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ENFORCEABILITY OF AGREEMENTS BETWEEN MORTGAGORS OF THE HOME OWNERS' LOAN CORPORATION AND THIRD PARTIES

RICHARD F. PAYNE

The Home Owners' Loan Corporation, for brevity referred to herein as the HOLC, was organized and exists under the laws of the United States, Home Owners' Loan Act, hereinafter referred to as the act. This act was passed for the purpose of providing emergency relief with respect to mortgage and other form of lien indebtedness against homes. 1

The passage and administration of this act has resulted in considerable litigation. The problem with which this article proposes to deal concerns the situation wherein the holder of the lien claim against the home owner contracted with the HOLC to accept its bonds in full settlement of the lien claim and to release the claim in full against the property of the home owner. However, at some stage during the proceedings of the granting of the loan by the HOLC to the home owner, some of the lien holders exacted from the home owner a collateral agreement that an additional sum would be paid to the lien holder by the home owner. The making of some types of these collateral agreements was expressly forbidden by certain provisions of the act, 2 and the making of other types was forbidden by the rules and regulations of the HOLC 3 which were provided for by other provisions of the act. 4 In many instances the home owner did not comply with the duty imposed by the collateral agreement and the lien holder resorted to the courts to enforce the rights given to him by it. 5 In other cases the home owner instituted proceedings in the courts to relieve him from the duty imposed by the collateral agreement. 6

Litigation concerning this problem has reached the appellate courts in nine states, and in eight of these states there have been decisions refusing to enforce the provisions of the collateral agree-

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1 48 STAT. 128 (1933) and amendments, 12 U. S. C. A. § 1461 et seq. (1936). "AN ACT To provide emergency relief with respect to home mortgage indebtedness, to refinance home mortgages, to extend relief to owners of homes occupied by them who are unable to amortize their debt elsewhere."
2 Id. at § 1467 (e).
3 Manual of Rules and Regulations c. 6, § 4-d (1).
However, in two of these eight states, and in one other state, there also have been decisions upholding them. In one of these two states the decision was based on the ground that there was no fraud in the making of the collateral agreement and that a representative of the HOLC had knowledge of it. The court did not determine the authority of this representative of the HOLC. The other decision enforcing the collateral agreement was determined largely on the fact that there was disclosure to the HOLC at the time the lien holder made the offer to the HOLC that the collateral agreement had been made. The only state that has squarely upheld such collateral agreement based its decision on the ground that "the note was not discharged by the release and the agreement was not void as against public policy."

The courts have refused to give legal sanctity to these collateral agreements mainly on the ground of public policy. Very little attempt has been made by the courts to analyze the contractual relationship of the parties, and to determine the bearing of it on the conclusion to be reached. Undoubtedly public policy has a bearing on all of these cases, but it seems that the contractual relationship of the parties should be analyzed carefully in order to determine what bearing it has on the problem.

The public policy that the courts have deemed applicable in these cases seems to have been summarized by Justice Strahl in Jessewich v. Abbene:

"This agreement is illegal and void, being made in violation of a statute, and plaintiffs cannot recover thereunder. . . .


11 Comment and criticism (1939) 52 Harv. L. Rev. 842.

12 See cases cited supra n. 7.

"The court takes judicial notice of, and the parties here-to are bound by, this provision and the fact that the Home Owners’ Loan Corporation, owned by the people of the United States, is strictly a relief agency to save homes from threatened or pending foreclosures, to save lifetime savings investments of home owners in distress, to save them from becoming paupers, and is the rehabilitating agency to guard and protect the small home owner by judiciously refinancing his obligations with enough to pay all the encumbrances on his home, but limiting the new mortgage to 80 per cent. of its appraisal value for the property, so he can meet his amortized mortgage by monthly payments on principal with interest. . . .

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

Since the economic disturbance in the United States was principally the cause of the inability of the home owner to keep up his lien payments on his home, brief mention of this situation seems necessary.

At the time of the creation of the act, the United States was subject to a great economic disturbance, which resulted in a large number of people being unemployed, or in being employed at greatly reduced incomes. Since a large number of the homes of the

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14 "The bonds were guaranteed by the United States, and any loss sustained by the Corporation would be the loss of the United States which would have to be made up by general taxation." Keller, J., in Anderson v. Horst, 200 Atl. 721, 722 (Pa. Super. 1938).

15 See Wickens, Adjusting the Mortgagors' Obligation to Economic Cycles (1938) 5 Law & Contemp. Prob. 617,
country are subject to a mortgage or other form of lien indebtedness, the economic disturbance resulted in widespread inability of the home owner to meet the mortgage payments as the same became due, and this brought about a decided increase in mortgage foreclosure, or threat of foreclosure.\textsuperscript{16}

Another result of the economic situation which concerned the home owner, was the decrease in the value of real estate. A vast portion of the mortgage indebtedness was created when the real estate had a high appraisal value and when money was cheap. In many instances the property had been overvalued for loan purposes, and this especially was true with respect to second or other junior mortgages. As the depression became more severe, the difference between the value of the property and the amount of the lien indebtedness against it became less and less, and in a great many instances the amount of the lien indebtedness became greater than the value of the property. Thus, many home owners were not only subject to the loss of their home property, but also they were subject to a deficiency decree. All of this caused great distress to thousands of people who were trying to secure a home of their own, causing many to despair of being able to do so.

The federal government attempted to relieve this condition by the passage of the act. The act authorized and directed the Federal Home Loan Bank Board, hereinafter called the board, to create and to administer the Home Owners' Loan Corporation.\textsuperscript{17} The board was authorized to make such by-laws, rules and regulations, not inconsistent with the provisions of the act, as was necessary for the proper conduct of the affairs of the HOLC.\textsuperscript{18} The act also authorized the board to make rules for the appraisal of the property on which loans were made under it, so as to accomplish its purpose.\textsuperscript{19} Acting under such authority the board proceeded to make such rules as were needed to carry on the business of the HOLC. These rules were incorporated in the "Manual of Rules and Regulations of the Home Owners' Loan Corporation.\textsuperscript{20}

\textsuperscript{17} 12 U. S. C. A. § 1463(a) (1936).
\textsuperscript{18} Id. at § 1463(h).
\textsuperscript{19} Id. at § 1463(h).
\textsuperscript{20} Note: The board passed many resolutions and distributed these resolutions to the field offices in the form of bulletins. All of these resolutions were consolidated in the "Manual of Rules and Regulations of the Home Owners' Loan Corporation". This manual was sent to the field offices on October 10, 1934, and remained in force and effect during the loan closing operations.
The refunding provisions of many mortgages were unsuited to the financial status of the mortgagor. For instance, many mortgages required the repayment of the loan in too short a period; others called for a large lump payment to be made at the expiration of the mortgage; others called for a small payment the first month and the payment increased each month thereafter until at the end of the mortgage period they were beyond the ability of the home owner to meet them; and others were the reverse of the latter situation. These and other evils of mortgage refunding were recognized and in order to alleviate them, the act provided that the loans of the HOLC were to be amortized over a period not to exceed fifteen years. The payments were $7.91 per month per $1,000 of the face of the loan. This guarded the home owner against the evils of refinancing the mortgage with the added costs of the same, and it made the payments the same each month throughout the duration of the loan, and thus the home owner would be in a better situation to meet them.

The act provided that the property of the home owner was to be appraised by designated officials of the HOLC, but it limited the new mortgage to 80 per cent. of the appraised value of the property. The purpose of this provision of the act was to better enable the home owner to meet the monthly payment.

After the home owner applied to the HOLC for a loan, before the HOLC could proceed with the proper steps in the making of the loan, the lien holder had to give to the HOLC a “Mortgagee’s Consent to Take Bonds,” hereafter referred to as bond consent. If the lien holder would not accept the bonds of the HOLC in settlement of the home owner’s obligation to him, it was useless for the HOLC to proceed further with the loan. The lien holder was under no duty to give this bond consent, but he was privileged to do so.

Owing to the situation of the lien holder in reference to the property of the home owner, most bond consents were readily given. If the HOLC granted the loan to the home owner, the

21 See Wallace, supra n. 15.
23 Ibid.
24 See Wallace, supra n. 15, at 482.
26 Often the situation of the mortgagee or other lien holder was no less deplorable than that of the mortgagor. The failure of the home owner to meet the lien payments, and the decrease in the value of the property jeopardized the investment of the mortgagee. Even though the mortgagee exercised
debt would be liquidated with bonds of the HOLC. These bonds could be converted into cash. Even though the amount of cash received might be less than the amount of the lien indebtedness, yet the dollar the lien holder obtained from the sale of the bonds had a greater purchasing power than the dollar he loaned. Thus, the lien holder in a great many instances was directly benefited by the act. In fact many home owners applied to the HOLC for a loan at the suggestion of the lien holder.27

The bond consent which the lien holder was privileged to fill out, sign and deliver to the HOLC,28 set forth the total amount of the lien indebtedness which the lien holder had against the property of the home owner, and the amount of HOLC bonds, face value, that would be accepted in full settlement of this claim. If the refunding of the obligation could be consummated on the part of the HOLC, the lien holder consented to accept these bonds in full settlement of the lien claim and to release all the claim held against the property of the home owner. The bond consent that was used after January 31, 1935, at which time the larger portion of the lending had been consummated, contained the following provision:

"The undersigned represents that he will not require of the applicant any second mortgage or other instrument evidencing any portion of the aforesaid obligation or the payment of any money or other additional consideration except only as follows...

27 The power of foreclosure, in most cases there were no purchasers for the property and the mortgagee had to purchase it in order to be protected. When a deficiency decree had to be taken by the mortgagee, it was frequently of little value, as in many cases the mortgagor had no other property of any value. Further, in all states foreclosure is expensive, and in some jurisdictions its cost is excessive. When the value of the property was less than the lien indebtedness and the home owner had no other property, the cost of foreclosure only increased the amount the mortgagee had in the property. The mortgagee often found himself the owner of real estate which was taken originally as security for a loan. Also, due to the conditions of the times, a large part of this property could not be rented profitably. Regardless of such financial distress, taxes continued to come due and had to be paid. However, it must be remembered the purpose of the act was to help the home owner and not his mortgagee. See Bridewell, Effects of Defective Mortgage Laws on Home Financing, 1930-1937 (1938) 5 LAW & CONTEMP. PROB. 545.


28 (a) First bond consent used.

Form No. 2
The Manual of Rules and Regulations contained a similar provi-
sion. The lien holder acknowledged that the HOLC would incur
trouble and expense in connection with its effort to refund the
indebtedness of the home owner, and in consideration of the same,
agreed that the bond consent would be binding for a stated time.

The bond consent contained a provision that the lien holder
"consents, if said refunding can be consummated, to accept in full
settlement" of his claim the bonds of the HOLC and to release all
of his claim against the property of the home owner. The word
"consent" considered in connection with the phrase that follows it,

MORTGAGEE'S CONSENT TO TAKE BONDS

TO HOME OWNERS' LOAN CORPORATION:
The undersigned is the 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) (State)
in the sum of $..................

Being informed that said owner has made application to Home Owners' Loan Corporation to refund his said indebtedness, the undersigned has con-
sidered 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 claims 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

........................................

(Signature)

Approved June 20, 1933.

(b) The second bond consent used was the same as (a) except it contained
these additional words in the option clause: "and thereafter until 10 days
written notice shall have been given the State manager of the Corporation."
Approved August 29, 1933.

(c) Same as (b) except it contained additional blanks for information con-
cerning the lien indebtedness.

Approved June 12, 1934.

(d) Same as (c) except the instrument was under seal and contained the
following additional words before the option clause: "The undersigned repre-
sents that he will not require of the applicant any second mortgage or other
instrument evidencing any portion of the aforesaid obligation or the payment
of any money or other additional consideration except only as follows..... ."
Approved January 31, 1935.

See Manual of Rules and Regulations c. 6, § 4-d(1).

See Mortgagee's Consent to Take Bonds, supra n. 27.

Ibid.
shows that the lien holder intended to induce action on the part of the HOLC, namely, that the HOLC would attempt to refund the obligation of the home owner. Then, if the obligation could be refunded, bonds of the HOLC would be accepted in full settlement of the claim and a release in full would be given. The lien holder was using the word "consent" in the sense of promising. Since the requirements of a legally sufficient promise involves an undertaking that something shall be done or happen or shall not be done or happen in the future, and since a promise, if intended, is an offer, therefore, the lien holder was using the word "consent" intending to make an offer to the HOLC. At the time the consent was given the HOLC, whether or not the obligation of the applicant could be refunded was not known, and could not be known until the officials of the HOLC went through the proper procedure to determine whether or not the application fell within the prescribed limits of the corporation as to the granting of loans to home owners. Considering this fact, the bond consent properly cannot be construed as an acceptance of an offer made by the HOLC. Also, the bond consent did not ask for a return promise on the part of the HOLC, as at that time legally none could be given. The offer of the lien holder was a promise, that, if the HOLC, after considering the application and finding that it came within the prescribed limits of the corporation as to the granting of loans to home owners, gave its bonds in full settlement of such obligation, then the lien holder would accept them in full settlement of the claim and give a release in full to the home owner. The offer of the lien holder called for an act on the part of the HOLC. A promise that calls for an act in the acceptance of it, calls for the creation of a one-sided contract. This type of contract is called a unilateral contract. "A unilateral contract is one in which no promisor received a promise as consideration for his promise."

In order to have a binding contract in law it is necessary that "legally sufficient consideration be given for the promise or promises therein." The lien holder, in giving the executed bond

32 1 Williston, Contracts (Rev. ed. 1936) § 24A; Restatement, Contracts (1932) § 24.
33 1 Williston, Contracts § 26; Restatement, Contracts § 25.
34 1 Williston, Contracts § 27; Restatement, Contracts §§ 25-26.
35 See 1 Williston, Contracts § 13; Restatement, Contracts § 12.
36 Ibid.
37 1 Williston, Contracts § 99.
consent to the HOLC desired in return that the HOLC would grant the application of the home owner and refund the lien indebtedness to him by giving its bonds. When done, this fulfilled the requisite of consideration in contracts. Ordinarily consideration is considered sufficient if there is a detriment incurred by the promisee, or a benefit received by the promisor at the request of the promisor. The lien holder gave his promise to the HOLC to accept its bonds and to give a full release of his claim against the property of the home owner in return for the act of the HOLC in giving him its bonds. This meets the requirements of consideration as defined by the American Law Institute: "Consideration for a promise is an act other than a promise . . . . bargained for and given in exchange for a promise."

The lien holder promised the HOLC not to revoke the offer for a stated time. The promisor expected the HOLC to incur trouble and expense in its attempt to refund the indebtedness of the home owner, and promised to give the offeree the stated time in order that it might determine if the application came within the prescribed limits as to the granting of loans. This promise was intended to induce action, and when it did induce action on the part of the HOLC, it became a binding option. After the HOLC did some act in attempting to make the loan, the lien holder was under a duty and the HOLC had a right that it have the stated time to fully determine if it could grant the loan. Therefore,

38 RESTATEMENT, CONTRACTS § 75. See 1 WILLISTON, CONTRACTS § 102.
39 See Mortgagee’s Consent to Take Bonds, supra n. 27.
40 See 1 WILLISTON, CONTRACTS § 61; RESTATEMENT, CONTRACTS §§ 24, 45, 46, 47.
41 An analysis of the legal relations of the parties shows that the home owner was privileged to make application to the HOLC for a loan. The HOLC was under no duty to attempt the refunding of the obligation until the bond consent was given by the lien holder. The lien holder was privileged to give the bond consent but was under no duty to do so. When the HOLC received the bond consent, by reason of the statutes it was under a duty to the home owner to attempt the refunding and the home owner had a right to compel the HOLC to attempt to do so. The HOLC owed no duty to the lien holder to attempt the refunding. After the HOLC did an act in attempting to refund the obligation, then it had the right to have the stated time in the option clause to determine if the refunding could be made, and the lien holder was under a duty that the HOLC have this stated time. Within the stated or a reasonable time, the HOLC had the power to accept the offer of the lien holder by tendering him its bonds, and during this time the lien holder was under a liability that the HOLC might do so. If the HOLC tendered to the lien holder its bonds, he was under a duty to accept them and to give to the home owner a full release. The lien holder was under a duty to the HOLC not to exact from the home owner any agreement requiring the home owner to pay the lien holder any further sum evidencing any part of the old obligation. The lien holder had the power of extinguishing the right of the HOLC to compel him
since the promise of the lien holder was the subject matter of the bargain between the parties and the promisee suffered a detriment by such action, there is sufficient consideration for this option according to the orthodox common-law definition or as defined by the American Law Institute.42

In many instances the appraised value of the property of the home owner was not sufficient to permit the HOLC to pay all the lien indebtedness against it, but the lien holder accepted the amount that would be advanced and gave a full release. "The payment of a smaller sum in satisfaction of a larger is not a good discharge of a debt,"43 is a rule of law in most states. The reason for this rule is that the debtor is only doing what he is bound to do and so suffers no legal detriment, and that the creditor in receiving the money obtains no legal benefit.44 Therefore, in order that the agreement be binding, there needs to be other consideration. Here such consideration is found (1) in the payment made by a third party with an understanding by the parties that it should be in full satisfaction of the obligation of the home owner, and (2) in a medium of payment different from that for which bound, namely, bonds of the HOLC. This brings the operative facts of the case within two of the recognized exceptions of the above stated rule, and hence there was good accord and satisfaction of the lien claim.45

The unilateral contract that was made between the lien holder and the HOLC created certain rights in favor of the home owner. When the HOLC gave its bonds to the lien holder, the lien holder was under a duty to the HOLC to give to the home owner a full release. Also, the lien holder was under a duty to the HOLC not to make any collateral agreement with the home owner regarding any part of the old obligation that remained unpaid. This duty resulted from the act itself and from the rules and regulations created thereunder, which forbade the lien holder from requiring of the home owner any agreement holding the home owner for the payment of any part of the old obligation or other additional

42See 1 WILLISTON, CONTRACTS §§ 112, 139, 140; ANSON, CONTRACTS (Corbin's ed. 1930) § 129; RESTATEMENT, CONTRACTS § 90.

43ANSON, CONTRACTS § 139.

441 WILLISTON, CONTRACTS § 140.

45See ANSON, CONTRACTS 121, n. 3; 1 WILLISTON, CONTRACTS §§ 121, 125; RESTATEMENT, CONTRACTS § 421; Jesewich v. Abbene, 154 Misc. 768, 277 N. Y. Supp. 599 (1935).
consideration, unless the HOLC gave its consent to such agreement.\textsuperscript{46} The bond consent used during the latter part of the lending period contained a similar provision.\textsuperscript{47} The contract between the lien holder and the HOLC was made for the benefit of both the home owner and the HOLC, in that the HOLC attempted to refinance the property of the home owner on a basis of his ability to meet the monthly payments as they came due, thereby giving more assurance to the HOLC that it would receive its advances. The lien holder by his course of dealing with the HOLC, led the HOLC to believe that no collateral agreement was being exacted from the home owner by him. If the lien holder were allowed to add extra payments to the home owner, without regard to his ability to pay, these extra payments might cause the home owner to default in his payments to the HOLC.\textsuperscript{48} Under these facts the home owner was donee beneficiary of the contract between the lien holder and the HOLC. He was entitled to a full release of the claim of the lien holder and legally no collateral agreement could be exacted from him. The rights of third party beneficiaries are recognized in most jurisdictions,\textsuperscript{49} and in these states the home owner could enforce this contract made for the benefit of himself as well as for the benefit of the HOLC. This three-cornered transaction has been termed a novation.\textsuperscript{50}

The home owner, having received new rights by virtue of the contract between the lien holder and the HOLC, proceeded to renounce these rights by the making of the collateral agreement. Under the circumstances of the case, have these renounced rights been lost? It seems they have not been lost, in view of the fact that the act and the rules and regulations made thereunder forbade the making of any agreement renouncing these rights.

The collateral agreement was not made under duress, as the term is usually defined,\textsuperscript{51} but the parties were not on a parity with each other so as to be in \textit{pari delicto}.\textsuperscript{52} The lien holder had started or was threatening to start foreclosure proceedings. The home owner had to agree to the making of the collateral agreement, otherwise he would lose his home through these foreclosure proceedings.

\textsuperscript{46} 12 U. S. C. A. § 1467 (e) (k) (1936). See Manual of Rules and Regulations c. 6, § 4-d(1).
\textsuperscript{47} See Mortgagee’s Consent to Take Bonds, \textit{supra} n. 27 (d).
\textsuperscript{49} See ANSON, CONTRACTS § 284; 2 WILLISTON, CONTRACTS § 356.
\textsuperscript{51} See \textit{"Duress"}, 3 WDS. & PHR. (3d Ser. 1928) 88.
The HOLC could not complete the loan to the home owner unless it received the cooperation of the lien holder. Under these circumstances there was such economic compulsion exerted on the part of the lien holder as to relieve the home owner of the charge of being in pari delicto as to the making of this forbidden collateral agreement. In effect this was a form of undue influence. Parol evidence is admissible to show that the validity of the collateral agreement was impaired by such undue influence. When the home owner is seeking affirmative relief, asking to have his notes surrendered and canceled and the device securing them removed from the records, or seeking to recover money paid under this void agreement, then the question of whether or not the home owner was in pari delicto with the lien holder in the making of this collateral agreement becomes important. Relief has been denied as to the recovery of money paid under such collateral agreement, though in the same case the court granted affirmative relief as to the setting aside of the illegal agreement. There is a contra holding though as to the recovery of money paid under such an agreement. Even though the collateral agreement was illegal, since the making of it was forbidden by a United States statute, refusal to allow the home owner to recover money paid under it might jeopardize the chances of the HOLC of receiving its payments. Public policy demands that recovery be allowed the home owner.

In view of the preceding facts, it seems that by the better reasoning the recovery of this money should be had. The question of pari delicto is not important when the home owner is the defendant, since he can set up as a defense to the suit on the contract its illegality.

Even though in some jurisdictions the promisee of the contract between the lien holder and the HOLC could sue at law, yet this is not an adequate remedy, since the measure of damages would be hard to ascertain. Further, regardless of the fact that under this contract the HOLC retained certain beneficial rights, the HOLC in some states could enforce this promise in equity, since there the rule is that the promisee of a contract made for the benefit of a third party can enforce the promise against the

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53 See 3 WILLISTON, CONTRACTS § 634.
promisor in a suit in equity, even though the promisee has retained no pecuniary benefits. Since the HOLC also retained pecuniary benefits under this contract, suit should be allowed in all equity courts.

The promisee and the beneficiary both have an interest in the performance of the promisor. Therefore, the home owner can bring a suit in equity for the specific performance of the contract made by the lien holder and the HOLC. The HOLC should be joined as a co-defendant with the promisor. "In this way all the parties have a chance to be heard. There may always be a possible question as to the respective rights of the promisee and the beneficiary, and also whether the promisor had a valid defense against the promisee, and these questions should not be determined in any litigation in which all three interested parties are not joined. Any procedure which not only permits but requires this meets the necessities of the case." Since the courts so far have not recognized the desirability of enforcing the rights of beneficiaries in equity or corresponding proceedings under codes, in which all are made parties to the suit other equitable grounds must be present. There are present here such other equitable grounds, namely, the home owner is entitled to have the collateral agreement, which usually in part consists of a negotiable instrument, surrendered and canceled and removed from record, if recorded. Further, if a suit by the lien holder against the home owner were pending at law, the home owner would be entitled to an injunction against the further prosecution of this suit, since equity could enforce the implied negative covenant of the lien holder not to make a collateral agreement with the home owner. In addition, if the claim founded on this illegal contract has been reduced to judgment in an action at law, this judgment can be set aside by a court of equity.

Many of the lien holders were willing to sign the bond consent and to obtain from the HOLC all that would be advanced against the property of the home owner, but at some time during the proceedings exacted from the home owner a collateral agreement that

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58 2 WILLISTON, CONTRACTS § 359.
59 Ibid.
an additional sum would be paid to the lien holder by the home owner. This additional sum might be for all or part of the difference between the face value of the bonds of the HOLC and their market value on the date of issue to the lien holder, or such additional sum might be for all or part of the difference between the amount received from the HOLC and the amount of the lien indebtedness against the property of the home owner.

The form of these collateral agreements varied. Some were merely in the form of an unsecured note; others were in the form of a second mortgage on the home being refinanced, and still others were in the form of a mortgage on other property of the home owner. The latter even might be a chattel mortgage on the household goods of the home owner.

In regard to the disclosure to the HOLC of these collateral agreements, the following type situations resulted or might have resulted: (1) disclosure on the bond consent; (2) disclosure to officials of the HOLC who had authority to act on the matter; (3) disclosure in the form of a written document in the HOLC file of the home owner; (4) disclosure to employees of the HOLC who did not have authority to pass upon the matter; (5) disclosure to the fee attorney (closing attorney) of the HOLC; (6) no disclosure in any form to the HOLC.

The collateral agreement whereby the home owner agreed to pay the lien holder the difference between the face value of the bonds and their market value on the date of issue is void under the provisions of the act. The act prohibited such an agreement and fixed a heavy penalty for its violation. The law sought to prevent this type of contract. The lien holder technically was not a party to the loan contract, but he was bound by its provisions.

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63 See Pye v. Grunert, Stager v. Junker, both supra n. 7.
71 12 U. S. C. A. § 1467 (e) (1938).
72 See Pye v. Grunert, 201 Minn. 104, 275 N. W. 615 (1937).
"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 board passed regulations regarding cases where the full amount of the lien indebtedness against the property of the home owner could not be refunded. The HOLC was authorized to permit the lien holder, in cases where the officials empowered to act upon the matter thought the second mortgage desirable, to take a second mortgage on the property of the home owner. The amount of the second mortgage could not exceed the difference between the HOLC's appraisal and the amount of its first mortgage. The taking of such second mortgage by the lien holder was not a matter of right, but one of privilege granted by the HOLC. In no event was the second mortgage to be in terms which would cause the payments of the home owner to be a hardship or deprive him of a reasonable opportunity to meet them when due.

The making of the collateral agreement when the same was disclosed to the HOLC by being noted on the bond consent presents no difficulties. The proper officials of the HOLC had to pass upon the matter before the loan could be granted. Of course if they ruled in favor of allowing the second mortgage within the prescribed bounds, no objection can be made by anyone. In the event the officials did not pass upon the matter before the loan was made, or passed upon it adversely but did not so notify the lien holder, this would prevent any defense on the grounds of the illegality of the collateral agreement. When the HOLC gave its bonds to the lien holder, it implied that it accepted the offer as made. "The offeror should not be obliged to speculate whether the offeree assents to the proposed terms."

Where the making of the collateral agreement was disclosed to an official of the HOLC who had power to pass upon the matter but did not do so, at first glance it would appear that the type of

71 Id. at 193.
72 Manual of Rules and Regulations c. 3, § 12, a, b, d, c. This created the Adjustment Section, giving authority to adjust claims of mortgagees, and to bind the HOLC by giving permission to the mortgagee to take a second mortgage or unsecured note.
73 Manual of Rules and Regulations c. 6, § 4d(2).
74 See Pye v. Grumert, 201 Minn. 191, 275 N. W. 615 (1937).
76 1 Williston, Contracts § 71. See Restatement, Contracts § 58.
"estoppel" as discussed in the preceding paragraph should apply. Since an offer can be varied before acceptance, and, since the bond consent was merely an offer, it would appear that the offer could be varied at will by the offeror. However, the bond consent also gave the HOLC a definite time to perform the act of acceptance. After the HOLC had done an act in its attempt to refund the obligation, there was consideration for this promise, and thereafter the offeror was not privileged to withdraw his offer during the period of this binding option. It follows that where the offer could not be withdrawn, it could not be changed. The evidence of the taking of the collateral agreement should not be admitted because the binding option was in effect. If, at the time the disclosure was made, the binding option had expired, then the notice to the HOLC of the collateral agreement was in effect a new offer from the lien holder. Since the first offer apparently had lapsed, the offeror was privileged to make a new offer. Then, if the HOLC accepted this offer, it would have to accept it with the collateral agreement as a part of it.

In cases where the disclosure of the collateral agreement was made to the HOLC by a document which was placed or should have been placed in the HOLC file of the applicant home owner, there again the problem of the binding option is encountered. If the document was given to the HOLC after the bond consent and after the HOLC had done an act in attempting the refund, the binding option would prevent it from making any change in the legal relations of the parties. In case the option had expired, then the offeror was in effect making a new offer, such being a renewal of the former offer with the collateral agreement as an addition to it. Before the loan could be granted to the home owner, the officials who had to approve it, were under a duty to examine all papers in the file. If the file was not properly examined, or, if properly examined but no disposition was made of this notice, then when the HOLC approved the loan and gave its bonds to the offeror, it was in effect approving the collateral agreement. The HOLC would be "estopped" to say that it had accepted part of the offer and rejected part of it, without giving notice of such rejection to the offeror. The effect of this notice of part rejection would

77 Anson, Contracts 55, n. 2.
78 See 3 Williston, Contracts § 634.
79 1 id. § 72.
80 Ibid.
be a counter offer on the part of the HOLC. A similar problem was before the supreme court of Michigan. The court enforced the collateral agreement. The decision was based, in part, on the ground of public policy. In this case the document giving notice of the collateral agreement was given to the HOLC at the same time that the bond consent was given. It seems that the decision could have been based on contract law.

In cases where the disclosure was made to the employees of the HOLC who were not empowered to act on the matter, whether or not the binding option had expired, there is little doubt but this notice would be ineffective and the collateral agreement would be unenforceable. Disclosure to an agent with limited authority of any information is not attributable to the principal, where the limited authority does not extend to the matter disclosed. The same conclusion would result where the disclosure was made to the fee attorney after the loan was closed. This disclosure would be of no effect as to the changing of the legal relations of the parties, since the contract between the lien holder and the HOLC at that time had been consummated.

In many instances the fee attorney drew the papers for the collateral agreement, and often such papers were drawn before or at the time of the closing of the loan and the giving of the bonds of the HOLC to the lien holder. This or any other disclosure to the fee attorney at such time raises a problem as to the status of the fee attorney to the HOLC. Of course if the binding option had not expired, the disclosure would be of no effect. If it had expired, then this status of the fee attorney must be determined.

In the first place it must be noted that the fee attorney as the

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81 See id. § 77; Restatement, Contracts § 60.
82 See Bay City Bank v. White, 283 Mich. 267, 277 N. W. 888 (1938). The decision of the court was on the following grounds: (1) really a sale of the property by the lien holder to the home owner; (2) the transaction did not minimize the security taken by the HOLC; (3) the taking of the collateral agreement was fully disclosed to the HOLC at the time the bond consent was given, and later a letter was written to the HOLC reiterating the details of the collateral agreement. The third reason seems to be sound, but why not say this was part of the offer to the HOLC? Query as to the second reason.
84 See Ridge Inv. Corp. v. Nicolosi, 15 N. J. Misc. 569, 193 Atl. 710 (1937). In this case it was held that the home owner was bound because the collateral agreement was prepared in the office of the closing attorney and this gave notice to the HOLC. Query, should not the authority of the agent be determined before the decision is made which by implication attributes the knowledge of the agent to the principal?
title indicates, was paid through the HOLC on a fee basis, and at no time was there a salary for such service. Also, all of the officials of the HOLC who were empowered to pass on the loan were on a salary basis. Further, "The Manual of Rules and Regulations of the Home Owners' Loan Corporation" prescribed the duties of the fee attorney, and those included only the examination of titles and clearances of defects, preparation of title reports and closing of loans. In other words, the fee attorney was charged with the sole duty of closing loans and certifying that the HOLC was obtaining a valid first lien on the property in question. It seems that the fee attorney was an agent with limited authority and that that authority did not extend to the matter of the lien holder making a collateral agreement with the home owner requiring any additional payments. A third party who deals with an agent with limited authority is bound to ascertain the extent of such authority. Even though "the principal is chargeable with notice of all the material facts that come to the knowledge of his agent in a transaction in which the agent is acting for the principal," however, "an agent may be given a very limited and special power over the subject-matter, and the fact in question may have no bearing upon the exercise of that power. In that case the knowledge of the agent would not be imputed to the principal." Where there was no disclosure to any official of the HOLC of the collateral agreement, and the collateral agreement was made when or after the bond consent was given but before the release in full was given, the same problem arises as in the preceding cases. Again, if the binding option is still operative, the collateral agreement would not be binding, as the offeror was not privileged to change his offer. On the other hand, if the binding option had expired, then there arises the question as to the effect on the HOLC of this "secret" agreement. In reference to such agreements some courts have termed them "secret," but this does not seem to be

85 See Manual of Rules and Regulations c. 6, § 1, d(2). "Fee Attorneys are not employees of this Corporation and shall be paid on a fee basis."
86 See Manual of Rules and Regulations c. 3, § 13, and c. 6, § 1d(1) (2) (3).
88 HUFFCUT, AGENCY § 141; MECHEM, AGENCY § 342; Devall v. Burbridge, 4 W. & S. 305 (Pa. 1842).
89 HUFFCUT, AGENCY 190; MECHEM, AGENCY § 488; Trentor v. Pothen, 46 Minn. 238, 49 N. W. 129 (1891).
90 ANSON, CONTRACTS 55, n. 2.
important. The Kansas court in *Cook v. Donner* said that "the matter of secrecy of the agreement is not very important," since the making of the agreement is forbidden by the rules of the HOLC. It seems that the matter of "secrecy" in such a case should be disposed of on the ground that the lien holder could not make a contract with the HOLC and then abrogate part of it by the making of a collateral agreement with the third party beneficiary of such contract, to the possible injury of both the HOLC and this third party beneficiary. In accepting the bonds of the HOLC and in giving a full release to the home owner, the lien holder led the HOLC to believe that the original offer was still operative. Under contract law there is no basis for allowing the lien holder to escape his contractual duties.

Another problem arises in the case where the lien holder had surrendered to the home owner part of the lien notes and accepted in payment of them the unsecured note of the home owner. Later the lien holder signed the bond consent for the unpaid balance of the lien debt, and for such unpaid balance of the lien debt, received the bonds of the HOLC, giving to the home owner a full release. In such a case the lien holder performed the contract in accordance with the terms of the offer, and the home owner received a full release of the lien. The letter of the contract was performed but the spirit was violated. It would be contended that the unsecured notes were no part of the transaction between the lien holder and the HOLC. In such a case, the question that instantly arises is: why should a lien holder surrender notes secured by a lien on real estate and in their place accept unsecured notes of the home owner, who at that time was in default of the payments of the lien indebtedness? Ordinarily do individuals exchange secured notes for unsecured notes? Where such a transaction occurred, and, then shortly afterwards, the lien holder gave a bond consent to the HOLC, it would seem that such exchange of notes was merely a part of a general scheme to allow the lien holder to obtain all possible from the HOLC and then to hold the home owner liable for the balance of the original indebtedness. A presumption in favor of such inference should be raised. In such a case it would seem that public policy would prevent the enforcement of such a contract.

91 See Jessewich v. Abbene, Stager v. Junker, both *supra* n. 7.
"Public policy is a variable test," yet there are situations where it is properly applicable. This is true with respect to all of these collateral agreements that cannot be determined on the principles of contract law. The court should deny enforcement of such a contract calculated and intended to defeat the very purpose of the act. The exacting of the collateral agreement on the part of the lien holder denoted bad faith towards the lending agency. It is an agreement in fraud of the law and thwarts the government in carrying out the benefits intended by the act. If any part of the agreement is upheld, it gives an advantage to a party not directly intended to be benefited and to the detriment of the intended beneficiary of the act and possibly to the detriment of the people of the United States who own the HOLC. Such contracts should not be tolerated in any respect. Mr. Justice Holmes said:

"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."

It has been contended by some lien holders that it is not equitable to make the lien holder subject to rules and regulations not set forth in the act, but the Michigan court said: "While the rules

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95 See Stager v. Junker, 14 N. J. Misc. 913, 188 Atl. 440 (1936). In Richardson v. Crandall, 48 N. Y. 348, 362 (1872), the court said: "In all cases where contracts are claimed to be void as against public policy it matters not that any particular contract is free from any taint of actual fraud, oppression or corruption.... The vice is in the very nature of the contract, and it is condemned as belonging to a class which the law will not tolerate."
96 Presiding Judge Keller in Anderson v. Horst, 200 Atl. 721, 722 (Pa. Super. 1938) said: "It was not intended for the relief of mortgagees, but they could secure its benefits if they were willing to reduce their claims and accept in settlement HOLC bonds for the reduced amount. The advantage to them was the receipt of readily marketable bonds—for a less amount, it is true—in place of foreclosing their mortgages and buying in real estate for which there was no available market under the depressed conditions prevailing. Nor was it the intention of Congress that the Corporation should merely be substituted for the mortgagee and should foreclose and buy in the mortgage and dispossess the home owner. The purpose and intent was to relieve pressing conditions and give the home owner a chance to work out his salvation. This could not be accomplished if following the refunding, and as a condition for the mortgagee's consent to it, the home owner should be burdened by a re-assumption of the debt, or part of it, which had been settled and released. The natural and probable effect of such an assumption would be to lessen the ability of the home owner to make his amortization payments and thus imperil the plan which Congress had devised for his relief, and lead up the Corporation with foreclosed real estate, to the injury of the Government and its taxpayers; and a levy upon and sale of the home owner's furniture and personal effects, which would destroy the character of the property as a home, would have the same effect."
HOLC AGREEMENTS AND THIRD PARTIES

and regulations are not widely publicized by the various governmental agencies, nevertheless the law does provide for such rules and regulations. The lien holder acknowledged in the bond consent that he "had considered the method of refunding the mortgage as provided in the Home Owners' Loan Act of 1933, as passed by Congress and approved by the President," and by such admission he must have known the board might pass rules and regulations concerning such cases. If the lien holder took no steps to ascertain whether rules and regulations had been passed, it seems he is estopped to plead his own negligence. The United States Supreme Court said: "The resolution adopted by the Board of Directors sets forth the nature of the ordinary charges that 'are authorized and required,' and the power of Congress to provide for such action by the Board is not open to question." In many cases the home owner will not plead the proper defense in a suit where the lien holder is trying to enforce the collateral agreement, and of course the court cannot plead the proper defense for him. Nor can the courts take judicial notice of defenses not pleaded by the parties. But the court may take judicial notice of public policy. Where such illegality exists as in most of these cases, and such illegality contravenes the act itself, the courts should take judicial notice of the public policy of the act.

In view of the purpose of the act and the needs of the home owner that the act attempted to remedy, it follows that the home owner is entitled to the benefit of the contract made between the HOLC and the lien holder, from the technical reasoning of contract law as well as from the standpoint of public policy. When the HOLC gave the lien holder its bonds in exchange for the promise of the lien holder as set forth in the bond consent, and the lien holder gave the home owner a full release, such contract was made for the benefit of both the HOLC and the home owner. If this contract is strictly enforced, the home owner will be more able to meet his payments as they come due, and the HOLC will be more likely to get its advances. Therefore, these contracts

99 See Mortgagee's Consent to Take Bonds, supra n. 27.
100 Kay v. United States, 303 U. S. 1, 9, 58 S. Ct. 468, 82 L. Ed. 607 (1937).
102 In Chaves County Building & Loan Ass'n v. Hodges, 40 N. M. 326, 59 P. (2d) 671, 672 (1936), the court said: "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. The
should be interpreted strictly, so that the lien holder will not enjoy the benefits of the contract made with the HOLC and then enjoy further privileges at the expense of both the home owner and the HOLC. To hold otherwise would be to contravene the purpose of the act itself, and to make it an act for the benefit of the lien holder, which was never intended by Congress.\footnote{3}

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 per cent. of the value of the home, and the creditor refuses to discount his claim, the law affords 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.\footnote{103}

\footnotetext{3}{Justice Butzel in Meek v. Wilson, 233 Mich. 679, 278 N. W. 731, 734 (1938) said: "Its purpose was not to assist holders of liens against the property, but to enable owners of homes to save their homes from foreclosure by advancing on first mortgages, sums to be used to pay off liens and to lighten the burdens of the home owners. Any benefit that might accrue to lienholders would be incidental. The HOLC, in refinancing a home owner's obligations, sought to readjust them in accordance with his ability to make payments. The salutary effect of such a readjustment would be nullified if a lienholder were permitted, without regulation, to defeat the purpose of the Home Owners' Loan Act. An agreement exacted by a lienholder which tends to counteract the relief of the home owner sought by the act is contrary to the purpose of the act and to the regulations adopted thereunder."}