Usury Laws and the Corporate Exception

Laurence M. Katz

Follow this and additional works at: http://digitalcommons.law.umaryland.edu/mlr

Part of the Corporation and Enterprise Law Commons

Recommended Citation
Laurence M. Katz, Usury Laws and the Corporate Exception, 23 Md. L. Rev. 51 (1963)
Available at: http://digitalcommons.law.umaryland.edu/mlr/vol23/iss1/5

This Casenotes and Comments is brought to you for free and open access by the Academic Journals at DigitalCommons@UM Carey Law. It has been accepted for inclusion in Maryland Law Review by an authorized administrator of DigitalCommons@UM Carey Law. For more information, please contact smccarty@law.umaryland.edu.
USURY LAWS AND THE CORPORATE EXCEPTION

LAURENCE M. KATZ

INTRODUCTION

Along with the growth of usury laws has come the so-called corporate exception, which relieves corporations from the effect of the usury statutes. The effect of the general law and its exception are diametrically opposed, and their interrelationship leads to situations where the furtherance of one undermines the other. The law's reactions to these conflicts has thus far been varied and inconclusive. The need for a systematic study of this problem is acute.

I. USURY

1. Background — From earliest times, the loan of money for profit has been subject to control by society. In the Middle Ages this practice was considered in foro conscientiae, the clergy believing that the charge of interest in any form was against Divine law both natural and revealed. Anyone found guilty of the practice was subject to Church punishment, and if after death, it was discovered that he had been a usurer, all of his chattels were forfeited to the king and his land escheated to the lord of the fee.

In the "dark ages of monkish superstition and civil tyranny, when interest was laid under a total interdict, commerce was also at its lowest ebb." While money during those times was conceived to be only a medium of exchange, it came to be recognized that it was of great convenience in trading and commerce where credit was

---

1 The term "usury" originally meant the loan of money for any amount of interest.
2 For an excellent discussion see Dunham v. Gould, 16 Johns 367, 376 et. seq. (N.Y. 1819).
3 Blackstone's Commentaries (Lewis' ed. 1900) 454.
5 Bacon's Abridgement (1852) 264 et. seq.
6 Blackstone, loc. cit. supra, n. 3.
7 Aristotle (Polit. L. 1. c. 10) has been attributed with saying that all money is naturally barren and to make it breed money is a perversion of its reason for existence which is to serve as a medium of exchange and not of increase. Blackstone, however, suspects that Aristotle never said this and that it was falsely attributed to him. Blackstone, loc. cit. supra, n. 3.
a necessity. It was this realization, combined with a lay reappraisal of the moral aspects of usury, that led to a series of English statutes which permitted the charge of interest at controlled rates. These statutes, however, bear witness to the Church's continued prejudice against the practice of usury in any form. The statute 13 Eliz. c. 8 which permitted interest at ten percent stated "that all usury being forbidden by the law of God is sin and detestable." 21 Joc. 1 contained a provision that "nothing in the law shall be construed to allow the practice of usury in point of religion or conscience."\(^9\)

The American colonies passed usury statutes which emulated those in force in England.\(^10\) Usurious contracts under these acts were wholly void and criminal penalties\(^12\)

---

\(^9\) BLACKSTONE, op. cit. supra, n. 3, 455: "And, as to any scruples of conscience, since all other conveniences of life may either be bought or hired, but money can only be hired, there seems to be no greater oppression in taking a recompense or price for the hire of this, than of any other convenience." However "to demand an exorbitant price is equally contrary to conscience." Blackstone set out what he believed to be a fair test for reasonable interest. It consisted of two parts — (1) A reasonable rate for the temporary inconvenience of parting with the money, and (2) A reasonable rate for the hazard of losing it entirely; "if the compensation allowed by law, does not exceed the proportion of the hazard run, or the want felt, by the loan, its allowance is neither repugnant to the revealed nor the natural law; but if it exceeds those bounds, it is then oppressive usury." Grotius as quoted in BLACKSTONE, op. cit. supra, n. 3, 455; BACON, loc. cit. supra, n. 5. BACON argues that the charge of a reasonable rate of interest is not against moral law, reasoning that if it is not immoral for the borrower to profit from the use of the money, it is equally moral for the lender to profit.


\(^12\) The statute 12 Anne c. 16, which was the prototype of all early state statutes, read,

"... That no person ... upon ... any ... contract which shall ... shall ... for loan of any monies, wares [etc.], above the value of five pounds for the forbearance of one hundred pounds for a year ... and that all bonds, contracts, and assurances ... for payment of any principal, or money to be lent ... upon or for any usury, whereupon or whereby shall be reserved or taken above the rate of five pounds in the hundred ... shall be utterly void; and that all and every person ... which shall ... receive, by way or means of any corrupt bargain, loan, exchange, chevizance, shift, or interest of any wares, merchandize, or other thing or things whatsoever, or by any deceitful way ... for the forbearing or giving day of payment for one whole year, of and for their money or other thing, above the sum of five pounds for the forbearing of one hundred pounds for a year ... shall forfeit ... the treble value of the monies, wares, merchandizes, and other things so lent. ..."

\(^11\) Cf. 10 West's ANNO CAL. CODES (1954) § 1916-3; 9 N.D. CENTURY CODE ANNO. (1960) § 47-14-11. In these states usury is still considered a misdemeanor punishable by fine or imprisonment.
were inflicted upon the usurer who was unable to recover interest or principal. Subsequent statutes have brought a steady mitigation of these punishments. In Maryland, for instance, prior to 1845, the proof of usury completely voided the contract. By passage of a statute in that year, usurious contracts could be enforced to the extent of the legal interest. This is the rule in the majority of United States jurisdictions today.

2. Rights Under Usurious Contracts — Basically statutes regulate usury in this country, since its legality was never considered by the common law. They provide for a maximum rate of interest varying from thirty to six percent. Since they were passed to protect the necessitous borrower from the oppression of too much interest, the borrower

---

23 91 C.J.S. 559, Usury, § 2.
26 91 C.J.S. 559, Usury, § 2.
34 H. No maximum statute rates — Maine, New Hampshire, see also 4 Colo. Rev. Stat. Ann. (1953) § 73-1-3; where there is no statute or a statute where no maximum rate is established, courts of equity have the power to pass on the reasonableness of the rate of interest in a given contract. Gate v. Merrill, 109 Me. 424, 84 A. 987, 988 (1912).
in a usurious transaction is not considered to be in pari delicto with the lender,\textsuperscript{19} his circumstances having forced him to conclude the agreement. It is only the borrower or those in privity with him who may avail themselves of the defense.\textsuperscript{20} The lender may not use usury laws to his advantage and attempt to avoid his part of the contract; this would be an attempted utilization of his own immoral acts.

II. THE CORPORATE EXCEPTION AND ITS EFFECTS

1. THE EXCEPTION

A. History — In England in the early Eighteenth Century, an exception to the right of a borrower to plead the defense of usury was created by statutory enactment. The statute of 3 Geo. 1, c. 8, § 39 in 1716 was the first statute passed which denied the defense of usury to a corporate body.\textsuperscript{21} It was specifically addressed to the Governor and Company of the Bank of England. It provided:

"That the said governor and company of the bank of England . . . shall have power and authority, and they are hereby enabled, in case they shall think fit, . . . to borrow or take up money upon any contracts, bills, bonds or obligations . . . at such rate or rates of interest, or upon such terms as they shall think fit, although the same shall happen to exceed the interest allowed by law to be taken. . . ."\textsuperscript{22}

In the United States, New York in 1850 passed the first statute which denied the defense of usury to all corporations.\textsuperscript{23} At the present time nineteen states have statutes which prohibit the defense of usury to corporations.\textsuperscript{24} Typical

\textsuperscript{20} Parker v. Bethel Hotel Co., 96 Tenn. 252, 34 S.W. 209 (1896); Hamilton v. Prouty, 50 Wis. 592, 7 N.W. 659 (1880).
\textsuperscript{21} Bacon's Abridgment, op. cit. supra, n. 5, 266.
\textsuperscript{22} By Geo. 1, c. 9, § 16 the same liberty was given to the South Sea Company.
\textsuperscript{23} 19 McKinney's N.Y. Laws (1957) § 374.
of such statutes is Maryland’s which reads, “No corporations shall interpose the defense of usury in any action.”

B. Rationale for Corporate Exclusion — Two reasons are advanced in favor of the corporate exception:

(i) Nature of usury statutes — The usury laws are based upon the assumption of the inequality of the individual needy borrower and the lender. The corporation it is said is not in need of the protection afforded to the individual. It was organized for the purpose of concentrating in one undertaking the combined capital of many individuals.

“It has no sensations and cannot be coerced by its necessities into any legal obligations beyond its defined and limited corporate powers. The individual borrows from a need springing from his own personal necessities, but the corporation becomes a borrower from a corporate exigency. The loss of the individual, singly or jointly, through usury, is at once both personal and immediate, but that of a corporation may or may not result in ultimate loss to its fluctuating membership, and therefore, while the corporate loss is immediate to the corporation, it is both mediate and proportional among the corporate membership.”

(ii) The desirability of advancing commerce — The usury laws, by placing a ceiling on the interest that may be charged, act as restraints “on the natural flow and supply of capital to the prejudice of industry and commerce.” By releasing the corporation, which is the prime vehicle of industry and commerce, from this restraint lenders are more willing to risk their capital on corporate ventures and commerce is increased.
C. Liberal Interpretation of the Corporate Exception — Exception statutes have been interpreted liberally on the ground that they restore the common law.\(^{30}\) When sued on a note that would otherwise be usurious, borrowing corporations have argued that a literal reading of statutes which provide that, "No corporation shall interpose the defense of usury . . .",\(^{31}\) would only prohibit corporations from using the usury defense in the pleadings. Such a proposed reading has been unanimously denied, and the protection of the usury laws have been denied to the corporations in all stages of litigation.\(^{32}\)


\(^{32}\) Curtis v. Leavitt, 15 N.Y. 9 (1857); Alston v. American Mortgage Co., 116 Ohio St. 643, 157 N.E. 374 (1927). Originally, there was some question as to the constitutionality of these statutes; however, it is now well settled that they are not in violation of the equal protection clause of the United States Constitution. E.g., Carozza v. Federal Finance & Credit Co., 149 Md. 223, 131 A. 332 (1925); Penrose v. Canton Nat. Bank, 147 Md. 200, 127 A. 852 (1925); Brierley v. Commercial Credit Co., 43 F. 2d 724 (D.C. Pa. 1929) aff'd, 43 F. 2d 730 (3rd Cir. 1930). In Danville v. Pace, 66 Va. 1 (1874) the court gives two reasons for upholding the constitutionality of the statute: (1) Rather than impairing the obligation of the contract the statute lends it validity. (2) The defense of usury was not available at common law; therefore, since the usury statutes are strictly penal in nature, the legislature had the power to take the defense away at any time.

Another early problem was whether the statutes were retrospective in effect and apply to obligations entered into by the corporation prior to their enactment. A number of courts decided the question in favor of the lender. In Curtis v. Leavitt, 15 N.Y. 9, 229 (1857) the court stated that the statute repealing the usury law as it is applied to corporations "obliterates the statute repealed, as completely as if it had not been passed, and it must be considered as a law that never existed, except for the purpose of those actions which were commenced, prosecuted and concluded while it was an existing law;" Southern Life Ins. & T. Co. v. Packer, 17 N.Y. 51 (1858). The reasoning has been either that the cause of action first accrued to the borrower when the loan became due and that the statute in effect at that time should govern, Horey v. Wark-Gilbert Co., 248 Mich. 502, 227 N.W. 549 (1929), or that the intent of the statute is that it should be all-embracing as shown by the absence of savings clauses which were present in a prior English statute. In Curtis v. Leavitt, 15 N.Y. 9, 228, 229 (1857) the court stated that:

"The statute was intended to embrace, in the prohibition, the setting up as a defense usurious agreements, made as well before as after the passage of the act. The intent is evident from the omission to insert in the act a saving clause in favor of existing rights and remedies of persons having a right to set up the defense of usury, as was done in the act of 17 and 18 Victoria ch. 90, repealing the English statutes of usury."

However when the corporate exception itself has been repealed an opposite conclusion has resulted. Holland v. Gross, 89 So. 2d 255 (Fla. 1956); Sohmer Factors Corp. v. The 273 Corp., 172 N.Y.S. 2d 856 (1958). The reason for this distinction may be explained on the grounds that since the usury laws are in derogation of the common law, they should be construed strictly; whereas the corporate exception is restorative of the common law and as such should be given full effect.


\(^{31}\) E.g., Carozza v. Federal Finance & Credit Co., 149 Md. 223, 131 A. 332 (1925); Holland v. Gross, 89 So. 2d 255 (Fla. 1956); Helos v. State
Corporations also met defeat when they tried to circumvent the exception statutes by bringing affirmative actions against the lender. They filed bills in equity to cancel corporate obligations, or to recover usurious premiums already paid, and brought suits in trover for property or securities deposited as collateral. These actions failed because "such a construction would defeat all the beneficial aims of the act, and usury would only cease to be a shield, to become the more obnoxious as a sword." The overall application of the exception statute to the corporation is now undisputed.

2. EFFECT OF THE EXCEPTION ON THOSE IN SPECIAL RELATION TO THE CORPORATION—Although the exception statutes only mention "corporations," those in special relationships to a corporation will also come under their egis when because of their position the courts hold them to the statute so that the lender will not be forced to accept an interest rate lower than the one to which they had agreed. Therefore, it is said that the defense of usury is denied to all persons in privity with the borrowing corporation. This test of privity had led to the judicial recognition of several groups that along with the corporation are affected by the exception statutes.

A. Receivers and Trustees in Bankruptcy — Receivers and trustees in bankruptcy have been denied the privilege of employing the usury statutes on obligations incurred by the corporation when such corporations could not them-

Land Co., 113 N.J. Eq. 239, 166 A. 330 (1933); Rosa v. Butterfield, 33 N.Y. 665 (1865).
37 Id., 668.
38 As to the corporations themselves, many courts in denying the defense of usury to them have merely quoted the corporate exception statutes. E.g., Product Sales Co. v. Guaranty Co., 146 Md. 678, 690, 127 A. 409 (1925) ("such a defense (usury) would not be maintainable under the laws of this State, since the defendant is a corporation"); Shriver v. Druid Realty Co., 149 Md. 385, 131 A. 815 (1926); Kinsey v. Drury, 146 Md. 227, 126 A. 125 (1924).
39 Winkle v. Scott, 99 F. 2d 299 (8th Cir. 1938).
41 In Re Kashmire Refinishing Co., 94 F. 2d 652 (2d Cir. 1938); In Re Bernard and Katz, 38 F. 2d 40 (2d Cir. 1930).
selves have used this defense. This fits the privity test and seems to be sound reasoning since receivers and trustees have "no greater or different rights than those that might have been asserted by the companies" and act in a representative capacity. However, where the receiver, after appointment, enters into an obligation, it is said that he does so as agent of the court and not of the corporation; consequently the defense of usury is available to him.

B. Assuming Vendee — One who purchases property mortgaged by a corporation (at what would normally be a usurious charge) and assumes the mortgage is barred from access to the usury statute. While he does not clearly meet the privity test, the result is reasonable since it protects the mortgagor from being forced to accept an interest payment lower than the one agreed to between himself and the corporation. If the person assuming the mortgage would be permitted to plead the usury laws, it would then seem possible for a corporate mortgagor to sell the property to a "straw man" who would then plead the usury law. If the corporation were liquidated after the sale, this would defeat the exception statute's object of permitting uncontrolled charges of interest to corporate borrowers.

C. Minority Stockholders — These persons are similarly barred from questioning corporate obligations since they are in fact a part of the borrowing corporation.

D. Collaterally Liable Persons — The courts, by further liberal construction of the statutes, include within their bounds indorsers, guarantors and sureties of corporate obligations, although these results have not been accomplished without difficulty.

A number of the earlier cases permitted collaterally liable persons to plead the usury statutes notwithstanding the fact that the principal party was prohibited. The two basic reasons for this view are illustrated in Hungerford's

42 Merchants' & Manufacturers' Securities Co. v. Johnson, 69 F. 2d 940, 945 (8th Cir. 1934).
44 Rosa v. Butterfield, 33 N.Y. 665, 668 (1865) ("By the letter of the act corporations alone are forbidden to interpose the defense. But the assignees or representatives of a corporation should be regarded as within its spirit."")
44 In Re West Counties Const. Co., 152 F. 2d 729 (7th Cir. 1950).
Bank v. Dodge\textsuperscript{47} and Market Bank of Troy v. Smith.\textsuperscript{48} In the former case, the court based its decision on the theory that the contracts of the principal and guarantor are entirely distinct, in that one is absolute while the other is conditional and that they, therefore, should be governed by different rules. The latter case held that the statute was only meant to affect the corporation's obligation, withdrawing from the corporation the protection of the usury laws, but not intended to validate the contracts themselves.

As the courts broadened their interpretation of the exception statutes and recognized that collaterally liable persons do come under their purview,\textsuperscript{49} the initial thought that the statute acted directly upon the corporation and only "indirectly and incidentally upon the contract,"\textsuperscript{50} was reversed so that it is now held that the contract itself is affected, and that the usury laws are completely repealed as they apply to corporations and their obligations. The contract being lawful\textsuperscript{51} collaterally liable persons are held to the literal purport of their obligations, "for they are said to assume the full contract made by the corporation."\textsuperscript{52}

Undoubtedly, practical considerations were of primary importance in reaching this conclusion.\textsuperscript{53} The basic purpose for the passage of the exception statutes was the desire to aid in the development of resources by allowing high rates of interest to attract capital to new ventures. If a loan to a corporation involved a high amount of risk, then the lender would try to secure himself by requiring a surety or guarantor. So, if the collaterally liable person were permitted to plead the usury law in defense to a suit on the loan, the lender would be deterred from making the loan, "and the social end to which the corporate exclusion is directed [would be] defeated."\textsuperscript{54}

\textsuperscript{47} 30 Barb (N.Y.) 626 (1860).
\textsuperscript{48} F. Cas. No. 9000 (D.C. Wis. 1858).
\textsuperscript{49} In Penrose v. Canton Nat. Bank, 147 Md. 200, 207, 127 A. 852 (1925) the court said, "... even an accommodation indorser, as well as the corporate maker, has been held barred from making this [usury] a defense." See also Carozza v. Federal Finance Co., 149 Md. 222, 131 A. 332 (1925); Winkle v. Scott, 99 F. 2d 290 (8th Cir. 1938); Pardee v. Fetter, 345 Mich. 548, 77 N.W. 2d 124 (1956); Feller v. Architects Display Bldgs., Inc., 54 N.J. Super. 205, 148 A. 2d 634 (1959); Hungerford's Bank v. Dodge, supra, n. 47, 629.
\textsuperscript{50} Hungerford's Bank v. Dodge, supra, n. 47, 629.
\textsuperscript{51} Winkle v. Scott, 99 F. 2d 290 (8th Cir. 1938).
\textsuperscript{52} Note, Defense of Usury Denied Accommodation Indorser of Corporate Note, 42 Iowa L. Rev. 601, 602 (1957); Stewart v. Bramhall, 74 N.Y. 85 (1878).
\textsuperscript{53} Rosa v. Butterfield, 33 N.Y. 665, 674 (1865).
\textsuperscript{54} Note, Defense of Usury Denied Accommodation Indorser of Corporate Note, op. cit. supra, n. 51, 603.
However, in giving full effect to the exception statutes, the underlying reasons for the usury laws and those for the corporate exception statutes may come into conflict. At the present time there is no exception statute which specifically addresses itself to the small corporations. Therefore, where the owners of small corporations have personally guaranteed their corporations' obligations, these persons have not been successful in avoiding the application of the exception statutes by alleging that their obligations were primary rather than collateral, i.e., that the loans, though in form made to the corporations, were in truth made to them. In the recent case of *Dahmes v. Industrial Credit Company*, where the "GUARANTY" agreement, signed by the owner of a small corporation, read, ""The undersigned agree: * * * that their liability hereunder is direct and unconditional and may be enforced without requiring LENDER first to resort to any other right, remedy or security; * * *", the Minnesota Court said:

"The rationale of the rule precluding guarantors from asserting the defense of usury, when it is not available to the principal debtor, relates to the character of the obligation rather than the means of enforcing it, and applies with equal force to both types of guarantees. The true and correct issue and question involved is whether the plaintiffs' promise is an original undertaking or a collateral one. Although the defendant [lender] here could proceed directly against the plaintiffs [surety], the plaintiffs' liability was, nevertheless, dependent upon the failure of the corporation to perform and hence was a collateral undertaking in which the defense of usury, not being available to the principal obligor, was similarly not available to the plaintiffs."

The dissenting opinion, however, questioned the propriety of the effect of such a decision on owners of small corporations:

"As the majority now construe [the corporate exception statute] in conjunction with [the general usury statute], the aftermath can only be the end of statutory protection against usury for individual owners of small corporate business enterprises in Minnesota. There-

---

55 110 N.W. 2d 484 (Minn. 1961).
56 Id., 487.
57 Id., 489.
under it is a certainty that in most cases only to such corporate enterprises will business loans be made. That such loans will bear interest in excess of 8 percent per annum is likewise quite certain. The process by which such higher rates can be safely attained will no longer be complex or hazardous under the decision here. When an individual business owner is compelled by economic conditions or otherwise to seek financing, it will be then revealed to him by prospective lenders that only corporate loans at excessive rates of interest are considered; that such loans must be secured by all corporate assets and, in addition, by pledge of such individual's assets otherwise exempt and protected against usury; and that direct and primary liability therefor must be assumed by the individual owner.

"Quite often, as in the instant case, the inevitable result is the financial doom of both the corporation and the individual, preceded, of course, by a vain and valiant effort to pay off an extortionate debt, seldom resulting in more than payment of the excessive interest thereon. A default therein, of course, is usually followed by prompt foreclosure of all corporate and individual assets and often, as here, by claims for deficiency judgments against the individual owner for any unpaid balance on the corporate debt after the various foreclosure sales."58

E. Promoters of the Corporation — Where a corporation is founded with a view towards solving the usury problem, the conflict between the usury laws and the exception statute is particularly acute. A common situation is where an individual borrower does not receive a loan because the interest rate permitted under the usury law is too low. The lender suggests that if the borrower incorporates, a loan can be arranged at an agreed rate of interest. A corporation is then formed and the borrower transfers property to secure the loan, which is then concluded at a rate of interest in excess of the amount which would have been originally permitted by the usury laws. To this loan the individual acts as a guarantor. The question is who is really the borrower — the corporation or the individual?

The courts were at first reluctant to permit this circumvention of the usury laws. Typical of these older

58 Id., 493.
cases is *First National Bank v. American Near East and Black Seas Lines* where the New York Supreme Court held:

"The answer alleges that it was agreed between Samuel Clark Williams [lender] and the defendants that the corporation appear as maker and the individual defendants as indorsers; that in fact no money was loaned to the corporation, but the loan was to the individual defendants; and that it was all pursuant to a plan to evade the usury statute, because the maker, being a corporation, would be unable, by reason of the statute, to avail itself of the defense of usury. * * * The law is that, if there is notice of an intent to take usury, the lender cannot evade the statute by disguising the borrower."79

This judicial trend, however, was reversed by *Jenkins v. Moyse*,60 decided by the New York Court of Appeals in 1930. The Court sanctioned a similar arrangement and held that the usury laws were not *evaded* but had been "followed meticulously in order to accomplish a result which all parties desire and which the law does not forbid. . . ."61 The Court continued:

"Corporations are, ordinarily, created because through the corporate form some advantage is obtained which would be denied to an individual or a group of individuals. That has been done here, and no ground has been shown for disregarding the corporate entity, though that entity has been formed for the purpose of doing something permitted to a corporation but forbidden to an individual."62

A vital, but unconvincing, distinction has been drawn by the later cases considering this situation. If, as in the *Jenkins* case and *Rabinowich v. Eliasberg*,63 a Maryland case relying on the *Jenkins* case, the lender *absolutely refuses* to make the loan to the individual, the loan will be considered the corporation's; but if the lender *agrees* to make the loan to the individual if he incorporates, then the loan will be considered the individual's obligation.64

---

60 119 Misc. 650, 197 N.Y.S. 856 (1922).
62 Id., 522.
63 Supra, n. 59, 522.
64 159 Md. 655, 152 A. 437 (1930).
65 In *Re Greenberg*, 21 N.J. 213, 121 A. 2d 520, 524 (1956) where the creditor explained that he intended to make a loan to "these people" and
The tenuous nature of this distinction can be seen in Gelber v. Kugel's Tavern, where the borrower testified that "They [the lenders] were willing to give me the loan if I would go and incorporate" and the lender testified that he told the borrower, "We do not make loans to individuals," and in answer to the borrower's question, "As a corporation, would you consider the loan?" he simply answered, "Yes," the Court said:

"Plainly, these conflicting proofs presented a jury question whether the loans were made to Kugel individually and whether the corporation was created at the insistence of the plaintiffs to serve as a cloak to cover usurious transactions to evade the usury statute." [Emphasis added.]

A knowledgeable lender can, therefore, take advantage of this hairline distinction by first absolutely refusing to make the loan to the individual but then suggesting that a corporation be formed and the loan be made to it. The effect is that the lender can always approach the transaction so as to bring the loan within the rule of the Jenkins and Rabinowich cases, thereby avoiding the consequences of an otherwise usurious contract.

Proof of the popularity of this scheme is evidenced by an amendment to the New York corporate exception statute enacted in 1955 to alleviate a situation whereby certain money lenders, using the above formula, had been making short term loans to homeowners requiring interest

he suggested that "they have a corporation and they were agreeable to the same," the court said, "[T]he transaction ... was in reality a loan to individuals and that the corporate device was invoked at the lender's insistence to circumvent or evade the State's policy against usurious transactions." See also, Sherling v. Gallatin Improvement Co., 145 Misc. 734, 260 N.Y.S. 229 (1932).


Id., 657.

Supra, n. 64, 657.

Comment, Usury Inc. — Incorporation to Avoid Usury Laws, 7 Miami Law Quarterly 375 (1953).


"The provisions of subdivision one of this section [the corporate exception statute] shall not apply to a corporation, the principal asset of which shall be the ownership of a one or two family dwelling, where it appears either that the said corporation was organized and created, or that the controlling interest therein was acquired, within a period of six months prior to the execution, by said corporation of a bond or note evidencing indebtedness, and a mortgage creating a lien for said indebtedness on the said one or two family dwelling. ..."
reportedly as high as 65 percent.\textsuperscript{70} The lenders had, by using this device, successfully evaded the entire spirit of the usury laws.\textsuperscript{71} The amendment allows the defense of usury to a corporation whose principal asset is the ownership of a one or two family dwelling where it appears that the corporation was organized within a period of six months prior to the corporation's execution of a mortgage on the one or two family dwelling.\textsuperscript{72}

3. Co-obligors — An individual joint primary obligor may defend on the grounds of usury even though the defense is denied to a co-obligor because of its corporate character.\textsuperscript{73} This is based upon the proposition that a joint primary obligor enters into an independent contract in which he has a beneficial interest. His right to a usury defense is not derived from the other obligors, as is true of collaterally liable persons, but is his in his own right.\textsuperscript{74} It has been said, however, that if he has no beneficial interest, i.e., he is an accommodation maker who signs along


\textsuperscript{71} Declaration of policy to 19 McKinney's N.Y. Laws (1957) § 374.

"The people of this state have a vital interest in encouraging its citizens to establish and maintain one and two-family homeowner communities, and in preventing the imposition of oppressive and unethical economic burdens upon the members of such communities. It is hereby declared that unfair, unjust, destructive, demoralizing and uneconomic practices have been and are now being carried on by money lenders using the corporate device to accomplish the exaction of oppressive and usurious rates of interest or other compensation for loans secured by mortgages upon such homes.

"To protect the well-being of our citizens, to protect the public welfare, to prevent the loss of such houses by the members of such communities through the foreclosure of mortgages securing such oppressive, unreasonable and usurious loans, to prevent the owners of such homes from becoming a burden upon the community and in furtherance of the public policy of this state that such homeowners be encouraged to establish and maintain one and two-family homeowner communities, the following provisions (section 374 as amended) are enacted in the exercise of the police power of the state."

In discussing this amendment, the court in Sohmer Factors Corp. v. 187-20 Tioga Drive Corp., 9 Misc. 2d 862, 169 N.Y.S. 2d 557, 560 (1957) said,

"Prior to the recent amendments money lenders must have realized that these usurious transactions violated, if not the letter, at least the spirit of legislation declaring an important social policy of the state. If they had discovered a loophole by which they could nullify that policy, they should have anticipated that corrective legislation would eventually be enacted to prevent such frustration."

A similar provision is to be found in Baldwin's Ky. Rev. Stat. (1962) § 360.025.

\textsuperscript{73} Astra Pictures, Inc. v. Shapiro, 182 Misc. 19, 48 N.Y.S. 2d 858 (1944); Schwartz v. Fifty Greenwich Street Realty Corp., 265 N.Y. 443, 193 N.E. 263 (1934).

with a corporate obligor, the defense will be denied to him, "because it would have to come through a corporate maker, by whom it is not possessed." This conclusion appears inconsistent with the Negotiable Instruments Law under which it was decided, and the Uniform Commercial Code which generally fix the rights and obligations of parties to notes viz a viz payees and holders, according to the manner in which they signed the instrument and not upon private agreements among themselves. However, while there may be inconsistency in the reasoning, the result is in harmony with the court's apparent goal of giving full effect to the corporate exception.

III. Conclusion

We have seen that the courts, desiring to give full effect to the corporate exclusion statutes, so that commerce may prosper, continuously interpreted them liberally. Insofar as their interpretation affects large corporations, it accomplishes all of the advantages attributed to the exclusion statutes and has minimal undermining effect on the general usury laws.

This is not the effect of the court's liberal interpretation, however, when a small corporation is involved. There, transactions may not be divorced from the individuals behind them as they are in large corporations. There, the corporation often is merely the alter ego of a single individual or a fiction drawn up to subvert the usury law. In the former case, the corporation may be driven by necessity, and coerced into unfair contracts as easily as individuals. In the latter case the entire force of the usury law is lost. Lenders almost invariably require that the owners act as sureties or guarantors to their obligations. On the other hand, it is often they, rather than the large corporations, which are in need of greater facility to the money market.

The courts, as has been shown, have deemed it necessary to prohibit the defense of usury to guarantors and sureties in order to give full effect to the corporate exclusion and encourage loans by lenders who otherwise would not risk their capital without the benefit of sureties and guarantors. If this is so, then is it not true that the lenders are ultimately relying on these individuals and not on the corporations and their assets to fulfill the obli-


Britten, Bills and Notes (2d ed. 1961) § 42; Uniform Negotiable Instruments Law, § 60; Uniform Commercial Code, § 3-413.
gations? Why then should these individuals, who are often the sole owners of the corporate obligors, be subject to a rate of interest not required of other individuals and which the usury laws have, in regard to other individuals, declared immoral?

Giving lenders a free hand in dealing with every corporation is not the answer. What appears to be a great injustice is the law's unwillingness or inability, under the corporate exception statutes, to look to the circumstances of each case to modify obviously unjust interest rates. The exception statutes do not pre-empt judicial discretion. For instance, a court's determination that one is primarily or secondarily liable will control the application of the statute. Conceivably, the courts could, by considering related legal principles, increase their role in determining the equity of applying the corporate exception to those in a special relationship to the corporation on an ad hoc, case by case basis. Though this is a possible approach to the solution of the problem, it has a number of obvious dangers and disadvantages. The law in these areas would be "stretched" in order to effect equitable solutions to individual cases and any changes would be sporadic, slow in development and unpredictable.

In an attempt to solve this problem by legislation, the State of Florida in 1955 enacted a statute which sets a separate maximum interest rate for individual and corporate obligors — ten percent for individuals and fifteen percent for corporations. The 1955 amendment to the New York statute exempts from the corporate exception statute, corporations formed by homeowners where the sole assets of these corporations is the ownership of a one or two-family dwelling and where such dwelling was mortgaged in order to obtain a loan. Though it attempts to solve one important problem, it does not examine the area as a whole and for this reason does not appear as satisfactory as the Florida legislation which does propose a comprehensive solution.

Changes which clearly should come about in this field must be brought by increased jurisdiction of the courts or by statutory enactment. In the interest of speed, clarity and predictability, the latter approach is suggested for new answers to this vexing problem.

77 19 FLA. STAT. ANNO. (1944) § 687.03.