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**LEGISLATION: CORPORATIONS --- "HOME OWNER"  
CORPORATIONS NOW PERMITTED DEFENSE OF USURY**

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## LEGISLATION

CORPORATIONS—"HOME OWNER" CORPORATIONS NOW PERMITTED DEFENSE OF USURY.—The law prohibiting corporations from interposing the defense of usury in New York has been amended, effective April 25, 1955, to exempt from its prohibition the "home-owner" corporation which has as its principal asset a private residence.<sup>1</sup> The object of the new legislation is to cope with a practice, disclosed by a grand jury investigation in Queens, by which lenders have used incorporation as a device to charge exorbitant rates of interest for second mortgage loans.<sup>2</sup>

The legal rate of interest in New York State is six percent per annum.<sup>3</sup> Interest charged in excess of this amount is usury and the usurer is subject to a series of penalties, one of which is the forfeiture of the principal amount of the loan.<sup>4</sup>

However, corporations are prohibited by statute from pleading the defense of usury.<sup>5</sup> The statute has a two-fold purpose: to enable a corporation to borrow money more readily for business purposes, and to prevent the corporation from avoiding its own contract on the ground that it was made in contravention of the laws against usury.<sup>6</sup>

In interpreting this statute, the Court of Appeals has held that where an individual adopts a corporate form solely for the purpose of circumventing the usury laws, this practice does not of itself vitiate the efficacy of the device.<sup>7</sup> In *Jenkins v. Moyses*,<sup>8</sup> the plaintiff was refused a loan on his real estate until he incorporated. This was done and the mortgage was executed for a much larger sum than the amount of the actual loan. The plaintiff, being the only stockholder, sought to have the transaction set aside because of illegality. The court refused to disregard the corporate entity, stating that "the corporate entity may be disregarded where it is a cloak or cover for fraud or illegality. Here the corporate entity is created because a statute permits a corporate entity to make a contract which

<sup>1</sup> L. 1955, c. 673, amending N. Y. Gen. Bus. L. § 374, which now reads (new matter in italics): "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 joint-stock companies having any of the powers and privileges of corporations not possessed by individuals or partnerships. *The provisions . . . of this section 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 that the corporation was organized and created 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 said one or two family dwellings.*

<sup>2</sup> N. Y. Times, Feb. 10, 1955, p. 1, col. 3.

<sup>3</sup> N. Y. GEN. BUS. L. § 370.

<sup>4</sup> N. Y. GEN. BUS. L. § 373.

<sup>5</sup> See note 1, *supra*.

<sup>6</sup> Merchants' Exchange Nat. Bank v. Commercial Warehouse Co., 49 N. Y. 625 (1872).

<sup>7</sup> The Dime Savings Institution of New York v. Wilmot, 94 N. Y. 221 (1883).

<sup>8</sup> 254 N. Y. 319, 172 N. E. 521 (1930).

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 desired and which the law does not forbid.<sup>9</sup>

Loan organizations and funding companies, taking advantage of this corporate exception from the usury laws, offered home owners who were pressed for cash, quick loans secured by a second mortgage. The home-owner incorporated, and transferred the home to the corporation, which gave the lender a second mortgage as security. Inasmuch as no limit is placed on the amount that a corporation may be charged for a loan, the applicant was made, in some cases, to pay forty to sixty percent in excess of the ordinary loan and service charges, and in addition was not entitled to make deductions on his federal income tax which he could have made as an individual. The Queens County grand jury investigation disclosed that over eight thousand home owners were so involved.<sup>10</sup>

The purpose of the amendment is to put an end to this practice. Now, a corporation *may* interpose the defense of usury where its principal asset is a one or two family dwelling, the debt secured by a mortgage on the home, and the corporation organized not more than six months before the indebtedness.<sup>11</sup>

The proponents of the new legislation do not feel it to be entirely adequate. The Grand Jury which studied the matter, and the Queens County District Attorney's office concur in the belief that too many loopholes still exist in the statute to effectively prevent unlicensed money lenders from wringing unconscionable profits from distressed home owners. To date, at least two of the funding organizations referred to the Grand Jury are believed to have resumed the practice complained of.<sup>12</sup>

One possible legislative solution, frequently advanced, would require all persons engaged in the business of lending money secured by mortgages on one or two family dwellings, to be licensed by the State and placed under the supervision of the Banking Department. Under such legislation funding companies would be brought under the strict control of a state agency whose function it would be to issue licenses, inspect books and records and revoke the licenses of those licensees whose business practices fall below the standards set by the legislature or the agency.

<sup>9</sup> *Id.* at 324, 172 N. E. 521, 522. See *Bradley v. Selengut*, 269 App. Div. 209, 54 N. Y. S. 2d 457 (1st Dept. 1945); *Kings Mercantile Co. v. Cooper*, 199 Misc. 381, 100 N. Y. S. 2d 754 (Sup. Ct. Queens Co. 1950).

<sup>10</sup> See note 2, *supra*.

<sup>11</sup> See note 1, *supra*.

<sup>12</sup> N. Y. Times, Nov. 18, 1955, p. 23, col. 1; N. Y. Post, Nov. 17, 1955, p. 2, col. 2.