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Berryl A. Speert

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Foreclosure Without Disclosure

Cooper-Merriken Fertilizers, Inc. v. Smith

Mortgagee and mortgagor entered into a written agreement for a public sale of the chattels covered by the mortgage. The property was to be sold by a third party in the mortgagor's name and the proceeds held for the benefit of the mortgagee. Plaintiff, a judgment creditor of the mortgagor, obtained summary judgment and subsequently levied an attachment on the property. The mortgagee then petitioned and was given leave to intervene in the proceedings to protect its lien, which it claimed to be superior to any claim of the judgment creditor. The Circuit Court for Kent County, in a Memorandum Opinion, held that the mortgagee did not lose its lien since the third party auctioneer was acting as a trustee for the mortgagee and not as agent of the mortgagor.

There are three types of agreements entered into by mortgagor and mortgagee in which the problem of the principal case may arise. First, the mortgagee may unconditionally consent to the selling of the property by the mortgagor in the mortgagor's name. It is undisputed that in such a situation the mortgagee loses his lien, and an at-

1 Daily Record, November 17, 1962 (Md. 1962).
taching judgment creditor prevails.\textsuperscript{2} Second, the mortgagee may consent to the sale of the property by the mortgagor in the mortgagor’s name, but on condition that the proceeds of the sale be applied to the mortgage debt. In such a situation, some courts have found the mortgagor to be the agent of the mortgagee,\textsuperscript{3} or have found an equitable assignment from mortgagor to mortgagee,\textsuperscript{4} and have upheld the mortgagee’s lien as superior to claims of others. Other courts, however, have held that the mortgagee loses his lien because the attaching party is without knowledge of the mortgage agreement.\textsuperscript{5} The third type of agreement, the one used in the instant case, is one which states that a third party is to sell the property in the mortgagor’s name and apply the proceeds to the mortgage debt. Although a problem of first impression in Maryland, other jurisdictions have consistently held that the mortgagee, in the absence of fraud, prevails over the attaching judgment creditor.\textsuperscript{6} This result has been said to be based upon the argument that such a third person receives the proceeds, not as the agent of the mortgagor, but as trustee for the mortgagee, and that as soon as the proceeds reach the trustee’s hands they become subject to the trust.\textsuperscript{7} Accordingly, he is under no obligation to pay them over to the mortgagor, nor can the latter collect them from him, and the garnishing creditor, acquiring no greater rights, cannot recover the proceeds from the garnishee.

In the instant case, the form of agreement thus furnished the mortgagee with an effective means of foreclosure on the mortgage debt without the necessity of any formal proceedings, and without the general public having knowledge that the sale was a foreclosure.

At common law the method of securing payment from a defaulting mortgagor was by strict foreclosure. The mort-

\textsuperscript{3} Farmers’ State Bank of Petersburg v. Anderson, 112 Neb. 413, 199 N.W. 728 (1924).
\textsuperscript{4} McIntyre v. Hauser, 131 Cal. 11, 63 P. 69 (1900).
\textsuperscript{5} Smith v. Clarke, 100 Iowa 605, 69 N.W. 1011 (1897); Smith v. Crawford County State Bank, 99 Iowa 252, 61 N.W. 378, 68 N.W. 690 (1894); First National Bank v. Bernard, 30 S.W. 580 (Texas 1896).
\textsuperscript{7} Anno., 36 A.L.R. 1379, 1390 (1925).
gagee, would bring a bill in equity calling upon the mortgagor to repay the debt. The court, after a hearing, would pass a decree appointing a day for payment. Upon failure of payment the decree would be made final and absolute and have the effect of vesting full title in the mortgagee without any sale necessarily occurring. It was necessary that all interested parties or persons who might be affected by the decree be joined as parties in the foreclosure proceeding so that their interests might be finally determined. Strict foreclosure is not generally used in the United States today, except where (1) the property is similar in value to the mortgage debt or (2) where a special foreclosure proceeding is required against a subsequent lienor. These situations would appear to be instances where the mortgagee would not be concerned with extinguishing the rights of third persons, either because third parties could not possibly have any interest worth protecting, or because a separate suit would, in any event, be later brought to foreclose third parties' interests.

In order to find a quicker and less expensive method of enforcing mortgages and also to bring the foreclosure sale under the jurisdiction of the court, legislative changes were enacted, beginning in Maryland as early as 1784. The current version of these statutory reforms permits the insertion of a clause in the mortgage agreement either providing for the mortgagor's assent to the passing of a decree for sale of the property upon default by the mortgagor or authorizing some person to sell the property upon default. Foreclosure under these methods, called "assent to a decree" and "power of sale" respectively, requires that an action be brought in equity but does not necessitate issuance or service of process, filing an answer, or holding a hearing. Before a sale can occur, the mortgagee must
post a bond with the court\textsuperscript{18} and the person authorized to sell must advertise the sale.\textsuperscript{19} If a third party has an interest in the property, he may apply to the court ratifying the sale and the court will distribute as much as is available from the surplus of the sale to satisfy his claim.\textsuperscript{20} Since the sale is under the jurisdiction of the court it would appear that the possibility of the mortgagee perpetrating a fraud on the rights of interested third parties is minimal.

No such advantage is present in the foreclosure method presented in the instant case, as neither the court nor the general public would know a foreclosure sale is transpiring. However, the very absence of general notoriety makes a more difficult practical problem of proving that a fraud has occurred. Furthermore, even if the mortgagee respects the rights of third parties, he would necessarily expend time and money searching records in an effort to discover all those who may have an interest in the mortgaged property.

On the other hand, several distinct advantages are presented by utilizing the type of transaction employed in the instant case. The private sale saves the expenses of formal court proceedings, including the bond required to be posted, thus leaving a greater surplus remaining for the mortgagor and claims of third persons. Also, a private sale is likely to realize a higher selling price than a court-supervised foreclosure sale. If the auctioneer at the sale is to be considered as a trustee for not only the mortgagee but all other interested parties as well, then the possibility of fraud being perpetrated by the mortgagee is unlikely.\textsuperscript{21}

\textbf{Berryl A. Speert}

\textsuperscript{18} Id., W74 a1.
\textsuperscript{19} Id., W74 a2.
\textsuperscript{20} Id., W75 a.
\textsuperscript{21} See cases \textit{supra}, ns. 6 and 7, wherein the auctioneer is described as a trustee for the mortgagee, but no mention is made whether the auctioneer also is representing the interests of other parties that may be involved. The cases do not discuss the duty of the trustee, if any, to determine whether there is an absence of fraud on the part of the mortgagor before turning the proceeds of the sale over to him.