

Mortgages to Secure Future Advances

Julien D. Goell

Follow this and additional works at: <https://scholarship.law.stjohns.edu/lawreview>

Recommended Citation

Goell, Julien D. (1934) "Mortgages to Secure Future Advances," *St. John's Law Review*: Vol. 8 : No. 2 , Article 12.
Available at: <https://scholarship.law.stjohns.edu/lawreview/vol8/iss2/12>

This Note is brought to you for free and open access by the Journals at St. John's Law Scholarship Repository. It has been accepted for inclusion in St. John's Law Review by an authorized editor of St. John's Law Scholarship Repository. For more information, please contact lasalar@stjohns.edu.

life beneficiary. Such a decision would eradicate any element of unlawful accumulation.

So run the opinions of the court. One who reads them is immediately struck with the powerful arguments on both sides. Where the Court of Appeals has disagreed by a four-to-three decision, there is room for much debate. It seems to us that the majority of the judges, influenced by considerations of justice in the abstract sense, have seized upon this close case to initiate a possible departure from previous well-defined rules of trust construction. While it is true that in all of these cases discussed and noted, the settlor intended to provide bounteously for his beneficiary, it is probably even more true that he rarely desired that any sums left unexpended at the death of the beneficiary should go to the heirs of the beneficiary rather than the remainderman expressly designated by himself. This is clearly manifested by the omnipresent clauses giving principal and any surplus of income to remaindermen. By judicial construction these provisions have been disregarded both as inconsistent with the intent of the settlor where he provides generally for the maintenance of the beneficiary and as violative of the statute against accumulations. It is quite possible that the court does intend to correct this situation. Certainly the vigorous and emphatic dissent more closely accords with established principles of law. What the future may bring is, of course, a matter for conjecture. It does not seem at all probable that the rule of the *Hoyt* case will be obliterated. It is possible that it will be narrowed down. It will be interesting to watch the effect of this decision upon the law of trusts.

MAX MILSTEIN.

MORTGAGES TO SECURE FUTURE ADVANCES.

Mortgages to secure future advances or liabilities are well recognized and fully established. Their validity is no longer open to question.¹ Where a mortgage on its face states that it is to secure future loans to a fixed amount, it is valid only up to that amount,² and a collateral oral agreement to extend the mortgage to cover future advances in excess of the limitation on the face of the instru-

¹ *Shirras v. Caig*, 7 Cranch 34 (U. S. 1812); *Leeds v. Cameron*, 3 Sumn. 488 (U. S.); *Fed. Cas. No. 8206* (1839); *Truscott v. King*, 6 N. Y. 147 (1852); *Robinson v. Williams*, 22 N. Y. 380 (1860); *Ackerman v. Hunsicker*, 85 N. Y. 43, 39 Am. Rep. 621 (1881); *Bank of Utica v. Finch*, 3 Barb. (N. Y.) c. 293, 49 Am. Dec. 175 (1848); *Forsyth v. Preer*, 62 Ala. 443 (1878); *Hubbard v. Savage*, 8 Conn. 215 (1830); *Straeffer v. Rodman*, 146 Ky. 1, 141 S. W. 742 (1913); *Newkirk v. Newkirk*, 56 Mich. 525, 23 N. W. 206 (1885).

² *Mowry v. Sanborn*, 68 N. Y. 153 (1877); *Ford v. Davis*, 168 Mass. 116, 46 N. E. 435 (1897).

ment will not be upheld.³ A mortgage for future advances may be made a continuing security for advances made at any time, so that when advances have been made to the amount limited by the mortgage and these are paid, wholly or in part, this mortgage is held to continue as security for further loans within the prescribed limit.⁴ Such a mortgage has not been extended to secure loans made to a partnership of which the mortgagor was a member.⁵

In a mortgage of this type, except for the fact that it secures loans only within the prescribed limit, the consideration expressed in the document is of little importance. In the case of *Miller v. Lockwood*⁶ the consideration expressed was \$25,000, although the indebtedness at the date of the making of the mortgage contract was only \$13,700. The claim set forth was that the amount of the mortgage being more than the actual consideration was proof of the fraudulent intent of the parties as against the creditors of the mortgagor. The court agreed only in so far as it held this circumstance to be a proper fact to be considered by the jury in determining the *bona fides* of the transaction, but held that it afforded no legal presumption of fraud since the instrument on its face was to cover not only present but also future liabilities.

Mortgages to cover any or all future advances with no limit set have been upheld as security for the real equitable claims of the mortgagees whether they existed at the inception of the mortgage or arose subsequently on the faith thereof.⁷ The amounts of the several advances may be shown by extrinsic proof, for in such case the proof does not contradict the mortgage or alter its legal operation and effect in any way.⁸ In such case, when the mortgagee gets actual notice of a subsequent lien, all further advances that he may make are subordinated to the claim of the lienor.⁹ This is a just rule as otherwise it is obvious that unscrupulous parties could prevent such subsequent incumbrancers from ever realizing their claims on the property by extending the mortgage to cover a sum equal to the value of the property.

³ *Stoddard v. Hart*, 23 N. Y. 556 (1861). But see *contra*: *Stone v. Lane*, 92 Mass. 74 (1865).

⁴ *United States v. Hooe*, 3 Cranch 73, 2 L. ed. 370 (U. S. 1805); *Robinson v. Williams*, *supra* note 1; *Brown v. Kiefer*, 71 N. Y. 610 (1877); *Commercial Bank of Rochester v. Weinberg*, 70 Hun 597, 25 N. Y. Supp. 235 (N. Y. 1893); *Shores v. Doherty*, 65 Wis. 153, 26 N. W. 577 (1886).

⁵ *Bank of Buffalo v. Thompson*, 121 N. Y. 280, 24 N. E. 473 (1890); *Bank of Batavia v. Tarbox*, 38 Hun 57 (N. Y. 1885).

⁶ 32 N. Y. 293 (1865); see also *Mowry v. Agricultural Ins. Co.*, 138 N. Y. 642 (1893).

⁷ *Shirras v. Caig*, *Robinson v. Williams*, both *supra* note 1.

⁸ *Hall v. Crouse*, 13 Hun 557 (N. Y. 1878).

⁹ *Robinson v. Williams*, *supra* note 1; *Fassett v. Smith*, 23 N. Y. 252 (1861).

The fact that the mortgage fails to disclose that it proposes to secure future advances will not militate against its validity,¹⁰ although in such case there is great ground for suspicion and the mortgagee is required to prove consideration by more strict proof than would be otherwise necessary.¹¹ Parol testimony as to the intent of the parties is admissible as between themselves¹² and against those subsequent lienors who are notified when their liens attached as to the purpose of the mortgage.¹³

Under the New York Recording Act,¹⁴ it is necessary as against subsequent encumbrancers for value for mortgages to be recorded.¹⁵ Thus a mortgage for future advances that was first recorded was given preference over a prior unrecorded purchase money mortgage as to all advances made prior to receiving notice of this mortgage.¹⁶ It is the general practice to record this mortgage before any actual indebtedness occurs,¹⁷ since although it does not become an actual lien till some debt or liability secured by it is created,¹⁸ and then only to the extent of such debt or liability,¹⁹ it is considered a potential lien for the entire amount of the contracted-for indebtedness.²⁰ This places all subsequent lienors upon inquiry to determine just what advances, if any, have been made and enables them by giving notice to prevent any further advances being made to their prejudice.²¹ The notice required is actual notice²² as the courts have construed the recording acts to be prospective and not retrospective in action. The authorities proceed upon the theory that the mortgage, as against subsequent incumbrances, becomes a lien for the whole sum advanced as of the date of its execution and recordation. There is slight authority that tends toward the rule that constructive notice will suffice, but the great weight of authority is otherwise.

¹⁰ *Craig v. Tappin*, 2 Sandf. at c. 76 (N. Y. 1844); *Bank of Utica v. Finch*, *supra* note 1; *Hall v. Crouse*, *supra* note 8; *Tully v. Harloe*, 35 Cal. 302, 95 Am. Dec. 102 (1868); *Westheimer v. Goodkind*, 24 Mont. 90, 60 Pac. 813 (1900); *Schofield Implement Co. v. Minot Farmers' Grain Assn.*, 31 N. D. 605, 154 N. W. 527 (1915); *Blackmar v. Sharp*, 23 R. I. 412, 50 Atl. 852 (1901); *Moses v. Hatfield*, 27 S. C. 324, 3 S. E. 538 (1887).

¹¹ *Craig v. Tappin*, *supra* note 10.

¹² *McKinster v. Babcock*, 26 N. Y. 378 (1863); *Cady v. Merchants Bank*, 47 Hun 631 (N. Y. 1888), *aff'd* without opinion, 113 N. Y. 657, 21 N. E. 415 (1889).

¹³ *Cady v. Merchants Bank*, *supra* note 12.

¹⁴ N. Y. REAL PROP. LAW (1909) §291.

¹⁵ *Ibid.*

¹⁶ *Reynolds v. Webster*, 71 Hun 378, 24 N. Y. Supp. 1133 (N. Y. 1893).

¹⁷ *Truscott v. King*, *Robinson v. Williams*, both *supra* note 1.

¹⁸ *Frentel v. Schmitz*, 299 Ill. 320, 132 N. E. 534 (1921).

¹⁹ *Dart v. McAdam*, 27 Barb. 187 (N. Y. 1858); *Freeman v. Auld*, 44 Barb. 14 (N. Y. 1865); *Watts v. Bonner*, 66 Miss. 629, 6 So. 187 (1889); *Schaemer v. Zeran*, 126 Wash. 219, 217 Pac. 1009 (1923).

²⁰ *Ackerman v. Hunsicker*, *supra* note 1.

²¹ *Ibid.*; *supra* note 17.

²² *Truscott v. King*, *Robinson v. Williams*, *Ackerman v. Hunsicker*, all *supra* note 1; *Creigh v. Jones*, 103 Neb. 706, 173 N. W. 687 (1919); *Central Trust Co. v. Continental Iron Works*, 51 N. J. Eq. 605, 28 Atl. 595 (1894).

If the logic behind the doctrine should appear to be specious, the necessity for expediency and safety in business transactions more than justifies the rule.

The New York Court of Appeals declared that the instrument should state the requisite facts as to the extent and certainty of the contract so that a junior creditor or a prospective purchaser might have notice of the extent of the incumbrance.²³ As far as this state is concerned, it can be seen that this statement describes the etiquette of the situation rather than the law. As a matter of law, it is unnecessary for the instrument to do more than apprise a junior creditor or would-be purchaser that there is a prior lien in existence, putting him on inquiry as to the extent and character of the lien.²⁴ The requirements of some jurisdictions make it necessary that the extent of the lien be limited in some manner.²⁵ Others follow the New York rule, holding that there is no necessity for limiting the amount of the intended advances in any way, if the mortgage shows that it is to cover future advances.²⁶

A problem which arises frequently and has caused great diversity of opinion among courts and law writers, is where subsequent lienors of the mortgaged premises deny that the prior mortgage lien properly embraces advances made subsequently to the attaching of their liens. Mortgages for future advances fall into two categories: the so-called *optional*²⁷ and *obligatory*²⁸ mortgages. The words are descriptive of the character of the advances to be made.

Where the contract makes it obligatory for the mortgagee to make the advances in any event, his lien is held superior to any subsequent lien whether or not he has actual or constructive notice

²³ Truscott v. King, *supra* note 1.

²⁴ Robinson v. Williams, *supra* note 1.

²⁵ DuBois v. First Nat. Bank, 43 Colo. 400, 96 Pac. 169 (1908); Benton Shingles Co. v. Mills, 13 Ga. App. 632, 79 S. E. 755 (1913).

Several states have statutory provisions requiring the debt secured to be described in the mortgage, which restrict the right to make mortgages for future advances. Georgia (Civ. Code 1926, #3257); Maryland (Ann. Code 1924, Art. 66, #2); New Hampshire (Public Stats. of N. H., 1926, c. 215, #3). In the two latter states the statutes necessitate the limiting of the mortgage by some definite means. Georgia requires only that the instrument point out some means for determining the amount of the debt.

²⁶ Lovelace v. Webb, 62 Ala. 271 (1878); Topia v. Demartini, 77 Cal. 383, 19 Pac. 641 (1888); Cazort & Co. v. Dunbar, 91 Ark. 400, 121 S. W. 270 (1909).

²⁷ Ackerman v. Hunsicker, *supra* note 1; Hyman v. Hauff, 138 N. Y. 48, 33 N. E. 735 (1893); Schmidt v. Zahrndt, 148 Ind. 447, 47 N. E. 335 (1897); Anderson v. Liston, 69 Minn. 82, 72 N. W. 52 (1897); Omaha Coal Co. v. Suess, 54 Neb. 379, 74 N. W. 620 (1898); Home Savings Assn. v. Burton, 20 Wash. 688, 56 Pac. 940 (1899).

²⁸ Ackerman v. Hunsicker, *supra* note 1; Hyman v. Hauff, *supra* note 27; Atkinson v. Foote, 44 Cal. App. 149, 186 Pac. 831 (1919); Boswell v. Goodwin, 31 Conn. 74, 81 Am. Dec. 169 (1862); Schmidt v. Zahrndt, *supra* note 27; Wilson v. Russell, 13 Md. 494, 71 Am. Dec. 645 (1859); Commercial Bank v. Cunningham, 41 Mass. 270, 35 Am. Dec. 322 (1837); Kuhn v. Southern Ohio Loan & Trust Co., 101 Ohio 34, 126 N. E. 820, *aff'g*, 12 Ohio App. 184 (1920).

of the attaching of such lien.²⁹ It would be manifestly inequitable to prefer the intervening creditor when, if the mortgagee, to protect himself, ceased his payments, he would be held liable to the mortgagor for breach of contract.³⁰ The theory relied upon to protect the mortgagee is that each payment relates back to the date of the mortgage. The only exception to this rule would occur under the recording acts of the various states in the case where a subsequent *bona fide* purchaser for value and without notice of the prior claim first recorded his instrument. In this instance, the mortgage first in time is nevertheless subordinated in its entirety.³¹

In the mortgage for future optional advances, the liability for breach of contract is non-existent³² and a different problem ensues. In England, it was first held that a mortgage securing future optional advances had priority not only for advances made prior to the execution of a second mortgage, but also for advances made by the mortgagee after actual notice of the second mortgage.³³ This doctrine, in so far as it allowed the mortgagee priority for advances made after receiving notice of the second mortgage, was overruled, but was reaffirmed in that the mortgagee for future advances was protected as to loans made without notice of the second mortgage and in this form is the law in England today.³⁴ This latter rule was adopted in the American courts and it is unquestionably the law today that as to all advances made prior to receiving notice of the intervening lien, even though such advances be made subsequently to the attaching of the lien, the mortgagee under the mortgage for future optional advances is granted priority.³⁵ As to advances made subsequent to receiving actual notice of the intervening lien the weight of authority grants priority to the intervening lienor.³⁶

A differentiation has been made in New York between a mortgage to secure purely optional or voluntary advances and one which by its terms gives the mortgagee an option to cease payments on the occurrence of a certain event.³⁷ Where the contract gave the mortgagee the right to cease delivery of materials and payments in case any lien or encumbrance should be docketed against, filed, or placed upon the property during the performance of the contract and the contingency provided against occurred but the lender failed to exercise his option and continued performance of the contract, the New

²⁹ *Ibid.*

³⁰ *Ibid.*

³¹ For effect of Recording Acts of various jurisdictions see 1 JONES, MORTGAGES, (8th ed. 1928) c. 12

³² *Supra* note 18.

³³ Gordon v. Graham, 7 Vin. Abr. 52, pl. 3, 2 Eq. Cas. Abr. 598 (1716).

³⁴ Hopkinson v. Rolt, 9 H. L. Cas. 514 (1861).

³⁵ Shirras v. Caig, Ackerman v. Hunsicker, both *supra* note 1; Hyman v. Hauff, Schmidt v. Zahrdt, both *supra* note 27; Union Nat. Bank v. Milburn & Co., 7 N. D. 261, 73 N. W. 527 (1897); McDaniels v. Colvin, 16 Vt. 300, 42 Am. Dec. 512 (1844).

³⁶ *Ibid.*

³⁷ Hyman v. Hauff, *supra* note 27, at 54.

York Court of Appeals nevertheless gave him preference as to all advances made, including those made after receipt of notice of the intervening mortgages.³⁸ The ruling was predicated on two reasons: that where a party to a contract waves a stipulation in his favor, a stranger to the contract cannot "derive and benefit or raise any question based upon a fact that no way concerned him"; and that since the intervening encumbrancer obtains no priority where the mortgagee subjects himself to damages by declining to perform or make the advances, there is no reason why he should be granted priority in a case "where the loss of the profits or fruits of the contract must follow a failure or omission to perform". A close analysis will show that the differentiation is arbitrary rather than logical. The subsequent mortgagees in this case are no more strangers to the contract than are the mortgagees in the *purely optional* mortgages, where they *are* given a priority. Where the mortgage is purely optional and the mortgagee ceases payments because of an intervening lien, he also suffers "loss of the profits or fruits of the contract" inasmuch as he must forego part of his intended investment. It was said that the contract was obligatory till the option was exercised. It would be a truer statement to say that it was obligatory till the mortgagee received notice of the subsequent liens, since, in that event, the mortgagee would no longer be subject to suit for breach of contract if he fails to continue his payments. This liability is the basis for the differentiation between obligatory and optional mortgages and, on the occurrence of the event, this liability disappears. By virtue of this decision, the New York court has taken a step back towards the rule as first expressed in England.³⁹

Mississippi adopted the old English rule without any variations.⁴⁰ Whether or not the mortgage is obligatory or optional, with or without notice of the intervening lien, the mortgage is preferred in its entirety where the subsequent encumbrancer has notice, actual or constructive, of the prior lien, and such notice gives the super-vening encumbrancer information as to the extent of the prior mortgage.

Unquestionably, such a ruling simplifies the entire problem of priorities in this type of mortgage. The theory underlying such a doctrine is that since the secondary lienor has knowledge as to just what extent the property is mortgaged, he should not expect to be given priority as to any part of that mortgage. Since the trend in law is theoretically towards simplification, the adoption of this rule with the additional safeguard of a statute similar in effect to that of Maryland, New Hampshire, or Georgia⁴¹ to insure unambiguous

³⁸ *Id.* at 56.

³⁹ *Supra* note 33.

⁴⁰ *Witczinski v. Everman*, 51 Miss. 841 (1876); *Gray v. Helm*, 60 Miss. 131 (1882), quoted and followed in *Lovelace v. Webb*, *supra* note 26.

⁴¹ *Supra* note 25.

language in describing the lien and thus providing ample protection against fraud would be a great step forward.

JULIEN D. GOELL.

RECEIVER OF RENTS AND PROFITS IN NEW YORK.

The recent decision by the Court of Appeals in the *Holmes v. Gravenhorst* case¹ has brought a solution to the problem as to whether, upon the appointment of a receiver in an action brought to foreclose a mortgage containing the covenant: "That the holder of said mortgage, in any action to foreclose it, shall be entitled (without notice and without regard to the adequacy of any security for the debt) to the appointment of a receiver of the rents and profits of said premises," a mortgagor-owner may be required to pay rent to the receiver or be evicted from the premises prior to a sale under a judgment of foreclosure and sale.

Tracing the recent New York decisions² our attention is brought to the conflicting interests of the mortgagor,³ lessee, and mortgagee, exhibiting the forceful influences exerted by them to control the powers of the receiver of rents and profits pending foreclosure.⁴ The issue arises most often between the mortgagee and lessee, concerning the handling of leases in existence during the period of receivership. "Confronted by a debtor who has defaulted and a security which is probably inadequate, the mortgagee is concerned with the making of the receiver's right to the rents and profits of the mortgaged premises productive of an amount sufficient to offset the contemplated deficiency.⁵ However, leases made by the mortgagor prior to the foreclosure action may not provide for an adequate

¹ 238 App. Div. 313, 263 N. Y. Supp. 738 (2d Dept. 1933).

² See (1933) 33 Col. L. Rev. 168. The discussion herein will be confined to New York as the only jurisdiction in which the more complex aspects of this problem have been litigated to any appreciable degree.

³ Unless otherwise indicated, the terms "landlord" and "mortgagor" will be used to designate the owner of the equity of redemption at the time of foreclosure, although in cases of assignments subsequent to the execution of the mortgage these parties may have different interests and may be different persons.

⁴ Under §254 subd. 10 of N. Y. REAL PROP. LAW, where the mortgagee may have a receiver appointed on default. Heretofore, the rights to the exercise of judicial discretion were unhampered, although it has, at times, been held to be "a contract right." *Butler v. Frazer*, 57 N. Y. Supp. 900 (Sup. Ct. 1896). In the absence of express provision in the mortgage, a receiver will be appointed upon application by the mortgagee, after the institution of foreclosure proceedings, only where the mortgagor is insolvent and the security inadequate. See *Finch v. Ray*, 208 App. Div. 251, 255, 203 N. Y. Supp. 560, 562 (3rd Dept. 1924). However, *cf.* *Cohen v. Bartlett*, 182 App. Div. 245, 169 N. Y. Supp. 604 (1st Dept. 1918) insolvency was not required.

⁵ See (1933) 33 Col. L. Rev. 1212.