhaps because of their being usually powerful associations, and the associates not usually being personally liable for their contracts . . . , the declaration of the law is that corporations need no protection of this sort. . . . Money lenders can have no undue influence over them . . . ." In *Griffith v. Connecticut*, 218 U.S.

Second, a corporation's liability is limited. If it is forced into bankruptcy, its loss is a matter of balance sheets and ledgers, and "may or may not" be proportionally distributed over its "fluctuating membership."<sup>450</sup> Furthermore, a corporation's capital reserves may better enable it to absorb the blows of financial adversity.<sup>451</sup> Corporate exemptions therefore reflect a legislative discrimination between those who can and cannot bear the cost of high interest rates.<sup>452</sup>

A third justification for corporate exemptions stresses the promotion of commerce. Usury laws, it is argued, restrict economic growth by limiting the supply of investment funds available in the corporate sector, and by raising the price of money. The result is to restrain "the natural flow and supply of capital to the prejudice of industry and commerce."<sup>453</sup> Corporations, therefore, borrow from a position of strength, and attain even greater strength through investment of the principal; individuals, however, borrow from a position of weakness, in the often vain hope of postponing financial disaster. Because individuals and corporations often borrow for fundamentally different purposes,<sup>454</sup> retention of a general usury law with a corporate exemption is thought to provide the best of both worlds.<sup>455</sup>

The distinction between individuals and corporations has been strongly

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563, 570 (1910), the Court justified a Connecticut statute allowing banks and trust companies chartered by the state to pay interest in excess of the general usury statute's maximum in this language: "Such institutions, managed by those accustomed to financial operations and familiar with the worth of money in the market from day to day, might well be deemed to require no statutory protection against being forced by their financial necessities to pay excessive interest for moneys borrowed." See *Southern Life Ins. & Trust Co. v. Packer*, 17 N.Y. 53 (1858); cf. *Central Trust v. Simmons Motor Corp.*, 28 Misc. 2d 826, 215 N.Y.S.2d 555 (Sup. Ct. 1961); *Dilig v. Bank of United States*, 224 App. Div. 223, 278 N.Y. Supp. 972 (Sup. Ct. 1935).

<sup>450</sup> *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 249-50, 131 Atl. 332, 342 (1925). See *Bock v. Lauman*, *supra* note 449.

<sup>451</sup> *Carozza v. Federal Fin. & Credit Co.*, *supra* note 450.

<sup>452</sup> This distinction is undermined by the lender's technique of requiring shareholders or members of the board of directors to individually guarantee corporate loans. This is often done where the corporation is small and wholly owned, and where individuals are required to incorporate as a prerequisite for obtaining the loan. Courts have generally held that where a corporation is prevented by statute from raising the defense of usury, individual guarantors and sureties are likewise estopped. See Annot., 63 A.L.R.2d 924, 950 (1959). The logic of this view is weak, however, and has been criticized. See *Lesser v. Strubbe*, 39 N.J. 90, 94, 187 A.2d 705, 707 (1963) (dissenting opinion).

<sup>453</sup> *Carozza v. Federal Fin. & Credit Co.*, 149 Md. 223, 249-50, 131 Atl. 332, 342 (1925).

<sup>454</sup> "[T]he financial requirements of corporations, as business is conducted to-day, are, generally speaking, entirely different from those of individuals." *Brierley v. Commercial Credit Co.*, 43 F.2d 724, 729 (E.D. Pa. 1929), *aff'd*, 43 F.2d 730 (3d Cir. 1930), *cert. denied*, 282 U.S. 897 (1931).

<sup>455</sup> See SPECIAL COMMITTEE, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, REPORT ON RETAIL INSTALLMENT SALES, CONSUMER CREDIT, SMALL LOANS AND USURY 12-16 (1965).

reflected in conflicts cases involving corporate borrowers.<sup>456</sup> The problem posed is typically one in which a corporate borrower is sued in its own state by a foreign lender, and attempts to raise the defense of usury available to corporations under forum law. The law of the lender's state, however, includes an exemption by which "no corporation"<sup>457</sup> is allowed to raise the defense of usury. Apart from cases of avoidable conflicts<sup>458</sup> which present different arrangements of contacts and those raising the distinct problems of incorporation to evade usury laws,<sup>459</sup> the courts have almost unanimously validated such contracts by applying the foreign lender's law.<sup>460</sup> The few exceptions are partly distinguishable on other

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<sup>456</sup> "[U]sury laws are designed to protect debtors from payment of exorbitant interest . . . . It is true that a higher rate of interest than 6% is contrary to the public policy of [Kentucky] . . . as expressed by the Legislature. . . . [But] this law should not be invoked to void or impair a contract entered into *between two corporations* in good faith under laws of another state which has a different statutory policy." "Interest itself is not such an evil . . . ." *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 622, 211 S.W.2d 831, 837 (1948). (Emphasis added.) The contract was validated by applying the corporate exemption of the foreign lender's state. For conflicts cases involving corporate borrowers generally see Annot., 63 A.L.R.2d 926 (1959), discussing only a partial list of cases involving corporate exemptions; EHRENZWEIG, *op. cit. supra* note 418, § 182, at 483 n.7.

<sup>457</sup> See, e.g., N.Y. GEN. OBLIGATIONS LAW § 5-501.

<sup>458</sup> In a large number of cases, application of either law would have produced identical results, notes 380-81 *supra* and accompanying text. In some, the laws of the two states were identical: *Meinhard, Greeff & Co. v. Edens*, 189 F.2d 792 (4th Cir. 1951) (corporate exemption in both states); *Le Sueur v. Manufacturers' Fin. Co.*, 285 Fed. 490 (6th Cir.), *cert. denied*, 261 U.S. 621 (1922) (foreign corporate exemption inapplicable without chattel security); *In re Champion Shoe Mach. Co.*, 17 F. Supp. 985 (E.D. Mo. 1937) (corporate exemption in both states); *Brierley v. Commercial Credit Co.*, 43 F.2d 724 (E.D. Pa. 1929) (held, a corporate exemption in both states), *aff'd*, 43 F.2d 730 (3d Cir. 1930), *cert. denied*, 282 U.S. 897 (1931); *Lyon v. Ewings*, 17 Wis. 61 (1863) (corporate exemption in both states); *Ballston Spa Bank v. Marine Bank*, 16 Wis. 125 (1862) (same). In others, the contract was valid under both laws: *Junction R.R. v. Bank of Ashland*, 79 U.S. (12 Wall.) 226 (1870); *Binghampton Trust Co. v. Auten*, 68 Ark. 299, 57 S.W. 1105 (1900) (New York corporate exemption, and interest rate under Arkansas's 10% maximum); *West Side Motor Express, Inc. v. Finance Discount Corp.*, 340 Mass. 669, 165 N.E.2d 903 (1960) (lender's law stipulated that borrower's rate should apply, and no maximum in borrower's state). In *Green v. Northwestern Trust Co.*, 128 Minn. 30, 150 N.W. 229 (1914), the contract was valid under the out-of-state borrower's law, *supra* note 374 and accompanying text. Although in *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964), *Consolidated Jewelers, Inc. v. Standard Fin. Corp.*, 325 F.2d 31 (6th Cir. 1963), and *Fahs v. Martin*, 224 F.2d 387 (5th Cir. 1955), there appear to have been corporate exemptions in both states, and the conflicts issue therefore avoidable, the courts seem to have overlooked this fact and assumed the contracts were usurious under the borrower's or lender's laws. Thus, while posing avoidable conflicts, these cases may be grouped with those cited at note 460 *infra*.

<sup>459</sup> See text accompanying notes 475-517 *infra*.

<sup>460</sup> *Clarkson v. Finance Co. of America*, 328 F.2d 404 (4th Cir. 1964); *Consolidated Jewelers, Inc. v. Standard Fin. Corp.*, 325 F.2d 31 (6th Cir. 1963); *Blackford v. Commercial Credit Corp.*, 263 F.2d 97, 113 (5th Cir. 1959); *Fahs v. Martin*, 224 F.2d 387 (5th Cir. 1955); *Albritton v. General Fin. Corp.*, 204 F.2d 125 (5th Cir. 1953); *Winkle v. Scott*, 99 F.2d 299 (8th Cir. 1938); *Merchants' & Mfrs. Sec. Co. v. Johnson*, 69 F.2d 940 (8th Cir.



grounds.<sup>461</sup> In the few cases in which neither state has a corporate exemption, and the contract is usurious under the borrower's law but valid under the lender's law, the tendency is to validate the contract by applying the more liberal lender's law.<sup>462</sup>

Corporate exemptions have generally been applied to all borrowers possessing the sole attribute of incorporation. Many borrowers, how-

1934); *Brierley v. Commercial Credit Co.*, 43 F.2d 730 (3d Cir. 1930), *cert. denied*, 282 U.S. 897 (1931); *United Divers Supply Co. v. Commercial Credit Co.*, 289 Fed. 316 (5th Cir. 1923); *In the Matter of Leeds Homes, Inc.*, 222 F. Supp. 20 (E.D. Tenn. 1963); *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 364 S.W.2d 158 (1963); *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964); *Santoro v. Osman*, 149 Conn. 9, 174 A.2d 800 (1961); *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 211 S.W.2d 831 (1948); *Franklin Nat'l Bank v. Feldman*, 42 Misc. 2d 839, 249 N.Y.S.2d 181 (Sup. Ct. 1964) (suit in lender's state); *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 157 S.E. 860 (1931), *remanded and contract sustained by lender's law on retrial*, 202 N.C. 604, 163 S.E. 676 (1931); *Manufacturers Fin. Co. v. Johnson & Co.*, 15 Tenn. App. 236 (1931). In *Ringer v. Virgin Timber Co.*, 213 Fed. 1001 (E.D. Ark. 1914) (court apparently ignored lender's corporate exemption), and *Gilbert v. Fosston Mfg. Co.*, 174 Minn. 68, 216 N.W. 778 (1927) (lender's corporate exemption construed as declaring usurious interest in excess of the lender's normal rate), the contracts were usurious under both laws; in both cases the more lenient lender's penalty was applied, see notes 394-98 *supra* and accompanying text. Early New York cases held that the corporate exemption applied to foreign corporate borrowers bringing actions in New York. The exemption was thus given extraterritorial effect. See, e.g., *Rosa v. Butterfield*, 33 N.Y. 665 (1865); *Southern Life Ins. & Trust Co. v. Packer*, 17 N.Y. 51 (1858). See also *Freese v. Brownell*, 35 N.J.L. 285 (Sup. Ct. 1871). Compare *Stack v. Detour Lumber & Ceder Co.*, 151 Mich. 21, 114 N.W. 876 (1908), and *Craven v. Atlantic & N.C.R.R.*, 77 N.C. 289 (1877). Both cases held corporate exemptions to have no extraterritorial effect.

<sup>461</sup> *E.C. Warner Co. v. W.B. Foshay Co.*, 57 F.2d 656 (8th Cir. 1932) (both corporations basically domestic parties, contract grossly usurious); *Ripple v. Mortgage & Acceptance Corp.*, 193 N.C. 422, 137 S.E. 156 (1927) (clearly fraudulent attempt to disguise usurious loan). *But see* *M. Lowenstein & Sons v. British-American Mfg. Co.*, 300 Fed. 853 (D. Conn. 1924), *rev'd on ground no usury shown*, 7 F.2d 51 (2d Cir. 1925); *Stack v. Detour Lumber & Ceder Co.*, 151 Mich. 21, 114 N.W. 876 (1908); *Craven v. Atlantic & N.C.R.R.*, 77 N.C. 289 (1877); *Bock v. Lauman*, 24 Pa. 435 (1855). *Stoddard v. Thomas*, 60 Pa. Super. 177 (1915), see note 370 *supra*, an avoidable conflict case in which the forum found the contract usurious by foreign law, despite a forum corporate exemption, seems to stand alone. The RESTATEMENT (SECOND), CONFLICT OF LAWS § 334d, at 60 (Tent. Draft No. 6, 1960), states that a contract will not be upheld by reference to a substantially related state if that state has "no prohibition against usury at all." The Reporter reasons further that a state with a corporate exemption is equivalent to a state with no prohibition against usury at all, and that the law of that state will never be applied to validate a contract which is otherwise usurious, *id.*, Illustration 1, at 56. The overwhelming majority of American cases, cited at note 460 *supra*, flatly contradicts this position.

<sup>462</sup> See *Coad v. Home Cattle Co.*, 32 Neb. 761, 49 N.W. 757 (1891). In *Cromwell v. County of Sac*, 96 U.S. 51 (1877), and *Green v. Northwestern Trust Co.*, 128 Minn. 30, 150 N.W. 229 (1914), the conflict was avoidable in light of the foreign corporate borrower's more liberal law, see notes 367-79 *supra* and accompanying text. *But cf.* *Personal Fin. Co. v. Gilinsky Fruit Co.*, 127 Neb. 450, 255 N.W. 558 (1934) (suit against corporate employer of individual borrower for assigned wages); *Yager v. Rubymar Corp.*, 34 Misc. 2d 704, 216 N.Y.S.2d 577 (Sup. Ct. 1961) (lender and borrower residents of forum, but corporate exemption not mentioned).

ever, despite their corporate form, are sufficiently small and inexperienced to resemble closely the necessitous individual.<sup>463</sup> The vulnerability of small corporations was first recognized, interestingly enough, by the first state to pass the corporate exemption. In 1955, New York amended its statute to allow small home owners, who had incorporated and mortgaged their homes, to raise the defense of usury in an action by the lender on the note.<sup>464</sup> More recently, several states have joined the trend toward greater corporate protection by repealing their corporate exemptions and replacing them with interest maximums similar to, but higher than, those for individual borrowers.<sup>465</sup>

In light of this trend, therefore, it is submitted that, at least as an initial starting point, the *lex debitoris* should also be applied to loan transactions when the borrower is a corporation. But this application of the *lex debitoris* should not be considered inflexible. The presumption of the *lex debitoris* should be rebutted, and the lender's law applied, when the lender has produced convincing evidence that the corporate borrower was sufficiently experienced to have been in an equal bargaining position.<sup>466</sup> When the court finds that the borrower did not need the protection of the usury laws, the more traditional conflicts doctrines of party intent or validation may control the choice of law. The value of this approach is that it places upon the lender the burden of rebutting the presumption that the borrower occupies an inferior bargaining position in all cases. The corporate borrower is not forced to rebut a presumption that it occupies an equal bargaining position. Further, it requires the lender

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<sup>463</sup> "The increased use of the corporate organization for very small businesses in the present day may make the generalization [that a corporation's "bargaining power" is equal to the lender's] less of a certainty than the legislature supposed it to be in 1878 [when the Wisconsin corporate exemption was passed] . . . ." *Country Motors, Inc. v. Friendly Fin. Corp.*, 13 Wis. 2d 475, 485, 109 N.W.2d 137, 142 (1961). See SPECIAL COMMITTEE REPORT, *op. cit. supra* note 455, at 15-16.

<sup>464</sup> "The provisions of [this section, the New York corporate exemption] . . . shall not apply to a corporation, the principal asset of which shall be the ownership of a one or two family dwelling, where it appears either that the said corporation was organized and created . . . within a period of six months prior to the execution, by said corporation of a bond or note evidencing indebtedness, and a mortgage creating a lien for said indebtedness on the said one or two family dwelling." N.Y. GEN. OBLIGATIONS LAW § 5-521. Compare KY. REV. STAT. § 360.025 (1962). See generally Legislation, 30 ST. JOHN'S L. REV. 126, 132 (1955); Legislation, 22 BROOKLYN L. REV. 142 (1955).

<sup>465</sup> See FLA. GEN. LAWS ch. 29705 (1955), now codified, FLA. STAT. ANN. §§ 687.02-.03, .07 (1957) (maximums of 10% for individual borrowers, 15% for corporate borrowers, and additional sanctions against interest charges over 25%); MISS. CODE ANN. § 37 (1956) (absolute forfeiture for any loan over 20%); N.Y. PEN. LAW § 2401 (any loan over 25% is a felony, punishable either by fine, imprisonment, or both).

<sup>466</sup> This evidence will be particularly weak when it is found that the lender required the individual borrower to incorporate as prerequisite to receipt of the loan. See text accompanying notes 475-517 *infra*.

to convince the court that it should create, in effect, a judicial corporate exception to the borrower's usury statute by applying a foreign law.<sup>467</sup>

The obvious objection to this approach is that it is too difficult for a court to weigh the many factors which determine the relative strengths of the parties' bargaining power. The most convincing reply to this objection is to point out that several courts have shown the willingness and ability to inquire into just this element of bargaining power. In *Ury v. Jewelers Acceptance Corp.*,<sup>468</sup> the court, after a detailed examination of the evidence, concluded that the agreement was not an "adhesion" contract.<sup>469</sup> In effect such a conclusion would allow the lender to rebut the presumption of the *lex debitoris*. The court stressed the existence of "extensive" and "persistent" negotiations, the availability of "legal advice," the fact that the contract was "not one of those fine print specimens which make comprehension of terms a fiction," and the evidence that the borrower had read and understood the contractual terms.<sup>470</sup> Although the presumption of equal bargaining power was sustained, the court's inquiries demonstrated a recognition that even corporate borrowers, when sufficiently small, may also be forced merely to adhere to a unilaterally drafted loan contract. In such a situation, given a "great disparity in bargaining power," a court may refuse to sanction a transac-

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<sup>467</sup> Once a court has construed the borrower's law as being designed to protect only a certain kind of necessitous borrower, and has concluded that the particular borrower before the court is not such a borrower, it could simply state that the borrower's usury statute was inapplicable to the controversy, and the borrower's common law therefore controlled. In such a case, the borrower's common law—or lack of any restriction on experienced corporate borrowing—and the lender's corporate exemption—removing all restraints on corporate borrowing—would each provide identical results when applied to the loan transaction. By narrowly construing the borrower's law, the court could in effect create an avoidable conflict, see text accompanying notes 380-81 *supra*. This approach may strike a court as dangerously close to "legislation," and it may prefer to reach the identical result in another way. It might state, therefore, that where a corporate borrower is found not to need the protection of his own law, there is no reason why he cannot obtain funds from out-of-state lenders at rates legal by their laws. The court would therefore validate the contract by applying the foreign lender's corporate exemption—certainly a traditionally acceptable conflicts procedure—rather than simply declaring the borrower's usury statute inapplicable, and validating the contract under forum common law.

<sup>468</sup> 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964). A California individual, after incorporating, obtained a loan from a New York lender at an interest rate in excess of the California maximum. The loan was valid under New York law, as New York exempts its corporations from the protection of its usury statute.

<sup>469</sup> *Id.* at 19, 38 Cal. Rptr. at 381-82. This decision was made despite the fact that the standardized form contract contained several provisions detrimental to the borrower. Although the offer to contract was made by the lender to the borrower, it was drafted in the form of an offer from the California borrower, to be accepted by the lender in New York. The payments were to be made in New York, and New York law was stipulated to govern the contract.

<sup>470</sup> *Ibid.*

tion whereby the borrower is stripped of the protection provided by his state's law.<sup>471</sup>

(b) *Experienced Individuals*.—Many businessmen and private individuals enter into loan transactions deliberately and cautiously. These borrowers possess sufficient business acumen to calculate their financial requirements, the long-term costs of high-risk loans, and their ability to repay them at the higher interest rates of other states. There is no persuasive reason why these borrowers should be denied access to foreign funds. Many courts have validated such transactions. A few have stressed the individual's equal bargaining power in cases where the borrower was a "business man" who was "presumed" to know the interest rates of both states.<sup>472</sup> These borrowers are unable to obtain funds from domestic sources because, for example, the risks involved may require the lender to charge a rate of interest which is illegally high, and this he refuses to do. Domestic funds are unavailable, not because the legislature has determined that these experienced borrowers also need statutory protection, but because the usury laws of their states are not sufficiently precise to fit the individual needs of each particular borrower.<sup>473</sup> Judicial validation of contracts stipulating the lender's higher interest rate is therefore merely a concession to the need for flexibility in a rigid statutory system. Once again, however, the presumption of the *lex debitoris* should be applied at the outset to every interstate loan contract involving an individual borrower. It should be overcome only after the lender has presented convincing evidence of the borrower's knowledge and experience, as well as the strength of his bargaining position.<sup>474</sup>

(c) *Incorporation by Individuals to Avoid Usury Statutes*.—Corporate exemption statutes<sup>475</sup> prohibiting corporations from raising the defense of usury furnish an obvious method for avoidance of a state's interest maximums. When an individual applies for a loan, he might very well be told by the lender that the permissible interest rate is too low to be profitable, but that should the individual incorporate, a loan at a higher rate would be forthcoming. The individual accordingly forms a corporation, conveys property to it—often business assets, or a home—signs a note, executes a mortgage on the corporate assets in the corporation's

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<sup>471</sup> *Id.* at 19, 38 Cal. Rptr. at 381. In *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 364 S.W.2d 162-63 (1963), the court stressed that the parties dealt "fairly with each other with full disclosure," and that the borrower had thirty days during which he could have terminated the agreement merely by giving notice.

<sup>472</sup> *E.g.*, *Bowman v. Price*, 143 Tenn. 366, 383, 226 S.W. 210, 215 (1920).

<sup>473</sup> See Meth, *A Contemporary Crisis: The Problem of Usury in the United States*, 44 A.B.A.J. 637 (1958); Note, 65 YALE L.J. 105 (1955).

<sup>474</sup> See Note, 65 YALE L.J. 105 (1955).

<sup>475</sup> See note 441 *supra* for a list of corporate exemption statutes.

name, and usually guarantees the note personally.<sup>476</sup> The validity of this transaction is usually tested in mortgage foreclosure proceedings against the corporation, or in personal actions against the individual guarantors. The lender relies upon the corporate exemption to prevent the borrower from successfully raising the defense of usury. The borrower is forced to argue that the corporate entity was merely a cover for a sham transaction, and that for the purposes of the usury defense, the corporate veil should be pierced.

Confronted with a corporation formed solely to avoid a particular state's usury statutes,<sup>477</sup> courts have most often framed their analysis in the language of the following question: Has the loan been made to the borrower in his "individual" or his "corporate" capacity?<sup>478</sup> Despite the hip service frequently paid this language,<sup>479</sup> and the small number of commentators<sup>480</sup> and apparently obsolete cases<sup>481</sup> which have taken it

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<sup>476</sup> Individual guarantors, sureties, and indorsers of corporate obligations are usually not allowed to raise the defense of usury where, by statute, that defense is not available to the corporation. In a few instances, however, a co-obligor of a corporate note has been allowed to plead usury. The rationale behind this rule is discussed in *Ferdon v. Zarriello Bros.*, 87 N.J. Super. 124, 134, 208 A.2d 186, 191 (Super. Ct. 1965). See generally Annot., 63 A.L.R.2d 924, 950-53 (1959).

<sup>477</sup> See generally Note, 38 CORNELL L.Q. 93 (1952); Legislation, 24 FORDHAM L. REV. 715 (1955); Comment, 23 MD. L. REV. 51, 61-64 (1963); Comment, 7 MIAMI L.Q. 375 (1952); Legislation, 30 ST. JOHN'S L. REV. 130-32 (1955); Annot., 63 A.L.R.2d 924, 954-57 (1959).

<sup>478</sup> See, e.g., *Shapiro v. Weissman*, 7 App. Div. 2d 752, 181 N.Y.S.2d 43 (1958). The famous New York case of *Jenkins v. Moyse*, 254 N.Y. 319, 172 N.E. 521 (1930), stated that the test of a loan's being usurious is "whether it was in fact made to . . . an individual though in form . . . to a corporation to hide the fact that the lender has exacted an illegal rate of interest from the real borrower." *Id.* at 324, 172 N.E. at 522.

<sup>479</sup> The *Jenkins v. Moyse* language, quoted in note 478 *supra*, invariably has been repeated in most New York opinions, but its use has become a meaningless ritual. In fact, *Jenkins v. Moyse* itself refused to follow it. Compare notes 484-85 *infra* and accompanying text. The courts readily acknowledge that the transaction will be validated if the corporate form is properly used throughout all aspects of the loan agreement, and they consider the use of loan proceeds, with the knowledge of the lender, exclusively for exclusively individual purposes, to be totally irrelevant. See, e.g., *Werger v. Haines Corp.*, 277 App. Div. 1108, 101 N.Y.S.2d 361 (1950), *aff'd*, 302 N.Y. 930, 100 N.E.2d 189 (1951); cases cited at note 486 *infra*.

<sup>480</sup> See, e.g., Comment, 23 MD. L. REV. 51, 62-63 & n.64 (1963). This Comment is criticized in note 498 *infra*.

<sup>481</sup> A few courts have taken the *Jenkins v. Moyse* language, quoted note 479 *supra*, literally, and have made cases of usury turn on a hairline distinction. Thus, when the lender has absolutely refused to lend money "to the individual," but has stated he would make a loan only "to a corporation," the loan has been validated; but when the lender agreed to make a loan "to the individual," and *only then* required him to incorporate as a condition precedent to taking the loan in the corporation's name, the transaction has been held invalid. This extreme test is illustrated by *Gelber v. Kugel's Tavern*, 10 N.J. 191, 89 A.2d 654 (1952). In that case the borrower testified that the lender had agreed to give "me the loan if I would go and incorporate." The lender testified he had said he did "not make loans to individuals." (Emphasis added.) The court found this evidence "conflicting" and held that

seriously, no recent case has turned on whether the loan was in fact made to an individual or a corporation. Rather, the issue actually decided has been whether the borrower's corporate form *alone* will be sufficient to bar the defense of usury, or whether it will be disregarded by using the equitable doctrine that substance controls over form.<sup>482</sup>

Various states have taken different positions with respect to this issue. New York, for example, has adopted a strictly formalistic approach. In *Jenkins v. Moyse*,<sup>483</sup> the New York Court of Appeals held that despite an individual borrower's incorporation to obtain a loan at an otherwise illegally high interest rate, "the law [had] not been evaded but [had] been followed meticulously in order to accomplish a result . . . which the law does not forbid."<sup>484</sup> The court found nothing wrong in using the corporate form to obtain benefits denied to individuals.<sup>485</sup> Subsequent New York cases have consistently followed this line of reasoning. The courts largely ignore factors indicating the actual state of affairs, such as the parties' motives for incorporation, whether the funds were to be used for personal or corporate purposes, or whether the lender knew the purposes to which the funds would be put.<sup>486</sup> One court has flatly stated that in such cases "form prevails over substance."<sup>487</sup>

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the issue was a "jury question." *Id.* at 197, 89 A.2d at 657. For cases relying on similar distinctions see *Holland v. Gross*, 89 So. 2d 255 (Fla. 1956); *Rabinowich v. Eliasberg*, 159 Md. 655, 152 Atl. 437 (1930); *Sherling v. Gallatin Improvement Co.*, 145 Misc. 734, 260 N.Y. Supp. 229 (Sup. Ct. 1932).

This test is woefully deficient. First, its outcome turns on the choice of words used by the witnesses at trial. Second, it cannot seriously be contended that it makes any difference in the long run to a helpless borrower whether the lender agreed to make a loan to him individually and then required him to incorporate, or first refused such a loan to the borrower in his individual capacity but then suggested the money would be available should he incorporate. In fact, a few subsequent cases in jurisdictions previously adopting this approach have discarded it in favor of more appropriate tests. See the New Jersey cases at note 498 *infra* and the Florida cases at note 506 *infra*.

<sup>482</sup> See, e.g., *Silver Sands v. Pensacola Loan & Sav. Bank*, 174 So. 2d 61, 64 (Fla. 1965) (citing further authority).

<sup>483</sup> 254 N.Y. 319, 172 N.E. 521 (1930). See note 478 *supra*.

<sup>484</sup> *Id.* at 324, 172 N.E. at 522.

<sup>485</sup> "Corporations are, ordinarily, created because through the corporate form some advantage is obtained which would be denied to an individual . . . . That is what has been done here, and no ground has been shown for disregarding the corporate entity, though that entity has been formed for the purpose of doing something permitted to a corporation but forbidden to an individual." *Ibid.* However, the normal advantage of limited liability in this context is largely illusory. See notes 511-12 *infra* and accompanying text.

<sup>486</sup> For a series of New York cases following this trend see *Shapiro v. Weissman*, 7 App. Div. 2d 752, 181 N.Y.S.2d 43 (1958); *Sohmer Factors Corp. v. Tioga Drive Corp.*, 8 App. Div. 2d 847, 190 N.Y.S.2d 555 (1955); *Werger v. Haines*, 227 App. Div. 1108, 101 N.Y.S.2d 361 (1950), *aff'd*, 302 N.Y. 930, 100 N.E.2d 189 (1951); *Freilicher v. C.R.F. Gen. Contractors Corp.*, 225 N.Y.S.2d 811 (Sup. Ct. 1962); *Metz v. Taglieri*, 29 Misc. 2d 841, 215 N.Y.S.2d 263 (Sup. Ct. 1961); *Rosen v. Columbia Sav. & Loan Ass'n*, 29 Misc. 2d 329, 213 N.Y.S.2d 765 (Sup. Ct. 1961); *Margulis v. Messinger*, 34 Misc. 2d 699, 210 N.Y.S.2d 855 (Sup. Ct.

Conflict-of-laws problems<sup>488</sup> arise in cases involving a lender from a state which adopts the *Jenkins v. Moyse* approach and a borrower from a state which rejects that reasoning in favor of a more protective test. A court in the latter state will ignore the corporate entity when it is used to evade the protection afforded an individual by a usury statute.<sup>489</sup> Interestingly, no court has specifically addressed itself to the question of which state's law should determine whether the corporate veil should be pierced. The two relevant usury cases considered below deal with this problem unconsciously. Their results indicate, however, through dictum or by implication,<sup>490</sup> that courts will apply their own doctrines as to whether the corporate entity should be ignored in favor of a forum borrower. They will not apply the equitable doctrines of a foreign jurisdiction. In other words, the fact of a borrower's corporate status may be sufficient to overcome the presumption that the *lex debitoris*<sup>491</sup> is the properly applicable law; but the courts refusing to follow New York's example will most likely reject this argument and nevertheless apply the *lex debitoris* if they find that the corporate form was used as a disguise, and that the borrower was in fact an individual. Because the threshold issue of which law should determine whether the corporate veil is to be pierced has apparently never been discussed,<sup>492</sup> the steps taken by the following two cases warrant careful consideration.

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1960); *Bloom v. Hardwick's Hilltop, Inc.*, 19 Misc. 2d 758, 185 N.Y.S.2d 377 (Sup. Ct. 1959); *Kings Mercantile Co. v. Cooper*, 199 Misc. 381, 100 N.Y.S.2d 754 (Sup. Ct. 1950).

<sup>487</sup> *Kings Mercantile Co. v. Cooper*, *supra* note 486, at 382, 100 N.Y.S.2d at 756.

<sup>488</sup> Research has discovered no secondary material discussing the choice of a law to pierce the corporate veil, nor any material on the conflicts aspects of incorporation to avoid usury statutes. For this reason the following cases will be discussed in substantial detail.

<sup>489</sup> The converse situation, involving an incorporating borrower from a state adopting the *Jenkins v. Moyse* approach and a lender from a more protective state, would merely pose an avoidable conflict on the issue of piercing the corporate veil, see notes 367-79 *supra* and accompanying text. The forum state would have no reason to apply the lender's stricter law and pierce the corporate veil when the borrower would receive under his own law all the protection to which he is entitled.

<sup>490</sup> For various reasons, neither of the following cases contains conflicts language on the issue of evasive incorporation which might be construed as a holding. Thus, *Atlas Subsidiaries Inc. v. O. & O., Inc.*, 166 So. 2d 458 (Fla. App. 1964), involved an avoidable conflict, see text accompanying notes 380-81 *supra*. Since both Florida and Pennsylvania law would have required that the corporate veil be pierced, see notes 503, 506-07 *infra*, application of either law would have produced identical results. In contrast, *Lesser v. Strubbe*, 56 N.J. Super. 274, 152 A.2d 409 (Super. Ct. 1959), *modified on other grounds*, 67 N.J. Super. 537, 171 A.2d 114 (App. Div. 1961), *aff'd per curiam*, 39 N.J. 90, 187 A.2d 705 (1963), involved an essential conflict, see text accompanying notes 367-79 *supra*, since New Jersey law would have pierced the attempted creation of a corporate entity, while New York law would not. See note 498 *infra*. However, the trial court's factual determinations prevented the appellate court from even reaching the issue of incorporation, see note 497 *infra*.

<sup>491</sup> See text accompanying notes 466-67 *supra*.

<sup>492</sup> EHRENZWEIG, *CONFLICTS IN A NUTSHELL* § 22, at 88 (1965).

In *Lesser v. Strubbe*,<sup>493</sup> a New York lender brought an action in New Jersey to foreclose two mortgages on New Jersey land executed by the defendants, Mr. and Mrs. Strubbe. The mortgages were collateral security for a \$600,000 note and mortgage on New York property which had been given the lender by West Albany Warehouses, Inc., a New York corporation. The defendants had signed the corporate note and mortgage as President and Secretary of West Albany, respectively. The New York mortgage was foreclosed first, whereupon the lender brought the present action for the balance of the note. In the interim, Strubbe had been adjudged bankrupt. His appointed trustee raised the defense of usury,<sup>494</sup> arguing that the loan was in fact made to Strubbe as an individual, and that the use of West Albany was a mere device to avoid the laws of New York or New Jersey, whichever should apply.<sup>495</sup>

The court found for the defendant, and allowed him to raise the defense of usury. It first held that the parties' attempted use of the corporation as principal obligor on the note had failed because of an illegality in the execution of the mortgage on behalf of the corporation,<sup>496</sup> and that in fact the loan had been made to Strubbe as an individual. Because the trial court had found, as a matter of fact, that the corporation was not the principal obligor due to the defect in its execution of the mortgage, the question of whether the corporate form should be disregarded did not arise. However, the court went on to consider, in what must be considered

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<sup>493</sup> 56 N.J. Super. 274, 152 A.2d 409 (Super. Ct. 1959), *modified on other grounds*, 67 N.J. Super. 537, 171 A.2d 114 (App. Div. 1961), *aff'd per curiam*, 39 N.J. 90, 187 A.2d 705 (1963).

<sup>494</sup> The \$600,000 obligation was to be repaid in one year at 6% per annum, but in the event of a default the interest was to increase to 2% a month, or 24% per annum, an amount in excess of the legal New Jersey maximum. In addition, \$70,000 was subtracted from the loan as a "premium." The court held that this amount constituted concealed interest.

<sup>495</sup> Both New Jersey, N.J. STAT. ANN. § 31:1-1 (1963), and New York, N.Y. GEN. OBLIGATIONS LAW § 5-501, provide for a maximum interest rate for individuals of 6% per annum; and both states, N.J. STAT. ANN. § 31:1-6 (1963), N.Y. GEN. OBLIGATIONS LAW § 5-521, provide for a corporate exemption. However, should a loan to an individual be usurious, New Jersey provides for forfeiture of all the interest, N.J. STAT. ANN. § 31:1-3 (1963). *But see* 6 RUTGERS L. REV. 568 (1952). New York on the other hand provides for forfeiture of both interest and principle, N.Y. GEN. OBLIGATIONS LAW § 5-511.

<sup>496</sup> The evidence disclosed that Mr. and Mrs. Strubbe were not in fact officers, directors, or shareholders of West Albany when they signed the West Albany mortgage papers, purporting to act as President and Secretary, respectively. The court held (despite the existence of an allegedly certified copy of minutes of a board of directors meeting stating that the Strubbes were the West Albany board of directors on the date of the mortgage's execution) that either no meeting to elect the Strubbes had ever taken place, or if it had it was "clearly illegal and accomplished nothing." 56 N.J. Super. at 283, 152 A.2d at 414. In the eyes of the trial court, the attempted use of the corporate entity was merely "part of a rather elaborate plan contrived to give the appearance of a mortgage loan being made to the West Albany corporation." *Ibid*.



rather significant dictum,<sup>497</sup> the differences between New York and New Jersey law with respect to a technically valid use of the corporate form to "obscure the true facts and sanction the exaction of usury with impunity . . . ."<sup>498</sup> The court first noted New York's lenient decisions, then rejected them in favor of New Jersey's less tolerant attitude toward such transactions:<sup>499</sup> "A court of equity ought not to lend its aid in support

<sup>497</sup> Although the legal significance of the court's language, 56 N.J. Super. at 285, 152 A.2d at 415, is not absolutely clear, two factors suggest it is dictum. First, once the court concluded that West Albany was not the borrower, even on paper, and that the loan was made to Strubbe individually, it followed automatically that the defense of usury was available under both New York and New Jersey law. For this reason, the court's language, which refers to a technically successful incorporation, is irrelevant. The statement that "equity looks to the intent or substance, rather than to the form," is therefore also irrelevant since no adequate "form" had been created for the court to pierce. Second, contemporaneous New York cases indicate that, under the facts of this case, New York would also have viewed the factual situation as an invalid attempt at establishing a corporate entity. *Cf.* *Metz v. Taglieri*, 29 Misc. 2d 841, 215 N.Y.S.2d 263 (Sup. Ct. 1961); *Margulis v. Messinger*, 34 Misc. 2d 699, 210 N.Y.S.2d 855 (Sup. Ct. 1960). These cases stressed the importance of technical compliance with the formal procedures by which transactions were handled in the name of the corporation. Therefore, even if it were successfully argued that New York corporate law should apply to the instant case, the attempted use of West Albany by the Strubbe's would also have failed. This would eliminate the need for a choice between New Jersey and New York law. Therefore, the court's language should be considered dictum, and not a holding, suggesting that in appropriate situations New Jersey will apply its own equitable doctrines to pierce the corporate veil.

<sup>498</sup> 56 N.J. Super. at 285, 152 A.2d at 415. For New York's position on incorporation to avoid usury, see text accompanying notes 483-87 *supra*. The position taken by New Jersey in earlier cases had already begun to differ significantly from New York's, and *Lesser v. Strubbe* accentuated this divergence. Although the New Jersey Supreme Court in *Gelber v. Kugel's Tavern*, 10 N.J. 191, 89 A.2d 654 (1952), had at first followed the formal distinction between a loan "to an individual" and "to a corporation," it stated in dictum that a borrower might raise the defense of usury "on loans made in fact to the individual though in form disguised as loans to a corporation . . . ." 10 N.J. 191, 196, 89 A.2d 654, 656 (1952). *In re Greenberg*, 21 N.J. 213, 221, 121 A.2d 520, 524 (1956), however, seems to reject the formalistic approach of *Gelber*, and to stress instead the knowledge and intentions of the parties to the transaction. Because it was "undoubtedly evident to [the attorney handling the incorporation procedure] . . . that the corporate device was being used because of the usury laws," the court found that the loan "was in reality a loan to individuals and that the corporate device was invoked to circumvent or evade the State's policy against usurious transactions." *But see* Comment, 23 Md. L. Rev. 51, 62-63 & n.64 (1963) (stressing testimony cited in the opinion, and suggesting that *In re Greenberg* was decided by the same test as *Gelber*). Finally in *Feller v. Architects Display Buildings, Inc.*, 54 N.J. Super. 205, 212, 148 A.2d 634, 638 (App. Div. 1959), the court adopted an approach similar to that in *Lesser v. Strubbe*, and interpreted *Gelber*—somewhat inaccurately—to have stated that "if the corporation to which the loan was ostensibly made was specifically incorporated at the request of the lender's agent and subsequent to the application for the loan, the defense of usury would apply." It appears, then, that an "essential" conflict existed between the laws used to pierce the corporate veil in New York and New Jersey at the time of *Lesser v. Strubbe*.

<sup>499</sup> "[O]ur courts have taken the position that the application of the usury statute to corporations shall be restricted in order 'that sympathetic sweep might be given to the State's policy against usury . . . .' [O]ur rule is opposite to that in New York, where it has been held that the usury statute should be liberally construed and where the corporate

of a usurious transaction but should . . . support the state's policy against usury. Equity looks to the intent or substance, rather than to the form."<sup>500</sup> Only after finding that the loan was usurious did the court invoke conflicts cases and reasoning to apply New Jersey statutory penalties to the transaction.<sup>501</sup>

The significance of *Lesser v. Strubbe* is its strong indication that New Jersey will apply its own equitable doctrines to pierce any corporate veil used to mask a transaction intended as a loan to an individual. The borrower's law, and in effect the principle of the *lex debitoris*, was ultimately applied to protect what was in fact, though not in form, an individual borrower.

In *Atlas Subsidiaries of Florida, Inc. v. O. & O. Inc.*,<sup>502</sup> a Florida case, the lender, a wholly-owned subsidiary of a Pennsylvania corporation, loaned money to Florida borrowers at a rate exceeding that permitted by Florida law.<sup>503</sup> Although the lender was incorporated to do business in Florida, it had its "honie office" in Pennsylvania. The trial court found that the borrowers had formed a corporation which would receive the loan "at the insistence of the [lender] and as a prerequisite to . . . the loan."<sup>504</sup> On appeal the district court of appeal refused to accept the lender's contention that the loan had been made to a corporate, and not an individual, borrower. Despite the borrower's apparently proper compliance with the

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device has been upheld as a compliance with the statute . . ." 56 N.J. Super. at 285, 152 A.2d at 415.

<sup>500</sup> *Ibid.* With respect to this position, the court further overruled a New Jersey decision, *Corradini v. V. & M. Holding Corp.*, 34 N.J. Super. 427, 112 A.2d 603 (Super. Ct. 1955) (which quoted *Jenkins v. Moyse*, see notes 406-07 *supra*, at length), to the extent it followed New York and not New Jersey authorities.

<sup>501</sup> 56 N.J. Super. at 288-89, 152 A.2d at 417.

<sup>502</sup> 166 So. 2d 458 (Fla. App. 1964).

<sup>503</sup> Florida provides for a maximum interest rate of 10% per annum for individual borrowers, and 15% for corporate borrowers. The penalty imposed is the loss of twice the interest paid. An absolute maximum of 25% for both individuals and corporations is also imposed, the violation of which subjects the lender to the total forfeiture of all interest and principal. See FLA. STAT. ANN. §§ 687.01-.07 (1965). Pennsylvania provides for a maximum rate of 6% per annum for individuals, PA. STAT. ANN. tit. 41, § 3 (1954), but imposes no limitation upon the interest chargeable to a corporate borrower, PA. STAT. ANN. tit. 15, § 2852-313 (1958); see also PA. STAT. ANN. tit. 41, § 2 (1954). The penalty imposed is loss of the excess interest charged, PA. STAT. ANN. tit. 41, § 4 (1954). The interest charged in the instant case was over 25%, 166 So. 2d at 459. The success of the lender's case, therefore, turned on demonstrating both that the loan was made to a corporation, and that the Pennsylvania corporate exemption applied. Should the first step in the argument fail, the contract would be usurious under either Florida or Pennsylvania law. Since that step was not established in the instant case, the policy considerations bearing on the court's choice of law concerned primarily the remedy and not the protection to be given the borrower. Because Florida imposed the stricter penalty, the case nevertheless posed an "essential" conflict, see notes 410-11 *supra* and accompanying text.

<sup>504</sup> 166 So. 2d at 461.

formal requirements of incorporation, the court brushed aside the corporate entity as a "sham contrivance and device [which] has so frequently been used in this state as to be an old acquaintance of those dealing in the lending arts. [It is] . . . typical of a long-existing practice on the part of scheming moneylenders who set out to flaunt the usury laws of the state on a magnificent scale."<sup>505</sup>

Significantly, the Florida court first automatically applied its own policies concerning incorporation to avoid usury,<sup>506</sup> with no reference to the policies of Pennsylvania,<sup>507</sup> the lender's state. Only after the corporate entity had been disregarded did the court consider, and reject, the lender's contention that Pennsylvania statutes should govern the transaction. The court's complete silence concerning the choice-of-law issue of piercing the corporate veil again demonstrates the tendency on the part of a borrower's court to apply the *lex debitoris* in the form of its own equitable doctrines.

The three primary justifications for the existence of corporate exemptions<sup>508</sup> are clearly inapplicable to most incorporating individuals. First, such an individual's bargaining power is no greater than that of any other non-incorporating individual borrower, and probably far less than that of most "business" or "trading" corporations.<sup>509</sup> The latter are

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<sup>505</sup> *Ibid.*

<sup>506</sup> Although the court cited no authority, Florida had clearly aligned itself with the states following New Jersey's example. To be sure, in *Holland v. Gross*, 89 So. 2d 255, 257-58 (Fla. 1956), the court upheld an incorporation procedure similar to the instant case, citing the New York case of *Jenkins v. Moyse*, 254 N.Y. 319, 172 N.E. 521 (1930), and equivalent authority. However, Florida repealed its corporate exemption following the actual loan transaction in *Holland*, see *Yaffee v. International Co.*, 80 So. 2d 910 (Fla. 1955), and imposed stricter requirements on loans to corporate borrowers, see note 503 *supra*. Subsequently, in *Gilbert v. Doris R. Corp.*, 111 So. 2d 682, 685 (Fla. 1959), the court clearly indicated its change in policy, holding that "using a corporation as borrower, where the loan is really for the individual's ultimate use and benefit, not only violates the usury statute by being a device or scheme to circumvent the law, but . . . adds to the evil which the law sought to prevent by imposing on a borrower the additional expense of forming or engaging a corporation to accomplish the forbidden purpose." See *Silver Sands, Inc. v. Pensacola Loan & Sav. Bank*, 174 So. 2d 61, 64 (Fla. 1965). Florida, therefore, had clearly rejected New York's approach, and had adopted a test stressing the parties' purpose in invoking the corporate entity, and the actual use to which the funds were put.

<sup>507</sup> For a statement of Pennsylvania policy on incorporation to avoid usury, and a review of Pennsylvania cases see *Walnut Discount Co. v. Weiss*, 205 Pa. Super. 161, 164-68, 208 A.2d 26, 27-29 (1965). The court held Pennsylvania authorities to be "in accordance with the New Jersey and Florida cases . . ." *Id.* at 166-67, 208 A.2d at 28. The similarity of Florida and Pennsylvania on the issue of incorporation to some extent moots the court's application of Florida law. Regardless of which law was applied, the corporate veil would no doubt have been pierced and the defense of usury granted to the individual borrowers. See text accompanying notes 380-81 *supra*. However, the issue of penalties would still remain. See note 503 *supra*.

<sup>508</sup> See text accompanying notes 445-55 *supra*.

<sup>509</sup> See *Legislation*, 30 ST. JOHN'S L. REV. 126, 132 (1955) (suggesting that the corporate

usually already organized<sup>510</sup> and have ready access to capital, management expertise, and legal counsel. If, owing to ignorance, short-sightedness, or pressing need, an individual borrower can be compelled into an oppressive and usurious contract, then that same borrower can for similar reasons and with equally disastrous consequences be compelled to incorporate for just such a loan. It makes a mockery of the usury laws to protect one and not the other. Second, because individuals are typically required both to convey their personal assets to the corporation and individually guarantee the corporate note,<sup>511</sup> they do not obtain the principal advantage of incorporation: limited liability.<sup>512</sup> In fact, the financial liability of the borrower is even greater since typically he must bear the costs of incorporation.<sup>513</sup> Third, it is questionable whether commercial prosperity does in fact depend on validation of such loans. While individuals occasionally do incorporate in preparation for some socially desirable business venture, judicial and legislative experience has shown that the individual's motivation for incorporation is more often "the necessity of attempting to save what he already has."<sup>514</sup> Because the corporate entity is only used to obtain the loan, and only serves the function of acting as principal obligor upon the note, commercial prosperity is not affected at all.

Multistate loan contracts involving inexperienced individuals who have incorporated at the insistence of foreign lending institutions should be treated by applying the rule of the *lex debitoris*. The presumption of the *lex debitoris* should include the presumption that the law of the borrower's state will determine whether a corporate entity created at the

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exemption should be applied only to "business" or "trading" corporations, thus preserving commercial freedom and protecting individual borrowers); *cf.* 40 OPS. CAL. ATT'Y GEN. 152-53 (1962) (distinguishing between "consumptive" and "productive" borrowers).

<sup>510</sup> See *Dahmes v. Industrial Credit Co.*, 261 Minn. 26, 32 & n.5, 110 N.W.2d 484, 488 & n.5 (1961) (relying on New Jersey and not New York authority). The court stressed the period of time the borrower was incorporated before receiving the loan, the use of the proceeds by the corporation rather than by the individuals, and the very nature of the transaction—accounts receivable financing—as "uniquely corporate." The court distinguished the case of a corporation used for the "obvious purpose of circumventing the usury laws." The *Dahmes* case is one of the few which have attempted to evolve workable tests for discriminating between individual and corporate borrowers.

<sup>511</sup> See *Lesser v. Strubbe*, 39 N.J. 90, 94, 187 A.2d 705, 707 (1963) (dissenting opinion).

<sup>512</sup> Guarantors of corporate loans typically cannot raise the defense of usury, see note 476 *supra*.

<sup>513</sup> See *Gilbert v. Doris R. Corp.*, 111 So. 2d 682, 685 (Fla. 1959).

<sup>514</sup> VOLD, *SALES* 327 (2d ed. 1959) (making a similar distinction in a related area). See *Lesser v. Strubbe*, 67 N.J. Super. 537, 544, 171 A.2d 114, 118 (1961), *aff'd per curiam*, 39 N.J. 90, 187 A.2d 705 (1963) (distinguishing between "venture borrowing and . . . the case of a debtor trying to raise funds"); *cf.* New York's experience with incorporating individual home owners, note 464 *supra*.

lender's insistence will be pierced.<sup>515</sup> If the borrower's state has a protective law with respect to this issue, the presumption should be rebutted and the corporate entity preserved only after the court has first determined that the particular borrower in question is sufficiently experienced not to need the protection of his state's laws.

Courts have been reluctant to determine the validity of an individual's incorporation to avoid the usury laws of his own state by the more permissive standards of lenders' states. This reluctance reflects a recognition that the policies of usury statutes are grounded in considerations of bargaining power, and that these policies would be nullified were foreign lenders allowed to use their superior bargaining strength to force borrowers to incorporate. On the other hand, piercing a corporate veil is generally considered to be an equitable defense adopted to prevent injustice in a particular case. The forum court, therefore, whether in the lender's or borrower's state, will probably be reluctant to defer to another jurisdiction's conception of what is fair or just.<sup>516</sup> Application of the *lex debitoris* may be less likely when suit is brought in the lender's state. No case, however, has expressly considered the choice-of-law issue with respect to the piercing of the corporate veil.<sup>517</sup>

The distinction between corporate and individual borrowers, drawn in terms of bargaining power, must not be obscured by discussions phrased in terms of "place of contracting" or "place of performance." Conceptually, these contacts are devoid of any relevant policy justification; in practice, they too often mirror the will of the dominant party. Judicial

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<sup>515</sup> Cases of avoidable conflict, notes 367-79 *supra* and accompanying text, in which the laws of the borrower's state are construed as not giving incorporated borrowers from that state certain protections, should be distinguished. A New York borrower, for example, who incorporated at the insistence of a lender from a state not following New York's policies in order to obtain the benefit of New York's corporate exemption, should not be released from his contract by adopting the lender's law to pierce the corporate veil. Similarly, when an incorporated borrower would be deemed by his own state's courts not to require the protection of his state's law—for example, when the borrower would be found by his courts to be sufficiently experienced to negotiate with equal bargaining power, see text accompanying note 466 *supra*—but where the lender's courts would normally view the incorporation procedure as a "sham," the contract should be sustained by the lender's law. Only that law contains a corporate exemption. However, the equitable "piercing" doctrines of the lender's state would not be applied. They should not be used to protect borrowers from out-of-state.

<sup>516</sup> "The conception of justice prevalent at home will override an opposing conception prevalent abroad . . ." *Dean v. Dean*, 241 N.Y. 240, 245, 149 N.E. 844, 846 (1925) (Cardozo, J., in a case not involving usury). See EHRENZWEIG, *op. cit. supra* note 492, § 22, at 88; *cf.* LATTY, *SUBSIDIARIES AND AFFILIATED CORPORATIONS* 191 (1936).

<sup>517</sup> EHRENZWEIG, *op. cit. supra* note 492, § 22 at 88. Despite this, "there are innumerable cases in which courts have applied their own law without discussion. It may very well be that the reason for this lack of [explicit] authority is simply that no lawyer would even attempt to persuade his court to forego application of its own conceptions of justice and equity where the law's test is in terms based on such conceptions." *Ibid.*

recognition of the need for interpretation of a corporate exemption in light of the *lex debitoris*, formulated in terms of the parties' relative bargaining power, would restore to usury laws their protective function, and provide the law of conflicts with a rational tool for analysis.

## 2. *Economic Considerations*

Usury laws consist of two distinct but related parts: a maximum interest rate, under which the borrower is deemed protected; and a sanction, by which the lender is to be deterred from violations of that rate. Both work in combination to protect a certain class of borrowers; but each has its own particular impact upon the choice of a law to govern an interstate loan contract.

Interest maximums perform their function of borrower protection when applied to contracts by domestic borrowers to restrict their paying more than a stipulated rate of interest. Sanctions, on the other hand, perform their function of borrower protection when imposed on both domestic and foreign lenders who can reasonably be expected to know of the interest regulations of the borrower's state, and to be deterred by the threat of sanctions. Different considerations, therefore, govern their applicability. Accordingly, courts should be able to use their freedom in multistate situations<sup>518</sup> to split off one part of a usury statute from the other, and apply each in varying degrees to implement their underlying policies. In so doing, they would create valid exceptions to the *lex debitoris*.

With respect to interest maximums, however, courts and other authorities have mistakenly treated *de minimis* variations in interest rates<sup>519</sup> as an exception to the *lex debitoris*. This view is unsupported by either logic or case law, and should be treated rather as a tentative judicial step toward recognition of the bargaining power exception.<sup>520</sup> The impact of sanctions for violation of usury statutes<sup>521</sup> on the courts' choice of law has perhaps been more important than any other single factor, yet courts have failed to state this in their opinions. The method described below will enable them to make this explicit.<sup>522</sup>

(a) *De Minimis Variations in Interest Rates*.—The decision by a state legislature to adopt a usury law at all must be distinguished from its determination of a particular interest maximum. "Politics, tradition, the

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<sup>518</sup> See Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. REV. 267 (1966).

<sup>519</sup> See text accompanying notes 523-65 *infra*.

<sup>520</sup> See text accompanying notes 439-517 *supra*.

<sup>521</sup> See text accompanying notes 566-618 *infra*.

<sup>522</sup> See text accompanying notes 600-18 *infra*.

market, [and] economic conditions"<sup>523</sup> all are a part of this calculation, and the many and conflicting factors are reflected in the wide variations in rates between the states.<sup>524</sup> The ultimate determination, however, is a compromise between the demands for higher rates—to attract foreign capital, provide funds for risk investments, and allow room for the forces of supply and demand in the money market to find their own level—and those calls for lower rates—to limit the monopolistic power of large financial institutions, restrain certain borrowers from too deeply obligating themselves, and increase the availability of credit for the purchase of land and other socially desirable items.<sup>525</sup> But these broad issues seldom

<sup>523</sup> Friedman, *The Usury Laws of Wisconsin: A Study in Legal and Social History*, 1963 Wis. L. Rev. 515, 521.

<sup>524</sup> No maximum rate: Maine; MASS. GEN. LAWS ANN. ch. 107, § 3 (1958); N.H. REV. STAT. ANN. § 336:1 (1955). Courts of equity still have the power to declare rates "unconscionable" and reform the contract, *Westchester Mortgage Co. v. Grand Rapids & I.R.R.*, 246 N.Y. 194, 158 N.E. 70 (1927).

30%: R.I. GEN. LAWS ANN. § 6-26-2 (1956) (for loans over \$50).

24%: COLO. REV. STAT. ANN. § 73-2-5 (Supp. 1963) (for loans over \$1500).

12%: CONN. GEN. STAT. ANN. § 37-4 (1960); HAWAII REV. LAWS § 191-3 (1955); NEV. REV. STAT. § 99.050 (Supp. 1959); N.M. STAT. ANN. § 50-6-16 (1953) (only 10% allowed if collateral present); WASH. REV. CODE ANN. § 19.52.020 (1961); WIS. STAT. ANN. § 115.05 (Supp. 1967).

10%: ARK. STAT. ANN. § 68-602 (1957); CAL. CONST. art. 20, § 22 (interest rates); FLA. STAT. § 687.02 (1965) (corporation rate 15%); KEN. GEN. STAT. ANN. § 16-202 (1964); MONT. REV. CODES ANN. § 47-125 (1961); OKLA. STAT. ANN. tit. 15, § 266 (1961); ORE. REV. STAT. § 82.010 (1965) (corporation rate 12%); TEX. REV. CIV. STAT. ANN. art. 5071 (1962); UTAH CODE ANN. § 15-1-2 (1953) (corporation rate 14%); WYO. STAT. ANN. § 13-477 (1957).

9%: NEB. REV. STAT. § 45-101 (1960).

8%: ALA. CODE tit. 9, § 60 (1958); ALASKA STAT. § 45.45.010 (1962); ARIZ. REV. STAT. ANN. § 44-1201 (1956); D.C. CODE ANN. § 28-2702 (1961); GA. CODE ANN. § 57-101 (1960); IDAHO CODE ANN. § 27-1905 (1948) (corporation rate 12% for loans over \$10,000); IND. ANN. STAT. § 19-12-101 (1964); LA. CIV. CODE ANN. art. 2924 (West 1952); MINN. STAT. ANN. § 334.01 (1947); MISS. CODE ANN. § 36 (1956) (corporation rate is 15%); MO. ANN. STAT. § 408.030 (1952); OHIO REV. CODE ANN. § 1343.01 (Baldwin 1961); S.D. CODE § 38.0109 (1939).

7%: ILL. ANN. STAT. ch. 74, § 4 (Smith-Hurd 1966); IOWA CODE ANN. § 535.2 (1950); MICH. STAT. ANN. § 19.11 (1959); N.D. CENT. CODE § 47-14-09 (1960); S.C. CODE ANN. § 8-3 (1962).

6%: DEL. CODE ANN. tit. 6, § 2301 (1953); KY. REV. STAT. § 360.010 (1962); MD. ANN. CODE art. 49, § 3 (1957); N.J. STAT. ANN. § 31:1-1 (1963); N.Y. GEN. OBLIGATIONS LAW § 5-501; N.C. GEN. STAT. § 24-1 (1953) (corporation rate 8% for certain loans over \$30,000); PA. STAT. ANN. tit. 41, § 3 (1954); TENN. CODE ANN. § 47-14-104 (1964); VT. STAT. ANN. tit. 9, § 31 (1959); VA. CODE ANN. § 6.1-318 (1966); W. VA. CODE ANN. § 4628 (1966).

Various penalties are imposed for violation of these rates. See notes 566-74 *infra*. For a current compilation of rates see *State Interest and Usury Laws—A Chart Setting Forth Statutory Provisions as to Legal Rates of Interest and Usurious Contracts*, 3 CCH FED. BANKING L. REP. ¶ 59,005 (Nov. 2, 1966).

<sup>525</sup> For a detailed historical exploration of the economic and social forces which have shaped the usury laws of a particular state, Wisconsin, see Friedman, *supra* note 523, at 528-65.

find their way into the courtroom. In domestic cases, the court's judgment is largely pre-empted by the legislature's determination of the point at which a borrower is protected from the dangers of his weakened financial condition.

Yet in cases of conflict between the interest maximums of various jurisdictions, this determination has often been ignored. No court dealing with a purely domestic loan would even contemplate the argument that "the broad policy of upholding transactions" in general should in some cases override "the specific policy of protecting debtors from usury."<sup>526</sup> Nonetheless, precisely such an argument has proved almost irresistible to the same courts when confronted with an interstate loan transaction.<sup>527</sup> This argument in multistate cases has taken two forms. The first has stressed *de minimis* variations in interest rates between the states. The second has stressed *de minimis* variations between different interest rates within one particular state.

(1) *Variations Between States.*—The argument for validation of interstate loan contracts once appeared in the now discarded raiment of "concessions to trade and commerce";<sup>528</sup> it has more recently been dressed in the modern theoretical garb of a "shared policy" between states of "enforcing agreements deliberately entered into,"<sup>529</sup> or a "common principle underlying [usury] acts."<sup>530</sup> Perhaps the most concise statement of this doctrine is offered in *Second Restatement of Conflicts*. While conceding that usury laws "protect debtors against extortion,"<sup>531</sup> the *Second Restatement* proposes a rule of validation which would consistently validate interstate loan contracts by the higher rate of the lender's state.<sup>532</sup> It limits validation, however, to cases where the available rates are "not greatly in excess" of each other.<sup>533</sup>

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<sup>526</sup> M. Traynor, *Conflict of Laws: Professor Currie's Restrained and Enlightened Forum*, 49 CALIF. L. REV. 845, 857 (1961).

<sup>527</sup> Compare *Curtis v. Securities Acceptance Corp.*, 166 Neb. 815, 825, 91 N.W.2d 19, 25-26 (1958), and *Nitzel & Co. v. Nelson*, 144 Neb. 662, 14 N.W.2d 197 (1944), with *Kinney Loan & Fin. Co. v. Sumner*, 159 Neb. 57, 65 N.W.2d 240 (1954).

<sup>528</sup> See text accompanying notes 221-32 *supra*.

<sup>529</sup> Weintraub, *The Contracts Proposals of the Second Restatement of Conflict of Laws—A Critique*, 46 IOWA L. REV. 713, 723 (1961).

<sup>530</sup> Currie, *Notes on Methods and Objectives in the Conflict of Laws*, 1959 DUKE L.J. 171, 180.

<sup>531</sup> RESTATEMENT (SECOND), CONFLICT OF LAWS § 334d at 54 (Tent. Draft No. 6, 1960).

<sup>532</sup> *Ibid.*

<sup>533</sup> *Ibid.* "Ordinarily, the permissible rate of interest will vary only slightly from state to state. When this is the case, application of the usury law of one state can hardly affect adversely the interests of another state, since the difference in the rate established by the laws of these two states will be a few percentage points at most. For this reason, the courts deem it more important to sustain the validity of a contract, and thus protect the expectations of the parties, than to apply the usury law of any particular state." *Ibid.* It is im-



This argument, it should be emphasized, makes no reference to the punitive sanctions imposed by each state.<sup>534</sup> The *Second Restatement's* approach appears designed to fit the following example: Assume a contract for eight per cent interest; the lender's law allows eight per cent, the borrower's only six. The only sanction provided by the borrower's law, if applied, is that the lender cannot collect the excess two per cent; he can, however, recover his principal and legal interest of six per cent. The critical issue, therefore, is which party must bear the loss of two per cent interest: the lender, by application of the borrower's law; or the borrower, by application of the lender's law. According to the *Second Restatement*, the two interest rates differ by only "a few percentage points," and the lender's law should control; it is "more important to sustain the validity of a contract, and thus protect the expectations of the parties, than to apply the usury law of any particular state."<sup>535</sup>

The argument based on a *de minimis* variation in interest rates has some merit and therefore requires consideration. First, it focuses attention where it belongs: upon the conflicting economic policies of different states and the crucial issue of debtor protection. If, for example, a borrower is deemed protected by paying no more than six per cent interest, then, so the argument goes, he cannot be greatly harmed by paying the "slightly" higher rate of eight per cent allowed by the lender's state. The two states, it is said, have a "common policy" of enforcing contractual obligations voluntarily assumed,<sup>536</sup> and given this "unanimity" there is "no true conflict of laws."<sup>537</sup> Validation by the lender's law, therefore, is thought to serve better this common interest and increase the stability of interstate lending. Second, the argument recognizes, albeit by implication, the demise of rigid, imperative conflicts rules, and acknowledges the substantial discretion left to individual courts. If a distinction is to be drawn between those cases where rates "differ slightly" and those where rates are "greatly in excess of that permitted by the state of the governing law,"<sup>538</sup> it can only be drawn at the discretion of the judiciary.

The *de minimis* argument, however, has several fatal deficiencies. First, it fails to indicate why interstate loan contracts should be treated

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portant to note, however, that where the different rates are "greatly in excess" of each other, the contract is not automatically invalidated. In such a case, § 334d provides that §§ 332-32b control the contract's validity—in which case the law of the lender's state will probably be applied. *Ibid.*

<sup>534</sup> Disregarded, for example, is the case where application of the borrower's law would impose a heavy forfeiture upon the lender. It is argued in text accompanying notes 579-90 *infra* that this issue of penalties has the greatest importance to a choice of law.

<sup>535</sup> RESTATEMENT (SECOND), *op. cit. supra* note 531, § 334d, at 54.

<sup>536</sup> *Id.* at 55.

<sup>537</sup> Cavers, *The Two "Local Law" Theories*, 63 HARV. L. REV. 822, 828 (1950).

<sup>538</sup> RESTATEMENT (SECOND), *op. cit. supra* note 531, § 334d, at 54-55.

differently from domestic contracts. Obviously no court would sustain a usurious domestic contract on the argument that a difference of a few per cent is only a "slight" variation, that validation would not adversely affect state interests, or that party expectations should be protected.<sup>539</sup> If a court finds that it must ignore the borrower's protective statute in favor of a less protective foreign statute, the very least one might expect is some attempt to justify this divergence. Although courts rarely consider this question, two possible justifications might be advanced for the different treatment given interstate loan contracts.

(i) It is arguable that an out-of-state lender has the right to engage in a business legitimate by the laws of his own state.<sup>540</sup> A balance must therefore be struck between the debtor's right to protection and the foreign lender's right to earn a living. The main objection to this proposed justification, however, is that usury laws are borrower-oriented, not lender-oriented.<sup>541</sup> A foreign lender may have the right to earn a livelihood by complying with his state's interest maximums when lending to borrowers protected by his state. But it does not follow that he has that same right with respect to borrowers protected by the laws of other states. It cannot be considered unjust to require all foreign lenders simply to comply with the borrower's law.<sup>542</sup> If a balance is to be struck between lender and borrower, the whole point of usury statutes dictates that it be heavily weighted in the borrower's favor.

(ii) Another possible justification for validation of interstate loan contracts is the argument that usury laws are antiquated devices that have outlived their usefulness,<sup>543</sup> and that courts no longer believe in the necessity of such arbitrary and harsh laws. Arguably, therefore, courts in conflicts cases have the opportunity to avoid deliberately their own stringent laws by applying the more lenient doctrines of other states. The

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<sup>539</sup> This is particularly true in states which have indicated a strong legislative aversion to usury by providing for stringent forfeitures and criminal sanctions, notes 568-75 *infra*.

<sup>540</sup> As Cavers formulates the problem, "But why shouldn't [a foreign lender] be able to do business in his own state under its own rules without having to check the rules of [the borrower's state]?" CAVERS, *THE CHOICE-OF-LAW PROCESS* 126 (1965). *Cf. Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 407 (1926) (a foreign lender can "legitimately lend funds outside the state" and nevertheless obtain the protection of his own laws).

<sup>541</sup> It is for this reason that usury is condemned only when borrowers *pay* more than allowed by their state maximum, and not when lenders *take* more than their state maximum allows—so long as the excess is extracted from borrowers whose own protective laws permit them to pay those higher rates. This has been strikingly apparent in cases permitting lenders to lend in excess of the maximums established by their own laws. See note 365 *supra*.

<sup>542</sup> For the argument that it imposes an undue burden on interstate lending activities see text accompanying notes 227-32 *supra* and notes 627-35 *infra*. For the few instances in which the lender might successfully argue unfair surprise see text accompanying notes 219-20 *supra* and notes 636-38 *infra*.

<sup>543</sup> See Note, 65 *YALE L.J.* 105 (1955). Compare Letter, 4 *CENT. L.J.* 140 (1877).

increasingly strict usury laws passed by the states over the past forty years effectively repudiate this argument.<sup>544</sup> If any trend exists today, it is toward greater debtor protection in all fields of commercial activity.<sup>545</sup>

A *second* deficiency in the *de minimis* argument is that it stresses differences in interest rates, and not differences between individual borrowers.<sup>546</sup> Any interest maximum is an average. Some borrowers can easily pay more than their own state's maximum; others would be hard pressed to pay even that. A court would be reluctant to impose upon a borrower the lender's higher rate in a case where the borrower could scarcely meet his own. In such cases the *Second Restatement's* "slightly differing" rates argument would seem somewhat irrelevant.

*Third*, in evaluating the economic burdens on individual borrowers, factors other than slight variations in rates are of equal importance. The size of a loan and the length of time specified for its repayment should also affect a court's judgment. For example, if the lender's rate of eight per cent per annum were applied to a ten year \$10,000 loan, instead of the borrower's rate of six per cent, an additional burden of \$200 per year would be imposed upon the borrower. Over ten years this would mean an added payment of \$2,000, or an additional one-fifth of the principal.<sup>547</sup>

*Fourth*, the argument that courts deem it more important to protect the expectations of the parties than to enforce strictly a usury statute is flatly opposed to the policy of such a statute. Usury statutes exist to overturn the expectations of certain parties. The argument that loan contracts should be validated merely because the lender expected to

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<sup>544</sup> "[S]ince 1921, eighteen states have decreased the allowable rate and none have increased it and of the eighteen, one state abandoned no maximum in favor of a 12 per cent limit." Meth, *A Contemporary Crisis: The Problem of Usury in the United States*, 44 A.B.A.J. 637, 640 (1958). See Horack, *A Survey of the General Usury Laws*, 8 LAW & CONTEMP. PROB. 36, 39-40 (1941).

<sup>545</sup> CURRAN, TRENDS IN CONSUMER CREDIT LEGISLATION (1965); McALISTER, RETAIL INSTALLMENT CREDIT: GROWTH AND LEGISLATION 11-155 (1964). See statutes cited at note 94 *supra*.

<sup>546</sup> See SPECIAL COMMITTEE, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS, REPORT ON RETAIL INSTALLMENT SALES, CONSUMER CREDIT, SMALL LOANS AND USURY 29-30 (1965). It should be noted that the *de minimis* argument cuts both ways. No greater burden is imposed upon the lender who is forced to lower his profit to the borrower's rate of 6%, than is imposed upon the borrower who must raise his payments to the lender's rate of 8%. Further, one would be inclined to think that an interstate corporate lender could better withstand the loss of an anticipated 2% return than could an individual borrower sustain the burden of paying it.

<sup>547</sup> In practice, commercial loans are rarely calculated on the declining balance method. *Hearings on S. 750 Before the Subcommittee on Production and Stabilization of the Senate Committee on Banking and Currency*, 88th Cong., 1st Sess. 6 (1963-64). Calculated by this method, however, an additional 2% interest over ten years would impose upon the borrower the extra burden of \$1,100.

receive interest from a borrower in excess of that borrower's law would, on the domestic level, reduce all usury statutes to absurdities.<sup>548</sup> Unless the foreign lender can persuade the court that his situation demands special consideration,<sup>549</sup> the argument remains equally absurd on the multistate level.

*Fifth*, a substantial element of uncertainty is introduced into interstate lending if courts are given the discretion to determine whether an interest rate is "slightly" or "greatly" in excess of the borrower's normal rate. The law of conflicts should not become a lottery in which the variation of a few percentage points imposes either a penalty upon the lender or an unjust burden upon the borrower. Predictability would be better served by application of the *lex debitoris*: unless the lender can clearly establish an exception, contracts would not be enforced in excess of the borrower's interest maximum.

*Sixth* and finally, the *Second Restatement's de minimis* argument is unsupported by many cases involving interstate loan contracts. While courts have often validated such contracts by the lender's slightly higher interest maximum,<sup>550</sup> they have just as often held them usurious under the slightly lower maximum of the borrower's law.<sup>551</sup>

(2) *Variations Within One State*.—An argument related to the *Second Restatement's de minimis* approach involves comparing a state's internal variations in permissible interest rates with the rates between the borrower's and lender's states. In *Ury v. Jewelers Acceptance Corp.*,<sup>552</sup> a loan for 20.3 per cent per annum was validated by foreign law against a California borrower, despite California's interest maximum of ten per cent. The court felt that California could not have a "strong public policy"

<sup>548</sup> Furthermore, the "expectations" argument is circular. The parties are justified in expecting judicial validation of interstate loan contracts only if the courts have consistently validated such contracts in the past.

<sup>549</sup> See text accompanying notes 227-32 *supra* and notes 627-35 *infra* for the undue burden argument; see text accompanying notes 219-20 *supra* and notes 636-38 *infra* for the unfair surprise argument.

<sup>550</sup> *E.g.*, *Pioneer Sav. & Loan Co. v. Nonnemacher*, 127 Ala. 521, 30 So. 79 (1900) (2% variation); *Hansen v. Duvall*, 333 Mo. 59, 62 S.W.2d 732 (1933) (2% variation); *Townsend v. Riley*, 46 N.H. 300 (1865) (1% variation); *Staples v. Nott*, 128 N.Y. 403 (1891) (1% variation); *Wayne County Sav. Bank v. Low*, 81 N.Y. 566 (1880) (2% variation); *Bowman v. Price*, 143 Tenn. 366, 226 S.W. 210 (1920) (2% variation); *cf.* *Peck v. Mayo, Follet & Co.*, 14 Vt. 33 (1842) (1% variation, but no interest specified in contract).

<sup>551</sup> *E.g.*, *United States Sav. & Loan Ass'n v. Scott*, 98 Ky. 695, 34 S.W. 235 (1896) (2% variation); *Smith v. Parsons*, 55 Minn. 520, 57 N.W. 311 (1893) (2% variation); *Shannon v. Bldg. & Loan Ass'n*, 78 Miss. 955, 30 So. 51 (1901) (4% variation); *Grand Rapids School Furniture Co. v. Hammerstein*, 18 N.Y.S. 766 (C.P. 1892) (1% variation); *Union & Planters Bank & Trust Co. v. Evans*, 8 Tenn. App. 63 (1928) (2% variation); *cf.* *Pellerin Laundry Sales Co. v. Hogue*, 219 F. Supp. 629 (W.D. Ark. 1963) (1% variation, lender's law applied).

<sup>552</sup> 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964).

against such loans where the state constitution had exempted from the operation of its usury laws many types of lending institutions, including banks, and had given the legislature the discretion to fix individual rates for each institution.<sup>553</sup> "In fact," the court declared, "the loan in this case, if it had been made by a bank in California and was payable here, could be enforced."<sup>554</sup> The court apparently felt that interest of 20.3 per cent could not be too burdensome for the borrower when even higher rates were allowed by related state legislation.<sup>555</sup>

This argument does not distinguish between general usury legislation and more specific legislation.<sup>556</sup> Small loan legislation, for example, typically allows higher interest rates on loans up to \$300.<sup>557</sup> These rates make it profitable for respectable loan institutions to enter the field, drive out loan sharks, and provide a source of funds for small borrowers.<sup>558</sup> Because the amounts of the loan are required to be small, the total amount charged even at higher rates is not considered an excessive burden.<sup>559</sup> Most importantly, the state carefully regulates the lending practices of these institutions and imposes upon them high standards of fairness.<sup>560</sup> The argument that the loan would have been valid if made by a California bank is inapplicable to *Ury*, because the state-regulated California banks apparently refused to lend him money on shaky credit.<sup>561</sup> Unless a borrower is sufficiently experienced and financially responsible, automatic validation of interstate loans negates the protective standards of fairness adopted by California.<sup>562</sup>

In sum, the arguments based on *de minimis* variations in interest rates used to support validation of interstate loan contracts are faulty.

<sup>553</sup> *Id.* at 20, 38 Cal. Rptr. at 382. See CALIF. CONST. art. XX, § 22, (interest rates) for the exempted institutions.

<sup>554</sup> 227 Cal. App. 2d at 20, 38 Cal. Rptr. at 382.

<sup>555</sup> For example, personal property brokers are permitted to charge 30% per annum on the first \$200, and 24% per annum on amounts between \$500 and \$5,000. CAL. FIN. CODE §§ 22451, 22453.

<sup>556</sup> See Hubachek, *The Development of Regulatory Small Loan Laws*, 8 LAW & CONTEMP. PROB. 108, 115 (1941).

<sup>557</sup> See note 592 *infra*.

<sup>558</sup> See generally Hubachek, *Progress and Problems in Regulation of Consumer Credit*, 19 LAW & CONTEMP. PROB. 4 (1953).

<sup>559</sup> Hubachek, *supra* note 556, at 115. *But see* 162 CONG. REC. 22015-16 (daily ed. Sept. 2, 1965) (remarks of Rep. Weltner).

<sup>560</sup> *E.g.*, Sullivan, *Administration of a Regulatory Small Loan Law*, 8 LAW & CONTEMP. PROB. 146, 148-53 (1941) (describing New Jersey's regulatory devices). *Cf.* Griffith v. Connecticut, 218 U.S. 563, 570 (1910).

<sup>561</sup> "[T]he borrower entered into the loan agreement only after he [had] exhausted available credit sources in California . . ." Brief for Appellant, p. 10, *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964).

<sup>562</sup> Courts should be careful to distinguish the different policies behind each particular type of lending regulation. See M. Traynor, *supra* note 526, at 858.

When application of the *lex debitoris* imposes no forfeiture upon the lender, but merely allows the lender to recover the legal principal and interest under the borrower's law, the choice-of-law issue becomes: Why should the lender be allowed to require that the borrower bear the burden of "slightly higher" interest rates? Because the *de minimis* arguments hide this critical issue of borrower protection, they should not be used to justify an exception to the *lex debitoris*. Courts should instead focus upon the bargaining power exception.<sup>563</sup> In interstate loan transactions, the lender is typically a large commercial institution and thus better able to absorb the loss of a "slightly lower" rate of interest, to discover and conform to the borrower's law, and to unilaterally dictate to its advantage all contractual terms.<sup>564</sup> For this reason, lenders should be required to rebut the presumption of the *lex debitoris*<sup>565</sup> before obtaining the benefits of their own laws.

(b) *Sanctions for Violation of Usury Statutes.*—A far more important economic consideration than *de minimis* variations in interest rates is the wide variation in punitive sanctions imposed by states for violation of their interest maximums. This variation has substantially influenced courts in conflicts cases. All states with usury laws<sup>566</sup> grant some remedy to their borrowers for the lender's violation of state law. The sanctions enforced by the states range from mild to highly penal. Some merely deprive the lender of any interest charged or received in excess of the legal maximum.<sup>567</sup> Others impose in addition a "forfeiture"<sup>568</sup> by which the lender is denied a part or all of the principal or legal interest. Of these, some require a forfeiture of all interest;<sup>569</sup> others provide for the for-

<sup>563</sup> See text accompanying notes 438-517 *supra*.

<sup>564</sup> See notes 413-20 *supra* and accompanying text.

<sup>565</sup> See text accompanying note 342 *supra*.

<sup>566</sup> Maine, Massachusetts, and New Hampshire have no interest maximum, and therefore no sanction. For tables of all interest maximums, see note 524 *supra*.

<sup>567</sup> DEL. CODE ANN. tit. 6, § 2304 (1953); IND. ANN. STAT. § 19-12-104 (1964); KAN. GEN. STAT. ANN. § 16-203 (1964); KY. REV. STAT. § 360.020 (1962); MD. ANN. CODE art. 49, § 4 (1957); MO. ANN. STAT. § 408.050 (1952); NEV. REV. STAT. § 99.050 (Supp. 1959); OHIO REV. CODE ANN. § 1343.04 (Baldwin 1961); PA. STAT. ANN. tit. 41, § 4 (1954); TENN. CODE ANN. § 47-14-117 (1964); VT. STAT. ANN. tit. 9, § 34 (Supp. 1965) (if lender "knowingly" or "wilfully" takes excessive interest, he can recover only one half the principal); W. VA. CODE ANN. § 47-6-9 (1966).

<sup>568</sup> The word "forfeiture" is hereinafter used to designate a sanction by which the lender is forced to give up some part of the original principal, legal interest, or both. "Penalty" is used to describe all remedies granted a borrower, including the return of the excess interest charged or paid.

<sup>569</sup> ALA. CODE tit. 9, § 65 (1958); ARIZ. REV. STAT. ANN. § 44-1202 (1956); CAL. GEN. LAWS ANN. act 3757, §§ 1-5 (Deering 1954); D.C. CODE ANN. § 28-2703 (1961); HAWAII REV. LAWS § 191-6 (1955); IOWA CODE § 535.2 (1962) (plus 8% of principal); LA. CIV. CODE ANN. art. 2924 (West 1952); MICH. STAT. ANN. §§ 19.12-19.13 (1959); MISS. CODE

feiture of a multiple of the interest charged<sup>570</sup> or taken;<sup>571</sup> and a number declare an absolute forfeiture of all interest and principal,<sup>572</sup> or an absolute forfeiture plus a fine consisting of a percentage of the principal.<sup>573</sup> Two states provide for an absolute forfeiture only when the interest exceeds a special rate.<sup>574</sup> Approximately one-third of the states impose possible criminal penalties as well.<sup>575</sup> Although these forfeitures are designed primarily to deter the lender from entering into illegal transactions,<sup>576</sup> and to punish him for his misconduct,<sup>577</sup> they often serve in fact to bestow an undeserved windfall upon the borrower.<sup>578</sup>

ANN. § 37 (1956) (all principal if rate over 20%); NEB. REV. STAT. § 45-105 (1960); N.J. STAT. ANN. § 31-1-3 (1963) (*but see* 6 RUTGERS L. REV. 568, 570-71 (1952)); S.D. CODE § 38.0109 (1939); VA. CODE ANN. § 6.1-319 (1966); WIS. STAT. ANN. § 115.06 (Supp. 1967) (plus amount of principal up to \$2,000); WYO. STAT. ANN. § 13-482 (1957).

<sup>570</sup> IDAHO CODE ANN. § 27-1907 (1948) (three times the interest reserved); ILL. ANN. STAT. ch. 74, § 6 (Smith-Hurd 1966) (twice the interest reserved); KAN. GEN. STAT. ANN. § 16-203 (1964) (twice the excess over the maximum rate); MONT. REV. CODES ANN. § 47-126 (1961) (twice the interest reserved); OKLA. STAT. tit. 15, § 267 (1961) (twice the interest reserved).

<sup>571</sup> ALASKA STAT. § 45.45.030 (1962) (twice the interest paid); CAL. GEN. LAWS ANN. act 3757, § 3 (Deering 1954) (three times the interest paid; see *Heald v. Friis-Hansen*, 52 Cal. 2d 834, 839, 345 P.2d 451, 461 (1959)); COLO. REV. STAT. ANN. § 73-2-7 (1963) (three times the interest paid over the maximum amount); FLA. STAT. ANN. § 687.04 (1965) (twice the interest paid); N.M. STAT. ANN. § 50-6-18 (1962) (twice the interest paid); N.C. GEN. STAT. § 24-2 (1953) (all interest charged, plus twice the interest taken); N.D. CENT. CODE § 47-14-10 (1960) (all interest charged, plus 25% of the principal, plus twice the interest paid); S.C. CODE ANN. § 8-5 (1962) (all interest charged, plus twice the interest paid); TEX. REV. CIV. STAT. ANN. art. 5073 (1962) (twice the interest paid); UTAH CODE ANN. § 15-1-7 (1953) (three times the interest paid); WASH. REV. CODE ANN. § 19.52.030 (1961) (all interest plus twice the interest paid).

<sup>572</sup> ARK. CONST. art. 19, § 13; CONN. GEN. STAT. ANN. § 37-8 (1960); MINN. STAT. ANN. § 334.02 (1947); N.Y. GEN. OBLIGATIONS LAW § 5-511; ORE. REV. STAT. § 82.120 (1965); R.I. GEN. LAWS ANN. § 6-26-4 (1956).

<sup>573</sup> IOWA CODE § 535.5 (1962) (plus 8% of unpaid principal); N.D. CENT. CODE § 47-14-10 (1960) (plus 25% of principal); VT. STAT. ANN. tit. 9, § 34 (Supp. 1965) (if lender "knowingly" or "wilfully" takes excessive interest, he forfeits one half of the principal); WIS. STAT. ANN. § 115.06 (Supp. 1967) (principal up to \$2,000).

<sup>574</sup> FLA. STAT. § 687.07 (1965) (if interest over 25%); MISS. CODE ANN. § 36 (1956) (if interest over 20%).

<sup>575</sup> See Horack, *A Survey of the General Usury Laws*, 8 LAW & CONTEMP. PROB. 36, 48-53 (1941). Connecticut provides for a maximum fine of \$1,000, or six months imprisonment, or both, CONN. GEN. STAT. ANN. § 37-7 (1960). New York provides that interest taken over 25% per annum constitutes "criminal usury," a felony punishable by five years imprisonment, a \$5,000 fine, or both, N.Y. PEN. LAW § 2401 (Supp. 1966). See Comment, 66 COLUM. L. REV. 167 (1966). Vermont provides a \$500 fine, six months imprisonment, or both, for the first "wilful" offense of usury, and a fine of \$1,000, one year imprisonment, or both, for further offenses, VT. STAT. ANN. tit. 9, § 34 (Supp. 1965).

<sup>576</sup> See Collins, *Evasion and Avoidance of Usury Laws*, 8 LAW & CONTEMP. PROB. 54 (1941) (criticizing the effectiveness of this deterrent).

<sup>577</sup> "Our statute of usury is highly penal. It forfeits the entire debt." *Hull v. Augustine*, 23 Wis. 383, 386 (1868). See *Penziner v. West American Fin. Co.*, 10 Cal. 2d 160, 74 P.2d

The most important of all the factors which persuade courts to reject the *lex debitoris* and apply a more lenient lender's law is an unwillingness to impose upon a lender a forfeiture which seems excessive with respect to the extra amount which the borrower would have to pay under the lender's law.<sup>579</sup> At the domestic level courts have little opportunity to express their aversion toward forfeitures.<sup>580</sup> If the loan is clearly usurious, by even a single percentile, the appropriate forfeiture must be imposed.<sup>581</sup> The availability of a lender's more lenient law, however, enables the court to use a choice-of-law method to avoid the more stringent sanctions of the borrower's law. Indeed, the stronger the forfeiture provisions of the *lex debitoris*, the more the courts are tempted to apply the lender's law. This problem is posed by the following hypothetical.

Assume a loan of \$1,000 to be repaid over five years at eight per cent per annum. Assume further that the lender's state allows a maximum of eight per cent per annum, but the borrower's only six. An action is brought against the defaulting borrower in his own state. If the borrower's law merely allows the lender recovery of the legal rate of six per cent, there are no convincing reasons why the *lex debitoris* should not be applied.<sup>582</sup> At the very least, the lender should bear the burden of a two per cent differential. If, on the other hand, the borrower's law provides for an absolute forfeiture of both interest and principal, the court will be caught between the desire to relieve the borrower from usurious interest

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252 (1937); *Frick Co. v. Tuten*, 204 S.C. 226, 229, 29 S.E.2d 260, 261 (1944). Although the borrower has also participated in the illegal act, his conduct is not considered reprehensible. The duress to which he is subjected negates his participation in the crime. Horack, *supra* note 575, at 39. Although the borrower's knowledge of the transaction's illegality is usually deemed irrelevant, *id.* at 41, there are a few circumstances where the borrower's conduct estops him from raising the usury defense, *id.* at 40 n.30.

<sup>578</sup> A few states, however, give the amounts forfeited to the school fund of the county in which the action is brought. *E.g.*, IOWA CODE ANN. § 535-5 (1950).

<sup>579</sup> The judicial aversion towards forfeitures has been generally stated as "the rule that a court of equity usually is reluctant to lend its aid in enforcing a forfeiture. But where . . . the right to the forfeiture is clear and is asserted in the public interest, equitable relief, if otherwise appropriate, is not withheld." *Kern River Co. v. United States*, 257 U.S. 147, 155 (1921). See *Brewster v. Lanyon Zinc Co.*, 140 Fed. 801, 818-19 (8th Cir. 1905). See generally 2 POMEROY, EQUITY JURISPRUDENCE § 459 (5th ed. 1941).

<sup>580</sup> Courts can, of course, increase the borrower's burden of proof. "*Due to the harshness of the New York usury laws the defense is not favored*, and in case of doubt a rather heavy burden of proof is thrown upon the person asserting that a bargain is usurious." RESTATEMENT, CONTRACTS § 526 (1932), *New York Annotations* (1933). (Emphasis in original.) See *In re Wilde*, 133 Fed. 562, 564 (S.D.N.Y. 1904); *Frick Co. v. Tuten*, 204 S.C. 226, 231, 29 S.E.2d 260, 262 (1944); NUSSBAUM, MONEY IN THE LAW 244 (1939).

<sup>581</sup> "The penalty [imposed by the usury statute] is severe. Perhaps unnecessarily so. That, however, is for the lawmaking body. The courts must apply the law as they find it." *Universal Credit Co. v. Lowell*, 166 Misc. 15, 18, 2 N.Y.S.2d 743, 746 (Rochester City Ct. 1938).

<sup>582</sup> See text accompanying notes 528-65 *supra*.



and the reluctance to impose a severe forfeiture upon the lender. Faced with this dilemma, courts have preferred to strip from borrowers the protection of their own laws, rather than to distribute what may appear to be the "pounds of lenders' flesh that their own usury laws call for."<sup>583</sup>

This result is paradoxical: The stronger a state's legislative policy against usury, the more apt the courts are to disregard that policy. As the punitive sanctions become increasingly stringent, it is correspondingly easier for the foreign lender to evade them with impunity. With a kind of perverse logic, a court's unwillingness to overturn a transaction grows with the amount of the loan and the usurious interest taken. Although many courts might be persuaded to enforce the forfeiture of a few hundred dollars,<sup>584</sup> few could be persuaded to declare a forfeiture of many thousands.<sup>585</sup> Ironically, if the lender is careful to extract usurious interest upon comparatively large loans, his invulnerability is virtually guaranteed. Heavy as the increase in the borrower's burden of payment may be under the loan contract, it is far outweighed by the court's abhorrence of an even greater forfeiture accompanied by a correspondingly large windfall to the borrower.

The influence exerted by judicial dislike of forfeitures has brought about two important consequences. First, courts in those states with heavy forfeiture provisions have generally strained to avoid imposing forfeitures upon foreign lenders.<sup>586</sup> It is in these states that validation theories

<sup>583</sup> Leflar, *Conflict of Laws, Contracts, and the New Restatement*, 15 *ARK. L. REV.* 163, 170 (1961).

<sup>584</sup> *E.g.*, *Mirgon v. Sherck*, 196 Wash. 690, 84 P.2d 362 (1938) (\$280).

<sup>585</sup> *E.g.*, *Depau v. Humphreys*, 8 Mart. (n.s.) 1 (La. 1829) (\$29,654.98); *Westchester Mortgage Co. v. Gand Rapids & I.R.R.*, 246 N.Y. 194, 158 N.E. 70 (1927) (\$14,000).

<sup>586</sup> This trend has been particularly noticeable in New York, which allows a maximum interest of only 6% per annum, and imposes an absolute forfeiture of all interest and principal, N.Y. GEN. OBLIGATIONS LAW §§ 5-501, -511. In an effort to avoid imposing this heavy forfeiture upon foreign lenders, New York courts have, with few exceptions, consistently applied any foreign law sufficiently connected with the transaction which would impose less severe consequences. See *Westchester Mortgage Co. v. Grand Rapids & I.R.R.*, 246 N.Y. 194, 158 N.E. 70 (1927); *Manhattan Life Ins. Co. v. Johnson*, 188 N.Y. 108, 80 N.E. 658 (1907); *Staples v. Nott*, 128 N.Y. 403, 28 N.E. 515 (1891); *Sheldon v. Haxtun*, 91 N.Y. 124 (1883); *Western Transp. & Coal Co. v. Kilderhouse*, 87 N.Y. 430 (1882); *Wayne County Sav. Bank v. Low*, 81 N.Y. 566 (1880); *Whitehead v. Heidenheimer*, 57 App. Div. 590, 68 N.Y. Supp. 704 (1901); *Hawkins v. Ringel*, 231 N.Y.S.2d 476 (Sup. Ct. 1962), *rev'd mem.*, 19 App. Div. 2d 649, 242 N.Y.S.2d 616 (1963); *Katz v. Fischel*, 174 Misc. 589, 21 N.Y.S.2d 572 (Sup. Ct. 1940); *Thompson v. Ward*, 33 Misc. 426, 67 N.Y. Supp. 687 (Sup. Ct. 1900); *Thorn v. Alvord*, 32 Misc. 456, 66 N.Y. Supp. 587 (Sup. Ct. 1900); *Balme v. Wombough*, 38 Barb. 352 (N.Y. Sup. Ct. 1862); *Potter v. Tallman*, 35 Barb. 182 (N.Y. Sup. Ct. 1861); *Berrien v. Wright*, 26 Barb. 208 (N.Y. Sup. Ct. 1857); *City Sav. Bank v. Bidwell*, 22 Barb. 118 (N.Y. Sup. Ct. 1856); *Bowen v. Bradley*, 9 Abb. Pr. (n.s.) 395 (N.Y. Super. Ct. 1870). A small number of earlier cases applied New York law. See *Dickinson v. Edwards*, 77 N.Y. 573 (1879); *Jewell v. Wright*, 30 N.Y. 259 (1864); *Hildreth v. Shepard*, 65 Barb. 265 (N.Y. Sup. Ct. 1873); *Weil v. Lange*, 6 Daly

have found the greatest acceptance.<sup>587</sup> On the other hand, those states with very mild penalties have been able to apply the *lex debitoris* with the confidence that such a rule will not drastically affect the lender's interests.<sup>588</sup> Second, when the borrower's law merely deprives the lender of the excess interest, the borrower often has no incentive to bring legal action. The amount he can recover is usually small, and "not worth the trouble or expense of suit."<sup>589</sup> In states imposing heavy forfeitures, how-

549 (N.Y. Ct. C.P. 1876). These cases soon fell into disfavor, however, and were distinguished often on highly dubious grounds. See, e.g., *Wayne County Sav. Bank v. Low*, *supra* at 571 (dismissing the New York contacts of place-of-contracting and place-of-performance as an "incidental circumstance"). New York courts themselves frankly conceded that it was "impossible to reconcile all the cases," and simply applied the more lenient foreign law without offering any reasons: "We do not think it necessary to attempt to reconcile the cases, but simply to say that, in our judgment, . . . [the foreign law] must be applied to the case at bar." *Whitehead v. Heidenheimer*, *supra* at 593, 68 N.Y. Supp. at 706. See Note, 11 N.Y. Supp. 925-26 (1890) (citing the conflicting authorities). New York courts have recently adopted a simple rule of validation. See cases cited at note 587 *infra*. See generally RESTATEMENT, *op. cit. supra* note 580, § 526.

A similar trend is found in Arkansas, which permits a maximum interest of 10% per annum, and imposes a like penalty of absolute forfeiture. ARK. STAT. ANN. § 68-609 (1957). For a list of older Arkansas cases applying "any substantially connected law which will hold the contract valid or at least minimize the forfeiture," see LEFLAR, *THE ARKANSAS LAW OF CONFLICT OF LAWS* § 102, at 222-24 (1938). More recently, however, Arkansas has reversed this trend and has held many contracts invalid under Arkansas law. "[T]he practice of selecting as governing the law under which the allegedly usurious contract can be sustained or the forfeiture minimized may be on the way out, or already abandoned, in Arkansas. It may be now that the anti-usury policy is stronger than is the contract-validating policy which has previously been dominant in the state." Leflar, *supra* note 583, at 167. For citation of authority supporting this view see *Huchingson v. Republic Fin. Co.*, 236 Ark. 832, 836 n.3, 370 S.W.2d 185, 187 n.4 (1963).

<sup>587</sup> In *Hawkins v. Ringel*, 231 N.Y.S.2d 476, 478 (Sup. Ct. 1962), *rev'd mem.*, 19 App. Div. 2d 649, 242 N.Y.S.2d 616 (1963), the court found that "the rule appears to be that the court . . . should apply the law of the state having relation to the transaction which is most favorable to the transaction." Cf. *Franklin Nat'l Bank v. Feldman*, 42 Misc. 2d 839, 249 N.Y.S.2d 181 (Sup. Ct. 1964) (adopting the same theory for a corporate borrower). For Arkansas decisions following the same doctrine see *Cooper v. Cherokee Village Dev. Co.*, 236 Ark. 37, 44, 364 S.W.2d 158, 162 (1963) (citing additional authority).

<sup>588</sup> Kentucky, for example, allows a maximum of 6% per annum, but only deprives the lender of the excess interest charged. KY. REV. STAT. §§ 360.010-.020 (1962). No forfeiture is imposed. The foreign lender can always obtain the return of his capital plus the legal rate of interest. Accordingly, in almost every case involving an individual Kentucky borrower, the *lex debitoris* has been applied. See *Commonwealth Farm Loan Co. v. Caudle*, 203 Ky. 761, 263 S.W. 24 (1924); *Locknane v. United States Sav. & Loan Co.*, 103 Ky. 265, 44 S.W. 977 (1898); *Wm. Glenny Glass Co. v. Taylor*, 99 Ky. 24, 34 S.W. 711 (1896); *United States Sav. & Loan Ass'n v. Scott*, 98 Ky. 695, 34 S.W. 235 (1896); *Southern Bldg. & Loan Ass'n v. Harris*, 98 Ky. 41, 32 S.W. 261 (1895). The exceptions to this trend are distinguishable. *Consolidated Jewelers, Inc. v. Standard Financial Corp.*, 325 F.2d 31 (6th Cir. 1963), and *Big Four Mills, Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 211 S.W.2d 831 (1948), involved corporate borrowers, see notes 456-62 *supra* and accompanying text. *United States Sav. & Loan Co. v. Harris*, 113 Fed. 27 (E.D. Ky. 1902), which rejected Kentucky law and followed instead a line of federal cases, is no longer controlling in light of *Erie R.R. v. Tompkins*, 304 U.S. 64 (1938).

ever, the stakes are much higher, and the borrower is well rewarded should he prevail.<sup>590</sup>

The combination of these two factors has meant that a sizeable proportion of the case law in usury and conflicts comes from states which have a strong bias against the *lex debitoris*, and a strong motivation toward some theory of validation. Courts in these states have constructed, therefore, a large and potentially misleading body of precedent. Courts in states with lenient penalties should, at the very least, rely only on precedent from states with similar sanctions. They should treat cases from states having heavier sanctions with great caution: significantly different judicial attitudes are involved in these cases.

The existence of disparate penalties among the states has forced the courts to weigh the burden on the borrower of paying the higher interest rates permissible in the lender's state against the hardship to the lender which would be caused by the imposition of the forfeiture provisions of the borrower's law. The courts have apparently felt that the only choice available to them was to apply either the borrower's or the lender's law in its entirety, and have chosen the latter as the lesser of two evils. As a result, borrowers have too often been deprived of their law's protection. An approach must therefore be found by which a court can in good conscience apply the *lex debitoris*.

Perhaps the most satisfactory solution is a statutory conflicts provision. Although such provisions are rarely found in general usury statutes,<sup>591</sup> they have been incorporated into small loan legislation<sup>592</sup> with varying degrees of success.<sup>593</sup> Similar provisions might profitably be adopted in usury legislation. A state might provide that its own rates and penalties will govern any interstate loan transaction between a domestic borrower and a foreign lender unless the lender's state has a statute which is "similar in principle" to its own.<sup>594</sup> In the latter situation the law of the

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<sup>589</sup> Note, 6 RUTGERS L. REV. 568, 575 (1952).

<sup>590</sup> If the loan is for a small amount, however, even total forfeiture may be insufficient to cover the expenses of litigation.

<sup>591</sup> CONN. GEN. STAT. ANN. § 37-3 (Supp. 1965), and GA. CODE ANN. § 57-101 (Supp. 1965), however, are exceptions.

<sup>592</sup> The UNIFORM SMALL LOAN ACT § 18 (6th Draft, 1935) provides: "No loan of the amount or value of three hundred dollars (\$300) or less for which a greater rate of interest, consideration, or charges than is permitted by this Act has been charged, contracted for, or received, wherever made, shall be enforced in this State and every person in anywise participating therein in this State shall be subject to the provisions of this Act, provided that the foregoing shall not apply to loans legally made in any State which then has in effect a regulatory small loan law similar in principle to this Act." Reprinted in HUBACHEK, ANNOTATIONS ON SMALL LOAN LAWS 203 (1938).

<sup>593</sup> See HUBACHEK, *op. cit.* *supra* note 592, at 116-18.

<sup>594</sup> UNIFORM SMALL LOAN ACT § 18 (6th Draft, 1935), as reprinted in HUBACHEK, *op. cit.* *supra* note 592.

lender's state would control. There are several drawbacks to this approach. First, it would leave to the courts the power to decide what is "similar in principle." The vagueness of this standard would partially defeat the purpose of the legislation. Second, if the borrower's law would merely restrict the lender to receipt of the principal and legal interest, it is not clear why the lender's law should be applied merely because it is "similar in principle" to the borrower's.<sup>595</sup> Third, and most important, the problem caused by the courts' aversion to forfeitures would not necessarily be solved. If application of the borrower's law would impose a substantial forfeiture upon the lender, courts may be tempted to stretch the wording, "similar in principle," to cover widely divergent statutes. And when the lender's law is clearly not "similar in principle," courts will again have to choose between borrower protection and severe punishment of lenders.

Another statutory approach, used in a related area, might be adopted to provide that when a foreign lender contracts with a domestic borrower, the contract will only be enforced up to the interest maximum of the borrower's state.<sup>596</sup> The lender would lose part of the expected interest, but would not forfeit part or all of the legal interest and the principal; and the borrower would pay no more than required by his own law. The primary defect in this approach is that the deterrent protection of the borrower's sanction is lost. Foreign lenders are virtually invited to extract as much interest from forum borrowers as they can. If caught, they would be allowed to collect, at the very least, as much interest as they would have collected had they originally complied with the borrower's law.<sup>597</sup>

This second statutory proposal would be useful only if suit were brought in the borrower's state. It fails to address itself to the problem which arises when the lender brings suit in his own state against a foreign borrower, or the borrower brings suit in the lender's state to recover usurious interest already paid. Even if the lender's state has a similar conflicts statute providing that a lender can recover only the interest legal in his state, a foreign borrower from a more protective state would still be required to pay interest in excess of his own maximum, or foreclosed from recovering usurious interest already paid. Only one state, Connecticut, has addressed itself to this problem. Its usury statute provides that,

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<sup>595</sup> See argument in text accompanying notes 526-65 *supra*.

<sup>596</sup> The California Legislature has used such an approach when an out-of-state borrower has moved into California, where he is sued for interest in excess of California's statutory maximum. See CAL. FIN. CODE § 24458 (West Supp. 1966); 32 OPS. CAL. ATT'Y GEN. 121, 126-27 (1958).

<sup>597</sup> Lenders might be tempted to charge more interest than allowed by either state, and stipulate in the contract that the borrower's law would apply. Because the large bulk of usurious contracts probably are not brought into court, the lender would earn a greater profit than each state allowed domestic lenders to earn.

when the borrower is a resident of another state, or the mortgage security is located in another state, a Connecticut lender can recover interest only up to the rate of interest allowed in the state where the contract was "made" or the security was "located."<sup>598</sup>

This provision is not completely satisfactory. Should it be held that the contract was "made" in the lender's state, for example, the borrower would be denied recovery. Therefore, to cover all the aforementioned variations, a statute might be drafted to allow lenders, whether domestic or foreign, to extract from borrowers, whether domestic or foreign, interest which does not exceed the legal rate in the state where the borrower has his "home."<sup>599</sup>

In the absence of statutory solutions, courts will have to develop their own methods for balancing the interests of lender and borrower. Perhaps the best approach, and one in accord with recent American<sup>600</sup> and continental<sup>601</sup> conflicts doctrines, would be to "split" the usury statutes into two component parts. The borrower's interest maximum and penalty would be applied independently, based upon the distinct policies underlying them and the particular facts of each case. Because the purpose of interest maximums is borrower protection, the borrower's maximum would be applied when the court determined that the borrower needed protection against higher rates. Because the purpose of penalties is to discourage lenders from charging borrowers excessive sums, the borrower's penalty would be applied when the court found that future borrowers in the state needed its deterrent protection. This technique would give the courts the flexibility to protect borrowers when necessary, yet refrain from imposing severe forfeitures upon lenders when unnecessary.

A neat division between rates and penalties, however, would not be easy to apply. A court could, for example, merely enforce the contract up to the borrower's interest maximum, and impose no penalty at all.

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<sup>598</sup> CONN. GEN. STAT. ANN. § 37-3 (Supp. 1965). See *West Side Motor Express, Inc. v. Finance Discount Corp.*, 340 Mass. 669, 165 N.E.2d 903 (1960) (construing this provision in an earlier version of the statute).

<sup>599</sup> For the concept of the borrower's "home" see text accompanying notes 346-55 *supra*. This statutory solution, however, would leave the courts no flexibility in dealing with the problems of penalties.

<sup>600</sup> Cf. *Babcock v. Jackson*, 12 N.Y.2d 473, 484, 191 N.E.2d 279, 285, 240 N.Y.S.2d 743, 752 (1963); see generally *Comments on Babcock v. Jackson, A Recent Development in Conflict of Laws*, 63 COLUM. L. REV. 1212 (Cavers at 1219, Cheatham at 1229, Currie at 1233, Elrenzweig at 1243, Leflar at 1247, Reese at 1251) (1963).

<sup>601</sup> According to the doctrine of *dépeçage*, a contract's validity and performance are governed by the different laws of the places of contracting and of performance, respectively; according to the doctrine of *Spaltung*, or "splitting up," the contractual obligations of each party to a bilateral contract are "split up" and governed by the parties' own domestic laws. See Lando, *The Proper Law of the Contract*, 8 SCANDINAVIAN STUDIES IN LAW 105, 118-25 (1964); Yntema, *"Autonomy" in Choice of Law*, 1 AM. J. COMP. L. 341, 354-55 (1952).

But this approach would destroy the deterrent protection of the borrower's sanction, and would not discourage foreign lenders from repeating such transactions in the future. Alternatively, the court could apply the borrower's interest rate, but apply the lender's penalty. This approach also has disadvantages. A state's interest rates and penalties are designed to fit together, to implement its policy coordinately.<sup>602</sup> Thus, the lender's state might provide for a penalty which is identical to, or heavier than,<sup>603</sup> the borrower's, but intend it to apply only when the lender's much higher rate is exceeded, and not when a rate higher than the borrower's but lower than the lender's is exceeded.<sup>604</sup> A court which applied its own interest maximum but the lender's penalty might misapply the foreign law. And when the lender's state provided for a lighter penalty than the borrower's, its application would again undermine the deterrent protection of the borrower's sanction.

In light of these difficulties, courts must begin to formulate an exception to the *lex debitoris* which will extend to the necessitous borrower the protections guaranteed him by his law, but which will not unnecessarily penalize foreign lenders. Perhaps the most workable approach is to apply the borrower's interest maximum when the borrower needs its protection, but allow the court in its considered discretion to reduce the borrower's penalty when the lender can persuade the court that such a reduction is reasonable.<sup>605</sup> Several considerations might guide a court in justifying this divergence from a purely domestic case, and influence its determination

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<sup>602</sup> For example, some states allow high interest maximums, but impose very severe penalties for their violation; others enforce much lower rates, but impose only the lenient penalty of loss of the illegal interest charged. See statutes cited in notes 524 & 566-74 *supra*.

<sup>603</sup> When the lender's state imposes a heavier penalty than the borrower's state, the court is confronted with an avoidable conflict with respect to the issue of penalties. See text accompanying notes 394-98 *supra*. Automatic application of the lender's sanction would serve no rational purpose.

<sup>604</sup> See, e.g., R.I. GEN. LAWS ANN. §§ 6-26-2, 6-26-4 (Supp. 1965), allowing lenders to extract up to 30% interest, but imposing the severe penalty of absolute forfeiture for any interest taken in excess of this rate.

<sup>605</sup> See, e.g., *Washington Nat'l Bldg., Loan & Inv. Ass'n v. Stanley*, 38 Ore. 319, 63 Pac. 489 (1901). In this case a Washington lender charged an Oregon borrower 12% interest upon a loan. Washington law allowed 12%, and Oregon law allowed 10%. Under Washington law, lenders charging usurious interest forfeited all interest charged plus twice the interest paid; under Oregon law, such lenders forfeited all their interest and principal. The loan contract was signed in Washington, the payments were to be made in Washington, and the mortgage stipulated that Washington law should control. Nevertheless, the court held that Oregon law applied, and declared the loan usurious. However, the court applied Oregon law only in part. Because it found that Oregon's law had hitherto been unclear, and that the lender could not be accused of bad faith in negotiating the loan, the court validated the contract up to the rate of 6%. In effect, the court enforced an interest rate protective by Oregon standards, but refused to apply Oregon's sanction of total forfeiture after a finding of good faith upon the part of the lender.

as to when a reduction would be "reasonable." First, the court might point out that the insolvency of a domestic lender as a result of a forfeiture imposed upon him by his statute places a burden upon his domestic creditors as well as his state which must support him. When a foreign lender is involved, however, another state must sustain this burden, and foreign creditors will suffer. Sanctions, therefore, could be applied differently to foreign lenders.<sup>606</sup> Second, the court could consider the size of the lender's business operations. If a foreign lender carried on a substantial amount of business with individual borrowers in the borrower's state, the imposition of the borrower's full penalty might be justified in view of its future deterrent effect. But if the loan is an isolated occurrence, there is scant danger that similar loans will be made to other forum borrowers; the problem of foreign lending would be comparatively small, and the imposition of heavy forfeitures would probably have little deterrent effect on such loans.<sup>607</sup> Third, imposition of the borrower's full sanction might turn upon whether the lender knew, or should be required to know, of the lower rates and higher penalties prevailing in the borrower's state.<sup>608</sup> Again size is relevant. A small, individual lender might not have sufficient resources or legal sophistication to investigate the laws of other states. Larger institutions, however, have the facilities to determine the precise interest maximums and penalties in every state.<sup>609</sup> A lender in the latter class could not convincingly argue that the existence of lower rates in the borrower's state unfairly surprised him.<sup>610</sup> Fourth, the size of the total penalty might affect the choice of law. If the loan is small, total forfeiture would not unduly burden the lender. The corresponding gain to the borrower might be used by him to defray his court expenses. If the loan is large, however, a total forfeiture might give the borrower a wind-fall far out of proportion to the burden which the higher rates of the loan contract would impose upon him. In such cases the court might wish to reduce the penalty.<sup>611</sup>

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<sup>606</sup> Although this argument might be factually inaccurate, for example, when the lender is not driven into insolvency, it might provide a court with a theoretical justification for its departure in a multistate context from its usual domestic rule. See Leflar, *Choice-Influencing Considerations in Conflicts Law*, 41 N.Y.U.L. REV. 267, 325-26 (1966).

<sup>607</sup> Compare cases cited note 300 *supra*.

<sup>608</sup> See text accompanying notes 219-20 *supra* and text accompanying notes 636-38 *infra*.

<sup>609</sup> For an accurate, current, and easily accessible compilation, see *State Interest and Usury Laws—A Chart Setting Forth Statutory Provisions as to Legal Rates of Interest and Usurious Contracts*, 3 CCH FED. BANKING L. REP. ¶ 59,005 (Nov. 2, 1966).

<sup>610</sup> This argument might succeed, however, when the lender could show that it was overly difficult to determine the state in which the borrower would be deemed to have his "home." See text accompanying notes 351-55 *supra*.

<sup>611</sup> On the other hand, a larger amount of usurious interest is generally extracted in larger loans. The court might therefore feel that the attempted evasion was more culpable, and wish to penalize the lender more severely.

Many commentators have noted the impact of judicial abhorrence of forfeitures on conflicts decisions.<sup>612</sup> Courts themselves have confessed their dislike of forfeitures in closely related areas;<sup>613</sup> but it is a rare opinion which makes a similar confession when validating an interstate loan contract.<sup>614</sup> The reason for this reluctance is perhaps not difficult to fathom. Although courts and individual judges unquestionably desire to reach a just result in each particular case,<sup>615</sup> they also desire to minimize the appearance of subjectivity so that it might "appear that the law operates inexorably, as a blind goddess supposedly does."<sup>616</sup> Courts may feel that it is both unseemly and haphazard to adopt expressly a choice-of-law method which turns upon the impressionistic determination of when a reduction in the penalty to be imposed upon a foreign lender is "reasonable." But if this determination in fact affects the ultimate choice of law, then the interests of rational predictability are better served by openly stating this fact.<sup>617</sup> This will occur when the courts consistently apply the borrower's interest maximum to those borrowers needing its

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<sup>612</sup> See LEFLAR, *CONFLICT OF LAWS* § 124, at 236-39 (1959); NUSSBAUM, *MONEY IN THE LAW: NATIONAL AND INTERNATIONAL* 166-67 (1950); Leflar, *supra* note 583, at 167, 170; Comment, 6 *ARK. L. REV.* 26, 33 (1951). In a special note, the *RESTATEMENT, CONTRACTS* § 526 (1932) stated, "It seems . . . true that the severer the consequences of usury under a local statute, the more inclined the courts are to withdraw doubtful cases from the operation of the statute." In Comment, 5 *MIAMI L. REV.* 493, 501 (1951), it was noted that "conflicts of laws are resolved so as to uphold the validity of an agreement and the law of the forum will not be applied where it requires forfeiture or penalty."

<sup>613</sup> For example, the evidentiary presumption that the law of another state, when not before the court in the pleadings, is the same as the forum's "will not be indulged in when the laws of the forum impose a penalty or forfeiture as in the case of usury." *Mackey v. Thompson*, 153 Fla. 210, 214, 14 So. 2d 571, 573 (1943) (citing further authority). In another situation, where a contract is usurious under both relevant laws, *supra* notes 394-98, 410-11, the law imposing the lesser penalty is often imposed for the express reason of avoiding a forfeiture. "Undoubtedly, the courts will go far to defeat the claim of usury, especially where the consequences are completely fatal to the contract." *George v. Oscar Smith & Sons*, 250 Fed. 41, 61 (5th Cir. 1918) (dissenting opinion). See *Terry Trading Corp. v. Barsky*, 210 Cal. 428, 433, 292 Pac. 474, 476 (1930); *Gilbert v. Fosston Mfg. Co.*, 174 Minn. 68, 72, 216 N.W. 778, 779 (1927) ("prevents a forfeiture"); *cf.* *Columbian Bldg. & Loan Ass'n v. Rice*, 68 S.C. 236, 238, 4 S.E. 63, 65 (1903).

<sup>614</sup> For such an example see *Pellerin Laundry Mach. Sales Co. v. Hogue*, 219 F. Supp. 629, 640 (W.D. Ark. 1963), applying the lender's stricter law: "The fact that there will be a partial forfeiture of the interest in excess of 8 per cent is not so drastic as would compel this court to construe the Arkansas law as controlling in order to prevent any forfeiture at all." This is a clear recognition of the approach that, should a forfeiture be found to be drastic, the contract would be construed as governed by another state's lenient law. *Cf.* *George v. Oscar Smith & Sons*, 250 Fed. 41, 61 (5th Cir. 1918) (dissenting opinion).

<sup>615</sup> See *Siegelman v. Cunard White Star, Ltd.*, 221 F.2d 189, 206 (2d Cir. 1955) (Frank, J., dissenting).

<sup>616</sup> Leflar, *supra* note 612, at 172.

<sup>617</sup> See Leflar, *supra* note 606, at 300. For a refreshing example of this approach in the area of torts see *Clark v. Clark*, 222 A.2d 205, 209 (N.H. 1966) (Kenison, J.).



protection,<sup>618</sup> and shape the penalties to fit the exigencies of each particular case.

3. *The Desperate Borrower, the Transient Debtor, and the Problem of the Surprised Lender*

In the majority of interstate loan transactions, the borrower is solicited in his state of residence by the lender's agent or through advertisements, or he himself solicits the loan by approaching an agent or office of the lender within the borrower's state. In such cases, courts have generally felt that the lender would not be unfairly surprised if the borrower's law were applied to govern the validity of the contract.<sup>619</sup> Two situations exist, however, in which the conduct of the borrower is such that courts have occasionally felt that the application of his law to the transaction would unreasonably release the debtor from an obligation voluntarily undertaken or unfairly surprise the lender. The first involves instances where the borrower travels to the lender's state to solicit the loan; the second occurs when the borrower changes his residence after obtaining the loan. Analysis of these two situations will reveal that the second and not the first should be treated as a possible exception to the *lex debitoris*.

(a) *The Borrower's Solicitation of the Loan.*—Loan transactions are occasionally initiated by borrowers who, either by mail or telephone, directly approach a foreign lender in his own state. In some cases the borrower may actually travel to the lender's state and personally negotiate a loan. When a contract would be usurious under the lender's law and valid under the borrower's law, courts have quite sensibly validated the contract by applying the law of the borrower's state.<sup>620</sup> Of greater difficulty, however, are those cases in which a borrower actively solicits a loan in another state and binds himself to pay interest in excess of that allowed by his own state.

Courts validating such contracts have generally used two arguments. Some have apparently contended that the borrower, much like a species of protected wildlife leaving its game preserve, must fend for himself

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<sup>618</sup> This assumes that the lender has been unable to rebut the *lex debitoris* presumption by arguing that the borrower has sufficient bargaining power to be allowed to contract at the higher rates of interest allowed by foreign states. See notes 432-37, 472-74 *supra* and accompanying text.

<sup>619</sup> "When parties come into this state . . . and loan money to a citizen of this state upon real-estate security situated here, they must expect to have the validity of the contract determined by the laws of this state." *Fidelity Sav. Ass'n v. Shea*, 6 Idaho 405, 416, 55 Pac. 1022, 1025 (1899).

<sup>620</sup> See *Arnold v. Potter*, 22 Iowa 194, 201 (1867); *Van Schaick v. Edwards*, 2 Johns. Cas. 355 (N.Y. 1801). See generally text accompanying notes 367-79 *supra*.

once he foresakes the sanctuary of his own state.<sup>621</sup> Others have felt that any borrower who leaves his state to obtain a loan from a businessman in another state, and then attempts to raise the defense of usury under his own law, must somehow be attempting to perpetrate a fraud upon the lender.<sup>622</sup> Courts refusing to validate such contracts, on the other hand, have argued that merely because a loan is negotiated outside the borders of the borrower's state is not sufficient to allow foreign lenders to nullify the protection of the borrower's usury laws.<sup>623</sup> Both arguments have merit, but only within the context of a clear discussion of bargaining power. Neither argument deals with the preliminary question of which borrowers have sufficient experience and bargaining power to be allowed to reach outside their state for funds.

Loan transactions are no doubt frequently entered into deliberately and cautiously by businessmen and private individuals who are able to assess and to pay the price of loan funds. Because these borrowers do not need the protection of their laws, they should be allowed to seek needed capital elsewhere.<sup>624</sup> Only after a court first makes this preliminary determination of bargaining power should it invoke the arguments for validation.

These arguments do not apply, however, to borrowers who clearly lack the experience or foresight to recognize the extent of, or their capacity to meet, contractual obligations assumed while negotiating from a position of extreme bargaining inequality. It is precisely this type of borrower that his state wishes to protect. Borrowers who are sufficiently desperate to leave their own states to obtain loans, after exhausting their credit at

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<sup>621</sup> "If our citizens choose to apply for loans to corporations in other states . . . they must abide by their agreement that the laws of that state shall govern in such matters." *Steinman v. Midland Sav. & Loan Co.*, 78 Kan. 479, 482-83, 96 Pac. 860, 861 (1908). See *Whitman v. Green*, 289 F.2d 566, 568 (9th Cir. 1961).

<sup>622</sup> "Certainly the [borrower] knew that 8 per cent was unlawful in Tennessee . . . . Surely he did not intend by stipulating 8 per cent to provide means of escaping payment of an honest debt. . . . The contract in question cannot be referred to Tennessee [forum] law without imputing bad faith to the [borrower] . . . ." *Bowman v. Price*, 143 Tenn. 366, 383, 226 S.W. 210, 215 (1920). See *Wayne County Sav. Bank v. Low*, 81 N.Y. 566, 571-72 (1880). Were this position universally adopted, any borrower who knew the contract rate was in excess of his legal maximum would automatically be deprived of its protection.

<sup>623</sup> "[I]t is unimportant where the contract was made . . . [for] it would be a novel doctrine if the usury laws of a state could not be violated by a transaction agreed upon outside its bounds." *Tallman v. Union Loan & Trust Co.*, 161 Ark. 614, 618, 256 S.W. 379, 381 (1923). See also *Jones v. Tindall*, 216 Ark. 431, 226 S.W.2d 44 (1950) (the lender's agent brought the borrower to the lender's state to sign the contract).

<sup>624</sup> See text accompanying notes 439-74 *supra*. In *Bowman v. Price*, 143 Tenn. 366, 383, 226 S.W. 210, 215 (1920), the borrower was described as a "business man" who was "presumed" to know the interest rates of both states. See also *Pioneer Credit Corp. v. Radding*, 149 Conn. 157, 176 A.2d 560 (1961) (corporate borrower went to the lender's office in the foreign state).

home, should not be deprived of their law's protection. These borrowers need that protection as much as, if not more than, other borrowers. The fact that a borrower actively solicits a loan, or even leaves his state to obtain a loan, should be considered totally irrelevant to the controlling issue of borrower protection. The lender should be allowed to rebut the presumption of the *lex debitoris*, not by showing that the borrower actively solicited the loan, but by demonstrating that the bargaining power<sup>625</sup> or economic<sup>626</sup> exceptions should be applied.

From the lender's point of view, two arguments have been made against application of the *lex debitoris* to such a situation. The first is that the economic burden of forcing the lender to adjust every out-of-state loan to the requirements of the borrower's state is too great.<sup>627</sup> The argument posits that a lending institution has the right to "legitimately lend funds outside [its] state and stipulate for repayment . . . in accordance with its laws and . . . rate of interest . . .,"<sup>628</sup> and that application of the borrower's law will "disturb the comity, and embarrass the intercourse which should exist" between the states.<sup>629</sup> The short answer to this laissez-faire argument is that lenders do not have the right to transact business in disregard of other states' laws. It is certainly illogical to set aside a protective statute on the ground that it unfairly burdens those persons it is designed to deter. The more temperate reply is that the burden upon the lender is not so great as might be feared. In light of a rapidly proliferating body of consumer credit and loan legislation, it cannot be unduly burdensome merely to require lenders to ascertain the state of the borrower's residence, and to comply with its interest maximums.<sup>630</sup> Certainly the value of borrower protection will outweigh the extra administrative inconvenience to the lender.

This judgment is reflected in a recent regulation issued by the Secretary of Defense and which affects all lenders and sellers exercising

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<sup>625</sup> See text accompanying notes 438-517 *supra*.

<sup>626</sup> See text accompanying notes 518-618 *supra*.

<sup>627</sup> See text accompanying notes 221-32 *supra*.

<sup>628</sup> *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 407 (1927).

<sup>629</sup> *Bowen v. Bradley*, 9 Abb. Pr. (n.s.) 395, 399 (N.Y. Super. Ct. 1870). "[W]ithin our closely-knit economy, we expect people to trade and extend credit freely across state lines. When the seller or lender is selling or lending to customers who have sought him out in his own market and wish to engage in transactions that are in accord with the laws prevailing there, the case for allowing him the benefit of those laws would ordinarily be a strong one." CAVERS, *THE CHOICE-OF-LAW PROCESS* 189 (1965).

<sup>630</sup> "Sometimes . . . the size and circumstances of the transactions would render it reasonable to require the local businessman to look into the legal situation of his customer under the laws of the latter's home state and to subject the former to the limitations they impose." CAVERS, *op. cit. supra* note 629, at 189. *Cf. Lilienthal v. Kaufman*, 239 Ore. 1, 395 P.2d 543 (1964). Compilations of all state laws are readily accessible. See chart of *State Interest and Usury Laws*, *supra* note 609.

the privilege of financing loans or credit sales of merchandise to members of the Armed Forces.<sup>631</sup> The regulation expressly rejects the doctrine, "Let the buyer beware,"<sup>632</sup> and states that businessmen wishing to obtain the assistance of the Defense Department in enforcing the obligations of servicemen<sup>633</sup> must comply with a number of "Provisions Desirable to Insure Fairness."<sup>634</sup> The first of these provides: "No finance charge made shall be in excess of the charge which could be made under the law of the place in which this contract is signed by the serviceman."<sup>635</sup>

This regulation embodies two fundamental policies. First, lenders and sellers will no longer be able to force their own laws upon borrowers and buyers in other states. The borrower's or buyer's law will govern the transaction. Second, although businessmen will be forced to discover and conform to the borrower's law, this additional economic and administrative burden is considered justifiable to effectuate the policy of borrower protection. If a lender is to earn his livelihood from the interest paid by out-of-state borrowers, then the least he can do is comply with their laws. This recent Department of Defense regulation, at least, has rejected the lender's argument that application of the *lex debitoris* imposes too great an economic burden upon the lender.

The lender's second argument against application of the *lex debitoris* stresses the problem of unfair and prejudicial surprise. When a borrower approaches a lender in his own state, there may be no indication that the borrower comes from out-of-state; to apply suddenly a stricter foreign law would unfairly prejudice the lender. This argument is weak. No intelligent lender would consider lending money without first determining the residence of the borrower. This inquiry is critical for evaluating the borrower's credit rating and security, and for facilitating the loan's enforcement. Because all but three states impose a maximum interest rate on loan contracts, lending institutions<sup>636</sup> can easily be placed on constructive notice of the borrower's law.<sup>637</sup> Unless the borrower managed to deceive

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<sup>631</sup> 32 C.F.R. Pt. 43 (1965) (Personal Commercial Affairs).

<sup>632</sup> 32 C.F.R. § 43.2 (1965).

<sup>633</sup> When a serviceman's obligation falls into default, a businessman only has the recourse of contacting that serviceman's superior officer and requesting him to speak to the soldier. If this aid is withdrawn, businessmen would have no way of enforcing their collections.

<sup>634</sup> 32 C.F.R. app. A, at 19 (1965).

<sup>635</sup> *Ibid.* The place where the contract is signed, however, may be completely fortuitous. The state where the serviceman was stationed would be a more reliable and predictable "contact."

<sup>636</sup> Exceptions might be made for individual lenders, see text accompanying notes 608-10 *supra*.

<sup>637</sup> CAVERS, *op. cit. supra* note 629, at 193, suggests that married women's contracts were at one time so common that the "requirement that the banker or merchant check the possible existence of these disabilities in dealing with a married woman from another state

the lender into thinking he resided in a state with a higher maximum rate than his home state, or there was some question as to the location of the borrower's home state,<sup>638</sup> the lender could not convincingly argue surprise against application of the borrower's law. The borrower's solicitation of the loan, therefore, should not be considered enough to create an exception to the *lex debitoris*.

(b) *The Transient Debtor*.—On the 25th of May, 1964, Robert Lyles, a resident of Tennessee, purchased an automobile in Arkansas from the McCaa Chevrolet Company. The conditional sales contract was signed at McCaa's office in Arkansas and immediately assigned to the Union Planters National Bank of Tennessee. The latter had extended credit to Lyles on several previous occasions. The contract provided for payments to be made at McCaa's office, "or at such office of any assignee as may be hereafter designated," and Lyles apparently made his payments at the Tennessee bank. Had Lyles defaulted upon his payments at this moment and been sued in either Tennessee or Arkansas, the conflict would have been "avoidable," and most courts would have denied him the defense of usury.<sup>639</sup> The contract would have been valid under the *lex debitoris*. But one event occurred which made Lyles' case unique: on October 16, 1964, he established residence in Arkansas. Union Planters filed an action for replevin in Arkansas to repossess the automobile, and Lyles raised the defense of usury under Arkansas law.<sup>640</sup>

This case, *Lyles v. Union Planters Nat'l Bank*,<sup>641</sup> aptly poses the problem of the transient debtor. Which law should be applied to a loan contract valid under the law of the borrower's home at the time he signed the contract, but usurious under the law of the borrower's new home? The court in *Lyles* chose to apply the *lex debitoris* at the time of the suit, and imposed a total forfeiture upon the bank. It failed, however, to provide any rational basis for this decision, and turned instead to traditional

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would not have taken him unawares." This argument applies with even greater force to usury statutes.

<sup>638</sup> See text accompanying notes 352-55 *supra*.

<sup>639</sup> Since the contract was valid under the law of the borrower's state, the case presented an avoidable conflict, see text accompanying notes 367-79 *supra*. No purpose could be served by applying Arkansas law: Arkansas had no interest in having its law applied, and Lyles had no right to demand the protections of Arkansas law, see note 349 *supra*.

<sup>640</sup> It was agreed that the contract was valid under Tennessee law, but usurious under Arkansas law. Under Arkansas law, but not Tennessee law, conditional sales contracts are subject to the provisions of the general usury statute. *Hare v. General Contract*, 220 Ark. 601, 249 S.W.2d 973 (1952). That statute provides for a maximum interest of 10% per annum, and an absolute forfeiture if a violation occurs.

<sup>641</sup> 393 S.W.2d 867 (Ark. 1965). Compare *Townsend v. Riley*, 46 N.H. 300 (1865) (also involving a transient debtor).

conflicts concepts. It held that, in the absence of a contrary intent, the law of the place of contracting should apply.<sup>642</sup> The problem of surprise to the lender is ignored. Given the increased mobility of debtors today,<sup>643</sup> the arguments which the court might have considered for and against invalidation are thus of particular importance.

The possible arguments for validation by applying the lender's law or the law of the borrower's former residence would stress the unfairness of surprising the lender: The lender, it might be contended, cannot reasonably be expected to examine the laws of all fifty states into which the borrower might move, and tailor the transaction to comply with all of them.<sup>644</sup> The lender should not be punished, for at the time of the transaction he had done nothing wrong; he can not be deterred, for he had no reason to anticipate the application of a different law. Arguably, therefore, the doctrine of the *lex debitoris* must be construed as referring to the law of the borrower's former home.<sup>645</sup> Imposition of the law of the borrower's new home would unfairly penalize the lender.

The arguments for invalidation under the law of the borrower's new home rest upon the goal of borrower protection: "The possibility of foreign debts forcing . . . new residents onto the relief rolls is a very real one,"<sup>646</sup> and "the danger that they might become public charges . . . [is] of grave concern to the state."<sup>647</sup> In fact, the higher the interest charged in the contract, the greater is the danger to the interests of the borrower and his newly adopted state.<sup>648</sup> Arguably, therefore, despite the unexpected loss to the lender, the overriding policy of borrower protection demands application of the *lex debitoris*.<sup>649</sup>

<sup>642</sup> 393 S.W.2d at 869.

<sup>643</sup> See DERVIN, *THE SPENDER SYNDROME: CASE STUDIES OF 68 FAMILIES AND THEIR CONSUMER PROBLEMS* *passim* (1965).

<sup>644</sup> Cf. *Bernkrant v. Fowler*, 55 Cal. 2d 588, 12 Cal. Rptr. 266, 360 P.2d 906 (1961); *People v. One 1953 Ford Victoria*, 48 Cal. 2d 595, 311 P.2d 480 (1957); Traynor, *Is This Conflict Really Necessary?*, 37 TEXAS L. REV. 657, 673 (1959).

<sup>645</sup> Compare RESTATEMENT (SECOND), CONFLICT OF LAWS § 346h(1) & Illustration 4, at 112 (Tent. Draft No. 6, 1960), in which the validity of a life insurance contract is to be determined by the "law of the state where the insured was domiciled at the time the policy was issued."

<sup>646</sup> 32 OPS. CAL. ATT'Y GEN. 121, 126-27 (1958). See generally Brunn, *Wage Garnishment in California: A Study and Recommendations*, 53 CALIF. L. REV. 1214, 1229-38, 1243-45 (1965).

<sup>647</sup> *Alaska Packers Ass'n v. Industrial Acc. Comm'n*, 294 U.S. 532, 542 (1935). See M. Traynor, *Conflict of Laws: Professor Currie's Restrained and Enlightened Forum*, 49 CALIF. L. REV. 845, 859-60 (1961).

<sup>648</sup> See 32 OPS. CAL. ATT'Y GEN. 121, 127 (1958).

<sup>649</sup> Cf. *Sun Ins. Office, Ltd. v. Clay*, 133 So. 2d 735 (Fla. 1961), *aff'd*, 377 U.S. 179 (1964), (Florida law applied to defeat twelve-month limitation-on-time-for-suit clause in property insurance contract made in Illinois, valid by Illinois law, where owner of policy moved to Florida before property destroyed); *Lilienthal v. Kaufman*, 239 Ore. 1, 395

Application of either alternative will adversely affect the interests of one party. Since no reconciliation between these conflicting arguments seems possible, a compromise is necessary. California, in its Personal Property Brokers Law, has made the most satisfactory attempt to reach such a compromise. The Broker's Law provides that loans "made outside the state"<sup>650</sup> will be enforced only "to the extent of but not to exceed" the sum of charges permissible upon a loan "of the same amount made within this state."<sup>651</sup> Thus, were a similar statute in effect in *Lyles v. Union Planters Nat'l Bank*, Arkansas could have applied its own maximum of ten per cent, but not its sanction of absolute forfeiture. Lyles would still be required to perform his obligation at the reduced rate. The interests of Arkansas would be fully served by restricting the rate to ten per cent.<sup>652</sup> Application of Arkansas's forfeiture would punish unjustifiably and would not deter.<sup>653</sup>

In the absence of statutory guidelines, courts will have to create their own compromise between the conflicting interests of borrower and lender.

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P.2d 543 (1964) (Oregon law applied to invalidate contract made in California by Oregon spendthrift, where California party had no warning of applicability of Oregon's law).

<sup>650</sup> CAL. FIN. CODE § 22459. 32 OPS. CAL. ATT'Y GEN. 121, 126-27 (1958) applies this statute to contracts made between two persons who both reside outside the state. It is arguable, however, that this statute would apply equally to a contract between a California borrower and a foreign lender which is "signed," and thus for conflicts purposes, "made" outside the state. If so, California borrowers would receive the protection of the *lex debitoris* in virtually every interstate loan contract. No case, however, has interpreted this statute. In *Ury v. Jewelers Acceptance Corp.*, 227 Cal. App. 2d 11, 38 Cal. Rptr. 376 (1964), the issue was not timely raised and therefore not considered. Cf. *People v. Fairfax Family Fund, Inc.*, 235 Cal. App. 2d 881, 47 Cal. Rptr. 812 (1964).

<sup>651</sup> CAL. FIN. CODE § 22459. See CAL. FIN. CODE §§ 22053, 22458-60.

<sup>652</sup> A situation might arise, however, in which the state of the borrower's former residence might be interested in having its law applied. Assume, for example, that the state of the borrower's new residence has a higher interest maximum than the borrower's old state, and that the contract is usurious under the law of the old state, but valid under the law of the new state. As far as the borrower's new state is concerned, the contract poses an avoidable conflict, see text accompanying notes 367-79 *supra*, and should be validated. However, an argument might be made that the old state's law should be applied to declare the contract usurious upon the grounds that validation would give an undeserved windfall to the lender, and would create disrespect for the deterrent effectiveness of the old state's law. This argument would probably fail. Once the borrower has moved his residence, the old state is no longer concerned with the rate of interest he pays. And because the lender would have no way of foreseeing the borrower's move into a more lenient state, the deterrent effectiveness of the old state's sanction would not be undermined.

<sup>653</sup> Application of Arkansas's entire forfeiture provision, however, would apparently not be subject to attack under the full-faith-and-credit or due process clauses. The residence of the borrower in Arkansas would give that state a legitimate interest in applying its law. See, e.g., *Alaska Packers Ass'n v. Industrial Acc. Comm'n*, 294 U.S. 532 (1935); Currie, *The Constitution and the Choice of Law: Governmental Interests and the Judicial Function*, 26 U. CHI. L. REV. 9, 75 (1958), reprinted in, CURRIE SELECTED ESSAYS ON THE CONFLICT OF LAWS 188, 271 (1963).

When the contract is valid under the borrower's old law but usurious under the new law, the more protective approach would be to apply the interest maximum of the borrower's new state, but impose no penalty whatsoever. The lender would only be deprived of a part of his expected return. The less protective method would be to apply the validating law of the lender's state or the borrower's old state. When a court follows this latter approach on the grounds that the borrower, under the facts of the particular case, is better able to pay the extra interest than the lender is able to forego it, the case of the transient debtor will constitute a limited exception to the application of the *lex debitoris*.

#### CONCLUSION

Nineteenth century doctrines of laissez-faire and freedom of contract are dead or dying. Yet their ghosts linger on to haunt the judicial mind. The world of reality is a world of adhesion contracts, ignorant borrowers, hidden charges, and deceptive advertising. But the world of judicial language is the world of "presumed intentions," "substantial relationships," "concessions to trade and commerce," and "special rules of validation." In the world of reality, great numbers of unskilled and semiskilled workers pay between forty and sixty per cent interest a year to large interstate lending corporations on debt consolidation loans.<sup>654</sup> In the world of judicial language, however, it is said that without validation of such loans "the commerce of the world would soon lapse into a chaotic state."<sup>655</sup> The two worlds are badly out of joint. A fresh analysis is required to bring them together.

American economic life is no longer conducted on a cash-and-carry basis. It is marked by an explosive growth in the use of consumer credit. With this development has come a concomitant growth in interstate lending, and today consumer credit companies have branches which operate in virtually every state in the union.<sup>656</sup> Yet the abuses which have accompanied this development have too often gone unchecked. The protective laws of usury and the legal doctrines of conflicts law have long been dominated by rigidity and dogma, and this has allowed foreign lenders to evade with ease the interest maximums enacted by the borrowers' states. Usury laws, often antiquated and crudely designed, are unable to discriminate between borrowers who do and do not need their protection. And choice-of-law rules, overly generalized and highly conceptual, often fail to reflect the conflicting economic and social policies of

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<sup>654</sup> 162 CONG. REC. 22015-17 (daily ed. Sept. 2, 1965) (remarks of Rep. Weltner).

<sup>655</sup> *Lilienthal v. Kaufman*, 239 Ore. 1, 9, 395 P.2d 543, 546 (1964) (spendthrift statute case, court referring to usury cases).

<sup>656</sup> 162 CONG. REC., *op. cit.* *supra* note 654, at 22017.



the various states. Courts have thus been handicapped by two sets of dogma, and as a result their efforts to chart a path between the necessities of individual borrowers, the demands of trade and commerce, and the legal principles of contracts and conflicts, have often ended in chaos. The law of usury and conflicts must deal in practicalities. A rational mechanism of choice must be built upon the policies underlying interest regulation.

These policies rest upon borrower protection. The ancient origins of the prohibitions against usury do not preserve archaic remnants of curious moralities or forgotten economies; rather, they reflect a continuing expression of concern for borrowers who, from necessity, weakness, or ignorance, are driven into oppressive contracts for the loan of money. This concern is today embodied in the interest regulations of each state. Because each borrower can only be deemed protected by his own law, the doctrine of the *lex debitoris*, or rebuttable presumption that the debtor's law will always be applied, must be the point of departure for any choice-of-law analysis of interstate loan contracts. The *lex debitoris* will be applied whenever the conflicts issue is avoidable, or, when it poses an essential conflict, the lender is unable to present to the court a justification for depriving the borrower of his law's protection. The lender will typically fail in this attempt when the borrower is an individual with relatively weak bargaining power.

Contracts will be validated by application of the lender's law when the lender can overcome the presumption of the *lex debitoris*. He will usually succeed when the borrower is a corporation, and occasionally when the borrower is an experienced individual. But when an individual suffering from the disabilities of inferior bargaining power has been forced to incorporate to avoid a particular interest maximum, the corporate exception will not be effective to validate the contract. The *lex debitoris* will be applied when the borrower's law merely deprives the lender of the interest in excess of the borrower's legal maximum. But when the *lex debitoris* would impose a forfeiture upon the lender which would outweigh the burden imposed upon the borrower under the loan contract, the borrower's interest maximum and penalty provisions will be "split" apart: The borrower will pay no more than his legal maximum permits, and the court in its discretion will adjust the penalty to be paid by the lender to fit the exigencies of each particular case. Finally, when the borrower leaves his state to solicit a loan, the lender will nevertheless be presumed to know the borrower's law and held to its standards. But when the borrower moves his residence to another state following the original transaction, the court will be forced to weigh the merits of borrower protection, as defined by the standards of the borrower's new state, against the values

of supporting lender expectations. The lender will prevail only when the latter is felt to be of greater importance.

The presumption of the *lex debitoris*, set against its countervailing exceptions, provides a flexible tool for analysis of interstate loan contracts. The court's choice of law will turn, not upon abstract theories or mechanical rules, but upon the merits and strengths of the policies underlying commercial transactions and borrower protection. A rational law of usury and conflicts will slowly grow, enabling each state to afford its borrowers the full and discriminating protection of their own laws.

*Tracy A. Westen*

# California Law Review

VOL. 55

APRIL 1967

No. 1

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