11-7-2011

# Creative Ventures, LLC v Jim Ward & Assocs.: (2011) 195 CA4th 1430, - CR3d

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## *Creative Ventures, LLC v Jim Ward & Assocs. (2011) 195 CA4th 1430, ___ CR3d*

**Mortgage company lacking real estate brokers license committed usury by arranging loans with combined interest rate and broker's fee totaling more than 10 percent. Individual investors providing financing were assignees and not holders in due course and thus also were liable for violation of usury laws.**

Licensed real estate broker (Ward) had retired and his mortgage business had merged out of existence. Coming out of retirement, Ward renewed his license on April 19, 1999. In August 2000, Ward formed a mortgage lender and loan processing company. Developers sought loans for two projects from that company, which they mistakenly believed was a licensed mortgage lender. The parties executed two promissory notes, two deeds of trust, and a construction loan on October 8, 2003. Each of the loans set an interest rate and broker's fee totaling more than 10 percent. Ward's company sought and secured independent investors to provide the financing. These investors generally received interest payments in amounts of 8 to 10 percent. Before the documents were executed, on October 1, 2003, the company president and legal counsel had been told that the company did not have a valid real estate license and that the Department of Real Estate (DRE) was investigating Ward in a disciplinary action. When the developers learned about the investigation, they filed suit for usury, breach of contract, and fraud against the company and for usury against the investors. The trial court found the company had committed usury and fraud, but held that the investors were holders in due course and took their partial interests free of the developers' defense of usury. The court of appeal affirmed in part and reversed in part. Under Cal Const art XV, §1, the maximum rate lenders can charge on nonpersonal loans is "the higher of 10 percent or 5 percent plus the Federal Reserve Bank of San Francisco's rate on the 25th day of the month preceding the date the agreement was contracted." Stoneridge Parkway Partners, LLC v MW Hous. Partners III, L.P. (2007) 153 CA4th 1373, 1379, 64 CR3d 61, reported at 30 CEB RPLR 190 (Nov. 2007). Here, the parties stipulated to a permissible maximum rate of 10 percent unless a usury law exemption applied. The company argued that Cal Const art XV, §1 provided one such exemption because a licensed real estate broker (Ward) arranged the loans, which were secured by a real property lien. But the promissory notes reflected the company as the licensed broker and evidence showed that the parties believed and intended that the company would arrange the loans. Company employees involved in the loan transactions mistakenly believed that the company was licensed. Fatally, the company was not so licensed, and a prominent employee had been warned 7 days before document execution that this likely was the case. Thus, the trial court properly held that the company had violated usury laws and that the interest terms were null and void. The court of appeal reversed the judgment in favor of individual investors. The investors were not holders in due course (who take their interest free of all defenses), but rather were merely assignees. Notably, the promissory notes were payable to the company and physically in the company's possession. A partial assignee cannot be a holder in due course. The investors' rights were derivative and subject to all equities and defenses existing in favor of the company. When the trial court held the interest terms null and void, the investors had no right to interest in any amount.

**THE EDITOR'S TAKE**: These investors lost the interest they should have earned because (1) their loan broker's lack of a license made their notes usurious and (2) they were assignees rather than holders in due course of those notes. Obviously, the loan broker should have kept his license current, and—equally obviously—he should be liable to the investors for their losses caused by his failure to have done so. (A separate question is whether he has any funds left to pay them.) But note that even with the promissory notes being usurious, the investors could have recovered on them had they been held to be holders in due course rather than merely assignees. Holders in due course take free of many defenses—usury being merely one of them—that assignees take subject to. Investors in loans—especially those made by small and semi-amateur loan brokers—are clearly better off when they can qualify for holder-in-due-course status with the immunity that it gives them against their loan broker's mistakes and conduct. Indeed, the loan brokers themselves would be safer, because their risk of having to indemnify their investors for losses would be much reduced by those investors having holder-in-due-course protection. The obstacles that stand in the way of restructuring loan participations like this one (to give investors holder-in-due-course status) are that the loan broker usually holds onto the note rather than physically transferring it to the investors, and that the investors usually buy only partial rather than entire interests in the notes they invest in. But the secondary market solved those difficulties long ago through the creation of special-purpose vehicles (SPVs) as intermediate transferees, with those SPVs then issuing the fractional interests in their assets to the investors. Would it be too difficult to come up with a similar arrangement in this minuscule counterpart of that gigantic secondary market? (And it would be even easier to avoid using MERS as the intermediary!)—*Roger Bernhardt*