USURY — CONSUMER CREDIT — REVOLVING CHARGE ACCOUNTS FALL UNDER THE IOWA USURY LAWS — *State ex rel. Turner v. Younker Brothers*, 210 N.W.2d 550 (Iowa 1973).

INTRODUCTION

Since 1965 Younker Brothers, Inc., has operated a revolving credit plan under which customers are allowed to charge items which they purchased. Customers not paying the full price of the goods charged within thirty days of billing are assessed a one and one-half percent per month finance charge on the unpaid balance.[1] Richard Turner, in his capacity as Attorney General of Iowa, and also in his individual capacity, brought an action against Younkers alleging this credit plan violated the Iowa usury statute.[2] Turner contended that the 1 1/2 percent per month finance charge resulted in interest payments computed at eighteen percent per year — usurious and illegal under sections 535.4[3] and 535.2[4] of the Iowa Code which allow an interest ceiling of nine percent.

The trial court found for Younkers, holding that an earlier Iowa decision, *Gilmore & Smith v. Ferguson & Cassell* [*Gilmore*],[5] had recognized the "time price doctrine" to be applicable to the Iowa usury statute, thus removing the credit sale of property from the nine

1. For a more detailed description of the Younkers' revolving charge plan see: State *ex rel.* Turner v. Younker Bros., 210 N.W.2d 550, 553 (Iowa 1973) [hereinafter cited as *Younker*].

2. Turner also challenged Younkers' retail installment contract plan which contained a 16.25% annual interest rate. *Younker* at 553. Due to the limited scope of this note, that portion of the suit will not be considered. However, the arguments presented to demonstrate the need for consumer credit rates in excess of nine percent for revolving charge accounts are equally applicable to installment credit contracts.

3. IOWA CODE ANN. § 535.4 (1946):

> No person shall, directly or indirectly, receive in money or in any other thing, or in any manner, any greater sum or value for the loan of money, or upon contract founded upon any sale or loan of real or personal property, than is in this chapter prescribed.

4. Section 535.2 limits the rate of interest that can be charged to "five cents on the hundred by the year . . . unless the parties shall agree in writing for the payment of interest not exceeding nine cents on the hundred by the year . . . . " IOWA CODE ANN. § 535.2 (Cum. Pamphlet 1973).

5. 28 Iowa 220 (1869).

percent interest limitation. The time price doctrine protects interest on credit sales from the strictures of a usury statute if two elements coalesce in the credit transaction: (1) there is a sale of property, and (2) the buyer's time for payment is extended beyond the purchase date.[6]

The Iowa supreme court reversed, overruling those portions of the *Gilmore* decision inconsistent with the present ruling. The court held that section 535.4 expressly covered *any* sale of property on credit, contrary to the usury statutes of most states, and thus expressed a legislative intent to reject the application of the time price doctrine in Iowa. The court held that the four elements which constituted usury in Iowa were present in Younkers' credit transactions; therefore, the interest rates charged by the store were usurious.[7]

The Iowa supreme court directed the district court to issue a permanent injunction enjoining Younkers from assessing its finance charges at a rate in excess of nine percent per year. It also ruled that those who had been paying usurious rates under the Younkers credit plan had no right to recovery. It is settled law in Iowa that "usurious interest" once paid cannot be recovered from the creditor.[8]

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6. The time price doctrine was defined by the United States Supreme Court in Hogg v. Ruffner, 66 U.S. (1 Black) 115, 118 (1861) where the court stated: "[I]t is manifest that if A propose to sell to B a tract of land for $10,000 in cash, or for $20,000 payable in 10 annual installments, and if B prefers to pay the larger sum to gain time, the contract cannot be called usurious." In 1926, the Alabama supreme court extended the application of the time price doctrine to the credit purchase of personal property. Commercial Credit Co. v. Tarwater, 215 Ala. 123, 110 So. 39 (1926). Most states have adopted Alabama's extension of the doctrine. *See, e.g.*, Cady L. Daniels, Inc., v. Fenton, 97 Colo. 409, _____, 50 P.2d 62, 63 (1935); District of Columbia v. Hamilton Nat'l Bank, 76 A.2d 60, 67 (D.C. Mun. Ct. App. 1950); Yeager v. Ainsworth, 202 Miss. 744, _____, 32 So. 2d 548, 550 (1947).

7. The four elements of the test are: 1) there must be a forebearance by the creditor—the court found this element in Younkers' extension of the time for payment. *Younker* at 562; 2) there must be an understanding between the parties that the principal shall be repayable absolutely—the court found that there was no question as to the existence of this element as all items purchased on credit had to be paid for in full. *Younker* at 560; 3) there must be exaction of greater profit than allowed by law—the court found that Younkers' eighteen percent interest rate resulted in a greater profit than the nine percent allowed by law. *Younker* at 561; 4) there must be an intention to violate the law—the court found the requisite intent existed because Younkers intended to assess a finance charge in excess of the nine percent allowed by law. *Younker* at 563. The usury test applied by the court was applied by the Wisconsin supreme court in State v. J.C. Penney Co., 48 Wis. 2d 125, _____, 179 N.W.2d 641, 645 (1970), when it found interest charges by the Penney Company on its credit transactions to be usurious. The test was later adopted by the South Dakota supreme court in 1972 when it found revolving credit rates usurious in that state. Rollinger v. J.C. Penney Co., 192 N.W.2d 699, 701 (S.D. 1972).

8. Phillips v. Gephart, 53 Iowa 396, 5 N.W. 683 (1880). Unlike Iowa, most states allow the debtor to recover interest paid at usurious rates. In the District of Columbia, for example, usurious interest payments can be recovered within a year after the payment is made. D.C. CODE ENCYL. ANN. § 28-3304 (1967). The Uniform

By its decision in the *Younker* case, the Iowa supreme court has decreed that the nine percent maximum interest charge contained in the Iowa usury statute is applicable to *all* forms of interest-bearing credit transactions. The potential impact of this decision upon the availability of consumer credit in Iowa and, ultimately, upon the growth of that state's economy, is great. The decision has created a situation which will, in all probability, require action by the Iowa Legislature. The necessity for that action, and its probable course, can only be comprehended with an understanding of the factors which prompted the court's decision and the effect the imposition of a nine percent interest rate level will have upon consumer buying in our credit-oriented society.

THE GROWTH OF CONSUMER CREDIT

Following World War II, credit trends in America changed dramatically. Earlier in our history, cash-on-the-barrel-head had been the economic way of life for the vast majority of Americans. Large purchases were financed, if at all, by loans obtained from banks or other lending institutions. Smaller purchases simply were not financed.[9] The end of World War II saw a tremendous demand for consumer goods and a consequent increase in production. This growth in economic activity brought with it an increasingly higher standard of living.[10] When people, desirous of more and better consumer goods, saw their ready supply of cash dwindling after purchasing appliances, furniture and clothing, a new economic concept appeared on the market to assure their continued access to consumer

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Consumer Credit Code also provides for the recovery of interest paid. UNIFORM CONSUMER CREDIT CODE § 5.202(3) (1969 version). In several states stiffer penalties are assessed. In Alaska, for example, a debtor is allowed to recover double the usurious interest paid. ALASKA STAT. § 45.45.030 (1962). In California three times the interest paid can be recovered. CAL. CIV. CODE § 1916-3 (West Supp. 1973).

9. M. NEIFELD, NEIFELD'S MANUAL ON CONSUMER CREDIT 428-29 (1961) [hereinafter cited as NEIFELD]. While there was a minimal amount of installment buying prior to the World War II dividing line ($4.5 billion in 1939) the real growth in consumer credit purchases followed the close of that conflict. P. MCCRACKEN, J. MAO, & C. FRICKE, CONSUMER INSTALLMENT CREDIT AND PUBLIC POLICY 6 (1965) [hereinafter cited as MCCRACKEN]. The $4.5 billion seems insignificant when one considers that between 1950 and 1971 the amount of consumer credit outstanding rose from $21.5 billion to $137.2 billion. The use of consumer credit in 1950 was five times as large as it was in 1939, and by 1971 it was over thirty times as great as the 1939 figure. REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT THE UNITED STATES 5 (1973).

10. I. MICHELMAN, CONSUMER FINANCE: A CASE HISTORY IN AMERICAN BUSINESS 284-85 (1st ed. 1965).

goods: easily obtainable retail consumer credit. The vehicles most commonly employed by retail concerns in offering this credit took two forms: first, the installment sales plans, which had been utilized prior to the war in the sale of automobiles and were later streamlined to handle credit purchases of other consumer goods; and second, the revolving charge plans, which appeared after the war and were designed by retail concerns to actively exploit the insatiable demand for consumer goods with no downpayment and easy repayment terms.[11]

The revolving charge plan (or charge account)[12] generally takes the form of an agreement between the customer (normally an ordinary consumer) and the seller (usually a large retail outlet) under which the consumer is permitted to purchase merchandise from the seller by using a credit card given him by the retailer. If the buyer pays for the goods within a specified period of time, the item does not appear on his monthly bill and no interest charge is assessed for the purchase. However, if the item is not paid for within the grace period, a service charge is levied.[13]

The economic foresight of retail merchants in developing the revolving credit concept is proven by the wide use of credit cards. It is estimated that in 1970 Americans held over 300 million credit cards and used them to purchase more than fifty billion dollars worth of goods and services.[14] With the population of the United States at just

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11. Neifeld traces the evolution from installment credit to revolving credit by retail concerns in their efforts to develop consumer purchasing power to its maximum level. As the demand for credit grew, installment credit with its large down payments and required weekly or monthly repayments was gradually replaced in many credit transactions with revolving credit accounts which required no downpayment and allowed flexible weekly or monthly repayment terms. NEIFELD at 429-32.

12. Under the Truth In Lending Act, 15 U.S.C. §§ 1601 *et seq.* (1970), credit accounts of this nature are labeled open end consumer credit plans. Regulation Z describes an open end account as one in which

> (1) the creditor may permit the customer to make purchases or obtain loans, from time to time, directly from the creditor or indirectly by use of a credit card, check, or other device, as the plan may provide; (2) the customer has the privilege of paying the balance in full or in installments; and (3) a finance charge may be computed by the creditor from time to time on an outstanding unpaid balance.

Reg. Z, 12 C.F.R. § 226.2(r) (1973).

13. An example of a revolving charge account agreement can be found in *Consumer Credit Symposium: Development in the Law,* 55 NW. U. L. REV. 301, 352 (1962). The sample would have to be rewritten somewhat to meet the comprehensive disclosure requirements for open end credit under the Truth In Lending Act, 15 U.S.C. § 1637 (1970), but it suffices to reveal the basic structure of revolving credit arrangements utilized by most retail concerns.

14. H.R. REP. No. 1500, 91st Cong., 2d Sess. (1970) [hereinafter cited as H.R.

over 200 million in 1970,[15] every American on the average owned one and one-half credit cards. Americans have clearly come to rely on the credit card as one of their major borrowing sources for financing all types of property acquisitions.

Despite its popularity, however, the sailing has not been entirely smooth for consumer credit in the form of the revolving charge account. The vast majority of states in this country still have on their books usury statutes similar to the Iowa statute discussed in the *Younker* decision.[16] In the past decade, there have been challenges in several states based upon the theory that the interest resulting from the revolving charge system was usurious within the meaning of the state's usury statute. The "service charge" levied on a monthly basis is generally construed as akin to ordinary interest. Though the monthly rate is small, when compounded at its annual rate, the charges are above the usury levels set by most states.[17]

The Supreme Court of Massachusetts in 1965 was the first court to hear a case in which the interest rate assessed by a revolving charge account was challenged as exceeding state interest ceilings.[18] The

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REP. No. 1500]. *See also* Comment, *The Apportionment of Credit Card Fraud Loss*, 4 U. CAL. DAVIS L. REV. 377 (1971).

15. U.S. BUREAU OF CENSUS, I CENSUS OF POPULATION: 1970 pt. A, at 1-41 (1973).

16. All fifty states have some type of usury statute. A compilation of these statutes appears at 1 CCH CON. CRED. GUIDE ¶ 510, at 1301-08.

17. NEIFELD at 437:

> As various forms of [revolving charge accounts] came into being . . . the statutory rate allowed for interest was insufficient to cover the added cost of the credit operation in the retail store. A service charge of 1% a month began to be used. With the advent of the varieties of revolving charge accounts, cost-conscious merchants raised the charge to 1.5% monthly.

The one and one half percent charge referred to by Niefeld becomes eighteen percent when compounded annually. No state has a legal usury limit near or exceeding eighteen percent, although some states do allow interest rates over eighteen percent if the interest is specified in a contractual relationship. For the usury rates charged by specific states, *see* note 16.

18. Uni-Serv Corp. v. Commissioner, 349 Mass. 203, 207 N.E.2d 906 (1965). Here the Commissioner of Banks for Massachusetts argued that Uni-Serv could charge no interest on its credit program because it was not licensed under the state's small loans statute which set the interest rates at which loans could be made. Since the small loans statute established the rates charged on loans, it was in effect a usury statute for Massachusetts. Prior to the *Uni-Serv* decision, two state courts had declared that interest on installment contracts which exceeded state interest limitation was usurious—Arkansas in Sloan v. Sears, Roebuck & Co., 228 Ark. 464, 308 S.W.2d 802 (1957) and Nebraska in Lloyd v. Gutgsell, 175 Neb. 775, 124 N.W.2d 198 (1963). Both found that the time price doctrine did not protect the interest incurred in credit sales of property from state usury rates. Since the rationale for exempting interest generated by installment sales from the usury statutes is analagous to that for revolving charge accounts, it is probable both state courts would also have found revolving charge interests were controlled by the usury limitations had the issue been presented before the courts.

court found that the credit card was used only for the purchase of property (retail goods) and that plaintiff's time of payment had been extended beyond the purchase date. Thus, the court found the two classic elements of the time price doctrine present in the credit transaction and applied that doctrine. The court found that the concept effectively protected the apparently excessive interest rates from the statutory rate ceiling.[19] A number of other state courts have since adopted the Massachusetts rationale when interest charged by credit plans has been attacked as usurious under their respective statutes.[20]

Unlike the Massachusetts decision, the Iowa supreme court in *Younker* found the challenged revolving credit plan illegal because of excessive interest charges. The finance charge assessed by Younkers on the unpaid balance, the court pointed out, was eighteen percent per year while the Iowa usury statute allowed only a nine percent interest rate.[21] The court noted that the time price concept was firmly rooted in American law and that most courts which have ruled on the legality of the interest rates generated by a revolving charge plan have found the rates non-usurious by placing the interest rate of the credit plan under the protection of the time price doctrine.[22] The Iowa court found, however, that the Iowa statute was more explicit than most in listing those credit transactions covered by the interest ceiling:

> No person shall, directly or indirectly, receive in money or in any other thing, or in any other manner, any greater sum or value for the loan of money, *or upon contract founded upon any sale or loan of real or personal property*, than is in this chapter prescribed. (Emphasis added).[23]

The court found that the statute did not differentiate between "the seller of property and the lender of money,"[24] a critical distinction upon which the time price doctrine is constructed (*i.e.*, there must be a sale of property).[25] Since contracts for "any sale or loan of

19. 349 Mass. at ______, 207 N.E.2d at 908.
20. Kass v. Garfinckel, 299 A.2d 542 (D.C. App. 1973); Standard Oil Co. (Ind.) v. Williams, 288 N.E.2d 170 (Ind. App. 1972); Cecil v. Allied Stores Corp., 513 P.2d 704 (Mont. 1973); Sliger v. R.H. Macy & Co., 59 N.J. 465, 283 A.2d 904 (1971); Dennis v. Sears, Roebuck & Co., 233 Tenn. 410, 446 S.W.2d 260 (1960).
21. *Younker* at 561.
22. *Id.* at 557-58.
23. IOWA CODE ANN. § 535.4 (1946), *discussed by the court in Younker* at 559.
24. *Younker* at 559.
25. Prior to the decision of the Iowa supreme court in *Younker* the courts of

real or personal property"[26] were expressly covered by the usury statute, the court held that the time price doctrine could not protect credit sales of property if the rate was in excess of nine percent per annum.

The decision of the Iowa court was clearly correct since the statute expressly included the sale of property within the protection of its interest limitations. Had the court ruled that section 535.4 did not cover the sale of property on credit, it would have ignored the clear language contained in the statute.

While the strict legal correctness of the court's decision cannot be questioned, it nonetheless presents important questions for the Iowa Legislature: should it take action to amend or totally rewrite its usury law to allow the interest rates, generated from credit plans such as Younkers, relief from the state's usury ceiling? Should it raise the usury limit itself to allow lending institutions to loan at a higher interest rate? The answer to both these questions would appear to be yes for two reasons: first, the legislature must realize that the age of consumer credit has arrived and recognize the economic problems that could result in Iowa if the *Younker* decision is allowed to stand; and second, the legislature must realize that usury statutes with low interest rates are a thing of the past.

THE PRACTICAL EFFECT OF YOUNKER

Iowa's usury statute, which now limits the interest charged by consumer credit plans to a maximum nine percent under its rate ceiling, may well rob a large portion of the Iowa population of its only dependable source of low interest financing. Large retail concerns,

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four other states had found that interest from the credit sale of property fell under the usury laws of their particular states: Arkansas, in Sloan v. Sears, Roebuck & Co., 228 Ark. 464, 308 S.W.2d 802 (1957); Nebraska, in Lloyd v. Gutgsell, 175 Neb. 775, 124 N.W.2d 198 (1963); South Dakota, in Rollinger v. J.C. Penney Co., 192 N.W.2d 699 (S.D. 1972); and Wisconsin, in State v. J.C. Penney Co., 48 Wis. 2d 125, 179 N.W.2d 641 (1970). In *Sloan*, the Arkansas court was faced with much the same problem encountered by the Iowa court. A specific constitutional provision provided that: "*All contracts* for a greater rate of interest that ten percent per annum shall be void as to principal and interest. . . . " (Emphasis added). ARK. CONST. art. 19, § 13. The constitution, the court noted, provided that "all contracts" that charged more than ten percent interest were invalid. This broad language was read by the Arkansas court to include credit sales of property. 228 Ark. at ____, 308 S.W.2d at 804.

26. *Younker* at 559.

such as Younkers, are America's largest distributors of credit cards.[27] These retailers will lose money on credit operations in Iowa if they are forced to operate at nine percent per annum under their revolving credit plans. Studies indicate that total credit costs incurred by retail stores utilizing a consumer credit arrangement exceed revenues even at an eighteen percent interest level.[28] Younkers itself testified that even at an interest rate of eighteen percent per annum on their revolving charge accounts, the cost of providing credit services exceeded its finance charge revenue by over $500,000 per year.[29] The reduction of Younkers' interest rate from eighteen to nine percent creates a loss margin that may well prove to be economically intolerable.

Most retail creditors have one of three choices in this type of high loss situation. First, they can reduce their interest rates to the state ceiling of nine percent and suffer heavy losses by continuing their revolving credit programs — certainly not a feasible course of action from an economic point of view. Second, they can either screen more carefully those applying for a credit card to insure that only sound borrowers are given credit, or drop their credit program altogether. In either case the result is the same. People who formerly had access to relatively cheap sources of credit are now deprived of that type of financing. The third alternative for retail creditors is to extend credit at the nine percent level while increasing the price of their products to make up for the losses sustained operating their credit program at low interest rates. The end result of this alternative is that people who think they are paying only nine percent in interest are actually paying closer to an eighteen percent level because the other nine percent is hidden in the increased price of the goods.[30]

27. H.R. REP. No. 1500. Of the 300 million credit cards held by Americans in 1970, at least half had been issued by independent retailers. *Id.*

28. Lynch, *Consumer Credit at Ten Per Cent Simple: The Arkansas Case*, 20 U. ILL. L. F. 592, 596-99 (1968) [hereinafter cited as Lynch]. Professor Lynch noted that a recent study of credit costs at fifteen retail stores revealed that total credit costs exceeded credit revenues even though thirteen of the stores charged one and one-half percent per month on revolving accounts. *Id.* at 596. In 54 MARQ. L. REV. 223 (1971), the author gives a breakdown of credit costs for J.C. Penney Co. in 1969: "Credit costs . . . amounted to $44 million to finance customer receivables; provisions for bad debts totaling $16 million, and $12 million to administer customer credit. Since the company collected only $79 million in revenue [interest charged under the plan] this left them with a $23 million deficit for 1969." *Id.* at 229.

29. *Younker* at 560.

30. In Arkansas, where revolving charge plans are limited to ten percent interest rates, whenever a retailer incurs credit costs in excess of revenues, he makes up for the loss by charging higher cash prices. In turn, that amount by which cash prices are raised to cover losses on credit operations represents a cash subsidy paid by cash buyers to the benefit of customers buying on credit. Lynch at 606.

These alternatives are not mere hypotheticals. The first readily ascertainable effects of the *Younker* decision have already occurred in Iowa and have taken the form of the second alternative listed above. On September 20, 1973, Younkers announced it would be necessary for the department store chain to *limit* the number of new charge customers it would accept and to *cancel* some existing accounts because credit costs could not be covered at the nine percent interest level.[31] A second result of the *Younker* ruling is that many Iowa shoppers will find it easier to get revolving charge accounts from stores in bordering states. Citizens of Iowa who find themselves ineligible for a credit card under the new stricter standards may choose to cross the border and use credit cards obtained from retail outlets there rather than paying cash for items at home. Consumers crossing state lines for their credit transactions will deprive retailers within Iowa's borders of a portion of their usual income.[32] The third

31. Omaha World Herald, Sept. 20, 1973 at 1, col. 1.

32. In his Arkansas study, Professor Lynch found that a high percentage of potential Arkansas purchasers went out of the state to border towns to obtain their goods. Lynch at 614. A study of the Arkansas credit situation by the *University of Illinois Law Forum* indicates that another economic factor could well enter the picture if the nine percent limitation on revolving charge plans is not lifted by the legislature. *An Empirical Study of the Arkansas Usury Law: "With Friends Like That . . . "* 20 U. ILL. L. F. 554 (1968). In Texarkana, a town divided approximately in half by the Texas and Arkansas border, sixteen of the seventeen automobile dealers and sixteen of the twenty-four retail furniture stores are located on the Texas side of the border. The owners all agreed that the large majority of the retail establishments were located on the Texas side because of the ten percent ceiling on interest in Arkansas. *Id.* at 582.

It seems then, that unless the Iowa Legislature raises the interest ceiling on revolving charge plans, future retail outlets may choose to establish or re-establish in states other than Iowa, costing the local communities as well as the state both revenue and jobs. This is particularly true since five out of the six states that surround Iowa have legislation allowing revolving charge accounts at rates higher than Iowa's nine percent limitation. *See* ILL. ANN. STAT. ch. 121½, § 528 (Smith-Hurd Supp. 1973-74); MINN. STAT. ANN. § 334.16 (Cum. Supp. 1973); MO. ANN. STAT. § 408.300 (Vernon, Cum. Supp. 1973); NEB. REV. STAT. § 45.207 (Reissue 1968); WIS. STAT. ANN. § 422.201 (Spec. Pamphlet 1973). South Dakota has no legislation permitting revolving charge accounts or setting their rates. Since the South Dakota supreme court found revolving charge rates of eighteen percent to be usurious in Rollinger v. J.C. Penney Co., 192 N.W.2d 701 (S.D. 1972), credit sales of consumer goods have been financed at the ten percent rate allowed by state statute. S.D. COMPILED LAWS ANN. § 54-3-7 (Supp. 1973).

There is the added fact that according to the recent United States census a large percentage of Iowa's population lives along her borders—four out of seven of the largest cities in Iowa are located on or near the border:

Council Bluffs	60,348 people
Davenport	98,469
Dubuque	62,309
Sioux City	85,925
	307,051 people

U.S. BUREAU OF CENSUS, I CENSUS OF POPULATION: 1970 pt. 17, 17-59 (1973).

effect directly related to the *Younker* decision occurred on January 8, 1974, when Attorney General Turner advised Iowans that they may not even have to pay a nine percent interest on credit purchases. Section 535.2, he noted, limited interest rates in Iowa to five percent unless the parties agreed in writing to a nine percent rate. If the store voluntarily reduced its rates from eighteen to nine percent following the *Younker* decision, but failed to have its customers sign a new credit agreement in which both parties agreed to the nine percent interest rate, Turner stated that the rate was usurious and no interest was owed on the remaining principal.[33] Understandably, economic conditions of this type may cause many retail creditors to withdraw their credit plans from the public, stripping Iowans of a dependable source of low interest credit.

Iowa's low usury rate, besides its impact upon credit cards, also precludes a large segment of Iowa's population from borrowing at the usual lending institutions (essentially banks). The *Younker* decision has brought an economic fact of life into dramatic perspective: a usury rate of nine percent does more harm than good to that segment of the population it was designed to protect — the lower economic classes who can least afford to pay high interest rates.[34]

While the general aim of usury laws is commendable, Iowa's statute has fallen short of its mark. The poorer economic class in Iowa, labeled by the credit industry as the high-risk borrower group, are unable to borrow at Iowa's banks and other lending institutions because of the state's low interest ceiling. High- and medium-risk borrowers cannot get bank loans at the nine percent level, or even at the twelve percent rate Iowa banks are allowed to charge for installment loans.[35] The risk of lending money to them at nine percent is

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A large percentage of this group may ultimately make their major purchases of consumer goods in states bordering Iowa where the borrowers' access to credit is enhanced by the higher interest rates under which the retailers are allowed to operate their credit programs.

33. Des Moines Register, Jan. 8, 1974 at 1, col. 5.

34. Usury statutes have been enacted upon the theory "that the lender and the borrower do not occupy the same relations of equality . . . and that the borrower's necessities deprive him of freedom in contracting, and place him at the mercy of the lender." State v. Cary, 126 Wis. 135, _____, 105 N.W. 792, 793 (1905). *See also* General Motors Acceptance Corp. v. Weinrich, 218 Mo. 68, _____, 262 S.W. 425, 428 (1924).

35. IOWA CODE ANN. § 524.906 (1946). It can be assumed that most banks will give out virtually all their loans on an installment basis to gain access to the twelve percent interest rates allowed by this statute. The figure of nine percent is used as the basis for this article since that is the general usury rate. Those factors which support an increase from the nine percent rate also support an increase from the twelve percent rate.

economically prohibitive from the viewpoint of late repayments, defaults and judgments.[36] In most instances the amount of money normal consumer borrowers will require is simply too small for the banks to enjoy a measurable profit at the nine percent level.[37] Since the effect of the *Younker* decision is to eliminate access to goods at the tolerable eighteen percent level for medium- and high-risk borrowers, the only remaining legal lending institution in Iowa which can give relief to the riskier borrowers are the small loan companies licensed by the legislature to lend at thirty-six percent per annum.[38] The end result is that Iowa's low interest usury statute precludes the poorer economic class it was designed to protect from access to nine percent loans at most banks and forces them to borrow at small loan agencies which have interest rates *double* those charged by the "usurious" Younkers credit plan. The low interest rate ceiling imposed by the usury law clearly restricts credit market access by medium- and high-risk borrowers.[39]

THE NEED FOR LEGISLATIVE ACTION

The Iowa supreme court in deciding *Younker* made no condemna-

36. Loans taken out at banks for the financing of consumer goods, such as appliances, have the highest delinquency rates. NEIFELD at 534-35. Studies also indicate that losses to banks on consumer credit loans are consistently higher than the same losses to consumer financing agencies. MCCRACKEN at 132-33. Chances of default, and ultimately the expenses of court time and repossession of property increases as the "risk" of the potential borrower goes up. Risk borrowers are those with low wages, unskilled occupations, poor employment records, etc. MCCRACKEN at 135-40.

37. In a study of 48 lending institutions, it was found that the operating costs of loans outstanding declined by $1.26 on the average with each $100 increase in average loan size. This is attributable to the fact that many of the operating costs do not change appreciably with the size of the loan made. J. CHAPMAN & R. SHAY, THE CONSUMER FINANCE INDUSTRY: ITS COST AND REGULATION 61-68 (1967). The larger the loans made, then, the greater the profit realized by the lending institution.

38. IOWA CODE ANN. § 536.13(4) (Cum. Pamphlet 1973). The statute allows small loan agencies to charge 36% through $105, 24% for loans over $150 through $300, and 18% for any loan over $300. *Id.*

39. Attempts have been made to create some uniformity in the usury area on a nationwide basis. The National Conference of Commissioners on Uniform State Laws has prepared the *Uniform Consumer Credit Code* (1969 version) [*UCCC*] which sets rates for all consumer credit sales (§2.201 & §2.207) and on all consumer loans (§3.201 & §3.508). However, only seven states have adopted some version of the *UCCC* since its appearance in 1968 so its future as a uniform regulator of interest rates on a nationwide basis is uncertain at best. For a compilation of those states which have adopted the code and the modifications each has made upon it before incorporating it into their state statutes, *see* 1 CCH CON. CRED. GUIDE ¶ 4770, at 5005. One writer has suggested that all usury laws be abolished, allowing all lending institutions a free entry into the credit market. This would cause a heightened competition among the lending agencies for borrowers with the result that rates would be lowered—the companies with the lowest interest attracting the highest number of borrowers. Warren, *Rate Limitations and Free Entry*, 26 BUS. L. 855 (1971).

tion of revolving charge rates. It simply found that the statute as written would not allow the credit sale of property above the specified usury limit. Its decision now shifts the burden to the legislature.

The Iowa Legislature, should it choose to take action, would do well to follow the precedent of legislatures of other states which have faced the same problem. In Nebraska and Wisconsin the legislatures set aside court decisions which held that interest rates on consumer credit plans were usurious under the controlling state usury statutes. The legislative effort in Nebraska was a complex one because a constitutional revision was required: the Nebraska supreme court had based its decision outlawing revolving charge rates on a state constitutional provision.[40] The Wisconsin legislature had an easier task: the Wisconsin court had simply been interpreting a state usury statute.[41] Less than a year after the Wisconsin court had found credit charges to be usurious, the legislature passed the Consumer Credit Act recognizing the legality of maximum per annum interest rates of eighteen percent on revolving charge accounts.[42]

A comprehensive rewriting of Iowa's interest statutes is demanded by the economic realities laid bare by the *Younker* decision. The legislature should take three steps in revamping its interest laws.

First, section 535.4 should be rewritten to remove all references to credit sales of property from the statute. In its decision, the court gave what it considered an acceptable construction of section 535.4 which would remove the interest rates in consumer credit transactions from the reaches of the usury statute.

> In order to construe code section 535.4 as [allowing the sale of property under the time price doctrine] . . . it would be necessary that the words "or upon contract founded upon any sale or loan of real or personal property" . . . be stricken

40. The Nebraska Legislature reacted swiftly to the court decision in Lloyd v. Gutgsell, 175 Neb. 775, 124 N.W.2d 198 (1963). It proposed a constitutional amendment in an extraordinary session convened in October of 1963, less than a month after the decision. NEB. LEGIS. JOUR., 74th Legis., (Extra) Sess. 216-19 (1963). The proposed amendment was placed on the ballot and approved by the Nebraska voters in the 1964 elections. Following the approval of the constitutional amendment the legislature passed the Nebraska Installment Sales Act with an emergency clause to assure immediate implementation. NEB. LEGIS. JOUR., 75th Legis., 1st Sess. 1636 (1965). The maximum interest rate established on credit sales by the new law was one and one-half percent per month or eighteen percent per year. NEB. REV. STAT. § 45-207 (Reissue 1968). In 1966 the Nebraska supreme court upheld the constitutionality of the act in Engelmeyer v. Murphy, 180 Neb. 295, 142 N.W.2d 343 (1966).

41. State v. J.C. Penney Co., 48 Wis. 2d 125, 179 N.W.2d 641 (1970).

42. WIS. STAT. ANN. § 422.201 (Spec. Pamphlet 1973).

> from the present statute. Thus amended the statute would read: "Illegal rate-prohibited usury. No person shall, directly or indirectly, receive in money or in any other thing, or in any manner, any greater sum or value for the loan of money than is in this chapter prescribed."[43]

Second, a statute setting the interest rates for consumer credit in Iowa would be required to insure that those institutions offering revolving credit plans do not demand too great an interest charge for their services. A majority of states that have enacted revolving credit interest ceilings have set them at one and one-half percent per month or eighteen percent per annum.[44] This is the level at which many stores were operating their credit transactions before the states enacted legislation to control such rates. Based on this, most legislatures decided that eighteen percent was a viable rate at which retail creditors could function economically,[45] and that it was not too great an interest burden on the borrowing public. An interest rate of eighteen percent is preferable to the current small loans rate in Iowa.[46]

Third, the Iowa Legislature should change its usury ceiling to make credit more accessible to the lower economic classes. The legislature's major concern will be the level of the interest rate that should be allowed under the usury statute. What is required is a rate that will allow the greatest number of people access to relatively low interest loans while protecting them from unfairly high interest rates.

In August of 1973, the Federal Reserve discount rate was seven and one-half percent.[47] Those banks which borrow from the Federal

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43. *Younker* at 559.

44. Legislatures in forty states have allowed interest rates on revolving credit plans at eighteen percent per annum or higher. *See* 1 CCH CON. CRED. GUIDE ¶ 630, at 2501-08.

45. While most retail outlets operating revolving charge accounts at eighteen percent do not make a profit (*see* note 28 *supra*) they are willing to offer the credit plan as a positive selling tool. The plans are designed to attract new customers and to hold customer allegiance by offering easy access to goods at a convenient credit rate. NEIFELD at 430. The profit from the added volume of sales exceeds losses incurred by operating a credit sales system. *Younker* at 560.

46. IOWA CODE ANN. § 536.13(4) (Cum. Pamphlet 1973).

47. 59 FED. RES. BULL. 788-89 (1973). It is interesting to note that in 1954 the contractual usury limit in Iowa was seven percent. IOWA CODE ANN. § 535.2 (1946). At the same time, the discount rate charged by the Federal Reserve to its member banks was only one and one-half percent. 59 FED. RES. BULL. A8 (Nov. 1973). Thus, a bank would enjoy a net interest gain of five and one-half percent on transactions with the Federal Reserve. However, in 1968, when the Iowa usury limit was still seven percent, the Federal Reserve rate had gone up to five and one-half

Reserve at seven and one-half percent and which are forced by state statute to lend at no higher than nine percent are recognizing an interest differential of only one and one-half percent which creates marginal profits at best even if all debts are repaid on a timely basis. Such a slim profit margin automatically precludes a bank from loaning to any medium- or high-risk borrowers.

An increase of four to five percent on the usury level would be beneficial to both lending institutions and to Iowa's consumer public. At fourteen percent the usury statute[48] could better serve the func-

percent, allowing banks an interest gain of only one and one-half percent. These figures indicate the most basic problem with usury statutes; once the limits are set in place by the legislature, that body is usually slow to react to economic changes which constantly require an updating of usury rates if the statute is to be effective. New Jersey amended its usury statute in 1968 to provide the needed flexibility in rate setting that is lacking in many statutes today. The Commissioner of banking was given the power to change the usury rate in New Jersey as the economic situation required and was given certain guidelines within which to act. He was to "consider the general state of the economy, the discount rates prescribed by the Federal Reserve Bank of New York and the Federal Reserve Bank of Philadelphia . . . " and the rate established was to "reasonably reflect prevailing market conditions, regionally and nationally. . . . " N.J. STAT. ANN. § 31:1-1 (Cum. Supp. 1973-74). Armed with this authority, the Commissioner raised the maximum rate to seven and one-half percent on April 7, 1971. Sliger v. R.H. Macy & Co., 59 N.J. 465, ——, 283 A.2d 904, 905 (1971). This rate generally paralleled the interest rate given by the Federal Reserve Bank of New York in the same time frame. 59 FED. RES. BULL. A8 (Nov. 1973).

48. The fact that banks would be allowed to charge fourteen percent interest on their loans does not necessarily mean that they will do so. Studies indicate that "assertions that rates always rise to the ceiling are incorrect *except when the price ceiling is set at or below the market rate for the particular form of credit* placed under price control." (Emphasis added). REPORT OF THE NATIONAL COMMISSION ON CONSUMER FINANCE, CONSUMER CREDIT IN THE UNITED STATES 96-97 (1973). All Iowans, then, will not be paying fourteen percent on loans from Iowa banks simply because the usury rate is at that level. In order to remain competitive with each other, banks will reduce their rates to those customers who are non-risk borrowers, secure in the knowledge that a reasonable profit can be made at less than fourteen percent interest because of few or no defaults on the loan repayment schedules.

Several states allow banks to give personal or consumer loans in excess of the fourteen percent rate proposed herein for Iowa. In Nebraska, for example, any registered bank may charge up to eighteen percent on such loans under $1,000. NEB. REV. STAT. § 8-820 (Reissue 1970). The *Uniform Consumer Credit Code* allows a "supervised lender" to charge thirty-six percent on the unpaid balance of the principal which is $300 or less, twenty-one percent on $300 to $1,000, and fifteen percent on loans of over $1,000. UNIFORM CONSUMER CREDIT CODE § 3.508 (1969 version). Supervised lenders under the *UCCC* include organizations authorized to "make loans and receive deposits or their equivalent, such as commercial banks, savings banks. . . . " UNIFORM CONSUMER CREDIT CODE § 1.301(17), (Comment (1969 version). The states of Colorado, Idaho, Oklahoma, Utah and Wyoming have incorporated the *UCCC* into their codes and have retained the interest rates set by § 3.508 with few modifications. 1 CCH CON. CRED. GUIDE ¶ 5248, at 6032.

The California constitution specifically provides that the state's usury rates do not apply to "any bank created and operating under and pursuant to any laws of this State or of the United States of America. . . . " CAL. CONST. art. 20, § 22. Banks in California are given complete freedom to determine the rates they will charge on personal loans. On the question of what rates banks will charge when they are comtion for which it was intended. The margin of profit for banks (using the Federal Reserve discount rate for August, 1973) would be six and one-half percent. This level of profit would allow banks to open their doors to a wider economic group, since a greater number of defaults, late payments and foreclosures could be tolerated at that interest rate. At the same time, the fourteen percent ceiling would insure against economic price gouging by lending institutions.

An increase in the interest rate under the Iowa usury statute would not eliminate the economic need for a legalized form of retail consumer credit in the state for two reasons. First, the consumer who wants to make a thirty-dollar purchase on Tuesday, and a sixty-dollar purchase six days later, does not want to go to a lending institution and negotiate small loans for each purchase. Many lending institutions themselves will not lend money in such small increments because of their small profit return.[49] Thus, the credit card serves as a viable alternative to the lending institution for such purchases. Secondly, if revolving charge accounts were allowed to operate at the standard eighteen percent per annum, that type of credit system would allow access to credit to a larger economic class than a usury statute at fourteen percent. The interest rate on revolving credit plans would be four percent greater at the eighteen percent level, so more risks could be taken by the issuer of the card. There is the added fact, as Younkers pointed out in its testimony, that many retail stores are willing to take greater credit risks than lending institutions such as banks, in an effort to attract and retain purchasing customers.[50]

peting with each other and are not controlled by a usury limitation, one California writer pointed out that "in California the consumer probably got his cheapest rates in those consumer transactions in which there was no effective rate regulation at all." Warren, *Rate Limitation and Free Entry*, 26 BUS. L. 855, 857 (1971). Also of interest is the fact that the bank credit card systems in California, which are immune from interest regulations under the California constitution, have established their rates to match those permitted under California's revolving credit statutes which permit a rate of eighteen percent per annum. Comment, *Bank Credit Cards and the Usury Laws*, 4 U. CAL. DAVIS L. REV. 335, 354 (1971). The competition of alternative forms of credit, then, has forced the banks in California to offer their credit card loans at eighteen percent, even though, legally, they could have charged a greater rate of interest.

49. *See* note 36 *supra*.

50. *Younker* at 560.

CONCLUSION

The decision of the Iowa supreme court in *Younker*, though clearly required by the controlling statutes, has stripped Iowans of their most reliable source of consumer credit by declaring the eighteen percent interest rates on revolving credit plans usurious under Iowa law. If the economy of Iowa is to remain fundamentally sound, the legislature must take action to insure that there is no substantial reduction in the availability of credit to the consumer.

To make certain that access to consumer credit remains available to those who need it, the Iowa usury statutes should be rewritten to allow the application of the time price doctrine to the credit sales of property. Legislative action of this nature would effectively set aside the *Younker* decision and again allow the operation of eighteen percent revolving charge plans in Iowa, thus guaranteeing a larger segment of the population access to revolving credit. Action should also be taken to increase the usury ceiling in Iowa from nine percent to fourteen percent. An increase of five percent would allow lending institutions to loan their money to a greater number of "risk" borrowers.

These measures would insure that the maximum amount of interest credit would be available to the maximum number of consumers who will use the credit to purchase goods — which is the requisite premise of an effective consumer market.

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