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Mortgages--Mortgage of a Vendee's Interest in an Installment Land Contract--Mortgagee's Rights upon Default--Fincher v. Miles Homes of Missouri, Inc.

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When the issue is next presented to a Missouri court it might heed the words of Charles T. McCormick writing in 1925:

> The ancient weapons, reshaped though they have been in the attempt to fit them for modern uses, will at some future day, one conjectures, be altogether thrown aside. [T]he law of landlord and tenant will be assimilated to the law of contracts generally.... No less certainly the logic, inescapable according to the standards of a "jurisprudence of conceptions," which permits the landlord to stand idly by the vacant, abandoned premises and treat them as the property of the tenant and recover full rent, will yield to the more realistic notions of social advantage which in other fields of the law have forbidden a recovery for damages which the plaintiff by reasonable efforts could have avoided.[91]

CHARLES F. MILLER

MORTGAGES—MORTGAGE OF A VENDEE'S INTEREST IN AN INSTALLMENT LAND CONTRACT—MORTGAGEE'S RIGHTS UPON DEFAULT

Fincher v. Miles Homes of Missouri, Inc.[1]

On May 11, 1967, Lester Stacey entered into a contract to purchase land from Jaurel Fincher for $1,200. A downpayment of $200 was to be followed by monthly installments of $47.50. One week later Stacey purchased pre-cut home materials from Miles Homes of Missouri, Inc. (Miles Homes) and executed a promissory note secured by a deed of trust on the tract of land described in the land contract. This deed of trust was recorded in June, 1967. In May, 1972, Stacey was unable to make further payments on the land contract. At Fincher's request Stacey signed a preprinted statement on the land contract which acknowledged his default and forfeiture of any remaining interest in the land. Fincher took possession of the land and in September, 1973, instituted a suit to quiet title in himself, naming Miles Homes and Stacey as defendants.

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91. McCormick, *supra* note 10, at 222.

1. 549 S.W.2d 848 (Mo. En Banc 1977).

The trial court found that Stacey did not have a mortgagable interest in the land and impressed the tract with an equitable lien[2] in favor of Miles Homes. The Springfield District of the Missouri Court of Appeals held that Stacey had the right to execute the deed of trust on his interest in the land. It affirmed the decision of the trial court, however, by holding that the mortgagee's (Miles Homes) rights were extinguished when the mortgagor (Stacey) surrendered his rights under the land contract. The case then was transferred to the Missouri Supreme Court which reversed the court of appeals and held that the action of Stacey in releasing his interest under the land contract did not terminate the rights of Miles Homes under that contract. The court made a specific finding that the vendor (Fincher) had actual knowledge of Miles Homes' deed of trust.[3] Consequently, because Miles Homes had not been notified by Fincher of Stacey's upcoming forfeiture, Miles Homes' rights under the deed of trust were not terminated.

The installment land contract is a land financing device used as a substitute for a mortgage or deed of trust.[4] The vendee goes into possession and makes payments according to the contract terms, but legal title to the land remains in the vendor. Upon receipt of the final payment, the vendor executes a deed to the vendee. The installment contract has been favored by some vendors as a means of avoiding the expense and delay in enforcing their rights under other financing methods. The main attraction of the installment land contract from the vendor's point of view has been that the vendee in default forfeited all his interest in the land.[5] If the vendee failed to make payments the vendor regained possession of the land and also retained all of the vendee's prior payments. As an installment contract nears completion, this type of forfeiture is difficult to distinguish from a penalty. Therefore, although some states still permit forfeiture, the trend has been to treat installment land contracts as mortgages, affording many of the traditional substantive rights granted mortgagors to vendees. Depending on the jurisdiction, defaulting vendees have been granted various remedies. Missouri courts have granted the right to specific performance upon tender of the balance of the purchase price.[6] Other courts have permitted the vendee to cure his default by paying arrearages on the con-

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2. *Id.* at 849. The equitable lien was in the amount of $1,883.03 whereas $3,988.76 was still due Miles Homes on the note.

3. *Id.* at 857.

4. G. NELSON & D. WHITMAN, REAL ESTATE FINANCE AND DEVELOPMENT 44 (1976).

5. Porter, *Installment Contracts for the Sale of Land in Missouri,* 24 MO. L. REV. 240 (1959); Warren, *California Installment Land Sales Contracts: A Time for Reform,* 9 U.C.L.A.L. REV. 608 (1962).

6. Key v. Gregory, 553 S.W.2d 329 (Mo. App., D. Spr. 1977); Nigh v. Hickman, 538 S.W.2d 936 (Mo. App., D.K.C. 1976).

tract.[7] In addition, courts have imposed the traditional mortgagor's remedy of a public foreclosure sale.[8]

In *Fincher* the Missouri court recognized that a vendee can mortgage his interest in an installment land contract.[9] The rights and protections due the mortgagee when the vendee-mortgagor defaults on the underlying installment land contract are the issues presented in this note.

In order to preserve his rights to notice of an imminent forfeiture, the vendee's mortgagee must give the vendor notice of the mortgagee's interest.[10] Several states have held that the mortgagee gives sufficient notice of his interest to the vendor if the mortgage has been recorded.[11] These states follow a constructive notice rule which is based either on an interpretation of the state forfeiture statute or on a combination of general principles of equity and the state recording statute. Another line of authority has held that the vendor's duty to notify the mortgagee of an upcoming forfeiture arises only if the vendor has actual notice of the mortgage.[12] A mortgagee who merely had recorded his mortgage would be unable to have a forfeiture set aside on the ground that he had had no notice. To protect himself, the mortgagee must give actual notice of his interest to the vendor.

In *Fincher* the Missouri Supreme Court did not determine whether Missouri should adopt the actual or constructive notice rule. The court found that the vendor had actual knowledge of the interest of the mortgagee. The court noted that the mortgage had been recorded,[13] but the opinion emphasized the actual knowledge of the vendor. This may be an indication of the potential for the future selection of the actual notice rule in Missouri.

The better policy would be to protect the mortgagee's interest if the mortgage has been recorded.[14] If the burden of providing actual notice to the vendor is placed on the mortgagee and the mortgagee fails to

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7. MINN. STAT. § 559.21 (Supp. 1977).

8. Skendzel v. Marshall, 261 Ind. 226, 301 N.E.2d 641, *cert. denied,* 415 U.S. 921 (1973); Powell, *Reforming the Vendor's Remedies for Breach of Installment Land Sale Contracts,* 47 So. CAL. L. REV. 191 (1973).

9. *See also* Lewis v. Gray, 356 Mo. 115, 201 S.W.2d 148 (1947); 59 C.J.S. *Mortgages* § 75e (1949).

10. *Contra,* Miles Homes, Inc. of Iowa v. Grant, 257 Ia. 697, 134 N.W.2d 569 (1965) (Iowa statute interpreted as never requiring the vendor to notify the mortgagee of an upcoming forfeiture).

11. Davis v. Milligan, 88 Ala. 523, 6 So. 908 (1889); Stannard v. Marboe, 159 Minn. 119, 198 N.W. 127 (1924); Simonson v. Wenzel, 27 N.D. 638, 147 N.W. 804 (1914).

12. Kendrick v. Davis, 75 Wash. 2d 456, 452 P.2d 222 (1969).

13. 549 S.W.2d at 850.

14. Comment, *Mortgages—Notice—Vendor and Purchaser—Vendor Not Charged With Constructive Notice of Subsequent Mortgage of Contract Purchaser's Equity—Mortgagee Required to Notify Vendor to Protect Security Interest,* 45 WASH. L. REV. 645 (1970).

prove such notice, his rights will be lost. As one commentator pointed out: "It would be far more equitable to place a burden of notification on the party who seeks to extinguish the rights of another completely, than to penalize for failure to give notice one who seeks only the opportunity to perform obligations under the contract."[15] There are other reasons why the constructive notice rule would be preferable. When a vendor seeks forfeiture he usually consults an attorney. Mortgagees, however, quite commonly give and record mortgages without the benefit of counsel. The vendor's lawyer would have knowledge of a constructive notice rule and would search the record for potential mortgages. A mortgagee acting alone would lose his interest in the land by relying on the commonly accepted tenet that recording provides protection. Adoption of the actual notice rule would reward ignorance. A vendor who did not search the public record would be in a better position than one who checked the jecord and discovered the mortgage.

Despite Fincher's actual knowledge of Miles Homes' interest, he did not provide Miles Homes prior notice of the forfeiture. If a forfeiture occurred under circumstances giving the mortgagee the right to prior notice, courts have found that a forfeiture without notice does not impair the rights of the mortgagee.[16] There is a split of authority, however, as to what these rights are.

Although not discussed in *Fincher,* authorities in the field of land transactions have stated that the mortgagee of the vendee's interest should acquire rights analogous to those possessed by a second mortgagee in a normal first and second mortgage situation.[17] The vendor's right to payment under the installment contract would have priority over a mortgage of the vendee's interest and would be equated with a senior mortgage.[18] Therefore, if the mortgagee fails to receive notice of a forfeiture of the vendee-mortgagor's interest in the installment contract, his rights should be analogous to those of an omitted junior lienor (second mortgagee). It has been noted that there are two principal rem-

15. *Id.* at 654.

16. *See* First Mortgage Corp. of Stuart v. de Give, 177 So. 2d 741 (Fla. 1965); Stannard v. Marboe, 159 Minn. 119, 198 N.W. 127 (1924); Sinclair v. Armitage, 12 N.J. Eq. 174 (1858); Knauss v. Miles Homes, Inc., 173 N.W.2d 896 (N.D. 1969); Simonson v. Wenzel, 27 N.D. 638, 147 N.W. 804 (1914); Sheehan v. McKinstry, 105 Or. 473, 210 P. 167 (1922); Kendrick v. Davis, 75 Wash. 2d 456, 452 P.2d 222 (1969); Norlin v. Montgomery, 59 Wash. 2d 268, 367 P.2d 621 (1961). As to the effect of an intervening vendee, see Houghton v. Allen, 75 Cal. 102, 16 P. 532 (1888); Houghton v. Allen, 2 C.U. 780, 14 P. 641 (1887) (court refused to preserve the mortgagee's rights). *But see* Davis v. Milligan, 88 Ala. 523, 6 So. 908 (1889); Sinclair v. Armitage, 12 N.J. Eq. 174 (1858).

17. Nelson & Whitman, *The Installment Contract—A National Viewpoint,* 1977 B.Y.U.L. REV. 573 (1977). In the usual mortgage situation the mortgagor has title to the land which is security for two mortgages.

18. *Id.* at 574. *See also* Knauss v. Miles Homes, Inc., 173 N.W.2d 896, 904 (N.D. 1969) (Teigen, C.J., dissenting).

edies available to a junior lienor who has not received notice of default of the senior mortgage or of the resulting foreclosure.[19] These available remedies, foreclosure and redemption, permit the omitted lienor to protect his interest in the land.

In foreclosure the first sale (where the junior lienor was omitted) is ignored, and the land is sold at auction subject to the revived senior mortgage. The purchaser at the first sale loses title to the land but is deemed the holder of the revived senior mortgage. The purchaser at this second sale takes the land subject to the revived senior mortgage. Proceeds from the second sale go to pay the junior lienor, to the extent of his interest in the land.

Under the redemption remedy the junior lienor must tender the balance which was due on the senior mortgage at the time of the foreclosure sale of which he had no notice. This is paid to the purchaser at that sale and an assignment of the "revived" senior lien to junior lienor is compelled. The junior lienor then owns two mortgages, either of which may be foreclosed upon default of the purchaser. The junior lienor does not acquire title to the land under either option unless he is the high bidder at his own foreclosure sale.

The remedies available to the junior lienor can be overcome by the purchaser at the first sale (who usually is the senior mortgagee). The senior mortgagee[20] can overcome the junior lienor's remedies by invoking his superior rights[21] of reforeclosure or redemption down. Under reforeclosure the land again is sold, but this time the senior mortgagee makes certain that all appropriate parties are joined. Proceeds from the sale go first to the purchaser at the first sale in the amount of the first mortgage, then to the junior lienor in the amount of his lien, with any surplus going to the prior purchaser. In order to redeem down, the purchaser at the first sale simply pays off the junior lien. Essentially, in both remedies the purchaser at the sale at which the junior lienor was omitted simply corrects the error at that initial sale. Thus, the rights of the omitted lienor *and* the purchaser at the first sale are protected.

These types of remedies can be adapted to the installment land contract situation. The vendor's interest under the installment contract would be viewed as a vendor's lien. This lien would have priority over the mortgage on the vendee's interest. The relationship between vendor and mortgagee would be like that of senior mortgagee and junior lienor. Under the omitted junior lienor remedies, the vendee's mortgagee would have the same two basic options.[22] The foreclosure option would

19. G. NELSON & D. WHITMAN, *supra* note 4, at 242-43.

20. If he was the high bidder at the prior foreclosure sale; the senior mortgagee enforces these rights as a purchaser.

21. For an explanation of why the senior mortgagee is able to overcome the remedies of the omitted junior lienor, see Nelson & Whitman, *supra* note 17.

22. Nelson & Whitman, *supra* note 17, at 574-75.

allow the mortgagee to foreclose on the revived vendee's interest. High bidder at the sale would acquire title subject to the vendor's right to payment under the installment contract.[23] The redemption option would require the mortgagee to pay the balance due on the defaulted land contract to the vendor or his successor. The mortgagee thus would acquire the vendor's rights under that contract as the vendor's assignee.[24] Title would be vested in the vendee subject to two liens. Both liens would be held by the vendee's mortgagee, one as the vendor's assignee and the other as mortgagee in the original mortgage transaction. This would enable the mortgagee to foreclose on either or both liens.

As in the mortgage situation, however, the successor to the vendee's interest[25] would have rights superior to those of the mortgagee and would be able to overcome these actions by the mortgagee. The vendee's successor could exercise reforeclosure (or the land contract equivalent thereof),[26] or he could redeem down. The first remedy probably would require a judicial foreclosure on the land, this time with all parties joined. Proceeds first would go to the vendor on the contract, then to the mortgagee, and then to the vendee or his successor in interest. Redeeming down would require the vendee's successor in interest to pay the balance owed by the vendee to the mortgagee. These remedies correct the omission of the mortgagee, and the transaction proceeds as if notice had been given correctly in the first instance. The rights of the mortgagee thus are protected upon default by the vendee.

Some jurisdictions have not adopted the first and second mortgage analogy to the installment land contract situation; these decisions indicate that the vendee's mortgagee can acquire title to the land simply by paying the vendor what is due under the installment contract.[27] Thus the mortgagee is allowed to acquire title to the property absent the functional equivalent of a foreclosure sale. While these decisions properly recognize that the mortgagee's rights should not be destroyed by his mortgagor's land contract forfeiture, they overcompensate in the remedy granted to the mortgagee. The intent of both the vendee-mortgagor and the mortgagee is that the mortgagee receive a security interest in the

23. "The mortgage lien was upon the contract of purchase, and entitled him to foreclose the mortgage, and have that contract sold for the satisfaction of the mortgage." Alden v. Garver, 32 Ill. 32, 36 (1863).

24. *See* Sinclair v. Armitage, 12 N.J. Eq. 174 (1858); Sheehan v. McKinstry, 105 Or. 473, 210 P. 167 (1922) (redemption remedy granted).

25. The vendee's successor is analogous to the purchaser at a first mortgage foreclosure sale of which the second mortgagee had no notice. He is the person holding title to the land after the vendee has lost his rights under the contract. This would be the vendor unless forfeiture involved the functional equivalent of a foreclosure sale wherein a third party outbid the vendor.

26. *See* text accompanying note 6 *supra.*

27. First Mortgage Corp. of Stuart v. de Give, 177 So. 2d 741, 747 (Fla. 1965); Bank of Greensboro v. Clapp, 76 N.C. 482 (1877); Knauss v. Miles Homes, Inc., 173 N.W.2d 896 (N.D. 1969).

land. The above approach, however, allows the mortgagee to recover more than the value of his secured loan when the value of the land exceeds the sum of the amounts due on the mortgage and the installment contract. This is clearly erroneous.

An opposing line of authority has limited the mortgagee's recovery to the amount he was owed by the vendee-mortgagor.[28] These decisions require a foreclosure sale by the mortgagee. The vendor's rights are protected by using the proceeds of the sale first to pay off the land contract. A court also may require the mortgagee to pay the balance owed to the vendor on the land contract before allowing the mortgagee to conduct a foreclosure sale.[29]

In *Fincher* the Missouri Supreme Court, after determining that the forfeiture of the vendee's interest was improper absent notice to the mortgagee, gave the vendor two choices.[30] The vendor (Fincher) could permit the mortgagee (Miles Homes) to cause a foreclosure sale of the land. Proceeds first would go to satisfy the amount due Fincher on the installment contract.[31] Miles Homes then would receive proceeds up to the amount secured by its deed of trust. Any remaining funds would go to Fincher who, as successor to the interests of the vendee, acquired the equitable interest in the land held by Stacey (the mortgagor-vendee). The second option open to the vendor was to pay the vendee's debt to the mortgagee. Fincher then would take unencumbered title to the land.

The *Fincher* court's remedies are consistent with use of the first and second mortgage analogy. A senior mortgagee would have reforeclosure and redemption down as possible alternatives to cure the omission of the junior lienor. The Missouri court essentially gave these same alternatives to the installment contract vendor in *Fincher.* Because the rights of the vendor would be superior to the mortgagee's rights of redemption and foreclosure under the first and second mortgage analogy, the court was justified in speaking only in terms of the vendor's rights.

The decision in *Fincher* establishes that the interest of a vendee in an installment land contract is mortgagable in Missouri. Although the standard for giving the installment contract vendor notice of such a mortgage was not prescribed, there are indications in the opinion that the court would favor an actual notice requirement. The better policy arguments, however, favor a constructive notice standard. The most important aspect of this decision was the means used to protect the installment contract mortgagee's rights when he has not received prior notice of a forfeiture. The court properly limited the mortgagee's recovery to

28. Sheehan v. McKinstry, 105 Ore. 473, 210 P. 167 (1922); Norlin v. Montgomery, 59 Wash. 2d 268, 367 P.2d 621 (1969).

29. *Id.*

30. 549 S.W.2d at 857.

31. *Id.* at 857. The first proceeds actually would go to pay the administrative costs of conducting the sale.