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## The Small Loan Problem in North Dakota

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The practice of law depends on high moral character and legal training. The state bar is allowed great autonomy in determining moral fitness, and its determination will be sustained despite an incidental impingement of freedom of religion, speech, belief, or political affiliation. Because of the high standing of lawyers in the community, the vital nature of the administration of justice, and the ability of a few to bring justice into disrepute, the argument is strong that a state can inquire into political affiliations to protect itself from subversion of such an important function. In the case of Communists it has been convincingly demonstrated that they will take advantage of positions of trust and confidence to advance their cause *i. e.*, the destruction of free institutions; therefore the courts, through their inherent powers, should be entitled to protect themselves from internal enemies by denying Communists admission to or continuance in the practice of law.

JOHN P. CRAVEN.

### THE SMALL LOAN PROBLEM IN NORTH DAKOTA

In a recent decision<sup>1</sup> the North Dakota Supreme Court upheld the granting of an injunction and appointment of a receivership against the Peerless Finance Company of Fargo. In the complaint filed by the state it was alleged that the loan company was guilty of gross violations of the usury laws<sup>2</sup> in lending small amounts of money at interest rates ranging from 149 to 277 percent per annum.

This case graphically illustrates the existence of the "loan shark" problem in North Dakota.<sup>3</sup> Usury and the plight of the small debtor is a problem as old as the recorded history of man.<sup>4</sup> However, the advent of the industrial revolution and the formation of modern capitalism fathered the loan shark as he exists today. It is easy to see that when men lived upon the soil their outside needs were relatively few, but with the coming of the machine age this independence was lost and the family became dependent on a pay slip and a money economy.

In America the populous states and the industrial centers were

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1. State *ex rel.* Burgum v. Hooker, 87 N.W.2d 337 (N.D. 1957).

2. N. D. Rev. Code §§ 47-1409, 47-1410, 47-1411 (1943).

3. The vicious term "loan shark" has been somewhat mildly defined by one author as follows: "A loan shark is one who lends comparatively small sums of money as a business, at high and almost always illegal rates of charge under conditions which defraud and oppress the borrower." Hubachek, *The Development of Regulatory Small Loan Laws*, 8 Law & Contemp. Prob. 108 (1941).

4. Deuteronomy XXIII, 19, 20; Hamilton, *In Re The Small Debtor*, 42 Yale L.J. 473 (1933).

the first to experience difficulties in the regulation of small loans.<sup>5</sup> The vast majority of states now have various types of special legislation regulating the lending of small amounts.<sup>6</sup> Although North Dakota is primarily an agricultural state, a study by the State Public Welfare Board indicates that the essential evils of loan-sharkery are in full bloom in this state.<sup>7</sup> The receiver of the Peerless Finance Company reported to the court that the records of the company show 406 borrowers owing a balance of over \$17,000.<sup>8</sup> A survey in which information was obtained from ten small loan companies in Bismarck, Grand Forks and Minot disclosed a total of 4,387 borrowers with a loan volume of \$335,000.00. It is obvious from the results of this study that "small loan business in North Dakota is a million dollar business."<sup>9</sup>

Centuries of experience have demonstrated that small loans cannot be abolished. Illness, pressure from creditors, temporary unemployment and many other exigencies require persons who ordinarily live from hand to mouth to raise cash immediately. Such people lack the credit standing and the security to borrow from a legitimate lending institution and are forced to turn to the loan shark. This ever-present borrower is not a single man seeking money but in ninety percent of the cases is a family man. It has been estimated that fully two-thirds of our American families do not lay up sufficient savings to provide for emergencies and unusual expenditures. If all of the economic and social factors effecting the problem of a small cash loan are considered, they establish the conclusion that credit is not merely expedient—it is a necessity.<sup>10</sup>

This problem cannot be solved merely by enforcement of the existing usury laws. North Dakota law makes usury a crime and also gives civil remedies to the debtor but these remedies are inadequate.<sup>11</sup> Borrowers of small sums are not aware of their rights and are unable to take the time or spend the money to hire legal

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5. See Eubank, *Loan Sharks and Loan Shark Legislation in Illinois*, 8 J. Crim. L. & Criminology 69 (1917). This article contains a discussion of the extent and methods of illegal lending in Chicago after the turn of the century.

6. See Barrett, *Compilation of Consumer Finance Laws* (1952).

7. See, Public Welfare Board of North Dakota, *Report on Study of Practice of Small Loan Companies Operating in North Dakota* (1950).

8. *State ex rel. Burgum v. Hooker*, 78 N.W.2d 337, 340 (N.D. 1957).

9. *North Dakota Report, Op. cit. Supra* note 7, at 1.

10. Kelso, *Social And Economic Background of the Small Loan Problem*, 8 Law & Contemp. Prob. 14 (1941). *North Dakota Report, Op. Cit. Supra* at 2. Of the twenty-six borrowers studied the average size of the families was found to be 4.5.

11. N. D. Rev. Code §§ 47-1409, 47-1410, 47-1411 (1943); *State ex rel. Burgum v. Hooker*, 78 N.W.2d 337 (N.D. 1957). The court allowed equitable relief because the civil and criminal remedies provided by our usury statutes are inadequate.

counsel to defend themselves in court.<sup>12</sup> Even the force of equity as used in the principle case is only a temporary cure, because prohibition alone does not solve the problem of providing small loans for the working man. Rigid enforcement of the present usury laws would only drive the loan shark under cover and cause him to exact still higher rates of tribute in consequence of the increased risk involved. Higher rates of interest will be charged as the stigma attached to the business and the danger of discovery and consequent loss are increased.<sup>13</sup>

The remedy, obviously, is the enactment of legislation providing for interest rates at which legitimate lenders can afford to make small loans on a commercial basis.<sup>14</sup> In the states where small loan companies are regulated and have the power to charge a fair interest rate the competition has been disastrous to the loan shark.<sup>15</sup> The Uniform Small Loan Act recommended by the Russell Sage Foundation, now in its seventh draft, is the result of thirty-five years of legislative and judicial experience. This law has proved to be an effective method of eliminating the loan shark in more than thirty states.<sup>16</sup>

The main provisions of the Uniform Small Loan Act are as follows: All lenders who wish to avail themselves of the special interest rates must be licensed by the state. Every person who pays the license fee, has the required capital and meets the other qualifications of character and experience may be granted a license.<sup>17</sup> The law operates as an exception to the usury law and allows licensees to charge a maximum of three percent per month

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12. In a case allowing equitable relief against usury the Supreme Court of Kansas used the following language: "The wage-earner has no time to attend court nor means to employ a lawyer to invoke the defense to the usurer's claim accorded by this statute. He must earn wages every working day to support his family. If garnishment proceedings are instituted . . . the unfortunate debtor is discharged. The dread consequence to the debtor can only be avoided by continued submission to defendants' usurious exactions." *State ex rel. Smith v. McMahon*, 128 Kan. 772, 280 Pac. 906, 907 (1929).

13. See Collins, *Evasion And Avoidance of Usury Laws*, 8 Law & Contemp. Prob. 54 (1941). This article outlines some of the many techniques used by illegal lenders to transact their business.

14. See Hilborn, *The Small Loan Act*, 14 A.B.A.J. 581 (1928).

15. See Kelso, *Social And Economic Background of The Small Loan Problem*, 16 Mo. L. Rev. 197 (1951).

16. See Barrett, *Compilation of Consumer Finance Laws*, 675 (1952) for a complete text of the seventh draft of the Uniform Small Loan Act. The Russell Sage Foundation is an endowed philanthropic agency which was established in 1907 and is recognized as the leader in the remedial loan field.

17. Uniform Small Loan Law (Hereafter cited USLL) §§ 2(a), 4; §4(b) (2) "that allowing such applicant to engage in business will promote the convenience and advantage of the community in which the licensed office is to be located." This provision allows the State Bank Examiner some discretion in granting a license. Some states have interpreted this section strictly and limited the number of licenses issued to those warranted by the volume of small loan demand. See Sullivan, *Administration of a Regulatory Small Loan Law*, 8 Law & Contemp. Prob. 146, 148. (1941).

on the unpaid balance.<sup>18</sup> Any extra charges either direct or indirect are prohibited.<sup>19</sup> The licensee is subjected to rather detailed regulations as to company name,<sup>20</sup> records,<sup>21</sup> annual reports,<sup>22</sup> advertising<sup>23</sup> and security.<sup>24</sup>

The State Bank Examiner is given supervisory powers over small loans within the state. This supervision includes an annual examination of each licensee<sup>25</sup> and the right to investigate the place of business and records of any small loan company.<sup>26</sup> The examiner is given the power to issue cease and desist orders,<sup>27</sup> suspend or revoke licenses<sup>28</sup> and apply to the courts for injunction and receivership<sup>29</sup> for violations of the act. Violations of the act are a misdemeanor and loans in violation thereof are void and uncollectible as to both principal and interest.<sup>30</sup> The act recommends that a maximum loan size be set at three hundred dollars.<sup>31</sup> However, a number of states have found that this amount is too small and accordingly have raised it to five hundred dollars or more.<sup>32</sup> It should be noted that banks, trust companies, savings and loan associations, credit unions and pawn brokers are exempted from the act and are ineligible to become licensees under its provisions.<sup>33</sup>

Although the small loan problem is becoming merged in the larger field of consumer finance and some type of code which regulates all types of consumer credit might ultimately become necessary to do complete justice, it is submitted that the first step that the legislature must take is enactment of a small loan law for North Dakota.<sup>34</sup>

JOHN MICHAEL NILLES.

18. USLL § 13 (a).

19. USLL § 13 (c); See Hubachek, Annotations on Small Loan Laws, 87 (1938) for a collection of cases defining what constitutes a violation of this section.

20. USLL §§ 5 (a), 12 (b).

21. USLL § 9 (a).

22. USLL § 9 (b).

23. USLL § 11 (a).

24. USLL § 12 (c) "No licensee shall take a lien upon real estate as security . . . except such lien as is created by law through the rendition or recording of a judgment." § 17 limits assignments of wages to the amount paid to the borrower and provided any one collection under such assignment does not exceed 10% of the borrowers wages.

25. USLL § 8 (a).

26. USLL § 8 (b).

27. USLL § 8 (d).

28. USLL § 7.

29. USLL § 8 (d).

30. USLL § 2 (d).

31. USLL § 15.

32. Barrett, Compilation of Consumer Finance Laws, XIV, n. 5 (1952); Ewart, *California Leads the Way in Small Loan Legislation*, 20 So. Calif. L. Rev. 172 (1947). This article contains a study of the proper maximum amount for small loans and reaches the conclusions that it should vary from state to state and \$300.00 is too low.

33. USLL § 2 (b).

34. See Hubachek, *Progress and Problems in Regulation of Consumer Credit*, 19 Law & Contemp. Prob. 4 (1954).