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by the courts of Oklahoma, it establishes an exception to the rule of *Brewer*.

In summary, *Brewer* creates a serious obstacle to any attempt to win compensation for consequential damages when the fact situation is strictly analogous, but in a significant number of cases the authority of the earlier cases will preclude the government from interposing the police power argument. In those latter cases, Oklahoma continues to follow the majority of jurisdictions which hold that a material impairment of access is a compensable injury to property.²³

Jerry M. Snider

HOME MORTGAGE "ESCROW ACCOUNTS"—NEW YORK LAW
REQUIRING MORTGAGE LENDING INSTITUTIONS TO PAY INTEREST
UPON ESCROW ACCOUNTS DECLARED CONSTITUTIONAL. *Jamaica
Savings Bank v. Lefkowitz*, 390 F. Supp. 1357 (E.D. N.Y. 1975).

In recent years public criticism has increasingly focused upon the profits derived by mortgage lending institutions from their beneficial use of funds prepaid by residential mortgagors into "escrow accounts."¹ As a result, by the end of 1974, Connecticut,² Massachusetts,³ New Hamp-

23. See generally Note, 5 ST. MARY'S L.J. 400 (1973).

1. In addition to monthly principal and interest payments, mortgage lending institutions commonly require residential mortgagors to prepay amounts in monthly installments sufficient when accumulated to satisfy taxes, assessments and hazard insurance premiums accruing to the mortgaged property. These monthly installments are credited to what are generally termed "escrow accounts." Institutional mortgagees customarily pay no interest upon the escrow account monies and are free to use and commingle these funds to their benefit so long as tax and insurance obligations of the properties are met. See generally Note, *Lender Accountability and the Problem of Noninterest-Bearing Mortgage Escrow Accounts*, 54 BOS. U.L. REV. 516 (1974); Note, *Trusts: Requiring Mortgage Loan Escrow Holders to Account for Profits Earned on Tax and Insurance Prepayments*, 28 OKLA. L. REV. 213 (1975); Note, *The Attack upon the Tax and Insurance Escrow Accounts in Mortgages*, 47 TEMP. L.Q. 352 (1974).

The practice of requiring escrow accounts arose during the depression years of the 1930's, in order to assure protection of the mortgagees' interests against superior tax liens and against loss due to destruction of the property. Escrow accounts are now required in connection with all FHA insured and VA loans and certain home mortgage loans made by federally chartered institutions. 24 C.F.R. § 203.23 (1974); 38 C.F.R. § 36.4512 (1974); 12 C.F.R. § 545.6-1(a)(4)(iii) (1975).

2. CONN. GEN. STAT. ANN. § 49-2 (Supp. 1975).

3. MASS. GEN. LAWS ANN. ch. 183, § 61 (Supp. 1975).

shire,⁴ and New York⁵ had enacted laws requiring lending institutions to pay interest to the mortgagors upon funds held in escrow accounts.

Oklahoma and other states⁶ are contemplating some type of escrow account legislation. Oklahoma's proposed law⁷ is virtually identical to that portion of the New York statute⁸ which was recently upheld as constitutional by a three-judge panel of the United States District Court for the Eastern District of New York in *Jamaica Savings Bank v. Lefkowitz*.⁹ Thus, *Jamaica* holds special interest for legislators in Oklahoma and other states where the proposed legislation is based upon the New York law.

Briefly, the challenged statute provides that mortgage lending institutions shall pay not less than two percent interest annually upon amounts maintained in escrow accounts established in connection with loans secured by mortgages on any one to six family dwellings occupied by the owner and located within New York. The imposition of service charges for maintaining escrow accounts is prohibited unless imposed pursuant to an express contract provision entered into prior to the law's effective date.¹⁰ The state's banking board is empowered to set a minimum rate of interest above the two percent floor and to establish a formula for computing the interest to be paid. Institutions are exempt from payment of interest in only three instances: where a contract entered into prior to the effective date of the law expressly provides for nonpayment of interest; where payment of interest would violate a federal law or regulation; or where escrow accounts are maintained by a mortgage servicing company, unaffiliated with the mortgage lending institution, pursuant to a prior written contract which does not permit the lending institution to use or receive a return upon the escrow funds.¹¹

Plaintiff (the bank) in *Jamaica* launched a comprehensive constitutional attack against the statute,¹² asking declaratory and injunctive

4. N.H. REV. STAT. ANN. § 384:16-c (Supp. 1973).

5. N.Y. BANKING LAW § 14-b (McKinney Supp. 1974); N.Y. GEN. OBLIG. LAW § 5-601 (McKinney Supp. 1974).

6. Note, *Trusts: Requiring Mortgage Loan Escrow Holders to Account for Profits Earned on Tax and Insurance Prepayments*, 28 OKLA. L. REV. 213, 215 (1975).

7. Okla. H.B. 1526, Okla. S.B. 133, 35th Legis., 1st Sess. (1975).

8. N.Y. BANKING LAW § 14-b (McKinney Supp. 1974).

9. 390 F. Supp. 1357 (E.D.N.Y. 1975).

10. N.Y. GEN. OBLIG. LAW § 5-601 (McKinney Supp. 1974).

11. N.Y. BANKING LAW § 14-b (McKinney Supp. 1974).

12. Although the interest requirement is contained in N.Y. GEN. OBLIG. LAW § 5-601 (McKinney Supp. 1974), as well as N.Y. BANKING LAW § 14-b (McKinney Supp. 1974), the plaintiff's attack was aimed only at the latter statute.

relief from enforcement based upon the statute's alleged violation of both the contract clause of article I, section 10 of the United States Constitution,¹³ and the due process and equal protection clauses of the fourteenth amendment to the United States Constitution.¹⁴

Arguing that contracts entered into prior to the effective date of the law were impaired by the statute contrary to the contract clause, the bank contended nonpayment of interest on escrow accounts, though not an express provision of prior contracts, was a term implied in fact. The implication was claimed to have arisen by reason of the stipulated fact that the mortgagors' attorneys knew that interest would not be paid upon escrow funds and acquiesced in the arrangement. In addition, the bank argued that it would not have entered into the loan contracts had payment of interest upon escrow accounts been required.

In rejecting the bank's argument, Judge Costantino stated that mere absence of a contract provision does not raise the implication of a term implied in fact.¹⁵ Relying on the decision of the United States Supreme Court in *El Paso v. Simmons*,¹⁶ the court held that as profits derived from the bank's use of escrow funds were not specifically allocated by the contracts, the legislature, by virtue of its police power, possessed the authority to provide for allocation of those profits in order to "safeguard the vital interests of its people."¹⁷

The court reached the central issue of the case in discussing the problem of adhesion and unconscionability inherent in such contracts.

It is uncontroverted that mortgagors could not have obtained mortgages if they had insisted upon a term in the contracts providing interest. These mortgage agreements—almost all identical—were drafted by the plaintiff and essentially offered to potential mortgagors on a take it or leave it basis. The state legislature properly exercised its power to correct an imbalance in the bargaining relationship.¹⁸

The plaintiff's claim that the payment of interest under the statute constituted a taking without due process of law in violation of the fourteenth amendment was held to be "not substantial."¹⁹ The mortgagors did not intend the mortgagee to have a beneficial interest in the

13. U.S. CONST. art. I, § 10.

14. U.S. CONST. amend XIV, § 1.

15. 390 F. Supp. at 1361.

16. 379 U.S. 497 (1965).

17. 390 F. Supp. at 1362.

18. *Id.*

19. *Id.* at 1363.

escrow funds but rather intended that the mortgagee should hold the money as agent for payment to third parties; therefore, the mortgagee held "no ultimate beneficial interest"²⁰ in the funds to which a taking could apply. Consequently, no violation of due process occurred.

Finally, the bank alleged infringement of the fourteenth amendment's equal protection clause, arguing that it was irrational to attempt to distinguish between contracts which expressly excluded payment of interest and those which were silent as to payment. However, the decision recognized that the statutory distinction between contracts containing expressly bargained-for terms and those in which specific assent and fairness were absent was entirely rational and not arbitrary.

The statute challenged in *Jamaica* appears to be the most restrictive of those enacted thus far.²¹ It affords the parties little ground upon which to formulate individual solutions to the escrow funds problem. In fact, probably the only alternative available under such a statute is one in which institutional mortgagees might elect, where permitted,²² to forego the requirement of escrow accounts altogether.²³ Yet, the profits derived from the free use of escrow account monies have long been relied upon by mortgage lending institutions as a source of income. With

20. *Id.* The court did conjecture that had the bank shown profits realized from escrow accounts to be insufficient so that the bank had had to utilize its own general funds to make the interest payments, there might have been a taking. Instead the bank offered proof only that it was currently losing money on its mortgage loans as a whole.

21. CONN. GEN. STAT. ANN. § 49-2 (Supp. 1975) provides that interest shall be paid by mortgage lending institutions at a rate of not less than two percent per annum, which interest shall be credited toward payment of taxes and insurance premiums. The statute imposes a maximum fine of \$100 per violation.

MASS. GEN. LAWS ANN. ch. 183 § 61 (Supp. 1975) requires payment of interest solely upon the amount prepaid monthly to satisfy tax obligations, and "at a rate and in a manner to be *determined by the mortgagee.*" (Emphasis added.) Institutional mortgagees must file annual statements of net profit or loss from investment of that portion of escrow accounts attributable to tax obligations. The state bank commissioner may, upon request, grant an exemption from payment of interest to mortgagees showing net losses.

N.H. REV. STAT. ANN. § 384:16-c (Supp. 1975) provides that banks must credit each escrow account with interest "at a rate not less than two percent below the rate paid on regular savings deposits in said bank."

22. As previously noted, escrow accounts are required on all FHA insured and VA loans and certain loans made by federally chartered institutions. 24 C.F.R. § 203.23 (1974); 38 C.F.R. § 36.4512 (1974); 12 C.F.R. § 545.6-1(a)(4)(iii) (1975). See note 1 *supra*.

23. In such an event, additional factors must be considered. For example, some borrowers view the maintenance of escrow accounts as a service provided by the lending institutions whereby the individual borrower is relieved of the burden of making large annual or semi-annual payments directly to the taxing authority and insurer. More importantly, in order to protect their interests, institutions would find it necessary to conduct periodic inquiries of taxing authorities and insurers to ascertain whether the obligations had been met. The expense involved in this inquiry process would ultimately be thrown upon the borrower in one form or another.

the elimination of or reduction in this income, institutions will be forced to look elsewhere for additional income to offset general operating expenses. Undoubtedly, the result will be reflected in higher costs to the borrower, either in the form of higher interest rates on loans or by the imposition of service charges.²⁴

As previously stated, numerous states are considering enactment of escrow account legislation.²⁵ The delicate dilemma facing those legislatures is one of balancing of interests. It is generally conceded that lending institutions should be allowed some method of safeguarding their interest in the mortgaged property, however, individual mortgagors must not be divested of their property prematurely and without just compensation.²⁶

In order to avoid the restrictive effect of a statute such as New York's, an arrangement fairer to both mortgagor and mortgagee should be considered. For example, the mortgagee and mortgagor could specifically agree, as an alternative to the establishment of the usual escrow account, that an amount necessary to satisfy tax and insurance obligations be paid by the mortgagor directly to the mortgagee *at the time the obligation actually accrues* in favor of the third parties (normally on an annual or semi-annual basis). The mortgagor under such a plan retains the use of his money until the debt is in fact owed, while the mortgagee retains a method to monitor payment and assure protection of its investment in the property.²⁷ In addition, the mortgagee's expense attributable to maintaining such an annual or semi-annual escrow account would certainly amount to no more than the maintenance ex-

24. Under the New York statute, service charges imposed specifically for the maintenance of escrow accounts are forbidden, unless imposed pursuant to an express contractual provision entered into prior to the law's effective date. N.Y. GEN. OBLIG. LAW § 5-601 (McKinney Supp. 1974).

25. Okla. H.B. 1526, Okla. S.B. 133, 35th Legis., 1st Sess. (1975); Note, *Trusts: Requiring Mortgage Loan Escrow Holders to Account for Profits Earned on Tax and Insurance Prepayments*, 28 OKLA. L. REV. 213, 215 (1975). See text accompanying note 6 *supra*.

26. State action is presently essential for protection of mortgagors' interests in light of a proposed amendment to Federal Home Loan Bank Board regulations. The proposed amendment to 12 C.F.R. 545.6-11 (1975) would apply to home mortgage loans within the Board's jurisdiction. The payment of interest upon escrow funds would be conditioned in part upon the existence, in the state in which the dwelling is located, of a specific statutory provision mandating payment of interest. 40 Fed. Reg. 4661 (1975).

27. If instead, a traditional escrow arrangement were preferred or required, then payment of interest could be imposed according to an appropriate statutory scheme. In any event, full disclosure of the escrow account requirement by the mortgagee to the mortgagor is imperative if that portion of the mortgage loan contract is to constitute a truly bargained-for term.