

1964

National American Life Insurance Co. v. Bayou Country Club, Inc. : Brief of Appellant

Utah Supreme Court

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IN THE SUPREME COURT of the STATE OF UTAH

UNIVERSITY OF UTAH

NATIONAL AMERICAN LIFE INSURANCE COM-
PANY, successor to CONTINENTAL REPUBLIC
LIFE INSURANCE COMPANY,

FEB 23 1967

Plaintiff-Appellant,

LAW LIBRARY

—vs.—
BAYOU COUNTRY CLUB, INC., a UTAH Corpora-
tion; FIDELITY INDUSTRIAL CREDIT CO., a Utah
Corporation; WESTERN ACCEPTANCE CORP., a
Utah Corporation; BRYCE WADE; FAMILY BUILD-
ING CREDITS COMPANY, a Utah Corporation;
KEITH R. NELSON d/b/a A.A.A. ELECTRIC SER-
VICE; WASATCH PLUMBING SUPPLY CO., a Utah
Corporation; STANDARD BUILDERS SUPPLY
COM., INC., a Utah Corporation; S. F. FREDRICK-
SON & MRS. PAUL H. HUPP d/b/a HUPP RE-
FRIGERATION COMPANY formerly known as
PAUL H. HUPP COMPANY; LA MAR KAY d/b/a
QUALITY ELECTRIC MOTOR REPAIRS; EDDIE
A. BUTTERFIELD d/b/a COOK, INC.; ROBISON
DISTRIBUTING COMPANY, INC., a Utah Corpora-
tion; WETHERBEE FIXTURE CO.; WILLIAMS
BUILDING SUPPLY COMPANY, a Utah Corpora-
tion; CLYDE V. BUXTON d/b/a BUXTON HEAT-
ING & AIR CONDITIONING; TOWN & COUNTRY
INTERIORS; STATE TAX COMMISSION OF THE
STATE OF UTAH; ELDRID S. BUNTING d/b/a
SCHOPPE SHEET METAL COMPANY; INDUS-
TRIAL COMMISSION OF THE STATE OF UTAH;
NEELEY INC., a Utah Corporation; INTERMOUN-
TAIN ASSOCIATION OF CREDIT MEN, a Utah
Corporation; UNITED STATES OF AMERICA; any
and all other persons or corporations claiming any
right, title, or interest in or to the property as in this
Complaint described, said parties being unknown to
plaintiff.

Supreme Court, Utah

Case
No.
10138

Defendants-Respondents.

BRIEF OF APPELLANT

Appeal from a Judgment of the Third District Court
UNIVERSITY OF UTAH for Salt Lake County

Honorable Merrill C. Faux, Judge

APR 29 1965

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IN THE SUPREME COURT
of the
STATE OF UTAH

NATIONAL AMERICAN LIFE IN-
SURANCE COMPANY successor to
CONTINENTAL REPUBLIC LIFE
INSURANCE COMPANY,

Plaintiff-Appellant,

—vs.—

BAYOU COUNTRY CLUB, INC., et
al.,

Defendants-Respondents.

Case
No. 10138

BRIEF OF APPELLANT

STATEMENT OF THE NATURE OF THE CASE

In an action to foreclose a mortgage on a country club, defendant Bayou Country Club, hereinafter called BAYOU, counterclaimed, asserting the loan was usurious and claiming forfeiture of unpaid interest, treble the amount of an alleged discount, treble the amount of sums paid allocable to interest, and an attorney's fee.

DISPOSITION IN LOWER COURT

The court at pretrial ruled:

(1) Bayou did not receive value to the extent of \$14,-
500.00 on a \$65,000 loan, despite receipt by it of a satis-

faction of its outstanding note in the amount of \$15,000, executed by Bayou in favor of a third party, Frank A. Nelson, Jr.

(2) The loan was usurious.

(3) Payments on the \$65,000 loan could not be allotted to principal rather than to interest.

(4) The amount of \$14,500 was held to be a discount and it, together with installment payments allocable to interest in the amount of \$2630.27 should be trebled and awarded to Bayou.

(5) Bayou was not estopped to assert usury.

The trial court ruled:

(6) The Utah usury statutes are constitutional.

(7) Plaintiff was given judgment on its complaint for \$65,293.81 together with \$6000 attorneys' fees and costs.

(8) Bayou was given judgment on its counterclaim for \$51,390.81 together with \$5000 attorneys' fees.

RELIEF SOUGHT ON APPEAL

Appellant seeks an award of interest on its note and reversal of Bayou's judgment on its counterclaim and dismissal of the counterclaim. In the alternative, appellant seeks reversal of Bayou's judgment on its counterclaim with a remand for trial on the questions of usury and estoppel and with direction that, in the event Bayou should recover on its counterclaim, such recovery should exclude treble the amount of the \$14,500 discount.

STATEMENT OF FACTS

A statement of facts which can be made based upon

the record in this case is necessarily fragmentary because the court, at a pretrial hearing, entertained a motion by Bayou for summary judgment, made without any notice, and granted the motion without affording plaintiff an opportunity to present evidence, despite the complicated factual situation involved.

Inasmuch as all issues except constitutionality and amount of attorneys fees were decided on summary judgment, the facts on all issues except those two should be considered in a light most favorable to appellant.

This action was commenced by Continental Republic Life Insurance Company, a Utah corporation, to foreclose on a \$65,000 note and mortgage executed by Bayou. Bayou was a newly incorporated corporation organized for profit. It was organized for the purpose of constructing club facilities and selling memberships to buyers, who would have no equity in the facilities, but only the right to use them. (R. 445, p. 2-3)

The venture was underfinanced. After acquiring land southeast of Salt Lake City, and starting construction of a clubhouse thereon, the corporation ran out of money. (R. 445, p. 4) Being desperately in need of funds, George Padjen, Leland Olsen and Nolan Olsen, the officers and organizers of the Bayou, asked Frank A. Nelson, Jr., the president of the Murray State Bank, where the new club had its account, to find a lender who would lend them enough to complete their building project.

Because of the nature of the loan and insolvency of the borrower, the Murray State Bank was not interested

in making the loan. Nelson, as Bayou's agent, approached Marvin Bainum, the president of Continental Republic Life Insurance Company, to interest that company in making a loan. A loan was made by Continental. A \$65,000 note was executed by Bayou. Bayou received an insurance policy, \$50,000 cash and cancellation of Bayou's outstanding note in the amount of \$15,000 payable to Nelson. There is no evidence at all as to the consideration for the \$15,000 note, or why or when it was given, but there is nothing to indicate that it was other than what it purported to be on its face. Assuming there was a cancellation of Bayou's debt to Nelson, as the court considering the matter on summary judgment should have done, Bayou received full value for the \$65,000 loan.

The lower court however assumed that there never was a debt from Bayou to Nelson, and that the note for \$15,000 and cancellation thereof was fictitious. In the event this court should also assume the \$15,000 note was fictitious, we set forth the following additional facts.

It was agreed that there should be a note and mortgage from Bayou to Continental Republic, in the amount of \$65,000 which would bear interest at 9%, but that \$500 would be retained to pay the premium on an insurance policy, and that there would be a discount of \$14,500 so that the net amount advanced would be \$50,000.

Bainum handled the negotiations for Continental Republic. Bainum had been familiar with usury laws of states which permitted such discount and it was his

opinion and belief that such a discount would not make the loan usurious in Utah. (R. 242)

Nelson, unknown to plaintiff was getting a commission from Bayou in addition to a \$2000 commission from plaintiff. (R. 242, 445, p. 24, 446 p. 14) The court refused to allow plaintiff to make Nelson a party to the suit.

Nelson arranged the closing of the transaction, which occurred September 7, 1961. (R. 446 p. 16) Continental Republic made its check in the amount of \$65,000 payable to Bayou and to McGhie Abstract Company. Bainum expected that McGhie Abstract Company, in closing the transaction, would cash the \$65,000 check and retain \$15,000 for Continental Republic (\$500 for the insurance premium and \$14,500 as a discount) and that Nelson would get a \$2000 commission from Continental Republic from the \$14,500.

Unknown to Bainum, a \$15,000 note bearing date of August 10, 1961 payable from Bayou Country Club to Frank Nelson was cancelled by Frank Nelson. The note was marked "Paid 9-12-61 Frank A. Nelson, Jr.," with the further statement thereon "September 6, 1961. TO WHOM IT MAY CONCERN: The Bayou Country Club is indebted to me personally, in the amount of \$15,000." (Signed) "Frank A. Nelson, Jr." (R. 448, p. 6, exhibit I) Unknown to Bainum, this cancelled note was delivered by Nelson to McGhie Abstract Company as consideration for the \$15,000 portion of the loan, which Bainum anticipated would be treated as a payment of premium and a discount. McGhie Abstract gave Nelson its check in the

amount of \$15,000 in payment for the \$15,000 note from Bayou to Nelson. (R. 448, p. 6, exhibit 5) What Nelson did with it does not appear in the record but Bayou conceded that it received value to the extent of \$500 for a premium on an insurance policy. McGhie Abstract held the remaining \$50,000 for Bayou's account but earmarked part for payment of mechanics liens and other encumbrances, so that it could issue a title policy insuring Continental Republic as mortgagee.

Five monthly payments totalling \$3876.56 were made by Bayou after which it defaulted on the loan. Continental Republic had to advance \$1540.10 for taxes and fire insurance on the mortgaged property, when Bayou failed to pay for them. Continental Republic demanded payment of the note and mortgage and when the demand was not met commenced a foreclosure proceeding.

The suit necessarily involved numerous parties including mechanics lien claimants. A receiver was appointed. The receiver employed Nolan Olsen, one of the organizers of Bayou, and Bayou's attorney, as his attorney. Bayou counterclaimed in the foreclosure action alleging usury.

After the commencement of the action and prior to this appeal, Continental Republic Life Insurance Company was merged into National American Life Insurance Company, which, as successor, inherited the problems which arose from its predecessor's dealings.

Judge Hanson on pretrial ruled, as a matter of law, that there was no consideration for \$14,500 of the \$65,000

loan; that such discount made the loan usurious; that, in addition to that portion of the monthly installment payments allocable to interest (\$2630.27) the \$14,500 discount should be trebled and awarded to Bayou. He also ruled that Bayou was not estopped to assert usury. He left two issues to be determined at the trial. (1) whether or not the usury laws of the state of Utah are unconstitutional, and (2) the amount the parties should recover as attorneys fees.

Judge Faux took evidence on only one issue, the amount of attorneys fees. He held the usury statutes constitutional and awarded plaintiff judgment for the full amount of its note together with advances but with no interest, in the total amount of \$65,293.81 together with \$6000 attorneys' fees, and awarded Bayou, on its counterclaim for usury, \$51,390.81, being the total of treble the amount of \$14,500 discount, treble the monthly instalment payments of \$2630.27 allocable to interest, and \$5000 attorneys' fees.

STATEMENT OF POINTS AND ARGUMENT

POINT 1

THERE WAS AN ISSUE OF FACT AS TO WHETHER OR NOT THE LOAN WAS USURIOUS.

No summary judgment determining that there was a usurious transaction should have been entered.

“Whether a transaction is usurious is a question of fact, unless the instrument on its face shows the exaction of an illegal rate of interest.” *Massie v. Rubin*, 270 F. 2d 60, 62.

If it be assumed that Bayou received full value for the \$65,000 loan, there would be no usury, regardless of how much plaintiff benefited from the loan.

In a similar situation, where the lender benefited by more than the maximum permissible interest rate, by virtue of receiving from a broker a portion of the commission paid by the borrower, it was held that there was no usury because the borrower received full value.

“Usury is not shown by the fact that a lender receives from the borrower’s agent, as a condition of making the loan, half of the commission which the borrower has already agreed to pay the agent for his services in procuring the loan, although the amount so received by the lender added to the rate reserved for the loan, exceeds the legal rate of interest—” *Mortgage Bond Co. v. Stephens*, (1937) 181 Okla. 182, 72 P. 2d 831, 839. See also, *Pushee v. Johnson* (1936) 123 Fla. 305, 166 S. 847, 105 ALR 789 and 55 *Am. Jur.* Usury Par. 71.

So, here, where Bayou’s obligation to pay \$15,000 was cancelled, the fact that plaintiff benefited by being able to discount the \$65,000 loan by the amount of \$14,500 does not make the loan usurious.

The record indicates that value *was* received by cancellation of the \$15,000 note. There is no evidence whatsoever that this note did not constitute a valid obligation. Neither Bayou nor Nelson has stated that no debt was cancelled. It was pure surmise by Judge Hanson that the note was fictitious. Nelson’s version of the transaction could not have been considered by Judge Hanson because he did not even open Nelson’s deposition.

It is still in its sealed envelope marked "Awaiting Order of the Court." Summary judgments were reversed in similar situations in *Thompson v. Ford Motor Co.*, 14 Utah 2d 334, 384 P. 2d 109, and in *Schubach v. Wagner*, 14 Utah 2d 335, 384 P. 2d 110. Even if witnesses had stated the \$15,000 note was fictitious, there would have been an issue of fact thereon. For Judge Hanson to rule, by way of summary judgment on *no* evidence, that the discharge of the note did not constitute consideration is doubly erroneous.

"Summary judgment can properly be granted under Rule 56(c) only if 'the pleadings, depositions, and admission on file, together with the affidavits, if any,' which are offered, show without dispute that the party is entitled to prevail. This condition is obviously not met if the allegations of the plaintiff's complaint stand in opposition to to the averments of the affidavits so that there are controverted issues of fact, the determination of which is necessary to settle the rights of the parties." *Christensen v. Financial Service Co.*, 14 Utah 2d 101, 377 P.2d 1010, 1012.

Plaintiff denied all of the allegations of Bayou's counterclaim thereby creating issues of fact (R. 25).

"In confronting the problem presented on this appeal we have been obliged to remain aware that a summary judgment, which turns a party out of court without an opportunity to present his evidence, is a harsh measure that should be granted only when, taking the view most favorable to a party's claims and any proof that might properly be adduced thereunder, he could in no event prevail." *Kidman v. White*, 14 Utah 2d 142, 378 P. 2d 898, 900.

The court there reversed a summary judgment because there were issues of fact which should have been determined upon a trial. The court should do likewise here.

POINT 2

THERE WAS AN ISSUE OF FACT AS TO WHETHER OR NOT BAYOU SHOULD BE ESTOPPED TO ASSERT USURY.

If it be assumed, however, that Judge Hanson was correct in determining, on no evidence, that Bayou did not receive value to the extent of \$14,500 by having its note for \$15,000 satisfied, such determination must then rest upon the conclusion that the \$15,000 note was fictitious. In that event, plaintiff was entitled to show at a trial that Bayou should be estopped to assert usury. Such estoppel would result from proof that plaintiff did not know the loan was usurious and did not know of the \$15,000 note, and that it was Bayou and Nelson who did know the loan was usurious and conspired to create a usurious loan, and that it would be inequitable to permit Bayou to recover when Bayou, not plaintiff, conspired to create a situation whereby Bayou could benefit by the forfeitures and penalties awarded on its counterclaim.

“The acts of a borrower in securing a loan may be such as to constitute fraud or to estop him from taking advantage of the penalties provided for in the usury statutes. . . . Usury statutes are enacted to protect borrowers from the demands of unscrupulous lenders, and not to provide vehicles for unjust windfalls.” *Massie v. Rubin*, 270 F. 2d 60, 62. See also *Nikkel v.*

Lindhorst, 85 Colo. 334, 276 P. 678 and annotation 63 ALR 962.

POINT 3

PAYMENTS MAY BE ALLOTTED BY THE LENDER TO PRINCIPAL RATHER THAN TO INTEREST AND THERE IS THEREFORE NO PAYMENT OF INTEREST TO BE TREBLED AS DAMAGES.

If it be assumed that there is usury, and that *payments of interest* by Bayou should be trebled and awarded to Bayou, there is nothing to be trebled, because so long as there is principal unpaid, allocations of payments will be made to reduction of principal instead of to interest. 15-1-7 UCA provides for forfeiture of all interest to be paid and for the recovery of three times the interest paid:

“15-1-7. USURY — FORFEITURE OF ALL INTEREST — TRIPLE DAMAGES FOR INTEREST ALREADY PAID—LIMITATION OF ACTION. — The taking, receiving, reserving, or charging of a rate of interest greater than is allowed by section 15-1-2, shall be deemed a forfeiture of the entire interest which the note, bill, or other evidence of debt carries with it, or which has been agreed to be paid thereon. In case the greater rate of interest has been paid the person by whom it has been paid, or his legal representatives, may recover back three times the amount of the interest thus paid from the receiver or taker thereof and reasonable attorney fees, provided that such action is commenced within two years from the time the usurious transaction occurred.”

Before applying such harsh treble damage provision—the cases require that the borrower be actually out of

pocket more than he has received from the lender. To rule otherwise would permit a totally uninjured borrower to get a windfall. Until the borrower has paid an amount equal to the principal, there has been no injury. Therefore, not only the discount, but also the five instalment payments which were made, should be allocated to reduce the principal.

This rule was applied in the case of *McBroom v. Scottish Mortg. & Land Invest. Co.*, 153 U.S. 318, 328, 38 L. Ed. 729, 733, 14 Sup. Ct. Rep. 852, which arose under a statute of New Mexico which provided that collection of interest at a higher rate than 12 per cent was a misdemeanor, and which statute gave a right of action to the borrower to collect double the amount so paid. Interest notes were given upon a loan of \$65,000.00 and a commission of 10 per cent upon the entire loan was paid to the lender at the time of the transaction. *After the first interest note was paid*, the borrower brought suit to recover double the amount of the commission. Said the U.S. Supreme Court:

“The contract of loan not being void, except as to the excess of interest stipulated to be paid, the question arises whether the lender is liable to an action for the penalty prescribed by the statute, so long as the principal debt, with legal interest thereon, after deducting all payments, is unpaid. We are of opinion that this question must be answered in the negative. While, under the statute, the mere charging of usurious interest may be a misdemeanor for which the lender can be fined, whether such usurious interest is or is not collected or received, the borrower has no

cause of action until usurious interest has been actually collected or received from him. Such cannot be said to have been collected or received, in excess of what may be lawfully collected and received, until the lender has in fact, after giving credit for all payments, collected or received more than the sum loaned. . . ." and, quoting from another case the court continued:

"From the origin of the loan, from the retaining of the first discount, through all the renewals up to the time of final payment of the principal, or up to the time of entering judgments, there is a *locus poenitentiae* for the party taking the excessive interest. Any time till then he may consider the excessive interest paid on account of the loan, and so apply it and lessen the principal. Up to that time he may make this election. When payment is actually made or judgment is entered the election is made; and if, as in these cases, judgment is entered for the face amount of the notes or full amount of the loan, or payment is taken in full without any reduction by taking out the excessive interest, the cause of action is complete."

Other statements of the same rule are the following:

". . . as between the parties to the transaction, or holders with knowledge, all payments of usurious interest made on the series of notes will be applied by the law to the extinguishment of the debt, and this even though the parties have treated such payments as payments of interest. . . ."
Gladwin State Bank v. Dow, 212 Mich. 521, 180 NW 601, 13 ALR 1233, 1243. See also *Citizens*

National Bank v. Gentry, 111 Ky. 206, 63 S.W. 454, 56 LRA 673; *First Natl. Bank v. Denson*, 115 Ala. 650, 22 So. 815.

“ . . . where partial payments are made on a usurious loan, the bank may at any time before payment of the principal apply the partial payment thereto and so avoid liability for the penalty for taking unlawful interest.” 55 *Am. Jur.*, Usury, Par. 151.

A recent case following the United States Supreme Court's decision in the *McBroom* case, is *Rukavina v. Accounts Supervision Corporation*, 241 MA 195, 237 S.W. 2d 503, 508.

Bayou cannot assert that it has been damaged until it has at least paid back a sum equal to the amount of principal it received.

POINT 4

A DISCOUNT IS NOT SUBJECT TO BEING TREBLED.

If it be assumed there was usury, and that payments cannot be allocated to principal, the only *interest payment* to be trebled would be a portion of the monthly instalment payments. The discount was never “paid” nor is it “interest,” both of which are required for any treble damages under 15-1-7 UCA 1953 as amended:

“In case the greater rate of *interest* has been paid, the person by whom it has been *paid* . . . may recover back three times the amount of the interest thus paid from the receiver or taker thereof and reasonable attorney's fees . . .”

Assuming, as Judge Hanson did, that Frank Nelson's cancellation of Bayou's note for \$15,000 was a sham and

an effort on Nelson's part to disguise the fact that Bayou had not received the full \$65,000, then the substance of the transaction, regardless of the form it may have had, was that plaintiff discounted the loan. That might make the loan usurious, but would not constitute a payment by Bayou subject to being trebled. If Bayou paid \$15,000 where did it get it? It had no funds. It's only source was plaintiff's loan. If it in fact received the \$15,000 and paid it back, there would be no discount, and therefore no usury at all. The only thing that might make the loan usurious is a discount. Bayou is most illogical in asserting that the loan is usurious because it was discounted \$15,000 and asserting, at the same time, that it actually paid out that same \$15,000, and that very discount should be trebled along with the trebling of installment payments allocable to interest, under our statute which trebles only interest paid.

"... the requirement of actual payment is not satisfied by the circumstance that when the evidence of the debt was executed and the loan made, a usurious discount was reserved. Deductions by way of a discount when money for a loan is advanced are not treated as payments, because they do not come out of the debtor's pocket, even though they lessen the amount which he receives, and even though when sued for the amount advanced he may plead usury and escape liability for the amount thus charged and retained. . . ."

55*Am. Jur.* Usury, Par. 149. *Brown v. Marion National Bank*, 169 U.S. 416, 42 L. Ed. 801, 18 S. Ct. 390, *Citizens National Bank v. Forman* (*Citizens National Bank v. Gentry*) 111 Kentucky 206, 63 S.W. 454, 56 LRA 673.

If anything is to be trebled it should only be payments allocable to interest, and not the amount of any discount.

POINT 5

THE USURY LAWS OF UTAH ARE UNCONSTITUTIONAL.

15-1-2 UCA 1953, as amended, provides, in part:

“15-1-2. MAXIMUM RATES. — The parties to any contract may agree in writing for the payment of interest for the loan or forbearance of any money, goods or things in action, not to exceed ten per cent per annum; provided:

* * *

“(d) That licensees under the Utah Small Loan Act may contract for and receive interest at the rates and subject to the limitations provided in chapter 10, Title 7, Utah Code Annotated 1953;

* * *

“(f) That industrial loan corporation may contract for and receive interest and charges at the rates subject to the limitations contained in chapter 8, Title 7, Utah Code Annotated 1953;

“(g) That any corporation, except small loan *licensees*, operating under the supervision of the state banking department of Utah, and any national bank or federal savings and loan association doing business in the state may add to or deduct in advance from the proceeds of any loan repayable in installments over a period of not more than 63 months and not exceeding \$5,000.00 in principal amount, interest or discount at a rate not exceeding seven per cent per annum upon the

principal amount of the loan for the entire period thereof; . . .”

This statute purports to “protect” sophisticated borrowers like Bayou, a corporation organized and operated to make a profit, from high interest rates, instead of “protecting” unsophisticated lower economic income groups such as small loan borrowers, who can be charged high rates.

The statute also has the effect of permitting the general lending public to charge a maximum of 10%, while at the same time it creates favored lending classes which can charge the following rates:

	<i>U.C.A.</i>	<i>Maximum Provision</i>	<i>Approximate effective rate per annum</i>
Small Loan Companies,	7-10-3	3% per month	36%
Credit Unions,	7-9- 2 7-9-11	Reasonable rates as provided by directors,	Reasonable
Industrial Loan Companies,	7-8-3	Deduct 1% per month in advance plus other charges	37%
Banks and Savings and Loans,	15-1-2	Deduct 7% per annum in advance	14%
In addition thereto, other acts allow other favored lenders to charge the following percentages:			
Pawnbrokers’,	11-6-2	5% per month for 6 months	60%
Conditional Seller,	15-1-2a	1% per month times number of months of contract	24%

This variation violates the provisions of Article I, Section 24, of the Utah Constitution, which provides:

“All laws of a general nature shall have uniform operation.”

A recent case construing this provision was *Justice vs. Standard Gilsonite Company*, 12 Utah 2d 357, 366 P. 2d 974. There the court held that an act which provided for a penalty for failure to pay wages within 24 hours after demand therefor was unconstitutional in its arbitrary exclusion of banks and mercantile houses from its provisions. The court said that the preferential treatment of banks was unreasonable. Applying this reasoning of the *Justice* case to usury, the preferential treatment of banks concerning permissible interest charges is unreasonable. There is no more reason to allow a bank to charge 14% interest under 15-1-2 than there is to allow a life insurance company or any other company or individual to do so. The State of Washington has so held. In a similar situation where a statute provided for a maximum rate of 12%, but provided that banks, etc., should be excepted therefrom, the act was held unconstitutional because it granted special privileges. *Acme Finance Company v. Huse*, 192 Wash. 96, 73 P. 2d 341, 348. The court said:

“Consolidating these sections and reducing the matter to its lowest terms, we have, remaining, a law which says, in effect: Any persons, firm or corporation, except a bank, trust company, building and loan association, credit union, industrial loan company, licensed pawnbroker, one making casual loans of his own money, or a retail

merchant selling under conditional sales contracts, who, by any method, including the receipt of discounts, or by making service or carrying charges or examination fees, charges a greater rate of interest than 12 per cent per annum simple interest on loans of \$300 or less, shall be guilty of a gross misdemeanor, . . .

“It seems to us that a mere statement of the matter is all that is required to show that the act, or, more accurately speaking, what remains of it, is unlawfully discriminatory. The excepted classes are so numerous and varied and cover such a broad field that the act, in fact, does not have the semblance of a general law, but of a special one aimed at a special and limited class. It clearly denies to that class the equal protection of the laws, within the meaning of the Fourteenth Amendment to the Federal Constitution, because, among other things, it permits the classes excepted by section 14 the right to collect service and carrying charges, etc., over and above the lawful 12 per cent interest rate, and provides a criminal penalty for all others who do so. By the same token, it grants to the excepted classes special privileges and immunities in violation of Article 1, Sec. 12, of the State Constitution. There is no warrant for so arbitrary a classification, especially in a criminal statute. The injury done by a usurious loan is the same when the loan is made by a bank or trust company or a licensed pawnbroker as when made by any one else.”

The Utah act also creates special privileges and is likewise unconstitutional. Utah's differentiation as to interest rates, depending on what lender is involved, is based upon no real difference in situation and circum-

stances. For example, Utah credit unions and savings and loans get preferential treatment. It has been argued that higher charges by such institutions are justified by the fact that they are cooperatives with benevolent objectives. Assuming high interest rates are bad, however, the fact that they are charged by a mutual institution is no justification therefor, if the following reasoning has any validity:

“The Legislature has suspended the general law in regard to usury for the benefit of the appellant, seemingly to promote the benevolent objects in view. The profit made does not ultimately benefit all the stockholders. Those who can live without borrowing from the association, and whose stock is not liable to be forfeited for the nonpayment of dues, will ultimately realize the large profits resulting from such usurious loans at the expense of those who have paid from twenty to fifty per cent for the use of the money. The fact that the money is loaned by the corporation to one of its members can make no difference. The entire transaction is against the letter and the spirit of the statute against usury.”

Henderson Building and Loan Association v. Johnson, 88 Ky. 191, 10 S.W. 787, 788.

Nebraska has recognized that preferential treatment of a conditional seller is unreasonable and unconstitutional special legislation. *Stanton v. Mattson*, 175 Neb. 767, 123 NW 2d 844 involved the constitutionality of the Nebraska conditional sales act providing for a 12% rate on conditional sales, which was in excess of the 9% general usury rate. Nebraska has a constitutional pro-

vision similar to the Utah provision prohibiting special laws regulating interest. The Nebraska provision is Article III, Sec. 18, of the Constitution which provides, in part:

“The Legislature shall not pass local or special laws in any of the following cases, that is to say: . . . regulating the interest on money.”

The Nebraska court held the conditional sales act unconstitutional as being special legislation on several grounds, among which was the ground that there can be no valid distinction between interest rates on secured and unsecured loans. The court said:

“It is provided in Sec. 1(5) of Legislature Bill 811, in part, as follows:

‘Retail installment contract or contracts shall mean an agreement . . . pursuant to which . . . a lien upon the goods is retained . . . by the seller as security for the payment of the retail installment contract’

“Legislative Bill 811 is an interest statute. We fail to see any connection between the fixing of an interest rate and the fact that security for the loan is taken or the title to the property retained. The provision is special and not general. It therefore is inhibited by Article III, Sec. 18, of the Nebraska constitution.”

Utah has a similar exception to 15-1-2 as a subparagraph 15-1-2a which allows a conditional seller to charge a higher rate of interest than a seller who either has no security or takes other security, which likewise is special legislation.

Nebraska had separate successive statutes. The prior one set a general usury rate of 9% (45-101 Revised Statutes Nebraska Cumulative Supplement 1961). A later separate act (Laws of Nebraska 1963 p. 805) provided for a higher rate for a conditional seller, "notwithstanding the provisions of any other law." Unlike Nebraska, Utah's general rate and exception thereto for conditional sellers were created by one act, Chapter 24, Laws of Utah, 1953, the title to which is as follows:

"CONTRACTS AND OBLIGATIONS IN
GENERAL
Chapter 24
INTEREST

"AN ACT TO AMEND SECTION 15-1-2, UTAH CODE ANNOTATED 1953, RELATING TO MAXIMUM RATES; AND ENACTING A NEW SECTION TO BE KNOWN AS SECTION 15-1-2a, UTAH CODE ANNOTATED 1953; PROVIDING FOR THE REGULATION OF CONTRACTS FOR THE CONDITIONAL SALE OF TANGIBLE PERSONAL PROPERTY AND PROVIDING FOR THE MAXIMUM RATES TO BE CHARGED IN CONNECTION THEREWITH AND PROVIDING PENALTIES FOR VIOLATIONS."

Therefore, whereas Nebraska held only the separate act creating the exception to be invalid as special legislation, Utah's usury law within its own framework creates special situations, so that instead of having only invalid exceptions, Utah has an invalid act. This is similar to the

situation in *Justice v. Standard Gilsonite Company*, 12 Utah 2d 357, 366 P. 2d 974, where the gilsonite company, which was not one of those favored by being in an excepted category, established the invalidity of the entire act relating to wages because the act unreasonably excepted banks, etc. In the case at bar, the life insurance company, which is not one of those favored by being in an excepted category, seeks to establish the invalidity of the entire act relating to interest, because the act unreasonably excepts banks, etc. The fact that one deals with wages and another with interest may be pointed out by Bayou as a distinction. It is a difference, but an immaterial difference. The court's reasoning is applicable to both cases.

In addition to the express prohibition of enactment of special laws relating to interest on money, Article VI, Section 26, provides:

“In all cases where a general law can be applicable, no special law shall be enacted.”

There can certainly be no argument with the proposition that a general maximum interest rate *can* be applicable to all situations. The various special exceptions to favored lenders is a clear violation of this provision.

Tennessee and Kentucky have both ruled on similar provisions:

A Tennessee constitutional provision that interest rates shall be uniform throughout the state and a constitutional requirement of equality and uniformity both pre-

clude the legislature from empowering the charging of a higher rate of interest by Small Loan Act companies only. In *Family Loan Company v. Hickeson*, 168 Tenn. 36, 73 SW 2d 694, 94 A.L.R. 664, 666, the court said:

“The Legislature could not clothe small loan companies with the right to uniformly charge all borrowers the maximum fees of 3 per cent per month, in addition to interest on all loans. Had the act been open to no construction other than that it conferred power upon loan companies to charge the maximum fee without reference to the service rendered, it would have been the duty of the court to declare the act void because violative of article 11, Sec. 7, of the Constitution, and because unreasonably discriminatory against other money lenders.”

A special statute authorizing a corporation to charge a higher interest rate than that allowed by the general law was held to be unconstitutional in Kentucky. *Gordon v. Winchester Building and Accumulating Fund Association*, 75 Ky 110, 23 Am. Rep. 713.

Plaintiff does not have to rely on the above general provisions, however, because the constitution has specifically covered 18 particular categories wherein there is a specific prohibition against special treatment. Among these 18 topics is usury. Article VI, Section 26, provides, in part:

“The Legislature is prohibited from enacting any private or special laws in the following cases:

* * *

"9. Regulating the interest on money.

"10. . . .

"11. Regulating county and township affairs."

"12. . . .

Our supreme court has had occasion to consider whether or not various acts relating to the 11th category have been "special laws." In *State v. Standford*, 24 Utah 148, 66 P. 1061, the court held unconstitutional an act which was applicable only to some counties, because it did not have uniform operation throughout the State. The court said:

"The state legislature is forbidden to pass any private or special laws regulating county affairs. The laws enacted must be uniform generally, and applicable to all of the counties throughout the state. In *Welsh v. Bramlet*, supra, it is said: 'Whenever it attempts to enact a law for one or more of the counties of the state upon subjects that it is directed to provide for by general laws, or which are to form part of a uniform system for the whole state, whether such counties are designated directly by name, or by reference to a class into which they have been placed for other subjects of legislation, it infringes these provisions of the constitution. . . .'

In *Lehi City v. Meiling*, 87 Utah 237, 48 P. 2d 530, 547, Mr. Justice Wolfe in his concurring opinion, said:

"The Legislature could not pass an act specifically directed at Salt Lake City or some other particular municipality."

In *State v. Holtgreve*, 58 Utah 563, 200 P. 894, 898, the court said that the constitution

“ . . . requires that all laws shall operate uniformly wherever uniform laws can be enacted. While it is true that this court, in common with others, has repeatedly held that legislative subjects may be classified and that legislative classification should not be interfered with by the courts unless such classification is clearly fanciful, capricious, arbitrary, or unnatural, yet, where such is the case, it becomes the duty of the courts to uphold the constitutional rights and privileges in that regard.”

In *Backman v. Salt Lake County*, 13 Utah 2d 412, 375 P. 2d 756, the court held the Civic Auditorium Act to be an unconstitutional special law, saying:

“As to the contention that the act violates Art. XI, sec. 5, prohibiting special laws to create municipal corporations, Art. VI, sec. 26, dealing with limited powers of the legislature, saying that where a general law can be applicable, no special law is enactable, and Art. I, sec. 24, providing that general laws must have uniform operation, we have the following to say:

“The act provides for a commission to operate an auditorium in counties having over 250,000 population.

“ . . . Although dealing with constitutional problems concerning county government, we think the reasoning of *State ex rel. Wright v. Stanford* apropos here. There the act held unconstitutional provided for inspectors in counties having 5,000 or more fruit trees and for deputies in counties having over 20,000 population. We had this to say:

“ . . . ‘The Act was doubtless intended to apply . . . to certain particular counties, to the

exclusion of others . . . The act is therefore not uniform throughout the state,' . . ."

Applying the reasoning of the Standford, Lehi and Backman cases to the 9th category, instead of to counties under the 11th category, the usury law is special legislation because of its various rates for various lenders depending upon what hat the lender wears.

Our Supreme Court has already ruled that the Industrial Loan Act is a *special act* in *Peoples Finance & Thrift Company v. Varney*, 75 Utah 355, 285 P. 304, 305. The court was there attempting to ascertain whether the then general maximum rate of 12% should be applicable to loans made by an Industrial Loan Company or whether the higher rate permitted by the Industrial Loan Act should be given effect. The court expressly noted that the constitutionality of the Industrial Loan Act of 1925 was not being questioned and then gave effect to the Industrial Loan Act interest provision *because it was a special act*. The court said:

" . . . If such an interpretation be not in harmony with the general usury statute, then it is more reasonable to hold that the Legislature, by the statute of 1925, intended, so far as the general usury statute may apply to industrial loan companies as defined by the act of 1925, to make an exception to the general usury statute, or, in so far as powers were conferred on such companies to make loans, to regard them not as coming under, or as being controlled by, the general usury statute. The validity of the 1925 act is not challenged. Thus, should there be a conflict between the general statute and the 1925 act, the former

must give way to the latter, which is a *special* and subsequent act, and which expressly repeals 'all laws in conflict' therewith."

If it were not for the decision in *Justice v. Standard Gilsonite Co.*, (supra), it might well be argued that the special exceptions to the general 10% limitation should be held invalid, but the 10% limitation should nevertheless be valid. The *Justice* case, however, holds that the entire act is void. There the entire act requiring payment of wages within 24 hours was held void because banks were excluded from the statute. The court did not hold that the exceptions did not apply. So here, 15-1-2 contains discriminatory exceptions and the entire act is therefore void.

The following article shows that government regulation of interest rates has little to justify it either economically or morally:

"In the United States usury is a statutory matter, and usurious rates are determined by reference to specific statutes. Although historically the term usury was synonymous with interest and applied to any cost paid for the use of money, the need for capital led to a narrowing of the definition to the charging of interest by a lender in excess of a legally prescribed rate. In early Egypt the maximum rate was set by law at 30%, and in the heyday of the Roman Empire, 50% was not considered excessive. The trend toward freedom of interest rates suffered a reverse during the Middle Ages, when money lenders became associated by a church-dominated society with wickedness and avarice. However, with the reappearance and further development of economics as a

science, most nations in Western Europe and five American states by the end of the 19th century had abandoned any serious attempts at interest restriction. The maximum-rate principle was retained in the great majority of states, however, and today 10 jurisdictions have maximum lawful contract rates of 6%, 26 range from 7% to 11%, and 15 states allow 12% or more, including those with no limit."

"One of the basic tenets of a free enterprise economy is that buyers and sellers, borrowers and lenders, are expected to compete in open markets for goods and services, including those of a financial nature, and indeed, apart from usury legislation of the type to be considered here, conventional mortgage interest rates are determined almost completely by market conditions.

"When there is a shortage of something, the price of it goes up. Interest rates, of which mortgage rates are an important part, represent, the price paid by the borrower for the use of the lender's money. Rates in the money market are not set by any diabolical collusion among banks, savings associations, or other lenders; when the nation as a whole decides to spend more money on goods than can be financed out of the current flow of savings, interest rates go up. While the principle is well understood in the financial community, it unfortunately is true that this economic fact is not fully understood by some legislators and a large segment of the public. . . .

"Some say that morality enters into the matter of determining the amount of interest to be paid. obviously this is true, but it also is true that a maximum-interest-rate law cannot be considered to be a declaration of any valid moral law.

If the collection of interest on money lent is moral at all, it does not cease to be moral at 6%. Indeed, it would be hard to reconcile any such theory with the conclusion that the 30% maximum interest rate legal in Rhode Island is moral, while any excess over the legal 6% rate in the neighboring state of New York is immoral.

“That arbitrary rate ceilings have little to do with morality is demonstrated by their across-the-board applicability and their general failure to make any exception based upon the ability or willingness to pay. A man who borrows not from need but from an incentive to accumulate more money has the same rate ceiling applied to his loan as the unemployed man who borrows to buy food. Any alleged morality of rate-fixing also becomes horned in some states on the dilemma of the large versus the ‘small’ loan. In Illinois, for example, small loans may bear interest of 36%, whereas ‘large’ loans generally are limited to 7%. Considered from the moral aspect of need, the person unable to offer security for a larger loan ordinarily is a much needier individual than the person who can. Yet for this needier individual a 36% rate is legal (hence moral) while for the larger borrower 8% is illegal (hence immoral). Morality as applied to a business corporation contracting voluntarily to pay a specified rate for its use of borrowed money is another nonsequitur; fortunately this has been recognized by statute in 21 states where corporations have been excepted from application of the usury laws. Although morality may be associated with excessive rate, it fails to follow that a rate ceiling applicable to all parties at all times is a manifestation of that morality.

"It is true that price ceilings under some circumstances cause little trouble. For example, a price ceiling of \$1.00 a point placed on butter would cause little concern today among the butter vendors. This is true because the current price is approximately 70c a pound. If demand increased, however, or the supply dwindled, the price ceiling overnight could become important.

"This is precisely what has happened in the case of rate ceilings placed on mortgage lending by interest-rate limitations and the usury laws in several eastern states. Having remained on the books without change since the early days of the republic when the economy was largely agricultural, a state usury law which fixes the rate ceiling at 6% appears to be as anachronistic today as the date of the legislation bears. The result is a bitter paradox, since the ceilings which were intended to help and protect the borrower succeed only in drying up his local sources of money; lenders will turn elsewhere, where the rates are more realistic.

"While possibly justifiable in times of national emergency, it can be seen that arbitrary price-fixing, both from the economic and the moral standpoints, represents a philosophy generally at odds with the concept of a private-enterprise, peacetime economy. Indeed, when the price-fixing is allowed to prevail at unrealistic levels the deleterious effects upon the economy can be severe." *United States Savings & Loan League Bulletin*. July 1960, p. 125-8.

There should, therefore, be no economic nor moral compunction to sustain our usuary laws.

The Utah Supreme Court has not directly considered the constitutionality of the usury statutes. Some dicta, however, are quoted:

Mr. Justice Wade in a concurring opinion in *Seaboard Finance Company v. Wahlen*, 123 Utah 529, 260 P. 2d 556, 563, said:

"It seems to be to be highly inconsistent to prohibit a man from charging more than 10 per cent interest on a loan to his neighbor or business acquaintance, but at the same time allow a finance company to charge 37 per cent for same loan."

Mr. Justice Henriod in a dissenting opinion in *Rossberg v. Holesapple*, 123 Utah 544, 260 P. 2d 563, 569, said:

"One wonders what the majority would conclude had Rossberg obtained the money from an industrial loan company, when we recently approved a charge by such a company of 37% interest, far in excess of the percentage involved in this case."

Mr. Justice Wade in a dissenting opinion in the *Rossberg case*, (supra at 570) said:

"Undoubtedly the statute was originally enacted to curb what is referred to as the loan shark business. It was intended to curb unconscionable charges made by professional lenders of money. But our statute, although very rigid and harsh in its remedy, now allows exceptions to its strict provisions in favor of the very people it was originally intended to curb. As we have noticed in the *Seaboard Finance Co.* case an industrial loan

company may charge as much as 37% interest on its loans with impunity. I cannot understand how our usury statute is constitutional when the evil which it was intended to curb is expressly permitted to flourish under exceptions to that statute."

We rely on the reasoning applied in the Nebraska case, that unreasonable exceptions create unconstitutional special legislation. Combining that with the reasoning in the Justice case, that an act which has exceptions is itself invalid, the conclusion is that 15-1-2 and 2a are unconstitutional.

As evidenced by national publicity given to the Nebraska decision (Time Magazine, November ..., 1963) Nebraska's economy is in chaos from the withdrawal of sellers and lenders from Nebraska because it is economically impossible for them to do business within a 9% maximum rate. Such would not be the result of a decision of unconstitutionality here. A ruling of unconstitutionality in this case would result in the elimination of all artificial economic controls and would enable the law of supply and demand to operate in a free economy to set interest rates.

We conclude that there is no reasonable basis for the many preferential special rates contained in 15-1-2 and 15-1-2a. Kentucky was held that interest limitations which except cooperatives such as savings and loans and credit unions are unreasonable. *Henderson Building and Loan Association v. Johnson*, (supra). Washington has held that interest limitations which except banks, trust companies, building and loan associations, credit

unions, industrial loan companies, licensed pawn brokers, casual lenders and conditional sellers, are unreasonable. *Acme Finance Company v. Huse* (supra). Nebraska has held that interest limitations which except secured lenders are unreasonable. *Stanton v. Mattson*, (supra). Utah has the same exceptions, which, are likewise unreasonable, which make the interest rate unreasonably dependent upon who the lender is rather than such reasonable factors as need of the borrower, risk, size of loan, etc. The unreasonable exceptions constitute special legislation. *Justice v. Standard Gilsonite Company* (supra).

POINT 6

DEFENDANT'S ATTORNEYS FEES ON ITS COUNTERCLAIM SHOULD BE REDUCED AS ITS AWARD ON ITS COUNTERCLAIM IS REDUCED.

Any reduction in recovery by Bayou in its counterclaim should be reflected in a reduction of the attorney's fee awarded Bayou, since the award of attorney's fees was based in part upon the amount recovered. If Bayou obtains no offset, it is entitled to no attorneys fees, since the allowance of attorneys fees is tied by our statute to the successful recovery of treble damages. *Rukavina v. Accounts Supervision Corporation* (supra).

CONCLUSION

Utah usury statutes are unconstitutional because they do not have uniform operation and are special legislation, (Point 5). This requires that plaintiff's award be increased by the amount of accrued interest and Bayou should have no offsetting award on its counterclaim.

Furthermore, since payments may be allotted by the lender in reduction of principal, Bayou must actually have paid money out of its own pocket, rather than merely pay back funds received from plaintiff before Bayou should recover treble damages (Point 3), which is an additional reason Bayou's award on its counterclaim should be eliminated.

Furthermore, a discount is a reduction of the principal advanced by the lender, not a payment of interest by the borrower, and is not to be trebled and awarded to Bayou (Point 4). This, alone, would require a reduction of Bayou's offset on its counterclaim of treble the \$14,500 or \$43,500.

Furthermore, there was an issue of fact as to whether or not Bayou received value by cancellation of its \$15,000 obligation to Nelson (Point 1) or whether or not if there was usury, Bayou should be estopped to assert it (Point 2). Either would require a reversal of the award on Bayou's counterclaim and a remand for trial.

If there is any reduction of Bayou's offset, its attorney's fees should be reduced proportionately (Point 6).

Respectfully submitted,

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