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Outlawed Mortgages and Vendors' Liens--Amendment to Real Property Law Permitting Cancellation as of Record

Harold E. Collins

CURRENT LEGISLATION

OUTLAWED MORTGAGES AND VENDORS' LIENS—AMENDMENT TO REAL PROPERTY LAW PERMITTING CANCELLATION AS OF RECORD.—At the session of the legislature concluded on March 13th last, a further amendment to Section 500 of the Real Property Law [1] was made which is noteworthy from a dual aspect. Aside from the fact that the amendment is extremely beneficial to certain property owners, it is also interesting for the further inroads it makes on the ancient and austere rules of equity jurisprudence. Of course, in the constant development of the law throughout the years, many old established doctrines have given way to more modern and useful rules, dictated perhaps by economic necessity. However, each change, each development, is worthy of particular observation and comment because of its historical enrichment.

The amendment in question adds subdivision 4 to Section 500 of the Real Property Law and provides, in substance, that where an action to foreclose a mortgage or to enforce a vendor's lien is barred by the statute of limitations, any person having an interest or estate in the real property affected, may institute an action to cancel the encumbrance of record as a cloud on title.[2] As a result of this statute real property which may have been subject to either of the enumerated encumbrances will now be more readily salable. The statute removes a serious obstacle facing a vendor who must satisfy his vendee that he has a marketable title to convey, and consequently the amendment tends to reduce litigation.

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[1] Laws of N. Y. 1948, c. 105.

[2] The full text of the amendment is as follows: "Where the period allowed by the applicable statute of limitation for the commencement of an action to foreclose a mortgage, or to enforce a vendor's lien, has expired any person having an estate or interest in the real property subject to such encumbrance may maintain an action against any other person or persons, known or unknown, including one under disability as hereinafter specified, to secure the cancellation and discharge of record of such encumbrance, and to adjudge the estate or interest of the plaintiff in such real property to be free therefrom; provided, however, that no such action shall be maintainable in any case where the mortgagee, holder of the vendor's lien, or the successor of either of them shall be in possession of the affected real property at the time of the commencement of the action. In any action brought under this section it shall be immaterial whether the debt upon which the mortgage or lien was based has, or has not, been paid; and also whether the mortgage in question was, or was not, given to secure a part of the purchase price.

"The interest had by any mortgagee or contract vendee of real property or by any successor in interest of either of them, is an 'interest in real property' as that phrase is used in this article of the real property law."

To understand the full significance of this amendment it is necessary to consider briefly Section 500 as a whole and also its historical development. The section is derived from Section 1638 of the Code of Civil Procedure, which in turn had its antecedents in qualified form in the Revised Statutes.[3]

Prior to the enactment of these statutes the methods of determining adverse claims to real property and removing clouds on title were by bills in equity known as bills of peace and bills *quia timet*. There was an essential distinction between the remedies afforded by these two ancient bills. The bill of peace was originally formulated by the court of chancery for the purpose of avoiding multiplicity of suits.[4] A development of the bill of peace used early in the law concerning real property was the bill to quiet title which was instituted to put finally at rest the claim of title of the adverse claimant and thereby put a stop to vexatious litigation. On the other hand, the bill *quia timet* was instituted for the purpose of removing clouds on title by compelling the adverse claimant to deliver up for cancellation the instrument under which he claimed, or to release the land from an encumbrance or lien. With respect to the cancellation of an instrument as a cloud on title, the rule was established at an early time that equity would only interfere when the instrument appeared valid on its face and extrinsic evidence was necessary to show the invalidity.[5] The reason advanced by the courts for so holding was that only those instruments which appeared to be valid would mislead the public and that those patently invalid would not be relied upon. Thus if the instrument were a mortgage and it appeared invalid on its face by reason of the statute of limitations, equity decreed that no interference was necessary[6] since this was merely a purported claim which no one could question.

This stringent and often criticized[7] rule was not confined to actions involving clouds on real property titles but was likewise followed where other instruments, such as promissory notes, were questioned as to their validity.[8] In such cases the courts held that no necessity existed for affirmative relief as there was a perfect defense at law.[9]

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[3] N. Y. LAW REVISION COMMISSION REPORT, LEGIS. DOC. No. 65(G) (1943).

[4] 1 POMEROY, EQUITY JURISPRUDENCE § 246 (5th ed. 1941).

[5] Cox v. Clift, 2 N. Y. 118 (1848).

[6] Capell v. Dill, 82 Kan. 652, 109 Pac. 286 (1910); Gibson v. Johnson, 73 Kan. 261, 84 Pac. 982 (1906); *cf.* Hall v. City of Lockport, 90 Misc. 429, 153 N. Y. Supp. 298 (Sup. Ct. 1915).

[7] 4 POMEROY, EQUITY JURISPRUDENCE § 1399 (5th ed. 1941); Finnegan, *Problems and Procedure in Quiet Title Actions*, 26 NEB. L. REV. 485 (1947).

[8] Allerton v. Belden, 49 N. Y. 373 (1872).

[9] Allerton v. Belden, 49 N. Y. 373 (1872); Minturn v. Farmers Loan & Trust Co., 3 N. Y. 498 (1850).

Ultimately, many of the states enacted statutes with respect to real property which codified the remedies afforded by the existing law and in many respects extended and liberalized the powers of the courts to quiet title.[10] In New York, after several statutory developments, Article 15 of the Real Property Law was adopted in 1920. Section 500 of this article enumerated the instances in which disputed claims to real property could be determined. Section 507[11] provided that the court could order any instrument purporting to create an interest, lien or encumbrance to be delivered up and cancelled. However, in spite of the broad sweep of the statutory language, the remedy was still subject to many of the limitations originally placed on such proceedings as laid down by the courts of equity. One of the most important limitations was that the party seeking a determination had to be in possession of the property. The rationale being that if the party were in possession his remedy at law was inadequate since in order to maintain ejectment at law he would have to be out of possession; therefore equity came to his aid. The statutory proceeding as then constituted continued this tenuous and inequitable condition.

In 1943 the statutory remedy was radically overhauled at the instance of the Law Revision Commission.[12] The requirement of possession was eliminated and the availability of the remedy was extended to those having an interest in land whereas previously only those having an estate in land could sue.

However, the amendment most pertinent to the present inquiry was the addition of subdivision 2 to Section 500 which reads as follows: "Such action may be maintained, even though the defendant's claim appears to be invalid on its face, or the court may have to determine the death of a person, or any statutory limitation of time, or any question of fact or law upon which an adjudication of the adverse claims of the parties may depend."

Thus for the first time it appeared that statutory machinery was available to determine claims based on instruments which were invalid on their face. This was, indeed, a substantial deviation from the long established equitable practice. But the fact that it was necessary for the legislature in 1948 to enact the amendment under consideration is proof that the hope of the statutory revisors was not entirely fulfilled. By virtue of the amendment the courts are now expressly empowered to cancel and discharge of record a mortgage which has been barred by the statute of limitations. Why, then, did not the 1943 revision as quoted above apply to such a situation? The

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[10] *See* Wehrman v. Conklin, 155 U. S. 314, 323, 39 L. ed. 167, 172 (1894); Finnegan, *Problems and Procedure in Quiet Title Actions*, 26 NEB. L. REV. 485 (1947).

[11] Now § 506 of Article 15.

[12] N. Y. LAW REVISION COMMISSION REPORT, LEGIS. DOC. No. 65(G) (1943).

answer simply is that the statutory proceeding is still imbued with equitable principles which dictate the result to be attained when the particular case shows that an injustice would otherwise occur. It has been aptly stated in a recent case that the statute has merely codified the remedies obtained through the bill of peace and the bill *quia timet.*[13]

Unaffected by the statute, therefore, was the firmly established rule that when a party comes into equity seeking affirmative relief, he must himself do equity. Therefore, one who goes into equity to ask that a mortgage which is barred by the statute of limitations be declared a cloud on title and that it be cancelled of record, is invariably reminded that the statute of limitations is a shield and not a sword.[14] His prayer for relief is thus denied unless he does equity himself and pays the debt due under the mortgage. This principle was reiterated as late as March, 1947, in the case of *Beach 102d Street Realty Corp. v. Ringel.*[15] There the plaintiff relied on the legal presumption of payment of a mortgage by reason of the running of the statute of limitations and prayed that the court decree that the mortgage be cancelled of record as a cloud on title. The court held that the plaintiff could not so employ the statute of limitations and that to be entitled to affirmative relief the debt would first have to be paid.[16]

It would appear, therefore, that in spite of the language of Section 500 as revised in 1943, in order to implement the statute, with respect to cancellation of patently invalid instruments, the plaintiff would have to show special equities in his favor, such as payment of the mortgage, in order to obtain the desired relief. Thus the law was not as favorable to the property owner as originally contemplated and the net result of these decisions was to retain substantially the rules of law formerly in force prior to the revision of 1943.

Perhaps such a condition would not be too inequitable between the original parties to the mortgage since in all fairness the mortgagor should return the money he received from the mortgagee in good faith. But it seems that one who holds an outlawed mortgage may nevertheless be possessed of a substantial remedy which he can avail himself of not only against the original mortgagor but also against subsequent purchasers of the real property covered by the mortgage and thereby defeat the very purpose of the statute of limitations. Many of these outlawed mortgages contain an express power of sale

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[13] Karp v. Twenty Three Thirty Ryer Corp., 185 Misc. 440, 56 N. Y. S. 2d 783 (Sup. Ct. 1945).

[14] Johnson v. Albany & Susquehanna R. R., 54 N. Y. 416 (1873); Morey v. Farmers Loan & Trust Co., 14 N. Y. 302 (1856).

[15] 190 Misc. 199, 74 N. Y. S. 2d 249 (Sup. Ct. 1947); *accord,* Wanger v. U. S. Trust Co., 190 Misc. 73, 74 N. Y. S. 2d 251 (Sup. Ct. 1947).

[16] It is specifically provided by the amendment under consideration that it is immaterial whether the debt upon which the mortgage or lien was based has, or has not, been paid.

and it has been held by the Court of Appeals in the case of *House v. Carr*[17] that where the mortgage debt is unpaid, such a power of sale in an outlawed mortgage may be exercised through the medium of foreclosure by advertisement. Under this method of foreclosure the property may be sold upon a default without any recourse to the courts. The power of sale is deemed a private agreement which may be exercised upon the happening of the condition which makes it operative.[18] The rule is that the running of the statute of limitations does not discharge the debt but only destroys the particular remedy to collect the debt, and if another remedy exists which is unaffected by the bar of the statute the mortgagee may enforce his debt in that manner.[19] Thus it seems that although the statute of limitations is intended as a statute of repose and a just penalty for one who is dilatory, the assurance that the statute should offer of an unimpeachable title by reason of the passage of time has not been attained. It is one thing to hold that the mortgagor must do equity and pay the debt if he desires affirmative relief and thus place the parties in *statu quo;* but it is quite another to allow the mortgagee who has been dilatory to obtain the exact relief which appeared to have been barred, through another means of recovery.

Moreover, there has been a line of cases which has further increased the instability of the overall picture by reason of the holdings in these cases that where the mortgage is barred by the statute of limitations the owner of the property, nevertheless, has a marketable title and can convey with impunity.[20] Indeed, it has been held that a vendee under a contract of sale must accept a conveyance under these conditions.[21] This is undesirable, to say the least, as it places the vendee in a very precarious position. Having purchased the property in good faith he should not be subjected to the possibility of losing it at the instance of the outlawed mortgagee.

The injustice of the entire situation has been succinctly summed up by Judge Mitchell in his forcible dissenting opinion in the case of *Maloney v. Finnegan*[22] as follows: "Every business man knows that an instrument may be so serious a cloud that no lawyer would pass the title, and no man buy the property, and yet a court, after grave deliberation, might hold that the instrument was void on its face, and,

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[17] 185 N. Y. 453, 78 N. E. 171 (1906).

[18] Elliott v. Wood, 45 N. Y. 71 (1871). The mechanics of the sale itself are regulated in New York by Article 17 of the Real Property Law.

[19] House v. Carr, 185 N. Y. 453, 78 N. E. 171 (1906); Kelley v. Hall, 144 Misc. 759, 259 N. Y. Supp. 383 (Sup. Ct. 1932).

[20] Ouvrier v. Mahon, 117 App. Div. 749, 102 N. Y. Supp. 981 (2d Dep't 1907); Paget v. Melcher, 42 App. Div. 76, 58 N. Y. Supp. 913 (1st Dep't 1899); *In re* Bond & Mortgage Guarantee Co., — Misc. —, 69 N. Y. S. 2d 564 (Sup. Ct. 1947).

[21] *In re* Bond & Mortgage Guarantee Co., — Misc. —, 69 N. Y. S. 2d 564 (Sup. Ct. 1947).

[22] 38 Minn. 70, 35 N. W. 723 (1887).

then, perhaps it would be void only because the court said so. To allow a defendant to commit legal suicide by urging that the instrument under which he claims is void, and for the court to hold on that ground that the plaintiff needs no relief, although his title is seriously clouded in fact, is neither just nor reasonable." [23]

It is evident, therefore, that the amendment to Section 500 which has just been enacted was not only desirable but necessary in order that the uncertainties and inequities which are now prevalent, might be finally resolved.

The procedure available under the new amendment is also applicable to outlawed vendors' liens as the problems inherent in such liens are analogous to those presented by outlawed mortgages.[24] The vendor's lien contemplated by this statute is the lien implied by law in favor of a vendor who has conveyed without taking security for the purchase price and also the lien which is expressly reserved by contract but which has not been raised to the dignity of a mortgage.[25]

The statute also provides that the interest of any mortgagee is an "interest in real property," as that phrase is used in the statutory proceeding and thus the remedy of cancellation is made available to a junior mortgagee whose mortgage might become a first lien upon cancellation of the outlawed mortgage. The remedy is also available to a contract vendee who has not as yet taken a conveyance as the statute likewise defines the interest of a contract vendee as an "interest in real property." [26]

HAROLD E. COLLINS.

AMENDMENT TO THE STOCK CORPORATION LAW RELATING TO CERTIFICATES OF INCORPORATION REQUIRING MORE THAN STATUTORY MAJORITY FOR CORPORATE ACTION.—Effective September 1, 1948, the Stock Corporation Law has been amended by inserting a new section to be Section 9.[1] The amendment permits certificates of incorporation to include therein provisions requiring more than a statutory majority or plurality for a quorum vote or consent of directors or shareholders. Four specific limitations are placed upon certificates of incorporation requiring more than the statutory majority. No such requirement will be deemed valid unless (1) it appears in the certificate as originally filed or as originally amended;

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[23] 38 Minn. 70, 71, 72, 35 N. W. 723, 724, 725 (1887).

[24] N. Y. LAW REVISION COMMISSION REPORT, LEGIS. DOC. No. 65(N) (1948).

[25] Franklin Savings Bank v. Ascension Memorial Church, — Misc. —, 55 N. Y. S. 2d 808 (Sup. Ct. 1945).

[26] N. Y. LAW REVISION COMMISSION REPORT. LEGIS. DOC. No. 65(N) (1948).

[1] Laws of N. Y. 1948, c. 862.