Creditors' Rights and Security Transactions – 1962 Tennessee Survey

Forrest W. Lacey

Creditors' Rights and Security Transactions— 1962 Tennessee Survey

*Forrest W. Lacey**

I. Usury

Three of the cases in this area involve usury problems. *Tanner v. Mobley*[1] presented the problem of who may bring an action to recover usury.[2] The plaintiff in the action, brought to recover usury and purge a trust deed and note of usury, was the daughter-in-law and grantee of the maker of the note and trust deed. The note and trust deed were executed in 1952. In 1954 the property covered by the trust deed was conveyed to plaintiff in consideration of her promise to pay the note and care for the grantor. Plaintiff continued to make payments on the note for several years after the death of grantor in 1955.

In affirming the action of the lower court in holding that plaintiff could not maintain the action, the court relied upon Tennessee Code Annotated section 47-1617 and several prior cases. The Code section provides:

> If usurious interest has been paid, the same may be recovered by action, at the suit of the party from whom it was taken, or his representative; or it may be subjected by any judgment creditor of such party to the satisfaction of his debt.

The opinion quotes from an earlier case:[3]

> "The reason and policy of the statute against usury is the protection of borrowers against the oppressive exactions of money lenders, and, to promote and sustain that policy, it is not necessary that other persons than the victim, or those standing in legal privity with him, should be given the benefit of all the statute."[4]

---

*Professor of Law, University of Tennessee College of Law.

1. 209 Tenn. 490, 354 S.W.2d 446 (1962).
2. A similar problem was considered in Post Sign Co. v. Jemc's, Inc., 48 Tenn. App. 13, 342 S.W.2d 385 (E.S. 1960), discussed in Lacey, *Creditors' Rights and Security Transactions*—1961 *Tennessee Survey*, 14 Vand. L. Rev. 1217 (1961).
3. Parker v. Bethel Hotel Co., 96 Tenn. 252, 34 S.W. 209 (1896).
4. 354 S.W.2d at 448-49.

The court then conceded that "The courts of the country are by no means in unanimity on who are . . . those who are standing in legal privity with the borrower."[5] However, the opinion continues:

> Clearly, in such a situation the grantee in this deed does not come within that class of people or representatives as hereinbefore set forth that are entitled to recover this usury or purge an instrument from a usurious taint.[6]

Adams v. Schwartz[7] deals with the problem of what constitutes usury. In this case, brought by the maker of a series of notes to purge them of usury, the plaintiff had originally given a series of bearer notes to a contractor as consideration for the construction of a house. The contractor, being in need of money to build the house, tried to sell the original notes, but was unable to do so. His agent, not knowing about the first set of notes, prepared another set and contacted defendant, who agreed to buy the notes, which had a face value of $7000, for $4500. The transaction was consumated. The defendant contended that he was a good faith purchaser of the notes. The lower court, in holding that the transaction was usurious and ordering the notes purged of usury, found that the transaction was not a purchase of the notes but a loan, and that defendant was not a holder in due course of the notes.

On appeal, it was held that the evidence supported these findings. The holding was affirmed, with the court quoting the applicable law to be:

> "As we understand the law of this state, on the subject of usury, no scheme or device to avoid the application of statutes on that subject, however ingenious or intricate same may be, will permit anyone guilty of participating in a usurious transaction to escape its consequences, when the facts are made to appear; and consent or cooperation of the one paying the usurious interest is immaterial. Also while it is permissible for anyone to buy at a discount negotiable paper which has already been issued, and in the capacity of an innocent purchaser for value and without notice, collect the full amount of such negotiable paper, even though there was usury in its inception (Bradshaw v. Van Valkenburg, 97 Tenn. 316, 37 S.W. 88); nevertheless, for this rule to apply, such paper must have been previously in the hands of some other holder from or through whom same is acquired; or at least, such purchaser must have reasonable grounds for believing that such former holder existed."[8]

In *Adams v. Schwartz*, although there is no discussion of the admissibility of parol evidence, such evidence must have been admitted

5. *Id.* at 448.
6. *Id.* at 449.
7. 356 S.W.2d 597 (Tenn. App. W.S. 1960).
8. *Id.* at 601, quoting Providence A.M.E. Church v. Sauer, 45 Tenn. App. 287, 303, 323 S.W.2d 6, 13 (W.S. 1958).

because the usury was not apparent from the face of the note. The court emphasized that usury could always be ferreted out.

> If the contract is in truth and fact a loan of money at usurious rates, it matters not what devices may be resorted to for the purpose of concealing its true character, the law will strip from it these devices, and adjudge it by what it is in fact, rather than by what it may in its terms appear to be.[9]

In contrast to this judicial attitude is that of the court in *Rush v. Chattanooga Du Pont Employees' Credit Union.*[10] The Credit Union sued a co-maker of a note which provided for "interest on the unpaid balance at the rate of one per cent per month." The defendant filed a sworn plea of usury, in that the note called for interest in excess of the legal rate. The only witness testified merely as to the amount due on the note. The trial court allowed recovery, apparently on the theory that the case was governed by Tennessee Code Annotated section 45-1820, which provides that "[T]he total of interest and all other charges for a loan shall not exceed one per cent (1%) per month on the unpaid balance. . . ."

The court of appeals reversed the decision of the trial court, holding that the note was usurious on its face. But the case was remanded for further proof on the authority of *Miller v. State*,[11] which the court of appeals interpreted as permitting evidence to show that the apparent charge of one per cent interest included other charges and was therefore legal. The opinion in the *Miller* case states: "The officer of the credit union testifies that this 1% as shown on the note included all charges of making the loan and the interest. This being true the note was not usurious. . . ."[12]

On appeal the supreme court reversed the decision of the court of appeals, and dismissed the case. It held that the quoted portion of the *Miller* case was dictum and not authority. As authority for holding that parol evidence was not admissible to show that the stated one per cent included other charges, the opinion quoted *Corpus Juris Secundum* to the effect that: "Parol evidence is not admissible to show . . . *that interest was to be paid at a rate other than that expressed in the instrument.*"[13] (Emphasis by the court). The dissenting opinion also quoted *Corpus Juris Secundum* as authority for the admissibility of parol evidence.[14]

9. *Id.* at 600.
10. 358 S.W.2d 333 (Tenn. 1962).
11. 195 Tenn. 181, 258 S.W.2d 751 (1953).
12. 195 Tenn. at 185, 258 S.W.2d at 753.
13. 358 S.W.2d at 336-37 quoting 32 C.J.S. *Evidence* § 895 (1942).
14. *Id.* at 338.

II. Use of Credit Life Insurance

The final case under survey, *Kincaid v. Alderson*,[15] presents an interesting and apparently novel question. In 1958 Alderson and his wife executed a chattel mortgage on a mobile home to secure payment to a finance company of a note for $6,439, payable in monthly installments over a period of five years. The amount of these payments included a premium on an insurance policy, payable to the finance company, on the life of Alderson, in an amount equal to the unpaid balance on the note. In January of 1960 the Kincaids purchased the mobile home from the Aldersons for $600 and a promise to assume and pay the monthly installments due on the note. The sellers gave the purchasers a title bond which provided:

> When the parties of the second part shall have paid in full the amount due the Commercial Credit Corporation and said purchase money chattel mortgage is cancelled, . . . said parties of the first part make, execute and deliver unto the said parties of the second part or their assigns a good and sufficient bill of sale and title . . .[16]

In September of 1960 Alderson was killed and the insurance company paid the finance company the balance due on the note. The Kincaids then brought this action to clear their title to the mobile home, requesting that Mrs. Alderson directly, or through the court, execute to them a clear title. The chancellor sustained a demurrer to the bill on the ground that the condition in the title bond, *i.e.*, payment by the purchasers, had not been performed.

In affirming the decision, the supreme court reasoned that after the purchasers assumed the mortgage they became primarily liable for the debt, and the Aldersons then became sureties. This step seems clear. The court went on to state, however, that as sureties Alderson's estate and his wife are subrogated to the rights of the finance company. This proposition is questionable.

The general rule is that a surety is entitled to subrogation,[17] (or reimbursement,[18] for that matter) only if or to the extent that the surety paid the obligation. In this case the insurance company paid the obligation.

Two authorities were relied upon by the court. The first, the *Restatement of the Law of Security*, section 104, clearly is referring to the situation where the surety was paid. Thus it does not appear to

15. 209 Tenn. 608, 354 S.W.2d 775 (1962).
16. 354 S.W.2d at 775.
17. Restatement, Security § 141 (1941).
18. *Id.* § 104. See Henegar v. Brannon, 24 Tenn. App. 1, 137 S.W.2d 889 (M.S. 1939), in which reimbursement was denied to a surety where payment was made by one other than the surety.

be applicable. The other is an admitted dictum in a court of appeals case, *Moneymaker v. Calloway*.[19] The court states that the *Moneymaker* case is the only case they found anywhere near the factual situation of the case under discussion. In that case Moneymaker contracted to buy a car on installment payments, and to take out an insurance policy on his life payable to the dealer. Actually Moneymaker's sister-in-law, Calloway, took possession of the car, paid the down-payment and the installments and the premium for the insurance policy. When Moneymaker died the insurance company paid into court the balance due. It was held that Calloway was entitled to the car and to the fund from the policy, which was ordered paid to the dealer. Thus the actual holding in the *Moneymaker* case would indicate that in the instant case the purchasers, the Kincaids, should get the benefit of the payment by the insurance company. However, in the *Moneymaker* case the court did say:

> If the administrator of the estate of . . . Moneymaker has any claim to this money, he must work it out in one of two ways. First . . . second, he may claim his intestate was secondarily, and not primarily, liable for the debt, and since his intestate paid the debt he is entitled to recover it from Lucy Calloway, for the reason she was primarily liable for the debt. No attempt has been made to show facts which would justify the Court in decreeing against Lucy Calloway on this last theory. . . .[20]

This dictum does support the holding in the *Kincaid* case, but it also assumes that the surety paid, which is not literally true.

The court recognized that Alderson had no rights under the insurance policy, because in response to a contention that the Kincaids were assignees of Alderson's rights under the policy, the opinion states:

> [T]he Aldersons had nothing to assign. The life insurance was written for the beuefit of the Commercial Credit Corporation. They were the beneficiaries of the insurance on Alderson, and Alderson had nothing to assign aud by auy contract that he made he couldn't make such an assignment.[21]

If the insured had no assignable rights under the policy, surely when the insurance company pays it cannot be said that the insured pays.

Although the opinion in the *Kincaid* case did not cite it, a somewhat similar decision is *Tighe v. Walton*.[22] In the *Tighe* case a deed of trust of real property was given as security for a loan, and a life insurance policy on the life of the borrower was obtained. The lender

19. 9 Tenn. App. 348 (E.S. 1928).
20. *Id.* at 350.
21. 354 S.W.2d at 779.
22. 233 Miss. 781, 103 So. 2d 8 (1958).

was first beneficiary. The amount of the policy was not stated in the opinion. Later the land was sold, first to a non-assuming grantee, and by him to a purchaser who assumed payment of the secured debt. The original grantor died and the insurance company paid the lender, who transferred the note and deed of trust to the wife of the insured. It was held that the wife was entitled to be subrogated to the rights of the lender who had been paid.

Although the same result was reached in both cases, the *Tighe* case is readily distinguishable from the *Kincaid* case. First, in *Tighe* the assuming grantee did not know of the life insurance. Second, he did not assume an obligation to pay the premiums on the insurance, as the Kincaids did. Third, in *Tighe* the estate of the insured was designated as a second beneficiary, whereas in the *Kincaid* case the court found no assignable interest in the insured.

If subrogation does not afford a satisfactory basis for deciding this case, what should the result be? The increasing use of insurance on the life of the debtor as security for payment of the debt would indicate that the problem of the instant case could become a common one. It seems desirable that the parties should control the result, which they can do either in the original contract or the later one whereby the rights and duties of the original debtor are assumed by another. If, as is frequently the case, premiums on the insurance policy are part of the periodic installment payments, surely the one assuming the debt would expect to benefit from the insurance as he is the one who is paying the premiums. However, it would also seem that he would prefer that the insurance be transferred to cover his life, as he is now the principal debtor.