Usury and the Purchase Money Mortgage — An Appellate Division Faux Pas (?)(!)

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Dare the bar suggest that the bench (the Third Department to be precise) has stubbed its legal toe? Although euphemisms and other such niceties are usually employed in urging that a decision has gone astray, perhaps it will still be deemed appropriately civil to observe that the discussion of usury and its relationship to a purchase money mortgage in the 1992 case of *Dallas v. Dallas*[1] is manifestly incorrect.

The offending pronouncement is the broad holding that a mortgage given to secure money borrowed to purchase real property is not only a purchase money mortgage (which unquestionably it is), but the variety which exempts that mortgage from all usury proscriptions. Such is what the *Dallas* case says, although the foundation is constructed of quicksand, failing to properly mine the distinction between a purchase money mortgage generally and a "true" purchase money mortgage.

Background

A careful reading of case law persuades convincingly that a certain variety of purchase money mortgage — denominated here as a "true" purchase money mortgage — is exempt from usury statues in New York.[2] A description intended to define the true purchase money mortgage rules it to be

> "a mortgage executed at the time of purchase of the land and contemporaneously with the acquisition of the legal title, or afterward, but as part of the same transaction, to secure an unpaid balance of the purchase price."[3]

Inherent in the definition is that the lender is selling the property at issue and taking back a mortgage to secure all or a portion of the purchase price.

It is this true purchase money mortgage that does not constitute a loan or forbearance within the meaning of the usury statute, G.O.L. §5.501.[4] If such a mortgage is neither a loan or a forbearance, it is incapable of even being addressed by any usury proscriptions. Consequently, even though the interest charged upon such a purchase money mortgage exceeds the legal maximum, it cannot constitute usury.[5]

That this differentiation between a true purchase money mortgage and a purchase money mortgage generally should be more obvious than obscure is apparent. Many, and probably most mortgages **are** purchase money mortgages. Typically, loaned funds secured by real estate are advanced for the very purpose of purchasing that property. Does this mean, therefore, that virtually every such mortgage need not address the limits of interest to be charged? Hardly. Many lenders would be delighted with such a proposition, but it just isn't so, although the *Dallas* case purports to rule to the contrary.

Dallas and Its Analysis

In this case, defendant borrowed $45,200 from plaintiff to purchase a parcel of property. The full loan proceeds were applied to the purchase and the property was mortgaged to the plaintiff. A substantial monetary default upon the mortgage undeniably occurred, which thereupon precipitated a mortgage foreclosure action.

One of the defenses interposed was usury.[6] The Third Department affirmed the trial court's rejection of usury as a defense to summary judgment. It found that:

(a) A purchase money mortgage does not constitute a loan or forbearance pursuant to usury statues; and
(b) Any distinction between a true purchase money

(Continued on Page 5)

(Continued from Page 4)

> mortgage where the seller holds the mortgage to further the sale of the property and a third party mortgage has no bearing. (Citation for the principle was to, *inter alia, Barone v. Frie*, 99 A.D.2d 129, 131, 472 N.Y.S.2d 119 and *Szerdahelyi v. Harris*, 67 N.Y.2d 42, 46, 490 N.E.2d 517, 499 N.Y.S.2d 650).

The Flaws in *Dallas*

The leading case analyzing the purchase money mortgage exception to usury is the Court of Appeals decision in *Mandelino v. Fribourg*.[7] Curiously, *Dallas* conspicuously made no mention of *Mandelino*, even though the facts and ruling of the latter are both instructive and dispositive.

In *Mandelino*, a building was purchased for $15,500. Of the purchase price, $1000 was paid in cash with the balance financed by the seller holding a mortgage for $14,500. The legal rate of interest at the time of the transaction in January, 1964, was 6%. The mortgage, However, bore an interest rate on its face of 7%. Procedurally, it was the mortgagor who sought to declare the mortgage void as usurious.

The Court of Appeals found the question in the case to be whether a purchase money mortgage was to be regarded as a loan. The facts of the case, of course, involved a mortgage held by the seller of the property with the financing a part of the consideration. Moreover, the Court specifically referred to the mortgage at issue as a "true purchase-money mortgage."

In finding the purchase money mortgage (a "true" purchase money mortgage) free of any usury consequences, the Court reviewed the history of the concepts at length, presenting more than ample precedent for the proposition. The summary of authority was presented thus:

> "A synthesis of the rule in quite classic terms was made by Proskauer, J., in *McAnsh v. Blauner* (222 App.Div. 381, 382, 226 N.Y.S. 379, 381, *affd.*, 248 N.Y. 537, 162 N.E. 515): 'There was in fact no usury. A contract Which provides for a rate of interest greater than the legal rate upon a deferred payment, which constitutes the consideration for a sale, is not usurious.'
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> This principle seems to have been regularly followed at the Appellate Division. 'There is no usury in the normal purchase money mortgage transaction where a seller demands a higher price because the consideration is not all in cash' (*Butts v. Samuel*, 5 A.D.2d 1008, 174 N.Y.S.2d 325 [2d Dept.]). To the same effect and in almost the same language see *Dennis v. Thomas* (14 A.D.2d 895, 221 N.Y.S.2d 350 [2d Dept.]). An instrument which appears on its face to be a purchase money mortgage may in truth be a cloak for an actual loan at excessive interest and in this situation it may be deemed usurious (*cf. Del Rubio v. Duchesne*, 284 App. Div. 89, 130 N.Y.S.2d 572). But that is not this case. There is no doubt at all here that the instrument is what it purports to be: a purchase-money mortgage. And there is no subterfuge about it.[8]
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> Upon settled authority, then, the purchase money here in issue is not void for usury."

Mandelino v. Fribourg,[9] has never been reversed. That being so, and with *Dallas* having refrained from analyzing *Mandelino*, it could be opined that the authorities cited by *Dallas* would have to stand alone to support the conclusion of the case regarding usury and the purchase money mortgage. Those authorities do not, However, fulfill that function.

The first case relied upon in *Dallas* is *Barone v. Frie*.[10] *Barone*, which itself relied upon *Mandelino* as authority, did indeed involve a true purchase money mortgage. The only different elements were that the mortgage under assault was held by one of the sellers instead of all three, and that the mortgage attached to a parcel other than the one which was the subject of the sale. Nevertheless, the court found no basis to sunder accepted principles and ruled that usury did not exist. Thus, *Barone* does not change the law and provides no underpinning for the *Dallas* holding.

Nor does the reference to *Szerdahelyi v. Harris*[11] buttress the *Dallas* formulation. The issue in this case was whether a tender of excess interest by lender to borrower upon a usurious loan could purge the usury and preserve that portion of the loan which was otherwise legal.[12]

Neither the facts nor the holding change the tenets of *Mandelino*. Here, plaintiff needed funds to purchase a cooperative apartment. A portion of the purchase price was advanced by defendant (at a patently usurious rate of interest) through her agent, who in turn held the stock certificate as additional security along with a promissory note and an irrevocable stock power.

Only upon appeal did any contemplation of a purchase money mortgage as a possible exception to the usury claim arise. Critically, a purchase money mortgage was observed to be a "narrow exception to the restrictions on interest found in the usury laws. . ." This statement was followed by citation to *Mandelino*. The court found that the transaction at issue was not even a mortgage — purchase money or otherwise.

It then proceeded to define a purchase money mortgage in its oft-cited verbiage:

> "a mortgage executed at the time of purchase of the land and contemporaneously with the acquisition of the legal title, or afterward, but as part of the same transaction, to secure an unpaid balance of the purchase price(.)"

How then *Szerdahelyi* might sunder *Mandelino* and support *Dallas* is singularly perplexing.

(Continued on Page 6)

(Continued from Page 5)

Conclusion

The subject of usury may ultimately be coherent. But it mandates so many qualifiers, dependent clauses and sundry other explanations to elucidate the precepts that one could argue usury to be an arena of incoherence. Whatever its level of lucidity, it certainly does not benefit from another layer of contention, which the subject case certainly imposes — or at least presents.

Although *Mandelino v. Fribourg*[13] is absolutely clear, both in its analysis and conclusion, the resultant distinction between a true purchase money mortgage and the more generic purchase money mortgage may not have seeped into the practical consciousness of some portion of both bench and bar. In other words, the concept may be just arcane enough to have elicited the legal lapse in the *Dallas* case.

The basic issue should *not* be clouded, but this case may have developed enough of a shroud to foster some considerable confusion. Unfortunately, we may have to await a further appeal or a more expansive and penetrating ruling before the verities are pristinely resurrected.

Endnotes

1. Dallas v. Dallas, ___ A.D.2d ___, 582 N.Y.S.2d 835 (3d Dept. 1992).
2. Szerdahelyi v. Harris, 67 N.Y.S.2d 42, 490 N.E.2d 517, 499 N.Y.S.2d 650 (1986); Mandelino v. Fribourg, 23 N.Y.2d 145, 252 N.E.2d 823, 295 N.Y.S.2d 654 (1968).
3. Szerdahelyi v. Harris, *supra* note 2.
4. Mandelino v. Fribourg, *supra* note 2; Skidelsky v. Merendino, 133 A.D.2d 149, 518 N.Y.S.2d 822 (2d Dept. 1987); Barone v. Frie, 99 A.D.2d 129, 472 N.Y.S.2d 119 (2d Dept. 1984); Snow v. Golden Triangle Realty, Inc., 78 Misc.2d 483, 357 N.Y.S.2d 823 (1974); Del Rubio v. Duchesne, 127 N.Y.S.2d 648 (Sup. Ct. 1953), *modified*, 284 A.D. 89, 130 N.Y.S.2d 572 (1st Dept. 1954).
5. *Mandelino*, *supra* note 2; Dry Dock Bank v. American Life Ins. & Trust Co., 3 N.Y. 344 (1850); *Skidelsky*, *supra*, note 4; Barone *supra* note 4; Bennis v. Thomas, 14 A.D.2d 895, 221 N.Y.S.2d 350 (2d Dept. 1961); Butts v. Samuel, 5 A.D.2d 1008, 174 N.Y.S.2d 325(2d Dept. 1958); Del Rubio v. Duchesne, *supra* note 4.

   There is, not surprisingly, some nuance to the cited formulation. For exploration of that, attention is invited to 1 *Bergman on New York Foreclosures*, § 6.03[1][b] (Matthew Bender & Co., Inc., 1990).
6. The rate of interest was 10.5% together with 25% of the increase in the property value at the time of sale to be paid to plaintiff. The court found that it need not address whether this constituted a usurious rate because usury precepts had no application to the case.
7. *Supra* note 2.
8. Illustrative of the points, the court cited these cases as authority: Jackson v. Westchester Auto Credit Corp., 293 N.Y.2d 840, 59 N.E.2d 436; Hall v. Eagle Ins. Co., 151 App.Div. 815, 136 N.Y.S. 744, *affd.*, 211 N.Y. 507, 105 N.E. 1085; Orvis v. Curtiss, 157 N.Y. 657, 52 N.E. 690; Siewart v. Hamel, 91 N.Y. 199; Smith v. Cross, 90 N.Y. 549; Quackenbos v. Sayer, 62 N.Y. 344; Schermerhorn v. Talman, 14 N.Y. 93; Brooks v. Avery, 4 N.Y. 225; King v. American Home Sales Corp., 15 A.D.2d 932, 226 N.Y.S.2d 55; Morris Plan Ind. Bank of Schenectady v. Faulds, 269 App.Div. 238, 55 N.Y.S.2d 372; People v. Guttin, 266 App.Div. 1023, 44 N.Y.S.2d 821; Archer Motor Co. v. Relin, 255 App.Div. 1023, 8 N.Y.S.2d 469; Florida Land Holding Co. v. Burke, 135 Misc. 341, 238 N.Y.S. 1, *affd.*, 229 App-.Div. 853, 243 N.Y.S. 799.
9. *Supra* note 2.
10. *Supra* note 4.
11. *Supra* note 2.
12. The court ruled in the negative.
13. *Supra* at note 2.

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