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# Invitation to Unconscionability

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# CASES NOTED

## INVITATION TO UNCONSCIONABILITY

The Gunn Plumbing, Inc., executed and delivered a promissory note to the plaintiff-bank which was personally guaranteed by the president of the defendant-company, a closely held corporation. A discounted amount was credited to the company's account, and the plaintiff was paid an additional sum for making the loan. At maturity the note was renewed, and when the renewal note was not paid, the plaintiff filed suit against the maker and the guarantor. When the defendants asserted the defense of usury, the parties settled through a stipulation in which a compromise amount was agreed upon, and the defendants in that stipulation withdrew their defenses for all present and future proceedings arising out of the transaction. Additionally, the stipulation provided that the plaintiff would renew the note, which was to be personally guaranteed by the company president and his wife. The individuals were also to guarantee a note for attorney's fees, both notes to be in consideration for the renewal. Upon default of the renewal note, suit was again filed, and the defendants again asserted the affirmative defense of usury. The plaintiff was granted summary judgment by the trial court, and the District Court of Appeal, Fourth District, affirmed.[1] Certiorari was granted by the Supreme Court of Florida on the basis of a conflict with a prior holding of the District Court of Appeal, Third District.[2] The supreme court in discharging the writ *held*: Regardless of whether the note was usurious or not, the stipulation entered into between the parties was binding and the defendants had effectively waived the right to raise the affirmative defense of usury.[3] *Gunn Plumbing, Inc. v. Dania Bank*, 252 So.2d 1 (Fla. 1971).

Usury has been defined as "the taking, or agreement for, a greater rate for the use or forbearance of money loaned, than is allowed by law."[4] At common law usury was not forbidden, and parties were free to contract to loan or borrow money at whatever rate they chose.[5] Therefore, the issue of usury became one of legislative concern, and today it is subject entirely to statutory regulation.[6] Florida makes it unlawful to charge interest in excess of 10 percent to any borrower other than a corporation and unlawful to charge in excess of 15 percent to a corporation.[7] The penalties for usury range from forfeiture of interest[8] to forfeiture of principal and interest.[9]

1. Gunn Plumbing, Inc. v. Dania Bank, 239 So.2d 88 (Fla. 4th Dist. 1970) [per curiam].
2. Coral Gables First Nat'l Bank v. Constructors of Florida Inc., 119 So.2d 741 (Fla. 3d Dist. 1960).
3. Mr. Justice Dekle filed a lone dissent.
4. County Comm'rs v. King, 13 Fla. 451, 466 (1869).
5. Matlack Properties, Inc. v. Citizens & Southern Nat'l Bank, 120 Fla. 77, 162 So. 148 (1935).
6. Florida first adopted a usury statute in 1891. *See* FLA. STAT. §§ 687.01-.11 (1971).
7. FLA. STAT. § 687.02 (1971).
8. FLA. STAT. § 687.04 (1971).
9. FLA. STAT. § 687.07 (1971).

However, in situations such as *Gunn*, where the issue is one of civil usury, the penalty is usually the forfeiture of interest unless the "interest is taken or reserved, or has been paid," in which case the creditor forfeits double the amount of interest so taken.[10]

Florida courts have stated that the purpose of the usury statute is "to bind the power of creditors over necessitous debtors and prevent them from extorting harsh terms in the making of loans,"[11] and, "to protect the needy borrower by penalizing the unconscionable money lender."[12] The law treats usurious lenders as oppressors,[13] and through the statute, attempts to place the borrower on an equal footing with his lender so as to overcome the lender's superior bargaining power and thus avoid unconscionability.

Since lenders have long attempted to avoid usurious contracts by devices such as renewal notes and releases, case law in Florida has developed with the policy behind the statute foremost in mind. In addressing itself to renewal contracts, the District Court of Appeal, Third District, in *Coral Gables First National Bank v. Constructors of Florida Inc.*,[14] enunciated the controlling principle that

> [t]he general rule followed in this state is that the usurious character of a contract must be determined as of its inception, and if usurious at that time, no subsequent transactions will purge it. When such contracts are *renewed* by a *new* or *substituted contract, usury follows* and becomes a part of the latter contract, making it vulnerable to the defense of usury in like manner as the original contract. This is not true, however, *when the old contract is abandoned and a new one is entered into free from the vice of the old.*[15]

The Supreme Court of Florida has also developed rules regarding renewal notes. The two ways of purging the contract of usury, as stated by the court, are:

> first by a renewal of the note or contract, after it has passed into the hands of a bona fide purchaser for value, without notice of the usury; secondly, by a reformation of the contract, by which the usurious interest is expunged by remitting the excess, and only lawful interest is retained or exacted.[16]

It is readily apparent that the only two ways the Gunn company's note could have been purged of any usury was either by remitting the excess interest charged[17] or by substituting a new agreement which would

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10. FLA. STAT. § 687.04 (1971).
11. River Hills, Inc. v. Edwards, 190 So.2d 415, 423 (Fla. 2d Dist. 1964).
12. First Mortgage Corp. v. Stellmon, 170 S.2d 302, 304 (Fla. 3d Dist. 1964).
13. Chakford v. Sturm, 65 So.2d 864 (Fla. 1953).
14. 119 So.2d 741 (Fla. 3d Dist. 1960).
15. *Id.* at 746-47 (emphasis in original).
16. Clark v. Grey, 101 Fla. 1058, 1065, 132 So. 832, 834 (1931).
17. *Id.*

contain only a lawful rate of interest.[18] The majority position regarding the purging of usury in renewal or substitute contracts is in accord with the Florida position[19] as expressed in *Clark v. Grey*.[20] Thus, if the amount owing on a usurious contract is compromised, the new amount must be such that the interest is brought below the statutory limit.[21]

The renewal contract technique is but one of the many methods used by lenders to circumvent the usury laws. In order to determine if a loan is usurious, Florida courts look to the substance of the transaction, rather than to the form.[22] This method is consistent with what the courts believe to be the legislative intent of the usury statutes—preventing the exaction of usury by the use of any scheme, device, or indirect process.[23]

In *Beacham v. Carr*,[24] the Supreme Court of Florida laid down rules governing schemes to evade the usury statutes:

> It cannot be held that a design formulated in the mind of the lender to evade the evident purpose of the usury laws and still exact his unlawful interest would be permitted, especially in a court of equity.
>
> "The cupidity of lenders, and the willingness of borrowers to concede whatever may be demanded or to promise whatever may be extracted in order to obtain temporary relief from financial embarrassment, as would naturally be expected, have resulted in a great variety of devices to evade the usury laws; and to frustrate such evasions the courts have been compelled to look beyond the form of a transaction to its substance, and they have laid it down as an inflexible rule that the mere form is immaterial, but that it is the substance which must be considered."[25]

However, it is important to note that procedurally usury is raised as an affirmative defense, and as such, is a purely personal defense which may be asserted or waived at the option of the aggrieved party.[26] In

18. Carter v. Leon Loan & Fin. Co., 108 Fla. 567, 146 So. 664 (1933). In referring to the substituted agreement with legal interest, the court stated that "it is an act of justice forbidden by no principle of public policy, and will be enforced." *Id.* at 569, 146 So. at 665.

19. *See* Annot., 74 A.L.R. 1184 (1931), *superseding* 13 A.L.R. 1213 (1921).

20. 101 Fla. 1058, 132 So. 832 (1931).

21. Calimpco, Inc. v. Warden, 100 Cal. App. 2d 429, 224 P.2d 421 (1950).

22. *See, e.g.*, May v. U.S. Leasing Corp., 239 So.2d 73 (Fla. 4th Dist. 1970); Indian Lake Estates, Inc. v. Special Investments, Inc., 154 So.2d 883 (Fla. 2d Dist. 1963); Kay v. Amendola, 129 So.2d 170 (Fla. 2d Dist. 1961).

23. *See, e.g.*, Gilbert v. Doris R. Corp., 111 So.2d 682 (Fla. 3d Dist. 1959).

24. 122 Fla. 736, 166 So. 456 (1936).

25. *Id.* at 742-43, 166 So. at 459, *quoting* 27 R.C.L. 211 § 12 (1929).

26. Mackey v. Thompson, 153 Fla. 210, 14 So.2d 571 (1943).

Under certain conditions usury may be a real defense. Deciding whether the defense is real or personal depends upon local law.

> If under . . . law the effect of . . . the illegality is to make the obligation entirely null and void, the defense may be asserted against a holder in due course. Otherwise it is cut off.

UNIFORM COMMERCIAL CODE § 3-305, Comment 6. *See also* W. BRITTON, BILLS AND NOTES § 127 (2d ed. 1961).

*Yaffee v. International Company*,[27] the court stated that the effect of the usury statute is not to invalidate contracts with usurious interest, but merely to give the maker "the personal privilege of setting up, or waiving . . . defenses . . . in respect to such contracts."[28] In order to prevail, the party asserting the defense must sustain the burden of proof.

After reviewing pertinent usury law, the supreme court in *Gunn* completely avoided the question of usury and based its decision on the stipulation to waive the defense, holding the waiver to be valid. In so doing, the high court quoted its 1939 decision in *Dunscombe v. Smith*,[29] which emphasized the long-standing position of Florida courts with respect to the integrity and enforceability of stipulations.[30]

> "This Court is committed to the rule that it not only approves but favors stipulations and agreements on the part of litigants and counsel designed to simplify, shorten or settle litigation and save costs to the parties, and the time of the Court, and when such stipulations or agreements are entered into between parties litigant or their counsel, the same should be enforced by the court, unless good cause is shown to the contrary. In order to obtain relief against stipulations, the regular course is not to ignore or attempt to evade it, but to make a seasonable and affirmative application by formal motion to the court, on notice and supported by affidavit for its withdrawal or revocation."[31]

Thus, having completely avoided the question of usury, the court found no conflict with *Coral Gables First National Bank v. Constructors of Florida Inc.*,[32] and discharged certiorari.

There are many factors which demonstrate the inherent weaknesses in the court's reasoning. First, based on its earlier decisions in *Mackey v. Thompson*[33] and *Yaffee v. International Company, Inc.*,[34] the court held that a waiver of the defense of usury was valid. However, it is questionable as to whether *Mackey* and *Yaffee* in fact yield such a result. In *Mackey*, the plaintiff had made a loan to the defendant in Indiana. When the note was not paid, suit was filed in Florida, since both parties had become Florida residents. The defendant pleaded the defense of usury and moved for a directed verdict, which was denied by the court. Upon motion of the plaintiff, the trial court instructed the jury that the contract was governed

27. 80 So.2d 910 (Fla. 1955).
28. *Id.* at 912.
29. 139 Fla. 497, 504, 190 So. 796, 799 (1939).
30. *See also* Smith v. Smith, 90 Fla. 824, 107 So. 257 (1925); Esch v. Forster, 123 Fla. 905, 168 So. 229 (1936).
31. Gunn Plumbing, Inc. v. Dania Bank, 252 So.2d 1, 4 (Fla. 1972), *quoting* Dunscombe v. Smith, 139 Fla. 497, 504, 190 So. 796, 799 (1939).
32. 119 So.2d 741 (Fla. 3d Dist. 1960).
33. 153 Fla. 210, 14 So.2d 571 (1943) [hereinafter cited as *Mackey*].
34. 80 So.2d 910 (Fla. 1955) [hereinafter cited as *Yaffee*].

by Indiana law. The defendant failed to offer any proof as to the usury law in Indiana, and plaintiff's judgment was affirmed on appeal.[35]

In *Yaffee*, a loan was made to the defendant prior to the enactment of Florida Statutes section 687.02 (1971) which extended the protection of the usury statutes to corporations. The court reasoned that because usury was unknown at common law, the anti-usury statute would not be applied retroactively to a loan predating its enactment.[36] Viewed in this light, it is readily apparent that these cases merely indicate that since usury is strictly regulated by statute, the party availing himself of the defense must prove that the transaction violated the governing usury statute at the time the transaction took place. The *Gunn* court, by granting a summary judgment based on the waiver of the defense of usury, clearly did not provide the defendants the opportunity to prove a usurious contract.

The second weakness of the court's reasoning in *Gunn* concerned the stipulation issue. Although stipulations are favorably regarded and will be enforced except upon motion to the court to rescind or reform based on good cause, the court's analysis failed to focus on the use of stipulations as a device to avoid usury laws. In *Smith v. Smith*,[37] the court stated:

> [g]enerally all stipulations of parties or their attorneys for the government of their conduct or the control of their rights . . . are enforced by the courts, if such stipulations are not unreasonable, nor against good morals or sound public policy.[38]

It is clear that the policy behind the usury laws is to protect the borrower; thus, the general law regarding contracts freely bargained and entered into should be disregarded. The *Gunn* court did not recognize, as the *Beacham v. Carr*[39] court had years before, that borrowers in financial distress are willing to pay whatever interest rate the lender demands in order to obtain temporary financial relief.[40] The court should have attacked the validity of the stipulation on the grounds that it was against public policy or that it was an illegal scheme to evade the usury laws.

By basing its decision on waiver and denying a conflict with *Coral Gables First National Bank v. Constructors of Florida, Inc.*,[41] the court has further complicated the development of anti-usury case law and opened an enormous loophole. Indeed, the facts in *Constructors* and *Gunn* are remarkably similar. In *Constructors*, a case which involved the foreclosure of usurious mortgages, the defendants answered and defended on the grounds that the note in controversy was a renewal of an earlier usurious

35. Mackey v. Thompson, 153 Fla. 210, 14 So.2d 571 (1943).
36. Yaffey v. Int'l Co., 80 So.2d 910 (Fla. 1955).
37. 90 Fla. 824, 107 So. 257 (1925).
38. *Id.* at 830-31, 107 So. at 260, *quoting* 20 ENCYCLOPAEDIA OF PLEADING AND PRACTICE 607 (1901).
39. 122 Fla. 736, 166 So. 456 (1936).
40. *See* note 25 *supra* and accompanying text.
41. 119 So.2d 741 (Fla. 3d Dist. 1960) [hereinafter cited as *Constructors*].

note.[42] The defendants also pointed to an executed usury release and argued that the release plus the purifying renewal note erased any usury claim.[43] Completely bypassing the release question specifically, the District Court of Appeal, Third District, rejected the defendants' arguments and held that

> the usurious character of a contract must be determined as of . . . its inception, and if usurious, at that time, no subsequent transactions will purge it. When such contracts are *renewed* by a *new* or *substituted contract, usury follows* and becomes a part of the latter contract, making it vulnerable to the defense . . . in like manner as the original contract.[44]

The facts in *Gunn* were strikingly similar, but with one notable exception. The *Gunn* court found and dwelled upon the stipulation of waiver of the defense of usury whereas the *Constructors* court had not. Thus, in *Gunn*, where the waiver/release was drawn as a stipulation, the defendant was able to escape the anti-usury statutes. *Gunn* may well have mapped the destruction of the Florida usury laws in one stroke.

In a strong dissent, Mr. Justice Dekle criticized the majority holding on three fronts: first, there were only limited statutory exceptions to the anti-usury law, and the *Gunn* fact pattern did not fit any of them; second, the decision was clearly contrary to both the legislative purpose of the statute and prior decisional law; and third, assuming for the sake of argument that the decision was correct, the stipulation could not have operated against Mrs. Gunn since she had not been a party to the first transaction.[45] The justice continued:

> The criterion here enunciated is but an invitation to the unfair lender simply to obtain the type of "waiver" so adroitly and unilaterally devised in this case, and to have the borrower immediately after the loan to sign and leave with the lender such a protective device.[46]

The *Gunn* court was faced with an opportunity to reinforce the strong anti-usury laws in Florida. In the face of this challenge, the court contented itself to decide the case on a procedural nicety, and in the process, ripped the very essence out of the enforceability of anti-usury laws. Furthermore, by estopping a non-signatory to the first note who did sign the second from raising the defense of usury, lenders have been provided with at least one method of securing court-enforced usury rates without the necessity of even a second note ceremony. In this era of increased

42. *Id.* at 743.
43. *Id.* at 745.
44. *Id.* at 746-47 (emphasis in original).
45. Gunn Plumbing, Inc. v. Dania Bank, 252 So.2d 1, 5 (Fla. 1971) (dissenting opinion).
46. *Id.* at 6.

sensitivity to consumer protection, the Supreme Court of Florida has taken a giant step backwards and has issued "an invitation to the unfair lender . . ."[47] to take unconscionable advantage of the unwary borrower.

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## COMITY: AN EFFECTIVE BAR TO COLLATERAL ATTACK OF A FOREIGN COURT'S JURISDICTION AFTER JUDGMENT

Defendant, Philadelphia Chewing Gum Corp., an American concern, planned to introduce "Tarzan chewing gum" into England in conjunction with the English plaintiff, Somportex, Ltd. The plans never reached fruition. Alleging the existence and breach of a contract, the English firm sought damages in the English courts. Extraterritorial service was had on the American defendant under an English long-arm statute.[1] The American firm responded by making a conditional appearance, permitted under English procedure,[2] to contest jurisdiction. The American defendant then attempted to withdraw its appearance, but the court refused. Its jurisdictional objections were overruled,[3] which had the effect, under English law, of converting the conditional appearance into an unconditional one.[4] On the basis of a second motion, the American company was given permission to withdraw from the proceedings.[5] The English Court of Appeal, however, reversed the lower court ruling which had allowed the American firm to withdraw; this placed Philadelphia Chewing Gum in the position of having entered an unconditional appearance.[6] The defendant made no further appearance in the English proceedings, even though the jurisdictional finding was apparently still open to appeal.[7] A default judgment was, thereafter, entered.[8] Enforcement of the English judgment was then sought in the federal district court in Philadelphia, where the English plaintiff was granted a summary judgment.[9] On appeal,

47. *Id.*

1. The English company obtained leave of court, under R. S. C. 1965, Ord. 12, r. 7, to serve notice of its suit extraterritorially.

2. R. S. C. 1965, Ord. 12, r. 7. A conditional appearance has an effect similar to that of a special appearance under FED. R. CIV. P. 12(b)(2).

3. Somportex, Ltd. v. Philadelphia Chewing Gum Corp., [1968] 3 All E.R. 26.

4. R. S. C. 1965, Ord. 12, r. 7.

5. Somportex, Ltd. v. Philadelphia Chewing Gum Corp., [1968] 3 All E.R. 26.

6. *Id.* at 29.

7. *Id.*

8. Somportex Ltd. v. Philadelphia Chewing Gum Corp., 318 F. Supp. 161 (E.D. Pa. 1970).

9. *Id.*