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USURY AS A DEFENSE TO CORPORATE BONDS SOLD BELOW PAR

As the prohibition of usury developed from a religious tenet to a legal concept, the problem of interpreting restrictions upon excessive exaction of interest shifted from religious leaders to the courts. But the removal of the problem of usury from the sphere of religion and its reallocation to the science of jurisprudence has not lightened the task of those charged with enforcing and interpreting the usury laws. Just as the ecclesiastics were troubled when the ancient laws became unjust and unsuitable because of changing economic conditions, so today the courts are sometimes troubled when old usury laws fail to meet the requirements of a more modern economy. One illustration of the difficulties which confront modern courts is the problem of usury as a defense to actions on corporate bonds sold below par.

Corporations sometimes issue bonds bearing the maximum legal rate of interest and sell them below par. When a bondholder brings an action against the corporation for the value of such bonds at maturity, or for interest payments, the corporation may defend by showing that the interest rate plus the discount rate exceeded the maximum interest charge. When this defense prevails and the bondholder is found to have contracted usuriously, he is subjected to a penalty ranging from loss of the amount in excess of the maximum interest rate to total loss of the value of his bonds.[1]

In weighing the defense advanced by the corporation, the court is called upon to consider two issues. First, it must decide

1. Forfeiture of principal and interest: Ark. Dig. of Stats. (1937) sec. 9401; Conn. Gen. Stats. (1930) sec. 4736. Forfeiture of all interest: Ala. Code Ann. (1928) sec. 8567; Ariz. Rev. Code (1928) sec. 1884; Fla. Comp. Gen. Laws (1927) sec. 6939; Ga. Code (1933) sec. 57-112; Idaho Code Ann. (1932) sec. 26-1907; Ill. Smith-Hurd Ann. Stats. (1935) c. 74, sec. 6; Iowa Code (1935) sec. 9407; Mich. Comp. Laws (1929) sec. 9239; Minn. Mason's Stats. (1927) sec. 7037; Miss. Code Ann. (1930) sec. 1946; N. J. Rev. Stats. (1937) tit. 31, sec. 1-3; N. C. Code Ann. (1935) sec. 2306; N. D. Comp. Laws (1913) sec. 6076; S. C. Code (1932) sec. 6740; S. D. Comp. Laws (1929) sec. 1044; Wash. Pierce's Code (1938) sec. 3161; Wis. Stats. (1937) sec. 115.06. Forfeiture of excess interest: Ind. Burns Stats. (1933) sec. 19-2004; Ky. Carroll's Stats. (1936) sec. 2219; Md. Ann. Code (1924) art. 49, sec. 4; R. S. Mo. (1929) sec. 2842; N. Y. Thompson's Laws (1939) "General Business Law," art. 25, sec. 372; Ohio Pages Ann. Code (1926) sec. 8306; Pa. Purdon's Stats. (1936) tit. 41, sec. 4; Tenn. Code (1932) sec. 7315; Vt. Public Laws (1933) sec. 7133; Va. Code Ann. (1936) sec. 5555; W. Va. Code (1932) sec. 4628(6). Some states impose no penalty: Colo., Me., Mass. (if amount is over $1000), Nev., N. H. These states have established legal rates of interest, but no maximum rates. Other states have miscellaneous provisions, such as double or treble forfeiture of interest.

whether the transaction was usurious; and second, *if there was usury*, the court must decide whether the corporation should be permitted to avail itself of the protection afforded by the usury statutes. Very often the second of these issues is not discussed in the opinion even though the court, having found the bondholder guilty of usury, perforce had to decide it. Nevertheless, it is not difficult to determine how the court disposed of the matter. If judgment was for the corporation, it must have been found that the corporation was entitled to invoke the usury laws; if judgment was for the bondholder, the transaction must have been non-usurious, and therefore the court was not obliged to decide whether the corporation could invoke the usury laws.[2]

These issues pertain to the meaning and intent of the usury statutes; consequently a court must consciously or unconsciously engage in the process of statutory interpretation before it can supply the answers. To determine the policy implicit in the usury statutes, a court must ask itself: (1) "Did the legislature intend, or would it have intended, that the interest and discount rates on corporate bonds be considered together as a single interest charge?" and (2) "Did the legislature intend to extend the protection of the usury laws to a corporation which sold its bonds at a discount rate which, combined with the interest rate, amounted to more than the maximum legal interest rate?" In various jurisdictions and under certain circumstances, each of these questions has been answered both affirmatively and negatively. It is the purpose of this discussion to show when and why the particular answers to these questions have been made, and what decisions can be expected in the future.

Before indicating the several lines of decision and statutory interpretation, it is necessary to state that there seems neither a problem of statutory interpretation nor a conflict of decisions when the plaintiff bondholder is not an immediate purchaser from the corporation. In an action brought by a transferee without notice, the defense of usury would probably be unavailing.[3]

2. If judgment was for the bondholder and the court did find the transaction usurious, the court would be able to arrive at its decision only by holding that the corporation could not defend on the grounds of usury. In that case, the court would have to discuss the issue.

3. See Fletcher & Sons v. Alpena (1904) 136 Mich. 511, 99 N. W. 748; Weed v. Gainesville, J. & S. Ry. (1904) 119 Ga. 576, 46 S. E. 885; Tyler County, Tex. v. Branch-Middlekauff (C. C. A. 5, 1927) 20 F. (2d) 504; 6 Fletcher, *Corporations* (2d ed. 1931) 626, sec. 2757.

No bond cases have been found involving the defense of usury to an action by a transferee with notice, or transferee after maturity.

I

In spite of contrary statements in some secondary authorities,[4] the courts have generally held that, when a *municipal* corporation issues bonds bearing the maximum rate of interest and sells them below par, the corporation may not defend on grounds of usury.[5]

The cases frequently refer to Simonton on *Municipal Bonds*[6] as the leading authority on the subject. Section 146 reads:

> That the bonds of a municipal corporation may be sold by it for less than par must be regarded as the general understanding of lawmakers of the states, as well as the officers of the municipalities, because, when it is desired to prevent such sale, that fact is incorporated in the enabling act or in the ordinance or resolution providing for the issue of the bonds.

It is this section of Simonton upon which a much-quoted Oregon case, *Kiernan v. Portland,*[7] bases its pronouncement that, "The weight of authority is to the effect that the sale of municipal bonds below par is not illegal, unless the act or ordinance authorizing the issue expressly directs that they shall not be sold for less than par."[8] Washington has adopted this statement as expressing the correct rule.[9] A Kansas case follows this rule, but adds a novel consideration by saying, "bonds issued * * * which

4. "It may be laid down as a general rule of law that where a corporation, *municipal or private,* borrows money in return for which it issues its bonds, the issuance thereof at a price below par makes the transaction a usurious one, in the absence of statutory provisions legalizing such issues by corporations or forbidding the defense of usury by such bodies." (Italics supplied.) (1920) 27 R. C. L. 218; (1912) 35 L. R. A. (N. S.) 1106.

5. Rowland v. Deck (1921) 108 Kan. 440, 195 Pac. 868; Orchard v. School-District (1883) 14 Neb. 378, 15 N. W. 730; Kornegay v. Goldsboro (1920) 180 N. C. 441, 105 S. E. 187; Kiernan v. Portland (1912) 61 Ore. 398, 122 Pac. 764, Ann. Cas. 1914B 255; Memphis v. Bethel (Tenn. 1875) 17 S. W. 191. Accord: Golden Gate Bridge and Highway Dist. v. Filmer (1933) 217 Cal. 754, 21 P. (2d) 112, 91 A. L. R. 1; O'Neill v. Yellowstone Irr. Dist. (1912) 44 Mont. 492, 121 Pac. 283; Board of Education v. Moore (1871) 17 Minn. 412; Hattrem-Nelson & Co. v. Salmon River-Grande R. H. Dist. (1930) 132 Ore. 297, 285 Pac. 231; Nalle v. Austin (1893) 85 Tex. 520, 22 S. W. 668; Lynchburg v. Slaughter (1880) 47 Va. 57; Yesler v. Seattle (1890) 1 Wash. 308, 25 Pac. 1014; Paine v. Seattle (1912) 70 Wash. 294, 126 Pac. 628; Uhler v. Olympia (1915) 86 Wash. 1, 151 Pac. 117; Hill v. Seattle (1919) 108 Wash. 572, 185 Pac. 631. Contra: Sherlock v. Winnetka (1873) 68 Ill. 530; Danville v. Sutherlin (1871) 20 Gratt. (Va.) 555; Lynchburg v. Norvell (1871) 20 Gratt. (Va.) 601.

6. (1896).

7. (1912) 61 Ore. 398, 122 Pac. 764, Ann. Cas. 1914B 255.

8. Kiernan v. Portland (1912) 61 Ore. 398, 122 Pac. 764, 765, Ann. Cas. 1914B 255.

9. Paine v. Seattle (1912) 70 Wash. 294, 126 Pac. 628, 127 Pac. 580; Uhler v. Olympia (1915) 87 Wash. 1, 151 Pac. 117, 152 Pac. 998.

earn the maximum interest named may be sold at a discount *if the sale is made on the best terms obtainable.*"[10] It is difficult to know whether this remark merely means that a fraudulent sale will vitiate the bonds—implied, of course, in all the decisions—or whether the court intended that there should be an investigation in each case to determine if the bonds might have been sold at a higher price.

How were the courts interpreting the usury statutes when they established the rule that municipal corporations may not hide behind the statutes? The fact that courts do not hesitate to add the nominal interest rate to the discount rate to find a single usurious rate where bonds of private corporations are concerned,[11] indicates that the courts do not believe that the usury statutes prohibit such computation where bonds of municipal corporations are concerned. Rather, in holding a municipal corporation fully liable on its bonds, the courts must feel that the usury statutes were not intended to apply to bonds issued by municipal corporations.

Considerations of policy seem to be the bases for not extending the protection of the usury statutes to municipal corporations. The courts, solicitous for the welfare of municipal corporations within their states, want to insure the high standing of municipal bonds so that subsequent issues will find a ready market. The courts apparently believe that bonds of municipal corporations would be impaired in the eyes of the securities-buying public if the defense of usury were permitted. Correctly, perhaps, the judges have realized that the legislature would never have intended such a result.[12]

In addition to cases that follow the rule that usury statutes do not apply to bonds of municipal corporations, there are inapposite cases which have been loosely cited as substantiating the rule.[13]

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10. Rowland v. Deck (1921) 108 Kan. 440, 195 Pac. 868, 871.

11. See infra, page 596, part II.

12. Cf. Ex parte Washer (1927) 200 Cal. 598, 254 Pac. 951; Griffith v. Burden (1872) 35 Iowa 138.

13. Kornegay v. Goldsboro (1920) 180 N. C. 441, 105 S. E. 187, in holding the city's bonds free of usury, was governed by a statute which expressly authorized the city to sell its bonds below par. Orchard v. School District (1883) 14 Neb. 378, 15 N. W. 730, also holding municipal bonds untouched by usury, was based on a case which was not in point—Armstrong v. Freeman (1879) 9 Neb. 11, 2 N. W. 353, which held that there was no usury in the sale to a third person of a note and mortage for less than their face value, where it was not a device to evade the usury laws. Griffith v. Burden (1872) 35 Iowa 138, and Memphis v. Brown (C. C. W. D. Tenn. 1872) Fed. Cas. No. 9415, did involve municipal corporation bonds but not the question of usury.

Almost always a statute authorizing the issuance of bonds by a municipal corporation also establishes the rate of interest the bonds may bear. Ordinarily, the rate thus established does not affect the issue of usury when bonds are sold at a discount, for the interest restriction is generally held to refer only to the interest rate appearing on the face of the bonds.[14] However, an Illinois case[15] supports the proposition that a limitation on the interest rate of the bonds is a limitation on the nominal and discount rates combined, and that the usury statutes apply to municipal corporation bonds which are subject to such restriction. In this case, bonds of the Village of Winnetka, bearing ten per cent interest and sold at ninety-five cents on the dollar, were held usurious because the governing statute limited the rate of interest to ten per cent.[16]

II

Unlike the effect of the usury statutes on bonds of municipal corporations, when a private corporation issues interest-bearing bonds and sells them at a discount the usury statutes operate to make the transaction usurious if the combined nominal interest

14. "The provision as to the amount of bonds to be issued, their denomination, and the rate of interest they shall bear has reference only to the form of the bonds and the method in which they shall be executed, in order to prepare them for sale." Kiernan v. Portland (1912) 61 Ore. 398, 122 Pac. 764, 765, Ann. Cas. 1914B 255. Rowland v. Deck (1921) 108 Kan. 440, 195 Pac. 868, 870, quotes this statement with approval. Note (1934) 91 A. L. R. 7.

15. Sherlock v. Winnetka (1873) 68 Ill. 530. This case might be decided differently today under Ill. Smith-Hurd Ann. Stats. (1935) c. 74, sec. 4, which provides that a corporation may contract to pay more than the statutory maximum of seven per cent.

16. Danville v. Sutherlin (1871) 20 Gratt. (Va.) 555, and Lynchburg v. Norvell (1871) 20 Gratt. (Va.) 601, decided in Virginia a little after the Civil War, seem in accord. However, these cases involved peculiar facts. Municipal bonds were bought with Confederate money worth only a fraction of the gold money with which they would have to be paid at maturity, inasmuch as the conclusion of the War had made Confederate money worthless. In one case, the plaintiff bought a $5,000 bond bearing six per cent interest, and maturing in twenty years, for $11,050 in Confederate money. However, since Confederate money was worth but one-tenth the value of gold money at the time, the purchase price really amounted to only $1105. In the other case, the plaintiff paid $4,000 in gold ($92,000 in Confederate money) for a bond, the total value of which would amount at maturity to $100,000 in gold. Though the language of these cases unequivocally states that the transactions were usurious, it seems plausible to think that the courts were influenced greatly by the enormous difference between purchase price and maturity value and by the fact that neither purchaser nor seller intended any such discount. These facts do not affect the issue of usury and municipal bonds, but, as the case was presented, the only manner in which the courts could hold the sale of the bonds invalid was by declaring them to be usurious.

and discount rates exceed the statutory maximum. This conclusion is supported by most text-writers and annotators.[17]

A few cases support the secondary authorities. In *Fletcher & Sons v. Alpena*,[18] mandamus was granted at the behest of a stockholder of the defendant corporation to compel continuance of a preliminary injunction restraining the company from issuing below par bonds bearing interest of six per cent, on the grounds that the issue and sale would be usurious. In *The Commissioners of Craven v. The Atlantic and North Carolina Railroad*,[19] the railroad company delivered to the defendants bonds of the par value of $100,000 in payment of a $76,899.13 debt. The bonds carried the legal maximum interest of eight per cent. The transaction was held to be usurious, because "in the absence of special legislation corporations are embraced in the usury laws just as natural persons are."[20] In a Michigan case,[21] which seems to extend the rule to cover a sale by the maker to a securities house, a brokerage house had contracted to buy at a ten per cent discount the defendant corporation's six per cent bonds, intending to sell them at a profit for its own benefit. The court held that the facts imported a loan and that the transaction was therefore subject to the usury laws. It should be noted, however, that this case differs from those in which a corporation places its bonds with a brokerage firm for the purpose of having that firm sell the bonds to the public, without investing any of its own capital. In such cases, a reasonable charge in the form of a discount by the brokerage firm does not affect the validity of the bonds. The charge is for services rendered, not for interest on a loan.[22]

In suits involving bonds issued by private corporations, it appears that the courts have interpreted usury statutes as permitting the combination of nominal interest and discount rates to attain a single usurious rate of interest, just as in cases in-

17. 6 Fletcher, *Corporations* (2d ed. 1931) 525, sec. 2678; Note (1912) 35 L. R. A. (N. S.) 1106.

18. (1904) 136 Mich. 511, 99 N. W. 748.

19. (1877) 77 N. C. 289.

20. The Commissioners of Craven v. The Atlantic and N. C. Ry. (1877) 77 N. C. 289, 292.

21. Stirling v. Gogebic Lumber Co. (1911) 165 Mich. 498, 131 N. W. 109, 35 L. R. A. (N. S.) 1106.

22. Even where the brokerage firm underwrites a bond issue at a great discount, the courts have held that there was no loan, and therefore no usury. Lubbock Hotel Co. v. Guaranty Bank & Trust Co. (C. C. A. 5, 1935) 77 F. (2d) 152; In re Danville Hotel Co. (C. C. A. 7, 1930) 38 F. (2d) 10; Note (1926) 45 A. L. R. 570; Miller & Co. v. Claridge Manor Co. (D. C. N. D. Ala. 1925) 14 F. (2d) 859. Accord: Busch v. Stromberg-Carlson Tel. Mfg. Co. (C. C. A. 8, 1914) 217 Fed. 328.

volving bonds of municipal corporations. But unlike the interpretation given usury statutes in cases involving bonds of municipal corporations, in private corporation bond cases the courts seem to have interpreted the statutes as allowing corporations to defend on the ground of usury in the same manner as natural persons.

It must be remembered, of course, that usury laws are directed solely at the lending or forbearance of money. It has been held, for example, that there was no usury when a railroad issued $150,000 worth of bonds in payment for construction work valued at $100,000. There had been no loan or forbearance of money.[23]

Even in those cases where the court found no usury because of special legislative enactments, there are *dicta* supporting the view that bonds sold too much below par would be usurious under the ordinary usury statutes.[24] The Supreme Court of Ohio, in holding that under the statutes of Indiana and Ohio the corporation in question might sell its bonds for less than par, said:

> Independent of special statutory provisions this transaction would clearly be a loan. It would be the case of a party obtaining money upon his own promise to repay it; and, wherever usury laws exist, when this is the case, the transaction necessarily imports a loan whatever form it may be made to assume. For, if this were not so, laws prescribing the rate of compensation for the use of money could be evaded and nullified at the pleasure of the parties.[25]

It is an apparently sound interpretation of usury statutes which permits a private corporation to defend on grounds of usury when sued for the value of bonds by an immediate purchaser from the corporation. Orthodox economists define a bond as evidence of a loan.[26] Any premium paid for the use of money is interest, regardless of the form that interest payments may take.[27] There is usury if the lender receives, solely for the

23. Real Estate Trust Co. v. Wilmington & N. C. Elec. Ry. (Del. Ch. 1910) 77 Atl. 756.

24. The White Water Valley Canal Co. v. Vallette (U. S. 1858) 21 How. 414; Clearwater County State Bank v. Bagley-Ogema Tel. Co. (1911) 116 Minn. 4, 133 N. W. 91, 36 L. R. A. (N. S.) 1132, Ann. Cas. 1913A 622; Coe v. Columbus, P. &. I. Ry. (1859) 10 Ohio St. 372, 75 Am. Dec. 518. Cf. MacQuoid v. Queens Estates (1911) 143 App. Div. 134, 127 N. Y. S. 867; Traders' Nat. Bank v. Lawrence Mfg. Co. (1887) 96 N. C. 298, 3 S. E. 363.

25. Bank of Ashland v. Jones (1865) 16 Ohio St. 145.

26. 1 Fairchild, Furniss, Buck, *Elementary Economics* (1931) 103.

27. Wintergirst v. Collateral Loan Co. (1895) 60 Mo. App. 166; Kreibohm v. Yancey (1900) 154 Mo. 67, 55 S. W. 260; Missouri Discount Corp. v. Mitchell (1924) 216 Mo. App. 100, 261 S. W. 743.

use of his money, a premium above the maximum specified in the statutes. Moreover, there is nothing to be found in the ordinary usury statute which expressly or impliedly denies corporations the defense of usury.[28]

III

In some jurisdictions, however, it is not true that a private corporation may defend on grounds of usury in an action for the value of its bonds. It is not that the courts in these jurisdictions believe, as in the case of municipal corporations, that the usury statutes do not apply to bonds of corporations as opposed to obligations of natural persons. Rather, these courts feel that usury statutes have nothing to do with the purchase and sale of bonds.

The idea that oft-repeated *dictum* becomes law is well illustrated by what may be termed the "chattel theory" of corporate bonds sold below par. This theory—that bonds in the hands of the issuing corporation are chattels, rather than potential evidence of loans, which may be bought and sold at any price regardless of usury laws—was first squarely and unqualifiedly presented as a basis of decision in 1929, decades after it had been suggested. In other cases which might be thought to establish the "chattel theory," the talk about bonds as chattels might well be considered outside the issues presented for adjudication. But this comparatively recent case[29] flatly declares that, if the issuer of bonds agrees with the purchaser for the *sale* of the bonds, the transaction is a sale of chattels and not a loan which can be touched by the usury statutes.

The "chattel theory" finds expression in two works of secondary authority.[30] However, these works fail to support their statements with adequate case material.[31] Nevertheless, so

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28. By "ordinary usury statute" is meant a statute which establishes a maximum legal rate of interest and provides a penalty for interest charges in excess of that rate.

29. Medical Arts Bldg. Co. v. Southern Finance & Development Co. (C. C. A. 5, 1929) 29 F. (2d) 969.

30. (1885) 64 Am. Dec. 429; (1912) 39 Cyc., Usury 936. The statement in Cyc. was deleted in Corpus Juris.

31. In the cited cases, bonds sold at excessive discount were held non-usurious, not because they were chattels, but for other reasons. Memphis v. Brown (C. C. W. D. Tenn. 1872) Fed. Cas. No. 9415, and Griffith v. Burden (1872) 35 Iowa 138, involved the sale of municipal bonds which had already been negotiated. In addition, the talk about bonds as chattels was not in reference to usury, for usury was not an issue in the case. A New York statute, 1 N. Y. Thompson's Laws (1939) 1076, c. 20, sec. 374, depriving corporations of the defense of usury, governed the decision in Gamble v. Queens County Water Co. (1890) 123 N. Y. 91, 25 N. E. 201,

firmly and persuasively do the cited cases insist in their *obiter dicta* that bonds are chattels, that an analysis of their argument should be presented. The proponents of the "chattel theory" concept look to historical material and modern mercantile custom for substantiation. In this treatise on *Personal Property,* Brown states:

> from earliest times a bond, that is a sealed obligation, was regarded as more than the evidence of the contract of the parties, and considered in law to be the contract itself, so that formerly any destruction of the paper or of the seal destroyed the obligation itself.[32]

On the other hand he points out that the early criminal law recognized bonds as but bits of paper evidencing legal relationships. There could be no larceny of bonds because they were not property. He mentions, however, that statutes which later declared theft of written documents to be larceny reconciled even the criminal law with the civil law concept of bonds as property. Moreover, it is common knowledge that under modern business customs bonds are bought and sold on the open market in the same manner as chattels. That the legal obligations contained in a bond do not completely control its market price is also regarded as significant by advocates of the "chattel theory."

These arguments stand for something less than the proposition that bonds are chattels. They attempt to utilize an axiom of mathematics, *viz.,* things equal to the same thing are equal to each other, by arguing that because chattels and bonds have certain common traits and characteristics they are the same. Bonds and chattels are not the same and no word-magic will make them so.

The word "chattel" (closely related to the old French "catel" or "chatel" and to the English word "cattle") is the name of a

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9 L. R. A. 527. In Traders' National Bank v. Lawrence Mfg. Co. (1887) 96 N. C. 298, 3 S. E. 363, the court withheld application of the usury laws because the corporate charter of the issuing corporation permitted it to borrow money on such terms as its directors might determine. In Coe v. Columbus (1859) 10 Ohio St. 372, 75 Am. Dec. 518, and Kornegay v. Goldsboro (1920) 180 N. C. 441, 105 S. E. 187, the court pointed to a statute legalizing the corporation's sale of bonds below par. Orchard v. School District (1883) 14 Neb. 378, 15 N. W. 730, was decided solely on the authority of Armstrong v. Freeman (1879) 9 Neb. 11, 2 N. W. 353, which held that there could be no defense of usury when the alleged usury arose from the sale to a third person of a note and mortgage. Memphis v. Bethel (Tenn. 1875) 17 S. W. 191, although authority for the proposition that municipal bonds are not subject to usury laws when sold at excessive discount because they are chattels, would probably have been decided differently had the bonds been issued by a private corporation.

32. Brown, *Personal Property* (1936) 13.

concept of goods and materials valuable in themselves.[33] There is little material value in a document. When a chattel is destroyed, nothing remains; when a bond is destroyed, the obligation represented by the document remains.[34] A buyer of a chattel exchanges something for a valuable, tangible object; a "buyer" of a bond exchanges something for a mere promise, and if the issuer fails to meet his obligation, the holder has lost the "purchase price." Concepts can be expanded, of course, but it seems intellectually dishonest to say, "We will stretch the concept of chattel to include a bond, even though there are great fundamental differences as well as superficial similarities between the two. Now, since a bond is a chattel, we apply the rule applicable to chattels: Lo! the usury laws do not apply to bonds."

IV

However weak may appear the judicial process of the courts which have advocated the "chattel theory," the resultant decisions—withholding from corporations the defense of usury—seem economically and socially sound. In fact, several states have enacted statutes which deprive corporations of the defense of usury.[35]

It is necessary to inquire into the history of the development of the usury laws in order to evaluate the wisdom of these *bond* cases which deny corporations the defense of usury and of the statutes which deny corporations the defense of usury in *all* cases. Usury laws are grounded in ideas of morality and social policy. The Mosaic Code contains the earliest prohibition of usury,[36] and the Gospel of St. Luke also enjoins the exacting of usury.[37] Later, Ambrose of Milan formulated the ecclesiastic teaching that anything accruing from capital is usury. This doctrine, which continued in force for nearly a thousand years, was a symptom of a primitive economy in which loans were almost uniformly consumer loans.[38] Under the ethical codes of the great

33. Webster's New International Dictionary (Merriam Co. ed. 1925).
34. There may be, of course, practical difficulties of proof.
35. Del. Rev. Code (1935) sec. 3101; Ill. Smith-Hurd Ann. Stats. (1935) c. 74, sec. 4; Iowa Code (1935) sec. 7932; Md. Ann. Code (1924) art. 49, sec. 2; Minn. Mason's Stats. (1927) sec. 7512; Neb. Comp. Stats. (1929) c. 74, art. 4; N. J. Rev. Stats. (1937) tit. 31, c. I, sec. 6; N. Y. Thompson's Laws (1939) "General Business Law," art. 25, sec. 374; N. C. Code Ann. (1935) sec. 2306; Pa. Purdon's Stats. (1936) tit. 41, sec. 2; S. C. Code (1932) sec. 6743; S. D. Comp. Laws (1929) sec. 9652; Va. Code Ann. (1936) sec. 5556; W. Va. Code (1932) sec. 4632; Wis. Stats. (1937) 115.06.
36. Leviticus, XXV: 36; Deuteronomy, XXIII: 20.
37. St. Luke, VI: 35.
38. 15 The Encyclopaedia of the Social Sciences (1934) 193.

religions, the immorality of exacting interest from a consumer borrower is self-evident. A distressed borrower cannot bargain for reasonable interest rates and after he has spent the money is frequently in a worse position than before borrowing.

With the advent of economic liberalism and the Renaissance, there began progress toward the realization that a fair return on the use of capital was not morally bad. In 1787 Jeremy Bentham wrote his "Defense of Usury." In the name of personal liberty he advocated the complete freedom of trade in money which prevailed in the trade of commodities.[39] The trend toward the relaxing of usury laws continued as bans on usury were removed by England in 1854, by Holland in 1857, by Belgium in 1865, and by Prussia and the North German Federation in 1867. These countries, however, soon learned that the removal of all usury laws provoked great abuses. Like Bentham, they had failed to distinguish between commercial or investment borrowing and consumer or small-loan borrowing. Therefore, in the latter part of the nineteenth century, they enacted laws, analogous to our small-loans acts, to protect inexperienced and ignorant borrowers.

Why should the lending of money be subject to arbitrary limits when the borrower is in an adequate bargaining position? In Massachusetts the Joint Select Committee of the Senate considered a petition for the repeal of the usury laws; in its report of March 19, 1834, it stated:

> The value of money like that of every other article, naturally regulates itself. If the rate of interest upon it, as fixed by law, coincides with the real market value, the law has no operation whatever. If, on the other hand, the rate of interest, as fixed by law, be lower than the market value of money, then the effect of the law is to check the circulation of money * * *. Thus in the only case in which it can operate at all, the operation of the law is directly injurious.[40]

The conclusion of the Committee, that the circulation of money is impeded when the rate of interest fixed by law is lower than the market rate as fixed by supply and demand, agreed with the argument of the petitioners, that

> Whenever the demand for money is such in the market as to render it worth more than the established rate of interest, the borrower, however pressing his want, however strong his necessity, cannot raise the requisite loan; for the money

39. What Bentham did for England, Turgot did for France. Stephens, *Life of Turgot* (1895); Leon Say, *Turgot* (Translation, 1888).
40. Ryan, *Usury and Usury Laws* (1924) 201.

> owner is not compelled to part with his money at less than its worth; and he will not be so foolish as to lend when he can find more profitable modes of investment.[41]

In addition to pointing out that the enforcement of the usury laws causes great harm, the Committee also emphasized the fact that usury laws are futile and cannot be satisfactorily administered. "The most general and pointed provisions that can be devised are easily eluded by slight changes in the form of the transaction, and the law is * * * constantly evaded."[42]

Massachusetts again attacked the usury laws in 1861 and abolished them entirely.[43] In a notable speech to the General Assembly, Representative Richard H. Dana, Jr., demonstrated that usury laws do not accomplish the purposes for which they are enacted. He stressed the fact that an artificial maximum interest rate established by law makes no allowance for the variance in cost and risk on different loans and pointed out that, when the interest rates are higher than the legal maximum, the laws are invariably broken. He also stated that if the statutes could be strictly enforced banks would receive inadequate compensation for their loans and thus deprive the small depositors of a just return on their savings.[44] The elements of Dana's speech are not outmoded, for modern economists such as Irving Fisher,[45] T. N. Carver,[46] and F. W. Taussig[47] agree that the usury laws are at best futile. John Maynard Keynes has intimated, moreover, that usury laws help destroy the equilibrium between savings and investment. As savings vary, the laws prevent a prompt readjustment of the interest rate.[48]

The fact that usury laws are mischievous and futile has gained recognition in at least five American states where usury laws have been abolished.[49] Fifteen states have wholly or in part deprived all or some corporations of the defense of usury.[50] An interesting background is furnished by a case in which a Londoner had loaned $225,000 to a New York bank, the lender retaining about $10,000 in addition to contracting for interest of six per cent. The New York Court of Appeals ruled that this

41. Ryan, op. cit. supra note 40, at 198.
42. Ryan, op. cit. supra note 40, at 201.
43. The usury laws had been only slightly modified in 1834.
44. Ryan, op. cit. supra note 40, at 61.
45. *Elementary Principles of Economics* (1913) 396.
46. See *Principles of National Economy* (1921) c. 38, 39.
47. See 2 *Principles of Economics* (1921) c. 38, 39, 40.
48. 2 Keynes, *A Treatise on Money* (1930) 203.
49. Colo., Me., Mass., Nev., N. H.
50. Supra, note 35.

transaction was usurious;[51] under New York law this meant that the borrower did not have to repay either principal or interest. Public opinion stimulated efforts to have the New York usury law repealed; but because of practical difficulties, the present law prohibiting corporations from defending on the grounds of usury was enacted as a compromise in 1850. If the statutory changes in the other fourteen states grew out of situations and popular sentiments similar to those in New York, then these states have also realized the undesirability of usury laws.

If usury laws should be abolished because they are harmful and ineffectual, then statutes denying corporations the defense of usury are steps in the right direction. Few economists have advocated that regulation of interest rates be eliminated in the field of consumer, small-loan borrowing;[52] but corporations are not consumer borrowers who, because of their weak bargaining position, need protection from sharp money-lenders. Corporations engage in commercial or investment borrowing. Nor is it a valid criticism of statutes denying corporations the defense of usury to say: "Why pick on corporations?" The fact that this legislation does not go the whole way does not make it undesirable if it is a partial correction of the law.

In the more common usury statutes, however, there is nothing which permits a court to withhold the defense of usury from a corporation. The courts which have invoked the "chattel theory" of corporate bonds have done violence to the purpose and intent of the legislatures which enacted the statutes. In fact, these "liberal" decisions may actually retard reform of the existing usury laws. The law should be changed, but the process of modification belongs to the legislatures, not the courts.

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51. The Dry Dock Bank v. American Life Ins. and Trust Co. (1850) 3 N. Y. 344.

52. Bentham, in advocating the repeal of usury laws, did not except small-loan transactions.