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Security Devices

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I. FEDERAL TAX LIENS

In *United States By and Through I.R.S. v. McDermott*,[1] the United States Supreme Court held that a federal tax lien had priority over the lien of a previously filed judgment as to property thereafter acquired by the debtor. The logic of the Court was that, while it is true that the lien given for federal taxes is not "effective . . . against . . . judgment creditors until notice is given" by filing[2] and that the doctrine of "first in time, first in right" ordinarily applies in determining priority in the absence of clearly defined statutory provisions to the contrary,[3] in dealing with the tax liens, a state lien is not entitled to priority until it is "perfected." For this purpose, perfection requires not only that the lien be filed but also that it identify lienor, the property subject to the lien, and the amount of the lien.[4] Since the "identity" of the property was not known until the debtor acquired it, the judgment creditor's lien was not perfected until then. This occurred, the court declared, after "notice" of the federal lien had been filed. Ergo, the tax lien had priority.[5] There do not seem to be any factors that could distinguish Louisiana judicial mortgages from the Utah judgment lien before the Court. More disturbingly, the provisions regulating the priority of tax liens apply not only to judgment creditors but also to any purchaser, holder of a security interest, or mechanic's lienor.[6] Section 6323 of the Internal Revenue Code, regulating federal tax liens, has a number of express exceptions and qualifications to the general proposition enunciated by the Court.[7] Constraints

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* Thomas A. Harrell, Campanile Professor of Law and Director, Louisiana Mineral Law Institute.

1. 113 S. Ct. 1526 (1993).
2. 26 U.S.C. § 6323(a) (1988).
3. *McDermott*, 113 S. Ct. at 1528.
4. *Id.*
5. The Court did not deal with the question of how notice that a lien exists over the property is given by filing against someone who is not the owner of the property and at that time has no intention of acquiring it. Nor did the court provide a reason why, if notice only that the debtor's present and future property is encumbered is adequate for tax liens, the same test should not be applied to ordinary liens—other perhaps than the fact that the government wins if the latter is not sufficient. The court admitted that both liens "attached" at the same time. "Like the state lien, it applied to the property at issue here by virtue of a (judicially inferred) after-acquired-property provision, which means that it did not attach until the same instant the state lien attached . . . and, like the state lien, it did not become 'perfected' until that time. We think, however, that under the language of § 6323(a) ('shall not be valid as against any . . . judgment lien creditor until notice . . . has been filed'), the filing of notice renders the federal tax lien extant for 'first in time' priority purposes regardless whether it has yet attached to identifiable property." *Id.* at 1530.
6. 26 U.S.C. § 6323(a) (1988).
7. 26 U.S.C. § 6323 (b) and (c) (1988).

of space do not permit an extended discussion of their effect upon the decision under consideration at this time. Suffice it to say now that the reasoning of the court that for a previously filed encumbrance to be "perfected," and thus have priority over a subsequently filed federal lien, it must not only identify the property it affects, but "the amount of the lien" is broad enough to include in its net, not only mortgages and privileges covering after acquired property, but also such encumbrances covering future obligations.

II. MORTGAGES

A. *Identity of the Mortgagor*

When a less than complete name of the mortgagor will invalidate recordation of a mortgage continues to plague the courts. In *Three Rivers Farm Supply, Inc. v. Webber*,[8] a default judgment against "E & D Greene" was filed in the mortgage records. The plaintiff apparently later discovered the deficiency in his judgment and filed an "amended petition" in the same action "to add as defendants Mrs. Emmitt Green and Dwayne Greene doing business as 'E & D Greene.'"[9] A second default judgment against the defendants in the manner prayed for was obtained and recorded by the plaintiff. The first judgment was indexed under the "E's" as "E & D Greene." Apparently, a notation was also entered under "G" as "Green, D & E." The second judgment was indexed under the names of the parties. Between the time the two judgments were recorded, the Concordia Bank & Trust Co. took a mortgage on some property from "various members of the Greene family" among whom, apparently, was Elzy Dwayne Greene. Some four years later, the bank requested a mortgage certificate in various names, including "Emmitt," "Elzy Dwayne" and "Dwayne" Greene. The clerk's certificate showed both judgments.

The plaintiff then filed a "mandamus action" against the clerk requiring him to erase from his certificate the first judgment, which ultimately was granted. The judgment creditor was also joined in the action. The judgment creditor first argued that the second judgment, based upon an "amended petition," was retroactive to the date of the original judgment, relying upon Article 1153 of the Code of Civil Procedure. The court properly rejected the argument. Whether or not an amendment or correction of a judgment is given retroactive effect, the fact remains that recording a judgment or other mortgage that does not adequately identify the mortgagor is not effective against third persons whether or not it is effective between the parties. The appellate court then held that the first judgment was not sufficient to serve as "notice" to third persons. The court relied upon two basic

8. 617 So. 2d 1220 (La. App. 3d Cir. 1993).
9. *Id.* at 1221.

factors in support of its conclusion. First, it distinguished those cases in which the courts have upheld, as adequate, use of a full name and middle initial, and implied that simply using initials was inadequate. Second, it thought the name "E & D Greene" without periods and with the ampersand, under contemporary usage, is a form "seldom used in reference to individuals," and thus, presumably implied that the judgment was rendered against some form of artificial entity. The court also refused to consider the applicability of Louisiana Revised Statutes 9:2728(A)(2) which, although described as "remedial legislation" in Section 2 of the act adopting it, could not, in the opinion of the court, retroactively be made applicable to cause a mortgage, formerly inferior to a later recorded one, to become superior to it.[10] The case admittedly is a close one. The court did not believe it significant that the judgment in question was indexed by the clerk, not only as against an entity "E & D Greene," but also under the name of "Greene" as though they were individuals. Most telling of all for the creditor, however, is the fact that the clerk apparently identified the judgment as being one that possibly affected the landowners, when he prepared his mortgage certificate.[11]

B. Extinction by Dation and Intervening Encumbrances

Mortgages are extinguished "[b]y confusion as a result of the obligees acquiring the ownership of the thing mortgaged."[12] In *Hibernia National Bank v. Continental Marble & Granite Co.*,[13] Hibernia National Bank made several loans to Continental Marble and Granite Co. which were secured by the mortgages

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10. *See* 1987 La. Acts No. 750, § 2. The court's determination in principle appears to be correct. However, there would seem to be no reason why mortgages which might be validated by Act 750 as containing a sufficient designation of the parties should not become effective as to third persons on the effective date of the provision. If such a document were refiled on the day Act 750 became effective, it would certainly prime subsequently filed documents. Since it is already recorded, it would be proper to hold the description adequate from that day. The court notes that the act also now requires the mortgagor's taxpayer identification number to be shown on all documents. However, it does not require the clerk or recorder to index the documents by those numbers. If the document does not adequately identify the debtor by his name, then theoretically at least, it does not put one on notice to investigate his identity. If it does, the "I.D." number may permit easier identification. But should its absence relieve the investigator from otherwise checking the mortgagor's identity?

11. Technically, it is difficult to see how a mandamus action lies to order the clerk to erase a notation from his certificate that there is a judgment of record against the judgment debtor, when such is in fact the case. The proper course would be to bring suit against the clerk and judgment creditor to erase the judgment from his records. Removing it from the certificate does not erase it from the records. Nor is the judgment ordering it erased from the certificate technically res judicata against anyone else who may deal with the property. Suppose the clerk shows it on the certificate again, before someone purchases the property. May they blithely ignore a statement by the recorder that this is a mortgage that affects the property? It is, after all, the responsibility of the clerk to make that determination, and if he does so, why does that not at least warn the persons receiving the certificate that the mortgage is there?

12. La. Civ. Code art. 3319(2).

13. 615 So. 2d 1109 (La. App. 5th Cir. 1993).

over several tracts of land.[14] On August 3, 1987, Continental transferred the property to Hibernia in settlement of part of the loans by a dation en paiement. There were then no encumbrances of record against the property. Two days later, on August 5, at 10:50 a.m., Hibernia filed the dation. Forty-nine minutes earlier, Doyle Coulon recorded a judgment against Continental. Apparently neither Continental nor Hibernia knew the Coulon judgment was recorded.[15]

Hibernia then sued to have the dation declared invalid for error of consent and cause on the grounds that it bargained to have the immovable transferred to it free and clear of encumbrances.[16] It also argued that the dation was not effective until recorded, and since an encumbrance existed at the time of recordation,. error rendered the dation void. This was properly rejected on the grounds that recordation does not create rights between the parties but merely extends to third persons the effect of rights which exist between the parties. The court then noted that, when the dation was executed, there was no encumbrance against the property. Accordingly, the court held there was no error which would invalidate the dation.[17]

Finally, Hibernia asserted that the mortgage was not extinguished by confusion because Hibernia did not receive "unencumbered" title. The court, citing Louisiana Civil Code articles 1903 and 3411, reiterated that when the dation was executed, "Hibernia . . . received unconditioned ownership of the property. Thus, by operation of law, the two collateral mortgages were extinguished by confusion."[18] This is subject to question. Ordinarily, if one who owns a real right over property acquires the property, the right is extinguished by confusion. However, if the property is subject to an intervening right, such as a mortgage, right of redemption, or claim by a third person, that subsequently divests the owner of his property, the real right is restored or revived. *Pugh v. Sample*[19] is perhaps the best exposition of the principle. In that case the holders of a judicial mortgage attempted to execute upon their judgment by a hypothecary action, praying that the defendant, who had acquired the property by a dation in settlement of his first mortgage, could not assert a claim to the proceeds by virtue of the mortgage because it has been extinguished by confusion. In rejecting the contention, the court said:

> [While] one cannot be, at the same time owner and mortgagee of the same property, if the title which, apparently conveying perfect ownership, is supposed to destroy the mortgage, by confusion turns out to be no title, or an imperfect title, the mortgage, which was suspended, and apparently

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14. Actually, they were secured by the pledge of collateral mortgage notes. For purposes of this discussion of the case, the distinction is of no consequence.

15. The opinion does not disclose whether the parties were aware of the existence of the judgment when the *dation* was executed. One would at least assume Continental was aware it had been sued and an executory judgment was in existence.

16. *Hibernia*, 615 So. 2d at 1110.

17. *Id.* at 1111.

18. *Id.* at 1112.

19. 123 La. 791, 49 So. 526 (1909).

> destroyed, upon the assumption of perfect ownership in the mortgagee, is revived; the cause of the supposed destruction no longer existing. . . . And so, in the instant case, if the defendant did not, by virtue of the conveyance to him get a perfect, unincumbered title to the property in question, his mortgage was not destroyed by confusion.
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> If he did get such a title, then the property is not incumbered by the judicial mortgage set up by plaintiffs.[20]

In the case of mortgages, application of the principle involves a problem that was not dealt with in *Pugh*, namely that even if the first mortgage is not extinguished, or is only provisionally extinguished by confusion, the debt it secures has been extinguished. Therefore, unless a mortgagee, such as Hibernia, can rescind the contract in its entirety and revive both the obligation and the mortgage securing it, it would have had no basis for asserting the provisional extinction contemplated by *Pugh*.[21] This, of course, is what Hibernia was trying to do. The court, however, could see no breach of warranty because, when the dation was made, there was no encumbrance against the property.

Louisiana Civil Code articles 2500 to 2503 do more than provide for a warranty of title. They establish the basic principle that the seller is obligated, in good faith, to deliver and maintain the buyer in possession of the thing he sells, unless the buyer intentionally assumes all or some particular risk of eviction. Article 2504 unequivocally declares that even in cases where warranty is dispensed with, the seller is nonetheless "accountable for what results from his personal act, and any contrary agreement is void."[22] This accountability is tempered only by the general proposition that the parties shift the burden of particular risks by disclosing them or agreeing that the land is transferred "subject to them." What Article 2504 prohibits is a general waiver of responsibility by one who sells something that he does not own or that is encumbered because he himself has made the transfer or caused the encumbrance.[23] The article also is modified by Article 2502 which requires that the "right of the person evicting shall have existed before the sale," and stipulates that the buyer has no complaint, if the "right before the sale was only imperfect and is afterwards perfected by the negligence of the buyer."[24] Hibernia claimed that it was not negligent in delaying recordation of the dation for a day and a half. The court agreed, but rejected the contention as being irrelevant,

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20. *Id.* at 797-98, 49 So. at 528-29.

21. If, for example, the sale of the property did not bring enough to satisfy the mortgage debt as it existed at the time of the *dation*, could the mortgagee hold the debtor for the deficiency? Suppose the *dation* had been made "without warranty"? If he cannot establish the obligation still exists, how can he claim any of the proceeds?

22. La. Civ. Code art. 2504.

23. This statutory prohibition must be distinguished from a "quit claim" in the true sense of a contract that is not intended to transfer ownership, but instead, is intended to abandon or relinquish a doubtful claim to a thing possessed by another.

24. La. Civ. Code art. 2502.

declaring that while the day and a half might be reasonable, it "still functions as a window in time during which the purchaser risks that someone may file an encumbrance against the immovable . . . and that Coulon's judgment must be recognized and *follows the immovable into Hibernia's hands.*"[25] There is, of course, no doubt that Coulon's judicial mortgage was superior to that of Hibernia. That is not the point. The question is whether the existence of the judgment and its recordation before the dation represents a breach of the seller's warranty of peaceful possession under Article 2501. The emphasized language of the opinion tacitly acknowledges that the source of the trouble was a claim arising with Continental, the seller. Article 2502 recognizes that the right of the person evicting the buyer may exist, and yet not be "perfected" at the time of the sale. Coulon's judgment existed before the sale and, although not then "perfect," was perfected against Hibernia before it obtained indisputable title. The eviction did not occur because of the negligence of Hibernia. Therefore, Hibernia would seem to have sufficient cause to rescind the dation. If this occurs, its mortgage should be reinstated and be superior to that of Coulon.

For many years it has been "hornbook" law that one should not purchase or take a mortgage upon immovables in this state unless the title is examined down to the very instant that the transaction is to become effective. This case provides one more illustration of the continued importance of that practice.

C. Effect of Dedication to the Public of Mortgaged Property

In *Newman v. Livingston Parish Police Jury*,[26] a subdivider mortgaged land before the subdivision plat was filed. The mortgage recognized the mortgagor intended to subdivide and provided for the release of the lots upon payment of a fixed sum per lot. The land was subdivided, and some of the lots were sold and released from the mortgage. The mortgagor then defaulted, and the mortgagee executed upon the unsold part of the property had come into the hands of the plaintiffs. Amoco Oil Company began producing oil and gas lands adjacent to the subdivision that were unitized with the subdivision. It convoked a concursus to determine the ownership of the production allocated to the streets dedicated to the public through the defendant Parish when the subdivision was formed.

The court held the mortgage, being anterior to the filing of the plat dedicating the streets to the public, was superior to the rights of the Parish and remained an encumbrance on the entire property including the streets.[27] The court rejected the argument that references to the future subdivision of the land represented the consent that the streets pass into the public domain free of the mortgage. The question of interpretation is a close one, but there should be no argument that a

25. Hibernia Nat'l Bank v. Continental Marble and Granite Co., 615 So. 2d 1109, 1111 (La. App. 5th Cir. 1993) (emphasis supplied).

26. 603 So. 2d 250 (La. App. 1st Cir. 1992).

27. *Id.* at 253.

landowner cannot invalidate his mortgage merely by donating the mortgaged land to the public.[28]

D. Effect of Homestead Waivers in Some, but Not All Mortgages

In *Acadian Bank v. Foret*,[29] the plaintiff executed a mortgage that contained a homestead waiver. A judgment obtained against the defendants prior to the mortgage contained no such waiver. The defendants (landowners) argued that the proceeds should be distributed by giving them the first $15,000 for their homestead exemption, then paying the judgment creditor, and thereafter distributing the balance to the mortgagee. The court properly rejected the argument, reasoning that although mortgages without a waiver cannot encroach upon the homestead, the holder of a mortgage that does have such a waiver has the right to be paid out of the proceeds attributable to the homestead ahead of subsequent mortgages that do not.[30] The amount of the homestead exemption reserved to the owner thus goes to the highest ranking mortgagees whose mortgages contain such a waiver. This interpretation is eminently correct. The "waiver" of the homestead exemption does not create a "fund" separate and apart from the land which requires a separate encumbrance, it is merely an agreement by the debtor not to oppose it against the mortgagee.[31] The real question in the case at hand was whether a second mortgagee can claim the homestead against the first mortgagee and thus receive ahead of him in the distribution of the proceeds of the sale. The court held, in effect, that he may. The holding is solid, since by waiving the homestead in the second mortgage the mortgagor consented that all of the proceeds of the sale would be dedicated to payment of the debt. The first mortgagee comes ahead of the second only to the extent that he has a superior claim to those proceeds of the sale. If the mortgagor does not waive the homestead in the first mortgage he has inferentially reserved the exempt portion for himself vis-a-vis that mortgagor, but having consented that they be used to satisfy the second mortgage, they should so be used.[32]

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28. The court did not consider what the status of the roads was vis-a-vis the owners of the lot that had been sold. Presumably the property was sold free of the subdivision plat and the dedication of the streets it contained. If this be true, the streets became non-existent and the lots that had been sold became enclosed estates. Nor does it appear from the opinion that the State was made a party to, or served with notice of, the proceedings executing upon the land. One would assume this would have been mentioned by the court had it occurred. It was, after all, the ownership of the land itself that was at issue, not just the right to the minerals produced from it.

29. 602 So. 2d 1097 (La. App. 1st Cir. 1992).

30. The court relied upon Harvey v. Thomas, 239 La. 510, 119 So. 2d 446 (1960) and Bank of Erath v. Broussard, 161 La. 657, 109 So. 347 (1926).

31. The defendants argued that an assignment or transfer of their right to claim the homestead against the first mortgagee would be required for the second mortgagee to claim the proceeds. The court responded that a waiver of the homestead exemption is an agreement with a mortgagee not to claim the homestead against that mortgagee. *Acadian Bank*, 602 So. 2d at 1098.

32. A contrary argument could be made that while the owner could not assert the homestead

E. Right of to a Single Executory Proceeding Under Several Mortgages

The petitioner's recovery in an action for executory process is limited to satisfying an obligation upon which judgment has been confessed out of property over which a mortgage or privilege exists as security for that obligation. To obtain further relief, if the proceeds realized are insufficient to satisfy the entire obligation, the creditor must resort to an ordinary suit. Furthermore, no proof is allowable in an executory proceeding of any obligation other than that upon which judgment has been confessed.[33] These limitations appear to have caused considerable difficulty recently. In *Rhodes v. Gulfco Finance Co.*,[34] plaintiffs originally owed defendant two separate obligations secured by separate mortgages upon separate immovables. Defendant apparently released the mortgage securing one of the obligations, without exacting payment in full. Later, the defendant brought proceedings for executory process upon the note still secured by the mortgage. At the sale of the property, defendant entered a bid in excess of the obligation secured by the mortgage. It then refused to pay the excess over, claiming that it could be applied to the other note.[35] The court properly rejected the claim, but for the wrong reasons.

The court stated that while the action was not one for a deficiency judgment, "it is, however, related to an executory proceeding in the same way that a deficiency judgment action is."[36] The court then considered the evidence presented at the hearing on the matter to determine whether the amount was actually owed to the defendant. The court declared that the "plaintiffs cannot assert in this separate action, minor procedural defects in an attempt to invalidate the sheriff's sale. They can, however, submit proof of facts which evidence a modification or extinction of their debts to Gulfco."[37] The fact of the matter is, however, that in the executory proceedings, Gulfco could not have "proven" any indebtedness, save that upon which the plaintiffs had confessed judgment and upon

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against the second mortgagee, since the homestead exemption is personal to the owner, the second mortgagee should not be permitted to assert it against the first. But, of course, then the first mortgagee could not resist allowance of the homestead to the owner, creating a form of "circular" priority. The court's solution appears to be the preferable one.

33. "Executory proceedings are those which are used to . . . enforce a mortgage or privilege . . . importing a confession of judgment . . . ." La. Code Civ. P. art. 2631. "An act evidencing a mortgage or privilege imports a confession of judgment when the obligor therein acknowledges the obligation secured thereby . . . and confesses judgment thereon . . . ." La. Code Civ. P. art. 2632.

34. 610 So. 2d 1073 (La. App. 3d Cir. 1992).

35. The mortgage that remained unreleased secured a note for something over $21,000. The other debt, also represented by a note, carried a balance of something over $10,000. The attorney filing the action through some sort of clerical error brought his suit on the wrong note praying that the property be sold to satisfy the obligation. The property was bid in by the defendant for $21,000, the amount of the note that actually was secured by the mortgage. Plaintiffs demanded of the sheriff the excess of the amount remaining over the amount due on the note which was actually the object of the executory proceedings and which, after costs, amounted to over $7,000. *Id.* at 1075.

36. *Id.* at 1076.

37. *Id.*

which the writ to the sheriff issued. It is true that one who has an inferior mortgage or privilege over the thing sold in an executory proceeding may assert his claim against the proceeds as long as they are in the hands of the sheriff. However, he must have a claim authorizing retention of the proceeds. Without a privilege, or a judgment authorizing seizure and sale of the defendant's assets, upon what grounds can the plaintiff in the executory proceedings, or a third person assert that he has any more right to seize the proceeds in the hands of the sheriff than he would if they were in a bank?

The only conceivable defense to the plaintiff's obligation to pay the balance of the purchase price over that owed to the creditor under the writ is that it has been extinguished by compensation because the debtor owes him an equally liquidated sum. Since this was not raised by the parties or discussed by the court, it can await discussion for another day.

The same basic problem, i.e., a creditor's attempt by executory process to divert funds secured by a mortgage to another debt not so secured, was raised in *First Federal Savings & Loan Ass'n v. Moss.*[38] The plaintiff, proceeding by executory process against several tracts, part of which were covered by a mortgage securing an obligation and another part of which were covered by another mortgage securing a different obligation, had the lots appraised and sold "in globo." The supreme court concluded that the procedure was improper. Each mortgage secured a separate debt, and, therefore, the parties "entered into two entirely separate transactions: two ordinary mortgages, with each mortgage securing only one specific debt."[39] It distinguished the case of *First Bank of Natchitoches & Trust Co. v. Chenault,*[40] which approved an "in globo" sale of lands covered by two separate collateral mortgages securing separate notes that had both been pledged to secure all of the obligations owed by the pledgor to the pledgee. In that case, the court said each collateral mortgage note was pledged to secure the entire debt.[41] In *Moss*, mortgage note was secured only by the lands covered by the mortgage securing it. In such a case, the lands could not be sold together in an executory proceeding.

The court in *Moss* correctly notes that the matter is predominately one of substantive, not procedural, law. Executory process is not execution upon a

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38. 616 So. 2d 648 (La. 1993).

39. *Id.* at 655.

40. 576 So. 2d 1123 (La. App. 3d Cir. 1991).

41. This statement, while correct, overlooks the fact that the mortgages do not secure the entire debt, but only the notes which each was given to secure. For example, suppose A executes a mortgage covering Lot 1 to secure a $20,000 "collateral mortgage note" and also executes a separate mortgage covering Lot 2 to secure another similar note. He then pledges both notes to a bank to secure a loan of $30,000. He defaults. The bank executes separately upon the notes. Lot 1 sells for $25,000. Lot 2 only sells for $15,000. What authority would the bank have to "lump" the two together and assert a priority over the $5,000 received from the sale of Lot 1? The pledge of the notes may secure the entire debt of $40,000, but the mortgages only secure the collateral mortgage notes of $20,000 each. To the extent the proceeds from either lot exceed that amount, they represent funds not covered by mortgage. Compare that with the situation at issue in *Moss*.

mortgage; it is execution upon an obligation as to which the debtor has confessed judgment. A mortgage is but an accessory to the obligation it secures. The object of the action is to enforce the obligation. That obligation may be enforced by executory process only to the extent the debtor has confessed judgment upon it and then only to the extent a mortgage or privilege secures it. The writ to the sheriff in such a proceeding can only order the seizure and sale of the property covered by the mortgage or privilege to satisfy the obligation upon which judgment is confessed. When that is done, the sheriff's authority is exhausted. If funds are left in his hands after satisfying the judgment, the sheriff has no authority to do anything with the funds but pay them to the owner of the property he has sold, unless he is enjoined by one having a claim to or asserting a privilege on the proceeds by a writ of sequestration in another action, or is enjoined in some other way in a separate action filed for that purpose.[42] The sheriff is not to deliver the property to the purchaser until he collects the price at the sale (saving to the purchaser only the right to withhold the proceeds to satisfy a mortgage or lien superior to that of the seizing creditor).[43] If two mortgages are given to secure a single obligation (or the same obligations) and judgment is confessed in both of them, there is no reason why a single action for executory process should not be brought and the property covered by each seized and sold together and in globo. There is one debt secured by two mortgages. It is no different from having one mortgage affecting two separate tracts. Since each secures the same obligation, the writ may properly order all of the property sold to satisfy the obligation, enforcement of which is the object of the action.

F. Usufruct upon Proceeds from Sale of Property Covered by a Mortgage

Watson v. Federal Land Bank,[44] considered the question of whether a usufructuary or naked owner of property covered by a mortgage established before the usufruct was created is entitled to the surplus resulting from execution by the mortgagee on the entire property. The court, noting that the matter is not expressly covered by statute, considered Article 620 of the Louisiana Civil Code which states that execution of a mortgage placed on the property before creation of the usufruct terminates it, although the usufructuary may have a claim against the naked owner or creator of the usufruct.[45] It then noted that Article 615 establishes the general rule that the conversion of the property into money or some other form continues the usufruct over the converted property or funds. The court concluded that enforcement of the mortgage only terminates the usufruct under Article 620 to the extent that the proceeds are appropriated by the mortgagee and that the usufruct

42. La. Code Civ. P. art. 2373.
43. La. Code Civ. P. art. 2335; La. Civ. Code arts. 2609, 2611.
44. 606 So. 2d 920 (La. App. 3d Cir.), *writ denied*, 609 So. 2d 229 (1992).
45. La. Civ. Code art. 620.

continues as to the proceeds that remain in the sheriff's hands.[46] The case appears to be correct.

G. *Effect of Discharge in Bankruptcy*

Haeuser Insurance Agency, Inc. v. Campo[47] reaffirms the exception to the rule that a mortgage is not extinguished by the conventional transfer of the property by the debtor that was recognized in *Losavio v. Gauthier*[48] in cases where the debtor has been discharged in bankruptcy from personal responsibility for the obligation. In *Losavio*, the court held that while the debtor's discharge does not directly affect the validity of mortgages held by his creditors over the property, it does, in effect, "freeze" the creditor's rights in the property to the "equity" he possessed at the time of bankruptcy so that the creditor can collect no more out of property or from the debtor if the latter chooses to pay.[49] Otherwise, subsequent payments, discharging a prior encumbrance, would inure to the benefit of the creditor and indirectly frustrate the effect of the debtor's discharge.

III. SURETYSHIP

A. *Sureties Signing in "Representative Capacity"*

In *Homer National Bank v. Springlake Farms, Inc.*,[50] the court was faced with the frequent problem of a note signed on behalf of a corporation by its president, on the reverse side of which was a guaranty or suretyship agreement also signed by the president with his name followed by a comma and the abbreviation "Pres." The president argued that his signature on the guaranty was intended to be in a representative capacity only. The court observed that "a notation of corporate position on the guaranty may be merely a title identification instead of a signature in a representative capacity."[51] It then pointed to Louisiana Revised Statutes 10:3-403(2)(b) which, in the words of the court, establishes "a rebuttable presumption between the immediate parties [to an instrument] that the representative who signs his name in a representative capacity but does not name the person represented is personally obligated in the instrument."[52] The evidence showed

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46. *Watson*, 606 So. 2d at 922.

47. 606 So. 2d 582 (La. App. 5th Cir.), *writ denied*, 609 So. 2d 257 (1992).

48. 412 So. 2d 1306 (La. 1982).

49. *Id.* at 1311.

50. 616 So. 2d 255 (La. App. 2d Cir. 1993).

51. *Id.* at 257. The court relied on American Bank & Trust Co. v. Wetland Workover, Inc., 523 So. 2d 942 (La. App. 4th Cir.), *writs denied*, 531 So. 2d 282, 283 (1988) and Fidelity Nat'l Bank v. Red Stick Wholesale Music Distrib., Inc., 423 So. 2d 15 (La. App. 1st Cir. 1982) as authority for this proposition.

52. *Spring Lake Farms*, 616 So. 2d at 257. Strictly speaking, the section in question says such a presumption prevails if the instrument "does not name the person represented." In this case no one doubted that the guarantor was identified by the instrument as being the president of the maker.

there were no discussions between the parties as to the capacity of the guarantor. In the mind of the court, the most telling evidence against the president's argument was the fact that it is nonsensical for a principal to guarantee his own obligation.[53] The court properly held him to be personally responsible.[54] The plaintiff obtained his judgment over three and a half years after filing suit.[55] There is no substitute for having the identity and capacities of the parties to a contract positively identified in the instrument. The practice, caused by the existence of "all purpose" forms of referring to the parties as "the undersigned" and relying upon the signature to identify the "capacity" in which they signed the document is a fairly modern one that inevitably will cause controversy.[56]

B. Suretyship Distinguished from Other Arrangements

Whether a particular agreement is one of suretyship is difficult to determine, although the consequences of this contract can be significant. In *Birner v. City of New Orleans*,[57] the plaintiff was injured by what he claimed was a defect in the sidewalk in front of Loyola University's property. The trial court dismissed the action against Loyola on a motion for summary judgment, and the plaintiff appealed. After noting that the sidewalk was on the street adjacent to the university's land and finding that the defect was not caused by Loyola, the court held the university owed no duty to the plaintiff for the condition of the sidewalk.[58] Plaintiff, who was a student, also claimed that Loyola's representative had represented to her that Loyola would pay her medical bills resulting from the accident. While admitting that there was conflicting testimony as to whether such a promise was made, and whether the representative had authority to make it, the court held that the summary judgment was nonetheless appropriate because parole

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53. Nor did the defendant help himself by at first claiming the signature was a forgery and relenting only after the plaintiff's expert found to the contrary. The plaintiff also proved that the defendant showed the loan to the corporation as his personal contingent liability on financial statements submitted to others.

54. *Springlake Farms*, 616 So. 2d at 259.

55. The suit was filed in August 1989; rehearing was denied in the present case in April 1993.

56. The practice is an American phenomena. For example, a typical French or continental act, even if authentic in form, contains no "lines" for signatures or words identifying the parties who execute it, or the capacity in which they do so. Instead, there is merely a large blank space at the end in which everyone who is a contracting party, witness, or notary places his or her signature in no order or designation, leaving it to the instrument itself to provide the juridical significance of the name placed upon it. Arguments about the "capacity" in which one "signs" are thus almost non-existent in France. The signatures signify the individuals assent to the document. The document describes the extent to which that assent has effect. That procedure is perhaps too radical for American practice, but it does provide solid evidence that when one signs a document, and the party wishes to limit his participation, or to extend it only to one for whom he is acting, an affirmative statement to that effect in the agreement or document is infinitely preferable to some ambiguous designation after his name.

57. 619 So. 2d 723 (La. App. 4th Cir. 1993).

58. *Id.* at 725.

evidence is inadmissable to prove either an agreement to pay the debt of a third person, or a suretyship.[59] Therefore, "there were no genuine issues of fact . . . regarding Loyola's obligation to pay the debt of plaintiffs[, and] Loyola [was] entitled to judgment as a matter of law."[60]

A promise directly made to a person to reimburse him for expenses he has incurred to another is not the promise to pay the debt of a third person, nor is it a suretyship.[61] For either of these, the promise must be to, or for the benefit of the creditor, not the debtor. An unconditional promise to a creditor to pay the debt of another, or an assumption of the debt, is not a suretyship. A promise by *X* made to *Y* that he will pay a debt owed by *Y* to *Z* need not be in writing if the cause of the promise is such that it represents an onerous undertaking between *X* and *Y*. In other words, there is no difference in the nature of the contract if *X* promises *Y* that he will pay him a sum of money or discharge his obligation to another. Nor is such an agreement a suretyship. Nor is there any reason to differentiate a contract by which *X* unconditionally agrees with *Y* to pay *Z*'s debt, if the nature of the agreement is such that an agreement with *Y* to pay the same amount of money would be deemed binding upon *X*. The requirement for a higher degree of formality—i.e., a writing—essentially arises from the fact that ordinarily, an agreement by *X* with *Z* to pay *Y*'s debt is gratuitous as to *Z*.[62]

C. "Lender Liability" and Defenses "Unrelated" to the Principal Obligation

So-called "lender liability" claims, used as a defense to payment of obligations owed lenders, still attract attention, despite their abysmal record of success. One reason they continue to be raised, even when the facts supporting them are weak, is that the mere assertion of such a claim permits the defendant to delay the plaintiff in his claim and essentially buys the defendant time in which to arrange his affairs, or encourage settlement by the plaintiff.[63] Recent cases indicate the courts may

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59. *Id.* at 726.

60. *Id.*

61. The essence of a contract of suretyship is that it is a promise given to guarantee the obligations of another, not to undertake primary responsibility for them. La. Civ. Code art. 3035. With only a minor exception or two, if the suit is on a contract of suretyship, an indispensable allegation to the action is that there is another obligation owed by another person that is due and owing by that person.

62. An agreement to "indemnify" a person for expenses incurred to another is not viewed as an "assumption" of that liability (since there is no agreement to be bound directly to the obligor). The assumption of the obligation made with the obligor is treated as a form of "stipulation pour autri" in favor of the obligee. Articles 1821 and 1823 also distinguish an agreement to assume a person's obligation made with the obligor from one that is made directly with the obligee. Each requires that the contract be in writing for the creditor to enforce it. A writing is not required when the obligor attempts to enforce the assuming party's promise to the obligor to pay his debt. La. Civ. Code art. 1821. When the promise is made to the obligor, the requirement for a writing is unnecessary "when the promisor has a material interest in making the promise and receives consideration for it. . . . This article does not intend to change that approach." La. Civ. Code art. 1823, cmt. (b).

63. Since the beginning of time, the universal plea of the debtor, who admits he owes the money,

have recognized the imbalance in equity that too liberal an interpretation of the law favoring the debtor may cause.

In *Lakeside National Bank v. Vinson Brothers, Inc.*,[64] suit was filed against the debtors of the plaintiff and their sureties. The debtor filed a reconventional demand asserting damages on the grounds that the plaintiff breached its credit agreement with the defendant, and also that it arbitrarily refused to extend further credit to the defendant under the agreement, thus causing it damage. The sureties filed a separate reconventional demand for damages they allegedly suffered, claiming that the bank had fraudulently agreed to forebear suit and had engaged in abusive efforts to collect from the debtor. In essence, they alleged an officer of the plaintiff told one of the defendants that suit would not be filed, nor would enforcement efforts be directed against the sureties. They claimed that filing of the suit increased their costs and injured their reputations. Plaintiff filed an exception of no cause of action to the reconventional demand, which was sustained.

The court rejected the claim of the sureties that fraudulent misrepresentations made to the debtor corporation was a breach of the loan agreement on the grounds that it stated no cause of action. Instead, such actions were assertable by the corporation itself, not by its guarantors.

In *Premier Bank, National Ass'n v. Percomex*,[65] the plaintiff sued upon two notes secured by a collateral chattel mortgage on the borrower's inventory and other assets, suretyships by three guarantors, and a mortgage given by one of the guarantors on his residence.[66] In their answers, the defendant corporation and the surety who had given the mortgage asserted that the plaintiff negligently damaged the inventory and breached its implied obligation of good faith by refusing to give a promised extension of time to the debtor, and that but for such actions there would have been adequate collateral to pay the amounts due. All of the sureties joined in a reconventional demand containing the same allegations. The plaintiff then filed a motion for summary judgment asking for judgment on the notes and suretyship, claiming that the defenses asserted essentially were for unliquidated tort claims "none of which had anything to do with liability on the notes" and that, as such, they could not be used as compensation against the principal claim.[67] The trial court agreed and gave judgment against the defendants, preserving the reconventional demands for trial.

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is for more time in which to pay. A defendant who can, in good faith, file a defense to a suit and thus move the case from the default category or prevent the successful filing of a motion for judgment on the pleadings or summary judgment can, under the crowded trial dockets facing many of our courts, essentially buy a year or two of time, during which he can avoid even having to pay interest.

64. 607 So. 2d 1009 (La. App. 3d Cir. 1992).

65. 615 So. 2d 41 (La. App. 3d Cir. 1993).

66. The opinion does not make it clear whether the mortgage was given to secure the principal obligation of the defendant, or of the suretyship given by the mortgagor.

67. *Percomex*, 615 So. 2d at 42.

The appellate court, in affirming the judgment, noted that in *American Bank v. Saxena*,[68] the Louisiana Supreme Court held that summary judgment is the "appropriate procedural device to enforce a negotiable instrument when the defendant establishes no defense against enforcement."[69] Further, the appellate court in *Percomex* noted that when a plaintiff, suing upon a promissory note as holder, proves the maker's signature, or the maker admits it, the holder has made out his case by mere production of the note and is entitled to recover in the absence of any further evidence.[70] It therefore gave summary judgement on the notes and against the sureties relegating the reconventional demands to a later trial.

The consequences of these decisions for the sureties go far beyond the immediate questions at issue in them. By granting a summary judgment on the note, and treating the "defenses" asserted by reconventional demand as "unrelated" to the plaintiff's claim, first and foremost, the court made it possible for the creditor to proceed with an executory judgment pending determination of the merits of the defendants' claim for "lender liability." Assuming the court was correct (as it undoubtedly was) that a summary judgment is appropriate when the defendant admits his signature to a negotiable instrument and raises no affirmative defenses to his liability on the note, it would appear that to appeal a judgment rendered on the note on the basis of such evidence would be an extremely arduous task and could even expose the defendant and his attorney to the risk of sanctions. If execution of the judgment cannot be delayed or enjoined, one of the principal "levers" available to the defendant to force a settlement of his claim—that of delaying collection of the primary obligation—will have disappeared.

However, the surety is placed in an even more precarious position. If payment can be delayed by him until a judgment is rendered in favor of the debtor on his reconventional demand, the surety can plead that the principal obligation has been discharged to the extent compensation of the principal obligation occurs between the creditor and the principal obligor.[71] At the moment of compensation it is as though the debtor had paid the creditor the amount which the latter owes him. Consequently, if the creditor is successful in his claim against the debtor before the surety pays, the surety can claim a reduction of the debt by virtue of the compensation that would occur because both obligations would be equally liquidated.

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68. 553 So. 2d 836 (La. 1989).

69. *Percomex*, 615 So. 2d at 42.

70. *Id.* (citing Thomas v. Bryant, 597 So. 2d 1065 (La. App. 2d Cir. 1992)). The court also noted that once the plaintiff has met his burden of proof, the burden shifts to the defendant to prove the existence of a triable issue of fact. *Saxena*, 553 So. 2d at 845-46. *See also* Scafidi v. Johnson, 420 So. 2d 1113 (La. 1982); *Thomas*, 597 So. 2d at 1068 (proof can be established through parole evidence); Equipment, Inc. v. Anderson Petroleum, Inc., 471 So. 2d 1068 (La. App. 3d Cir. 1985) (the evidence must be admissible as a matter of law and must consist of specific factual details); and Louisiana Nat'l Bank v. Jumonville, 563 So. 2d 965 (La. App. 1st Cir. 1990) (parole evidence is not admissible to vary the terms of the instrument).

71. "Compensation between obligee and principal obligor extinguishes the obligation of a surety." La. Civ. Code art. 1897.

However, if the creditor's claim is reduced to judgment after the surety has paid the debt, the result is quite different and perhaps extremely detrimental to the surety.

The surety who has paid the debt is entitled to proceed directly against the principal obligor *on the principal obligation* either by way of subrogation to the guaranteed debtor or by means of a direct action for reimbursement on the obligation he has guaranteed.[72] There is no basis for the surety to claim that his payment of what was owed on the note of the debtor entitles him to any preference or subrogation to any obligation that the *creditor* might owe the debtor, even if they arise out of the transaction giving rise to the note. The claim for reimbursement or subrogation to the original obligation will give the surety no preference or privilege over the obligation of the former creditor to the debtor, and, for example, another creditor who seizes the claim, or a bankruptcy trustee, could assert priority over the surety.

On the other hand, if the claim of the debtor can be so fashioned as to reduce the amount owed by the debtor on the note or as a breach of the suretyship, the benefits can be directly claimed by the surety.[73] For example, in *Vinson Bros.*, mentioned above, the corporation asserted that the bank had "negligently" injured the inventory over which it had given the bank a security interest. This was held by the court to be a "claim unrelated" to the note. The "impairment of real security" held by the creditor as security for the debt will release the commercial surety to the extent he is injured by the actions of the creditor.[74]

72. La. Civ. Code art. 3050.

73. The surety may assert against the creditor any defense to the principal obligation that the principal obligor could assert except lack of capacity or discharge in bankruptcy of the principal obligor. La. Civ. Code art. 3046.

74. La. Civ. Code art. 3062.