Chapter 3A

Standard Clauses in Mortgages

§ 3A:1 The New York Statutory Form Mortgage

There is no form that may be called customary in New York. There is a statutory short form of mortgage in New York, and comparable forms in other states,[1] but the New York statutory form mortgage is not complete. For example, it does not contain the "lien clause," which is necessary to maintain priority of the mortgage lien over some mechanics' liens,[2] and the statutory acceleration clause contains blanks for "grace periods" and presupposes an agreement as to how these blanks are to be filled in.[3] The New York statutory form is of substantial advantage because its brief clauses are given an expanded statutory construction.[4] The statutory construction governs when the mortgage is

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1. For statutory forms in other states, see MD. CODE, REAL PROP. § 4-202; MASS. GEN. LAWS ch. 183, app. (5); MINN. STAT. § 507.15; NEV. REV. STAT. § 106.040; N.H. REV. STAT. § 477:29; N.J. STAT. §§ 46:9-1 to 46:9-6; N.M. STAT. 47-1-44; S.D. CODIFIED LAWS § 44-8-3; WYO. STAT. § 34-2-107.
2. The "lien clause" is provided for by N.Y. LIEN LAW § 13(3). *See infra* section 3A:12.
3. *See infra* section 3A:1.4.
4. The statutory form in N.Y. REAL PROP. LAW § 258, Schedule M, is construed in N.Y. REAL PROP. LAW § 254.

in statutory or substantially similar form,[5] but is not lost by inclusion of additional provisions.[6] The statutory rules also apply to the extension and modification of mortgages and other mortgage agreements.[7]

The statutory form is not in general use as such in New York. Its use is permissive, and other forms are not thereby invalidated.[8] A statute allows the recording office to charge a penalty of $5 for the recordation of a mortgage with long forms of covenants,[9] but this is rarely invoked. Perhaps the most frequently used forms are those printed by various title companies for the use of their clients and forms prepared for legal stationers. Lending institutions for the most part have their own forms that are apt to be longer, more detailed, and more favorable to the mortgagee. These are, basically, the statutory form with some clauses added and others modified. The mortgagee is not entitled, per se, to these additional or expanded provisions. For example, if a clause is included that permits the mortgagee to accelerate maturity of the debt for failure of the owner to maintain the premises in a reasonably good state of repair, after notice, the buyer may properly refuse to execute the mortgage.[10] The same is apparently true if the mortgage permits acceleration upon a sale of the property.[11]

The advent of short form instruments in England was greeted with a fear of mischief "if an unnatural and secondary meaning is given by" statute to words that are prima facie clear and intelligible, for the effect is to increase the difficulty of legal documents to the unprofessional reader. *See* W. RAWLE, COVENANTS § 20 (5th ed. 1887). This fear was realized in Albertina Realty Co. v. Rosbro Realty Corp., 180 N.E. 176 (N.Y. 1932) (relying on statutory construction to hold thirty-day grace period did not apply to payment of principal). As a result of *Rosbro*, the acceleration provision of the statutory form mortgage was changed. N.Y. LEGIS. DOC. No. 65(H)35 (1945). *Compare* Engel v. Thompson, 146 N.E.2d 657 (Mass. 1957), *overruled on other grounds*, Silverblatt v. Livadas, 164 N.E.2d 875, 878 (Mass. 1960).

5. Seligman v. Burg, 251 N.Y.S. 689 (App. Div. 2d Dep't 1931) (*but see* Leakey v. Schwing, 270 N.Y.S. 69 (Cty. Ct. Jefferson Cty. 1934)).
6. Prudential Ins. Co. v. Sanford Real Estate Corp., 284 N.Y.S. 73 (Cty. Ct. Monroe Cty.), *aff'd*, 282 N.Y.S. 840 (App. Div. 4th Dep't 1935).
7. Bankers Tr. Co. v. Fuller, 37 N.Y.S.2d 536 (Sup. Ct. 1942).
8. Goldberg v. Norek, 166 N.Y.S. 1023 (Sup. Ct. Kings Cty. 1917).
9. N.Y. REAL PROP. LAW § 327.
10. *Compare* Ansorge v. Belfer, 161 N.Y. 450 (N.Y. 1928). *But see* Goldberg v. Norek, 166 N.Y.S. 1023, 1024 (Sup. Ct. Kings Cty. 1917) (whether a clause is "usual" depends on its general use and not upon its conformance to any statutory provision). Jackson v. Domschot, 239 P.2d 1058 (Wash. 1952), excused the buyer from joining in a mortgage containing provisions not found in the executory contract; *accord* Johnson v. Goldberg, 279 P.2d 131 (1st Dist. Ct. App. 1955).
11. Merriam v. Leeper, 185 N.W. 134 (Iowa 1921). For due-on-sale clauses, *see infra* section 3A:3.

Mortgage forms vary from state to state and within each state. There is considerable variation in the material added to basic forms, the most elaborate being those prepared for banks and other lending institutions. The forms used in New York have been developed to a greater degree than those in some other states. Their clauses should illustrate most of the questions that are apt to arise in all states. For this reason, this section uses as a basis for discussion the New York statutory form mortgage clauses. This section also considers modifications to the statutory form clauses that are often added to amplify the coverage, as well some variations outside New York. The remainder of this chapter then considers additional clauses that are often added to mortgages in New York and other states. Cases cited to support this discussion are not only from New York, but include other states with the thought of giving a general picture of U.S. mortgages.

§ 3A:1.1 Payment of Indebtedness

The New York statutory form mortgage provides:

1. That the mortgagor will pay the indebtedness as hereinbefore provided.[12]

This clause makes the mortgage serve as a bond as well as a mortgage.[13] It overrides a statutory rule that a "mortgage of real property does not imply a covenant for the payment of the sum intended to be secured . . . ."[14] This means that the failure of the mortgagor to sign a bond or promissory note, or the inability of the mortgagee to find and produce a bond or note, does not prevent the mortgagee from suing the mortgagor for the debt or seeking a deficiency judgment upon foreclosure.[15]

When there are multiple owners of the property, normally all owners sign both the promissory note and the mortgage. Liability issues can become complicated when less than all of the owners-mortgagors sign the note. A mortgagor who does not sign the

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12. N.Y. REAL PROP. LAW § 258, Sch. M.
13. Neidich v. Petilli, 71 A.D.2d 999 (N.Y. App. Div. 2d Dep't 1979); Sullivan v. Corn Exch. Bank, 154 A.D. 292 (N.Y. App. Div. 2d Dep't 1912). Other states follow the same rule. Pioneer Sav. & Loan Co. v. City of Cleveland, 479 F.2d 595 (6th Cir. 1973); Mateyka v. Schroeder, 504 N.E.2d 1289 (Ill. App. Ct. 1987); Warner v. Webber Apartments, Inc., 400 N.E.2d 1180 (Ind. Ct. App. 1980).
14. N.Y. REAL PROP. LAW § 249.
15. The statutory construction states that the clause means "that the mortgagor . . . doth covenant and agree to pay to the mortgagee . . . , the principal sum of money secured by said mortgage, and also the interest thereon as provided by said mortgage." N.Y. REAL PROP. LAW § 254(3).

promissory note can become liable on the note by virtue of a promise to pay in the mortgage.[16]

§ 3A:1.2 Insurance

The New York statutory form mortgage provides:

> 2. That the mortgagor will keep the buildings on the premises insured against loss by fire for the benefit of the mortgagee; that he will assign and deliver the policies to the mortgagee; and that he will reimburse the mortgagee for any premiums paid for insurance made by the mortgagee on the mortgagor's default in so insuring the buildings or in so assigning and delivering the policies.[17]

In a case of first impression, a court held that a mortgagor complied with the New York insurance covenant by delivery of a "Home Owners Policy"; that is, a multiple risk policy insuring against liability and other risks in addition to fire.[18]

Delivery of a fire insurance policy with a standard mortgagee clause is not sufficient in itself to stop the running of the statute of limitations with respect to the mortgage.[19]

Covenant 4 of the New York covenants[20] was amended in 1945 to permit acceleration of the mortgage debt for breach of the insurance covenant. Otherwise, the mortgagee would not be empowered to call the mortgage for the mortgagor's failure to supply the mortgagee with required insurance.[21]

The insurance clause may be expanded to entitle the mortgagee to extended coverage and war damage insurance when available and to insurance on personal property covered by the mortgage, and to clarify the mortgagee's right to retain insurance policies that may be unexpired after completion of a foreclosure.

In commercial transactions, the mortgagor often promises to provide "comprehensive all risk insurance." An "all risk" policy is property

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16. Ehrlich v. Mangicapra, 626 So. 2d 702 (Fla. Dist. Ct. App. 1993) (mortgage covenant "to pay promptly when due the principal and interest and other sums of money provided for in said note" creates personal liablity on note).
17. N.Y. REAL PROP. LAW § 258, Sch. M.
18. Century Fed. Sav. & Loan Ass'n v. Mers, 231 N.Y.S.2d 66 (Sup. Ct. N.Y. Cty. 1962), *aff'd*, 236 N.Y.S.2d 939 (App. Div. 1st Dep't 1963).
19. Greenfield v. Kaplan, 179 N.Y.S.2d 381 (Sup. Ct. Kings Cty. 1958).
20. *See infra* section 3A:1.4.
21. Johnson v. N. Minn. Land & Inv. Co., 150 N.W. 596, 598–99 (Iowa 1915); Spires v. Lawless, 493 S.W.2d 65 (Mo. Ct. App. 1973). There is authority for denying acceleration for failure to supply insurance where the mortgagee's security is not impaired. *See* Freeman v. Lind, 226 Cal. Rptr. 515 (3d Dist. Ct. App. 1986).

insurance that covers damage resulting from all risks, other than those specifically excluded from coverage. The term "all risk" is a misnomer, because "all risk" policies invariably have some exclusions. Policies typically exclude coverage for war, pollution, earthquake, and flood.

Prior to the events of September 11, 2001, "all risk" policies covered property damage caused by acts of terrorism. After 9/11, insurance companies began excluding damage from terrorist attacks from their "all risk" policies. This change in the "all risk" policy has triggered disputes between lenders and borrowers as to whether the borrower must insure against terrorism. *Omni Berkshire Corp. v. Wells Fargo Bank, N.A.*,[22] is illustrative. In 1998, Omni Hotels borrowed $250 million, secured by five hotels located in New York City, Chicago, and Texas. Omni agreed to provide "comprehensive all risk insurance" on the hotels as well as "such other reasonable insurance" as the lender might request. In 2002, when it renewed its "all risk" policy, Omni was unable to find a policy that covered terrorism due to the reform made by insurance companies. Instead of offering "all risk" policies that insured against terrorism, insurance companies offered separate, stand-alone terrorism policies. The quoted annual premium for Omni's five hotels was over $1 million. Omni negotiated with Wells Fargo, the servicing agent for the loan, over whether Omni would obtain terrorism coverage. Wells Fargo agreed to accept a $60 million policy at a time when the loan balance was $230 million, but negotiations broke down. Omni brought an action seeking a declaratory judgment that it was not required to obtain terrorism insurance. The court agreed with Omni's position that its obligation to maintain "all risk" insurance did not require it to purchase terrorism insurance. In the loan agreement, the parties did not define "all risk." In the insurance industry, "all risk" policies have evolved over time, with companies previously adding exclusions for mold problems and Y2K problems. Thus, Omni's duty to provide "all risk" insurance was measured not by the policy as it existed in 1998, when the loan was made, but by an evolving standard. The court, however, held that Wells Fargo acted reasonably in requiring $60 million worth of terrorism coverage under the "other reasonable insurance" clause. Omni had a quote for such a policy for an annual premium of $316,000, and evidence indicates that many hotels presently carry terrorism insurance.

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22. Omni Berkshire Corp. v. Wells Fargo Bank, N.A., 307 F. Supp. 2d 534 (S.D.N.Y. 2004).

[A] Purchase of Insurance by Mortgagee

The mortgagee is under no implied obligation to obtain insurance when the mortgagor fails to insure.[23] The fact that the mortgagee has a right to insure is immaterial. But he may make himself liable if he agrees to insure and does not,[24] or if he undertakes to insure and fails to obtain proper coverage,[25] as where he omits a garage[26] or insures the wrong property.[27] The measure of damages for breach of duty to place fire insurance is the amount that would have been due under the policy if it had been obtained.[28] Consequential damages have been recovered.[29] The mortgagee is not responsible for the insolvency of the insurer at the time the claim is filed.[30]

Many mortgages require that the mortgagor make monthly escrow payments to the mortgagee, which the mortgagee customarily uses to pay for real property taxes and insurance premiums. Occasionally, an insurance policy is cancelled when neither mortgagor nor mortgagee timely pays the premium. There is a split of authority as to the mortgagee's liability to the mortgagor for policy cancellation when

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23. Beckford v. Empire Mut. Ins. Grp., 135 A.D.2d 228 (N.Y. App. Div. 2d Dep't 1988). Other states follow the same rule. Purcell v. Williams, 511 So. 2d 1080 (Fla. 1st Dist. Ct. App. 1987).
24. Providence Wash. Ins. Co. v. Smith, 253 S.W.2d 226 (Ark. 1952) (borrower's promissory note included fire insurance premium).
25. Warrener v. Fed. Land Bank, 99 S.W.2d 817 (Ky. 1936); Crouse v. Vernon, 59 S.E.2d 185 (N.C. 1950); 62 HARV. L. REV. 1069 (1949).

    Hudson v. Ellsworth, 105 P. 463 (Wash. 1909), holds that a mortgagee's agreement to procure insurance, made after execution of the mortgage, was a gratuitous undertaking and without consideration though the mortgagor had paid the mortgagee the amount of the premiums. The mortgagee was held liable only for the return of the money paid. In a somewhat similar situation the mortgagee was held liable for fraud. First Nat'l Bank v. Dowdell, 157 So. 2d 221 (Ala. 1963) (overruling defense of ultra vires).

    For the comparable rules as between landlord and tenant, see MILTON R. FRIEDMAN, FRIEDMAN ON LEASES (5th ed., Patrick Randolph, ed. 2005) [hereinafter FRIEDMAN ON LEASES], § 38:1 (Supp. Nov. 2013).
26. Wellens v. Perpetual Bldg. Ass'n, 184 A.2d 36 (D.C. 1962). Colonial Sav. Ass'n v. Taylor, 544 S.W.2d 116 (Tex. 1976), where one of two buildings was omitted, reversed a judgment for the owner against the mortgagee and remanded the case to determine if the owner had relied on the mortgagee's gratuitous undertaking to obtain insurance. The court relied on RESTATEMENT (SECOND) OF TORTS § 323 (1965).
27. Boyce v. Union Dime Permanent Loan Ass'n, 67 A. 766 (Pa. 1907).
28. Cromartie v. Carterette Sav. & Loan Ass'n, 649 A.2d 76 (N.J. Super. Ct. App. Div. 1994); Hardcastle v. Greenwood Sav. & Loan Ass'n, 516 P.2d 228 (Wash. Ct. App. 1973).
29. *See* Cromartie v. Carteret Sav. & Loan Ass'n, 649 A.2d 76 (N.J. Super. Ct. App. Div. 1994).
30. Gulfco Fin. Co. v. King, 552 So. 2d 1199 (La. 1989).

the mortgagee holds escrowed funds. New York[31] and some other states hold that a mortgagee who receives escrow deposits from the mortgagor for payment of taxes and insurance is not liable for failure to pay insurance premiums,[32] but an almost equal number of cases have recognized a mortgagee's duty to renew the policy or notify the mortgagor of its imminent lapse.[33]

Similar issues arise when the mortgagee is involved with or knows of the cancellation of the insurance policy. As a general matter, the mortgagee is under no implied duty to notify the mortgagor of a cancellation of the policy, even though the mortgagee is in receipt of a notice of cancellation of the policy sent by the insurer.[34] The mortgagee may justifiably assume that the insurer also gave notice of cancellation to the mortgagor when the policy is of a type that cannot legally be cancelled without such notice to the mortgagor. In one case, a mortgagee's return of a policy for cancellation, in the mistaken belief that the policy had been replaced, was held to have no effect on the

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31. Dookie v. Astoria Fed. Sav., 95 A.D.3d 936 (N.Y. App. Div. 2d Dep't 2012) (mortgagor received notice from insurer stating that mortgagor must notify insurer to renew policy, which he failed to do).

32. Home Fed. Sav. & Loan Ass'n v. Dooley's, 716 P.2d 1042 (Ariz. Ct. App. 1985); Agee v. First Nat'l Bank, 386 N.E.2d 899 (Ill. App. Ct. 1979); Hassell v. Sterling Fed. Sav. & Loan Ass'n, 271 N.E.2d 7 (Ill. App. Ct. 1971); Rayborn v. Fort Thomas Bldg. & Loan Ass'n, 453 S.W.2d 558 (Ky. 1970) (court noted that mortgagor was an insurance agent who would be expected to give notice of a policy's expiration; Beckford v. Empire Mut. Ins. Grp., 525 N.Y.S.2d 260 (App. Div. 2d Dep't 1988); Brown v. C&S Real Estate Servs., 445 S.E.2d 463 (S.C. Ct. App. 1994) (mortgagee holding escrow funds not obligated to procure flood insurance). In Boyce v. Nat'l Commercial Bank & Tr. Co., 247 N.Y.S.2d 521 (Sup. Ct. Eq. Term Albany Cty.), *aff'd per curiam*, 254 N.Y.S.2d 127 (App. Div. 3d Dep't 1964), the opinion states, *obiter*, that a mortgagee with sufficient escrow funds would be liable for failure to pay the insurance premium after demand by the mortgagor or insurer. The sting of the holding of no duty absent demand was removed by the court's other holding that the insurer, also a defendant, had not effectively exercised a cancellation right.

33. First Fed. Sav. & Loan Ass'n v. Savage, 435 S.W.2d 67 (Ky. 1968); Cromartie v. Carteret Sav. & Loan Ass'n, 649 A.2d 76 (N.J. Super. Ct. App. Div. 1994); Pacheco v. Heussler, 390 N.Y.S.2d 761 (App. Div. 4th Dep't 1977) (jury question as to whether mortgagee breached duty by failing to pay); Hardcastle v. Greenwood Sav. & Loan Ass'n, 516 P.2d 228 (Wash. Ct. App. 1973). In Tincher v. Greencastle Fed. Sav. Bank, 580 N.E.2d 268 (Ind. Ct. App. 1991), a judgment for the mortgagee was remanded to determine if there was a separate agreement by the mortgagee to maintain insurance or a promissory estoppel.

34. Beckford v. Empire Mut. Ins. Grp., 525 N.Y.S.2d 260 (App. Div. 2d Dep't 1988); *see* Rocque v. Co-Operative Fire Ins. Ass'n, 438 A.2d 383 (Vt. 1981) (in dispute concerning whether mortgagor had received notice of cancellation from insurer, court rejected insurer's argument that mortgagee who had received notice had duty to inform mortgagor).

mortgagor's rights to enforce the policy.[35] But another court has held a mortgagee liable for canceling a policy in the mistaken belief that the policy had been superseded by another.[36]

Credit life insurance has been treated somewhat similarly. A mortgagee who was held under the circumstances to be a broker for the credit insurer was held liable for failure to notify the mortgagor's widow that the insurer was placed in governmental rehabilitation.[37] A mortgagee's breach of an agreement, made simultaneously with the mortgage, to obtain credit life insurance for the mortgagor, was a defense to foreclosure.[38]

When a mortgagee purchases insurance solely for his protection and with his own funds, the insurer, after paying the mortgagee his loss, is subrogated to the right of the mortgagee against the mortgagor.[39] But when the policy solely in the mortgagee's name is procured by the mortgagee pursuant to the authority of the mortgage and at the expense of the mortgagor, the insurer has no right of subrogation and the proceeds of insurance are applied to the mortgage debt.[40]

[B] Restoration of Premises

Prior to 1966, the New York statutory covenant to insure gave the mortgagee the choice of applying insurance moneys either to reduction of the mortgage debt (despite repairs or restoration by the mortgagor) or to restoration of the premises.[41] Most other states, then and now, follow this rule—it being generally held that a provision making insurance proceeds payable to a mortgagee entitles him to these proceeds to the extent of the mortgage debt, and to hold any surplus after extinguishment of the mortgage debt for the benefit of the

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35. Falchook Mkts., Inc. v. Warner Reciprocal Insurers, 388 N.Y.S.2d 100 (App. Div. 1st Dep't 1976) ("replacement" policy was on other property).
36. Hatfield v. Minden Bank & Tr. Co., 361 So. 2d 901 (La. Ct. App. 1978).
37. Kinder Mortg. Co. v. Celestine, 635 So. 2d 527 (La. Ct. App. 1994). *Kinder* discusses cases in comparable situations.
38. Bonner v. Bank of Coushatta, 445 So. 2d 84 (La. Ct. App. 1984) (mortgage was cancelled).
39. Pantano v. Md. Plaza P'ship, 507 N.W.2d 484 (Neb. 1993); *see* Mann v. Glens Falls Ins. Co., 541 F.2d 819 (9th Cir. 1976); Emp'rs' Fire Ins. Co. v. British Am. Assurance Co., 131 S.E.2d 36, 38 (N.C. 1963).
40. *Emp'rs' Fire*, 131 S.E.2d 36. In *Employers' Fire*, the mortgagor purchased one policy insuring herself with a standard mortgagee endorsement and the mortgagee purchased a policy naming only himself as insured, but he added the premium to the mortgage debt. Charging the premium to the mortgagor was sufficient to bring the case within the rule mentioned. Each insurer was held liable for that part of the loss its policy bore to the total insurance.
41. Savarese v. Ohio Farmers' Ins. Co., 182 N.E. 665 (N.Y. 1932), noted in 42 YALE L.J. 788 (1933).

mortgagor.[42] A mortgagee's reasonable delay in asserting its rights to the proceeds will not bar its claim, even if the mortgagee notifies the mortgagor of its election after the mortgagor has completed restoration.[43] An owner who repairs without getting his mortgagee's commitment to apply funds to the restoration acts at his peril. But if, after an insured loss, the mortgagee agrees to allow proceeds for restoration, such an agreement is enforceable in accordance with general principles of contract law.[44]

A few cases entitle the mortgagor to the insurance moneys when the mortgage is in good standing and the security is not impaired.[45] This approach has been criticized for requiring a lawsuit to determine the value of the remaining security,[46] but a mortgagor might prefer litigation to an inability to rebuild.

The operation of the majority rule can be rough on a mortgagor who paid premiums for years for fire insurance and then learned, after the event, that by application of the insurance moneys to reduction of the mortgage, he had half a building and half a mortgage, but no money for restoration. Some mortgagees have used this situation as a lever to depart from their bargain by increasing the interest rate or calling a mortgage they regretted making. A mortgagee's use of fire damage to

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42. Walter v. Marine Office, 537 F.2d 89, 97 (5th Cir. 1976) (Louisiana law); Price v. Harris, 475 S.W.2d 162 (Ark. 1972) (seller retained vendor's lien, with buyer promising to insure building; parties treated this agreement as mortgagee clause, entitling vendor to retain proceeds despite buyer's restoration); Pearson v. First Nat'l Bank, 408 N.E.2d 166, 169–70 (Ind. Ct. App. 1980); Pink v. Smith, 274 N.W. 727 (Mich. 1937); Gen. G.M.C. Sales, Inc. v. Passarella, 481 A.2d 307 (N.J. Super. Ct. App. Div. 1984); English v. Fischer, 660 S.W.2d 521 (Tex. 1983) (rejects application of implied covenant of good faith and fair dealing; parol promise lacks consideration).

43. First Fed. Sav. & Loan Ass'n v. Stone, 467 N.E.2d 1226, 1234 (Ind. Ct. App. 1984) (when owners "authorized the repair of the home without an assurance from [mortgagee] that the insurance proceeds would be applied to repair the home, they gambled that [mortgagee] would not elect to apply the insurance proceeds to the mortgage debt and lost").

44. *See* United Bilt Homes, Inc. v. Sampson, 832 S.W.2d 502 (Ark. 1992) (mortgagee and mortgagor agreed, after fire, that mortgagee would reimburse mortgagor for cost of repairs; mortgagee's failure resulted in action by contractor against mortgagor; mortgagee was liable for compensatory and punitive damages).

45. Schoolcraft v. Ross, 146 Cal. Rptr. 57 (Ct. App. 1978) (*but cf.* Lee v. Murphy, 61 Cal. Rptr. 174 (1st Dist. Ct. App. 1967)); Cottman Co. v. Cont'l Tr. Co., 182 A. 551 (Md. 1936); Starkman v. Sigmond, 446 A.2d 1249 (N.J. Super. Ct. Ch. Div. 1982). *See also* English v. Fischer, 660 S.W.2d 521, 526–27 (Tex. 1983). *Starkman v. Sigmond* was disapproved in Gen. G.M.C. Sales, Inc. v. Passarella, 481 A.2d 307 (N.J. Super. Ct. App. Div. 1984), *aff'd per curiam*, 499 A.2d 1017 (N.J. 1985).

46. Knapp v. Victory Corp., 302 S.E.2d 330, 331 (S.C. 1983).

call a mortgage might be justified in the occasional case of a large mortgage made in reliance on the security of high credit tenants, where destruction terminated these leases.

Parties to a mortgage are free to enter into an agreement that will govern application of the insurance proceeds in event of a loss, and such agreements sometimes allow the mortgagor to use the insurance money to restore the property rather than to pay the mortgage debt.[47] In substantial mortgages, involving a borrower with bargaining power, the mortgage may expressly require the mortgagee to apply the insurance moneys to restoration. This may be by payment to the mortgagor immediately, or not until restoration. Or it may provide for payment in stages as restoration progresses, with a specified percentage held back until completion. The mortgage may provide for remission of the moneys to a trustee, usually a bank, to make these payments.

When the mortgagee makes the payments to a contractor who performs restoration work, a written contract should specify the criteria the mortgagee will follow in deciding when and how much to pay. If such a contract agreed to the mortgagor does not require inspections of the work, a court has held that a mortgagee who paid insurance moneys to a contractor whose work was deficient was not liable for negligent conduct or as an implied trustee.[48]

When the mortgagee releases insurance moneys to the mortgagor for the purpose of restoration, the mortgagor's use for other purposes may be an actionable wrong.[49]

In 1966, New York departed from the majority rule, which gives the mortgagor no right to use insurance proceeds to restore unless the mortgage expressly allows such restoration. A statute revised the construction of the insurance covenant in statutory form mortgages, providing that the mortgagee hold the insurance proceeds "as trust funds until paid over or applied."[50] If the mortgagor notifies the mortgagee of the fire within thirty days thereafter and makes "good the damage by means of such repairs, restoration or rebuilding as may be necessary to restore the buildings to their condition prior to the damage," then upon presentation of proof the mortgagor becomes

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47. Hoosier Plastics v. Westfield Sav. & Loan Ass'n, 433 N.E.2d 24, 27 (Ind. Ct. App. 1982); Pearson v. First Nat'l Bank, 408 N.E.2d 166, 169–70 (Ind. Ct. App. 1980).
48. McWaters v. Frederick W. Berens, Inc., 238 S.E.2d 717 (Ga. Ct. App. 1977) (mortgagee complied with contract requirement that contractor should be paid in "25% increments").
49. Law v. Dewoskin, 447 S.W.2d 361 (Tenn. 1969) (mortgagee allowed to pursue claim after purchasing at foreclosure for full amount of debt due under non-recourse mortgage).
50. N.Y. REAL PROP. LAW § 254(4).

entitled to reimbursement from the insurance moneys.[51] The mortgagee is not required to advance any proceeds to the mortgagor before repairs are made.[52] The mortgagor's right to the insurance proceeds is conditioned on there being no "default by the mortgagor in the performance of any of the terms or provisions of the mortgage on his part to be performed."[53] The statute gives the mortgagor a maximum of three years to restore, but he is under pressure to restore promptly because he gets no benefit from the insurance and must pay for restoration, plus taxes and all mortgage charges, with little or no income from the property, until restoration is complete. In essence, the mortgagor's rights depend on restoring the mortgagee to his original security position.[54]

Inasmuch as the use of the statutory form mortgage is merely permissive, the statutory construction conferring restoration rights on the mortgagor may be avoided by stipulating otherwise in the mortgage. Most mortgage forms prepared for lending institutions stipulate otherwise by giving the mortgagees the rights they held before the 1966 amendment, though in large transactions this may be changed, as mentioned above. If a mortgage loan was made in reliance on the existence of a lease to a high credit tenant, a mortgagee's agreement to apply insurance proceeds to restoration may be conditioned on the continuance of the lease after restoration. If a group of such leases is involved, the condition may be that the aggregate annual rents do not drop, by reason of the damage, below a specified sum or percentage.

[C] Application of Insurance Proceeds to Debt

The statutory construction for the New York insurance covenant provides that insurance proceeds received by the mortgagee and not payed to the mortgagor "shall be applied in reduction of the principal of the mortgage."[55] The standard mortgage clause has been called "a pre-appropriation of insurance proceeds to payment of the mortgage debt."[56] Making the insurance moneys payable to a mortgagee does

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51. *Id.*
52. Fonda v. First Pioneer Farm Credit, ACA, 86 A.D.3d 693 (N.Y. App. Div. 3d Dep't 2011).
53. N.Y. REAL PROP. LAW § 254(4).
54. The statute does not apply to a purchaser under an installment contract of sale. *See infra* section 3A:1.2[K].
55. N.Y. REAL PROP. LAW § 254(4).
56. Sureck v. U.S. Fid. & Guar. Co., 353 F. Supp. 807, 810 (W.D. Ark. 1973) (mortgagee's right to insurance proceeds paramount to claim of mortgagor's attorney for legal work done to collect on policies); Leiden v. Gen. Motors Acceptance Corp., 220 S.E.2d 716 (Ga. Ct. App. 1975). *See also* Giberson v. First Fed. Sav. & Loan Ass'n, 329 N.W.2d 9 (Iowa 1983).

not, per se, give the mortgagee a free hand in their application. When the proceeds of insurance are payable to a mortgagee, with no obligation to apply them otherwise than to the mortgage debt, the mortgagee is usually required to apply them to installments of interest and principal as they fall due. This bars him from foreclosing for current defaults at a time when an owner may be hard pressed in order to hold the insurance moneys as security for final installments of the mortgage debt.[57] It may also require him to hold the insurance money, if the mortgage has not matured, until the debt or part of it becomes due.[58]

However, the disposition of insurance moneys may be controlled by agreement between mortgagor and mortgagee, usually found in the mortgage itself. And a mortgage provision permitting a mortgagee to apply the insurance money against the mortgage debt or for other purposes has been held to permit application to the balance of the debt payable at maturity instead of to installments next accruing.[59] Application to the balance payable at maturity is permitted under the New York statute.[60]

[D] Claims of Co-Owners and Holders of Other Interests

A mortgagee who plans to pay the proceeds of insurance to an owner should consider the possible rights of a junior lienor or a co-owner in these proceeds. Any such rights would be based on the terms of the mortgage or the insurance policy or both. A mortgagee who might have applied the proceeds, as of right, to the mortgage debt was held liable for the diversion made possible by paying the proceeds to one of several co-owners.[61] If the insurance is for the benefit of first

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57. Crone v. Johnson, 403 S.W.2d 738 (Ark. 1966) (*but see* Price v. Harris, 475 S.W.2d 162 (Ark. 1972)); Hadjis v. Anderson, 271 A.2d 350 (Md. 1970); Zeigler v. Fed. Land Bank, 86 S.W.2d 864 (Tex. Civ. App. 1935); Thorp v. Croto, 65 A. 562 (Vt. 1907); *see* Lee v. Murphy, 61 Cal. Rptr. 174, 176 n.1 (1st Dist. Ct. App. 1967).

    But note Ziello v. Superior Court, 42 Cal. Rptr. 2d 251 (Ct. App. 1995), where the mortgage provided that absent a contrary agreement the proceeds of insurance should not postpone the date of the periodic payments or change their amount.

58. Thorp v. Croto, 65 A. 562 (Vt. 1907).

59. Lee v. Murphy, 61 Cal. Rptr. 174 (1st Dist. Ct. App. 1967); Atl. & Gulf Props., Inc. v. Palmer, 109 So. 2d 768 (Fla. Dist. Ct. App. 1959).

60. Terraqua Corp. v. Emigrant Indus. Sav. Bank, 75 N.Y.S.2d 453 (Sup. Ct. N.Y Cty. 1947), *aff'd*, 76 N.Y.S.2d 610 (App. Div. 1st Dep't 1948).

61. Conn. Mut. Life Ins. Co. v. Scarnmon, 117 U.S. 634 (1886). *Cf.* McWaters v. Frederick W. Berens, Inc., 238 S.E.2d 717 (Ga. Ct. App. 1977) (mortgagee who paid contractor for restoration work did not breach duty of care in failing to ascertain completeness of work).

and second mortgagees, the first mortgagee is liable to the second for the proceeds in excess of the first mortgage debt[62] and may not, as against the second mortgagee, remit the proceeds to the mortgagor for purposes of repair.[63] If the first mortgage requires insurance for a stated amount, the first mortgagee is estopped from claiming a greater amount, with the junior mortgagee entitled to apply the excess proceeds to its debt.[64]

When senior and junior mortgagees are named in the same policy, their rights inter se may be governed by the terms of the senior mortgage. In this situation, a clause in the first mortgage that gives its holder the choice of applying the proceeds either to reduction of the debt or to repair of the damage has been upheld against a junior mortgagee.[65] A mortgage that permitted its holder to apply the proceeds of insurance to the mortgage debt, to restoration, or for any other purpose, without impairment of the lien of the mortgage, was held to justify payment to the owner without regard to restoration.[66]

A junior mortgagee who is not named in a policy insuring the owner and first mortgagee has been held to have no valid objection to use of the proceeds for restoration[67] or even, possibly, for their diversion.[68] But query whether a junior mortgagee who is not named in the policy may not on timely application prevent the use of the proceeds for a purpose other than that of repair or reduction of a paramount mortgage. The doctrine of marshalling assets is applicable when two or more creditors of the same debtor have successive claims on the same property, and the creditor prior in right holds additional security. In this situation, equity will compel one creditor to collect from the funds unavailable to the other, where this can be done with

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62. Parker v. Ross, 11 S.W. 865 (Tex. 1889).
63. Carlin v. Frey, 141 N.Y.S. 580 (App. Div. 3d Dep't 1913).
64. Knapp v. Victory Corp., 302 S.E.2d 330 (S.C. 1983) (fire insurance procceds were $225,000, but mortgage only required mortgagor to maintain insurance of $160,000).
65. Application to the first mortgage debt was upheld in Woody v. Lytton Sav. & Loan Ass'n, 40 Cal. Rptr. 560 (2d Dist. Ct. App. 1964).

    An agreement between mortgagor and mortgagee controls disposition of insurance moneys and binds other lienors. Lee v. Murphy, 61 Cal. Rptr. 174 (1st Dist. Ct. App. 1967).

    A first mortgagee was held justified in paying the proceeds to the owner in reliance on an affidavit that restoration had been made. The first mortgagee was held not negligent as a matter of law in relying on the affidavit. Walton v. Gen. Am. Life Ins. Co., 383 S.W.2d 854 (Tex. Civ. App. 1964).
66. Meltzer v. Blumberg, 231 N.Y.S. 513 (Sup. Ct. Kings Cty. 1928) (junior mortgagee not named in policy).
67. Gordon v. Ware Sav. Bank, 115 Mass. 588 (1874).
68. *See* Meltzer v. Blumberg, 231 N.Y.S. 513 (Sup. Ct. Kings Cty. 1928).

justice to all concerned.[69] The doctrine of marshalling assets, however, does not apply between a mortgagee and a subsequent purchaser of the property. In *Peoples State Bank v. Marlette Coach Co.*,[70] a first mortgagee and the owner agreed, after their collection, to apply the insurance proceeds to an unsecured debt. This agreement was held binding on a junior mortgagee who, though known to the first mortgagee, was not a party to the policy. At the time of the action the junior mortgagee acquired title to the property through foreclosure. This ended its lien and its claim as a creditor. For this reason the court refused to apply the doctrine.[71]

The existence of a tenant and a paramount mortgage may create a three corner priority. In one case a lease required the tenant to restore after a fire, at the tenant's expense and with no liability therefor on the landlord, but entitled the tenant to reimbursement to the extent of the insurance.[72] The tenant was required to supply replacement value insurance for the benefit of both landlord and tenant and any paramount mortgagee. After a fire the paramount mortgagee elected to take enough of the insurance proceeds to satisfy its mortgage. The tenant restored at its expense and received the balance of the insurance money, a sum insufficient for full reimbursement. If there were no mortgage the insurance proceeds would have paid for restoration and any balance would have gone to the landlord. To avoid giving the landlord a windfall (satisfaction of its mortgage debt) at the tenant's expense, the tenant was given a right against the landlord by subrogation to be made whole by deferred payments for the cost of restoration.

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69. *See* Peoples State Bank v. Marlette Coach Co., 336 F.2d 3 (10th Cir. 1964); Bartley v. Pikeville Nat'l Bank & Tr. Co., 532 S.W.2d 446 (Ky. 1975). *See also* Ranier v. Mount Sterling Nat'l Bank, 812 S.W.2d 154 (Ky. 1991).

70. Peoples State Bank v. Marlette Coach Co., 336 F.2d 3 (10th Cir. 1964).

71. Marshalling assets cannot be availed of by an unsecured creditor. Eisenhart v. Schreimann, 889 S.W.2d 887, 892 (Mo. Ct. App. 1994). The doctrine does not apply where it would not be equitable to do so. *In re* Oxford Dev. Ltd., 67 F. 3d 683 (8th Cir. 1995) (purchase of part of land subject to a mortgage).

Sale of mortgaged property in foreclosure in separate parcels in the inverse order in which the parcels were sold by the mortgagor (the "inverse order of alienation") is a form of marshaling assets. *See In re* Boswell Land & Livestock, Inc., 86 B.R. 665 (D. Utah 1988). *But see* Hill v. Lane, 848 P.2d 43 (Okla. Ct. App. 1933). Comparable to this is the rule that foreclosure of a mortgage covering homestead and non-homestead property requires sale of the non-homestead property first. Lee v. Mercantile First Nat'l Bank, 765 S.W.2d 17 (Ark. Ct. App. 1989).

Where a second mortgage is paramount to subsequent mortgages, the second mortgagee may have a sale under the first mortgage and seek satisfaction first from properties in which the subsequent mortgagees have an interest. *In re* Shull, 72 B.R. 193 (Bankr. D.S.C. 1986).

72. Loving v. Ponderosa Sys., 479 N.E.2d 531 (Ind. 1985).

The requirement in a first mortgage that the owner insure for the mortgagee was held to give a junior wraparound mortgagee a right to insurance because of the owner's obligation in the wraparound to comply with the first mortgage.[73]

Suppose an owner of the premises fails to supply the mortgagee with fire insurance, but obtains such insurance for his own benefit. If the owner was under no obligation to insure for the mortgagee's benefit, the proceeds of such insurance are the sole property of the owner.[74] This is an application of the general rule that one who is not a party to an insurance contract has no claim to its proceeds.[75]

If the owner is liable on the covenant to insure, as in the case of either the mortgagor or a subsequent owner who has effectively assumed the mortgage, this covenant is sufficient in most states to predicate a lien in the mortgagee's favor on the proceeds of such insurance[76] that is paramount to rights of the mortgagor's creditors.[77]

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73. Ark. Teacher Ret. Sys. v. Commando Props. Ltd., 801 S.W.2d 50 (Ark. Ct. App. 1990).

74. Bodwitch v. Allen, 459 N.Y.S.2d 148 (App. Div. 4th Dep't 1983). This was applied to earthquake insurance not required by the mortgage. For this reason Alexander v. Sec.-First Nat'l Bank, 62 P.2d 735 (Cal. 1936), was distinguished. Ziello v. Superior Court, 42 Cal. Rptr. 2d 251 (Ct. App. 1995). In *Ziello*, the mortgagee's reference to the provision in the mortgage assigning to the mortgagee all sums due and payable for injury to the property was rebuffed by the holding that insurance is a personal contract and its proceeds are payment on a contract, not a judgment.

75. *See* Peoples State Bank v. Marlette Coach Co., 336 F.2d 3 (10th Cir. 1964).

76. Alexander v. Sec.-First Nat'l Bank, 62 P.2d 735, 737–38 (Cal. 1936); Lakeshore Bank & Tr. Co. v. United Farm Bureau Mut. Ins. Co., 474 N.E.2d 1024 (Ind. Ct. App. 1985); Cromwell v. Brooklyn Fire Ins. Co., 44 N.Y. 42 (1870); *see* Oregon Mut. Ins. Co. v. Cornelison, 330 P.2d 161, 165 (Or. 1958). But there is authority to the effect that the mortgagee has no lien in this situation unless the owner has obtained insurance with an intention of complying with the covenant to insure. Stearns v. Quincy Mut. Fire Ins. Co., 124 Mass. 61 (1878); *see* Papamechail v. Holyoke Mut. Ins. Co., 397 N.E.2d 1153 (Mass. App. Ct. 1979); First Nat'l Bank v. Cappellini, 26 A.2d 119, 120 (Pa. Super. Ct. 1942).

In this situation the insurer is not liable to the mortgagee for paying the insurance moneys to the mortgagor if without actual or constructive knowledge of the mortgagee's rights. Paskow v. Calvert Fire Ins. Co., 579 F.2d 949, 952 (5th Cir. 1978).

A mortgagor's parol agreement to insure for the mortgagee's benefit was held binding. Butson v. Misz, 160 P. 530 (Or. 1916).

A mortgage requirement that the mortgagor insure against fire and deliver the policies to the mortgagee was held a covenant to insure for the mortgagee's benefit, on the ground there was no other reason for delivering the policies to the mortgagee. Winneshiek Mut. Ins. Ass'n v. Roach, 132 N.W.2d 436 (Iowa 1965).

77. Gulf Nat'l Bank v. Hartford Fire Ins. Co., 264 So. 2d 401 (Miss. 1972).

But this lien is subordinate to a junior mortgagee who has the benefit of insurance bearing a mortgagee endorsement in his favor.[78] Furthermore, a covenant to insure does not run with the land, and if in this situation an owner has not assumed the mortgage, he is entitled to receive the proceeds of insurance free of any claim of the mortgagee.[79] Accordingly, it is essential that a mortgagee always have proper insurance policies from the owner. If the mortgage contains the provisions herein discussed, the mortgagee has two remedies: (1) an owner's failure to supply the mortgagee with insurance is a breach that permits the mortgagee to accelerate the mortgage; or (2) the mortgagee may obtain the insurance himself and add this cost to the mortgage debt.[80] If in this situation the mortgagee insures for himself, the policy is held dual interest insurance, covering the mortgagor and the mortgagee, requiring the mortgagee to apply the insurance proceeds to reduction of the mortgage and depriving the insurer of any subrogation against the mortgagor.[81]

A mortgagee with insurance in its name is entitled to its proceeds to the exclusion of a prior mortgage[82] or lien.[83]

The lien of a mortgagor's lawyer on the insurance moneys, for effecting their collection, is usually subordinate to the right of the mortgagee thereto.[84]

[E] Transfers of Mortgaged Premises or Mortgage Loan

The fact that an owner who has not assumed the mortgage is not personally liable for the premiums, or for any other part of the

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78. Hartford Fire Ins. Co. v. Landreneau, 140 So. 52 (La. Ct. App. 1932); Dunlop v. Avery, 89 N.Y. 592 (1852).
79. Kaplan v. Wilderman, 123 A. 165 (N.J. Ch. 1924); Sheenan v. Spring Valley Wood Prods. Corp., 185 N.Y.S. 641 (App. Div. 2d Dep't 1920), *aff'd*, 135 N.E. 918 (N.Y. 1922); Rollman Corp. v. Goode, 400 A.2d 968 (Vt. 1979).
80. The New York statutory mortgage is so construed. N.Y. REAL PROP. LAW § 254(4). Where not so implied, a comparable provision should be expressed. The two remedies are not mutually exclusive. Upon the mortgagor's default, the mortgagee may elect to pay the insurance premium and proceed to foreclose. Farmers & Merchs. Bank v. Copple, 373 P.2d 219 (Kan. 1962) (mortgagee paid premium on last day of grace period before cancellation of policy).
81. *In re* SPG, Inc., 833 F.2d 413 (2d Cir. 1987). This is not true with respect to subrogation where a mortgagor's breach of the policy makes it unenforceable by the mortgagor.
82. Butler v. Ringrose, 16 P.2d 202 (Wash. 1932).
83. Midland Lumber & Supply, Inc. v. J.B. Builders, 626 A.2d 89 (N.J. Super. Ct. 1993).
84. Sureck v. U.S. Fid. & Guar. Co., 353 F. Supp. 807 (W.D. Ark. 1973); Howard, Singer & Meehan v. Clayton Fed. Sav. & Loan Ass'n, 578 S.W.2d 56 (Mo. Ct. App. 1978).

mortgage debt, does not preclude the mortgagee from enforcement of the rights given him by the mortgage.

A purchaser of mortgaged property who neglected to have his name substituted on a fire policy for that of his mortgagor-vendor was denied recovery on the policy after a disastrous fire.[85] The mortgagee recovered enough to satisfy its mortgage, but this sum was less than half the amount of the damage. This result seems unduly technical because the purchaser had assumed the mortgage and paid the insurance premiums, which were included in his payments to the mortgagee.

A mortgagor who sells the property retains an insurable interest if he remains liable for the mortgage debt, despite an assumption of the mortgage by the grantee.[86]

When a mortgagee assigns a promissory note and mortgage, the assignee may become the named mortgagee on the insurance policy if the parties contact the insurer to request a change. This step, however, is often not taken. Failure to do so may jeopardize insurance coverage in the event of casualty, but usually is not fatal. The assignment of the mortgage loan by the initial mortgagee carries with it the assignor's rights in the insurance unless the insurance policy contains express language voiding the mortgage clause if the current mortgagee's name does not appear therein.[87] Moreover, an action for reformation may be available to correct the name of the mortgagee.[88]

A policy requirement that the mortgagee give the insurer notice of a change of ownership that comes to his attention is not applied to a transfer to the mortgagee. The latter is already an insured and his increased interest in the property subjects the insurer to no increased

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85. Am. Family Mut. Ins. Co. v. Walton, 926 F. Supp. 811 (S.D. Ind. 1996). This case compares with those that involve the right of an insurance company that pays a loss, say to a landlord, to be subrogated to the amount of its payment against the wrongdoer who caused the damage. This usually involves recovery against a tenant who negligently caused a fire. If the tenant is included in the landlord's policy, making the tenant an insured, the insurer has no such right of subrogation because the insurer has no right to recover against its insured. But some cases hold that if tenant's rent expressly includes a charge for insurance or if this is included in rent escalation, then the result is the same and tenant is absolved. Some cases hold that a tenant's mere payment of rent, with no more, presumably goes in part to pay for insurance and here too tenant is absolved. *See* FRIEDMAN ON LEASES, *supra* note 25, § 9:10.1 (Supp. Mar. 2014).

86. Reid v. Hardware Mut. Ins. Co., 166 S.E.2d 317 (S.C. 1969).

87. Sprouse v. N. River Ins. Co., 344 S.E.2d 555 (N.C. Ct. App. 1986).

88. Cheperuk v. Liberty Mut. Fire Ins. Co., 693 N.Y.S.2d 304 (App. Div. 3d Dep't 1999) (fire occurred eleven months after mortgage assignment; granting reformation when failure to change name of mortgagee on policy was inadvertent and company did not claim it would have discontinued coverage had it received notice of change of mortgagee).

risk.[89] The rule applies when the policy has a standard mortgagee clause. The rule is contra where the mortgagee's interest is reflected in a loss payment clause.[90]

The policy requirement that the mortgagee notify the insurer of a change in ownership is necessary for the mortgagee's protection, not the mortgagor's. When a mortgagor sold a house to his brother and the insurer denied coverage after a fire, a court held that the mortgagee was not liable to the mortgagor or his brother for failing to notify the insurer of the ownership change.[91]

[F] Mortgagee Endorsements

Insurance policies name the mortgagor-owner as the insured, but a mortgagee endorsement is invariably added. There are two different types of mortgagee endorsements: (1) the standard or "union" endorsement, and (2) the "open" mortgage or loss payable clause. They vary substantially in their effect.[92]

The standard or union mortgage endorsement is more than a mere assignment to the mortgagee of a right to the proceeds of insurance. It is deemed to create a separate contract between the mortgagee and the insurer. The mortgagee is entitled to its own notice of cancellation.[93]

The primary effect of the mortgagee endorsement is to insulate the mortgagee from any act or omission of the mortgagor. This benefit is highly significant. If the mortgagor should violate some provision of the policy, such as by maintaining inflammables or explosives on the premises, this too would not prejudice the mortgagee's rights under

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89. S. States Fire & Cas. Ins. Co. v. Napier, 96 S.E. 15 (Ga. Ct. App. 1918); Union Cent. Life Ins. Co. v. Franklin Cty. Farmers Mut. Ins. Ass'n, 270 N.W. 398 (Iowa 1936); Pioneer Sav. & Loan Co. v. St. Paul Fire & Marine Ins. Co., 70 N.W. 979 (Minn. 1897); Binghamton Sav. Bank v. Mount Vernon Fire Ins. Co., 162 N.Y.L.J. 2, 14 (Sup. Ct. 1969); Union Cent. Life Ins. Co. v. Clinton Mut. Ins. Ass'n, 199 N.E. 223 (Ohio Ct. App. 1935). *But see* Royal Ins. Co. v. Drury, 132 A. 635 (Md. 1926) (sale to note holders a change of ownership).

90. Boston Co-op Bank v. Am. Cent. Ins. Co., 87 N.E. 594 (Mass. 1909); *see* Royal Ins. Co. v. Drury, 132 A. 635, 641 (Md. 1926).

91. Nassar v. Utah Mortg. & Loan Corp., 671 P.2d 667 (N.M. Ct. App. 1983). *Cf.* Rocque v. Co-Operative Fire Ins. Ass'n, 438 A.2d 383 (Vt. 1981) (mortgagee has no duty to notify mortgagor of receipt of notice of cancellation of insurance policy).

92. Louisiana cases discussing extensively the different forms of endorsements appear in Bohn v. La. Farm Bureau Mut. Ins. Co., 482 So. 2d 843 (La. Ct. App. 1986).

93. Firstbank Shinnston v. W. Va. Ins. Co., 408 S.E.2d 777 (W. Va. 1991) (insurer's failure to notify mortgagee of policy cancellation resulted in survival of insurer's liability to mortgagee).

the standard mortgage endorsement. Nor does arson committed by the mortgagor deprive the mortgagee of insurance coverage.[94]

An owner's failure to file proof of loss does not prevent recovery by a mortgagee under the standard mortgagee clause.[95] In *Hartford Fire Insurance Co. v. Moore*,[96] an owner's failure to file proof of loss did not prevent recovery by a mortgagee under the standard mortgagee clause. The owner's failure to file proof of loss or to begin an action within their respective time limits was waived by the insurer's full payment to the mortgagee. The mortgagee made proof of loss, and the insurer had taken an assignment of the mortgage. The owner's action was not for money, but to have the mortgage lien canceled of record. The court noted that the insurer made payment to the mortgagee without disclaiming liability to the owner.

A clause in a policy, typical of Lloyd's underwriters, terminating the policy in case of reduction in the amount of similar insurance maintained on the premises with other insurers, was held without effect on the mortgagee.[97] A provision voiding the policy for vacancy of the property for sixty days was held inapplicable to a mortgagee.[98]

Furthermore, if the insurer claims the policy never had a valid inception because of misrepresentation by the mortgagor in his application, this too is without effect on the mortgagee's rights.[99]

Despite the foregoing, there is a slight suggestion that a mortgagee is protected by the standard mortgage endorsement only so long as he had no knowledge of the mortgagor's default or other act.[100]

If the policy is void as to the mortgagor, payment by the insurer to the mortgagee may subrogate the insurer to the mortgagee's rights against the mortgagor. Many policies expressly entitle the insurer to subrogation in this situation.[101] These clauses are enforceable. In the

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94. Aetna Life & Cas. Co. v. Charles S. Martin Distrib. Co., 169 S.E.2d 695 (Ga. Ct. App. 1969).
95. McDowell v. St. Paul Fire & Marine Ins. Co., 101 N.E. 457 (N.Y. 1913).
96. Hartford Fire Ins. Co. v. Moore, 412 S.W.2d 860 (Ky. 1967).
97. Nat'l Factors, Inc. v. Waters, 249 N.Y.S.2d 121 (Sup. Ct. N.Y. Cty. 1964).
98. Roosevelt Sav. Bank v. State Farm Fire & Cas. Co., 556 P.2d 823 (Ariz. Ct. App. 1976).
99. *See generally* Iowa Nat'l Mut. Ins. Co. v. Cent. Mortg. & Inv. Co., 708 P.2d 480 (Colo. Ct. App. 1985); Syracuse Sav. Bank v. Yorkshire Ins. Co., 94 N.E.2d 73, 76–77 (N.Y. 1950); Firstbank Shinnston v. W. Va. Ins. Co., 408 S.E.2d 777, 783 (W. Va. 1991).
100. *See* Nassar v. Utah Mortg. & Loan Corp., 671 P.2d 667, 671 (N.M. Ct. App. 1983); 10A G. COUCH, INSURANCE § 42:735 (2d ed. 1982).
101. *See, e.g.*, the New York statutory form policy, N.Y. INS. LAW § 168.

absence of a subrogation clause, some courts deny the insurer subrogation,[102] but others allow it.[103]

Suppose the mortgagor should obtain a second policy, which insures him alone and results in over-insurance. Whatever effect this may have on the mortgagor's rights, it does not affect the mortgagee's.

Proceeds of insurance paid to a mortgagee under a standard mortgagee endorsement are for the benefit of both the mortgagor and the mortgagee, and operate to reduce the mortgage debt.[104] The standard endorsement provides that whenever the insurer pays the mortgagee and claims it is under no liability to the mortgagor, the insurer will be subrogated to the rights of the mortgagee under the mortgage. This provision is valid and the right of subrogation is enforceable against the mortgagor.[105] The insurer's right of subrogation against the owner is not dependent upon an express provision to this effect in the mortgage clause.[106]

A literal reading of the mortgagee endorsement indicates that a mere claim of non-liability is sufficient to establish the insurer's rights against the mortgagor. As it is construed, however, the right of subrogation depends on proof that the policy is void as against the mortgagor.[107] Cases have arisen in which one of several co-owners was guilty of arson or other intentional injury to the property. Some decisions give full recovery to the innocent owner.[108] Others have denied recovery.[109] Still others depend on "a reasonable expectation by

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102. *See* Fields v. W. Millers Mut. Fire Ins. Co., 48 N.E.2d 489, 491 (N.Y. 1943), criticized in 12 FORDHAM L. REV. 289 (1943).

103. *E.g.*, Twin City Fire Ins. Co. v. Walter B. Hannah, Inc., 444 S.W.2d 131 (Ky. 1969). *See* Campbell, *Non-Consensual Suretyship*, 45 YALE L.J. 69, 101–02 (1935).

104. Liverpool & London & Globe Ins. Co. v. Orrell, 190 So. 552 (Fla. 1939); *see* O'Neil v. Franklin Fire Ins. Co., 145 N.Y.S. 432, 438 (App. Div. 4th Dep't 1913), *aff'd*, 110 N.E. 1045 (N.Y. 1915).

105. Surratt v. Fire Ass'n, 43 F.2d 467 (4th Cir. 1930); Auto-Owners Mut. Ins. Co. v. Newman, 851 S.W.2d 22 (Mo. Ct. App. 1993;) Larchmont Fed. Sav. & Loan Ass'n v. Ebner, 454 N.Y.S.2d 450 (App. Div. 2d Dep't 1982).

106. First Nat'l Bank v. Springfield Fire & Marine Ins. Co., 178 P. 413 (Kan. 1919).

107. Cronenwett v. Dubuque Fire & Marine Ins. Co., 186 P. 826 (Cal. 1st Dist. Ct. App. 1919); Sun Ins. Office v. Heiderer, 99 P. 39 (Colo. 1909); Ins. Co. of St. Louis v. Lounsbury, 199 So. 2d 730 (Fla. Dist. Ct. App. 1967); Frontier Mortg. Corp. v. Heft, 125 A. 772 (Md. 1924); Loewenstein v. Queen Ins. Co., 127 A. 772 (Mo. 1909); Reed v. Fed. Ins. Co., 510 N.Y.S.2d 618 (App. Div. 2d Dep't 1987); O'Neil v. Franklin Fire Ins. Co., 145 N.Y.S. 432 (App. Div. 4th Dep't 1913), *aff'd*, 110 N.E. 1045 (N.Y. 1915).

108. Reed v. Fed. Ins. Co., 510 N.Y.S.2d 618 (App. Div. 2d Dep't 1987).

109. *See id.* at 621.

the innocent party that his or her individual interest would be protected without reference to the acts committed by the coinsured."[110] If the insured is a corporation, then recovery is barred by willful acts of its agents.[111]

The insurer is not entitled to subrogation unless it satisfied the mortgage in full.[112] This is an application of the general rule under which a party is not entitled to be subrogated to the rights or security of a creditor until the creditor's claim has been fully paid.[113]

When the insurer has paid the mortgagee and has subrogation rights due to its nonliability to the mortgagor, the proceeds of insurance are not applied to reduction of the mortgage debt.[114]

With a standard mortgagee endorsement, analysis can become more complicated when the property is rented and the tenant obtains the insurance policy. In one case, a net lease obligated a department store tenant to purchase insurance, which was issued with a mortgagee endorsement naming the lessor's mortgagee.[115] The court concluded that the policy was procured for the benefit of the lessor-mortgagor, although not named in the policy, as well as the mortgagee. The mortgagee's acceptance of the proceeds of insurance was held to require their application in reduction of the mortgage.

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110. *Id.*

111. *See id.* at 622.

112. Nat'l Union Fire Ins. Co. v. Price, 99 So. 848 (Ala. 1924).

113. *But see* Garrison v. Great S. Ins. Co., 809 F.2d 500 (8th Cir. 1987), which held that an insurer that paid a mortgagee for its fire loss became subrogated to the rights of the mortgagee against the mortgagor to the extent that the insured paid the mortgage debt. The mortgagor had permitted its interest in the policy to lapse.

114. Auto-Owners Mut. Ins. Co. v. Newman, 851 S.W.2d 22 (Mo. Ct. App. 1993); Dollar Fed. Sav. & Loan Ass'n v. Herbert Kallen, Inc., 410 N.Y.S.2d 1004 (App. Div. 2d Dep't 1978).

The insurer's right against the first assuming grantee may be questioned because the latter's liability is sufficient to create an insurable interest. *See* Palisano v. Bankers & Shippers Ins. Co., 84 N.Y.S.2d 637 (Sup. Ct. Erie Cty. 1948), noted in 49 COLUM. L. REV. 866 (1949), *aff'd*, 95 N.Y.S.2d 543 (App. Div. 4th Dep't 1950).

Where the insurer paid off mortgagor's mortgage it was subrogated to mortgagee's right to enforce payment of the mortgage and accompanying note. Silman Custom Painting, Inc. v. Aetna Life & Cas. Co., 990 F.2d 1063 (8th Cir. 1993).

When an insurer paid the mortgage debt and took an assignment of the mortgage and debt on the ground of arson by a second grantee-assumer of the mortgage, the insurer's claim for reimbursement was upheld against the second and the previous grantee against whom there was no claim of arson. Fireman's Fund Ins. Co. v. Rogers, 712 S.W.2d 311 (Ark. Ct. App. 1986).

115. United Stores of Am., Inc. v. Fireman's Fund Ins. Co., 420 F.2d 337 (8th Cir. 1970). The insurer unsuccessfully claimed a right of subrogation against the lessor-mortgagor.

The "open" mortgage or loss payable clause is, in substance, an assignment by a mortgagor to a mortgagee. It makes the mortgagee an appointee for collection and gives the mortgagee no greater rights than that of the mortgagor, so that a breach of conditions of the policy by the mortgagor that would bar recovery by the mortgagor acts to bar recovery by the mortgagee.[116] But, under the prevailing authority, the mortgagee under a loss payable clause is not bound by an arbitration or settlement between the insurer and the mortgagor made without his consent.[117]

[G] Mortgagee's Acquisition of Title Before Insured Loss

A mortgagee's right to receive the proceeds of insurance, to the exclusion of the owner-mortgagor was considered above.[118] That consideration was predicated on two separate interests then vested in the mortgaged property: (1) the fee interest, in the owner-mortgagor, and (2) the mortgage lien, in the mortgagee. If the mortgage interest is converted into a fee by foreclosure or otherwise, the mortgagor's interest is extinguished and the entire ownership is now in the former mortgagee. If he is still named in a fire insurance policy only by way of a mortgage endorsement, his right to receive the entire proceeds of insurance, to the exclusion of the former mortgagor, depends on several factors.

Under the "union" or standard mortgagee endorsement the proceeds of insurance are payable "as interest may appear." A preliminary question is is whether "interest" means interest in the mortgage debt, or in the mortgaged realty, or both? The prevailing view is that "interest" means both.[119] Based on this perspective, when the mortgagee acquires title to the realty before a loss, his interest is then in the fee and he is entitled to the full proceeds of insurance regardless of

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116. Ins. Co. of N. Am. v. Gulf Oil Corp., 127 S.E.2d 43 (Ga. Ct. App. 1962); First Nat'l Bank v. Newark Fire Ins. Co., 180 A. 163 (Pa. Super. Ct. 1935) (arson); Note, *The Standard Mortgage Clause in Fire Insurance Policies*, 33 COLUM. L. REV. 305 n.3 (1933); *see* Fields v. W. Millers Mut. Fire Ins. Co., 48 N.E.2d 489, 490 (N.Y. 1943).

    In holding that the stockholders of a corporate mortgagor have an insurable interest, a defense on this ground against a loss-payee mortgagee was overruled. Booker T. Wash. Ins. Co. v. Transcon. Ins. Co., 263 F. Supp. 1005 (N.D. Ala. 1966).

117. Woody v. Lytton Sav. & Loan Ass'n, 40 Cal. Rptr. 560 (2d Dist. Ct. App. 1964).

118. *See supra* section 3A:1.2[B].

119. For another view, see Hartford Fire Ins. Co. v. Bleedorn, 132 S.W.2d 1066, 1072 (Mo. Ct. App. 1939): "'As its interest may appear' does not refer to appellant's interest in the property, but refers to the amount of the debt owed to it secured by the deed of trust" (citations omitted).

what is left of the debt; that is, the protection of the policy does not end with foreclosure, although the debt is satisfied thereby.[120] The extent of the coverage depends on the extent of the mortgagee's interest at the time of the loss, not on the continued existence of the mortgage.[121]

After foreclosure, in many states the mortgagor has a statutory right of redemption. A mortgagee has been held entitled to insurance proceeds during the mortgagor's period of redemption[122] and after expiration of the redemption period.[123] A mortgagor redeeming during the redemption was held entitled to the insurance.[124]

The requirement in the standard mortgage endorsement that the mortgagee give the insurance company notice of any change of ownership is held inapplicable to the mortgagee's acquisition of title unless an increase of hazard is involved. It is said that this is no change of ownership, merely an enhancement of the mortgagee's interest.[125]

A fire occurring after the mortgagee bid the full amount of the debt, but before the mortgagee obtained a deed was treated as a bid made

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120. 495 Corp. v. N.J. Ins. Underwriting Ass'n, 430 A.2d 203 (N.J. 1981).

121. Nationwide Mut. Fire Ins. Co. v. Wilborn, 279 So. 2d 460 (Ala. 1973); 495 Corp. v. N.J. Ins. Underwriting Ass'n, 430 A.2d 203 (N.J. 1981). In *495 Corp.*, the mortgagee recovered the full amount of the loss, to the policy limits, subject to the rights of a superior mortgage. The court ruled that the mortgage endorsement protects the interest of the mortgagee in the insured property. It overcame a difficulty in construing the clause by centering on the words "a mortgagee's interest in the insurance is not invalidated by foreclosure." The insurer had argued that the mortgagee's interest was limited to the debt, and that at the time of the fire there was no debt and therefore no insurable interest in the former mortgagee. The court reasoned that the insurer would reap a windfall if premiums were paid covering a full loss with nobody eligible for payment of the loss for the reason that the former owner lacked an insurable interest. The court distinguished the mortgagee's post-loss acquisition, where recovery is limited to the deficiency in the mortgage debt and where, if the property is acquired in its full satisfaction, the former mortgagee is not entitled to any proceeds of insurance.

122. City of Chi. v. Maynur, 329 N.E.2d 312 (Ill. App. Ct. 1975). *Contra* Wharen v. Markle Banking & Tr. Co., 20 A.2d 885 (Pa. Super. Ct. 1941).

123. Citizens Mortg. Corp. v. Mich. Basic Prop. Ins. Ass'n, 314 N.W.2d 635 (Mich. Ct. App. 1981); Pioneer Sav. & Loan Co. v. St. Paul Fire & Marine Ins. Co., 70 N.W. 979 (Minn. 1897).

124. Malvaney v. Yager, 54 P.2d 135 (Mont. 1936).

125. Esch v. Home Ins. Co., 43 N.W. 229, 232 (Iowa 1889); Citizens Mortg. Corp. v. Mich. Basic Prop. Ins. Ass'n, 314 N.W.2d 635 (Mich. Ct. App. 1981); 495 Corp. v. N.J. Ins. Underwriting Ass'n, 430 A.2d 203, 208 (N.J. 1981); Equitable Life Assurance Soc'y v. Great Atl. Ins. Co., 330 N.Y.S.2d 840, 842–43 (Sup. Ct. N.Y. Cnty. 1972), *aff'd*, N.Y.S.2d 983 (App. Div. 1st Dep't 1972); Laurel Nat'l Bank v. Mut. Benefit Ins. Co., 444 A.2d 130, 132 (Pa. Super. Ct. 1982).

after acquisition of title, and the mortgage moneys were paid to the mortgagee.[126]

A few cases differ from the foregoing and limit a mortgagee's recovery to the preforeclosure debt for damage accruing after his acquisition of title.[127]

[H] Mortgagee's Acquisition of Title After Insured Loss

If the mortgagee acquires title to the mortgaged property after the loss, the property in its damaged state is deemed a payment of the mortgage debt to the extent of its then-value. Any recovery of insurance proceeds by the mortgagee without deduction for this value of the property is deemed an impermissible double recovery.[128] This is a corrolary of a more general rule that after payment of a mortgage debt in full, the mortgagee has no right to the proceeds of insurance.[129]

A mortgagee's acquisition of title after an insured loss is often accomplished by foreclosure. Not surprisingly, the casualty often makes it difficult for the mortgagor to continue making timely payments. If the mortgagee bids the full amount of the debt at the foreclosure sale the debt is extinguished[130] and his recovery of insurance proceeds barred.[131] A lesser bid reduces the debt, and his right to

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126. Estate of Brindisi v. State Farm Ins. Co., 564 N.Y.S.2d 985 (Sup. Ct. Erie Cty. 1991).

127. Fed. Nat'l Mortg. Ass'n v. Great Am. Ins. Co., 300 N.E.2d 117 (Ind. Ct. App. 1973); Equitable Life Assurance Soc'y v. Great Atl. Ins. Co., 330 N.Y.S.2d 840, 842–43 (Sup. Ct. N.Y. Cty. 1972), *aff'd*, N.Y.S.2d 983 (App. Div. 1st Dep't 1972).

Equitable Life follows Rosenbaum v. Funcannon, 308 F.2d 680, 684 (9th Cir. 1962), and Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 311 N.Y.S.2d 75 (App. Div. 2d Dep't 1970), *aff'd*, 270 N.E.2d 694 (N.Y. 1971), and assumes the time of mortgagee's acquisition of title does not affect his right to insurance money. *See also* Burner v. Mut. Protective Ass'n, 185 S.E. 222 (W. Va. 1936).

128. Rosenbaum v. Funcannon, 308 F.2d 680, 684 (9th Cir. 1962); Nationwide Mut. Fire Ins. Co. v. Wilborn, 279 So. 2d 460, 464 (Ala. 1973); 495 Corp. v. N.J. Ins. Underwriting Ass'n, 430 A.2d 203, 208 (N.J. 1981).

129. Meyers v. Norwich Union Fire Ins. Soc'y Ltd., 262 N.Y.S.2d 579 (Sup. Ct. Ulster Cty. 1965) (mortgagee claimed right to insurance because of his surviving liability under another mortgage after sale of property). *See also* Chrysler Capital Realty, Inc. v. Grella, 942 F.2d 160 (2d Cir. 1991).

130. On this rationale there is a series of California cases precluding a mortgagee who purchases the property by a full credit bid; *i.e.*, the amount of the debt, from recovering from a third party for waste and other claims; though the cases differ where the claim is for fraud. *See* Pac. Inland Bank v. Ainsworth, 48 Cal. Rptr. 2d 489 (Ct. App. 1995).

131. *In re* Vota, 165 B.R. 92 (Bankr. D.R.I. 1994).

insurance proceeds, pro tanto.[132] This makes it advisable for a mortgagee to bid at foreclosure no more than the value of the property in its damaged condition.[133]

A Florida case illustrates the importance of preserving the right to insurance proceeds by bidding less than the debt at foreclosure. In *Sea Island Operating Corp. v. Hochberg*,[134] after hurricane damage, the mortgagee bought the property for $1 million when the mortgage debt was $1,302,635, seeking no deficiency judgment. In an interpleader action, the court awarded the insurance proceeds to the mortgagee as against the mortgagor. The endorsement was apparently standard and, in addition, gave the mortgagee the option to apply the insurance to the debt or to the mortgagor.[135]

Even if there is a deficit at the foreclosure sale any claim of the mortgagee may be barred if the mortgage debt is deemed satisfied by the mortgagee's failure to apply for or obtain a deficiency

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132. Rosenbaum v. Funcannon, 308 F.2d 680, 684 (9th Cir. 1962); *In re* Cayer, 150 B.R. 829 (Bankr. M.D. Fla. 1993) (mortgagee, whose rights were fixed at time of loss, recovered entire proceeds because foreclosure sale insufficient to satisfy mortgage debt); Nationwide Mut. Fire Ins. Co. v. Wilborn, 279 So. 2d 460, 464 (Ala. 1973); Ark. Teacher Ret. Sys. v. Commando Props. Ltd., 801 S.W.2d 50 (Ark. Ct. App. 1990); Rollins v. Bravos, 565 A.2d 382 (Md. Ct. Spec. App. 1989) (despite assignment in mortgage of insurance to mortgagee); Nw. Nat'l Ins. Co. v. Mildenberger, 359 S.W.2d 380 (Mo. Ct. App. 1962); Power Bldg. & Loan Ass'n v. Ajax Fire Ins. Co., 164 A. 410 (N.J. 1933); Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 311 N.Y.S.2d 75 (App. Div. 2d Dep't 1970), *aff'd*, 270 N.E.2d 694 (N.Y. 1971), followed in Kessler v. Gov't Emps. Ins. Co., 579 N.Y.S.2d 13 (App. Div. 1st Dep't 1992). *Contra* Laurel Nat'l Bank v. Mut. Benefit Ins. Co., 297 Pa. Super. 473 (1982).

In this connection it may be said, "'As its interest may appear' does not refer to appellant's interest in the property, but refers to the amount of the debt owed to it secured by the deed of trust. . . ." Hartford Fire Ins. Co. v. Bleedorn, 132 S.W.2d 1066, 1072 (Mo. Ct. App. 1939) (citations omitted).

133. Some cases cited in this subsection resulted from mortgagees' unawareness of the rule. In Nw. Nat'l Ins. Co. v. Mildenberger, 359 S.W.2d 380 (Mo. Ct. App. 1962), mortgagee believed, and informed prospective bidders that, there would be full recovery of insurance moneys. *Whitestone*, 311 N.Y.S.2d 75, surprised New York practitioners.

134. Sea Island Operating Corp. v. Hochberg, 198 So. 2d 336 (Fla. Dist. Ct. App. 1967).

135. *See also* Lutheran B'hood v. Hooten, 237 So. 2d 23 (Fla. Dist. Ct. App. 1970) (mortgagee entitled to proceeds; foreclosing and obtaining deficiency judgment not inconsistent with claim to proceeds); Meyers v. Norwich Union Fire Ins. Soc'y Ltd., 262 N.Y.S.2d 579 (Sup. Ct. Ulster Cty. 1965) (mortgagee acquired property at foreclosure by $250 bid, resold it for $7,000, and also recovered insurance proceeds); Nat'l Union Fire Ins. Co. v. Davis, 389 S.W.2d 941 (Tenn. Ct. App. 1965).

judgment.[136] The New York statute makes failure to apply for a deficiency judgment a presumption that the proceeds of sale in the foreclosure action are in full satisfaction of the mortgage debt.[137] The Nevada statute is even stronger; it renders failure to apply for a deficiency judgment equivalent to a finding that the mortgage debt is extinguished.[138] This defeats a claim by the mortgagee to the insurance proceeds.[139] The California statute bars deficiency judgments, but does not prevent a mortgagee from realizing on other security; and a mortgagee who acquired title on a bid of less than the mortgage debt was held entitled to the proceeds of insurance to the extent of the deficit.[140]

A mortgagee's insurance is on the mortgagee's interest in or lien upon the realty, not upon the realty itself. In a Nebraska case, the mortgagee obtained a fire policy after the mortgagor defaulted, with the policy insuring only the mortgagee.[141] After a fire occurred, the insurer paid proceeds to the mortgagee. Six months after the fire, the mortgagee purchased the property at foreclosure for a price substantially less than the outstanding debt. The mortgagee was denied a deficiency judgment under the Nebraska anti-deficiency statute, which denies a deficiency judgment if either the value of the property or the price bid at foreclosure is at least as much as the mortgage debt.[142] This action terminated the mortgagee's interest in the debt as well as its insurable

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136. Coppotelli v. Ins. Co., 631 F.2d 146 (2d Cir. 1980); Bohn v. La. Farm Bureau Mut. Ins. Co., 482 So. 2d 843 (La. Ct. App. 1986); Moke Realty Corp. v. Whitestone Sav. & Loan Ass'n, 370 N.Y.S.2d 377 (Sup. Ct. Nassau Cty. 1975), *aff'd*, 382 N.Y.S.2d 289 (App. Div. 2d Dep't 1976), *aff'd*, 363 N.E.2d 587 (N.Y. 1977).

137. N.Y. REAL PROP. ACTS. LAW § 1371. *See* Moke Realty Corp. v. Whitestone Sav. & Loan Ass'n, 370 N.Y.S.2d 377 (Sup. Ct. Nassau Cty. 1975), *aff'd*, 382 N.Y.S.2d 289 (App. Div. 2d Dep't 1976), *aff'd*, 363 N.E.2d 587 (N.Y. 1977).

138. NEV. REV. STAT. § 40.455 (1986).

139. Hellman v. Capurro, 549 P.2d 750 (Nev. 1976). In Mann v. Glens Falls Ins. Co., 541 F.2d 819 (9th Cir. 1976), a mortgagee accepted a deed in lieu of foreclosure and released the mortgagor from liability. Applying Nevada law, the court denied the mortgagee a recovery from the insurer. Denial, however, was based on the mortgagee's refusal to permit subrogation against the mortgagor, to whom the insurance had not been assigned. *Accord* Indus. Indem. Co. v. Great Am. Ins. Co., 686 P.2d 1216 (Alaska 1984).

140. CAL. CIV. PROC. CODE § 580b. *See* Redingler v. Imperial Sav. & Loan Ass'n, 120 Cal. Rptr. 575 (1st Dist. Ct. App. 1975). The same was applied to a claim for waste. Hickman v. Mulder, 130 Cal. Rptr. 304 (4th Dist. Ct. App. 1976).

141. Pantano v. Md. Plaza P'ship, 507 N.W.2d 484 (Neb. 1993).

142. NEB. REV. STAT. § 76-1013.

interest, thereby triggering an obligation on the mortgagee's part to return all insurance proceeds to the insurer. The court distinguished California and Oregon cases holding that denial of a deficiency judgment under comparable statutes does not bar the mortgagee from claiming against a guarantor of the mortgage.

Under the New York statutory insurance covenant, the mortgagee is not required to collect insurance proceeds from the insurer to apply them to the debt. In *Crossland Mortgage Corp. v. Douglas*,[143] the mortgagee began foreclosure after the destruction of a house by fire. The mortgagors claimed that the mortgagee's "failure to seek payment under a fire insurance policy insuring its interest in the property constituted a complete defense and setoff" against the foreclosure claim. The court rejected the "contention that the availability of fire insurance proceeds is an affirmative defense to a foreclosure action," calling this position "novel" and concluding that the mortgagee was not required to pursue insurance proceeds before foreclosing.[144]

[I] Loss Payable Endorsement

The preceding two subsections considered the right of a mortgagee to proceeds of insurance when claiming under a "union" or standard endorsement. If, instead, the mortgagee's claim is under an open or loss payable endorsement, the mortgagee has no interest other than as assignee of the mortgagor-owner. If the interest of the latter is extinguished, there is nothing that can pass to the mortgagee, and an extinguishment of the interest of the mortgagor is an extinguishment of the interest of both.[145] A Missouri court has explained the rationale for this interpretation:

> If the clause in question is to be construed as an ordinary open mortgage clause then whatever rights the plaintiff had as mortgagee were terminated when the property was deeded to it under foreclosure. It then became the owner but the defendant did not insure it as such and no rule of construction justifies this court in

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143. Crossland Mortg. Corp. v. Douglas, 706 N.Y.S.2d 273 (App. Div. 3d Dep't 2000).

144. *Id.* at 274.

145. Reynolds v. London & Lancashire Fire Ins. Co., 60 P. 467 (Cal. 1900); Prudential Ins. Co. v. German Mut. Fire Ins. Ass'n, 60 S.W.2d 1008 (Mo. Ct. App. 1933); Burner v. Mut. Protective Ass'n, 185 S.E. 222 (W. Va. 1936). *Contra* German Ins. Co. v. Churchill, 26 Ill. App. 206 (1887). *Burner* deemed a mortgagee's acquisition of title a merger of the mortgage. The case apparently involved a loss payable clause, but this is not clear.

In Lutheran B'hood v. Hooten, 237 So. 2d 23 (Fla. Dist. Ct. App. 1970), which also apparently involved a loss payable endorsement, mortgagee foreclosed and recovered deficiency judgment and was held entitled to recover the proceeds of insurance.

> writing into the policy coverage of an interest that was not stipulated to be insured by the parties.[146]

Just as in the case of a standard mortgage endorsement, a loss payee mortgagee who bids the full amount of the debt loses any right to insurance.[147]

[J] Liability of Mortgagee for Insurance Premiums

Cases have arisen with respect to the liability of a mortgagee for payment of premiums on insurance supplied by a mortgagor. Under a loss payable clause the mortgagee is clearly not liable.[148] The standard mortgagee endorsement is more difficult because of its language; that is, that the interest of the mortgagee in the insurance shall not be invalidated by any act or neglect of the mortgagor, provided that if the mortgagor shall fail to pay a premium the mortgagee shall on demand pay the same. Under the majority rule "provided" is held a condition, not a covenant; that is, if the mortgagee does not choose to pay, the insurance is invalidated as to him.[149] The minority and older cases construe the clause as a covenant by the mortgagee to pay.[150] The mortgagee should obviously require a standard or "union" endorsement.

[K] Installment Land Contracts

An installment land contract "provides for payment of the purchase price in installments with periodic interest on the unpaid balance thereof, possession to the vendee at the time of execution thereof, risk of loss and responsibility for procuring fire and liability insurance and payment of real property taxes on the vendee, but retention of title in the vendors until the purchase price is paid in full."[151] As the above quote suggests, when the land includes valuable improvements, the installment land contract often requires the purchaser to buy and maintain fire insurance. Resolving the conflicting claims of vendor and purchaser to insurance proceeds has proven nettlesome, with

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146. Prudential Ins. Co. v. German Mut. Fire Ins. Ass'n, 60 S.W.2d 1008, 1010 (Mo. Ct. App. 1933).
147. Universal Mortg. Co. v. Prudential Ins. Co., 799 F.2d 458 (9th Cir. 1986) (and cases discussed; bid in error in ignorance of interior damage to structure).
148. Stevens Ins., Inc. v. Howells, 155 Mont. 494, 473 P.2d 523 (1970) (applied to vendor); Wharen v. Markle Banking & Tr. Co., 20 A.2d 885 (Pa. Super. Ct. 1941).
149. Coykendall v. Blackmer, 146 N.Y.S. 631 (App. Div. 3d Dep't 1914); *see* Stoddart v. Black, 8 P.2d 305 (Kan. 1932); Gen. Credit Corp. v. Imperial Cas. & Indem. Co., 95 N.W.2d 145 (Neb. 1959).
150. Stoddart v. Black, 8 P.2d 305 (Kan. 1932).
151. Meade v. N. Country Co-Op. Ins. Co., 487 N.Y.S.2d 983, 984 (Sup. Ct. Franklin Cty. 1985), *aff'd*, 501 N.Y.S.2d 944 (App. Div. 3d Dep't 1986).

inconsistent judicial decisions largely due to uncertainty as to the characterization of the installment land contract. It is widely recognized that the installment land contract is a mortgage substitute, but classically courts have not treated such contracts as mortgages per se or as equitable mortgages. Rather, they have applied the general body of contract law to such contracts.

The purchaser is not entitled to a mortgagor's rights to use the insurance proceeds for restoration when the policy is issued in the vendor's name only because the New York statutory covenant does not apply[152] and there is no such right at common law.[153] The purchaser, however, is entitled to have the insurance proceeds on a policy he purchases reduce the balance remaining on the purchase price. This is true even if the purchaser is in default in making payments at the time of the fire.[154] Likewise, if the purchaser is in possession during a redemption period following the entry of a judgment of forfeiture, the purchaser is entitled to the insurance proceeds stemming from a casualty taking place during the redemption period.[155]

Courts sometimes apply mortgage rules for casualty insurance to installment land contract disputes. A New York court has held that the vendor under a land contract is treated as a mortgagee under a fire insurance policy obtained by the purchaser, which named the purchaser as owner of the property and the vendor as "mortgagee or secured party."[156] The insurer denied the purchaser's claim due to the purchaser's misconduct, but the court ruled that the insurer was liable to the vendor under a standard mortgagee clause, with the insurer holding subrogation rights against the purchaser to the extent of any payments made to the vendor. The court observed that the parties' relationship was "the functional equivalent of a mortgagor-mortgagee

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152. *See* section 3A:1.2[B] *supra*.

153. Upham v. Lowry, 485 N.Y.S.2d 680 (Sup. Ct. Madison Cty. 1985) (rejecting argument N.Y. REAL PROP. LAW § 254(4)(a) should apply because land contract is the "equivalent" of a mortgage).

154. Madero v. Henness, 607 N.Y.S.2d 153, 155 (App. Div. 3d Dep't 1994) (purchasers entitled to specific performance; vendors must accept insurance proceeds in payment of remaining price because purchasers' default was "not sufficiently egregious to trigger the agreement's forfeiture provisions"). In Upham v. Lowry, 485 N.Y.S.2d 680 (Sup. Ct. Madison Cty. 1985), the vendors conceded that the purchasers were entitled to apply the proceeds to reduce the contract balance.

155. *In re* Kelly, 51 B.R. 9 (Bankr. E.D. Mich. 1984) (vendor took possession pursuant to forfeiture judgment seven days after windstorm destroyed barn; forfeiture has effect of eliminating purchaser's debt, equivalent to foreclosure of mortgage that yields a price equal to full amount of mortgage debt).

156. Meade v. N. Country Co-Op. Ins. Co., 501 N.Y.S.2d 944 (App. Div. 3d Dep't 1986).

relationship."[157] Similarly, another New York court held that a policy insuring a vendor and a purchaser "as interest may appear" was not voided as to the vendor by reason of the purchaser's arson.[158]

In an appropriate case, the vendor can recover on an insurance policy obtained by the purchaser even though the policy does not name or mention the vendor. In *Marbach v. Gnadl*,[159] the contract obligated the purchasers "as additional security to keep all buildings on aforesaid premises insured in such company or companies as the said party of the first part may direct for at least the sum of unpaid balance of purchase price."[160] A forfeiture provision in the installment land contract entitled the vendors to terminate the contract for a breach by the purchasers and to retain all payments in liquidation of damages sustained. The purchasers obtained insurance and after a fire they defaulted in making payments, prompting the vendors to declare a forfeiture. Both the vendors and the purchasers claimed the insurance proceeds. The court allowed the vendors to recover the insurance proceeds, up to the unpaid balanace due on the contract, reasoning that they had an equitable lien upon the insurance policies. The vendors' declaration of forfeiture voided the contract as of the time of the breach, not *ab initio.* On forfeiture, the vendors were entitled to the land, and after the damage the insurance proceeds stood in its place.

§ 3A:1.3 Building Removal

The New York statutory form mortgage provides:

3. That no building on the premises shall be removed or demolished without the consent of the mortgagee.[161]

The purpose of the clause is to give the mortgagee "notice and an opportunity to safeguard his security interest in the event the mortgagor intend[s] to remove or demolish the structure on the mortgaged property."[162] Thus, the mortgagee's consent is unnecessary if the government condemns a structure, ordering its demolition as a safety hazard.[163] Likewise, this clause does not obligate the mortgagor to take

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157. *Id.* at 946.
158. Richardson v. Providence Wash. Ins. Co., 237 N.Y.S.2d 893 (Sup. Ct. Tompkins Cty. 1963).
159. Marbach v. Gnadl, 219 N.E.2d 572 (Ill. App. Ct. 1966).
160. *Id.*
161. N.Y. REAL PROP. LAW § 258, Sch. M.
162. Mortgagee's consent is unnecessary if the structure is condemned as a hazard. Bodwitch v. Allen, 459 N.Y.S.2d 148, 150 (App. Div. 4th Dep't 1983).
163. *Id.* (demolition apparently needed due to casualty; mortgagor collected insurance proceeds).

affirmative steps to prevent strangers from demolishing or injuring a building.[164]

This covenant may be amplified by forbidding material alterations of the buildings on the premises, requiring the mortgagor to maintain the premises in a state of repair and in accordance with requirements of law, and permitting the mortgagee's inspection to ascertain compliance with these obligations. In the absence of this addition and a satisfactory acceleration clause, a mortgagor is not bound to rebuild or repair structures destroyed by fire or otherwise damaged without his fault,[165] and such condition does not authorize acceleration of the mortgage debt.[166]

When the mortgage allows acceleration for the removal of buildings, the failure to make repairs, or the making of alterations without the mortgagee's consent, the mortgagee must prove impairment of security in order to accelerate and foreclose.[167] Impairment may exist even though the mortgagee is adequately secured if the removal or change substantially reduced the property value.[168]

§ 3A:1.4 Acceleration of Debt

The New York statutory form mortgage provides:

4. That the whole of said principal sum and interest shall become due at the option of the mortgagee: after default in the payment of any installment of principal or of interest for ___ days; or after default in the payment of any tax, water rate

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164. Garliner v. Glicken, 196 N.Y.S.2d 784 (Sup. Ct. Monroe Cty. 1960) (claim that mortgagor failed "to provide adequate guards or watchmen against vandalism," thus permitting "cottages in effect to become substantially demolished").

165. Kirkorian v. Grafton Co-op Bank, 44 N.E.2d 665 (Mass. 1942) (hurricane damage).

166. Campbell v. Macomb, 4 Johns. Ch. 534, 537 (N.Y. 1820); Brayton v. Pappas, 383 N.Y.S.2d 723 (App. Div. 4th Dep't 1976); Sidrane v. F.D.R. Realty Corp., 61 N.Y.S.2d 828, 831 (Sup. Ct.), *aff'd*, 73 N.E.2d 550 (N.Y. 1947).

167. United States v. Angel, 362 F. Supp. 445 (E.D. Pa. 1973) (mortgagee must prove impairment to foreclose for failure to maintain and repair); Bart v. Streuli, 52 P.2d 922 (Cal. 1935) (covenant against removal or demolition of any building; foreclosure denied when mortgagor removed front porch as part of scheme of improvement, thereby enhancing value of premises); Loughery v. Catalano, 191 N.Y.S. 436 (Sup. Ct. Bronx Cty. 1921) (alterations that did not change character of building and enhanced its value), *aff'd*, 201 N.Y.S. 919 (App. Div. 1st Dep't 1923).

168. Laber v. Minassian, 511 N.Y.S.2d 516 (Sup. Ct. 1987) (removal of gas station; value with improvements was $233,000 and value without was $220,000; debt was far less).

> or assessment for ___ days after notice and demand; or after default after notice and demand either in assigning and delivering the policies insuring the buildings against loss by fire or in reimbursing the mortgagee for premiums paid on such insurance, as hereinbefore provided; or after default upon request in furnishing a statement of the amount due on the mortgage and whether any offsets or defenses exist against the mortgage debt, as hereinafter provided.[169]

The blanks for numbers of days are to be filled in. Failure to do so raises a substantial risk that the mortgagee has no right to accelerate the debt for the first two reasons mentioned in the clause. One court held that a failure to fill in blanks relating to the "grace period" implied a right in the mortgagee to declare the mortgage due within a reasonable time after default.[170] There appears to be no justification for this result. Delivery of an executed contract, with blanks, implies authority to fill in the blanks as the parties contemplated,[171] particularly where the blanks are purely formal.[172] But, where the blanks indicate a failure even to consider the matter in question, the entire clause is disregarded, as if it were not part of the contract.[173] Taxes have been held in default under these clauses, allowing acceleration of the debt, as soon as the taxes begin to bear interest.[174]

A mortgagor's breach of other covenants in the mortgage does not, per se, permit acceleration of the mortgage debt.[175] A court refused to allow acceleration when a homeowner failed to pay water rates as

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169. N.Y. REAL PROP. LAW § 258, Sch. M.

170. Genton Realty Corp. v. Balsamo, 132 N.Y.L.J. 12, Oct. 18, 1954 (Sup. Ct. 1954). *Compare* Grayson v. LaBranche, 225 A.2d 922 (N.H. 1967) (buyer entitled to benefit of mortgage contingency, which had blank, not filled in, for amount of loan).

171. Roe v. Town Mut. Fire Ins. Co., 78 Mo. App. 452, 455 (1899); Natlo v. Bear Ridge Lake Corp., 142 N.Y.S.2d 504 (Sup. Ct. Westchester Cty. 1955); Sec. Bank v. Hawk, 517 N.E.2d 886 (Ohio 1988) (description subsequently filled in); Tosh v. Witts, 113 A.2d 226 (Pa. 1955); 2 S. WILLISTON, CONTRACTS § 275 (3d ed. 1959); 15 *id.* § 1909 (3d ed. 1961) (*but compare* 4 *id.* § 585 (3d ed. 1961)).

172. Kinney v. Schmitt, 12 Hun. 521 (N.Y. 1878) (blank could be filled in with "his" or "her").

173. Realty Corp. v. Park Cent. Valet, Inc., 297 N.Y.S. 40 (App. Div. 1st Dep't 1937) (provision that lease might be renewed "for term of years"); *see* Starr v. Holck, 28 N.W.2d 289, 292 (Mich. 1947); 17 C.J.S. *Contracts* § 65 (1963). *But see* Tunkel v. Filippone, 66 A.2d 339 (N.J. Super. Ct. App. Div. 1949).

174. Nylen v. Geeraert, 226 A.2d 878 (Md. 1967). *Accord* Bishop v. Brown, 325 N.W.2d 594, 598 (Mich. Ct. App. 1982).

175. Bodwitch v. Allen, 91 A.D.2d 1177 (N.Y. App. Div. 4th Dep't 1983) (not allowing acceleration when mortgagor demolished building condemned by city as safety hazard).

required by a reverse mortgage.[176] Accordingly, the acceleration clause is sometimes expanded to cover a breach of any of the mortgagor's covenants, so that the mortgage debt may be declared due and payable on breach of any covenant on the mortgagor's part that is included in the mortgage. A sentence is sometimes added to the effect that any right the mortgagee may otherwise have for breach of covenant or for injunctive relief is not thereby impaired.

A court may refuse to enforce an acceleration clause where refusal does not impair the mortgagee's security. This was true in case of failure to pay real estate taxes and maintain hazard insurance.[177] It has also been held true in case of removal of buildings[178] or waste.[179] Equity has denied acceleration when its strict enforcement would impose an unconscionable hardship on the mortgagor and give the mortgagee an unconscionable advantage.[180]

The right to accelerate may be waived.[181] If a pattern of late payments leads the mortgagor to believe it may continue, he may be entitled to notice and warning before the mortgagee elects to accelerate.[182] This

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176. Metlife Home Loans v. Vereen, 43 Misc. 3d 537 (N.Y. Sup. Ct. 2014) (relying in part on federal regulation that allows mortgagee to pay property charges on behalf of mortgagor).

177. Brady v. Edgar, 415 So. 2d 141 (Fla. Dist. Ct. App. 1982).

178. *See supra* section 3A:1.3.

179. *See infra* section 3A:6.

180. United States v. Forrester, 118 F. Supp. 401, 412 (W.D. Ark. 1954). Mid-State Tr. II v. Jackson, 854 S.W.2d 734 (Ark. Ct. App. 1993); 59 C.J.S. *Mortgages* § 495(6) (1949). *Cf.* Graf v. Hope Bldg. Corp., 174 N.E. 884, 886 (N.Y. 1930) (Cardozo, J.).

181. Nassau Tr. Co. v. Montrose Concrete Prod. Corp., 436 N.E.2d 1265 (N.Y. 1982) (may not withdraw oral waiver without reasonable notice). A valid tender of enough to expunge a default is a defense to foreclosure. Call v. LaBrie, 498 N.Y.S.2d 652 (App. Div. 4th Dep't 1986). Acceptance of part payments after acceleration has barred foreclosure. Amerifirst Fed. Sav. & Loan Ass'n v. Century 21 Commodore Plaza, Inc., 416 So. 2d 45 (Fla. Dist. Ct. App. 1982). The same applies to acceptance of a full installment. Rawhide Farms v. Darby, 589 S.W.2d 210 (Ark. 1979).

Acceleration is disallowed when payment of an installment is impossible. Fowler v. White, 295 S.E.2d 83 (Ga. 1982) (no executor appointed for deceased mortgagee).

A statute permitting waiver of notice to accelerate (ME. REV. STAT. ANN. tit. 11, § 3-511 (1964)) has been enforced. Maine Sav. Bank v. Chee, 576 A.2d 1358 (Me. 1990).

182. Miller v. Uhrick, 706 P.2d 739 (Ariz. 1985), *approved*, 707 P.2d 309 (Ariz. 1985); First Fed. Sav. & Loan Ass'n v. Stone, 467 N.E.2d 1226 (Ind. Ct. App. 1984); Smith v. Smith, 352 P.2d 1036 (Kan. 1960). *See also* Caulder v. Lewis, 338 S.E.2d 837 (S.C. 1985). *But cf.* Mariash v. Bastianich, 452 N.Y.S.2d 190 (App. Div. 1st Dep't 1982).

This is the rule with respect to late payments of rent. FRIEDMAN ON LEASES, *supra* note 25, § 16:5.1 (Supp. July 2014).

would not apply if the mortgagee has made continual objections and warnings to the mortgagor or if the mortgage provides for acceleration without notice.[183] A mortgage clause providing that a waiver of a right to accelerate upon one default shall not constitute a waiver at another time has been enforced,[184] but the circumstances and the jurisdictions in which non-waiver clauses are enforced is the subject of considerable variation.[185]

Some acceleration clauses provide that the mortgage will become due and payable a specified number of days after default. The majority cases hold this clause is not self-operative, but is for the benefit of the mortgagee, who has the option to accelerate or not.[186] Acceleration requires an affirmative act or election by the mortgagee, which may consist of an unequivocal declaration by the mortgagee to the mortgagor that he is exercising the option.[187] Until such election, tender of

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183. Trs. of Wash.-Idaho-Mont. Carpenters-Emps. Ret. Tr. Fund v. Galleria P'ship, 780 P.2d 608, 613–14 (Mont. 1989) (enforcement of anti-waiver clause); Caulder v. Lewis, 338 S.E.2d 837 (S.C. 1986); Allendale Furniture Co. v. Carolina Commercial Bank, 325 S.E.2d 530 (S.C. 1985). For the comparable rule with respect to rents, see FRIEDMAN ON LEASES, *supra* note 25, § 16:5.1 (Supp. July 2014).

184. Fed. Nat'l Mortg. Ass'n v. Cobb, 738 F. Supp. 1220 (N.D. Ind. 1990); Farris v. Jim Walter Homes, Inc., 519 So. 2d 1338 (Ala. 1988); First Fed. Sav. & Loan Ass'n v. Stone, 467 N.E.2d 1126 (Ind. Ct. App. 1984); Postal Sav. & Loan Ass'n v. Freel, 698 P.2d 382 (Kan. Ct. App. 1984); Price v. First Fed. Sav. Bank, 822 S.W.2d 422 (Ky. Ct. App. 1992); Gaul v. Olympia Fitness Ctr., Inc., 623 N.E.2d 1281, 1286 (Ohio Ct. App. 1993).

185. *See* Dorn v. Robinson, 762 P.2d 566 (Ariz. Ct. App. 1988), particularly when a time of the essence clause is included. *See also* M.J.G. Props. v. Hurley, 537 N.E.2d 165, 166 (Mass. App. Ct. 1989). For comparable disclaimer clauses in leases, see FRIEDMAN ON LEASES, *supra* note 25, § 16:5.2 (Supp. July 2014).

186. Peter Fuller Enters., Inc. v. Manchester Sav. Bank, 152 A.2d 179 (N.H. 1959); Seligman v. Burg, 251 N.Y.S. 689 (App. Div. 2d Dep't 1931); 6 S. WILLISTON, CONTRACTS § 2025 (rev. ed. 1938), *see* Frenzel v. Frenzel, 260 Iowa 1076, 152 N.W.2d 157 (1967). Cases pro and con are collected in 159 A.L.R. 1077 (1945); usury, as affected by acceleration clause, Annot., 66 A.L.R.3d 650–716 (1975); late charges, Annot., 63 A.L.R.3d 50 (1975).

A provision for acceleration without notice was enforced. David v. Sun Fed. Sav. & Loan Ass'n, 461 So. 2d 93 (Fla. 1984); Allendale Furniture Co. v. Carolina Commercial Bank, 325 S.E.2d 530 (S.C. 1985).

187. Moss v. McDonald, 772 P.2d 626 (Colo. Ct. App. 1988); Butter v. Melrose Sav. Bank, 435 N.E.2d 1057 (Mass. App. Ct. 1982); Miller v. Jones, 635 S.W.2d 360 (Mo. Ct. App. 1982); Comer v. Hargrave, 598 P.2d 213 (N.M. 1979); 5 A.L.R.2d 968, 970 (1949).

For mortgagee's ambiguous behavior as a bar to acceleration, see First Fed. Sav. & Loan Ass'n v. Stone, 467 N.E.2d 1226 (Ind. Ct. App. 1984).

payment by the mortgagor is permitted.[188] In the case of co-mortgagees, the election to accelerate must be made by both to be effective.[189]

Provisions for payment of late charges are enforceable prior to acceleration,[190] but not thereafter, when the mortgagee may refuse to accept installment payments.[191] "Default interest," that is, higher

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188. Yelen v. Bankers Tr. Co., 476 So. 2d 767 (Fla. Dist. Ct. App. 1985); Kent v. Pipic, 462 N.W.2d 800 (Mich. Ct. App. 1990); Overholt v. Merchs. & Planters Bank, 637 S.W.2d 463 (Tenn. App. 1982).

189. Cresco Realty Co. v. Clark, 112 N.Y.S. 550 (App. Div. 2d Dep't 1908); Lapidus v. Kollel Avreichim Torah Veyirah, 451 N.Y.S.2d 958 (Sup. Ct. Sullivan Cty. 1982).

The New York cases were distinguished in Creamer v. Aultman, 445 So. 2d 382 (Fla. Dist. Ct. App. 1984), where the owner made half payments to each co-owner, was up to date with one but not the other. The latter was permitted to accelerate and foreclose his part on joining the co-owner as defendant. The court relied on English cases.

190. Sec. Mut. Life Ins. Co. v. Contemporary Real Estate Assocs., 979 F.2d 329 (3d Cir. 1992) (citing cases); Mack Fin. Corp. v. Ireson, 789 F.2d 1083 (4th Cir. 1986); FDIC v. MFP Realty, 870 F. Supp. 451 (D. Conn. 1994); *In re* Tavern Motor Inn, Inc., 69 B.R. 138 (Bankr. D. Vt. 1987); *In re* Richardson, 63 B.R. 112 (Bankr. W.D. Va. 1986); Bowery Sav. Bank v. Layman, 233 N.E.2d 492 (Ind. Ct. App. 1968); Centerbank v. D'Assaro, 600 N.Y.S.2d 1015 (Sup. Ct. Suffolk Cty. 1993). *See* O'Malley, *Late-Payment Charges: Meeting the Requirements of Liquidated Damages*, 27 STAN. L. REV. 1133 (1975).

Bona fide late charges were held non-usurious. Li v. Astoria Fed. Sav. & Loan Ass'n, 438 N.Y.S.2d 865 (App. Div. 2d Dep't 1981). They are enforceable if in compensation for administration expenses and the cost of money withheld. Crest Sav. & Loan Ass'n v. Mason, 891 A.2d 120 (N.J. Super. Ct. Ch. Div. 1990); NELSON & WILSON, REAL ESTATE FINANCE LAW, 443 *et seq.* (2d ed. 1985), and are not waived by accepting late payments. Basciano v. Toyet Realty Corp., 561 N.Y.S.2d 252 (App. Div. 1st Dep't 1990). *Contra* Swindell v. Fed. Nat'l Mortg. Ass'n, 409 S.E.2d 892 (N.C. 1991). A late charge amounting to $60 a month on a monthly rent of $150 was held unconscionable. N. Am. Inv. Co. v. Lawson, 854 P.2d 384 (Okla. Ct. Ap. 1993).

Late charges have been approved in bankruptcy. *See* BANKRUPTCY CODE § 506(b) (1979); *In re* LHD Realty Corp., 726 F.2d 327, 333 (7th Cir. 1984); Shadhali v. Hintlian, 41 Conn. App. 225, 675 A.2d 3 (1996).

191. Sec. Mut. Life Ins. Co. v. Contemporary Real Estate Assocs., 979 F.2d 329 (3d Cir. 1992) (suggesting possibility of contra result if mortgage so provides); *In re* Tavern Motor Inn, Inc., 69 B.R. 138 (Bankr. D. Vt. 1987). A mortgagee suing under acceleration for the entire debt is not entitled to late charges on an installment. Reis v. Decker, 516 N.Y.S.2d 851 (Cty. Ct. Delaware Cty. 1987). Somewhat comparable is a New Jersey case holding late charges were applicable to payment of rent but not to nonpayment. Fanarjian v. Moskowitz, 568 A.2d 94 (N.J. Super. Ct. 1989).

Late charges were held inapplicable to the balance of the mortgage debt; *i.e.*, to the balloon payment. The mortgage entitled mortgagee to attorneys fees. A different result would give double recovery. Trustco Bank v. 37 Clark St., Inc., 599 N.Y.S.2d 404 (Sup. Ct. Saratoga Cty. 1993).

interest after the mortgagor's failure to pay at a specified time, has been held enforceable in some cases, but not in others.[192]

Minority states distinguish between notice by the mortgagee (1) of an election to accelerate, which they do not require or whose waiver they permit,[193] and (2) of an intent to foreclose after a completed acceleration, which they do require.

When no definite time is specified a mortgagee's election to accelerate must be made within a reasonable time after the event that gives rise to the right to accelerate.

A mortgagee who accelerates the mortgage debt may retract the acceleration,[194] but not over the mortgagor's objection, when the mortgagor has changed his position in reliance on the acceleration.[195]

The dominant cases hold that the mortgagee's acceptance of an installment payment after acceleration is a waiver of acceleration, absent some compelling reason to the contrary.[196]

If a mortgage provides for payment of an installment at a specified time, or permits acceleration at a specified time for nonpayment, and also includes a provision for late charges if payment is not made at a later time, which provision governs? The few cases are not in accord. Some allow the mortgagee to treat the mortgagor as in default before the date on which a late charge is assessable,[197] but others allow the mortgagor the benefit of a grace period, durning which acceleration is precluded.[198] It would be well to clarify this in the mortgage.

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192. Eyde Bros. Dev. Co. v. Equitable Life Ins. Co., 697 F. Supp. 1431 (W.D. Mich. 1988), allowed default interest. *In re* Entz-White Lumber & Supply, Inc., 850 F.2d 1338 (9th Cir. 1988), held that a debtor may cure a defaulted mortgage note at the contract interest rate as opposed to the default rate, because curing is supposed to return a claim to its pre-fault condition and is not supposed to enable the mortgagee to impose its distribution scheme on the bankruptcy court. Conversely, *in dicta*, *In re* LHD Realty Corp., 726 F.2d 327 (7th Cir. 1984), suggests that a mortgagee may have an allowable claim for a late charge designed to cover the extra expense involved in handling delinquent installments.

193. Carpenter v. Riley, 675 P.2d 900 (Kan. 1984); Cortez v. Brownsville Nat'l Bank, 664 S.W.2d 805 (Tex. Civ. App. 1984).

194. *In re* Adu-Kofi, 94 B.R. 14 (D.R.I. 1988).

195. Kilpatrick v. Germania Life Ins. Co., 75 N.E. 1124 (N.Y. 1905); W. Portland Dev. Co. v. Ward Cook, Inc., 424 P.2d 212 (Or. 1967); 59 C.J.S. *Mortgages* § 495(6)(c) (1949).

196. *See In re* Parks, 193 B.R. 361, 365–66 (Bankr. N.D. Ala. 1995).

197. *E.g.*, Auto-Plaza, Inc. v. Cent. Bank, 394 So. 2d 6 (Ala. 1980) (fifteen-day late payment charge does not create "grace period"; allowing acceleration when mortgagor tendered payment three days late).

198. Baypoint Mortg. v. Crest Premium Real Estate Inv. Ret. Tr., 214 Cal. Rptr. 531 (Ct. App. 1985) (time not of the essence with respect to payment on first of month due to late payment fee); Fed. Home Loan Mortg. Corp. v. Taylor, 318 So. 2d 203 (Fla. Dist. Ct. App. 1975) (late payment fee creates

Some mortgages make nonpayment of taxes a default that permits foreclosure with no prior notice. But payment before foreclosure precludes foreclosure.[199]

The mortgagor may direct, when making payment, whether his payment is to be applied to principal, interest, or taxes, and the mortgagee is bound by this direction.[200]

The mortgagor's payment by mail is not operative as payment unless received, or the mortgagee had consented to payment by mail.[201]

[A] Notice of Acceleration

The New York clause requires no notice before accelerating for nonpayment of an installment of principal or of interest.[202] The court in *Charter One Bank, FSB v. Leone*[203] explained:

> [W]here, as here, a mortgage contains an acceleration clause in statutory form, neither notice of default nor demand for payment is a condition precedent to the commencement of a foreclosure action, as plaintiff's act of commencing the action and the filing of a lispendens constitutes a valid election to accelerate the maturity of the unpaid principal balance and accrued interest.[204]

Notwithstanding the mortgagor's lack of a legal right to notice of acceleration under the statutory form for default in paying principal and interest, the mortgagee nevertheless should follow the practice of giving notice to the mortgagor, even for five or ten days, for nonpayment of all monetary defaults, just in case the payment is misdirected or the amount of the payment is incorrect. For nonmonetary repairs, involving repair construction, curing violations, etc., the notice should be longer, but should provide that the mortgagor's beginning with promptness and continuing with reasonable diligence and continuity should prevent acceleration. The mortgagor should

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"grace period" within which mortgagor may pay installment "without further obligation"; acceleration not allowed when mortgagor tendered installment before late charge was due and mortgagee had accepted prior past-due installments with late charges included).

199. Eberly v. Balducci, 484 A.2d 1043 (Md. Ct. Spec. App. 1984).
200. Cent. Nat'l Bank v. Paton, 439 N.Y.S.2d 619 (Sup. Ct. Otsego Cty. 1981); Bank of Cal. v. Webb, 94 N.Y. 467, 472 (1884).
201. Cornwell v. Bank of Am. Tr. & Sav. Ass'n, 274 Cal. Rptr. 322 (4th Dist. Ct. App. 1990).
202. Albertina Realty Co. v. Rosbro Realty Corp., 180 N.E. 176, 177 (N.Y. 1932); Hudson City Sav. Inst. v. Burton, 451 N.Y.S.2d 855, 856 (App. Div. 3d Dep't 1982).
203. Charter One Bank, FSB v. Leone, 845 N.Y.S.2d 513 (App. Div. 3d Dep't 2007).
204. *Id*. at 514 (citations omitted).

be permitted to pay assessments in installments where permitted and to challenge any taxes or other impositions before any lien or penalty is incurred.

The acceleration clause is necessary because the doctrine of anticipatory breach, as the basis for immediate action against one who repudiates an executory contract, has no application to contracts for the payment of money only. Accordingly, the failure of a mortgagor to meet installments of principal or interest, or to pay taxes, assessments, or insurance will not cause the whole debt to mature at once upon default, absent a provision in the mortgage to such effect.[205] Similarly, a provision for acceleration for failure to pay interest or taxes does not permit acceleration for failure to pay installments of principal.[206]

The New York covenant explicitly requires notice before accelerating for nonpayment of taxes, water rates, or assessments.[207] When notice of acceleration is given, or required to be given, a notice that the debt may be accelerated is insufficient.[208] The notice must be given to

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205. Terrell v. Cheatham, 255 S.W. 262 (Ky. 1923); Better v. Williams, 102 A.2d 750 (Md. 1954); Pa. Co. for Ins. on Lives v. Broadway Stevens Co., 148 A. 575 (N.J. Ch. 1930); Indian River Islands Corp. v. Mfrs. Tr. Co., 2 N.Y.S.2d 860 (App. Div. 1st Dep't 1938); Crouse v. Nantucket Vill. Dev. Co., 460 N.E.2d 1389 (Ohio Ct. App. 1983); 88 U. PA. L. REV. 94 (1939); 55 AM. JUR. 2D *Mortgages* § 371 (1971); 59 C.J.S. *Mortgages* § 495(3)(a) (1949); 1 C. WILTSIE, MORTGAGE FORECLOSURES § 39 (5th ed. 1939).

Acceleration was permitted despite absence of an acceleration clause where monthly payments were in default for several years. Gonzales v. Tama, 749 P.2d 1116 (N.M. 1988).

Where a mortgage, but not the accompanying note, contains an acceleration clause there is conflict on the effect of this clause on the note. Some hold the acceleration is limited to a mortgage foreclosure. Others hold the clause permits advancement of the debt for all purposes. *See* authorities collected in Poultrymen's Serv. Corp. v. Brown, 185 A.2d 706 (N.J. Super. Ct. 1962); Note, 15 ALA. L. REV. 549 (1963).

The question does not arise where the acceleration clause is incorporated in the note by reference, as by a provision permitting the holder of the note to accelerate in case of any default that would permit acceleration of the mortgage, or where the note also contains an acceleration clause.

In the absence of an acceleration provision, the statute of limitations runs separately to each installment as it becomes due. Visioneering, Inc. Profit Sharing Tr. v. Belle River Joint Venture, 386 N.W.2d 185 (Mich. Ct. App. 1986). If there is no election to accelerate, the statute does not begin to run until the last date for payment of the principal. *In re* Lake Townsend Aviation, Inc., 361 S.E.2d 409 (N.C. Ct. App. 1987).

206. S.D. Walker, Inc. v. Brigantine Beach Hotel Corp., 129 A.2d 758 (N.J. Super. Ct. 1957).

207. Cent. Nat'l Bank v. Paton, 439 N.Y.S.2d 619 (Sup. Ct. Otsego Cty. 1981).

208. Ogden v. Gibraltar Sav. Ass'n, 640 S.W.2d 232 (Tex. 1982).

the mortgagor or there must be some unequivocal overt act that accomplishes an election.[209]

[B] Reinstatement After Acceleration

Once the mortgage debt has been accelerated by reason of default, may the acceleration be annulled by payment of the pre-acceleration arrears? The cases are split when the acceleration was based on nonpayment of interest or an installment of principal.[210] There is less reluctance to annul an acceleration that was based on nonpayment of taxes,[211] because "the punctual payment of interest has an importance to the lender as affecting his way of life, perhaps the very means for his support, whereas the importance of payment of the taxes is merely as an assurance of security."[212] In bankruptcy cases, annulment of acceleration may be permitted even where state courts would hold otherwise.[213] Statutes in a number of states permit

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209. 446 W. 44th St., Inc. v. Riverland Holding Corp., 44 N.Y.S.2d 766 (App. Div. 1st Dep't 1943).

210. Nonannulment: Fed. Home Loan Mortg. Corp. v. Dutch Lane Assocs., 775 F. Supp. 133, 139 (S.D.N.Y. 1991); Bank of Honolulu v. Anderson, 654 P.2d 1370, 1376 (Haw. Ct. App. 1982); Graf v. Hope Bldg. Corp., 171 N.E. 884 (N.Y. 1930); Salishan Hills, Inc. v. Krieger, 660 P.2d 160 (Or. Ct. App. 1983); Bell Fed. Sav. & Loan Ass'n v. Laura Lanes, Inc., 435 A.2d 1285 (Pa. Super. Ct. 1981) (noting that commercial property was involved). *Contra* Console v. Torchinsky, 116 A. 613 (Conn. 1922).

For the tendency of New York cases to distinguish *Graf* on equitable grounds, see Karas v. Wasserman, 458 N.Y.S.2d 280, 281–82 (App. Div. 3d Dep't 1982); Fairmont Assocs. v. Fairmont Estates, 472 N.Y.S.2d 208 (App. Div. 3d Dep't 1984).

211. Balducci v. Eberly, 500 A.2d 1042, 1049 (Md. 1985) (payment of delinquent taxes prior to commencement of the foreclosure action bars acceleration and foreclosure); Foothill Ind. Bank v. Mikkelson, 623 P.2d 748 (Wyo. 1981) (recognizing same rule, but finding taxes not paid when foreclosure began). *See* dissenting opinion of Cardozo, J., in Graf v. Hope Bldg. Corp., 171 N.E. 884, 887 (N.Y. 1930). *Contra* Derechinsky v. Epstein, 130 A. 720 (N.J. Ch. 1925), *aff'd*, 131 A. 922 (N.J. 1926).

ALASKA STAT. § 34.20.070(b) (1990) permits an obligor under a note secured by a deed of trust to terminate a non-judicial sale and undo the effect of an acceleration clause by paying all pre-acceleration arrears. The statute may be invoked no more than twice. Hagberg v. Alaska Nat'l Bank, 585 P.2d 559 (Alaska 1978). COLO. REV. STAT. § 38-39-118 (1990) is a similar statute, applicable to mortgage foreclosures, but not to an action on the note only. Smith v. Certified Realty Corp., 585 P.2d 293 (Colo. Ct. App. 1978).

212. Cardozo, J., in Graf v. Hope Bldg. Corp., 171 N.E. 884, 887 (N.Y. 1930).

213. *See In re* Stokes, 39 B.R. 336 (Bankr. E.D. Va. 1984); *In re* Wilder, 22 B.R. 294 (Bankr. M.D. Ga. 1982); *In re* Taddeo, 9 B.R. 299 (Bankr. E.D.N.Y. 1981). *Contra In re* LaPaglia, 8 B.R. 937 (Bankr. E.D.N.Y. 1981).

reinstatement of an accelerated mortgage debt prior to a foreclosure sale on payment of arrears without acceleration.[214]

§ 3A:1.5 Appointment of Receiver

The New York statutory form mortgage provides:

5. That the holder of this mortgage, in any action to foreclose it, shall be entitled to the appointment of a receiver.[215]

This clause entitles the mortgagee to the judicial appointment of a receiver without notice or regard to adequacy of the security of the debt.[216] Under the statutory construction, the mortgagee "shall be entitled, without notice and without regard to adequacy of any security of the debt, to the appointment of a receiver of the rents and profits of the premises covered by the mortgage."[217] The New York practice of dispensing with notice does not deprive a mortgagor of due process.[218] Under this clause, the mortgagee's procurement of a receiver does not require him to show probable success in the foreclosure action.[219]

Without the receivership clause the mortgagee must move for a receiver on notice and on proof of inadequacy of the security.[220] In

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214. *See* statutes collected in *In re* LaPaglia, 8 B.R. 937, 945 (Bankr. E.D.N.Y. 1981). A statutory modification that eliminated a mortgagor's right to reinstate a mortgage was held "substantial," as distinguished from "procedural," and was denied retroactive effect. Wash. Nat'l Ins. Co. v. Sherwood Assocs., 795 P.2d 665 (Utah Ct. App. 1990).

215. N.Y. REAL PROP. LAW § 258, Sch. M.

216. Baker v. Bloom, 536 N.Y.S.2d 267 (App. Div. 3d Dep't 1989).

217. N.Y. REAL PROP. LAW § 254(10).

218. Foxfire Enters., Inc. v. Enter. Holding Corp., 837 F.2d 597 (2d Cir. 1988) (*ex parte* appointment of receiver to collect rents in mortgage foreclosure action).

219. Meyer v. Indian Hill Farm, Inc., 258 F.2d 287 (2d Cir. 1958) (New York law); 366 Fourth St. Corp. v. Foxfire Enters., Inc., 540 N.Y.S.2d 489 (App. Div. 2d Dep't 1989).

Life Ins. Co. v. Hodroft Assocs., 606 A.2d 1150 (N.J. Super. Ct. 1992), departs from earlier New Jersey cases and grants a receiver on a comparable clause. If noted, the mortgagor was not liable on the mortgage debt.

Despite the clause a court has discretionary power to deny the application. *See* Home Title Ins. Co. v. Isaac Scherman Holding Corp., 267 N.Y.S. 84 (App. Div. 2d Dep't 1933) (delayed application).

Appointment of a prepetition receiver is not a preferential transfer in New York. *In re* Fin. Ctr. Assocs., L.P., 140 B.R. 828 (Bankr. E.D.N.Y. 1992).

220. First Nat'l Bank v. Caputo, 507 N.Y.S.2d 516 (App. Div. 3d Dep't 1986) (consent by owners/mortgagors, makes no difference when tenant in possession objected and mortgage did not authorize appointment of receiver).

federal courts a showing of more than inadequacy of security and doubtful financial standing of the debtor is necessary to warrant a receiver.[221] But when a federal bankruptcy court applies state law, as it must in determining whether a property interest has been perfected,[222] mortgagees filing a claim to cash collateral in the form of rental income[223] entitles the mortgagee to recover rental income where this would be true under state law.[224] Where the mortgagee is the Department of Housing and Urban Development (HUD), a federal interest is involved and federal, not state, law applies.[225] In many jurisdictions a mortgage provision for appointment of a receiver does not entitle a mortgagee to a receiver as a matter of right. These cases hold that the parties cannot force a court of equity to grant a remedy to a party who does not need it.[226]

The receivership clause may also contain the following obligations of an owner of the premises:

1. To pay to the receiver the use and occupational value of the premises.

Absent such provision, the owner may occupy the premises free during the pendency of a foreclosure.[227]

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221. Chase Manhattan Bank, N.A. v. Turabo Shopping Ctr., Inc., 683 F.2d 25 (1st Cir. 1982). *But cf. In re* Westwood Plaza Apts., Ltd., 154 B.R. 916 (Bankr. E.D.Tex. 1993).

For the Minnesota law, see *In re* Johnson, 108 B.R. 689 (Bankr. D. Minn. 1989).

In Florida, appointment of a receiver is a matter of judicial discretion not a matter of right. Barnett Bank v. Steinberg, 632 So. 2d 233 (Fla. Dist. Ct. App. 1994).

Appointment of a receiver is by federal standards, though once appointed his powers are those of the state. For the federal standards, see Midwest Sav. Ass'n v. Riversbend Assocs. P'ship, 724 F. Supp. 661 (D. Minn. 1989).

222. Butner v. United States, 440 U.S. 48, 55 (1979).

223. BANKRUPTCY CODE § 546(b).

224. Va. Beach Fed. Sav. & Loan Ass'n v. Wood, 901 F.2d 849 (10th Cir. 1990).

225. *In re* Westwood Plaza Apts., Ltd., 154 B.R. 916 (Bankr. E.D. Tex. 1993) (assignment of rents to mortgagee operated automatically on mortgagor's default).

226. *See* Barclays Bank P.L.C. v. Davidson Ave. Assocs., 644 A.2d 685 (N.J. Super. Ct. 1994) (citing many other states); 3 R. POWELL, REAL PROPERTY ¶ 465 (1994); 59 C.J.S. *Mortgages* § 663 (1949).

A prepetition demand by mortgagee had the same effect under a Florida statute that makes mortgagor's assignment of rents absolute upon mortgagor's default and mortgagee's written demand. *In re* 163rd St. Mini Storage, Inc., 113 B.R. 87 (Bankr. S.D. Fla. 1990).

227. Holmes v. Gravenhorst, 188 N.E. 285 (N.Y. 1933); 50 YALE L.J. 1424, 1433, 1442 (1941). *But see* Greenebaum Sons Bank & Tr. Co. v. Kingsbury, 248 Ill. App. 321 (1928) (owners of cooperative apartments liable for rent).

2. To permit the mortgagee, in event of default, to take possession of the premises and collect rent from the tenants and use and occupational value from an owner in possession.

This clause, however, is not effective for its stated purpose in New York[228] and in a number of other states where a mortgage is deemed a lien, as distinguished from the "title" theory states.[229] In those states, a mortgagee's right to possession can be predicated only upon a consent of the owner given after default or by the mortgagee's impounding the rents by receivership or otherwise. Despite this general rule, several states have held that a mortgage default plus a mortgagee's demand entitles the mortgagee to the rents.[230] The same

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Though a mortgagee may obtain a receiver without notice, the owner's liability for rent, or use and occupational value may be fixed only after notice. Essex v. Newman, 632 N.Y.S.2d 636 (App. Div. 2d Dep't 1995).

A mortgage provision entitling a receiver to rent and "use and occupational value" was one factor in disregarding a twenty-year lease at $1.00 a month rent. N.Y. City Cmty. Pres. Corp. v. Michelin Assocs., 496 N.Y.S.2d 530 (App. Div. 2d Dep't 1985).

228. Dime Sav. Bank v. Altman, 9 N.E.2d 778 (N.Y. 1937); Sullivan v. Rosson, 119 N.E. 405 (N.Y. 1918); 1180 Anderson Ave. Realty Corp. v. Mina Equities Corp., 465 N.Y.S.2d 511 (App. Div. 1st Dep't 1983) (entry on default, without permission, illegal).

229. *In re* Vill. Props., Ltd., 723 F.2d 441 (5th Cir. 1984) (Texas law); Prudential Ins. Co. of Am. v. Fifty Assocs., 503 F.2d 925 (9th Cir. 1974); *In re* Ventura-Louise Props., 490 F.2d 1141 (9th Cir. 1974) (California law); Democratic Cent. Comm. v. Wash. Met. Area Transit Comm., 21 F.3d 1145 (D.C. 1994) (District of Columbia law); *In re* Keller, 150 B.R. 836 (Bankr. N.D. Ga. 1993) (Georgia law); *In re* Harbour Point Ltd. P'ship, 132 B.R. 501 (Bankr. D.D.C. 1991) (Virginia law; distinguishes assignment for security from unconditional assignment); *In re* Raleigh/Spring Forest Apartments Assocs., 118 B.R. 42, 44 (Bankr. E.D.N.C. 1990); *In re* Winzenburg, 61 B.R. 141 (Bankr. N.D. Iowa 1986) (cites Iowa cases); *In re* Gotta, 47 B.R. 198, 203 (Bankr. W.D. Wis. 1985); *In re* Stuckenberg, 374 F. Supp. 15 (E.D. Mo. 1974) (Missouri law); *In re* DiToro, 17 B.R. 836 (Bankr. E.D. Pa. 1982); Fed. Nat'l Mortg. Ass'n v. Kostrunek, 228 F. Supp. 777 (S.D. Iowa 1964); Bevins v. Peoples Bank & Tr. Co., 671 P.2d 875 (Alaska 1983); Roosevelt Sav. Bank v. State Farm Fire & Cas. Co., 556 P.2d 823 (Ariz. Ct. App. 1976); Comerica Bank-Ill. v. Harris Bank, 673 N.E.2d 380 (Ill. App. Ct. 1996) (either actual or constructive possession is possession); Marcon v. First Fed. Sav. & Loan Ass'n, 374 N.E.2d 1028 (Ill. App. Ct. 1978); Wolf v. Greek Am. Realty Co., 190 N.E.2d 135 (Ill. App. Ct. 1963); Mut. Benefit Life Ins. Co. v. Frantz Klodt & Son, Inc., 237 N.W.2d 350 (Minn. 1975); Taylor v. Brennan, 621 S.W.2d 592 (Tex. 1981); Taylor v. Brennan, 605 S.W.2d 657 (Tex. Civ. App. 1980); Nat'l Bank v. Equity Inv'rs, 546 P.2d 440, 448 (Wash. 1976); Wuorinen v. City Fed. Sav. & Loan Ass'n, 191 N.W.2d 27 (Wis. 1971).

230. *In re* Wheaton Oaks Office Ltd. Partners, 27 F.3d 1234 (7th Cir. 1994); Fed. Home Loan Mortg. v. Tarrytown Corp., 822 F. Supp. 137 (S.D.N.Y. 1993). *Accord* Fed. Home Loan Mortg. Corp. v. Dutch Lane Assocs., 775 F. Supp. 133 (S.D.N.Y. 1991) (distinguishing cases where the rent assignment was

was true where a foreclosure was begun before a stay caused by the mortgagor's bankruptcy.[231]

3. To hold the rents and profits of the premises, after default, in trust to pay taxes, carrying charges, and for service of the mortgage debt.

In many states there is now a tendency for the mortgage to provide that the rents belong to the mortgagee immediately on default by the mortgagor and notice of the default by the mortgagee to the mortgagor.[232] This avoids the necessity of a receivership, but query if it assures the tenants who pay the rents that they will receive the

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only for security); *In re* 5028 Wis. Ave. Assocs., 167 B.R. 699 (Bankr. D.D.C. 1994) (rents to be used by mortgagee for maintaining property; landlord's demand before bankruptcy effective); *In re* Seaside Co., 152 B.R. 878 (Bankr. E.D. Pa. 1993) (Pennsylvania law). A clause entitling the mortgagee to the gross rents, giving him discretion to apply them or not to operation expenses was enforced. *In re* Union Partners, 165 B.R. 553 (Bankr. E.D. Pa. 1994) (Pennsylvania law).

This was true even though the instrument permitted the mortgagor to use the rents until default and despite the mortgagor's filing for bankruptcy a few days after the default. *In re* Scotsdale Med. Pavilion, 159 B.R. 295 (B.A.P. 9th Cir. 1993).

The distinction between an absolute assignment and one "for further security" was also made in *In re* Vienna Park Props., 136 B.R. 43 (Bankr. S.D.N.Y. 1992) (Virginia law). *Vienna Park* distinguishes between a mortgagee's perfection of a right to rent, which may be merely by recordation, and its enforcement. The case determines the mortgagee's right in bankruptcy of the mortgagor. *Vienna Park* determined that mortgagee's right to rents failed because it was not enforced prior to bankruptcy. (*Accord In re* Vienna Park, 976 F.2d 106 (2d Cir. 1992)). Following *Vienna Park*, 136 B.R. at 54, *In re* Mount Pleasant Ltd. P'ship, 144 B.R. 727 (Bankr. W.D. Mich. 1992), ruled that perfection of a lien is putting third parties on notice, while its enforcement realizes the right; and that mortgagee's notice in bankruptcy (while a stay is in force) has the same effect. *Mt. Pleasant* was disregarded on the basis of MICH. COMP. LAWS ANN. § 554.232 (1988); *In re* Newberry Square, 175 B.R. 910 (Bankr. E.D. Mich. 1994). Connecticut is in accord with *Vienna Park* on the distinction of assignment and perfection of the right to rents. It held that an assignment of existing and future rents was sufficient to vest a right to the rents without more, prevailing over a creditor under CONN. GEN. STAT. § 49-10 (1994).

231. *In re* Nw. Commons, Inc., 136 B.R. 215 (Bankr. E.D. Mo. 1991) (noting demand was made before tenant's bankruptcy); *In re* S. Pointe Assocs., 161 B.R. 224 (Bankr. E.D. Mo. 1993) (mortgagee had also demanded rents from tenants); Bevins v. Peoples Bank & Tr. Co., 671 P.2d 875 (Alaska 1983).

232. Until the mortgagee takes actual possession it has no right to the rents. *In re* Ledgemere Land Corp., 116 B.R. 338 (Bankr. D. Mass. 1990). But it has also been held in Massachusetts, a title state, that mortgagor's default and mortgagee's demand establish mortgagee's right to rents, although there was no collection until after mortgagor's bankruptcy. *In re* White Plains Dev. Corp., 136 B.R. 93 (Bankr. S.D.N.Y. 1992) (Massachusetts law).

maintenance and services they are entitled to from the mortgagor. A federal court sitting in New York enforced such a clause.[233] But a clause stating it is absolute but permitting the mortgagor to collect rents until a default or otherwise, qualifying its enforcement, is construed as merely for security and not an absolute assignment.[234] In Colorado and New Jersey an assignment of rents clause in a mortgage may be self-executing upon default, as distinguished from a pledge of rents as a security device that requires affirmative action by the mortgagee.[235] In Indiana an assignment of rents to a mortgagee as security, followed by a mortgagor's default, a foreclosure, and appointment of a receiver, did not give title to the rents to the mortgagee where all this was followed by the mortgagor's bankruptcy under Chapter 11, with the mortgagor as a debtor in possession. The mortgagee's receiver was held a mere custodian of the rents without title. Title was held in the estate of the debtor.[236] In Delaware, a lien state, an absolute

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In practical terms, the difference between a "lien theory" and a "title theory" as to the nature of a mortgage is that under the latter the mortgagee may enter into possession of the mortgaged premises upon default and before foreclosure, whereas under the "lien theory" there is no right of possession; the mortgagee must await sale of the mortgaged property and obtain satisfaction of the mortgagor's debt from the proceeds of sale. Maglione v. BancBoston Mortg. Corp., 557 N.E.2d 756, 758 (Mass. App. Ct. 1990).

233. *In re* Carmania Corp., 154 B.R. 160 (Bankr. S.D.N.Y. 1993). *Accord In re* McCann, 140 B.R. 926 (Bankr. E.D. Mass. 1992) (Ohio law). *See* Randolph, *Recognizing Lender's Rents Interests in Bankruptcy*, 27 REAL PROP., PROB. & TR. J. 281 (1992); Randolph, *The Mortgagee's Interest in Rents: Some Policy Considerations and Proposals*, 29 KAN. L. REV. 1 (1980).

234. United States v. Redevelopment Agency, 926 F. Supp. 928 (N.D. Cal. 1995); *In re* Koula Enters., Ltd., 197 B.R. 753 (Bankr. E.D.N.Y. 1996); *In re* Turtle Creek Ltd., 194 B.R. 267 (Bankr. N.D. Ala. 1996); *In re* Raleigh/Spring Forest Apartments Assocs., 118 B.R. 42 (Bankr. E.D.N.C. 1990).

235. McArthur Exec. Assocs. v. State Farm Life Ins. Co., 190 B.R. 189 (Bankr. D.N.J. 1995); *In re* Princeton Overlook Joint Venture, 143 B.R. 625 (Bankr. D.N.J. 1992) (extended discussion of cases); *In re* Pine Lake Vill. Apartment Co., 17 B.R. 829, 833 (Bankr. S.D.N.Y. 1982); Great W. Life Ins. Co. v. Raintree Ins., 837 P.2d 267 (Colo. Ct. App. 1992); Int'l Bus. Machs. Corp. v. Axinn, 676 A.2d 552 (N.J. Super. Ct. 1996); Stanton v. Metro. Lumber Co., 152 A. 653 (N.J. Ch. 1930); Paramount Bldg. & Loan Ass'n v. Sacks, 152 A. 457 (N.J. Ch. 1930).

Even in Florida, a pledge of rents requires a mortgagee to take possession or obtain a receiver. *In re* Ormand Beach Assocs., Ltd. P'ship, 204 B.R. 336 (Bankr. D. Conn) (citing Florida cases).

Wisconsin upholds provisions entitling a mortgagee to rents on default, although it disapproves of them because they afford an easy way of evading the lien theory. *In re* Century Inv. Fund VIII Ltd. P'ship, 937 F.2d 371, 377 (7th Cir. 1991). In *Century*, the court noted that the mortgagee had taken further affirmative action.

236. *In re* Willows of Coventry, Ltd. P'ship, 154 B.R. 959 (Bankr. N.D. Ind. 1993).

assignment was held merely for security in the face of inconsistent language. The case noted that some title states would reach the same result.[237] Iowa holds that a mortgage that grants rents, in distinction to pledging them, entitles the mortgagee, as against the mortgagor, to rents from the inception of the mortgage with no further action by the mortgagee.[238] Other states hold that an unconditional assignment of rents to the mortgagee entitles the mortgagee without more, other than possible remand, on the mortgagor's default.[239] In a "title" state then the mortgagee is automatically entitled to the rents on the mortgagor's default,[240] but this is not always true in the bankruptcy of the mortgagor.[241]

A mortgagee who was barred from enforcing his right to rents, by reason of an automatic stay in the bankruptcy of his mortgagor, was held entitled to receive rents collected by the trustee in bankruptcy after the stay was lifted.[242]

The effect of the mortgagor's bankruptcy on the mortgagee's right to post-petition rents should be noted. In a title theory state, a mortgagee's right accrues on default in the mortgage, which is not

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237. *In re* Guardian Realty Grp., 205 B.R. 1 (Bankr. D.D.C. 1997) (Delaware law).

238. *In re* Porter, 90 B.R. 399 (N.D. Iowa 1988); Fed. Land Bank v. Lower, 421 N.W.2d 126 (Iowa 1988).

239. Fed. Deposit Ins. Corp. v. Int'l Prop. Mortg., Inc., 929 F.2d 1033 (5th Cir. 1991) (applying Texas law); *In re* Somero, 122 B.R. 643 (Bankr. D. Me. 1991); *In re* Galvin, 120 B.R. 767 (Bankr. D. Vt. 1990) (said to be minority rule); *In re* Townside Partners, 125 B.R. 8 (Bankr. W.D. Va. 1991).

Kansas and Virginia have statutes protecting a mortgage that includes an assignment of rent, or a separate assignment of rent, and makes it unnecessary to take possession or have a receiver appointed. KAN. STAT. § 8-2343 (1991) (effective May 23, 1991); *In re* Kan. Office Assocs. Ltd., 173 B.R. 745 (Bankr. D. Kan. 1994). This in effect overrules *In re* Wiston Ltd. P'ship, 141 B.R. 429, 432 (Bankr. D. Kan. 1992); VA. CODE ANN. § 55-22-1 (Laws 1992, ch. 667).

The Virginia statute fully protects a mortgagee who records a mortgage that includes an assignment of rent and makes it unnecessary to take possession or have a receiver appointed. The responsibility and disadvantages of a mortgagee taking possession are noted in *In re* Hall Coltree Assocs., 146 B.R. 675, 677 (Bankr. E.D. Va. 1992). Similar to the Virginia statute is 1991 Kan. Sess. Laws. ch. 161, at 1067–68, which in effect overrules *In re* Wiston Ltd. P'ship, 141 B.R. 429, 432 (Bankr. D. Kan. 1992), *appealed*, 147 B.R. 575 (Bankr. D. Kan. 1992).

240. *See In re* Epco Newport News Assocs., 14 B.R. 990, 995 (Bankr. S.D.N.Y. 1981). *See also* Kelley/Lehr & Assocs., Inc. v. O'Brien, 551 N.E.2d 419 (Ill. App. Ct. 1990), discussing the distinction in this respect between lien and title states and the effect of the Illinois change from title to lien state.

241. *See In re* Turtle Creek Ltd., 194 B.R. 267 (Bankr. N.D. Ala. 1996) (Alabama law); *In re* Lyons, 193 B.R. 637 (Bankr. D. Mass. 1996).

242. Hoelting Enters. v. Tailridge Inv'rs, L.P., 844 P.2d 745 (Kan. Ct. App. 1993); *In re* Sam A. Tisci, Inc., 133 B.R. 857 (Bankr. N.D. Ohio 1991).

changed by bankruptcy.[243] In a lien state there is a split. There it has been held that bankruptcy of the mortgagor, and its consequent automatic stay, does not bar the mortgagee's right to rents if he files a post-petition notice of this claim under section 546(b) of the Bankruptcy Code.[244] However, there is solid authority contra.[245]

By obtaining a receiver instead of being a mortgagee in possession the mortgagee avoids the responsibility of a mortgagee in possession. A mortgagee in possession has the right and duty to collect rents and is liable for waste or gross mismanagement of the property or its depreciation due to a failure to make necessary and proper repairs.[246]

The right of a mortgagee in possession or a receiver to collect rents that are past due when the receiver is appointed or the mortgagee takes possession is the subject of slight authority.[247]

A substantial mortgage of commercial property may include a broad rent pledge covering "rents, issues, revenues, and profits," or the like. If

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243. *In re* McCutchen, 115 B.R. 126 (Bankr. W.D. Tenn. 1990) (construing TENN. CODE ANN. § 66-26-116 (Acts 1989, ch. 213, § 30)); *In re* Epco Newport News Assocs., 14 B.R. 990 (Bankr. S.D.N.Y. 1981).

244. *In re* Colter, Inc., 46 B.R. 510 (Bankr. D. Colo. 1984). Saline State Bank v. Mahloch, 834 F.2d 690 (8th Cir. 1987) (construing Nebraska law), involved Chapter 11 proceedings that were begun before the mortgage went into default. It held that the mortgagee's right to rents did not accrue upon the post-petition default, but not until the mortgagee's application to sequester the rents.

245. *In re* Winzenburg, 61 B.R. 141 (Bankr. N.D. Iowa 1986); *In re* Gotta, 47 B.R. 198 (Bankr. W.D. Wis. 1985). Commerce Bank v. Mountain View Vill., Inc., 5 F.3d 34 (3d Cir. 1993); *In re* Westport-Sandpiper Assocs. Ltd. P'ship, 116 B.R. 355 (Bankr. D. Conn. 1990).

Saline State Bank v. Mahloch, 834 F.2d 690 (8th Cir. 1987) (construing Nebraska law), involved Chapter 11 proceedings that were begun before the mortgage went into default. It held that the mortgagee's right to rents did not accrue upon the post-petition default, but not until the mortgagee's application to sequester the rents.

246. *In re* Raleigh/Spring Forest Apartments Assocs., 118 B.R. 42, 44–45 (Bankr. E.D.N.C. 1990); Marcon v. First Fed. Sav. & Loan Ass'n, 374 N.E.2d 1028, 1030 (Ill. App. Ct. 1978); Prince v. Brown, 856 P.2d 589 (Okla. Ct. App. 1993); 3 R. POWELL, REAL PROPERTY ¶ 454 (1994).

Mortgagee's suggestion of the name of a receiver who is subsequently appointed does not make the receiver an agent of the mortgagee or make the mortgagee liable for deterioration of the property during the receivership. *In re* Greenleaf Apts., Ltd., 158 B.R. 456 (Bankr. S.D. Ohio 1993).

Acceptance of rent by a mortgagee in possession does not convert him into a landlord or preclude him from purchasing at foreclosure and terminating a lease. Reilly v. Firestone Tire & Rubber Co., 764 F.2d 167, 172 (3d Cir. 1985); 51C C.J.S. *Landlord & Tenant* § 93(5), at 309 (1968).

247. MDFC Loan Corp. v. La Salle Nat'l Bank, 834 F. Supp. 275 (N.D. Ill. 1993), awarded such rents to the receiver after a good discussion and citing older cases that are not clearly applicable. It remarked that a mortgagor in default is in no position to object to back rents being applied to the debt, but indicates a different position if nonpayment was due to collusion.

the mortgagor operates a business that generates income from the operation of real estate, as well as from business operations, there may be a conflict on what is included in the rent pledge. The scope of rent pledges by hotels has proven to be a vexing problem. The majority cases hold that income from hotel rooms is not rent.[248] One case ruled that room charges were not rent, but were included in "issues and revenues."[249] Income from the restaurant and bar was not included, nor was income from the sale of tangible items.

Similar problems arise for other businesses. Revenues from a nursing home were deemed based mainly on service and not rent.[250] Income of a golf course—fees, receipts of bar and restaurant, and sales—were not rent.[251] A storage bin agreement was held a lease and payments thereunder cash collateral.[252] "Tipping fees," that is, charges for depositing waste in a land fill, are not "rents or profits of property," but instead are revenues derived from a business operation.[253]

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248. *In re* Tollman-Hundley Dalton, L.P., 162 B.R. 26 (Bankr. N.D. Ga. 1993); *In re* Shore Haven Motor Inn, Inc., 124 B.R. 617 (Bankr. S.D. Fla. 1991); *In re* Punta Gorda Assocs., 137 B.R. 535 (Bankr. M.D. Fla. 1992); *In re* Nendels-Medfor Joint Venture, 127 B.R. 658 (Bankr. D. Or. 1991) (also holding income from food and beverages not rent; distinguishing *In re* Mid-City Hotel Assocs., on ground of broad language quoted above). *Contra In re* T-H New Orleans Ltd. P'ship, 148 B.R. 456 (E.D. La. 1992); *In re* S.F. Drake Hotel Assocs., 131 B.R. 156 (Bankr. N.D. Cal. 1991). *See* Donahue & Edwards, *The Treatment of Assignments of Rents in Bankruptcy; Emerging Issues Relating to Perfections, Cash Collateral, and Plan Confirmation*, 48 BUS. LAW. 633, 639–40 (1993). The majority cases are the subject of an extended criticism for their reasoning, as well as their result in diluting a lender's security and making financing difficult for hotels. Boyce, *Hotel Revenues in Bankruptcy: An Analysis and Analytic Framework*, 28 REAL PROP. PROBATE & TR. J., 535–92 (Fall 1993).

249. *In re* Mid-City Hotel Assocs., 114 B.R. 634 (Bankr. D. Minn. 1990). In Great W. Life Ins. Co. v. Raintree Ins., 837 P.2d 267 (Colo. Ct. App. 1992), the assignment clause was broad enough to include the entire hotel income. *Accord In re* Churchill Props., Ltd. P'ship, 164 B.R. 607 (Bankr. N.D. 1994) ("rent issues and profits sufficient to make hotel income rents"); Great W. Life & Annuity Assurance Co. v. Park Imperial Canton, Ltd., 177 B.R. 843 (Bankr. N.D. Ohio 1994) ("profit," as distinguished from rent, includes hotel revenues—room revenues, food, beverages, etc.; remanded to determine if filing sufficient under Ohio statute); Travelers Ins. Co. v. First Nat'l Bank, 621 N.E.2d 209 (Ill. App. Ct. 1993) (same), *contra In re* Tri-Growth Ctr. City, Ltd., 133 B.R. 524 (Bankr. S.D. Cal. 1991).

In re Kearney Hotel Partners, 92 B.R. 95, 99 (Bankr. S.D.N.Y. 1988), indicates that longer hotel stays and other circumstances may make hotel income rent more of a lease.

250. *In re* Hillside Assocs., Ltd. P'ship, 121 B.R. 23 (B.A.P. 9th Cir. 1990).

251. *In re* McCann, 140 B.R. 926 (Bankr. D. Mass. 1992) (Ohio law).

252. *In re* Safeguard Self-Storage Tr., 2 F.3d 967 (9th Cir. 1993) (California law).

253. *In re* W. Chestnut Realty, Inc., 173 B.R. 322 (Bankr. E.D. Pa. 1994).

§ 3A:1.6 Payment of Taxes and Charges

The New York statutory form mortgage provides:

> 6. That the mortgagor will pay all taxes, assessments or water rates, and in default thereof, the mortgagee may pay the same.[254]

The statutory construction makes the mortgagee's advances for these purposes additions to the mortgage debt.[255] This part of the statute is unnecessary. It merely codifies the mortgagee's common law rights.[256] Advances so made by the holder of a junior mortgage remain subordinate, under the majority rule, to the lien of a paramount mortgage.[257] If the tax is legal on its face, it is immaterial that the mortgagor claims that it is invalid. The mortgagee need not contest its legality at his own expense or let it go unpaid at his peril.[258]

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254. N.Y. REAL PROP. LAW § 258, Sch. M.

255. N.Y. REAL PROP. LAW § 254(6) (if mortgagee pays taxes, "the mortgagor will repay the same with interest, and the same shall be liens on said premises and secured by the mortgage").

256. *In re* Plunket, 191 B.R. 768 (Bankr. E.D. Wis. 1995); Stafford v. Russell, 255 P.2d 814 (Cal. 2d Dist. Ct. App. 1953); Sidenberg v. Ely, 90 N.Y. 257 (1882); Pa. Co. for Ins. on Lives v. Bergson, 159 A. 32 (Pa. 1932); *accord* Scult v. Bergen Valley Builders, Inc., 197 A.2d 704 (N.J. Super. Ct. 1964); 3 T. COOLEY, TAXATION § 1263 (4th ed. 1924); Annot., 60 A.L.R. 425 (1929); Annot., 84 A.L.R. 1366 (1933); Annot., 123 A.L.R. 1248 (1939); 55 AM. JUR. 2d *Mortgages* §§ 2 & 4, 295 (1971).

The mortgagee is entitled to reimbursement only on showing he paid the taxes. Law v. Dewoskin, 447 S.W.2d 361 (Tenn. 1969).

257. Pearmain v. Mass. Hosp. Life Ins. Co., 92 N.E. 497 (Mass. 1910); Laventall v. Pomerantz, 188 N.E. 271 (N.Y. 1933); Buskirk v. State-Planters Bank & Tr. Co., 169 S.E. 738 (W. Va. 1933); Annot., 61 A.L.R. 587, 604 (1929); Annot., 106 A.L.R. 1212, 1222 (1937); Annot., 123 A.L.R. 1248, 1261 (1939).

Mortgagee's claim for tax payments is part of the mortgage debt and is unenforceable after foreclosure satisfies the mortgage debt. *Plunkett*, 191 B.R. 768; 55 AM. JUR. 2d *Mortgages* § 548 (1971).

It is immaterial whether the mortgage expressly permits the mortgagee to add the advance to the mortgage debt, *Buskirk*, 169 S.E. 738, or includes no such provision, *Pearmain*, 92 N.E. 497. A junior mortgagee who pays the taxes thereby bars the senior mortgagee from foreclosing for nonpayment, and may not thereafter assert their existence as against the senior mortgagee, *Laventall*, 188 N.E. 271.

A mortgagor cannot buy a tax title and assert it successfully against a mortgagee. Danforth v. Gautreau, 556 A.2d 217 (Me. 1989) (mortgagor failed to pay real estate taxes).

The minority cases are collected in Annot., 84 A.L.R. 1366, 1393 (1933).

258. Garland v. Fed. Land Bank, 140 A.2d 568 (N.H. 1958) (and authorities collected). *Cf.* Strong v. Merchs. Mut. Ins. Co., 309 N.E.2d 510 (Mass. App. Ct. 1974) (mortgagee entitled to treat insurer's improper cancellation of insurance as default by mortgagor).

The liquidation of charges for real estate taxes, water charges, and assessments is necessary because the liens of these items are paramount to existing mortgages.[259]

A mortgage is paramount to a federal tax lien subsequently filed against the mortgagor.[260] Advances made by the holder of such mortgage for taxes, water, insurance, and other charges are also paramount to the federal tax lien, even though the advances were made after the federal lien was filed. This is one change effected by the Federal Tax Lien Act of 1966.[261] Before this, advances made after the filing of the federal lien were subordinate thereto, although made to protect a prior mortgage.[262]

§ 3A:1.7 Estoppel Certificate

The New York statutory form mortgage provides:

> 7. That the mortgagor within ___ days upon request in person or within ___ days upon request by mail will furnish a written statement duly acknowledged of the amount due on this mortgage and whether any offsets or defenses exist against the mortgage debt.[263]

This statement is known as an "estoppel certificate." A mortgage securing a bond is a nonnegotiable instrument and an assignee takes subject to any defenses good as against the mortgagee.[264] In

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259. Sec. Building & Loan Ass'n v. Carey, 18 N.Y.S.2d 511 (App. Div. 4th Dep't 1940), *aff'd*, 36 N.E.2d 690 (N.Y. 1941); *see* Annot., 75 A.L.R.2d 1121 (1961). *Contra*, as to water charges, Higley v. City of Sacramento, 149 F. Supp. 118 (N.D. Cal. 1957).

A provision for payment of taxes when due was held enforceable, although no tax foreclosure was possible for three years. Resolution Tr. Corp. v. Friesen, 783 F. Supp. 1292 (D. Kan. 1992).

260. I.R.C. § 6323(a) (1954). A requirement that mortgagor pay all taxes and assessments that may become liens was held inapplicable to income taxes. Denise v. Paxson, 413 S.E.2d 433 (Ga. 1992).

A statute requiring the notice of federal lien to contain a description of the property is not binding on the federal government. The notice was held sufficient as against a subsequently recorded mortgage. United States v. Union Cent. Life Ins. Co., 368 U.S. 291 (1961).

261. I.R.C. § 6323(e) (1954) (as amended in 1966 by Pub. L. No. 89-719).

262. United States v. Buffalo Sav. Bank, 371 U.S. 228 (1963) (advances for taxes) discussed at length in Creedon, *On Mortgage Foreclosures and Federal Tax Liens*, 18 BUS. LAW. 1117 (1963); United States v. Bond, 279 F.2d 837 (4th Cir. 1960), noted in 13 STAN. L. REV. 389 (1961) (same); First Fed. Sav. & Loan Ass'n v. Lewis, 218 N.Y.S.2d 857 (App. Div. 2d Dep't 1961) (tax and insurance advances). *Contra* Fischer v. Hoyer, 121 N.W.2d 788 (N.D. 1963).

263. N.Y. REAL PROP. LAW § 258, Sch. M.

264. *In re* Levine, 23 B.R. 410, 413 (Bankr. S.D.N.Y 1982); Atl. Seabord Co. v. Borough of Seaside Park, 115 A.2d 110 (N.J. Super. Ct. 1955); Liebowitz v.

New York the assignee is also subject to any latent equities that may exist in favor of unknown third parties.[265] This rule is limited almost entirely to New York.[266] The same is true where the mortgage secures a nonnegotiable note.[267] This rule does not apply to agreements that are merely collateral to the mortgage and are not a part of the consideration that was the basis or foundation of the mortgage or was expressed in the mortgage.[268] No well-advised party will accept an assignment of such mortgage without an estoppel certificate, and this clause entitles the mortgagee to one whenever the occasion requires.

More points should be noted about assignments of mortgages. An assignment of a mortgage or other security agreement, without including the mortgage note or bond or other evidence of the debt, is a nullity and vests no rights in the assignee.[269] Conversely, one who pays a mortgage note, negotiable or not, or a mortgage bond without obtaining a surrender of such instrument is chargeable with notice of its possible assignment to a third person or some other defect in the payee's position, and runs the risk of having to pay again to the then-owner of the instrument.[270] An assignor of a mortgage warrants by implication that the mortgage is what it purports to be; that is, an existing valid legal obligation enforceable against the property ostensibly secured thereby, without guaranteeing its collection.[271]

Arrow Roofing Co., 182 N.E. 58 (N.Y. 1932); Kommel v. Herb-Gner Constr. Co., 176 N.E. 413 (N.Y. 1931); TRW-Title Ins. Co. v. Stewart Title Guar. Co., 832 S.W.2d 344 (Tenn. Ct. App. 1991); 59 C.J.S *Mortgages* § 368 (1949).

For a discussion of estoppel certificates, the effect of duress in obtaining them, and of the assignee's knowledge of defenses, see Hammelburger v. Foursome Inn-Corp., 431 N.E.2d 278 (N.Y. 1981).

265. *In re* Levine, 23 B.R. 410 (Bankr. S.D.N.Y. 1982); Schafer v. Reilly, 50 N.Y. 61 (1872); 55 AM. JUR. 2d *Mortgages* § 1042 (1996). Protection against the debtor is possible by an estoppel certificate from the debtor. This is not possible against unknown third persons.

266. 55 AM. JUR. 2d *Mortgages* § 1303 (1971); 59 C.J.S *Mortgages* § 371 (1948).

267. Holly Hill Acres, Ltd. v. Charter Bank, 314 So. 2d 209 (Fla. Dist. Ct. App. 1975); Mid-State Homes, Inc. v. Donnelly, 574 P.2d 1036 (Okla. 1978).

268. McCune v. Gross, 105 A.2d 367 (Pa. 1954).

269. *In re* Hurricane Resort Co., 30 B.R. 258 (Bankr. S.D. Fla. 1983); Kluge v. Fugazy, 536 N.Y.S.2d 92 (App. Div. 2d Dep't 1988).

270. Assets Realization Co. v. Clark, 98 N.E. 457 (N.Y. 1912); *see also* Rodgers v. Seattle-First Bank, 697 P.2d 1009 (Wash. Ct. App. 1985); RESTATEMENT (SECOND) OF CONTRACTS § 338 comment h (1981). But payment of a mortgage to the named mortgagee, without notice of its assignment, was held effective to discharge the mortgage. Sixty St. Francis St., Inc. v. Am. Sav. & Loan Ass'n, 554 So. 2d 1003 (Ala. 1989).

271. Gen. Elec. Credit Corp. v. Air Flow Indus., Inc., 432 So. 2d 607 (Fla. Dist. Ct. App. 1983); 5 H. TIFFANY, REAL PROPERTY § 1448 (3d ed. 1939);

Adding "without recourse" to the assignment indicates merely that there is no guaranty the debtor will pay the debt, but does not eliminate the implied representation that the mortgage is valid and effective.[272]

§ 3A:1.8 Notices

The New York statutory form mortgage provides:

8. That notice and demand or request may be in writing and may be served in person or by mail.[273]

In the absence of this provision, notice or demand by a mortgagee, or under any agreement or statute, generally must be made in person.[274] This may be as difficult at times as the service of process.

§ 3A:1.9 Warranty of Title

The New York statutory form mortgage provides:

9. That the mortgagor warrants the title to the premises.[275]

Without such covenant the mortgage does not impliedly warrant title; it operates only upon the present right of the mortgagor and an after-acquired right or title does not inure to the benefit of the mortgagee.[276] But, if there is an express warranty of title in the mortgage, then if an interest that the mortgage purports to cover is not owned by the mortgagor at the inception of the mortgage, the mortgagor's subsequent acquisition of such interest brings the same under the mortgage, on theory of estoppel.

The cases conflict on the application of this rule to purchase money mortgages.[277] Some courts have distinguished purchase money

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9 G. THOMPSON, REAL PROPERTY § 4792, at 578 (repl. 1958); 59 C.J.S *Mortgages* § 365 (1949); 6 AM. JUR. 2d *Assignments* § 107 (1963). The same applies to assignment of a contract of sale.

272. Gen. Elec. Credit Corp. v. Air Flow Indus., Inc., 432 So. 2d 607 (Fla. Dist. Ct. App. 1983); 6 AM. JUR. 2d *Assignments* § 107 (1963).

273. N.Y. REAL PROP. LAW § 258, Sch. M.

274. Steinhardt v. Bingham, 75 N.E. 403 (N.Y. 1905) (seller's contract obligation to give buyer notice of name of steamship and quantity of goods "within five days of the date of bill of lading" requires actual notice).

275. N.Y. REAL PROP. LAW § 258, Sch. M.

276. Smyth v. Rowe, 33 Hun. 422 (1st Dep't 1884), *aff'd*, 98 N.Y. 665 (1885). *But compare* Robinson Shore Dev. Co. v. Gallagher, 128 A.2d 884, 887–88 (N.J. Super. Ct. Ch. Div.), *aff'd*, 133 A.2d 353 (N.J. Super. Ct. App. Div. 1957), *rev'd on other grounds*, 138 A.2d 726 (N.J. 1958).

Operation of the warranty on after-acquired title may involve priorities vis-à-vis bona fide purchasers. *See* section 8:14.5.

277. Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224, 244 (1940).

mortgages from others, refusing to apply the doctrine of estoppel by deed, reasoning that any initial shortage results from the mortgagee-vendor's failure to convey enough.[278] This would not apply where the purchase money mortgage runs to a third person advancing part of the purchase price.

§ 3A:1.10 Adding Other Clauses to New York Statutory Form

The following sections discuss additional clauses, besides the New York statutory clauses in their original or amplified versions, which mortgagees often add to their instruments, in New York and in other states.

In New York, where the statutory form is amplified and added to, a provision may be included to the effect that the additional provisions shall be deemed in addition to and not exclusive of the statutory provisions, and that the latter shall receive the statutory construction. The purpose of this clause is to avoid the few questionable decisions that limit a statutory construction to mortgages following the statutory form literally.[279]

§ 3A:2 Dragnet

A "dragnet" clause provides that the mortgage also secures other obligations that the mortgagor owes or in the future may owe to the mortgagee. Dragnet clauses present special problems. Courts have developed several different approaches to dragnet clauses. One approach is highly deferential to freedom of contract and is formalistic. If the literal language of the dragnet clause encompasses the other

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278. Robinson Shore Dev. Co. v. Gallagher, 133 A.2d 353 (N.J. Super. Ct. App. Div. 1957), *rev'd on other grounds*, 138 A.2d 726 (N.J. 1958), holds that where both deed and purchase money mortgage, which are part of the same transaction, contain covenants of title, the mortgagee is not entitled to a lien on an after-acquired title of the mortgagor, but is restricted to the title that he had conveyed to the mortgagor.

A grantee is not estopped from recovering against his grantor on a covenant against encumbrances by reason of a similar covenant in a purchase money mortgage running from the grantee to the grantor. Haynes v. Stevens, 11 N.H. 28 (1840). But where the purchase money mortgage contains a warranty of title, and the deed is without warranty, an after-acquired title of the mortgagor inures to the benefit of the mortgagee. Saunders v. Publishers' Paper Co., 208 F. 441 (D.N.H. 1913).

279. Williams v. Wisner Bldg. Co., 200 N.Y.S. 802 (Sup. Ct. N.Y. Cty. 1923), *aff'd*, 203 N.Y.S. 959 (App. Div. 1st Dep't 1924); Leakey v. Schwing, 270 N.Y.S. 69 (Cty. Ct. Jefferson Cty. 1934); *see* N.Y. LEGIS. DOC. No. 65(H)41 (1945).

debt, it is secured by the mortgage. Georgia cases exemplify this approach. In Georgia, an open end or "dragnet" clause mortgage, which secures "any other present or future indebtedness," may be increased, after purchaser's acquisition of title, by loans made to the original mortgagor.[280] By statute, tort claims are excluded from the dragnet.[281]

At the other end of the spectrum, some states apply a bright-line rule that refuse to secure existing obligations through a dragnet unless specifically described in the mortgage.[282] The dragnet clause is not sufficient to sweep in the obligation. The rationale is that the mortgage could have explicitly described the debt, rather than relying upon the general language of the dragnet clause. In many states, another rule limits the application of a dragnet clause to the same or a series of similar transactions unless otherwise specified.[283] Dragnet clauses are construed against the mortgagee and have been denominated "anaconda mortgages" for their tendency to enwrap a mortgagor in debts he did not contemplate.[284]

Many jurisdictions follow an intermediate approach that rejects per se rules. The dragnet clause is one factor to be analyzed to determine whether the other debt is secured, but the clause is not conclusive. Under this approach, the lender bears the burden of proving that the parties intended existing or contemporaneous debts to be within the scope of the dragnet clause.[285]

When there are multiple mortgagors, the issue sometimes arises as to whether the dragnet clause covers only joint obligations of all of the mortgages or also extends to a sole obligation of an individual mortgagor. The issue is one of intent, resolved by examination of

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280. Commercial Bank v. Readd, 242 S.E.2d 25 (Ga. 1978); Courson v. Atkinson & Griffin, Inc., 198 S.E.2d 675 (Ga. 1973).
281. GA. CODE § 44-14-1.
282. United Nat'l Bank v. Tellan, 644 So. 2d 97 (Fla. Dist. Ct. App. 1994).
283. *In re* Ballarino, 180 B.R. 343 (Bankr. D. Mass. 1995); *In re* Mullan, 196 B.R. 818, 827–29 (Bankr. W.D. Ark. 1996) (with broad dragnet clause, citing Union Nat'l Bank v. First State Bank & Tr. Co., 697 S.W.2d 940 (Ark. Ct. App. 1985), and other cases with similar clauses); Sowers v. Fed. Deposit Ins. Corp., 96 B.R. 897 (Bankr. S.D. Iowa 1989).
284. Berger v. Fuller, 21 S.W.2d 419, 421 (Ark. 1929). *See also* Merchs. Nat'l Bank v. Stewart, 608 So. 2d 1120, 1125–27 (Miss. 1992) (narrow construction against mortgagee). For a detailed discussion and authorities of the debts included by dragnet clauses and the differences among states in interpreting the clauses, see Lundgren v. Nat'l Bank, 756 P.2d 270, 277–80 (Alaska 1987). Restrictions on the scope of dragnet clauses are discussed in Decorah State Bank v. Zidlicky, 426 N.W.2d 388 (Iowa 1988).
285. Fischer v. First Int'l Bank, 1 Cal. Rptr. 3d 162 (Ct. App. 2003) (finding ambiguity as to whether dragnet clause made borrower's residence security for business loan).

the particular clause.[286] A Georgia case holds that a security deed executed by a married couple covered the individual debts of each spouse, relying in part on the security deed's boilerplate statement that the terms "grantor" and "grantee" . . . "shall be construed to mean both the singular and the plural."[287] A court, however, may impose limitations even if the dragnet clause is clear, especially in the context of marital property. A Wisconsin case allows a dragnet clause to reach a husband's subsequent loan only if the loan was "in the interest of the marriage or the family."[288]

The dragnet mortgage is a relative minor example of the broader and much more used mortgage for future advances. If a mortgage provides for obligatory advances, they have priority over subsequent liens. But if the advances are optional, and the mortgagee had knowledge of subsequent liens at the time the advances are made, these lose priority over the subsequent liens. If, however, the mortgagee does not have such knowledge, the optional advances take priority whether made before or after the subsequent liens, and in this connection the mortgagee must have actual knowledge of the subsequent liens, not the constructive knowledge imparted by their recordation.[289] In other words, the mortgagee need not check the records before making subsequent advances.[290]

§ 3A:3 Due-on-Sale

§ 3A:3.1 History

Prior to the 1970s, the sale of mortgaged property subject to the continuance of the mortgage required a consideration of little more than whether the purchaser was to take the property subject to the mortgage or subject to the mortgage plus an assumption by the purchaser of the mortgagor's obligations under the mortgage. Since the 1960s, due-on-sale clauses have come into widespread use, injecting considerable complications. The clause purports to authorize the mortgagee to

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286. *In re* Lemka, 201 B.R. 765 (Bankr. E.D. Tenn. 1996) (dragnet does not extend to subsequent loan made to husband and wife when husband's mother was also party to deed of trust).

287. *In re* Ryles, 457 B.R. 138, 141 (Bankr. M.D. Ga. 2011) (dragnet clause also referred to liability of "Grantor (or any one or more of Grantors, if there be more than one)").

288. Schmidt v. Waukesha State Bank, 555 N.W.2d 655, 661 (Wis. Ct. App. 1996) (applying marital property statute).

289. La Cholla Grp., Inc. v. Timm, 844 P.2d 657 (Ariz. Ct. App. 1992).

290. *See* Dyches, *Priority Disputes in Future Advance Mortgages: Picking the Winner in Arizona*, 1985 ARIZ. ST. L.J. 537 (problems of notice, difference between optional and obligatory advances is not always clear; at times mortgagee makes advances that are legally optional but "economically obligatory," as where more money is necessary to complete a building, pay taxes, insurance, etc.).

accelerate the mortgage debt if the mortgagor sells or encumbers the property. The language of the clause may vary and its scope may be broader than mentioned above.[291]

Before federal legislation enacted in 1982, a sizeable body of cases among the states resulted in a general enforcement of due-on-sale clauses, with some qualifications, exceptions, and conflict. Traditionally, lenders justified this based on risk of default and impairment of mortgage security. This was the original purpose of the clause, but beginning in the 1960s, lenders used it as protection from the risks of inflation. The question is whether a lending institution that makes a twenty- to thirty-year mortgage at a fixed current interest rate must commit itself inflexibly to this bargain in the face of increasing interest rates and inflation, with its consequent reduced ability to pay or attract depositors. Many courts decided that lenders' use of due-on-sale clauses to retire unprofitable loans when the buyer sold the property was legitimate.[292] But other courts disagreed, reasoning that the clause was an unreasonable restraint on alienation.[293]

§ 3A:3.2 *Garn-St. Germain Depositary Institutions Act*

[A] Automatic Enforceability

In 1982, Congress enacted the Garn-St. Germain Depository Institutions Act (the "Garn-St. Germain Act"),[294] which swept away most of the case law that had denied enforcement to the clause. The

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291. The clause in Patton v. First Fed. Sav. & Loan Ass'n, 578 P.2d 152, 156 (Ariz. 1978), noted in 1979 ARIZ. ST. L.J. 367, authorized acceleration on mortgagor's giving a lease for over five years, a lease with an option to purchase, involuntary divestiture of ownership, further encumbrance of the property, change of its character or use, digging for gas, oil, or other minerals, and, in case of partnership or corporate ownership, a transfer of the interest of a general partner or of more than 25% of the stock. All transfers other than leases for less than two years was the test in Siegel v. Empire Sav. Bank, 304 N.W.2d 335 (Minn. 1981). The clause in Lake v. Equitable Sav. & Loan Ass'n, 674 P.2d 419 (Idaho 1983), included transfer of possession by lease. A requirement in the mortgage that the premises shall be owner occupied can have the same effect as a due-on-sale clause in the context of leasing. Inv'rs Sav. & Loan Ass'n v. Ganz, 416 A.2d 918 (N.J. Super. Ct. Ch. Div. 1980) (premises must be "primary place of residence"). The mortgagee in *Investors* contended that nonoccupying owners tend to restrict and minimize maintenance and upkeep to enhance financial return.

292. *E.g.*, Dunham v. Ware Sav. Bank, 423 N.E.2d 998, 1001 (Mass. 1981).

293. The best-known decision was Wellenkamp v. Bank of Am., 582 P.2d 970 (Cal. 1978). *See also* Cent. Nat'l Bank v. Shoup, 501 N.E.2d 1090 (Ind. Ct. App. 1986) (lender must prove transfer prejudiced security and that purpose was not solely to increase interest rate).

294. Garn-St. Germain Depository Institutions Act, 12 U.S.C. § 1701j-3.

act preempts inconsistent state statutory and case law, making the clause generally enforceable. The act adopts the automatic enforceability theory of due-on-sale clauses followed by some state courts. The lender's reasons or motives for enforcement are not material. The lender generally has complete discretion to approve or disapprove a proposed transfer.

[B] Scope

The Garn-St. Germain Act applies to every "real property loan" defined as "a loan, mortgage, advance, or credit sale secured by a lien on real property, the stock allocated to a dwelling unit in a cooperative housing corporation, or a residential manufactured home, whether real or personal property."[295] The identity of the lender does not matter; the act covers all such loans whether made by institutional lenders or others.

The Garn-St. Germain Act defines a due-on-sale clause as "a contract provision which authorizes a lender, at its option, to declare due and payable sums secured by the lender's security instrument if all or any part of the property, or an interest therein, securing the real property loan is sold or transferred without the lender's prior written consent."[296] Most clauses used by lenders meet this definition. Note that the definition speaks in terms of the lender's *option* to declare the loan due and payable. Occasionally, due-on-sale clauses are worded so it appears that if the owner transfers without consent, the loan balance is *automatically* due and payable in full without any option or action by the lender. Such a variant of the due-on-sale clause is arguably not covered by the federal act and is thus subject to whatever state law rule applies.

The Garn-St. Germain Act generally applies to all transfers made after its effective date in 1982, regardless of when the loan was made. To cushion the shock in states that had restricted lenders' use of due-on-sale clauses by judicial decision or statute, the act provided for a three-year window period, expiring on October 15, 1985, within which state law would remain in effect as to loans made by non-federally chartered lenders before October 15, 1982.[297] State legislatures were

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295. 12 U.S.C. § 1701j-3(a)(3).

296. 12 U.S.C. § 1701j-3(a)(1).

297. Federally chartered lenders were not subject to the window-period restrictions on enforceability. First Fed. Sav. & Loan Ass'n v. Stacha, 688 S.W.2d 269 (Ark. 1985); First Fed. Sav. & Loan Ass'n v. Siegel, 456 So. 2d 579 (Fla. Dist. Ct. App. 1984). For an example of window-period protection of borrowers, see Snow v. W. Sav. & Loan Ass'n, 730 P.2d 204 (Ariz. 1986) (lender deemed unreasonable in demanding a 3% increase in the interest rate and a "balloon payment" after five years on commercial loan; threat sufficient to constitute anticipatory breach of contract).

granted the power to extend the window period beyond 1985. Five states exercised that power, three for a limited time,[298] and two enacted a permanent extension.[299] The statutory language and the regulations dealing with window period loans are complex and, with respect to some points, ambiguous.[300] However, with the passage of time and the normal retirement of loans, issues concerning the treatment of window-period loans are no longer significant on a national basis.

The federal Office of Thrift Supervision (OTS) was granted authority to issue rules and regulations and publish interpretations of the Garn-St. Germain Act.[301] The agency took a broad view of federal preemption of due-on-sale clauses. The statutory definition of real property loan may be read as not extending to due-on-sale clauses in leasehold mortgages and in installment land contracts. The OTS

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298. Arizona extended until 1987, and Minnesota extended until 1990. Utah enacted an indefinite extension, but repealed its due-on-sale protections in 2008. 2008 UTAH LAWS, c. 139, § 2, repealing former UTAH CODE §§ 57-15-1 to 57-15-11.

299. MICH. COMP. LAWS §§ 445.1621 to 445.1629; N.M. STAT. §§ 48-7-15 to 48-7-24. The Michigan law protects only residential borrowers. Cases differ as to whether the New Mexico law protects only residential borrowers, or commercial borrowers as well. Los Quatros, Inc. v. State Farm Life Ins. Co., 800 P.2d 184 (N.M. 1990) (protection extends to commercial mortgage for statute's ban on prepayment penalties); Quintana v. First Interstate Bank, 737 P.2d 896 (N.M. 1987) (clause in commercial mortgage permits mortgagee to refuse consent for any reason).

300. The window period is considered at length in Geier, *Due-On-Sale Clauses Under the Garn-St. Germain Depository Institution Act of 1982*, 17 S.F. L. REV. 355 (1983); Note, *Garn-St. Germain. Congress Preempts Due-On-Sale—Fills Void Left by De La Cuesta*, 12 STETSON L. REV. 461 (1983). Window period cases are discussed in Annot., 61 A.L.R.4th 1070, 1087–96 (1988).

Phillips v. Super. Ct., 692 P.2d 1038 (Ariz. Ct. App. 1984), is an example of denial of enforcement of a loan made during the window period (a period beginning on July 8, 1971 in Arizona). *Accord* New Mexico v. N.M. Fed. Sav. & Loan Ass'n, 699 P.2d 604 (N.M. 1985).

A clause included in a window-period mortgage was enforceable because of mortgagor's refusal to supply information as to whether the security was impaired. Santa Clara Sav. & Loan Ass'n v. Pereira, 211 Cal. Rptr. 54 (Ct. App. 1985). Florida, a window period state enforced the clause where security would have been impaired because it would have enforced the clause for this reason before Garn-St. Germain. Weiman v. McHaffie, 470 So. 2d 682 (Fla. 1985).

Nevada is not a window period state. Boyes v. Valley Bank, 701 P.2d 1008 (Nev. 1985).

301. In 2011, the Dodd-Frank Wall Street Reform and Consumer Protection Act abolished OTS and transferred its regulatory and rulemaking authority to the Office of the Comptroller of Currency, the Federal Deposit Insurance Corporation, and the Federal Reserve. 12 U.S.C. §§ 5412, 5413.

adopted a regulation in 1989 asserting that the act applies to due-on-sale clauses in these two transactions.[302]

[C] Exemption for Nonsubstantive Transfers

The Garn-St. Germain Act protects residential borrowers by barring enforcement of a due on sale clause for the creation of junior liens and various other transfers (sometimes called "nonsubstantive transfers") when the loan is "secured by a lien on residential real property containing less than five dwelling units."[303] They are:

(1) the creation of a lien or other encumbrance subordinate to the lender's security instrument that does not relate to a transfer of rights of occupancy in the property;

(2) the creation of a purchase money security interest for household appliances;

(3) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(4) the granting of a leasehold interest of three years or less not containing an option to purchase;

(5) a transfer to a relative resulting from the death of a borrower;

(6) a transfer where the spouse or children of the borrower become an owner of the property;[304]

(7) a transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property

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302. 12 C.F.R. § 591.2(h):

> Loan secured by a lien on real property means a loan on the security of any instrument (whether a mortgage, deed or trust, or land contract) which makes the interest in real property (whether in fee, or in a leasehold or subleasehold) specific security for the payment of the obligation secured by the instrument.

303. 12 U.S.C. § 1701j-3(d).

304. *In re* Smith, 469 B.R. 198 (Bankr. S.D.N.Y. 2012) (borrower's transfer to her daughter does not require lender's consent; after borrower died, daughter is entitled to loss mitigation); *but see* Generations Bank v. Sciotti, 982 N.Y.S.2d 721 (Sup. Ct. 2014) (son who inherited home from mother not entitled to loss mitigation). *In re* Cady, 440 B.R. 16 (Bankr. N.D.N.Y. 2010), holds the lender cannot enforce its due-on-sale clause upon the borrower's conveyance to his daughter and son-in-law. *Cady* interprets the exception to enforceability broadly in two respects. Exception 7 allows a transfer to "children" but not expressly to a borrower's son-in-law. Second, the property in *Cady* was a family dairy farm, which resembles commercial real estate in some respects even though the farm presumably included at least one dwelling unit.

settlement agreement, by which the spouse of the borrower becomes an owner of the property;

(8) a transfer into an *inter vivos* trust in that the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property; or

(9) any other transfer or disposition described in regulations prescribed by the Office of Thrift Supervision.[305]

[D] Case Law

Since the Garn-St. Germain Act was enacted, courts have routinely enforced due-on-sale clauses when the lender employed standard language, and no exception for a "nonsubstantive transfer" applies.[306] The cases hold that a mortgagee's right to accelerate the debt is absolute, with no standard of reasonableness.[307]

A due-on-sale clause is enforced in bankruptcy of the mortgagor.[308] A clause invocable on a change of ownership of the property, or any part thereof, was held enforceable after the mortgagor transferred a half interest therein to her husband.[309] The due-on-sale clause requiring

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305. 12 U.S.C. § 1701j-3(d).

306. First Fed. Sav. & Loan Ass'n v. Quigley, 445 So. 2d 1052 (Fla. Dist. Ct. App. 1984); Home Fed. Sav. & Loan Ass'n v. Campney, 357 N.W.2d 613 (Iowa 1984); Stenger v. Great S. Sav. & Loan Ass'n, 677 S.W.2d 376 (Mo. Ct. App. 1984); United Sav. Bank Mut. v. Barnette, 695 P.2d 73 (Or. Ct. App. 1985); Sec. Fed. Sav. & Loan Ass'n v. Coleman, 325 S.E.2d 546 (S.C. 1985).

The clause in a contract of sale between private individuals was enforced. W. Life Ins. Co. v. McPherson K.M.P., 702 F. Supp. 836 (D. Kan. 1988); Lyons v. Skunda, 514 N.E.2d 944 (Ohio Ct. App. 1986); Morris v. Woodside, 682 P.2d 905 (Wash. 1984).

A conveyance to a trustee of a land trust triggered the clause. N. Cmty. Bank v. Nw. Nat'l Bank, 467 N.E.2d 1094 (Ill. App. Ct. 1984). Same as to transfer of a beneficiary's interest in a land trust. Barnes v. VNB Mortg. Corp., 334 S.E.2d 531 (Va. 1985).

Inclusion of the clause in the mortgage but not the note was immaterial to its enforcement. Abdul-Karim v. First Fed. Sav. & Loan Ass'n, 462 N.E.2d 488 (Ill. 1984).

307. Destin Sav. Bank v. Summer House of FWB, Inc., 579 So.2d 232 (Fla. Dist. Ct. App. 1991). *See also* Cent. Nat'l Bank v. Shoup, 501 N.E.2d 1090 (Ind. Ct. App. 1986). Cases prior to *Garn-St. Germain* hold the same.

In *Destin Sav. Bank*, 579 So. 2d 232, there was no legal objection to the mortgagee's demand of a second mortgage on the mortgagor's house or the pledge to the mortgagee of a $100,000 certificate of deposit.

308. *In re* Martin, 176 B.R. 675 (Bankr. D. Conn. 1995).

309. Lyons v. Skunda, 514 N.E.2d 944 (Ohio Ct. App. 1986). This would be a non-substantive transfer, for which acceleration is not allowed, if the mortgaged property was residential real estate with less than five units. The *Lyons* opinion does not indicate the nature of the property.

consent to the transfer of "any interest" in the property was triggered when the owner granted an option to purchase.[310]

An installment sale,[311] as well as a land contract sale,[312] have been held to trigger the due-on-sale clause. A court has held that a Louisiana bond for deed, pursuant to which the buyer takes possession and pays the purchase price in installments, triggers the clause,[313] although an older federal decision held that a similar contract of sale did not trigger the clause.[314]

The clause was not activated by the introduction of a new general partner followed by withdrawal and substitution of partners.[315] A clause providing for acceleration after a taking in condemnation of any part of the premises was denied effect after a small part was taken with no showing of an impairment of security.[316]

A loan made by a federal savings and loan institution is enforceable under federal law despite the conversion of the lender into a state institution.[317] A federal bankruptcy court has ruled that a national bank that makes a mortgage loan is not subject to the Garn-St.

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310. Auernheimer v. Metzen, 780 P.2d 796 (Or. Ct. App. 1989) (optionee was tenant under lease).

311. Income Realty & Mortg., Inc. v. Columbia Sav. & Loan Ass'n, 661 P.2d 257 (Colo. 1983); Capitol Fed. Sav. & Loan Ass'n v. Glenwood Manor, 686 P.2d 853 (Kan. 1984) (no restraint on alienation); Greater Louisville First Fed. Sav. & Loan Ass'n v. Etzler, 659 S.W.2d 209 (Ky. Ct. App. 1983) (though transaction labeled an option); Darr v. First Fed. Sav. & Loan Ass'n, 393 N.W.2d (Mich. 1986); Blue Ash Bldg. & Loan Co. v. Hahn, 484 N.E.2d 186 (Ohio Ct. App. 1984); New Home Fed. Sav. & Loan Ass'n v. Trunk, 482 A.2d 625 (Pa. Super. Ct. 1984), *see also* cases in Cent. Nat'l Bank v. Shoup, 501 N.E.2d 1090, 1095 (Ind. Ct. App. 1986).

Contra Boyes v. Valley Bank, 701 P.2d 1008 (Nev. 1985).

Darr held that excepting subordinate liens from a due-on-sale clause does not permit an installment sale.

312. First Fed. Sav. & Loan Ass'n v. Perry's Landing, Inc., 463 N.E.2d 636 (Ohio Ct. App. 1983).

313. Levine v. First Nat'l Bank of Commerce, 948 So. 2d 1051 (La. 2006) (bond for deed was transfer of "any interest" in property).

314. First Fed. Sav. & Loan Ass'n v. Botello, 725 F.2d 350 (5th Cir. 1984). The cases can be reconciled in that the *Levine* clause prohibited the transfer of "any interest" in the property, but the *Botello* clause prohibited only "the sale or transfer" of the property.

315. Fid. Tr. Co. v. BVD Assocs., 492 A.2d 180 (Conn. 1985). This has long been the law with respect to nonassignment clauses in leases. *See* FRIEDMAN ON LEASES, *supra* note 25, § 7:3.3[B] (Supp. Mar. 2014).

316. Sessler v. Arshak Corp., 464 So. 2d 612 (Fla. Dist. Ct. App. 1985).

317. Freedom Sav. & Loan Ass'n v. LaMonte, 448 So. 2d 51 (Fla. Dist. Ct. App. 1984); Aetna Cas. & Sur. Co. v. Valdosta Fed. Sav. & Loan Ass'n, 333 S.E.2d 849 (Ga. Ct. App. 1985). The converse of this appears in New Mexico v. N.M. Fed. Sav. & Loan Ass'n, 699 P.2d 604 (N.M. 1985).

Germain Act.[318] The federal bankruptcy court misread the statutory definition of the term "lender."[319]

A standard due-on-sale clause is not self-executing. The lender has an option to accelerate the loan, which requires an election—affirmative action on the lender's part.[320]

The clause may be waived.[321] The mortgagee has a reasonable time to enforce it,[322] but taking an excessive time is a waiver.[323]

A mortgagee who exercises his rights under the clause is not entitled to a prepayment premium.[324] The premium is collectable on a voluntary prepayment,[325] which is not applicable to mortgagee's enforcement of the clause.

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318. *In re* Black, 221 B.R. 38 (Bankr. S.D. Fla. 1998) (lender not subject to statutory prohibition due to transfer resulting from marriage property settlement).

319. The Act defines lender as "a person or government agency making a real property loan." 12 U.S.C. § 1701j-3(a)(2). The court incorrectly reasoned that a private bank is not a person.

320. McJenkin v. Cent. Bank of Tuscaloosa, N.A., 417 So. 2d 153 (Ala. 1982); Roosevelt Sav. Bank v. A.V.R. Realty Corp., 544 N.Y.S.2d 650 (App. Div. 2d Dep't 1989). This turns on the wording of the clause, andaccords with the general rule of acceleration. A due-on-sale clause can be written to operate automatically, as can acceleration of the debt for other reasons, but lenders rarely choose to draft such clauses.

321. Powell v. Phx. Fed. Sav. & Loan Ass'n, 434 So. 2d 247 (Ala. 1983); Cooper v. Deseret Fed. Sav. & Loan Ass'n, 757 P.2d 483 (Utah Ct. App. 1988) (four years too long); 12 C.F.R. § 591.5(b)(4) (authorizing waiver and release or original borrower by written agreement).

Contra Auernheimer v. Metzen, 780 P.2d 796 (Or. Ct. App. 1989). The fact that the statute of limitations to collect the debt has not run is immaterial. *Cooper*, 757 P.2d 483.

322. Capitol Fed. Sav. & Loan Ass'n v. Glenwood Manor, 686 P.2d 853 (Kan. 1984) (no restraint on alienation); First Fed. Sav. & Loan Ass'n v. Perry's Landing, Inc. 463 N.E.2d 636 (Ohio Ct. App. 1983); Rakestraw v. Dozier Assocs., Inc., 329 S.E.2d 437 (S.C. 1985); Longview Sav. & Loan Ass'n v. Nabours, 673 S.W.2d 357 (Tex. Civ. App. 1984). *But see* Columbia Sav. & Loan v. Easterlin, 466 A.2d 968 (N.J. Super. Ct. Ch. Div. 1983) (mortgagee's acceptance of grantee's checks for two years, accompanied by payment coupons in name of original grantee no waiver).

323. McJenkin v. Cent. Bank of Tuscaloosa, N.A., 417 So.2d 153.

324. Abramoff v. Life Ins. Co., 92 B.R. 698 (Bankr. W.D. Tex. 1988); Tan v. Cal. Fed. Sav. & Loan Ass'n, 189 Cal. Rptr. 775 (Ct. App. 1983); Los Quatros, Inc. v. State Farm Life Ins. Co., 800 P.2d 184 (N.M. 1990) (discusses window period); Wide Scope, Inc. v. Freedom Fed. Sav. & Loan Ass'n, 520 N.E.2d 35 (Ohio Mun. Ct. Franklin Cty. 1987); 12 C.F.R. § 591.5(b)(2), (3). *Abramoff*, 92 B.R. 698, deemed a combination of due-on-sale clause and a prepayment premium a restraint on alienation. Prepayment penalties are generally limited to mortgagor's voluntary payments.

325. Garn-St. Germain is not retroactive. Boyes v. Valley Bank, 701 P.2d 1008 (Nev. 1985).

A mortgagee who agreed to permit grantee to assume a mortgage at 9.5% interest but increased this to 13.5% after execution of a contract of sale was held liable for breach of contract and of promissory estoppel, though not for intentional interference with an advantageous relationship.[326]

§ 3A:3.3 Express Standards in Due-on-Sale Clause

Sometimes, borrowers bargain for an express standard that governs the lender's approval right over a transfer of the property, or the loan documents used by the lender might contain an express standard or limitation. The Garn-St. Germain Act prescription that due-on-sale clauses are automatically enforceable does not apply to such clauses. The language agreed upon by the parties determines whether the lender has the right to withhold consent to a proposed transfer.

A clause reading, "To protect the security of this Deed of Trust, Grantor agrees . . ." indicates that its purpose was merely to protect the security of the mortgage and is unenforceable unless the mortgagee shows an impairment of security.[327] A clause that limits transfers to those made with the mortgagee's consent, such consent not unreasonably to be withheld, has been construed both ways, one holding that the consent may not be conditioned on an increase of interest rate,[328] and another holding that it is not unreasonable for a mortgagee to demand an increase in interest.[329] A clause that permits acceleration in limited circumstances does not permit acceleration generally.[330]

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326. Rosa v. Fla. Coast Bank, 484 So. 2d 57 (Fla. Dist. Ct. App. 1986).

327. O'Boskey v. First Fed. Sav. & Loan Ass'n, 678 P.2d 1112 (Idaho 1984), *later opinion*, 739 P.2d 301 (Idaho 1987) (upholds injunction and class action).

328. Fogel v. S.S.R. Realty Assocs., 461 A.2d 1190 (N.J. Super. Ct. 1983).

329. W. Life Ins. Co. v. McPherson K.M.P., 702 F. Supp. 836 (D. Kan. 1988); Rubin v. Centerbanc Fed. Sav. & Loan Ass'n, 487 So. 2d 1193 (Fla. Dist. Ct. App. 1986); Torgerson-Forstrom H.I. v. Olmsted Fed. Sav. & Loan Ass'n, 339 N.W.2d 901 (Minn. 1983).

Western and *Torgerson* hold the purpose of the clause is to protect the mortgagee's interest in the money market as well as to protect his security.

330. A clause permitting acceleration with neither mortgagee's consent nor assumption of the mortgage did not permit acceleration when grantee assumed. Morse v. City Fed. Sav. & Loan Ass'n, 567 F. Supp. 699 (S.D. Fla. 1983); Sec. First Fed. Sav. & Loan Ass'n v. Jarchin, 479 So. 2d 767 (Fla. Dist. Ct. App. 1985).

A clause providing that a transfer purchaser shall not assume the mortgage unless the mortgage shall immediately become due did not apply to a three-year lease providing for a conveyance thereafter. First Sav. & Loan Ass'n v. Treaster, 490 N.E.2d 1149 (Ind. Ct. App. 1986).

A clause that permits the making of a junior mortgage is not activated by the foreclosure of that junior mortgage.[331]

§ 3A:3.4 Cure of Violation

The cases are in conflict as to whether a borrower who violates a due-on-sale clause can avoid acceleration and foreclosure, or unwind acceleration, by curing the violation. A New Jersey decision, prior to Garn-St. Germain, allowed a cure,[332] but cases in Iowa and Missouri has gone the other way.[333] These cases can be reconciled in that the cure in the New Jersey case took place promptly after the lender objected, but the purported cure in the other cases took place long after the commencement of litigation.

§ 3A:3.5 Fannie Mae/Freddie Mac Uniform Instruments

The due-on-sale clause set forth in the forms jointly promulgated by two federal entities, the Federal National Mortgage Association (Fannie Mae) and the Federal Home Loan Mortgage Association (Freddie Mac), have been used in millions of home mortgage loans.

The most recent version of the Fannie Mae/Freddie Mac clause provides as below.

CLAUSE 3A-1

Due-on-Sale Clause

(From Fannie Mae/Freddie Mac)

Transfer of the Property or a Beneficial Interest in Borrower. As used in this Section 18, "Interest in the Property" means any legal or beneficial interest in the Property, including, but not limited to,

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331. Blitz v. Marino, 786 P.2d 490 (Colo. Ct. App. 1989) (conveyance in lieu of foreclosure); Yelen v. Bankers Tr. Co., 476 So. 2d 767 (Fla. Dist. Ct. App. 1985). *Accord In re* Ruepp, 321 S.E.2d 517 (N.C. Ct. App. 1984) (permitting a junior mortgage is an anticipation that it may be foreclosed). *Contra* Unifirst Fed. Sav. & Loan Ass'n v. Tower Loan, Inc., 524 So. 2d 290 (Miss. 1986).

332. Fid. Land Dev. Corp. v. Rieder & Sons Bldg. & Dev. Co., 377 A.2d 691 (N.J. Super. Ct. App. Div. 1977) (corporate borrower conveyed to its principal shareholder for tax purposes).

333. Home Fed. Sav. & Loan Ass'n v. Campney, 357 N.W.2d 613 (Iowa 1984) (borrower entered into installment land contract, which was subsequented forfeited due to purchaser's default); Stenger v. Great S. Sav. & Loan Ass'n, 677 S.W.2d 376 (Mo. Ct. App. 1984) (reconveyance took place after borrower commenced litigation to challenge due-on-sale clause on other grounds; court implies result might be different if reconveyance occurred before acceleration of debt).

those beneficial interests transferred in a bond for deed, contract for deed, installment sales contract or escrow agreement, the intent of which is the transfer of title by Borrower at a future date to a purchaser.

If all or any part of the Property or any Interest in the Property is sold or transferred (or if Borrower is not a natural person and a beneficial interest in Borrower is sold or transferred) without Lender's prior written consent, Lender may require immediate payment in full of all sums secured by this Security Instrument. However, this option shall not be exercised by Lender if such exercise is prohibited by Applicable Law.

If Lender exercises this option, Lender shall give Borrower notice of acceleration. The notice shall provide a period of not less than 30 days from the date the notice is given in accordance with Section 15 within which Borrower must pay all sums secured by this Security Instrument. If Borrower fails to pay these sums prior to the expiration of this period, Lender may invoke any remedies permitted by this Security Instrument without further notice or demand on Borrower.[334]

§ 3A:3.6 Commercial Property

A strict due-on-sale clause used by a financial institution for business property, after substantial changes made by the author (Milton Friedman) is shown below.

CLAUSE 3A-2

Due-on-Sale Clause

Financial Institutions for Business Property

The Mortgagee may declare the sum secured by this mortgage immediately due and payable in case of

(a) any transfer of title to the mortgaged property or any part thereof;
(b) any issuance or transfer of stock in the Mortgagor, if the Mortgagor is a corporation, or of any interest in the Mortgagor if the Mortgagor is a partnership or joint venture, whether by sale, exchange, conveyance, merger, consolidation, or otherwise; or

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334. Multistate Fixed Rate Note—Single Family—Fannie Mae/Freddie Mac Uniform Instrument, Form 3200 (Jan. 2001).

(c) a conveyance of an interest in the mortgaged property to a trustee of a land trust or a transfer in whole or part of a beneficiary's interest in a land trust.

The matters mentioned in (a), (b), and (c), above, shall apply to any transaction that is voluntary or occurs by operation of law, other than by death.[335] Any consent to or waiver by the Mortgagee of, or any estoppel of the Mortgagee to object to, any matter mentioned in (a), (b), or (c), above, shall apply only to that matter and not to anything thereafter occurring.

The extension of due-on-sale clauses to transfers of interest in corporate borrowers (or other entities) can raise issues of interpretation and planning.[336] A mortgagor will note that if it is a corporation listed on a stock exchange, it cannot control transfers of its stock, and that if it is not on an exchange but has a sizeable number of shareholders, the clause should permit transfers and issuance of shares in an amount of, perhaps, a maximum of 25% of the stock existing after completion of all such transfers and issuance. If the number of partners or joint venturers is substantial a comparable provision should be applicable.

Subdivision (b) of the clause inhibits issuance of stock dividends, which could be changed by revising (b) to read:

(b) any issuance or transfer of stock in the Mortgagor, if the Mortgagor is a corporation (unless such issuance is to an existing holder of such stock and in the same proportion as such holder owned in the corporation immediately prior to such issuance), or of any interest in the Mortgagor if the Mortgagor is a partnership or joint venture, whether by sale, exchange, merger, consolidation, or otherwise.

§ 3A:4 Purchase Money Mortgage

It is customary and good practice to include in a mortgage given to secure part of the purchase of real estate a recital that the mortgage is a

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335. But a sale by an administrator or executor is subject to the clause. Howell v. Murray Mortg. Co., 890 S.W.2d 78 (Tex. Ct. App. Amarillo 1994) (holding clause is not undue restraint on alienation and does not interfere with probate court's authority to order sale of assets).

336. One clause was triggered "in the event there is a transfer of ownership of the stock of the Borrower . . . excepting only by the laws of descent and distribution." Barry M. Dechtman, Inc. v. Sidpaul Corp., 429 A.2d 411, 413 (N.J. Super. Ct. App. Div. 1981), *rev'd*, 446 A.2d 518 (N.J. 1982). Query: Would this language apply to one or more transfers of part of the stock of the corporate owner?

purchase money mortgage. This recital generally follows the description of the mortgaged premises and may read substantially as below.

CLAUSE 3A-3

Recital: Mortgage As a Purchase Money Mortgage

> Being the same premises conveyed to the mortgagor by the mortgagee by deed dated and intended to be recorded simultaneously herewith in the Office of _____, this being a purchase money mortgage given to secure a portion of the purchase price.

There are advantages in a purchase money mortgage over other mortgages and this recital is of evidentiary value to the mortgagee or subsequent holder of such mortgage. In fact, some statutes afford the benefits of a purchase money mortgage only to those mortgages that expressly recite they secure the purchase price of the property, in whole or in part.[337]

A deed and a purchase money mortgage are presumably a single transaction[338] and the two are construed together.[339] The lien of the purchase money mortgage is presumably coextensive with the estate passing by the accompanying deed, and this presumption may be sufficient to correct an inadvertent error in drafting the mortgage.[340]

A mortgage may be a purchase money mortgage although not executed the same day as the deed, provided it is part of one continuous transaction.[341] A purchase money mortgage may be validly given to a third party, provided the money was loaned for use in

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337. MD. CODE ANN., REAL PROP. § 7-104; N.C. GEN. STAT. § 45-21.38.
338. Stephenson v. Naumann, 195 N.Y.S. 768 (Sup. Ct. Kings Cty.), *aff'd*, 197 N.Y.S. 951 (App. Div. 2d Dep't 1922).
339. DeGarmo v. Phelps, 68 N.E. 873 (N.Y. 1903); McDuffie v. Clark, 9 N.Y.S. 826 (Sup. Ct. 1890) (corrects wrong initials of grantee).
340. A recital that the mortgage is given to secure purchase money may, therefore, help establish a lien broader than a limited reading of the mortgage might indicate. *In re* City of New York (Lawrence Ave.), 169 N.Y.S. 1018 (App. Div. 2d Dep't 1918) (street rights included in deed but omitted from mortgage); *see* Annot., 134 A.L.R. 1041 (1941).
341. G. GLENN, MORTGAGES § 345.2 (1943); 55 AM. JUR. 2D *Mortgages* § 13 (1971); 59 C.J.S. *Mortgages* § 231(b) (1949). A mortgage executed eight months after a conveyance by purchaser's corporation and covering only part of the land conveyed was held a purchase money mortgage for the purpose of an anti-deficiency statute. Swenson v. Rampage, 762 P.2d 851 (Mont. 1988). *See also* Sunshine Bank v. Smith, 631 So. 2d 965 (Ala. 1994) (mortgage described the wrong land; corrected mortgage recorded eleven months later qualifies as purchase money mortgage).

payment of the purchase price,[342] and in this event it is a purchase money mortgage only to the extent that the consideration therefore was used for the purchase.[343] It is a purchase mortgage only with respect to the property conveyed to the mortgagor.[344] A mortgage, the proceeds of which are not used for the acquisition of the realty, is not a purchase money mortgage.[345]

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342. Martin v. First Nat'l Bank, 184 So. 2d 815 (Ala. 1966); Garrett Tire Ctr., Inc. v. Herbaugh, 740 S.W.2d 612 (Ark. 1987); Mercantile Collection Bureau v. Roach, 15 Cal. Rptr. 710 (3d Dist. Ct. App. 1961); Banc Fla. v. Hayward, 689 So. 2d 1052 (Fla. 1997); Sarmiento v. Stockton, Whatley, Davin & Co., 399 So. 2d 1057 (Fla. Dist. Ct. App. 1981); Hand Trading Co. v. Daniels, 190 S.E.2d 560 (Ga. Ct. App. 1972); Pulse v. N. Am. Land Title Co., 707 P.2d 1105 (Mont. 1985); Boies v. Benham, 28 N.E. 657 (N.Y. 1891).

343. Carteret Sav. Bank v. Citibank Mortg. Corp., 632 So. 2d 598 (Fla. 1944) (part used for construction no purchase money mortgage), *aff'g* Citibank Mtg. Corp. v. Ceret Sav. Bank, 612 So. 2d 539 (Fla. Dist. Ct. App. 1992); Syracuse Sav. & Loan Ass'n v. Hass, 234 N.Y.S. 514 (Sup. Ct. Onondaga Cty. 1929) (part used for construction no purchase money mortgage). *Contra* Barone v. Frie, 472 N.Y.S.2d 119 (App. Div. 2d Dep't 1984) (may be purchase money though given on other property).

It is not a purchase money mortgage with respect to property that was not acquired by the mortgagor as part of the transaction in which the mortgage was given. Loretz v. Cal-Coast Dev. Corp., 57 Cal. Rptr. 188 (1st Dist. Ct. App. 1967); Banc Fla. v. Hayward, 689 So. 2d 1052 (Fla. 1997); Dobias v. White, 80 S.E.2d 23 (N.C. 1954).

Contra to *Syracuse Savings & Loan Ass'n*, 234 N.Y.S. 514, the priority of a purchase money mortgage was held to cover not only the part thereof used to purchase the property but also the amount intended for construction. Hand Trading Co. v. Daniels, 190 S.E.2d 560 (Ga. Ct. App. 1972); Resolution Tr. Corp. v. Bopp, 850 P.2d 939 (Kan. Ct. App. 1993).

344. Armel Mgmt. Corp. v. Stanhagen, 241 S.E.2d 713 (N.C. Ct. App. 1978). A mortgage given on one house to buy another was held not a purchase money mortgage, at least within an antideficiency statute. Cely v. De Concini, McDonald, Brammer, Yetwin & Lacy, 803 P.2d 911 (Ariz. Ct. App. 1990) (following California law).

345. Union Bank v. Anderson, 283 Cal. Rptr. 823 (5th Dist. Ct. App. 1991) (mortgage on corporate owned realty given to secure payment of shares of stock of that corporation); Slate v. Marion, 408 S.E.2d 189 (N.C. Ct. App. 1991) (mortgage subordinate to judgment lien against mortgagor). *See also* C&L Lumber & Supply, Inc. v. Tex. Am. Bank/Galeria, 795 P.2d 502 (N.M. 1990).

Earlier cases are discussed in Brock v. First Sav. Ass'n, 10 Cal. Rptr. 2d 700 (3d Dist. Ct. App. 1992), and 55 A.L.R.2d 1115 (1957). *Brock* relies largely on Fisk v. Potter, 2 Keyes (N.Y.) 64, 2 Abb. Ct. App. Dec. 138 (1865), which ruled in favor of a purchase money mortgagee on the ground that an unrecorded vendor's lien was tantamount to a secret lien that would not be found in the public records. This would not apply to *Brock* because the mortgagee knew of the lien when the deed and mortgage were

A purchase money mortgage is a limitation on the title conveyed, not an encumbrance.[346] It takes precedence over prior judgments recovered against the mortgagor[347] and over an after-acquired property clause in a prior mortgage,[348] is paramount to any dower interest in

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delivered. *Brock* also cites cases based on a preference for legal over equitable liens. *Fisk* was one of the cases "that were omitted from the official reports between 1863 and 1869. They were published without official sanction and from lack of authentic information or the necessary materials for preparing reports. There are some opinions that the court did not adopt and others without the statements necessary to show what was actually decided. They are regarded as of questionable authority and only cited with caution." 2 Abbot, N.Y. DIG., Consol. Ed. at xxiii.

346. Troyer v. Mundy, 60 F.2d 818, 821 (8th Cir. 1932).

347. *In re* Register, 37 B.R. 708 (Bankr. N.D. Ga. 1983); United States v. Miller, 400 F. Supp. 1080 (S.D.N.Y. 1975); Transamerica Fin. Serv., Inc. v. Lafferty, 856 P.2d 1188, 1194 (Ariz. 1993); Garrett Tire Ctr., Inc. v. Herbaugh, 740 S.W.2d 612 (Ark. 1987); Baron v. Aiello, 319 So. 2d 198 (Fla. Dist. Ct. App. 1975); Cty. of Pinellas v. Clearwater Fed. Sav. & Loan Ass'n, 214 So. 2d 525 (Fla. Dist. Ct. App. 1968); Murray v. Chulak, 300 S.E.2d 493 (Ga. 1983); Bank of Homewood v. Gembella, 199 N.E.2d 293 (Ill. App. Ct. 1964); Boggs v. O.S. Kelly Mfg. Co., 90P. 765 (Kan. 1907); DeGarmo v. Phelps, 68 N.E. 873 (N.Y. 1903); Shilowitz v. Wadler, 261 N.Y.S. 351 (App. Div. 3d Dep't 1932); Nelson v. Stoker, 669 P.2d 390 (Utah 1983) (deed of trust); N. State Bank v. Toal, 230 N.W.2d 153 (Wis. 1975). This is codified by DEL. CODE ANN. tit. 25, § 2108 (provided mortgage recorded within five days after deed to mortgagor); D.C. CODE ANN. § 15-104; MD. CODE ANN., REAL PROP. § 7-104; N.J. STAT. ANN. § 46:9-8; N.Y. C.P.L.R. § 5203(a)(2); *see* CAL. CIV. CODE ANN. § 2898.

The rule applies to a mortgage that is a substitute for a purchase money mortgage. Commerce Sav. Lincoln, Inc. v. Robinson, 331 N.W.2d 495 (Neb. 1983).

The rule was applied despite the mortgagor's earlier interest in the property as purchaser under an installment sale. Liberty Parts Warehouse, Inc. v. Marshall Cty. Bank & Tr., 459 N.E.2d 738 (Ind. Ct. App. 1984). Contra to *Liberty Parts* is C&L Lumber & Supply, Inc. v. Tex. Am. Bank/Galeria, 795 P.2d 502 (N.M. 1990), which holds that a mortgage given by a purchaser in possession to pay off a land sales contract is not a purchase money mortgage.

The rule was applied where the deed and purchase mortgage referred to the wrong property and were corrected by instruments eleven months later. Sunshine Bank v. Smith, 631 So. 2d 965 (Ala. 1994).

348. Chase Nat'l Bank v. Sweezy, 281 N.Y.S. 487, 492 (Sup. Ct. N.Y. Cty. 1931), *aff'd*, 259 N.Y.S. 1010 (App. Div. 1st Dep't 1932), *aff'd*, 185 N.E. 803 (N.Y. 1933); 2 G. GLENN, MORTGAGES § 348 (1943); G. OSBORNE, MORTGAGES § 556 (1943).

An intending purchaser gave a mortgage on property he did not yet own. Later, a purchase-money mortgage was given on a sale of this property. The purchase-money mortgage was held prior despite an argument that an after-acquired provision in the earlier mortgage gave it priority. Libby v. Brooks, 663 A.2d 422 (Me. 1995). *Cf.* Ala. Home Mortg. Co. v. Harris, 582 So. 2d 1080 (Ala. 1991).

the mortgagor's wife despite her failure to join in the execution of the mortgage,[349] and homestead rights,[350] and, when made by a corporation, is valid without any stockholder consent that may be required by statute in connection with corporate mortgages generally.[351] A purchase money mortgage made to a third party is superior to a vendor's lien.[352] All this because the parties so subordinated "are no worse off than they were before." Without the proceeds from the purchase-money mortgage the property would not have been acquired.[353] But if a purchase money mortgagee fails to record his mortgage, he will be postponed to subsequent innocent purchasers for value.[354] A purchase money mortgage has been held paramount, under the New Jersey statute, to a mechanic's lien predicated on work done on the property on behalf of a purchaser.[355] But this is not invariably true.[356]

A purchase money mortgage is not a loan or forbearance and involves no usury merely because a seller obtains a higher price than if the consideration were paid wholly in cash.[357] It has been held consistent with this that the interest rate on a purchase money mortgage may validly be higher than the maximum fixed by usury

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349. Boggs v. O.S. Kelly Mfg. Co., 90 P. 765 (Kan. 1907); DeGarmo v. Phelps, 68 N.E. 873 (N.Y. 1903); 2 G. GLENN, MORTGAGES § 345 (1943); 28 C.J.S. *Dower* § 36(c) (1941).

350. Harlem Sav. Ass'n v. Lesniak, 257 N.E.2d 230 (Ill. App. Ct. 1970).

351. N.Y. STOCK CORP. LAW § 16 (repealed Sept. 1, 1963); 7 W. FLETCHER, CYCLOPEDIA OF CORPORATIONS § 3117 (rev. 1988). *But see* Peerson v. Gray, 184 Ala. 312, 63 So. 467 (1913).

352. Brock v. First Sav. Ass'n, 10 Cal. Rptr. 2d 700 (3d Dist. Ct. App. 1992); Fisk v. Potter, 2 Keyes (N.Y.) 64, 2 Abb. Ct. App. Dec. 138 (1865); Johnson v. Fugate, 293 P.2d 559 (Okla. 1956). *Contra* Rader v. Dawes, 651 S.W.2d 629 (Mo. Ct. App. 1983).

353. Banc Fla. v. Hayward, 689 So. 2d 1052, 1054 (Fla. 1997).

354. *Id.*; Kemp v. Zions First Nat'l Bank, 470 P.2d 390 (Utah 1970); G. OSBORNE, MORTGAGES § 213 (2d ed. 1970).

355. Dev. Design, Inc. v. Rainbow Dev., Inc., 444 F. Supp. 155 (E.D. Tex. 1978); Am. Lumber & Bldg. Supply v. D&M, Inc., 210 A.2d 119 (N.J. Super. Ct. 1965).

356. A mechanic's lien, based on work visibly done before delivery of the deed, was held paramount to a purchase money mortgage. Summer & Co. v. DCR Corp., 351 N.E.2d 485 (Ohio 1976). The court stated the Ohio mechanic's lien displaced the doctrine of simultaneous seizin. It said the seller's remedy is either to record the purchase money mortgage before the construction (an awkward procedure if before the conveyance) or expressly reserve a vendor's lien (a remedy with some disadvantages).

Cf. Sontag v. Abbott, 344 P.2d 961 (Colo. 1959), where an optionee of real property ordered materials for an improvement. After he acquired title, a mechanic's lien based on this material was given precedence over a purchase money mortgage given by the optionee.

357. S. WILLISTON, CONTRACTS § 1685, at 4766 (rev. ed. 1938); Annot., *Advance in Price for Credit Sale as Compared with Cash Sale as Usury*, 14 A.L.R.3d 1065 (1967).

laws.[358] This assumes that the transaction is not a cloak for a loan at excessive interest rates. This rationale applies only to purchase money mortgages running to a seller. It would not apply to a third party who loans money for the purchase of real property. A purchase money mortgage was held not secondary financing within the contemplation of a first mortgage that forbade any payments with respect to secondary financing unless the first mortgage was current.[359]

A purchase money mortgage given by one without authority, therefore, as in the case of an infant, is valid unless and until the accompanying conveyance is repudiated.[360] The mortgagor cannot repudiate one without repudiating the other. A claim of the grantee-mortgagor arising out of the sale of the property is assertable by the mortgagor in an action to foreclose the mortgage.[361]

When a purchase money mortgage is given to several persons, it is advisable to have written evidence as to their form of ownership of the mortgage. In the absence of evidence, a Massachusetts court applied a presumption that their ownership should correspond with their former ownership of the property that they sold.[362] In this situation, joint tenants of the property took the mortgage as joint tenants with the right of survivorship, not as tenants in common.

§ 3A:5 Description of Mortgaged Property

§ 3A:5.1 Generally

A mortgage must contain a description of the property that is adequate or a reference to another writing, thereby incorporating an adequate description.[363] In general, courts apply the same standards to mortgages as they do to deeds of conveyance.[364] If the mortgage

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358. Mandelino v. Fribourg, 242 N.E.2d 823 (N.Y. 1968), noted in 15 N.Y.L.F. 405 (1969); followed in Barone v. Frie, 472 N.Y.S.2d 119 (App. Div. 2d Dep't 1984).
359. DHNH Realty Corp. v. Marino P. Jeantet Residence for Seniors, Inc., 432 N.Y.S.2d 829 (Sup. Ct. Queens Cty. 1980).
360. Stephenson v. Naumann, 195 N.Y.S. 768 (Sup. Ct. Kings Cty.), *aff'd*, 197 N.Y.S. 951 (App. Div. 2d Dep't 1922); Content v. Servoss, 3 Barb. 128, 141–42 (N.Y. 1848); 2 G. GLENN, MORTGAGES § 344 (1943). *But see* Fulton Sav. Bank v. Downs, 148 N.Y.S.2d 556 (Sup. Ct. Suffolk Cty.), *aff'd*, 153 N.Y.S.2d 578 (App. Div. 2d Dep't 1956).
361. Snyder v. Potter, 521 N.Y.S.2d 175 (App. Div. 3d Dep't 1987).
362. Bertolami v. Corsi, 537 N.E.2d 1271 (Mass. App. Ct. 1989) (statutory rule that conveyance creates tenancy in common unless otherwise expressly stated is not applicable to mortgages).
363. *In re* Poteat, 176 B.R. 734 (Bankr. D. Del. 1995) (grossly inadequate description, no metes and bounds description, street address, road names, or reference to any other instrument).
364. *See generally* section 10:7.2.

properly describes a parcel of real estate, the mortgage automatically conveys appurtenances to that parcel. In a Georgia case, a mortgage included airspace rights over a neighboring parcel, as an appurtenance, when the airspace was improved with part of a parking garage that was chiefly built on the parcel described in the mortgage.[365]

It occasionally happens that a description is on an exhibit to be attached to a preprinted mortgage form and the exhibit is not attached or is lost before recordation.

In the case of a purchase money mortgage, there would appear to be no reason for question with respect to the scope of the mortgage lien. The mortgagee is selling specified real estate and the mortgage should cover this realty.[366]

An easement acquired by a mortgagor after the date of the mortgage comes under the lien of the mortgage automatically.[367]

§ 3A:5.2 Fixtures and Personal Property

The sale may include not only land and permanent improvements to the land, but also fixtures as well as personal property. If all such property is to be security for the purchase price, it is necessary not only that the contract of sale should so indicate but that proper steps be taken to comply with statutory prerequisites for effecting a lien thereon. The general rule is that a mortgage on real property covers fixtures, both those existing upon execution of the mortgage and as well as after-acquired fixtures.[368] In this respect, after-acquired fixtures are treated the same way as permanent improvements made by the mortgagor, which become part of the mortgaged property by the doctrine of accession. The mortgagee, however, will not necessarily have first priority as to after-acquired fixtures. A seller or financer who acquires a purchase-money security interest in the fixture may achieve first priority under the Uniform Commercial Code.[369] Without special

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365. *In re* Huckabee Auto Co., 58 B.R. 826 (Bankr. M.D. Ga. 1986).

366. "There is a necessary intent to mortgage back the identical lands conveyed to the mortgagor." *In re* City of New York (Lawrence Ave.), 169 N.Y.S. 1018 (App. Div. 2d Dep't 1918).

367. *In re* Bende, 152 B.R. 677 (Bankr. S.D. Fla. 1993); Gurevich v. Goldman, 105 A.2d 466 (Conn. 1954); Crawford v. Lesco, 136 N.Y.S.2d 771 (Sup. Ct. Eq. Term Monroe Cty. 1955).

368. K & L Distribs., Inc. v. Kelly Elec. Co., 908 P.2d 429 (Alaska 1996); McFadden v. Allen, 32 N.E. 21 (N.Y. 1892) (buildings and machinery installed after grant of mortgage became accessions and fixtures). In *K & L Distributors* the deed of trust covered after-acquired electrical equipment installed in a warehouse. The lender's right to the fixtures was not affected by the mortgagor's voluntary return of them to the installer for nonpayment.

369. *See* Revised U.C.C. § 9-334(d).

provisions, a mortgage on real property will not reach personal property that has not become a fixture.[370]

The difference between fixtures and personal property is technical and may not be self-revealing. For instance, in a few states, gas ranges and refrigerators are personal property and are not automatically included in a mortgage of real property.[371] In other states, gas ranges and refrigerators are treated as fixtures, and thereby included, without express provision therefore, in a mortgage or conveyance.[372] In a number of states, the "assembled industrial plant doctrine" makes machinery that is indispensable to an industry a fixture covered by the lien of a real property mortgage.[373] In this situation, physical annexation is unnecessary.[374]

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370. White v. Murtha, 343 F.2d 831 (5th Cir. 1965) (mortgage does not reach hotel's furniture and furnishings); *In re* Shore Haven Motor Inn, Inc., 124 B.R. 617 (Bankr. S.D. Fla. 1991) (hotel revenues); McKeage v. Hanover Fire Ins. Co., 81 N.Y. 38 (1880) (mirrors hung on walls and gas fixtures, screwed onto gas pipes, are removable personal property, not fixtures); Annot., 175 A.L.R. 404 (1948).

For an extended clause covering existing and future fixtures and personal property in a hotel but appropriate for any high rise building, see *In re* Johnson, 139 B.R. 208, 210 (Bankr. D. Minn. 1992). The clause was held to cover framed wall paintings.

For a catalogue of articles covered by mortgages as fixtures, see 1 L. JONES, MORTGAGES §§ 530 *et seq.* (8th ed. 1928); 36A C.J.S. *Fixtures* § 45 (1961). Mobile homes attached to the ground are held fixtures and are usually subject to the lien of a real property mortgage. They are also real property for the purpose of state and local taxation. *See In re* Cliff's Ridge Skiing Corp., 123 B.R. 753, 760 (Bankr. W.D. Mich. 1991); C.I.T. Fin. Servs. v. Premier Corp., 747 P.2d 934 (Okla. 1987). A rented telephone system was held personal property. Hoffman Mgmt. Corp. v. S.C.L., Inc., 800 S.W.2d 755 (Mo. Ct. App. 1990).

For annotations on specific articles as fixtures coming under lien of a mortgage, see Annot., 48 A.L.R. 1146, 1147 (1927) (water heater); Annot., 126 A.L.R. 599, 600 (1951) (heating plant); Annot., 19 A.L.R.2d 1300, 1311 *et seq.* (1940) (sprinkler); Annot., 43 A.L.R.2d 1378, 1382 (1955) (air conditioning equipment); Annot., 52 A.L.R.2d 222, 234 *et seq.* (1957) (plumbing and plumbing accessories); Annot., 55 A.L.R.2d 1044 (1957) (carpets, linoleum, and other floor coverings).

371. Madfes v. Beverly Dev. Co., 166 N.E. 787 (N.Y. 1929); *accord* State v. Feves, 365 P.2d 97 (Or. 1961).

372. Tifton Corp. v. Decatur Fed. Sav. & Loan Ass'n, 222 S.E.2d 115 (Ga. Ct. App. 1975); Guardian Life Ins. Co. v. Swanson, 3 N.E.2d 324 (Ill. App. Ct. 1936); First Mortg. Bond Co. v. London, 244 N.W. 203 (Mich. 1932); Glueck & Co. v. Powell, 61 S.W.2d 406 (Mo. Ct. App. 1933); Mortg. Bond Co. v. Stephens, 74 P.2d 361 (Okla. 1937); Tudor Arms, Inc. v. McKendall Land Co., 6 A.2d 735 (R.I. 1939); Knoxville Gas Co. v. W.I. Kirby & Sons, 32 S.W.2d 1054 (Tenn. 1930); Leisle v. Welfare Bldg. & Loan Ass'n, 287 N.W. 739 (Wis. 1939) (gas ranges fixtures when in apartment house; dictum that result contra when ranges in private residence); Kratovil, *Fixtures and the Real Estate Mortgagee*, 97 U. PA. L. REV. 180, 184 (1948).

373. Com. v. Haveg Indus., 192 A.2d 376, 378 (Pa. 1963).

374. Metro. Life Ins. Co. v. Kimball, 94 P.2d 1101 (Or. 1939).

In some cases it may be desirable to obtain a separate security agreement pursuant to Article 9 of the Uniform Commercial Code to cover personal property, but it is possible to include the grant of a security interest on personal property in the real property mortgage.[375] The New York statutory form mortgage[376] is construed to include "all fixtures and articles of personal property attached to, or used in connection with, the premises."[377] The usual mortgage forms broaden this language as follows:

CLAUSE 3A-4

Mortgage Clause Covering Personal Property

> Mortgagor also mortgages all fixtures and personal property now or hereafter attached to or used in connection with the described premises.

This language purports to cover after-acquired property as well. Forms prepared for banks and other institutions or prepared especially for a particular transaction contain more elaborate personal property clauses.

It is current practice in connection with mortgages on apartment, office, and industrial buildings to obtain from a mortgagor and file a financing statement under the Uniform Commercial Code, which brings fixtures and personal property under the lien of the real property mortgage. This practice is not applied to one- and two-family houses.

A mortgagor's claim against the engineer and the architect of an office building, based on defective design and construction, was held a personal right under Louisiana law and not included in the lien of a mortgage.[378]

§ 3A:5.3 After-Acquired Fixtures and Personal Property

The after-acquired personal property clause mentioned above[379] may be expanded by a more specific list of articles to be covered and also by a requirement that any owner of the premises deliver further instruments from time to time on the mortgagee's request to confirm the lien of the mortgage on the articles specified. This makes evidence available in the event of foreclosure to prove the full extent of the lien.

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375. For discussion of the law prior to adoption of the Uniform Commercial Code, see Milton R. Friedman, *The Scope of Mortgage Liens on Fixtures and Personal Property in New York*, 7 FORDHAM L. REV. 331 (1938).
376. N.Y. REAL PROP. LAW § 258, Schedule M.
377. N.Y. REAL PROP. LAW § 254.
378. *In re* Schrewe, 108 B.R. 116 (Bankr. E.D. La. 1989).
379. *See supra* section 3A:5.1.

It also helps to hurdle a difficulty that has historically troubled after-acquired property clauses. A mortgage on after-acquired property is, in legal theory, not a lien *in praesenti*, but merely a covenant to give a mortgage in the future. This covenant is self-effecting as to the mortgagor but, being an affirmative covenant, does not run with the land to bind a subsequent owner who has not assumed the mortgage.[380] Therefore, articles of personal property may not come under the mortgage lien, though within the scope of the after-acquired personal property clause, when installed by a subsequent owner. Inasmuch as the articles in question, such as refrigerators and ranges, are replaced comparatively frequently, the problem is practical in a jurisdiction like New York where these articles are personal property. The problem under modern law is confined to real property. The Uniform Commercial Code explicitly authorizes an after-acquired property clause in a security agreement, with no necessity for the debtor to authenticate any additional record in the future when the debtor acquires the after-acquired property.[381]

If the mortgagee is relying on the law of mortgages to gain a security interest in after-acquired fixtures, rather than an Article 9 security agreement, then the mortgage clause requiring that the mortgagor execute further instruments permits a solution. The same result may be achieved by a provision permitting foreclosure if any subsequent owner fails on request of the mortgagee to assume the mortgage or at least the obligations under the after-acquired property clause. There is authority that disregards an after-acquired property clause as a covenant for future performance. It rules that a specification in a mortgage of equipment that is part of the realty brings after-acquired property of the specified nature under the lien of the mortgage, regardless of whether the installer of such equipment assumed the mortgage.[382] A purchase money security interest in personal property, other than inventory, has priority under the Uniform Commercial Code over a fee mortgagee's after-acquired personal property clause, but only if it is perfected within twenty days after delivery of the personal property. Otherwise, title to the personal property is subordinated to that of the fee mortgagee.[383]

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380. Guar. Tr. Co. v. N.Y. & Queens Cty. Ry., 170 N.E. 887, 890 (N.Y. 1930); *see* Milton R. Friedman, *Creation and Effect of Personal Liability on Mortgage Debts in New York*, 50 YALE L.J. 224 at 241 (1940). The rule was apparently overlooked in Gen. Synod of Reformed Church v. Bonac Realty Corp., 75 N.E.2d 841 (N.Y. 1947).

381. U.C.C. § 9-204(a).

382. *In re* Dover's Landing, 19 B.R. 139 (Bankr. N.D. Fla. 1981).

383. U.C.C. § 9-334); *see also* Regan v. ITT Indus. Credit Co., 469 So. 2d 1387, 1391 n.5 (Fla. Dist. Ct. App. 1984), and cases collected in 3 FLA. ST. U. L. REV. 150, 156 n.26 (1975).

§ 3A:6 Waste

Most mortgage covenants have a waste clause, which in its simplest form merely codifies the mortgagor's common law obligation not to commit waste: either voluntary waste, which consists of the mortgagor removing or damaging improvements; or permissive waste, which consists of the mortgagor failing to make necessary repairs or otherwise take proper care of the property. Permissive waste generally includes keeping the property in reasonable and customary repair, but does not include restoration or rebuilding occasioned by a major casualty. The impairment may be by physical damage to the property or economic loss to the mortgagee.[384] A California court held it was not waste for a mortgagor to fail to repair damage to buildings from an earthquake and a fire.[385]

Most waste actions against mortgagors take place after the mortgagee has acquired title to the property through foreclosure. In most states, a mortgagee may maintain an action for waste prior to foreclosure and prior to any default by the mortgagor in paying the debt.[386] This applies whether the state is a lien or title state.[387] The owner of the property is liable for waste whether or not he is liable on the mortgage debt[388] and even though he is solvent.[389]

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384. *See* Travelers Ins. Co. v. 633 Third Assocs., 14 F.3d 114 (2d Cir. 1994); Genesco, Inc. v. Monumental Life Ins. Co., 577 F. Supp. 72, 84 (D.S.C. 1983), *aff'd*, 747 F.2d 253 (4th Cir. 1984).

385. Krone v. Goff, 127 Cal. Rptr. 390 (Ct. App. 2d Dist. 1975) (fire not due to mortgagor's negligence; mortgagee, a purchase-money mortgagee, would have been barred from recovery of deficiency judgment by anti-deficiency judgment statute). *Cf.* Watson, *Impairment of Purchase Money Security by Disaster and Anti-Deficiency Judgment: The Sounds of Silence*, 47 LA. B. BULL. 146 (1972).

386. Jaffe-Spindler Co. v. Genesco, Inc., 747 F.2d 253 (4th Cir. 1984) (failure to repair roof, which led to constructive eviction of shopping center tenant, constitutes waste); McCorristin v. Salmon Signs, 582 A.2d 1271 (N.J. Super. Ct. 1991); Syracuse Sav. Bank v. Onondaga Silk Co., 14 N.Y.S.2d 356 (Sup. Ct. Onondaga Cty. 1939).

For cases requiring mortgagee to foreclose and establish a deficiency as a prerequisite to recovery of damages for waste, see Hummer v. R.C. Huffman Constr. Co., 63 F.2d 372, 374 (7th Cir. 1933).

387. Genesco, Inc. v. Monumental Life Ins. Co., 577 F. Supp. 72, 84 (D.S.C. 1983), *aff'd*, 747 F.2d 253 (4th Cir. 1984).

388. Jaffe-Spindler Co. v. Genesco, Inc., 747 F.2d 253 (4th Cir. 1984) (nonrecourse mortgage); Jowdy v. Guerin, 457 P.2d 745, 748–49 (Ariz. Ct. App. 1969); Prudential Ins. Co. v. Spencer's Kenosha Bowl, Inc., 404 N.W.2d 109 (Wis. 1987) (in lien states mortgagee recovers only to extent of deficiency of purchase price in foreclosure of mortgage).

389. Hummer v. R.C. Huffman Constr. Co., 63 F.2d 372, 375 (7th Cir. 1933); Syracuse Sav. Bank v. Onondaga Silk Co., 14 N.Y.S.2d 356 (Sup. Ct. Onondaga Cty. 1939); City of Toledo v. Brown, 200 N.E. 750, 752 (Ohio 1936).

The mortgagee's recovery for waste prior to foreclosure is limited to the sum then owing on the mortgage debt[390] and must be applied toward the mortgage debt.[391]

Under one line of cases, waste is actionable only if there is impairment of security.[392] This is the majority rule in lien theory jurisdictions, which hold that the mortgagee does not have title to the mortgaged property, only a lien.[393] The competing line of authority allows an action for waste prior to foreclosure, regardless of how well-secured the mortgagee happens to be. The value of any security remaining after any such recovery and application is immaterial, because the mortgagee bargained for such security.[394]

The measure of damages for waste is either the cost to restore the premises or the decrease in market value resulting from the waste.[395] A mortgagee who is out of possession need not mitigate damages.[396]

Foreclosure and sale changes the analysis with respect to a mortgagee's waste claim. A mortgagee's bid for the full amount of the mortgage debt bars a claim for waste because he cannot thereafter establish a claim for impairment of security.[397] This "full credit bid

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390. Brayton v. Pappas, 383 N.Y.S.2d 723 (App. Div. 4th Dep't 1976); Planters Bank v. Lummus Cotton Gin Co., 128 S.E. 876, 882 (S.C. 1925).

391. Genesco, Inc. v. Monumental Life Ins. Co., 577 F. Supp. 72, 86 (D.S.C. 1983), *aff'd*, 747 F.2d 253 (4th Cir. 1984).

392. *In re* Tremblay, 43 B.R. 221 (Bankr. D. Vt. 1984); Douglas v. Lowery, 266 N.E.2d 107 (Ill. App. Ct. 1971); Brayton v. Pappas, 383 N.Y.S.2d 723 (App. Div. 4th Dep't 1976); Frio Inv., Inc. v. 4M-IRC/Rohde, 705 S.W.2d 784 (Tex. Ct. App.–San Antonio 1986) (removal of dilapidated buildings). *Frio Investments* states the rule is based on the mortgagee's non-ownership of the property, *id.* at 786, suggesting that the rule might be different in a title state.

393. *See* Leipziger, *The Mortgagee's Remedies for Waste*, 64 CALIF. L. REV. 1086, 1097 (1976).

394. Hummer v. R.C. Huffman Constr. Co., 63 F.2d 372, 374–75 (7th Cir. 1933); W. & R. Inv. Co. v. Edwards Supply Co., 24 N.E.2d 518, 519 (Mass. 1939).

395. Genesco, Inc. v. Monumental Life Ins. Co., 577 F. Supp. 72, 86 (D.S.C. 1983), *aff'd*, 747 F.2d 253 (4th Cir. 1984); Jowdy v. Guerin, 457 P.2d 745, 749 (Ariz. Ct. App. 1969); Bell v. First Columbus Nat'l Bank, 493 So. 2d 964 (Miss. 1986).

A similar rule applies to a tenant's liability for the condition of leased premises at expiration of the term. *See* FRIEDMAN ON LEASES, *supra* note 25, § 18:1, at 18-18 to 18-24 (Supp. July 2013).

396. Genesco, Inc. v. Monumental Life Ins. Co., 577 F. Supp. 72, 87 (D.S.C. 1983) (mortgagee has no duty to repair leaking roof), *aff'd*, 747 F.2d 253 (4th Cir. 1984).

397. Sumitomo Bank v. Taurus Developers, Inc., 229 Cal. Rptr. 719 (4th Dist. Ct. App. 1986); W. & R. Inv. Co. v. Edwards Supply Co., 24 N.E.2d 518 (Mass. 1939); Monte Enters., Inc. v. Kavanaugh, 303 S.E.2d 194 (N.C. Ct. App. 1983).

rule," however, does not necessarily bar other actions the mortgagee may have against the mortgagor.[398] A mortgagee who bid the full amount of the debt in foreclosure was barred from recovering damages despite his claim that the value of the property was less.[399] When the mortgagee purchases at foreclosure for a price less than the outstanding debt, his waste action against the mortgagor is preserved to the extent of the deficiency.[400]

In California, an action for "bad faith waste" against the mortgagor survives a foreclosure, despite the anti-deficiency judgment, to the extent that the foreclosure price is less than the debt.[401]

Whether nonpayment of real estate taxes is waste is the subject of conflicting cases.[402] The Restatement takes the position that it is waste when the mortgagor "fails to pay before delinquency property taxes or governmental assessments secured by a lien having priority over the mortgage."[403] The issue usually is important only if the mortgage is non-recourse or is subject to anti-deficiency judgment legislation.

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398. Sumitomo Bank v. Taurus Developers, Inc., 229 Cal. Rptr. 719 (4th Dist. Ct. App. 1986) (barring waste action, but allowing claim against mortgagor-developer for negligence in building condominium project with defects).

399. Chrysler Capital Realty, Inc. v. Grella, 942 F.2d 160 (2d Cir. 1991) (Michigan law), relying on Whitestone Sav. & Loan Ass'n v. Allstate Ins. Co., 270 N.E.2d 694 (N.Y. 1971) (mortgagee who bid full amount of debt precluded from recovering insurance proceeds for pre-foreclosure fire).

400. A similar analysis follows with respect to a mortgagee's claim against a third party who causes injury to the mortgage property. *See* Moseley v. Bi-Lo Supermarket, Inc., 341 So. 2d 222 (Fla. Dist. Ct. App. 1976) (after settlement of foreclosure action, mortgagee allowed to pursue action against judgment creditor of mortgagor based on pre-foreclosure damage incident to writ of execution). For mortgagee's recovery generally against mortgagor, its right to participate in mortgagor's recovery against third party guilty of the waste, and the effect of mortgagor's settlement with third parties on mortgagee's rights, see Stevenson v. Goodson, 924 P.2d 339, 348–53 (Utah 1996). Leipziger, *The Mortgagee's Remedies for Waste*, 64 CALIF. L. REV. 1086 (1976), is a comprehensive consideration of the entire subject.

401. Hickman v. Mulder, 130 Cal. Rptr. 304 (4th Dist. Ct. App. 1976) (permissive waste by failure to preserve quality of agricultural land).

402. *E.g.*, Travelers Ins. Co. v. 633 Third Assocs., 14 F.3d 114, 123 (2d Cir. 1994) (New York law; nonpayment is waste); N. Am. Sec. Life Ins. Co. v. Harris Tr. & Sav. Bank, 859 F. Supp. 1163 (N.D. Ill. 1994) (nonpayment is waste); Nippon Credit Bank v. 1333 N. Cal. Boulevard, 103 Cal. Rptr. 2d 421 (Ct. App. 1st Dist. 2001) (nonpayment is waste if in bad faith); Chetek State Bank v. Barberg, 489 N.W.2d 385 (Wis. Ct. App. 1992) (nonpayment of interest and taxes not waste; distinguishes cases authorizing appointment of receiver for nonpayment).

403. RESTATEMENT (THIRD) OF PROPERTY (Mortgages) § 4.6(a)(3) (1997).

§ 3A:7 Non-Recourse

In substantial commercial transactions it is very common for the parties to include a nonrecourse provision in the promissory note and mortgage that purports to release the mortgagor from all personal liability.[404] The mortgage instruments may validly provide that the mortgagor will not be personally liable for the mortgage debt, thus limiting the remedy of the mortgage to the mortgaged premises.[405]

In the past, clauses for this purpose tended to give the mortgagor a complete release. A complete non-recourse mortgage leaves the mortgagor with the beneficial interest in the property, but subjects the lender to the risk of loss from all possible uninsured harm to the property, including failure to repair, failure to comply with all federal and local laws, misuse of the income of the property, etc.

Today, few institutional lenders make complete non-recourse loans. Modern non-recourse provisions generally have express "carve-outs," which call for personal liability of the mortgagor for various, specified claims.

A provision making the mortgage nonrecourse does not absolve the mortgagor from personal liability for waste, although at times the nature of waste may not be certain.[406] This is a default rule; a mortgagee may seek to include an express carve-out for waste, but in its absence many courts will protect the mortgagee from at least some types of serious waste. In *Travelers Insurance Co. v. 633 Third Associates*,[407] a broadly worded non-recourse provision barred "any action or proceeding wherein damages or any money judgment shall be sought . . ., except a foreclosure action against the Mortgaged Property." The mortgagee brought an action based on the mortgagor's failure to pay real property taxes. The court ruled that this language precluded a tort action for damages for waste, but largely unwound this determination by holding in a subsequent appeal that the mortgagee could pursue claims in equity, seeking injunctive relief and specific performance of the mortgagor's promise to pay taxes.[408]

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404. This is exemplified in section 4.03(c)(ii) of the contract of sale for New York office, commercial, and multi-family residential premises, prepared by the Real Property Committee of the Association of the Bar of the City of New York, distributed by Julius Blumberg, Inc. (Form No. 154), New York, N.Y. 10013.
405. Bedian v. Cohn, 134 N.E.2d 532 (Ill. App. Ct. 1956).
406. *See* Travelers Ins. Co. v. 633 Third Assocs., 14 F.3d 114 (2d Cir. 1994).
407. Travelers Ins. Co. v. 633 Third Assocs., 973 F.2d 82 (2d Cir. 1992).
408. Travelers Ins. Co. v. 633 Third Assocs., 14 F.3d 114 (2d Cir. 1994). Query, would the clause in *Travelers* absolve a mortgagor from liability from an express clause not to remove buildings? In other words, to what extent will an exculpatory clause be enforced? *See* FRIEDMAN ON LEASES, *supra* note 25, ch. 17, Exculpatory Clauses (Supp. July 2014).

Decisions such as *Travelers* demonstrate why mortgagees are better served by drafting express, precise carve-outs for waste, rather than leaving the matter to the courts.

Some mortgage commitments expressly exclude waste from the nonrecourse provision and specify many other detailed items excluded from the mortgagor's exculpation.[409] The mortgagee seeks to limit the release to the mortgage debt alone, preserving personal liability for waste or the financial equivalent of waste. A sample clause for this purpose appears below:

CLAUSE 3A-5

Non-Recourse Clause

(a) Notwithstanding anything to the contrary contained in this mortgage, except as set forth in subsection (c) below, the obligation of the mortgagor for payment of the mortgage debt is limited solely to recourse against the property secured by this mortgage; and in no event shall the mortgagor be personally liable for breach of this mortgage or the obligation hereby secured.

(b) The provisions of subection (a) shall apply to any bond, note, or collateral instrument evidencing the debt secured by this mortgage.

(c) The provisions of subection (a) shall not apply to any liability the mortgagor might have, but for said subection (a), for the commission of waste to the mortgaged premises or for the breach of any obligation of the mortgagor under this mortgage, or any instrument referred to in subection (b), by: cancelling or modifying any lease, collecting any rent in advance of the current monthly rent, or failure to apply the net proceeds of any insurance against casualty or the net award of partial condemnation, which shall be paid to or applied on behalf of the mortgagor, to repair or restoration of the premises damaged by an event insured so against or by such condemnation, or for failing to hold the rents and profits of the mortgaged premises, after default, in trust to pay for real estate taxes, carrying charges of said premises, and for service of the mortgage debt.

It is unnecessary to include in the foregoing clause any reference to possible fraud or affirmative misrepresentation by the mortgagor in

409. A good discussion of the general subject appears in Edwards, *Commercial Loan Commitments: A Borrower's Perspective*, REAL PROP., PROB. & TR. J. 28–30 (July/Aug. 1994).

obtaining the mortgage because of the mortgagee's other remedies for this.

Some lenders agree to non-recourse, but insert so many carve-outs as to leave the exculpation from liability with little value.[410]

Waste is not the only implied exception from the non-recourse provision. An Ohio court has ruled that a non-recourse clause does not bar the effect of an assignment of rent clause.[411]

The non-recourse provision should provide for personal liability for liens affecting the property that are superior to the mortgage; and for liens subordinate to the mortgage, which are likely to involve personal liability of the mortgagor, except to the extent that the proceeds thereof have been applied to improvements.[412] Query, should reference be made at this point to fraud or affirmative misrepresentation in obtaining the mortgage because the mortgagee has remedies for these? It has also been suggested that the carve-outs should include bad-faith cancellation of leases and unknown environmental problems.[413] For some of these, reference is made to "milking" and the absolute assignment of rent to a mortgagee.

In effect, the diversity as to the nature and extent of carve-outs means that there are not just two types of mortgage loans: recourse and non-recourse. Rather, there is a broad spectrum ranging from unlimited personal liability to "complete non-recourse," that is, no express carve-outs. In considering where to position itself within that spectrum, the mortgagee should give thought to the fiscal responsibility of the mortgagor, as well as to the amount of the equity vested in that party.

A clause excusing a mortgagor from liability for principal and interest leaves the mortgagor liable for other, possibly substantial, obligations.[414] A line of Florida cases deal with variations of clauses

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410. See the items listed and discussed in Morrison & Senn, *Carving Up the "Carve-Outs" in Nonrecourse Loans*, REAL PROP., PROB. & TR. J., May/ June 1958.

411. Prudential Ins. Co. v. Corp. Circle, Ltd., 658 N.E.2d 1066 (Ohio Ct. App. 1995) (lender entitled to rents under assignment of leases from time it commenced foreclosure action, notwithstanding nonrecourse provision).

412. *See* Morrison & Senn, *Carving Up the "Carve-outs" in Nonrecourse Loans*, REAL PROP., PROB. & TR. J., May/June 1995, at 9–12.

413. These are included in a more extended discussion in Stein, *Nonrecourse Carveouts: How Far Is Far Enough?*, 1997 REAL ESTATE REV. at 3 (Winter 1997).

414. *See* Fed. Home Mortg. v. Inland Indus., 869 F. Supp. 99 (D. Mass. 1994) (mortgagee may collect late fees, attorneys' fees, and other items under clause barring personal liability for principal and interest, but expressly preserving personal liability "for the payment of all other amounts payable under the Note and for the performance of all other covenants" in mortgage).

providing that the mortgaged property is the "sole security" for the debt, highlighting the need for careful drafting if the mortgagor desires a non-recourse loan.[415]

The use of nominees or straw men to execute mortgage instruments in order to insulate the real party in interest from liability for the mortgage debt is an alternative to mortgage execution by the real party in interest with the addition of non-recourse provisions.[416]

§ 3A:8 Maintenance of Premises in Good Condition

In 1984, New York added a new statutory construction for a mortgagor's covenant to maintain the premises and improvements in "good condition or repair" for a mortgage on property with residences for four or more families.[417] Such a covenant means the mortgagor must keep the property "free from violations of applicable municipal or state laws, codes or regulations."[418] If a government agency certifies to the existence of a violation "involving a serious danger to the health and safety of the occupants" of the mortgaged property, the mortgagee is authorized to acclerate the debt and foreclose, unless the mortgagor cures the violation within a reasonable period of time, which is not less than thirty days.[419] A 2008 amendment extended the construction to authorize acceleration and foreclosure upon the judicial appointment of an administrator, at the instance of tenants, to collect rents and apply them to remedy conditions dangerous to life, health, or safety.[420]

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415. Mellor v. Goldberg, 658 So. 2d 1162 (Fla. Dist. Ct. App. 1995) (language stating land "shall be the sole security for the indebtedness . . . and a deficiency judgment shall not be obtained against the mortgagor in the event of foreclosure" is ambiguous; parol evidence is admissible to determine whether parties intended to allow mortgagee to bring action on the note); Thomas v. Hartman, 553 So. 2d 1256 (Fla. Dist. Ct. App. 1989) (language stating land "shall be the sole security for the note" does not bar personal judgment on debt); Heim v. Kirkland, 356 So. 2d 850 (Fla. Dist. Ct. App. 1979) (language stating land was sole security with no further recourse against the maker-mortgagor bars any claim for deficiency); Policastro v. Rudt, 180 So. 2d 472 (Fla. Dist. Ct. App. 1965) (personal judgment precluded by language in mortgage stating land shall be "sole security for payment of all sums" evidenced by note and mortgagor shall not "be personally liable" on note, even though note itself had no such language).

416. The use of nominees and straws is discussed in sections 6:1 and 6:1.5.

417. N.Y. REAL PROP. LAW § 254(4-a).

418. *Id.*

419. *Id.*

420. N.Y. Laws 2008, ch. 529, § 1, codified at N.Y. REAL PROP. LAW § 254(4-a) (cross referencing to N.Y. Real Property Actions and Proceedings article 7-a).

A clause permitting the mortgagee to declare the mortgage debt due and payable for failure to maintain the premises in a state of repair is generally not enforced unless the deterioration has impaired the mortgagee's security.[421]

§ 3A:9 Prepayment

Under a rule known as "perfect tender in time," a mortgagor is not allowed to prepay the debt without the mortgagee's consent. An owner has no implied right to prepay even on tendering full interest to maturity.[422]

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421. United States v. Angel, 362 F. Supp. 445 (E.D. Pa. 1973) (mortgagee must prove impairment to foreclose for failure to maintain and repair); Bart v. Streuli, 52 P.2d 922 (Cal. 1935) (covenant against removal or demolition of any building; foreclosure denied when mortgagor removed front porch as part of scheme of improvement, thereby enhancing value of premises); Loughery v. Catalano, 191 N.Y.S. 436 (Sup. Ct. Bronx Cty. 1921) (alterations that did not change character of building and enhanced its value), *aff'd*, 201 N.Y.S. 919 (App. Div. 1st Dep't 1923).

422. Eyde Bros. Dev. Co. v. Equitable Life Ins. Co., 697 F. Supp. 1431 (W.D. Mich. 1988); *In re* Brannon, 683 So. 2d 994 (Ala. 1996); McCarty v. Mellinkoff, 4 P.2d 595 (Cal. Dist. Ct. App. 1931); Dugan v. Grzybowski, 332 A.2d 97 (Conn. 1973); Lindsay Realty Corp. v. Bellina, 320 So. 2d 572 (La. Ct. App. 1975) (installment sale; collecting authorities); Trahant v. Perry, 149 N.E. 149 (Mass. 1925); Chapp v. Paterson, 397 P.2d 5 (Nev. 1964); Patterson v. Tirollo, 581 A.2d 74 (N.H. 1990); Troncone v. Canelli, 538 N.Y.S.2d 39 (App. Div. 2d Dep't 1989); Young v. Sodara, 456 S.E.2d 31 (W. Va. 1995); 5 H. TIFFANY, REAL PROPERTY § 1472 (3d ed. 1939); 59 C.J.S. *Mortgages* § 447 (1949). A mortgage payable "within" a specified time may be paid off at any time. However, a mortgage that is payable "within" a specified number of years is not so prepayable if it calls for installments in an amount that will evenly amortize the debt by the end of the specified time. *See* Bloomfield Sav. Bank v. Howard S. Stainton & Co., 159 A.2d 443 (N.J. Super. Ct. 1960); Los Quatros, Inc. v. State Farm Life Ins. Co., 800 P.2d 184 (N.M. 1990); Mahoney v. Furches, 454 A.2d 1117, 1119 (Pa. Super. Ct. 1983), *rev'd*, 468 A.2d 458 (Pa. 1983); Annot., *Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt*, 86 A.L.R.3d 599 (1978); Poommipanit v. Sloan, 510 N.W.2d 542 (Neb. Ct. App. 1993) (installment contract of sale; collecting cases); 55 AM. JUR. 2d *Mortgages* § 397 (1971).

In Mahoney v. Furches, 468 A.2d 458 (Pa. 1983), a purchase money mortgagor sought without success (1) to subdivide and sell parts of the mortgaged property, and then (2) to prepay the debt. Neither was provided for in the mortgage. The court ruled that a right of prepayment depends on the language in the mortgage and the intent of the parties. It held a mortgage, otherwise silent, is presumably prepayable. Hatcher v. Rose, 407 S.E.2d 172 (N.C. 1991), is in accord, *rev'g* 389 S.E.2d 442 (N.C. Ct. App. 1990). This was said to conform to the early common law rule. Frank S. Alexander, *Mortgage Prepayment: The Trial of Common Sense*, 72 CORNELL L. REV. 288, 292–305 (1987) [hereinafter Alexander]. *See also* the dissent in *Brannon*, 683 So. 2d 994. But the common-law rule is a matter of dispute. *See* Hatcher v. Rose, 407 S.E.2d 172, 177 (N.C. 1991).

Mahoney was a hard case and, it is submitted, makes bad law. A presumption of prepayment is a retroactive change in the law that may wreak havoc on existing mortgages, and future mortgages prepared on old forms. For a discussion and authorities on the retroactive and prospective effects of overruling decisions, see Mendes v. Johnson, 389 A.2d 781, 787 *et seq.* (D.C. 1978); Erhard v. F.W. Woolworth Co., 372 N.E.2d 1277 (Mass. 1978); Van Dyke v. Chappell, 818 P.2d 1023 (Utah 1991). There has been no custom to expressly negate a right of prepayment (despite *Connolley* and *Hartford Life Ins. Co.*, cited *infra* this note) except when giving a mortgagor a qualified right (*e.g.*, no prepayment for three years). Prepayment may abort an investment, and an installment sale that triggers an otherwise avoidable capital gains tax on a mortgagee. The court's statement that a contra rule would be a restraint on alienation strikes the author as correct, but not the majority of courts that rule on the converse situation of payment under due-on-sale clauses.

For an extensive discussion and collection of authorities, see Metro. Life Ins. Co. v. Promenade Towers Hous. Corp., 581 A.2d 846 (Md. Ct. Spec. App. 1990); Alexander, *supra. Metropolitan Life Ins. Co.* was affirmed in a comprehensive opinion with many more authorities and a background of Maryland law, *sub nom.* Promenade Towers Mut. Hous. Corp. v. Metro. Life Ins. Co., 597 A.2d 1377 (Md. 1991).

Prepayment can impose daunting economic sacrifices upon a mortgagee, not the least of which include the loss of the bargained-for rate of return, an increased tax burden, and unanticipated costs occasioned by the need to reinvest the principal, and, for those creditors anxious to ensure regular payments not unlike an annuity, it undoes the mortgagee's purpose in making the loan. Arthur v. Burkich, 520 N.Y.S.2d 638, 639 (App. Div. 3d Dep't 1987).

Under statutes relating to residential property, Florida and North Carolina permit prepayment without penalty if it is not expressly forbidden by the mortgage. FLA. STAT. § 697.06 (1990); MO. REV. STAT. § 408.036 (Laws 1990, H.B. 1125 § A). An Illinois statute forbids a prepayment penalty when the interest rate exceeds 8%. 815 ILL. COMP. STAT. 205/4(n)(2)(a) (1993). Massachusetts permits prepayment of a first mortgage on a dwelling of three or less households occupied by the mortgagor. MASS. GEN. LAWS ch. 183, § 57 (1991). New Jersey permits prepayment at any time without penalty. N.J. STAT. § 46:10B-2 (1989). North Carolina permits prepayment without penalty when the mortgage makes no reference to prepayment. N.C. GEN. STAT. § 24-2-4 (1994). A Maryland statute is similar. MD. CODE ANN., REAL PROP. § 24-2.4 (Laws 1991, ch. 409). A Tennessee statute makes the right of prepayment governed by the contract between the parties. TENN. CODE ANN. § 47-14-108 (1990). A Texas statute that limits prepayment penalties when the interest exceeds a specified amount made unenforceable a mortgage clause that forbade any prepayment when the mortgage interest exceeded that specified in the statute. Groseclose v. Rum, 860 S.W.2d 554 (Tex. Civ. App. 1993). Many more detailed statutes relating to residential mortgages are collected and discussed in Baldwin, *Prepayment Penalties*, 40 VAND. L. REV. 409, 430–34 (1987); Alexander, *supra*, at 324–28, 334–36.

A provision permitting prepayment at two specified times did not permit prepayment at other times. Metro. Life Ins. Co. v. Strnad, 876 P.2d 1362 (Kan. 1994).

It follows that an express right to pay the principal does not include a right to make part payment.[423] The importance of a prepayment right was highlighted in a case upholding a mortgagee's right to exact a bonus of $2,000 as a condition of accepting prepayment of a mortgage on which less than $15,000 was owing.[424] The cases hold generally that in case of prepayment, either under a right given in the mortgage

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A right to prepay if the owner paid an additional 2% premium was held not to justify the mortgagee's retention of this 2% when payment was effected by mortgagee's resort to proceeds of fire insurance. Chestnut Corp. v. Bankers Bond & Mortg. Co., 149 A.2d 48 (Pa. 1959). *Accord*, as to eminent domain, Associated Schs., Inc. v. Dade County, 209 So. 2d 489 (Fla. Dist. Ct. App. 1968); *see* Berenato v. Bell Sav. & Loan Ass'n, 419 A.2d 620 (Pa. Super. Ct. 1980) (discussing cases on eminent domain and insurance proceeds). But a mortgagee's right to a prepayment premium on exercising an election to accelerate the mortgage debt on a sale of the property was left open in Kadner v. Shields, 97 Cal. Rptr. 742 (2d Dist. Ct. App. 1971).

A mortgage clause permitting prepayment of 20% of principal each year was held to prevail over another clause requiring monthly payments of $1,491.15 "or more." Aronoff v. W. Fed. Sav. & Loan Ass'n, 470 P.2d 889 (Colo. Ct. App. 1970).

A contract providing for monthly payments of not less than $223.84 was held to permit prepayment of the balance as part of any monthly payment. Peters v. Fenner, 199 N.W.2d 795 (Minn. 1972).

A provision for releases from the mortgage in parcels, on specified payments, has been held the equivalent of a right to prepay. A requirement that mortgagor file a subdivision map before becoming entitled to releases was held inapplicable to payment of the entire mortgage. Davlick Constr. Co. v. Krohn Assocs., Inc., 242 N.Y.S.2d 647 (Sup. Ct. Nassau Cty. 1963).

A provision expressly forbidding prepayment is valid. Stouffer Hotel Co. v. Teachers Ins. & Annuity Ass'n, 737 F. Supp. 1553, 1561 (M.D. Fla. 1990); Connolley v. Harrison, 327 A.2d 787 (Md. Ct. Spec. App. 1974); Hartford Life Ins. Co. v. Randall, 583 P.2d 1126 (Or. 1978); McCausland v. Bankers Life Ins. Co., 757 P.2d 941 (Wash. 1988) (no prepayment for seven years).

A prepayment premium, during the first five years, of one year's interest of the sum prepaid in excess of 20% of the original principal, was held no unjust enrichment. Lazzareschi Inv. Co. v. S.F. Fed. Sav. & Loan Ass'n, 99 Cal. Rptr. 417 (Ct. App. 1971); Century Fed. Sav. & Loan Ass'n v. Madorsky, 353 So. 2d 868 (Fla. Dist. Ct. App. 1977). *See also* Williams v. Fassler, 167 Cal. Rptr. 545 (5th Dist. Ct. App. 1980).

For cases in accord, see 86 A.L.R.3d 599, 613 (1978).

Annot., *Validity and Construction of Provision of Mortgage or Other Real Estate Financing Contract Prohibiting Prepayment for a Fixed Period of Time*, 81 A.L.R.4th 423 (1990).

423. First Phila. Realty Corp. v. Albany Sav. Bank, 609 F. Supp. 207 (E.D. Pa. 1985).

424. Feldman v. Kings Highway Sav. Bank, 102 N.Y.S.2d 306 (App. Div. 2d Dep't), *aff'd*, 102 N.E.2d 835 (N.Y. 1951); *accord* Lindsay Realty Corp. v. Bellina, 320 So. 2d 572 (La. Ct. App. 1975) (installment sale; collecting authorities); see authorities in Dugan v. Grzybowski, 332 A.2d 97 (Conn. 1973).

or under an agreement made thereafter, a premium is properly collectible that, when added to the interest, does not bring the aggregate payments above the legal maximum for the original term of the mortgage, but that when payment is involuntary, as where the mortgagee elects to accelerate, the sum payable may not bring the interest above the legal maximum to the date of payment.[425]

A mortgage payable "within" a specified time may be paid off at any time. However, a mortgage that is payable "within" a specified number of years is not so prepayable if it calls for installments in an amount that will evenly amortize the debt by the end of the specified time. *See* Bloomfield Sav. Bank v. Howard S. Stainton & Co., 159 A.2d 443 (N.J. Super. Ct. 1960); Mahoney v. Furches, 454 A.2d 1117, 1119 (Pa. Super. Ct. 1983), *rev'd on other grounds*, 468 A.2d 458 (Pa. 1983); Annot., *Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt*, 86 A.L.R.3d 599 (1978).

425. McCae Mgmt. Corp. v. Merchs. Nat'l Bank, 553 N.E.2d 884 (Ind. Ct. App. 1990); Mut. Life Ins. Co. v. Hilander, 403 S.W.2d 260 (Ky. 1966); Connolley v. Harrison, 327 A.2d 787 (Md. Ct. Spec. App. 1974); Chapp v. Paterson, 397 P.2d 5, 8 (Nev. 1964); Bloomfield Sav. Bank v. Howard S. Stainton & Co., 159 A.2d 443 (N.J. Super. Ct. 1960); Feldman v. Kings Highway Sav. Bank, 102 N.Y.S.2d 306 (App. Div. 2d Dep't), *aff'd*, 102 N.E.2d 835 (N.Y. 1951); Lyons v. Nat'l Sav. Bank, 113 N.Y.S.2d 695 (App. Div. 3d Dep't 1952); Annot., 130 A.L.R. 73 (1941); Annot., 75 A.L.R.2d 1265 (1961). *See also* Williams v. Fassler, 167 Cal. Rptr. 545 (5th Dist. Ct. App. 1980). *But see In re* Fin. Ctr. Assocs., L.P., 140 B.R. 829 (Bankr. E.D.N.Y. 1992); Baldwin, *Prepayment Penalties*, 40 VAND. L. REV. 409, 420–24 (1987); Comment, *Secured Real Estate Loan Prepayment and the Prepayment Penalty*, 51 CALIF. L. REV. 923, 925–26 (1963).

An institutional mortgagee is justified in requiring a reasonable premium for prepayment by reason of loss of interest pending reinvestment of the money. Furthermore, although the borrower pays the cost of the loan, putting a mortgage on the company's books entails expense, if only in overhead. Prepayment may be more serious to the holder of a purchase money mortgage given in connection with an installment sale, under which the seller-mortgagee returns as income that percentage of the buyer's payments that the gross profit on the sale bears to the total contract price. I.R.C. § 453(b) (1954). In this situation prepayment may substantially alter the mortgagee's tax position to his possible detriment. Chapp v. Paterson, 397 P.2d 5 (Nev. 1964).

In Williams v. Fassler, 167 Cal. Rptr. 545 (5th Dist. Ct. App. 1980), a 50% penalty on the amount voluntarily prepaid was held not unconscionable where reasonably related to vendor's anticipated increased tax liability. A prepayment charge of about $2.5 million on a mortgage of $15 million was disallowed in bankruptcy as unreasonable. *In re* Skyler Ridge, 80 B.R. 500 (Bankr. C.D. Cal. 1987). *Cf.* Teachers Ins. & Annuity Ass'n v. Butler, 626 F. Supp. 1229 (S.D.N.Y. 1986). A detailed criticism of *Skyler Ridge* appears in Stark, *Prepayment Charges in Jeopardy: The Unhappy and Uncertain Legacy of* In re *Skyler Ridge*, 24 REAL PROP., PROB. & TR. J. 191 (1989), for its "blatant result-oriented basis." There are other instances in which very high recoveries have been denied where they

Prepayment requires payment of only such interest as accrues to the date of payment.[426] But interest paid in advance, in accord with a requirement for payment in advance, is not refundable.[427]

A mortgagor's right to prepay the mortgage debt without penalty and without payment of interest beyond the time of payment may be created by language stating that payment shall be "on or before" or "within" a specified time or "not less then" a specified amount.[428] If prepayment is for the full amount of the mortgage debt the interest on this debt ceases after this payment. The same is true of partial prepayments under most mortgages,[429] but this may be unclear in the face of required prepayment premiums. If the mortgage is an

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are based on prospective damages. Under present and prior bankruptcy laws landlords have been limited in recovery based on future rents under long term leases. Bankruptcy Reform Act of 1978, § 502(b)(6); FRIEDMAN ON LEASES, *supra* note 25, § 16:2.4 (Supp. July 2014). Landlords have been denied enforcement in tenant bankruptcy of lease provisions authorizing cancellation of the lease on tenant's bankruptcy. Enforcement would give landlord the "bonus value" of the lease and prevent continuance of tenant's business, which might create assets for tenant's other creditors. Bankruptcy Reform Act of 1978 §§ 365(b)(2), 365(e)(1); FRIEDMAN, *supra*. After breach of a contract of sale of real property the wronged party has at times recovered, and at times been denied, increased financial charges occasioned by the breach.

Annot., *Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt*, 86 A.L.R.3d 599 (1978).

426. Fortson v. Burns, 479 S.W.2d 722 (Tex. Civ. App. 1972).

427. Shelly v. Bristol Sav. Bank, 26 A. 474 (Conn. 1893); Wishnoff v. Guardian Sav. & Loan Ass'n, 339 N.E.2d 494 (Ill. App. Ct. 1975); Crowley v. Kolsky, 57 S.W. 386 (Tenn. Ct. App. 1900).

428. Tryon v. Carter, 94 Eng. Rep. 1069 (K.B. 1734); L.A. Inv. Co. v. Wilson, 185 P. 853 (Cal. 1919); Garner v. Sisson Props., 31 S.E.2d 400 (Ga. 1944); Peters v. Fenner, 199 N.W.2d 795 (Minn. 1972); Brenner v. Neu, 170 N.E.2d 897, 899 (Ill. App. Ct. 1960); *In re* John & Cherry Sts., 19 Wend. 659, 13 N.Y. Com. L. Rpts. 741 (N.Y. Sup. Ct. 1839); Beth-June, Inc. v. Wil-Avon Merch. Mart, 233 A.2d 620 (Pa. Super. Ct. 1967); Alexander, *Mortgage Prepayment: The Trial of Common Sense*, 72 CORNELL L. REV. 288, 318 (1987).

But "unless sooner paid" created a prepayment, right was held a factual question. Troncone v. Canelli, 538 N.Y.S.2d 39 (App. Div. 2d Dep't 1989) (denying summary judgment). *Contra* Matimer v. Grundy Cty. Nat'l Bank, 607 N.E.2d 294 (Ill. App. Ct. 1992) (gives right to prepay).

Providing for interest payments "on or before" the fifteenth of a month gave no right to prepay the principal. Comarron W. Props. v. Lincoln Loan Co., 860 P.2d 871 (Or. Ct. App. 1993) (installment sale of realty; distinguishing Phillips v. Johnson, 514 P.2d 1337, 1344 (Or. 1973), on this ground).

429. *See generally* Annot., *Construction and Effect as to Interest Due on Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt*, 86 A.L.R.3d 599–624 (1978); 45 AM. JUR. 2d *Interest* § 99 (1969).

installment mortgage (that is, providing for fixed payments applicable first to interest and then to principal) and the mortgagor makes a payment as of right, larger than the installment due, the mortgage principal is reduced more than that contemplated by the original schedule and the mortgagee is entitled only to lesser interest than that computed upon the original payment schedule.

The right to prepay the mortgage is often subject to a prepayment premium. Cases generally hold that the premium is applicable to voluntary prepayment and not to condemnation awards or insurance proceeds, but the mortgage terms may provide otherwise. The premium may be substantial when computed to preserve the mortgagee's bargain. If interest rates fall, the premium may be the difference between the rate on government bonds with a maturity close to that of the mortgage and the mortgage rate computed to the expiration of the original mortgage term. At the least this sum may be discounted to its then-value.

An obligation to pay a prepayment premium is generally limited to a voluntary prepayment by the mortgagor and does not apply, inter alia, to a mortgagee's right to proceeds of insurance, a condemnation award, or to payment under a due-on-sale clause, or other form of acceleration.[430] But a provision expressly making a prepayment

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430. *In re* LHD Realty Corp., 726 F.2d 327 (7th Cir. 1984); Eyde Bros. Dev. Co. v. Equitable Life Ins. Co., 697 F. Supp. 1431 (W.D. Mich. 1988); *In re* Pinebrook, Ltd., 85 B.R. 160 (Bankr. M.D. Fla. 1988); Ferriera v. Yared, 588 N.E.2d 1370 (Mass. App. Ct. 1992); George H. Nutman, Inc. v. Aetna Bus. Credit, Inc., 453 N.Y.S.2d 586 (Sup. Ct. Queens Cty. 1982) (acceleration). See cases collected in Pac. Tr. Co. v. Fid. Sav. & Loan Ass'n, 229 Cal. Rptr. 269, 273 (6th Dist. Ct. App. 1986). A right to prepay if the owner paid an additional 2% premium was held not to justify the mortgagee's retention of this 2% when payment was effected by mortgagee's resort to proceeds of fire insurance. Chestnut Corp. v. Bankers Bond & Mortg. Co., 149 A.2d 48 (Pa. 1959) (dictum that parties may agree otherwise). *Accord*, as to eminent domain, Associated Schs., Inc. v. Dade County, 209 So. 2d 489 (Fla. Dist. Ct. App. 1968); DeKalb County v. United Family Life Ins. Co., 219 S.E.2d 707 (Ga. 1975) (during period mortgage closed to prepayment); Vill. of Rosemont v. Maywood-Proviso State Bank, 501 N.E.2d 859 (Ill. App. Ct. 1986) (despite application of prepayment clause to transfer by operation of law; collects cases); Jala Corp. v. Berkeley Sav. & Loan Ass'n, 250 A.2d 150 (N.J. Super. Ct. App. Div. 1969); Silverman v. State, 370 N.Y.S.2d 234 (App. Div. 3d Dep't 1975); and to a sale induced by a threat of condemnation, Landohio Corp. v. Nw. Mut. Life Mortg. & Realty Inv'rs, 431 F. Supp. 475 (N.D. Ohio 1976). *See also* cases in Eyde v. Empire Fed. Sav. Bank, 701 F. Supp. 126, 129 (E.D. Mich. 1988); First Ind. Fed. Sav. Bank v. Md. Dev. Co., 509 N.E.2d 253 (Ind. Ct. App. 1987). *But see* 84 A.L.R.3d 946 (1978). A condemnor is generally not liable for a prepayment

premium applicable to involuntary prepayment has been enforced,[431] but not in bankruptcy of the debtor.[432] A prepayment premium was held enforceable after an intentional default for the purpose of avoiding

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premium. *See id.* Payment under protest is not a condition of recovery of an improper payment. Schmidt v. Interstate Fed. Sav. & Loan Ass'n, 421 F. Supp. 1016 (D.D.C. 1976).

Prepayment premium has been denied to a mortgagee enforcing a due-on-sale cause, Eyde v. Equitable Life Assurance Soc'y, 697 F. Supp. 1430 (W.D. Mich. 1988); Abramoff v. Life Ins. Co., 92 B.R. 698 (Bankr. W.D. Tex. 1988); Tan v. Cal. Fed. Sav. & Loan Ass'n, 189 Cal. Rptr. 775 (Ct. App. 1983); Slevin Container Corp. v. Provident Fed. Sav. & Loan Ass'n, 424 N.E.2d 939 (Ill. App. Ct. 1981); Los Quatros, Inc. v. State Farm Life Ins. Co., 800 P.2d 184 (N.M. 1990); McCausland v. Bankers Life Ins. Co., 757 P.2d 941 (Wash. 1988). *Contra* Warrington 611 Assocs. v. Aetna Life Ins. Co., 705 F. Supp. 229 (D.N.J. 1989) (Pennsylvania law). The question was left open in Kadner v. Shields, 97 Cal. Rptr. 742 (2d Dist. Ct. App. 1971). The premium was allowed in a case applying federal law to a federal savings and loan association. Borenstein v. Franklin Soc'y Fed. Sav. & Loan Ass'n, N.Y.L.J., Mar. 22, 1978, at 7, col. 2 (Sup. Ct.). Some statutes codify the rule that bars a prepayment premium after acceleration of residential mortgages under a due-on-sale clause. *See* N.Y. REAL PROP. LAW § 254(4-a). The New York statute has been held retroactive. Rogers v. Williamsburgh Sav. Bank, 361 N.Y.S.2d 531 (Dist. Ct. Suffolk Cty. 1974). *But cf. Borenstein, supra.* When mortgagor's sale would permit mortgagee to invoke a due-on-sale clause, a voluntary prepayment before the sale has permitted mortgagee to collect the prepayment premium. First Nat'l Bank v. Equitable Life Assurance Soc'y, 510 N.E.2d 650 (Ill. App. Ct. 1987); First Ind. Fed. Sav. Bank v. Md. Dev. Co., 509 N.E.2d 253 (Ind. Ct. App. 1987). Mortgagee's refusal to consent to such sale was immaterial. *First Indiana, supra.* This would seem to penalize an owner for avoiding acceleration and a subsequent useless foreclosure action. For due-on-sale clauses generally, see section 3A:2.

The rule is codified, as to condemnation, in CAL. CIV. PROC. CODE § 1265.240; MASS. GEN. LAWS ch. 183, § 57. Other statutes require the condemnor to pay prepayment charges. ARIZ. REV. STAT. ANN. § 11-965; CONN. GEN. STAT. § 8-282 (1983); OKLA. STAT. tit. 27, § 10; S.C. CODE ANN. § 28-11-30.

Prepayment premium is generally denied to a mortgagee when prepayment is made for a reason other than under the mortgagor's option. Annot., 86 A.L.R.3d 599, 605 (1978).

431. *In re* Fin. Ctr. Assocs., L.P., 140 B.R. 835 (Bankr. E.D.N.Y. 1992); Eyde v. Equitable Life Assurance Soc'y, 697 F. Supp. 1430 (W.D. Mich. 1988); Teachers Ins. & Annuity Ass'n v. Butler, 626 F. Supp. 1229 (S.D.N.Y. 1986); Pac. Tr. Co. v. Fid. Sav. & Loan Ass'n, 229 Cal. Rptr. 269 (6th Dist. Ct. App. 1986) (redemption by junior mortgagee); Golden Forest Props., Inc. v. Columbia Sav. & Loan Ass'n, 248 Cal. Rptr. 316 (2d Dist. Ct. App. 1988) (purchase by junior mortgagee at trustee's sale).

Provision in the same contract for a prepayment penalty, late charges, and an increased rate of interest after a default have all been enforced. TMG Life Ins. Co. v. Ashner, 898 P.2d 1145, 1161 (Kan. Ct. App. 1995).

432. *In re* Ridgewood Apartments, Ltd., 174 B.R. 712 (Bankr. S.D. Ohio 1994).

the prepayment premium.[433] Retraction of acceleration, when permitted, restores the mortgagee's right to a prepayment premium.[434]

Some statutes and regulations entitle a homeowner to prepay at a modest or no premium.[435] Federal regulations, however, may preempt state statutes that prohibit prepayment premiums. A New Jersey case, *Glukowsky v. Equity One, Inc.*,[436] considered prepayment penalties charged on alternative mortgage transactions (AMTs). An AMT is any home mortgage loan with an interest rate or finance charge that may be adjusted or renegotiated. Beginning in the 1980s, home lenders began offering various types of AMTs as alternatives to the standard self-amortizing fixed-rate loan. Many states prohibited state-chartered financial institutions from offering AMTs or imposed substantial restrictions on such loans. In contrast, federal regulations allowed federally chartered lenders to offer AMTs. Congress enacted the Alternative Mortgage Transaction Parity Act of 1982 to allow state-chartered institutions to offer AMTs. The act grants rulemaking authority to the Office of Thrift Supervision (OTS) to prevent discrimination against state-chartered institutions. In 1996, the OTS enacted a regulation authorizing state lenders to charge prepayment penalties in AMTs. This regulation conflicted with a New Jersey statute, which prohibited prepayment penalties. The regulation, if valid, preempted conflicting state laws. In *Glukowsky*, a borrower obtained a balloon loan in 1999 and sold his home in 2001. The loan documents provided for a 2% prepayment fee, which the borrower paid under protest. The appellate division held for the borrower on the ground that the OTS regulation was beyond the scope of the agency's rulemaking authority. In a four-to-three decision, the New Jersey Supreme Court reversed, reasoning that the OTS is entitled to substantial deference in deciding how to enforce the Parity Act. The OTS rescinded the regulation effective July 2003. After reexamining the issue, it concluded that preemption of state prepayment laws was not essential to achieve the goals of the Parity Act. Nonetheless, the regulation was valid and enforceable when it applied, between 1996 and 2003.

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433. Eyde v. Empire Fed. Sav. Bank, 701 F. Supp. 126 (E.D. Mich. 1988). *Contra* Eyde v. Equitable Life Assurance Soc'y, 697 F. Supp. 1430 (W.D. Mich. 1988); Fla. Nat'l Bank v. Bankatlantic, 557 So. 2d 596 (Fla. Dist. Ct. App. 1990), *aff'd*, 589 So. 2d 255 (Fla. 1991).

But see Ferriera v. Yared, 588 N.E.2d 1370 (Mass. App. Ct. 1992); Rodgers v. Rainier Nat'l Bank, 757 P.2d 976 (Wash. 1988).

434. *In re* Adu-Kofi, 94 B.R. 14 (Bankr. D.R.I. 1988).

435. 38 C.F.R. § 36.4310 (no premium or fee for loans insured by Veterans Administration); MO. REV. STAT. § 408.036 (forbids penalty after five years and allows maximum of 2% until then); N.J. STAT. § 46:10B-2 (no penalty); N.Y. BANKING LAW § 393(2) (allowing limited penalty during first twelve months for loans from savings and loan associations).

436. Glukowsky v. Equity One, Inc., 848 A.2d 747 (N.J. 2004).

When the mortgagor has the right to prepay without a premium, it may be necessary to determine whether a charge imposed by the lender is a prepayment charge or a premium. To facilitate prepayment, institutional lenders generally provide a payoff statement upon request, and they sometimes charge a fee for such statements. Courts have rejected borrowers' contentions that such fees are proscribed prepayment charges.[437]

Partial payment of a mortgage generally reduces the interest payable thereafter to that accruing on the diminished principal. It was so held under a mortgage making installment payments applicable first to interest and then to principal, and also giving the mortgagor a right of partial prepayment.[438] The Connecticut Supreme Court noted that the mortgagee could bar this only by using one of three methods: a mortgage barring prepayment; a mortgage to secure an aggregate sum of the principal, plus an amount equal to the interest for the entire term; or a mortgage including a prepayment premium.

When a mortgage requires interest at higher than the market rate it is to the mortgagor's advantage to pay off the mortgage and refinance at current rates. If the mortgage does not permit prepayment, the mortgagee need not accept payment.[439] Any right to voluntary prepayment probably requires payment of a premium.[440] If the mortgagor defaults on an installment and the mortgagee accelerates maturity of the entire debt, the mortgagee is generally not entitled to the prepayment premium.[441] The mortgagor is tempted, therefore, to try

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437. Krause v. GE Capital Mortg. Serv., Inc., 731 N.E.2d 302 (Ill. App. Ct. 2000) (borrower gets first payoff statement free, but pays $15 for each additional statement and pays $10 if sent by fax); Colangelo v. Nw. Mortg., Inc., 598 N.W.2d 14 (Minn. Ct. App. 1999) ($10 fax fee is for special service; borrower can prepay without payoff statement or by getting one through mail); Cappellini v. Mellon Mortg. Co., 991 F. Supp. 31 (D. Mass. 1997) ($25 payoff statement fee and $15 fax fee are not prepayment charges; payoff statements are often used for purposes other than prepaying loan, such as financial planning).

438. Dugan v. Grzybowski, 332 A.2d 97 (Conn. 1973), 45 AM. JUR. 2d *Interest* § 99 (1978). *But see* Ziello v. Superior Court, 42 Cal. Rptr. 2d 251 (Ct. App. 1995).

Annot., *Construction and Effect as to Interest Due of Real Estate Mortgage Clause Authorizing Mortgagor to Prepay Principal Debt*, 86 A.L.R.3d 599 (1978).

439. A borrower who reneged on a loan commitment was held liable for the difference between the contract rate and the market rate for borrowers. Teachers Ins. & Annuity Ass'n v. Butler, 626 F. Supp. 1229 (S.D.N.Y. 1986). *Cf. In re* Skyler Ridge, 80 B.R. 500 (Bankr. C.D. Cal. 1987).

440. If not forbidden by statute the mortgage may provide otherwise.

441. *See* Trident Ctr. v. Conn. Gen. Life Ins. Co., 847 F.2d 564 (9th Cir. 1988); Teachers Ins. & Annuity Ass'n v. Butler, 626 F. Supp. 1229 (S.D.N.Y. 1986). For the business disadvantages of default by a mortgagor, see *Trident*, 847 F.2d at 568.

to escape from the onus of a high interest rate by defaulting on an installment to compel acceleration.[442] It is not easy for the mortgagee to counter this unless there is a right to partial foreclosure. In New York, there is a statutory right, when the entire debt is not due, to foreclose against the property to satisfy the amount of the debt then due, subject to the continuing lien of the mortgage against the property for the debt not then due and unpaid.[443] Outside New York, the amount of relevant law is sparse and not consistent.[444] In New York, the reported cases indicate little use of partial foreclosure. When partial foreclosure is not available, mortgagees have sought to collect the rents of the property when available without foreclosure or consent of the mortgagor.

A provision often sought by a mortgagor is the right of prepayment, to be available whenever refinancing may be in order. This right is often conditioned upon prior written notice of between thirty and ninety days and payment of some additional sum in order to compensate the mortgagee for the delay, trouble, and expense of reinvestment. In some mortgages, there may be a right of partial prepayment, usually in multiples of at least several thousand dollars, thus avoiding a necessity on the mortgagee's part of accepting sums too small for practical use.

Suppose a mortgagor who has a right to prepay in whole or in part on, for example, thirty days' notice, gives notice of an election to prepay the entire mortgage debt or a substantial part of it. May the mortgagor withdraw the election? The mortgagee may have taken steps or made commitments in anticipation of receipt of the money. Under the usual prepayment clause, it would appear that the mortgagor may rescind his election. For this reason it may be advisable to provide that the mortgagor's election to prepay shall, ipso facto, make the mortgage debt become due at the time and to the extent of the mortgagor's election.

A sample prepayment clause reads as follows.

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442. N.Y. REAL PROP. ACTS. LAW § 1351; Golden v. Ramapo Improvement Corp., 432 N.Y.S.2d 238 (App. Div. 2d Dep't 1980) (background of statute). *Accord* MINN. STAT. § 580.09. No splitting of a cause of action is involved because part of the debt is not due. *Golden*, 432 N.Y.S.2d at 241.

443. 3 R. POWELL, REAL PROPERTY ¶ 463 (4) (1990). N.J. REV. STAT. § 2A:50-40 is similar to the New York statute.

444. Baker v. Bloom, 536 N.Y.S.2d 267 (App. Div. 3d Dep't 1989).

CLAUSE 3A-6

Prepayment Clause

Any owner of the mortgaged premises shall be privileged to prepay the debt hereby secured [in full or in multiples of $__] on at least__ days' prior written notice to the Mortgagee.

On the giving of such notice that a specified sum shall be prepaid, such sum, together with the interest thereon accrued, shall become due and payable hereunder at the time in such notice specified with the same force and effect as if this mortgage made such sum payable at the time in such notice specified.

Any partial prepayment of the debt hereby secured shall be credited to the final installment or installments due hereunder, and shall not postpone the accrual of any installment of interest or principal becoming due after such prepayment.

If a mortgage requires installment payments, and permits an owner to prepay part of the debt, there may be a question of whether an owner who has made partial prepayment may rightfully skip paying one or more installments, on the ground that these were covered by the prepayment. The mortgagee could never be certain just when he could expect the next payment. The little authority on point indicates that partial prepayment does not postpone the installment next due, but is to be credited against the final payment.[445] It is best for the mortgage to avoid any question by specifying how, in this respect, partial prepayment is to be treated, as in the final paragraph of the preceding form.

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445. Annot., 89 A.L.R.3d 947 (1979). *Contra* Gulf Life Ins. Co. v. Pringle, 216 So. 2d 468 (Fla. Dist. Ct. App. 1968). *Cf.* Terraqua Corp. v. Emigrant Indus. Sav. Bank, 76 N.Y.S.2d 610 (App. Div. 1st Dep't 1948) (mortgagee's receipt of proceeds of insurance, in reduction of mortgage, held not to postpone accrual of subsequent amortizations).

The same rule obtains with respect to prepayment under installment contracts of sale. Carpenter v. Winn, 566 P.2d 370 (Colo. Ct. App. 1977); Edward v. Smith, 322 S.W.2d 770 (Mo. 1959); De Villiers v. Balcomb, 446 P.2d 220 (N.M. 1968); Zerkel v. Lindsey, 528 P.2d 1041 (Or. 1974); Annot., 89 A.L.R.3d 947 (1979); 77 AM. JUR. 2d *Vendor and Purchaser* § 303 (1975). Snide v. Larrow, 464 N.E.2d 480 (N.Y. 1984), recognizes the rule that application of payment may be directed by debtor in absence of such direction, and absent any such direction presumptively to that part of the debt first to become due.

There is no prepayment right by implication under an installment contract of sale of realty. Cimarron W. Props. v. Livoln Loan Co., 860 P.2d 871 (Or. Ct. App. 1993).

§ 3A:10 "Brundage" Clause

The Brundage clause permits acceleration of the debt in the event of any change in state or local laws "for the taxation of mortgages or mortgage debts for state or local purposes, or the manner of the collection of any such taxes."[446] The clause, first used in 1888, was named after an upstate New York assemblyman (Azariah Brundage), who sponsored a bill that would have shifted property tax liability from the owner to the mortgagee according the proportion between the debt and the property value.[447] Because the Brundage clause is not included in the statutory short-form mortgage, courts have held that a lender may not add it to a mortgage on the basis that it is "implied as a part of the mortgage called for by the contract."[448]

§ 3A:11 Sale in One Parcel

This clause provides for the sale of the mortgaged premises in one parcel in the event of foreclosure. It seeks to overcome any rule that only so much of the premises shall be sold as shall be necessary to pay the mortgage debt.[449] The reason for requiring a sale in parcels rather than a whole, where feasible, is to open the sale to more bidders, obtain better prices, and permit the mortgagor to redeem part of the property if unable to redeem the whole.[450]

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446. Oppenheim v. McGovern, 100 N.Y.S. 712 (App. Div. 1st Dep't 1906) (quoting full clause), *aff'd*, 82 N.E. 1130 (N.Y. 1907).

447. *See* Ernest H. Breuer, *Who Was Brundage?*, 20 ALB. L. REV. 23 (1956); William Wolfman, *Book Review*, 13 BAR BULL. (N.Y. CTY. LAWYERS ASSOC.) 106, 108 (1955).

448. Ansorge v. Belfer, 161 N.E. 450, 452 (N.Y. 1928).

449. Where the mortgaged tract is laid out in parcels the sale should be in parcels. Ellsworth v. Lockwood, 42 N.Y. 89, 101 (1870); Ames v. Lockwood, 13 How. Pr. 555 (N.Y. 1856).

A sale in two parcels was held regular where authorized by the mortgage. Keever v. Gen. Elec. Credit Corp., 234 S.E.2d 696 (Ga. Ct. App. 1977).

Statutes that specify separate sales of farms and tracts have been held subject to waiver, where appropriate, by mortgage clauses. John W. Swenson & Sons, Inc. v. Aetna Life Ins. Co., 571 F. Supp. 895, 901 (D. Minn. 1983); George v. Fed. Land Bank, 501 So. 2d 432 (Ala. 1986); Ames v. Pardue, 389 So. 2d 927, 930 n.1 (Ala. 1980); Metro. Life Ins. Co. v. Foote, 290 N.W.2d 158, 160 (Mich. Ct. App. 1980).

450. J.H. Morris, Inc. v. Indian Hills, Inc., 212 So. 2d 831, 843 (Ala. 1968); 2 C. WILTSIE, MORTGAGE FORECLOSURES § 685 (5th ed. 1939).

The rule is judge-made but incorporated in many statutes and rules of court. *See* WILTSIE § 682. In New York, premises within the same city lot are to be sold together. N.Y. REAL PROP. ACTS. LAW § 231(5). For qualifications of the rule, see Lamerson v. Marion, 8 Barb. 9 (N.Y. 1850); Griswold v. Fowler, 24 Barb. 135 (N.Y. 1857); WILTSIE §§ 682 *et seq.*

In the absence of this clause, there is no general requirement that an undivided parcel must be sold in foreclosure in parcels,[451] but the outcome will turn on the particular circumstances involving the property, including its conveyancing history and mortgage.

The "sale in one parcel" clause is not necessarily effective where several parcels are included in a single mortgage.[452]

§ 3A:12 Lien Clause

This provides that if the mortgage is recorded less than four months after completion of improvements, repairs, or alterations to the premises (the time within which notice of mechanics' liens may be filed)[453] the mortgagor will receive advances on the mortgage loan and the right to receive such advances "as a trust fund to be applied first for the purpose of paying the cost of improvement, and that he will apply the same first to the payment of the cost of improvement before using any part of the total of the same for any other purpose."[454] By including this provision, the mortgagee takes precedence over mechanics' liens filed within the time specified, and the party supplying the work or materials is protected by the trust fund.[455] The words "the right to receive such advances," added in 1942, protect potential lienors against frustration of this protection by assignment of advances prior to their actual receipt. The lien clause is unnecessary in a purchase money mortgage.[456]

The Texas mechanic's lien statute requires the owner to retain 10% of the contract price for "30 days after the work is completed."[457]

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451. Dixon v. Farm Credit Bank, 689 So. 2d 135 (Ala. Ct. Civ. App. 1996).
452. N.Y. REAL PROP. ACTS. LAW § 231(5): "5. If the property consists of two or more distinct buildings, farms or lots, they shall be sold separately, unless otherwise ordered by the court; but where two or more buildings are situated in the same city lot, they shall be sold together." The California, Minnesota, and North Dakota statutes permit waiver. CAL. CIV. CODE § 2924g(b) ("When the property consists of several known lots or parcels, they shall be sold separately unless the deed of trust or mortgage provides otherwise."); *In re* Kjeldahl, 52 B.R. 916 (Bankr. D. Minn. 1985); Prod. Credit Ass'n v. Henderson, 429 N.W.2d 421 (N.D. 1988).
453. N.Y. LIEN LAW § 10(1). The four-month period applies to work on a single-family dwelling. A 1982 amendment extended the period for filing mechanic's liens for work on other improvements to eight months after completion. *Id. See In re* Abbott, 828 N.Y.S.2d 788 (cooperative apartment is single-family dwelling, requiring filing wirhin four months).
454. N.Y. LIEN LAW § 10(3).
455. *Id.* § 13(5).
456. Shilowitz v. Wadler, 261 N.Y.S. 351 (App. Div. 3d Dep't 1932).
457. TEX. PROP. CODE § 53.101.

To reach the retained funds, mechanics must file a lien affidavit within that thirty-day period.[458] The time for a subcontractor to file a lien affidavit runs from the termination of the general contract. In *Page v. Structural Wood Components, Inc.*,[459] a subcontractor completed its work on a remodeling project in mid-March. Other work continued and, after a dispute between the owner and the general contractor, the owner terminated the general contract on April 14. Thirty-one days later (May 15) the subcontractor filed a lien affidavit. The owner hired replacement contractors, who finished the remodeling work on July 21. The trial court and the court of appeals held the lien affidavit was timely filed, reasoning that the retainage period continues until completion of all work contemplated by the original contract, even if accomplished by a replacement contractor. The Texas Supreme Court reversed, interpreting the statute to restrict retainage and lien filings to individual contracts. Two justices vigorously dissented.

§ 3A:13 Condemnation

A condemnation clause is generally added to entitle the mortgagee to all payments, to the extent of the mortgage indebtedness, plus his counsel fees, for a taking of the property or any appurtenances, or for a change of grade. A mortgagee has first right to condemnation awards without this provision,[460] but would not otherwise be entitled to an award for change of grade.[461] A mortgagee has been held to have a lien on the mortgagor's claim against a third party for damages to the mortgaged premises.[462]

In case of partial condemnation, an apparent majority holds the mortgagee is entitled to the entire award up to the amount of the

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458. *Id.* § 53.103.

459. Page v. Structural Wood Components, Inc., 102 S.W.3d 720 (Tex. 2003).

460. Muldoon v. Mid-Bronx Holding Corp., 39 N.E.2d 217, 218 (N.Y. 1942).

461. Nat'l City Bank v. Cleveland & Buffalo Transit Co., 289 N.Y.S. 405 (App. Div. 4th Dep't 1936). For a note on what constitutes change of grade, see Annot., 156 A.L.R. 416 (1945).

462. L.A. Tr. & Sav. Bank v. Bortenstein, 190 P. 850 (2d Dist. Ct. App. 1920) (lien on judgment for damage by flood occasioned city's tortious acts). The case stands possibly alone and is said to be "judge-made law." McMurray, *A Review of Recent California Decisions in the Law of Property*, 9 CALIF. L. REV. 447, 453 (1921).

A mortgage clause assigning "all award" to the mortgagee was held to transfer a claim for restoration against the United States as tenant. Sampson v. United States, 529 F.2d 1299 (Ct. Cl.), *cert. denied*, 426 U.S. 921 (1976).

mortgage debt.[463] But some courts award a mortgagee no more than enough to avoid impairment of his security.[464]

§ 3A:14 Attorneys' Fees

Another clause provides that if the mortgagee participates in any legal proceedings affecting the mortgage, other than an action to foreclose the mortgage or collect the mortgage debt, the mortgagee's expenses of litigation shall be added to the mortgage debt. This clause is enforceable. Provisions for attorneys' fees are valid where not forbidden by local law.[465]

A provision for attorneys' fees is applicable to litigation other than to enforce the mortgage, in which protection of the mortgage lien is necessary.[466]

§ 3A:15 Corporate Execution

Prior to 1963, in the case of a mortgage made by a corporation under New York statutory law required consent by the holders of at least two-thirds of the corporate stock entitled to vote thereon.[467] It was then customary for a corporate mortgage to contain a recital of such shareholder consent. This was sufficient to create a presumption of compliance with a statutory requirement that became conclusive after one year if the proceeds of the loan were paid to the corporation.[468] Under present statutory law, no vote or consent of stockholders is required for a corporate mortgage unless the certificate of

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463. Chicago v. Salinger, 52 N.E.2d 184 (Ill. 1933); *In re* City of New York (Houghton Ave.), 193 N.E. 539 (N.Y. 1934); *In re* Woods Run Ave., 43 Pa. Super. 475 (1910).

464. Swanson v. United States, 156 F.2d 442 (9th Cir. 1946); People v. Redwood Baseline Ltd., 149 Cal. Rptr. 11, 17 (4th Dist. Ct. App. 1978) (mortgagees entitled to part of award even though property value after condemnation exceeded debts); N.J. Transp. Comm'r v. Kastner, 433 A.2d 448 (N.J. Super. Ct. 1981); Teague, *Condemnation of Mortgaged Property*, 44 TEX. L. REV. 1535, 1540 *et seq.* (1966). *See generally* Leipziger, *The Mortgagee's Remedies for Waste*, 64 CALIF. L. REV. 1086, 1097 (1976); Miller, *Valuation of the Mortgagee's Interest upon Partial Condemnation*, 15 LOY. L.A. L. REV. 227 (1982).

465. United States v. Pioneer Am. Ins. Co., 374 U.S. 84 (1963); *In re* Am. Motor Prods. Corp., 98 F.2d 774 (2d Cir. 1938); City of Utica v. Gold Medal Packing Corp., 283 N.Y.S.2d 603 (Sup. Ct. Oneida Cty. 1967).

466. Engelsberg v. Cinderella Homes, Inc., 192 N.Y.S.2d 317 (Sup. Ct. Queens Cty. 1959) (sets forth clause).

467. Former N.Y. STOCK CORP. LAW § 16.

468. Former N.Y. STOCK CORP. LAW § 17.

incorporation provides otherwise.[469] Accordingly, it is now prudent for a New York mortgage made by a corporation to recite approval by the board of directors and an affirmation that the certificate of incorporation requires no other action, including shareholder approval.[470]

§ 3A:16 Lease Modification

An "anti-milking" clause provides that no important lease shall be modified, cancelled, or merged in the fee without the mortgagee's consent. The clause may define such a lease as one with a rent over $10,000 a year and an unexpired term of over two years. Without such provision, mortgagees were helpless during the 1930s when a mortgagor's last act before foreclosure might be the cancellation of an important lease in return for a substantial payment.[471] Sometimes the purpose of this provision is effected otherwise by collateral assignment of an important lease to the mortgagee.[472] The clause may also forbid the mortgagor to collect substantial amounts of rent in advance and thereby interfere with the administration of a foreclosure receiver or a mortgagee in possession.[473] It may also entitle the mortgagee to

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469. N.Y. BUS. CORP. LAW § 202(a)(5) (corporation has power, "subject to any limitations provided in this chapter or any other statute of this state or its certificate of incorporation," to "mortgage or pledge, or create a security interest in, all or any of its property, or any interest therein, wherever situated").

470. *See* N.Y. BUS. CORP. LAW § 911: "The board may authorize any mortgage or pledge of, or the creation of a security interest in, all or any part of the corporate property, or any interest therein, wherever situated. Unless the certificate of incorporation provides otherwise, no vote or consent of shareholders shall be required to approve such action by the board."

471. City Bank Farmers Tr. Co. v. C.R.H. Bldg. Corp., 36 N.E.2d 683 (N.Y. 1941); Katzen v. Eight-Twenty Park Ave. Corp., 28 N.Y.S.2d 105 (Sup. Ct. N.Y. Cty.), *aff'd*, 29 N.Y.S.2d 144 (App. Div. 1st Dep't 1941); 50 YALE L.J. 1424, 1437–38 (1941); 46 HARV. L. REV. 491, 494 *et seq.* (1933); *see* 2 G. GLENN, MORTGAGES §§ 183 *et seq.* (1943); G. OSBORNE, MORTGAGES § 158 (1951). *Contra* First Nat'l Bank v. Gordon, 4 N.E.2d 504 (Ill. App. Ct. 1936).

An express covenant by a mortgagor not to cancel or modify leases was enforced in Mut. Life Ins. Co. v. Gotham Silk Hosiery Co., 39 N.Y.S.2d 310 (Sup. Ct. N.Y. Cty.), *aff'd*, 43 N.Y.S.2d 514 (App. Div. 1st Dep't 1943).

472. The collateral assignment does not preclude the landlord-mortgagor-assignor from enforcing the lease against a tenant while the mortgage is in good standing. Fifty States Mgmt. Corp. v. Pioneer Auto Parks, Inc., 355 N.Y.S.2d 856 (App. Div. 4th Dep't 1974).

The collateral assignment bars any modification or cancellation of the lease without consent of the mortgagee-assignee. F.W. Woolworth Co. v. Buford-Clairmont Co., 769 F.2d 1548, 1554–55 (11th Cir. 1985) (and authorities cited).

473. This clause was enforced in eviction proceedings by a receiver against tenants. Dickens v. Smith, 180 N.Y.S.2d 565 (Mun. Ct. Manhattan 1958).

statements of the financial operation of the premises and a summary of leases. Savings banks tend increasingly to require this data, often at the suggestion of state banking supervisors, in order to keep informed about their collateral.

A New York statute, which became effective on July 1, 1960, permits restriction of an owner's power as against a mortgagee, without the mortgagee's consent, to cancel, abridge, or otherwise modify leases or subleases, or accept prepayment of rent.[474] Under this statute, a provision in a recorded mortgage or agreement affecting a mortgage which so limits an owner, binds existing tenants and subtenants after their receipt of written notice and a copy of the provision. After July 1, 1960, the recordation of such a mortgage or agreement is made sufficient notice to a tenant or subtenant who acquires his interest after such recordation. The statute is inapplicable to leases and subleases that are primarily for residential purposes or that have, at the time of the restriction, an unexpired term of less than five years. The statute is also inapplicable to a present assignment of rent.[475] After a present assignment, landlord and tenant may not cancel the lease as against the assignee.[476]

§ 3A:17 Survival of Mortgagor's Liability

Sometimes a "survival clause" is added to prevent a release of the personal liability of the mortgagor or a subsequent obligor by events subsequent to a conveyance of the premises. In general, an agreement between the mortgagee and a subsequent owner of the premises extending the time of payment of the mortgage or otherwise modifying its terms without the consent of the mortgagor, releases the latter from personal liability. If the subsequent owner assumed the mortgage by an agreement made with the mortgagor, the subsequent agreement discharges the mortgagor completely;[477] otherwise, the release is to the

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A similar clause in a recorded New Jersey mortgage was enforced against tenants under subsequent subordinate leases. Payment of rents in advance was held not binding on the mortgagee. Kirkeby Corp. v. Cross Bridge Towers, 219 A.2d 343 (N.J. Super. Ct. 1966).

474. N.Y. REAL PROP. LAW § 291-f.

475. The statute specifies that a stipulation with respect to it should mention the statute. But E. N.Y. Sav. Bank v. 520 W. 57th St. Corp., 611 N.Y.S.2d 459 (Sup. Ct. 1994), holds that a provision in a mortgage that was somewhat similar to the statute without mentioning it barred a mortgagor of a residential cooperative tenant building from reducing rents after application of a receiver in a foreclosure action.

476. Poughkeepsie Sav. Bank v. R&G Sloane Mfg. Co., 445 N.Y.S.2d 560 (App. Div. 2d Dep't 1981). *Accord* Darling Shop v. Nelson Realty Co., 79 So. 2d 793, 797–98 (Ala. 1954).

477. Moss v. McDonald, 772 P.2d 626 (Col. Ct. App. 1988); Calvo v. Davies, 73 N.Y. 211 (1878).

extent of the value of the property at the time of the modification agreement.[478] A conveyance of the mortgaged property by a subsequent owner to the mortgagee, in settlement of a foreclosure, has also released the original mortgagor.[479] It may be wondered how the only party liable on an instrument can be treated like a surety. The answer is that, in legal theory, after a conveyance the land is deemed primarily liable for the debt and the mortgagor only secondarily so.[480] The survival clause provides, in the event of any agreement between the mortgagee and a subsequent owner modifying the mortgage, that the liability of the mortgagor shall continue nevertheless, but modified in accordance with the tenor of the agreement. This provision is valid.[481] The clause may further provide that after a conveyance of the premises the mortgagee shall not be required, as a result of any

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An assuming grantee's demolition of buildings, with the mortgagee's consent, released the mortgagor. Lundquist v. Nelson, 395 N.Y.S.2d 568 (App. Div. 4th Dep't 1977). The rule with respect to leases differs. A lease that permits tenant to assign only with landlord's consent is deemed to imply that landlord may consent. Consequently, such consent does not release a surety. *See* FRIEDMAN ON LEASES, *supra* note 25, § 7:5.2 (Supp. Mar. 2014). Here, regardless of consent, demolition was a substantial impairment of security.

478. First Fed. Sav. & Loan Ass'n v. Arena, 406 N.E.2d 1279 (Ind. Ct. App. 1980); Murray v. Marshall, 94 N.Y. 611 (1884); Branch Banking & Tr. Co. v. Kenyon Inv. Corp., 332 S.E.2d 186, 193 (N.C. Ct. App. 1985).

The release is limited in this situation because the mortgagor, who paid the mortgage debt, would have a limited right of reimbursement or subrogation; *i.e.*, against the mortgaged property.

479. Prigal v. Kearn, 557 So. 2d 647 (Fla. Dist. Ct. App. 1990) (mortgagee then resold property at twice amount of mortgage).

480. *See generally* Milton R. Friedman, *Discharge of Personal Liability on Mortgage Debts in New York*, 52 YALE L.J. 771 (1943); Stevens, *Extension Agreements in the "Subject To" Mortgage Situation*, 15 U. CIN. L. REV. 58–60 (1941); Annot., 41 A.L.R. 277 (1926); Annot., 72 A.L.R. 389 (1931); Annot., 81 A.L.R. 1016 (1932); Annot., 112 A.L.R. 1324 (1938); 59 C.J.S. *Mortgages* § 400 (1949); 55 AM. JUR. 2d *Mortgages* § 1391 (1971).

481. Kohn v. Beggi, 264 N.Y.S. 274 (Sup. Ct. N.Y. Cty. 1933). The clause is construed strictly against the mortgagee, First Fed. Sav. & Loan Ass'n v. Arena, 406 N.E.2d 1279 (Ind. Ct. App. 1980); Mut. Life Ins. Co. v. Rothschild, 160 N.Y.S. 164 (Sup. Ct. N.Y. Cty. 1916), *modified*, 163 N.Y.S. 1124 (App. Div. 1st Dep't 1917), *aff'd*, 123 N.E. 880 (N.Y. 1919); Excelsior Sav. Bank v. Brill, 163 N.Y.S. 1017 (App. Div. 1st Dep't 1917), *aff'd sub nom.* Excelsior Sav. Bank v. Cohen, 127 N.E. 912 (N.Y. 1920), and is inapplicable to a modification beyond the scope of the consent, *First Fed. Sav. & Loan*, 406 N.E.2d 1279; Schuck v. Kings Realty Co., 23 N.Y.S.2d 764 (App. Div. 2d Dep't 1940), *aff'd*, 34 N.E.2d 907 (N.Y. 1941). *See generally* Milton R. Friedman, *Discharge of Personal Liability on Mortgage Debts in New York*, 52 YALE L.J. 771, 788 (1943).

First Fed. Sav. & Loan released a mortgagor because of a modification agreement between mortgagee and a subsequent owner. Strict construction of a survival clause against mortgagee was based on an apparently

demand by the mortgagor, to foreclose the mortgage or enforce payment of the mortgage debt.[482] This rule, just mentioned, releasing a mortgagor, has been carried to this extreme: if the mortgage falls due after a conveyance by the mortgagor and continues in existence though not formally extended, and the mortgagee accepts an installment of interest a few days before it is fully earned, there is a rebuttable presumption of an extension of the mortgage to the date when such interest will be so earned, with a possible release of the mortgagor.[483] Accordingly, some mortgages lacking a full survival clause preclude this possibility by a provision that in such event the mortgagee shall have the right to return unearned interest or apply it in reduction of principal.

§ 3A:18 Escrow Deposits

Many mortgages, particularly those on houses, require the mortgagor to make periodic deposits with the mortgagee to accumulate funds for payment of taxes and, often, insurance premiums.[484] These provisions do not supersede any obligation of the mortgagor to pay taxes, and impose no liability on the mortgagee if the deposits are insufficient.[485] Nor is the mortgagee obligated to seek a separate tax assessment if the assessment of the mortgaged premises includes other property.[486] A mortgagee with sufficient payments from the mortgagor, who fails to pay the taxes, is guilty of breach of fiduciary duty and liable to the mortgagor for damages.[487] A general acceleration clause,

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unintended significance of a comma. Punctuation is not often given this importance in determination of intent. *See* FRIEDMAN ON LEASES, *supra* note 25, § 26:5.6 (Supp. July 2014); 3 A. CORBIN, CONTRACTS § 52, at 209 (1960); 26 C.J.S. Deeds § 88 (1956).

482. Thus, avoiding the possible effect of Pain v. Packard, 13 Johns. 174 (Sup. Ct. 1816), a rule applicable in a minority of the states. *See* A. STEARNS, SURETYSHIP § 16 (4th ed. 1934); 10 S. WILLISTON, CONTRACTS § 1236 (3d ed. 1967); Milton R. Friedman, *Discharge of Personal Liability on Mortgage Debts in New York*, 52 YALE L.J. 771, at 796 (1943).

483. Germania Life Ins. Co. v. Casey, 90 N.Y.S. 418 (App. Div. 1st Dep't 1904), *aff'd*, 76 N.E. 1095 (N.Y. 1906). The rule is in disfavor. Kings Cty. Tr. Co. v. Giovinco, 194 N.E. 60 (N.Y. 1934); Milton R. Friedman, *Discharge of Personal Liability on Mortgage Debts in New York*, 52 YALE L.J. 771, 784 (1943).

Cases pro and con are collected in Shelly v. Bristol Sav. Bank, 26 A. 474, 476 (Conn. 1893).

484. A general discussion of this is in Annot., *Rights in Funds Representing Escrow Payments Made by Mortgagor in Advance to Cover Taxes or Insurance*, 50 A.L.R.3d 697 (1973). A mortgagee's right to such deposits is restricted by CAL. CIV. CODE § 2954 (1990).

485. Merrimack Indus. Tr. v. First Nat'l Bank, 427 A.2d 500 (N.H. 1981).

486. *Id.*

487. Davis v. Dime Sav. Bank, 557 N.Y.S.2d 775 (App. Div. 3d Dep't 1990).

permitting its exercise for any breach, was held applicable to a mortgagor's failure to make deposits for taxes and insurance premiums.[488]

Some authority entitles the mortgagor to interest on these funds.[489] Other authority is contra.[490] A New York statute, applicable to a mortgage on a one- to six-family residence occupied by the owner and located in New York State, requires a mortgage investment institution to pay interest on the average deposits, at a rate to be fixed by the State Banking Board, but at no less than 2% per annum.[491] This has been extended to residence property owned by a cooperative corporation.[492] These deposits may not be reached by creditors of the mortgagor.[493]

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488. Cramer v. Metro. Fed. Sav. & Loan Ass'n, 258 N.W.2d 20 (Mich. 1977), *cert. denied*, 436 U.S. 958 (1978).

489. Carpenter v. Suffolk Franklin Sav. Bank, 291 N.E.2d 609 (Mass. 1973); Tierney v. Whitestone Sav. & Loan Ass'n, 353 N.Y.S.2d 104 (Civ. Ct. Queens Cty. 1974); MASS. GEN. LAWS ch. 183, § 61 (1977); see *Comment*, 23 SYRACUSE L. REV. 845 (1972).

Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 577 P.2d 477 (Or. 1978), noted in 13 REAL PROP., PROB. & TR. J. 814 (1978) (good discussion and collection of cases), a class action, held mortgagors entitled to interest at passbook rates on tax and insurance deposits made under compulsion, but not on insurance deposits made voluntarily. The decision is based on unjust enrichment-quasi contract and constructive trust. The court stated it is the first case of last resort in the country to hold this after a trial.

490. Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 481 S.W.2d 725 (Ark. 1972); Zelickman v. Bell Fed. Sav. & Loan Ass'n, 301 N.E.2d 47 (Ill. App. Ct. 1973); Surrey Strathmore Corp. v. Dollar Sav. Bank, 325 N.E.2d 527 (N.Y. 1975); Raab v. Bowery Sav. Bank, 355 N.Y.S.2d 748 (Civ. Ct. N.Y. Cty. 1974).

This represents the majority rule by far. See cases collected in Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 577 P.2d 477, 493 n.19 (Or. 1978).

491. N.Y. GEN. OBLIG. LAW § 5-601.

This statute applies to mortgages made after its effective date, July 1, 1974, and to those theretofore made unless the latter expressly provide no interest is to be paid. This statute was fully upheld in Jamaica Sav. Bank v. Lefkowitz, 390 F. Supp. 1357 (E.D.N.Y.), *aff'd*, 423 U.S. 802 (1975), and in Fed. Nat'l Mortg. Ass'n v. Lefkowitz, 390 F. Supp. 1364 (S.D.N.Y. 1975). *Jamaica* deemed it unnecessary to determine, as did Carpenter v. Suffolk Franklin Sav. Bank, 291 N.E.2d 609 (Mass. 1973), that the deposits were a trust fund.

The Massachusetts statute, MASS. GEN. LAWS ch. 183, § 61, is applicable to a first mortgage on a dwelling of four or fewer units occupied in whole or in part by the mortgagor.

CONN. GEN. STAT. § 49-2a (*but cf. id.* § 49-2c) applies to owner-occupied residential property of up to four units and housing cooperatives occupied solely by shareholders thereof.

492. N.Y. GEN. OBLIG. LAW § 5-601, as amended by N.Y. Laws 1979, ch. 32.

493. *In re* Simon, 167 F. Supp. 214 (E.D.N.Y. 1958). *See* Jamaica Sav. Bank v. Lefkowitz, 390 F. Supp. 1357, 1361 (E.D.N.Y. 1975).

§ 3A:19 Transferable Development Rights

In *Newport Associates, Inc. v. Solow*,[494] a zoning law permitted a landowner to improve his land with a building with floor space equal to (1) the maximum allowed such land under the applicable zoning law, plus (2) unutilized floor space of adjoining property that was under lease to such owner.[495] The owner held one parcel in fee simple and held a long-term leasehold in a contiguous parcel. Pursuant to the zoning law, he transferred development rights from the leasehold parcel to the fee parcel. The court held that this appropriation of space, made without the lessor's consent, barred full use of the allowable floor space of the leased premises for an indefinite period. Under this rule, a mortgagor could presumably divert to adjoining property unutilized space within the mortgaged premises, to the prejudice of a mortgagee. A clause, for inclusion in a mortgage, forbidding this is set forth below. It involves development rights, colloquially called "air rights."[496]

CLAUSE 3A-7

Development Rights Clause

Mortgagor shall not permit the mortgaged premises or any part thereof to be used to qualify for fulfillment of any municipal or other governmental requirements for the construction or maintenance of any building, structure, or other improvement on premises not mortgaged hereunder; and mortgagor hereby assigns to mortgagee all rights to consent to such use. No building or other improvement now or hereafter constructed on the mortgaged premises shall rely

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494. Newport Assocs., Inc. v. Solow, 283 N.E.2d 600 (N.Y. 1972), *cert. denied*, 410 U.S. 931 (1973).

495. *Id.*

496. For more on air and development rights and a list of relevant authorities, see FRIEDMAN ON LEASES, *supra* note 25, § 3:2.2[G] (Mar. 2014). *See also* Brennan, *Lots of Air—A Subdivision in the Sky*, REAL PROP., PROB. & TR. J. 24–30 (1955); Pfister, *Airspace: A New Dimension in Property Law*, 1960 U. ILL. L. FORUM 303–13; Note, *Conveyance and Taxation of Air Rights*, 64 COLUM. L. REV. 338–54 (validity of air right conveyances, method of execution, drafting problems, tax consequences); Bell, *Air Rights*, 23 ILL. L. REV. 250 (1928); Ball, *Landscape Above the Surface*, 39 YALE L.J. 616 (1930); Liebman, *Development of Air Rights*, N.Y.L.J., Nov. 12, 13, 14, 15 (1968); E. Morris, *Air Rights: Fertile Field*, N.Y.L.J., Apr. 13, 14, 15, 16 (1970); Richards, *Transferable Development Rights: Corrective, Catastrophe or Curiosity*, 12 REAL ESTATE L.J. 26 (1983); Pedowitz, *Transfer of Air Rights and Development Rights*, 9 REAL PROP., PROB. & TR. J. 183 (1974); Pedowitz, *Transferable Development Rights*, 19 REAL PROP., PROB. & TR. J. 604 (1984).

> on any premises not mortgaged hereunder in order to qualify for fulfillment of any municipal or other governmental requirements. Mortgagor shall not impair, or permit impairment of, the integrity of the mortgaged premises as a single zoning lot or lots separate and apart from other premises. Any attempt by mortgagor to violate any of the provisions of this paragraph shall be void.[497]

Without such a clause, a court might protect the mortgagee under some circumstances. In a Florida case, the mortgagor's transfer of development rights, which diminished the value of the property and made the mortgagee's lien insufficient security, resulted in giving the mortgagee a lien on the property to which the rights were transferred.[498]

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497. Based on a clause made available through the courtesy of B. Harrison Frankel, Esq., of the New York Bar. A comparable provision should be included in any lease that could empower the tenant to appropriate unutilized space in the leased property for the benefit of other property.

498. Gordon v. Flamingo Holding P'ship, 624 So. 2d 294 (Fla. Dist. Ct. App. 1993). The court noted that this remedy would be sparingly applied.