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STATUS OF SECOND MORTGAGES EXECUTED BY BORROWERS FROM HOME OWNERS' LOAN CORPORATION

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IT HAS developed that, when the Home Owners' Loan Corporation was making loans in accordance with the Act of Congress approved on June 13, 1933, and subsequently amended, a number of original mortgagees of the borrowers who obtained loans, took back second mortgages in addition to the bonds and cash which they received from the Corporation. The validity or effect of such second mortgages has been the basis of a considerable number of suits brought for cancellation of the lien, or interposed as a defense when used as the basis for an action.

Among various powers and authorities granted to the Home Owners' Loan Corporation was the provision that the Corporation would be "under the direction of the Board and operated by it under such by-laws, rules and regulations as it may prescribe for the accomplishment of the purpose and intent of this section." The Act further specifically provided that, "The Board is authorized to make such by-laws, rules and regulations not inconsistent with the provisions of this Section, that may be necessary for the proper conduct of the affairs of the Corporation."

In accordance with the terms of the Act, the Board, from time to time, promulgated many rules and regulations which concerned the procedure of taking applications for loans, the various preliminary phases to making loans, and the final consummation of first liens, coupled with payment to the mortgagee or mortgagees then of record, through the medium of bonds or cash.

Although the Act did not specifically preclude the execution of a second mortgage by the borrowers to the original mortgagee, the Board, in its Manual of Rules and Regulations, passed in accordance with the power or authority conferred by the Act, did provide that: "The Corporation will not refund any indebtedness where the mortgagor is required to pay more than he owes, through agreements either to pay future interest

to the original mortgagee, or to absorb any loss of interest by the original mortgagee, or to guarantee any difference between the face value of the bonds plus accrued interest thereon and the market value of the same, or to cover any assumed loss on account of acceptance of the bonds of the Corporation by the mortgagee. The Corporation will not become a party to any contract between a mortgagor and mortgagee in reference to indebtedness refunded by the Corporation." In addition to this general statement, the Manual further provided that: "Where the full amount of the indebtedness against the property cannot be refunded by the Corporation, the mortgagee or other lien holder will be permitted to take a second mortgage or second deed of trust if the amount of such second mortgage or deed of trust does not exceed the difference between the Corporation's appraisal and the amount of the Corporation's first mortgage. In no case shall the second trust or second mortgage to such other mortgagee or lien holder be in terms which would cause the mortgagor's payments to the Corporation to be a hardship, or deprive the mortgagor of reasonable opportunity to pay such second mortgage or second trust."

The procedure used by the Corporation was, first, to decide that the applicant was elegible and that the value of the property permitted the making of a loan, and second, to obtain the consent of the mortgagee to accept the amount of bonds or cash which the Corporation, under its rules, could pay. In order to satisfy this second requirement, a mortgagee was required to sign an instrument known as "Mortgagee's Consent to Take Bonds." This consent was addressed to the Corporation, and originally read in part as follows:

"The undersigned is a holder of a first mortgage or other obligation, which constitutes a lien or claim on the title to the home property of ---------- located at ----------
(Number) (Street) (City)
----------in the sum of $----------
(State)

"Being informed that said owner has made application to Home Owners' Loan Corporation to refund his said indebtedness, the undersigned has considered the method of refunding mortgages provided in Home Owners' Loan Act of 1933, as passed by Congress and approved by the President, and the undersigned hereby consents, if said refunding can be consummated, to accept in full settlement of the claim of the

undersigned the sum of $_____, face value of the bonds of Home Owners' Loan Corporation, to be adjusted with not exceeding $50 cash as provided in said act, and thereupon to release all the cliam of the undersigned against said property.

"It is understood that you will incur trouble and expense in connection with your effort to refund the indebtedness of said home owner, and this consent is executed in consideration of the same and shall be binding for a period of_____days from date.

"This, the_____day of_____, 193____."

There are several main questions which seem to be involved in determining the legality of a second mortgage which was taken back by the original mortgagee. The first of these is whether the Mortgagee's Consent to Take Bonds, wherein the mortgagee agreed to accept bonds of the Home Owners' Loan Corporation in full settlement of his claim, operates as a release in full of the borrower's indebtedness, and the second, whether the note secured by a second mortgage taken back by the original mortgagee is void as against public policy.

To determine these questions, the procedure used by the Corporation in closing its loans must be borne in mind. It must further be remembered that the Mortgagee's Consent was executed by him voluntarily, and that prior to the execution of such Consent, the mortgagee had the choice of resorting to his legal remedies under the lien which he then held (and which necessarily had to be delinquent) in settlement of his claim. He chose, however, to voluntarily sign a Consent and to accept the bonds in the amount offered to him by the Corporation.

The determination of the question now properly brings to mind the consideration of whether the consent complies with the doctrine of accord and satisfaction. An accord is defined as being "An agreement whereby one of the parties undertakes to give or perform, and the other to accept in satisfaction of a claim, liquidated or in dispute, and arising either from contract or from tort, something other than or different than what he is, or considers himself entitled to; and a 'satisfaction' is the execution of such agreement." (Improved Industrial Order of Wise Men vs. Muskogee Securities National Bank, 139 Okla. 16, 280 Pac. 1087.)

Ordinarily accord and satisfaction is confined to unliquidated or disputed claims, but it may also apply to liquidated claims or to liquidated claims not in dispute.

Assuming that the lien which the Home Owners' Loan Corporation took over was a liquidated claim, the courts very generally have approved the principle that if a payment be made from funds furnished by or derived from another than the debtor, even though the amount is less than the liquidated or undisputed claim, it is an accord and satisfaction. (1 C. J., Accord and Satisfaction, Sec. 51; 1 RCL, Accord and Satisfaction, Sec. 28; Peoples Exchange Bank vs. Miller, 139 Kan. 3, 29 Pac. (2) 1079.)

In all cases where the Corporation refunded an indebtedness, there was no dispute between the parties as to the method of refinancing, and the transaction constituted an absolute agreement to substitute a different performance for the one provided by the original paper.

In 1 C. J., Accord and Satisfaction, Sec. 60, there is the statement that:

"The acceptance of bills of exchange or checks of a third person for a less amount than that due, in satisfaction thereof, operates as an accord and satisfaction. So the giving and acceptance of an order on a third person for less than the amount due, which order is duly paid, operates as an accord and satisfaction." (Citing cases.)

Further in 1 RCL, Accord and Satisfaction, Sec. 27, it is stated that:

"If a debtor gives his creditor a note, check or other security of a third person for a sum less than the debt and this is received in full satisfaction of the debt, this will constitute a good accord and satisfaction. This is a clear case of the creditor receiving something to which he was not entitled by his contract, and which he could not demand." (Citing cases.)

The adequacy of the consideration, if questioned, is immaterial. 13 C. J. Contracts, Sec. 637, enunciates the principle that:

"The inadequacy, as has been well said, is for the parties to consider at the time of making this agreement."

Where the amount received by the original mortgagee was not liquidated or matured, then, of course, the general proposition is that:

"Where a claim is unliquidated or in dispute, payment and acceptance of a less sum than claimed, in satisfaction, operates as an accord and

satisfaction, in the absence of fraud, artifice, mistake or imposition. * * *." (1 C. J., Accord and Satisfaction, Sec. 71.)

It would thus seem to be established that payment by the Corporation to an original mortgagee in bonds of a total value less than the sum due the creditor, regardless of whether the claim was liquidated or unliquidated, matured or unmatured, such payment by the Corporation and receipt by the original mortgagee would be sufficient basis for the courts to apply the doctrine of Accord and Satisfaction.

The second question is whether or not a second mortgage executed by the borrower to the original mortgagee for a deficiency when refinancing the loan, is void as against public policy. It must be borne in mind that the courts have uniformly held the Home Owners' Loan Corporation to be a relief agency and as such, it is to be considered in somewhat of a class by itself. In Pye vs. Gunart, 275 N. W. 615, the court stated that:

"The policy announced by the Home Owners' Loan Act is a policy of the United States by which we are bound, and there can be no question but that the United States can make its prohibition binding upon others than the technical parties to the loan contract in order to protect the borrowers. The Home Owners' Loan Corporation was created as a relief agency to save the investment of small home owners in distress by judiciously refinancing their obligations on such homes, and in connection with the significant purpose of the Act it justifiably prohibited contracts of the nature herein involved."

The principle that a contract is unenforceable which tends in a marked degree to bring about results sought to be prevented by an Act of Congress is found in Sage vs. Hampe, 235 W. S. 99, 59 L. Ed. 147:

"A contract that invokes prohibited conduct makes the contractor a contributor to such conduct. (Citing cases.) And more broadly, it long has been recognized that contracts that obviously and directly tend in a marked degree to bring about results that the law seeks to prevent cannot be made the ground of a successful suit. (Citing cases.) It appears to us that this is a contract of that class. It called for an act that could not be done at the time, and it tended to lead the defendant to induce the Indian owner to attempt what the law, for his own good, forbade."

In the case of Chaves County Building and Loan Assn. vs. Hodges, 59 Pac. (2nd) 671 (New Mex.), a case which

involved a violation of a Mortgagee's Consent to Take Bonds, the court states that:

"It has been held that the courts should take judicial notice of the fact that the Home Owners' Loan Corporation is strictly a relief agency, organized to aid distressed home owners in saving their homes. The reduction in the amount of the home owner's debt (which, of course, can be accomplished only with the consent of his creditor) is the most effective aid, in most instances, which can be rendered to him. Merely to put off the evil day of foreclosure would fail to carry out the purposes of the act. If the debt is more than 80% of the value of the home, creditor refused to discount his claim, the law afford no remedy. However, the creditor generally chooses to exchange his lien for a smaller sum in bonds. The Home Owners' Loan Corporation is interested in the reduction of the indebtedness of the home owner who procures a loan."

"The exact amount of the indebtedness to be canceled by the acceptance of its bonds and the amount loaned by the creditor on the tendered security are subjects upon which the Home Owners' Loan Corporation is entitled to accurate information; and which we may assume is to be considered in determining the amount which can be safely loaned to the home owners."

The case of Cook vs. Donner, 66 Pac. 2nd Series, p. 587 (Kans.), which concerned a second mortgage on property refinanced by the Home Owners' Loan Corporation, decided that:

"The Note and Mortgage sued on in this action were out of harmony with the statute and rules authorizing the work of the Home Owners' Loan Corporation and the release issued thereunder and showed bad faith, and were against public policy and therefore null and void."

In the Cook case, the court further considered the fact that certain state officials of the Corporation, and its attorneys, knew that a second mortgage was going to be executed by the borrower for the benefit of the original mortgagee, and claimed that such knowledge would comply with the Corporation's requirements governing the approval of second mortgages. Concerning this point, the court stated:

"That the claimed ratification was not effective because of the absolute invalidity of the Note and Mortgage."

In the case of Jessevich vs. Abbene, 277 N. Y. S. 599, the ruling of the court was against "secret collateral agreements as violative of the Home Owners' Loan Act." Further stating:

"Collusive agreement between creditor and home owner creating on the owner-occupied home encumbrances too heavy and terms too se-

vere for the home owner to work out his problem would easily defeat the very purpose of this act, interfere by trickery with this Corporation collecting its bonds, and the government's financial assistance would merely delay the inevitable foreclosure suit which it meant to prevent. The second mortgagee would thereby benefit by his own wrong, first, in being paid by the government the greater part of his second mortgage in its tax exempt bonds which it guarantees unconditionally both as to principal and interest; then by getting the defendant's homestead through foreclosure for the small balance due; and, lastly, by getting the benefit of the excellent first mortgage thereon, never intended for him."

"This contract calls for an act by the defendant owners which the law for their own good forbade. The United States can make its prohibitions binding to the extent necessary effectively to carry out its policies. Sage vs. Hampe, 235 U. S. 99, 35 S. Ct. 94, 59 L. Ed. 147. It is against the policy of the law to enable either party in controversies between themselves to enforce an agreement in fraud of the law. Edward Hart vs. City Theatres Co., 215 N. Y. 322, 109 N. E. 497."

An attempt was made in the Cook v. Donner case to distinguish between a "secret collusive agreement" and one where the state officials of the Corporation knew that a second mortgage was to be executed. In disposing of this point, the court stated that "Such agreement would seem to be prohibited whether they be secret or not."

In the First Citizens Bank and Trust Company of Utica vs. Speaker, 294 N. Y. S. 831, the plaintiff took a secured note for the balance allegedly due after refinancing with the Corporation. The court stated:

"We are of the opinion that the taking of the note on which this suit is based is against public policy and that the note itself is void."

Other cases are: Lyon vs. Adams, 294 N. Y. S. 732; Westchester Trust Company vs. Beicher, 247 App. Div. Rep. 778 (N. Y.); Meek vs. Wilson, 278 N. W. 731 (Mich.).

Stager vs. Junker, et al., 188 Atl. 440, contains the statement that:

"The Home Owners' Loan Act, 48 Stat. 128 (see USCA 1461 et seq.), was intended to provide emergency relief with respect to home mortgage indebtedness, and the rules of the corporation provide that no loan will be made where there was a separate understanding or agreement between the debtor and the holder of the mortgage calling for any payments other than those required by the corporation. The plaintiff, in order to facilitate the loan, stated the full extent of his debt and agreed to accept a definite number of bonds at face value in full settlement thereof. *He was then precluded from exacting any further or other*

agreement from his debtor looking to the payment of the additional sum. The mere fact that he exacted the instrument in suit, while the negotiations were pending and after he had agreed to accept a definite number of bonds in full settlement, *denotes bad faith toward the lending agency.* When he agreed to an acceptance of such reduction of bond interest, the acceptance related back to the first agreement, and was a reiteration of the promise there made to accept the bonds agreed upon in full settlement of the defendant's obligation in accordance with the rules of the lending corporation deemed necessary to rehabilitate the home owner. By means of the secret agreement the plaintiff could not defeat the express terms of his own agreement to accept the bonds of the lending agency in full settlement of the defendants' obligation."

In another recent decision, Anderson vs. Horst, 200 Atl. 721, the Superior Court of Pennsylvania, dealing with a second mortgage, stated:

"We are of opinion, therefore, that an agreement between the mortgagee and the home owner, made without the approval of the Corporation, by which the home owner assumes or agrees to pay all or any part of the mortgage debt which had been settled and released by the refunding effected by the Corporation is void as against public policy and will not be allowed to be enforced by the mortgagee."

Finally, assuming that the defense of ratification or subsequent approval is interposed, 13 C. J. 506 (Sec. 452-53) states that:

"A contract malum in se against public policy cannot be made valid by ratification. * * * An agreement void as against public policy cannot be rendered valid by invoking the doctrine of estoppel."

"It is obvious that a contract illegal or against public policy cannot be rendered valid by a subsequent ratification." 2 Elliott on "Contracts," Sec. 679.

Although other legal issues may be involved in any particular case, the foregoing is intended merely as a general discussion of the salient points in controversies between original borrowers and mortgagees as to the validity of second mortgages or deed of trust executed in connection with loans refinanced by the Home Owners' Loan Corporation.