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**Right Of Mortgagee To Sue Assuming Grantee  
Of Mortgage Debt**

*Rosenberg v. Rolling Inn, Inc.*<sup>1</sup>

Plaintiffs operated coin machines in a supper club managed by Villa Donna, Inc. In July of 1949 the Villa Donna corporation executed a mortgage, payable in one year, on the real and personal property of the supper club to secure a debt of \$5,200, owed by Villa Donna to the plaintiffs. The mortgage was never recorded. In November of 1949, Villa Donna, Inc. sold the supper club under a written contract to three individual vendees who were the promoters and later became the first stockholders of the defendant corporation. The contract provided that the vendees would assume the mortgage obligation owed by Villa Donna, Inc. to the plaintiffs. One week later, defendant corporation ratified the assumption. However, since no written evidence of this ratification could be found, defendant repudiated its obligation and, on June 2, 1951, ceased to make payments. Plaintiff brought this suit at law for the balance due on the mortgage debt. Defendant pleaded the Statute of Frauds. On judgment for defendant, plaintiffs appealed. The Court of Appeals, in reversing the lower court, held that the Statute of Frauds did not apply since the defendant made its promise to the original debtor. "Where the promise to pay a debt or obligation is not to the creditor,

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<sup>1</sup> 212 Md. 552, 129 A. 2d 924 (1957).

but to the original debtor, the promise does not fall within the statute."<sup>2</sup>

This application of the Statute of Frauds is one uniformly accepted.<sup>3</sup> Its application here, however, emphasizes that this was a promise made by the grantee to the grantor of the mortgaged land. This would appear to make defendant corporation an assuming grantee of the mortgage debt, here sued *at law* by the mortgagee on that debt.

Decisions and statements by the Court of Appeals indicate the adoption in Maryland of the rule of *Lawrence v. Fox*,<sup>4</sup> which permits a third-party creditor beneficiary to maintain an action at law on the promise made for his benefit.<sup>5</sup> In *Small v. Schaefer*,<sup>6</sup> the defendant and A entered into an agreement whereby defendant promised to pay A's debt to the plaintiff if A would deliver certain bonds to the defendant. Upon delivery of the bonds, defendant refused to perform his promise. In a suit at law, the Court, affirmed a verdict for the plaintiff, on the ground that where one person makes a promise to another to do an act beneficial to a third person, the third person may maintain an action on the promise.

In *Boulevard Corp. v. Stores Corp.*,<sup>7</sup> on facts parallel to *Small v. Schaefer*,<sup>8</sup> the Court, in an equity proceeding against the promisor by the third-party beneficiary, held for the promisor since the beneficiary could not prove an alleged fraud. The present importance of the decision lies in the fact that *Small v. Schaefer*<sup>9</sup> was cited for the proposition that the beneficiary had an adequate remedy at law against the promisee on his original promise to pay the debt owed.

The most explicit statement of Maryland's position concerning the creditor beneficiary is found in a *dictum* in *Mackubin v. Curtiss-Wright Corp.*<sup>10</sup>

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<sup>2</sup> *Ibid.*, 556.

<sup>3</sup> 2 CORBIN, CONTRACTS (1950) §357; 2 WILLISTON, CONTRACTS (Rev. ed. 1936) §478.

<sup>4</sup> 20 N. Y. 268 (1859), where, upon consideration moving from A to B, B promised to pay A's debt to C. Upon failure of B to pay, C sued. *Held*: C may sue B at law on the theory that the contract was made directly for the benefit of C.

<sup>5</sup> *Small v. Schaefer*, 24 Md. 143 (1866); *Boulevard Corp. v. Stores Corp.*, 168 Md. 532, 178 A. 707 (1935). See also, *Mackubin v. Curtiss-Wright Corp.*, 190 Md. 52, 57 A. 2d 318 (1948), noted 10 Md. L. Rev. 67 (1949); *Levy v. Glen Falls Indem. Co.*, 210 Md. 265, 123 A. 2d 348 (1956).

<sup>6</sup> *Ibid.*

<sup>7</sup> *Supra*, n. 5.

<sup>8</sup> 24 Md. 143 (1866).

<sup>9</sup> *Ibid.*

<sup>10</sup> 190 Md. 52, 178 A. 707 (1935). The Court held that a stock-listing agreement between the N. Y. Stock Exchange and the defendant whereby

"A third person is a creditor beneficiary where no purpose to make a gift appears and performance of the promise will satisfy an actual or supposed or asserted duty of the promisee to the beneficiary, or a right of the beneficiary against the promisee which has been barred by the Statute of Limitations, or by a discharge in bankruptcy, or which is unenforceable because of the Statute of Frauds. 1 *Restatement, Contracts*, sec. 133. The great weight of American authority now recognizes that a direct right of action, either at law or in equity, arises from a contract promising performance for the benefit of either donee beneficiary or creditor beneficiary. 2 *Williston on Contracts*, sec. 356."<sup>11</sup>

Despite the generality of this statement in the *Mac-kubin*<sup>12</sup> case, it has been thought that the right of the creditor beneficiary to sue the promisor in his own name was subject to one exception: a mortgagee suing on the promise of an assuming grantee of the mortgaged property.

In a majority of jurisdictions, a mortgagee has a cause of action against a grantee of the mortgaged property who assumes the mortgage debt on one (or possibly both) of two theories. As a creditor beneficiary, he may sue the grantee on the latter's promise to pay the debt<sup>13</sup> or he may be subrogated to the mortgagor's right to the performance of the grantee's promise under the doctrine of equitable subrogation.<sup>14</sup>

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the defendant was to inform the Stock Exchange promptly of any action by the defendant concerning dividends was not intended primarily to benefit prospective purchasers, one of which was the plaintiff; thus the plaintiff was not a donee beneficiary. The plaintiff could not sue as a creditor beneficiary since no debt or duty was owed her by the Stock Exchange.

<sup>11</sup> *Ibid.*, 57. This *dictum* was cited with approval in *Levy v. Glens Falls Indem. Co.*, 210 Md. 265, 123 A. 2d 348 (1956), where materialmen were permitted to recover on a contractor's performance bond since it was executed expressly for their benefit.

<sup>12</sup> *Supra*, n. 10.

<sup>13</sup> The third party beneficiary doctrine is predicated on the theory that where a grantee assumes the mortgage debt of his grantor, the agreement may be enforced by the mortgagee in a direct action at law since the contract of assumption is made for his benefit; *KEIGWIN, CASES ON MORTGAGES* (1936) 447; 2 *JONES, MORTGAGES* (8th Ed. 1928) §§948, 952; 21 A. L. R. 439; 47 A. L. R. 339. See also *Hayes v. Betts*, 227 Ala. 630, 151 So. 692 (1933); *Mullin v. Claremont Realty Co.*, 39 Ohio App. 103, 177 N. E. 226 (1930); *Herbert v. Corby*, 124 N. J. L. 249, 11 A. 2d 240 (1940). For other cases stating this doctrine, see: 2 *WILLISTON, CONTRACTS* (Rev. ed. 1936) §383.

<sup>14</sup> The equitable subrogation doctrine is based on the theory that the purchaser of lands subject to a mortgage who assumes and agrees to pay the mortgage debt becomes, as between himself and his vendor, the principal

In *Scherr v. Building & Loan Ass'n.*,<sup>15</sup> the Maryland Court of Appeals explicitly rejected the contention that the mortgagee could sue as a third party beneficiary stating that:

"The covenant in the deed to the appellants that they should be primarily liable upon all the covenants contained in the mortgage was an agreement exclusively between them and their grantors. *It created no direct contractual relationship between the appellants and the mortgagee.*<sup>16</sup> Whatever rights and remedies in equity may have inured to the mortgagee from the covenants in the deed for the assumption and payment of the mortgage debt by the grantee, we must hold that the covenant is unavailable to the mortgagee in an action at law."<sup>17</sup>

The above quotation seems necessarily to indicate that in this fact situation, the contracting parties had no intention of benefiting the mortgagee and thus he could not be a third party beneficiary. The Court concluded:

". . . the covenant sought to be utilized by a mortgagee for the purposes of a special statutory proceeding was not made for the mortgagee's benefit, but solely for the advantage of the grantors in the deed in which the covenant was embodied."<sup>18</sup>

In the *Scherr* case,<sup>19</sup> A for valuable consideration, covenanted to assume B's mortgage debt owed to C. A also promised to be liable for a deficiency decree in case he defaulted and the mortgaged property was sold for less than the amount of the mortgage. A defaulted and following a foreclosure sale, C brought a suit at law against A for a deficiency decree. The Court held that under a local

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debtor, and the liability of the vendor, as between the parties, is that of surety. Under this theory, the mortgagee does not have a direct right against the purchaser, but rather his rights are subrogated or substituted in equity to the rights of the mortgagor (vendor) for the purpose of collecting the debt owed. *KEIGWIN, op. cit., ibid.* 446; *JONES, op. cit., ibid.* 954, 955; 21 A. L. R. 439; 47 A. L. R. 339. For cases applying this doctrine see *Keller v. Ashford*, 133 U. S. 610 (1890); *Hopkins v. Warner*, 109 Cal. 133, 41 Pac. 868 (1895); *Thompson v. Cheeseman*, 15 Utah 43, 48 Pac. 477 (1897); *Hubard & Appleby v. Thacker*, 132 Va. 33, 110 S. E. 263, 21 A. L. R. 423 (1922).

<sup>15</sup> 166 Md. 106, 170 A. 197 (1934).

<sup>16</sup> Italics supplied.

<sup>17</sup> *Supra*, n. 15, 111.

<sup>18</sup> *Ibid.*, 112.

<sup>19</sup> 166 Md. 106, 170 A. 197 (1934).

statute<sup>20</sup> only those who have a right to sue at law on the covenants of the mortgage may obtain a deficiency decree. Since there was no direct contractual relationship between A and C, C could not maintain a suit at law against A.

Neither, in those cases<sup>21</sup> cited by the *Scherr* case,<sup>22</sup> nor in the cases<sup>23</sup> which subsequently have cited *Scherr* as authority, does the Court say that "equitable subrogation" is the principle to be applied. Yet, in those cases and in the *Scherr* case,<sup>24</sup> the Court uses the nomenclature of equitable subrogation, particularly in describing the resulting relationship as one in which the assuming grantee becomes the principal debtor and the mortgagor the surety for the payment of the mortgage debt.<sup>25</sup>

In the principal case the facts, the terms of the agreement and the language used by the Court definitely indicate an assumption of a mortgage debt. When the three promoters, who later were instrumental in forming the defendant corporation, purchased the supper club, the business was encumbered with a mortgage. The contract of sale provided that the vendees assumed "the absolute obligation of the payment of . . . the obligation of several mortgage indebtednesses existing as a lien against said property and most specifically . . . an unrecorded mortgage to Harry Rosenberg and Moe Kaminsky."<sup>26</sup> Yet, a suit *at*

<sup>20</sup> Md. Code P. L. L. (1930), Art. 4, Sec. 731A, Charter & P. L. L. of Balto. City (1949), Sec. 521, which provides that if, in a foreclosure sale, the proceeds do not suffice to pay the mortgage and accrued interest:

" . . . the court may, upon the motion of the plaintiff, the mortgagee or his legal or equitable assignee, after due notice, by summons or otherwise, as the court may direct, enter a decree *in personam* against the mortgagor or other party to the suit or proceeding, who is liable for the payment thereof, for the amount of such deficiency; provided the mortgagee or his legal or equitable assignee would be entitled to maintain an action at law upon the covenants contained in the mortgage for said residue of said mortgage debt so remaining unpaid and unsatisfied by the proceeds of such sale or sales; . . ."

<sup>21</sup> *George v. Andrews*, 60 Md. 26 (1883); *Chilton v. Brooks*, 72 Md. 554, 20 A. 125 (1890); *Warner v. Williams*, 93 Md. 517, 49 A. 559 (1901).

<sup>22</sup> *Supra*, n. 15, 109.

<sup>23</sup> *County Trust Co. v. Harrington*, 168 Md. 101, 106, 176 A. 639 (1935), quoting *Chilton v. Brooks*, *supra*, n. 21, "where a grantee covenants, or by apt terms assumes, to pay a mortgage debt charged on the granted premises, for the payment of which the grantor is bound, the relation of principal and surety arises". See also *Mashkes v. Building & Loan Ass'n.*, 167 Md. 270, 173 A. 54 (1934); *Safe Dep. & Tr. Co. v. Strauff*, 171 Md. 305, 189 A. 195 (1937).

<sup>24</sup> 166 Md. 106, 170 A. 197 (1934).

<sup>25</sup> Moreover, in the passage from *Keller v. Ashford*, 133 U. S. 610 (1890), quoted by the court in the *Scherr* case, *supra*, n. 24, the United States Supreme Court describes an equitable subrogation and its consequences. For a general discussion of the rights of a mortgagee, see *Slingluff, Mortgagee's Rights in the Event of a Deficiency*, 1 Md. L. Rev. 128 (1936).

<sup>26</sup> *Rosenberg v. Rolling Inn, Inc.*, 212 Md. 552, 554, 129 A. 2d 924 (1957).

law was permitted. This suggests, at least, a departure from the *Scherr* rule. All things considered, however, it would be unsafe to infer an intention to overrule *Scherr* from this decision.

A previous Law Review note<sup>27</sup> suggested that the *Scherr*<sup>28</sup> rule might apply only to deficiency judgments under the local statute. Considering, however, that the reason given for denial of the action at law was the absence of a "direct contractual relationship," there seems no reason to assume such a limitation was intended.

Considering it a novation<sup>29</sup> would remove the present case from the areas of both equitable subrogation and third party beneficiary. The fact that the purchasers and Kaminsky, one of the plaintiffs, had agreed that the defendant corporation could amortize the mortgage on the same basis as the mortgagor, might suggest a novation.<sup>30</sup> However, by deciding the Statute of Frauds question as they did, the Court appears to have ruled out this possibility.

Most important was the fact that the defendant corporation did not challenge the power of this plaintiff to bring this action. The Court was not offered the opportunity to decide whether the *Scherr* exception to the rule of *Lawrence v. Fox*<sup>31</sup> should continue.

However, the fact remains that the principal case has raised a shadow of doubt as to the actual rights of a mortgagee beneficiary. Until the Court of Appeals has made a more definite statement in this area, the doubt will remain.

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<sup>27</sup> Note, *Action at Law by a Creditor Beneficiary in Maryland*, 10 Md. L. Rev. 67, 71 (1949).

<sup>28</sup> 166 Md. 106, 170 A. 197 (1934).

<sup>29</sup> A novation is defined as:

"... a contract that

(a) discharges immediately a previous contractual duty or a duty to make compensation, and

(b) creates a new contractual duty, and

(c) includes as a party one who neither owed the previous duty nor was entitled to its performance."

RESTATEMENT, CONTRACTS (1932), §424.

<sup>30</sup> See *supra*, n. 23, the Mashkes and Safe Deposit cases, where a promise to the assuming grantee by the mortgagee to extend the time of maturity was held to be a novation. It appears that the Court is not unwilling to find a novation where the facts of the case permit.

<sup>31</sup> 20 N. Y. 268 (1859).