TO: XXXX
FROM: Katherine Brim
RE: Usury and Conflict of Law Clauses in Consumer Contracts
DATE: 1 June 2010

You have asked me to research public policy exceptions to the general rules found in Restatement (Second) of Conflict of Laws ("R2CoL")§§ 187, 203 (which govern, respectively, choice of law provisions in general, and contractual issues with respect to usury charges), for the following states: Alabama, Arizona, California, Florida, Louisiana, Missouri, Nevada, Tennessee, Utah, and Virginia.

After thorough review of the relevant state statutes, including both conflict of law and specific usury law provisions, it appears that none of these states have carved out an explicit statutory "public policy" exception to the general rule allowing parties to contract for choice of law. The Restatement itself states that a choice of law provision should not be upheld if "application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue."

Relevant case law for these states only loosely develops the Restatement's concepts of "fundamental policy" and "materially greater interest," relying most heavily on identifying policies and interests which *don't* fall under this exception. As such, the case law favors enforcement of choice of law provisions, provided the chosen state law has a reasonable relationship to the transaction, and the contract itself is not unconscionable; standards which should be easily satisfied with thoughtful business planning and skillful drafting.

Although you asked me to focus on the public policy exception, I included in my discussion an overview of the substantial relationship requirement for upholding choice of law provisions for three main reasons: first, it is well settled that conflicts of law are determined according to the law of the forum state, and all but two of the states at issue here require that the chosen state law bear a reasonable relationship to the transaction or parties; second, in most cases the public policy exception is either successfully invoked, or glossed over and dismissed based on whether the chosen state satisfies the relationship requirement; and third, some case law interprets the concept of "materially greater interest" to mean that the forum state must satisfy the relationship requirement to a greater degree than the chosen state in order to even trigger a "fundamental policy" analysis. Since this was not the focus area of this memo, I made my coverage brief. I have completed the research necessary to provide a more detailed treatment of this issue, and would be happy to expand that section if you feel it will be helpful.

Below I have provided a short answer section (pp.2-3), followed by discussions of the substantial relationship requirement (pp.5-8), the Restatement's Usury section (pp. 8-9), Fundamental Policy (pp.9-12), and a state by state overview of case law and policy concerns (pp.12-17). Finally, I have included an appendix list of the interest caps for each of the relevant states (p. 18), as well as an overview of the status of state laws regarding payday loans (separate document).

I originally intended to include information regarding usury and contracts of adhesion, as well as recommendations for the client, but since these were outside the scope of the original project, and due to the time constraints, I was unable to include them. If you feel it would be helpful I would be happy to write up these sections as well.

ISSUES AND SHORT ANSWERS

I. HAVE COURTS INVALIDATED CHOICE OF LAW PROVISIONS ON PUBLIC POLICY GROUNDS, AND IF SO, BASED ON WHAT POLICY?

ANSWER: **Yes**, based on two different policies: first, where the choice of law bore no reasonable relationship to the transaction or parties and it was apparent to the court that it was chosen specifically as a device to evade usury laws, and second, where case law and legislative record reflect a historical preference for enforcing usury laws.

II. HAVE COURTS INVALIDATED CHOICE OF LAW PROVISIONS ON PUBLIC POLICY GROUNDS IN THE STATES AT ISSUE (AL, AZ, CA, FL, LA, MO, NV, TN, UT, and VA)?

ANSWER: **No.** So far, case law relevant to the states at issue has not found public policy regarding usury sufficient to override choice of law provisions that satisfy the normal/reasonable/substantial relationship test; however, the issue has not been specifically addressed in many of the states.

III. DO ANY OF THE STATES AT ISSUE STATUTORILY PROHIBIT, OR HOLD UNENFORCEABLE, CHOICE OF LAW PROVISIONS IN CONSUMER LOAN CONTRACTS?

ANSWER: **No**, although there are certain requirements which must be met for choice of law provisions to be enforceable.

IV. IS THERE A DISTINCTION IN ENFORCEABILITY BETWEEN CHOICE OF LAW AND CHOICE OF JURISDICTION?

ANSWER: **Yes**, while choice of law (when appropriately chosen based on substantial relationship) is generally upheld, choice of jurisdiction is more difficult to enforce, particularly in the arena of consumer lending. Subjecting consumers to a choice of forum outside their state of residence is likely to be so difficult, inconvenient, and cost prohibitive that it will, for all practical purposes, deprive them of their day in court.

V. WHAT IS THE GENERAL RULE REGARDING ENFORCEMENT OF CHOICE OF LAW PROVISIONS IN CONTRACTS?

ANSWER: **Generally**, R2CoL provides that choice of law provisions **should be upheld UNLESS:**

A) The **chosen state doesn't have a substantial or reasonable connection** to the parties or transaction,

OR

B) applying **the law of the chosen state**:

1) Produces results **contrary to a fundamental policy of a state with a greater material interest** in the issue than the chosen state,

AND

2) The **state with the greater material interest would've been chosen** by a court as the default law **if the parties had failed to specify**.

a) A state will be chosen as the default if it's shown to have **the *most* significant relationship to both the transaction and the parties** (the significant relationship must be clear cut, if compelling arguments can be made for both states, this will probably fail) taking into account certain facts including:

i) the place of contracting,

ii) the place of negotiation of the contract,

iii) the place of performance,
iv) the location of the subject matter of the contract, and
v) the domicile, residence, nationality, place of incorporation and place of business of the parties.

See R2CoL §§187,188

VI. IN GENERAL, CAN A CHOICE OF LAW PROVISION PROTECT A CONTRACT FROM INVALIDATION ON GROUNDS OF USURY?

ANSWER: **Yes**, as long as:

A) the interest rate is legal in the chosen state,

B) the chosen state has a substantial relationship to the transaction or the parties, and

C) the interest rate is not greatly in excess of the maximum permitted by the usury laws of the state whose law would've been chosen as the default had the parties failed to specify (*See above §V.B.2.a.*.).

See R2CoL §§188, 203

VII. WHAT IS THE NORMAL/REASONABLE/SUBSTANTIAL RELATIONSHIP REQUIREMENT FOR DETERMINING CONFLICTS OF LAW?

ANSWER: Different sources of law use various adjectives (Normal=Supreme Court, Reasonable=UCC, Substantial=R2CoL) to describe the relationship the must be present between the choice of law and the transaction or parties, however the test is essentially the same regardless of source. Courts look at the factors outlined in the Restatement (*see above §V.B.2.a.*), as well as any facts specific to the case which support the inference that the choice of law was reasonable.

VIII. ARE THERE STEPS A LENDER CAN TAKE TO INCREASE THE LIKLIHOOD THAT A CHOICE OF LAW PROVISION WILL BE UPHELD IN THEIR STANDARD CONTRACT?

ANSWER: Yes. There are two main things a lender can do:

A) The first and most important step a lender should take is to ensure that the main substance of the contract takes place in the chosen state (*see the factors listed above in §V.B.2.a.*).

B) Second, is to ensure that the choice of law provision of the contract is brought to the attention of the consumer prior to its execution.

IX. ARE CHOICE OF LAW PROVISIONS ENFORCEABLE IN ADHESION CONTRACTS?

ANSWER: **Yes.** According to comment b. under R2CoL § 187, "choice of law provisions contained in such contracts are usually respected. Nevertheless, the forum will scrutinize such contracts with care and will refuse to apply any choice-of-law provision they may contain if to do so would result in substantial injustice to the adherent." In general, choice of law provisions are upheld when brought to the consumer's attention prior to execution of the agreement.

DISCUSSION: Introduction

I. MODERN CASE LAW REGARDING CHOICE OF LAW IN CONSUMER CONTRACTS IS DOMINATED BY ANALYSIS OF R2CoL §187.2.a,b.

Virtually all cases involving conflict of law and choice of law provisions, particularly with respect to usury, are guided by **R2CoL § 187** which states:

> "(1) The law of the state chosen by the parties to govern their contractual rights and duties will be applied if the particular issue is one which the parties could have resolved by an explicit provision in their agreement directed to that issue.
>
> (2) The law of the state chosen by the parties to govern their contractual rights and duties will be applied, even if the particular issue is one which the parties could not have resolved by an explicit provision in their agreement directed to that issue, unless either
>
> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties."

R2CoL §188:

> "(2) In the absence of an effective choice of law by the parties (see § 187), the contacts to be taken into account in applying the principles of § 6 to determine the law applicable to an issue include:
>
> (a) the place of contracting,
> (b) the place of negotiation of the contract,
> (c) the place of performance,
> (d) the location of the subject matter of the contract, and
> (e) the domicile, residence, nationality, place of incorporation and place of business of the parties.
>
> These contacts are to be evaluated according to their relative importance with respect to the particular issue."

This basically means that that a choice of law provision will be enforced where the chosen forum has a substantial relationship to the parties or the transaction and the application of the usury law of the chosen forum is not contrary to a fundamental public policy of the state in which the action is brought.

DISCUSSION PART 1: The "Substantial Relationship" Requirement

Perhaps the most compelling reason to examine the relationship requirement for choice of law provisions is the fact that, when exercising diversity jurisdiction, it is well settled that courts apply the forum state's choice of law rules to determine which state's substantive law applies. *Klaxon Co. v. Stentor Elec. Mfg. Co.*, 313 U.S. 487, 495-97, 61 S.Ct. 1020, 85 L.Ed. 1477 (U.S. 1941). In the case of a consumer loan transaction, if the normal/substantial/reasonable relationship requirement is not satisfied by the chosen state and the forum state is the borrower's place of residence, the forum state's relationship to the borrower is likely to persuade a court to apply the forum state's law.

1. Sources of Law: Supreme Court, UCC.

The "substantial relationship" prong in §187.2.a. is based on the "normal relation" requirement set forth by the Supreme Court in *Seeman v. Philadelphia Warehouse Co*., 274 U.S. 403, 47 S.Ct. 626,(U.S.1927), which is still good law and frequently cited in modern case law:

"A qualification of these rules, as sometimes stated, is that the parties must act in good faith, and that the form of the transaction must not 'disguise its real character.'... The effect of the qualification is merely to prevent the evasion or avoidance at will of the usury law otherwise applicable, by the parties' entering into the contract or stipulating for its performance at a place ***which has no normal relation to the transaction and to whose law they would not otherwise be subject.*** Wharton, in his Conflict of Laws, section 210o, in discussing this qualification, says:

'Assuming that their real, bona fide intention was to fix the situs of the contract at a certain place which has a ***natural and vital connection with the transaction***, the fact that they were actuated in so doing by an intention to obtain a higher rate of interest than is allowable by the situs of some of the other elements of the transaction does not prevent the application of the law allowing the higher rate.' " *Id.* at 628 *(emphasis added).*

The "substantial" or "normal" relationship requirement set forth above has also been incorporated into the Uniform Commercial Code (as the requirement for a "reasonable" relationship) in §1-301, which in turn has been adopted as state law by all but two of the states at issue (LA and IN):

UCC §1-301:

"(c) Except as otherwise provided in this section:

(1) an agreement by parties to a domestic transaction that any or all of their rights and obligations are to be determined by the law of this State or of another State is effective, whether or not the transaction bears a relation to the State designated;

…

(e) If one of the parties to a transaction is a consumer, the following rules apply:

(1) An agreement referred to in subsection (c) is ***not effective unless the transaction bears a reasonable relation to the State*** or country designated." (*emphasis added*).

The common adoption of the UCC rule appears in the state Conflict of Laws statutes for AL, AZ, CA, FL, MO, NV, TN, UT, and VA in the following form:

"Territorial applicability; parties' power to choose applicable law.

(a) Except as otherwise provided in this section, when a transaction ***bears a reasonable relation*** to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties." (*emphasis added.*)

2. Satisfying the Rule.

Regardless of the adjective used to describe the relationship between the chosen state and the transaction or parties ("normal," "substantial," "reasonable," etc.), the factors used to determine its existence are the same, and are not subject to a heavier burden of proof depending on which adjective is applied. A choice of law provision in a contract is presumed valid until it is proved invalid. The party seeking to prove such a provision is invalid bears the burden of proof. *Delhomme Industries, Inc. v. Houston Beechcraft*, 669 F.2d 1049 (5th Cir.1982).

State and federal courts alike consider the factors set forth in R2CoL §188.2:

a) the place of contracting,
b) the place of negotiation of the contract,
c) the place of performance,
d) the location of the subject matter of the contract, and
e) the domicile, residence, nationality, place of incorporation and place of business of the parties.

Courts also consider any other case-specific facts from which a reasonable relationship to the chosen state may be inferred. In general, it's not enough to show that the forum state has a reasonable relationship to the transaction or parties, or even that the forum bears a more significant relationship than the chosen state; it must be established that the chosen state's relationship is absent, de minimus, or

clearly a sham to avoid the usury laws of the forum state. The following excerpt from the 5th Circuit involving a loan secured by personal property provides a good illustration of how the relationship requirement is applied:

> **"Texas clearly had the most significant contacts with the transaction**-the borrower was a Texas partnership conducting business in Texas, the lender also conducted some business in Texas, the borrower initiated the loan in Texas, and the farm equipment was at all times located in Texas. **By contrast, Mississippi's only contacts** with the transaction arose from the facts that the lender, a Georgia corporation, maintained its principal offices in Mississippi, the parties finally executed the loan in Mississippi, and the borrower initially made payments in Mississippi. **We concluded, however, that Mississippi's contacts were sufficient to constitute a "reasonable relation"** to the transaction…" *Admiral Ins.Co. v. Brinkcraft Development, Ltd.* 921 F.2d 591, 593 (5th Cir.1991) (*emphasis added).*

What this means for the client is that, in order to substantiate the validity of the choice of law provision, every effort should be made to conduct as much of the transaction in the chosen state as possible.

3. The Interrelationship between the Relationship Requirement and the Material Interest and Fundamental Policy Concerns Addressed in R2CoL §187.

Relevant case law suggests that another important reason to conduct as much of the substance of the transaction as possible in the chosen state is the fact that a strong and substantial relationship to the chosen state often results in courts avoiding an in depth policy analysis altogether. Many circuits give short shrift to policy concerns where the relationship requirement is established and at least one, the 5th Circuit, has taken the approach that the fundamental policy issue is not even implicated if the substantial relationship requirement is met. In *Uniwest Mortg. Co.v. Dadecor Condominiums, Inc.*, 877 F.2d 431, 436 (5th Cir. 1989), the 5th circuit states:

> "The second inquiry mandated in [R2CoL] section 187(1)(b) is more difficult and involves two standards: first, **whether Texas' interest in the contract is materially greater** than Colorado's interest in the contract, **and if so, only then whether** application of Colorado law to the contract would be **contrary to a fundamental policy** of Texas…
>
> **"To answer whether Texas' interest** in the contract **is materially greater** than Colorado's, **we examine** the largely undisputed facts in light of **the factors set forth in** Restatement [Second] of Conflict of Laws §188(2)…"
> (*emphasis added*).

The court proceeds to analyze the sufficiency of the relationship using the R2CoL factors, then states:

> "From these facts, we conclude as a matter of law that **Texas' interest in the contract is not *materially* greater** than Colorado's interest in the contract…. **Accordingly, we must refrain from upsetting the expectations of the parties;** we, therefore, apply the contractual choice of Colorado law to this case.
>
> "Because of our conclusion, **we need not decide whether the contract in this case violates a fundamental policy** of the state of Texas under [R2CoL] Section 187…" *Id.*at 437 (*emphasis added*).

As stated above, this suggests that the client may be able to avoid the fundamental policy issues altogether by tailoring their business to satisfy as many of the R2CoL factors as possible.

DISCUSSION PART 2: R2CoL Usury Rule

I. VALIDITY OF CONSUMER CONTRACTS WITH RESPECT TO USURY GOVERNED BY R2CoL §§ 187,188, 203.

In addition to the requirements that a chosen state's laws not produce results contrary to the fundamental interests of the forum states, R2CoL §203 sets forth a specific rule governing usury cases:

"The validity of a contract will be sustained against the charge of usury if

> it provides for a rate of interest that is permissible in a state to which the contract has a substantial relationship **and**
>
> is not greatly in excess of the rate permitted by the general usury law of the state of the otherwise applicable law under the rule of s 188." (*tabulation and emphasis added*)."

At first glance this section appears to severely restrict the rate of interest for which parties may contract, however, for the restriction to apply the forum state must have a strong enough relationship to the transaction or parties that a court would apply the forum state's laws had the parties failed to specify a choice of law. If the chosen state can show an equal or more significant relationship to the transaction than the forum state (*see Discussion Part 1*), then any interest restrictions imposed by the forum state will be moot. This emphasizes yet again that conducting the main substance of the contract in the chosen state is critical to prevail in upholding the choice of law.

Unless the relationship between the chosen state and the parties/transaction is so strong that a court would obviously choose to apply the chosen state's law under R2CoL §188, the interest rate must not greatly exceed that of the forum state.

1. How courts interpret the language "greatly exceed":

If a court determines that the chosen state and forum state have relatively equal relationships to the transaction/parties, a court will generally engage in a comparison of interest rates. Typically courts invalidate contracts when the disparity between contract rates and the legal rate in the forum state involve triple digits. Courts have upheld contracts even where the contract rate was double the legal rate in the forum state, but contracts with upwards of 200% + per annum are invalidated as having greatly exceeded the law of the forum state.

Although not expressly stated in any case law, if the relationship of the chosen state is not clear cut in terms of paramount significance, triple digit+ interest rates seem to have the effect of "shocking the conscience" of the judge, giving way to a more detailed scrutiny of any avenue available to invalidate the contract—elements of the relationship requirement that suffice in other cases are dismissed as inadequate, or public policy concerns deemed insufficient to override parties' expectations and freedom to contract in other cases suddenly take center stage.

DISCUSSION PART 3: Fundamental Policy

Courts only get to a serious analysis of whether the forum state's public policy is "fundamental" in two instances: first, when the chosen state has only a passing relationship to the transaction or the parties, but the main substance of the contract takes place in the forum state, and second, when the interest rate of the contract greatly exceeds the legal limit of the forum state.

1. Relationship between R2CoL Usury section § 203 and Fundamental Policy Concerns in § 187.

Although the R2CoL Usury section (§203) says nothing of "fundamental policy," comment b to this section strongly implicates the public policy concerns underlying the provision:

"b. **Rationale**. A prime objective of both choice of law and of contract law is to protect the justified expectations of the parties. Subject only to rare exceptions, the parties will expect on entering a contract that the provisions of the contract will be binding upon them. For this reason, the **courts will not apply an invalidating rule to strike down the contract unless the value of protecting the justified expectations of the parties is outweighed in the particular case by the interest of the state** with the invalidating rule in having this rule applied.

Usury is a field where this policy of validation is particularly apparent. To protect debtors against extortion, many states have enacted usury laws which limit the rate of interest that can legally be charged.

The 4th Circuit discussed the overlap between the Usury section and the fundamental policy issue in *Barnes Group, Inc. v. C&C Products, Inc.*716 F.2d 1023, 1031 (4th Cir.1983):

> "First, not every situation where contractually chosen law diverges merely in degree from that of the state whose law would otherwise apply impinges upon the fundamental policy of that state….
>
> This is seen most clearly in regard to usury statutes, where the parties' choice of law has been held to validate interest rates that would be usurious and unenforceable in the jurisdiction whose law would prevail absent the contractual stipulation of controlling law. …"

This excerpt states an important corollary to R2CoL §203: differences between chosen and forum law which amount only to a degree do not affect the validity of the contract, and do not implicate fundamental policy concerns. The 4th Circuit goes on to state:

> "At the other extreme, it seems apparent that where the law chosen by the parties would make enforceable a contract flatly unenforceable in the state whose law would otherwise apply, to honor the choice-of-law provision would trench upon that state's "fundamental policy."

Contracts held "flatly unenforceable" by the forum state would likely be those which, in the language of the Restatement, "greatly exceed" the legal limits of the forum state. Here, the 4th Circuit goes beyond the implication of comment b and directly links an excessive difference in legal interest rates with a contravention of fundamental policy.

2. Arguing Public Policy in Favor of Applying Choice of Law.

Most interesting, and perhaps most helpful to the client is the gray area described by the next section of the opinion:

> "Between these extremes fall situations where the law of the jurisdiction stipulated by the parties and that of the state whose law would control absent the choice-of-law provision differ significantly-not merely in degree but in approach…"

The last sentence of the excerpt is important—the fact that the chosen law and forum state law differ significantly is not the crux of the fundamental policy issue, it's *why* they differ that matters. The distinction between a difference in degree and a complete difference in approach opens the door for competing fundamental policy arguments between the parties. The difference in approach refers to the contrast between states that have enacted usury laws, imposing caps on interest rates, etc., and states which have specifically opted not to enact usury legislation at all.

While the fundamental policy argument for states with usury laws is clear (consumer protection, fairness, etc.), states without usury laws have typically only argued on the basis of contract policy—upholding the expectations of the parties and preserving their freedom to contract. However, in light of the current economic conditions and the national focus on consumer protection, these traditional policy concerns may not overcome the protective policies upheld by state usury laws. In a recent opinion, Judge Posner posits a potential policy argument in favor of states without usury laws:

> "A contrary school of thought points out that people who cannot borrow from a bank because they have poor credit may need a loan desperately. If a ceiling is placed on interest rates, these unfortunates may be unable to borrow because the ceiling may be too low for the interest rate to compensate the lender for the risk of default. As a result, they may lose their house or car or other property or find themselves at the mercy of loan sharks. See Todd J. Zywicki, "Consumer Welfare and the Regulation of Title Pledge Lending,"" *Midwest Title Loans, Inc. v. Mills*, 593 F.3d 660 (7th Cir.2010).

While this type of policy argument would be a stretch for a company without a positive consumer track record, lenders like our client who have been recognized by the state for their fair business practices and show a genuine interest in their customers, whose contracts with consumers are straightforward, clear, and easy to understand, and whose substantive business takes place in the chosen state may very well successfully argue the point set forth by Posner.

3. Case Law and Policy.

Case law relevant to the states at issue for our client is favorable in terms of its application of R2CoL §187 (2):

> "The law of the state chosen by the parties to govern their contractual rights and duties will be applied…unless either
>
> (a) the chosen state has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or
>
> (b) **application of the law of the chosen state would be contrary to a fundamental policy of a state which has a materially greater interest than the chosen state** in the determination of the particular issue and which, under the rule of § 188, would be the state of the applicable law in the absence of an effective choice of law by the parties." (*emphasis added*)

The "fundamental policy" issue has not yet been addressed by every state at issue here, but where it has, in every case where the relationship requirement was met by the chosen state, courts have held the choice of law valid, declining to place the policy considerations ahead of the rights and expectations of the parties.

4. Potential Effect of Economy and Consumer Protection Laws.

Much of the relevant case law for the states at issue dates between 1980 and 2000. Recent proposals for the creation of a federal Consumer Financial Protection Agency, along with the push for additional consumer protection legislation and a rapidly growing pool of vigilant consumer interest groups suggests that claims challenging consumer loan contracts on usury grounds will not be far behind. The Supreme Court has yet to set precedent for the application of the "fundamental policy" and "materially greater interest" language in R2CoL §187, but the national focus on consumer financial protection in the wake of current economic conditions sends a strong message about national public policy, and could have a very real and significant impact on how courts interpret the Restatement going forward.

5. Helpful Factors for Identifying Fundamental Policies.

The 11th Circuit has identified four factors that indicate whether the countervailing public policy overrides the expectations of contracting parties:

1) whether the statute evincing the policy is fraught with exceptions;

2) whether the statute is frequently amended, thereby reflecting a flexible public policy;

3) whether the policy is fundamental to the legal system; and

4) whether the outcome has a limited effect upon the contract.

Mazzoni Farms, Inc. v. E.I. DuPont De Nemours and Co.,223 F.3d 1275, 1281(11th Cir.2000).

These factors don't come anywhere close to creating a bright line, but looking at how state statutes treat usury issues is a helpful guide for determining whether or not they evince a "fundamental" public policy. Accordingly, I have included a brief discussion of the statutory treatment of both Conflict of Laws and Usury for each of the states below.

DISCUSSION PART 4: State by State Overview

I. ALABAMA

1. Fundamental Public Policy Exception: Choice of law stipulations designed solely to evade usury laws void as against public policy (This is easily overcome by establishing the relationship requirement).

Supporting Case Law:

United States Savings & Loan Co. v. Beckley, 33 So. 934, 934 (Ala. 1903).
"Under established rules, a note or bond made payable at a particular place, or which is expressly made with reference to the laws of a particular state, is governed, in respect to its obligation as to interest, by the law of the place so stipulated as the place of performance. * * * **An exception to these rules is where such stipulations are found to be a mere device to evade the usury laws, in which case they will be held void as against public policy."** (*emphasis added*)

2. Do Statutes point to Evidence of a Fundamental Policy? No. Both the Conflict of Law and Usury statutes are very basic and don't reflect any special legislative consideration.

Conflict of Law: Alabama code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: Alabama code provides only a basic max interest cap.

II. ARIZONA

1. Fundamental Public Policy Exception: None. State case law focuses on the relationship requirement as defined by place of performance.

Burr v. Renewal Guaranty Corp., 105 Ariz. 549, 468 P.2d 576 (Ariz. 1970)

"The general principle in relation to contracts made in one place, to be executed in another, is well settled. They are to be governed by the law of the place of performance, and if the interest allowed by the laws of the place of performance is higher than that permitted at the place of the contract, the parties may stipulate for the higher interest, without incurring the penalties of usury." **(*This states the basic principle set forth in R2CoL§187*)**

2. Do Statutes point to Evidence of a Fundamental Policy? No. Both the Conflict of Law and Usury statutes are very basic and don't reflect any special legislative consideration.

Conflict of Law: Arizona code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: Arizona code provides only a basic max interest cap.

III. CALIFORNIA

1. Fundamental Public Policy Exception: Nothing explicit; relevant case law reiterates both that California has a strong public policy against usury, but has no specific policy against rates of interest legally permitted to the lender.

*Mencor Enterprises, Inc., v. Hets Equities Corp.*190 Cal.App.3d 432, 235 (Cal.App.1987).

"California has a strong public policy against usury, that is, the charging and receiving interest on the loan or forbearance of money in excess of the rate allowed by law. **It has no strong public policy against a particular rate of interest so long as the charging of that rate is permitted by law to the specific lender…"**

2. Do Statutes Point to Evidence of a Fundamental Policy? Probably. While California's Conflict of Law provisions are relatively basic, the usury law may be protective enough to support the conclusion that it reflects a fundamental policy of the state.

Conflict of Law: In addition to the same version of the UCC incorporated by 8 out of the 10 states at issue, California actually carves out a specific place for contract law, stating:

> "LAW OF PLACE. A contract is to be interpreted according to the law and usage of the place where it is to be performed; or, if it does not indicate a place of performance, according to the law and usage of the place where it is made."

Usury: California usury law imposes guilt for loansharking for *any* transaction involving interest over the legal limit. This definitely supports an inference that usury regulations are a fundamental concern.

IV. FLORIDA

1. Fundamental Public Policy Exception: None; in fact Florida has the most developed body of case law on the subject, all of which reject the idea that public policy concerning usury is strong enough to override the policy of giving effect to the expressed intention of the parties.

*Morgan Walton Properties, Inc. v. International City Bank & Trust Co.*404 So.2d 1059 (Fla., 1981).

"The certified question asks whether Florida's legislation on usurious interest establishes a public policy that prevents the application of the traditional choice of law rules to these contracts executed and to be performed in Louisiana.

"On review of the Continental Mortgage case by this Court, it was held that since Massachusetts had a normal and reasonable relation to the contract, the designation of Massachusetts law would be enforced.

"**The "public policy" against usury, we said, was not so strong as to overcome the policy in favor of giving effect to the expressed intentions of contracting parties, even though as a factual matter the designation may indeed have been motivated by a desire to "evade" Florida's usury law.**

"Although a few jurisdictions do attach such a public policy to their usury laws, it is generally held that usury laws are not so distinctive a part of a forum's public policy that a court, for public policy reasons, will not look to another jurisdiction's law which is sufficiently connected with the contract and will uphold the contract .... We do not think the mere fact that there exists in Florida a usury statute which prohibits certain interest rates establishes a strong public policy against such conduct in this state where interstate loans are concerned."

2. Do Statutes point to Evidence of a Fundamental Policy? Possibly. The Conflict of Law statute is very basic and doesn't reflect any special legislative consideration, however the usury statute is more developed than other states.

Conflict of Law: Florida code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: Beyond simply imposing interest caps for different types of transactions and institutions, Florida usury code specifically criminalizes loansharking, defining the misdemeanor level offense as any loan

bearing interest of 25-45% per year, and defining the felony offense as anything in excess of 45% per year. Additionally, Florida code provides a penalty allowing a victim of a usurious contract to recover double the usurious amount of interest they paid. Current Florida case law specifically states that the public policy regarding usury is not fundamental, but the relevant cases don't were not decided in the current economic situation, so it's possible that a court seeking to overrule previous cases and advance a more protective public policy could find that the protective and punitive agenda set forth in the usury law supports a finding that usury protection is a fundamental policy for the state.

V. INDIANA

1. Fundamental Public Policy Exception: None; I found no relevant case law for the state or the 7th Circuit discussing fundamental public policy with respect to conflict of law, consumer contracts, or usury.

2. Do Statutes Point to Evidence of a Fundamental Policy? Yes. Indiana's Conflict of Law statute is so overly protective of its citizens that is was recently held unconstitutional as a violation of the Commerce Clause. Indiana has no current usury law, but legislation is pending that will establish usury limits.

Conflict of Law: Although Indiana's statute must be amended to pass Constitutional muster, a court could definitely view it as clear evidence that the protection of its citizens is a fundamental policy concern.

Usury: No current usury law established, but legislation is pending to establish limits.

VI. LOUISIANA

1. Fundamental Public Policy Exception: Nothing explicit, however relevant case law takes a slightly different approach, suggesting that the purpose of the contract itself may determine whether a public policy consideration exists sufficient to justify the refusal to honor a choice of law provision.

Whitehurst v. James Noel Flying Services, 509 So.2d 1035 (3rd Cir.1987).

"It is well established that where the parties stipulate the state law governing the contract, Louisiana conflict of laws principles require that the stipulation be given effect, unless there is statutory or jurisprudential law to the contrary or strong public policy considerations justifying the refusal to honor the contract as written..

Plaintiff has made no showing that the stipulation is invalid due to an express legislative or constitutional prohibition**, or a showing that the purpose of the contract contravenes good morals or public interest."** (*emphasis added*)

2. Do Statutes Point to Evidence of a Fundamental Policy? Possibly. The Conflict of Law statute protects individuals from subjecting themselves to the jurisdiction (as in forum, *not* law) of another state, and the usury law criminalizes loansharking. Both statutes are more protective than other states, but probably not to a degree where a court would be compelled to find evidence of a fundamental policy.

Conflict of Law: Louisiana code invalidates any agreement entered into by a resident in which they agree to be subject to the jurisdiction of another state. This refers only to a restriction on forum, it does not affect the individual's ability to agree that the contract will be governed by the laws of another state.

Usury: Like the Florida code, beyond simply imposing interest caps for different types of transactions and institutions, Louisiana usury code specifically criminalizes loansharking, defining as a felony any transaction bearing interest of 45% or greater per year.

VII. MISSOURI

1. Fundamental Public Policy Exception: None, in fact there is no relevant case law available for either the state, or the 8th Circuit, which discusses public policy with respect to conflict of law or usury. All the cases dealing with these issues focus solely on whether the chosen state law has a substantial connection to the transaction or the parties.

2. Do Statutes point to Evidence of a Fundamental Policy? No. The Conflict of Law statute is very basic and doesn't reflect any special legislative consideration, and while the usury statute is slightly more developed than other states, it neither advances nor reflects an overly protective or punitive agenda.

Conflict of Law: Missouri code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: Missouri code is slightly more expanded than other states, but the additional provisions function mainly to categorize different types of transactions.

VII. NEVADA

1. Fundamental Public Policy Exception: None; relevant case law touches on contravention of public policy only with respect to it implication in R2CoL §203.

*S.E.C. v. Elmas Trading Corp.*865 F.2d 265 (9th Cir.1988).

"The district court was correct in holding that even if Nevada, which has no usury prohibition, had a substantial relationship with the contract, the contract provides for interest "greatly in excess of the rate permitted by the general usury law of [Arkansas]…the de facto rate of 500% (without annualizing) on the Calhoun/Peck loan was well in excess of the 13% allowed in Arkansas at the time. The contract accordingly was usurious." **(*Again as stated above, this provision is ONLY applied when the forum state has a more significant relationship to the transaction/parties than the chosen state*)**

2. Do Statutes point to Evidence of a Fundamental Policy? No. The Conflict of Law statute is very basic and doesn't reflect any special legislative consideration.

Conflict of Law: Nevada code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: Nevada has no specific usury legislation.

VIII. TENNESSEE

1. Fundamental Public Policy Exception: None. Relevant case law does not discuss fundamental policy with respect to upholding choice of law in consumer contracts and instead underscores a choice of law policy favoring validity and alluding to the relationship requirement.

Goodwin Bros. Leasing, Inc. v. H & B Inc.,597 S.W.2d 303 (Tenn., 1980).

> "Tennessee, like many other states, has long recognized a choice of law principle unique in usury cases that parties are presumed to have chosen that law which will uphold the legality of their bargain. That law which will lend greatest validity to the transaction will be applied if it is otherwise logically relevant."

2. Do Statutes point to Evidence of a Fundamental Policy? No. The Conflict of Law statute is very basic and doesn't reflect any special legislative consideration, and while the usury law is well developed, it does not reflect fundamental policy.

Conflict of Law: Tennessee code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: The Tennessee usury includes what is probably the most choice of law friendly provision in the nation. § 47-14-116 states:

> "A claim or defense based on usury or excessive loan charges, commitment fees, or brokerage commissions will not be sustained where the person against whom the claim or defense is made, in computing and making such charges, fees, or commissions, has relied on a statute, or a rule or regulation promulgated by an administrative agency, or on the final order of any such administrative agency in a proceeding involving such person."

This seems to provide that as long as the parties rely on the statutes of the chosen state in determining the terms of the loan, Tennessee law will uphold the choice of law.

IX. UTAH

1. Fundamental Public Policy Exception: None; I found no relevant case law for the state or the 10th Circuit discussing fundamental public policy with regard to conflict of law, consumer contracts, or usury.

2. Do Statutes point to Evidence of a Fundamental Policy? No. The Conflict of Law statute is very basic and doesn't reflect any special legislative consideration.

Conflict of Law: Utah code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: Utah has no specific usury legislation.

X. VIRGINIA

1. Fundamental Public Policy Exception: Nothing explicit; however the 4th Circuit has suggested that where the law chosen by the parties would make enforce a contract that would be flatly unenforceable in the state whose law would otherwise apply, honoring the choice of law provision would trench upon that state's fundamental policy. This case is discussed in further detail above (*See* pp. 10-11 *Infra.*).

2. Do Statutes Point to Evidence of a Fundamental Policy? Possibly. Although the conflict of law statute is basic and reflects no special legislative consideration, the usury statute provides the largest penalty award of any of the states at issue, a fact a court may consider evidence of a protective fundamental policy.

Conflict of Law: Virginia code incorporates the same version of the UCC (*See p. 6 Infra.*) incorporated by 8 of the 10 states at issue.

Usury: Like Florida code, Virginia codes provides a penalty allowing a victim of a usurious contract to recover double the usurious amount of interest they paid, but goes a step beyond by awarding all attorney fees and court costs in addition to the double interest.

APPENDIX 1: Usury Laws for States at Issue

ALABAMA, the legal rate of interest is 6%; the general usury limit is 8%. The judgment rate is 12%.

ARIZONA, the legal rate of interest is 10%.

CALIFORNIA, the legal rate of interest is 10% for consumers; the general usury limit for non-consumers is more than 5% greater than the Federal Reserve Bank of San Francisco's rate.

FLORIDA, the legal rate of interest is 12%; the general usury limit is 18%. On loans above $ 500,000 the maximum rate is 25%.

INDIANA, the legal rate of interest is 10%. Presently there is no usury limit; however, legislation is pending to establish limits. The judgment rate is also 10%.

LOUISIANA, the legal rate of interest is one point over the average prime rate, not to exceed 14% nor be less than 7%. Usury limit for individuals is 12%, there is no limit for corporations. (As warned, you cannot evade the limit by forming a corporation when the loan is actually to an individual.)

MISSOURI, the legal and judgment rate of interest is 9%. Corporations do not have a usury defense. (Remember that a corporation set up for the purpose of loaning money to an individual will violate the usury laws.)

NEVADA, the legal rate of interest is 12%; there is no usury limit.

TENNESSEE, the legal rate and judgment rate of interest is 10%. The general usury limit is 24%, or four points above the average prime loan rate, WHICHEVER IS LESS.

UTAH, the legal rate of interest is 10%. Judgments bear interest at the rate of 12%, or a lawfully agreed upon rate. There are floating rates prescribed for consumer transactions. Please see counsel for information.

VIRGINIA, the legal rate of interest is 8%. Judgments bear interest at the rate of 8%, or the lawful contract rate. Corporations and business loans do not have a usury limit, and loans over $ 5,000 for "business" or "investment" purposes are also exempt from usury laws. Consumer loans are regulated and have multiple rates.