The grants of easement here in question, designated with respect to the number of the instrument, the location of the land by township and county, and the name of the grantor, are as follows:

Number	Location	Name
478	Weathersfield Township, Trumbull County, Ohio	City of Niles, Ohio
590	Bethel Township, Clark County, Ohio	Florence Marquart
591	Bethel Township, Clark County, Ohio	Florence Marquart
694	Richland Township, Allen County, Ohio	Fanny Schumacher and Amos Schumacher

By the above grants there is conveyed to the State of Ohio, certain lands described therein, for the sole purpose of using said lands for public fishing grounds, and to that end to improve the waters or water courses passing through and over said lands.

Upon examination of the above instruments, I find that the same have been executed and acknowledged by the respective grantors in the manner provided by law and am accordingly approving the same as to legality and form, as is evidenced by my approval endorsed thereon, all of which are herewith returned.

Respectfully,
HERBERT S. DUFFY,
Attorney General.

511.

BANKS—COMMERCIAL AND SAVINGS BANKS—ADOPTION OF SPECIAL PLANS — DISCOUNTING COMMERCIAL PAPER—RATES OF INTEREST—PURCHASE OF NOTES—GOOD FAITH PURCHASE — ENFORCEMENT — USURY.

SYLLABUS:

1. *Under the statutes, a commercial and savings bank may apply for an amendment to its charter to take on the powers of a special plan bank, and with such an amendment may adopt the banking practice of requiring periodic or deposit payments as additional security, thus effecting an increase in interest rate beyond the statutory maximum of eight per cent.*

2. *A commercial and savings bank, in discounting commercial papers, since such discounts are tantamount to loans, is limited to the legal rate of interest.*

3. *By outright purchase a commercial and savings bank may acquire promissory notes at a reduction, or what is broadly termed a dis-*

count, amounting to more than eight per cent. The transaction must not be a mere device to hide usury, and the substance rather than the form will be scrutinized to determine the bona fides of the purchase.

4. *When a note, by special exception to the maximum statutory rate, bears interest at more than eight per cent, the contract may be carried out by a purchaser, and it matters not to the original maker who enforces it.*

5. *If a note carries a flat rate above eight per cent on its face, in ordinary banking, that rate is usurious. If by extra charges the rate is increased beyond eight per cent the criterion is whether or not the charges are bona fide or a mere device for exacting usury.*

COLUMBUS, OHIO, April 24, 1937.

HON. S. H. SQUIRE, *Superintendent of Banks, Columbus, Ohio.*

DEAR SIR: This will acknowledge receipt of your communication, which reads as follows:

> "Under what cricumstances, if any, may a bank authorized by its articles of incorporation to transact a commercial and savings banking business, legally invest its funds in the purchase before maturity of promissory notes secured by chattel mortgage, which notes provide for the payment of interest in excess of that prescribed by Section 8303 of the General Code."

The inquiry incorporated in your letter raises a basic consideration of the charging of interest rates which amount to usury. Such excessive charges can be brought about in two ways. They will result from the open stipulation of a rate on an interest-bearing instrument which is above the statutory rate of eight per cent (8%). They will also result from more circuitous business practice which, even if the rate stated be only eight per cent (8%), effect through such a device as deposit payments, bonus, or extra charges, a rate which in the end is actually more than eight per cent 8%).

Section 8303, General Code, reads:

> "The parties to a bond, bill, promissory note, or other instrument of writing for the forebearance or payment of money at any future time, may stipulate therein for the payment of interest upon the amount thereof at any rate not exceeding eight per cent per annum, payable annually."

History discloses that in the beginning of organized society the taking of interest was regarded as an evil which during successive periods was prohibited by law. As the centuries passed and commercial activity expanded, this early disfavor gave place to toleration and then an acceptance of the doctrine that money lent entitled the creditor to a return. Thus the ancient Mosaic prohibition, afterwards reflected in England, was overcome, so that both in England and in America interest was recognized as a legitimate aspect of business.

In the common understanding today, usury means the taking of an unlawful profit for the use of money. Interest itself is recognized only as the result of a contract, express or implied. Usury is purely a creature of statute. Consequently, courts in determining the rights and remedies of parties to such a transaction look solely to such statutory definition. In Ohio law it is expressly stated that the legal rate of interest shall "not exceed eight per cent per annum, payable annually."

Technically, it may be taken as a general rule that interest is due and payable when the principal is due and payable. This principle, however, has yielded to the modern developments of business. It is stated in 66 Corpus Juris, page 207, that:

> "While it would seem to be clear that, except where expressly authorized by statute, taking the highest lawful rate of interest upon the face amount of a loan or obligation in advance, or discounting it by the amount of the highest lawful rate of interest, thereby in effect diminishing the principal sum by the amount of such interest or discount so taken, is usurious in principle, a concession was early made to such usage or practice among banks and other persons dealing in commercial paper whose customary short term loans made the amount of the excessive interest insignificant * * *."

Thus there has been developed that aspect of financial enterprise which is termed "discount." Yet in *Fleckner* vs. *Bank of the United States,* 8 *Wheat,* 338, 5 L. Ed. 631, it is stated that:

> "Nothing can be clearer than that, by the language of the commercial world and the settled practice of banks, a discount by a bank means, ex vi termini, a deduction or drawback made upon its advances or loans of money, upon negotiable paper, or other evidences of debt, payable at a future day, which are transferred to the bank."

See also 5 Ohio Jurisprudence, page 478.

Your letter necessitates a consideration of those business enterprises known as "special plan banks." Section 710-41, General Code, formerly read:

> "Any number of persons, not less than five, a majority of whom are citizens of this state, may associate and become incorporated to establish a commercial bank, a savings bank, a trust company, or to establish a bank having departments for two or more or all of such clasess of business upon the terms and conditions and subject to the limitations hereinafter and by law prescribed.
>
> The articles of incorporation shall contain:
>
> * * * * * * * *
>
> (c) The purpose for which it is formed, whether that of a commercial bank, savings bank, trust company, or a combination of two or more or all of such classes of business, or a special plan bank, as provided in Section 710-180 of this act.
>
> * * * * * * * *"

As now stated in Page's Code Service No. 18, the first paragraph of the section, as amended, reads:

> "Any number of persons, not less than five, a majority of whom are citizens of this state, may associate or become incorporated to establish a commercial bank, a savings bank, a trust company, a special plan bank * * *."

Paragraph C has also been shifted around to require that the articles shall read:

> "The purpose for which it is formed whether that of a commercial bank, savings bank, trust company, special plan bank or combination of two or more or all of such classes of business."

Special plan banks are of comparatively recent origin. They are a good example of the process by which the social and economic developments meet new circumstances in the national life and of the efforts of the law to readjust itself to such changes. In an opinion given June 20, 1928, (Opinions of the Attorney General for 1928, Volume 2, page 1537), the Attorney General then in office said:

"Prior to the enactment of Section 710-180, this office, in Opinions of the Attorney General for 1916, at page 1401, held that the Morris Plan Bank method of loaning money was not authorized by the laws of the State. Following that opinion the section was enacted and at the same time Section 710-41 was enacted, replacing a prior section and including authorization for the formation of a special plan bank. The language of Section 710-41 is rather peculiar in that the first paragraph thereof apparently only authorizes the incorporation of a commercial bank, a savings bank, a trust company or a bank having departments for two or more or all of such classes of business. When, however, the latter portion of the section is examined, it is found that, in the purpose clause of the Articles of Incorporation, it may be stated that the purpose of the corporation is that of 'a commercial bank, savings bank, trust company or a combination of two or more or all of such classes of business or a special plan bank as provided in Section 180 of this act.' In my opinion, a careful reading of paragraph c of Section 710-41 is dispositive of your questions. The Legislature has clearly recognized the right of one corporation to combine the functions of a commercial bank, savings bank and trust company. You will observe, however, that the reference to special plan banks is made in the alternative to the other classes of business mentioned. Had it been the legislative intent to permit a combination of the ordinary banking businesses with that of a special plan bank, it could easily have so expressed by incorporating the reference to a special plan bank along with a commercial bank, savings bank and trust company in the first part of the sentence. * * * Accordingly, I am of the opinion that a commercial bank, savings bank, trust company or a combination of two or more or all of such classes of business may not engage in the special plan banking authorized by Section 710-180 of the General Code.

For like reasons I am also of the opinion that a special plan bank, incorporated as such and functioning under Section 710-180, may not engage in the business of a commercial bank, savings bank, trust company or combination of two or more of such classes of business."

The change in language suggested by the opinion just cited was subsequently made. In consequence, a commercial bank and savings bank is now authorized, by amendment of its charter to assume the functions of a special plan bank.

Enlarging Section 710-41, which says that a corporation may be formed to establish "a commercial bank, savings bank, trust company, special plan bank or a combination of two or more or all of such classes of business," Section 710-41a adds:

> "Any existing corporation organized or transacting business under the provisions of this chapter and desiring to establish and conduct departments in any such classes of business, not authorized by its existing articles of incorporation, shall file with the secretary of state of Ohio a certificate of amendment to its articles of incorporation, setting forth the classes of business it desires to establish or conduct."

It is thus observed that a commercial and savings bank, by formal application to the state authority, may have its charter amended to encompass the business of a special plan bank, while conversely a special plan bank may be expanded into a commercial and savings bank.

As Morris Plan banks sprang up in Ohio about twenty years ago and took over a field of business in which small loans were made on the basis of personal credit or two-signature notes, so now another new development in business is demanding attention. By what amounts to a reverse process, some commercial and savings banks in Ohio have already sought entrance into business transactions heretofore regarded largely as the province of the special plan banks. In fact, this new field appears to be considered by financiers as a bright hope for new activities and new profits. The question, therefore, arises, as to the legal powers of commercial and savings banks. Is it altogether necessary for them to have their charters amended to include the features of special plan banking; or may they under their present powers take over this new and inviting business?

At this point, it is well to remember that special plan banks are permitted by law to circumvent what actually might be regarded as usury by requiring periodical or deposit payments. As a general rule, interest is due and payable when the principal of the loan becomes due and payable. Interest, nevertheless, may become due and payable before the maturity of the principal, if that agreement is the true intendment of the parties to the contract. Periodic or deposit payments, however, are distinguished from advanced payments of interest, and are thus part payments which discharge the debt pro tanto. In reference to such periodic or deposit payments on the principal of a loan at a special plan bank, Section 710-180 says:

"Any bank organized and doing business as a special plan bank, and which by the terms of its contract with its depositors provides for the receipt of deposits which are not payable unconditionally upon demand or at a fixed time, may in the case of any loan made upon the security of the character and earning capacity of the borrower and of the co-makers or endorsers on the borower's note evidencing the loan, in addition to discounting interest at the rate allowed by law, require such borrowers as additional security for such loan to make equal periodical deposits in such bank during the period of the loan, with or without an allowance of interest on such deposits, and such transaction shall not be deemed usurious. A special plan bank shall keep only the same reserve as is required of savings banks against all deposits which by the contract with the depositor are not to be paid upon demand or at a fixed time, and no reserve shall be required against deposits hypothecated to secure indebtedness of the depositor to the bank."

By such a system of payments, it is readily seen that the borrower periodically reduces his debt by making deposits, and consequently, as those deposits increase, pays interest on money he does not possess. In effect, therefore, he pays and the bank charges more than a legal rate of interest on the original face of the loan. The statute, however, meets this exigency of financial practice by saying that "such transaction shall not be deemed usurious."

As the receipt of deposit payments is permitted to corporations originally organized as special plan banks, so of course it will be permitted to corporations originally organized as commercial and savings banks which have their charters amended to include the business of special banking.

Referring again to your letter, it concisely raises the question as to investment by a commercial and savings bank in promissory notes secured by chattel mortgage which provide for payment of interest above the statutory eight per cent.

Section 710-111, which is too prolix for quotation, enumerates the securities in which commercial banks may invest. They include, in a detailed list, United States bonds, state, municipal, school district bonds, external bonds of foreign countries, bonds or indentures of any province of Canada. There is special enumeration of "bankers acceptances of the kind and maturity made eligible by law for rediscount with federal reserve banks, provided the same are accepted by a bank incorporated under the laws of this state or any member of the federal reserve system." There are also enumerated "mortgage bonds, collateral

trust bonds, debenture bonds or notes of any regularly incorporated company which for four years has shown an earning; or of such a corporation which does not have incumbrances in excess of 50% of the actual value of the property securing the bonds or notes." Railroad equipment bonds or car trust certificates are likewise approved, as are bonds or notes secured by mortgage on improved real estate. Then by a more recent amendment bonds, notes or debentures issued under the National Housing Act are added. Altogether there are enumerated fifteen types of securities for investment by banks

Section 710-140, directly referring to savings banks, also sets forth the mediums of investment for such banks. It says:

> "A savings banks may invest its funds in:
>
> (a) The securities mentioned in Section 111 of this Act subject to the limitations and restrictions therein contained, except that the investment in real etsate securities shall be subject to the restrictions contained in Section 112.
>
> (b) Stocks of companies, upon which or the constituent companies, dividends have been earned and paid for five consecutive years. * * *
>
> (c) Promissory notes of individuals, firms or corporation when secured by a sufficient pledge of collateral approved by the executive committee or board of directors.
>
> (d) Ground rents or certificates in improved lands * * *".

It clearly appears from the foregoing citations that a commercial and savings bank is empowered to invest its funds in promissory notes secured by sufficient collateral.

Your letter, however, suggests that the notes under consideration call for an interest rate in excess of that prescribed by Ohio law.

Section 710-136, pertaining to loans and discounts, reads:

> "Commercial banks may lend money upon personal or collateral security, discount, buy, sell, or assign promissory notes, drafts, bills of exchange, trade and bank acceptances, and other evidences of debt and buy and sell exchange, coin and bullion."

Section 710-139, pertaining to savings banks, reads:

> "A savings bank may invest its funds in or loan money on, discount, buy, sell or assign promissory notes, drafts, bills of exchange, trade and bank acceptances or other evidences of

> debt; but all such investments or loans made except those secured by mortgages on real estate or pledge of collateral security shall be upon notes, drafts, bills of exchange, trade or bank acceptances, or other evidences of debt payable at a time not exceeding six months from the date thereof, but not more than thirty per cent of the capital surplus, and deposits of such bank shall be so invested."

From the foregoing citations, it again appears clear that investment may properly be made in notes which are not violative of some statutory provision. At the same time, Section 8303 just as clearly says that parties to a promissory note "may stipulate therein for the payment of interest * * * not exceeding eight per cent per annum, payable annually."

What amounts to a reversal of the statutory limit of eight per cent, under Section 8303, is of course set forth in Section 710-180, under which special plan banks may * * * "in addition to discounting interest at the rate allowed by law, require such borrowers as additional security for such loans to make periodic deposits in such banks during the period of the loan * * *". True, the periodic payments are called "additional security"; but a payment by another name is just as sweet. The borrower has to return money which is part of the face of the loan. From the moment he pays his first "additional security" he is paying the continuing interest on a loan which has been reduced. As he adds to the "additional securities" month by month, he automatically increases the interest rate on the money he actually has in his possession or subject to his use. Thus a man skillful with figures could prove that such a borrower pays substantially more than the so-called legal rate of eight per cent.

Naturally, the methods and the business of commercial and savings banks were different. Then came the historic events beginning in 1929. The banking business thereafter was not what it had been. As a result there appears to be a new interest in the type of loans hitherto identified with special plan banking. At the same time, it is not yet clear that commercial and savings banks may enter that field without amendment to their charters to fit the purposes of Section 710-180.

It has been seen that by deducting interest in advance, or discounting a note, the interest rate, in effect, may be increased to more than eight per cent. A similar effect is reached by requiring periodic payments as additional security. A third method which comes close to increasing the interest rate is that of making charges associated with a loan and with notes such as those adverted to in your letter.

These charges may arise from the expense of examining securities, perfecting titles, preparing papers, or other details deemed necessary to

facilitate the lending. It is not always easy to distinguish those which are bona fide from those which are simply a ruse for evasion of usury.

> "The law seems to be well settled that where a contract for a loan provides for the rendition of services by the lender to the borrower, a fair charge for the service in addition to the legal rate of interest on the money loaned does not render the contract usurious. The aforementioned charges are always subject to the limitation that they can not be made for the purpose solely of evading the usury laws; therefore, the additional charge must be shown to be based on some service rendered, some trouble encountered, inconvenience sustained, or risk assumed by the lender, other than by the advance of money. The reasonableness as to the amount of such charges seems to be given considerable weight in determining their character as usurious or not." 40 O. J. 853.

At the same time, the charging of a bonus is regarded as usurious. A similar view is taken of any loan conditioned on a collateral advantage to the lender, as where the borrower is required to buy from the lender a parcel of land at an exorbitant price. Yet when money is borrowed in one place and is to be paid in another the addition of a charge for exchange is held not to be usurious. The criterion, therefore, is that such charges must honestly arise from the facilitation of the loan and that the charge itself must be reasonable.

Although in England at one time usury was regarded as a mortal sin, and even later was held by some legal authorities to be an indictable offense at common law, such a view does not prevail in Ohio. In fact, the present statutes contain no definition of usury as an offense and no prescriptive penalty. They simply declare that an interest rate in excess of eight per cent shall not be charged, so that usury is malum prohibitum rather than malum in se. Consequently, interpretation arises from the statutes themselves. The limitation is fixed by the legislature, and the legislature may change or altogether remove that limitation.

The clear purpose of such statutes is to protect the debtor. It is humanely recognized that a person in desperate straits will momentarily welcome any avenue of financial escape, make any obligation that offers hope, accede to any demand. Thus the intent of what are popularly termed usury laws is to protect the oppressed borrower and to restrain lenders who may be oppressive.

Still, with human nature what it is, there are frequently discovered transactions by which it is sought to evade the usury laws. In these shifts, loans are disguised as perhaps false sales, or else the actual interest

rate is hidden. See 40 Ohio Jurisprudence, page 836. It is of course obvious that a merely colorable sale of a note, bond, or other security at a greater discount than the limit of legal interest, in order to disguise a loan, is within the prohibition of usury laws. Idem. page 837, citing *Dunkle* vs. *Renick,* 6 O. S. 527; *Bailey* vs. *Smith,* 14 O. S. 396. The conclusion, therefore, is that a loan may not carry an interest rate in excess of the statutory eight per cent.

It might be well at this point to consider discounts as related to loans.

> "The term discount may be understood as a counting off, an allowance, or deduction made from a gross sum on any account whatever." *Dunkle* vs. *Renick,* 6 O. S. at p. 536.

In banking, the term is applied where interest on a loan is taken in advance by deducting the amount thereof for the term of the loan, giving the borrower the face value of the obligation less the interest. 5 O. J., p. 478, citing *Dunkle* vs. *Renick.* It is equally applicable to business or accommodation paper; *discounting paper is only a mode of loaning* (lending) money, but every loan is not a discount; without taking interest in advance there is no discount. Ib. citing *Niagara County Bank* vs. *Baker,* 15 O. S. 68. In the business of banking, the purchase and discounting of paper is only a mode of lending money, and the authority of a bank to discount commercial paper can hardly be questioned. Ibid, citing *National Bank* vs. *Alstitter,* 4 O. F. D. 514. Express authority is given commercial banks to discount promissory notes, drafts, and bills of exchange. General Code, Section 710-136. National banks are authorized to acquire notes and bills which are perfect and available in the hands of a borrower, as well as the borrower's own paper made directly to the bank; for they are given such incidental powers as shall be necessary to carry on the business of banking by discounting and negotiating promissory notes. *National Bank* vs. *Alstitter,* supra.

A turn of opinion is given when the transaction is regarded as a sale rather than a loan or discount. It is well settled that commercial paper actually in existence and complete may be bought and sold on such terms as the vendor and purchaser may agree upon, and however small the price paid the transfer is not usurious, if in good faith, and not a mere attempt to disguise a borrowing and lending of money. This is true although the seller endorses the note and remains responsible thereon. 40 O. Jur., p. 837, citing *Dunkle* vs. *Renick,* supra.

The outright purchase of commercial paper at any price is not usurious; the sale, however, must be complete and the paper sold in such a state as to enable the holder to bring suit on it; a bill which is not accepted before negotiated with the bank must be deemed to be discounted,

and not purchased. 5 O. Jur. p. 481, citing *McLean* vs. *LaFayette Bank,* 2 O. F. D. 412. Where, however, a bank takes from its debtor, in good faith and in payment of pre-existing debts, negotiable promissory notes of a third party at a rate of discount greater than which it is legally permitted to charge, such transaction will not be regarded as usurious, for the restriction as to the rate of interest applies only to transactions in the nature of a loan, and not to the bona fide sale of a note, bond, or other security. 5 O. Jur., p. 481, citing *Dunkle* vs. *Renick,* supra.

Strong reliance is placed on the old case of *Dunkle* vs. *Renick,* decided December 1856. The syllabus reads:

> "Where the charter of a bank gives it power to loan money, buy, sell, and negotiate promissory notes and to discount, upon banking principles and usages, promissory notes and other negotiable paper, with a proviso that said bank shall not take more than six per cent per annum in advance, upon its loans and discounts; and such bank receives from its debtor, in good faith, and in payment of a pre-existing debt, but at a rate of discount greater than six per cent per annum, the negotiable promissory note of a third party, the same being bona fide business paper, such transaction is not usurious, nor beyond the capacity of the bank."

In the opinion, Scott, J., said, in part:

> "It is true that the term 'discount' may, in a general sense, be understood to be a counting off * * * or deduction made from a gross sum on any account whatever. But in the section under consideration, this term is evidently used in a more limited and technical sense. It is applied in the proviso to transactions in which the bank may take interest in advance. The power to discount promissory notes, upon banking principles and usages, is given in terms as distinct from, and additional to the power to buy, sell, and negotiate promissory notes, which is also given in terms and is unqualified. The restriction of the proviso was, doubtless, intended to define and prohibit usury by the bank, and must be construed as applying only to transactions in the nature of a loan. * * *
>
> It is well settled that the bona fide sale of a note, bond, or other security at a greater discount than the limit of legal interest is not per se a loan, and the purchaser is not liable to the imputation of usury, although the note may be endorsed by the seller, and he remains responsible.

Had the sale been merely colorable to disguise a loan, the law would be other."

Manifestly, the courts seek to find distinctions between a discount or loan and a bona fide sale. Where a transaction may be construed as either a sale or a loan, and would be illegal as a loan because usurious, and if there is no evidence of an intent at evasion, the courts will construe it as a sale. Where, however, the consummation of usury is intended and the departure from the ordinary form of usury is employed merely as a veil to disguise the real features of the transaction, the law will defeat the device. *Commercial Bank of Manchester* vs. *Nolan,* 8 Miss. (How.) 508.

In order to constitute usury, there must be an expressed or implied loan. Usury, therefore, is not predicable on a purchase, no matter at what price. *Salmon Falls Bank* vs. *Leyser,* 22 S. W. 504 (116 Mo. 51.) The law permits the purchase of existing paper by a bank at such rates as the parties may fairly agree upon. *Smith* vs. *Hart,* 39 Mich. 515. Such a purchase, when not used as a mere cover for usury, may be made at any rate of discount agreed upon by the parties, although the seller indorses or guarantees the paper on its transfer to the purchaser. *Niagara County Bank* vs. *Baker,* 15 O. S. 65.

Such sales, however, do not appear exactly to fit into the speculation raised by the notes you define. The legal analysis concerning them examines the relations between the seller and the buyer, and holds that they may agree to any amount of reduction. It does not relate to what might have been the original terms of the note and of course does not indicate that there was an illegal rate of interest stipulated by the original debtor and creditor. What it does show is that the holder of a note may sell that note at any reduction that satisfies him so long as the sale is bona fide rather than a disguised discount or loan. Thereupon the rights of the original holder vests in the buyer.

In banking practice, there is a popular distinction between collateral loans and chattel mortgage loans. A chattel mortgage is a transfer of personal property as security for a debt which is subject to a condition of defeasance and which leaves an equity in the mortgagor. To cover chattel mortgages for small loans at special rates, there is a separate division of the General Code apart from the Banking Act, and those making such loans, under Section 6337, et seq., are peculiarly licensed and regulated. Section 6346-1 says that:

"It shall be unlawful for any person, firm, partnership, association, or corporation, to engage, or continue in the business of making loans, on plain, endorsed, or guaranteed notes, or due-

bills, or otherwise, or upon the mortgage or pledge of chattels or personal property of any kind, or of purchasing or making loans on salaries or wage earnings, or of furnishing guarantee or security in connection with any loan or purchase, as aforesaid, at a charge or rate of interest in excess of eight per cent per annum, including all charges, without first having obtained a license so to do from the Commissioner of Securities and otherwise comply with the provisions of this chapter."

An analysis of such chattel loans is given in Opinion No. 2273, Opinions of the Attorney General for 1928, Vol. II, p. 1573. The Division of Securities had set forth transactions in which A, licensed under Section 6346 to make loans on chattels, desired to borrow money from B, who was not so licensed; whereupon A placed with B notes bearing interest at a rate greater than eight per cent, secured by mortgages as collateral, but with the agreement that A was to make all collections.

One of the questions asked was: "If B may legally purchase these notes from A, may B continue to collect interest on same at a rate greater than 8% per annum?"

The Attorney General then in office expressed the opinion that:

"Since A is a licensee, there can be no contention that the original loans were tainted with usury under the assumptions herein set forth. That is to say, if they were within the provisions of Section 6346-5, supra, A had a perfect right to make the loans. * * * Consequently, if A sued upon the notes there is apparently no defenses available to the borrowers. * * *

From the wording of your inquiry, however, it is apparent that you have some question about the right of B to hold these individual notes and mortgages at all without securing a license therefor from the Division of Securities. I have no hestitancy in saying that a license would not be required. The obvious purpose of the sections of the Code hereinabove referred to is to prevent the exaction of interest beyond that allowed by law by a lender from a borrower and to regulate and control lending at a rate greater than the ordinary rate under certain circumstances. The terms of the statute deal exclusively with regulation between the original debtor and creditor. The state is not interested in the subsequent disposition of the loans, nor is the borrower. So long as the original loan is lawful, in my opinion, it matters not in the eyes of the law in whom the right of action resulting from the debt ultimately is vested.

You next inquire whether B, instead of taking the notes

as collateral, may purchase these notes from A.

* * * While the notes in question could not be legally acquired by other than a licensee in the first instance by a direct loan, I know of no rule of law precluding their subsequent sale. * * * After the original loan, which defines the amount of the obligation of the debtor, it is immaterial to him who subsequently enforces his contract. * * *"

It is prudent to remember that while the Small Loan Act especially excepts from the limitation of eight percent interest, under Section 8303, it also is severe in its own restrictions and provides a criminal penalty for violations. Thus section 6346-8, General Code, reads:

"Any person, firm, partnership, corporation or association, and any agent, officer, or employe thereof, violating and provisions of this act (G. C. 744-14 to 744-24, 6346-10, 6373-3, 6373-7 and 6373-24) shall for the first offense be fined not less than fifty dollars nor more than two hundred dollars and for a second offense not less than two hundred dollars nor more than five hundred dollars and imprisoned for not more than six months. The Commissioner of Securities upon such second offense shall revoke any license theretofore issued * * *"

In addition to such penalties, the section also provides that:

"Any instrument taken in connection with the transaction upon which the conviction is made, shall be illegal, void and of no effect, and it shall then be the duty of the Commissioner so to notify the borrower in writing. Any charge of interest paid in excess of that provided herein may be recovered by the payer in an action at law."

A good case in point is *Northern Finance Corporation* vs. *Weiss, et al.*, 31 O. N. P. (N. S.) 196. In that case, the corporation was within the statute in charging three per cent per month on the first $300 and eight per cent per annum on the sum above $300. Section 6346-5 also states "that upon the amount in excess of $300 * * * no licensee shall directly or indirectly charge, contract for, or receive any interest or consideration greater than eight per cent * * * which shall include all charges * * *". There were, however, charges for attorney's fees, repairs, and storage. The corporation, on default of payment, sought to reposses the car.

The court, in part, said:

"In Ohio the law seems well established that a lender who in *an ordinary* transaction charges a rate of interest beyond that

allowed by law can recover the amount lent plus the legal rate of interest. The contract of loan is void only as to the charges in excess of the statutory limitations.

In this case, however, we do have a professional lender licensed by law and granted the right to charge certain exorbitant rates.

There is no question that a contract expressly prohibited by statute is illegal and void and that no rights or obligations can accrue from it.

Counsel for the plaintiff contends that the provisions in the mortgage giving the finance company the right to collect attorney's fees, storage, and repair expenses cannot be construed to constitute a charge in violation of the statute.

According to my interpretation, the legislature intended to declare null and void all papers made in connection with a contract for a usurious loan. * * * Regardless of the form in which the exorbitant profit on a loan is disguised, the courts will look to the substance of the charges and determine whether or not the loan is usurious."

In contrast with the criminal penalties relating to those operating under the statutory exceptions set forth above, it is observed that the effect of usury in other instances has tended away from the ancient severity. In some states there is still a lingering tendency to void the entire contract, or even to enforce a loss of the security; but in Ohio a more lenient opinion prevails. Thus it is well settled in this state that usurious contracts are not void, that the contract is vitiated only to the extent of the usury, that where usury is shown a recovery may still be had upon a contract for the principal and the legal rate of six per cent. Furthermore, since usurious contracts are not themselves void in Ohio, collateral securities taken with them are not void. *Smith* vs. *Parsons,* 1 Ohio 236, 13 Am. Dec. 608; *Finance Corp.* vs. *Weiss,* supra. See also 40 O. J., p. 857, et seq.

In the Bank Act there are nine distinct grounds upon which the Superintendent of Banks may take possession of the business and property of a bank charged with violating the state laws or effecting a forfeiture of its charter. The exaction of usurious interest does not appear to be a fatal delinquency, and since specific causes of forfeiture are enumerated all others are deemed excluded. It also was held in an early case that the contracting by a bank to take an illegal rate of interest does not work a forfeiture. *State, ex rel. Prosecuting Attorney* vs. *Commercial Bank,* 10 Ohio 535.

Banking, however, is a business essentially of public nature and

consequently is subject to a high degree of regulation. It also is a general rule that a state may deal in different ways with different money lenders without violating constitutional provisions. At the same time, there is in Ohio no statutory definition of usury, and all limitations upon the right to charge interest are creatures of the statutes which may be changed at any time by the legislature.

It is common knowledge that there are often complaints against the methods by which banking companies deal in notes and even increases the interest rates by extra charges. There are today such complaints in some parts of the state that the people are asking for investigations by grand juries as to interest rates and charges, as well as the seizure and sale of cars. It is hardly possible to foresee all the circumstances attending such transactions. It, therefore, does not seem possible to outline with final exactitude every possible instance in which notes coming to a bank might, by direct stipulation or by some indirect device, carry more than eight per cent interest.

With those conditions in mind, and in specific answer to your question as to what are the circumstances, if any, under which a bank authorized by its charter to transact a commercial and savings banking business, may legally invest its funds in the purchase before maturity of notes, secured by chattel mortgage, which provide for more than eight per cent, it is my opinion that:

1. A commercial and savings bank may apply for amendment to its charter, to the end that it may take on the powers of a special plan bank; but that only when such an amendment is authorized may it follow the practice of accepting periodic or deposit payments, which in effect increase the interest rate beyond eight per cent.

2. There is a positive distinction between the methods and charges of licensees operating under the Small Loan Act and corporations engaged in general banking, and any exceptional charges permitted to the former may not be employed by the latter.

3. A commercial and savings bank by the practice of ordinary discount, if the interest rate is eight per cent, in effect may increase the rate by the advance deduction.

4. Where a contract with an interest rate and charges amounting to an excess of eight per cent, under special statutory exception, was legal in the first instance, a bank may acquire such an instrument and carry out its terms, and since the orginal loan was not tainted with usury there is no rule of law prohibiting its sale, with the vesting of clear rights in the purchaser.

5. There may be additions to the maximum rate by charges in connection with the negotiation of a loan, and if such charges are bona fide they are accepted as legal and non-usurious; but if charges made

in addition to the maximum rate are a shift or device for increasing the interest, they are usurious and illegal.

6. Since Section 6346-5, General Code, which states that a licensee shall make no loans "at a greater total charge, including interest, than three per cent a month," is a special legislative declaration to cover a recognized class of small loan business, with severe penalties for violations of the law, it is not easy to foresee how notes not under that exception, which provide for interest in excess of that prescribed by Section 8303, do not on their face reveal a condition of usury.

7. It is well understood that companies dealing in articles sold on long-time payments, frequently running to eighteen months, in addition to the maximum rate of interest, superimpose numerous charges. Thereupon is written a note covering the grand total which is to be paid in monthly installments, so that from the payment of the first installment the principal is periodically reduced, as in special plan banking, while the interest throughout the term is continued on the full face, thus increasing the rate far above eight per cent. Such notes likely fit into your inquiry. Whether or not they may be taken by banks obviously depends on the transaction from which they arise. If the charges, not from the form but from the substance of the contract, are legitimate and there is no taint of usury, the bank by purchase inherits the rights of the original payee, and since the contract is legal, it little concerns the original debtor who enforces it. On the other hand, if charges are but devices for covertly increasing the interest rate, or are in any way spurious, the rate amounts to usury.

8. Under Section 8303, General Code, no person, either an individual or a corporation, may charge an interest rate in excess of eight per cent per annum, and the law clearly declares that the usurious charge, even if stipulated, may not be collected, if such a defense is invoked.

9. If commercial and savings banks are desirous of engaging more actively in the purchase of notes which bear interest at a rate of more than eight per cent and which hitherto have been more generally the business of finance and acceptance companies, there is final recourse to the legislature since that body is empowered to make exceptions to the prevailing effect of Section 8303, or to change in any way it deems just the statutory prescriptions as to rates of interest.

Respectfully,

HERBERT S. DUFFY,

Attorney General.