Case Western Reserve Law Review

Volume 18 | Issue 2

1967

Mortgages--Construction and Operation--Lien and Priority [*Gulesersan v. Fields*, 218 N.E.2d 397 (Mass. 1966]

David L. Rosenzweig

markets, thus protecting the public from injury and themselves from suit.

Despite any criticisms levied at strict tort liability in cases such as *Lonzrick*, the trend of the decisions indicates that the doctrine is rapidly finding acceptance throughout the country, and it is doubtful that this trend will be halted. The Ohio courts now recognize strict liability in actions for personal injury absent any express representations to the consumer and to the user, be he active or passive.[83] It appears that if the courts follow the route they have traveled in abolishing the requirement of privity in actions based on express warranty,[84] the next step may well be to allow recovery, in the absence of privity, for pecuniary loss arising from a breach of implied warranty.

STANLEY E. BLOCH

MORTGAGES — CONSTRUCTION AND OPERATION — LIEN AND PRIORITY

Guleserian v. Fields, 218 N.E.2d 397 (Mass. 1966).

The recent Massachusetts case of *Guleserian v. Fields*[1] appears to be one of first impression in construing Massachusetts mortgage law. As a result of that decision, a senior mortgagee may change the amount of mortgage principal payments without prejudice to his priority even though a junior mortgagee, who obtained his second mortgage subsequent to the first mortgage but prior to the change, refused to give his consent to such change.[2]

The action arose when the mortgagors and the senior or first mortgagee sought to change the first mortgage note payment terms so that monthly principal payments due the first mortgagee within the twenty-four month period following the agreement's execution would be postponed until the maturity date of the mortgage, with no increase in interest rate or principal.[3] It is important to note that the proposed change was not the usual extension of time beyond the

[83] See *id.* at 227, 218 N.E.2d at 185; Rogers v. Toni Home Permanent Co., 167 Ohio St. 244, 147 N.E.2d 612 (1958).

[84] The court, in Rogers v. Toni Home Permanent Co., *supra* note 83, took the first step by eliminating privity in an action based on breach of express warranty for personal injuries. Then in 1965, it abolished privity in an action based on express warranty for pecuniary loss. Inglis v. American Motors Corp., 3 Ohio St. 2d 132, 209 N.E.2d 583 (1965).

maturity date. Rather, the first mortgagee was simply foregoing payment of the principal for two years, the amount unpaid to be added to the balance due at maturity as a balloon payment.[4]

In resolving the issues involved, the court held, *inter alia*, that such an extension or modification would neither affect nor diminish the priority of the first mortgagee's security interest as it existed at the time the second mortgage was executed.[5] The court asserted:

> The general rule is that a renewal or extension of an existing senior mortgage and the note (or other obligation) secured thereby, without an increase of the principal or interest payable with respect to the secured indebtedness, will not result in any loss of priority of that senior mortgage over junior encumbrances.[6]

In Massachusetts, such changes in the payments under mortgages are authorized by statute,[7] and the very existence of this provision must be considered a warning to junior lienholders of the possibility of such an extension.[8]

Moreover, in *Fields*, the junior mortgagee was warned of the possibility of an extension not only by the statutory mortgage covenants but also by a special covenant between the mortgagor and the first mortgagee included in the first mortgage.[9] It is this special covenant that forms the basis for the concurring opinion.[10]

In concluding that the second mortgagee was not prejudiced and was therefore not entitled to priority over the first mortgagee, the court also stated that the junior mortgagee, being on notice of the possibility of such an extension, could have easily guarded against it.[11] This point is indeed correct and perhaps, as suggested by the concurring opinion,[12] would have been a better foundation for the decision. However, the majority went to great lengths to establish that the extension did not prejudice the junior mortgagee's position

---

1 218 N.E.2d 397 (Mass. 1966).

2 *Ibid.*

3 *Id.* at 400. However, the interest payments were to continue even though the principal payments were postponed.

4 *Id.* at 401.

5 *Id.* at 402.

6 *Id.* at 401. See, *e.g.*, Crutchfield v. Johnson & Latimer, 243 Ala. 73, 8 So. 2d 412 (1942); State Life Ins. Co. v. Freeman, 308 Ill. App. 127, 31 N.E.2d 375 (1941); 1 JONES, MORTGAGES § 438, at 560-61 (8th ed. 1928).

7 MASS. GEN. LAWS ANN. ch. 168, § 36 (1958).

8 Guleserian v. Fields, 218 N.E.2d 397, 402 (Mass. 1966).

9 *Id.* at 399 n.2.

10 *Id.* at 403-05.

11 *Id.* at 402 n.6, 403.

12 *Id.* at 404.

— an argument which, from a practical point of view, is difficult to accept. The court, in fact, does concede that the extension will result in interest being "paid upon the amount of the postponed principal payments for a longer period than was originally contemplated."[13] In reality, this results in the mortgagor's increasing his original burden by having to pay greater amounts of interest than were originally contemplated by both the first and the second mortgagee when the second mortgage was executed. Simple mathematics indicate that the more the mortgagor must pay the first mortgagee the less the mortgagor will have available for either working capital or for payments to the second mortgagee. Thus, the possibility that the mortgagor will default is heightened and the risk (prejudice) to the second mortgagee's security interest is increased.

Justice Spiegel, in his concurring opinion, detected this flaw in the court's reasoning. Postponing payments of principal for a two-year period, he noted, would result in a decrease of the second mortgagee's security.[14] The reasoning is simple. Once such a postponement agreement goes into effect, "the unpaid principal balance at any time thereafter" would be greater "than it would have been had the payments been made as scheduled."[15] The full impact of this disadvantage would be felt if the mortgagor should eventually default in his principal payments. In such event, the second mortgagee "would be required to pay more than the amount it would otherwise pay in order to be subrogated to the rights of the . . . first mortgagee."[16]

Assuming prejudice, perhaps a reallocation of priorities would be appropriate so that the junior mortgagee, in the event of a subsequent default by the mortgagor and foreclosure by the first mortgagee, would have first priority, at least to the extent that he has been prejudiced by the extension agreement.

---

[13] *Id.* at 401.

[14] *Id.* at 403-04.

[15] *Ibid.*

[16] *Ibid.* This very point was also strongly argued by the defendant (second mortgagee) in his brief, but to no avail:

> A waiver of payments on the prior mortgage for any period necessarily adversely impairs the position of the second mortgagee. The holder of a second mortgage has the right to protect himself by becoming subrogated to the position of the first mortgagee on payment of the mortgage indebtedness. The effect of a waiver of payments for a period of time would be to increase the payment which the holder of the second mortgage would have to pay to protect himself in the event of default or to be subrogated to the first mortgagee's position. Brief for Defendant, p. 6, Guleserian v. Fields, 218 N.E.2d 397 (Mass. 1966).

There are decisions, though factually distinguishable, which have attempted to protect the junior mortgagee when his interests were seriously prejudiced.[17] The Iowa Supreme Court, for example, has taken the position that an extension of the maturity date without the knowledge and consent of the second mortgagee would prejudice his security interest.[18]

In the past, some junior mortgagees have unsuccessfully argued that their position is analogous to that of a surety who is not bound by any extension granted to the creditor without the surety's consent.[19] The first mortgagee in the *Fields* case answered this possibility by saying that such a principle is "untenable" as well as being unsupported by case law.[20] The first mortgagee's brief pointed out that the second mortgagee has no real legal connection with the first mortgage, nor does he, like a surety, guarantee the mortgagor's performance of the first mortgage. Hence, the second mortgagee cannot in any real sense be considered a surety.[21]

Research has failed to disclose an Ohio case factually on point in every respect with *Fields*, but the overall case law is sufficient to provide a rather accurate indication of how such an action might be resolved.

The appropriate Ohio statutes are by no means as numerous or complex as those considered in the principal case. The Ohio statutory mortgage condition[22] does not contain a reference to "any ex-

---

17 *E.g.*, Wheeler v. Menold, 81 Iowa 647, 47 N.W. 871 (1891); Bunker v. Barron, 93 Me. 87, 44 Atl. 372 (1899); Pettis v. Darling, 57 Vt. 647 (1885).

18 Wheeler v. Menold, *supra* note 17, at 649, 47 N.W. at 872. In this case the junior mortgagee was permitted to redeem the prior mortgage and foreclose because the mortgagor's failure to pay was in violation of the requirements of the senior mortgage.

The court's reasoning could easily apply to the principal case. The junior mortgagee, argued the court, could protect himself in only one way — by inspecting the record before giving the second mortgage to determine what encumbrances were outstanding and their maturity dates. Based on this information the junior mortgagee could then intelligently determine the risks involved and whether he was willing to take them. The court therefore refused to permit any change that would result in prejudice to the subsequent encumbrance, stating that the junior mortgagee would be prejudiced because he would be "delayed in the foreclosing of his mortgage, and the redemption under it, while the security is being consumed by the accumulation of interest on . . . the senior mortgage." *Id.* at 648-49, 47 N.W. at 872. See Brockton Sav. Bank v. Shapiro, 324 Mass. 678, 88 N.E.2d 344 (1949); Empire Trust Co. v. Park-Lexington Corp., 243 App. Div. 315, 276 N.Y. Supp. 586 (1934).

19 Miami Real Estate Co. v. Baxter, 98 Fla. 900, 124 So. 452 (1929); Farmers & Merchants State Bank v. Hildebrandt, 221 Wis. 394, 267 N.W. 42 (1936).

20 Brief for Plaintiff, p. 16, Guleserian v. Fields, 218 N.E.2d 397 (Mass. 1966).

21 *Ibid.*

22 OHIO REV. CODE § 5302.14.

tension" of the mortgage, as does the Massachusetts statute.[23] The record, therefore, would give no notice of the possibility of an extension to a subsequent mortgagee unless the mortgagor and the prior mortgagee had themselves so agreed to the possibility and had included such a statement in the mortgage terms themselves.

Furthermore, Ohio does not have a statute similar to Massachusetts'[24] authorizing mortgagee savings banks to make subsequent changes in the amount of periodic mortgage payments. This Massachusetts statutory provision is the equivalent of notice to the subsequent mortgagee "that the holder of a savings bank mortgage may wish to extend the debt,"[25] and the bank, under this statute, is authorized to grant the extension.[26] It was not clear from the face of the statute precisely how this would affect subsequent mortgagees, but both parties in the principal case stipulated that the practice had been to grant such changes or extensions "without checking for the existence or seeking the assent of junior lienors on the mortgaged property."[27]

In Ohio, therefore, it would seem that the question of *notice* would be a key factor in determining priorities and whether a subsequent mortgagee will be unduly prejudiced by permitting such a change.[28] Although a case similar to the principal case would probably result in the same decision if tried in Ohio, the court would very likely adopt the view of the concurring opinion which favors a notice test to determine if there has been prejudice to the subsequent

---

[23] MASS. GEN. LAWS ANN. ch. 183, § 20 (1958).

[24] MASS. GEN. LAWS ANN. ch. 168, § 36 (1958).

[25] Guleserian v. Fields, 218 N.E.2d 397, 402 (Mass. 1966).

[26] *Ibid.*

[27] *Id.* at 402 n.7.

[28] In Riegel v. Belt, 119 Ohio St. 369, 164 N.E. 347 (1928), the Ohio Supreme Court held that the priority of an unrecorded prior mortgage, expressly referred to in a junior mortgage, would not be affected by renewal of the prior mortgage subsequent to execution and delivery of the junior mortgage. It was noted that such a renewal would in no way result in prejudice to the junior mortgagee.

In Union Cent. Life Ins. Co. v. Bonnell, 35 Ohio St. 365 (1880), the Ohio Supreme Court held that a new agreement, within the contemplation of an original mortgage condition, will modify the original mortgage condition just as if the new terms were incorporated into the original condition. This would indicate that a modification may be freely made when the original terms give fair notice of such possibility.

Section 5301.231 of the Ohio Revised Code might, at first blush, appear to be directly in point: "All amendment or supplements of mortgages, or modifications or extensions of mortgages . . . shall . . . take effect from the time they are delivered . . . for record." However, although this recording statute clearly relates to the validity of such a modification or extension, it would not seem intended to abrogate the general rule that a modification of a senior mortgage without prejudice to the junior mortgage does not affect the priority of the senior mortgage.

mortgagee,[29] rather than the view that there is simply no prejudice as a matter of law.[30]

The question still remains as to what the junior mortgagee might do to protect his investment. It was suggested that the junior mortgagee could have included a clause in the second mortgage prohibiting modification of previous mortgage payment terms, thus avoiding the result in this case.[31] Had he done so, any extension or postponement in the principal installment payments on the first mortgage note would constitute a breach of the second mortgage thereby entitling the second mortgagee to foreclose.[32] Although this statement does not carry the weight of a "holding," it would appear to be a rather positive indication of the future path of the law in this area.

The *Fields* case establishes that in Massachusetts a modification of the type herein discussed, even without the second mortgagee's consent, does not affect the senior mortgagee's priority.[33] Second or junior mortgagees, at least in Massachusetts, would do well to heed the court's advice regarding the avoidance of similar situations.[34]

DAVID L. ROSENZWEIG

---

[29] See Guleserian v. Fields, 218 N.E.2d 397, 403-05 (Mass. 1966) (concurring opinion).

[30] See Guleserian v. Fields, *supra* note 29. Of course, this is not an ideal solution since such a clause, if violated, would only result in a default, and not in a change of priorities. Perhaps its best effect would be to deter the mortgagor and first mortgagee from making such a modification without the second mortgagee's consent.

[31] *Id.* at 403 (dictum).

[32] The court stated that the second mortgagee could perhaps
> have included in the second mortgage an express condition that the mortgagors must continue, without any extension or postponement, to make the installment payments of principal on the first mortgage note. If such a provision had been made, postponement of any such payments by the proposed extension agreement would constitute, we assume, a breach of such a special condition of the second mortgage. *Ibid.*

[33] *Id.* at 402.

[34] *Id.* at 403.