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NOTES

Ohio Lien Priority Rules Affecting Mortgages, Mechanics' Liens, and Fixture Security Interests

OHIO LAW provides at least three basic methods by which a creditor can encumber a debtor's real property in order to secure the payment of an obligation: the mortgage,¹ the mechanic's lien,² and the fixture security interest.³ When several creditors have encumbered a debtor's realty, priority problems may arise if the value of the land at the time of the debtor's default is insufficient to satisfy all the claims. Priority rules generally govern two situations: those in which the creditors hold similar liens, and those in which the creditors have encumbered the same property with different types of liens. This study is primarily concerned with the rules controlling the latter situation. The variations in these priority rules caused by the use of open-end agreements and after-acquired property clauses will also be discussed. However, before considering the priority rules involved, it is necessary to first establish the scope and effect of the various security transactions.

I. ENCUMBRANCES ON REAL PROPERTY IN OHIO

A. *The Real Property Mortgage*

A real property mortgage has been defined by Ohio case law as a transfer of title to secure the payment of an obligation, which transfer becomes void upon payment of the debt.⁴ Generally, the mortgage lien attaches to the realty described in the deed and all things which are appurtenant thereto,⁵ becoming effective on the date the mortgage is submitted for record.⁶ By agreement, the lien

¹ See text accompanying notes 4-31 *infra*.

² See text accompanying notes 32-45 *infra*.

³ See text accompanying notes 46-74 *infra*.

⁴ *Division of Aid for the Aged v. Huff*, 110 Ohio App. 483, 486, 168 N.E.2d 316, 318 (1960). See White, *Ohio Theory of a Mortgage*, 3 U. CINC. L. REV. 405 (1929). Mr. White suggests that "for all practical purposes, Ohio is a 'lien theory' state; and the theory that 'legal title' ever passes to the mortgagee is . . . outworn . . ." *Id.* at 406.

⁵ OSBORNE, MORTGAGES 103 (1951). The effect of this rule as it applies to fixtures is discussed in text accompanying notes 100-03 *infra*.

⁶ OHIO REV. CODE § 5301.23 (Supp. 1966). This date will be referred to as the "recording date" of the mortgage.

may also apply to property not specifically described in the instrument and acquired after the execution of the mortgage.⁷ However, the right to satisfy the debt from the after-acquired property exists only in equity and is not enforceable against an intervening mortgagee who has no *actual* notice of the original agreement.⁸ The recording statutes have restricted the after-acquired mortgagee's equitable rights where third parties are concerned.⁹ Hence, another mortgage describing the after-acquired property must be recorded to make a lien on it effective against third parties.¹⁰

(1) *The Purchase-Money Mortgage*.—Mortgages are commonly created as part of a real estate sale to secure the balance of the unpaid purchase price. Because the security arrangement makes the purchase possible, the purchase-money mortgage executed simultaneously with the deed of conveyance is generally preferred over the claims of the mortgagor's creditors attaching to the newly acquired property.¹¹

(2) *Mortgages Securing Future Advances*.—In addition to securing the original debt, the agreement may stipulate that the original mortgage lien will secure future loans from the mortgagee.

Prior to 1965 the mortgagee, pursuant to a future advances clause in the mortgage, could make additional loans to the mortgagor which would be secured by the original collateral.¹² If the mortgagee was in fact contractually obligated to make the future advances, he could obtain priority for the loans over intervening liens upon the land.¹³ No particular formalities were required of the mortgage instrument.

⁷ Clark v. Strickler Bros. Canning Co., 11 Ohio App. 250 (1919).

⁸ *Ibid.*

⁹ *Ibid.* Maher v. Isaac Smead Heating & Ventilating Co., 5 Ohio C.C. Dec. 159 (1896).

¹⁰ *Ibid.* The decision in Maher v. Isaac Smead Heating & Ventilating Co., *supra* note 9, specifically stated that the legal rights of third party mortgagees could not be displaced by the after-acquired mortgage clause irrespective of notice, "the object of the [recording statute] . . . being to avoid all the vexed questions of notice, actual or constructive, in determining priorities of liens." *Id.* at 160. Nevertheless, the later case of Clark v. Strickler Bros. Canning Co., 11 Ohio App. 250 (1919) (citing *Maher*) suggests that an intervening mortgagee with *actual* knowledge of an after-acquired clause in a prior mortgage could be defeated by the lien arising out of that clause. *Id.* at 251-52.

A well-recognized exception to *Maher* giving *legal* rights on an after-acquired property clause which would be effective against third parties exists in favor of railroad companies because of the "peculiar nature of railroad property and the public interests to be subserved." *Id.* at 253; OSBORNE, *op. cit. supra* note 5, at 96-98.

¹¹ The priority rules determining the rights of the purchase-money mortgagee over other creditors are discussed in more detail in text accompanying notes 113-20 *infra*.

¹² See Note, *The Open-End Mortgage in Ohio*, 25 U. CINC. L. REV. 82 (1956).

¹³ *Id.* at 85-87. "The rationale of the distinction between optional and obligatory

In 1965, however, an "open-end" mortgage statute¹⁴ was enacted which *purports* to change the law of "future-advances" mortgages. The new statute provides that a mortgage, "whether or not it secures any other debt or obligation . . . may secure *unpaid balances of loan advances* made by the holder of the mortgage . . . after the mortgage is delivered to the recorder for record."¹⁵ Furthermore, it is explicitly stated that balances must comply with the following requirements: (1) the mortgage instrument must indicate, in substance or effect, an intention to make future advances; (2) the aggregate amount of the future loans must be specified; and (3) the instrument must state, at the beginning, that it is an "OPEN-END MORTGAGE; Total Indebtedness Not to Exceed \$_____."¹⁶ Presumably, then, non-compliance with the above would make balances yet unpaid at the time the mortgage is recorded. This rule seems too strict where third parties have not intervened, since a valid debt obligation to the extent of the later payments is contemplated by the parties in their agreement. A better result could be obtained by analogizing the "failure to comply" clause to the law governing a failure to record an ordinary mortgage instrument. This rule would hold the lien valid as against the mortgagor with respect to advances but would not enforce the lien against a properly recorded intervening lien.¹⁷

If the mortgagee is contractually obligated to make the advances at the time he receives written notice of intervening liens, the statute will give priority to the loans over the intervening liens.¹⁸

future advances is twofold. First, the intervening claimant has constructive notice of the obligation Second, under the obligatory type of mortgage the mortgagee . . . could not avoid making the advance without breaching his contract to make such advances." *Id.* at 87.

The validity of the first rationale stated above seems questionable since a contract making the advances obligatory, if not included in the mortgage instrument, would give no constructive notice to an intervening mortgagee.

¹⁴ OHIO REV. CODE § 5301.23 (Supp. 1966). For another discussion of the statute, see 17 W. RES. L. REV. 1429 (1966).

¹⁵ OHIO REV. CODE § 5301.23(B) (Supp. 1966). (Emphasis added.)

¹⁶ *Ibid.*

¹⁷ *Betz v. Snyder*, 48 Ohio St. 492, 499, 28 N.E. 234, 236 (1891).

¹⁸ OHIO REV. CODE § 5301.23 (Supp. 1966). A problem arises under the new statute when the obligation is not created until the time when the money is actually advanced. For example, if the mortgage fund is being used for construction purposes, the mortgagee may not be obligated to make an advance until a particular portion of the work is completed to contract specifications. Thus, it is arguable that the advances are *optional* at the time written notice of an intervening lien is given and hence the priority of the advances could be defeated by the intervening lien. The mortgagee thus loses his priority on the advance but is nevertheless obligated to make the future payment to the mortgagor.

However, a mortgagee extending optional advances may enjoy priority for those advances over intervening liens only if he has not received *written notice* of the liens.¹⁹ The statute therefore benefits third party creditors by giving them notice of the total amount which might be secured by the open-end mortgage and by providing them with a means of defeating the priority of later optional payments.

The language of the open-end mortgage statute is quite broad and thus may arguably encompass *all* mortgages which in fact secure future advances. Unfortunately, however, the statute does not explicitly state this conclusion, and some confusion as to the scope of the statute may therefore arise.²⁰

(3) *The Improvement (or Construction) Mortgage.*—The parties can create the "improvement" or "construction" mortgage if the loan is made at least partly to either improve the premises or to discharge prior encumbrances.²¹ If the instrument evidences such a purpose, contains the name and address of the mortgagee, and includes a covenant²² by the mortgagee to pay the adverse interests involved, the parties can enjoy special benefits to the extent that the mortgagee actually makes payments in accord with the statute.²³ The improvement mortgage is particularly helpful to a

¹⁹ OHIO REV. CODE § 5301.23 (D) (Supp. 1966).

²⁰ The statute applies specifically to mortgages which purport to secure *unpaid balances of loan advances*. It might thus be contended that the statute affects only those mortgages in which the total amount of the loan has been "advanced" (that is, allocated to the credit of the mortgagor), with balances of the fund yet unpaid. Under this interpretation, the open-end mortgage would be rather impractical in most instances since mortgages securing future advances are conceived not only to provide for future needs but also to avoid interest payments on unused funds. For a discussion of the purposes underlying the creation of the mortgage for future advances, see OSBORNE, *op. cit. supra* note 5, at 276-77.

²¹ OHIO REV. CODE § 1311.14. Part of the funds must in fact be used for the purposes of improving the realty or for discharging prior encumbrances. *Ibid.*

²² The covenant was originally considered insufficient if the instrument failed to specifically require adherence to the statute. See *In re Taylor*, 20 F.2d 8 (6th Cir. 1927). However, later cases have liberalized this rule. See *Knollman Lumber Co. v. Hillenbrand*, 64 Ohio App. 549, 29 N.E.2d 61 (1940); *First Fed. Sav. & Loan Ass'n v. Robbins*, 36 N.E.2d 991 (Ohio Ct. App. 1939). On the basis of these later cases, a clause in the mortgage stating that the parties "may" comply with the statute is sufficient. *Id.* at 992; see *Knollman Lumber Co. v. Hillenbrand*, *supra* at 551, 29 N.E.2d at 62.

²³ The statute provides:

(D) Such mortgagee shall pay on the order of the owner, the accounts of such materialmen and laborers as have filed with such mortgagee a written notice as provided in this section, the amounts due for material then furnished and labor then performed . . . and shall retain out of said mortgage fund such money to become due as is shown by said notice so served and shall hold such money, and shall pay on the order of the owner, the amounts due to such persons who have served such notices, if said mortgagee has sufficient money in

person who is *in the process* of improving his realty and who lacks adequate funds to pay the contractors. With this improvement security arrangement, he can pay the contractors and thus avoid having his land burdened by their liens (called mechanics' liens), and his mortgagee can obtain priority over all those mechanic's lien claimants who record their liens after the mortgage recording date.²⁴

(4) *Improvement and Open-End Mortgages Compared.*—The question arises as to whether an improvement mortgage must be created in accordance with the open-end mortgage statutory requirements. Although neither the improvement nor the open-end mortgage statutes seem to expressly relate to each other, a relationship does exist by virtue of the effect of the improvement mortgage statute²⁵ which clearly indicates that an improvement mortgage may often secure future advances. The mortgage becomes a lien on the improved premises "from the time it is filed for record for the full amount that is ultimately and actually paid out . . . regardless of the time when the money secured thereby is advanced."²⁶ Also, after the improvement is completed, the mortgagee must pay the balance of the mortgage fund, that is, the money left over after the completion of the improvement, to the owner or to whomever he directs.²⁷

Therefore, if the open-end mortgage statute is interpreted to

his hands to do so and also to complete said improvement; but if such mortgagee has funds in his hands insufficient to pay all . . . in full . . . he shall retain sufficient to complete said improvement and to distribute the balance pro rata among the materialmen and laborers who have filed such notices.

(E) If such owner refuses to issue an order to pay the amount of such notice filed, said mortgagee shall retain the whole amount claimed until the proper amount has been agreed upon or judicially determined; provided that said mortgagee may withhold sufficient funds to complete said improvement.

(F) Such mortgagee shall pay out on the owner's order, directly to materialmen or laborers who have performed labor or furnished material for said improvement.

(G) Such mortgagee shall pay the balance of said mortgage fund after said improvement is completed to the owner, or to whomsoever such owner directs.

This section . . . shall be liberally construed in favor of such mortgagees, a substantial compliance by such mortgagees being sufficient. OHIO REV. CODE § 1311.14.

No clear definition for the term "substantial compliance" has been propounded by the courts. But for applications of the term, see *Hillsdale Loan & Bldg. Co. v. Creager*, 5 Ohio Misc. 147, 214 N.E.2d 703 (C.P. 1965); *Knollman Lumber Co. v. Hillenbrand*, *supra* note 22; *First Fed. Sav. & Loan Ass'n v. Robbins*, *supra* note 22; *Magrish, Disbursement of Ohio Construction Mortgage Loans*, 12 U. CINC. L. REV. 1 (1938).

²⁴ OHIO REV. CODE § 1311.14.

²⁵ See *ibid.*

²⁶ OHIO REV. CODE § 1311.14. (Emphasis added.)

²⁷ *Ibid.*

apply to *all* future-advances mortgages, the improvement mortgage, when it actually secures future advances, should be prepared in accordance with the requirements for open-end mortgages. The wisdom of this course of action is apparent because the open-end mortgage statute specifically includes mechanic's lien claimants among those creditors who may issue written notice to the mortgagee to defeat the priority of optional advances.²⁸

On the other hand, the improvement mortgage would seem to satisfy the *purpose* of the open-end mortgage statute whether or not it complies with the statute's formalities. Undoubtedly, the open-end mortgage provisions were imposed to provide notice of the future advances and the means whereby intervening creditors could defeat optional advances.²⁹ However, the improvement mortgage itself provides the requisite notice to intervening lien claimants since the mortgage must contain the improvement mortgage covenant.³⁰ Furthermore, lien claimants, by following the improvement mortgage procedures, may enforce their rights of payment against the improvement mortgage fund.³¹ Thus, there seems to be no substantial reason for imposing the open-end mortgage formalities upon the improvement mortgage. Nevertheless, the broad language of the open-end mortgage statute would seem to include those improvement mortgages which in fact secure future advances.

B. Mechanics' Liens

(1) *General Characteristics.*—As previously mentioned, the persons who actually improve a piece of property or who supply materials or labor for the improvement can obtain liens upon the debtor's interest in that property to secure payment.³² In particular, the mechanic's lien arises in favor of any "person or corporation [or subcontractor] who does work or labor upon, or furnishes machinery, material, or fuel for . . . erecting, altering, repairing, or removing a house . . . or any furnace . . . building, appurtenance, [or] fixture . . . by virtue of a contract, express or implied."³³ The interest of the person "buying" the improvement (and any sub-

²⁸ See OHIO REV. CODE § 5301.23 (Supp. 1966).

²⁹ See 17 W. RES. L. REV. 1429, 1431 (1966).

³⁰ See OHIO REV. CODE § 1311.14; note 22 *supra*.

³¹ See OHIO REV. CODE § 1311.14; note 23 *supra*.

³² OHIO REV. CODE § 1311.02 (Supp. 1966).

³³ *Ibid.* See Note, 18 W. RES. L. REV. 297, 301-05 (1966).

sequent interest acquired) in the land and buildings improved is subject to the lien.³⁴ Also, any materials *constructively* incorporated at the time of default may secure the lien.³⁵

(2) *Perfection.*—Basically, the lien is perfected by both serving a statement upon the person who purchased the improvements and recording an affidavit of lien within sixty days from the completion of the lienor's performance.³⁶ In contrast to the ordinary mortgage, however, the lien does not take effect upon the date of recording but rather on the date upon which the work was begun.³⁷ Determining this effective date could be difficult where many lien claimants are involved in a contract. Although the time when the general construction begins may be readily ascertainable, it may be impossible for third parties to know when each lien claimant starts his work. This difficulty is resolved, however, by the statutory provision that all mechanics' liens related to the general contract become effective on the first day that any materials are supplied or

³⁴ *Ibid.*

³⁵ New materials are "constructively" incorporated "as soon as they are delivered upon the premises and title thereto has passed, although actual incorporation has been prevented by some fault of the owner and without fault on the part of the supplier." *Connecticut Gen. Life Ins. Co. v. Birzer Bldg. Co.*, 101 N.E.2d 408, 419 (Ohio C.P. 1950).

³⁶ OHIO REV. CODE §§ 1311.04, .06; Note, *supra* note 33, at 305.

The requirements for the contractor's statement are:

Whenever any payment of money becomes due from the owner, part owner, or lessee, or whenever the original contractor desires to draw any money from the owner, part owner, or lessee, under their contract . . . such contractor shall make out and give to the owner . . . a statement under oath, showing the name and address of every laborer in his employ . . . and of every person furnishing . . . material . . . which statement shall be accompanied by a certificate signed by every person furnishing . . . material to him. OHIO REV. CODE § 1311.04.

The requirements for the lien affidavit are:

Every person . . . who wishes to avail himself of [the mechanic's lien laws] . . . shall make out and file for record . . . an affidavit showing the amount due over and above all legal setoffs, a description of the property to be charged with the lien, the name and address of the person to or for whom such . . . material . . . was furnished and labor performed, the name of the owner, part owner, or lessee, if known, and the name and address of the lien claimant . . . Such affidavit may be verified before any person authorized to administer oaths . . . OHIO REV. CODE § 1311.06.

³⁷ The test for determining the beginning date of construction is stated as follows:

[Is] the work, improvement, or construction of such a nature that apparently, obviously, and visibly it formed in and of itself a component part of the structure, so that when the structure arose from the ground the work, improvement, or construction commenced . . . would appear as part of the structure itself as a physical identity which, speaking in its own behalf, would indicate the situation *Connecticut Gen. Life Ins. Co. v. Birzer Bldg. Co.*, 101 N.E.2d 408, 414 (Ohio C.P. 1950), citing *North Shaker Blvd. Co. v. Harriman Nat'l Bank*, 22 Ohio App. 487, 493, 153 N.E. 909, 910 (1924).

labor performed.³⁸ Thus, the first effective date inures to the benefit of all related liens, and any unrelated encumbrances perfected after the start of construction are generally secondary in priority to the mechanics' liens.³⁹ One exception to this priority rule arises in favor of the improvement mortgage which, although recorded after the first day of work, prevails over all mechanics' liens which are *recorded* after the recording of the improvement mortgage.⁴⁰ As noted above,⁴¹ the improvement mortgage can be created when the owner is in the process of improving his realty but lacks sufficient funds to pay the mechanics' liens. The priority over the liens granted to the improvement mortgage is thus conditioned upon actual payment to the lien claimants.⁴²

A second exception arises in favor of the purchase-money mortgage.⁴³ It is conceivable that a person in possession of realty may contract for improvements before he actually owns the property. Thus, a debtor's interest in the improved property may be nonexistent on the effective date of the mechanics' liens. Since the liens will attach to a debtor's "subsequently acquired interest"⁴⁴ in the improved realty, the effective lien date becomes the date of the debtor's acquisition. However, the liens will attach subject to a purchase-money mortgage because that mortgage made the purchase possible.⁴⁵

C. Fixture Security Interests

(1) *General Characteristics.*—A third type of encumbrance on real property is the fixture security interest. This creditor interest is derived from Ohio's version of article 9 of the Uniform Commercial Code (UCC)⁴⁶ and attaches to goods which are or which become affixed to the debtor's real property. The statute, as adopted

³⁸ OHIO REV. CODE § 1311.13(A). An exception to this "common priority" arises in favor of persons performing manual labor who are given "priority [over other related lien claimants] to the extent of the labor performed during the thirty days immediately preceding the date of performance of the last labor." *Ibid.*

³⁹ OHIO REV. CODE § 1311.13(B). Clearly, all the liens attach to the debtor's interest in the entire property, including the constructively incorporated materials.

⁴⁰ OHIO REV. CODE § 1311.14.

⁴¹ See text accompanying notes 21-24 *supra*.

⁴² See text accompanying notes 82-89 *infra*.

⁴³ See text accompanying notes 113-20 *infra*.

⁴⁴ OHIO REV. CODE § 1311.02 (Supp. 1966).

⁴⁵ *Golner v. Bede*, 11 Ohio App. 137 (1919). See text accompanying notes 113-20 *infra*.

⁴⁶ OHIO REV. CODE ch. 1309.

by Ohio states that the interest cannot apply to "goods incorporated into a structure in the manner of lumber, bricks, tile, cement, glass, metal work and the like,"⁴⁷ but it does attach to those items which, under other local law, are deemed fixtures on the real estate.⁴⁸ Thus, in Ohio, goods not incorporated into the structure become fixtures if (1) the goods are in fact annexed or affixed to the realty; (2) the goods become adapted to the use or purpose to which the realty is devoted; and (3) the person making the annexation intends that the goods become fixtures.⁴⁹ The UCC concept of "fixture" is entirely characteristic of neither real property (since the creditor can sever the goods from the realty to satisfy the debt) nor chattels (since the goods actually become affixed to the realty).⁵⁰ The concept under Ohio law may even be considered anomalous⁵¹ since fixtures in Ohio under pre-UCC law had generally been considered to be part of the realty. Moreover, since the Ohio decisions have not always been consistent in their application of the Ohio fixture test,⁵² a secured creditor may find himself guessing as to the nature of his collateral.

(2) *Perfection.*—To become perfected and enforceable, a fixture security interest must attach to the goods,⁵³ a security agreement must be executed,⁵⁴ and a financing statement evidencing the agreement must be recorded.⁵⁵ The first of these conditions is met when (1) an agreement is reached that it attach; (2) the debtor ac-

⁴⁷ OHIO REV. CODE § 1309.32(A) (Supp. 1966) (UNIFORM COMMERCIAL CODE § 9-313(1)) [hereinafter cited as UCC].

⁴⁸ *Ibid.*

⁴⁹ *Roseville Pottery v. County Bd. of Revision*, 149 Ohio St. 89, 95, 77 N.E.2d 608, 612 (1948), citing *Teaff v. Hewitt*, 1 Ohio St. 511, 530 (1853).

⁵⁰ 2 COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE § 16.07(z) (1966).

⁵¹ See *id.* at 1712[1]. Under pre-UCC law, by the leading case of *Teaff v. Hewitt*, 1 Ohio St. 511 (1853), a fixture became part of the real estate and acquired all characteristics of real estate. Hollander, *Imperfections in Perfection of Ohio Fixture Liens*, 14 W. RES. L. REV. 683, 686-87 (1963). With the adoption of article 9, *Teaff v. Hewitt* was "simultaneously incorporated into the code and overruled by it." *Id.* at 686.

As to the pre-UCC rule governing the secured party's right of severance of fixtures, compare Hollander, *supra*, with Shanker, *An Integrated Financing System for Purchase Money Collateral: A Proposed Solution to the Fixture Problem Under Section 9-313 of the Uniform Commercial Code*, 73 YALE L.J. 788 (1964).

⁵² Compare *Holland Furnace Co. v. Trumbull Sav. & Loan Co.*, 135 Ohio St. 48, 19 N.E.2d 273 (1939), with *Holland Furnace Co. v. Joy*, 16 Ohio L. Abs. 251 (C.P. 1934). The principal hazard created by the creditor's guess is discussed in text accompanying notes 60-61 *infra*.

⁵³ OHIO REV. CODE § 1309.14 (UCC § 9-203).

⁵⁴ OHIO REV. CODE § 1309.15 (UCC § 9-303).

⁵⁵ OHIO REV. CODE § 1309.21(A)(4) (UCC § 9-302(1)(d)). See 1 COOGAN, HOGAN & VAGTS, *op. cit. supra* note 50, § 3.16.

quires "rights" in the collateral; and (3) value is given.⁵⁶ When a security agreement describing the collateral is signed by the debtor, the security interest is enforceable against him and third party general creditors who have not themselves obtained perfected liens.⁵⁷ However, the security interest does not become enforceable against the perfected liens of third parties until the security interest has attached and has itself been perfected by the recording of a financing statement evidencing the agreement.⁵⁸ While chattel security interest financing statements are filed in chattel records,⁵⁹ the fixture security interest financing statements must be indexed in the real estate records.⁶⁰ This difference in filing requirements creates a problem where the secured party is not certain that his collateral is a fixture. If he fails to take the precaution of "double filing,"⁶¹ his election to file only in the real estate records may leave him with an unperfected security interest should a court later determine that his collateral consists of chattels and not fixtures.

(3) *The Fixture Security Interest as an Encumbrance on Real Property.*—By definition, the fixture security interest is not entirely an interest in real property.⁶² Nevertheless, it is important to note that the fixture security interest effectively encumbers the real prop-

⁵⁶ OHIO REV. CODE § 1309.15(A) (UCC § 9-204(1)). "Rights" includes remedies. OHIO REV. CODE § 1301.01(JJ) (UCC § 1-201(36)). A person gives "value" for rights if he acquires them (a) in return for a binding commitment to extend credit or for the extension of immediately available credit . . . or (b) as security for or in total or partial satisfaction of a pre-existing claim; or (c) by accepting delivery pursuant to a pre-existing contract for purchase; or (d) generally, in return for any consideration sufficient to support a simple contract. OHIO REV. CODE § 1301.01(RR) (UCC § 1-201(44)).

⁵⁷ See OHIO REV. CODE § 1309.20 (UCC § 9-301).

⁵⁸ OHIO REV. CODE § 1309.22 (UCC § 9-303).

A financing statement is sufficient if it is signed by the debtor and the secured party, gives an address of the secured party from which information concerning the security interest may be obtained, gives a mailing address of the debtor and contains a statement indicating the types, or describing the items, of collateral. A financing statement may be filed before a security agreement is made or a security interest otherwise attaches. When the financing statement covers . . . goods which are or are to become fixtures, the statement must also contain a description of the real estate concerned [and thereof.] A copy of the security agreement is sufficient as a financing statement if it contains the above information and is signed by both parties. OHIO REV. CODE § 1309.39(A) (UCC § 9-402(1)).

⁵⁹ See OHIO REV. CODE § 1309.38 (UCC § 9-401).

⁶⁰ See *ibid.*; OHIO REV. CODE § 1309.40 (Supp. 1966). See also 2 COOGAN, HOGAN & VAGTS, *op. cit. supra* note 50, at 1704 & n.51.

⁶¹ See *id.* at 1806-07; Shanker, *supra* note 51, at 797-98, which suggests double filing as a precaution. But even double filing may not be completely adequate. See Shanker, *supra* note 51.

⁶² See text accompanying notes 50-52 *supra*.

erty upon which the collateral becomes affixed. If the fixture security interest is perfected and the goods become affixed prior to the attaching of other liens on the realty, the fixture secured creditor may enter upon the land and sever his collateral from the realty.⁶³ If the fixtures to be severed are essential to the value of the property, the threat of severance may coerce the other creditors into paying the obligation to preserve the value of the realty. Even if the right of severance is not available because of prior liens, the fixture secured creditor can levy on the property and force a foreclosure or other judicial proceeding.⁶⁴ Thus, although technically the collateral for the fixture security interest is neither chattel nor realty, the security interest actually effectively encumbers the land upon which the goods are affixed. This observation is further supported by the fact that fixture security interests are recorded in the real property, not the chattel, records.⁶⁵

(4) *Future Advances*.—Section 9-204 of the UCC⁶⁶ states that "obligations covered by a security agreement may include future advances or other value *whether or not the advances are given pursuant to commitment*."⁶⁷ Thus, if the security agreement so provides, the interest will secure the advances irrespective of an obligation on the creditor's part to make the loans.⁶⁸ Furthermore, the advances apparently may be made for any amount, and the possibility of advances need not be disclosed in the financing statement which is filed for public record.⁶⁹ These results seem to be in direct opposition to the policies established by the open-end mortgage statute. This may not create a significant problem, however, since a fixture secured creditor would probably not be willing to advance a substantial amount of money only on the security of fixture collateral. Hence, in view of the value of the entire property to which the goods are affixed, an intervening creditor, although prejudiced in priority, may not actually be harmed. On the other hand, a loss of certain fixtures due to severance by the fixture secured creditor could endanger the total value of the real estate.

⁶³ See OHIO REV. CODE § 1309.32 (Supp. 1966) (UCC § 9-313).

⁶⁴ OHIO REV. CODE § 1309.44 (UCC § 9-501).

⁶⁵ OHIO REV. CODE § 1309.38 (UCC § 9-401).

⁶⁶ Adopted in Ohio as OHIO REV. CODE § 1309.15.

⁶⁷ OHIO REV. CODE § 1309.15(E) (UCC § 9-204(5)). (Emphasis added.)

⁶⁸ OHIO REV. CODE § 1309.15(C) (UCC § 9-204(3)). It should be recalled that a memorandum of this agreement is required (where the debtor has possession of the goods) to make the security interest enforceable. OHIO REV. CODE § 1309.20 (UCC § 9-301). See text accompanying notes 55-61 *supra*.

⁶⁹ See OHIO REV. CODE § 1309.39 (Supp. 1966) (UCC § 9-402). As to the requirements for the financing statement set by this statute, see note 58 *supra*.

(5) *Fixture Security Interests and Mechanics' Liens Compared.*—It has perhaps become evident that the collateral securing a fixture security interest might also secure a mechanic's lien. The mechanic's lien statutes specifically state that a lien will arise in favor of one who furnishes machinery or material for "erecting, [or] altering . . . any furnace . . . appurtenance, [or] fixture."⁷⁰ Since the mechanic's lien law was enacted before the adoption of article 9 of the UCC, the use of the word "fixture" undoubtedly reflects the Ohio pre-UCC idea that a fixture becomes part of the real estate. However, it now seems arguable that any person who provides the debtor with goods which become fixtures on the debtor's land could choose either a mechanic's lien or a fixture security interest to secure payment.⁷¹ Although the creditor may elect either security arrangement, it is doubtful that he can use both types of interests simultaneously and accumulate his remedies.⁷² In any event, the creditor should be aware that his choice not only affects his duties regarding perfection but also alters his remedies on the debtor's default. For example, the perfection requirements for the fixture security interest seem less burdensome than those for mechanics' liens.⁷³ Nevertheless, a mechanic's lien becomes effective upon the first date of construction (or installation of the goods) even though the lien may not be perfected until sometime within sixty days after completion of the installation, whereas the fixture security interest becomes perfected only after (among other things) the financing statement is recorded. Also, the mechanic's lien will apply to the debtor's interest in the entire property improved, while the fixture security interest attaches solely to the goods affixed.⁷⁴ On the other hand, the mechanic's lien claimant has no right to sever the collateral to satisfy the debt.

II. PRIORITY RULES

It will be recalled that the ordinary real property mortgage

⁷⁰ OHIO REV. CODE § 1311.02 (Supp. 1966).

⁷¹ See Shanker, *A Further Critique of the Fixture Section of the Uniform Commercial Code*, 6 B.C. IND. & COM. L. REV. 61, 67-68 (1964). Not all mechanic's lien claimants can obtain fixture security interests, however, since mechanics' liens will apply to fixtures and to goods *incorporated* into the structure. This latter class of collateral was excluded by the UCC. See OHIO REV. CODE § 1309.32(A) (Supp. 1966) (UCC § 9-313(1)).

⁷² Shanker, *supra* note 71, at 67 & n.25.

⁷³ Compare the text accompanying notes 55-61 *supra*, with the text accompanying notes 36-40 *supra*.

⁷⁴ See Shanker, *supra* note 71, at 68; text accompanying notes 34-35, 46-47 *supra*.

attaches to the realty described in the mortgage instrument and to any structure or object which becomes affixed to that property.⁷⁵ The improvement (or construction) mortgage, however, attaches not only to the land and appurtenances but also to materials *constructively* incorporated into the premises. This variation arises because the sum supplied by the improvement mortgage must go towards paying the mechanics' liens originating from the improvement.⁷⁶ Since the mechanics' liens apply to the improved land, its appurtenances, and to the constructively incorporated materials, it follows logically that the improvement mortgage should likewise attach to this broader base of security.

The presence of the fixture security interest further complicates the relationships in this class of problems. Although the fixture security interest attaches specifically to goods which have become affixed to the realty rather than to the realty itself, the interest nevertheless effectively encumbers the realty upon which the goods are affixed.⁷⁷ It is therefore apparent that one piece of "common ground" may be encumbered by a variety of security arrangements which in turn gives rise to a variety of priority problems.

A. *Conflicting Real Property Mortgages*

Ohio has established essentially a "race" scheme of priorities governing conflicting real property mortgages. The basic pattern, set out by statute, indicates that mortgages generally become effective on the date submitted for recording rather than on the date of agreement;⁷⁸ and "if two or more mortgages are presented for record on the same day, they shall take effect in the order of presentation."⁷⁹

B. *Real Property Mortgages vs. Mechanics' Liens*

(1) *General Rule.*—Consistent with the race scheme of priority between conflicting mortgages on the same property is the

⁷⁵ See text accompanying notes 4-10 *supra*.

⁷⁶ See text accompanying notes 34-35 *supra*.

⁷⁷ See text accompanying notes 62-65 *supra*.

⁷⁸ OHIO REV. CODE § 5301.23 (Supp. 1966). The date the mortgage is submitted for recording will be discussed as the "recording date."

⁷⁹ *Ibid.* It is also relevant to note that "all amendments or supplements of mortgages, or modifications or extensions of mortgages, or of the debt secured thereby, which have been executed in the manner provided in section 5301.01 . . . shall . . . take effect from the time they are delivered . . . for record." OHIO REV. CODE § 5301.231 (Supp. 1966).

rule that a mortgage recorded prior to the *effective* date⁸⁰ of a mechanic's lien enjoys a priority superior to that lien.⁸¹

(2) *Exception - The Improvement Mortgage.*—A variation of this rule arises when the statutory improvement mortgage is involved. The statute provides that an improvement mortgage will have priority over conflicting mechanics' liens recorded after the mortgage recording date, to the extent that the mortgagee advances the mortgage fund pursuant to the statutory payment requirements.⁸² The statute makes no express differentiation between improvement mortgages recorded before the start of construction and those recorded after; however, in *Rider v. Crobaugh*⁸³ the Ohio Supreme Court determined that the statute was intended to apply only to improvement mortgages recorded after the start of construction.⁸⁴ Thus it would seem that the mortgagee could advance sums to the mortgagor without regard to the statutory payment requirements.

Notwithstanding the *Rider* rule, however, the prior recorded improvement mortgagee may lose priority for future advances to the extent that the payments are not made in accordance with the statute.⁸⁵ This result occurs not by virtue of the statute, but by operation of the general law of future advances. Under the law existing prior to the adoption of the open-end mortgage statute, the priority of *obligatory* advances could not be defeated by intervening liens. Where the parties have created a statutory improvement mortgage, an implied obligation to make the advances arises.⁸⁶ That obligation requires that the mortgagee advance the sums pursuant to the improvement mortgage statutory provisions, regardless of when the mortgage is recorded. Hence, any advances not com-

⁸⁰ It should be recalled that the effective date of the mechanic's lien is not the recording date of the lien affidavit but rather the date upon which construction began. See text accompanying notes 38-39 *supra*.

⁸¹ See OHIO REV. CODE § 1311.13(B).

⁸² See OHIO REV. CODE § 1311.14; text accompanying notes 21-24 *supra*.

⁸³ 100 Ohio St. 88, 125 N.E. 130 (1919).

⁸⁴ *Id.* at 98-100, 125 N.E. at 133-34; see *Holgate State Bank v. Gauggel*, 6 Ohio St. 2d 256, 257, 217 N.E.2d 867 (1966).

⁸⁵ See *Connecticut Gen. Life Ins. Co. v. Birzer Bldg. Co.*, 101 N.E.2d 408 (Ohio C.P. 1950).

The case of *A. G. Sharp Lumber Co. v. Manus Homes, Inc.*, 189 N.E.2d 447 (Ohio Ct. App. 1961) would seem to be contrary. However, in the *Sharp* case, all the "improper" advances had been made before any other adverse liens had become effective. *Id.* at 448.

⁸⁶ *Kuhn v. Southern Ohio Loan & Trust Co.*, 101 Ohio St. 34, 38, 126 N.E. 820, 822 (1920).

plying with the statute would be considered optional and thus subject in priority to intervening liens.⁸⁷

A similar result follows if the improvement mortgage is also deemed to be governed by the provisions of the recent open-end mortgage statute.⁸⁸ Under this statute, however, the improper advances would be subject to intervening liens only if the intervening lien claimant has given written notice of the lien to the mortgagee before the advance is made.⁸⁹ Thus, it is evident that, despite the *Rider* rule, advances made under an improvement mortgage should be made pursuant to the requirements of the statute, regardless of when the mortgage is recorded.

C. Mortgages Securing Future Advances

In a preceding section, the scope of the recent open-end mortgage statute was questioned, and it was noted that the improvement mortgage might be a type of future-advances mortgage not controlled by the open-end mortgage statute.⁹⁰ Assuming that such limitations exist, it is necessary to discuss the priority of future advances made under each of the various agreements as that priority affects intervening encumbrances upon the property.

(1) *Payments Made Under the Statutory Open-End Mortgage.*—If the open-end mortgage statute is interpreted to include *all* mortgages securing future advances, that statute will also determine the priority of the advances made. Under the statute, the prior recorded open-end mortgage will secure all advances made (to the maximum set in the mortgage) in priority over the mechanics' liens, if the mortgagee is contractually obligated to make the loans.⁹¹ Even if the loans are optional, they will be secured if the mortgagee receives no written notice of the intervening liens.⁹² These results differ slightly from those obtained under the Ohio common law priority rules governing future advances, as shown in the following discussion.

(2) *Loans Made Under a Common Law Future-Advances Mortgage.*—If a distinction can be drawn between certain future-

⁸⁷ See *Connecticut Gen. Life Ins. Co. v. Birzer Bldg. Co.*, 101 N.E.2d 408 (Ohio C.P. 1950).

⁸⁸ See text accompanying notes 25-31 *supra*.

⁸⁹ OHIO REV. CODE § 5301.23(D) (Supp. 1966).

⁹⁰ See text accompanying notes 20, 25-31 *supra*.

⁹¹ OHIO REV. CODE § 5301.23(D) (Supp. 1966).

⁹² *Ibid.* This rule applies to *any* creditor who fails to give written notice as required by § 5301.23.

advances mortgages and the statutory open-end mortgage, the priority of future advances under the former types will not be determined by the open-end mortgage statute but rather by Ohio's common law applicable to future advances. Under these common law rules, the future advances are superior to all intervening encumbrances if the mortgagee is contractually obligated to make the loans.⁹³ On the other hand, if the advances are optional, intervening liens will take priority over subsequent loans.⁹⁴

In the case of the improvement mortgage, it has been held that the existence of the improvement mortgage covenant requiring the mortgagee to pay the funds according to the improvement mortgage statute gives rise to an inference of fact that the mortgagee is obligated to make the advances.⁹⁵ These advances will therefore be superior to intervening liens to the extent that the payments are in fact properly made.⁹⁶

(3) *The Improvement and Future-Advances Mortgages Compared.*—The mortgagee loaning funds for the improvement of realty who can record before the effective date of the mechanics' liens should create the statutory open-end mortgage with a corresponding obligation to make the advances.⁹⁷ The mortgagee can thereby effectively secure the priority of all advances made, even though some might be paid after the effective date of the mechanics' liens, and the contingency of improper payments resulting from the use of the improvement mortgage is avoided.

On the other hand, if the construction has already begun, the open-end mortgage should be specified as an improvement mortgage so that priority can be obtained over those mechanics' liens recorded after the mortgage recording date.⁹⁸ This special benefit (of defeating the lien priorities) is available only to the improvement mortgage.

(4) *An Example.*—The following factual situation should illustrate the rules stated above.

(a) *Facts.*—On January 1, O purchases property from V

⁹³ Second Nat'l Bank v. Boyle, 155 Ohio St. 482, 485, 99 N.E.2d 474, 476 (1951).

⁹⁴ If the open-end mortgage is recorded *after* the effective date of the mechanics' liens, the mortgage will be subject to the general rule that gives mechanics' liens priority over subsequent encumbrances. See text accompanying notes 80-81 *supra*.

⁹⁵ Kuhn v. Southern Ohio Loan & Trust Co., 101 Ohio St. 34, 38, 126 N.E. 820, 822 (1920).

⁹⁶ See text accompanying notes 82-89 *supra*.

⁹⁷ See Magrish, *Disbursement of Ohio Construction Mortgage Loans*, 12 U. CINC. L. REV. 1, 6-7 (1938).

⁹⁸ See text accompanying notes 82-89 *supra*.

and gives *V* a purchase-money mortgage for a portion of the purchase price. *V* records the mortgage. On January 2, *O* and *M* agree to a loan from *M* which is intended for improving the realty. They execute a proper open-end mortgage for a maximum amount of \$5,000, and *M* promises to advance loans totalling \$5,000. *M* records that same day.

Also on January 2, *O* completes a contract with *B* for improvements costing \$5,000. Construction begins January 5 and is completed in March. *B* and his subcontractors perfect their mechanics' liens in March.

Advances are made by *M* to *O* with written notice of the intervening liens, some of which are perfected before the last advances are made.

O thereafter defaults on all his obligations.

(b) *Results.*—*V*'s purchase-money mortgage lien has first priority, since *V*'s mortgage was recorded before both *M*'s recording date and the effective date of *B*'s lien. *M* has second priority. Even though his funds were to be used for the improvements, *M* does not hold an improvement mortgage, since there was no covenant in *M*'s mortgage to meet the payment requirements of the improvement mortgage statute. Holding a valid open-end mortgage with an obligation to pay the advances, he prevails over the mechanics' liens which became effective on January 5, the first day of construction.

Two variations in *M*'s mortgage could alter this priority. For example, if *M* and *O* had stipulated that advances were to be made in accord with the improvement mortgage statute, a failure by *M* to make proper payments could result in a ruling that *M*'s advances were in fact optional and hence subject to those intervening liens of which *M* had written notice. Secondly, if *M*'s agreement was such that he was not obligated to make the advances until certain portions of the improvement were satisfactorily completed, *M* would, under the open-end mortgage statute, probably lose his priority for those advances over intervening liens of which he had written notice before the time the obligation arose.

It should also be evident that if *M* had failed to record his mortgage before January 5, the mechanics' liens would have become effective before *M*'s mortgage and thus would have obtained second priority. In this situation, *M* should negotiate for an improvement mortgage which, if properly executed, would give *M* superior rights

at least over all those liens recorded after the recording date of the improvement mortgage.⁹⁹

D. *Real Property Mortgages vs. Fixture Security Interests*

(1) *General Rule.*—A fixture security interest will take priority over any encumbrance on real property if the fixture security interest is perfected *and* the goods are affixed to the realty before the later encumbrance is recorded or perfected.¹⁰⁰ This rule is established by Ohio's version of UCC section 9-313.¹⁰¹ In contrast, the "uniform" section 9-313 (rejected by Ohio) provides that a fixture security interest which *attaches*¹⁰² to the goods before they become affixed is superior to all interests in the realty, except those interests of:

- (a) a subsequent purchaser for value of any interest in the real state; or
- (b) a creditor with a lien on the real estate subsequently obtained by judicial proceedings; or
- (c) a creditor with a prior encumbrance of record on the real estate to the extent that he makes subsequent advances if the subsequent purchase is made, the lien by judicial proceedings is obtained, or the subsequent advance under the prior encumbrance is made or contracted for without knowledge of the security interest and before it is perfected.¹⁰³

(2) *Example.*—*V* holds a real property mortgage which has been recorded before any other interest has attached to *O*'s realty.

Thereafter, on January 1, *O* and *S* agree that *S* will supply goods which will become fixtures on the land. A security agreement is executed and the financing statement is filed January 1.

⁹⁹ This last result depends, of course, upon *M*'s making advances in accordance with the improvement mortgage statute. See text accompanying notes 82-89 *supra*. In a prior discussion, a possible distinction was noted between the future-advances mortgage and the statutory open-end mortgage. See text accompanying note 20 *supra*. If such a distinction is possible, note that in the hypothetical problem, *M* could have created a nonstatutory prior-recorded future-advances mortgage with an obligation to make the future loans. If *M* had done this (assuming it is possible), the priority of his advances would be determined by the rules found in text accompanying notes 93-96 *supra*.

¹⁰⁰ OHIO REV. CODE § 1309.32(C) (Supp. 1966). It would seem that the latter encumbrances must be recorded, or otherwise perfected, even though the statute provides that the security interest will be valid over "any person *with an interest in the real estate.*" *Ibid.* (Emphasis added.) This follows from the fact that these adverse interests are usually not legally effective against third parties until recorded. See *Kuhn v. Southern Ohio Loan & Trust Co.*, 101 Ohio St. 34, 126 N.E. 820 (1920).

¹⁰¹ OHIO REV. CODE § 1309.32 (Supp. 1966).

¹⁰² See text accompanying notes 55-61 *supra*.

¹⁰³ UCC § 9-313.

On January 2, *M* loans money to *O* which is secured by an ordinary real property mortgage. The mortgage is recorded January 2. *M* has knowledge of *S*'s security interest.

On January 3, the goods are affixed to the land, pursuant to the agreement with *S*. Thereafter, *O* defaults.

The results are that *V*'s mortgage has first priority in Ohio because his mortgage was recorded prior to the affixation of the goods. *V*'s mortgage is also prior to *M*'s mortgage by virtue of Ohio's race scheme governing conflicting real property mortgages. *M*'s mortgage takes second priority by the same rationale which placed *V* first.

Under the "uniform" rule of the UCC, however, *S*'s fixture security interest would be prior to both the mortgage of *V* and of *M*, since (1) *S*'s interest *attached* before the goods became affixed to the realty; and (2) *M* had knowledge of the security interest. Thus, under the uniform rule, *S* could sever the goods from the realty to satisfy *O*'s debt to him.

E. Fixture Security Interests vs. Mechanics' Liens

(1) *General Rule.*—The Ohio statutes are not particularly clear on questions of priority between a mechanic's lien and a fixture security interest. The mechanic's lien law provides that mechanics' liens are inferior in priority to "all other titles, liens or encumbrances which may attach to . . . [the] improvement, or . . . the land upon which [the improvement is] . . . situated,"¹⁰⁴ where the encumbrance is either "given or recorded" prior to the effective date of the mechanics' liens.¹⁰⁵ As suggested above, the fixture security interest actually encumbers the realty,¹⁰⁶ and thus it is arguable that a security interest which has either *attached* or has been *perfected* prior to the effective date of the mechanics' liens should prevail over those liens. And, in light of the statutory language, this result would follow whether or not the goods were actually affixed prior to the effective date of the liens.¹⁰⁷ This would be consistent with the uniform version of the UCC¹⁰⁸ if the security interest attached prior to the affixation of the goods.

Yet the above interpretation seems contrary to the scheme es-

¹⁰⁴ OHIO REV. CODE § 1311.13(B).

¹⁰⁵ *Ibid.*

¹⁰⁶ See text accompanying notes 62-65 *supra*.

¹⁰⁷ See OHIO REV. CODE § 1311.13; OHIO REV. CODE § 1309.32 (Supp. 1966).

¹⁰⁸ UCC § 9-313.

tablished by Ohio's version of section 9-313. Under the Ohio rule, the security interest, in order to have priority, must be perfected *and* the goods be affixed *before* the subsequent encumbrance is acquired.¹⁰⁹ This latter rule should probably govern so that consistent treatment is given to the fixture security interest when it conflicts with another type of encumbrance. This rationale is further reinforced by the fact that the mechanic's lien statutes were enacted long before the fixture security interest was conceived. Nevertheless, the mechanic's lien statute speaks of encumbrances in general and therefore does not specifically exclude the security interest. Also, the words "given or recorded" seem to indicate that something less than recording (and therefore attachment) is sufficient to establish priority over the mechanics' liens. The application of these rules may be illustrated by another hypothetical example.

(2) *Example.*—On January 1, *Y* contracts with *O* to supply certain goods which will become fixtures on *O*'s land. In an unrelated contract, *L* agrees to improve *O*'s land. *L* begins construction of the improvement on January 5.

Y completes installation of the goods on January 6, and *L* thereafter perfects his mechanic's lien.

The results here, following the general Ohio rule that a fixture security interest must be perfected *and* the goods must be affixed prior to the perfection of another encumbrance to defeat the priority of that encumbrance, is that *Y*'s security interest is secondary to *L*'s lien. If, however, it is only necessary that the security interest *attach* (as the mechanic's lien statute seems to suggest) before the mechanic's lien becomes effective, the lien is secondary to the security interest.

Note that *Y* could have chosen to secure payment for the goods by using a mechanic's lien, since he is dealing with fixtures.¹¹⁰ Assuming that *Y*'s contract and *L*'s contract are unrelated, the lien with the first effective date would take priority over the later lien.¹¹¹ Thus, if *Y* had begun installation of the goods before January 5, making the effective date of his lien prior to that of *L*'s lien, *Y* would have obtained priority over *L*.¹¹²

III. AFTER-ACQUIRED PROPERTY

For various reasons, a secured creditor may seek to impose his

¹⁰⁹ OHIO REV. CODE § 1309.32(B) (Supp. 1966).

¹¹⁰ See text accompanying notes 70-74 *supra*.

¹¹¹ See OHIO REV. CODE § 1311.13; text accompanying notes 36-39 *supra*.

¹¹² *Ibid.*

lien upon property subsequently acquired by the debtor. A creditor may feel his present collateral is inadequate and may therefore bargain for an express clause in the security agreement attaching the lien to newly acquired property. Or the lien may arise by operation of law to protect a creditor when, at the time of the execution of the security agreement, the debtor actually owned no interest in the collateral. In either case, variations in the priority rules often result. These variations will be considered in light of (1) the purchase-money mortgage, (2) estoppel by deed, (3) after-acquired property clauses, and (4) accession.

A. *The Purchase-Money Mortgage*

Although technically not a mortgage securing after-acquired property,¹¹³ the difficulties attending the purchase-money mortgage are analogous to those arising under after-acquired property situations.

A person seeking to buy real estate often obtains assistance in financing the transaction, usually inducing either the seller or a third party to pay part of the purchase price in return for a first mortgage lien on the property. Ordinarily, the deed and mortgage instruments would be executed and recorded simultaneously, but if in fact the mortgage is recorded prior to the recording of the vendor's deed of conveyance, the mortgage is secured by property which, in the eyes of third parties, has not yet been acquired by the debtor-buyer.¹¹⁴ Nevertheless, it has been held that the purchase-money mortgage gives constructive notice of its lien from the mortgage recording date,¹¹⁵ and the mortgage therefore becomes a valid first lien over all encumbrances which might thereafter arise.¹¹⁶ If the vendor is also the purchase-money mortgagee, his creation of a mortgage lien operates as a waiver of his vendor's common law lien for the unpaid balance of the purchase price.¹¹⁷

If the financier of the transaction is not the vendor but rather a third party, his purchase-money mortgage takes priority over prior

¹¹³ *Equitable Dev. Corp. v. V & L Constr. Co.*, 3 Ohio Misc. 198, 207 N.E.2d 803 (C.P. 1965).

¹¹⁴ The third parties, relying on the recording statutes would not have notice of the deed of conveyance.

¹¹⁵ *Equitable Dev. Corp. v. V & L Constr. Co.*, 3 Ohio Misc. 198, 207 N.E.2d 803 (C.P. 1965).

¹¹⁶ *Ibid.* *Id.* at 201, 207 N.E.2d at 805 suggests, however, that a mortgage given after a purchase-money mortgage and which is recorded before the purchase-money mortgage might defeat the priority of the purchase-money mortgage.

¹¹⁷ OHIO REV. CODE § 5301.26.

equitable claims to the property.¹¹⁸ The unsecured vendor's lien is also defeated by the purchase-money mortgage.¹¹⁹ These results can be justified since the transaction would not have occurred without the third party's money.

It would seem, however, that a mortgage executed by the vendor to secure his right to the purchase price would be prior to the purchase-money mortgage if the vendor's mortgage was recorded prior to the purchase-money mortgage.¹²⁰

B. Estoppel by Deed

A mortgagor who executes a security agreement which purports to attach to property not actually in his ownership, is later estopped to assert the defect in the mortgage when the mortgagor in fact obtains the property.¹²¹ This situation is distinguished from the purchase-money mortgage situation since reliance by the mortgagee upon the purported title of mortgagor is necessary to establish the estoppel.¹²² The purchase-money mortgagee cannot rely on purported title since he knows that the mortgage fund is to be used to purchase the property.

C. After-Acquired Property Rights

(1) *Express Agreements.*—A mortgage instrument may expressly state that the lien will be secured by any realty, not described in the original mortgage, which is subsequently acquired by the debtor. The clause creates an equitable lien on newly acquired property which is enforceable against the debtor but subject to all intervening valid mortgage liens created on the new property.¹²³ The mortgagee holding the equitable lien can perfect it by executing a new mortgage instrument describing the newly acquired property, thus giving notice to subsequent creditors.¹²⁴

Such after-acquired property clauses may also arise in the fixture

¹¹⁸ Ward v. Carey, 39 Ohio St. 361, 364 (1883); Jarvis v. Hannan, 40 Ohio St. 334 (1883); Neff v. Crumbaker, 40 Ohio St. 85 (1883); Lipps v. Lipps, 87 N.E.2d 823 (Ohio Ct. App. 1949), 19 U. CINC. L. REV. 293 (1950).

¹¹⁹ Neff v. Crumbaker, *supra* note 118; OHIO REV. CODE § 5301.26.

¹²⁰ See OHIO REV. CODE § 5301.23; Equitable Dev. Corp. v. V & L Constr. Co., 3 Ohio Misc. 198, 201, 207 N.E.2d 803, 805 (C.P. 1965).

¹²¹ Gossard v. Akers, 18 Ohio App. 129 (1924).

¹²² OSBORNE, MORTGAGES 89-90 (1951).

¹²³ Cases cited note 9 *supra*.

¹²⁴ *Ibid.*

security agreement.¹²⁵ When used in a *chattel* security agreement, the security interest in the newly acquired goods is automatically perfected upon acquisition of the goods.¹²⁶ It is possible that this rule applying to chattels may also extend to fixtures, thus allowing the fixture security interest to defeat intervening encumbrances on the land. There seems to be no statute specifically denying this result, although it would seem to be in conflict with the result reached under the other Ohio rules governing after-acquired property clauses.

(2) *By Operation of Law.*—An encumbrance may apply to after-acquired property not only as a result of an express statement in the agreement but also through operation of law. By statute, a mechanic's lien already perfected on a debtor's interest in particular property will attach to any additional interest in that realty thereafter acquired by the debtor.¹²⁷ For example, a person who improves real estate pursuant to a contract with the lessee thereon can obtain a lien upon the lessee's interest in that real estate, and if the lessee thereafter purchases the full interest, the mechanic's lien will automatically attach to the greater interest. The same result obtains if the debtor actually owned no interest in the realty at the time of the improvement.¹²⁸ It is important to distinguish the operation of this statutory rule from that concerned with an express after-acquired property clause in a real estate mortgage. Where a mortgage contains an express clause, all after-acquired property including that which is separate from the realty described in the original deed will become subject to the mortgagee's equitable lien. However, the mechanic's lien statutes allow the lien to attach only to a debtor's increased interest in the *realty on which the improvements are made*.¹²⁹ Thus, a mechanic's lien perfected on Blackacre for improvements made thereon will not attach to Whiteacre later acquired by the debtor. Furthermore, if the debtor actually never acquires any interest in the property improved, the mechanic's lien will not attach to the improved property,¹³⁰ and the lien claimant will have to utilize other remedies should the debtor default.

¹²⁵ OHIO REV. CODE § 1309.15(C) (UCC § 9-204(3)); *Cain v. Country Club Delicatessen, Inc.*, 25 Conn. Supp. 327, 203 A.2d 441 (Sup. Ct. 1964).

¹²⁶ See 1 COOGAN, HOGAN & VAGTS, SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE 237-38 (1966). This interest will be subject to a purchase money security interest in the newly acquired goods. *Ibid.*

¹²⁷ OHIO REV. CODE § 1311.02 (Supp. 1966).

¹²⁸ *Golner v. Bede*, 11 Ohio App. 137, 139 (1919).

¹²⁹ OHIO REV. CODE § 1311.02 (Supp. 1966).

¹³⁰ *United Banking & Trust Co. v. Russell*, 38 Ohio App. 275, 176 N.E. 166 (1931).

D. Accession

A security agreement may attach to after-acquired property through the doctrine of accession.¹³¹ The rules governing accession can be determined from the priority rules already established,¹³² but the effect of these rules should be briefly considered. It will be recalled that a general race scheme of priorities has been established in Ohio to govern conflicting encumbrances on real property. Since the liens usually apply both to the land and the structures thereon, the value of any improvements (or goods affixed) on the realty feeds the liens of the prior encumbrances. Thus, a prior secured creditor often obtains benefits through the improvements which he never relied on for security, and the improver of the property may be least likely to obtain payment for his services. The avoidance of this result undoubtedly gave rise to the UCC's uniform rule (rejected by Ohio) that a fixture security interest generally takes priority over prior interests in the realty.¹³³

The rule of accession apparently is of doubtful value to the fixture secured creditor since his security interest attaches to particular goods affixed on the realty. However, since he holds an encumbrance on the land, new improvements indirectly inure to his benefit.

IV. CONCLUSION

This study has attempted both to establish the various priority rules governing conflicting security interests and to point out problems presently existing in this area of Ohio law.

The most significant difficulties arise in connection with the recently adopted open-end mortgage statute. The statute does not clearly delineate which situations fall within its language; hence, it is questionable whether an improvement mortgage, which in fact secures future advances, is subject to the statute. It should also be determined whether the policies of the act should apply to fixture security interests which in fact secure future advances. A second problem concerns the priority rules governing the situation in which fixture security interests conflict with mechanics' liens. If a mechanic's lien which becomes effective either before the security in-

¹³¹ The term accession as used in the text applies to the affixation of goods to realty. It is not used in the UCC article 9 sense which is concerned with goods becoming affixed to other personalty. See OHIO REV. CODE § 1309.33 (UCC § 9-314).

¹³² For a discussion of the rules, see text accompanying notes 75-112 *supra*.

¹³³ See text accompanying notes 100-112 *supra*.

terest is perfected or before the goods are affixed is to be superior to the security interest, then the confusing mechanic's lien statute (suggesting a different result) should be amended to effect this result. Finally, the fixture security interest after-acquired property clause should be reconsidered and the applicable statutes should be amended to clearly state the effect of such a clause upon intervening encumbrances. Legislative clarification in these problem areas would significantly increase the effectiveness of the Ohio law.

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