

Mortgages--Charge for Privilege of Prepaying Mortgage Not Usurious (Feldman v. Kings Highway Savings Bank, 278 App. Div. 589 (2d Dep't 1951))

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MORTGAGES—CHARGE FOR PRIVILEGE OF PREPAYING MORTGAGE NOT USURIOUS.—Plaintiff was charged two thousand dollars for the privilege of prepaying a fifteen-thousand-dollar mortgage held by defendant-savings bank. The mortgage, then one year old, was a ten year five percent lien containing a prepayment privilege after five years upon forfeiture of ninety days interest. Plaintiff sought four thousand dollars as a "double the payment" forfeiture for usurious charges under New York Banking Law Section 108.¹ *Held*, judgment for plaintiff reversed. *Feldman v. Kings Highway Savings Bank*, 278 App. Div. 589, 102 N. Y. S. 2d 306 (2d Dep't 1951).

Special Term gave judgment for the plaintiff,² stating that to hold the two thousand dollar charge anything but a usurious interest payment would be to render the banking statute without substance.³ This decision caused considerable concern in real estate and banking fields.⁴ "If correct, it . . . might result in a revision of mortgage financing policy. . . ."⁵

The Appellate Division, Second Department reversed⁶ on the following grounds: first, the payment was not interest, but was consideration for a separate contract;⁷ second, even if the payment was interest there would be no usury, since the amount that could be earned had the loan run the full five years had not been exceeded.⁸

The weight of authority supporting these principles renders them indisputable.⁹ There is, nevertheless, no New York decision

¹ N. Y. BANKING LAW § 108, subd. 1. ". . . no bank . . . shall take, receive, reserve or charge on any loan . . . interest at a rate greater than six per centum per annum." The broad wording, "take, receive, reserve or charge," has been in the statute since 1882, surviving many amendments and revisions. Laws of N. Y. 1882, c. 409.

² *Feldman v. Kings Highway Savings Bank*, 124 N. Y. L. J. 252, col. 4 (Sup. Ct. Aug. 15, 1950).

³ "To condone this situation would be the equivalent of circumvention of the law, since if a 14 per cent 'prepayment charge' were to be sustained, then there would be no substance to the express language of section 108 of the Banking Law but only lip service. . . ." *Feldman v. Kings Highway Savings Bank*, *supra* note 2.

⁴ See N. Y. Herald Tribune, Nov. 2, 1950, p. 38, col. 6, Feb. 6, 1951, p. 27, col. 6.

⁵ *A Summary of Recent Decisions Relating to the Law of Real Property*, 14 TITLE GUARANTEE AND TRUST COMPANY 58 (1950).

⁶ The decision is being appealed to the Court of Appeals.

⁷ The court cites: *Hamilton v. Kentucky Title Savings Bank and Trust Co.*, 159 Ky. 680, 167 S. W. 898 (1914); *McCarty v. Mellinkoff*, 118 Cal. App. 11, 4 P. 2d 595 (1931).

⁸ The court cites: *French v. Mortgage Guarantee Co.*, 16 Cal. 2d 26, 104 P. 2d 655 (1940); *Barringer v. Jefferson Standard Life Ins. Co.*, 9 F. Supp. 493 (1935); see Note, 130 A. L. R. 73 (1941); 6 WILLISTON, CONTRACTS 4801, § 1696 (rev. ed. 1938).

⁹ See Note, 130 A. L. R. 73 (1941), and the many cases cited therein: ". . . courts in a majority of jurisdictions in which the question has arisen hold that a loan transaction which would be free from usury if the loan were paid at the agreed maturity is not rendered usurious by the borrower's voluntary repayment of the loan before maturity. . . ." *Id.* at 73. "In cases where the loan contract contained no option permitting repayment before maturity, it has

directly supporting these propositions.¹⁰ New York, however, is not entirely without analogous authority. "If the payment be conditional, and that condition is within the power of the debtor to perform, so that the creditor may, by the debtor's act, be deprived of any extra payment, it would not be usurious."¹¹ This principle was applied to cases where the *usurious option* was included in the express contract. In the instant case, despite the fact that the creditor set the amount of forfeiture (two thousand dollars), the payment was voluntarily made by the debtor. The principle cited, therefore, would seem more readily applicable to this situation since the usury laws are meant to protect the debtor¹² and, herein, the debtor voluntarily caused the alleged usury.

Unanswered by the Appellate Division, however, is the following observation of the special term judge: ". . . if a 14 percent [two thousand dollars] 'prepayment charge' were to be sustained . . . [charges] of amounts even greater . . . might well follow."¹³ It is possible to conceive of a situation where a bank might charge and receive a ten thousand dollar payment for prepayment of a ten thousand dollar mortgage. The lower court attempted to limit a bank's ability to charge by labeling the prepayment charge usurious *interest*.¹⁴ The charge was not interest,¹⁵ however, and in this the lower court erred.

Where prepayment rights are expressed in the mortgage, there is no problem. Our situation arises in cases where a borrower must bargain for the creditor's right to retain the mortgage. A withholding of this right by the bank does not constitute duress, because the bank

been generally held not usurious for the lender to require and receive a premium. . . ." *Id.* at 78.

¹⁰ A possible exception is the case of *Kilpatrick v. Germania Life Ins. Co.*, 95 App. Div. 287, 88 N. Y. Supp. 628 (1st Dep't 1904), relied upon heavily in appellant's brief. This decision, however, was subsequently *reversed* on the ground that the prepayment taken therein was paid under duress. Its usury aspect, therefore, was not decided. See 183 N. Y. 163, 75 N. E. 1124 (1905). It is interesting to note that the lower court opinion of the principal case cited the *Kilpatrick* decision for its duress holding.

¹¹ *Sumner v. People*, 29 N. Y. 337, 338 (1864); *Diehl v. Becker*, 227 N. Y. 318, 125 N. E. 533 (1919); *Pomeroy v. Ainsworth*, 22 Barb. 118 (N. Y. 1856); *Florida Land Holding Corp. v. Burke*, 135 Misc. 341, 238 N. Y. Supp. 1 (Sup. Ct. 1929), *aff'd*, 229 App. Div. 853, 243 N. Y. Supp. 799 (1st Dep't 1930).

¹² 6 WILLISTON, *CONTRACTS* § 1682 (rev. ed. 1938); WHITNEY, *LAW OF CONTRACTS* 150 (4th ed. 1946). "But in order to protect needy borrowers from unscrupulous lenders usury laws were enacted in England and have been enacted in most of our states."

¹³ *Feldman v. Kings Highway Savings Bank*, 124 N. Y. L. J. 252, col. 4 (Sup. Ct. Aug. 15, 1950).

¹⁴ Note that Section 108 of the Banking Law imposes a penalty for a charge of *interest* at a rate greater than six per centum per annum.

¹⁵ *Feldman v. Kings Highway Savings Bank*, 278 App. Div. 589, 590, 102 N. Y. S. 2d 306, 307 (2d Dep't 1951), ". . . the prepayment . . . was not a payment of interest and therefore could not be the basis of a claim of usury."

has the right to withhold.¹⁶ Banking, however, is affected with a public interest.¹⁷ Thus, should not banks be limited in their ability to exercise their right to withhold prepayment?

If the market value of mortgaged property rises during the term of a mortgage the risk lessens and the mortgage, as a lien, becomes more valuable. Prepayment, then, deprives a bank of an asset that has become more secure and therefore more valuable. Conversely, prepayment when the property's value falls is more desirable for a bank but less likely to be requested by the mortgagor. Why, then, should not a bank be permitted to bargain for its right to retain the lien?

It has been the policy of certain federal and state enactments to control the prepayment of mortgages by requiring the inclusion of prepayment provisions in mortgages.¹⁸ Possibly, New York should follow this trend as a matter of public protection. A proposed addition to the New York Real Property Law recently considered in the State Senate¹⁹ would require the inclusion of a borrower's prepayment option in all mortgages and extension agreements of amounts less than fifteen thousand dollars. This option would be exercisable at any time, but if exercised within eighteen months of the execution of the mortgage, the debtor would forfeit ninety days interest. This measure would protect small property owners who frequently enter mortgage contracts without legal counsel. Creditors holding the larger, more valuable liens would still have the right to bargain for prepayment.



MORTGAGES—LIMITATIONS—CONVEYANCE SUBJECT TO A MORTGAGE WHICH HAS BECOME BARRED.—Prior to this litigation there was a complicated series of transactions between plaintiff wife and defendant husband. In 1929, the wife conveyed the property which was the subject matter of this action to the husband who gave a bond and purchase money mortgage for 10,000 dollars on the property. In 1934, a short time after due date of the mortgage, the husband reconveyed to his wife. The deed stated that the mortgage was not

¹⁶ See 5 WILLISTON, CONTRACTS § 1601 *et seq.* (rev. ed. 1938).

¹⁷ *Leary v. Capitol Trust Co. of Schenectady*, N. Y., 238 App. Div. 661, 265 N. Y. Supp. 856 (3d Dep't 1933), *aff'd*, 263 N. Y. 640, 189 N. E. 735 (1934).

¹⁸ U. S. CODE, LAWS OF THE 78TH CONGRESS, SECOND SESSION 1944, c. 268, p. 313 (Serviceman's Readjustment Act of 1944), permits the Veteran's Administrator to require "G.I." mortgages to contain prepayment provisions. New York Banking Law, Section 393, requires that Savings and Loan Association mortgage loans shall be repayable upon forfeiture of ninety days' interest or one year's interest if the loan has not yet run for one year.

¹⁹ N. Y. State Assembly Introductory No. 16. Other compulsory prepayment bills are pending review in committee.