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Usury - Interest after Maturity - Applicability of Usury Statute

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This should be reason enough to provide him with the habeas corpus remedy to insure that his individual rights are fully protected.

Courts should consider giving a liberal interpretation to the custody requirement of the Great Writ in recognition of the fact that the range of modern penal sanctions encompasses many restraints on a person's liberty which are more subtle than a plain physical confinement, yet serve essentially the same functions. The writ of habeas corpus is not a creature of the legislature, but a device fashioned by the courts to protect and extend their own jurisdiction. It should not require legislative reform before it can become a viable remedy for those citizens who are victims of illegal restraint. This is particularly true at a time when rapid expansion of the meaning of the due process and equal protection clauses of the Fourteenth Amendment is being made. In this respect the writ of habeas corpus commands general recognition as the essential remedy to safeguard a citizen against unjust imprisonment by state or federal government in violation of his constitutional rights.

PEDER ANDERSON

USURY—INTEREST AFTER MATURITY--APPLICABILITY OF USURY STATUTE—Defendant executed and delivered a promissory note to the Republic Supply Company in August 1962. The note called for repayment of the principal in five installments with interest on each installment at the rate of seven percent per annum. In the event of default in any payment of principal or interest, the note specified interest thereon at the highest legal rate permitted by contract under state law, but in no event in excess of ten percent per annum, from the date of default until paid. In February, 1965, when the entire note was in default, Republic assigned it to the plaintiff. The plaintiff sued to collect the note and defendant contended that the clause in the note which provided for a possible higher rate after maturity than the lawful rate in North Dakota made the note usurious. The trial court held that the provision called for greater interest after maturity than before and was void, and that after maturity the note drew interest at the legal rate of four percent. Defendants appealed, specifying as error the trial court's failure to apply the penalty for usury by forfeiting all of the interest and one fourth of the principal as provided by Section 47-14-10 of the North Dakota Century Code. The North Dakota Supreme Court *held* that the usury statute applied only to interest before maturity

and any provision in a contract providing for a higher rate after maturity, regardless of the rate, is void as to the increase and has no other effect on the contract. *Oil Investment, Inc. v. Dallea Petroleum Corp.*, 152 N.W.2d 415 (N.D. 1967).

The North Dakota Supreme Court held that the provisions of the note regarding a higher rate of interest after maturity did not violate the usury statute, section 47-14-09 of the North Dakota Century Code,[1] on the basis of section 47-14-05.[2] The section states:

> All contracts shall bear the same rate of interest after maturity as they bear before maturity, and any contract attempting to make the rate of interest higher after maturity shall be void as to such increase of interest.

The defendant's contention that contracts which specify a higher than lawful interest rate after maturity should be subject to the penalties of the usury statute is not persuasive in view of the explicit language of section 47-14-05. The court concluded, and a brief study of the relevant statutes confirms, that section 47-14-09 governs the interest rate before maturity and section 47-14-05 governs interest after maturity. This conclusion is inevitable if both statutes

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1. The section provides as follows:
Usury—Definition—Maximum contract rate—Prohibition.— Except as otherwise provided by the laws of this state, no person, copartnership, association, or corporation, either directly or indirectly, shall take or receive, or agree to take or receive, in money, goods, or things in action, or in any other way,any greater sum or greater value for the loan or forbearance of money, goods, or things in action than seven per cent per per annum, and in the computation of interest the same shall not be compounded. No contract shall provide for the payment of interest on interest overdue, but this section shall not apply to a contract to pay interest at a lawful rate on interest that is overdue at the time such contract is made. Any violation of this section shall be deemed usury.
The civil liability for usury is set forth in section 47-14-10.
If an inlawful rate is contracted for but not paid, all of the interest is forfeited plus 25% of the principal. If the unlawful rate of interest has been paid, the borrower may (1) recover twice the amount of interest paid plus 25% of the principal, or (2) offset twice the amount of such interest against any indebtedness which the borrower may owe the lender.

2. The dictrict court also recognized that the note was not controlled by the usury statute as to the interest rate after maturity, but appears to have misconstrued § 47-14-05. In effect, the note carried the same rate after maturity as before although that result was probably not intended by the lender. But since the note specified 7% before maturity, and the highest rate permitted by contract in North Dakota is also 7%, it is most difficult to determine how the district court found a higher rate after maturity. The district colrt then proceeded to the conclusion that the lender was entitled only to the legal rate of 4% after maturity, which also appears to contrary to § 47-14-05. Section 47-14-05 only requires a forfeiture of the *difference* between the before and after rate, not the application of the legal rate. The legal rate after maturity would be applied in a case where the borrower defaulted on a non-interest bearing note. A non-interest bearing note would thus draw the legal rate after maturity as a measure of compensatory damages for the detention of money. Allen v. Miller, 84 N.W.2d 571 (N.D. 1957).

Where the parties have specifically agreed to an interest rate before maturity, § 47-14-05 applies and insists on the same rate after maturity, not the legal rate (unless, of course, the agreed rate before maturity was 4%).

The district court's construction of the note as calling for a higher rate after maturity was not specified as error and the supreme court was unable to discuss the question. Had the opportunity been presented, there can be little doubt that the district court's construction would have been set aside.

are to be given their intended effect, and as the court noted, "[I]f the Legislature had intended to apply the usury statute to interest rates after maturity, it would have been a simple matter to so state, in which event Section 47-14-05 would not have been needed."[3]

North Dakota, by statute, adheres to the general rule that a higher than lawful rate after maturity is not usurious.[4] The reasoning which supports the majority position is based on the premise that parties contract for the use of money for a definite period. At maturity, the borrower is bound to pay the principal plus the agreed upon interest rate. The borrower's obligation is therefore fixed and his only remedy for a higher than lawful rate applicable before maturity is the relief given by the usury statute. But if the borrower is contractually subjected to a higher than lawful rate after maturity, he can avoid the unlawful rate by promptly paying the obligation at maturity. The majority rationale seems to be founded on the philosophy that the law should not help those who do not help themselves.

The minority jurisdictions, including South Dakota,[5] take a pragmatic attitude toward interest rates and make no distinction between before and after rates. The usury penalty is applied whenever a higher than lawful rate is contracted for in order to give debtors the complete protection of the statute. In many instances the debtor may be unable to pay his debt at maturity and thereby avoid the higher than lawful rate. Hence, it is just as onerous to require the debtor to pay the rate after maturity as before when circumstances are such that prompt payment is impossible.[6]

Both views have an inflexible quality which somewhat detracts

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3. Oil Investment, Inc. v. Dallea Petroleum Corp., 152 N.W.2d 415, 419 (N.D. 1967).

4. *E.g.*, Lloyd v. Scott, 29 U.S. (4 Pet.) 205 (1830); Easton v. Butterfield Live Stock Co., 48 Idaho 153, 279 P. 716 (1929); and Oil Investment, Inc. v. Dallea Petroleum Corp., *supra* note 3.

5. Tennessee and Texas are apparently the only other jurisdictions comprising the minority. The leading cases in these jurisdictions are Bang v. Phelps & Bigelow Windmill Co., 96 Tenn. 361, 34 S.W. 516 (1896), and Parks v. Lubbock, 92 Tex. 635, 51 S.W. 322 (1899).

6. In the case of Ulviden v. Sorken, 58 S.D. 466, 237 N.W. 565, 566 (S.D. 1931), the South Dakota Supreme Court stated the following:

> Requiring the maker of a note to pay a higher rate of interest after maturity for the use of money is likely to be as oppressive as when required to pay a higher rate during the term of the loan. It may not be within the power of the borrower promptly to meet his obligations at maturity. If a borrower is to be protected from the extortion of an excessive rate for the use of money, there is no apparent reason why it should be limited to the term of the loan . . . What difference can it make in the essence of the transaction that the excessive rate shall be agreed to be paid for one period rather than another? Is it not equally the compensation demanded by the lended or the creditor for the use of his money? We think it is, most certainly. The fact that the party might relieve himself from this payment by payment of the bill at the day agreed upon for its falling due, only prevents other contracts from being enforced against him; but if he for any cause failed to pay, then the interest at the rate contracted for becomes due by virtue of the agreement, is paid as interest for the continued use of money, and is contrary to the requirements of the law.

from the strength of their reasoning. The majority assumes that the debtor can *always* avoid the higher by prompt payment and views debtors as a financially liquid class. The minority, on the contrary, holds to the other extreme and assumes that debtors are *never* in a position to pay their obligations promptly. Neither position is, of course, in accord with reality.[7] The majority view is not entirely rigid, however, since if the parties do not act in good faith and there is an intent to evade the usury laws, the penalty of the usury statute would apply.[8] This qualification of the general rule is useful, but it does not answer the minority's criticism that even though the contract is entered into in good faith and there is no intent to evade the usury laws per se, these factors are little consolation to the debtor who is subject to the unlawful rate because he was unable to pay his debt at maturity.

The minority urges another basis for its holding which is far less persuasive. The usury statutes prohibit the taking of excessive interest. At common law, interest was defined as compensation for the use or forbearance of money.[9] By definition, therefore, compensation for the detention of money was not considered as interest, but rather as a penalty for failing to pay at maturity. The rate thus specified after maturity could not be subject to the usury laws since interest was not taken, only a penalty.[10]

The minority asserts, however, that the common law definition of interest was expanded by statute. In South Dakota, for example, the statute defines interest as the compensation for the use or forbearance *or detention* of money.[11] Therefore, that which was considered a penalty at common law was made interest by the statute and a stipulation for an unlawful rate after maturity for the detention of money was usurious as an unlawful taking of interest.[12]

On the basis of the statutory definition of interest, it would appear that North Dakota should align itself with the minority since the North Dakota Century Code definition is identical with the South Dakota statute.[13] The court in the instant case distinguished the South Dakota position, however, on the ground that the

7. A middle postion would perhaps be more desirable. Such a postion might apply the usury statute to those situations where the debtor satisfactorily proves that he is unable to meet his obligations at maturity. There would be inherent in this position such problems as the quantum of proof required, but the difficulties in applying this test would not be insurmountable. Moreover, this position is one which would allow the courts to base a decision on the merits of the case rather than a conclusive legal presumption which has doubtful validity.

8. Oil Investment, Inc. v. Dallea Petroleum Corp., *supra* note 3, at 419.

9. Parks v. Lubbock, *supra* note 5, at 323.

10. *Id.*

11. S.D. CODE § 38.0103 (1939).

12. Ulviden v. Sorken, *supra* note 6, at 566.

13. N.D. CENT. CODE § 47-14-04 (1960) provides as follows: " 'Interest' defined.—Interest is the compensation allowed for the use, or forbearance, or detention of money, or its equivalent."

South Dakota usury statute was dependent on the word "interest" whereas the North Dakota statute did not mention interest.[14] Moreover, the court stated that the public policy of North Dakota as to interest rates after maturity was clearly manifested by section 47-14-05. South Dakota has no similar provision and this fact alone should suffice as a basis for explaining the opposing views. Interest is a creature of the statute law,[15] and there is nothing to be gained from attempting to justify differences in individual state public policy on the basis of nebulous definitional concepts which amount to little more than legal niceties.[16]

Section 47-14-05 prohibits *any* increase in the interest rate after maturity, even though such increase is within the maximum permitted by law. In effect, the statute sets the limit of compensatory damages for the detention of money at the rate charged before maturity. The reasoning of the statute is found in *Allen v. Miller*,[17] where the court stated the following:

> . . . the imposition of a higher rate does have a coercive quality which the law may well frown upon. Such a rate may be more than compensatory. These considerations no doubt prompted our Legislature to prohibit increases in the rate of interest after maturity.[18]

Generally, a higher but lawful rate after maturity is not considered penal and will be enforced.[19] This issue is also a matter

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14. See the text of the statute, *supra* note 1. This reasoning appears rather strained, however, since if one takes, in money, a certain percentage per annum on a loan of money, the logical term for the sum so taken is interest .

15. Consolidated Police and Fireman's Pension Fund Commission v. Passaic, 23 N.J. 645, 130 A.2d 377, 381 (1957).

16. The weakness of the definitional distinction is emphasized by the fact that Tennessee uses the common law definition of interest but still holds to the minority view. The court in Bang v. Phelps & Bigelow Windmill Co., *supra* note 5, apparently considered the term "forbearance" is including the element of detention. Conversely, the Texas court, in Parks v. Lubbock, *supra* note 5 at 323, defined forbearance as excluding detention and stated "[t]he forbearance occurs when there is a debt due or to become due, and the parties agree to extend the time of its payment. The detention of money arises in a case when a debt has become due, and the debtor withholds its payment, without a new contract giving him a right to do so."

This definitional morass in the minority jurisdictions indicates the futility of distinguishing the two positions on the basis of the so-called "common law" meaning of interest.

17. *Supra* note 2.

18. *Id.* at 574.

19. *E.g.*, Greenbaum v. Citizens Federal Savings & Loan Ass'n, 5 Mich. App. 121, 145 N.W.2d 864, 865 (1966); Moffitt-Harrison Builders, Inc. v. Sandman, 177 Neb. 425, 129 N.W.2d 524 (1964); and Flynn v. Dick, 13 A.D.2d 756, 215 N.Y.S.2d 382 (Sup. Ct. 1961).

In Western Securities Co. v. Naughton, 124 Neb. 702, 248 N.W. 56, 57 (1933), the court stated the following:

> Where a note provides for a lawful rate of interest from date until maturity, and a higher and lawful rate of interest afterwards, the rate of interest which the note draws from its date to maturity is the contract rate for that time, and the rate which the note draws after maturity is the contract rate from that date.

The Florida decision of Conneticut Mutual Life Insurance Co. v. Fisher, 165 So.2d 182 (Fla.Ct.App. 1964), involved a situation where the note provided for interest on

of local public policy for the legislature to determine,[20] and North Dakota has chosen to declare that parties to a contract for the loan of money may not liquidate damages. Implicit in such a policy is the old notion that money is a commodity basically static in value[21] and damages for its loss of use are highly predictable. It is unlikely, for example, that a lender making a short term loan bearing the current money market interest rate could, after maturity, employ such money at a higher rate. Under such circumstances, a higher rate after maturity may well be penal.

Minnesota also prohibits any increase in the rate after maturity.[22] Although the Minnesota rule has long been established, it has met with some criticism. The criticism, well founded, is directed to the rule's restriction on the parties' freedom to contract. As the court in *Talcott v. Marston*[23] stated:

> The reasoning upon which the rule of law has been established is entirely unsatisfactory to my own mind, and I think an agreement of parties, deliberately entered into, and fully understood, to liquidate the damages on breach of contract to pay money, ought to be enforced as much as any other contract.[24]

The court apparently had no opportunity to discuss one other major issue which appears to be raised by the terms of the note. The note specified that interest at the highest legal rate permitted by contract was payable in the event of default in any installment of principal or interest. The borrower was thus required to pay

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defaulted payments of principal or interest at the highest rate permitted under Florida law. The court stated that as to the higher rate on defaulted payments of principal" . . . the provision for payment [of the higher rate after maturity] did not infect the transaction with usury, as it only designated a different rate of interest to be paid after maturity than the rate payable for the time prior to maturity." *Id.* at 184. Moreover, since Florida law did not prohibit the payment of interest on interest overdue, the after maturity rate on defaulted payments of interest did not constitute usury. Not only did the court consider interest on interest overdue as lawful, but also stated the following at page 184:

> The agreement was made upon the faith of a regular and punctual payment of the interest and the computation of interest upon the interest supplies the place of prompt payment and indemifies the creditor for his forbearance. It is founded upon a moral and equitable consideration, the forbearance and extension of time.

20. In Re Black Ranches, Inc., 362 F.2d 8,16 (8th Cir. 1966).

21. Consolidated Police and Fireman's Pension Fund Commission v. Passaic, *supra* note 15 at 381.

22. MINN. STAT. ANN. § 334.01 (1966). The section states the following:

> Contracts shall bear the same rate of interest after they become due as before, and any provision in any contract, note, or instrument providing for an increase of the rate of interest after maturity, or any increase therein after making and delivery, shall work a forfeiture of the entire interest . . . .

The penalty for violation of the statute is considerably harsher than that contained in § 47-14-05 of the North Dakota Century Code which only forfeits the difference between the before and after maturity rate.

23. 3 Minn. 339, 3 Gil. 238 (1859).

24. *Id.* at 244.

interest on any installment of interest overdue. The usury statute provides as follows:

> No contract shall provide for the payment of interest on interest overdue, but this section shall not apply to a contract to pay interest at a lawful rate on interest that is overdue at the time such contract is made. Any violation of this section shall be deemed usury.[25]

Until 1933, the practice of contracting for interest on interest which might become overdue in the future was sanctioned by the usury statute. The Session Laws of 1935 provided for the basic prohibition and the case of *Security Credit Co. v. Wieble*,[26] decided in 1937, supplied judicial interpretation which, in 1943, prompted incorporation of the exception.[27] Minnesota[28] and South Dakota[29] permit the contracting for interest on interest overdue, but our legislature, prompted perhaps by the economic conditions of the depression years, chose to declare such contracts usurious as a matter of public policy. The opinion in the instant case would have been much more satisfying, and indeed complete, if it had discussed the issue or at least stated the reason for the lack of discussion.

In North Dakota, the matter of interest after maturity, at least on the principal, is regulated by statute as a means of limiting compensatory damages for the breach of a contract to pay money. The matter of interest on payments of interest after maturity is also a matter of statutory regulation, but such a charge is prohibited as usurious. Perhaps there should be no distinction between the two and whatever policy prompted the legislature to prohibit the payment of interest on interest overdue has probably been eroded by prevailing business practices.

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25. N.D. CENT. CODE § 47-14-09 (1960).
26. 67 N.D. 407, 272 N.W. 750 (1937).
27. In the Security Credit Co. v. Wieble case, the defendants defaulted on a note in the amount of $177.15. The note consisted of $130.00 past due principal and $47.15 interest which had accured on the former principal. The plaintiff, rather than collecting the sum originally due him, consented to a new note which included the past due interest as a part of the new principal. When plantiff attempted to collect this note, the defendants claimed that the note was usurious by virtue of its charging interest on interest overdue. The court held that there was no usury and stated:

> In 1933 (Chapt. 140), after a lapse of forty-three years, the legislature reversed the policy which it had adopted in 1890. It changed the law by changing a few words therein and making it read, 'Any violation of this Section shall be deemed usury; provided that any contract hereafter made, to pay interest on interest overdue shall be deemed usury.' It thus prohibited that which formerly it had permitted to be done, namely, to contract for the payment of interest on interest which might in the future become overdue. It did not thereby change the general rule that such interest could be contracted for on interest after it became past due. *Id.* at 751.

The exception to the general prohibition was incorporated into the N.D. REV. CODE § 47-1409 (1943).
28. MINN. STAT. ANN. § 334.01 (1966).
29. Wieland v. Loon, 79 S.D. 608, 116 N.W.2d 391 (1962).

A strong argument can be made for the permitting of interest on past due payments of interest by examining the consequences of a default. After interest has accrued and its payment is due, the interest is a contract debt and can be collected at law just as a default in an installment of principal.[30] Both are due the lender by the terms of the contract. As a result, it would seem perfectly proper to establish a rate of interest after maturity to be applied to both as a matter of compensatory damages for the wrongful detention of the sum due. This would not constitute compound interest, which is also prohibited under the usury statute,[31] as long as the interest after maturity was computed separately as to each defaulted installment of interest from the date it was due until paid.[32] Compound interest only results when interest is added to the principal and the combined sum is then made to bear additional interest.[33]

Any change in this area will have to come from the legislature. Interest and usury are statutory subjects which are dependent upon current economic conditions for their appropriateness and vitality of enforcement. A review of these statutes in view of current public policy by our legislature might reveal a need for change.

BRUCE E. BOHLMAN

CONSTITUTIONAL LAW—UNITED STATES—DESECRATION OF THE FLAG—Defendant was accused of desecrating the American flag by the comtemptuous use of the flag in a display at his art gallery. The display contained thirteen three dimensional objects described as constructions. One of the objects was an American flag stuffed in a form suggesting a human body and suspended from a yellow noose. A second construction was a white cross with a bishop's mitre on the head piece, the arms wrapped in ecclesiastical flags, and a flag wrapped phallus made from an American flag. Defendant contends that this was merely an expression of opposition to church-condoned aggressive warfare in Vietnam and was protected under his constitutional right to free speech. Prosecution was brought under New York Penal Law §1425 subd. 16. *HELD*; statute prohibiting desecration of American flag does not violate freedom of speech guarantee. One member dissenting. *People v. Radeck*, 279 N.Y.S.2d 680, (1967).

30. Security Credit Co. v. Wieble, *supra* note 26 at 751.
31. N.D. CENT. CODE § 47-14-09 (1960).
32. *See* Hovey v. Edmison, 3 Dak. 449, 22 N.W. 594 (1885).
33. N.D. CENT. CODE § 1-01-36 (1959).