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Emergency Mortgage Legislation

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incidental monopoly was not within the statute. The *American Sugar Refining* case [19] held that the particular contract there involved was intrastate and hence the federal courts had no jurisdiction. In the *Northern Securities* case,[20] the concurring opinion of Justice Brewer referred to the common law rule of reason.[21] This "rule of reason" was proclaimed by the majority of the Court in the *Standard Oil* case [22] and the *American Tobacco* case.[23] The *U. S. Steel Corp.* case [24] declared that a monopoly must be successful or a series of acts must be prejudicial to society before a combination would be declared illegal. Thus the plain meaning of the Act was hedged about and construed away until it merely affected the form of combination, but was powerless to hinder monopolies which produced at minimum social cost. The recognition of this fact led to the Federal Trade Commission Act [25] and, under the sponsorship of the Commission, over a hundred trade practice conferences have been held in the past fifteen years. In spite of the rulings of the Federal Trade Commission which have been upheld by the Court,[26] the mushroom growth of the holding companies, culminating in the unstable pyramid of the 1929 boom and resulting in the recent collapse, brought home to the administration that monopoly is necessary and may be beneficial in the form of trade associations and labor unions under the rigid control of the government. Thus we see that the suspension of the anti-trust laws by the National Recovery Act is not a bolt from the blue in so far as it indicates a change in policy, but is the final recognition by the present administration of the underlying economic trend of the last half century.

RHEA JOSEPHSON.

EMERGENCY MORTGAGE LEGISLATION.—Out of the land has come the enormous wealth of this country and in the land has been invested the greater part of the wealth which the land has produced.

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[19] United States v. E. C. Knight Co., 156 U. S. 1 (1895).
[20] 193 U. S. 197 (1903).
[21] Mogul Steamship Co. v. McGregor, 61 L. J. Q. B. 295 (1892) A. C. 25.
[22] *Supra* note 15.
[23] *Id.* at 106.
[24] United States v. United States Steel Co., 251 U. S. 417, 40 Sup. Ct. 293 (1919).
[25] 38 STAT. 717 (1914) 15 U. S. C. A. 41, 45, 46 (1928), declaring that "unfair methods of competition in commerce are declared unlawful," that the Federal Trade Commission is established, *inter alia*, for investigation of compliance with anti-trust decrees; for investigation of violation of anti-trust statutes; and for readjustment of business corporations violating anti-trust satutes.
[26] Federal Trade Commission v. Gratz, 253 U. S. 421, 40 Sup. Ct. 572 (1920); Federal Trade Commission v. Beechnut Packing Co., 257 U. S. 441, 42 Sup. Ct. 150 (1922); Federal Trade Commission v. Sinclair Refrigerator Co., 261 U. S. 463, 43 Sup. Ct. 450 (1923).

There is no one who is not affected by mortgages on real property and a mortgage on good land has always been regarded as among the safest of investments.

Because of this fact, we find that Savings banks[1] in New York can invest up to sixty-five per cent of their funds in first mortgages on improved property and the portfolios of life insurance companies[2] hold a large proportion of them. Trust companies bought them in their fiduciary capacity[3] and prudent individuals chose them as a sure way of building up a secondary income. Lawyers recommended them to their clients for investments.

New York City was the prime field and its offerings found a ready market among mortgage investors. From this fact there was developed the conservative guaranteed mortgage which was issued by title or mortgage companies and sold by them to their clients with the companies' guaranty of payment of interest and principal at maturity and any charges which might be against the property because of the mortgagor's default.[4]

Mortgages in large amounts were sold to the banks, insurance companies, and the sizeable trusts. To provide an investment for the person of small means, the mortgage certificate was developed. This was a share or participation in a large mortgage or a group of small loans and was sold in units of $50.00 and $100.00.

The issuing company, as mortgagee, received all payments under the indenture both in the case of whole loans or certificates, and deducted one-half of one per cent from the interest rate in consideration of its guarantee. These companies were under the jurisdiction of the insurance department of the state, but they were not governed by the strict rules which have always been applied to the life insurance companies. There was no actuarial control, but this form of investment, nevertheless, had an exceptional record of safety for many years.

In the period from 1921 until 1929, realty experienced an unprecedented boom in the metropolitan area. Developments varying from small houses to the gigantic business buildings in Manhattan were erected and the mortgage market easily and greedily absorbed all offerings. The demand for securities and the facility with which they were sold undoubtedly caused competitive bidding between the companies which is proving disastrous in some instances. The guaranteed loans referred to here, however, are not to be confused with the speculative mortgage bond flotations which were also flourishing in this decade. Values mounted altitudinously and the amounts loaned on bond and mortgage rose proportionately. Rents were

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[1] N. Y. BANKING LAWS (1914) §239.

[2] N. Y. INS. LAW (1909) §100.

[3] N. Y. DEC. EST. LAW (1909) §111.

[4] *Supra* note 2, §§170-183.

high, but they were being collected by the landlord and the mortgagee was having scant trouble with defaults.

With the Wall Street crash of 1929, the high interest rate for call money dropped and starting in March, 1930, funds which had been diverted to the call money market came back to the mortgage field. There was a greater demand than supply and at a time when most securities had no sale at all.

The basis of value of real estate is, obviously, its income, and income is determined by supply and demand. The debacle of 1929 did not begin to be felt acutely in real estate until 1931. Reductions in income which persons received, and in an ever increasing number of cases, entire cessation of income, because of economic conditions, caused an upheaval which has now only started to settle back. Tenants had to remove to lower priced quarters; store-keepers had to have lower rents or close their shops; two and even three families began living together to conserve their slender resources. To offset this, landlords had to reduce their rentals to retain or attract tenants so that they might get some revenue from their holdings.

Meantime, fixed charges, such as interest and taxes were unchanged and the income was seriously impaired. Loans made in the boom years of 1926-1928 began to mature and it was found that there was an enormous shrinkage in value, due to decreased income.

Guaranteed mortgages, sold by title and mortgage companies, had an "eighteen months" clause in them which provided that, on maturity, the company could defer payment of the principal for that period of time. For the first time in their history, these companies invoked this clause in the fall of 1931.

Most investors in this type of security were usually content to let their funds remain with the companies, but financial distress caused tremendous numbers of them to ask the companies to redeem them at this time. Doing so, the liquidity of the companies was impaired and, also, paying interest and taxes on defaulted properties had rapidly eaten up the funds which their companies had been obliged to borrow from the Reconstruction Finance Corporation in 1932.

Savings banks and insurance companies with their millions in mortgages, both guaranteed and placed by them direct with borrowers, were caught in the deluge of foreclosure and in this time of chaos, President Roosevelt declared the Banking Holiday. Distress was everywhere; no section was immune. Properties could not be sold for amount of the first mortgages. All types of investors were involved, hardship faced many of them, and the income of our largest institutions was impaired, upon which, in turn, depositors and policy holders were depending absolutely.

To meet such a crisis temporarily, the following statutes were enacted by the Legislature of the State of New York during the regular and extraordinary sessions in 1933:

I. Mortgage Modification and Extension Act.[5]

II. Re-organization of Title and Mortgage Guaranty Companies.[6]

III. Certificate Holders Protective Corporation.[7]

This legislation was enacted entirely because of a serious public emergency. It contravenes the constitutions both of the United States [8] and the state of New York,[9] unless it is justified by public policy. To date of this writing, the Court of Appeals has not reported a decision on any of the various cases now in litigation.

I. Mortgage Modification and Extension Act.

Considering these three provisions as listed *supra,* the first enactment was effective April 21, 1933,[10] and it provides that "corporations, trustees, executors, administrators, guardians and other persons holding trust funds, savings banks and other corporations" which have investments on bond and mortgage now matured or maturing before April 1, 1935, which were within the legal ratio when made, but which may now be less than that ratio because of depreciated values, these institutions and individuals may extend these mortgages for a period of not more than five years from date of extension, and either with or without consideration, they may waive or modify any conditions or terms thereof, whether the mortgage be guaranteed or not.

In the present market it would be impossible in most cases to replace these loans with another mortgagee. To foreclose them would be a hardship not only on the mortgagor, but also on the mortgagee. Such an act would only lead to greater difficulty and perhaps result in a deficiency judgment against a mortgagor who had always been punctilious in observing his obligations under the indenture.

The banks, likewise, are enabled to do an act which would otherwise be illegal. Savings banks may lend up to sixty per cent of the appraised value of real property,[11] while trust money [12] and insurance funds [13] may be loaned up to sixty-six and two-thirds per cent.

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[5] N. Y. LAWS (1933) c. 319.

[6] *Id.* at c. 745.

[7] *Id.* at c. 453.

[8] U. S. CONST., Art. I, §10 and Amend. XIV.

[9] N. Y. CONST., art. I, §6.

[10] *Supra* note 5.

[11] *Supra* note 1.

[12] *Supra* note 3.

[13] *Supra* note 2.

The standing of guaranteed mortgages as conservative and safe investments can be shown by no better illustration than that the Legislature expressly authorized trustees to purchase them with the funds in their care.[14]

II. Re-Organization of Title and Mortgage Guaranty Companies.

This statute was enacted to be effective May 3, 1933,[15] and provides for the protection of holders of guaranteed mortgages and certificates of participation. The legislature acted because of public emergency so that the funds of these companies might be safeguarded for the good of the greatest number of the people of the state and to provide an orderly manner of liquidation, if needed.

Under this statute, the superintendent of insurance is vested with powers and "may take over, administer, exercise, conduct, execute and manage or he may restrict, limit, govern, control, direct, and regulate any or all of the functions of any guaranty corporations with respect to any mortgage investment sold or guaranteed by such corporation," whenever such action is deemed advisable by him in the interests of the security-holders, when, first, he has taken the company over for rehabilitation, or secondly, the security is in default.

The superintendent himself, or by agent, may perform any act which the company can do and may regulate the company's actions. Under this power he has continued the control which he exercised over the companies on March 15, 1933, during the Banking Holiday.[16]

As a result of his rulings, these companies are not permitted to disburse any moneys under any mortgage agreement, unless they have received these moneys from the mortgagor. That this is altering a contract in violation of the Constitution of the United States and also depriving the holder of property without due process would be beyond argument,[17] save for the crisis in public welfare. It is fully as justified in this economic strife as any war measure would be in time of invasion by a foreign enemy.

In this way only can the payment of principal be made more certain ultimately. To disburse the funds now available to those whose loans are maturing first would be grossly unjust to the other holders of similar securities whose holdings may not mature for two or three years. Such priority could not be justified on any equitable basis.

Under this authority, fourteen companies are now being operated in this manner and an orderly process of equitable administration and liquidation is in progress. No obligation to a security holder

[14] O'TOOLE, LAW OF TRUSTS (1933) 89.

[15] *Supra* note 6.

[16] N. Y. LAWS (1933) c. 40.

[17] *Supra* notes 9 and 10.

is impaired or waived by such operation under the Act. Various economies have been effected through consolidations and by eliminating expensive duplications. In the report to Governor Lehman by the Superintendent of Insurance, there is much to be found which confirms the hope of the ultimate benefit to all.[18]

III. Certificate Protection Corporation.

This statute [19] permits five or more persons to incorporate so as to operate the properties represented by the mortgage participation certificates which it holds for their owners. The corporation's life is limited to five years, but it may be renewed for a five-year period. Five directors, and not more than ten, all of whom must be citizens of the state of New York, endorsed by both the Governor and the Superintendent of Insurance conduct the corporation affairs for the benefit of those who deposit securities with it.

Expense of operation is shared on a *pro rata* basis of the security holdings of the members. The corporation stands in place of the mortgagee and has all his powers over the property which it may operate or manage and if it forecloses, it becomes a fee owner on sale. The corporation is governed by the New York General Corporation Law and the Stock Corporation Law, except when they conflict with this statute. Its capital is limited to $1,000 and shares have par value of $5.00.

These three enactments are most drastic in establishing public policy as supreme in a time of emergency, flaunting as they do the time-honored rules relative to contract rights [20] and the due process clause.[21]

The peril is so great and the distress so acute and general that it is difficult to see how the legislature's action could have been otherwise. It is unfortunately true that many mortgagors, like lessees, will believe that a valid instrument is only another scrap of paper which does not bind them at all. This class of persons has always existed and has usually felt that identical way about most of their obligations. Morally they are immune to everything and the legislature cannot change them. It is hard to think, however, that because of these emergency enactments individuals and corporations who have always heretofore met their obligations willingly and are now prevented from doing so only by extreme economic conditions, will not again perform their part of their contracts, when their financial positions are restored to them.

The home is the foundation of our national existence and its safety is the country's safety. The most desirable loan for a mort-

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[18] N. Y. L. J., Nov. 13, 1933, at 1739.
[19] *Supra* note 7.
[20] *Supra* note 9.
[21] *Supra* note 10.

gage investor whether he had a few thousand dollars of his own or was purchasing for an institution which had a billion, has always been the small home. Hence, more obligations affecting a maximum number of both borrowers and lenders are involved in our present crisis.

We have a triangle of three great institutions of our national life: our homes, our savings banks, and our life insurance companies. Select the one which we are going to let fall and then try to find a replacement for it. No small part of our present difficulty has been caused by improper financing and thousands of homes were purchased by families who should have deferred such action until they had more money to invest at the start. The speculative builder of large structures did the same thing. While they are seeking to remedy our emergency, and in so doing, are riding roughshod over the contract and due process clauses, perhaps the legislature might continue their action and avoid future repetitions, in part, by making drastic changes in the limits on mortgages and the minimum amount of cash which prospective purchasers or builders would have to put into an operation. Our forward progress might be at a much lower rate of speed, but the average attained might be higher. It would seem that the preventive powers of public policy should be as great as it is remedial.

In his message to Congress on April 13, 1933, concerning the Home Owners Loan Corporation, President Roosevelt said:

> "The broad interests of the nation require that special safeguards should be thrown around home owners as a guarantee of social and economic stability and that to protect home owners from inequitable enforced liquidation, in time of general distress, is a proper concern of the government."

J. H. C.