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# *Mortgage Investments and the Usury Problem*

Gordon M. Harrell\*

**A** CONTINUOUS AND STEADY EXPANSION of residential dwelling is desirable from both a sociological and economic standpoint. Continuing support is required from risk capital willing to invest throughout the United States. This necessarily means that, if funds are to be drawn from areas of financial plenty to areas experiencing a financial drought, the investor will often not be a party to the original loan transaction, but will be a transferee of a local mortgage lender.

Real estate mortgages, which are the most frequently used method of investing in home financing, are always subject to the risk of waste as well as the possibility of a defaulting mortgagor in a declining real estate market, who will, in effect, be judgment proof since his only asset of significance will be the mortgaged property.

Keeping informed of the diverse usury statutes and case law of the various states is such an onerous burden that risk capital will be driven to other fields of investment, especially when one considers the extreme penalties imposed in some jurisdictions, unless some legislative relief is forthcoming. While this risk has always been present in the real estate mortgage transaction, it has now become a problem of more than passing interest due to continued rising interest rates which have accompanied the general tight money policy of the Eisenhower Administration.

We will consider those situations which are most often the foundation for an allegation of usury by the borrower—where there is a substantiated charge of usury against the originating mortgagee as well as his transferee. Certain principles will also be discussed which restrict the risk of usury to the lender and his transferee.

## **The Mortgage as a Security Device**

The real estate mortgage as a security device has been known to the common law for some centuries. In 1190, Ranulph de Glanville, a justice in eyre, described two types of land pledges.<sup>1</sup>

Historically, the mortgage has been and is a two-party transaction in which A, owning an estate in land, uses this interest as a security for some risk undertaken by a second person, B. At common law the transaction was evidenced by a complete grant of A's legal title to B, subject, however, to a condition subsequent whereby A could reenter and revest himself with the legal title

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<sup>1</sup> Glanville, *Treatise on the Laws and Customs of England*, Bk. 10, cc. 6-9 (Beames Ed. 1900).

when he had fully performed his obligation.<sup>2</sup> The doctrines which have developed as to an equity of redemption<sup>3</sup> left the legal title of the mortgagee existing but vitiated.

A trust deed, which is also used in real estate financing, is distinguished from a mortgage in that title is conveyed to a third person or trustee for the benefit of both the maker and the holder of the evidence of the indebtedness. In Illinois, case law and the statutes treat a trust deed in the nature of a mortgage.<sup>4</sup>

The mortgage, as a security device, plays an important part in the financing of both urban<sup>5</sup> and rural<sup>6</sup> land operations. Long term credit has been a need of our economic system for centuries. Few persons acquiring a home or a farm have the full purchase price in cash.

### The Background of Usury Regulation

The term *usury* was originally applied to the exaction of any interest for the use of principal. Aristotle regarded it as unnatural.<sup>7</sup> The Old Testament forbade it as unbrotherly.<sup>8</sup> The common law of England and as it has been adopted and followed in the United States has never forbidden the exaction of usury on loans of money as a matter of general law or public policy, irrespective of statute. At this time the question of usury is to be considered as merely *malum prohibitum*, based exclusively on statutory prohibition, and should not be considered as *malum per se*.<sup>9</sup>

<sup>2</sup> Littleton on Tenures, Sec. 332 (Wambaugh Ed. 1903).

<sup>3</sup> The equity of redemption had become firmly established and fully defined by the time of *Casborne v. Scarfe*, 1 Atk. 603, 26 Eng. Rep. 377 (1737).

<sup>4</sup> Ill. Rev. Stat., c. 3, Sec. 152; c. 95, Sec. 23; c. 83, Sec. 11b; 1 Reeves, *The Law of Mortgages and Foreclosures in Ill.*, c-9 (1932).

<sup>5</sup> Since 1944 the Natl. Bureau of Economic Research has been engaged in work on Urban Real Estate Finance. Their project has been subdivided into (a) a basic study on "Urban Real Estate Markets: Characteristics and Financing," prepared by Ernest M. Fisher; (b) studies of urban mortgage lending by the four chief types of institutions, namely, large insurance companies (R. J. Saulnier), commercial banks (Carl F. Behrens), savings and loan associations (Edward E. Edwards), and the Home Owners' Loan Corp. (C. Lowell Harriss); and three summary volumes dealing with the Impact of Government on Real Estate Finance in the United States (Miles L. Colean), Comparative Markets and Risk Experience of Mortgage Lenders (J. E. Morton), and Economic Fluctuations and Urban Real Estate Finance (Wolfgang Stolper).

<sup>6</sup> Burkett and Parsons, *Buying Farms with Hundred Percent Loans*, 27 *Land Economics* 151 (1951).

<sup>7</sup> *Politics*, i, 3.

<sup>8</sup> Exodus 22:25-27; Leviticus 25:35-37; Deuteronomy 23:20.

<sup>9</sup> *Missouri K. & T. Trust Co. v. Krumseig*, 172 U. S. 351, 43 L. Ed. 474, 19 Sup. Ct. 179 (1899); *Lloyd v. Scott*, 4 Pet. (U. S.) 205, 7 L. Ed. 833 (1830); *Matlack Properties, Inc. v. Citizens' & S. Nat. Bank*, 120 Fla. 77, 162 So. 148 (1935); *Thomas v. Clarkson*, 125 Ga. 72, 54 S. E. 77, 6 L. R. A. (n. s.)

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The power of the legislature to regulate the rate of interest received for the use of money has been recognized from an early period in this country, although the degree of regulation has varied markedly.

Usury statutes are held to be valid police regulation for the protection of heedless borrowers whose necessities, real or imagined, frequently place them at the mercy of the lender.<sup>10</sup> The legislature has very broad powers in the regulation of usury, and statutes establishing maximum rates of interest will generally be upheld as not being in violation of the prohibition against class legislation.<sup>11</sup>

### Definition and Determination of Usury

The definition of usury imports the existence of certain essential elements generally stated to be (1) a loan or forbearance, either express or implied, of money or of something circulating as such; (2) an understanding between the parties that the principal shall be repayable absolutely; (3) the exaction of a greater profit than is allowed by law; and (4) an intention to violate the law.<sup>12</sup> The presence of these elements infallibly indicates usury irrespective of the form in which the parties disguise the transaction; on the other hand, the absence of any one of them conclusively refutes the claim of usurious practice.<sup>13</sup> In order that a transaction be deemed usurious these elements

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658 (1906); *Jones v. Nossman*, 114 Kan. 886, 221 Pac. 271, 37 A. L. R. 317 (1923); *Gehlert v. Smiley* (Mo.) 114 S. W. 2d 1029 (1937); *Houghton v. Page*, 2 N. H. 42 (1819), 9 Am. Dec. 30; *Lee v. Hillman*, 74 Wash. 408, 133 Pac. 583 (1913), L. R. A. 1918B 581, Ann. Cas. 1915A 759; *Hamilton v. Prouty*, 50 Wis. 592, 7 N. W. 659 (1880), 36 Am. Rep. 866.

<sup>10</sup> *State ex rel. Ornstein v. Cary*, 126 Wis. 135, 105 N. W. 792 (1905), 11 L. R. A. (n. s.) 174, writ of error dismissed. 204 U. S. 669, 51 L. Ed. 672, 27 Sup. Ct. 788 (1907).

<sup>11</sup> *Youngblood v. Birmingham Trust & Sav. Co.*, 95 Ala. 521, 12 So. 579 (1892), 20 L. R. A. 58, 36 Am. St. Rep. 245; *Re Stephan*, 170 Cal. 48, 148 Pac. 196 (1915); Ann. Cas. 1916E 617; *Straus v. Elless Co.*, 245 Mich. 558, 222 N. W. 752 (1929); *Wessell v. Timberlake*, 95 Ohio St. 21, 116 N. E. 43 (1916), L. R. A. 1917D 641, Ann. Cas. 1918B 402.

<sup>12</sup> *Jenkins v. Dugger*, 96 F. 2d 727, 119 A. L. R. 1484 (C. C. A. 6th, 1938), cert. den. 305 U. S. 623, 83 L. Ed. 398, 59 Sup. Ct. 84 (1938); *Seebold v. Eustermann*, 216 Minn. 566, 13 N. W. 2d 739, 152 A. L. R. 585 (1944); *Planters' Nat. Bank of Virginia v. Wysong & Miles Co.*, 177 N. C. 380, 99 S. E. 199, 12 A. L. R. 1412 (1919), cert. den. 250 U. S. 665, 63 L. Ed. 1197, 40 Sup. Ct. 13 (1919), writ of error dismissed. 251 U. S. 568, 64 L. Ed. 418, 40 Sup. Ct. 343 (1919); *Coast Finance Corp. v. Powers Furniture Co.*, 105 Ore. 339, 209 Pac. 614, 24 A. L. R. 855 (1922); *Beach v. Guaranty Sav. & L. Ass'n.*, 44 Ore. 530, 76 Pac. 16 (1904), 1 Ann. Cas. 408.

<sup>13</sup> *Lloyd v. Scott*, *supra* note 9; *MacRackan v. Bank of Columbus*, 164 N. C. 24, 80 S. E. 184 (1913), 49 L. R. A. (n. s.) 1043, Ann. Cas. 1915D 105; *Beach v. Guaranty Sav. & L. Ass'n.*, *supra* note 12; *Bexar Bldg. & L. Ass'n. v. Robinson*, 78 Tex. 163, 14 S. W. 227 (1890), 9 L. R. A. 292, 22 Am. St. Rep. 36.

must exist at the inception of the contract,<sup>14</sup> since a contract which in its inception is unaffected by usury can never be invalidated by any subsequent usurious transaction. It is the agreement to exact and pay usurious interest, and not the performance of the agreement, which renders it usurious.<sup>15</sup> The test to be applied in any given case is whether the contract, if performed according to the terms, would produce a rate of interest for the lender in excess of the amount allowed by law, and whether the parties intended such a result.<sup>16</sup>

The courts generally feel that the ingenuity of lenders and eagerness of borrowers to accede to any demand made by the lenders in order to obtain momentary relief from financial strain have resulted in a variety of devices to avoid the usury regulations. As a consequence, the courts will generally look to the substance of the transaction and disregard its form when the elements of usury appear to be present.<sup>17</sup> The cases are not decided by what the parties appear to be representing themselves as, but rather by what the transaction actually is as disclosed by a consideration of the entire evidence.<sup>18</sup>

### The Effect of Usury

A transaction intended to create a mortgage may not reach its objective, either wholly or in part, because the mortgagee had insisted upon receiving more interest than permitted by statute. The statutes vary in their provisions as to the effects which result when a loan is held to be usurious. One group of statutes imposes only a forfeiture of the excess interest or imposes a speci-

<sup>14</sup> *Nichols v. Fearson*, 7 Pet. (U. S.) 103, 8 L. Ed. 623 (1833); *Lloyd v. Scott*, *supra* note 9; *Gaither v. Farmers' & M. Bank*, 1 Pet. (U. S.) 37, 7 L. Ed. 43 (1828); *Sharp v. Mortgage Secur. Corp.*, 215 Cal. 287, 9 P. 2d 819 (1932); *State v. Bankers Finance Corp.*, 26 A. 2d 220 (Del., 1942); *Unity Plan Finance Co., Inc. v. Green*, 179 La. 1070, 155 So. 900 (1934); *Ayer v. Tilden*, 15 Gray (Mass.) 178, 77 Am. Dec. 355 (1860); *Richardson v. Campbell*, 34 Neb. 181, 51 N. W. 753 (1892), 33 Am. St. Rep. 633, overruled on another point in *Havemeyer v. Paul*, 45 Neb. 373, 389, 63 N. W. 932 (1895), and *Connecticut Mut. L. Ins. Co. v. Westerhoff*, 58 Neb. 379, 383, 78 N. W. 724 (1899), 79 N. W. 731, 76 Am. St. Rep. 101; *Armijo v. Henry*, 14 N. M. 181, 89 Pac. 305 (1907), 25 L. R. A. (n. s.) 275; *Southall v. Farish*, 85 Va. 403, 7 S. E. 534 (1888), 1 L. R. A. 641; *Ward v. Cornett*, 91 Va. 676, 22 S. E. 494 (1895), 49 L. R. A. 550; *Cissna Loan Co. v. Gawley*, 87 Wash. 438, 151 P. 792 (1915), L. R. A. 1916B 807, Ann. Cas. 1917D 722; *Heaberlin v. Jefferson Stand. L. Ins. Co.*, 114 W. Va. 198, 171 S. E. 419 (1933).

<sup>15</sup> *Seebold v. Eustermann*, *supra* note 12; *Southall v. Farish*, *supra* note 14.

<sup>16</sup> *Seebold v. Eustermann*, *supra* note 12.

<sup>17</sup> *Houghton v. Burden*, 228 U. S. 161, 57 L. Ed. 780, 33 Sup. Ct. 491 (1913); *Omaha Hotel Co. v. Wade*, 97 U. S. 13, 24 L. Ed. 917 (1877); *Andrews v. Pond*, 13 Pet. (U. S.) 65, 10 L. Ed. 61 (1839).

<sup>18</sup> *McBroom v. Scottish Mortg. & Land Invest. Co.*, 153 U. S. 318, 38 L. Ed. 729, 14 Sup. Ct. 852 (1894); *Omaha Hotel Co. v. Wade*, *supra* note 17; *Scott v. Lloyd*, 9 Pet. (U. S.) 418, 9 L. Ed. 178 (1835); *Bank of United States v. Waggener*, 9 Pet. (U. S.) 378, 9 L. Ed. 163 (1835); *Bank of United States v. Owens*, 2 Pet. (U. S.) 527, 7 L. Ed. 508 (1829).

fied penalty. Under this type of statute the mortgagor may secure a cancellation of the recorded mortgage by paying the debt with only the lawful interest,<sup>19</sup> and the mortgagee may foreclose, but only for the debt plus lawful interest.<sup>20</sup> A second group is more drastic—the transaction is completely invalidated, permitting the mortgagor to have the recorded mortgage cancelled without any payment whatsoever<sup>21</sup> and completely barring the mortgagee from foreclosure.<sup>22</sup>

A synopsis of the usury statutes of the various states is appended at the end of this article.

National banks are governed as to interest rates by a combination of federal and state statutes, and as to the penalties for usury by the federal regulations alone. The National Bank Act<sup>23</sup> provides, in essence, that a national bank may not charge or receive interest on a loan or discount at a greater rate than that allowed by the laws of the state, territory, or district in which the bank is located, or at a rate based on (and one per cent in excess thereof) of the rate in effect in the Federal Reserve Bank in the Federal Reserve District where the national bank is located, whichever of the two rates may be greater, except that if a different rate is limited for banks organized under state laws, the rate so limited shall be allowed to national banks organized or existing in such state.<sup>24</sup>

The penalties for non-compliance with the state usury laws by national banks are provided by federal regulations, to wit: forfeiture of the entire interest which the evidence of the debt carried with it or which has been paid, and liability for an action for double the amount of the interest paid.<sup>25</sup>

<sup>19</sup> *Heacock v. Swartwout*, 28 Ill. 291 (1862); *Walter v. Calhoun*, 88 Kan. 801 (1913); *Levenson v. Cohen*, 250 Mich. 31, 229 N. W. 433 (1930).

<sup>20</sup> *Poult v. Cairo Bkg. Co.*, 158 Ga. 338, 123 S. E. 292 (1924); *Harbison v. Houghton*, 41 Ill. 522 (1866); *Boynton v. Remsen*, 133 Md. 101, 104 Atl. 527 (1918); *Pond v. Causdell*, 23 N. J. Eq. 181 (1872); *Rogers v. Booker*, 184 N. C. 183, 113 S. E. 671 (1922); *Gunness v. Stever*, 60 Okla. 24, 158 Pac. 568 (1916); *Ward v. Sharp*, 15 Vt. 115 (1843).

<sup>21</sup> N. Y. Stat. (McKinney, 1950) Gen. Bus. Law sec. 377, expressly forbidding any judicial requirement of payment as condition of clearing the record title. Applying this statute, *Jaen v. Greater Co. Realty Corp.*, 83 N. Y. S. 2d 360 (1948).

<sup>22</sup> *Munter & Faber v. Linn*, 61 Ala. 492 (1878); *Mitchell v. Preston*, 5 Day (Conn.) 100 (1811); *Drury v. Morse*, 85 Mass. 445 (1862); *Genl. Motors Accept. Corp. v. Weinrich*, 218 Mo. App. 68, 262 S. W. 425 (1924); *Laskowitz v. Getzowitz*, 211 App. Div. 239, 207 S. 355 (1925); *Weaver Hard. Co. v. Solomovitz*, 235 N. Y. 321, 139 N. E. 353 (1923); *Casner v. Hoskins*, 64 Ore. 254, 130 Pac. 55 (1912); *Heath v. Page*, 48 Pa. 130 (1864); *Robertson v. Campbell*, 2 Call (Va.) 421 (1800); *Fay v. Lovejoy*, 20 Wis. 428 (1866).

<sup>23</sup> 12 U. S. C. A. Sec. 21, *et seq.*

<sup>24</sup> 12 U. S. C. A. Sec. 85.

<sup>25</sup> In *First Nat. Bank v. Childs*, 130 Mass. 519, 39 Am. Rep. 474 (1881), it was pointed out that the rate of interest which a national bank in any

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### Where the Risk of Usury Lies

It is obvious that usury will lie where the rate of interest shown on the face of the note exceeds the statutory maximum. Therefore, this article will consider those matters that are not quite so apparent.

The charges with which the mortgage lender must concern himself are what is known in the trade as *finders* or *placement fees* and *closing costs*, covered below under the title of *commissions* and *expenses* respectively. It should be borne in mind, however, that usury will only lie where the total of these charges plus the interest set forth in the mortgage note exceed the legal maximum.

The reasonableness of the charges as to amount against the borrower seems to be given considerable weight in determining their character as usurious or not. Many cases refer to the unreasonableness of such charges as a ground for considering them illegal.<sup>26</sup>

#### 1. *Commissions*

While the courts generally hold that the payment of a commission to one acting as agent for the borrower in negotiating a loan will not render the loan usurious, they hold different views as to the effect on the loan when the borrower's agent shares his commission with the lender. Most courts hold that if a part of the commission is paid to the lender as an inducement to grant the loan, the transaction will be deemed usurious.

Usually when the lender takes a share in the commission paid to the borrower's agent as a part of the consideration for the loan, it will be considered to be a device to obtain more than the legal rate of interest, and consequently will make the loan usurious.<sup>27</sup> There have been some cases, however, where loans have been held not to be usurious, even though it appeared that the division of the broker's commission with the lender was exacted as a condition of granting the loan, on the theory, that the borrower had already agreed to pay the commission to his

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state may take is determined and fixed by the federal statute, although it is measured in such state by reference to the local law concerning interest, if there is one; and that when a bank takes interest in excess of the legal rate, it violates a federal law, and not the law of the state, the consequences being those provided by federal law and not those provided by state law.

<sup>26</sup> *Sherwood v. Roundtree* (CC Ga.), 32 Fed. 113 (1887); *Douglass v. Boulevard Co.*, 91 Conn. 601, 100 Atl. 1067 (1917); *Avery v. Creigh*, 35 Minn. 456, 29 N. W. 154 (1886).

<sup>27</sup> *Fisher v. Porter*, 23 Fed. 162 (1885) (recognizing rule) (CC Neb.), *Jones v. Phillippe*, 135 Ark. 578, 206 S. W. 40 (1918); *O'Neil v. Cleveland*, 30 N. J. Eq. 273 (1878).

agent, and therefore was not paying any more simply because the agent divided the commission with the lender.<sup>28</sup>

A division of the commission of the borrower's agent with the agent of the lender will not charge the lender with usury when he does not have knowledge of the division and does not authorize or benefit from it.<sup>29</sup>

The majority rule is that a loan is not made usurious if the lender's agent charged the borrower a commission or bonus in excess of the maximum legal rate of interest for procuring the loan, when the charge was made for the agent's own benefit, was made without the knowledge of the lender or his consent either express or implied, and was not ratified or shared in by the lender.<sup>30</sup>

When an agency is general, it has been decided in several cases that the lender will be affected by the exactions of the agent even though made without the actual knowledge or authority of the lender and even in some cases contrary to his express instructions.<sup>31</sup>

It is generally held that the exaction of a commission from the borrower by the lender's agent will render the transaction usurious if such exaction is known to, or authorized by, the lender.<sup>32</sup>

Authority of a nature to make the lender responsible for usury has frequently been inferred from the fact that there was either an express or implied understanding between the lender and his agent that the latter would get his compensation from the borrower.<sup>33</sup> The understanding that the lender's agent will be remunerated by the borrower has often been adduced from the fact that the lender avails himself of the agent's services without paying him anything.<sup>34</sup>

<sup>28</sup> *Jones v. Phillippe*, *supra* note 27; *Pushee v. Johnson*, 123 Fla. 305, 166 So. 847, 105 A. L. R. 789 (1936); *Patterson v. Blomberg*, 196 N. C. 433, 146 S. E. 66 (1929).

<sup>29</sup> *Dickey v. Brown*, 56 Iowa 426, 9 N. W. 347 (1881); *Union Cent. L. Ins. Co. v. Edwards*, 219 Ky. 748, 294 S. W. 502 (1927); *Acheson v. Chase*, 28 Minn. 211, 9 N. W. 734 (1881).

<sup>30</sup> *Call v. Palmer*, 116 U. S. 98, 29 L. Ed. 559, 6 Sup. St. 301 (1885); *Ginn v. New England Mortg. Secur. Co.*, 92 Ala. 135, 8 So. 388 (1890); *Condit v. Baldwin*, 21 N. Y. 219, 78 Am. Dec. 137 (1860), *affg.* 21 Barb. 181.

<sup>31</sup> *Matzenbaugh v. Troup*, 36 Ill. App. 261 (1889); *Avery v. Creigh*, *supra* note 26; *Ridgway v. Davenport*, 37 Wash. 134, 79 Pac. 606 (1905).

<sup>32</sup> *Eddy v. Badger*, 8 Biss 238, Fed. Cas. No. 4276 (CC Ill. 1878); *Vahlberg v. Keaton*, 51 Ark. 534, 11 S. W. 878 (1889), 4 L. R. A. 462, 14 Am. St. Rep. 73; *Rose v. Baxter*, 67 Ohio App. 1, 21 Ohio Ops. 41, 33 Ohio L. Abs. 546, 34 N. E. 2d 1011 (1941).

<sup>33</sup> *Clarke v. Havard*, 111 Ga. 242, 36 S. E. 837 (1900), 51 L. R. A. 499; *Freedman v. Katz*, 246 Mich. 296, 224 N. W. 325 (1929); *Brown v. Johnson*, 43 Utah 1, 134 Pac. 590 (1913), 46 L. R. A. (n. s.) 1157, Ann. Cas. 1916C 321 (recognizing rule).

<sup>34</sup> *Vahlberg v. Keaton*, *supra* note 32; *France v. Munro*, 138 Iowa 1, 115 N. W. 577 (1908), 19 L. R. A. (n. s.) 391; *Western Storage & Warehouse Co. v. Glasner*, 169 Mo. 38, 68 S. W. 917 (1902).



When a bonus or any part thereof which was taken by the lender's agent was exacted directly for the benefit of the lender, and he accepts it knowingly, he thereby becomes chargeable with usury.<sup>35</sup>

The requirement that the borrower pay a commission to the intermediary, through whom the loan was actually or apparently negotiated, will be held to constitute usury when the court can determine that the payment in excess of lawful interest was really exacted as a consideration for the loan, and not as a fee for the services of the agent to the borrower.<sup>36</sup> If the actual lender, in attempting to evade the usury statute, pretends to act as agent or broker, and takes a commission for his alleged service in negotiating the loan from a third party, the court will declare the transaction to be usurious.<sup>37</sup>

Commissions paid to an agent have also been held to render a loan usurious when the borrower was required or induced to go through the form of employing an agent, who was in fact acting for the lender; or even to execute an instrument in connection with the loan, containing a statement that the intermediary, through whom it was negotiated, was the borrower's agent.<sup>38</sup> Also held to be usurious are transactions by which one member of a family takes a commission for alleged services in negotiating loans from another member of the same family, when such arrangements appear to be a disguise for excessive compensation for the loan.<sup>39</sup>

## 2. Expenses

The majority view is that payment by the borrower of reasonable expenses incidental to the loan and of reasonable compensation for trouble and service involved in or necessitated by it, when done in good faith and not as consideration for the loan, is not usury even though the expenses may make the cost of the transaction to the borrower exceed the highest legal interest rate.<sup>40</sup>

<sup>35</sup> *Jones v. Phillippe*, *supra* note 27; *Rogers v. Buckingham*, 33 Conn. 81 (1865); *Scottish Mortg. & Land Invest. Co. v. McBroom*, 6 N. M. 573, 30 Pac. 859 (1892), *affd.* 153 U. S. 318, 38 L. Ed. 729, 14 Sup. Ct. 852.

<sup>36</sup> *Tompkins v. Vaught*, 138 Ark. 262, 211 S. W. 361 (1919); *Fitzgerald v. Maupin*, 5 Ky. L. R. 242 (abstract, 12 Ky. Ops. 246) (1883); *Adelson v. B. F. Dittmar Co.*, 124 Tex. 564, 80 S. W. 2d 939 (1935).

<sup>37</sup> *Commercial Secur. Co. v. Holcombe* (C. A. 5th Ala.), 262 Fed. 657 (1920); *Gardner v. Ruffner*, 206 Ala. 666, 91 So. 580 (1921); *Robertson v. Merwin*, 154 App. Div. 723, 139 N. Y. S. 726 (1913).

<sup>38</sup> *Sherwood v. Roundtree*, *supra* note 26; *State ex rel. Fatzer v. Miller*, 177 Kan. 324, 279 P. 2d 223, 52 A. L. R. 2d 691 (1955); *Olmsted v. New England Mortg. Secur. Co.*, 11 Neb. 487, 9 N. W. 650 (1881).

<sup>39</sup> *Armstrong v. McCluskey*, 188 Ark. 406, 65 S. W. 2d 558 (1933); *Braine v. Rosswog*, 13 App. Div. 249, 42 N. Y. S. 1098 (1897), *app. dismd.* 153 N. Y. 647, 47 N. E. 1105; *Dayton v. Dearholt*, 85 Wis. 151, 55 N. W. 147 (1893).

<sup>40</sup> *Lassman v. Jacobson*, 125 Minn. 218, 51 L. R. A. (n. s.) 465, 146 N. W. 350 (1914), *Ann. Cas.* 1915C, 774; *Iowa Sav. & L. Ass'n v. Heidt*, 107 Iowa

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Generally held not to render a loan usurious are the actual and reasonable expenses of preparing abstracts and of investigating and passing upon the title of the borrower to the property which will be mortgaged to secure the loan.<sup>41</sup> The actual and reasonable expenses to perfect the title of the borrower to the property offered as security for the loan and for removal of prior encumbrances can be charged against the borrower without rendering the loan usurious.<sup>42</sup> The requirement that the borrower shall pay the actual and reasonable cost of drawing or acknowledging or recording the papers connected with the loan will not constitute usury.<sup>43</sup>

The cases are not in accord as to whether attorney's fees or other expenses resulting from efforts to collect or settle an indebtedness may be included in a note given to secure additional time for payment without thereby causing it to be usurious.<sup>44</sup>

### 3. *Interest in Advance*

The problem area is the taking of interest before the expiration of the proportionate part of the entire period of the loan that represents the amount of the interest taken, assuming the interest to be computed at the maximum legal rate. The essence of the matter is that interest has been paid or promised for a future period as to which the borrower has not yet had the benefit of the principal.

The taking of interest at the highest lawful rate annually in advance has been held usurious. These decisions appear to have been based on strict *a priori* logic in applying the usury regulations.<sup>45</sup> The courts have upheld semi-annual advance interest payments, sometimes commenting that there is no objection to the taking of interest in advance.<sup>46</sup> The "net principal loaned"

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297, 43 L. R. A. 689, 70 Am. St. Rep. 197, 77 N. W. 1050 (1899); Robertson Bkg. Co. v. Chamberlain, 143 C. C. A. 82, 228 Fed. 500 (1916), reversing *Re Elmore Cotton Mills*, 217 Fed. 810 (1914).

<sup>41</sup> *Amondson v. Ryan*, 111 Ill. 506 (1885); *London Realty Co. v. Riordan*, 207 N. Y. 264 (1913), 100 N. E. 800, Ann. Cas. 1914C 408, affirming 148 App. Div. 854, 133 N. Y. Supp. 595 (1912); *Testera v. Richardson*, 77 Wash. 377, 137 Pac. 998 (1914).

<sup>42</sup> *Ballinger v. Bourland*, 87 Ill. 513, 29 Am. Rep. 69 (1889); *Testera v. Richardson*, *supra* note 41; *Rozier v. Evans*, 113 Ga. 1162, 39 S. E. 481 (1901).

<sup>43</sup> *Baird v. Millwood*, 51 Ark. 548, 11 S. W. 881 (1889); *Rozier v. Evans*, *supra* note 42; *London Realty Co. v. Riordan*, *supra* note 41.

<sup>44</sup> *Kent v. Phelps*, 2 Day (Conn.) 483 (1807); *Harger v. McCullough*, 2 Denio (N. Y.) 119 (1846); *Toole v. Stephen*, 4 Leigh (Va.) 581 (1833); *Whitworth v. Davey*, 279 Mo. 672, 216 S. W. 736 (1919), approving as to this point 185 S. W. 241 (Mo. App. 1916).

<sup>45</sup> *Penn Mut. Ins. Co. v. Carpenter*, 40 Ohio St. 260 (1883); *Polkinghorne v. Hendricks*, 61 Miss. 366 (1883).

<sup>46</sup> *Hoyt v. Pawtucket Institution for Sav.*, 110 Ill. 390 (1884); *Stark v. Coffin*, 105 Mass. 328 (1870); *Roller v. Hamilton*, 13 Tenn. App. 241 (1931).

formula has caused loans to be tainted with usury where the interest was taken quarterly in advance.<sup>47</sup> But the taking of interest monthly in advance will not generally render a loan usurious.<sup>48</sup>

When the lender has so delayed the delivery of the principal loaned that the period of actual enjoyment of the loan by the borrower is so abbreviated as to no longer support the interest taken as being within the statute, then usury will lie.<sup>49</sup>

Usury will not result, however, if the paying or taking of interest in advance is done voluntarily, on the part of the borrower, by way of personal convenience and not as a matter of contractual compulsion.<sup>50</sup>

### Principles Restricting the Risk of Usury to the Lender

#### 1. *Special Statutes covering Building and Loan Associations*

A number of courts have adopted a view of the relation between a building and loan association and a borrowing member, which is analogous to the partnership theory: that the relationship consists of two distinct and separate contracts, the one of membership and the other of the loan.<sup>51</sup> In several jurisdictions it is held that the loan contract of a building association is in the nature of a sale of a member's stock to the association, or more strictly, an advance by the association in anticipation of the maturity of the borrower's stock,<sup>52</sup> and that the sum advanced is not the debt or part thereof, but that the obligation of the member receiving it is to make the payments agreed upon until the unredeemed shares attain their face value.

The other view is that the transaction is simply a loan of money.<sup>53</sup>

<sup>47</sup> *Purvis v. Frink*, 57 Fla. 519, 49 So. 1023 (1909); cf., *Johnson v. Groce*, 175 S. C. 312, 179 S. E. 39 (1935).

<sup>48</sup> *Pope v. North Texas Bldg. & Loan Ass'n.*, 87 S. W. 2d 494 (Tex. Civ. App., 1935); *Geisberg v. Mutual Bldg. & Loan Ass'n.*, 60 S. W. 478 (Tex. Civ. App., 1900); cf., *Taylor v. Budd*, 217 Cal. 262, 18 P. 2d 333 (1933).

<sup>49</sup> *Smith v. Parsons*, 55 Minn. 520, 57 N. W. 311 (1893); *Mindlin v. Davis*, 74 So. 2d 789 (Fla. 1954).

<sup>50</sup> *Van Beil v. Fordney*, 79 Ala. 76 (1885).

<sup>51</sup> *Bell v. Southern Home Bldg. & L. Ass'n.*, 140 Ala. 371, 37 So. 237 (1904), 103 Am. St. Rep. 41; *Reeve v. Ladies Bldg. Ass'n.*, 56 Ark. 335, 19 S. W. 917 (1892), 18 L. R. A. 129.

<sup>52</sup> *Butson v. Home Sav. & T. Co.*, 129 Iowa 370, 105 N. W. 645 (1906), 4 L. R. A. (n. s.) 98, 113 Am. St. Rep. 463; *Bertche v. Equitable Loan & Invest. Ass'n.*, 147 Mo. 343, 48 S. W. 954 (1898), 71 Am. St. Rep. 571; *Washington Nat. Bldg. Loan & Invest. Ass'n. v. Stanley*, 38 Ore. 319, 63 Pac. 489 (1901), 58 L. R. A. 816, 84 Am. St. Rep. 793; *Crabtree v. Old Dominion Bldg. & L. Ass'n.*, 95 Va. 670, 29 S. E. 741, 64 Am. St. Rep. 818 (1898).

<sup>53</sup> *Lindsay v. United States Sav. & L. Co.*, 120 Ala. 156, 24 So. 171 (1898), 42 L. R. A. 783; *Falls v. United States Sav. L. & Bldg. Co.*, 97 Ala. 417, 13 So. 25 (1892), 24 L. R. A. 174, 38 Am. St. Rep. 194; *Bank of Newport v. Cook*, 60 Ark. 288 (1895), 30 S. W. 35, 29 L. R. A. 761, 46 Am. St. Rep. 171.

The majority of the courts hold that contracts of building and loan associations with their members, for a loan at a legal rate of interest, are not rendered usurious by the fact that the premiums, dues and fines exacted bring the total payment by the borrower to an amount exceeding the lawful interest on the loan.<sup>54</sup>

In many states special statutes have been enacted exempting building and loan associations from the operation of the general usury statutes.<sup>55</sup> A large majority of the courts have upheld the constitutionality of these exemptions,<sup>56</sup> on the basis that the plan of business adopted and the mutual participation in the profits arising from it make the associations so distinct a class as to justify special or distinctive legislation.<sup>57</sup>

Allegations of usury in connection with loans made by building and loan associations are usually based upon the premiums which the borrowers are required to pay in addition to legal interest. This allegation will not lie in those jurisdictions where the transaction is not regarded as a loan, but as a sale of the borrower's future interest in his stock, and the premium is considered to be a discount for payment in advance. Usury will not lie where, by a valid statute, associations are permitted to take premiums from borrowers and the taking of the premium conforms to the statutory terms.<sup>58</sup> The taking of premiums will, however, constitute usury where the taking did not conform to the statutory provisions therefor.<sup>59</sup> Thus, when a statute states that the premium is to be determined by open competitive bidding or in some other designated manner, a premium not thus taken taints the loan with usury when the premium and the interest combined exceed the statutory maximum.<sup>60</sup>

## 2. Corporations—Denial of the Defense of Usury

A statute denying a corporation the defense of usury was first enacted in New York in 1850, following the decision in *Dry*

<sup>54</sup> *West Winsted Sav. Bank & Bldg. Ass'n. v. Ford*, 27 Conn. 282, 71 Am. Dec. 66 (1858); *Delano v. Wild*, 6 Allen (Mass.) 1, 83 Am. Dec. 605 (1863); *Hickman v. Oklahoma Sav. & L. Ass'n.*, 169 Okla. 224, 36 P. 2d 928 (1934); *Collings v. Industrial Sav. Soc.*, 94 Okla. 271, 221 Pac. 1036 (1923); *Harper v. Middle States Loan, Bldg. & Constr. Co.*, 55 W. Va. 149, 46 S. E. 817 (1904), 2 Ann. Cas. 42.

<sup>55</sup> *Anna Loan & Improvement Co. v. Dorris*, 342 Ill. 567, 174 N. E. 865 (1931); *Iowa Sav. & L. Ass'n. v. Heidt*, *supra* note 40; *Preston v. Rockey*, 185 N. Y. 186, 77 N. E. 1156 (1906).

<sup>56</sup> *Cramer v. Southern Ohio Loan & T. Co.*, 72 Ohio St. 395, 74 N. E. 200 (1905), 69 L. R. A. 415, 2 Ann. Cas. 990.

<sup>57</sup> *Spithover v. Jefferson Bldg. & L. Ass'n.*, 225 Mo. 660, 125 S. W. 766 (1909), 26 L. R. A. (n. s.) 1135, 20 Ann. Cas. 1248.

<sup>58</sup> *Washington Nat. Bldg. Loan & Invest. Ass'n. v. Stanley*, *supra* note 52.

<sup>59</sup> *Falls v. United States Sav. Loan & Bldg. Co.*, *supra* note 53.

<sup>60</sup> *Anna Loan & Improvement Co. v. Dorris*, *supra* note 55.

*Dock Bank v. American Life Insurance & Trust Co.*,<sup>61</sup> whereby a New York banking corporation had succeeded in having its corporate obligations of \$250,000 declared void on the ground that they had been given in payment for usurious loans to the bank. This complete avoidance of liability made apparent the necessity of legislation to prevent the recurrence of such a result. A number of other states have since followed New York's lead, and have enacted similar legislation. This data is included in the table at the end of this note.

These statutes, depriving corporations of the right to the defense of usury in any action, have generally been held constitutional.<sup>62</sup>

In several cases it has been decided that statutes providing that corporations shall not interpose the defense of usury in any action are retrospective in operation, and apply to obligations incurred by corporations prior to the effective date of such legislation.<sup>63</sup>

Statutes which deny a corporation the right to interpose the defense of usury have generally been held to preclude a receiver of a corporation from interposing such defense.<sup>64</sup> Creditors are also generally precluded from the defense when the debtor corporation is itself under such a prohibition.<sup>65</sup> A few cases hold that, even though the corporation is denied the defense of usury, an individual who is a co-maker with a corporation on a usurious instrument may interpose the defense of usury.<sup>66</sup>

### 3. *Special F. H. A. Statute*

The F. H. A. has sponsored a statute, whereby locally chartered banks and sometimes locally chartered building and loan associations and insurance companies are authorized to invest in F. H. A. loans without being subject to the state usury statutes as well as certain other regulatory statutes. To the best of my knowledge, there is not yet any developed case law construing this statute, which has been enacted by about twenty-seven states. A typical enactment of this law will be found in New York *Unconsolidated Laws*, Ch. 13, Sec. 1.

<sup>61</sup> *Dry Dock Bank v. American Life Ins. & T. Co.*, 3 N. Y. 344 (1850).

<sup>62</sup> *Wm. S. & John H. Thomas, Inc., v. Union Trust Co.*, 251 Mich. 279, 231 N. W. 619 (1930); *Carozza v. Federal Finance & Credit Co.*, 149 Md. 223, 131 Atl. 332, 43 A. L. R. 1 (1925).

<sup>63</sup> *Curtis v. Leavitt*, 15 N. Y. 9 (1857).

<sup>64</sup> *Manufacturers' Finance Co. v. McKey*, 294 U. S. 442, 79 L. Ed. 982, 55 Sup. Ct. 444 (1935), revg. 72 F. 2d 471 (CA 7 Ill.) (Illinois Statute); *Felin v. Arrow Motor Mach. Co.*, 96 N. J. Eq. 44, 124 Atl. 448 (1924); *Curtis v. Leavitt*, *supra* note 63.

<sup>65</sup> *In The Vigilancia*, 73 Fed. 452 (C. A. 2 N. Y.), affg. 68 Fed. 781 (D. C. 1896).

<sup>66</sup> *Cabrera v. Olsen*, 165 Misc. 374, 300 N. Y. S. 524 (1937).

The effect of this is that locally chartered lending institutions can make an F. H. A. loan, which would otherwise be rendered usurious, whereas a local non-banking institution, federal savings and loan association, or foreign lender would be prohibited or subject to the penalty of the usury laws.

It is possible that a national bank could also make such loans under the protection of this statute, on the theory that a national bank may charge a higher rate of interest than that permitted under the national bank act, in those states where the statutory maximum for state chartered commercial banks is higher than the maximum set forth under the national bank act (12 USCA 85).

#### 4. *Negotiable Instruments Law Theory*

The preceding principles, which restrict the impact of the usury laws, apply to the original parties to the transaction as well as to a transferee of the parties. The NIL theory, absent any of the preceding protection, will afford protection only to a transferee of the mortgagee.

A mortgage alone will not ordinarily be considered negotiable;<sup>67</sup> however, when it has been given to secure a negotiable instrument and when the two documents are negotiated together, the mortgage will, in most jurisdictions, acquire some qualities of negotiability.<sup>68</sup>

The rule said to be followed by the majority of the courts is that when a mortgage and note have been negotiated to a holder in due course, the mortgage shares the same immunity from defenses as the note which is secured thereby. To have this status, the note must have been negotiated in such a manner as to free it from all equities existing in favor of the maker of the note, prior indorsers, or third parties.<sup>69</sup>

This rule has been developed as follows: The mortgage is simply a security for the debt which is evidenced by the note. To exist, a mortgage must secure a debt.<sup>70</sup> Thus, since the

<sup>67</sup> *Sanford v. Kane*, 133 Ill. 199, 24 N. E. 414 (1890), 8 L. R. A. 724; *Union Dime Sav. Inst. v. Wilmot*, 94 N. Y. 221 (1883), 46 Am. Rep. 137; *Weyh v. Boylan*, 85 N. Y. 394 (1881), 39 Am. Rep. 669; *Marling v. Fitzgerald*, 138 Wis. 93, 120 N. W. 388 (1909), 23 L. R. A. (n. s.) 177, 131 Am. St. Rep. 1003.

<sup>68</sup> *Foster v. Augustanna College & Theological Seminary*, 92 Okla. 96, 218 Pac. 335, 37 A. L. R. 854 (1923); *Lewis v. Kirk*, 28 Kan. 497, 42 Am. Rep. 173 (1882); See also *Jemison v. Howell*, 230 Ala. 423, 161 So. 806, 99 A. L. R. 1511 (1935).

<sup>69</sup> *Chicago R. Equipment Co. v. Merchants' Nat. Bank*, 136 U. S. 268, 34 L. Ed. 349 (1890); *Jemison v. Howell*, *supra* note 68; *Des Moines Sav. Bank v. Arthur*, 163 Iowa 205, 143 N. W. 556 (1913), Ann. Cas. 1916C 498; *Murphy v. Barnard*, 162 Mass. 72, 38 N. E. 29 (1894), 44 Am. St. Rep. 340.

<sup>70</sup> *Walsh, Mortgages*, Sec. 61 (1934) ("an assignment of the mortgage without the debt is a nullity in lien states and in title theory states the equi-

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mortgage is incidental to the note or debt, the negotiability of the note is imputed to the mortgage, therefore only those defenses which could be raised against the note can be raised against the mortgage.

This rule, said to be followed by the majority of states,<sup>71</sup> seems to be very narrow, if, in fact, it is actually followed.

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table or actual right to the security remains with the debt in spite of the assignment"); 2 Jones, *Mortgages*, Sec. 1019 (8th ed. 1928); Glenn, *Mortgages*, Sec. 314 (1943); 5 Tiffany, *Real Property*, Sec. 1448 (3rd ed. Jones 1939).

<sup>71</sup> *Alabama*: Hart v. Adler, 109 Ala. 467, 19 So. 894 (1896); Jackson v. Johnson, 189 Ala. 227, 66 So. 623 (1914); Royal Tire Service v. Shades Valley Boys' Club, 232 Ala. 357, 168 So. 139 (1936).

*Arizona*: Stock Growers Finance Corp. v. Hildreth, 30 Ariz. 505, 249 Pac. 71 (1926).

*California*: Hayward Lumber & Invest. Co. v. Naslund, 125 Cal. App. 34, 13 P. 2d 775 (1932).

*Colorado*: Frost v. Fisher, 13 Colo. App. 322, 58 Pac. 872 (1899); Cowing v. Cloud, 16 Colo. App. 326, 65 Pac. 417 (1901).

*Florida*: Taylor v. American Nat. Bank, 63 Fla. 631, 57 So. 678 (1912), Ann. Cas. 1914A 309; McClure v. American Nat. Bank, 67 Fla. 32, 64 So. 427 (1914); Pensacola State Bank v. McClure, 67 Fla. 289, 64 So. 1022 (1914).

*Indiana*: Gabbert v. Schwartz, 69 Ind. 450 (1880); Reeves v. Hayes, 95 Ind. 521 (1884).

*Iowa*: Clasey v. Sigg, 51 Iowa 371, 1 N. W. 590 (1879); Des Moines Sav. Bank v. Arthur, 163 Iowa 205, 143 N. W. 556 (1913), Ann. Cas. 1916C 498; Bank of Wayland v. Staidley, 185 Iowa 1286, 172 N. W. 9 (1919).

*Kansas*: Converse v. Bartels, 46 Pac. 940 (Kan. 1896); Berry v. Berry, 57 Kan. 691, 47 Pac. 837 (1897), 57 Am. St. Rep. 351.

*Kentucky*: Duncan v. Louisville, 13 Bush 378, 26 Am. Rep. 201 (1877).

*Maine*: Sprague v. Graham, 29 Me. 160 (1848).

*Massachusetts*: Watson v. Wyman, 161 Mass. 96, 36 N. E. 692 (1894); Murphy v. Barnard, *supra* note 69; Bon v. Graves, 216 Mass. 440, 103 N. E. 1023 (1914); Paika v. Perry, 225 Mass. 563, 114 N. E. 830 (1917).

*Michigan*: Barnum v. Phenix, 60 Mich. 388, 27 N. W. 577 (1886); Williams v. Keyes, 90 Mich. 290, 51 N. W. 520 (1892), 30 Am. St. Rep. 438; Costigan v. Howard, 100 Mich. 335, 58 N. W. 1116 (1894).

*Missouri*: Logan v. Smith, 62 Mo. 455 (1876); Goodfellow v. Stillwell, 73 Mo. 17 (1880); Hagerman v. Sutton, 91 Mo. 519, 4 S. W. 73 (1887).

*Nebraska*: Wortendyke v. Meehan, 9 Neb. 221, 2 N. W. 339 (1879); Cheney v. Cooper, 14 Neb. 415, 16 N. W. 471 (1883); Doll v. Hollenbeck, 19 Neb. 639, 28 N. W. 286 (1886); Cheney v. Janssen, 20 Neb. 128, 29 N. W. 289 (1886).

*New Hampshire*: Paige v. Chapman, 58 N. H. 333 (1878).

*New York*: Gould v. Marsh, 1 Hun. 566 (1874); Weaver Hardware Co. v. Solomovitz, 98 Misc. 413, 163 N. Y. Supp. 121 (1917).

*North Carolina*: Parker v. Thomas, 192 N. C. 798, 136 S. E. 118 (1926).

*North Dakota*: First Nat. Bank v. Flath, 10 N. D. 281, 86 N. W. 867 (1901).

*Oklahoma*: Farmers' Nat. Bank v. McCall, 25 Okla. 600, 106 Pac. 866 (1910), 26 L. R. A. (n. s.) 217; Smith v. Smith, 80 Okla. 136, 184 Pac. 82 (1919); Hummell v. Brown, 93 Okla. 256, 221 Pac. 738 (1923).

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The rule apparently stemmed from the decision in *Carpenter v. Longan*,<sup>72</sup> where the mortgagor gave a negotiable note secured by a mortgage, which was negotiated to an innocent purchaser for value. The transferee of the note and mortgage instituted foreclosure proceedings against the mortgagor-maker, the latter interposing a defense of set-off to the mortgage based on payments for grain due from the mortgagee to the mortgagor. The foreclosure was permitted notwithstanding the defense. The court stated that the mortgage followed the note and partook of the negotiable character thereof; thus the defense was not allowed against the mortgage. However, the court also stated that, since the holder of the negotiable note and the mortgage could recover against the mortgagor as maker in an action on the note, and could in turn satisfy the judgment from the mortgaged property, the holder could foreclose the mortgage to prevent a multiplicity of suits.

An analysis of this case, which is illustrative of today's practice of selling mortgages in the secondary market, as well as an examination of many cases decided under the so-called majority rule, will disclose that on the same or similar facts the same result

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*Oregon*: Bamberger v. Geiser, 24 Ore. 203, 33 Pac. 609 (1893); Starvaggi v. Ludden, 116 Ore. 119, 240 Pac. 432 (1925).

*Rhode Island*: Emery v. Mariano, 43 R. I. 376, 113 Atl. 3 (1921).

*South Carolina*: Dearman v. Trimmier, 26 S. C. 506, 2 S. E. 501 (1886); Patterson v. Rabb, 38 S. C. 138, 17 S. E. 463 (1893), 19 L. R. A. 831; Talbert v. Talbert, 97 S. C. 136, 81 S. E. 644 (1914).

*South Dakota*: Gold Bros. Secur. Co. v. Fidelity Trust Co., 47 S. D. 31, 195 N. W. 830 (1923); Barbour v. Finke, 47 S. D. 644, 201 N. W. 711, 40 A. L. R. 829 (1925).

*Tennessee*: Milan Mill. & Mfg. Co. v. Gorten, 93 Tenn. 590, 27 S. W. 971 (1894), 26 L. R. A. 135, 4 Inter. Com. R. 851; Nashville Trust Co. v. Smythe, 94 Tenn. 513, 29 S. W. 903 (1895), 27 L. R. A. 663, 45 Am. St. Rep. 748.

*Texas*: West v. First Baptist Church, 123 Tex. 388, 71 S. W. 2d 1090 (1934); Van Burkleo v. Southwestern Mfg. Co., 39 S. W. 1085 (Tex. Civ. App. 1896); Thomason v. Flippen-Prather Realty Co., 93 S. W. 2d 799 (Tex. Civ. App. 1936).

*Virginia*: Williams v. Gifford, 139 Va. 779, 124 S. E. 403 (1924).

*Washington*: Spencer v. Alki Point Transp. Co., 53 Wash. 77, 101 Pac. 509 (1909), 132 Am. St. Rep. 1058; American Sav. Bank & T. Co. v. Helgesen, 64 Wash. 54, 116 Pac. 837 (1912), Ann. Cas. 1913A 390, affd. on rehear., 67 Wash. 572, 122 Pac. 26 (1912), Ann. Cas. 1913A 396; Kiley v. Bugge, 165 Wash. 677, 5 P. 2d 1038 (1933).

*West Virginia*: Tucker County Bank v. Phares, 86 W. Va. 64, 103 S. E. 349 (1920); Morgan v. Farmington Coal & Coke Co., 97 W. Va. 83, 124 S. E. 591 (1924).

*Wisconsin*: Franke v. Neisler, 97 Wis. 364, 72 N. W. 887 (1897); Fred Miller Brewing Co. v. Manasse, 99 Wis. 99, 74 N. W. 535 (1898), 67 Am. St. Rep. 854.

<sup>72</sup> 16 Wall. 271, 21 L. Ed. 313 (U. S. 1873).



could have been reached under equitable principles without resort to the "negotiability rule."

Set forth below are but a few of the other principles which must be considered in connection with the "negotiability of mortgages rule."

According to most decisions, the holder in due course of a negotiable note secured by a mortgage cannot, in the absence of equities specially arising, enforce the mortgage if the transaction of mortgage was void and not merely voidable.<sup>73</sup> If duress is practiced in obtaining the execution of a mortgage securing a negotiable note, it is regarded by the court as rendering the transaction of the mortgage void; such fact, in the absence of additional circumstances raising a superior equity against the mortgagor, is available as a defense to the mortgage, even though the note has been negotiated to a due course holder.<sup>74</sup>

Another modification of the rule is that a purchaser or indorsee of the note secured by a mortgage takes it subject to rights previously acquired, if all the facts taken together, including sources of information and such circumstances which should provoke inquiry, show that to allow the transferee the status of a due course holder would not be equitable.<sup>75</sup>

For purposes of comparison, the minority doctrine followed in several jurisdictions<sup>76</sup> is that, even though a mortgage secures a negotiable note, the former is simply a chose in action, that none of the negotiability of the note is imputed to the mortgage, and

<sup>73</sup> *Parker v. Thomas*, *supra* note 71 (N. C.); *First Nat. Bank v. Bryan*, 62 Iowa 42, 17 N. W. 165 (1883); *Berry v. Berry*, *supra* note 71 (Kan.).

<sup>74</sup> *First Nat. Bank v. Bryan*, *supra* note 73; *Berry v. Berry*, *supra* note 71 (Kan.); cf., *Mack v. Prang*, 104 Wis. 1, 79 N. W. 770 (1899), 45 L. R. A. 407, 76 Am. St. Rep. 848.

<sup>75</sup> *Murphy v. Barnard*, *supra* note 69.

<sup>76</sup> *Illinois*: *Shippen v. Whittier*, 117 Ill. 282, 7 N. E. 642 (1886); *Barrett v. Hinckley*, 124 Ill. 32, 14 N. E. 863 (1888), 7 Am. St. Rep. 331; *Hirsh v. Arnold*, 318 Ill. 28, 148 N. E. 882 (1925).

*Louisiana*: *Schmidt v. Frey*, 8 Rob. 435 (1844); *Gardner v. Maxwell*, 27 La. Ann. 561 (1875). Minority in that negotiable theory not followed but ordinarily due course holder protected from defenses between original parties.

*Minnesota*: *Johnson v. Carpenter*, 7 Minn. 176, Gil. 120 (1862); *Hostetter v. Alexander*, 22 Minn. 559 (1876); *Blumenthal v. Jassoy*, 29 Minn. 177, 12 N. W. 517 (1882).

*New Jersey*: *Woodruff v. Morristown Inst. for Sav.*, 34 N. J. Eq. 174 (rule intimated) (1881). But in *Magie v. Reynolds*, 51 N. J. Eq. 113, 26 Atl. 150 (1893), support was given to the rule excluding defenses.

*Ohio*: *Baily v. Smith*, 14 Ohio St. 396, 84 Am. Dec. 385 (1863); *Ranney v. Hardy*, 43 Ohio St. 157, 1 N. E. 523 (1885); *Osborn v. McClelland*, 43 Ohio St. 284, 1 N. E. 644 (1885); *Pittsburgh, C. C. & St. L. R. Co. v. Lynde*, 55 Ohio St. 23, 44 N. E. 596 (1896) (affd. *Pittsburgh C. C. & St. L. R. Co. v. Long Island Loan & T. Co.*, 172 U. S. 493, 43 L. Ed. 528, 19 Sup. Ct. 238, 12 Ohio F. Dec. 333 (1899); *First Nat. Bank v. Brotherton*, 78 Ohio St. 162, 84 N. E. 794 (1908); *Ashland Bldg. & L. Co. v. Kerman*, 23 Ohio App. 127, 155 N. E. 245 (1926) (recognizes majority rule).

that it is subject in the hands of a holder in due course to all the equities and defenses to which it was subject in the hands of the mortgagee-payee.

### Summary

As asserted earlier in this article, one of our country's greatest needs is an ample supply of risk capital to invest in real estate mortgages. The remote lender, typified by life insurance companies and pension funds, can meet this need. Generally, however, they cannot be at the point of *closing*, and thus assure themselves that their mortgage investment is free of the defense of usury.

Although a transferee lender can avail himself of several defenses noted above, even these have serious limitations. In the case of a loan originated by a building and loan association, the mortgage purchaser must satisfy himself that the operational statutes have been strictly complied with, particularly with respect to the question of premium, which today has come to be more popularly known as *points*. The denial of the defense of usury to corporations is, of course, very effective as it relates to corporate borrowers. Even though these statutes are of great value in the financing of commercial structures, they do not afford any significant protection to the investor in residential mortgages. The special F. H. A. statute adopted in some states appears to afford a measure of protection, although there does not seem to have been any court test of its use as a defense, as yet.

The NIL negotiable mortgage theory also offers some protection to the investor, but, as shown above, it is neither universal nor clear-cut in the protection afforded. Further, the introduction of the Uniform Commercial Code in several of the states bodes fair to further confuse an already confused area of law.<sup>77</sup>

It is submitted that the time has come for a change in our usury laws as they relate to residential housing. It can be seen that no great hardship has been suffered by corporate borrowers who have lost such a defense. It may be argued that they are, on the whole, better informed than other borrowers; however, I would suggest that the average borrower who has had the acumen to accumulate the equity money for a conventional mortgage loan likewise has the capacity to evaluate his loan contract without the benefit of a paternalistic statute. As to minimum down payment loans insured by the federal government, both the V. A. and the F. H. A. have comprehensive bodies of regulations to protect

<sup>77</sup> Beggan and Kaelin, Uniform Commercial Code—Commercial Paper Transactions Between Code and Non-Code States: A Problem of Applicable Law, 34 Notre Dame Law 209 (1959); DeMartin, Negotiable Instruments—Burden of Proof on a Holder in Due Course, Comparison of Uniform Commercial Code with the Uniform Negotiable Instruments Law, 10 Mercer L. R. 211 (1958).

the borrower, and both agencies examine their loan transactions very thoroughly.

Neither can it be argued that a modification of the usury laws would be unduly in derogation of the common law, since the entire body of usury regulation is strictly statutory and any modification thereof would be restorative of the common law.

The parties to a real estate loan transaction should have the freedom to contract as regards usury and real estate mortgages. Rather than depend on tenuous protective principles, with their varying weaknesses, I suggest the adoption of a uniform statute in the several states to achieve the freedom urged. A single statute would be superior to the amendment of the Negotiable Instruments Law or the inclusion in the proposed Uniform Commercial Code, since it has been shown that the former already leads to confusion and the complete state-by-state adoption of the latter is probably a long way off. Such a statute could probably be most effectively promulgated by the National Conference of Commissioners on Uniform State Laws.

# TABLE OF STATE USURY STATUTES

State	Interest Rates (per cent)		Penalty for Violation	Statute
	Legal	Highest		
Ala.	6	8	Forfeiture of all interest and usurious interest paid deducted from principal.	Ala. Code (1940), as amended, Tit. 9, Secs. 60, 65, 66.
Alaska	6	8	All interest forfeited. Person paying usurious interest may recover double amount thereof by action brought within two years.	Alaska Comp. Laws Ann. (1949), Sec. 25-1-3.
Ariz.	6	8	Where greater rate than 8% is contracted for or received, all payments made on account thereof shall be deemed payments on principal.	Ariz. Rev. Stat. Ann. (1956), as amended, Sec. 44-1203.
Ark.	6	10	Interest and principal forfeited.	Ark. Const. Art. 19, Sec. 13.
Cal.	7	10	Usury is a misdemeanor. All interest is forfeited. Three times usurious interest paid may be recovered if over 12%.	Const. Art. XX, Sec. 22; Gen. Laws 1937, Act 3757, Secs. 1-3.
Colo.	6	12*	Three times excessive interest paid may be recovered.* (* Banks and savings and loan associations are generally exempt.)	Colo. Rev. Stat. (1953), Secs. 73-1-1, 73-3-1, 73-3-7, 73-3-10.
Conn.	6	12— but none if real estate mortgage in excess of \$5,000.	Neither interest nor principal can be recovered.	Conn. Gen. Stat. (1949) C. 325 Secs. 6776, 6779, 6782, 6783; Supp. (1955) C. 325, Sec. 2891d.
Del.	6	6	Forfeiture of excess over 6% interest. Corporation may not plead usury.	Del. Code Ann. (1953), Tit. 6, Sec. 2304.
D. C.	6	8	All interest forfeited. Usurious interest may be recovered.	Dist. of Col. Code (1951), Sec. 28-2701-04.
Fla.	6	10	All interest forfeited. Double the amount of interest collected is forfeited. Corporation cannot plead usury, unless higher than 15%. If interest in excess of 25% charged, both interest and principal are forfeited and lender is guilty of a misdemeanor.	Fla. Stat. 1957, Secs. 687.01 and 687.07.
Ga.	7	8	All interest forfeited and if paid may be applied against principal indebtedness.	Code of Ga. Ann. (1953), Sec. 57-101, 102, 112, 113.
Hawaii	6	12	All interest forfeited. Fine and/or imprisonment for charging usurious interest.	Rev. Laws of Hawaii (1955), C. 191, Secs. 1, 3, 4, 6.

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State	Interest Rates (per cent) Legal      Highest	Penalty for Violation	Statute
Idaho	6      8	All interest forfeited; twice the amount of usurious interest paid may be recovered.	Idaho Code Ann. 1948, as amended, 26-1907.
Ill.	5      7	All interest forfeited. Corporations may not plead usury.	Ill. Rev. Stat. (1957) C. 74, Secs. 1, 4, 6.
Ind.	6      8	Contract void as to interest in excess of 6%. Corporation may not plead usury.	Burns Ind. Stat. Ann. 1933, as amended, Sec. 19-2004.
Iowa	5      7	Principal only can be recovered; judgment rendered in favor of state for 8% per annum on amount of judgment.	Iowa Code Ann. (1950), Sec. 535-2, 4, 5, 6, 7.
Kan.	6      10	Double excess over 10% forfeited. Corporation can not plead usury.	Kan. Gen. Stat. Ann. (1949), as amended, Sec. 41-102 and Sec. 17-4103.
Ky.	6      6	Contract for more than legal rate is void as to the excess only. A corporation may not plead usury.	Laws (1960), Sec. 225.
La.	5      8	Where usurious interest is charged in a contract, in any suit thereon the rate is properly reduced to the highest rate allowed by statute—8%.	La. Rev. Stat., as amended, Art. 2924.
Me.	6      none on loan over \$300.00.	No usury law, except loans not exceeding \$300 are unenforceable if rate exceeds statutory limits.	Rev. Stat. Maine 1954, as amended, Chap. 59, Sec. 217.
Md.	6      6	Principal and legal interest thereon only can be recovered. Corporation may not plead usury.	Ann. Code of Md. 1957, as amended, Art. 49-4.
Mass.	6      None	No usury law.	Ann. Laws of Mass. (1954), C. 107, Sec. 3; Spec. Supp. (1958), C. 106, Sec. 3-122(4).
Mich.	5      7	Loss of all interest. Corporation may not plead usury.	Comp. Stat. Mich. (1948), Secs. 438.51-53, 450.78.
Minn.	6      8	Contract void, except as to bona fide purchaser. Corporation may not plead usury.	Minn. Stat. 1957, as amended, Sec. 334.03, and Sec. 334.021.
Miss.	6      8	All interest forfeited. All interest and principal when interest exceeds 20%.	Miss. Code Ann. (1942) Recompiled (1957), Secs. 36, 37.
Mo.	6      8	Corporation cannot plead usury. All interest over maximum forfeited. Borrower may recover such excessive interest paid and costs of any action.	Mo. Rev. Stat. (1949), Sec. 408.020, .030, .050, .060.

Mont.	6	10	Forfeiture of double the amount of interest received.	Rev. Code of Mont. (1947), Sec. 47-124, 125, 126.
Neb.	6	9	Forfeiture of all interest. Usurious interest paid is credited on principal.	Rev. Stat. of Neb. (1943—reissued 1952); Sec. 45-101, 102, 105.
Nev.	7	12	Interest in excess of maximum forfeited.	Nev. Stat. Rev. (1957) Tit. 8, Sec. 99.040, .050.
N. H.	6	None	No usury law.	N. H. Rev. Stat. Ann. (1955), Sec. 336:1.
N. J.	6	6	Principal only may be recovered. Corporation may not plead usury.	N. J. Stat. Ann., Perm. Ed., as amended, 31:1-6.
N. M.	6	10	Principal only may be recovered, less the interest contracted for. A borrower may recover twice the amount of interest paid. Corporation may not plead usury.	N. M. Stat. Ann. (1953), as amended, Sec. 50-6-18 and Sec. 51-2-34.
N. Y.	6	6	Corporation cannot plead usury (except under certain conditions in the case of one or two-family dwellings). All interest and principal forfeited and possible additional penalty of 2 times amount of interest paid.	G. B. L. Secs. 370, 372, 373, 374; B. L. Sec. 108, as amended 1957, C. 597.
N. C.	6	6	All interest forfeited and borrower may recover twice amount of interest paid.	Gen. Stat. of N. C. (1953), Sec. 24-1; Supp. (1957), Sec. 24-2.
N. D.	4	7	All interest forfeited plus 25% of principal. A borrower may recover double the amount of usurious interest paid plus 25% of principal.	N. D. Rev. Code (1943), Secs. 47-1405 and 1410.
Ohio	6	8	Interest payments in excess of 6% may be applied on the debt. A corporation may not plead usury.	Ohio Rev. Code Ann. (1953), as amended, Sec. 1309.04 and Sec. 1701.85.
Okla.	6	10	Forfeiture of double entire interest. A corporation may not plead usury.	Okla. Stat. (1951) as amended, Sec. 15-267-8; Laws 1947, H. B. 20, Sec. 26.
Ore.	6	10	Entire debt is forfeited. A domestic or foreign business corporation may not claim usury on written agreement if has entered into providing for interest not in excess of 12%.	Ore. Rev. Stat. (1953), Sec. 82.010, as amended L. 1959, C. 65, app'd 5/4/59.
Pa.	6	6	Corporation cannot plead usury. Interest in excess of maximum rate forfeited and may be recovered by borrower if paid or applied to principal indebtedness.	Purdon's Pa. Stat. Ann. (1954) Tit. 41, Secs. 2, 3, 4; Tit. 15, Sec. 2852.313.

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P. R.	6	9 on amounts up to \$3000; 8 on amounts over \$3000.	No interest is recoverable; creditor may recover only 75% of principal, balance is awarded to people of Puerto Rico.	Civil Code, Sec. 1652.
R. I.	6	30	Contract is void. Usury is a misdemeanor.	R. I. Gen. Laws (1956), Sec. 6.26.1, .2, .3, .4.
S. C.	6	7	All interest forfeited. A borrower may recover double the amount of usurious interest paid. Any corporation for profit with capital stock of \$10,000 or more is denied defense of usury.	Code of Laws of S. C. (1952), Secs. 8-2, 3, 5, 8.
S. D.	6	8	All interest forfeited. Only a railroad corporation may not plead usury.	S. D. Code (1939), Secs. 38.0108, .0109, .0110, .0111, and 52.0906.
Tenn.	6	6	Obligation void if usurious on its face. Where usury is not apparent on face of contract, the usurious part may be set aside, but the contract is enforceable as to the remainder. Usurious interest paid may be recovered	Tenn. Code Ann. (1955), Sec. 47-1604, 1612, 1615, 1617.
Tex.	6	10	All interest forfeited. A borrower may recover double the amount of usurious interest paid.	Vernon's Tex. Stat. (1948), as amended, Sec. 5073.
Utah	6	10	Interest is forfeited. If greater rate than lawful is paid, three times the amount so paid may be recovered.	Utah Code Ann. (1953), as amended, Sec. 15-1-7.
Vt.	6	6	Excess over 6% is forfeited or may be recovered.	Vt. Stat. Rev. (1947), Secs. 5438, 5441.
Va.	6	6	Principal only may be recovered. Corporation may not plead usury.	Code of Va. (1950), Sec. 6-346, 347, 349, 350, 351.
Wash.	6	12	Principal only may be recovered, less interest at contract rate. A borrower may recover twice the amount of usurious interest paid.	Rev. Code of Wash. (1951), as amended, Sec. 19-52-030.
W. Va.	6	6	Contract void as to interest in excess of 6%. Corporation may not plead usury.	W. Va. Code (1955), Secs. 4627, 4628, 4630, 4631, 4632.
Wis.	5	10	All interest is forfeited. Anyone paying over 10% may recover treble the amount paid over 10%. Corporation may not plead usury.	Wis. Stat. Ann. (1957), Sec. 115.04, .05, .06, .07; Supp. (1958), Sec. 115.04.
Wyo.	7	10	All interest forfeited and interest paid may be applied to principal indebtedness. Borrower may recover cost of any action.	Wyo. Compiled Stat. (1945), Sec. 39-1101, 1102, 1105.