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Kenneth E. Galchus

Charles G. Martin

Ashvin P. Vibhakar

A HISTORY OF USURY LAW IN ARKANSAS: 1836-1990

Kenneth E. Galchus, *
Charles G. Martin, **
*Ashvin P. Vibhakar****

> If you lend money to any of my people with you who is poor, you shall not be to him as a creditor, and you shall not exact interest from him.[1]
>
> You shall not lend upon interest to your brother, interest on money, interest on victuals, interest on anything that is lent for interest.[2]

These quotations from the Bible indicate that restrictions on interest rates extend back to biblical times. While interest rate limitations in Arkansas do not extend back quite that far, the controversy over the need and usefulness of usury laws dates back at least to 1836. In that year, the first Arkansas legislature passed a law limiting the amount of interest that could be charged a borrower.[3] This legislation provided:

> That the said bank's branches shall not take more than eight per cent per annum upon any of its loans and discounts; nor shall it take more than seven per cent per annum on loans or discounts payable within eight months; nor more than six per cent per annum on any loan or discount, payable within four months after such loans or discounts.[4]

Before the Civil War, the customary rate of interest charged on loans in Arkansas ranged from 6% to 10%, and the rate was generally 10% from 1860 to 1868.[5] Although the rate limitations given in the 1836 legislation were potentially binding, the law had little impact on banking because no penalties were stated in case excessive interest

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* Associate Professor of Economics, University of Arkansas at Little Rock; Ph.d., J.D.

** Associate Professor of Finance, University of Arkansas at Little Rock; Ph.d.

*** Associate Professor of Finance, University of Arkansas at Little Rock; Ph.d.

1. *Exodus* 22:25.
2. *Deuteronomy* 23:19.
3. Penick, *The Impact of Usury Law on Banks in Arkansas,* 8 ARK. L. REV. 420, 422 (1954).
4. *Id.* at 423 (quoting WORTHEN, EARLY BANKING IN ARKANSAS 45 (1906)).
5. *Id.* (citing WORTHEN, at 127).

was charged.[6] As a result, usury did not become a significant political issue until after the Civil War.

Under the Reconstruction Acts of 1867, ex-confederates were denied the right to vote, and Arkansas was placed under military rule until such time as a new constitution could be approved by voters and accepted by Congress.[7] The constitution drafted by Republicans in 1868 contained a usury provision that differed substantially from the usury legislation passed in 1836. The new constitution provided that "[N]o law limiting the rate of interest for which individuals may contract in the State shall ever be passed."[8]

Capital shortage was a severe economic problem in the South under reconstruction. The 1868 usury law, typical of laws passed in other southern states, was designed to attract outside capital and facilitate redevelopment of the state.

After the new constitution was enacted, Republicans took control of state and local government, and interest rates rose rapidly. During the 1870s rates of 20% and higher could be found.[9] State finances were soon brought to near bankruptcy by fraudulent public bond issues which were supported by a large increase in taxes.[10] In the early 1870s a national depression caused by a widespread banking panic, which started in New York, wrecked havoc on the state's agricultural economy. When voting rights were restored to ex-confederates in 1873, Democrats won overwhelming support from voters for a new constitutional convention. The 1868 constitution had become a symbol for every perceived social and economic ill caused by Republicans in the state. As a result, the Democrats retaliated against the Republicans and adopted a very rigid constitution—one designed to curb government power.[11] Although usury was an obscure issue during the 1874 convention, the high interest rates of the 1870s caused the convention to adopt a very strict usury law: "All contracts for a greater rate of interest than ten percent per annum shall be void, as to principal and interest, and the General Assembly shall prohibit the same by law; but when no rate of interest is agreed upon, the rate

6. *Id.*

7. Act of Mar. 2, 1967, ch. 153, 14 Stat. 428 (1867); Act of Mar. 23, 1867, ch. 6, 15 Stat. 2 (1867).

8. ARK. CONST. of 1868, art. XV, § 21.

9. Penick, *supra* note 3, at 423 (citing WORTHEN, at 128).

10. Nunn, *The Constitutional Convention of 1874*, 27 THE ARKANSAS HISTORICAL QUARTERLY 182 (1968).

11. *Id.* at 203-04.

shall be six per centum per annum."[12]

Given the mood of the Democrats, it is not surprising that they reacted to the problems of Reconstruction as they did. Unfortunately, the retaliatory usury law that was enacted would soon prove to be incompatible with modern business practices.

As implied by this constitutional provision, the 10% limit did not vary with the type of loan or its terms. This made the courts' task of identifying the maximum interest rate allowed by law relatively easy. It also simplified the process of identifying those contracts containing usurious interest rates. Thus, on one hand, the simplicity with which this part of the 1874 constitution was stated made this maximum interest rate difficult to evade. On the other hand, the 1874 constitutional provision did not spell out what ancillary charges were to be considered part of the interest rate nor did it address acceptable methods for calculating an interest rate. The failure to provide a clear definition of the interest rate (and the unwillingness to alter the constitutional provision) led to approximately 100 years of litigation designed to circumvent and, consequently, to define the limits of the usury provision.

For about seventy-five years, the Arkansas Supreme Court tempered the harsh effects of the 10% usury limit. Although the court was willing to declare an interest rate usurious when the situation clearly indicated it, the court at the same time allowed various evasive charges designed to circumvent the operation of the usury law. For example, the court condoned various service fees charged to the borrower which were clearly designed to conceal usury.[13] The court provided lenders the largest loophole by accepting the argument that there could be a difference between the time price and the cash price of merchandise. The difference between these two prices was not considered to be usury so long as the credit price was quoted as part of a legitimate time sale. This theory, expounded shortly after the 1874 Constitutional Convention, first appeared in the case of *Ford v. Hancock*.[14] The court in this case stated, in effect, that the time price differential would be viewed favorably by the courts as long as the

12. ARK. CONST. art. XIX, § 13 (1874).

13. *See, e.g.*, Citizens' Bank v. Murphy, 83 Ark. 31, 36, 102 S.W. 697, 699 (1907) (1½% fee for collecting accounts; " 'Usury will not be inferred where from the circumstances the opposite conclusion can be reasonably and fairly reached'." *Id.* (quoting First Nat'l Bank v. Waddell, 74 Ark. 241, 85 S.W. 417 (1905)). *See also*, Matthews v. Georgia State Savings Ass'n, 132 Ark. 219, 200 S.W. 130 (1918) (inspection fee and compulsory insurance).

14. 36 Ark. 248 (1880).

higher credit price was not in consideration for forbearance but rather was quoted in connection with a legitimate credit sale.

In 1951 the state legislature codified the liberal trend of the Arkansas usury decisions by passing the Arkansas Installment Loan Law.[15] This Act, directed principally at those making small loans, merely restated what the court had said in its long line of cases dealing with the usury issue;[16] that is, the Act provided lenders a way to circumvent the 10% usury limit. This was done by allowing lenders to collect from borrowers various fees that were not to be characterized as interest. These charges were for such things as credit investigations, inspections, closing costs, and title insurance.[17] The allowable charges also included fees paid an attorney for legal services rendered in connection with the loan.[18] Such charges, however, were to bear a reasonable relation to the service rendered. The Act provided a maximum fee schedule that depended on the principal amount of the contract.[19]

This codification of past, liberal court decisions regarding usury, however, soon proved to be one of the causes of the Act's demise.[20] The Act attracted the attention of many who had been unaware of the court's liberal trend on the usury issue. Thus, passage of this act led to a reconsideration of the whole usury issue once again.

After the state legislature's stamp of approval of this liberal trend, the reaction of the national finance companies was swift. Numerous finance companies were immediately opened to take advantage of the newly codified loopholes in the state usury law. During the one year in which the Act was effective (before being declared unconstitutional), over thirty thousand small loans were made with the total loan amount exceeding eight million dollars.[21] It is easy to see why it was advantageous for finance companies to establish offices in Arkansas. The number and variety of allowed service charges provided finance companies an effective way to circumvent the Arkansas

15. Arkansas Installment Loan Law, 1951 Ark. Acts 203 (repealed 1953).

16. The law was specifically directed at lenders making loans of less than $2500 and excluded banks, building and loan associations, and others who were already under state supervision.

17. 1951 Ark. Acts 203, § 27 (repealed 1953).

18. *Id.*

19. Total charges were not to exceed 7% of the principal, not in excess of $300 and 5% of that part of the principal not in excess of $600, and 4% on any part of the principal amount exceeding $600. *Id.*

20. Penick, *supra* note 3, at 443.

21. *Id.* at 441.

10% usury limit, making small loans to Arkansas borrowers very profitable. However, this profitable climate was not to last.

Approximately one year after the passage of the Arkansas Installment Loan Law, the Arkansas Supreme Court decided the first of a line of cases that gradually spelled the demise of the Act and of the numerous loopholes that had sprung up over the years. In *Winston v. Personal Finance Co.*[22] the supreme court served notice on those using such loopholes that:

> [A] caveat is hereby given that in litigation concerning loans made subsequent to the effective date of this opinion, this court will feel free to consider anew this question of travel expenses and inspection fees which the lender may charge the borrower and in which the charged items go to pay the expenses of the agents or employees of the lender. The question will be reconsidered in the light of the Constitutional inhibition against usury.[23]

The court in *Winston* did not declare the entire Installment Loan Law unconstitutional, but did void those sections dealing with charges. In this regard, the court stated:

> We unhesitantingly declare that any provisions in the said Act 203 which attempt, in any guise whatsoever, to permit an evasion of the Constitution, are null and void. . . . [T]he Constitution fixes interest at a maximum rate of 10%, and any charge for the use of money above that amount is usurious.[24]

On the same day that the decision in *Winston* was handed down, the court decided yet another case dealing with the Installment Loan Law. In *Strickler v. State Auto Finance Co.*[25] the court declared unconstitutional other sections of the Act. Again these charges were being used to circumvent the 10% usury limit.

Other cases handed down in 1952 continued to chip away at the Installment Loan Law and the validity of the time/price differential as a means of evading the usury law. For example, in *Hare v. General Contract Purchase Corp.*,[26] the court served notice on sellers that, while it would uphold the validity of the time/price differential one last time, from that point on having a cash price and a time price might no longer provide protection from the usury law.[27] In the

22. 220 Ark. 580, 249 S.W.2d 315 (1952).
23. *Id.* at 584, 249 S.W.2d at 318.
24. *Id.* at 588, 249 S.W.2d at 319.
25. 220 Ark. 565, 249 S.W.2d 307 (1952).
26. 220 Ark. 601, 249 S.W.2d 973 (1952).
27. *Id.* at 607, 249 S.W.2d at 977. *See also* Schuck v. Murdock Accept. Corp., 220 Ark. 56, 247 S.W.2d 1 (1952).

words of the court:

> [W]e now give the public a caveat that the effect of transactions, such as in the case at bar, may impinge on the constitutional mandate against usury, and transactions entered into after this appeal becomes final, may be subjected to the taint of usury with the aforementioned decisions affording no protection.[28]

The *Hare* decision effectively closed the time/price differential loophole for evading the usury law. The final blow to the time/price doctrine came in 1957 when the court, in *Sloan v. Sears, Roebuck & Co.*,[29] stated that the *Hare* caveat applied not only to transactions involving finance companies but also to sales of merchandise on credit.

By the end of the year the liberalization trend had been completely reversed. The sections of the Installment Loan Law that were not declared null and void in 1952 were effectively repealed during the 1953 legislative session.[30] Thus, in little more than a year, the liberal trend established over a seventy-five year period came to an abrupt halt. All the decisions that had been part of this trend were effectively reversed, and from this point on the court interpreted the 1874 constitutional provision strictly.

The finance companies, which had invested over one million dollars in start-up costs, were not prepared to stand for this reversal without a fight.[31] A series of cases tested both the limits of the caveat as stated in *Hare* and the validity of transactions entered into prior to the date of that decision. The decisions in these cases upheld the law as stated by the court in its caveat.[32] Transactions entered into prior to the ruling in *Hare* were decided on the basis of previous court decisions which had upheld the time/price doctrine but which now conflicted with the more recent rulings of the court. With the failure of the assault on the newly defined usury law, along with the failure of other loopholes and legislative initiatives, most finance companies saw no other choice than to leave the state.[33] In their view, a strictly construed 10% usury rate left a less than adequate profit margin on

28. *Hare*, 220 Ark. at 607, 249 S.W.2d at 977.

29. 228 Ark. 464, 308 S.W.2d 802 (1957).

30. 1953 Ark. Acts 391 (repealing 1951 Ark. Acts 203).

31. Penick, *supra* note 3, at 451.

32. *See* Murdock Accept. Corp. v. Clift, 222 Ark. 313, 259 S.W.2d 517 (1953); Pacific Finance Corp. v. Tinsley, 222 Ark. 723, 262 S.W.2d 282 (1953); Aunspaugh v. Murdock Accept. Corp., 222 Ark. 141, 258 S.W.2d 559 (1953); Crisco v. Murdock Accept. Corp., 222 Ark. 127, 258 S.W.2d 551 (1953); Murdock Accept. Corp. v. Higgins, 222 Ark. 140, 258 S.W.2d 558 (1953). *See also*, Penick, *supra* note 3, at 450.

33. *See generally*, Penick, *supra* note 3, at 451-57.

which to base lending activity of this type in Arkansas.[34]

The legacy that the State was left with after this reinterpretation of the 1874 constitutional provision was a usury law that was strictly construed. The 10% limit did not vary with the nature of the loan or its parameters. Thus, determining the interest rate limit in Arkansas was not a difficult problem. Not only did the constitution make determining the maximum rate relatively easy, it also prevented any special legislation or business practices designed to circumvent the 10% limit. This meant that Arkansas was left with what amounted to an ironclad 10% rate that permitted no exceptions. Over the years many cases were brought that tested both the limits and severity of the usury provision.[35] As defendants and plaintiffs soon found, however, courts strictly construed the usury provision, and any subterfuge or attempt to evade the usury law was met with the prescribed, heavy penalties (forfeiture of both principal and interest).[36]

As harsh as this interpretation was, this was the situation that existed from the late 1950s through the 1970s. This usury limit was not a major problem as long as the market rate of interest remained well below the 10% limit. This was essentially the case during this period. For example, throughout the early 1950s the prime rate ranged between 2% and 3.5%. By the latter part of the 1950s the rate had inched up into the 4% range, finally hitting 5% in September 1959. During the first half of the 1960s, the prime rate stayed around the 5% level but began a steady climb thereafter. In the period from 1966 to 1970, the prime rate rose steadily from 5.5% in 1966 to 8% in early 1970. Soon after, however, interest rates began a gradual decline so that by the beginning of 1972 the prime rate was back down to the 4% range. This brief respite from high rates was not to last long.

Beginning in April 1972 interest rates began to rise once again. By the beginning of 1973 the prime rate had risen to 6%, and by September of that year the rate was fluctuating between 9% and 10%.[37] The prime rate fell slightly in the first quarter of 1974 (into

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34. It is interesting to note that the prime rate during this period (1951-53) was approximately 3%. Thus, a 7% differential between the prime and the usury limit at this time was evidently not large enough for finance companies to maintain a profitable operation in Arkansas. *See*, 56 Fed. Res. Bull. A33 (1970). All interest rate data quoted throughout this article are found in the yearly volumes of the Federal Reserve Bulletin.

35. *See, e.g.*, Redbarn Chemicals, Inc. v. Bradshaw, 254 Ark. 557, 494 S.W.2d 720 (1973); Arkansas Savings and Loan Ass'n v. Mack Trucks of Arkansas, Inc., 263 Ark. 264, 566 S.W.2d 128 (1978); Strawn Furniture Co. v. Austin, 280 Ark. 69, 655 S.W.2d 397 (1983).

36. *See* ARK. CONST. art. XIX, § 13.

37. It should be kept in mind that the prime rate is the rate that banks charge their best

the 8-9% range) but continued its climb in the second and third quarters of the year. By election time the prime rate was at 11%.

The relatively high interest rates in this period put banks and other lending institutions under tremendous pressure. It simply was not profitable to lend money at 10% in Arkansas when the same money could earn the market rate in other states that were not hampered by a strict usury law. As a result, Arkansas began to experience a capital outflow. Loanable funds began flowing to other states that allowed higher interest rates. This, in turn, resulted in credit rationing within the state as lending institutions began to restrict loans to all but their best customers. The stringent usury law also led to higher retail prices as retailers raised prices to cover the extra cost of servicing their lending activities in the state.[38] In one study, for example, it was shown that major appliances cost from 4% to 7% more in Little Rock as compared to comparable cities outside the state.[39] The relatively high prime rate and the resulting capital outflow brought renewed attention to the Arkansas usury law.

Due to the pressure that lending institutions were facing in the state, the Arkansas Credit Requirement Committee was formed in the latter half of 1973 by business and financial interests to work for passage of Proposed Amendment 57 to the Arkansas Constitution. The committee was composed mainly of businessmen from the Little Rock area.[40] The proposed amendment read as follows: "All contracts for an unlawful rate of interest shall be void as to principal and interest. The maximum lawful rate of interest, except when the General Assembly shall determine otherwise, shall be 10% per annum. When no rate is agreed upon, the rate shall be 6% per annum."[41] The proposed amendment was designed to place the regulation of interest rates in the hands of the state legislature. Thus, the proposed amendment would not strike the 1874 amendment. It would just add another clause, giving the legislature authority to change the usury rate. If the legislature did not act the rate would remain at 10%.[42] The idea was that economic conditions could be reviewed every few years with an

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and most reliable customers. For customers not falling into this category, interest rates are generally much higher.

38. *Arkansas: A Usury Law Dries Up Loan Funds*, BUS. WK., Sept. 29, 1973, at 73-74.

39. *Id.*

40. L. Brown, *The History and Effect of the Arkansas Usury Law on Arkansas Institutions and Worthen Bank and Trust Company, N.A.*, Exhibit 11 (1980) (available at Worthen Bank and Trust Co., Little Rock, AR.).

41. Arkansas Gazette, Dec. 29, 1973, at A2, col. 1.

42. If the contract did not specify an interest rate the maximum rate was to be 6%. This was the same as the 1874 provision.

appropriate adjustment in the usury rate by the state legislature if necessary.

The arguments that the proponents used in urging passage of Proposed Amendment 57 can be summarized as follows: 1) cash prices in Arkansas were abnormally high because of merchants' efforts to cover the cost of offering credit in the state; 2) Arkansas border cities, such as Texarkana and Fort Smith, were suffering because of differential interest rates; 3) credit sales were limited and merchants were demanding faster payment; 4) risky investment projects were unable to get financing; and 5) credit standards were extremely high, meaning that people with poor credit histories were unable to get loans.[43]

Those urging defeat of Proposed Amendment 57 were many. The state AFL-CIO,[44] the Arkansas Education Association,[45] the Arkansas Farmers Union,[46] and then Governor Bumpers[47] all came out in opposition to Proposed Amendment 57. Although these groups were basically opposed to the proposed amendment, one can nevertheless discern two distinct, but nonetheless related, positions on the issue. On the one hand, there were those who believed that there should not be any change in the usury law whatsoever. They believed that Arkansas was not being hurt by the 10% limit and that removal of this limit would result in higher prices and in a "money grab" by finance companies taking advantage of the higher rate. They also viewed the state legislature as being controlled by the bankers and thought that turning over the decision regarding the interest rate limit to the legislature would be tantamount to economic suicide.[48]

The other major position was held by those who felt that some change in the usury law was necessary but that this was not the way to do it. They distrusted the state legislature and felt that passage of Proposed Amendment 57 would in effect leave Arkansans without any interest rate ceiling and that a ceiling was definitely necessary.[49] Thus, they were afraid that the interest rate ceiling would be set at too high a level if the legislature was given the authority Proposed in Amendment 57. Instead, they wanted a law that would not only remove the 10% restriction but would also leave the interest rate ceiling

43. Arkansas Gazette, Mar. 7, 1974, at A6, col. 3.
44. Arkansas Gazette, Feb. 17, 1974, at A4, col. 1.
45. Arkansas Gazette, Sept. 11, 1974, at A7, col. 3.
46. Arkansas Gazette, Oct. 31, 1974, at A1, col. 2.
47. Arkansas Gazette, Aug. 30, 1974, at A1, col. 6.
48. For one example of this view, see Arkansas Gazette, Feb. 17, 1974, at A4, col. 1.
49. *See, e.g.*, Arkansas Gazette, Jan. 19, 1974, at A7, col. 1.

free of any legislative interference. One proposal advanced during the debate over Proposed Amendment 57 was that the ceiling be set at twice the Federal Reserve discount rate.[50] The discount rate at this time was 7.5%. This would have made the interest rate ceiling 15% under this formula. The prime rate in January 1974, for example, was slightly below 10%, making the 15% rate an attractive alternative to the constitutionally imposed usury limit.

The petition drive to place the proposed amendment on the ballot was successful with the proponents collecting over 200,000 signatures (only about 65,000 were needed).[51] However, the proposed amendment was overwhelmingly defeated in the general election held on November 5, 1974. Despite the best efforts of the proponents, only 13% of the voters cast their ballots in favor of Proposed Amendment 57. The effort to change the constitutionally imposed 10% limit was dead at least for the time being.

One of the factors that undoubtedly led to the defeat of Proposed Amendment 57 was fear of what the legislature might do with its newly acquired authority over the interest rate ceiling. However, another influence was at work during the latter part of 1974 that played a role in the defeat of the proposed amendment. This influence resulted from passage of a new federal law—the so-called Brock Act—which essentially circumvented state usury laws for commercial and agricultural loans over $25,000.[52]

The Brock Act was introduced into the Senate by Senator William E. Brock III (Rep., Tenn.). It was cosponsored in the Senate by Senators William Fulbright (Dem., Ark.) and Mike Mansfield (Dem., Mont.).[53] The expressed intent of the Act was to provide temporary federal legislative relief from the strict usury laws that existed in Arkansas, Tennessee,[54] and Montana.[55] The Act's three-year life was designed to give the states some breathing room and an opportunity to change their usury laws.

The Brock Act amended both the National Bank Act[56] and the

50. *Id.*

51. Arkansas Gazette, June 28, 1974, at A19, col. 4.

52. Brock Act, Title II, Pub. L. No. 93-501, 88 Stat. 1557, 1558-60 (1974) (codified as amended in scattered sections of 12 U.S.C.). The Brock Act was set to expire on the earlier of July 1, 1977, or such date that a state legislature might override the provisions of the Act. *See* 206 of the Act.

53. Arkansas Gazette, Oct. 14, 1974, at A1, col. 5.

54. TENN. CONST. art. XI, § 7 (1870).

55. MONT. REV. CODE ANN. § 47-125 (1947).

56. National Bank Act, 12 U.S.C. § 85 (Supp. V, 1975).

Federal Deposit Insurance Act.[57] As was noted above, the Brock Act provided for federal preemption of state usury laws for national and federally insured state banks and savings and loans. The law allowed such institutions to charge 5% above the Federal Reserve discount rate on business and agricultural loans over $25,000. The law went into effect on October 29, 1974, and was set to expire on July 1, 1977.

The passage of the Brock Act was undoubtedly another factor that led to the defeat of Proposed Amendment 57. The business and financial community in general realized that some of the pressure for the proposed amendment had been reduced as a result of this Act, but only for loans over $25,000. The discount rate in November 1974 was 8%, so the maximum rate that national banks, insured state banks, and savings and loans could charge for loans over $25,000 was 13%. With the prime rate in this period at about 11%, the Act provided lending institutions a two percentage point spread and some much needed relief. Vendor and all other financing remained bound by the Arkansas 10% usury limit.

Although the Brock Act provided some relief, its one major problem was that it indexed the interest rate to the Federal Reserve discount rate rather than to a market-oriented rate. Normally, the discount rate does not provide any clear indication of monetary conditions. In fact, Arthur Burns, chairman of the Federal Reserve Board at the time, stated that something like the ninety-day U.S. treasury bill rate would have been a better index than the discount rate.[58] The Brock Act most likely utilized the discount rate since the National Bank Act[59] already provided for a rate equalling 1% over this rate for national banks. Thus, there was some precedent for tying the interest ceiling under the Act to the discount rate. Despite this shortcoming of the Brock Act, it provided states with needed relief from restrictive usury laws.[60]

Right after the defeat of Amendment 57 interest rates began to decline, so that by the middle of January 1975 the prime rate stood at 10%, a full percentage point lower than at election time. Rates con-

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57. Federal Deposit Insurance Act, 12 U.S.C. § 1831a (Supp. V, 1975).

58. Arkansas Gazette, Oct. 8, 1974, at A6, col. 1.

59. National Bank Act, 12 U.S.C. § 85 (Supp. V, 1975).

60. In Stephens Sec. Bank v. Eppivic Corp., 411 F. Supp. 61 (W.D. Ark. 1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977), the defendant corporation challenged the validity of the Brock Act on constitutional grounds. The Brock Act and Arkansas' strict usury limit were obviously in direct conflict. After a careful examination of the history of federal control over state (through the Federal Reserve and FDIC systems) and national banking systems, the court concluded that the Brock Act was constitutional and, thus, able to preempt the 10% Arkansas usury limit.

tinued to fall throughout the year. By the middle of January 1976, the prime rate was 6.75%, a rate that had not been seen for about three years. The prime rate stayed at about this level during 1976, closing the year at 6.25%. During this period of relatively low interest rates, the Arkansas usury law, as in the past, was not a major problem for business and financial interests in the state. The spread between the prime rate and the 10% usury rate was large enough to mute much of the public grumbling about the restrictive nature of the state's usury law.[61] However, that all changed once again in the middle of 1977 when interest rates began another climb to what would be a record level for this century.

On August 22, 1977, the prime rate moved upward to 7% from 6.75%. This signalled a trend that was not to be reversed for the next three years. At the beginning of 1978 the prime rate stood at 8%, and it continued its climb for the rest of the year. By the beginning of 1979 the prime rate once again was 11.75%. Interest rates continued to increase during the rest of the year, with the prime rate eventually climbing to 15.25% by the beginning of 1980.

As expected, the large increase in interest rates during the years 1977 through 1980 created another credit crunch in the state. Once again the business and financial communities began to call for a change in the Arkansas usury law.[62] Since the Brock Act had expired on July 1, 1977, Arkansas did not even have the benefit of the federal override of the state limit for large business loans. This meant that Arkansans were once again bound across the board by the 10% interest rate ceiling.

The second major credit crunch of the 1970s did not fully take hold in the state until about the middle of 1978, when the prime rate increased to 8.75% on June 16 and then increased even further (to 9%) on June 30. These high rates were a direct result of the federal government's efforts to control inflationary pressures within the economy.

61. One need only look at the number of usury related articles in the Arkansas Gazette during the periods 1975-77 and 1973-74 to get some idea of the decline in interest in the usury law during this time. There was a total of 80 usury related articles in the Arkansas Gazette during the high interest rate years of 1973-74. This number had dwindled to a mere 13 articles during the years of 1975-77, after interest rates had eased. *See* S.J. Henderson, *Arkansas Gazette Index*, Arkansas Tech University Library, Russellville, Arkansas.

62. The large increase in the number of usury related articles in the Arkansas Gazette in the period, 1978-80, reflected this dissatisfaction. There were 225 usury related articles in the Arkansas Gazette in the period 1978-80 as opposed to 13 for the period 1975-77. *See* S.J. Henderson, *Arkansas Gazette Index*, Arkansas Tech University Library, Russellville, Arkansas.

In 1978 the business and financial communities within the state responded to these high rates in a variety of ways. First, midway through 1978, lenders stopped making VA and FHA loans because these rates had gone to 9.5%.[63] Lenders were fearful that the ½% to 1% mortgage insurance premium, on top of the 9.5% rate, might put these loans into the usurious category. At the time, there was no federal preemption of state usury laws for VA and FHA loans. Also, mortgage bankers began to require a minimum of 20% down for conventional mortgage loans.[64]

Lenders also began to tighten their requirements for making small, consumer-type loans in response to these high interest rates. As a result, many consumers with poor credit histories were unable to obtain loans. Also, many bankers refused to make consumer loans of less than $3000 because of the restrictive nature of the state usury law.[65] They argued that loans smaller than that amount were unprofitable.

The second major response from within the state to the usury limit came in the form of pressure on the federal government to pass another override bill (such as the Brock Act) to preempt the 10% limit. The Arkansas congressional delegation supported such a bill. Also, the financial community sent a steady stream of lobbyists to Washington to drum up support for such legislation.[66] However, Senator William Proxmire, Chairman of the Senate Banking Committee, was opposed to any further federal overrides of the Arkansas usury limit. He felt that this was a state problem and that it should be dealt with at that level.[67] The federal government, by the Brock Act, had given Arkansans a chance to do something about the state usury limit, and the state had done nothing in response. Why should the federal government bail the state out a second time? Because of this opposition, no federal override of state usury laws was passed during 1978.

A third reaction by the financial community in response to the relatively high interest rates in 1978 was its use of a provision of the National Bank Act[68] which permitted national banks to charge 1% over the discount rate for any type of loan.[69] At this point the discount rate was 9.5% which allowed national banks to charge 10.5%

63. Arkansas Gazette, July 2, 1978, at E5, col. 1.
64. *Id.*
65. Arkansas Gazette, Aug. 30, 1978, at C5, col. 2.
66. Arkansas Gazette, Aug. 2, 1978, at A1, col. 6.
67. *Id.*
68. 12 U.S.C. § 85 (1982).
69. Arkansas Gazette, Nov. 3, 1978, at A1, col. 8.

on all loans. While national banks in Arkansas were permitted to charge more than the usury rate, the extra ½% (over the 10% rate) did not give the banks much breathing room. The prime rate at this time was already 10.75%. Also, since this provision only applied to national banks, state chartered banks and savings and loans were excluded from this extra ½% point return.

A fourth response to the credit crunch in the state was a suit, filed in November 1978, challenging the constitutionality of the state's 10% usury limit.[70] The suit filed by the First National Bank of Little Rock, the American State Bank of Charleston, and a joint business venture (Quinn-Moore), sought a declaratory judgment that the state's 10% usury limit violated several sections of the United States Constitution and should be declared invalid. The complaint alleged that the 10% rate was a burden on interstate commerce.[71] Plaintiffs argued that when the price of money approaches the 10% limit borrowers cannot borrow money originating from another state. This occurs because lenders do not find it profitable to borrow outside the state at rates that are higher than the Arkansas usury limit. This, the plaintiffs argued, places an unreasonable burden on interstate commerce by impeding the flow of money across state lines. Other bases for the suit were the supremacy clause[72] and the fourteenth amendment due process, equal protection,[73] and privileges and immunities clauses. Trial was scheduled for the fall of 1979.

As 1979 began, the prime rate was at 11.75%, almost four percentage points higher than it was at the same time the previous year. The relatively high interest rates in the early part of 1979 led Arkansas bankers to renew their efforts to obtain another federal usury override through Congress.[74] The proposed legislation would bypass Arkansas' usury provision for business and agricultural loans over $25,000. The rate allowed on such loans was to be 5% above the Federal Reserve discount rate for both national banks and federally chartered institutions. As originally proposed, the legislation would not affect the 10% usury limit for home mortgages, consumer loans,

70. Quinn-Moore v. Lambert, No. 78-6045 (Pulaski Co. Cir. Nov. 1978), *aff'd*, 272 Ark. 324, 614 S.W.2d 230, *appeal dismissed* (for want of a federal question), 454 U.S. 805 (1981).

71. U.S. CONST. art. I, § 8(3).

72. U.S. CONST. art. VI, § 2.

73. With respect to the equal protection claim, plaintiffs argued that the state usury provision did not apply equally to all citizens of Arkansas because some were able to borrow at higher rates outside the state while others could not.

74. Arkansas Gazette, Feb. 23, 1979, at A8, col. 1. As interest rates continued their rise, Sen. William Proxmire's earlier opposition to a new federal usury override began to disappear.

or loans under $25,000.[75] Both the Arkansas Senate and House delegations were solidly behind the legislation.[76] Also, the proposed legislation was to remain in effect only until December 31, 1980. This would give Arkansans, who were to vote on a new constitution in 1980, another chance to change the state's usury provision.[77]

While this legislation was making its way through Congress, other federal legislation was introduced by the Arkansas congressional delegation that would exempt both VA and FHA housing loans from state usury limits.[78] As noted above, many lenders in Arkansas had stopped making VA and FHA loans as the market rate of interest moved past the 10% usury limit. This legislation was designed to correct that problem.

At the state level, as interest rates continued to rise, the pace of activity surrounding the usury issue became more frantic. This was to be expected since lenders were limited to charging the 10% rate while having to borrow in the marketplace at rates approaching 15% by year's end.

Several developments occurred during 1979 which illustrate the pace of this activity. First, the Fair Arkansas Interest Rates Committee (FAIR) was formed during 1979 to work for a change in the Arkansas usury provision.[79] Second, the *Quinn-Moore* trial, involving the constitutionality of Arkansas' 10% usury limit got underway. The trial started on September 18, 1979, and was to last five weeks. Third, state banks received a favorable ruling from the Attorney General's office allowing them to participate in national bank loans at rates higher than the 10% usury limit.[80] At this point (September 1979) national banks were making loans at 11.5% (1% over the discount rate of 10.5%). In a later opinion, the Attorney General's office gave its stamp of approval for the same type of activity on the part of savings and loans.[81] Fourth, state banks revealed plans to bring suit to challenge the federal law that allowed national banks to charge

75. Arkansas Gazette, Mar. 1, 1979, at A1, col. 5.

76. Arkansas Gazette, Feb. 23, 1979, at A8, col. 1.

77. The constitutional convention held in 1979 decided that the usury issue should be a separate item on the ballot. The reason for doing this was to insure that a negative vote on the usury question would not have any effect on the constitution being proposed. Arkansans were to be given two choices regarding usury. One was to leave the current 10% limit unchanged, while the other would allow a limit of 5% over the discount rate or 10%, whichever was greater. Arkansas Gazette, Aug. 7, 1979, at A4, col. 4.

78. Arkansas Gazette, May 2, 1979, at A1, col. 4.

79. Arkansas Gazette, Mar. 15, 1979, at C6, col. 3.

80. 79 Op. Att'y Gen. 116 (1979).

81. 79 Op. Att'y Gen. 143 (1979).

more for loans (1% over the discount rate) than state banks.[82]

In September an event occurred that added further evidence to the debate over the relative inefficiency of the state's usury limit. Toward the end of the third quarter in 1979, the yield on six-month treasury bills moved above the 10% level (10.315%). Rates on money market certificates, a relatively new instrument at the time, were tied to the six-month treasury bill rate. In order to stay abreast of the market rate on these short term investments and to insure an adequate supply of funds, three Arkansas savings and loans (two with a federal charter and one with a state charter) began to offer rates above 10% on money market certificates.[83] The federally chartered savings and loans were arguing that they were entitled to circumvent the state usury limit because they were members of the Federal Home Loan Bank system. This, they argued, included them under federal laws which allowed the Federal Home Loan Bank Board to set interest rates for its members.[84] Both the state bank and state securities commissioners[85] disregarded this argument. Instead they issued opinions stating that "usury is usury" and that the 10% usury limit also applied to what banks and savings and loans could pay to depositors.

In addition to muddying the waters surrounding the usury issue, these opinions placed the financial community under increased pressure to find alternative sources of funding. A 10% cap on deposits meant that money would continue to flow outside the state in order to seek the highest rate possible.

Most national banks did not exceed the 10% usury limit on money market certificates. Their position was that a subsection of Regulation Q,[86] which governed interest rates for national banks, prevented them from paying more to depositors than what state banks could pay under existing state regulations.[87] Four national banks did, however, begin offering a rate higher than the 10% limit on money market certificates.[88] State banks responded to this by appealing to the comptroller of the currency to begin enforcing Regulation Q which prevented national banks from offering depositors higher rates

82. Arkansas Gazette, Sept. 25, 1979, at A1, col. 2.

83. Arkansas Gazette, Sept. 13, 1979, at A1, col. 4.

84. 12 U.S.C. § 1425a (1982).

85. The securities commissioner supervised the savings and loans in the state.

86. 12 C.F.R. § 7.7310 (1979).

87. Arkansas Gazette, Sept. 13, 1979, at A1, col. 4.

88. National banks at Fayetteville, Springdale, Fort Smith, Malvern, and Stuttgart were paying the going national rate of 10.662% on money market certificates in October 1979. Arkansas Gazette, Oct. 17, 1979, at A11, col. 1.

than what state banks could offer.[89]

In the midst of the confusion over what banks could legally pay their depositors on money market certificates, the State Banking Board decided to reverse its position and allow state banks to pay more than the 10% rate on these short-term instruments.[90] In effect, the Banking Board decided to ignore the state constitutional usury provision. The payment of more than 10% was made contingent on three conditions. First, the bank had to agree not to raise the defense of usury on any liability to its depositors. Second, the bank had to agree to publish a notice to this effect in a newspaper and to send a copy to the bank commissioner. Third, if the bank decided to pay more than 10%, it would have to insure that its usury pledge was part of the deposit contract and that the bank's board of directors approved the action.[91] This action on the part of the State Banking Board prompted the Attorney General to file suit to determine what rates depositors could be paid under the state's usury law.[92] However, this suit was soon withdrawn, and many other suits became moot when President Carter, in the last two months of the year, signed several bills that preempted state usury laws.[93]

Toward the end of 1979, it became clear that Congress was becoming increasingly concerned about the problems caused by the restrictive usury laws in many states. Congressional concern about these problems is typified by the remarks of Representative Hinson: "Many of our states, approximately 20, are now experiencing problems by hitting the bottom of their statutory usury ceiling. . . . The problem is growing more serious. Many of our state-chartered banks are having trouble with agricultural and mortgage loans. . . ."[94] Congress responded to these concerns by passing, in the last few months of the year, several pieces of legislation designed to override restrictive state usury laws. For example, on November 5, 1979, President Carter signed what was commonly known as the Borrower's Relief Act.[95] This legislation, which had been introduced in Congress earlier in the year by the Arkansas Senate and House delegations, was specifically designed to alleviate the problems in the state caused by

89. *Id.*

90. Arkansas Gazette, Oct. 23, 1979, at A1, col. 3.

91. *Id.*

92. Arkansas Gazette, Oct. 30, 1979, at A4, col. 3.

93. Arkansas Gazette, Nov. 3, 1979, at A1, col. 8.

94. 125 CONG. REC. H12127 (daily ed. Dec. 17, 1979).

95. Borrower's Relief Act, Pub. L. No. 96-104, 93 Stat. 789 (codified as amended in scattered sections of 12 U.S.C.).

the 10% usury limit. Its purpose was to provide interim relief to Arkansans while the more general, federal legislation (The Depository Institutions Deregulation and Monetary Control Act (DIDMCA)[96] which would become effective in 1980) was wending its way through the legislative process. The Borrower's Relief Act was to expire if Arkansans voted to keep the 10% usury limit, or on July 1, 1981, which ever came first.

The Borrower's Relief Act was not a consumer-oriented bill in that it did not provide any direct relief for consumers. However, it did give financial institutions some relief from the state usury provision, which ultimately had an impact on consumers. The Act permitted all federally insured institutions to charge 5% above the Federal Reserve discount rate on business and agricultural loans greater than \$25,000.[97] The discount rate at this point was 12%, so the Act allowed Arkansas financial institutions to begin making loans at 17%. The prime rate was 15.25% which gave lending institutions about a two percentage point spread between the prime and loan rate. The Act also preempted state-imposed ceilings on rates paid for sizeable deposits. This meant that both banks and savings and loans were now able to pay the going rate (approximately 12%) for certificates of deposit and money market certificates.

It is important to realize what the Act did not do. It did not apply to consumer loans nor loans of less than \$25,000. Thus, it did not help car, furniture, or appliance dealers sell their products. Also, the Act provided no relief for the housing industry, so real estate loans were still bound by the state's 10% usury limit. However, legislation signed by the President later in the year did provide some needed help in this area.

On November 28, 1979, President Carter signed a bill which exempted all VA housing loans from state usury limits if FHA housing loans were also made exempt.[98] The FHA counterpart to this bill was signed into law on December 21, 1979, so both types of loans were exempt from the state's rigid 10% limit.[99] While this legislation provided some assistance, conventional (nonbusiness) real estate loans were still bound by the 10% usury limit.

Congress responded to the continuing pressure felt by the

96. Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, 161 (codified as amended in scattered sections of 12 U.S.C.).

97. Thus, all federally insured state banks and savings and loans were also exempt from the state usury provision.

98. 38 U.S.C. § 1828 (1982).

99. 12 U.S.C. § 1735f-7 (1982).

housing industry in Arkansas by passing yet another stopgap measure which was signed into law on December 28, 1979, and was to last for three months. This was the Consumer Services and Usury Act which superceded state usury provisions for loans secured by a first lien on residential property and business or agricultural loans in excess of $25,000.[100] There was no maximum interest rate for loans secured by such a mortgage, and therefore, loans made in accordance with this section could not be challenged under any state usury limitations. The upper limit on the interest rate for agricultural or business loans was not to exceed "5 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal Reserve district where the bank is located."[101] Any transactions not covered by the Act came in under the individual state usury limitations.

At the start of 1980 the prime rate was 15.25%. During the first part of the year it continued to climb, ultimately, reaching a record high of 20% by April 2. Thereafter, the prime rate fell steadily, falling to a low of 11% by the end of July. However, by the end of August the prime rate began another steady increase and eventually surpassed the record (20%) set just a few months earlier. By the end of December, the prime had set a new, modern day record of 21.5%.

Despite the presence of the preemptive federal legislation, the business and banking communities in Arkansas realized that these were only stopgap measures that would eventually expire.[102] The constitutional convention that had met in 1979 provided voters a choice between two alternative amendments in the November 1980 general election. One amendment left the 10% usury rate intact; the other allowed a maximum rate of 5% over the discount rate. The constitutional convention was to meet again in the summer of 1980 to finalize the usury proposals and the proposed constitution and to make any necessary changes in anticipation of the November general election.

In January of that year, in what was called an extended session,[103] the legislature began to consider its own constitutional amendment on usury. This meant that the voter might be faced with three usury proposals on the November ballot—one emanating from the General Assembly and two from the constitutional convention. The General Assembly proposed that the legislature set the interest

100. Consumer Services and Usury Act, Pub. L. No. 96-161, 93 Stat. 1233 (1979) (codified as amended in scattered sections of 12 U.S.C.).

101. 93 Stat. at 1235, §§ 201, 202.

102. The VA and FHA housing usury overrides were, however, permanent.

103. The General Assembly had recessed in April 1979 and reconvened in January 1980.

rate, despite the fact that this same proposal was soundly defeated in the 1974 election.

The proposal finally passed by the General Assembly left the interest rate at 10% unless changed by the state legislature.[104] There were to be different classes of loans with differing interest rates, and a two-thirds vote in both houses was required to either raise or lower the rate. The then current penalty for usury—loss of interest and principal—would be the same unless changed by the legislature. Governor Clinton expressed some skepticism about this proposed amendment in light of the 1974 defeat of a similar proposal.[105] Governor Clinton acknowledged, though, that some change in the 10% usury limit was definitely in order.[106] The Fair Arkansas Interest Rates Committee (FAIR) favored the proposed constitutional amendment as passed by the legislature.[107] On the other hand, the state AFL-CIO opposed any change in the state usury law.[108]

One plan that was defeated during this extended session of the General Assembly tied the maximum interest rate to the discount rate.[109] Members of the banking and business communities felt that more flexibility would be attained by giving the legislature authority over the maximum rate rather than having it tied to an economic indicator. The business community also argued that a maximum rate tied to some national rate would represent an enormous administrative burden because it might be difficult to tell what the usury limit was at any particular time.[110] Despite the fact that a proposal similar to the one passed by the legislature had been defeated in 1974, many members of the state legislature felt that the period of high interest rates had eased most people's fears about having the General Assembly determine the maximum interest rate. This assumption soon proved to be incorrect.

On March 7, 1980, the Arkansas Circuit Court of Appeals issued the *Quinn-Moore* decision.[111] After a five-week trial, with over 130 witnesses, Judge Bullion ruled that the state usury limit did not

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104. H.R.J. Res. 9, 72nd Gen. Assembly, Extended Sess. 1980, 1981 Ark. Acts 2380.

105. Arkansas Gazette, Jan. 9, 1980, at A4, col. 1.

106. *Id.*

107. The Arkansas Farm Bureau argued that letting the state legislatures set the maximum rate would be too hard to sell to farmers. The Bureau called for a maximum of 3% above the discount rate. Arkansas Gazette, Jan. 15, 1980, at A10, col. 1.

108. Arkansas Gazette, Jan. 9, 1980, at A4, col. 1.

109. Arkansas Gazette, Jan. 15, 1980, at A1, col. 2.

110. Arkansas Gazette, Jan. 6, 1980, at A14, col. 1.

111. Quinn-Moore v. Lambert, No. 78-6045 (Pulaski Co. Cir. Nov. 1978), *aff'd*, 272 Ark. 324, 614 S.W.2d 230, *appeal dismissed*, 454 U.S. 805 (1981).

conflict with the due process clause, equal protection clause, or commerce clause of the United States Constitution. This decision would eventually be upheld on appeal by the Arkansas Supreme Court in 1981. Thus, one additional avenue for changing the state constitutional usury provision had been closed to the business and banking communities in the state.

On April 1, 1980, the Depository Institutions Deregulation and Monetary Control Act (DIDMCA) of 1980[112] formally went into effect. Title V of this Act specifically concerned state usury laws.[113] Title V, which essentially paralleled and extended for three years the federal override legislation passed in 1979,[114] effectively dispensed with state interest rate limitations on loans secured by first mortgages on residential real property and agricultural and business loans in excess of $25,000.[115] The DIDMCA limited business and agricultural loans of over $25,000 to a rate that was not to exceed 5% more than the Federal Reserve discount rate. The DIDMCA placed no interest rate limit on residential real estate loans secured by a first mortgage. On October 8, 1980, the $25,000 limit on business and agricultural loans was lowered to $1000.[116]

The section of the DIDMCA dealing with residential housing loans was permanent. However, states had a right to reject this section, and consequently reimpose whatever state usury limit had existed before DIDMCA, by acting before April 1, 1983. The portion of the DIDMCA relating to business and agricultural loans over $25,000 (later $1000) was to expire on April 1, 1983, but could be overridden by states if they so chose.

At this time, the prime rate was 20% while the discount rate stood at 13%. Thus, financial institutions in Arkansas were allowed

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112. *See supra* note 96.

113. Arkansas was by no means the only state to have interest rate restrictions. Many states had usury laws on their books. For example, at the start of 1980, 39 states had either fixed maximum rates or ceilings that floated with some market index for mortgage loans. In many of these states, the maximum rate for mortgage loans was below the general market rate. The DIDMCA was designed to provide some relief from these restrictive state usury laws. Congress, seeing the harm that might result in the economy from these restrictive usury laws, decided to take the initiative since states were not relaxing their ceilings quickly enough. But Congress deferred to the states' historical role in setting usury ceilings by giving them an opportunity to override any or all of the provisions of Title V.

114. Consumers Services and Usuary Act, *supra* note 100.

115. It should be pointed out that the DIDMCA did not abolish state usury laws. It merely provided that state usury laws would not apply to these transactions. Also, if a state so chose, it could override the provisions regarding residential housing, business, and agricultural loans.

116. 12 U.S.C. § 86a (1982).

to make business and agricultural loans above the federally mandated minimum dollar values at 18% and consumer loans at 11%.

One provision of DIDMCA that had not been contained in any previous federal legislation was an amendment which Senators Bumpers and Pryor managed to get added to the Bill. This section of the DIDMCA allowed federally insured state banks, savings and loans, and credit unions to charge 1% over the discount rate on any loan.[117] Previously, only federally chartered financial institutions had this authority. This provision was added to the DIDMCA to prevent federally chartered institutions from being able to charge higher rates than insured state banks and savings and loans. Thus, it was designed to prevent national banks from gaining what was seen as an unfair competitive advantage over these state institutions. These sections of the DIDMCA were permanent, and there was no time limit set for states to override this provision.

Realizing that a lawsuit had been filed over the legality of the extended legislative session and, thus, that the proposed legislative constitutional usury amendment might not make it on the November ballot, FAIR began a two-pronged assault on the 10% usury limit. First, FAIR began a petition drive to place a proposed constitutional amendment on the ballot that would give the legislature authority to set the maximum interest rate. This was to guard against the possibility that the legislative proposal might eventually be declared invalid.[118] Second, FAIR began a coordinated effort to convince delegates to the constitutional convention to replace the two proposed constitutional amendments approved in 1979 with one amendment that would allow the legislature to set the maximum rate.

FAIR's fear was realized in June when the Arkansas Supreme Court ruled in *Wells v. Riviere*[119] that the 72nd General Assembly violated the state constitution by merely recessing in April 1979 and reconvening its regular session in January 1980. The court pointed out that the state constitution provided for a sixty day legislative session. After this time the legislators were free to go home if the state's business was finished; if that was not the case, the session could be extended by a two-thirds vote. By recessing and reconvening whenever it wanted to, the General Assembly violated the provisions set out in the state constitution. This being the case, the court held that the usury amendment was not properly adopted because the legisla-

117. Title V, Part C, *supra* note 96, at 164.

118. Arkansas Gazette, May 25, 1980, at A4, col. 3.

119. 269 Ark. 156, 599 S.W.2d 375 (1980).

ture could not enact legislation after the end of the regular session in 1979. This meant that the proposed constitutional amendment, as passed by the legislature in the extended session, could not appear on the November ballot. This may not have caused too much concern within the ranks of the FAIR committee because its own proposed amendment was identical to the now invalid legislative proposal.

The FAIR committee eventually collected approximately 125,000 signatures (only 53,429 were actually needed) in favor of placing its proposed constitutional amendment on the ballot.[120] The FAIR committee also persuaded the constitutional convention to include the committee's amendment in the proposed constitution instead of the two amendments that the convention had considered earlier.[121] Thus, on November 4th, voters were able to consider the identical usury question twice—once as part of the proposed constitution and again as a separate ballot item.

For the second time in six years voters rejected a usury proposal that would have allowed the legislature to set the maximum interest rate. Proposed Amendment 60 was defeated with 161,424 people voting for the amendment and 201,197 voting against it (55%).[122] However, the margin of defeat was less than in the 1974 election. The proposed constitution also failed to win approval when it received only 35% of the vote (93,530 voting for and 170,532 voting against).[123] These voting results suggest that it was not the proposed usury amendment that led to the defeat of the new constitution.

The proposed usury amendment was defeated for several reasons. First, voters clearly were still telling the business and financial community that they did not want the legislature to set the maximum rate. This distrust of the state legislature had led to the defeat of a similar proposal in 1974. It is thus clear that the financial community made a tactical error again in 1980 when it decided to push for legislative determination of the maximum rate rather than having it tied to an economic indicator, such as the discount rate. The margin of defeat was small enough to suggest that Proposed Amendment 60 might have passed had the maximum rate been tied to an economic index. It is also clear that the public's distrust of the state legislature had been tempered somewhat by the recent period of high interest rates.

120. Arkansas Gazette, June 24, 1980, at A1, col. 5.

121. The earlier proposals were to leave the 10% usury rate unchanged and to tie the maximum rate to the discount rate.

122. Arkansas Gazette, Nov. 5, 1980, at A2, col. 2.

123. *Id.*

A second possible reason why the proposed usury amendment failed was that, after peaking at 20% at the beginning of April, the prime rate had fallen to 14.5% by election time. While still high by historic standards, the rate at election time was considerably less than it had been just a few months earlier. This rapid fall in the prime rate probably led to a diminished sense of urgency about changing the constitutional usury provision in Arkansas. Thus, after spending a reported 1.5 million dollars on the campaign to change the constitutional usury limit, the financial community, at the end of 1980, was left with the same 10% usury limit that had existed for the previous 106 years.[124]

A decision by the Arkansas Supreme Court late in 1980 threw the financial community into a state of shock, but one from which it recovered quickly. In *McInnis v. Cooper Communities, Inc.*[125] the court had initially held that the DIDMCA did not preempt Arkansas' 10% usury limit. The court reasoned that interest rates are not interstate commerce which can be regulated by Congress. The court also stated that "[t]he option of a state to exempt transactions within that state from the pertinent provisions of the Depository Institutions Deregulation & Monetary Control Act of 1980, is a total contradiction of any suggestion that the act is an exercise of the power of Congress to regulate interstate commerce."[126] This decision created confusion in the financial community since many loans had been made in reliance on the federal override provisions of DIDMCA. It created the potential of having thousands of loans suddenly being declared usurious. As a result of this confusion, some banks stopped making loans while others continued to rely on the federal override provisions, believing that the court's decision was obviously in error.[127]

Perhaps feeling the pressure of the business and financial community and seeing the potential harm that might result, the court quickly amended its opinion seven days later.[128] In its amended opinion, the court pointed out that its decision did not apply to national or state banks nor to federally chartered or insured savings institutions.[129] Thus, the court had narrowed its holding so that it would apply only to mortgage loans made by real estate development firms which were not financial institutions as defined by the DIDMCA.

124. Arkansas Gazette, Nov. 23, 1980, at E5, col. 2.
125. No. 80-254, slip op. (Ark. Dec. 22, 1980).
126. *Id.* at 4.
127. Arkansas Gazette, Dec. 23, 1980, at A1, col. 8.
128. McInnis v. Cooper Communities, Inc., 271 Ark. 503, 611 S.W.2d 767 (1981).
129. *Id.* at 506.

The financial community was relieved by this amended opinion but was concerned that the court had not completely reversed its initial decision.[130] Bankers wanted the court to declare unequivocally that the DIDMCA preempted Arkansas' 10% usury limit. There was a feeling that the court might change its mind once again and revert to its original decision, which applied to all financial institutions.[131]

To resolve the continuing question of whether Congress had the authority to pass legislation overriding state usury limits, Cooper Communities, on January 9, 1981, requested a rehearing of the case by the Arkansas Supreme Court.[132] On February 23, 1981, the court reversed itself once again and ruled that Congress acted within its authority to pass legislation that preempted state usury laws.[133] In agreeing that the DIDMCA preempted state usury laws, the court conceded that the flow of money between states involved interstate commerce and, thus, that Congress had the power to regulate that flow by preempting Arkansas' 10% usury limit. The court also relied on *Stephens Security Bank v. Eppivic Corp.*[134] wherein the court found that the 1974 Brock Act could legitimately preempt state consitutional usury provisions. Consequently, this decision finally laid to rest questions surrounding the legitimacy of the DIDMCA usury provisions.[135]

The business and banking community breathed a collective sigh of relief after the court's reversal of this case since a potential disaster had been avoided. However, the decision did nothing to help the long-term situation in the state. The basic problem facing the state at the end of 1980 was what to do about the 10% usury limit, especially in light of the fact that one of the important usury override provisions of the DIDMCA would expire in little over two years time (April 1, 1983).[136]

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130. Arkansas Gazette, Dec. 30, 1980, at A1, col. 8.

131. The uncertainty created by the decision in *McInnis* caused the Federal National Mortgage Association to cease making purchases of mortgages with interest rates of more than 9.5% from Arkansas institutions. *See* Arkansas Gazette, Jan. 17, 1981, at C5, col. 1.

132. Arkansas Gazette, Jan. 10, 1981, at A7, col. 1.

133. McInnis v. Cooper Communities, Inc., 271 Ark. 503, 611 S.W.2d 767 (1981).

134. 411 F. Supp. 61 (W.D. Ark. 1976), *aff'd*, 553 F.2d 102 (8th Cir. 1977).

135. The vote was 4-3 to overturn its previous decision. The justices had not really changed their minds, however. Three new judges were on the court at the start of 1981. *See* Arkansas Gazette, Feb. 24, 1981, at A1, col. 2.

136. Most of the DIDMCA's usury override provisions were permanent. For example, the federal preemption for residential real estate loans was permanent unless rejected by a state acting before April 1, 1983. This means states could reimpose ceilings if they so chose. The one section that was not permanent was the one preempting state ceilings on business and agricultural loans of $25,000 or more. This preemption was to expire on April 1, 1983. De-

At the beginning of 1981 the prime rate stood at 20.5%, and the rate remained at that level throughout most of the first three quarters of the year.[137] By the end of September, however, the rate began to drop, eventually settling at 15.75% by the end of the year. At the start of 1981 the discount rate stood at 13%, making the maximum rate on business and agricultural loans 18%. Thus, financial institutions were allowed to charge a maximum of 18% under the DIDMCA usury provisions. This was still 2.5 percentage points below the prime rate, which placed banks and other institutions under continuing pressure to do something about the state's restrictive usury provision.

While the business, agricultural, and housing sectors were given some relief by the federal override legislation, consumers had been overlooked by Congress in its haste to aid the ailing financial community. Banks were able to make consumer loans at 14% (1% plus discount), but car dealers and furniture stores, for example, were still confined by the 10% usury limit. This meant that store owners were in the position of having to borrow money at considerably higher rates in order to finance consumer purchases at 10% interest. This fact and knowledge that the business and agricultural loan exemption under the DIDMCA would expire in 1983 led to continuing pressure in 1981 to either do away with Arkansas' restrictive 10% usury limit or to somehow get around it. The Arkansas Supreme Court was of little help in this regard.

In 1981 the Arkansas Supreme Court decided another important case involving the usury issue. The case, *Quinn-Moore v. Lambert,*[138] had been argued the previous year. The plaintiffs argued that Arkansas' 10% usury limit interfered with interstate commerce and denied due process and equal protection under the law. The state argued that it had the right under its police power to protect the health, safety, and welfare of its citizens. Using this as a basis, the state posited that it was protecting the welfare of its citizens by limiting the amount of interest that could be charged on contracts in the state.

The court, in a 6-0 decision, upheld the lower court ruling that Arkansas' usury provision did not violate any provisions of the United States Constitution. Thus, the court found no violation of due process, no burden on interstate commerce, and no violation of the

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pository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. No. 96-221, 94 Stat. 132, 161 (codified as amended in scattered sections of 12 U.S.C.).

137. The rate dropped the first four months of the year, eventually settling at 17% on April 2nd, before climbing back up to 20% by May 19th.

138. 272 Ark. 324, 614 S.W.2d 230, *appeal dismissed,* 454 U.S. 805 (1981).

equal protection clause of the Constitution. As the court stated, "Ultimately the question in this case narrows down not to an issue of constitutional law but to one of public policy: What should be the maximum interest rate in Arkansas? . . . If it is to be changed it must be done by popular vote, not by judicial decision."[139] This case was eventually appealed to the United States Supreme Court, but the Court refused to hear it, finding no substantial federal issue involved. Therefore, another avenue around Arkansas' restrictive constitutional usury provision had been blocked.

Continuing high interest rates and the lack of any relief for businesses making consumer loans led to several efforts in 1981 to either change the constitutional usury provision or to get around it by using various subterfuges. With the General Assembly in session, efforts were begun early in the year to deal with the restrictive usury limit at the state level. These efforts took two forms. First, legislation was introduced that would allow banks and savings and loans to charge various fees on loans that would not be characterized as interest. House Bill 128 proposed that loan origination fees, loan commitment fees, credit life insurance premiums, late payment charges, and other specified fees were to be excluded from the definition of interest.[140] This was an obvious attempt to circumvent the state usury provision, as the opponents of this legislation were quick to point out. An amended version of House Bill 128[141] passed the House in a 57-8 vote[142] but died in the Senate Judiciary Committee, reportedly as a result of opposition by the state AFL-CIO.[143]

The second effort to deal with the usury issue at the state level was more successful than the first. During the closing days of the General Assembly in March of 1981, the legislature voted to offer voters another opportunity to remove the 10% interest ceiling.[144] The proposed constitutional amendment[145] would establish a 17%

139. *Id.* at 330, 614 S.W.2d at 233.

140. H.B. 128, 73d Gen. Assem., Reg. Sess. (1981).

141. An amended version of the bill defined "other charges" to be title opinion fees, survey fees, termite inspection fees, appraisal fees, membership fees, credit report fees, hazard insurance premiums, taxes, and assessments. Also, loan orientation fees and loan commitment fees could not exceed 3% of the principal amount of the loan. A final amendment before House passage removed membership fees, late charges, and assessments from the fees listed above. *See* Arkansas Gazette, Feb. 25, 1981, at A1, col. 2.

142. *Id.*

143. Arkansas Gazette, Mar. 15, 1981, at A9, col. 2.

144. H.J.R. 7, 73d Gen. Assem., Reg. Sess. (1981).

145. The popular name for this amendment was "The 1982 Interest Rate Control Amendment."

maximum on credit extended primarily for personal, family, or household purposes and a maximum of 5% over the Federal Reserve discount rate for other loans.[146] The penalty for charging more than 17% for consumer loans was forfeiture by the creditor of both principal and interest. General loans that had a rate of interest greater than the maximum lawful rate were to be void as to the unpaid interest. Under the proposed amendment, any person who had been charged more than the maximum rate on a general loan was eligible to recover twice the amount of interest paid. Voters were given an opportunity to vote on this proposed amendment in the November 1982 general election.[147]

Despite the fact that a new usury amendment had been proposed and passed by the legislature, the more immediate problem of what to do about the high interest rates in 1981 remained unresolved. Be-

146. The proposed amendment read as follows:

(a) General Loans:

(i) The maximum lawful rate of interest on any contract entered into after the effective date hereof shall not exceed five percent (5%) per annum above the Federal Reserve Discount Rate at the time of the contract.

(ii) All such contracts having a rate of interest in excess of the maximum lawful rate shall be void as to the unpaid interest. A person who has paid interest in excess of the maximum lawful rate may recover within the time provided by law, twice the amount of interest paid. It is unlawful for any person to knowingly charge a rate of interest in excess of the maximum lawful rate in effect at the time of the contract, and any person who does so shall be subject to such punishment as may be provided by law.

(b) Consumer Loans and Credit Sales: All contracts for consumer loans and credit sales having a greater rate of interest than seventeen percent (17%) per annum shall be void as to principal and interest and the General Assembly shall prohibit the same by law.

(c) Definitions: As used herein, the term:

(i) "Consumer Loans and Credit Sales" means credit extended to a natural person in which the money, property, or service which is the subject of the transaction is primarily for personal, family or household purposes.

(ii) "Federal Reserve Discount Rate" means the Federal Reserve Discount Rate on ninety day commercial paper in effect in the Federal Reserve Bank in the Federal Reserve District in which Arkansas is located.

(d) Miscellaneous:

(i) The rate of interest for contracts in which no rate of interest is agreed upon shall be six percent (6%) per annum.

(ii) The provisions hereof are not intended and shall not be deemed to supersede or otherwise invalidate any provisions of federal law applicable to loans or interest rates including loans by residential real property.

147. This was not the only constitutional amendment relating to usury proposed during this session of the legislature. H.J.R. 21 would have allowed a 17% interest rate limit for loans under $50,000, with no limit on loans over that amount. Under a usurious contract, the lender would have to forfeit 150% of the interest paid. *See* H.J.R. 21, 73d Gen. Assem., Reg. Sess. (1981).

cause nothing more could be done at the state level, the business and financial community looked again to the federal government for interim relief from the state's 10% limit. Various bills were introduced in Congress that would provide relief from restrictive state usury limits for retailers making consumer loans.[148] For example, one bill would prohibit all state usury ceilings on consumer as well as business and agricultural loans.[149] Another bill, introduced by Senators Pryor and Bumpers of Arkansas, would amend the DIDMCA to allow an interest rate of 1% over the discount rate on any type of loan, thus providing some aid to retailers making consumer credit loans.[150] However, Congress was in no mood to pass additional legislation to help states that continually rejected efforts to change their restrictive usury laws. Consequently, no additional preemptive federal legislation was forthcoming in 1981. Arkansans would have to wait until the November 1982 general election for some further assistance in dealing with the 10% usury limit.

Toward the end of 1981, the banking and business community geared up for another campaign to change the constitutional usury provision. The Arkansas Credit Council, an umbrella organization for such groups as the Farm Bureau, Arkansas State Chamber of Commerce, and the Automobile Dealers Association, was formed to carry out the campaign.[151] The committee faced the task of succeeding at something that the Fair Arkansas Interest Rate Committee had failed to do in 1980—convincing voters to change the 10% interest limit. Those opposed to the proposed constitutional amendment included the state AFL-CIO, which wanted a maximum of 1% or 2% over the discount rate as the new interest limit.[152]

The prime rate was 15.75% at the beginning of 1982. After reaching 17% toward the end of February, the rate began a downward trend that saw the prime rate fall to 11.5% by December. The Federal Reserve discount rate—the index to which the nonconsumer

148. There were no fewer than five bills introduced into the 97th Congress (1st session) that would provide further relief for states with restrictive usury limits. These were: H.R. 2501 (would prohibit state usury limits for consumer, business, and agricultural loans); H.R. 3172 (would provide for 1% over discount for any type of loan); S. 963 (companion bill to H.R. 3172); S. 1406 (would eliminate the then current federal rate ceiling for business and agricultural loans and would preempt all state usury laws for consumer credit loans); S. 1720 (would eliminate the then current federal rate ceiling for business and agricultural loans and would preempt all state usury laws for consumer credit loans).

149. H.R. 2501, 97th Cong., 1st Sess. (1981).

150. S. 963, 97th Cong., 1st Sess. (1981).

151. Arkansas Gazette, Dec. 18, 1981, at A4, col. 1.

152. Arkansas Gazette, Nov. 8, 1981, at E11, col. 1.

loan rate in the proposed amendment was tied—started the year at 12% and fell to 8.5% by the end of 1982. This steady decline in interest rates throughout 1982 imposed one more hurdle for supporters of the new amendment who were concerned that the decline in interest rates might erode some of the support for a new usury provision.

The debate over Amendment 60 (as the new constitutional usury provision, to be voted on in the November 1982 general election, was called) did not begin in earnest until the middle of 1982, but by then, the battle lines were well drawn. Endorsing Amendment 60 were over seventy organizations,[153] practically every newspaper and TV station in the state, every major state office-holder, and every candidate for major office.[154] The reasons given by proponents for supporting Amendment 60 were the same ones that had been used previously. In seeking a higher return, money was flowing from Arkansas to states where a higher market rate of interest prevailed. Retail credit was drying up, forcing many small businesses out of existence. As a result, credit rationing was occurring, which meant that those in the high risk category were, in many cases, unable to obtain loans.[155] Also, because retailers were forced to borrow at relatively high rates while financing consumer purchases at only 10%, proponents of the amendment argued that businesses were making up the difference by charging higher prices.[156]

Supporters of Amendment 60 pointed out that Arkansas' 10% limit was the most restrictive usury provision in the nation. By 1982 all states either had no limit on rates or limits that were considerably higher than that in Arkansas.[157] On automobile loans, for example, Alaska had the lowest limit of all the other states, approximately 15%.[158] The very restrictive nature of Arkansas' constitutional usury provision, supporters argued, negatively affected the state's economy

153. Some of the organizations endorsing Amendment 60 were: the American Association of Retired Persons; the Arkansas Automobile Dealers Association; the Arkansas Bankers Association; the Arkansas Farm Bureau; the Arkansas Furniture Dealers Association; the Arkansas Homebuilders Association; the Arkansas Mortgage Bankers Association; the Arkansas Realtors Association; the Arkansas Savings and Loan League; the Arkansas State Chamber of Commerce. Governor Frank White endorsed the amendment as did Senators Pryor and Bumpers and former Governor Bill Clinton. *See* Arkansas Gazette, July 11, 1982, at F1, col. 2.

154. Arkansas Gazette, Nov. 3, 1982, at A1, col. 4.

155. Arkansas Gazette, Oct. 22, 1982, at A10, col. 6.

156. Arkansas Gazette, Aug. 29, 1982, at C1, col. 2.

157. Arkansas Gazette, Oct. 17, 1982, at A1, col. 4.

158. *Id.*

resulting in fewer available jobs.[159] Proponents of the amendment also pointed out that the federal override for business and agricultural loans (DIDMCA) would expire April 1, 1983, and that Congress was unwilling to provide any additional assistance in the form of new federal override legislation to states with restrictive usury laws.[160] Congress viewed state usury laws as a local problem that had to be dealt with at the local level. Opponents of the amendment pointed out, however, that, at the request of the Arkansas Credit Council, the Arkansas congressional delegation worked to kill federal legislation that would have extended for another year that portion of the DIDMCA that preempted the 10% limit on business and agricultural loans.[161] Supporters countered that further overrides were not an adequate solution to the usury situation in Arkansas because they did not cover retail consumer credit and that the legislation would not have passed anyway.[162]

J. Bill Becker, President of the Arkansas State AFL-CIO, was the major spokesperson for those leading the fight against the proposed usury amendment to the constitution. Other groups opposing Amendment 60 were the National Association for the Advancement of Colored People (NAACP) and the Arkansas Community Organizations for Reform Now (ACORN).[163] The opposition's arguments against Amendment 60 can be summarized as follows:[164] a) people in Arkansas would not be able to afford the large increase in interest rates that would occur as a result of the passage of Amendment 60—5% over the discount rate was too large and 17% was too much for consumer loans; b) the federal government would control local interest rates since Amendment 60 would tie the maximum rate to the Federal Reserve discount rate; c) Amendment 60 weakened the penalty for usurious farm and business loans because instead of forfeiting all principal and interest, the lender was only responsible for twice the amount of interest paid (the penalty for usurious consumer loans was to remain the same); d) Amendment 60 would prevent Arkansas from

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159. Arkansas Gazette, Sept. 5, 1982, at A9, col. 1.

160. Arkansas Gazette, Oct. 21, 1982, at A7, col. 1.

161. A usury amendment was initially included in S. 2879 (which would eventually become known as the Garn-St. Germain Depository Institutions Act of 1982), 97th Cong., 2d Sess., 128 Cong. Rec. 25,179 (1982). Although accepted by the Senate, the usury amendment was rejected by the House and was formally deleted in a Senate-House conference committee. H.R. Rep. No. 97-899, 97th Cong., 2d Sess. (1982).

162. Arkansas Gazette, Nov. 3, 1982, at A1, col. 4.

163. The Ku Klux Klan also stated its opposition to Amendment 60. Arkansas Gazette, Nov. 15, 1982, at A13, col. 4.

164. Arkansas Gazette, Oct. 31, 1982, at A1, col. 5.

ever establishing its own ceiling on first mortgage home loans.[165]

Another attack on Amendment 60 came in the form of a lawsuit filed by the opposition (specifically J. Bill Becker and the AFL-CIO, as well as others) seeking to disqualify the amendment from the ballot because of a misleading title.[166] The ballot title for Amendment 60 was: "An Amendment to Section 13 of Article XIX of the Constitution of the State of Arkansas to Control Interest Rates and Set the Penalty for Violations Thereof."[167] Bill Becker and the AFL-CIO argued that this title was misleading because Amendment 60 would decontrol interest rates by allowing the maximum rate to fluctuate, not control the rates and that this made the ballot title deceptive.

In a 4-3 decision, the Arkansas Supreme Court upheld the sufficiency of the proposed ballot title. The court did not dispute the fact that the ballot title might be misleading. However, the court noted that under the Arkansas Constitution,[168] the purpose of a ballot title on an amendment referred by the legislature, as opposed to one referred by the people, is merely to identify the proposal and to distinguish it from other measures on the ballot. It did not have to inform the voters of its content. According to the court, a ballot title which meets this test will be upheld unless it constitutes a manifest fraud on the public. In the case of Amendment 60, the court concluded that the ballot title, while misleading, was sufficient to identify the proposed amendment and distinguish it from other measures on the ballot. The court, therefore, refused to remove the proposed constitutional amendment from the November ballot.[169]

In the November general election, Arkansans approved Amendment 60, with 59% of the voters voting in favor of it.[170] This was the

165. The DIDMCA provided that states, should they so desire, could reassert a usury limit for mortgages and other financing arrangements which were secured by first liens on residential real property (12 U.S.C. § 1735f-7 (Supp. 1989)). As passed by Congress, the Act provided for no such limit. Thus, the legislature and voters in Arkansas had the opportunity to reimpose a usury limit for such loans when they considered Amendment 60 in 1982. But instead of reasserting such a limit, Amendment 60 (§ d(ii)) contained a provision that specifically endorsed the federal preemption. Thus, the legislature wanted to make it clear that Amendment 60 was not intended to override any portion of the DIDMCA and, thus, that there would be no interest limit on such loans. *See* Amendment 60, *supra* note 146.

166. Becker v. Riviere, 277 Ark. 252, 641 S.W.2d 2 (1982).

167. H.J.R. 7, 73d Gen. Assem., Reg. Sess. (1981).

168. ARK. CONST. art. XIX, § 22.

169. The dissenters argued that deception in a ballot title, no matter what form it takes, should never be allowed. 277 Ark. at 255-60, 641 S.W.2d at 4-7 (Smith, J.; Hickman, J.; Purtle, J., dissenting).

170. The certified voting results were 442,325 for and 302,461 against Amendment 60. *See* Arkansas Gazette, Nov. 21, 1982, at A2, col. 3.

first change in Arkansas' usury provision in over one hundred years and was greeted with approval by the business and financial community in the state. However, several issues immediately arose that cast some doubt on the state legislature's ability to draft clear and unambiguous legislation. First, there was confusion over when the new constitutional amendment would take effect. Some thought that it might be effective immediately. Others thought that it would become effective only after a certain period of time. The Attorney General's office finally decided the question when it issued an opinion saying that the new amendment would not take effect until thirty days after the general election.[171] Second, there was some confusion over whether retail merchants offering "revolving charge" accounts might apply the new rates to existing credit balances or whether the new rates just applied to newly incurred balances. Based on public relations considerations and on truth-in-lending laws which require fifteen days notice before raising rates[172] it was widely recognized that retailers would probably charge the higher rates on newly incurred balances only.[173] It was recognized that contract rates would have to remain the same. Third, the rate that retailers could charge under the newly adopted usury provision was another source of confusion. The legislative intent had been to have a floating rate (5% over the discount rate) on what the legislature called "general loans" and a 17% cap on consumer loans. The legislature did not specify anything else about the consumer loan rate. Also, the legislature never defined what it meant by "general loans," although at the same time it was thought that it referred to business and agricultural loans only. After the passage of Amendment 60, some argued that "general loans" included consumer loans as well because that category had never been explicitly defined by the state legislature. Thus, approximately one week after the approval of the new usury amendment, a legal question arose over whether consumer loans were to be included in the "general loan" category. The question was important because the answer dictated the maximum rate on consumer loans. If, as the legislature intended, consumer loans were not to be included in the "general loan" category, the "market rate of interest" rate would prevail on such loans, with a maximum of 17%. On the other hand, if consumer loans were considered part of the "general loan" category, the maximum rate on such loans would be the lesser of 5% over the discount

171. 82 Op. Att'y Gen. 152 (1982).

172. 12 C.F.R. § 226.9(c) (1988). *See generally* 15 U.S.C. §§ 1601-1667e (1982).

173. Arkansas Gazette, Nov. 4, 1982, at A1, col. 4.

rate or 17%. In December 1982, for example, the discount rate was 8.5% making the maximum rate allowable on consumer loans under this interpretation 13.5%, not 17%.

All of this led to a confusing situation for those making consumer loans because no one knew what the maximum interest rate was on consumer loans. Some lenders opted to protect themselves by charging 13.5% (8.5% + 5%), while others charged more, betting that the original legislative interpretation would eventually prevail in a lawsuit. The business community realized that the question would eventually have to be decided by the Arkansas Supreme Court. The business and financial communities were waiting for the opportunity to have the courts settle the question, and they did not have to wait long. On December 22, 1982, Richard Bishop filed suit in Pulaski County Chancery Court against Linkway stores arguing that he was charged 15% interest on various furniture items when the maximum allowable rate was 5% over the Federal Reserve discount rate, or 13.5%.[174] Bishop had purchased some $700 worth of furniture executing in part payment a conditional sales contract providing for a total of $92.26 in interest over an eighteen month period. After a trial on February 18, 1983, which lasted only two hours since the issues were clear,[175] the Chancellor ruled on March 21, 1984, that 17% was the maximum rate on consumer loans—not the discount rate plus 5%.[176] The ruling was based on the fact that the 17% maximum on consumer loans had been the original intent of Amendment 60 and that was what the public had understood to be the case when they approved the new constitutional provision.

The case was appealed to the Arkansas Supreme Court, and a decision on this question was handed down on July 11, 1983. In *Bishop v. Linkway Stores*[177] the court, in a 4-3 decision, reversed the lower court ruling and decided that Amendment 60 specified a flexible interest rate on consumer loans—one that floated with the discount rate.[178] The court observed that the "general loan" category in Amendment 60 stated that the maximum rate on "any contract" was

174. Bishop v. Linkway Stores, No. 82-5572 (Pulaski Co. Chancery Ct. Dec. 22, 1982), *rev'd*, 280 Ark. 106, 655 S.W.2d 426 (1983).

175. Arkansas Gazette, Feb. 19, 1983, at B1, col. 5.

176. Arkansas Gazette, Mar. 22, 1983, at A1, col. 2.

177. 280 Ark. 106, 655 S.W.2d 426 (1983).

178. The Arkansas Supreme Court, in Southwest Arkansas Communications, Inc. v. Arrington, 296 Ark. 141, 753 S.W.2d 267 (1988), reaffirmed the decision in *Bishop* when it ruled that Amendment 60 limits interest rates on consumer loans to the lesser of 17% or 5% over the Federal Reserve discount rate.

to be 5% above the discount rate.[179] Since, according to the court, consumer loans certainly fall within the category of "any contract," the court decided that the maximum rate on consumer loans would have to be the lesser of 17% or 5% over the discount rate.[180] The dissent argued that both the legislative and voter intents were being violated by the decision and that the spirit of Amendment 60 was of paramount importance. A rehearing was requested in the case, but the Arkansas Supreme Court, in a 4-3 vote, refused to reconsider its ruling.[181]

Retailers complained bitterly about the decision in *Bishop*.[182] They argued that a floating interest rate on consumer loans made it difficult to monitor open-ended accounts where interest is applied to a balance consisting of several items purchased at different times and potentially different interest rates. Another complaint was that they would have a difficult time tracking the discount rate and might not always be aware of a decline in this rate. This, they argued, might force them to charge less than 5% over discount in order to protect themselves. Other questions dealt with the effective legal date of a change in the discount rate and what portions of a customer's existing account would be subject to the changed rate.[183] Banks and savings and loans had fewer problems with a floating rate on consumer loans, since most of their loans were made at fixed rates. However, the financial community did predict that consumer credit might have to be

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179. ARK. CONST. art. XIX, § 13 (Amendment 60) provides in pertinent part:

(a) General Loans:

(i) The maximum lawful rate of interest on any contract . . . shall not exceed five percent (5%) per annum above the Federal Reserve Discount Rate at the time of the contract.

* * *

(b) Consumer Loans and Credit Sales: All contracts for consumer loans and credit sales having a greater rate of interest than seventeen percent (17%) per annum shall be void . . . .

180. The effect of this ruling was that penalties on usurious consumer loans differed depending on whether the maximum rate exceeded was 5% over the discount rate or 17%. Consumer loans with rates exceeding 5% over the discount rate were now void as to unpaid interest and debtors could recover twice the amount of interest paid. Consumer loans with rates exceeding 17% came in under the original provision which stated that such loans were to be void as to principal and interest.

181. Arkansas Gazette, Sept. 21, 1983, at B1, col. 5.

182. The Arkansas Supreme Court in W.E. Tucker Oil Co. v. Portland Bank, 285 Ark. 453, 688 S.W.2d 293 (1985), upheld Amendment 60 and rejected an argument that the Amendment, because of its reliance on the discount rate, unconstitutionally delegates state authority to the federal government.

183. For a discussion of all the interpretative questions that arose with regard to the language of Amendment 60, see Barrier, *Usury in Arkansas: The 17% Solution*, 37 ARK. L. REV. 572 (1983).

rationed once again if the "market rate of interest" rate continued to rise and the discount rate did not. Thus, the financial community realized that one of the problems with Amendment 60 was that the discount rate was not necessarily a good indicator of the market rate. The discount rate is a policy tool of the Federal Reserve system and does not necessarily reflect market conditions. As a result of real and perceived problems with Amendment 60, and less than one year after the passage of Amendment 60, both the business and financial community began to discuss the possibility of a revised usury amendment.[184]

The stability of interest rates in 1983 mitigated, at least to a certain extent, the effects of the *Bishop* decision. The prime rate began the year at 11% and ended the year at the same rate.[185] The discount rate was 8.5% throughout most of the year, which created a certain amount of stability for retailers trying to decide what rate to charge on consumer loans. An 8.5% discount rate combined with a relatively low prime rate put retailers, and the financial community in general, in a much better position than they had been in for many years. The 2.5% spread between the maximum rate (13.5%) and the prime rate (11%) gave the business and financial community some breathing room and helped lessen, in 1983, the degree of credit rationing that had existed in earlier years. Despite the less turbulent times, the *Bishop* decision nevertheless created a great deal of uncertainty for retailers. The uncertainty involved deciding what interest rate should be charged on consumer loans. Many retailers decided that it would be best to continue charging 10% interest because of the difficulty in dealing with a floating rate. Other options available to retailers were to charge less than a maximum rate or to have a true floating rate.[186]

The problems that arose with Amendment 60 as a result of the *Bishop* decision prompted the financial community in early 1984 to begin seeking a federal override of the state's new usury amendment. As early as January 1984 Arkansas bankers were in Washington, D.C. visiting the state's congressional delegation urging support for a

184. One problem that arose with respect to the language of Amendment 60 concerned the provision that the maximum rate on general loans could not exceed 5% over the discount rate *at the time of the contract*. This last phrase can be interpreted to mean that the maximum rate is set at the time of the contract. Under this interpretation, adjustable rate notes that allowed the interest rate to increase as the discount rate increased would be considered usurious if the rate exceeded the rate existing at the time of the contract. For a more thorough discussion of the "time of contract" question, see Barrier, *supra* note 183.

185. The prime rate fell to 10.5% on February 28th, but increased to 11% on August 8th. It remained at this rate for the rest of the year.

186. Arkansas Gazette, Sept. 21, 1983, at B1, col. 5.

pending bill that would abolish all state interest rate maximums, leaving the rate to fluctuate with market conditions.[187] This usury provision was part of a comprehensive banking deregulation bill sponsored by Senator Jake Garn.[188] Under this measure, interest limits on business and agricultural loans would be set at 5% over the three year rate on treasury bills. Tying the maximum rate to the treasury bill rate reflected an awareness of the fact that the Federal Reserve discount rate was not "market sensitive" and, thus, not an appropriate rate to use in a usury provision. This usury provision was to override all state imposed interest rate ceilings for three years, although states could reimpose their rate limits during this time if they so desired.

Bankers in Arkansas supported this new federal override because they felt that the "market insensitivity" of the discount rate would, if rates were to rise any further, produce problems similar to those they had experienced in the past. They feared that with higher rates, Arkansas would again experience credit rationing and an outflow of funds to other states, the two major problems that had plagued the state in the years before Amendment 60. They also feared that if the banking system were deregulated any further, and if rates on deposits were allowed to rise, they would be caught in a profit squeeze if the rate they could charge (which was tied to the discount rate) did not reflect market conditions. Thus, the support for yet another federal override came about partly as a result of the *Bishop* decision and partly as a result of the realization that the discount rate would not provide the flexibility needed by the business and financial community.

The Senate overwhelmingly approved Senate Bill 2851 on September 13, 1984, by a 89-5 vote.[189] Senators Pryor and Bumpers voted against the bill because of the usury provision.[190] Bumpers was against the bill because he felt that it was not right for the federal government to override something (Amendment 60) that the people of Arkansas had just voted in. Pryor, on the other hand, felt that a new federal override would increase interest rates for businessmen and farmers, whom he felt were already struggling. Despite easy Senate passage of this bill, Garn's House counterpart, Fernand St. Germain, opposed bank deregulation and promoted his own bill that would merely close certain legal loopholes that had been available to

187. Arkansas Gazette, Jan. 26, 1984, at A1, col. 5.

188. S. 2830, 98th Cong., 2d Sess., 114 Cong. Rec. S11162 (1984).

189. *Id.*

190. Arkansas Gazette, Sept. 23, 1984, at A8, col. 1.

the banking system.[191] Because of differences between the House and Senate over banking reforms that could not be resolved, the efforts to pass a major bank deregulation bill in 1984 were blocked. Thus, Senate Bill 2851, along with its usury provision on which the Arkansas financial community had pinned its hopes to get around the dictates of Amendment 60, died a quiet death in the 98th Congress.

Despite the failure of Congress to pass a new usury override provision, the business and financial community in the state during 1984 was not facing the same critical problems that it had faced in the years before passage of Amendment 60. During 1984 the prime rate fluctuated between 10.75% and 13%, whereas the discount rate varied between 8.5% and 9%. Thus, as a result of Amendment 60, banks and retailers were able to charge between 13.5% and 14% on loans. The difference between the maximum rate and the prime rate, while less than the business and financial community would have wanted, was nevertheless much greater than the rate that would have existed in the absence of Amendment 60. Thus, despite its defects, Amendment 60, with its floating ceiling, was an improvement over the old constitutional limit of 10% and provided at least some relief to the business and financial community in the state.

The years 1985 and 1986 saw a continuation of the trend toward lower interest rates. The prime rate began 1985 at 10.5% and declined throughout the year. By December 1985 the rate had fallen to 9.5%. The rate continued to decline throughout 1986 and ended the year at 7.5%. Although the discount rate declined throughout this period also, the spread between the maximum rate and the prime rate was usually in the vicinity of three percentage points.[192] This reduced the pressure to alter Amendment 60, and these years were relatively quiet in that respect. However, by early 1987 it became clear that the downward trend in interest rates had been reversed. Interest rates generally rose throughout the year, with the prime rate ending the year one percentage point higher (8.75%) than the beginning of the year. As interest rates rose during 1987, proposals to revise the usury amendment to the constitution began to reappear.[193] Also, talk about Amendment 60's harmful effects on the state's economy also became more frequent.[194]

Interest rates continued to climb throughout 1988, with the

191. 98th Cong., 2d Sess., 40 Cong. Q. 12 (1984).

192. The discount rate was 8% at the beginning of 1985 and had fallen to 5.5% by the end of 1986.

193. Arkansas Gazette, Nov. 10, 1987, at C1, col. 5.

194. Arkansas Gazette, Dec. 13, 1987, at C3, col. 5.

prime rate starting the year at 8.5% and ending the year two percentage points higher. As rates rose, the discount rate lagged behind the market rate, with the result that Arkansas began to experience some of the same problems it faced when the old 10% limit was in effect. For example, by the end of 1988, the maximum rate under Amendment 60 was only one percentage point higher than the prime rate which produced yet another "interest rate squeeze" within the state. The effects were predictable. Loanable funds began to flow to other states and credit rationing began to reappear. As a result of this pressure, the financial community began yet another effort to change the state's usury law.[195] This effort took the form of drafting a new usury amendment to the constitution that would be presented to the 1989 legislative session for referral to the voters.

The year 1989 began with a prime rate of 10.5% and a discount rate of 6.5%, making the maximum rate on loans, under Amendment 60, 11.5%. The prime rate increased to 11.5% on February 24th but was back down to 11% by the beginning of June. Meanwhile, the discount rate was increased to 7% in February of the year.

By the beginning of 1989, efforts by a coalition of lenders were well under way to change the state's constitutional interest limit.[196] Although there were differences of opinion as to how best to accomplish the goal of revising Amendment 60, two areas of clear agreement quickly emerged. First, any new proposal would have a maximum (nonfloating) 17% rate on consumer loans. Second, the interest rate on general loans should be tied to a competitive interest rate and not the discount rate. The main area of disagreement within the coalition centered on the index to which the interest rate on general loans should be tied. The coalition, which included the Arkansas Bankers Association, wanted the interest rate on general loans to be set at 5% over the one year treasury bill rate. However, the Arkansas Association of Bank Holding Companies (AABHC), one of the coalition members, wanted the maximum rate on general loans to be 5% over the prime rate. The AABHC argued that the prime rate was a better indicator of the price that banks actually pay for the money that they lend.[197] The Association contended that the treasury bill rate was the rate that the government pays for money not what the banks pay for money.[198] The coalition, also known as the Arkansas

195. Arkansas Gazette, Aug. 6, 1988, at C1, col. 2.

196. Arkansas Gazette, Feb. 2, 1989, at A6, col. 1.

197. Arkansas Gazette, Feb. 7, 1989, at C1, col. 4.

198. Arkansas Gazette, Feb. 21, 1989, at A5, col. 3.

Credit Council, believed that, although the prime rate was probably a better indicator of what banks actually pay for money, using the prime rate might doom the chance of any changes in the usury law because of peoples' perception that the prime rate is controlled by the big New York City banks. Since the coalition of businessmen could not agree on a compromise, the group asked the General Assembly to consider two separate bills. The main difference between the two bills was the index to which the rate on general loans would be tied. Both would allow a maximum rate of 17% on consumer loans. Even though the coalition of bankers and businessmen working on the usury amendment could not agree on the index to which the rate on general loans should be tied, the Arkansas Credit Council nevertheless endorsed both proposals and agreed to support either one.[199]

Bill Becker was the leading spokesperson against the proposed usury amendment. Becker argued that Arkansas, one of the poorest states in the United States, could not afford the huge increase in interest rates that he predicted would occur if a new usury law were passed. He also argued that banks and retail stores were not going out of business in Arkansas, which, according to Becker, meant that they were not being hurt by Amendment 60 as much as they claimed to be.

On March 1, 1989, it was announced that the Arkansas Credit Council and the Association of Bank Holding Companies had reached a compromise on a proposed usury amendment.[200] The compromise contained the following provisions: a) consumer loans were to carry a 17% interest rate ceiling; b) business and agricultural (general) loans below $250,000 were to have an interest rate not to exceed five percentage points above the one-year treasury bill rate, thus, removing the overall 17% cap on rates for general loans; and c) business loans greater than $250,000 were to have no ceiling. An added provision allowed for the possibility of adjustable rate loans.[201]

The proposed constitutional amendment, now that a compromise had been reached, was submitted to the subcommittee of the Joint Committee on State Agencies and Government Affairs which had

199. Arkansas Gazette, Feb. 10, 1989, at A6, col. 1.

200. Arkansas Gazette, Mar. 1, 1989, at C1, col. 2.

201. Under the interpretation given Amendment 60, the maximum interest rate was set at the time of the contract, making variable rate loans, where the interest rate exceeded the initial rate, usurious. This had not been a problem for residential loans which had been exempt from such restrictions by the DIDMCA.

been studying the two original bills.[202] The full committee had to decide which of the approximately two dozen proposed constitutional amendments to refer to the voters for their approval.[203] Finally, on March 17, 1989, the legislature selected the interest rate proposal as one of three proposed constitutional amendments to be presented to voters in the November 1990 general election.

On November 22, 1989, the forces attempting to ease state interest rate limits began their organizational efforts by forming a committee to work for passage of the usury amendment in the November 1990 general election.[204] The organization, named "The Committee for the 1989 Interest Rate Control Amendment," includes ten business and professional organizations, including the Arkansas Automobile Dealers Association, the Arkansas Association of Bank Holding Companies, and the Arkansas Bankers Association. The campaign to change the state's usury law should begin in earnest as the November general election date approaches.

CONCLUSIONS

As this survey of Arkansas usury law shows, Arkansans have been preoccupied with the question of an appropriate interest rate limit for the better part of 154 years. The usury issue has not been settled yet, despite years of lawsuits and legal maneuvering. The continuing controversy over an appropriate interest rate limit is likely to remain an issue until Arkansans decide either to scrap the idea of having a maximum rate altogether or to adopt a constitutional amendment that allows the interest rate to fluctuate freely with market conditions. In addition, to avoid the massive outflow of funds that the state has experienced in the past, any new constitutional usury provision must be structured so that both the business and financial communities are allowed a reasonable differential between their cost of funds and what they can charge for those funds. Without either of these changes, continuing efforts to keep the interest rate in the state at artificially low levels will continue to create economic problems for the state of the type seen in the past.

202. The subcommittee had been formed to help reach a compromise between the two competing proposals originally submitted by the Arkansas Credit Council and the AABHC.

203. By law, the legislature is empowered to refer a maximum of three constitutional amendments to the voters in a general election. ARK. CONST. art. XIX, § 22. The proposed usury amendment to the constitution was only one of approximately two dozen other proposals (dealing with such matters as school desegregation and legislative pay) under consideration. Arkansas Gazette, Mar. 1, 1989, at C1, col. 2.

204. Arkansas Gazette, Nov. 23, 1989, at B2, col. 3.

In looking at the history of the usury issue in Arkansas, there are a few points worth noting. First, we have not attempted to estimate the cost to Arkansans of the numerous attempts over the years to deal with the usury question. However, we do not doubt that the cost, measured not only in terms of actual dollars spent but also in terms of time and effort, has been enormous. Numerous lawsuits, the legislature's time spent in wrestling with this question, efforts at the federal level to override state usury laws, millions of dollars spent on campaigns, and in holding elections all represent real costs to society that Arkansans certainly can ill afford to bear. Unfortunately, these costs represent only part of the burden that Arkansans have had to bear as a result of an artificially low interest rate. Other costs, in the form of a higher unemployment rate, higher prices, and the inability of borrowers to gain access to needed funds have occurred as a result of the restrictive nature of the state's usury law. If all these costs were converted into dollar amounts there is no doubt that the price of having an artificially low interest rate at various times throughout the state's history would run into the millions of dollars. All of this could have been avoided by enacting a more realistic usury provision years ago when it first became obvious that the 1874 constitutional provision had become outdated. This is essentially the direction in which the state has been moving over the last few years.

Second, it is interesting to point out that either Arkansans are more cognizant of the need for a more reasonable usury law or else the drafters of the successive usury amendments over the years have grown more adept at recognizing what people in the state want. In the 1974 general election on Amendment 57, only 13% of the voters voted for the amendment, which would have allowed the legislature to set the maximum rate. Six years later, in the 1980 general election, Amendment 60, which was similar to Amendment 57, went down to defeat by a much narrower margin. This time 45% of the voters had voted for the new usury provision. Thus, in just six years' time, even though Amendment 57 and Amendment 60 were similar in that both would allow the legislature to set the maximum rate, the increase in support for a new usury amendment was obvious. Finally, in 1982 Arkansans approved Amendment 60 by nearly 60% of the vote. Although Amendment 60 was structured differently than the previous two amendments, each would have had the effect of freeing the state from the restrictive 1874 constitutional usury provision. If the trend in approval rates holds true to form and if the prevailing interest rate climate does not diminish the perception of a need for a revision, one would expect the proposed usury amendment to be approved by a healthy margin in the 1990 general election.