Formation of a Corporation to Evade the Usury Laws

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stupidity and clumsiness then surely one afflicted by disease should not be penalized by the statute. The question to be asked in a case of this kind has been tersely stated in a dissenting opinion by O'Brien, J., in the Andrews case: 22 "Did the workman's employment require him to be in the place, whether a floor or a walk or other structure, which caused his injury." To us it seems that if this question is answered in the affirmative the award should be allowed. This would be interpreting the statute in accordance with its general purpose and the policy intended.

In view of the authorities herein reviewed, it is difficult to approve of the viewpoint taken by the majority of the New York Court of Appeals in the Andrews case. The Court seems to have entirely disregarded the spirit as well as the letter of the Workmen's Compensation Law. On principle as well as on precedent, approval of Andrews' claim would appear to have been a better holding.

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FORMATION OF A CORPORATION TO EVADE THE USURY LAWS.

Progressive courts and judges of the current day do much to overcome the ill effect of the application of ancient common law rules to modern-day conditions. They do more, and justifiably so, to overcome the legislative lethargy in the matter of removing archaic and anachronistic laws from the statute books. More than ever the rationale of the recent decisions is found in the contemporary social and economic concepts.

No better example of the incongruity of the rules of positive law and the complex economic conditions of the day is found than in the usury statutes. It may well be conceded that such laws were splendid pieces of paternal legislation and needed at the time of their enactment. However, the increased complexity of commercial activities and the interdependency of all people under the money economy of the present day has rendered unnecessary, it seems, the need for continuing such paternal legislation. Certainly, today, the price of commercial money is not controllable by such a simple instrument as a rule of law. The changed relationship between supply and demand, the effect of the monetary system, modern-day use of credit, and other factors of the new economic order govern, and govern alone.

22 Supra Note 7 at 104.

1 N. Y. Gen. Bus. Laws, sec. 370 et seq.: "The rate of interest upon the loan or forbearance of any money, goods or things in action, except as otherwise provided by law, shall be six dollars upon one hundred dollars, for one year, and, at that rate, for a greater or less sum, or for a longer or shorter time."
Moreover, there is a growing tendency on the part of the people to resent paternalistic legislation even when it is needful and effective.

The usury laws not only fail to accomplish their purpose of checking the alleged unquenchable avarice of money lenders, but render it difficult to obtain commercial loans.

"Conceded almost unanimously by economists to be inoperative in controlling the price of commercial money, such statutes have succeeded only in accentuating, in the field of consumptive borrowing, the evils at which they were primarily directed. Laudably intent upon protecting the necessitous borrower from the mercy of the money lender, the Legislature fixed rates of interest so prohibitively low as to drive the entire business outside the law. The money lenders flourished upon rates notoriously extortionate, while the borrower, unable to obtain help at legal interest, was reduced to seek it elsewhere at a price which included the insurance of his lender against the risks incident to violating the very law which had been passed for the borrower's protection." ²

As early as 1850, not many years after the original usury laws were enacted, the Legislature, as if a bit doubtful of their wisdom, effected a partial repeal by an amendment forbidding corporations the right to set up the defense of usury.³ The alleged purpose of making the exception to the general rule was to render it easier for corporations to obtain money.⁴ The purpose of the amendment in itself was an admission that usury laws are not economically sound, in that they make it difficult to borrow money and, consequently, tend to stifle commercial activities.

In a recent case decided this year,⁵ the Court of Appeals has seen fit to extend the benefits of the exception intended for corporations to an individual. The plaintiff in this case, now seeking to invalidate a loan on the ground that it is usurious, was anxious to obtain money in order to meet pressing obligations in connection with a parcel of real estate that he owned. So anxious was he that he agreed to pay a premium for the loan in excess of the lawful rate of interest as fixed by the statute. However, the prospective lender, in order to protect himself against the very action which the plaintiff was now taking, refused to make the loan to the plaintiff individually, but agreed to make the loan to a corporation, to be formed by the plaintiff. In con-

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² (1929) 42 Harv. L. Rev. 689.
³ N. Y. Ben. Bus. Laws, sec. 374: "No corporation shall hereafter interpose the defense of usury in any action. The term corporation, as used in this section, shall be construed to include all associations, and joint stock companies having any of the powers and privileges of corporations not possessed by individuals or partnerships.
⁴ Rosa v. Butterfield, 33 N. Y. 674 (1865).
⁵ Jenkins v. Moyse, 254 N. Y. 319 (1930).
formity with the proposition of the lender, a corporation was formed, the real estate transferred to it, and the loan made to the corporation, the evidence of the debt being executed in the corporate name under the hand of the plaintiff as president. In setting up the plea of usury, the contention of the plaintiff was that "the corporate veil should be pierced" and the loan regarded as made to him individually and, therefore, usurious. In answer to this contention the Court said:

"The corporate entity may be disregarded where it is used as a cloak or cover for fraud or illegality. For that there is ample authority. Here the corporate entity has been created because the statute permits a corporate entity to make a contract which would be illegal if made by an individual. The law has not been evaded but has been followed meticulously in order to accomplish a result which all parties desire and which the law does not forbid." ⁶

That the usury law has been avoided though not evaded is the essence of the holding of the Court. A nice distinction is to be made not only in the law of taxation ⁷ but in other branches of the law, as well, between avoidance and evasion. If the use of a corporate entity palpably works an injustice, the courts are quick to term it an evasion.⁸ Such an example is found in the attempt of contractors to limit the liability for personal injuries suffered by workmen on a dangerous job, by setting up a separate corporation with limited resources for the job.⁹ On the other hand, there is no judicial condemnation of the use of the corporate entity so as to limit a merchant's liability for debts incurred in a commercial undertaking, in the absence of extenuating circumstances. However, the limitation of liability afforded through the corporate entity is in itself avoidance of liability. Between these two extremes there are many border-line cases and the decision as to whether the adoption of the corporate form of doing business leads to an evasion or an avoidance is determined by the social consequences of the particular act under consideration.

Since the consequence of circumscribing the effect of the usury law works no harm to society as a whole, it being the consensus of opinion that the application of the usury law works the harm, and both parties having mutually agreed to the circumscription, there is little wonder that the Court in the recent case refused to "pierce the corporate veil." Employment of the corporate entity and thereby

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⁶Ibid. at 324.
"meticulously following the law" was the effectuation of a progressive court's disposition to temper archaic legislative enactments.

As a practical matter, if one does seek to evade the usury laws, he must be careful to meticulously follow the law in that the loan must, in effect, be made to a corporation and not to an individual.\(^{10}\)

"The first thing the court will look at is whether the contract was made by the corporation in its own capacity, for its own benefit, or whether made by an individual in his own capacity, and for his own benefit."\(^{11}\)

Since it is the duty of courts to interpret the law and not to make it, they cannot and will not directly antagonize legislative edicts. Consequently, in seeking to avoid the usury law, one must be careful to bring the transaction within the narrow confines of the exception permitted, or else the court has no means through which it can effectuate its progressive attitude toward the cumbersome and useless rule of the positive law.

Though the result of the decision in the instant case is just and commendable from a social utilitarian viewpoint, one cannot but feel that the decision has a bad effect in that it permits a perversion of the purpose for which corporations should normally be formed. It is difficult to justify the use of the legal fiction of a corporate entity solely for the purpose of avoiding the law. The corporate idea was not conceived, and ordinarily is not practiced, to attain this end, but owes its existence to worthier and more substantial objectives. The fact that a high court will endorse the use of a corporation simply to avoid the effect of a harmful law is proof enough that that law should be repealed. The usury laws have been repealed in many states and in England. In our own state a partial repeal has been effected through the enactment of special banking laws\(^{12}\) relaxing the provisions of the usury law so as to allow a moderate increase of interest upon small loans. Effective small loan laws cover the needs of the small borrower and it would seem that those laws should measure the extent to which the legislative action need go in this modern day.

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\(^{12}\) N. Y. Banking Law, sec. 345.