

Usury Revisited: The Illinois Supreme Court Rights The Balance in Mortgage Lending

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I. Introduction

The authors reported on a disturbing development under the Illinois Interest Act in a recent issue of the Quarterly Report.¹ In *U.S. Bank N.A. v. Clark*,² the Illinois Appellate Court held that mortgage lenders violated the cap on points which had been placed in the Interest Act in 1974 despite the nearly universal belief that the cap was

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The authors' firm participated in *U.S. Bank N.A. v. Clark*, 348 Ill. App. 3d 856, 807 N.E.2d 1009 (2004), __ __, Ill. 2d __, __ N.E.2d __, 2005 Ill. Lexis 961 (Sept. 22, 2005), which is discussed extensively in this article.

¹ John L. Ropiequet, and Eugene J. Kelley, Jr., *Usury Strikes Back: Recent Developments Under the Illinois Interest Act*, 59 Consumer Fin. L.Q. Rep. 118 (2005).

² 348 Ill. App. 3d 856, 807 N.E.2d 1109 (2004), *rev'd*, __ Ill. 2d __, __ N.E.2d __, 2005 Ill. Lexis 961 (Sept. 22, 2005) (hereinafter *Clark*).

either preempted by the Depository Institutions Deregulation and Monetary Control Act of 1980 (DIDMCA),³ implicitly repealed by a 1981 amendment to a different section of the Interest Act, or both.

The Appellate Court's ruling caught lenders off guard in particular because the Seventh Circuit had found that the 1974 provision was preempted years before.⁴ Even the Illinois Attorney General had agreed with this view.⁵ But acting with reasonable dispatch,⁶ the Illinois Supreme Court has now removed a great deal of uncertainty in Illinois mortgage lending by holding that the 1974 provision capping points at 3% on loans where the interest rate is greater than 8% was preempted by DIDMCA, was implicitly repealed by the 1981 enactment and was not revived by a 1992 amendment to the Interest Act. This ruling, which conforms Illinois law to what everyone but a determined group of plaintiffs' consumer credit attorneys thought it was, "ends the guessing game," in the court's own words.⁷

II. Background

A. Interest Act Provisions

The controversy started with a 1974 amendment to the Interest Act. Section 4.1a of the Act⁸ imposed a 3% limit on points for all mortgages where the interest rate was greater than 8%. When enacted, this provision simply forbade what the legislature

³ 12 U.S.C. § 1735f-7a.

⁴ *Currie v. Diamond Mortgage Corp. of Illinois*, 859 F.2d 1538, 1542 (7th Cir. 1988).

⁵ Illinois Attorney General Op. No. 96-37, 1997 Ill. AG Lexis 32 (Dec. 3, 1996).

⁶ The Illinois Supreme Court granted a petition for leave to appeal in *Clark* on November 24, 2004, heard oral argument on May 3, 2005 and issued its ruling on September 22, 2005.

⁷ *Clark*, 2005 Ill. Lexis 961 at *33.

⁸ 815 ILCS 205/4.1a.

determined was an excessive level of points on high rate mortgage transactions. As such, it operated like any other usury prohibition.

After that enactment, however, circumstances changed dramatically in the marketplace. Interest rates for mortgages soared nationally. The Illinois legislature recognized this in 1981 by amending the general usury limit in Section 4 of the Act by eliminating the cap on all forms of interest as follows:

It is lawful to charge, contract for, and receive any rate or amount of interest or compensation with respect to the following transactions:

* * *

(l) loans secured by a mortgage on real estate;⁹

This amendment mirrored Congress' elimination of interest rate caps on a nationwide basis under DIDMCA, which was enacted the previous year. Since the amendment to Section 4 eliminated any cap on interest or "compensation" on home mortgage loans, there was a clear conflict with the points cap in Section 4.1a. However, the Illinois legislature did not repeal the points cap when it amended Section 4 and it has not done so by any subsequent amendment to the Interest Act.

Section 4.1a was revisited by the legislature in 1992. At that time, an amendment added two additional exceptions to the list of items which were to be excluded from the limitation of points: NSF check charges and late charges of up to 5% of the loan installment.¹⁰ Nothing else was changed in Section 4.1a to affect the 1974 wording.

B. DIDMCA Preemption

⁹ 815 ILCS 205/4(1)(l).

¹⁰ 815 ILCS 205/4.1a(e)-(f) (as amended eff. Jan. 1. 1992).

Congress responded to surging interest rates on home mortgages in 1980 by acting to preempt state usury limits in Section 501(a)(1) of DIDMCA.¹¹ This section preempted all state laws or constitutional provisions that limited interest or points "secured by a first lien on residential real property."¹²

States were permitted to opt out of the preemption in two ways. First, a state could adopt a new law or new constitutional provision within three years after the April 1, 1980 effective date of DIDMCA "which states explicitly and by its terms that such State does not want the provisions of subsection (a)(1) of this section to apply with respect to loans, mortgages, credit sales, and advances made in such State."¹³

In the absence of an "explicit" law or constitutional provision opting out of the DIDMCA preemption within that three-year window, states could "override" DIDMCA by enacting new legislation at any time after the April 1, 1980 effective date "placing limitations on discount points or such other charges on any loan, mortgage, credit sale, or advance" covered by DIDMCA.¹⁴

C. Subsequent Case Developments in Illinois

Prior to the Appellate Court decision in *Clark* in 2004, the cases which addressed the discrepancy between the points cap limitation in Section 4.1a and the elimination of interest and points cap in Section 4 found that Illinois had not opted out of the DIDMCA preemption and that the 1974 provision was impliedly repealed by the 1981 provision – with one important exception.

¹¹ 12 U.S.C. § 1735f-7a(a).

¹² *Id.* § 1735f-7a(a)(1)(A).

¹³ *Id.* § 1735f-7a(a)(b).

¹⁴ *Id.* § 1735f-7a(b)(4).

The first reported case to examine the issues was *Currie v. Diamond Mortgage Corp. of Illinois*.¹⁵ The mortgage loan there had an interest rate of 15.5% and a loan origination fee of 16%. The Seventh Circuit first found that the DIDMCA preemption applied to the points cap limitation in Section 4.1a of the Interest Act because Illinois had not enacted any statute that expressly opted out of the preemption during the 1980-83 opt-out period provided in DIDMCA.¹⁶ The court went on to find that the points cap in Section 4.1a was also impliedly repealed by the 1981 amendment to Section 4 of the Interest Act, because it "removed all limits on interest rates, points and other consideration charged on residential real estate mortgages."¹⁷ The court stated that it was compelled to find an implied repeal of the limitation in Section 4.1a because it was irreconcilable with the subsequently enacted provision in Section 4(1)(I), which was intended "to increase the availability of funds for home financing previously restricted by the statute's limits on interest rates and fees associated with real estate loans."¹⁸

The Illinois Appellate Court disagreed with the *Currie* ruling in *Fidelity Financial Services, Inc. v. Hicks*.¹⁹ The case involved a counterclaim in a mortgage foreclosure action which asserted that the 3-point limit in Section 4.1a had been violated by the lender with respect to a home improvement loan that carried a 29.93% interest rate plus 13.64% in points. The court held that Section 4.1a addressed "ancillary" charges that were not dictated by the cost of money, unlike the subject matter of Section 4, which dealt with a different subject matter. Section 4.1a accordingly dealt with different

¹⁵ 859 F.2d 1538 (7th Cir. 1988).

¹⁶ *Id.* at 1542.

¹⁷ *Id.*

¹⁸ *Id.* at 1543.

¹⁹ 214 Ill. App. 3d 398, 574 N.E.2d 15, *app. denied*, 141 Ill. 2d 539 (1991).

consumer protection concerns, "onerous and undisclosed fees" and "redlining," which were different from the market concerns that the amendment to Section 4 addressed. Because Section 4.1a had not been taken off the books by the legislature, the court presumed that it was still in effect. Because it was not incompatible with the amendment to Section 4, it would be given effect.²⁰ The court also noted that since the mortgage in question was a junior lien rather than a first lien, DIDMCA preemption did not apply in any event.²¹

The points cap in Section 4.1a was addressed in scattered federal district court decisions and one Seventh Circuit case in subsequent years. Not surprisingly, the district courts followed *Currie* and rejected the analysis in *Hicks*.²² In particular, the courts rejected the argument that the 1992 amendment to Section 4.1a, which merely added a couple of subsections without changing its existing provisions, was intended by the Illinois legislature to override the DIDMCA preemption.²³

The federal cases culminated in the Seventh Circuit's reaffirmation of *Currie* in *Reiser v. Residential Funding Corp.*²⁴ The court reversed a federal district court decision which had held that the 3-point cap on points applied to a second mortgage, following the Illinois Appellate Court's decision in *U.S. Bank N.A. v. Clark*. The Seventh Circuit found that there was no reason to deviate from its ruling in *Currie* that the points cap

²⁰ *Id.* at 404, 574 N.E.2d at 19.

²¹ *Id.* at 407, 574 N.E.2d at 22.

²² See e.g., *Gora v. Banc One Financial Services, Inc.*, 1995 WL 6131 (N.D. Ill. Oct. 17, 1995).

²³ *Reed v. Worldwide Financial Services, Inc.*, 1998 U.S. Dist. Lexis 19452 at *7-9 (N.D. Ill. Nov. 25, 1998).

²⁴ 380 F.3d 1027 (7th Cir. 2004).

was of no effect even though its earlier decision was "an educated guess about how the Supreme Court of Illinois will rule."²⁵

III. The *Clark* Ruling in the Appellate Court

Although mortgagors' attempts to make use of the *Hicks* ruling in affirmative defenses or counterclaims to mortgage foreclosure proceedings were repeatedly rejected in federal court, they continued to raise the issue in state court proceedings. A large group of these cases was administratively consolidated in 2000 before one judge for decision on motions to strike affirmative defenses and dismiss counterclaims.²⁶ The trial court relied on federal regulations and state agency opinion letters to find that DIDMCA preemption did apply to the points cap in Section 4.1a for all first liens and that Illinois had never opted out of the preemption. The court also rejected the argument that the 1992 amendment to Section 4.1a operated to override DIDMCA preemption. It held that since it merely copied the prior provision without changing it, the amendment was not sufficient to demonstrate a legislative intention to override federal preemption.²⁷ The court struck all of the affirmative defenses and dismissed all of the counterclaims that relied on the 3-point cap in Section 4.1a.

On appeal, *Clark* was assigned to the same panel of the Appellate Court which had decided *Hicks*, and the opinion was written by one of the justices who decided that case. The court went to considerable lengths to deal with the trial court's characterization of its rulings in *Hicks* as dicta and chastised it for not following *Hicks*.²⁸

²⁵ *Id.* at 1029.

²⁶ Admin. Order, Sept. 27, 2000.

²⁷ Slip Op. at 4-6 (May 16, 2001).

²⁸ *Clark*, 348 Ill. App. 3d at 862-64, 807 N.E.2d at 1115-16.

However, in response to the lenders' argument that the case was not correctly decided, the court found no need to reexamine *Hicks* because the 1992 amendment to Section 4.1a was sufficient to override DIDMCA preemption. The court stated that as a general rule of statutory construction,

[I]f the legislature amends the statute after the courts have interpreted a prior version of the statute, the legislature is presumed to have been aware of the judicial decisions and to have acted with that knowledge In this case, our General Assembly passed amendments to section 4.1a of the Interest Act on June 26, 1991, after *Currie* and *Hicks* were decided. The General Assembly, which was presumed to have been aware of these cases (and the tension between them), did not amend or strike the language in section 4.1a to conform it to either *Currie* or *Hicks* on the issue of preemption. Instead, the legislature reenacted the broad pre-DIDMCA language regarding the calculation of fees for loans with an interest rate exceeding 8%. When a state reenacts a usury limitation, it is unlikely that it will do so in ignorance of the federal preemption or market forces.²⁹

Thus, the 1992 amendment, which it found to be a reenactment of the original 1974 points cap, operated to override DIDMCA preemption.³⁰

The points cap was therefore found to be in full force and effect.

IV. The Illinois Supreme Court Ruling

The Illinois Supreme Court made short work of the Appellate Court's decision in a lengthy opinion. By the end of that opinion, the court had found squarely in favor of both federal preemption and implicit repeal by the state legislature of the points cap in Section 4.1a.

The court started by examining the various legislative enactments amending the Interest Act in chronological sequence. It noted that Section 4(1)(l) was added to the

²⁹ *Id.* at 868, 807 N.E.2d at 1119.

³⁰ *Id.* at 870, 807 N.E.2d at 1121.

Interest Act in 1981 to exclude all home mortgages and further amended in 1982 to exclude all types of real estate mortgages from usury limits, "thereby legalizing the receipt of any rate or amount of interest or compensation on *any* real estate mortgage."³¹ The question then became whether this provision in fact repealed the points cap in Section 4.1a by implication, as the *Currie* court found and as the *Hicks* court did not.

This determination turned on its view of the wording of the amendment to Section 4. The court noted that Section 4 permitted any rate or amount of interest or "compensation" to be charged on real estate mortgages. The court could find "no functional distinction between noninterest 'compensation' in *Section 4* and the noninterest 'charges' in *Section 4.1a*."³² This supported its view that Section 4(1)(l) clearly and unambiguously lifted any cap on points:

By refusing to restrict either the interest or "compensation" available for lenders "with respect to" mortgage loans, the legislature evinced its intent to prevent a broad category of charges to be imposed in connection with secured real estate loans.³³

The court's reading of the amendment to Section 4 made it conflict irreconcilably with the points cap in Section 4.1a. Since the *Hicks* ruling was "at odds with the legislature's 1981 intention to amend *Section 4* to remove the artificial limits on the interest and other compensation lenders may receive from mortgage loans, thereby allowing market forces to prevail," it had to be overruled.³⁴ Accordingly, as the Seventh Circuit had found in both *Currie* and *Reiser*, the Supreme Court held that Section 4

³¹ *Clark*, 2005 Ill. Lexis at *12 (emphasis in original).

³² *Id.* at *18-19 (emphasis in original).

³³ *Id.* at *18.

³⁴ *Id.* at *21 (emphasis in original).

implicitly repealed the limitation in Section 4.1a.³⁵ The court also found that the enactment of the High Risk Home Loan Act effective January 1, 2004³⁶ did nothing to reinvigorate the points cap in Section 4.1a. Even though that Act capped finance fees at 6% on "high risk" loans,³⁷ and preempted other state laws, it expressly did not preempt the Interest Act.³⁸

The court then addressed the argument raised by the intervening Attorney General that DIDMCA only preempted purchase money first liens rather than all types of first liens, including refinanced mortgages. Noting that even one of the authorities cited by the Attorney General recognized that the term "first lien" as used in DIDMCA included refinanced loans, the court could find no basis in DIDMCA itself for treating the two types of first liens differently since both types would meet the statutory requirements of DIDMCA. In addition, the "great weight of federal authority" accepted that view.³⁹

Finally, the court examined the effect of the 1992 amendment to Section 4.1a. The court found that merely adding two subparts to the existing statute was insufficient to show a legislative intent to opt out of the DIDMCA preemption. The court cited the Illinois Statute on Statutes for the proposition that if the language in the new enactment is the same as what was in the old one, it would be construed as a continuation of the old one, not a new enactment.⁴⁰ The Supreme Court held that its decision in *Davis v.*

³⁵ *Id.* at *22.

³⁶ 815 ILCS 137/1 *et seq.*

³⁷ 815 ILCS 137/55.

³⁸ *Clark*, 2005 Ill. Lexis at *22, citing 815 ILCS 137/170.

³⁹ *Id.* at *26.

⁴⁰ *Id.* at *30, citing 5 ILCS 70/2.

City of Chicago,⁴¹ on which the Appellate Court had relied in coming to a contrary conclusion concerning the 1992 amendment, was inapplicable. Unlike that case, the relevant language of Section 4.1a was not changed by the legislature and the legislature had no compelling need to overcome a definitive court ruling interpreting the statute for the simple reason that because the Supreme Court had not yet ruled, there was no definitive resolution of any issues on any such issues by 1992. The court agreed with the Seventh Circuit in *Reiser* that any conclusions concerning the interpretation of Section 4.1a up to that point were mere "educated guesses" as to what its ruling would ultimately be.⁴²

V. Conclusion

The Appellate Court's decision in *Clark* caused considerable consternation in the lending industry. The practice of charging more than 3 points on higher interest mortgage loans was as widespread in Illinois as it was in most parts of the nation, since a nearly unbroken string of court decisions had found that not only was the 1974 enactment preempted by DIDMCA as to first liens, it was also superseded by Section 4(1)(l) a year after DIDMCA was enacted. The *Hicks* case was seen as an anomaly that was not even followed by Illinois regulatory agencies. Instead, they followed the Seventh Circuit's ruling in *Currie*.⁴³ The points cap in Section 4.1a was basically seen as a dead issue.

⁴¹ 59 Ill. 2d 439, 322 N.E.2d 29 (1974).

⁴² *Clark*, 2005 Ill. Lexis at *33, citing *Reiser*, 380 F.3d at 1029.

⁴³ See, e.g., Illinois Attorney General Op. No. 96-37, 1997 Ill. AG Lexis 32 (Dec. 3, 1996). Even though the Illinois Attorney General filed an amicus brief on behalf of the mortgagors in *Clark*, this opinion was never withdrawn.

Mortgage lenders were deeply concerned because the Illinois Interest Act provides for truly draconian penalties for usury violations, with limited safe harbors available. A mortgagor could potentially recover twice the total of all interest and points charged under an offending mortgage, even if it had not yet been paid, plus attorneys fees.⁴⁴ Given the amount of interest and points charged on a single mortgage transaction, clearly hundreds of millions of dollars' worth of existing loans was at stake.

The mortgage industry breathed a large sigh of relief after the Illinois Supreme Court restored the legal situation to what it had been before the Appellate Court's bombshell decision. Existing mortgages will remain valid and lenders can resume lending at market rates without fear of incurring potentially ruinous penalties. Numerous individual and class action cases seeking to enforce the point cap which had been stayed in state and federal courts pending the final ruling in *Clark* will now be dismissed. And filing suit in state court instead of federal court will no longer be outcome determinative on whether usury penalties will apply to a mortgage transaction.

Under the Supreme Court's ruling in *Clark*, only a new statute that clearly overrides the DIDMCA preemption and abrogates the elimination of interest and points caps in Section 4(1)(f) could change the picture. Should such legislation be introduced and enacted, the industry would have very clear warning of the change, something which was totally absent in the circumstances surrounding the Appellate Court's ruling.

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⁴⁴ 815 ILCS 205/6.