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Usury, Inc. -- Incorporation to Avoid Usury Laws

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COMMENTS

USURY, INC. — INCORPORATION TO AVOID USURY LAWS

Where the real truth is a loan of money, the wit of man cannot find a shift to take it out of the statute. — Lord Mansfield, *Floyer v. Edwards*, 1 Cowp. 112 (1774).

The Statute

"No corporation shall interpose the defense of usury in any action in any court in this state." Fla. Stat. § 612.62 (1951). The statute is not violative of the 14th amendment of the United States Constitution or the equal protection clause[1] of the Florida Constitution.[2] Similar enactments expressly denying the defense of usury to corporations exist in many states and have successfully withstood attacks upon their constitutionality.[3]

Interpretation

Since the statute refers merely to a *defense*, and is silent as to any positive action, there have been attempts to avoid its effect by bringing a bill in equity to cancel the agreement,[4] or by instituting suit to recover back premiums.[5] These have proven unsuccessful, since the statute has been interpreted to mean any position or attitude by which the corporation seeks to avoid its contract by showing it is usurious.[6] The courts recognize that a strict construction would defeat the beneficial aims of the Act[7] and the corporation should not be permitted to accomplish by indirection what it cannot do directly.[8] A clearly defined provision similar to that contained within the modern Business Corporation Act of Oklahoma[9] would eliminate this unnecessary litigation. The provision in the aforementioned Act is embodied in the Proposed Florida Business Corporation Act[10] which was introduced into the 1951 Legislature and is now in an interim committee.

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1. Fla. Const., Decl. of Rights § 1 (1951).
2. 759 Riverside Ave., Inc. v. Marvin, 109 Fla. 473, 147 So. 848 (1933).
3. Brierley v. Commercial Credit Co., 43 F.2d 724 (D. C. Pa. 1929), *aff'd*, 43 F.2d 730 (3rd Cir. 1930); State v. Hurlburt, 82 Conn. 232, 72 Atl. 1079 (1909); Freese v. Brownell, 35 N.J.L. 285, 10 Am. Rep. 239 (1871); Carozza v. Federal Finance & Credit Co., 149 Md. 223, 131 Atl. 332 (1925); Wm. S. & John H. Thomas v. Union Trust Co., 251 Mich. 279, 231 N.W. 619 (1930); Smoot v. People's Perpetual Loan And Building Ass'n, 95 Va. 686, 29 S.E. 746 (1898). *But see* Gordon v. Winchester Bldg. Ass'n, 12 Bush, 110, 23 Am. Rep. 713, 715 (Ky. 1876).
4. Isle of Wight Co. v. Smith, 51 Hun, 562, 4 N.Y. Supp. 73 (1889).
5. Rosa v. Butterfield, 33 N.Y. 665 (1865).
6. Matlack Properties v. Citizens & Southern Nat. Bank, 120 Fla. 85, 162 So. 148 (1935).
7. *Supra*, note 5.
8. *Supra*, note 4.
9. Okla. Stat. tit. 18, § 1.26 (Supp. 1949).
10. Prepared by the Fla. Corporation Code Revision Committee, Floyd A. Wright, Chairman and Draftsman.

PURPOSE

In order to appreciate fully the hypothetical problem to be presented, it is necessary to discuss briefly the purpose of a usury law in comparison with the purpose of the statute which denies the defense of usury to corporations. "The prime purpose of the usury law is to protect needy borrowers by penalizing unconscionable money lenders."[11] It is ". . . to bind the power of creditors over necessitous debtors and prevent them from extorting harsh and undue terms in the making of loans."[12] The usury laws, then, proceed upon the theory that the loan can be attributed to such an inequality in the relation of the lender and borrower that the borrower's necessities "deprived him of freedom in contracting and placed him at the mercy of the lender."[13] On the other hand, the statute depriving a corporation of the defense of usury proceeds upon the theory that corporations do not borrow by necessity, but voluntarily, to enable them to carry forward some enterprise which affords a reasonable expectation of profits sufficient to repay the interest without loss or sacrifice.[14]

Of prime consideration is the fact that the usury laws increase the value of money and credit, and are restraints on the natural flow and supply of capital to the prejudice of industry and commerce.[15]

SCOPE

The statute with which we are here concerned is based upon plain and practical considerations of public policy and this writer has no quarrel over its enactment — it is the application of the statute that has provoked this comment. The following hypothetical question presents a popular method employed by money lenders to avoid the usury laws:

Mr. Borrower applies for a loan. Mr. Lender informs him that the interest rate allowed in an individual loan is not satisfactory but, if Mr. Borrower will incorporate, a loan can be arranged at an agreed rate of interest. Mr. Borrower, subsequent to incorporation, conveys property to the corporation in order to secure the loan. The note and mortgage are executed by the corporation with Mr. Borrower as endorser, and the loan is made at a rate of interest in excess of the amount legally allowed by the usury laws. In a mortgage foreclosure proceeding the borrower defends on the ground of usury. Upon a motion to strike the defense, who prevails?

APPLICATION

Unfortunately an answer to the preceeding hypothetical situation is not readily ascertained inasmuch as the law in this regard is unsettled. There have been few cases in which the precise point has been litigated. None have been reported in Florida. The leading case is *Jenkins v. Moyse*,[16]

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11. Stubblefield v. Dunlap, 148 Fla. 401, 4 So.2d 519, 521 (1941).
12. Chandler v. Kendrick, 108 Fla. 450, 146 So. 551, 552 (1933).
13. Carozza v. Federal Finance & Credit Co., 149 Md. 223, 131 Atl. 332, 342 (1925).
14. Southern Life Ins. And Trust Co. v. Packer, 17 N.Y. 51 (1858).
15. Carozza v. Federal Finance & Credit Co., 149 Md. 223, 131 Atl. 332 (1925).
16. 254 N.Y. 319, 172 N.E. 521 (1930).

a New York Court of Appeals decision. In refusing to grant relief to the borrower, the court "hung its hat" on the fact that the loan was *refused* the individual — that the lender never *agreed* to make the loan to *him*. The court said that there must be evidence that a loan to the individual was agreed upon and that the corporation was used to conceal an individual transaction. The opinion in *Jenkins v. Moyse* did not close the door on a usury defense in our hypothetical situation, but one must concede it left it only slightly ajar. In effect, it depends on the way the lender approaches the deal.[17] If, then, the lender *agrees* to make the loan to the individual, and the corporation is used to conceal the usurious agreement, the motion to strike the defense will be denied.[18] The lender, if he knows how, can bring himself safely within the *Jenkins v. Moyse* rule. In *First National Bank of Brooklyn v. American Near East and Black Sea Line*,[19] the court stated, "The law is that, if there is notice of an intent to take usury, the lender cannot evade the statute by disguising the borrower."[20] This decision was followed in *Arona Holding Corp. v. West 25th St. Realty Corp.*[21] These cases, decided in the lower courts of New York prior to *Jenkins v. Moyse*, have not been expressly overruled. A recent decision of that state granted the lender a summary judgment in a case where the loan was also *refused* the individual, the court stating, "The law has not been evaded but has been followed meticulously in order to accomplish a result which all parties desired and which the law does not forbid."[22]

In a Maryland case,[23] the court relied upon the decision in *Jenkins v. Moyse* and estopped the borrower from denying the validity of the corporation. In that case too, the loan was refused the individual. Relief was denied although the court recognized "that the primary and decisive consideration was the avoidance of a conflict with the usury laws of the state."[24]

The problem has also been presented to the courts of New Jersey in a foreclosure proceeding. The defense was raised that the loan was made in fact to an individual, while in form to the corporation, and that the corporation was not to engage in business or exercise any function whatsoever. The court said that, having succeeded by false and fraudulent representation in obtaining a certificate of incorporation, the corporation cannot now benefit by this fraud and avoid its obligation.[25] In a recent action at law

17. Sherling v. Gallatin Improvement Co., Inc., 145 Misc. 734, 260 N.Y. Supp. 229 (1932), *rev'd on other grounds*, 237 App. Div. 535, 261 N.Y. Supp. 747 (1933), *appeal dismissed*, 262 N.Y. 641, 188 N.E. 101 (1933).
18. *Ibid.*
19. 119 Misc. Rep. 650, 197 N.Y. Supp. 856 (1922).
20. *Id* at page 856.
21. 198 N.Y. Supp. 660 (1923).
22. Werger v. Haines Corp. 94 N.Y.S.2d 691, 692 (1950), *aff'd*, 277 App. Div. 1108, 101 N.Y.S.2d 361 (1950), *aff'd*, 302 N.Y. 930, 100 N.E.2d 189 (1951).
23. Rabinowich v. Eliasberg, 159 Md. 655, 152 Atl. 437 (1930).
24. *Id* at page 438.
25. Silberman v. Cades, 107 N.J. Eq. 547, 153 Atl. 473 (1931).

the court held that whether the loan was *refused* the individual or *agreed* upon was an issuable question of fact for the jury to determine.[26] This latter decision of the New Jersey court adopts the rule established in *Jenkins v. Moyse.*

CONCLUSION AND RECOMMENDATION

It is apparent from the foregoing analysis that the lender can protect himself by first refusing to make the loan to the individual and then suggest that, if the borrower will incorporate, a loan will be made to the corporation. Should the lender agree to make the loan to the individual and then impose the condition that the borrower incorporate, he may well find himself subject to the penalties provided by the usury laws. This hairline distinction should not be recognized. The courts have repeatedly struck down various devices employed to avoid the usury laws.[27] The Supreme Court of Florida has said, concerning the usury laws, ". . . we deem it to be of paramount importance that a statute so salutary in its operation as is the statute against usury, should be sedulously guarded against the ingenious shifts and devices so often resorted to to evade its operation."[28] To frustrate evasions, the courts look beyond the form of transactions to their substance.[29] They will not, however, by "piercing the corporate veil," defeat the purpose of the statute depriving the corporation of the defense of usury. However, they cannot escape the fact that blindly closing their eyes to tainted transactions defeats the very letter and spirit of the usury laws. It is inconceivable that the law itself has provided unscrupulous money lenders with a device to successfully avoid the usury statutes. The needy borrower is no less deprived of his freedom of contracting and is as much at the mercy of the lender in this instance as in any other. When the problem presents itself to the courts the transaction should be closely scrutinized. If the court finds that the loan was to the corporation in form only while in fact it was to an individual, then it should make no difference in the way the lender approached the deal. The transaction should be considered as just another shift or device to avoid the usury statutes and be dealt with accordingly. Reality, not appearance, should determine legal rights.

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COVENANTS FOR TITLE — PROTECTION AFFORDED BUYER OF REALTY IN FLORIDA

The "Covenants for Title", sometimes referred to as the "Common Law Covenants for Title", are six in number. They are: 1) The covenant

26. Gelber v. Kugel's Tavern, Inc., 10 N.J. 191, 89 A.2d 654 (1952).
27. See *Evasion and Avoidance of Florida Usury Laws*, Comment, 5 MIAMI L.Q. 493 (1951).
28. Belden v. Gray, 5 Fla. 504, 508 (1854).
29. Beachan v. Carr, 166 So. 456 (Fla. 1936). *But see* Kings Merchantile Co. v. Cooper, 199 Misc. 381; 100 N.Y.S.2d 754, 756 (1950).