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# Mortgages--Lien and Priority--Mortgages and Mechanics' Liens [*Wayne Building & Loan Co. v. Yarborough*, Ohio St. 2d 195, 228 N.E.2d 841 (1967)]

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## MORTGAGES — LIEN AND PRIORITY — MORTGAGES AND MECHANICS' LIENS

*Wayne Building & Loan Co. v. Yarborough*, 11 Ohio St. 2d 195, 228 N.E.2d 841 (1967).

Ohio courts have long been among a minority in holding that constructive notice, rather than actual notice, is sufficient to defeat the priority of nonobligatory[1] future advance mortgages.[2] The recent case of *Wayne Building & Loan Co. v. Yarborough*[3] upheld this position, and, in addition, declared that a construction mortgagee who makes future advances conditioned upon the satisfactory progression of work is not deemed to have been under an obligation to make such advances.[4]

*Wayne's* importance is not simply its impressive and exhaustive treatment of mortgage law. More importantly, the case narrows the gap which exists between the common law and the statutory treatment of liens and priorities in Ohio.

A contract for the purchase of land and the construction of a house generated the series of transactions which culminated in this litigation. The complex facts of the case are most clearly viewed from a time sequence approach as follows:[5]

*August 28, 1963.* Yarborough, the builder, and the Lantzes, the ultimate purchasers of the house, entered into a written agreement whereby Yarborough proposed to purchase the land for the Lantzes from Sauter, the developer of the community, and to construct a house upon it. The Lantzes executed a cognovit note to Yarborough for $8,000.

*October 11, 1963.* The Lantzes paid to Yarborough $4,000 of the $8,000 downpayment.

*October 16, 1963.* Yarborough informed the developer of his contract with the Lantzes, whereupon the developer approved the

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[1] A nonobligatory future advance mortgage consists of a series of optional payments by the mortgagee to the mortgagor, each payment being a separate promise supported by its own consideration. *See* G. OSBORNE, MORTGAGES § 114 (1951) [hereinafter cited as OSBORNE]. An obligatory mortgage arises when the mortgagee is firmly bound to advance monies in accordance with the original mortgage agreement. A nonobligatory mortgage does not bind the mortgagee. For a discussion of the theories which make these distinctions, and a criticism of these theories, see *id.* §§ 117, 117a.

[2] *See* Annot., 80 A.L.R.2d 179 (1961).

[3] 11 Ohio St. 2d 195, 228 N.E.2d 841 (1967).

[4] *Id.* at 221, 228 N.E.2d at 858.

[5] *Id.* at 198, 228 N.E.2d at 844-45.

plans for the Lantzes' house, and deeded the lot to Yarborough in return for $1,000 cash and a promissory note for $4,600.

Yarborough, in order to raise construction money, then applied to Wayne Building and Loan for a $22,000 mortgage loan. Wayne Building and Loan valued the land at $6,000[6] and the proposed house at $24,000. Yarborough informed Wayne of his transactions with the developer and the Lantzes,[7] and Wayne Building and Loan approved the plans for the house.

*October 24, 1963.* As security for his promissory note of October 16 for the purchase of the lot, Yarborough executed, but did not record, an ordinary mortgage to the developer.

*October 31, 1963.* Yarborough entered into a formal construction mortgage arrangement with Wayne Building and Loan.[8]

*November 1, 1963.* Wayne Building and Loan recorded its October 31 mortgage agreement with Yarborough.

*November 21, 1963.* Construction on the Lantzes' house commenced thus setting the priority date for mechanics' liens.[9]

*December 11, 1963.* The developer filed his October 24 purchase money mortgage. His warranty deed to Yarborough was also filed, immediately followed by Wayne Building and Loan's refiling[10] of its October 31 mortgage deed to perfect the chain of title.

*Subsequent to December 11, 1963.* Wayne Building and Loan

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[6] Wayne Building and Loan actually appraised the value of the land at $5,500. Record at 34, Wayne Bldg. & Loan Co. v. Yarborough, 11 Ohio St. 2d 195, 228 N.E.2d 841 (1967) [hereinafter cited as Record].

[7] The evidence did not prove that Wayne Building and Loan knew the amount of the downpayment given, nor knew that the Lantzes, specifically, gave the downpayment. 11 Ohio St. 2d at 201-02, 228 N.E.2d at 847.

[8] Other papers were signed including an assignment of funds agreement and a mechanics' lien agreement. Record at 25.

[9] The construction was done by Prior Homes, Inc., Yarborough's wholly owned general contractor. Labor and materials were contracted for by Yarborough himself, acting both as an officer of Prior Homes, Inc., and as an owner of the realty.

[10] The refiling was necessary because Wayne Building and Loan's mortgage was out of the chain of title. The argument made in the court was that under OHIO REV. CODE ANN. §§ 1311.13(B), 5301.23 (Page 1962), the first filing was invalid. The court held that Wayne's first recording was sufficient. It reasoned that the mechanics' lienors claimed through Yarborough, since he had contracted for the labor and material. The lienors, if they had checked the record, would have found Yarborough's mortgage to Wayne Building and Loan. Merely because the warranty deed was unrecorded at the time did not mean that the lienors could ignore the mortgage. The record would have put them on inquiry as to whether Yarborough really owned the land. This fact could easily be discovered by asking Yarborough. It was the duty of the mechanics' lienors to know when the person through whom they claimed had acquired title. Their failure to do so was not the fault of Wayne Building and Loan, whose mortgage was properly recorded. *See generally* OSBORNE § 197.

disbursed $18,500 to Yarborough in accordance with its lending agreement.[11]

*March 10, 1964.* The Lantzes paid $4,000 to Yarborough to fulfill their downpayment obligation.

*April 1964.* The Lantzes first learned of Yarborough's previous dealings with the developer and Wayne Building and Loan.

*June 1964.* The building and loan company, having learned that Yarborough was in financial distress and that he had used the mortgage money to pay past indebtedness, filed an action for foreclosure and the marshalling of liens against Yarborough.

The Lantzes appealed to the supreme court from findings of the lower courts giving lowest priority to their vendee's lien.[12] In reversing the decisions of the lower courts, the supreme court held that the priorities should have been as follows:[13]

1) The Lantzes' vendee's lien for the $4,000 which they paid on the land purchase contract before construction began.

2) The mechanics' lienors.

3) The Lantzes' vendee's lien for $4,000 paid on the contract after construction had begun.

4) The developer, in the amount of his purchase money mortgage lien.

5) Wayne Building and Loan, in the amount of its mortgage lien.

Whether the Ohio Supreme Court reached the correct result through valid reasoning, and whether the court's holding engenders sound precedent, are two separate propositions. It must be acknowledged that statutory amendments[14] since the case arose could have produced different results. But this does not concern the Lantzes' vendee's lien, as the changes would affect only the nature of the building and loan company's obligation on the construction mortgage.

The Lantzes claimed a vendee's lien of $8,000. Their argument[15] was based upon the premise that a vendee of a land contract can protect his interest through possession or recordation. But in

[11] The court found that this money was used by Yarborough to pay past indebtedness. 11 Ohio St. 2d at 210, 228 N.E.2d at 852.

[12] *Id.* at 198, 228 N.E.2d at 845.

[13] *Id.* at 222, 228 N.E.2d at 859.

[14] OHIO REV. CODE §§ 5301.232-.233 (1967 CCH ADVANCE SESS. LAWS, SENATE BILLS 605-07 (effective Nov. 24, 1967)), *amending* OHIO REV. CODE ANN. § 5301.23 (Page 1962).

[15] Brief for Appellant Lantz at 7, Wayne Bldg. & Loan Co. v. Yarborough, 11 Ohio St. 2d 195, 228 N.E.2d 841 (1967).

the common real estate purchase agreement, such as found here, the vendee can comply with neither act; he has no title to record and no right to possession until he has paid the purchase price in full.[16] The court followed this line of reasoning in acknowledging the Lantzes' vendee's lien. Insofar as the purchase agreement was not recordable, the rights of the parties were to be established by general principles of law and equity.[17]

In reversing the lower courts,[18] the supreme court found that the two intervening mortgagees had sufficient knowledge of Yarborough's transaction with the Lantzes to put them on inquiry. Though the developer had actual knowledge of the Lantzes' contract with Yarborough, the building and loan company knew only that Yarborough had contracted with some party for the sale of the land and construction of a house upon it. The court held[19] that because both mortgagees at least had knowledge of facts sufficient to put them on inquiry, they were not bona fide purchasers and thus could not cut off the Lantzes' prior equitable lien. The fact that a portion of the purchase price was paid after the developer and the building and loan company had recorded their mortgages was of no consequence because the vendee's lien was outside the ambit of the recording act and could only be cut off by *actual* notice to the vendee before his payments were made.[20]

While it was only fair for the court to give effect to the Lantzes' vendee's lien, the holding clearly applies only when the vendee has no knowledge of any mortgages, and when the mortgagees can also be charged with knowledge of the vendee's lien. If the facts were altered so that the building and loan company and the developer had had no knowledge of the contracts Yarborough had made, it would appear that the developer would have had priority over the Lantzes because of his purchase money mortgage. But could the court then have held as to the building and loan that it

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16 8A G. THOMPSON, REAL PROPERTY § 4449 (1957).

17 11 Ohio St. 2d at 200, 228 N.E.2d at 846.

18 The common pleas court agreed with Wayne that it recorded and gave value under its mortgage without knowledge of the Lantzes' contract. The court of common pleas found that "the Lantzes had failed 'to show any knowledge of an outstanding contract of the vendee upon the part of the mortgagee in this case.'" *Id.* at 201, 228 N.E.2d at 846. The court of appeals narrowed this holding and found that while Wayne Building and Loan may have had constructuve notice of the Lantzes' contract with Yarborough, this knowledge was not legally sufficient to defeat its priority over the prior equitable lien of the buyer. *Id.*

19 *Id.* at 204-05, 228 N.E.2d at 848-49.

20 *Id.* at 203, 228 N.E.2d at 848.

should have asked, in its loan application, who owned the house or lot, and whether any interests were outstanding? It would certainly seem fair to place this burden on the mortgagee rather than upon an unwary home buyer. It seems clear from the court's holding that the building and loan company and the developer should have both conducted an inquiry as to the Lantzes' interest in the property. Such an inquiry would have reasonably led them to contact the Lantzes and ask them to subordinate their interest to that of the mortgages. The effect would have been that the Lantzes would have then had actual knowledge of the mortgages. Under the *Wayne* holding as to future payments, the Lantzes' lien would then have been subordinate whether or not they consented.

In deciding the Lantzes' interest as against the mechanics' lienors, the court held[21] that because the Lantzes paid out $4,000 prior to the beginning of construction, they were entitled to priority to the extent of this amount over the mechanics' lienors. The *Ohio Revised Code*[22] provides that mechanics' liens attach at the commencement of construction. The statutes favor the mechanics' lienors against any subsequent payments by the vendee of a land contract whether or not the vendee had any knowledge of the commencement of construction.[23] It is not necessary to point out the reasons for this section except to note that most home buyers are aware of when construction begins. Placing the burden on mechanics' lienors to discover who the beneficial owner of the future house may be, is a hardship if the vendor contracts for labor and materials. The court therefore awarded the mechanics' lienors priority for the half of the $8000 which was paid after construction had commenced.[24]

The relative priorities among the mechanics' lienors, the developer, and the building and loan company presented a more complex problem to the court, partially, at least, because Ohio employs essentially a "race" scheme of priorities. In Ohio, mortgages become effective on the date submitted for recording and in the order submitted should more than one mortgage be submitted on the same day.[25] A mortgage recorded prior to the commencement of

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[21] *Id.* at 205-06, 228 N.E.2d at 849.

[22] OHIO REV. CODE ANN. §§ 1311.02, .13 (Page 1962).

[23] *Id.* § 1311.13(B).

[24] 11 Ohio St. 2d at 222, 228 N.E.2d at 859.

[25] OHIO REV. CODE ANN. § 5301.23 (Page Supp. 1966).

construction generally is accorded priority over mechanics' liens.[26] An exception to this "race" scheme arises when the mortgage is recorded subsequent to the commencement of construction, and, therefore, after the mechanics' liens had attached to the land.[27]

Essentially, the building and loan company employed the benefits of two distinct theories to defeat the mechanics' liens. It reasoned that if its first recording (November 1) were valid, and there was an obligation to advance monies to Yarborough, then its lien was not subject to intervening claimants. If, however, the second recording (December 11) were valid, then it would be within the purview of the statutory improvement mortgage section[28] and would defeat the mechanics' liens. As to its second contention, there was formal compliance with the requirements necessary for the face of the mortgage,[29] but no evidence was offered to show compliance with the statutory scheme for disbursements.[30] This defect was fatal because under the statutory improvement mortgage scheme, a mortgagee can gain priority over mechanics' liens even though the mortgage is recorded subsequent to the beginning of work, if the mortgagee follows a special scheme for disbursements.[31] The mort-

[26] *Id.* § 1311.13(B) (Page 1962).

[27] *See id.* § 1311.14.

[28] *Id.*

[29] *Id.*

[30] *Id.*

[31] The statute provides:

(A) Said mortgagee may at any time pay off said prior encumbrance, or withhold the amount thereof for that purpose.

(B) Out of the residue of said fund such mortgagee may at any time retain sufficient funds to complete the improvement, according to the original plans, specifications, and contracts, and within the original contract price.

(C) Such mortgagee may from time to time pay out on the owner's order, directly to contractors or subcontractors, or to the owner himself if he is his own contractor, such sums as said owner certifies to be necessary to meet and pay labor payrolls for said improvement.

(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 his hands to do so and also to complete said improvement; but if such mortgagee has funds in his hands insufficient to pay all such laborers and materialmen in full and to complete said improvement, 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

gagee gains priority, because he must pay the mechanics' lienors directly so that they are in no worse position. The theory behind this approach is to encourage a mortgagee to loan funds where construction has already been started but the owner lacks the necessary funds to proceed further.[32] The express condition though is that the laborers and materialmen must be paid out of the mortgage fund. The building and loan company did not comply with the disbursement scheme, and to allow it priority under the statute would have been to deprive the materialmen of their earnings.[33]

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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. *Id.*

[32] In the early part of the century if a mortgage were filed after construction had been begun, a case could arise whereby a mechanic's lien could be filed for work performed after recordation of the mortgage and still be prior to the mortgages. This was because mechanics' liens related back to the time of the original construction. *See* Rider v. Crobaugh, 100 Ohio St. 88, 125 N.E. 130 (1919). This situation most often arose when one's premises were being improved, rather than constructed. The Ohio Legislature had two basic choices; they could have stated that liens could not attach at the commencement of construction, but rather when each laborer begins his specific task. While it would be difficult to determine when each laborer had commenced, it would have prevented a lien from arising perhaps as much as a year or more before the actual work was performed. The other alternative was to adopt a scheme such as OHIO REV. CODE ANN. § 1311.13 (Page 1962), which in part provides:

> Such liens shall be preferred to all other titles, liens, or encumbrances which may attach to or upon such construction, excavation, machinery, or improvement, or to or upon the land upon which they are situated, *which shall either be given or recorded subsequent to the commencement of said construction, excavation, or improvement. Id.* § 1311.13(B) (emphasis added).

*Rider* pointed out that before the Legislature had acted in this matter, when a lien was placed on the premises this had the effect of stopping the work entirely, because few mortgagees would be willing to risk a mortgage on property already secured. 100 Ohio St. at 99, 125 N.E. at 133.

Perhaps the difficulty today, construing § 1311.14 as applying to mortgages recorded after the commencement of construction, arose from the language in *Rider* when the court stated that "an inspection of the *entire act*, however, would clearly indicate that the legislative intention was to apply its force only to mortgages which were given and filed for the purpose of improving real estate, after the actual commencement of operations." *Id.* at 98, 125 N.E. at 133 (emphasis added). Professor Shanker feels that this holding was clearly a mistake. Interview with Morris G. Shanker, Professor of Law, Case Western Reserve University, in Cleveland, Ohio, October 16, 1967. Professor Shanker's argument has much validity, and would have the effect of requiring all mortgagees to disburse in the manner set forth in OHIO REV. CODE ANN. § 1311.14 (Page 1962). This would protect all parties involved by making sure that the mortgage funds were, in fact, properly disbursed. *See* text accompanying note 57 *infra.*

[33] An interesting facet of the case is that the building and loan company had two alternatives by which to defeat mechanics' liens. Disregarding this strange factual situation, the question arises that if its first recording had been valid by including the deed, could the building and loan company then rerecord and claim to be under section 1311.

Because this case arose before amendments to the *Ohio Revised Code*,[34] the court was able to hold that if the building and loan company were not under an obligation to disburse the monies under the mortgage loan to Yarborough, then each advance made after construction had begun would be subsequent in priority to valid mechanics' liens.[35] The problem is whether or not the court was correct in holding the advances to be optional. The reasoning used was that because there was no express agreement between mortgagor and mortgagee requiring the mortgagee "to advance a *certain and definite sum*, in a *particular manner* . . . ."[36] the payments of monies to Yarborough were nonobligatory. The evidence discussed by the court[37] at least proves that the mortgagee did have some discretion as to whether the building was progressing satisfactorily enough for further payments. But was this sort of discretionary policy enough to make the loan advances optional; or was the mortgagee merely reserving this discretion out of commercial necessity?

Considering the October 31, 1963 note between the building and loan company and Yarborough,[38] the mortgage deed between these parties,[39] and Yarborough's assignment of funds to the mortgagee,[40] it is difficult to understand how the court found no obligations on the part of the mortgagee to make future advances. The promissory note[41] named a definite total sum as a present loan. While this could be considered an intentional misrepresentation of facts, a majority of the courts hold this to be a valid mortgage not only between the mortgagor and the mortgagee, but as against creditors and subsequent encumbrancers.[42] As one writer in the field states, "[T]he business advantages of such a useful device outweigh

14. *Rider* seems to answer in the negative. The benefit of two recordings would accrue to the mortgagee who could not be sure that his advances would be treated by the courts as obligatory. Thus, if the courts found the advances not to be obligatory, the mortgagee could then claim first priority if he had complied with section 1311.14 by recording *after* construction had commenced *and* complying with that section's disbursement scheme.

34 OHIO REV. CODE §§ 5301.232-.233 (1967 CCH ADVANCE SESS. LAWS, SENATE BILLS 605-07 (effective Nov. 24, 1967)), *amending* OHIO REV. CODE ANN. § 5301.23 (Page 1962).

35 *See* 11 Ohio St. 2d at 219, 228 N.E.2d at 857.

36 *Id.* at 220, 228 N.E.2d at 858.

37 *Id.* at 221, 228 N.E.2d at 858.

38 Record at 19.

39 *Id.* at 20.

40 *Id.* at 25.

41 11 Ohio St. 2d at 221, 228 N.E.2d at 858.

42 OSBORNE § 116.

any possible dangers and objections involved in its employment."[43] The assignment of funds to the building and loan company[44] had the effect of placing this money in escrow with a third party and saving Yarborough interest expense until the money was actually disbursed.[45] But this in no way makes for any less of an obligation on the part of the mortgagee to pay out the funds.

The supreme court argued that the mortgagee's wide discretion made the loan one which had to be considered optional. In the companion case the court placed great emphasis on the fact that the mortgagee had unilaterally reduced the upper limit on the loan.[46]

Whatever the reasons behind the mortgagee's unilateral action to reduce the amount of the loan, it does not necessarily follow that the mortgagee could, under its agreement, do so. The fact that Yarborough did not bring an action for a breach of the agreement does not mean that he did not have such a cause of action against the mortgagee.

The better way to view the construction mortgage agreement would be as a series of payments each upon a condition precedent.[47] The obligation arose with the original note and mortgage, and continued as long as construction proceeded properly. If Yarborough had said that a certain portion of the house was completed and that he therefore needed funds, could the mortgagee have refused? As long as the event, progress on the building, arose, there was an obligation to disburse a portion of the funds. "[W]here it appears as a matter of law . . . that the . . . mortgagee may decline to make advances at his pleasure, without taking the risk of subjecting himself to damages or loss . . . ."[48] the mortgagee will lose his priority for the advances made after he had knowledge of the mechanics' liens. The building and loan company made no advances prior to the commencement of construction, and was, therefore, subjected to the last priority. Yet his mortgage was recorded prior to the beginning of the work. The court tended to neglect not only the sanc-

[43] *Id.* at 283.

[44] Record at 25.

[45] Of interest here is the nature of the Mechanics' Lien Agreement which makes it Yarboroughs' responsibility to guard against mechanics' liens, and which states that the funds are in escrow at The Wayne Agency Co. Record at 25. For a discussion of the escrow theory see OSBORNE § 115.

[46] Wayne Bldg. & Loan Co. v. Yarborough, 11 Ohio St. 2d 224, 226-27, 228 N.E. 2d 860, 862 (1967).

[47] *See* A. CORBIN, CONTRACTS § 628 (one volume ed. 1952).

[48] *In re* Mayerhofer's Estate, 43 Misc. 2d 32, 33, 249 N.Y.S.2d 896-97 (Sup. Ct. 1964).

tity of the binding agreement between the mortgagee and Yarborough, but the fact that the building and loan company may have had to make future advances in order to protect its initial investment.[49] The new amendment to the *Ohio Revised Code*[50] seems to support the obligatory nature of the agreement.[51]

The obligatory-nonobligatory distinction merely penalizes the mortgagee who does not appear to be disbursing funds in the proper manner. Certainly, such a mortgagee should be penalized at least to the extent that other lienholders would be deprived of their rights when they follow the statutory schemes. Yet the court should not have reasoned that future payments were optional. A better argument could have been made on the basis just mentioned; if a mortgagee is negligent with the funds his interest should give way to other lienors. While this may be considered a windfall to other creditors, it is less of a windfall than allowing third parties to benefit from the court's analysis. If mechanics' lienors who have perfected their liens gain priority over a mortgagee, it is not because of anything which they have done. Rather, it is because a court has subsequently stated that an agreement was optional.

If the agreement were obligatory, nothing could intervene to affect the mortgagee's priority.[52] It would be inequitable in the sense that Wayne Building and Loan would have been in breach of contract had it decided that because of liens it would not risk the loss. Yet accepting the court's view that the advances were merely optional, constructive notice was enough to defeat the priorities of the mortgagee's advances. Recognizing that the majority rule is

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[49] *See* Recent Legislation, 17 W. RES. L. REV. 1429 (1966).

[50] OHIO REV. CODE §§ 5301.232-.233 (1967 CCH ADVANCE SESS. LAWS, SENATE BILLS 605-07 (effective Nov. 24, 1967)), *amending* OHIO REV. CODE ANN. § 5301.23 (Page 1962).

[51] Section 5301.232(E)(4) states:

> A holder of a mortgage is "obligated" to make an advance if such holder or the person to whom the repayment of such advance is owed has a contractual commitment to do so, *even though the making of such advance may be conditioned upon the occurrence or existence, or the failure to occur or exist, of any event or fact*, which event or fact must occur or exist or fail to occur or exist within three years following the time the mortgage is delivered to the recorder for record; provided, that such three-year limitation does not apply to any mortgage given to secure, in whole or in part, loan advances made to pay the cost of any construction, alteration, repair, improvement, enhancement, or embellishment of any part of the mortgaged premises. *Id.* (emphasis added).

[52] This is probably based upon the notion that a law should never be enforced if by enforcing it the court would place one in breach of contract.

that actual notice is necessary to defeat the priority,[53] the court did not feel "disposed to change the traditional Ohio rule."[54] There are equities in favor of both the majority and minority views[55] as to whether or not there need be actual notice. But under the Ohio rule of mere constructive notice, it does not seem an undue burden for a mortgagee who is engaged in construction financing every day to check the records before making further advances. It can be a burden, however, on a mortgagee who has an interest in only one or two parcels of land, and knows little of checking records.

The problem in *Wayne* is not so much whether actual or constructive notice is sufficient, as whether a mortgagee could, under previous Ohio law, have made his advances obligatory. Taking the court's opinion, a mortgage would have had to state that the mortgagee was obliged to pay out a certain sum as certain conditions were met. Added to this perhaps should have been a statement noting that if the advances were not so made, the mortgagee would be in breach of contract. Yet, even given these facts, it is not at all clear from the *Wayne* opinion that the advances would have been found obligatory. The court pointed out that though the assignment of funds agreement subjected the disbursement of funds to the rules and regulations of the building and loan company, the company never offered proof as to the content of the rules.[56] One would think that reasonable rules and regulations would have been implied. The court's finding that the advances were not obligatory appears to be merely a legal-sounding argument for defeating the priority of a mortgagee whose carelessness in disbursing funds resulted in prejudice to lienors who should have been subsequent in priority.

The new amendment[57] to the *Ohio Revised Code* does much to

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[53] 11 Ohio St. 2d at 219, 228 N.E.2d at 857.

[54] *Id.*

[55] For a discussion of this point see OSBORNE § 119.

[56] 11 Ohio St. 2d at 221, 228 N.E.2d at 858.

[57] The amendment reads in part:

> (A) Whether or not it secures any other debt or obligation, a mortgage may secure unpaid balances of loan advances made after the mortgage is delivered to the recorder for record, to the extent that the total unpaid loan indebtedness, exclusive of interest thereon, does not exceed the maximum amount of loan indebtedness which the mortgage states may be outstanding at any time. With respect to unpaid balances, division (B) of this section is applicable if the mortgage states, in substance or effect, that the parties thereto intend that the mortgage shall secure the same, the maximum amount of unpaid loan indebtedness, exclusive of interest thereon, which may be outstanding at

alleviate many of the problems that existed when the *Wayne* case was decided. The new amendment requires the mortgage to state the total indebtedness and that it is an *open end mortgage*, which puts subsequent creditors on notice of the interests in the land. It allows future advances to be secured when recorded. If the advances are optional, written notice will cause future advances to be subsequent to the party's interest who gave the notice. If the advances are obligatory within the meaning of the section, there can be no intervening encumbrances.

If the building and loan company's obligations to disburse money to Yarborough could be considered obligatory under the new amendment, then further legislation is needed to curb such careless mortgagees who follow no statutory schemes in disbursing funds. Perhaps the improvement mortgage section 1311.14 should be clarified by the legislature and made to apply to all mortgages whether recorded before or after the commencement of construction. Subjecting the mortgagee to section 1311.14 would be no hardship in that careful lenders would require the bills to be presented to them directly thus insuring that the laborers and materialmen would be paid. The burden should be on the mortgagee to

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any time, and contains at the beginning thereof the words "OPEN-END MORTGAGE".

(B) A mortgage complying with division (A) of this section and securing unpaid balances of loan advances referred to in such division shall be a lien on the premises described therein from the time such mortgage is delivered to the recorder for record for the full amount of the total unpaid balances of such advances that are made under such mortgage, plus interest thereon, regardless of the time when such advances are made. If such an advance is made after the holder of the mortgage receives written notice of a lien or encumbrance on the mortgaged premises which is subordinate to the lien of the mortgage, and if such holder is not obligated to make such advance at the time such notice is received, then the lien of the mortgage for the unpaid balance of the advance so made shall be subordinate to such lien or encumbrance. If an advance is made after the holder of the mortgage receives written notice of work or labor performed or to be performed or machinery, material, or fuel furnished or to be furnished for the construction, alteration, repair, improvement, enhancement, or embellishment of any part of the mortgaged premises and if such holder is not obligated to make such advance at the time such notice is received, then the lien of the mortgage for the unpaid balance of the advance so made shall be subordinate to a valid mechanic's lien for the work or labor actually furnished as specified in such notice.

. . . .

(F) This section is not exclusive, does not apply to any mortgage filed or recorded in conformity with section 1701.66 of the Revised Code, *and does not prohibit the use of other types of mortgages permitted by law.* OHIO REV. CODE § 5301.232 (1967 CCH ADVANCE SESS. LAWS, SENATE BILLS 605-07 (effective Nov. 24, 1967)), *amending* OHIO REV. CODE ANN. § 5301.23 (Page 1962) (emphasis added).

make sure that the money which it disburses will be used in the construction of the building, the purpose for which it was intended.

Though the *Wayne* court concerned itself with the obligatory-nonobligatory distinction of the mortgage, it seems apparent that the court was stretching the facts in order to avoid the clearly unjust result which Ohio's peculiar statutory scheme would have dictated. Rather than attempt to construe an apparent obligation as optional, the courts should be able to make the decision reached in *Wayne* on the basis that the monies were improperly disbursed so as to deprive mechanics' lienors of their fair compensation. But only if the legislature further clarifies the mortgage statutes by setting out a pattern of disbursement characteristics for *all* mortgagees, can the courts place their decisions on such sound legal grounds.

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