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Notes and Comments

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NOTES AND COMMENTS

NEGOTIABILITY OF ILLINOIS MORTGAGES

Does the assignee of a negotiable note, and the mortgage securing it, take the mortgage subject to all the equities, infirmities, and defenses which the mortgagor could have asserted in an action brought to enforce the mortgage by the original mortgagee?

Marks v. *Pope*,[1] the latest Illinois case on this subject, has taken another important step toward removing Illinois from the small minority of states[2] which have answered the above query in the affirmative. This case arose when a trustee sought to foreclose a trust deed on Chicago real estate for the benefit of the holders of bonds secured by the trust deed and the maker of the bonds asserted a defense of usury. The facts of the case were somewhat involved[3] and the findings of the trial court were not as complete as they might have been, but the court passes over the non-essential facts to state the question as follows, "The question for decision, therefore, is whether the individual maker of a series of bonds which are payable to bearer, so as to be negotiable without endorsement, may interpose the defense of usury as against a holder in due course, when the trustee brings an action to foreclose the trust deed for the benefit of all bondholders."[4]

In an able and well reasoned opinion by Chief Justice Shaw, the court answered this question in the negative, limiting its decision, however, to the particular facts of this case. The court seemed to be impressed with the importance of the question here involved as it affects present day real estate loan transactions and hence consented to reexamine the

[1] 370 Ill. 597, 19 N. E. (2d) 616 (1939).

[2] Only three states seem to have followed the minority rule consistently. See Olds v. Cummings, 31 Ill. 188 (1863); Hirsh v. Arnold, 318 Ill. 28, 148 N. E. 882 (1925); Johnson v. Carpenter, 7 Minn. 176 (1862); Smith v. Parsons, 55 Minn. 520, 57 N.W. 311 (1893); Union Trust Co. v. New York, C. & St. L. R.R. Co., 9 Ohio Dec. 773 (1887); Baily v. Smith, 14 Ohio St. 396 (1863).

[3] The essential facts in the Marks case: Nicholas Pope and his wife, on October 8, 1925, executed a trust deed conveying real estate to Arnold K. Marks, as trustee, to secure the payment of their fifty-eight bonds, aggregating $40,000 in principal amount, dated October 10, 1925, due serially to October 10, 1932, payable to bearer, with interest at 7 per cent per annum. All of the bonds were delivered by the makers to Marks & Company, the house of issue, but, by a collateral agreement, Marks & Company withheld a commission of $4,000, or 10 per cent. Bonds totalling $18,000 in principal amount were paid as they matured, and all interest coupons due to and including October 10, 1932, were paid as due. There was a default in payment of the remaining $22,000 of principal on October 10, 1932, and the trustee filed a bill to foreclose for the benefit of the bondholders. The defendant asserted a defense of usury, and the trial court found that the defense had been proved, but held that it could not be asserted against holders in due course. The appellate court reversed the decree of the chancellor. Marks v. Pope, 289 Ill. App. 558, 7 N. E. (2d) 481 (1937).

[4] The appellate court had some difficulty with the question of whether the intervenor (a bondholder) had proved herself to be a holder in due course, but the Supreme Court dismissed the question, stating that Section 59 of the Uniform Negotiable Instruments Act (Ill. Rev. Stat. 1937, Ch. 98, § 79) provides that "every holder is deemed prima facie to be a holder in due course. . . ."

entire doctrine as laid down by previous Illinois cases.

The problem is probably as old as the practice of making mortgages of real estate to secure loans of money, but it seems to be peculiarly an American problem, since the practice of giving negotiable notes, instead of individual non-negotiable bonds, to evidence the indebtedness arose in this country. The history of the problem, the two contrary doctrines, and the reasons underlying them have been ably set out by Professor Britton in his article on assignment of mortgages[5] and need not be reexamined here.

The earliest case in Illinois squarely to present the problem was *Olds v. Cummings*,[6] decided in 1863, wherein the court committed Illinois to the rule later designated as the minority rule.[7] Although the opinion indicates that the court had found no cases contrary to the rule adopted

5 Wm. E. Britton, "Assignment of Mortgages Securing Negotiable Notes," 10 Ill. L. Rev. 337 (1915). Professor Britton states that the first case presented to an American court was Reeves v. Scully, Walkers Ch. (Mich.) 248 (1843), wherein the Michigan court adopted the majority rule without argument and without citing authority. The entire decision is as follows, "The decree must be entered for the amount of the note and mortgage. Reeves, as a *bona fide* endorsee of the note, was not affected by the equities existing between Hawkins and Scully. It would have been otherwise, if a bond, instead of a note, had been given with the mortgage." According to Professor Britton, the next cases arose as follows: Fisher v. Otis, 3 Pinney (Wis.) 78 (1850) stated the majority rule by way of dictum; Martineau v. McCollum 3 Pinney (Wis.) 455 (1852) adopted the majority rule without mentioning the previous Wisconsin or Michigan cases; Dutton v. Ives, 5 Mich. 515 (1858), and Craft v. Bunster, 9 Wis. 503 (1859), follow the previous holdings of these states. In Johnson v. Carpenter, 7 Minn. 176 (1862), the court examined the Michigan and Wisconsin cases but refused to follow them, adopting the minority rule. In 1863 came Olds v. Cummings, 31 Ill. 188, and Baily v. Smith, 14 Ohio St. 396, in which both courts adopted the minority rule on independent reasoning. In 1870 the Colorado Territorial Court, in Longan v. Carpenter, relied on Olds v. Cummings, 31 Ill. 188 (1863), and adopted the minority rule. This decision was reversed by the United States Supreme Court in Carpenter v. Longan, 83 U.S. (16 Wall.) 271, 21 L. Ed. 313 (1873) in a strong opinion. This soon became the leading case in the United States and was the basis for the rapid adoption of the majority rule in various states. For further discussion of the general topic, statements of the two rules and the reasoning on which they are based, and further citation of authorities see 41 C. J. 693, 694.

6 31 Ill. 188 (1863).

7 Perhaps the clearest statement of the minority rule is contained in Union Trust Company v. New York, C. & St. L. R. R. Co., 9 Ohio Dec. 773 (1887), "Whatever may be the law of any other state . . . in this state, it has been the settled and undisputed law . . . that a mortgage given to secure negotiable notes or bonds is itself a non-negotiable chose in action, and open to all defenses existing between the mortgagor and the mortgagee, even when the notes and bonds secured thereby, in the hands of innocent holders for value are not themselves open to any such defenses." A complete statement of the majority rule is contained in State National Bank v. Flathers, 45 La. Ann. 75, 12 So. 243 (1892): "A bona fide holder of a negotiable note acquired before maturity, secured by a mortgage duly recorded, which has been executed by one having lawful authority to make it, and bearing on its face nothing to impeach its validity, cannot be defeated in his mortgage rights by secret equities between the original parties existing before or arising after its execution, of which neither the act nor the public records afforded any notice, and of which he had no actual notice, at least when such equities are opposed by the original mortgagor or in his right."

in that case,[8] there were already decisions in other states holding to both the minority rule[9] and the majority rule.[10]

As with most legal problems affecting a large proportion of the people and involving substantial amounts of money, there were logical arguments to support both views. It was only natural that the early courts were loath to allow mortgages to take on the character of negotiable paper when mortgagor and mortgagee were known to each other, with the mortgagee usually being also the payee of the note and with neither party intending that the instruments circulate in commerce in the manner of bills and notes.[11] This view was adequate to the transactions of our pioneer days and, no doubt, worked substantial justice in most cases. It was no hardship in those days for a purchaser of a mortgage to get in his buggy and drive over to the mortgagor's house or farm and inquire whether the mortgage was valid and would be paid.[12] The Illinois court seemed satisfied with the rule of the Olds case and, during the next twenty years, applied it without question to cases of individual mortgages where the assignee attempted to defeat the defenses raised by the mortgagor.[13]

With the coming of the railroads and the growth of large cities, new methods of finance were necessary to raise the capital to develop our resources. The very size of industrial enterprises and construction projects made it necessary that the lenders of money be numerous and widely scattered. The device of the conveyance to a disinterested trustee to secure the payment of large issues of notes and bonds then came into general use. That this presented new problems to the courts is readily apparent. What inquiry could a bondholder in Illinois make of a railroad corporation in Delaware regarding the building of the road in Nebraska or the existence of fraud or usury in the contract with

8 The court states, "We have not met with a single case, where remedy has been sought in a court of chancery, upon a mortgage, by an assignee, in which every defense has not been allowed which the mortgagor or his representatives could have made against the mortgagee himself. . . . "

9 Johnson v. Carpenter, 7 Minn. 120 (1862).

10 Reeves v. Scully, Walkers Ch. (Mich.) 248 (1843); Dutton v. Ives, 5 Mich. 515 (1858); Fisher v. Otis, 3 Pinney (Wis.) 78 (1850); Martineau v. McCollum, 3 Pinney (Wis.) 455 (1852); Croft v. Bunster, 9 Wis. 503 (1859).

11 This view is admirably expressed in the Olds case: "Here is expressed the very essence of the reason of the law. Mortgages are not commercial paper. It is not convenient to pass them, from hand to hand, performing the real office of money in commercial transactions, as notes, bills and the like . . . it [commercial paper] relies upon personal security, and is based upon personal credit. It is a part of the credit system, which is said to be the life of commerce, which requires commercial instruments to pass rapidly from hand to hand. Mortgage securities are too cumbersome to answer these ends."

12 In the Olds case, it was said: "When one takes an obligation secured by a mortgage, relying upon the mortgage as the security, he must do it deliberately, and take time to inquire if any reason exists why it should not be enforced. . . . "

13 Hamilton v. Lubukee, 51 Ill. 415 (1869); Kleeman v. Frisbie, 63 Ill. 482 (1872); White v. Sutherland, 64 Ill. 181 (1872); Haskell v. Brown, 65 Ill. 29 (1872); Thompson v. Shoemaker, 68 Ill. 256 (1873); Bryant v. Vix, 83 Ill. 11 (1876); Melendy v. Keen, 89 Ill. 395 (1878); U. S. Mortgage Co. v. Gross, 93 Ill. 483 (1879); Ellis v. Sisson, 96 Ill. 105 (1880).

the corporate trustee or underwriting house in New York? Should the holders of such bonds, who were unquestionably bona fide purchasers for value without notice, be deprived of their rights because of some latent infirmity in the mortgage transaction as between the maker of the bonds and the underwriter, or between the maker and the construction company which accepted the bonds in payment for services and sold them on the market? There could be but one answer to the latter question and the Illinois court had no difficulty in answering in the negative in *Peoria and Springfield Railroad Co.* v. *Thompson*,[14] decided in 1882. That case expressed dissatisfaction with the rule of the Olds case, stating, "The rule . . . rests, at least in part, on technical grounds, which have lost much of their force in more recent times. . . ."

Since that time the court has held that the rule of the Olds case does not apply to large bond issues, but has continued to apply the rule to individual mortgages,[15] and also to chattel mortgages.[16] The court, however, has refused to apply the rule where the mortgagor made the payee his agent to sell the notes in the market,[17] where the notes were accommodation paper,[18] and where the defenses arose out of a collateral transaction between the mortgagor and mortgagee.[19]

Thus the court has whittled away at the broad rule of the Olds case and it is apparent that the rule now applies only within the narrower confines of individual mortgage transactions; but the basic, underlying principle that mortgages are assignable only in equity and that they pass to the assignee subject to all equities and defenses remains in the law of Illinois.[20]

No reason is apparent why the present day individual real estate loan, secured by a mortgage or trust deed, should not also be held to be free from all equities and defenses in the hands of a bona fide purchaser for value without notice. The reasons for the former rule have almost completely disappeared and it seems that the rule should go with them. It is now almost the universal practice, at least as regards urban loans, to execute bearer notes negotiable in form and to convey

14 103 Ill. 187 (1882).

15 Towner v. McClelland, 110 Ill. 542 (1884); Shippen v. Whittier, 117 Ill. 282, 7 N. E. 642 (1886); Hazle v. Bondy, 173 Ill. 302, 50 N. E. 671 (1898); Schultz v. Sroelowitz, 191 Ill. 249, 61 N. E. 92 (1901); Bouton v. Cameron, 205 Ill. 50, 68 N. E. 800 (1903); Bartholf v. Bensley, 234 Ill. 336, 84 N. E. 928 (1908); Peacock v. Phillips, 247 Ill. 467, 93 N. E. 415 (1910); Pittsburgh Plate Glass Co. v. Kransz, 291 Ill. 84, 125 N. E. 730 (1920); Hirsh v. Arnold, 318 Ill. 28, 148 N. E. 882 (1925).

16 Bryant v. Vix, 83 Ill. 11 (1876); Hodgson v. Eugene Glass Co., 156 Ill. 397, 40 N. E. 971 (1895).

17 McIntire v. Yates, 104 Ill. 491 (1882).

18 Naef v. Potter, 226 Ill. 628, 80 N. E. 1084 (1907); Foreman Trust & Savings Bank v. Cohn, 342 Ill. 280, 174 N. E. 419 (1931); Miller v. Larned, 103 Ill. 562 (1882).

19 Colehour v. State Savings Institution, 90 Ill. 152 (1878).

20 In Marks v. Pope, 370 Ill. 597, 19 N. E. (2d) 616 (1939), after summarizing the history of the doctrine in Illinois, the court states, "Inasmuch as the reasons for the decision in the Olds v. Cummings case do not exist in cases of a bond issue secured by a trust deed and intended to be sold on the open market, the rule does not apply." This seems to leave the rule of the Olds case in force in Illinois, with the few exceptions mentioned above.

the property to a corporate trustee who has no interest in the transaction (save to identify the note and trust deed). The mortgagor usually has all his dealings with a mortgage house or loan correspondent who handles all the details of closing and paying out the loan, but who has no intention of retaining the paper for investment. A large proportion of the loans are sold to insurance companies, investment trusts, university endowment funds, trust funds, and city banks, the purchasers of the loans relying on what is disclosed on the face of the instruments and on the public records.[21] Does it seem equitable to hold that such holders of notes and mortgages should be subject to all equities, defenses, and infirmities that may arise between a mortgagor and his broker or mortgage banker in an active and competitive loan market?[22]

The trend of thought among the members of the bar seems to be toward the view that notes and mortgages should be allowed to circulate as freely as possible, as is shown by some of the provisions of the proposed mortgage act prepared by a committee of the Chicago Bar Association.[23]

It is well that we now have definite assurance that urban bond issues, intended to be sold to the public, are free from latent equities and defenses; but the decision comes at a time when most of the defaulted bond issues of the 1920's have been foreclosed.[24] What will be the trend

[21] Of course, the large investors usually require the mortgagor to execute a so called "waiver of defense," in order to give themselves some protection from latent equities or defenses. This document merely recites that a certain mortgage and note, executed on a certain date and recorded on a certain date, is good and valid and free from all equities and defenses. The usual practice is to date these waivers subsequent to the note and mortgage, but they are generally executed in blank along with the mortgage and filled in later by the mortgagee or broker. Just what value this document would have in a real controversy, if the true facts of its execution were known, is problematical.

[22] While most loans are now being made at low rates of interest and small commissions, it must be remembered that we are not so far away from the days when 6 per cent to 7 per cent interest was not unusual and commissions often exceeded 4 per cent and 5 per cent. Thus the usurious loan contract is not wholly theoretical.

[23] See "Draft of a Bill for an Act to Revise the Law in Relation to Mortgages of Real Estate and the Foreclosure Thereof," Chicago Bar Association, 1939. Section 12 reads as follows: "A mortgage shall be considered as incident to the indebtedness thereby secured and shall be subject only to such matters of defense as appear of record at the time the mortgage is recorded or appear in the mortgage itself or would be available in an action at law upon the instrument evidencing the indebtedness secured by the mortgage."

[24] Foreclosures filed in Cook County, as reported in "Statistics on Mortgages and Foreclosures" published by Chicago Mortgage Bankers Association quarterly, January, 1939, edition:

Year	Number	Consideration Involved
1932	15,302	$587,055,603
1933	15,993	352,084,797
1934	12,632	166,661,467
1935	9,859	106,590,771
1936	8,369	91,613,274
1937	4,843	50,242,764
1938	3,247	35,949,564

For a thorough discussion of the foreclosure of urban bond issues see Homer

of the methods of financing in the next real estate boom is a matter of conjecture, but it now seems that a larger portion of the financing will be done by the corporate investors and trust funds mentioned above. It is to be hoped that the statutes can be revised to place Illinois in the list of states which allow mortgage paper to circulate freely, thus making real estate loan investments more attractive. But, until the statutes are revised, it is to be hoped that the Illinois Court will take the next logical step beyond the Marks case and overrule *Olds* v. *Cummings*[25] expressly and completely, thus freeing all mortgages from latent equities and defenses.

W. S. McCLANAHAN

RELEASE—RIGHT TO CONTEST VALIDITY—RESTORATION OF CONSIDERATION AS PREREQUISITE TO AVOIDANCE OF RELEASE PROCURED BY FRAUD IN THE INDUCEMENT.—In the last issue of the CHICAGO-KENT LAW REVIEW we had occasion to consider the question as to whether the Illinois courts would hold restoration of consideration to be a prerequisite to the avoidance of a release procured by fraud in the inducement, in a subsequent tort action based upon the same subject matter.[1] The New York case[2] upon which the comment was predicated has since been affirmed.[3] As the review of the earlier cases tended to indicate, it is now certain in New York that, where the cause of action is founded upon a completed rescission, payment or tender must be made before commencement of the action, but if the action is designed to secure rescission it will be sufficient to offer to return the amount received in the complaint and make the tender on the trial.

Eight days after the aforementioned decision, the Illinois Appellate Court handed down a decision[4] which throws some official light on the question so far as this state is concerned. The action was brought under the Injuries Act[5] to recover for the death of the plaintiff's intestate arising from an automobile collision. The defendant filed a motion to dismiss. attaching thereto a copy of a release procured from the deceased in his lifetime.[6] Upon denial of the motion, the defendant asserted the same matter in an answer. The plaintiff filed a reply in which it was averred that the deceased at the date of the release was of unsound mind and was unable to comprehend the nature of the release. Defendant denied the allegations of the reply, and the case was at issue. At the close of the evidence the defendant entered a motion for a directed verdict on the ground that the plaintiff's failure to return the fifty dollars which had been paid for the release was fatal to the cause of action. The Circuit Court overruled this motion and gave judgment for the plaintiff on the verdict. On appeal by the defendant, this was reversed, on the ground

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F. Carey and John W. Brabner-Smith, "Studies in Realty Mortgage Foreclosures in Cook County," 27 Ill. L. Rev. 475, 595, 717, 849, 28 Ill. L. Rev. 1.

25 31 Ill. 188 (1863).

1 17 CHICAGO-KENT LAW REVIEW 93.

2 Gilbert v. Rothschild, 5 N.Y.S. (2d) 52 (1938).

3 19 N. E. (2d) 785 (1939).

4 Roggenkamp v. Marks, 19 N. E. (2d) 828 (Ill. App., 1939).

5 Ill. Rev. Stat. 1937, Ch. 70.

6 Ill. Rev. Stat. 1937, Ch. 110, § 172 (g).

that the court should have sustained the defendant's motion for a directed verdict.

The court points out that a person seeking to avoid a contract for misrepresentation or lack of capacity is bound to restore all that he has received under it, and, while he might not be compelled to rescind before the suit is brought, as where he does not know of the existence or nature of the contract, still the rescission and offer to restore must be at the earliest practicable moment. The plaintiff's failure to so offer before defendant's motion for a directed verdict resulted in too long a delay and hence barred a recovery. Seemingly the only element which obviates the necessity of returning the money is "actual intended fraud."[7]

L. BRUNETTE

CIVIL PRACTICE ACT CASES

ACTION—ABOLITION OF DISTINCTION AS TO FORM—AVAILABILITY OF MOTION IN NATURE OF CORAM NOBIS IN CHANCERY PROCEEDINGS.—Section 72[1] of the Illinois Civil Practice Act, abolishing the writ of error coram nobis[2] and providing a similar remedy by motion to correct "all errors in fact, committed in the proceedings of any court of record, and which, by the common law, could have been corrected by said writ," was held applicable to chancery proceedings in the recent case of *Frank* v. *Newburger*.[3] It has generally been held, in the absence of statutory provision otherwise, "that a writ of error coram nobis has no place in chancery proceedings, and is strictly a common-law writ,"[4] although some equity courts have treated the petition for the writ as a bill to avoid a decree[5] or a motion for a new trial.[6] While the Frank case seems to reach a just result,[7]

[7] Pawnee Coal Co. v. Royce, 184 Ill. 402, 56 N. E. 621 (1900).

[1] "The writ of error coram nobis is hereby abolished, and all errors in fact, committed in the proceedings of any court of record, and which, by the common law, could have been corrected by said writ, may be corrected by the court in which the error was committed, upon motion in writing, made at any time within five years after the rendition of final judgment in the case, upon reasonable notice. . . . " Ill. Rev. Stat. 1937, Ch. 110, § 196.

[2] The writ of error coram nobis, or coram vobis, was a common law writ for the purpose of correcting a judgment in the same court in which it was rendered. The writ was predicated on an alleged error in fact not appearing on the record, which error it was presumed would not have been committed had the fact in the first instance been brought to the notice of the court. See Fugate v. State, 85 Miss. 94, 37 So. 554, 107 Am. St. Rep. 268 (1904), and 2 R. C. L. 305, § 259.

[3] 298 Ill. App. 548, 19 N. E. (2d) 147 (1939).

[4] Bradford v. White, 130 Ark. 532, 197 S.W. 1175, L.R.A. 1918A 1177 (1917). See also Reid's Adm'r v. Strider's Adm'r, 7 Gratt (Va.) 76, 54 Am. Dec. 120 (1850).

[5] "The pleading . . . though denominated a petition for writs of error *coram nobis*, is a bill to avoid a decree as well." Leftwick v. Hamilton, 9 Heisk. (Tenn.) 310 (1872).

[6] Estes v. Nell, 163 Mo. 387, 63 S.W. 724 (1901).

[7] The original proceeding was one to foreclose a mortgage. The defendants defaulted. Thereafter, the complainants, by leave of court, amended their complaint without notifying the defendants. The new decree found a larger amount to be due than that which had been allowed by the original decree and also stated that the plaintiff was entitled to recover from the defendants "the value of all