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CHOICE OF LAW AND USURY LIMITS UNDER TEXAS LAW AND THE NATIONAL BANK ACT

by

Fred C. Pedersen* and John C. Cox**

RELATIVELY high interest rates,¹ combined with the limited interest rate ceilings existing in many states, have severely restricted the available money supply and have caused sophisticated borrowers and lenders to search for every conceivable avenue to make funds available at profitable yet legal interest rates. Because of the sometimes draconian penalties imposed upon lenders for charging usurious interest,² all transactions involving charges for the use, detention, or forbearance of funds must be scrutinized by lenders and their counsel with great care. Methods of avoiding adverse usury laws vary. The most common procedure for increasing the effective yield on a loan without raising the interest rate involves the addition of sundry charges, such as commitment fees. A considerable amount of discussion exists concerning the "interest" aspect of such charges,³ and most jurisdictions have clearly defined the limits of this approach. Another approach is simply to move a transaction to a jurisdiction having permissive interest ceilings⁴ or, in the case of corporate

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1. This Article was conceived in the winter of 1980, during a period of dramatically rising interest rates.

2. In New York, for example, usurious obligations are declared void by statute. N.Y. GEN. OBLIG. LAW § 5-501 (McKinney 1978). Borrowers may recover twice the interest they have paid under usurious obligations, and criminal penalties are available. N.Y. PENAL LAW § 60.05(4) (McKinney 1978). In Texas any person contracting for or receiving interest in excess of the legal limit forfeits to the obligor three times the amount of interest so contracted for or received (plus reasonable attorneys' fees) "except that in no event shall the amount forfeited be less than Two Thousand Dollars or twenty percent of the principal, whichever is the smaller sum." TEX. REV. CIV. STAT. ANN. art. 5069—1.06 (Vernon Pam. Supp. 1971-1979).

3. See, e.g., Danforth, *Usury: Applicability to Collateral Fees and Charges*, 16 S.D.L. REV. 52 (1971); Loiseaux, *Some Usury Problems in Commercial Lending*, 49 TEXAS L. REV. 419 (1971); Schrader, *The Wrap-Around Mortgage: A Critical Inquiry*, 21 U.C.L.A. L. REV. 1529 (1974); Sintenis, *Current Treatment of the Non-Refundable Commitment Fee and Related Problems*, 86 BANKING L.J. 590 (1969); Comment, *Usury Implications of Front-End Interest and Interest in Advance*, 29 SW. L.J. 748 (1975); Note, *Indexed Principal: A Way Around the Usury Laws?*, 31 ARK. L. REV. 141 (1977); Note, *Late Changes in Deeds of Trust as Usury*, 30 BAYLOR L. REV. 174 (1978). Numerous annotations also analyze this issue. See, e.g., Annot., 92 A.L.R.3d 769 (1979); Annot., 91 A.L.R.2d 1344 (1963); Annot., 17 A.L.R.2d 288 (1951).

In addition to changing the form of the lender's compensation, the parties may alter the legal status of the borrower to render applicable different interest rate maximums. See, e.g., Note, *Incorporation to Avoid the Usury Laws*, 68 COLUM. L. REV. 1390 (1968).

4. The provisions of state usury laws vary greatly. Some states, such as Arkansas and

borrowers, to a jurisdiction that prohibits assertion of the usury defense by corporations.⁵ Because moving a transaction to another jurisdiction frequently is physically impossible or impractical, lenders have in some instances either incorporated choice of law provisions in loan documentation or structured contracts so that the usury laws of a state or jurisdiction other than the jurisdiction of the borrowers' or lenders' domicile would apply to their transactions. In some situations, these parties have sought to apply the law of a jurisdiction that has, at best, a marginal connection with the transaction or the parties. To bolster the argument that the choice of governing law should be enforced, these parties frequently have attempted to arrange as many contacts as possible between the transaction and the jurisdiction whose law they select. The success of such a strategy is ordinarily a function of the choice of law principles of the jurisdiction in which litigation concerning the transaction arises.

Situations that necessitate a choice of law decision include those in which interstate finance companies solicit mail-order customers through national media, and credit card issuers issue credit cards to persons in states having varying interest rate maximums. One commentator has reported, for example, that a Kentucky corporation in the business of making interstate loans had loans of \$3,500,000 outstanding to California residents alone and was increasing this amount by some \$90,000 per week.⁶ In such situations, the lender or credit card issuer must carefully evaluate the choice of law principles in each jurisdiction in which credit is extended, lest even an express choice of governing law by the parties be disallowed.

Choice of law questions also arise in contexts other than those in which the parties expressly choose the governing law or intentionally structure a

Tennessee, have a single maximum rate of interest that may be charged by all lenders to all borrowers. ARK. CONST. art. 19, § 13; TENN. CONST. art. 11, § 7. Other states, notably Texas, have usury legislation that provides different interest rate maximums or usury exemptions for different types of borrowers or different classes of loans. TEX. REV. CIV. STAT. ANN. art. 5069—3.01 (Vernon 1971). As might be expected, the method of calculating interest charged in a particular situation varies from state to state, as do penalties for charging excessive interest. Overlying all of these state laws is the National Bank Act, 12 U.S.C. §§ 21-215b (1976), which provides the method for calculation of the applicable interest rate maximum for national banks. *Id.* § 85. Finally, international transactions may involve the provisions of a foreign usury law when a loan is made through a foreign branch of a United States bank or to a foreign borrower.

5. See, e.g., IOWA CODE ANN. § 535.2 (1979); KAN. STAT. ANN. § 17-7105 (1975); MICH. COMP. LAWS ANN. § 438.31 (1979). Such laws are also found in Illinois, Louisiana, Minnesota, Missouri, New Jersey, New York, Ohio, and Oklahoma, among other states. The rule that corporate borrowers may not assert the usury defense is apparently derived from the early case of *New York Dry Dock Bank v. American Life Ins. & Trust Co.*, 3 N.Y. 344 (1850). In that case, a New York bank had obtained a loan from a British lender. The State of New York imposed an interest rate ceiling of 6%, but the loan in question provided for an interest rate of 11%. In litigation concerning the loan, the court, applying New York law, upheld the usury defense set up by the borrowing bank and directed the forfeiture of the entire principal and interest. The decision caused considerable public outcry, and shortly thereafter New York enacted a statute denying to corporations the defense of usury.

6. See Comment, *Usury in the Conflict of Laws: The Doctrine of Lex Debitoris*, 55 CALIF. L. REV. 123, 124 (1967).

transaction to avoid the usury laws of a particular jurisdiction. Many large lending transactions, corporate bond offerings,⁷ and similar transactions involving interest, and thus potential usury questions, have contacts with and involve persons in numerous jurisdictions. Moreover, many loans are syndicated, with participating lenders located in several jurisdictions. In syndicated loan transactions, many difficult questions arise. Among these are whether all lenders participating in such a transaction should be permitted to charge interest at the same rate and, if so, which of the participant's local interest rates should apply. When all participants may charge interest at the rate permitted to them by a managing or lead bank, another question is whether an exception should be made in situations in which the lead bank is chosen solely for the liberal interest rate maximum available in its jurisdiction.

In each of the above contexts, a determination must be made concerning (i) whether more than one jurisdiction's interest rate ceiling potentially applies to the transaction; if so, (ii) which of these jurisdictions' interest rate ceilings is the most favorable; and (iii) whether that jurisdiction's law may be applied merely on the basis of a choice of law provision in one or more documents evidencing the transaction, or whether its law may be rendered applicable through creative structuring of the transaction.

If the interest rate limitations of one jurisdiction are deemed to be particularly advantageous in a given transaction, still other issues must be addressed. For example, while one jurisdiction's usury laws may be favorable to the lender, other laws of that jurisdiction may have an unfavorable impact upon one of the parties or the transaction as a whole. In such a situation, the parties might seek to apply the laws of more than one jurisdiction to a single transaction. Thus, a contract might state that one jurisdiction's law governs with respect to usury issues arising from the transaction while the laws of another jurisdiction govern interpretation, construction, enforceability, and other aspects of the contractual relationship. Contractual choices of more than one law raise serious questions, however, particularly when the parties choose one jurisdiction's law only for purposes of controlling interest rate maximums. Because these questions involve a collateral issue of choice of law, and because Texas authority in this area appears to be completely lacking, this Article does not discuss the ramifications of choosing more than one law.⁸

Additional and perhaps unforeseen problems may be encountered when one or more of the lenders is a national bank. Federal laws governing national banks do not provide clear guidelines as to the interest rate maxi-

7. In addition to other types of interest, offerings of debentures also frequently involve original issue discount. *See, e.g.,* *United States v. Midland-Ross Corp.*, 381 U.S. 54 (1965).

8. The parties to a transaction may choose not merely a single "governing law," but also may make specific provision regarding the law to govern certain issues such as contractual formalities, modes of performance, and perfection or validity of security arrangements. *See* Reese, *Dépeçage: A Common Phenomenon in Choice of Law*, 73 COLUM. L. REV. 58 (1973). The term "dépeçage" is used to refer to the process of applying different rules to different issues arising within a single contract or transaction. *See also* Cavers, *Contemporary Conflicts Law in American Perspective*, 3 RECUEIL DES COURS 137 (1970).

imum that may be applicable to loans made by a national bank.⁹ In numerous transactions having multijurisdictional aspects, many national banks are currently seeking, through an express choice of governing law, to apply another jurisdiction's laws to govern interest rate maximums when little or no authority exists to support that position. In fact, statutory authority exists that could be interpreted to prohibit such activity.¹⁰

This Article examines the enforceability of an express contractual choice of governing law¹¹ by considering the approach of the *Restatement (Second) of Conflict of Laws*¹² and the choice of law principles of the Uniform Commercial Code¹³ and by focusing upon the general rules enunciated in principal Texas decisions. For purposes of this analysis, no distinction will be made between situations in which a single jurisdiction's law is chosen to govern all aspects of a transaction and those in which the laws of more than one jurisdiction are chosen, each to govern distinct issues. In addition, this Article analyzes the approaches taken by the *Restatement* and Texas courts when the issue of enforceability of an express contractual choice of governing law arises in the special context of a usury challenge. Finally, this Article considers the position of United States national banks¹⁴ vis-à-vis state interest rate ceilings. The authors advocate a liberal

9. See notes 131-37 *infra* and accompanying text.

10. "Any association may take, receive, reserve, and charge on any loan or discount made . . . interest at the rate allowed by the laws of the State, Territory, or District where the bank is located . . ." 12 U.S.C. § 85 (1976).

11. Choice of law clauses raise numerous issues aside from their effectiveness or ineffectiveness. For example, a selection of governing law includes only the substantive law of the chosen jurisdiction. The law of the forum governs issues that may be characterized as "procedural" and, according to the weight of authority, also determines the characterization of an issue as substantive or procedural. *See, e.g.,* Klaxon Co. v. Stentor Elec. Mfg. Co., 313 U.S. 487 (1941); Erie R.R. v. Tompkins, 304 U.S. 64 (1938); Fahs v. Martin, 224 F.2d 387 (5th Cir. 1955); Dailey v. Transiron Overseas Corp., 349 F. Supp. 797 (S.D. Tex. 1972), *aff'd sub nom.* Dailey v. Transiron Elec. Corp., 475 F.2d 12 (5th Cir. 1973). *See also* Sedler, *The Erie Outcome Test as a Guide to Substance and Procedure in the Conflict of Laws*, 37 N.Y.U. L. REV. 813 (1962); RESTATEMENT (SECOND) OF CONFLICT OF LAWS §§ 122-143 (1971) [hereinafter cited as RESTATEMENT]. In addition, a choice of law clause is generally construed as selecting the governing law as it exists from time to time, not as fixing this law as of the date of the contract. *But see* American Nat'l Bank & Trust Co. v. General Outdoor Adv. Co., 18 Ill. App. 2d 602, 153 N.E.2d 110 (1958); *Compania De Inversiones Internacionales v. Industrial Mortgage Bank*, 269 N.Y. 22, 198 N.E. 617 (1935). Moreover, a choice of governing law is ordinarily deemed to incorporate only the local law of the jurisdiction whose law is selected rather than its whole law including its choice of law principles. *See* RESTATEMENT, *supra* note 11, § 186, Comment b; *id.* § 187(3), Comment h. *See also* Siegelman v. Cunard White Star Ltd., 221 F.2d 189 (2d Cir. 1955); *Reger v. National Ass'n of Bedding Mfrs. Group Ins. Trust Fund*, 83 Misc. 2d 527, 372 N.Y.S.2d 97 (Sup. Ct. 1975); *Sharwood, Renvoi and Contractual Choice of Law*, 5 AM. J. COMP. L. 120 (1956). *But see* A. VON MEHREN & D. TRAUTMAN, *THE LAW OF MULTISTATE PROBLEMS* 522-30 (1965).

Attorneys drafting choice of law clauses should also give careful consideration to the scope of the choice of law provision in question. In *In re Caver*, 6 U.C.C. Rep. 869 (D. Me. 1969), a choice of law clause referred to another jurisdiction's law for purposes of governing the "validity and construction" of a note. The court held, in a suit on the note, that the law of the forum nonetheless governed the issues of enforceability and that therefore the transaction in question was usurious.

12. RESTATEMENT, *supra* note 11.

13. U.C.C. § 1-105.

14. United States national banks are banking associations created pursuant to and governed by the National Bank Act. 12 U.S.C. §§ 21-215b (1976).

interpretation of the National Bank Act,¹⁵ which would permit national banks choosing the maximum rate of interest they may charge to use the same choice of law analysis available to state chartered lenders. Such an approach, in the view of the authors, would best effectuate the *raison d'être* of the National Bank Act: the promotion of a truly national banking system.¹⁶

I. CHOICE OF LAW AND USURY

A. *General Rules Regarding Express Choice of Law*

In the United States, the general rule applied to an express choice of law made for the purpose of controlling issues such as the validity, enforceability, interpretation, and construction of a contract is that such a choice of law will be enforced¹⁷ if the contract in question and the transaction of which it is a part bear a "reasonable relationship" to the jurisdiction whose law is chosen.¹⁸

Restatement Rule. The rule of the *Restatement (Second) of Conflict of Laws*¹⁹ accords with rules operative in most jurisdictions. The *Restatement* provides that a contractual choice of law will be enforced unless (i) the chosen jurisdiction has no substantial relationship to the parties or the transaction and there is no other reasonable basis for the parties' choice, or (ii) application of the law chosen would be contrary to a fundamental policy of a jurisdiction that has a materially greater interest than the jurisdiction whose law is chosen in the determination of the particular issue. The latter jurisdiction would be the jurisdiction of applicable law under the *Restatement*²⁰ in the absence of an effective choice of law by the parties.²¹ Thus, according to the *Restatement*, in a two-party lending transaction in which the borrower is located in Texas, the lender is located in New York, the transaction is negotiated in both states, and other aspects of the trans-

15. *Id.*

16. See generally S. REP. NO. 730, 86th Cong., 1st Sess. (1959), reprinted in [1959] U.S. CODE CONG. & AD. NEWS 2232.

17. Exception will be made, however, if public policy would be contravened thereby. See notes 118-26 *infra* and accompanying text.

18. See, e.g., H. GOODRICH, HANDBOOK ON THE CONFLICT OF LAWS 203-07 (4th ed. E. Scoles 1964); R. WEINTRAUB, COMMENTARY ON THE CONFLICT OF LAWS 269-75 (1971); Levin, *Party Autonomy: Choice-of-Law Clauses in Commercial Contracts*, 46 GEO. L.J. 260 (1958). For a treatment of express stipulations of applicable law in international transactions, see G. DELAUME, LEGAL ASPECTS OF INTERNATIONAL LENDING AND ECONOMIC DEVELOPMENT FINANCING 74-91 (1967).

19. Although the *Restatement* is widely considered persuasive authority, many of the contracts portions of the *Restatement* have not been adopted as Texas law. In view of the recent Texas Supreme Court decision in *Gutierrez v. Collins*, 583 S.W.2d 312, 318 (Tex. 1979), however, in which the court rejected common law choice of law principles and adopted the most significant relationship test of the *Restatement* for "all conflicts cases sounding in tort," *id.* at 318, Texas courts may also adopt *Restatement* rules applicable to contract actions. See generally Comment, *Abandonment of Lex Loci Delicti in Texas: The Adoption of the Most Significant Relationship Test*, 33 Sw. L.J. 1221 (1980).

20. See RESTATEMENT, *supra* note 11, § 187.

21. *Id.* § 188.

action are disbursed between the states, the parties may in the ordinary case safely choose to apply the law of either Texas or New York to their transaction. The most frequently cited rationale for this rule is that it best protects the expectations of the parties; hence the rule that a choice of law that renders a contract invalid will ordinarily not be enforced.²²

In many respects, a choice of governing law is little more than a shorthand incorporation of a jurisdiction's substantive law into a contract. While the parties to a contract might prefer to delineate in the contract many of the rules that they deem applicable to their agreement, they can accomplish much the same goal through an express choice of governing law.²³

Whenever parties wish to make an express choice of law to govern their transaction, the question arises as to what constitutes the requisite substantial or reasonable relationship between the transaction and the jurisdiction whose law they select. Although the *Restatement* sets forth no dispositive criteria on the basis of which to determine the existence of a substantial relationship in the context of a contractual choice of law, the contacts deemed relevant by the *Restatement* as a basis for selecting a governing law in the absence of an express choice of law include (i) the place of contracting, (ii) the place of negotiation of the contract, (iii) the place of performance, (iv) the location of the contract's subject matter, and (v) the domicile, residence, nationality, and place of business of the parties.²⁴ Insofar as these factors are set forth in the *Restatement* as a means to determine those jurisdictions that "are most likely to be interested" in a transaction,²⁵ one might reasonably conclude that such factors may also serve to establish a substantial relationship to validate an express choice of law. The comments to *Restatement* section 187 note that a substantial relationship to the parties or the contract exists when the chosen jurisdiction is "that where performance by one of the parties is to take place or where one of the parties is domiciled or has his principal place of business"²⁶ or "the place of contracting except, perhaps, in the unusual situation where this place is wholly fortuitous and bears no real relation either to the contract or to the parties."²⁷ Thus if the choice of law does not contravene a funda-

22. *Id.* § 187, Comment e.

23. The effectiveness and enforceability of an express choice of law are issues distinct from an ex post facto judicial determination of governing law, which may be made through (1) an interest analysis, *see, e.g.,* *Hurtado v. Superior Court*, 11 Cal. 3d 574, 522 P.2d 666, 114 Cal. Rptr. 106 (1974); *Bernkrant v. Fowler*, 55 Cal. 2d 588, 360 P.2d 906, 12 Cal. Rptr. 266 (1961); (2) a "center of gravity" or grouping of contacts approach, *see, e.g.,* *Auten v. Auten*, 308 N.Y. 155, 124 N.E.2d 99 (1954); (3) or other analysis that may be made in the absence of an express choice of law or in the event that an express choice of law is held to be ineffective. In some jurisdictions courts have held that an express choice of governing law is but one of the contacts to be considered in making a determination as to governing law. *See, e.g.,* *Haag v. Barnes*, 9 N.Y.2d 554, 175 N.E.2d 441, 216 N.Y.S.2d 65 (1961). Yet cases involving no express choice of governing law are of some value in analyzing the position of a jurisdiction with respect to applicable law in general.

24. *RESTATEMENT*, *supra* note 11, § 188(2).

25. *Id.* Comment e.

26. *Id.* § 187, Comment f.

27. *Id.*

mental policy of a materially more interested jurisdiction, the *Restatement* generally affords to contracting parties a considerable measure of autonomy in selecting governing law when relatively minimal contacts with the chosen jurisdiction exist.²⁸

*Uniform Commercial Code Rule.*²⁹ Under the Uniform Commercial Code (UCC), when a transaction bears a "reasonable relationship" to two states, the parties may agree that either state's law shall govern with respect to their "rights and duties."³⁰ Concerning the required reasonable relationship, the UCC notes that "[o]rdinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs,"³¹ but that a choice of law may "sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen."³² Although the UCC does not clarify what constitutes a "significant enough" portion of the making or performance of a contract, the rule would appear to afford contracting parties considerable latitude in choosing governing law, and, in practice, an express choice of law under the UCC is seldom disregarded.³³

28. In addition, judicial precedent exists for the proposition that a substantial relationship could be found even in the absence of any physical contacts between the transaction and the jurisdiction whose law is chosen. In *Duskin v. Pennsylvania-Central Airlines Corp.*, 167 F.2d 727 (6th Cir.), *cert. denied*, 335 U.S. 829 (1948), the court examined a situation in which the laws of Pennsylvania had been chosen to govern a contract made in another state between nonresidents of Pennsylvania. While finding a relationship between the contract and the state of Pennsylvania on the basis of limited activities in and over Pennsylvania, the court noted: "There seems no . . . justification for precluding parties to a contract from stipulating that the laws of any jurisdiction, even if foreign to the elements of the contract, should govern the rights and obligations of the parties, where not against public policy . . ." 167 F.2d at 730. *See also* *Vita Food Prods., Inc. v. Unus Shipping Co.*, [1939] A.C. 277.

29. U.C.C. § 1-105(2) lists a few exceptions to the general rule. *Id.* §§ 2-402, 4-102, 6-102, 8-106, 9-102 & 9-103.

30. *Id.* § 1-105(1). For the history of this section, see Braucher, *The Legislative History of the Uniform Commercial Code*, 58 COLUM. L. REV. 798, 810-12 (1958). *See also* Note, *Conflict of Laws and the Appropriate Relation Test of Section 1-105 of the Uniform Commercial Code*, 40 GEO. WASH. L. REV. 797 (1972).

U.C.C. § 1-105(1) expressly refers only to the selection of a system of law to govern the "rights and duties" of the parties to a contract. The UCC does not clarify whether parties to a contract controlled by the UCC may select a law to govern matters of contractual validity. On the issue of whether a choice of law clause controls questions of contractual validity, see R. WEINTRAUB, *supra* note 18, at 270-75. *See also* *Pritchard v. Norton*, 106 U.S. 124 (1882); *Standard Register Co. v. Kerrigan*, 238 S.C. 54, 119 S.E.2d 533 (1961); *Nordstrom, Choice of Law and the Uniform Commercial Code*, 24 OHIO ST. L.J. 364 (1963); *Tuchler, Boundaries to Party Autonomy in the Uniform Commercial Code: A Radical View*, 11 ST. LOUIS U.L.J. 180 (1967). For an application of § 1-105(1), see *Fairfield Lease Corp. v. Pratt*, 6 Conn. Cir. Ct. 537, 278 A.2d 154 (1971); *Jim v. CIT Fin. Serv. Corp.*, 87 N.M. 362, 533 P.2d 751 (1975).

31. U.C.C. § 1-105, Comment 1.

32. *Id.*

33. *See, e.g.*, *Three-Seventy Leasing Corp. v. Ampex Corp.*, 528 F.2d 993 (5th Cir. 1976); *Fleischmann Distilling Corp. v. Distillers Co.*, 395 F. Supp. 221 (S.D.N.Y. 1975); *Baker v. Gotz*, 387 F. Supp. 1381 (D. Del.), *aff'd*, 523 F.2d 1050 (3d Cir. 1975); *Windsor Mills, Inc. v. Collins & Aikman Corp.*, 25 Cal. App. 3d 987, 101 Cal. Rptr. 347 (1972); *Mell v. Goodbody & Co.*, 10 Ill. App. 3d 809, 295 N.E.2d 97 (1973). *But see* *Woco v. Benjamin Franklin Corp.*, 20 U.C.C. Rep. 1015 (D.N.H. 1976).

Common Law Rules. Delineating the precise rule applied by courts in each jurisdiction in assessing the enforceability of an express choice of governing law is beyond the scope of this Article. A few jurisdictions have expressly adopted the *Restatement* rule,³⁴ and a great majority follow the general UCC rule. The general reasonable relationship rule set forth above is in fact representative of the vast weight of modern judicial authority.³⁵

Texas Choice of Law Rules. In Texas, though few judicial decisions have considered the enforceability of an express choice of law,³⁶ modern au-

34. See, e.g., *Scientific Holding Co. v. Plessey, Inc.*, 510 F.2d 15 (2d Cir. 1974); *Southern Int'l Sales Co. v. Potter & Brumfield Div.*, 410 F. Supp. 1339 (S.D.N.Y. 1976).

35. See, e.g., *Craig v. Bemis Co.*, 517 F.2d 677 (5th Cir. 1975) (applying Minnesota substantive law under Alabama choice of law principles); *Aboussie v. Aboussie*, 441 F.2d 150 (5th Cir.) (applying Texas law), *rev'd and remanded*, 446 F.2d 56 (5th Cir. 1971); *Tele-Controls, Inc. v. Ford Indus., Inc.*, 388 F.2d 48 (7th Cir. 1967) (applying Oregon substantive law to determine if Illinois' reversibility standard met); *Massengale v. Transitron Elec. Corp.*, 385 F.2d 83 (1st Cir. 1967) (applying Massachusetts law); *National Union Fire Ins. Co. v. D&L Constr. Co.*, 353 F.2d 169 (8th Cir. 1965) (under Missouri law, refusing to enforce express choice of California law because of lack of logical basis upon which to do so), *cert. denied*, 384 U.S. 941 (1966); *Consolidated Jewelers, Inc. v. Standard Fin. Corp.*, 325 F.2d 31 (6th Cir. 1963) (applying New York substantive law under Kentucky choice of law principles); *MGM Grand Hotel, Inc. v. Imperial Glass Co.*, 65 F.R.D. 624 (D. Nev. 1974) (refusing application of California substantive law on the basis of lack of contacts with California and Nevada public policy), *rev'd on other grounds*, 533 F.2d 486 (9th Cir.), *cert. denied*, 429 U.S. 887 (1976); *Michael v. SS Thanasis*, 311 F. Supp. 170 (N.D. Cal. 1970) (dictum, applying California law); *B.M. Heede, Inc. v. West India Mach. & Supply Co.*, 272 F. Supp. 236 (S.D.N.Y. 1967) (applying New York law); *Parks v. Baldwin Piano & Organ Co.*, 262 F. Supp. 515 (D. Conn.) (applying Ohio substantive law under Connecticut choice of law principles), *aff'd*, 386 F.2d 828 (2d Cir. 1967).

36. Historically, Texas decisions have sought to carry out the parties' intent in applying the law of a particular jurisdiction. If the intention of the parties cannot be discerned from the contract or transaction, courts in Texas have applied the law of the place of contracting or the law of the jurisdiction in which the parties intended their contract to be performed if the place of performance was other than the place of contracting on the theory that the law of the place of performance was intended to govern. See, e.g., *Docutel Corp. v. S.A. Matra*, 464 F. Supp. 1209 (N.D. Tex. 1979); *Fidelity Mut. Life Ass'n v. Harris*, 94 Tex. 25, 57 S.W. 635 (1900); *Seiders v. Merchants' Life Ass'n*, 93 Tex. 194, 54 S.W. 753 (1900); *W.A. Ryan & Co. v. Missouri, K. & T. Ry.*, 65 Tex. 13 (1885); *Grace v. Orkin Exterminating Co.*, 255 S.W.2d 279 (Tex. Civ. App.—Beaumont 1953, writ ref'd n.r.e.); *Western Union Tel. Co. v. Parsley*, 121 S.W. 226 (Tex. Civ. App. 1909, writ dismissed); *Western Union Tel. Co. v. Garrett*, 102 S.W. 456 (Tex. Civ. App. 1907, no writ); *Western Union Tel. Co. v. Buchanan*, 80 S.W. 561 (Tex. Civ. App. 1904, writ ref'd); *Thomas v. Western Union Tel. Co.*, 61 S.W. 501 (Tex. Civ. App. 1901, writ ref'd); *Mexican Nat'l R.R. v. Ware*, 60 S.W. 343 (Tex. Civ. App. 1900, writ dismissed). In none of the above decisions, however, was the analysis of the courts very thorough and none involved an express choice of governing law. See also Beale, *What Law Governs the Validity of a Contract*, 23 HARV. L. REV. 1 (1909).

In several early Texas cases not involving usury, an express choice of governing law was approved, albeit without discussion. The earliest of these cases, *Mullen v. Mutual Life Ins. Co.*, 89 Tex. 259, 34 S.W. 605 (1896), involved an insurance policy issued by a New York insurer to two Texas residents. The application for insurance contained a provision that it was "subject to . . . the laws of New York." One of the insured died but the insurer refused to pay under the policy because the insured had failed to pay two premiums due prior to her death. Under Texas law, the defense of the insurer apparently would have prevailed. New York law provided that such an insurance policy could be cancelled only after written notice to the insured. Such notice had not been given. In a suit by the beneficiary against the insurer, the Texas Supreme Court held that "the provisions of the New York statute, under the facts shown in this case, entered into and became a part of the contract between the parties." *Id.* at 261, 34 S.W. at 606. The court reviewed the decisions of the New York

thority focuses upon the nature and extent of the contacts between the transaction and the jurisdiction whose law is selected. A choice of governing law will be enforced by Texas courts if the jurisdiction whose law is chosen is reasonably related to the contract and the transaction. For example, in *Dowling v. NADW Marketing, Inc.*,³⁷ NADW Marketing, a Louisiana corporation that was registered to do business in Texas, entered into a contract with Dowling, a Texas resident. In a section entitled "Contract Interpretation," the contract provided that the contract "shall be interpreted and construed under the laws of the State of Louisiana."³⁸ Dowling thereafter brought suit against NADW and contended that Texas law should be applicable. The court of civil appeals rejected Dowling's contention and simply held that "Texas courts have long recognized that parties to a contract, under certain circumstances, may choose the law applicable to the transaction in which they are engaging."³⁹ In *Teas v. Kimball*,⁴⁰ perhaps the most frequently cited Texas authority concerning the enforceability of an express choice of law, the court held: "If the parties specify in the contract that the contract is to be governed by the law of a particular place, that law will govern if it has a reasonable relationship to the contract."⁴¹ Numerous other judicial decisions in Texas affirm this rule although none expressly analyzes the elements of the required reasonable relationship.⁴²

In summary, under the *Restatement* and the UCC as well as Texas common law, the modern judicial trend apparently is to give controlling effect to a contractual choice of law, at least when the jurisdiction whose law is chosen is reasonably related to the contract and transaction.⁴³

courts construing the statute in question and held that in the absence of the requisite notice to the insured, the beneficiary would be entitled to recover under the policy. See also *New York Life Ins. Co. v. English*, 95 Tex. 391, 67 S.W. 884 (1902); *Washington Life Ins. Co. v. Berwald*, 72 S.W. 436 (Tex. Civ. App.), *aff'd*, 97 Tex. 111, 76 S.W. 442 (1903); *New York Life Ins. Co. v. Orlopp*, 61 S.W. 336 (Tex. Civ. App. 1901, writ ref'd); *Germania Life Ins. Co. v. Peetz*, 47 S.W. 687 (Tex. Civ. App. 1898, writ ref'd). In the absence of such a stipulation of governing law, Texas courts considering almost the same factual circumstances and the same New York statute have analyzed the issue of governing law in terms of the place of contracting and/or the place of intended performance. See, e.g., *Metropolitan Life Ins. Co. v. Bradley*, 98 Tex. 230, 231-32, 82 S.W. 1031, 1032 (1904).

37. 578 S.W.2d 475 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.).

38. *Id.*

39. *Id.* at 476. See also *Austin Bldg. Co. v. National Union Fire Ins. Co.*, 432 S.W.2d 697 (Tex. 1968), a case not involving an express choice of law, wherein the Texas Supreme Court held that "[t]he effect of a contract is to be determined by the law intended by the parties to control, and in the absence of a contrary manifestation, the presumption is that the parties contract with reference to where the contract was made." *Id.* at 701. *Accord*, *Dailey v. Transiron Overseas Corp.*, 349 F. Supp. 797 (S.D. Tex. 1972), *aff'd sub nom.* *Dailey v. Transiron Elec. Corp.*, 475 F.2d 12 (5th Cir. 1973); *Foundation Reserve Ins. Co. v. Cody*, 458 S.W.2d 214 (Tex. Civ. App.—Dallas 1970, no writ).

40. 257 F.2d 817 (5th Cir. 1958).

41. *Id.* at 823.

42. See notes 36 & 39 *supra*.

43. See also R. LEFLAR, *AMERICAN CONFLICTS LAW* § 147 (3d ed. 1977) and authorities cited therein.

B. *Usury and Express Choice of Law*

On the basis of the general reasonable relationship rule, contracting parties may select for themselves many of the legal rules that will govern their transaction for purposes of determining its validity or enforceability, or for purposes of interpretation or construction of their contract. With respect to other contractual matters, however, the parties may not enjoy the same degree of latitude. Certain issues lie beyond the contractual capacity of either natural or juristic persons,⁴⁴ and all states have mandatory rules that may not be avoided through the simple device of a choice of foreign law. If, for example, persons were permitted in all cases to select the interest rate maximum applicable to their transactions, lenders could easily circumvent usury laws to the detriment of necessitous borrowers, and usury laws could be rendered nullities. A state might then be placed in the anomalous position of enforcing a contract violative of its own usury laws, though the only connection between the contract and the chosen law is the single fact that the parties selected such governing law. Accordingly, in certain situations courts have refused to recognize an express choice of governing law as determinative of the applicable interest rate maximum with respect to a particular transaction. This refusal has been based on a number of theories, but two are of primary importance: (i) that the governing law was selected in an attempt by the lender⁴⁵ to evade the usury limits imposed by the law of the borrower's jurisdiction;⁴⁶ and (ii) that the enforcement of such a choice of law would violate the public policy of the forum.⁴⁷

44. A simple example might involve a minor who, under the laws of his domicile, lacks capacity to contract. Clearly, that person cannot vest himself with capacity to contract through the simple expedient of a specification in his agreement that the law of another jurisdiction will govern the contract. Similarly, contracting parties may not avoid their domicile's formal contractual requirements, such as a written agreement or payment of consideration, merely by choosing the law of a jurisdiction having no such requirement to govern a transaction. See RESTATEMENT, *supra* note 11, § 187, Comment d.

45. One author has suggested that "courts are concerned only with the lender's, and not the borrower's intent." Comment, *supra* note 6, at 162 n.243. One might wonder whether a court should also be concerned with the borrower's intent, particularly when the borrower is an issuer of corporate bonds or debentures.

46. See, e.g., *Dupree v. Virgil R. Coss Mortgage Co.*, 167 Ark. 18, 267 S.W. 586 (1924). See also *Cooper v. Cherokee Village Dev. Co.*, 364 S.W.2d 158 (Ark. 1963); *Dairy Equip. Co. v. Boehme*, 92 Idaho 301, 442 P.2d 437 (1968); *Zimmerman v. Brown*, 30 Idaho 640, 166 P. 924 (1917); *Cobe v. Guyer*, 237 Ill. 568, 86 N.E. 1088 (1908); *Majestic Loan Co. v. Edmonson*, 172 Okla. 222, 45 P.2d 504 (1935); Note, *Fraud on the Law—The Doctrine of Evasion*, 42 COLUM. L. REV. 1015, 1020 (1942). Whether the lender has attempted to evade the law of a particular jurisdiction has been analyzed in some decisions in terms of the subjective intention of the lender and in other decisions as a function of the requirement that the contract or transaction bear a "normal and natural" relationship to the jurisdiction whose law is chosen. See Comment, *supra* note 6, at 162-70. The RESTATEMENT, *supra* note 11, § 203, Comment c, has adopted the latter approach.

47. See, e.g., *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 157 S.E. 860 (1931); *Stoddard v. Thomas*, 60 Pa. Super. Ct. 177 (1915). See also *Trinidad Indus. Bank v. Romero*, 81 N.M. 291, 466 P.2d 568 (1970); *Bowman v. Price*, 143 Tenn. 366, 226 S.W. 210 (1920). In addition to the exceptions set forth in the text, certain other obvious exceptions to the rule of party autonomy exist. For example, a choice of law that is induced by improper means such as fraud or overreaching will not be enforced. See RESTATEMENT, *supra* note 11, § 187,

Restatement Rule. The *Restatement*, like the courts, appears to take a stricter approach to the enforceability of an express choice of governing law in the specific context of usury. *Restatement* section 203 provides:

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 § 188 [the general *Restatement* rule of most significant relationship].⁴⁸

Thus, the *Restatement* requires that the jurisdiction whose law is chosen bear a *substantial* relationship to the contract. Moreover, the rate of interest charged must not greatly exceed the permissible rate of the state most significantly affected by or related to the transaction. The *Restatement* further provides: "The parties will not be permitted, by means of a choice-of-law provision, to obtain still more favorable treatment [than is available under *Restatement* section 203] for the contract by application of the local law of a state which has no substantial relationship to the contract."⁴⁹ The key to application of the *Restatement* rule, therefore, is the existence of a substantial relationship with the jurisdiction whose law is chosen. Comment c to section 203 describes this relationship:

To have a substantial relationship to a contract as to a particular issue, a state must have a normal and natural relationship to the contract and the parties. The required relationship is unlikely to be based solely upon contacts purposely located in the state by the parties in an attempt to gain the benefit of that state's usury statute⁵⁰

Whether the requirement of a substantial relationship in this section is in fact an alteration of the ordinary *Restatement* choice of law standard is uncertain, however, in view of the fact that the *Restatement*⁵¹ requires a substantial relationship to validate any express choice of law. Yet the *Restatement* analysis of substantial relationships appears to be only a rephrasing of the reasonable relationship analysis found in many decisions. Moreover, the "fundamental policy" referred to in *Restatement* section 187⁵² as a basis for invalidating an express choice of governing law outside the usury context is present in section 203 because of the requirement that the rate of interest charged may not greatly exceed the rate permitted by the jurisdiction having the most significant relationship to the transaction. Nevertheless, insofar as *Restatement* section 203 appears to disregard certain purposefully arranged contacts, it probably states a rule stricter than that embodied by section 187 and more in line with judicial decisions that

Comment b. See also *Fricke v. Isbrandtsen Co.*, 151 F. Supp. 465 (S.D.N.Y. 1957). A choice of law will not be enforced when it is contained in an adhesion contract. See *RESTATEMENT*, *supra* note 11, § 187, Comment b; Ehrenzweig, *Adhesion Contracts in the Conflict of Laws*, 53 COLUM. L. REV. 1072 (1953). See also *Davis v. Humble Oil & Ref. Co.*, 283 So. 2d 783 (La. Ct. App. 1973).

48. *RESTATEMENT*, *supra* note 11, § 203.

49. *Id.* Comment e.

50. *Id.* Comment c.

51. *Id.* § 187(2)(b).

52. *Id.* § 187.

reject some contacts as evasions of otherwise-applicable law.⁵³

In summary, under the *Restatement*, (i) to have a substantial relationship to a contract, a state must have a normal and natural relationship to the contract and the parties; (ii) such a relationship generally may not be based solely upon contacts purposely located in a chosen jurisdiction in an attempt to secure application of its law; and (iii) a substantial relationship may exist with a jurisdiction that is either the state of the borrower's principal place of business, the state of performance, or the state in which a loan is actually made, if each state has a normal and natural relationship to the contract.⁵⁴

Texas Rule. Under general Texas choice of law principles applicable in usury cases, contracting parties may specify that the validity and enforceability of an agreement and the rights and obligations of the parties thereunder, including the maximum interest rate, are to be governed by the law of a particular jurisdiction. In such a case, the substantive local law of the chosen jurisdiction⁵⁵ will be applied by Texas courts if the contract and the transaction of which it is a part bear a reasonable relationship to that jurisdiction, provided: (i) neither such choice of law nor the reasonable relationship between the contract and the jurisdiction whose law is chosen constitutes a subterfuge or contrivance to evade application of Texas law,⁵⁶ and (ii) neither the choice of another jurisdiction's law nor maintenance of an action based upon such law contravenes Texas public policy.⁵⁷ This rule is similar to the rule of many other jurisdictions.⁵⁸

In *Securities Investment Co. v. Finance Acceptance Co.*⁵⁹ a Missouri lender advanced funds to a Texas borrower, secured by certain of the borrower's receivables that were assigned to the lender. The loan agreement between the parties provided that it was to be governed by Missouri law. The borrower challenged the transaction as usurious on the basis of Texas law. The trial court upheld the position of the borrower, applied Texas

53. See notes 80-117 *infra* and accompanying text.

54. *RESTATEMENT*, *supra* note 11, § 203, Comment c.

55. As a general rule, the forum will apply its own law with respect to procedural issues. See, e.g., *California v. Copus*, 158 Tex. 196, 309 S.W.2d 227, *cert. denied*, 356 U.S. 967 (1958).

56. *Building & Loan Ass'n v. Griffin*, 90 Tex. 480, 39 S.W. 656 (1897); *Hi Fashion Wigs Profit Sharing Trust v. Hamilton Inv. Trust*, 579 S.W.2d 300 (Tex. Civ. App.—Eastland 1979, no writ); *Securities Inv. Co. v. Finance Acceptance Corp.*, 474 S.W.2d 261 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.).

57. See, e.g., *Burt v. Isthmus Dev. Co.*, 218 F.2d 353 (5th Cir.), *cert. denied*, 349 U.S. 922 (1955); *Castilleja v. Camero*, 414 S.W.2d 424 (Tex. 1967).

58. See, e.g., *Frame v. Merrill Lynch, Pierce, Fenner & Smith, Inc.*, 20 Cal. App. 3d 688, 97 Cal. Rptr. 811 (1971) (applying the rule in a non-usury case); *Nasco, Inc. v. Gimbert*, 239 Ga. 675, 238 S.E.2d 368 (1977) (applying the rule in a non-usury case); *Fidelity Sav. Ass'n v. Shea*, 6 Idaho 405, 55 P. 1022 (1899) (applying the rule in a usury case); *Chalmers & Williams v. Surprise*, 70 Ind. App. 646, 123 N.E. 841 (1919) (applying the rule in a non-usury case); *Big Four Mills Ltd. v. Commercial Credit Co.*, 307 Ky. 612, 211 S.W.2d 831 (1948) (applying the rule in a usury case); *Castleman v. Canal Bank & Trust Co.*, 171 Miss. 291, 156 So. 648 (1934) (applying the rule in a usury case); *Shotwell v. Dairymen's League Coop. Ass'n*, 22 N.J. Misc. 171, 37 A.2d 420 (1944) (applying the rule in a non-usury case).

59. 474 S.W.2d 261 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.).

law, and awarded damages based upon a violation of Texas usury statutes.⁶⁰ The court of civil appeals reversed, however, holding that “[w]here the parties to a contract specify in the instrument that it is to be governed by the law of a particular state, that law will apply if it has a reasonable relationship to the contract,”⁶¹ but that the chosen law would not be applied “if it is established that the agreement was merely a contrivance to evade the Texas usury statute.”⁶² In the *Securities Investment Co.* case, a reasonable relationship clearly existed between the contract and the state of Missouri because the lender was a Missouri corporation and loan proceeds had been advanced in Missouri. An equally clear reasonable relationship existed with Texas, however, which the court failed to discuss. The court also failed to address whether the choice of Missouri law was a contrivance to evade Texas law, perhaps because the parties failed to develop the issue.

Thus, Texas courts have analyzed the enforceability of an express choice of law in the usury context by requiring a reasonable relationship to the jurisdiction whose law is chosen. Yet the basis for a finding of the requisite relationship is seldom articulated. The bulk of the discussion in Texas decisions focuses upon public policy and the doctrine of evasion.⁶³ Even so, Texas courts have also declined to analyze in detail either of these aspects of choice of law enforceability. The analysis that follows, by reviewing authorities from Texas and other jurisdictions, examines the problems involved in determining a reasonable relationship, an evasion of local law, or a contravention of public policy and provides a basis upon which lenders and their counsel may evaluate the enforceability of a contractual choice of governing law when a transaction is challenged as usurious.

The Required Reasonable Relationship. Of the numerous Texas decisions considering the issue, none appears to have focused upon the requirement of a “reasonable relationship” or to have articulated the basis for the finding of such a relationship between the transaction and the chosen jurisdiction. Texas courts also have not fully analyzed the effect upon an express choice of law when reasonable relationships concurrently exist between a transaction and more than one jurisdiction. In those instances in which an express choice of law has been upheld, Texas courts generally find the necessary connection implicit if one of the parties to the contract resides in the jurisdiction whose law is chosen.⁶⁴

A representative Texas decision is *Hi Fashion Wigs Profit Sharing Trust v. Hamilton Investment Trust*,⁶⁵ in which a New Jersey lender had provided construction financing to two Oklahoma employee benefit trusts for

60. *Id.* at 264.

61. *Id.* at 271.

62. *Id.* at 272.

63. See notes 55-62 *supra* and accompanying text.

64. See, e.g., *Dowling v. NADW Marketing, Inc.*, 578 S.W.2d 475 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.).

65. 579 S.W.2d 300 (Tex. Civ. App.—Eastland 1979, no writ).

the purpose of constructing an apartment project and an office building in Texas. Each of the significant loan documents included a choice of the "internal law" of the State of Oklahoma. The agreement pertaining to the office building loan also included a choice of forum clause under which the borrowers irrevocably consented to the jurisdiction of the courts of Oklahoma. The agreements had been negotiated in Oklahoma and New Jersey and the loan closing had occurred in New Jersey. All advances were made in Oklahoma, and all payments of principal and interest were made in New Jersey at the lender's office.

The two employee benefit trusts sued the lender in Texas, alleging that the lender had contracted for, charged, and received usurious interest.⁶⁶ The lower court found, on the basis of the express choice of law, that Oklahoma law was applicable.⁶⁷ The Texas court of civil appeals affirmed,⁶⁸ citing the general reasonable relationship rule and rejecting without discussion the contention of the plaintiffs that the "State of Oklahoma does not bear a reasonable relationship to the parties involved and the transaction sued upon."⁶⁹ While not specifically relying upon any particular contacts or group of contacts between the State of Oklahoma and the transaction in question, the court noted that not only had the agreements been negotiated in Oklahoma and the advances made there, but also both the plaintiff borrowers and the persons who represented them in the negotiation and execution of the loan documents were Oklahoma residents. Furthermore, the persons representing the borrowers in these negotiations were experienced in lending transactions and both were attorneys, and the usury claim was being asserted affirmatively rather than as a defense to a suit by the lender. For purposes of establishing the required reasonable relationship, therefore, the court apparently relied upon the residence of the borrowers in Oklahoma, the disbursements in Oklahoma, and the residence of the borrowers' representatives in Oklahoma.

Other Texas decisions implicitly finding a reasonable relationship include *Southwest Park Outpatient Surgery, Ltd. v. Chandler Leasing Division*.⁷⁰ Southwest Park, a Texas partnership, had leased certain equipment from Chandler Leasing Division. The lease agreement provided that Massachusetts law would apply to the "construction" of the lease.⁷¹ Chandler brought suit against Southwest Park and certain guarantors, alleging a default in payments of monthly rentals. As one affirmative defense, the defendants asserted that the purported lease constituted a conditional sales agreement and that usurious interest had been charged. The defense was rejected by the trial court. On appeal, the court simply held

66. The plaintiffs also sued for statutory penalties.

67. 579 S.W.2d at 301.

68. *Id.* at 303.

69. *Id.* at 302. The court's only discussion of the doctrine of evasion, *discussed at notes 80-117 infra*, was that the trial court found "the agreement . . . free from any taint of sham, subterfuge, or coercion." *Id.*

70. 572 S.W.2d 53 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ).

71. *Id.* at 55.

that the trial court's rejection of the usury defense could "be sustained upon the basis of an implied finding that the law of Massachusetts governed the transaction."⁷² The court did not discuss the relationship between the contract and the State of Massachusetts; the only apparent connection was that the plaintiff lender was a Massachusetts corporation. No reference was made to the place of negotiation of the agreement, the domicile or residence of the parties or to any other connecting factor. Unfortunately, a similar lack of sufficient analysis characterizes numerous Texas cases.⁷³

Another example is *Walker v. Associates Financial Services Corp.*⁷⁴ in which a Texas resident borrowed money by mail from an Indiana lender. Their agreement provided that the transaction was to be governed by the laws of Indiana. The Texas court of civil appeals held that Indiana law applied because the borrower sought the loan from the finance company; the transaction was conducted by mail; and the borrower's application was accepted in Indiana, where the loan was made and the lender's office was located.

Hi Fashion Wigs, Southwest Park, and Walker are representative of modern Texas authority. No reported Texas decision involving an express choice of law has held to be lacking a "reasonable relationship" between the transaction and the jurisdiction whose law was chosen to govern the transaction.⁷⁵ Nevertheless, parties should be aware that courts in other jurisdictions have applied a somewhat stricter interpretation of "reasonable relationship," and accordingly have refused to enforce certain express contractual stipulations of governing law.⁷⁶ Therefore, when an express

72. *Id.*

73. See, e.g., *Black v. Kidder, Peabody & Co.*, 559 S.W.2d 669 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ).

74. 588 S.W.2d 416 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.). The borrower in *Walker* had made "no claim of fraud or subterfuge," *id.* at 418, and the court did not discuss the effect of Texas public policy. See notes 118-26 *infra* and accompanying text. Moreover, the court failed to indicate which of the parties had initiated the allegedly usurious transaction although this point conceivably could constitute a significant factor in a court's decision in a case involving finance companies operating by mail.

75. See, e.g., *Dugan v. Lewis*, 79 Tex. 246, 14 S.W. 1024 (1891); *Black v. Kidder, Peabody & Co.*, 559 S.W.2d 669 (Tex. Civ. App.—Houston [1st Dist.] 1977, no writ).

76. For example, in *Brierley v. Commercial Credit Co.*, 43 F.2d 724 (E.D. Pa. 1929), *aff'd*, 43 F.2d 730 (3d Cir. 1930), *cert. denied*, 282 U.S. 897 (1931), a Pennsylvania corporation borrowed funds from a Delaware corporation whose principal office was in Maryland. The parties' agreement specified that Delaware law would govern. The court held the stipulation of governing law to be ineffective because Delaware had "no normal relation to the transaction." 43 F.2d at 727. See also *National Union Fire Ins. Co. v. D & L Constr. Co.*, 353 F.2d 169, 172 (8th Cir. 1965) (finding a "lack of a logical basis" for application of a particular jurisdiction's law), *cert. denied*, 384 U.S. 941 (1966); *Consolidated Jewelers, Inc. v. Standard Fin. Corp.*, 325 F.2d 31, 34 (6th Cir. 1963) (holding that under Kentucky law, in addition to the reasonable relationship requirement, some "vital element" of the contract must be associated with the jurisdiction whose law is chosen); *George Foreman Assoc. v. Foreman*, 389 F. Supp. 1308, 1311 (N.D. Cal. 1974) (noting that a stipulation of applicable law "may bind the parties *inter se* [but] it cannot . . . force a court to apply [such] law under circumstances where such application would otherwise be inappropriate"), *aff'd*, 517 F.2d 354 (9th Cir. 1975); *MGM Grand Hotel, Inc. v. Imperial Glass Co.*, 65 F.R.D. 624 (D. Nev. 1974) (applying the *Restatement* rule and refusing enforcement of a contractual choice of

choice of governing law is made in an agreement potentially subject to Texas interest rate limits, the transaction should be structured to have as many contacts as possible with the jurisdiction whose law is chosen. The transaction should be substantially negotiated in the jurisdiction whose law is chosen, and the loan closing or other formalities of finalization should take place in that state. In the case of a loan, funding and, if possible, repayment should occur in the chosen jurisdiction. The state whose law is selected should be the domicile of a party, the principal place of business of a party, or the situs of an office or other place of business of a party.⁷⁷ The location of security for a loan may also be of some importance, though in most cases it would appear to be largely fortuitous and not indicative of those jurisdictions actually possessing an interest in the transaction.⁷⁸ Texas cases illustrate that a few of the above contacts with the chosen jurisdiction will suffice to establish the required reasonable relationship. To remove any question as to the intent of the parties, however, an express choice of law, broadly drafted, should appear in each of the important documents. A choice of forum clause selecting the jurisdiction whose law is chosen as the exclusive forum for litigation will also indicate the parties' intent and may provide an additional relevant contact.⁷⁹

Avoiding Subterfuge or Contrivance. The second element of the prevailing Texas choice of law analysis is that neither the choice of law itself nor the arrangement of contacts between a transaction and the jurisdiction whose law is selected may constitute a subterfuge or contrivance to evade

governing law in view of materially greater interest of another state), *rev'd on other grounds*, 533 F.2d 486 (9th Cir.), *cert. denied*, 429 U.S. 887 (1976).

77. On the basis of the decision in *Southwest Park*, 572 S.W.2d at 53, the domicile of the lender would apparently provide sufficient connection with the transaction, even in the absence of other contacts, to validate an express choice of that jurisdiction's law.

78. *But see* *Green v. Northwestern Trust Co.*, 128 Minn. 30, 150 N.W. 229 (1914).

79. An exclusive choice of forum clause may also have the effect of entirely removing the issue of applicable law from the Texas courts. For example, assume a Texas lender makes a loan to a foreign borrower having a place of business in New York. New York law is chosen to govern and the courts of New York are selected as the exclusive forum for litigation related to the loan. If the borrower later brought suit in Texas, the initial issue to be determined would be the effectiveness of the choice of New York as an exclusive forum. Under the authority of *The Bremen v. Zapata Off-Shore Co.*, 407 U.S. 1 (1972), *In-Flight Devices Corp. v. Van Dusen Air, Inc.*, 466 F.2d 220 (6th Cir. 1972), and *Copperweld Steel Co. v. Demag-Mannesmann-Boehler*, 347 F. Supp. 53 (W.D. Pa. 1972), a Texas court should hold, subject to questions of reasonableness and availability of the chosen forum, that the suit should proceed only in the courts of New York. The New York courts would then make the necessary choice of law determination. Because a forum may be more likely to enforce a choice of its own substantive law, the likelihood of enforcement of the choice of New York law would seem increased in such a case. This technique could be used to avoid raising the choice of law issue in a forum inhospitable to the choice of law or otherwise likely to refuse to recognize the parties' choice. For discussion of choice of forum clauses, see, e.g., Farquharson, *Choice of Forum Clauses—A Brief Survey of Anglo-American Law*, 8 INT'L LAW. 83 (1974); Juenger, *Supreme Court Validation of Forum-Selection Clauses*, 19 WAYNE L. REV. 49 (1972); Note, *The Enforcement of Forum Selection Provisions in International Commercial Agreements: M/S Bremen v. Zapata Off-Shore Co.*, 11 COLUM. J. TRANSNAT'L L. 449 (1972).

Texas usury laws. Texas courts generally have declined to analyze this issue in depth. The evasion issue, however, would appear to merit even more judicial scrutiny than the "reasonable relationship" issue because a reasonable relationship may ordinarily be established through deliberate arrangement of contacts between the transaction and the chosen jurisdiction. The key issue, therefore, is whether a relationship so established, either deliberately or through fortuitous contacts, will be upheld because it is neither a subterfuge nor contrivance to evade Texas law.

Few Texas cases have expressly held that either an express choice of law⁸⁰ or the structuring of a transaction to induce a court's choice of applicable law⁸¹ constitutes a subterfuge or contrivance to evade application of Texas law, although the opinions of many courts in Texas mention this issue.⁸² The majority of Texas decisions that address the evasion issue concern situations involving no express choice of law. In some of these cases Texas courts have held that certain contacts between the transaction and one or more jurisdictions were spurious, merely a matter of form, or not indicative of the true intention of the parties regarding the applicable law.⁸³ Such contacts therefore would not form the basis of a choice of applicable law by the court.⁸⁴ When the courts consider an agreement containing an express choice of law, however, they are particularly unlikely to view the choice as a contrivance to evade usury limits, exhibiting instead a traditional solicitude for freedom of contract.⁸⁵

A significant early Texas decision is *Dugan v. Lewis*.⁸⁶ In *Dugan* an individual resident in Texas, acting through his agent in New York, borrowed a sum of money from a British lender. The loan agreement had been made in New York. The note was payable in New York and was secured by a deed of trust on Texas land with the lender's New York agent as trustee. Both the deed of trust and the note were delivered to the lender in New York. The transaction also had contacts with Texas. Two additional notes to cover the expenses of the borrower's agent in procuring the loan were executed and delivered in Texas and were payable to a Texas resident. A choice of law provision in the deed of trust, referring to the

80. No Texas court has refused to uphold an express choice of governing law on the basis that such choice constituted a subterfuge to evade application of Texas law.

81. See, e.g., *Building & Loan Ass'n v. Griffin*, 90 Tex. 480, 39 S.W. 656 (1897).

82. See, e.g., *Lubbock Hotel Co. v. Guaranty Bank & Trust Co.*, 77 F.2d 152, 156 (5th Cir. 1935); *Hi Fashion Wigs Profit Sharing Trust v. Hamilton Inv. Trust*, 579 S.W.2d 300, 302 (Tex. Civ. App.—Eastland 1979, no writ); *Securities Inv. Co. v. Finance Acceptance Corp.*, 474 S.W.2d 261, 271 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.).

83. Texas courts initially will seek the true intention of the parties. If the parties' "true" intention cannot be derived from the contract or the jurisdictions to which the transaction somehow related, Texas courts will apply either the law of the place of contracting or the law of the place of performance. See note 36 *supra*.

84. See, e.g., *Building & Loan Ass'n v. Griffin*, 90 Tex. 480, 39 S.W. 656 (1897); *Grace v. Orkin Exterminating Co.*, 255 S.W.2d 279 (Tex. Civ. App.—Beaumont 1953, writ ref'd n.r.e.).

85. See, e.g., *Hi Fashion Wigs Profit Sharing Trust v. Hamilton Inv. Trust*, 579 S.W.2d 300 (Tex. Civ. App.—Eastland 1979, no writ); *Securities Inv. Co. v. Finance Acceptance Corp.*, 474 S.W.2d 261 (Tex. Civ. App.—Houston [1st Dist.] 1971, writ ref'd n.r.e.).

86. 79 Tex. 246, 14 S.W. 1024 (1891).

note and transaction in general, selected the law of Texas "where [the contract] is made."⁸⁷ The borrower brought an action to prevent enforcement of the deed of trust, arguing that New York law was applicable and that under New York law the transaction was usurious and, as a result, void.

The Texas Supreme Court held that Texas law was applicable, primarily based upon a finding that the parties did not subjectively intend to violate or evade either New York or English usury laws.⁸⁸ The court noted the respective contacts between the transaction and the States of New York and Texas, but did not analyze these contacts either in terms of a "reasonable relationship" or otherwise. The court cited with approval decisions that had relied upon the fact that parties acted in good faith in making a contract subject to the laws of a jurisdiction where their transaction would not be usurious.⁸⁹ The court also noted that while choice of law may not be used to evade Texas usury laws, evasion was unlikely where the law of the borrower's residence was chosen.⁹⁰

In *Building & Loan Association v. Griffin*,⁹¹ a typical Texas case involving no express choice of governing law, the Supreme Court of Texas analyzed the structuring of the transaction in somewhat greater detail than in *Dugan* to determine whether it constituted a sham or contrivance to evade Texas usury limits. In *Griffin* a husband and wife residing in Texas borrowed funds from a building and loan association situated in South Dakota. The loan was secured by a deed of trust on Texas property. The lender imposed several additional charges in connection with the loan which, although permissible in South Dakota, clearly rendered the transaction usurious under Texas law. The trial court and court of civil appeals found the transaction to be usurious on that basis.⁹² On appeal, the lender argued that the lower courts had erred in not applying the law of South Dakota to determine the applicable interest rate maximum,⁹³ basing its argument upon the provision of the agreement that "expressed that the money [the payments of the borrower] is to be paid in [South Dakota]."⁹⁴

In its examination of the issue, the Texas Supreme Court noted that the lender had qualified to conduct business in Texas and "[i]t therefore became domiciled in the State the same as an individual would."⁹⁵ Indeed, the lender had been qualified to do business in Texas for ten years. The borrower was domiciled in Texas and all of his property, some of which

87. *Id.*

88. *Id.* at 253, 14 S.W. at 1026.

89. *Id.* at 252-53, 14 S.W. at 1026.

90. *Id.*

91. 90 Tex. 480, 39 S.W. 656 (1897).

92. *Id.* at 483-84, 39 S.W. at 656-57.

93. *Id.* at 485, 39 S.W. at 657.

94. *Id.* at 482, 39 S.W. at 658. Under traditional Texas choice of law rules, when the intention of the parties as to governing law is not expressed, the law of the place of contracting will be applied or, if the place of performance was other than the place of contracting, its law would be applicable. See note 36 *supra*. Thus, in *Griffin*, if the place of performance were actually South Dakota, the laws of that state should have been applicable to govern the maximum interest rate that could be charged.

95. 90 Tex. at 488, 39 S.W. at 659.

secured the loan, was situated there. No enforcement of the contract was likely in South Dakota. On the basis of these factors, the court looked to the subjective intent of the parties and found no intent that the contract be performed in South Dakota.⁹⁶ Rather, the court found that the parties actually intended the transaction to be performed in Texas and that the lender's intent to evade Texas law was clear.⁹⁷ The court held:

The fact that the contract expresses that the money borrowed is to be paid in the territory of Dakota is met by the real substantial provisions for its enforcement and the circumstances under which the business was transacted with such overwhelming force that we are brought to the conclusion that the contract, in so far as it provided by its terms for the payment of the money in the territory of Dakota, was simply a device to evade the laws of this state [F]rom the facts and circumstances of this case the intent to evade the laws of Texas is manifest.⁹⁸

The court in *Griffin* quoted approvingly one commentator who suggested:

[W]hen a contract is made payable at a place other than the residence of either of the parties, and foreign to the subject-matter of the contract, and a higher rate of interest is stipulated for than the laws of a place of contract permit, the parties will be presumed to have intended a fraudulent invasion [*sic*] of those laws.⁹⁹

Thus, if both the borrower and the lender are located in the jurisdiction in which all substantial activities are to be carried out in connection with a particular transaction, a Texas court will presume the intent to evade Texas law where only minimal performance aspects of the transaction such as payments by the borrower are to take place in another jurisdiction having a higher permissible interest rate maximum. Presumably, Texas courts would take the same position when the parties expressly select the law of the other, marginally connected, jurisdiction to govern their transaction.

Several other Texas cases of the same period reached conclusions consistent with *Griffin*.¹⁰⁰ In *Crenshaw v. Hedrick*¹⁰¹ a Louisiana corporation qualified to do business in Texas made a loan to a Texas resident after several years of engaging in business there. The debt was evidenced by a note secured by a deed of trust on Texas real property owned by the borrower. The borrower also made payments to the lender's branch office in Texas. The bylaws of the lender provided that all monies were to be payable at the lender's principal office in New Orleans and "[a]ll contracts made by or with the association shall be deemed to have been made at the home office in New Orleans."¹⁰² Louisiana law precluded the borrower

96. *Id.* at 488-89, 39 S.W. at 659.

97. *Id.* at 489, 39 S.W. at 659.

98. *Id.*

99. *Id.* (quoting TYLER, USURY 83 [*sic*]).

100. See, e.g., *Southern Bldg. & Loan Ass'n v. Atkinson*, 50 S.W. 170 (Tex. Civ. App. 1899, writ ref'd); *People's Bldg., Loan & Sav. Ass'n v. Bessonette*, 48 S.W. 52 (Tex. Civ. App. 1898, writ ref'd); *Crenshaw v. Hedrick*, 47 S.W. 71 (Tex. Civ. App. 1898, writ ref'd).

101. 47 S.W. 71 (Tex. Civ. App. 1898, writ ref'd).

102. *Id.* at 73.

from raising the defense of usury because the borrower was a stockholder of the lender.

The borrower brought suit in Texas after his default on the loan, alleging usury in an attempt to enjoin the sale of his land under the deed of trust. The loan documents contained no choice of governing law. The court of civil appeals held that the contract was of the same character as the agreement held usurious in *Griffin*.¹⁰³ The contract was clearly intended to be performed in Texas, not in Louisiana. As a result, the laws of Texas governed with respect to the charge of usury because Texas was the place of performance and the place of contracting, and, under Texas law, the contract was usurious.

Similarly, in *People's Building, Loan & Saving Association v. Besonette*,¹⁰⁴ in which a loan was made to Texas residents by a New York lender, the court of civil appeals held the contract usurious under the principles enunciated in *Griffin*. No choice of law provision was contained in the loan documentation, but the lender argued that because the loan was made payable in New York at the office of the lender, the laws of New York, the place of performance, should govern. The court, however, rejected the argument on the basis of *Griffin*.¹⁰⁵

Due to the dearth of broadly applicable analysis in *Dugan*, *Griffin*, and related cases, particular caution must be exercised before attempting to extend these holdings beyond their own facts. On the basis of *Dugan*, however, an express choice of governing law apparently will be enforced if the law of the borrower's residence is selected, at least if other contacts with such jurisdiction exist, because this law probably would not be selected for purposes of evading Texas usury laws.¹⁰⁶

Whether *Griffin* and similar cases limit the relatively broad holding of *Dugan* is unclear. Undoubtedly, though, on the basis of *Griffin*, the placement or arrangement of any contact between a contract and a particular jurisdiction purely as a matter of form will be considered evasive for choice of law purposes when all other provisions of the contract and all substantial aspects of the transaction relate to another jurisdiction.¹⁰⁷ *Grif-*

103. *Id.* at 75.

104. 48 S.W. 52 (Tex. Civ. App. 1898, writ ref'd).

105. *Id.* at 53; *accord*, *Southern Bldg. & Loan Ass'n v. Atkinson*, 50 S.W. 170 (Tex. Civ. App. 1899, writ ref'd).

106. *See Brierly v. Commercial Credit Co.*, 43 F.2d 724 (E.D. Pa. 1929), *aff'd*, 43 F.2d 730 (3d Cir. 1930), *cert. denied*, 282 U.S. 897 (1931).

107. In *Lubbock Hotel Co. v. Guaranty Bank & Trust Co.*, 77 F.2d 152 (5th Cir. 1935), the Fifth Circuit Court of Appeals considered a similar usury question in the context of a bond issuance. The hotel company, a Texas corporation, issued certain corporate bonds to a Louisiana bank and a Louisiana securities broker. To secure the bond issuance, the issuer executed a deed of trust and bond indenture covering Texas property. The bonds were payable in New Orleans. In litigation several years later after default by the issuer, the issuer asserted that its obligations under the bonds were usurious and that the contacts between the transaction and Louisiana were "the result of a device to avoid Texas usury laws." *Id.* at 155. The court held that the contacts were not merely a colorable device to evade Texas law, but rather, that the "bonds were Louisiana contracts, made, issued, and to be performed there." *Id.* at 156. The court distinguished *Griffin* on the following basis:

[*Griffin*] merely held under the facts of that case that a Texas court would

fin suggests that the mere designation of a jurisdiction as the place where payments are to be made under a loan agreement is an insufficient nexus with such jurisdiction to induce a Texas court, at least in the absence of an express choice of law, to apply the usury laws of that jurisdiction.

A choice of governing law would seem particularly subject to attack as an evasion of Texas law when the only contact between the contract and the jurisdiction whose law is chosen is a relatively insubstantial one. *Griffin* and other Texas cases dealing with the issue appear to attribute the most weight to those contacts arising from actual performance of a transaction, such as the place of disbursement of loan proceeds and the place of repayment. Although some broad authority upholds a choice of law that is ultimately purely nominal, in practice a contractual stipulation that selects the law of a jurisdiction that is neither the domicile nor residence of any party is likely to trigger judicial inquiry into the issue of evasion. The courts of Texas, as well as those of other states, are particularly prone to find an attempt to evade state usury laws when the legal interest rate maximum of the chosen jurisdiction is more permissive than that of the forum state. Unless connected to a more substantial aspect of the transaction, such as the residence of one of the parties, the place of disbursement of loan proceeds, or the domicile of the indenture trustee in connection with a bond issuance, the place of the agreement's execution may bear no particular relationship to the actual agreement between the parties or to the performance of that agreement and, standing alone, might well be deemed an insufficient basis for an express choice of law.¹⁰⁸ Similarly, the place of negotiation of a loan or other transaction would seem insufficient alone to overcome a charge that a selection of that jurisdiction's more permissive local usury law constitutes an evasion of Texas law. Even when a loan was both executed and negotiated in the same jurisdiction, a choice of that jurisdiction's permissive usury laws could be questionable.¹⁰⁹ Moreover, the location of collateral would appear, in itself, to be an insufficient contact.¹¹⁰

Conceivably, a selection of the law of a non-Texas lender's domicile could withstand a charge of evasion if the lender does not do business in Texas or have an office in Texas, even if the loan is to a Texas borrower. In both *Griffin* and *Crenshaw*, the lender had an office in Texas through

reject as untrue, and as merely a part of an usurious device, the provision of the contract that it was made and to be performed, not in Texas, but in another state, when every fact and circumstance in the case showed that this was not so. It does not purport to lay down as a general rule that good-faith contracts for money which would be usurious under Texas laws if made and to be performed there will, merely because they are secured by liens on Texas property, be held invalid in suits in Texas courts, though valid in the state of the making or of the performance of the contract. It is well settled that the general rule in both state and federal courts is to the contrary of this.

Id.

108. See RESTATEMENT, *supra* note 11, § 188(2), Comment e.

109. See *Bundy v. Commercial Credit Co.*, 200 N.C. 511, 157 S.E. 860 (1931).

110. *But see Lanier v. Union Mortgage, Bank & Trust Co.*, 64 Ark. 39, 40 S.W. 466 (1897); *Arnold v. Potter*, 22 Iowa 194 (1867).

which it conducted most of its operations in connection with the loan. The selection of the law of its domicile, and contractual provisions making the loans payable at the lender's domicile, were plainly efforts to evade more restrictive Texas usury limits. If other aspects of a transaction took place in, or were connected to, the state of a lender's domicile, a choice of its law would appear valid.¹¹¹ In the absence of such an additional connection, however, courts in other jurisdictions have refused to apply the law of the lender's domicile.¹¹²

A more difficult question arises regarding the extent to which Texas law permits the deliberate arrangement of contacts without running afoul of the evasion issue. If a New York lender making a loan to a Texas borrower chooses New York law to govern the transaction and arranges numerous contacts with New York, such as conducting negotiations, closing the loan, disbursing funds, and scheduling payments in New York, the transaction should not be susceptible to criticism because real and substantial connections exist with the selected jurisdiction. Thus, New York law legitimately could be selected to govern the transaction. If, on the other hand, all of the transaction's contacts other than the domicile of the lender were with Texas, a choice of New York law probably would be held to constitute an evasion of Texas law.¹¹³ This outcome is probable despite the fact that, with the possible exception of the parties' respective domiciles, all of the contacts in both examples are reasonably within the control of the parties. The basis upon which a Texas court might hold a transaction to be an evasion of Texas law merely because such contacts are "arranged" with another state are not immediately apparent. Accordingly, some question remains as to the ability of parties to such a transaction to structure their contacts deliberately with usury limits in mind.

While no Texas case appears to have considered this issue explicitly, the United States Supreme Court held in *Seeman v. Philadelphia Warehouse Co.*¹¹⁴ that if the usury limits in force at the place of performance and the place of contracting differ, the parties may choose the higher of the two rates.¹¹⁵ The Court further explained:

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." . . . As thus stated, the qualification, if taken too literally, would destroy the rules themselves for they obviously are to be invoked only to save the contract from the operation of the usury laws of the one jurisdiction or the other. 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

111. See *Green v. Northwestern Trust Co.*, 128 Minn. 30, 150 N.W. 229 (1914).

112. See, e.g., *United States Bldg. & Loan Ass'n v. Lanzarotti*, 47 Idaho 287, 274 P. 630 (1929); *Stoddard v. Thomas*, 60 Pa. Super. Ct. 177 (1915).

113. See text accompanying notes 101-03 *supra*.

114. 274 U.S. 403 (1927).

115. *Id.* at 407.

otherwise be subject. Wharton, in his Conflict of Laws, § 510 o, 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."¹¹⁶

Thus, according to *Seeman*, parties to an agreement may legally arrange their transaction so as to avoid otherwise potentially applicable usury statutes, at least when the jurisdiction selected by them and with which they arrange the contacts of their transaction has a "natural and vital" connection with the transaction.¹¹⁷ At the same time, courts are likely to view more favorably those arrangements that evidence the concurrence of both the lender and the borrower rather than arrangements made solely by the lender.

In addition, courts probably will look to the principal business activity of the lender in making a determination as to evasive intent. If, for example, the lender is domiciled in a state having a high interest rate ceiling, but its principal or sole business activity consists of making mail-order loans to persons in states with lower maximum interest rates, a court would no doubt view the plight of the lender unsympathetically. The contrary should be true if the lender's activity in a state with a lower usury ceiling were sporadic.

Public Policy. Assuming that a court can establish that a transaction bears a reasonable relationship to the jurisdiction whose law is chosen and that the selection of such law does not constitute a subterfuge or contrivance to evade Texas law, it must still establish that Texas public policy is not offended by the choice of law. A Texas court will not apply the law of a foreign jurisdiction when to do so would violate the public policy of the state of Texas.¹¹⁸ As the court in *Griffin* indicated, the forum was not obligated to enforce contracts that would be invalid under its laws and "which

116. *Id.* at 408.

117. *See also* Union Dime Sav. Inst. v. Wilmot, 94 N.Y. 221 (1883), wherein the New York Court of Appeals analyzed a claim that a transaction had been structured as a contrivance to evade otherwise applicable usury statutes. The court held:

There is no evidence whatever that the transaction took the form it did as a cover for usury. In one sense it took this form for the purpose of escaping usury. But the parties had a perfect right to deal with each other with the usury laws before their eyes, and to so shape the transaction as to avoid the condemnation of those laws. It is always the right of one having money to loan or to invest to require, in order that he may obtain more than six per cent, that securities . . . shall be presented to him before he will advance money

Id. at 227; *accord*, Jenkins v. Moyle, 254 N.Y. 319, 172 N.E. 521 (1930).

118. *See, e.g.*, Gutierrez v. Collins, 583 S.W.2d 312, 321 (Tex. 1979); Castilleja v. Carnero, 414 S.W.2d 424 (Tex. 1967); Means v. Limpia Royalties, 115 S.W.2d 468 (Tex. Civ. App.—Fort Worth 1938, writ *dism'd*); Ayub v. Automobile Mortgage Co., 252 S.W. 287 (Tex. Civ. App.—El Paso 1923), *rev'd on other grounds*, 266 S.W. 134 (Tex. Comm'n App. 1924, opinion adopted).

are so contrary to the laws of the state in which they are sought to be enforced as to work an injury and injustice to the people of the [forum] state or government, or a serious interference with its own policy or laws."¹¹⁹

In some jurisdictions, courts have seized upon this rule to strike down an otherwise enforceable express choice of governing law. For example, in *O'Brien v. Shearson Hayden Stone, Inc.*,¹²⁰ Washington residents, who were customers of a New York stockbroker, had entered into margin contracts with the broker. The contracts provided that New York law was applicable thereto. The Supreme Court of Washington, however, held that Washington usury laws should apply, though they rendered the transaction usurious, primarily because of the "fundamental" policy of the State of Washington against charging interest to Washington residents at a rate greater than the maximum allowed by Washington law.¹²¹ Authorities emphasize, however, that a choice of foreign law will only be disregarded when it clearly violates a fundamental policy of the jurisdiction whose law would otherwise be applicable.¹²² The *Restatement*, for example, provides that application of the chosen law may be refused where application of that law "would be contrary to a fundamental policy of a state . . . in the determination of the particular issue" if the state would be the jurisdiction whose law would be applicable in the absence of an effective choice of law by the parties.¹²³ Although the public policy rule has been similarly construed in Texas in another context,¹²⁴ no Texas cases involving an express choice of law appear to have considered the public policy issue, and no Texas decisions have held in a usury case that a choice of foreign law by a Texas resident was violative of a fundamental policy of the State of Texas. Yet the *Griffin* case, in which no express choice of law was made, suggests in a dictum that structuring a transaction to render applicable another state's more permissive maximum interest rate may be violative of Texas public policy.¹²⁵

In summary, Texas decisions do not indicate whether a Texas court would hold a choice of foreign law for usury purposes violative of Texas public policy. Numerous Texas decisions, however, have approved the application of the usury laws of other states even when the borrower resides

119. 90 Tex. at 490, 39 S.W. at 660.

120. 90 Wash. 2d 680, 586 P.2d 830 (1978), *aff'd on rehearing*, 93 Wash. 2d 51, 605 P.2d 779 (1980).

121. 586 P.2d at 833. *See also* DeKorwin v. First Nat'l Bank, 318 F.2d 176 (7th Cir.), *cert. denied*, 375 U.S. 922 (1963).

122. *See, e.g.*, RESTATEMENT, *supra* note 11, § 187. *See also* Bundy v. Commercial Credit Co., 200 N.C. 511, 157 S.E. 860, 864 (1931) (the mere fact that a loan is made to a North Carolina resident by a resident of another state at a rate of interest in excess of that permitted in North Carolina does not "necessarily offend the public policy of this state").

123. RESTATEMENT, *supra* note 11, § 187(2)(b).

124. *See, e.g.*, Wells Fargo Bank & Union Trust Co. v. Titus, 41 F. Supp. 171, 173 (S.D. Tex. 1941) ("Generally those cases holding foreign contracts void, because violative of public policy in the state of the forum, have dealt with things positively prohibited by law, or violative of public morals or destructive of its settled policy.")

125. 90 Tex. at 490, 39 S.W. at 660.

in Texas.¹²⁶ A judicial invalidation of a choice of foreign law seems particularly unlikely when the Texas borrower in question is reasonably sophisticated and possesses bargaining power roughly equivalent to that of the lender. Moreover, when the only Texas resident involved in a transaction is a lender, a "public policy" invalidation of a contract, valid under the usury laws of the borrower's residence or under the choice of law principles of the borrower's state of residence, would seem at odds with the basic policy underlying usury limits: protection of necessitous borrowers.

The Rule of Validation. While no Texas court appears explicitly to have so held, many authorities,¹²⁷ including the *Restatement*,¹²⁸ indicate that in the area of usury a distinct set of principles may exist affecting choice of law rules.¹²⁹ These authorities have suggested that judicial decisions commonly evidence a desire to uphold a contract despite a charge of usury when the contract or transaction bears a reasonable relationship to any jurisdiction under whose law the contract may be upheld. This approach is particularly evident when the interest rate actually charged is only slightly greater than the interest rate permitted under the law of the state that would declare the transaction usurious.¹³⁰

II. USURY AND CHOICE OF LAW UNDER SECTION 85 OF THE NATIONAL BANK ACT

The maximum rate of interest that may legally be charged, collected, or received by a national bank is governed by section 85 of the National Bank

126. See, e.g., *Lubbock Hotel Co. v. Guaranty Bank & Trust Co.*, 77 F.2d 152 (5th Cir. 1935); *Dowling v. NADW Marketing, Inc.*, 578 S.W.2d 475 (Tex. Civ. App.—Eastland 1979, writ ref'd n.r.e.); *Southwest Park Outpatient Surgery, Ltd. v. Chandler Leasing Div.*, 572 S.W.2d 53 (Tex. Civ. App.—Houston [1st Dist.] 1978, no writ).

127. See, e.g., H. GOODRICH, *supra* note 18, at 216-19; R. LEFLAR, *supra* note 43, at 312-14; Comment, *supra* note 6, at 124, and authorities cited therein.

128. RESTATEMENT, *supra* note 11, § 203.

129. The decision generally cited as forming the basis of this rule is *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403 (1927). In *Seeman* a transaction that had contacts with both Pennsylvania and New York would have been usurious in New York although it was legal in Pennsylvania. In a suit on the contract, the issue of usury was asserted on the basis of New York law. The United States Supreme Court, in upholding the contract, first noted the well-established rule of *Andrews v. Pond*, 38 U.S. (13 Pet.) 65 (1839), that if a contract is made in one jurisdiction and performable in another, the parties may apply the higher usury ceiling of the place of performance. The Court then noted:

In support of a policy of upholding contractual obligations assumed in good faith, this Court has adopted the converse of the rule . . . [of *Andrews v. Pond*]. "If the rate of interest be higher at the place of the contract than at the place of performance the parties may lawfully contract in that case also for the higher rate." . . .

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." . . . As thus stated, the qualification, if taken too literally, would destroy the rules themselves, for they obviously are to be invoked only to save the contract from the operation of the usury laws of the one jurisdiction or the other.

274 U.S. at 407-08 (citations omitted); see text accompanying notes 114-17.

130. See H. GOODRICH, *supra* note 18, at 216.

Act,¹³¹ and to the extent incorporated through section 85, by state law. Section 85 reads in part:

Any association may take, receive, reserve, and charge on any loan or discount made, or upon any notes, bills of exchange, or other evidences of debt, interest at *the rate allowed by the laws of the State, Territory, or District where the bank is located*, or at a rate of 1 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, or in the case of business or agricultural loans in the amount of \$25,000 or more, at a rate of 5 per centum in excess of the discount rate on ninety-day commercial paper in effect at the Federal reserve bank in the Federal reserve district where the bank is located, whichever may be the greater, and no more, except that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations *organized or existing* in any such State under this chapter.¹³²

National banks are thus allowed to collect interest at the greater of the rate provided by the "laws" of the state in which the bank is "located"¹³³ or a rate calculated on the basis of the appropriate federal discount rate.

Section 85 and its predecessors¹³⁴ have been interpreted for over a hundred years to give national banks advantages equal to those enjoyed by state banks under state law. Numerous judicial decisions analyzing section 85 have reasoned that the section is enabling rather than restraining.¹³⁵ National banks are, in the words of the United States Supreme Court, the

131. 12 U.S.C. § 85 (1976). Although the Act of June 3, 1864, ch. 106, was originally entitled "An Act to Provide a National Currency . . .," its title was altered by Congress in 1874 to the "National Bank Act." Act of June 20, 1874, ch. 343, 18 Stat. 123.

132. 12 U.S.C. § 85 (1976) (emphasis added).

133. A national bank is located at the place where it maintains its principal place of business and where its operations of discount and deposit are performed. *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978); *Fisher v. First Nat'l Bank*, 538 F.2d 1284 (7th Cir. 1976), *cert. denied*, 429 U.S. 1062 (1977). A national bank's location must be specified on the bank's organizational certificate. 12 U.S.C. § 22 (1976). A bank may also be located at the site of its authorized branches. *Citizens & S. Nat'l Bank v. Bougas*, 434 U.S. 35 (1977).

134. Section 85 was enacted in its original form as § 30 of the National Bank Act of 1864, ch. 106, § 30, 13 Stat. 108.

135. *Daggs v. Phoenix Nat'l Bank*, 177 U.S. 549 (1900) (purpose of statute was to place national banks on equal footing with state banks); *Tiffany v. National Bank*, 85 U.S. (18 Wall.) 862 (1874) (statute was intended to give national banks advantages equal to state banks); *First Nat'l Bank v. Nowlin*, 509 F.2d 872 (8th Cir. 1975) (purpose of statute was to put national banks in position to compete with state banks); *Brown v. First Nat'l City Bank*, 503 F.2d 114 (2d Cir. 1974) (section 85 was intended solely to place national banks on equal footing with state banks); *Hiatt v. San Francisco Nat'l Bank*, 361 F.2d 504 (9th Cir.) (competitive opportunities of national banks should not be thwarted by limitations on interest rates more restrictive than those applicable to state banks), *cert. denied*, 385 U.S. 948 (1966). *See also* *Roper v. Consurve, Inc.*, 578 F.2d 1106 (5th Cir. 1978) (national banks on equal footing with state banks), *aff'd sub nom.* *Deposit Guar. Nat'l Bank v. Roper*, 48 U.S.L.W. 4279 (1980); *Ray v. American Nat'l Bank & Trust Co.*, 443 F. Supp. 883 (E.D. Tenn. 1978) (application of "most favored lender" doctrine); *Monongahela Appliance Co. v. Community Bank & Trust, N.A.*, 393 F. Supp. 1226 (N.D.W. Va. 1975), *aff'd mem.*, 532 F.2d 751 (4th Cir. 1976) (purpose of National Bank Act is to put national and state banks on equal footing).

"national favorites."¹³⁶ In creating a system of national banks, Congress did not intend to expose these national banks to unfair competition from state banks or to allow the states to discriminate unfairly against them by legislation.¹³⁷

Section 85 seeks to achieve this goal of equality between state and national banks by providing that national banks located in a particular state may charge or receive interest on their loans at the rate permitted by state law for similarly situated state banks. Thus, if a state's interest rate maximum is eighteen percent, national banks located in that state are permitted to charge or receive interest at the rate of eighteen percent. An interpretive dilemma arises, however, with respect to the intended scope of the phrase "laws of the state . . . where the bank is located" in section 85. In light of the fact that the purpose of section 85 was to establish competitive equality between state and national banks, a reasonable interpretation of the above phrase would include a state's choice of law rules within the scope of "laws of the state." This reading would allow national banks the same latitude enjoyed by state banks in those states in which parties to state bank transactions may choose to apply the higher usury ceiling of another state having the requisite contacts. If, however, the phrase is interpreted to refer only to such state's substantive usury laws, the opposite result would obtain. Under this second construction, national banks would be subject to serious discrimination, because, unlike state banks, they would be unable to apply, through choice of law, another state's higher usury limits.

The discriminatory impact of a narrow interpretation of section 85 may be avoided if the reference to the laws of the state of a national bank's location is interpreted to include not only the substantive usury laws of such state, but also its choice of law principles. This interpretation would allow national banks the same limited flexibility accorded to state banks in making an effective choice of law. Although no reported cases have expressly addressed the question of whether section 85 encompasses a state's choice of law rules, dicta in several opinions would support such an interpretation. In *Daggs v. Phoenix National Bank*¹³⁸ the United States Supreme Court held that "[t]he intention of the national law is to adopt the state law, and permit to national banks what the state law allows to its citizens and to the banks organized by it."¹³⁹ In *First National Bank v. Nowlin*¹⁴⁰ the Eighth Circuit held, without reference to choice of law principles, that section 85 incorporates state interpretations of the proper method for calculating the legal rate of interest and not merely the maximum numerical rate of interest specified by state law.¹⁴¹ The court further

136. *Tiffany v. National Bank*, 85 U.S. (18 Wall.) 862, 864 (1873).

137. *Id.*

138. 177 U.S. 549 (1900).

139. *Id.* at 555.

140. 509 F.2d 872 (8th Cir. 1975).

141. *Id.* at 876. *But see* *Evans v. National Bank*, 251 U.S. 108 (1919); *Northway Lanes v. Hackley Union Nat'l Bank & Trust Co.*, 464 F.2d 855 (6th Cir. 1972); *Ray v. American Nat'l Bank & Trust Co.*, 443 F. Supp. 883 (E.D. Tenn. 1978), which held that § 85 incorporates state law only to the extent of establishing the maximum numerical rate while federal law

indicated that section 85 adopts the entire case law of a state.¹⁴²

Several other recent decisions involving multistate transactions may be read to support an interpretation of section 85 that would encompass state choice of law rules. In *Meadow Brook National Bank v. Recile*¹⁴³ a Louisiana district court held that the laws of a state other than the state of a national bank's location governed as to the applicable interest rate in an interstate loan. Thus the court in *Meadow Brook* found that a loan made by a New York national bank to a Louisiana borrower was not governed by New York's usury laws but by Louisiana's. In order to reach this result, the court first determined that because the lender was located in New York, New York's substantive usury law would govern interest rates if section 85 were applicable to the transaction.¹⁴⁴ Yet application of New York law would, according to the court, subvert the purpose of section 85, which was to place national banks on an equal footing with state banks.¹⁴⁵ This purpose would be thwarted in the opinion of the court because consistent application of the usury law of the state where a national bank was located would unfairly benefit banks located in states with high usury limits and penalize national banks located in states with low usury ceilings.¹⁴⁶ Accordingly, the court held that section 85 does not fix the rate of interest chargeable on interstate loans and applies only to "loans made in the state where the bank is located."¹⁴⁷

Aside from the difficulty inherent in determining where a loan is "made," the *Meadow Brook* decision ignores the plain wording of section 85, which clearly calls for application of the law of the state where the national bank is located. The *Meadow Brook* court could have avoided application of New York usury law by looking to the whole law of New York, including its choice of law rules. Had the court applied New York

governs as to whether such rate may be charged by discount or through annual percentage rates. The cited cases may, however, be distinguished from *Nowlin* and *Daggs* because the former primarily discussed the issue of whether the taking of interest in advance, and thereby increasing the lender's effective yield, amounted to usury when such practice would cause a specific loan to be usurious under state law. Because § 85 specifically provides that national banks may collect interest in advance, the courts in *Evans*, *Northway*, and *Ray* rightly determined that the issue before them was governed by federal law and not state law. The same holding does not, according to the *Nowlin* court, apply to all issues concerning the determination of how interest is to be measured. 509 F.2d at 879.

142. 509 F.2d at 876. The application of a state's entire statutory and case law may be significant apart from the difference that may exist between states with respect to numerical usury limits. For instance, a number of jurisdictions prohibit the assertion of the defense of usury by a corporation. See note 5 *supra*.

143. 302 F. Supp. 62 (E.D. La. 1969).

144. *Id.* at 72. The court failed to recognize that application of New York law could include not only New York substantive law, but its choice of law principles as well.

145. *Id.* at 74; see note 137 *supra* and accompanying text.

146. 302 F. Supp. at 74. The same argument was made by the plaintiff in *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), discussed at notes 152-57 *infra* and accompanying text. The Supreme Court held, however, that the development of a national banking system was the paramount concern of Congress in enacting the National Bank Act and that a certain amount of discrimination even between national banks located in different states was inherent in such a system.

147. 302 F. Supp. at 75.

choice of law rules, it could reasonably have found that under such rules Louisiana's substantive usury law would control. The court could have thus reached the result it desired and remained consistent with section 85.

Another case that lends support to the argument that national banks should have access to their state's choice of law principles is *Fisher v. First National Bank*.¹⁴⁸ The issue presented in *Fisher* was whether a national bank located in Illinois could, under section 85, charge interest to an Iowa borrower based upon Illinois usury ceilings. The Seventh Circuit Court of Appeals first held that because the bank was located in Illinois, section 85 allowed the application of Illinois usury limits to loans made by such bank regardless of the location of the borrower. Without discussing the application of choice of law principles under section 85, the court then turned its attention to construing the "except clause" at the end of the first sentence of section 85. This clause states: "[E]xcept that where by the laws of any State a different rate is limited for banks organized under State laws, the rate so limited shall be allowed for associations organized or existing in any such State under this chapter."¹⁴⁹ The court determined that if a national bank were located in Illinois, but "existed" in Iowa, the bank could, with respect to a loan made in Iowa, charge interest based upon either Iowa or Illinois usury law. The court declined, however, to expand upon what constitutes "existing" in a state.¹⁵⁰ Clearly, though, because the national bank in this case was undeniably located in Illinois, the term "existing" must refer to something other than being physically located in a state. Arguably then, under section 85, a national bank exists in a state whenever it makes loans in such state and when it exists in a state, it should be permitted to charge interest at the rate permitted by the laws of that state.¹⁵¹

The Seventh Circuit unfortunately failed to explain in *Fisher* how to determine when a loan is made in a certain jurisdiction for purposes of determining where a bank exists under section 85. Consider, for example, the case of a loan made by a Texas national bank to a Delaware corporation having its principal place of business in New York. The loan is secured by property owned by the corporation and located in Idaho.

148. 538 F.2d 1284 (7th Cir. 1976), *cert. denied*, 429 U.S. 1062 (1977).

149. 12 U.S.C. § 85 (1976) (emphasis added). When the United States Supreme Court decided *Tiffany v. National Bank*, 85 U.S. (18 Wall.) 862 (1873), the "except clause" only referred to "associations organized in any such state." The addition of the words "or existing" may be an indication that Congress envisioned national banks making loans in a foreign state and being governed by such foreign state's usury laws, without actually being located there.

150. In *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299 (1978), *discussed at* notes 152-57 *infra* and accompanying text, the Court, while determining where Omaha Bank was located, declared that it would not seek to determine the meaning of the phrase "organized or existing in any such state" or its relationship to the term "located." 439 U.S. at 308-09 n.19.

151. Without extensive analysis the Eighth Circuit, in *Fisher v. First Nat'l Bank*, 548 F.2d 255 (8th Cir. 1977), followed the Seventh Circuit's *Fisher* opinion and held that if a national bank located in one state makes a loan in another state, the bank may charge interest at the highest rate in effect in either state.

Negotiations for the loan are held at the corporation's offices in New York. The documents are signed by the corporation's chief executive officer at his home in New Jersey. Payments on the loan are to be made in Texas. Without reference to choice of law principles, no consistent method exists for determining where the loan was made and thus which jurisdiction's laws apply.

In *Marquette National Bank v. First of Omaha Service Corp.*¹⁵² the United States Supreme Court addressed a fact situation similar to that in *Fisher*.¹⁵³ *Marquette* involved a national bank in Nebraska, where the interest rate ceiling was eighteen percent,¹⁵⁴ that issued credit cards to persons in Minnesota, where the maximum interest rate was set at twelve percent.¹⁵⁵ Another national bank situated in Minnesota filed suit to enjoin the operation of the credit card program, insofar as it involved the issuance of credit cards to Minnesota residents, claiming that First National Bank of Omaha, by virtue of its lending to Minnesota borrowers, was located in Minnesota and therefore subject to Minnesota usury laws. The defendant answered that no usury was involved because, under section 85, it had the ability to make loans, even to Minnesota residents, at the interest rate permitted under the law of the jurisdiction where it was located, that is Nebraska.

The issue thus presented was whether a national bank's location, for purposes of section 85, should be stationary and based upon its physical situs, or flexible and dependent upon a given transaction's contacts with a specific jurisdiction. The Court reasoned that to establish a national bank's location by reference to a series of contacts would introduce confusion into the already complex system of modern banking. According to the Court, if a national bank's location varied, a bank could never be certain whether it had a sufficient nexus with another jurisdiction so as to alter its location and thus open the way to the application of that jurisdiction's usury laws. Accordingly, the Court held that a national bank's location for purposes of section 85 was at its situs.¹⁵⁶

The plaintiff in *Marquette* also argued that the exportation of interest rates from one state to another would hinder the capability of states to enact and enforce usury laws. In enacting the National Bank Act, Congress, according to the plaintiff, envisaged only "local" national banks making intrastate loans and not national banks making loans of an interstate character. If the system of the national banks were truly interstate, and thereby allowed a national bank to charge interest on loans, wherever made, at a rate permitted in the jurisdiction where it was physically situ-

152. 439 U.S. 299 (1978).

153. 538 F.2d 1284 (7th Cir. 1976), *cert. denied*, 429 U.S. 1062 (1977).

154. Interest on unpaid balances on credit card accounts may be charged at a rate of 18% per annum on the first \$1000 and 12% on the balance over \$1000. NEB. REV. STAT. §§ 8-815-8-823, 8-825-8-829 (1974).

155. Interest rates on Minnesota card holder accounts are limited to 12%. MINN. STAT. § 48.185 (1979).

156. *Marquette Nat'l Bank v. First of Omaha Serv. Corp.*, 439 U.S. 299, 312-13 (1978).

ated, national banks located in states with low usury ceilings would be discriminated against because they would be limited by their state's low ceilings while national banks located in other states could make loans at the higher rates permitted by the jurisdiction of such location.

Rejecting these arguments, the Supreme Court recognized that the application of section 85 to interstate transactions might adversely affect local banks, including national banks making intrastate loans, but nevertheless held that Congress's paramount intention in enacting the National Bank Act was to create an interstate banking network and that the Act should apply to interstate loans.¹⁵⁷ The Court further noted that the impairment of state usury laws was inherent in the establishment of a national banking system.¹⁵⁸

In analyzing the holding of the Supreme Court in *Marquette*, one must keep in mind both the particular facts of the case and the Court's assessment that one of Congress's primary objectives in enacting the National Bank Act was to create an interstate banking system. Under the facts of *Marquette*, the plaintiff, by encouraging an elastic interpretation of the word "location," was attempting to *limit* the ability of national banks to make interstate loans. If the Court had accepted the plaintiff's arguments and held that a national bank's location was variable depending on where and to whom it made loans, it would have discouraged banks in states with high usury ceilings from making loans to borrowers in states with low ceilings because such banks would be forced to make the loans under the more restrictive usury laws of the state with the low ceiling. That result would have thwarted the evolution and growth of the interstate banking system. On the other hand, in determining that a national bank's location is static and based upon situs, the Court rendered an opinion that, upon the facts, *encourages* the growth of the interstate banking system. Following *Marquette*, a national bank, at the very minimum, may charge interest on interstate loans based upon the usury ceiling of the state of its location.

Arguably, the uncertainties involved in determining a bank's location by reference to a series of contacts, which the *Marquette* Court declined to inject into the federal banking laws, is comparable to the problems existing when choice of law is considered in the application of section 85. To be sure, however, any difficulties inherent in applying choice of law principles to national banks are not of a different character than those presently confronted by state chartered lenders making interstate loans.

If state chartered lenders are able to deal with uncertain choice of law principles, no reason exists to support the belief that national banks and their counsel are any less capable. The next logical step after *Marquette* is to interpret section 85 to encompass the choice of law rules of the state where the national bank is physically situated and thus to further encourage interstate banking. The incorporation of choice of law principles would ensure that national banks could not only charge interest at the rate

157. *Id.* at 318.

158. *Id.* at 314.

permitted by the substantive usury laws of the state of their location but, in addition, would have the option, assuming an effective choice of law provision in the loan documents and a reasonable relation between the loan and another jurisdiction, of choosing such other jurisdiction's usury limits to govern the transaction. Such an interpretation clearly would be consistent with the Supreme Court's expressed intent in *Marquette* to interpret section 85 broadly to encourage the growth of interstate banking.

Furthermore, if the National Bank Act is to be broadly construed to facilitate and expand the interstate banking system without regard to the effect on local usury laws and to allow a national bank physically located in a jurisdiction with a high interest ceiling to make loans in states with low interest ceilings, a national bank located in a state with a low interest ceiling should be allowed, through use of an express choice of law provision in the relevant loan documents, to make loans in a state with a high ceiling if the transaction has a reasonable relation to that state. Otherwise, only national banks located in states with high usury limits are benefited by the interstate character of our national banking system. National banks, such as Marquette National Bank, located in states with low usury ceilings, such as Minnesota, could suffer unreasonable discrimination and in times of tight money would be unable to make loans to anyone, even out-of-state borrowers, at the current market rate.¹⁵⁹

Finally, permitting a national bank located in a jurisdiction with a low maximum interest rate to make loans to a borrower situated in a state with a higher maximum interest rate does not offend any legitimate public policy of either state related to the transaction. A state with a low ceiling is concerned primarily with protecting its residents from paying excessive interest. Its scope of legislative authority does not extend to residents of other states, who elect their own legislatures to decide upon an appropriate interest ceiling. Similarly, a state with a relatively high statutory usury limit has already made the policy determination to allow its citizens to borrow funds pursuant to its stated interest ceiling. A state with high interest ceilings should thus be unconcerned that its residents pay interest at the legal maximum to out-of-state lenders.¹⁶⁰

No reported decisions to date have construed section 85 to encompass choice of law rules.¹⁶¹ In *Marquette* the Supreme Court held that the law of the state where the bank is located governs usury limits applicable to

159. The prime rate was at a record 20% on April 4, 1980. Wall St. J., April 4, 1980, at 1, col. 2. Thus, in April 1980, Minnesota lenders were required either to lend funds below the market rate or place loans out of state.

160. For an introduction to relevant governmental interest analysis, see R. LEFLAR, *supra* note 43, § 92.

161. *But see* Letter No. 116, Comptroller Staff Interpretive Letters, [1979] FED. BANKING L. REP. (CCH) ¶ 85,191, in which the Comptroller of the Currency issued a letter ruling on the issue of whether a national bank located in a state with a low usury ceiling could make loans pursuant to the usury laws of another jurisdiction having a higher usury rate. Based upon an analysis of choice of law principles and the holdings of the Seventh Circuit in *Fisher v. First Nat'l Bank*, 538 F.2d 1284 (7th Cir. 1976), *cert. denied*, 429 U.S. 1062 (1977), and the Eighth Circuit in *Fisher v. First Nat'l Bank*, 548 F.2d 255 (8th Cir. 1977), which were both based upon the "except clause" in § 85, the Comptroller reasoned that a national

such bank. This rule standing alone, however, would hinder development of our interstate banking system because of the penalty it places upon national banks located in states with low usury limits. The Court did not address the question of whether the "laws of the state" where a bank is located includes such state's choice of law principles; thus, that interpretation could be made without overruling *Marquette*. In *Fisher* the Seventh Circuit determined that a national bank had a choice of applying the law of the state where it was located or the law of the state where the loan was made. Problems arise with this opinion because in many interstate transactions, absent use of choice of law principles, the place where a loan is "made" is indeterminable. Finally, the court in *Meadow Brook* only reached its decision to apply the substantive law of a jurisdiction other than that of the bank's location by a contorted reading of the statute.

These courts failed to reach a decision that would in all cases be consistent with a careful analysis of section 85 and the policies that underlie its enactment. Attainment of a reasonable result in consonance with the objectives of section 85 can be realized through an interpretation that refers to the choice of law principles in effect in the state where a lending bank is located.

III. CONCLUSION

As the foregoing analysis demonstrates, an express choice of law and careful structuring of a transaction should, in most circumstances, render applicable to a transaction the usury laws of the state chosen by the parties. In Texas no judicial decision involving express choice of law has failed to enforce such a choice of law in the usury context.

The impact of the National Bank Act in a multi-jurisdictional situation is less certain. A national bank in a state with high interest rate maximums may make loans under the National Bank Act at rates allowed by the laws of such bank's location to borrowers domiciled in states having lower interest rate maximums. The argument of the authors, however, that national banks should be permitted to utilize the choice of law rules of the state of their location in determining applicable interest rate maximums has yet to be tested in the courts. Accordingly, situations are certain to arise involving loans by national banks in which the applicable interest rate maximum is open to question. National banks should be permitted to utilize the choice of law rules of their respective jurisdictions in making a determination as to applicable usury law, much as they select the law applicable to other aspects of their lending transactions. Whether this result will actually be reached under the National Bank Act is an issue that must await review in the courts.

bank is not bound by the usury ceiling of the state of its location when making loans to out-of-state borrowers.

