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Usury - Required Purchase of Insurance from Creditor - Illinois Adopts Reasonableness Test

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liable for his debts. The court stated that it was in full accord with Griswold's view.[25]

The position taken by the *Restatement*[26] is in agreement with the court in the *McKeown* case. The *Restatement* states that the executor or administrator of the estate of a deceased beneficiary of a spendthrift trust is entitled to accrued income from the trust if he would have been entitled to that income were it not for the spendthrift clause.[27]

The most cogent argument for treating a personal receipt spendthrift clause the same as other spendthrift clauses insofar as remainder interests are concerned is put forth by Griswold in his work *Spendthrift Trusts*.[28] Griswold acknowledged that there are some decisions that a spendthrift clause prevents an estate from vesting.[29] He points out that there is no basis on which such a conclusion can be supported as the mere restraint on alienation has nothing to do with vesting. He concludes:

> It [the power of alienation] relates only to the power to alienate the interest, and the question whether that is 'vested' or not depends on the contingencies that may affect the ultimate ownership of the interest–contingencies which do not depend on the power of alienation.[30]

In conclusion, it appears that *Northern Trust Co. v. North* represents a significant departure from the effect personal receipt spendthrift clauses are to be given in determining the disposition of remainder interests. In the future, remainders are to be determined from the dispositive language of the instrument regardless of whether there is a spendthrift clause with or without personal receipt language.

Douglas Mitchell

[25] *Ibid.*

[26] RESTATEMENT (SECOND), TRUSTS § 158(2) (1959).

[27] *Ibid.*

[28] GRISWOLD, SPENDTHRIFT TRUSTS (2d ed. 1947).

[29] In his discussion Griswold cites *Routt v. Newman*, *First Nat'l Bank v. Cleveland Trust Co.*, and *Cowdery v. Northern Trust Co.* (*Id.* at 324).

[30] GRISWOLD, SPENDTHRIFT TRUSTS, *op. cit. supra* note 28, at 323–24.

USURY–REQUIRED PURCHASE OF INSURANCE FROM CREDITOR–ILLINOIS ADOPTS REASONABLENESS TEST

Defendant borrowed $25,000 from plaintiff and gave as partial security a twenty-five year, five per cent mortgage note. As a condition precedent to obtaining the loan, defendant was required to purchase one of plaintiff's life insurance policies and assign the policy to plaintiff as collateral security for the note. At the time of the loan, defendant had an insurance estate, in policies with other insurance companies, with a face

amount of $58,500 and the mortgaged real estate with a market value of $38,500. When the defendant could not meet his monthly payments, the plaintiff instituted a foreclosure action. The trial court held for the plaintiff, but the Illinois Appellate Court reversed, holding that the insurance requirement was not reasonably necessary to secure the loan, rendering the loan usurious. *Equitable Life Assur. Soc'y of the United States v. Scali*, 75 Ill. App. 2d 255, 220 N.E.2d 893 (1966).

The *Scali* case is a case of first impression and is significant because it establishes a new test for determining whether a transaction is usurious. The Appellate Court stated that the test to be applied is that when insurance is required as a condition precedent to obtaining a loan, the loan is usurious if the insurance is not reasonably necessary to secure the loan. It is the purpose of this note to analyze the factors which render a transaction, requiring the purchase of an insurance policy, usurious. In so doing a history of usury, examples of transactions that have been held usurious and the decision in the instant case will be discussed.

While during the Middle Ages the terms interest and usury were synonymous, the layman of today commonly thinks of usury as an interest charge in excess of the legally permitted rate.[1] However, the legal conception of usury is more inclusive as to the types of charges that could render a loan usurious.

Broadly speaking, the states fall into two general categories as to the legal conception of usury. The two blocks of states agree on the essential elements constituting usury,[2] but differ on their interpretation of the word interest. One group of states interprets the word narrowly;[3] while

[1] See 30 AM. JUR. *Interest* § 3 (1958) for a brief discussion of the history of the concept of usury.

[2] "To constitute usury, in contemplation of law, the following essential elements must be present: (1) There must be a loan or forbearance; (2) The loan must be of money or something circulating as money; (3) It must be repayable absolutely and at all events; (4) Something must be exacted for the use of the money in excess of and in addition to the interest allowed by law." Clemens v. Crane, 234 Ill. 215, 229, 84 N.E. 884, 889 (1908).

[3] The following jurisdictions interpret interest narrowly: COLO. REV. STAT. ANN. § 73-2-5 (1963); CONN. GEN. STAT. ANN. § 37-4 (1958); DEL. CODE ANN. tit. 6 § 2304 (1953); D.C. CODE ANN. § 28-3301 (Supp. V, 1965); GA. CODE ANN. § 57-102 (1933); IDAHO CODE ANN. § 27-1906 (1947); IND. ANN. STAT. § 19-12-103 (1965); KAN. STAT. ANN. § 16-203 (1963; KY. REV. STAT. ANN. § 360.030 (1963); LA. REV. STAT. ANN. § 2924 (West 1964); ME. REV. STAT. ANN. ch. 9, § 228 (1964); MD. CODE ANN. art. 49, § 3 (1957); MASS. ANN. LAWS ch. 107, § 3 (1932); MICH. STAT. ANN. § 19.11 (1964); MINN. STAT. ANN. § 334.04 (1965); MISS. CODE ANN. § 36 (1942); MO. ANN. STAT. § 408.050 (1959); MONT. REV. CODES ANN. § 47-124 (1947); NEB. REV. STAT. § 45-104 (1943); NEV. REV .STAT. § 99.010 (1963); N.H. REV. STAT. ANN. § 336-1 (1955); N.J. STAT. ANN. § 31:1-1 (1937); N.M. STAT. ANN. 50-6-5 (1953); N.C. GEN. STAT. § 24-1 (1963); OHIO REV. CODE ANN. § 1343.04 (Baldwin 1962); OKLA. REV. STAT. ANN. tit. 15, § 267 (1961); PA. STAT. ANN. tit. 41, § 5 (1965); R.I. GEN. LAWS ANN. § 6-26-3 (1956); S.C. CODE ANN. § 8-5 (1962); S.D. CODE § 38.0110 (1939); TENN. CODE ANN. § 47-14-104 (1964); VT.

the other group considers interest to be a very broad concept.[4] Connecticut and California are two states which fall into the former and latter categories, respectively;[5] their statutes may be examined to see the variance in the two views.

A comparison of the two statutes points to a unique distinction. The narrow block of states, represented by the Connecticut statute, by emphasizing the word interest in their statutes, force the courts to exclude charges other than actual interest in their definition of interest. The broad block of states, represented by the California statute, do not have this problem because the key words "or in any other way" enable the court to denominate all charges as interest. Illinois falls within the latter group of states that interprets interest broadly.[6] The *Scali* case illustrates the broad interpretation given the word interest in Illinois, since the decision held that insurance premiums are interest when paid concurrently with repayments of principal and interest for the primary loan.

The distinction, however, is a fine one and is little used by the courts. From an examination of the cases dealing with the requirement of an insurance purchase as rendering a loan usurious, it appears that the cases are not decided solely on the interpretation of a broad or narrow usury statute. Instead, the jurisdictions have developed several different factors which are applied to determine whether the loan is usurious.[7]

STAT. ANN. tit. 9, § 32 (1959); VA. CODE ANN. § 6.1-319 (1950); W.VA. CODE ANN. § 4627 (1961); WYO. STAT. ANN. § 13-482 (1957).

[4] The following states interpret interest broadly: ALA. CODE tit. 9 § 65 (1958); ALASKA STAT. § 45.44.020 (1962); ARIZ. REV. STAT. ANN. § 44-1202 (1956); CAL. GEN. LAWS ANN. art. 3757, § 2 (Deering 1954); FLA. STAT. ANN. § 687.03 (1965); HAWAII REV. LAWS § 191-6 (1955); ILL. REV. STAT. ch. 74, § 5 (1963); IOWA CODE ANN. § 535.4 (1962); N.Y. GEN. OBLIGATIONS LAWS § 5-501(2) (1964); N.D. CENT. CODE § 14-14-09 (1965); ORE. REV. STAT. § 82.110(1) (1966); TEX. REV. CIV. STAT. ANN. art. 5071, (1948); UTAH CODE ANN. § 15-1-5 (1953); WASH. REV. CODE ANN. § 19.52.020 (1962); WIS. STAT. ANN. § 115.05 (1963).

[5] The Connecticut statute states, "No person and no firm or corporation . . . shall, as guarantor or otherwise, directly or indirectly, loan money to any person and directly or indirectly, charge, demand, accept or make any agreement to receive therefor interest at a rate greater than twelve per cent per annum." CONN. GEN. STAT. ANN. § 37-4 (1958).

The California statute states, "No person . . . shall, directly or indirectly, take or receive in money, goods or things in action, or in any other manner whatsoever, any greater sum or greater value for the loan or forbearance of any money, goods or things in action, than twelve dollars upon one hundred dollars for one year, . . ." CAL. GEN. LAWS ANN. art. 3757, § 2 (Deering 1954).

[6] Illinois' statute reads as follows: "No person or corporation shall directly or indirectly accept or receive, in money, goods, discounts or thing in action, or in any other way, any greater sum or value for the loan, forbearance or discount of any money, goods or thing in action, than is expressly authorized by this Act or other laws of this State. . . ." ILL. REV. STAT. ch. 74, § 5 (1963).

[7] See Annot., 91 A.L.R.2d 1344, 1354-69 (1963). The factors enumerated in the annotation are: (1) retention of the commission or the making of a profit by a lender which

There are three major types of transactions that have been judged to render a loan usurious by a majority of courts. The instant case involved one of these transactions, but in order to acquire a fuller understanding of the decision in *Equitable Life Assur. Soc'y of the United States v. Scali*, a discussion of the other two types of transactions will be presented before considering the type of transaction in point there. The first type exists when the lender promises to procure insurance for the borrower and fails to do so after he has charged the borrower for the insurance. The majority of courts have held that the insurance charge is merely a cover for the usurious intent of the lender.[8]

The second type of usurious loan exists when the lender exacts an excessive premium or imposes an unusual condition upon the borrower. A lender may require, as a condition precedent to obtaining the loan, that the borrower take out insurance and assign it to the lender as security for the loan. The requirement per se will not, in a majority of jurisdictions (Illinois included), render the loan usurious.[9] However, when the lender exacts from the borrower a premium in excess of what he would charge a non-borrower, the excessive premium is held to be a mere cover for the usurious intent of the lender.[10]

The third type of transaction can render a loan usurious when the lender requires the borrower to purchase insurance as security for the loan when such insurance is not necessary or in excess of the amount needed to reasonably secure the loan. One block of courts[11] holds that

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is not an insurance company; (2) the making of a profit by an insurance company lender; (3) the exaction of an excessive premium or the imposition of an unusual condition; (4) requiring insurance which is not necessary, or which is excessive as security for the loan; (5) denial of the option to select an insurance company; (6) failure to procure the policy.

[8] For cases holding that such insurance charge renders the transaction usurious see: Columbia Auto Loan, Inc. v. District of Columbia, 78 A.2d 857, *aff'd* 90 App. D.C. 419, 193 F.2d 34 (4th Cir.) *cert. denied* 342 U.S. 942 (1951); Joy v. Provident Loan Soc'y, 37 S.W.2d 254 (Tex. Civ. App. 1931); Higgens v. Mosseer Acceptance Co., 140 S.W.2d 532 (Tex. Civ. App. 1940), *error dismissed;* Ware v. Paxton, 266 S.W.2d 218 (Tex. Civ. App. 1954).

[9] See In the Matter of Fuller, 15 Cal. 2d 425, 102 P.2d 321, (1940); Tribble v. State, 89 Ga. App. 593, 80 S.E.2d 711, (1954); Equitable Life Assur. Soc'y of the United States v. Scali, 75 Ill. App. 2d 255, 220 N.E.2d 893 (1966).

[10] See Cochran v. State, 270 Ala. 440, 445, 119 So.2d 339, 343 (1960); Nash v. State, 271 Ala. 173, 175, 123 So.2d 24, 25 (1960); Hartzo v. Wilson, 205 Ark. 965, 968; 171, S.W.2d 956, 957 (1943); Peebles v. State, 87 Ga. App. 649, 653, 75 S.E.2d 35, 38 (1953).

[11] Washington Life Ins. Co. v. Paterson Silk Mfg. Co., 25 N.J. Eq. 160 (1874); Lane v. Washington Life Ins. Co., 46 N.J. Eq. 316, 19 Atl. 618 (1889); John Hancock Mut. Life Ins. Co. v. Nichols, 55 How. Pr. 393 (N.Y. 1878); Union Cent. Life Ins. Co. v. Hilliard, 63 Ohio St. 478, 59 N.E. 230 (1900), *reversing* 16 Ohio C.C. 434, 8 Ohio C.D. 437 (1898).

the loan will not be rendered usurious as long as the premium is not in excess of that amount charged to the non-borrowers for the same type and amount of insurance. The reasonableness of the requirement and the financial position of the borrower are rarely, if ever, considered. These courts adopt the philosophy that the lender has the right to lessen his risks involved in making the loan and that the requirement of the purchase of insurance does much to lessen those risks. In *Homeopathic Mut. Life Ins. Co. v. Crane*,[12] Judge Dodd said, "Where a policy is issued in good faith, at the fair and customary rate, as part of a general operation wherein a loan to the policyholder is the other part, I see no reason to question the legality of the loan, even though it depends on the taking out of the policy." In *Union Cent. Life Ins. Co. v. Morrow*,[13] the court held that the loan was not rendered usurious when the lender required the borrower to purchase insurance on the usual terms and conditions.

Another block of courts[14] holds that such a requirement can render the loan usurious irrespective of the premium charged, because the court examines the reasonableness of the requirement. In *Moore v. Union Mut. Life Ins. Co.*,[15] the court held that a requirement by the lender that the borrower had to purchase $80,000 of life insurance to secure a $20,000 loan rendered the loan usurious. In *Miller v. Life Ins. Co. of Va.*,[16] the court determined that a requirement to purchase insurance in the face amount of the loan rendered the loan usurious where it appeared that the borrower had real estate with a market value approximately twice that of the loan, which he was willing to assign to the lender.

While the instant case[17] is a case of first impression, Illinois courts have always held that no matter what type of collateral agreement is used in conjunction with a loan, the court will always look beyond the form of the transaction and examine its substance.[18] If it can be surmised that the collateral agreement was used as a cover for the usurious intent of the lender, the loan will be declared usurious.[19] In *Equitable v. Scali*, the col-

[12] 25 N.J. Eq. 418 (1874), *aff'd* 27 N.J. Eq. 484 (1875).

[13] 16 Ohio C.C. 351, 8 Ohio C.D. 419 (1898); *aff'd without opinion in* 61 Ohio St. 661, 57 N.E. 1133 (1900).

[14] Missouri Valley Life Ins. Co. v. Kittle, 2 Fed. 113 (8th Cir. 1880); National Life Ins. Co. v. Harvey, 2 McCrary 576, 7 Fed. 805 (8th Cir. 1881); Brower v. Life Ins. Co. of Va., 86 Fed. 748 (4th Cir. 1898); Strickler v. State Auto Fin. Co., 220 Ark. 565, 249 S.W.2d 307 (1952).

[15] 17 Fed. Cas. 703 (8th Cir. 1876). [16] 118 N.C. 612, 24 S.E. 484 (1896).

[17] Equitable Life Assur. Soc'y of the United States v. Scali, *supra* note 9.

[18] Ferguson v. Sutphen, 8 Ill. 547, 567 (1846); Cooper v. Nock, 27 Ill. 301, 302 (1862); Clemens v. Crane, *supra* note 2, at 230, 84 N.E. at 889.

[19] Sanford v. Kane, 133 Ill. 199, 205, 24 N.E. 414, 415 (1890); Springer v. Mack, 222 Ill. App. 72, 75 (1921); I.C. Bank and Trust Co. v. Geary, 274 Ill. App. 327 (1934).

lateral agreement consisted of the requirement to purchase insurance. The usurious intent is evidenced by the factual circumstances which consisted of the lender-insurer receiving something other than the interest on the loan, "namely, the profit involved in the insurance transaction . . ."[20]

The court in the instant case made no attempt to reconcile their ultimate position with that of the opposing block of courts. The decision merely stated that the requirement of insurance can, at times, render the loan usurious, as a result of the peculiar facts of a case.[21] Finally, the court after reflecting on the foregoing decisions[22] deduced the test it felt to be applicable to the instant case; that is, "whether the insurance is reasonably necessary to secure the loan."[23]

The decision in the *Scali* case is legally significant not as a case of first impression, but rather, as an indication of a trend in future decisions in Illinois. While it is always important to take that first judicial step in the development of any new test, it must be remembered that the court had a clear, unequivocal statute[24] to apply to the facts of the case. The court did not rule out the existence of other tests,[25] but the test of reasonableness appears to be the most basic and all-inclusive of the several tests. Thus, it appears that insurance charges will, in future cases, have to meet the test of being reasonably necessary to secure the loan in order that the loan not be declared usurious.

Dennis Passis

[20] Equitable Life Assur. Soc'y of the United States v. Scali, *supra* note 9, at 261, 220 N.E.2d at 896.

[21] *Id.* at 259, 220 N.E.2d at 895.

[22] Strickler v. State Auto Fin. Co., *supra* note 14; Moore v. Union Mut. Life Ins. Co., *supra* note 15; Miller v. Life Ins. Co. of Va., *supra* note 16.

[23] Equitable Life Assur. Soc'y of the United States v. Scali, *supra* note 9.

[24] ILL. REV. STAT. ch. 74, § 5 (1965).

[25] Equitable Life Assur. Soc'y of the United States v. Scali, *supra* note 9.