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VIRGINIA LAW OF INTEREST AND USURY

*John W. Edmonds, III**

INTRODUCTION

The concept of a limitation upon the charges that may be imposed for the hire of money is hardly modern. Although it may not be the oldest usury law, a reference to Deuteronomy should suffice:

> Unto a stranger thou mayest lend upon usury; but unto thy brother thou shall not lend upon usury.[1]

This has been termed the earliest "corporate" exception to the usury laws. Gentiles passing through Israel were tradesmen and hiring of money to tradesmen was not against the law of Moses. "Brethren" were fellow Hebrews, akin to our present class of "consumers" or neighbors in need. One can reflect that the present statute[2] forbidding a plea of usury upon business and investment loans of an initial $5,000.00 or more is nothing new since the law of Moses.

In 1730, Virginia passed its first interest and usury law legalizing a 6% rate.[3] Interest was fixed at $6.00 per $100.00 in 1819 and a

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1. *Deuteronomy* 23:20 (King James). Usury is defined as "interest exceeding the lawful rate for the loan or forbearance of money." 19 MICHIE'S JURISPRUDENCE, *Usury* § 2, at 251.

2. VA. CODE ANN. § 6.1-330.44 (Cum. Supp. 1975) provides:

> No person shall, by way of defense or otherwise, avail himself of the provisions of this chapter, or any other section relating to usury to avoid or defeat the payment of interest, or any other sum, when such loan is made to an individual or individuals or other entity for the acquisition or conduct of a business or investment as sole proprietor, owner, joint venturers or owners provided the initial amount of the loan is five thousand dollars or more.
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> For the purposes of this section, if a borrower shall represent in his own handwriting the purposes of the loan, such representation shall be conclusive and binding upon him.
>
> For the purposes of this section, unless a loan is for family, household, or personal purposes (which shall not include a passive or active investment), it shall be deemed to be for business or investment purposes within the meaning of this section.

3. 4 Hennings Stat. 194. This rate was reduced to 5% in 1734, but restored to 6% per annum in 1796.

higher charge rendered the obligation, both principal and interest, utterly void.[4] Virginia had a legal, contract and judgment rate of 6% in 1819.[5] In 1873, the contract rate was raised to 8% and banks were permitted to discount or collect interest in advance at the rate of 2/3 of 1% for thirty days, or 8% annually;[6] a more significant change, however, was to provide that the penalty for usury nullified the excess interest only.[7]

Two other statutory enactments affected interest rates in Virginia during this period. First, Congress in 1864 passed the National Bank Act, referring to the state law of the location of the national bank for permissible interest charges.[8] Second, Virginia in 1873 adopted legislation denying to corporations the plea of usury.[9] At that time, corporations were created by special act of the legislature; Virginia, like other states, was without a general business corporation act. Although some background material on the corporate usury statute appears in the case law,[10] there is little discussion of the rationale for its enactment. Presumably such statutes rest upon the fact that corporations are sophisticated creatures with limited liability.

4. Code of 1819, ch. 102, at 373-74. There was also a limitation on broker's fees of $.25 per $100.00, with a lesser $0.17 per $100.00 permitted on renewals.

5. The meanings of the different rates are discussed in text accompanying notes 52-54 *infra*.

6. Code of 1873, ch. 137, § 4, at 977.

7. *Id.* § 5.

8. Act of June 3, 1864, ch. 106, § 30, 13 Stat. 108, *codified at* 12 U.S.C. § 85 (1945). *See* note 16 *infra*.

An early interpretation of 12 U.S.C. § 85 in Tiffany v. National Bank, 85 U.S. (18 Wall.) 409 (1873), spelled out the fact that national banks were not necessarily limited by state law, but might avail themselves of the rate permitted by the state to any lender, even though state banks expressly did not have this privilege. Evans v. National Bank, 251 U.S. 108 (1919), pointed out that national banks might discount or collect interest in advance even though such discount is expressly denied to state banks by state law.

Judicial construction of 12 U.S.C. § 85 has been consistently liberal. *See, e.g.*, Northway Lanes v. Hackley Union Nat'l Bank and Trust Co., 464 F.2d 855 (6th Cir. 1972) (national bank can charge closing costs prohibited to state banks but permitted to savings and loan associations); Commissioner of Small Loans v. First Nat'l Bank, 268 Md. 305, 300 A.2d 685 (1973) (national banks can charge interest on small loans at same rate as small loan companies are permitted to charge on comparable loans even though state banks are limited to a lesser rate); *cf.* Partain v. First Nat'l Bank, 467 F.2d 167 (5th Cir. 1972) (national banks, in connection with a credit card operation can charge small loan rates, but cannot charge interest on interest where this was expressly denied to small loan companies.)

9. Va. Acts of Assembly 1873, ch. 213, at 194, *codified at* Code of 1873, ch. 57, § 36, at 544.

10. *See* Town of Danville v. Pace, 66 Va. (25 Gratt.) 1 (1874), where it was held that the statute was retroactive in effect and not unconstitutional.

In general, the interest laws of Virginia remained untouched until the 1960's, with three exceptions, all relating to consumer credit and smaller loans. Virginia in 1918 adopted a Small Loan Law permitting loans up to $300, at a rate of 3½% per month on the unpaid principal balance.[11] One can speculate that the monthly rate was used to avoid infringing what had come to be the sacrosanct 6% per annum. While the maximum rate declined, the maximum loan amount increased so that in 1973 the statutory rates were 2½% per month on the first $300.00 and 1½% per month on the next $700.00.[12] In 1974, such rates and maximum loans were referred to the State Corporation Commission and an initial maximum loan amount was fixed at $1,500.00.[13] In the 1974-75 recodification the provisions relating to loans by small loan companies were left in a separate statute and no attempt was made to combine them in the new Chapter 7.2 of Title 6.1.

In 1928, Virginia enacted its first add-on interest rate, giving industrial loan associations the right to charge 6% add-on, plus an initial 2% service charge.[14] The industrial loan associations lent money to individuals who agreed to pay it back in regular installments. At the time of the legislation, self-amortizing monthly payment real estate loans were not routine devices for financing residential real estate transactions. The add-on interest rate preserved what might be referred to as the 6% myth. A nominal rate of 6% on the initial balance was retained, without giving credit against the 6% interest rate for principal payments, thereby providing an actual yield of somewhat less than twice the nominal yield. The add-on privilege was granted to banks in 1938.[15]

In 1933, another gloss was added to the interest rates permitted

11. Va. Acts of Assembly 1918, ch. 402, § 14, at 666. The rate was lowered to 2% in 1942. Va. Acts of Assembly 1942, ch. 107, at 126. It was raised to 2½% in 1944. Va. Acts of Assembly 1944, ch. 370, § 4168-a 37, at 562.

12. VA. CODE ANN. § 6.1-272 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1974, ch. 371, at 640.

13. Va. Acts of Assembly 1974, ch. 371, at 640, *codified at* VA. CODE ANN. §§ 6.1-271, -271.1 (Cum. Supp. 1975).

14. Va. Acts of Assembly 1928, ch. 448, § 6, at 1143. Industrial loan associations were originally authorized in 1920. Va. Acts of Assembly 1920, ch. 74, at 61.

15. The add-on privilege for banks was incorporated into the section permitting the discount or collection of interest in advance. Va. Acts of Assembly 1938, ch. 72, at 126. The section appears in the recodification at VA. CODE ANN. § 6.1-330.13 (Cum. Supp. 1975).

national banks.[16] It was argued that the member bank privilege of borrowing from Federal Reserve banks had little chance of acting as a safety valve in times of tight money, unless the banks were guaranteed a profit or at least assured of no loss on the money borrowed for relending purposes. The Carter Glass Amendment,[17] named after the Virginia Senator who acted as its sponsor, gave to national banks only (and not to state member banks of the Federal Reserve System) the right to charge 1% more than the 90-day discount rate at the regional Federal Reserve bank.[18]

The General Assembly in 1960 recognized the existence of a national interest market and permitted lenders principally in the business of making real estate loans for resale to impose an initial 1% service, processing or investigation fee.[19] The legislature was not enacting a new charge on mortgage loans, but merely recognizing an

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16. 12 U.S.C. § 85 (1945) governs the interest rates permitted national banks and provides in part:

> Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at the rate allowed by the laws of the State, Territory, or District where the bank is located, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter. When no rate is fixed by the laws of the State, or Territory, or District, the bank may take, receive, reserve, or charge a rate not exceeding 7 per centum or 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and such interest may be taken in advance, reckoning the days for which the note, bill, or other evidence of debt has to run.

17. Act of June 16, 1933, ch. 89, § 25, 48 Stat. 191.

18. It should be noted that the right of the national bank to impose such a rate does not depend upon the fact of borrowing by the particular national bank from its Federal Reserve bank.

19. Va. Acts of Assembly 1960, ch. 438, at 691, *codified at* VA. CODE ANN. § 6-348.3 (Cum. Supp. 1964), *recodified at id.* § 6.1-323 (Repl. Vol. 1966). Savings and loan associations were also given the right to collect the 1% initial service charge, as well as a 2½% fee on construction loans. Va. Acts of Assembly 1966, ch. 584, at 821-22, *codified at* VA. CODE ANN. § 6.1-195.17 (Repl. Vol. 1973). Both acts were repealed by Va. Acts of Assembly 1975, ch. 448, at 769 but § 6.1-195.17 was recodified at VA. CODE ANN. § 6.1-330.24 (Cum. Supp. 1975).

In 1964, banks and other lenders were given the right to charge the 1% initial fee on mortgage loans and 2½% on construction loans. Va. Acts of Assembly 1966, ch. 584, at 855, *codified at* VA. CODE ANN. § 6.1-324 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.23 (Cum. Supp. 1975).

existing charge which could have become questionable with the rise in interest rates on long term mortgages. Mortgage bankers were closing loans in their own names for the purpose of reselling them as a package to out-of-state investors. The brokers had long imposed this 1% initial charge. Until long term mortgage rates went over 5% per annum, there could have been no question as to the legality of such a 1% charge.

The plea of usury on FHA and VA loans was eliminated in 1960,[20] in recognition of the fact that there was federal regulation of these rates and that Virginia FHA and VA mortgages competed in a national, not a state or local, market. Also in 1960, banks were permitted to charge 1% per month on plans for revolving credit.[21] The impetus for this change was twofold. A new concept in credit, check credit or overdraft banking had reached its time. Under more advanced bookkeeping, bank customers having a pre-arranged line of credit could write checks which would otherwise create overdrafts and the bank would make automatic loans by transferring multiples of $100.00 or other pre-arranged amounts to cover such checks.[22]

There was concern in 1966 about alleged gouging on second mortgage loans, which, except for industrial loan associations and banks, were limited to 6% simple interest. The legislative solution was to permit all lenders, not otherwise supervised and licensed by the State Corporation Commission or the federal government, to charge 6% add-on interest. All loans by such lenders at charges in excess of such rates were void as to both principal and interest.[23] This solution invited into the second mortgage market other legitimate lenders attracted by the more economically realistic rates, while making the penalty for violation harsher and a greater deterrent.

In 1968, interest rates had started their upward climb and the 6%

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20. Va. Acts of Assembly 1960, ch. 65, at 68, *codified at* VA. CODE ANN. § 6.1-328 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.38 (Cum. Supp. 1975).

21. Va. Acts of Assembly 1960, ch. 74, at 97, *codified at* VA. CODE ANN. § 6-348, *recodified at id.* § 6.1-330.19 (Cum. Supp. 1975).

22. The Comptroller of the Currency has indicated that national banks might do this by reference to 12 U.S.C. § 85 and the rate allowed other lenders under the doctrine of Tiffany v. National Bank, 85 U.S. (18 Wall.) 409 (1873). COMPTROLLER'S MANUAL FOR NATIONAL BANKS, ¶ 7.7310 (Jan. 1974).

23. Va. Acts of Assembly 1966, ch. 285, at 460, *codified at* VA. CODE ANN. § 6.1-330.3 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.25 (Cum. Supp. 1975).

general limitation on interest tended to keep needed mortgage and other investment money out of Virginia. A special commission was created to study the interest laws and it recommended a 12% contract interest rate which would permit rates to be fixed at a competitive level while prohibiting excessive gouging.[24] The argument against a less significant increase in the interest rate was that it would merely suggest an automatic increase to the maximum contract rate.[25] Again the economy moved faster than the legislature and Virginia found in 1970 a severe drought in mortgage money. Theorizing that there was a supply and demand economy in first mortgages, the General Assembly adopted a policy that a first mortgage could be enforced at the rate stated in the mortgage, without regard to normal usury limitations.[26]

Due to computer capacity in the late 60's, the credit card was beginning to take hold. At least one system had operated in Virginia utilizing the 1% per month charge permitted on revolving credit.[27] Many merchants, operating under the time-price doctrine, were charging a monthly rate of 1½% on merchandise credit allowing the normal thirty days from billing for payment. New legislation conferred upon all lenders the right to charge 1½% per month on this type of credit if it was not paid within twenty-five days from the billing date.[28] The justification for the 25-day free period lay in the fact that most money lenders or sellers bill from the same numerical date each month.[29]

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24. H. DEL. DOC. No. 14, 1968 General Assembly, at 9.

25. The contract rate was raised to 8% by Va. Acts of Assembly 1968, ch. 92, at 142, *codified at* VA. CODE ANN. § 6.1-319 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.11 (Cum. Supp. 1975). The statute was unique in that it required amounts paid by persons other than the borrower, *e.g.* bonus points paid by the seller, to be included for rate computation purposes.

26. Va. Acts of Assembly 1970, ch. 38, at 31-32, *codified at* VA. CODE ANN. § 6.1-319.1, *recodified in parts at id.* §§ 6.1-330.27, -330.37, -330.40 (Cum. Supp. 1975). The legislature provided that the statute would apply only to transactions closed within two years or prior to July 1, 1972. The author is happy to report that the evidence showed Virginia lenders following or staying slightly under national averages and the two year limitation was dropped in 1972.

27. *See* VA. CODE ANN. § 6.1-320 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.19 (Cum. Supp. 1975).

28. VA. CODE ANN. § 6.1-362 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.20 (Cum. Supp. 1975).

29. The specification of a 25-day free period as opposed to a 30-day free period generally keeps such credit card operators from having to take the blame for delay in the mails. Also 28 days in February would create an annual problem.

In 1970 partnerships were added to the persons limited in invoking the plea of usury.[30] This action presented problems as well as solutions. To protect against lenders requiring sham partnerships for borrowing purposes, the exception was made applicable to those partnerships which had filed under the partnership certificate statute.[31] To obtain money at the current market price, many business enterprises were being forced to incorporate where a partnership entity would have been preferable for tax and other purposes. The subsidiary question of whether limited partnerships had to file a partnership certificate as well as a limited partnership certificate[32] was presented, and cured by a 1972 amendment which provided that limited partnership certification was sufficient.[33] Certain real estate joint ventures were also included among the entities which could not invoke the usury laws.[34] Foreign partnerships were covered by recent legislation[35] providing that no foreign partnership can plead usury, without regard to its filing of a Virginia certificate.

Another 1972 amendment denied the plea of usury on a second mortgage where it secured a loan to an individual for business purposes and the loan was for $5,000.00 or more.[36] In 1972, the Virginia Supreme Court pointed out that the Second Mortgage Act was separate from the other usury laws and that the limitation on the plea of usury applied only to loans under Chapter 7 and not to loans under Chapter 7.1, the Second Mortgage Act.[37] Three 1973 amendments were designed to modify this result.[38]

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30. Va. Acts of Assembly 1970, ch. 234, at 310, *codified at* VA. CODE ANN. § 6.1-327 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.43 (Cum. Supp. 1975).

31. VA. CODE ANN. § 50-74 (Repl. Vol. 1974).

32. VA. CODE ANN. § 50-45 (Repl. Vol. 1974).

33. Va. Acts of Assembly 1972, chs. 636, 677, at 840, 904, *codified at* VA. CODE ANN. § 6.1-327 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.43 (Cum. Supp. 1975).

34. *Id.*

35. Va. Acts of Assembly 1975, ch. 448, at 778, *codified at* VA. CODE ANN. § 6.1-330.43 (Cum. Supp. 1975).

36. Va. Acts of Assembly 1972, ch. 517, at 592, *codified at* VA. CODE ANN. § 6.1-327.1 (Repl. Vol. 1973), *recodified at id.* § 6.1-330.44 (Cum. Supp. 1975).

37. Tuttle v. Haddock, 213 Va. 63, 189 S.E.2d 363 (1972). The case involved a loan to a corporation secured by a second deed of trust on certain property. Upon bankruptcy, the trustee for the guarantor contended the note was usurious. The noteholders pointed to VA. CODE ANN. § 6.1-327 (Repl. Vol. 1973) denying the plea of usury to corporations. The court, however, noted that the statute applied only to loans under Chapter 7 and that section 6.1-330.1 of Chapter 7.1 was applicable, rendering the note usurious.

38. Va. Acts of Assembly 1973, ch. 318, at 433, *codified at* VA. CODE ANN. §§ 6.1-327,

Interest and usury seems to be an annual topic for the legislature, after remaining dormant (or nearly so) for about 100 years. The 1974 session was no exception. Banks and savings and loan associations were extended the 7% add-on privilege and the $1,000.00 limitation on the 2% service charge in the case of banks was omitted.[39] Savings and loan associations and other lenders were permitted to charge 3% more than the rate being paid on savings and time deposits on loans secured by such savings.[40]

In 1974, the Virginia General Assembly restored the rule of Deuteronomy[41] prohibiting the plea of usury on loans for business or investment purposes in an initial amount of $5,000.00 or more.[42] The statute permits a lender to inquire of a borrower the purpose of a loan and the handwritten representation of the borrower is conclusive. The statutory language was suggested by the holding in *Heubusch v. Boone*,[43] in which a lawyer was estopped from characterizing a loan as illegal and usurious when he had endorsed it and given a written opinion as to its validity at time of closing.

Imitation may be the sincerest form of flattery, and in 1974, Congress passed legislation relating to insured banks and permitting a charge of 5% above the Federal Reserve discount rate on business loans of $25,000.00 or more.[44] The federal statute, in addition to having a higher threshold amount, does not contain statutory language permitting the borrower to represent in writing the purpose of the loan or a definition of business purpose as provided by the Virginia statute. It also does not contain the qualifying word "initial" before the amount of the loan, thereby leaving uncertain the effect of a payment reducing the principal amount of the loan below the statutory amount. The Virginia statute permits and encourages such prepayments, while the federal statute leaves a problem as to the applicable rate on such loan as it is paid down. Comparison of the federal statute and the Virginia statute leaves one with an appreciation of Moses both as a law giver and an economist.

-327.1, -330.1, *recodified at id.* §§ 6.1-330.43, -330.44 (Cum. Supp. 1975).

39. Va. Acts of Assembly 1974, chs. 284, 290, at 429, 440.

40. *Id.*, chs. 261, 284, at 387, 428.

41. *See* text accompanying note 1 *supra*.

42. Va. Acts of Assembly 1974, ch. 393, at 679, *codified at* VA. CODE ANN. § 6.1-319.2 (Cum. Supp. 1974), *recodified at id.* § 6.1-330.44 (Cum. Supp. 1975).

43. 213 Va. 414, 192 S.E.2d 783 (1971).

44. Act of October 29, 1974, Pub. L. No. 93-501, § 201, 88 Stat. 1557.

THE RECODIFICATION

The Virginia Code Commission, pursuant to Senate Joint Resolution 41,[45] drafted and submitted to the 1975 General Assembly a recodification and rearrangement of the statutes relating to money and interest. This recodification and rearrangement was enacted[46] and is contained in a new Chapter 7.2 of Title 6.1 of the Virginia Code. Thus, with the exception of the interest laws applicable to small loan companies[47] and one 1975 enactment this Chapter contains the entire interest laws of Virginia. With one exception it became law on June 1, 1975.[48]

New Chapter 7.2 contains 43 sections divided into ten articles. The remainder of this article is a section by section analysis of the new statutes. Although few substantive changes were made in 1975, where they were made they will be specifically pointed out in the discussion of the section where the change occurs.

Article I: General

Article I contains three sections which encompass the provisions of seven previous sections.[49] Section 6[50] continues the dollar, cent and mill as the money of account in Virginia and maintains that no writing shall be invalid merely because the amount of money is expressed otherwise than in the money of account of Virginia.

Section 7 provides that in a suit for a sum of money expressed in

45. S.J. RES. 41, Virginia General Assembly, Regular Session (1974).

46. Va. Acts of Assembly 1975, ch. 448, at 769, *codified at* VA. CODE ANN. § 6.1-330.6 *et seq.* (Cum. Supp. 1975).

47. *See* VA. CODE ANN. §§ 6.1-244 to -310 (Repl. Vol. 1973) (interest laws applicable to small loan companies); *id.* § 6.1-5.2 (Cum. Supp. 1975) (allows the State Corporation Commission to confer upon state banks the power to charge 1% above the discount rate charged banks by the Federal Reserve Bank of Richmond on 90-day commercial paper). Previously Title 6.1 contained a general Chapter 7 relating to money and interest, a Chapter 7.1 relating to unlicensed and unsupervised lenders and various other sections, particularly the statutes relating to savings and loan associations.

48. VA. CODE ANN. § 6.1-330.26 (Cum. Supp. 1975) relating to late charges applies only to transactions arising after July 1, 1975. This resulted not from any particular legislative intent, but from the failure of the draftsmen to focus upon the fact that in odd years legislative acts take effect on June 1 rather than July 1.

49. *See* VA. CODE ANN. §§ 6.1-311 to -317 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769.

50. For purposes of clarity and differentiation, the new sections will be referred to only by the number after the last decimal. For example, in the text § 6.1-330.6 will be referred to as section 6. The more complex statutes will be set out in the notes.

foreign currency or otherwise than in the dollar, cent and mill, the trier of fact is required to ascertain the value in dollars, cents and mills, making such an allowance for the difference of exchange as shall be just. The question whether the exchange value should be computed as of the date of the contract, the date of supposed performance, the date of the trial, or some other date is left unanswered, due to the complex fluctuation of exchange rates and a lack of strong feeling as to which time would be more appropriate.

Section 8 prohibits the issuance by any association or company of any note, bill, scrip or other paper or thing intended to be circulated as currency unless authorized by law.[51] This section also provides that any contract or security originating from any illegal currency dealings is void.

Article II: Interest Rates Generally and on Judgments

This Article sets forth three fundamental interest rates, the legal rate, the judgment rate, and the contract rate. Section 9 fixes the legal rate at 6% per annum. The legal rate is not the rate that judgments bear, nor is it the highest lawful rate of general application. Basically, it is the rate which is implied by law where the obligation calls for the payment of interest, but no rate is fixed. However, if a negotiable instrument under Article 3 of the Uniform Commercial Code calls for the payment of interest without specifying a rate, the rate is deemed to be the judgment rate.[52] Section 10 fixes the judgment rate at 8% per annum. A conforming amendment makes the general judgment rate applicable to judgments in favor of small loan companies.[53]

Except as otherwise provided, the maximum rate of interest at which parties may contract is fixed in section 11 at 8% per annum.[54]

51. The prohibition of section 8 stands "unless authorized by law." *See* VA. CODE ANN. §§ 6.1-370 to -379 (Cum. Supp. 1975) (regulation of the sale and issuance of money orders).

52. VA. CODE ANN. § 8.3-118(d) (Add. Vol. 1965).

53. Va. Acts of Assembly 1975, ch. 270, at 465-66, *codified at* VA. CODE ANN. § 6.1-273 (Cum. Supp. 1975). Formerly, the judgment rate applicable to small loan companies was 6% per annum.

54. VA. CODE ANN. § 6.1-330.11 (Cum. Supp. 1975):

> Except as otherwise permitted by law, no contract shall be made, for the loan or forbearance of money at a greater rate of interest than eight per centum per annum, including points expressed as a percentage of the loan divided by the number of years

The second paragraph of this section specifies the articles containing the numerous exceptions to the 8% maximum contract rate. Although this paragraph might more properly belong in a footnote, it was intentionally made a part of the section by the Commission on the premise that statutes are more widely read than footnotes.

The provisions of section 11 continue the requirement that "points" must be included in the computation of the 8% maximum contract rate. This is true without regard to who pays the "points," so long as they are received by the lender, and not otherwise expressly permitted by statute, as in the case of the 1% processing fee on real estate loans permitted under sections 22 and 23.[55] The statutory conversion of points to interest differs from the truth-in-lending concept of annual percentage rate.[56] Under section 11, points are converted to a percentage rate by dividing the points by the number of years of the loan contract. This is true even though the principal balance is declining throughout the term of the loan. For example, if 10 points are paid on a five-year contract, this would be equal, under section 11, to 2%. Conversion of points to an actuarial annual percentage rate under truth-in-lending would result in a higher rate in view of the declining balance of the loan contract.

Article III: Add-on Interest

Article III contains six sections involving add-on interest. Section 12 defines "charge in advance" in the context of installment loans as meaning that interest may be added to the principal amount of the note but may not be deducted from it.[57] It is now applicable to

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of the loan contract. For the purpose of this section the term "points" is defined as the amount of money, or other consideration received by the lender, from whatever source, as a consideration for making the loan and not otherwise expressly permitted by statute.

For contracts which may be at a greater interest than eight per centum per annum, reference is hereby made to article 3 . . . relating to add-on rates, article 4 . . . relating to revolving and monthly rates, article 5 . . . relating to other charges on real estate loans, article 8 . . . relating to transactions not subject to usury or subject to special limitations to usury, and to article 9 . . . enumerating borrowers not entitled to plead usury. Further reference is hereby made to chapter 6, §§ 6.1-244 to 6.1-310 relating to powers of small loan companies.

55. *See* text accompanying notes 78-80 *infra*.

56. Truth in Lending Act, 15 U.S.C. §§ 1601, 1606 (1974).

57. The definition was taken from VA. CODE ANN. §§ 6.1-234 -330 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769, dealing with industrial loan associations and unlicensed lenders respectively.

all add-on lenders. If a 7% add-on loan is made for a period of one year and the amount advanced is $1,000.00, the face amount of the note would be $1,070.00. It is clearly impermissible under this new definition to make the note for $1,000.00 and advance $930.00, a practice referred to as discount installment lending. In a one-year installment loan transaction, the difference between "add-on" and "discount" may be relatively minor but as the term of the loan increases to three or four years, the interest variation occasioned thereby will be much greater. A discount installment rate might in some instances still be used in connection with a time-price transaction, or with a person who is not permitted to plead usury.[58] The definition of "charge in advance" would seem to be binding upon national banks, notwithstanding the privilege of discount under 12 U.S.C. § 85.[59] For example, in *First National Bank v. Nawlin*[60] the Eighth Circuit held that a national bank may not under 12 U.S.C. § 85 discount *installment* loan notes if such practice violates state law. The court continued to recognize the established rule that national banks may discount short term single payment notes notwithstanding state law. A dictum in the opinion appears to indicate that short term single payment paper is paper that matures in one year or less.

Section 13 permits a bank to charge a 7% add-on rate. The language in the prior statute[61] permitting acceleration of an add-on note has been deleted from section 13 as superfluous, but acceleration is still permitted under general law and specifically sanctioned

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58. The "time-price" doctrine has been described thus:

> The recognized rule is that a sale of an article on credit at a price higher than for cash is not usurious if it is a bona fide sale of that character, which is known to the buyer, and is not a subterfuge for charging a higher interest rate. This is so even though the difference between the two prices would make the total amount paid exceed the amount of the interest that could lawfully be charged on the cash price. Lundstrom v. Radio Corp. of America, 17 Utah 2d 144, 405 P.2d 339, 342 (1965).

See note 76 *infra*. The time-price doctrine has been abrogated with regard to transactions involving consumer goods by section 21. *See* text accompanying notes 76-77 *infra*. Therefore, a discount installment rate in a time-price transaction involving real estate or personal property other than consumer goods may be acceptable or in a consumer goods transaction if its charge does not exceed the amount permitted by section 21.

59. *See* note 16 *supra*.

60. 509 F.2d 872 (8th Cir. 1975).

61. VA. CODE ANN. § 6.1-320 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769.

under section 35 of the new law.[62] A note may be subject to acceleration for many other reasons not affecting negotiability.[63] The permissible 2% investigation fee is continued in section 13, but is now designated as a "service charge." The 2% service charge permitted savings and loan associations under previous law[64] is now stated in section 14, which allows a savings and loan association to charge the 7% add-on rate on certain home improvement related and mobile home loans and in addition to impose a 2% service charge on the loan amount.

Industrial loan associations are permitted to charge an add-on rate under section 15 and a 1975 substantive amendment increased the add-on rate from 7% to 8%. Industrial loan associations may also impose the 2% service charge. In view of the consistent judicial construction of 12 U.S.C. § 85, it would appear that national banks may charge 8% add-on.[65]

The add-on privilege allowed to unlicensed and unsupervised lenders secured by subordinate mortgages on one to four-family residential property is contained at section 16. A 1975 substantive amendment increased the add-on rate to 8% per annum plus a 2% service charge. However, pursuant to sections 25 and 48,[66] the 8% add-on rate on subordinate mortgages does not apply to lenders licensed by and under the supervision of the State Corporation Commission or the federal government or to state and national banks, state and federal savings and loan associations, and state and federal credit unions. Notwithstanding the negation of national banks under section 25, it would seem that under 12 U.S.C. § 85 and its liberal judicial interpretation, national banks may charge the 8% add-on rate under section 16, as well as section 15. Under section 16, a subordinate mortgage would be a condition precedent for the national bank, but this would not be true under section 15. A national bank could charge 12% simple interest on a loan secured by

62. *See* text accompanying notes 90-91 *infra*.

63. *See* VA. CODE ANN. § 8.3-105 (Add. Vol. 1965) (factors not rendering an instrument unconditional). *See also* text accompanying notes 90-91 *infra*, relating to permissible acceleration, and enunciating a rule that one cannot accelerate unearned interest.

64. VA. CODE ANN. § 6.1-195.34(i) (Repl. Vol. 1973) (amended to delete reference to interest and service charges).

65. *See* note 8 *supra*.

66. *See* text accompanying notes 83-84 *infra*.

a second mortgage on such qualifying residential real estate under paragraph D of section 16.

Previously, statutory language[67] provided that the charges permitted to second or subordinate mortgage lenders could not be made on a new or additional loan until after the passage of eighteen months. This was amended, in order to clearly state the legislative intent, by prohibiting the imposition of the 2% service charge upon money already lent. Section 16 specifically states that to the extent new money is advanced in addition to the outstanding principal balance at the time of the advance, the 2% service charge may be imposed only upon the new advance. Without this change, the statute seemed to work a very peculiar result in that, if the borrower wanted to secure additional financing on the same residence or to secure additional financing on another residence, he could not go to the same lender. Section 16 also makes clear that on subordinate mortgage loans, rates otherwise permitted under any other section or otherwise permitted by law may be utilized.

The language relating to acceleration was left in section 16. This language requires a default for a period of 30 days prior to acceleration on a loan secured by a subordinate mortgage. Section 35 contains no 30-day default provision. However, a lender should not be able to collect unearned interest on accelerated section 16 loans in accordance with the prohibition of such collection under section 35.[68]

A new paragraph D in section 16 permits a 12% per annum simple interest rate on a loan secured by a subordinate mortgage. This would have its primary application to a single maturity second mortgage loan to an individual which is not for a business purpose or if for a business purpose, is in an initial amount of less than $5,000.00. The 2% service charge permitted in paragraph A, in addition to 8% add-on, is *not* found in paragraph D.

Section 17 deals with the quotation of installment loan rates for consumer credit purposes. In a consumer transaction, as defined for federal truth-in-lending purposes,[69] the lender may not quote solely

67. VA. CODE ANN. § 6.1-330 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769.

68. *See* text accompanying notes 90-91 *infra*.

69. 15 U.S.C. § 1602(h) (1970).

in terms of an add-on discount installment rate, but must quote an annual percentage rate. Use of the annual rate computed pursuant to the Federal Truth-in-Lending Act[70] is compliance with this statute. An interpretation by the Federal Reserve, issued pursuant to the advertising provisions of the Act,[71] states that in a consumer transaction, the loan should be quoted only in terms of annual percentage rate and that an add-on rate should not be used. For this reason, the lender should encourage its employees to speak only in terms of annual percentage rates when discussing loans with prospective borrowers. Nevertheless, because a violation of section 17 imposes a civil penalty upon a lender[72] and the advertising provisions of the Federal Truth-In-Lending Act[73] do not impose a civil penalty, the prefatory language of "not solely in terms of an add-on or discount installment rate" was retained to cover the situation where an employee might inadvertently say "at a 6% add-on rate which is the equivalent of 11%." It is submitted that in such case, there has been a full disclosure and the lender should not be penalized for such quotation.

A new paragraph B in section 17 codifies an opinion of the Attorney General[74] that a note or other evidence of indebtedness which provides for an add-on or discount rate may state in such note or other evidence of indebtedness the annual percentage rate quoted in accordance with the federal truth-in-lending statutes. This seems an obvious conclusion because the federal statutes indicate that such disclosure might be made in the note itself. The general practice with regard to installment notes is to state both the total amount of the obligation and the amount of each installment, without any breakdown of principal and interest or statement of the annual percentage rate or the add-on or discount rate. The new subsection seems to make abundantly clear that which should already be clear, *i.e.*, disclosing or quoting the annual percentage rate in an add-on installment note as required by federal law does not render the note usurious.

70. *Id.* § 1606.

71. FRB Letter of March 29, 1971, No. 465, CCH CONSUMER CREDIT GUIDE ¶ 30,663.

72. The penalty is twice the amount of the finance charges, but in no event less than $100.00 or more than $1,000.00.

73. 15 U.S.C. §§ 1661-65 (1970).

74. OP. ATT'Y GEN. (October 7, 1974).

Article IV: Revolving and Monthly Rates

This article attempts to gather in one place the various rates allowable on a monthly basis. In a consumer credit transaction, under federal truth-in-lending, the annual percentage rate must still be quoted.

Section 18 permits a credit union to make loans at a rate of interest not exceeding 1% per month computed on unpaid balances. A borrower from a credit union is permitted by section 28 to prepay his loan in whole or in part at any time without penalty. It is submitted that the proper interpretation of section 18 is that a credit union may make a loan either at the rate of 1% per month or as otherwise permitted by law.[75]

A bank is permitted by section 19 to charge 1% per month on daily balances or on maximum calendar or fiscal monthly balances on written contracts for revolving credit. Additionally, a bank may charge a service fee of $.25 for each check, draft or other order. A 2% service charge on the amount of the loan is also permitted. The primary utilization of this section has been in connection with overdraft banking or check credit plans, and in connection with cash advances under credit cards, where some banks have, in addition, imposed a 2% initial service charge on each advance.

Section 20 sets forth a permissible 1½% per month or 18% per annum service charge on open-end credit or similar plans under which a service charge may be imposed if the unpaid balance is not paid in full within a period of twenty-five days from the billing date. It is required that the 1½% per month charge be imposed on the average daily balance or on the balance existing on the billing date (or end of the fiscal billing period) or on a balance which does not result in a greater charge than computable under the former two methods. Unlike section 20, section 19 does not require an average daily balance computation in order to charge its 1% per month rate.

The 1½% per month charge allowed by section 20 is conditioned upon the seller or lender mailing the statement not later than eight days (excluding Saturdays, Sundays and holidays) after the billing date. A clarifying amendment changed the words "less than" to

75. For example, if the loan is made to a person not permitted to plead usury under section 43. *See* text accompanying note 98 *infra*.

"later than" in the eight-day rule. An over-technical reading of "less than" could have led one to conclude that if a creditor mailed the statement before the expiration of eight days after the billing date, it could not impose a service charge, but it would be able to impose a service charge if the statement were mailed on or after the eight-day period—a conclusion which would have been clearly at odds with the intent of the statute.

Section 21 continues the limitation on the time-price doctrine[76] as applicable to sales or leases of consumer goods as defined in the Uniform Commercial Code. The permissible service charge for sales of consumer goods remains as "not exceeding 2% per month." A 1975 amendment makes it clear that a deferral or extension of time for payment may be made subject to the 2% per month service charge. Another change specifies the balance on which the service charge may be imposed, *i.e.* the balance at the end of the billing period next preceding each successive payment, and provides that such balance may include the deferred portion of the sales price of consumer goods, and the costs and charges incidental to the transaction, including insurance premiums financed in connection therewith. In the case of an automobile purchase, this ought to cover titling costs.

On precomputed transactions, the debtor has the right under section 21 to prepay and receive a rebate determined in accordance with the Rule of 78's (sum of the digits)[77] or any other method

76. Since 1873, it has been settled in Virginia that usury does not attach to bona fide sale transactions. The time-price doctrine holds that a seller of property may exact a higher time price than cash price, and that the time price differential "is not considered interest in the strict sense and may exceed an amount which, if considered interest, would be usurious." General Elec. Credit Corp. v. Lunsford, 209 Va. 743, 748, 167 S.E.2d 414, 418 (1969). *See* Kidd v. Brothers, 212 Va. 197, 183 S.E.2d 140 (1971); Graeme v. Adams, 64 Va. (23 Gratt.) 225 (1873).

77. The Rule of 78's is defined at VA. CODE ANN. § 6.1-330.32 (Cum. Supp. 1975):

> A. The Rule of 78 is so named because the months of one year, i.e. one through twelve added together, total seventy-eight.
>
> B. To determine the amount of the rebate of unearned interest under the Rule of 78 on a loan where payment is anticipated:
>
> 1. Determine the number of months over which the loan is to be repaid according to its terms. Write the numbers in sequence and add (for example, for a four-year loan write the numbers one through forty-eight). The total will be the denominator of a fraction to be determined below.
>
> 2. Determine the number of months remaining on the loan after payment is antici-

selected by the seller provided the service charge imposed for the time the debt is actually outstanding does not exceed 2% per month. In any event a seller is permitted to condition rebates upon earning a minimum of $25.00 in service charges. This provision is designed to cover minimum acquisition charges. Late charges permitted under section 26 may be imposed without regard to the 2% per month otherwise permitted.

Premiums for credit life insurance and credit accident and health insurance purchased by the debtor are not within the 2% per month limitation if the insurance coverage is purchased voluntarily by the debtor. In the case of property insurance, the purchaser may be required to have such insurance (as in the case of a car loan), but the insurance premium is not within the 2% per month limitation, unless the seller requires the purchase of such insurance from or through the seller.

While the primary thrust of section 21 is upon merchants and sellers of consumer goods, it nevertheless *has application to lenders* who purchase such paper from merchants and sellers. If the transaction is lawful in the first instance, it should be valid notwithstanding the fact that a later sale of the obligation to a third party at a discount causes the service charge to exceed 2% per month. Conversely, if the initial transaction between the seller and the buyer violates the statute, a subsequent sale of the obligation arising from such transaction to a third party would not validate the obligation. An assignee of the seller must ascertain at its peril the fact that the transaction initially complied with section 21, although the assignee should be entitled to the benefit of its good faith if a negotiable instrument is involved.

Article V: Other Charges on Real Estate Loans

Section 22 permits a bank or other lender to charge and collect

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pated. Write in inverse sequence and add (for example, for a four-year loan anticipated after the third month, write the numbers forty-five back to one). The total will be the numerator of the fraction of which subparagraph 1 above is the denominator.

3. Multiply the original amount of interest that would have been paid over the life of the loan by the fraction derived as above, such figure, so determined, is the amount to be rebated.

Payment anticipated between scheduled payment dates shall not be considered but instead the succeeding scheduled payment date shall be used in the above determination, notwithstanding any contrary provision of law.

service charges not to exceed 2½% of the amount of a loan for construction on or improvement of real estate. In lieu of the 2½% charge, the bank or lender may require the borrower to pay the actual cost and expenses of supervising and inspecting the construction or improvement. The statute further permits the imposition of a service charge of 1% on real estate mortgage loans generally, but if the bank or other lender makes both the construction loan and the permanent loan, its total fees may not exceed 2½%. Finally, section 22 permits the bank or other lender to recover the reasonable and necessary charges of third persons or other out-of-pocket expenses.[78]

The permissible service charges for savings and loan associations on real estate loans are set out at section 23. Non-application of section 22 to savings and loan associations and the existence of section 23 are best explained by the fact that section 23 generally parallels federal regulations[79] relating to federal savings and loan associations. It contains generally the same criteria and permissible charges as section 22 with the following differences:

(a) It permits a 2½% service charge on construction loans or a minimum fee of $50.00, whichever is greater.

(b) On other loans secured by real estate, it permits a minimum charge of $20.00 or 1% of the principal amount, whichever is greater. (The minimum dollar provisions appear to have their application to construction loans and other real estate loans of less than $2,000.00—a relative rarity in these times.)

(c) The express language contained in section 22 prohibiting the same bank or lender from making 2½% on the construction loan and 1% on the permanent loan is not contained in section 23. The same concept, however, may be implicit in section 23 by the phrase "on all other loans secured by real estate."[80]

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78. Examples of such "reasonable and necessary charges" enumerated by the statute are: recording fees, title insurance, attorney's fees, insurance, appraisals, credit reports and surveys.

79. 12 U.S.C.A. §§ 1464-66 (1969).

80. VA. CODE ANN. § 6.1-330.23 (Cum. Supp. 1975) provides:

> To cover the costs of investigating and processing the loan, a savings and loan association may charge and collect in advance from the borrower a service charge not to exceed fifty dollars or two and one-half per centum of the principal amount of the loan, whichever is the greater, on construction loans, and, on all other loans secured by real estate a service charge not to exceed twenty dollars or one per centum of the principal

(d) Savings and loan associations are permitted to recover "reasonable and necessary charges" under section 23 as opposed to "out-of-pocket expenses" permitted other lenders under section 22. The primary difference would seem to relate to "appraisals." A bank or other lender should be able to pass along the cost of such an appraisal under section 22 only if the appraisal fee was payable to a third person (which might include a bank employee or bank director). A savings and loan association apparently can collect and retain an appraisal fee under section 23.

Section 24 relates to other charges on real estate loans secured by a subordinate mortgage and made by an unlicensed and unsupervised lender. Section 25 makes section 24 inapplicable to licensed and supervised lenders. The statute allows the lender to pass along the "actual cost" of title examination, title insurance, recording fees, surveys, attorney's fees and appraisal fees. This differs from section 22 which requires such cost to be "out-of-pocket expenses" and from section 23 which permits collection of certain "reasonable and necessary charges."

The actual cost of "credit reports" is not an enumerated permissible charge under section 24. Fire and extended coverage insurance and decreasing term life insurance are permitted, but mortgage guaranty insurance which is permitted under both sections 22 and 23 is not enumerated in section 24. Presumably credit reports and mortgage guaranty insurance might be paid by the lender and recovered from the borrower within the 8% add-on plus 2% service charge permitted under section 16.[81] Accident and health insurance may be provided by the lender at the *borrower's option* and the premium therefor is not considered a finance charge.

With regard to unenumerated charges, section 24 expressly prohibits other charges including certain fees and brokerage fees. Nei-

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amount of the loan, whichever is greater, unless the laws of this State shall otherwise provide for a higher amount, in which case the latter shall be applicable. An association also may require the borrower to pay the reasonable and necessary charges in connection with making the loan, including the cost of title examination, title insurance, recording and filing fees, taxes, insurance, including mortgage guaranty insurance, appraisals, credit reports, surveys, drawing of papers and closing the loan.

Such fees and charges shall not be considered in determining whether a contract for a loan or forbearance of money or other things is illegal within the meaning of this title.

81. *See* text accompanying notes 62-68 *supra*.

ther sections 22 nor 23 contain any specific limitation on other fees. Section 24 expressly permits a broker's or finder's fee which is paid by the lender from the service charge or interest allowed to the lender under section 16, or is paid by the borrower if the total interest, service charge, and such broker's or finder's fee does not exceed the 8% add-on plus the 2% service charge. Broker's fees, except those in connection with loans by unlicensed and unsupervised lenders and which are secured by subordinate mortgages, should still be permitted in addition to interest under the rule enunciated in *Chakales v. Djiovanides*.[82]

Section 25 states that sections 24, 16 and 31 do not apply to loans made by certain *licensed* and *supervised* lenders. However, section 24 still applies to loans by banks, savings and loan associations and credit unions formed under the laws of another state. An FDIC insured bank organized under the laws of a state other than Virginia might be said to be "supervised" by the federal government, but admission to the status of insurance of deposits does not seem to be within the term "licensed." A subsidiary of a bank holding company is probably "supervised" but not "licensed." Approval of the Federal Reserve Board prior to acquisition by a holding company does not seem to be a "license" within this statute. A subsidiary of a state or national bank presents a more puzzling problem. Approval of the State Corporation Commission is not required for acquisition or conduct of business through a subsidiary.[83] A limitation on amount of investment without Commission approval is not the equivalent of "licensing." It is hard to theorize that the bank subsidiary succeeds to the bank's status under section 25 or section 48.[84]

The application of sections 25 and 48 to insurance companies, both domestic and foreign, who are licensed by and under the supervision of the State Corporation Commission would seem to be clear, but perhaps academic in this type of loan.

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82. 161 Va. 48, 170 S.E. 848 (1933). The court stated:

> The majority of the cases which have passed upon the question hold that where the lender has to borrow the money loaned, he may, without being guilty of usury, contract with the borrower to make good to him the reasonable expenses actually incurred by him in good faith in procuring the money to be loaned, including any brokerage or commissions he may have to pay to get it. *Id.* at 86, 170 S.E. at 861.

83. *See* VA. CODE ANN. § 6.1-58.1 (Repl. Vol. 1973).

84. *See* text accompanying note 103 *infra*.

Article VI: Late Charges

Prior to 1975, Virginia had three sections relating to late charges.[85] Section 26 combines these former sections and provides that in the case of an installment or single maturity debt, any lender or seller may impose a late charge not to exceed 5% of the amount of such installment payment.[86] Late charges in excess of 5% are invalid to the extent they exceed 5%, but the obligation is not otherwise affected. The charge must be specified in the contract between the lender or seller and the debtor. "Timely" payment was not defined by prior statutes, but is defined here as a payment made by the date fixed for payment or within a period of seven calendar days after such due date.

If the Secretary of Housing and Urban Development, the Veterans Administration, or any other federal agency or organization should adopt any rules or regulations dealing with the application of late penalties to loans insured or guaranteed by such federal agency, then those rules and regulations control.

Article VII: Prepayment and Acceleration Laws

Technically, prepayment charges are not charges for use of money, but are charges for the privilege of avoiding a contract to pay interest. Regulation of prepayment penalties is generally found in the interest statutes and it was decided to place the sections relating to early payment, whether by prepayment or acceleration, in one article. Section 28 permits a borrower from a credit union to prepay in whole or in part at any time *without any penalty.*

Section 27 permits a maximum one percent prepayment penalty on first deed of trust loans of less than $75,000 and provides that any prepayment penalty in excess of 1% is unenforceable as to the

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85. VA. CODE ANN. § 6.1-324 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769, permitted reasonable late charges in the case of real estate loans. *Id.* § 6.1-195.17 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769, permitted the same for real estate loans by savings and loan associations. The statute of most general application appeared to be *id.* § 6.1-2.2, Va. Acts of Assembly 1973, ch. 111, at 156, *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769, which provided a maximum late penalty of 5% of the amount of the payment in the case of an installment debt.

86. Late charges do not include charges imposed because of acceleration of the entire debt or costs of collection and attorney's fees. The limitations apply to debts created after July 1, 1975.

excess. The one percent penalty must be applied against the unpaid principal balance. The primary application of this statute is to commercial loans, in view of section 29, which provides a different rule for prepayment penalties in connection with owner occupied residences. Under section 27, can a borrower insist on being permitted to make a partial prepayment, and if so what penalty can the lender charge? Suppose the unpaid principal balance is $60,000.00 and the borrower desires to prepay $10,000.00. This section could be interpreted to permit assessment of the maximum penalty of $600.00. But suppose a second partial prepayment is made? Can the lender now assess another penalty? It is submitted that the prudent and safe construction of the statute is that the prepayment penalty may not ever exceed 1% of the principal balance at the time of the first prepayment, and that in the case of a partial prepayment, a lender should not attempt to assert the maximum prepayment penalty rate to the outstanding principal balance at the time of each partial prepayment. Section 27 does not apply if another statute (sections 28 through 34) or federal regulation relating to prepayment is applicable. For example, federal savings and loan associations are governed by federal regulation.

A prepayment penalty of 2% on loans secured by owner occupied residences is provided by section 29. A substantive amendment made the statute applicable only to loans secured by "a home which is occupied or to be occupied in whole or in part by the borrower," and a committee amendment made the 2% permissible prepayment penalty applicable to any lender. The penalty is not now limited to first deeds of trust. The statute does not specify, as does section 27, the effect of a violation, but merely states that the penalty shall not exceed 2%. Unlike section 27, this section applies to loans in excess of $75,000.00. Thus, under sections 27 and 29 the following prepayment penalties are permissible in real estate loans covered thereby:

(1) Home loans without regard to amount and where the home is occupied by the borrower—2%.

(2) Other loans under $75,000.00—1%.

(3) Other loans of $75,000.00 or more—as agreed by the parties.

Under section 30 natural persons borrowing from industrial loan associations may prepay at any time *without penalty*. On loans where the interest has been added to the face amount of the note, the borrower is entitled to credit for unearned interest computed in accordance with the Rule of 78's. The credit or rebate is subject to an anticipation premium equal to the contract interest allowable under the Rule of 78's for the next six payments. If the borrower is a natural person and the interest has not been added to the face amount of the note, it would seem that no premium is permissible. A corporation or partnership borrowing from an industrial loan association ought to be within the 1% prepayment provision of section 27 if the initial amount of the loan is less than $75,000.00 and if the loan is secured by a first deed of trust.

Section 31 permits the borrower under a loan secured by a subordinate mortgage and made by a lender not licensed or supervised by the State Corporation Commission to prepay at any time, and, in the case of an add-on loan, to receive a rebate of unearned interest based on the Rule of 78's.

The Rule of 78's, which is the statutory method for rebate under section 30 (industrial loan associations), section 31 (unlicensed and unsupervised lenders) and section 21 (certain time-price transactions) is codified at section 32. In *Beneficial Discount v. Johnson*,[87] the Virginia Supreme Court held that identification of the method of rebate as opposed to an explanation of the method of rebate complied with the requirements of disclosure under Regulation Z.[88]

Section 33 provides that no prepayment penalty on a loan secured by not more than four family residential units may be collected if prepayment results from enforcement of the lender's right to call the loan upon sale of the real property securing the loan. A 1975 amendment expressly provides that if the loan is prepaid because of a sale to a person whom the lender has rejected or has failed to approve within fifteen days after written request for approval, the prepayment is presumed to result from enforcement of the right to call the loan. However, if a borrower requests the lender to approve assumption of a deed of trust by prospective purchaser A, and A is rejected or not approved within fifteen days and the property is then sold to B, the prepayment penalty may still be assessed. The statute does

87. 215 Va. 582, 211 S.E.2d 571 (1975).
88. 12 C.F.R. § 226.8(b)(7) (1975).

not expressly permit the lender to require any financial information in connection with a written request for approval of a new grantee as substitute borrower, but such a request is not prohibited.

If a loan, secured by not more than four family residential dwelling units, is subject to acceleration or renegotiation upon the sale or conveyance of the property or part thereof,[89] section 34 requires the mortgage or deed of trust to contain in the body or in the margin a statement, either in capital letters or underlined, advising the borrower:

> NOTICE. THE DEBT SECURED HEREBY IS SUBJECT TO CALL IN FULL OR THE TERMS THEREOF BEING MODIFIED IN THE EVENT OF SALE OR CONVEYANCE OF THE PROPERTY CONVEYED.

The 1975 amendments do not require the deed of trust to contain the exact statutory language. It is submitted, however, that tracking the statutory language is the prudent and safe course to follow. Printing the notice in bold-type does not comply with the statute, even though this may be more conspicuous than capital letters or underlining.

Section 35 provides that the note evidencing an installment loan at an add-on rate may provide that the unpaid balance, at the option of the holder, may become due and payable upon default in the payment of any installment. The lender, if it accelerates, is not entitled to judgment for unearned interest, even though the face amount of the note may not distinguish between interest and principal. The accelerated balance is computed as if the borrower had made a voluntary prepayment on the date of acceleration and received a credit for unearned interest based upon the Rule of 78's. The accelerated balance thereafter bears interest, until judgment, at the annual percentage rate shown under a truth-in-lending disclosure pursuant to federal law.

This section is limited, however, by section 11-4.3[90] which provides that in a contract or other evidence of indebtedness arising from the sale or financing of consumer goods, no acceleration or repossession is permitted upon default if payment and applicable

89. *See generally* VA. CODE ANN. § 6.1-2.5 (Cum. Supp. 1975) which restricts the right of acceleration on mortgage loans on certain residential property because of a further encumbrance.

90. VA. CODE ANN. § 11-4.3 (Cum. Supp. 1975).

late charges are paid within ten days of the date on which the installment was due. Thus, it would appear that in section 11-4.3 transactions the balance may not be accelerated until the 11th day after default and the balance would be computed as if a voluntary prepayment were made on the 11th day after default.[91]

Section 36 confers upon the buyer of consumer goods the right to refinance certain balloon loan payments. If the seller retains a security interest in the consumer goods purchased and any installment payment, other than the down payment, is more than 10% greater than the regular installment payment, the buyer may refinance such payment or payments on the basis of an extended period of time and additional payments. The refinancing must allow the unpaid balance to be paid in as few periodic payments not to exceed 10% of the regular scheduled installment payments as are required to pay the balance. The section is inapplicable where the parties agree in a separate writing that one or more payments or the intervals between such payments are reduced or expanded in accordance with the desires or needs of the borrower, if the fluctuations are expressly arranged to coincide with anticipated fluctuation in the buyer's capability to make such payments. If the seller refuses to comply with this section, he is not entitled to return or repossession of the goods involved, or to a judgment for the unpaid balance at the time of his failure to comply. Technically the statute imposes the penalty only upon the seller, but it would be prudent for an assignee of the seller to act as if such assignee were also subject to the penalties of this statute.

Article VIII: Transactions Not Subject to Usury or Subject to Special Limitations as to Usury

Section 37 provides that a first deed of trust or first mortgage may be lawfully enforced at the interest rate stated in the contract. There has been some imprecision and perhaps indecision as to what constitutes the contract in which the interest rate must be stated. The contract for repayment is the note and while most prudent lenders insert the interest rate in both the note and deed of trust, it was thought that insertion of the rate in either the note or the deed

91. *See* VA. CODE ANN. § 6.1-330.16 (Cum. Supp. 1975) relating to certain subordinate mortgages. *See also* text accompanying notes 66-68 *supra*.

of trust would comply with the statute. A 1975 Senate amendment added the provision that disclosure of charges, which are not otherwise specified in the note, deed of trust or mortgage, in an interest disclosure statement pursuant to federal disclosure laws is sufficient compliance with section 37.

A leasehold estate of not less than twenty-five years is considered to be real estate for purposes of section 37. The statute further lays down rules as to fluctuating rates by providing that if a rate fluctuates in accordance with any exterior standard, such as "2% above prime" or "2% above passbook savings rate," such rate is not an "interest rate stated therein" and is not enforceable in excess of the contract rate of 8%, unless made to a person not entitled to plead usury.

Another 1975 amendment specifies that if the same lender holds both a first deed of trust and second deed of trust from the same grantor or mortgagor, the second deed of trust is treated as a first deed of trust for purposes of section 37. Thus, the interest rate limitations on subordinate deeds of trust do not apply here. If a second mortgagor assumes the obligation under a first mortgage, the first and second mortgages are considered as being made by the same mortgagor and if the same lender holds both mortgages, the second mortgage is treated as a first mortgage. (This is sometimes referred to as "one plus two equals one.")

Section 38 provides that no person by way of defense or otherwise may avail himself of the provisions of this Chapter or any other sections relating to usury to avoid or defeat the payment of any interest or any fee or any other sum, if the loan is insured by FHA or guaranteed by VA, or is insured or guaranteed by any similar federal governmental agency, or is directly or indirectly assisted in any manner by the Virginia Housing Development Authority. The broad reference to "the provisions of this Chapter or any other section relating to usury" and to "any interest or fee or any other sum" is prompted by the decision in *Tuttle v. Haddock*.[92]

A bank or other lending institution which is licensed or supervised by the state or federal government is permitted by section 39 to charge a rate of interest 3% in excess of the rate paid on passbook

92. 213 Va. 63, 189 S.E.2d 363 (1972). *See* note 37 and accompanying text *supra*.

savings accounts, savings certificates and certificates of deposit securing the loan. The loan must be secured "in full" by the savings account or certificate in order for the lender to avail itself of this section. Thus, if a borrower has a $5,000.00 certificate of deposit and a $3,000.00 savings account and wishes to borrow $7,000.00, the lender should make two loans, one secured in full by the certificate of deposit and the other in full by the passbook savings account so that there is no question about the applicable rate. This section also provides that a lender may, in connection with a loan secured by a savings account or other certificate, charge any other rate otherwise permitted by law, such as an add-on rate. The General Assembly dropped prior statutory[93] language requiring the loan to be secured "solely" by the savings account. This was done because many instruments pledging collateral to secure a note also secure any other indebtedness to the bank, and the requirement of being secured "solely" by a savings certificate was thought to be an unintentional trap for a lender whose employees might be unaware of the provisions in all the forms in current use.

Section 40 lifted provisions from prior law[94] which permitted banks and certain brokers to make loans for agricultural purposes, whether or not secured, at a rate not to exceed the maximum effective rate permitted installment loans. In lieu of the maximum effective rate for installment loans, the rate of 12% per annum was inserted which is less than the former effective rate.[95] The amendment removed any question as to whether the reference to "maximum effective rate" was one for the actual term of the agricultural loan or for any hypothetical term. If the 12% rate on agricultural loans is used, the 2% service charge associated with the installment rate and otherwise permitted under section 13 is not permitted under section 40. If the loan is for agricultural purposes under section 40 and for an initial amount of $5,000.00 or more, then under section 44 the general usury provisions do not apply. Hence, section 40

93. Va. Acts of Assembly, 1974, ch. 261, at 387, *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769.

94. VA. CODE ANN. § 6.1-319.1 (Repl. Vol. 1973), *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769.

95. VA. CODE ANN. § 6.1-320 (Repl. Vol. 1973), *as amended by* Va. Acts of Assembly 1974, ch. 290, at 440, *repealed by* Va. Acts of Assembly 1975, ch. 448, at 769, permitted a 7% add-on rate.

would seem to have its primary application to loans in the initial amount of less than $5,000.00. Section 40 allows agricultural credit corporations to charge on loans for agricultural purposes a rate of 1½% in excess of the rate charged by a federal intermediate credit bank to such credit corporations or to charge the 8% contract rate permitted under section 11.

Banks and certain brokers are permitted to collect interest in advance at the rate of 8% on the basis of a 360-day year for periods up to one year by section 41. When the discount rate of the Federal Reserve Bank of Richmond on 90-day commercial paper is higher than 7%, a national bank may, under 12 U.S.C. § 85, collect interest in advance at a rate of 1% above the discount rate, and so may a state bank *if* the State Corporation Commission allows it by regulation.[96]

The statute also permits a minimum fee or discount fee of $5.00 which may not be charged on renewals except after the passage of ninety days. It further permits a service charge not exceeding 2% of the amount of the loan. But a 1975 amendment expressly provides that the 2% service charge may not be imposed on a renewal or extension except after the passage of 360 days from a prior imposition. If a national bank were to discount a note in excess of 8% pursuant to the provisions of 12 U.S.C. § 85, the 2% service charge under this section would not be permitted because the service charge is in addition to the 8% otherwise permitted under section 41, not what is permitted under 12 U.S.C. § 85.[97] In addition to the 2% service charge in this section, banks may charge it on add-on loans under section 13 and also on revolving credit loans under section 19.

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96. VA. CODE ANN. § 6.1-5.2 (Cum. Supp. 1975) provides:

> In addition to the permissible interest rates and charges specifically granted to banks and to lenders generally by this title, the State Corporation Commission may by order, from time to time, confer upon State banks the power to take, receive, reserve, and charge on any loan or discount made, at a rate of one per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve Bank for the fifth Federal Reserve District, it being intended the State Corporation Commission may thereby confer upon State banks the power to make comparable charges permitted under any federal statute or regulation to any national banking association.

97. Under 12 U.S.C. § 85, a national bank may collect interest in advance without regard to state law at the maximum rate permitted by state law or at 1% above the discount rate permitted by state law or at 1% above the discount rate on 90-day paper charged by the Federal Reserve Bank in the region of the national bank. *See* note 16 *supra*.

A broker-dealer licensed by the State Corporation Commission and registered with the Securities and Exchange Commission is permitted under section 42 to charge a customer to whom it extends credit on pledged securities an amount not to exceed a monthly charge at the rate of 1¼% per annum above the rate charged the broker-dealer by a bank doing business in Virginia. The rate charged by the bank to the broker must be on loans collateralized by securities. Before the 1975 amendment, the statute referred to the rate charged by banks to broker-dealers on such loans, and seemed to imply a uniform statewide rate from bank to bank and from locality to locality. It would appear that the broker-dealer must actually have an existing loan (as opposed to a "line of credit") in order to come within the scope of this section. It is not required that the loan from the bank to the broker equal the amount of loans by such broker-dealer to its customers. If the broker-dealer has loans from two banks collateralized by similar securities, and the rates of the banks differ, the broker *ought* to be allowed to tie its rate to the higher rate charged to it.

Article IX: Borrowers Not Entitled to Plead Usury

Article IX specifies the persons who cannot avoid paying interest they have contracted to pay. Section 43 denies the defense of usury to corporations, partnerships, professional associations, real estate investment trusts and certain joint venturers organized for holding, developing and managing real estate. Partnerships which are required to file a certificate as well as foreign partnerships are also denied this defense. Before, if one loaned money to a foreign partnership, that partnership could argue it was not required to file a partnership name certificate or a limited partnership certificate and therefore could possibly assert a plea of usury. The prohibition against pleading usury or avoiding interest or any other sum relates to any provision of Chapter 7.2, or any other section relating to usury. This eliminates the construction problem posed by *Tuttle v. Haddock*.[98]

98. 213 Va. 63, 189 S.E.2d 363 (1972). *See* note 34 *supra*. VA. CODE ANN. § 13.1-2.1 (h) (Cum. Supp. 1975) permits a corporation to borrow money and pay such rates as the corporation agrees upon. A similar statute was construed as having usury connotations in Waterman v. Howard Paper Co., 124 Ga. App. 511, 184 S.E.2d 226 (1971). The court in *Tuttle* rejected a similar contention apparently feeling that the predecessor of section 43 was the only statute applicable in Virginia to bar the plea of usury by a corporation.

Section 44[99] denies the plea of usury on business or investment loans in the amount of $5,000.00 or more. Business or investment purposes is defined as the converse of the truth-in-lending definition of family, household or personal purposes, with the one modification that farm loans are considered business loans rather than consumer loans. The statute provides that if the borrower represents in his own handwriting the purpose of the loan, this representation is conclusively binding upon him. This does not require a handwritten representation as a prerequisite to invoking the business or investment exception, but merely provides a reasonable method by which a lender can resolve any doubt as to the borrower's intention.

Article X: Usury-Penalty

Generally, articles one through nine set forth what lenders may charge and exact from borrowers. Article X, on the other hand, sets forth the penalties to be assessed against a lender who overcharges. Beware! Section 45 provides for the forfeiture of future interest. When the defendant is successful with his plea, judgment can be for the principal amount only.

In the case of usury already paid, section 46 holds the lender responsible to the borrower for twice the total interest paid within the previous two years. If the note is sold, it seems clear that the statute would cover only the interest paid to or received by the noteholder who actually took or received the usurious interest, and not to the succeeding holders of the note. The statute requires that the suit be brought within two years from the time "the usurious transaction occurred." *Baker v. Lynchburg National Bank,*[100] interpreting the federal usury penalty statute which is similar to the Virginia statute, holds that each payment of excessive interest is a usurious transaction, upon which a suit may be brought within two years from the time of each such payment.

Section 47 provides a null and void penalty applicable to usury violations by unlicensed and unsupervised mortgage lenders on loans secured by subordinate mortgages on residential property composed of one to four family units. A waiver by the borrower of

99. *See* note 2 *supra* and accompanying text.
100. 120 Va. 208, 91 S.E. 157 (1917).

the benefit of this chapter or a release of any rights under this chapter is deemed to be against public policy. It should be noted, however, that a borrower may in some cases be estopped to set up the defense of usury.[101]

In the case of a person acquiring notes from such an unlicensed and unsupervised lender, section 47 provides that the null and void penalty does not apply to any contract or note which has been assigned to a person who is not the agent or principal of the lender, and has taken the obligation in good faith and in reasonable reliance upon the provisions of section 44 relating to business loans in the initial amount of $5,000.00 or more. If the assignee invokes the good faith provisions of this statute, it is submitted that he would need to show that he inquired into the business purpose involved. Normally a note which is null and void in the hands of a holder is also null and void in the hands of a holder in due course. Thus, if a subsequent holder is to avoid the null and void penalty he must be sure he falls well within the exception provided in this section.[102]

Section 48 states the non-applicability of section 47 to loans made by lenders licensed and supervised by the State Corporation Commission or federal government or by state and national banks, state and federal savings and loan associations, and state and federal credit unions. As a practical matter, national banks are subject only to the federal penalty for usury.[103] Hence, the state penalty for usury is not applicable to national banks, but it is applicable to state banks organized under state laws other than Virginia. Finally, section 48 spells out clearly that section 16 and section 47 do not apply to a seller in a real estate transaction who takes a subordinate mortgage on such real estate.

CONCLUSION

Chapter 7.2 is generally a rearrangement and hopefully a clarification of the Virginia laws relating to money and interest. Very few

101. *See* Heubusch v. Boone, 213 Va. 414, 192 S.E.2d 783 (1973).

102. No opinion is intended as to the status of a loan by a lender subject to section 47 and sold to a national bank which by both federal and state statute is not subject to the provisions of section 47 on loans made directly by it. *See* VA. CODE ANN. § 6.1-330.48 (Cum. Supp. 1975); 12 U.S.C. § 86 (1945).

103. 12 U.S.C. § 86 (1945).

substantive changes were made; only three basic ones—8% add-on for industrial loan associations,[104] 8% add-on[105] and 12% simple interest[106] for unlicensed and unsupervised lenders on subordinate mortgages. Hopefully, judges and lawyers, as well as lenders and borrowers, will find the money and interest laws less burdensome to work with and more understandable.

It is easy to justify one primary standard for interest and usury laws. They should be clear, explicit and unambiguous. A lack of any of these elements will increase the lender's risk and such increased risk will lead to either increased interest charges or a lack of available money in the risk area. A statute which insures the creditor the prompt and certain repayment of his money works to the advantage of the consumer. For the lower the risk taken by the creditor, the less charged for the money lent.

The progress of the interest and usury statutes during the past fifteen years has led the author to conclude that there is much truth in the comment that the well-to-do have learned one thing the poor man has known for years. There is one thing worse than a high interest rate, and that is money being unavailable when you need it. Perhaps this was what Moses was saying many centuries ago.

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104. *See* text accompanying note 65 *supra.*
105. *See* text accompanying notes 66-68 *supra.*
106. *Id.*