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Usury, Extra Payments, Deficiencies...

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Some new cases of vital importance to mortgage servicers lend themselves to a broad examination of a particular subject. Some critical holdings can be dealt with in fewer paragraphs. So, as not to neglect those, we offer the following potpourri of important decisions.

Usury is still usury

One of the dirtiest words in the lexicon of mortgages is usury. It is truly devastating.

Depending upon what category the lender or servicer finds itself (although this can vary from state to state), the best it can hope for if a loan is found usurious is loss of all the interest which would have attached to the obligation. The worst is that the loan will be declared absolutely null and void, with a consequent forfeiture of all interest and principal.

A rather standard attempt to avoid such a result is boilerplate language in many mortgages to the effect that if the loan is found to be usurious, the interest rate reverts down to a legal rate, thus saving the entire transaction. That was the approach relied upon by the lender in a New York case, *Simsbury Fund v. New St. Louis Associates, A.D. 2d, 611 N.Y.S.2d.557 (1st Dept. 1994).*

There, the lender assessed interest not only upon the monies advanced to the borrower, but also upon escrowed funds to which the borrower had no access. The lender's cause was not helped by the court's finding of the effective annual interest at approximately 80%!

The counter argument asserted by the lender was twofold. First, it said that ultimate full payment upon the loan would possibly yield a non-usurious rate. Additionally, there was verbiage in the documents attempting to reduce the interest to a legal rate if there was a finding of usury.

The court rejected the arguments *(citing Durst v. Abash, 22 A.D.2d 39, 253 N.Y.S.2d 351 affd 17 N.Y.2d 445, 266 N.Y.S.2d 806, 213 N.E.2d 887).* Aside from avoiding usury in any event, the ultimate lesson is confirmation that the so-called saving language doesn't save. Usury is still usury.

More than just P&I?

If a lender recoups all the principal and interest at the conclusion of a mortgage term (or earlier, depending upon the circumstances), success has been achieved. Where there has been a default - and a subsequent foreclosure - the lender or servicer will strive to also obtain legal fees and such costs, disbursements and allowances as the law in any given state may allow.

But there can be more - if the mortgage so provides - all as confirmed in a new case from New York, *SMG Associates v. Fine, A.D.2d, 611 N.Y.S.2d 643 (2d. Dept 1994).* Although the concept is likely to find application in more sophisticated mortgage transactions, the point is noteworthy for all.

A large parcel of property was sold. Both the deed and the resultant purchase money mortgage contained a provision that if the purchaser obtained a building permit for more than 134 units, then the purchase price would be increased by $4,500 per unit in excess of 134. The clause was stated to run with the land and be binding upon the purchaser.

When more than the threshold number of units *could* be built, the purchaser-mortgagor moved to declare void the further compensation provision, based upon claimed mistake or fraud. The court said no, finding a heavy presumption that a deliberately prepared written instrument manifests the true intentions of the contracting parties. Additionally, the court observed that the agreement was between worldly business persons represented by counsel and was unambiguous on its face.

The extra payment clause was upheld.

This one isn't so unique, but it comes up often enough (in New York, at least), to suggest value in making the point. Perhaps in that way lenders and servicers may avoid the pitfall we see too frequently. Consider the facts and remember the lesson.

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A fire substantially damaged mortgaged premises. The mortgagee was unfortunately not listed as a loss payee, but was nevertheless assured by the owners' insurance broker that mortgagee would be compensated for the covered loss. The insurance proceeds check was indeed written to both the owner and the mortgagee. Nevertheless, the owner deposited the check without the mortgagee's endorsement.

The inevitable foreclosure concluded with the mortgagee as the purchaser. No deficiency judgment was pursued. Ultimately, the damaged mortgagee sued the bank that negotiated the check (absent the mortgagee's signature), arguing various legal theories including conversion, negligence, breach of contract and an equitable interest in the insurance proceeds. One might think that justice would be on the side of the mortgagee, but not under these circumstances.

Because a mortgagee is entitled to only one satisfaction of the debt, bidding in of the debt at the foreclosure sale is the equivalent of a satisfaction of the obligation - and satisfaction terminates the insurable interest. Even had a deficiency emerged (that is, if the mortgagee had not bid up to its debt) where a deficiency judgment is not pursued, the proceeds of the sale must be deemed a full satisfaction of the mortgage obligation.

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As to conversion, only a person with rights in the instrument (the check) can claim conversion. However, when the insurable interest was extinguished, so, too, were the rights in the instrument. Likewise wiped out was any equitable claim to the insurance proceeds by virtue of the foreclosure sale coupled with neglect to procure a deficiency judgment. *(Bellusci v. Citibank, A.D.2d, 611 N.Y.S.2d 958 [3rd Dept. 1994].)*

The moral of this story is that the intersection of a foreclosure sale and a fire insurance loss likely requires pursuit of a deficiency judgment (to preserve the claim) and definitely necessitates exploring carefully the arcane law which applies. It's a minefield. SM