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CRIMINAL LAW: Usury:

An advance payment of interest on a loan for more than one year must be prorated over the life of the loan and the interest computed on the amount actually received by the borrower at the time of the loan. If the resulting computation exceeds 25 percent per annum in any year of use by the borrower, the lender violates the Michigan criminal usury law.

No. 4662 February 6, 1969.

Honorable James F. Smith
State Representative
House of Representatives
Lansing, Michigan

You have requested my opinion concerning Michigan's criminal usury law[1] involving the following hypothetical question:

> "Let us presume that lender (A) loans money to borrower (B) and from the amount advanced to this borrower, he deducts 12 percent per year from the receipts of the loan and gives the balance of the money to the borrower. Let us also assume that the loan is to run for a period of five years. Would the 12 percent deduct charge be in excess of 25 percent simple annual interest?"

You have also advised that we may assume the face value of the loan to be $10,000.00, that the total interest for the five year period at 12 percent each year totals $6,000 and that this $6,000 is deducted from the face amount of the loan, leaving $4,000.00 to be paid over to the borrower.

You have therefore inquired, in effect, whether an advance payment of interest of 12% per annum on a five year loan is in violation of the criminal usury law.

The criminal usury law provides:

> "Sec. 1. A person is guilty of criminal usury when, not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding 25% at simple interest per annum or the equivalent rate for a longer or shorter period. Any person guilty of criminal usury may be imprisoned for a term not to exceed 5 years or fined not more than $10,000.00, or both.
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> "Sec. 2. A person is guilty of possession of usurious loan records when, with knowledge of the contents thereof, he possesses any writing, paper, instrument or article used to record criminally usurious transactions prohibited by this act. Any person guilty of possession of usurious loan records may be imprisoned for a term not to exceed 1 year or fined not more than $1,000.00, or both."

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[1] Act 259, P.A. 1968; M.C.L.A. §§ 438.41-42; M.S.A. Curr. Mat. §§ 19.15(51)-19.15(52) p. 495.

The general principles governing construction of statutes are that the intention of the legislature be ascertained and given effect[2] and that any construction given must carry out the general purpose of the act.[3] When a statute is adopted from another state, it is a general, though not unyielding rule of construction that the legislature was aware of the construction it had received in the original state.[4] It has also been held that the legislature is presumed to have used a particular word in the sense in which the courts had previously interpreted such word.[5]

Our Supreme Court has said that the purpose of the law of usury is:

> "* * * to protect the necessitous borrower from extortion. In the accomplishment of this purpose a court must look squarely at the real nature of the transaction, thus avoiding, so far as lies within its power, the betrayal of justice by the cloak of words, the contrivances of form, or the paper tigers of the crafty. We are interested not in form or color but in nature and substance."[6]

The Michigan criminal usury law is substantially identical with the New York criminal usury law. The New York criminal usury law[7] provides as follows:

> "A person is guilty of criminal usury when not being authorized or permitted by law to do so, he knowingly charges, takes or receives any money or other property as interest on the loan or forbearance of any money or other property, at a rate exceeding twenty five per-centum per annum or the equivalent rate for a longer or shorter period.
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> "A person is guilty of possession of usurious loan records when, with knowledge of the contents thereof, he possesses any writing, paper, instrument or article used to record criminally usurious transactions prohibited by section 190.40."

The New York courts have had occasion to construe a usury law involving the following factual situation in *Feldman v. Kings Highway Savings Bank.*[8] Plaintiff borrowed $15,000 from the defendant. The plaintiff was to make monthly payments of $159.10 to be applied first on the amount of interest at the rate of 5 percent per annum and then on the unpaid balance of the principal, the note to run for ten years. After the first year the plaintiff paid off the note and paid a $2,000 pre-payment privilege charge. The New York court held that this charge was not interest and therefore could not form the basis of a claim of usury. However, the court stated, even if considered as interest, the payments on account of interest did not total a sum greater than the aggregate of interest that could law-

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[2] *Detroit Edison Company v. Department of Revenue* (1948), 320 Mich. 506.

[3] *Consumers Power Company v. Corporation and Securities Commission* (1950), 326 Mich. 643.

[4] *People, ex. rel, Attorney General, v. Welch's Estate* (1926) 235 Mich. 555.

[5] *People v. Powell* (1937), 280 Mich. 699.

[6] *Wilcox v. Moore* (1958), 354 Mich. 499, 504.

[7] 39 McKinney's Consolidated Laws of New York Annotated, Penal Law, §§ 190.40, 190.45.

[8] 102 N.Y.S. 2d 306, affd. 303 N.Y. 675, 102 N.E. 2d 835 (1951).

fully have been earned had the debt continued to the earliest maturity date. Therefore, there was no usury.

Later the New York court in *Reisman et. al. v. William Hartman & Son, Inc., et al,*[9] was faced with these facts: On July 16, 1965, the corporate defendant executed a promissory note for $15,000 at 6 percent per annum interest, to be self-amoritizing and repaid in 60 equal monthly installments of $290 each, including interest. The defendant received only the sum of $11,000. As security for the loan the defendant executed a mortgage. Foreclosure proceedings ensued and the issues concerning the criminal usury law were raised. There was an advance payment of $4,000 by the defendant which nevertheless was still obligated to pay 6 percent interest per annum.

The New York court in *Reisman* considered the *Feldman* case as controlling and, since the plaintiff had deducted $4,000, the loan was considered to be in the amount of $11,000 rather than $15,000; therefore the total interest was considered as prorated over the life of the loan to the earliest maturity based on this sum. However, the court calculated that, as the defendant was to pay 6 percent per annum on $11,000 and the advance interest of $4,000 prorated over the course of five years was $800 interest per year, the total interest in each year did not exceed 25 percent.

The State of Michigan in a somewhat similar situation concluded there was a usurious transaction. In *Wright v. First National Bank of Monroe* (1941), 297 Mich. 315, $7,500 was loaned to the plaintiff and the defendant bank retained $500 of the loan as an advance interest charge while charging on the loan interest of 7 percent annually. The court concluded that the retention of $500 should be divided $400 to the bank and $100 to a broker for his service in securing the loan was out of proportion to any legitimate fee that the bank was entitled to receive and, since the rate of interest was 7 percent annually, it amounted therefore to more than can legally be charged and constituted usury under the existent civil usury law.[10]

Further support for this conclusion can be found in *Hillman's v. Em 'N Al's* (1956), 345 Mich. 644, at page 655, where the court quoted with approval the following statement:

> " 'Where the principal sum of a loan or debt is made payable in installments at specified intervals within the full period of the loan, but interest for the full period on the whole principal sum is agreed to be paid, or is taken or withheld by the lender in advance, or is included in the face amount of the note, the transaction is usurious, whether or not the rate of interest stipulated in the contract exceeds the maximum specified by law, if the sum so agreed to be paid or so deducted as interest is greater than interest at the lawful rate on the principal sum for the period for which it is actually lent.' 66 CJ, Usury, § 125, p 205."

States other than New York and Michigan have considered the advance interest payment problem. Some have concluded that it is usurious to deduct the total interest in advance where that total would exceed the lawful rate

[9] 273 N.Y.S. 2d 296 (1966).

[10] M.C.L.A. §§ 438.51-438.53; M.S.A. §§ 19.11-19.13.

for one year.[11] Generally these cases concern obligations of one year or less.

On the other hand some states considering the same problem have determined that advance interest payments are not usurious.[12] Most of these decisions turn upon whether interest is calculated upon the amount actually received by the borrower for his use or upon the face amount of the note or loan. From the New York decision in *Reisman,* supra, construing a statute virtually identical to that of Michigan, it is my opinion that the calculation should be made upon the amount received by the borrower rather than upon the face amount of the note or loan.

In your hypothet, $10,000 is the face amount of the loan and there is a deduction or advance payment of $6,000 interest, which $6,000 represents 12 percent of the face amount per year over the course of five years. The borrower receives for his use only $4,000. If the amount of interest is deducted in advance, plainly the borrower cannot use the money deducted in the form of interest. Thus he fails to receive the full amount of his loan. He cannot use that which he was to receive unless it is paid to him. It renders no service, pays no debt, buys no property, and satisfies no wants for which he should be compelled to pay interest. Interest should be computed only on that amount actually received by the borrower over which he has some control and use rather than on the face value of the loan which he cannot put to use.

It is therefore my opinion that an advance payment of interest must be prorated over the life of the loan and computed upon the amount actually received by the borrower and if that computation exceeds 25 percent in each year of use of the borrower or in any one year of use by the borrower the lender is in violation of the statute. Thus, in the case put by you, the amount of interest paid was $6,000 over a five year period or $1,200 interest each year upon a loan of $4,000, which was all the borrower received. The interest rate is therefore 30% which exceeds the maximum interest rate permitted under the Michigan criminal usury law.

FRANK J. KELLEY,
Attorney General.

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[11] *Robinson v. Morris Plan Company,* 47 Ga App. 737, 171 S.E. 394 (1933); *Burdick v. Unrath,* 47 R.I. 227, 132 A 728 (1926); *Coppock, Administrator v. S. Kuhn & Sons,* 3 Ohio C.C. 599, 2 Ohio C.D. 347, affd.; *Leonard v. Administrator of Kubler,* 50 Ohio St 444, 34 N.E. 659 (1893); *Clemmons v. Missouri State Life Insurance Company,* 171 Ark. 744, 286 S.W. 813 (1926); *Lydick v. Stamps,* 316 S.W. 2d 107 (Texas Civ. App.) (1958).

[12] *Brown v. Johnson,* 43 Utah 1, 134 P. 590 (1913); *Parker v. Cousing,* Va (2 Gratt) 372, 44 Am. Dec. 388 (1845);*Cobe v. Guyer,* 237 Ill. 516, 86 N.E. 1071 (1908); *Hutchinson v. Herrick,* 58 Minn. 473, 59 N.W. 1103 (1894); *Fagerberg v. Denny,* 57 Ariz. 179, 112 P. 2d 578 (1941).