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The Original Mortgagor, After Foreclosure of a First Mortgage

Joseph G. Wood
Member, Indianapolis Bar

Richard Oberreich
Member, Indianapolis Bar

REVIVAL OF A SECOND OR SUBSEQUENT MORTGAGE, UPON REACQUISITION OF TITLE BY THE ORIGINAL MORTGAGOR, AFTER FORECLOSURE OF A FIRST MORTGAGE

By JOSEPH G. WOOD AND RICHARD H. OBERREICH*

Early in 1934 the Legal Department of the Home Owners' Loan Corporation in Indiana issued a ruling that *where a mortgagor regains title to real estate, after foreclosure, upon which he had executed a first and second mortgage, the second mortgagee either not having been joined or having been made a party but not having had his rights adjudicated, the second mortgage immediately revives.*

Ordinarily, the possibility of a mortgagor regaining title after foreclosure is remote. The existence of so few cases on this point substantiates that proposition. However, an extraordinary number of foreclosures were filed during the depression, following which the Home Owners' Loan Corporation, a Governmental agency organized for the purpose of assisting distressed home owners to retain or regain their property, amounted to a medium through which a home lost through foreclosure could be recovered, and, therefore, this question becomes more vital in importance because many mortgagors were enabled to recover their homes lost through foreclosure.

At the outset, we may state that we are of the opinion that the Indiana ruling above referred to correctly states the law and that a second or subsequent mortgage will revive after foreclosure unless such second or subsequent mortgage is fully adjudicated in the foreclosure proceedings. We find no Indi-

* Joseph G. Wood of the Indianapolis Bar, Dean of the Indiana Law School, and former Indiana Counsel for Home Owners Loan Corporation. Richard H. Oberreich of Indianapolis Bar and Examining Counsel for Home Owners Loan Corporation.

ana authority to fully support the rule, but there is respectable authority for the rule in other states.

At the outset, also, it must be remembered that in Indiana a second mortgagee is a proper party defendant in a suit to foreclose the first mortgage, but the second mortgage need not necessarily be foreclosed in that proceeding. The second mortgagee may default or he may answer and yet not have his second mortgage foreclosed or adjudicated, and it is in those cases that this question becomes involved. The default or failure to foreclose on the part of the second mortgagee does not prevent the first mortgagee from proceeding with his foreclosure, and, upon sheriff's sale to satisfy the first mortgage, the title is good in the purchaser at such sheriff's sale as against such second mortgagee and title is further good in any subsequent purchaser, from such sheriff's sale purchaser, except and until the title gets back to the original mortgagor, in which case the second mortgage, not having been adjudicated, immediately revives. This rule applies where the mortgagor was obligated under a covenant to pay such second mortgage and where such second mortgage contained a "warranty" clause. It appears that the "warranty" clause is the key to the principle, the word "warranty" in our modern mortgage meaning that the mortgagor warrants or guarantees the title for the protection of the mortgagee.

In holding that such second mortgages revive, the courts have, generally speaking, followed three distinct theories.

The first—*The Payment Theory*—is subject to considerable criticism and is the least well settled. It is the theory that where a first mortgage is foreclosed, the rights of the second mortgagee not being adjudicated, sale being made by the sheriff and the property purchased by the mortgagor, the payment of the money to the sheriff operates merely as a payment of the first mortgage and leaves the second mortgage in force and in full effect.

The basis of this ruling is that the mortgagor had agreed to pay the first mortgage. If he had paid it off when the debt became due, of course the second mortgage would still be a lien. The fact that he paid it off after foreclosure of the

mortgage did not really alter the situation. In the words of the Chancellor in the case of *Otter v. Lord Vaux, et al,*[1] decided in 1856 that an attempt to set up a title acquired under the power of sale of the first incumbrancer as against a subsequent incumbrancer "would be sacrificing substance to form. The case is therefore to all intents and purposes that of a mortgagor liable to pay a sum of money to his first incumbrancer, paying it and getting a transfer, but that transfer is something which upon general principle he cannot set up against a creditor claiming by title subsequent to that of the person whose charge he has so paid off."

In the case of *Hilton v. Bissell,*[2] in reaching the same conclusion the court took the view that the mortgagor was bound by his covenants to pay off the first mortgage and would not be permitted to take advantage of his own wrong in failing to do so.

The first case cited apparently is based solely on the theory that the transfer to the mortgagor upon payment of the amount due on the first mortgage operated merely as a payment and that, although sale of the property was made, in substance this was merely operated to wipe out the debt to the first incumbrancer. The second case cited, although reaching the same conclusion, is based on the theory that the mortgagor was bound by his covenants to pay the first mortgage, that in so doing he was merely doing his duty, therefore he would not be permitted to take advantage of his own wrong in establishing in himself a title free from the lien of the second mortgage.

In those cases in which the theory of payment is not accepted, it is found that usually the facts differ sufficiently so that the conclusions may be readily justified, at the same time accepting the payment theory as being sound. In the case of *Commercial-Germania Trust and Savings Bank v. Russell, et al,*[3] a Louisiana case, it was decided that a second lien did not revive upon reacquisition of the title. The feature distinguishing it from the facts in the cases cited above

[1] 43 English Reprints 1381.
[2] 1 Sandf. Ch. 407.
[3] 86 So. 831 (1921).

is the fact that title upon sale of the property by sheriff passed to a third party, thence to the mortgagor The court reasoned immediately upon foreclosure the second lien was extinguished, the purchaser took his title free and clear of all incumbrances, this being a well-recognized principle, and the title that the purchaser received was entirely distinct from any previous title. Obviously, title could not be in both the third party who purchased at the sale and the mortgagor and "the assertion that the foreclosure was a mere payment and not a sale, and that the title continued to remain in the Russells (mortgagors) is therefore nothing more or other than a denial of the plain and admitted fact that there was a sale to the homestead association (third party)" In this case the court distinguished this case from others cited by counsel for the plaintiff by saying that those cases had application only where the mortgage debtor himself was the purchaser at the foreclosure sale.

One case, recently handed down by the Texas Court of Civil Appeals,[4] in which the mortgage debtor purchased the property at the sale, holds that the theory of payment is not sound. The reasoning relied upon by the court was that the remedy of the second lien holder lay in his right to bid at the sale of the property upon foreclosure of the first mortgage and that his failure to do so extinguished his rights in the property, even though the mortgage debtor might reacquire it.

The second—*The Covenant to Defend Title Theory*—is based upon the effects of covenants of warranty contained in the second mortgage. The principle involved is set out clearly in the case of *Merchants National Bank v. Miller*,[5] a North Dakota case, in which it is stated that "the mortgagor agreed with the plaintiff (the second mortgagee) that he would defend this title to the premises against all lawful claims, and therefore he agreed to defend it against the first mortgage." Apparently the court was of the opinion that the foreclosure of the first mortgage operated as a breach of the warranty in

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[4] 72 S. W (2nd) 1103.
[5] 229 N. W 357.

the second to defend the title against anyone attempting to enforce a paramount title.

Under this principle, there is a wide divergence of opinion among various courts relative to one point, i. e., whether or not a provision in the second mortgage in substance as follows, "Subject however to a first mortgage in the amount of ..... Dollars," affects the liability of the debtor in the event he reacquires title.

In the North Dakota case above cited, the court held that this provision in the second mortgage in no way affected the warranty, stating that "the covenant of warranty and to defend that title is not restricted by the exception as to the incumbrances." The fact that a restriction was placed on the warranty against incumbrances does not in any way show the parties intended to restrict and qualify the covenant of warranty to defend. This view that the exception of the first mortgage does not relieve the mortgagor from the force of his covenant of warranty is not accepted in the case of *Sandwich Manufacturing Company v. Zellmer,*[6] a Minnesota case, it being there held that the mortgagor excepted from his covenant the first mortgage, therefore did not agree to defend the title against the exercise of a paramount title by the first mortgagee. Hence, after foreclosure of the first mortgage, title being reacquired by the mortgagor, the second mortgagee had no cause for complaint, inasmuch as the mortgagor had not agreed to defend the title against the mortgage that actually was foreclosed.

Which of these theories is preferable certainly would be a matter of debate. Before going further, we might offer this criticism of the theory expressed in the case of *Merchants National Bank v. Miller*[7] That case holds that the mortgagor agrees with the second mortgagee that he will defend the title to the premises against all lawful claims, therefore agreeing to defend it against the first mortgage. In Bouvier's Law Dictionary, warranty is defined, "An assurance by the grantor of an estate that the grantee shall enjoy the same without interruption by virtue of paramount title." When

[6] 51 N. W 379.
[7] 229 N. W 357.

a first mortgage is foreclosed and sheriff's deed issued, obviously the interest of the second mortgagee in the title is disturbed. It occurs to us that it is not the assertion of paramount title by the purchaser at the sale under the first mortgage that should be the proper theory of these cases. It is the attempt of the mortgage debtor to assert a paramount title upon reacquisition of the property, against which the warranty will be good.

The third—*The Covenant of Warranty of Title Theory*—is also based upon the warranty contained in the second mortgage. This theory we believe to be much the soundest, most flexible and the one which may be properly called the law This theory is concisely expressed in the case of *Pancoast, et al v. Travelers Insurance Company.*[8] In this case the defendant in an action to foreclose attempted to attack his own title to the mortgaged premises. The mortgage contained a covenant of warranty The court says

"This he could not do. He is bound by and estopped from denying his title to the mortgaged premises at the date of the mortgage, and, where in the mortgage he has warranted the title, any title that he might subsequently acquire would enure to the benefit of the mortgagee."

The mortgagor has warranted that the property described in the mortgage shall be security for the debt. The pledge of the property is a part of the consideration. It is the contract duty of the mortgagor to produce the property if he fails to pay the debt. If for some reason, such as foreclosure of a first mortgage, title vesting in a third party, the mortgagor is prevented from producing the security, he is not therefore relieved of his contract obligation but it is merely postponed to such time as he will be able to fulfill it.

This theory is free from the objections to the other two theories and we believe it works toward a fulfillment of the real intention of the parties. We find one case cited supra which substantiates the application of this principle to the question considered. That is the case of *Merchants National Bank v. Miller,*[9] in which case appears the following·

[8] 79 Ind. 172.

[9] 229 N. E. 357.

"Our statute, Section 6731 of the Code (Comp. Laws 1913), says: 'Title acquired by the mortgagor subsequent to the execution of the mortgage inures to the mortgagee as security for the debt in like manner as if acquired before the execution.'

"This applies to a case where the mortgagor had title, lost it, and subsequently reacquired title, as much as it does to a case where the mortgagor did not have title at first, but gave a mortgage and afterwards acquired title."

It will be noted that the wording in this statute is almost identical with the court's ruling in the Pancoast case and expresses clearly the principle that we believe best.

Another case along the same line is *Baird v. Chamberlain.*[10] Here the defendant had executed two mortgages on his property The first was foreclosed and the mortgagee was the purchaser. The mortgagor then went through bankruptcy Subsequently he repurchased the property from the first mortgagee. The question was then presented whether the holder of the second mortgage could foreclose, inasmuch as the acquisition of the property was subsequent to the mortgages in question, and after the discharge in bankruptcy through repurchase from a first mortgagee who had acquired the property by sheriff's deed on the foreclosure of its first mortgage. The second mortgage provided "Mortgagor hereby covenants with mortgagee that mortgagor is now seized in fee simple of said premises, that mortgagee shall enjoy same without lawful disturbance and mortgagor warrants same. Subject to first mortgage of $2000.00." The court held the second mortgage revived. This decision is based on the theory that the covenant of warranty in a second mortgage will revive the lien. It concerns itself particularly with determining the effect of the phrase "subject to first mortgage of $2,000.00." The court said, "We are of the opinion that a recital in a mortgage that it is subject to a prior mortgage is not properly construed as a qualification of the covenants of warranty which bind the mortgagor to protect the mortgagee against lawful disturbance and against every person lawfully claiming the premises." The

[10] 236 N. W 724.

reasoning in this case is drawn from *Merchant's National Bank v. Miller* [11]

We have considered the subject of this article largely from the application of certain rules adopted in other jurisdictions, and we may say here that we have by no means discussed all the cases decided on this point, merely having stated the principles that are generally accepted. So far as we have been able to find, the specific point in issue has never been raised in Indiana. There is one case, *Burke, et al v. Abbott, et al,*[12] which might be relied on, but only by analogy, to substantiate the payment theory

In a brief prepared by Henry C. Burnham, attorney for the Title Insurance Corporation of Saint Louis, he said

"It has been held in many cases (and can probably be said to be the general rule) that when a person executes two or more mortgages or deeds of trust on the same land, a foreclosure under the senior mortgage will only temporarily extinguish or cut out a junior mortgage, if the mortgagor subsequently acquires title to the land, and the junior mortgage will be revived and reinstated as a valid lien against the property (Jones on Mortgages, Sec. 1887, 1918 L. R. A., B. 770).

"The reason for the rule of revival or reintsatement is because of the statutory warranty contained in the junior deed of trust. In most states 'Grant, Bargain and Sell,' or some similar phrase, is a statutory warranty, and after acquired title inures to the benefit of the grantees. Hence, when the words, 'Grant, Bargain and Sell,' appear in the junior deeds of trust or mortgages, a foreclosure of a prior lien will not cut out the junior mortgages where the mortgagor buys the property at the trustee's sale, and if a stranger buys at such sale, thereby extinguishing the junior liens, they will be revived should the property be reconveyed to the mortgagor. And if the land is sold subject to two mortgages, which the grantee assumes and agrees to pay, said grantee cannot buy at the foreclosure sale under the senior and cut out the junior mortgage. Such a purchase is considered a payment of the senior lien (Jones on Mortgages, Sec. 1887, Wiltsie on Mortgage Foreclosure, Sec. 775)."

He also cites *Jensen v. Duke,*[13] in which case one Jensen executed a deed of trust to Abbott and then sold the property to Duke, who executed a second deed of trust to Jensen.

[11] 229 N. W 357.

[12] 103 Ind. 1.

[13] 71 Cal. App. 210, 234 Pac. 876.

The first was foreclosed and the purchaser conveyed back to Duke. This was an action to foreclose the Jensen deed of trust. It was held that the Jensen deed of trust was revived by inurement and that the ruling in *Plumb v. Studebaker,*[14] is not the correct exposition of the law in California.

Another case cited in M. Burnham's brief is *Martin v. Raleigh State Bank.*[15] In this case one Martin executed a deed of trust to the Raleigh State Bank which stated that it was a second deed of trust. The first was foreclosed and the title later became vested in Martin again. The second was then foreclosed and the beneficiary bought in at the sale and brought this suit for possession. The defense was that, by virtue of the clause in the second deed of trust reciting that it was second and subordinate to the first, the Raleigh State Bank lost its rights to proceed against the land. It was held that the doctrine of the Massachusetts court, as stated in *Huzzey v. Hefferman*[16] is not applicable in this state, and that the title Martin acquired subsequent to the execution of the second deed of trust inures to the benefit of the beneficiary of the latter.

Further cases cited in Mr. Burnham's brief that deal with the revival of second mortgage theory are *Plumb v. Studebaker Bros. Mfg. Co.,*[17] *Hickman v. Dill,*[18] *Moore v. Lindsay,*[19] *Sandwich Mfg. Co. v. Zellmer,*[20] and *Huzzey v. Hefferman.*[21]

The third theory is simple and strictly in accord with the agreement of the parties. Under this theory, as well as the second, a question might arise if in the warranty the first mortgage is excepted. It is our belief, however, that this exception should be interpreted as a mere matter of form, nothing more than an identification of a lien already existing and superior from the standpoint of priority upon foreclosure,

14 89 Mo. 162.
15 111 So. (Miss.) 448.
16 143 Mass. 232, 9 N. E. 570.
17 89 Mo. 162.
18 39 Mo. App. 246.
19 52 Mo. App. 474.
20 48 Minn. 408, 51 N. W 379.
21 143 Mass. 232, 9 N. E. 570.

but in no way affecting the agreement to produce the property as security for the debt in the event of a default.

The examination of these and other authorities leads us to believe that the only safe ruling where this question arises is that the second lien reattaches, and it would be very dangerous to pass a title where a mortgage debtor has reacquired the title after foreclosure of a first mortgage where the interests of the second mortgagee were not adjudicated and the second mortgage has not been released.