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SECURITY DEVICES

*Thomas A. Harrell**

SURETYSHIP

Effect of the Deficiency Judgment Act

The effect of the Deficiency Judgment Act[1] upon the liability of a surety where the principal debtor is released as a consequence of the sale of his property without benefit of appraisal has created considerable difficulty for the courts. The fourth circuit, in *General Motors Acceptance Corp. v. Smith*,[2] held that the release of the principal debtor in such a case released his surety, even though the surety expressly had agreed to pay the obligation notwithstanding the "release or discharge" of the principal obligor. The court noted that the jurisprudence has generally recognized that the Deficiency Judgment Act does not directly apply to sureties or others secondarily liable for the debt secured by a mortgage, but rather its effect as to them is derivative. The surety in such a case is ordinarily released because of the general principle that the discharge of the principal obligor (resulting from the effect of the Act) releases his sureties.[3] The courts have also recognized that the surety may remain bound where he expressly consents to the sale of the principal debtor's property without appraisal and agrees to pay the deficiency remaining after such a sale.[4] Notwithstanding these cases, the court in the instant case held that the surety was released. It reasoned that to give effect to the agreement would allow circumvention of the public policy embodied in the Act.

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1. 1934 La. Acts, No. 28, § 1 (appears at LA. R.S. 13:4106-4107). "If a mortgagee or other creditor takes advantage of a waiver of appraisement of his property . . . by a debtor . . . the debt shall stand fully satisfied and discharged insofar as it constitutes a personal obligation of the debtor." LA. R.S. 13:4106 (1950 & Supp. 1952 & 1960).

2. 399 So. 2d 1285 (La. App. 4th Cir. 1981).

3. Southland, Inc. v. Motor Sales, 198 La. 1028, 5 So. 2d 324 (1941); Exchange Nat'l Bank v. Spalitta, 295 So. 2d 18 (La. App. 4th Cir. 1974), *rev'd on other grounds*, 321 So. 2d 338 (La. 1975); Commercial Credit Equity Corp. v. Parrott, 212 So. 2d 869 (La. App. 3d Cir.), *writ ref'd*, 214 So. 2d 719 (La. 1968); Farmerville Bank v. Scheen, 76 So. 2d 581 (La. App. 2d Cir. 1954); Simmons v. Clark, 64 So. 2d 520 (La. App. 1st Cir. 1953).

4. Southland, Inc. v. Motor Sales, 198 La. 1028, 5 So. 2d 324 (1941); Farmerville Bank v. Scheen, 76 So. 2d 581 (La. App. 2d Cir. 1954).

> The debtor cannot himself waive the public policy of §4106, and a surety cannot be allowed to waive it for the debtor, and the creditor cannot be allowed to defeat that public policy by the simple device of obliging the debtor to provide a surety who can then collect from the debtor. The provision of the surety's contract making his liability unaffected by the discharge of the debtor is inconsistent with the unwaivable public policy of R.S. 13:4106 and is therefore unenforceable.[5]

The court's conclusion that to permit recovery from the surety would necessarily circumvent the policy of the Act, by permitting the surety to then recover from the debtor, was primarily based upon dictum of the Louisiana Supreme Court in *Louisiana Bank & Trust Co. of Crowley v. Boutte*.[6] There the court held that the release by a creditor of the principal debtor, with reservation of rights against a surety who bound himself "in solido" with principal debtor, did not release the surety. In *Boutte*, the court also intimated that the surety might still recover from the debtor. It thus seems clear that a surety may sometimes agree that the security held by the creditor may be executed upon and sold without appraisal without affecting his liability and also that a surety may consent to the "discharge" of the debtor and remain bound for the debt. If this is true, one may question the correctness of the court's opinion. At the same time it is also correct, as the court suggests, that the public policy embodied in the Deficiency Judgment Act should not be as easily circumvented as the court suggests might otherwise be the case.

The writer would suggest the decision, while correct in result, failed to properly address the issues presented. The Deficiency Judgment Act unfortunately does not prescribe the juridical basis for its effect in a manner that permits easy integration of that effect into the law of obligations. Originally, the Act simply provided that the sale without appraisal operated as a discharge of the debt.[7] In 1952 the Act was amended to provide that the debt was fully satisfied and discharged insofar as it constituted "a personal obligation against the debtor."[8] Further proceedings against the property of the debtor are permitted only if the creditor holds other real security; otherwise, the debt stands discharged. The court in the present case noted that there was no reason to infer from the amendment of the statute "an intent to limit the discharge of the debt to the principal debtor alone and to deny discharge to sureties or other persons secondarily liable."[9] It explained the rationale of the Act as follows:

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5. 399 So. 2d at 1288.
6. 309 So. 2d 274 (La. 1975).
7. LA. R.S. 13:4106 (as it appeared prior to 1952 La. Acts, No. 20).
8. 1952 La. Acts, No. 20.
9. 399 So. 2d at 1287 n.3.

> The statute as originally enacted in 1934 provided for full discharge of the debt by unappraised sale, and later amendments indicate no legislative intent to depart from that scheme except to preserve in rem liability as to other property included in the pledge or mortgage. The logic of the full discharge is simple: because sales without appraisal often produce an unfair price (often with the creditor as the buyer), that price should not be treated as the equivalent of a price produced by a sale with appraisal, which must bring two-thirds of the appraised value or be readvertised . . . . The unappraised sale thus having no price providing an acceptable measure for deduction from the debt, *the legislature has taken the position that an unappraised sale will be treated as if its proceeds were sufficient to pay off the debt entirely, save, since, the 1952 amendment, the in rem liability of other pledged or mortgaged property.*[10]

This seems to be a logical and correct analysis of the matter. If a surety "guarantees . . . to pay [the] full amount remaining unpaid upon demand" and also stipulates that his liability "shall not be affected . . . by the discharge or release of the obligation [of the debtor]," as was the case of the agreement[11] before the court in *General Motors Acceptance*, it can hardly be doubted that the "discharge or release" contemplated by the parties does not include a discharge or release resulting from the payment or performance of the obligation by the principal debtor. The "discharge or release" referred to must be construed to be those that occur from bankruptcy, conventional remission, or other circumstances where the debt itself remains unperformed. Certainly, the creditor does not contemplate receiving payment twice, once from the debtor and again from the surety. Therefore, the agreement of the surety to "remain" bound upon the release or discharge of the principal debtor should not permit the creditor to continue to hold the surety bound where the debtor is "discharged" because the debt is extinguished by payment or an event equivalent to payment. If the creditor agrees to take property of the debtor under circumstances which the law treats as being equivalent to a *dation en paiement*—a payment or full performance of the obligation—as is the case with the Deficiency Judgment Act, there should be no recovery from the surety. There is no "deficiency" to be paid by the surety because, by accepting a waiver of the benefit of appraisal, the creditor (as the court noted) is in effect agreeing to accept the property or its proceeds in full satisfaction of the debt. The debtor is not "released" or "discharged" as is contemplated by the *General Motors Acceptance* type agreement of suretyship if the debt is so

10. *Id.* at 1287 (emphasis added).
11. *Id.* at 1287-88 n.4 (quoting the agreement).

satisfied. On the other hand, if when the debt becomes due the surety should agree, in consideration of the acceptance by the creditor of some of the property of the debtor, that he will pay some additional amount to satisfy the debt the surety should be permitted to do so. Such an agreement does not violate either the spirit or the purpose of the Deficiency Judgment Act. If the surety pays the creditor in full (as the creditor may insist he do), he will be subrogated to the debt and have the same options as the creditor had with respect to the debtor. The surety then may pursue the debtor by ordinary process or execute without benefit of appraisal upon such property as he can reach and charge off the balance as a loss. One final observation may be in order. Despite the dictum in the *Boutte* case, it is by no means certain that a "surety" who binds himself for the debt of another and agrees to pay it despite the remission or conventional discharge of the debtor may thereafter recover from the debtor what he pays the creditor. In the first place, such a promise should not be characterized as one of suretyship. The essence of suretyship is that it is an accessory promise given to guarantee performance of another obligation.[12] If the obligation of the surety is not dependent upon the existence of the principal obligation, it may be a binding contract—but it is not one of suretyship.[13] The right of a surety to recover by way of indemnification, rather than subrogation, from the debtor whose debt he has paid is grounded upon principles of *mandate* or *negotiorum gestio*, depending upon whether the surety gave the suretyship at the request of the debtor or whether the surety gave it without the debtor's knowledge in order to aid him in procuring the credit.[14] In either case, when the principal debtor is released from that obligation, the promise of the "surety" to then pay "the debt" (which has been extinguished as to the debtor) cannot be deemed the promise of a surety. Nor is there any reason to permit the "surety" who thereafter pays the creditor to recover from the debtor who was obligated to perform or interested in seeing that the creditor was paid. The structure of the Code supports this conclusion. If the surety pays after the conventional discharge of the principal debtor, he obviously cannot recover by way of subrogation. Article 3056 also clearly indicates that the right of indemnification is not available to a surety who pays *at a time when the debtor has a defense to the claim of the creditor*.[15]

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12. *See* LA. CIV. CODE arts. 1771 & 3035.

13. Aivolasiti v. Versailles Gardens Land Dev. Co., 371 So. 2d 755 (La. 1979) (dictum); Collier v. Brown, 19 La. App. 567, 141 So. 405 (2d Cir. 1932); Wallenburg v. Kerry, 16 La. App. 221, 133 So. 823 (2d Cir. 1931).

14. *See* 3 H.L. MAZEAUD & J. MAZEAUD, LECONS DE DROIT CIVIL 46 (5th ed. 1977); 2 M. PLANIOL, CIVIL LAW TREATISE pt. 2, no. 2357 (11th ed. La. St. L. Inst. trans. 1959).

15. LA. CIV. CODE art. 3056 provides that if the surety pays without being sued and

CROP PLEDGES

Effect on Subsequently Issued Documents of Title

The United States Court of Appeals for the Fifth Circuit recognized[16] that the holder of a crop pledge, properly filed for record, could pursue his claim for the crop against one who, in good faith, had purchased warehouse receipts for the crop from the pledgor who had placed it in the warehouse. The purchaser of the receipts made a search for a crop pledge in the records of the parish in which the seller said he resided but apparently was doubly misled. First, he was misled by the fact that while the pledge was registered in the name of Charles R. Weems, the pledgor had said his name was "Jack Weems," and second, the purchaser was misled because there was another farmer named Charles R. Weems (who resided in an adjoining parish) with whom the purchaser had done business and who he assumed was the pledgor of the recorded pledge. The court held that the good faith of the purchaser and the misrepresentation of the seller were both irrelevant. Relying upon a prior Louisiana case,[17] the court held that the issuance of a warehouse receipt covering crops subject to a pledge could not affect the pledgee's rights. This seems correct. The provisions of the Commercial Code regulating documents of title (including both warehouse receipts and bills of lading) provide that a document of title gives to its holder no rights superior to those of a person "who before issuance of the document had an interest protected by law" in the property represented by the document, unless the document was issued with the knowledge or consent of that person.[18]

Effect of "Share Cropping" Arrangements

Guaranty Bank & Trust Co. of Alexandria v. Daniels[19] recognizes

without notifying the debtor, his right of indemnification is subject to such defenses as the debtor had at the time the surety paid the creditor. Obviously, if the surety notifies the debtor that he intends to pay, and the debtor informs the surety that the debtor is not bound, it should also mean that the surety must pay at his own risk. *See* Hatchett v. Pegram, 21 La. Ann. 722 (1869); Gates v. Renfroe, 7 La. Ann. 569 (1852); Thompson v. Wilson's Ex'r, 13 La. 138 (1833); H.L. MAZEAUD & J. MAZEAUD, *supra* note 14, at 48. This does not necessarily mean that the surety may not in any case recover what he has paid from the released debtor. The right of recovery, however, must be based upon some grounds other than suretyship, arising out of the surety's relationship with the debtor, as for example, where the agreement to pay the creditor notwithstanding the release is made at the debtor's behest with an express or implied promise to reimburse the creditor in the future.

16. U.S. v. Weems, 680 F.2d 26 (5th Cir. 1982).
17. Alexandria Prod. Credit Ass'n v. Horn, 199 So. 430 (La. App. 2d Cir. 1940).
18. LA. R.S. 10:7-503 (Supp. 1982).
19. 399 So. 2d 790 (La. App. 3d Cir. 1981).

that a lease in which the lessee agrees to pay a rent of "twenty-five [sic] (25%) of all the crop [of soy beans] or $150,000 which ever is more" is sufficiently definite to vest ownership in the lessor of twenty-five percent of the soy beans harvested by the lessee as against a pledgee of the crop.[20] The pledgee argued that since its pledge was recorded and the lease was not, it should have had priority over the lessor. The court correctly noted that registry of the lease is not required. In the absence of registry, the lessor would be presumed to be the owner of all of the crop.[21] Since the pledgee had to rely upon the lease to establish the pledgor's rights to the crop, the pledgee could hardly assert that the terms of the lease were not effective to limit the pledgor's rights to three-quarters of the crop.

PRIVATE WORKS ACT

There were the usual number of cases construing the Private Works Act during the last term.[22] Many of the points at issue in the cases hopefully have been clarified by the recent revision of the Act.[23] However, a number of questions were raised that will continue to be of interest in the future.

Abandonment of the Work

The prior Act did not expressly establish a time for the filing of privileges when the work was abandoned by the owner. The jurisprudence, likening an abandonment to a completion of the work, held that the time for filing expires sixty days after the owner had "made some outward manifestation" of his intentions to discontinue the project.[24] The new Act essentially adopts the same view.[25] In *Stanley v. Falgoust*,[26] the court found that the work had been abandoned more than sixty days before the filing of the notice of privilege; the owner had run out of funds and work had obviously ceased upon the job, although the owner apparently had evidenced some desire to continue it. He also borrowed money for the ostensible purpose of completing the project, giving a mortgage upon the property, but in fact used the money to finish other jobs he was working on. The

20. "In a lease of land for part of the crop, the part which the lessor is to receive is considered at all times the property of the lessor." LA. R.S. 9:3204 (1950).

21. LA. CIV. CODE arts. 483 & 485.

22. 1981 La. Acts, No. 724, §§ 1 & 2, *adding* LA. R.S. 9:4801-4842.

23. 1981 La. Acts, No. 724. This Act completely revised the Private Works Act, replacing former sections 4801-4842 with new sections numbered 4801-4842.

24. *See* Jonesboro State Bank v. Tucker, 381 So. 2d 578 (La. App. 2d Cir. 1980); First Wisconsin Nat'l Bank of Milwaukee v. Norem, 349 So. 2d 370 (La. App. 4th Cir. 1977). *But see* Singer Lumber Co. v. King, 45 So. 2d 567 (La. App. Orl. 1950).

25. LA. R.S. 9:4822(I) (Supp. 1981).

26. 398 So. 2d 1240 (La. App. 4th Cir. 1981).

trial court apparently was satisfied that, despite his continued assertion of his intention to complete the job, the owner's financial position and subsequent actions cast serious doubt upon whether he in fact intended to do so. The appellate court, deferring to the judgment of the lower court, affirmed on the grounds that the matter was essentially one of fact.

Neither the jurisprudence nor the new Act provide precise guidelines for resolving the question of when an abandonment takes place. Consequently, where an owner engaged in constructing an improvement on the land, either directly or through a contractor, ceases all activity for some extended period, it behooves those supplying materials or labor to the job to ascertain the nature of the stoppage.

The new Act does afford some greater protection to claimants who file a contract made with a builder, because the time for filing notices of privileges does not start, even in case of abandonment, until a written notice of termination also is filed.[27] Furthermore, to prove an abandonment of work, the owner now must either notify "persons engaged in its performance that he no longer desires to continue it or otherwise objectively and in good faith [manifest] the abandonment or discontinuance of the project."[28] This would seem to require not only a discontinuance of the work but also some additional and objectively demonstrable act by the owner sufficient to indicate to third persons that they are in danger of losing their rights because the time for filing their notices is running. It would also appear, contrary to the opinion of the court in the present case, which relied strongly upon the rule that statutes establishing privileges are to be strictly construed, that a more liberal interpretation of this aspect of the Act should be afforded privilege holders. The law now provides a method by which the owner can clearly manifest his intention to abandon the work—he may start the filing period (whether or not a contract is filed) by filing a notice of termination.[29] Since the Act provides a clear definitive method by which the owner can make his intentions known, it is not unreasonable to require the owner (who has done nothing but discontinue work and fail to file a notice of intention) to otherwise evidence his intentions in such a manner as to reasonably advise the claimant that his rights are in jeopardy.[30]

27. LA. R.S. 9:4822(A), (E)(3), (F) (Supp. 1981).

28. LA. R.S. 9:4822(I) (Supp. 1981).

29. LA. R.S. 9:4822(A), (E)(3), (F) (Supp. 1981).

30. *See* LA. R.S. 9:4820(C) (Supp. 1981). This section provides that an affidavit may be relied upon by persons "acquiring or intending to acquire a mortgage . . . or other rights in or on an immovable." An affidavit that there is a partially completed house on the immovable could hardly suffice. Whether such an affidavit protects a person if the architect certifies that no work has commenced, although an improvement has been completed within the preceeding thirty or sixty days, is a different question.

Subcontractors Claim to a Laborers' Privilege

A number of interesting questions as to the nature and extent of the privileges given by the Private Works Act were involved in *Tharpe & Brook, Inc. v. Arnott Corp.*[31] The court first confirmed the fact that a mortgagee may conclusively rely upon the affidavit of a surveyor that work had not begun upon the job, even though some work had apparently been done and then, in the words of the court, " 'undone' prior to the inspection."[32] This is correct because the pattern of the Act places responsibility upon the surveyor for erroneous or false affidavits and, absent proof of some collusive action between the mortgagee and surveyor that would permit holding the mortgagee liable with the surveyor for fraud, the mortgagee should be protected.

Having established the priority of the mortgage, the court then considered whether a subcontractor, whose privilege would ordinarily be inferior to the mortgage,[33] may assert a laborer's privilege for work personally performed by him under the subcontract. Relying upon the case of *Pringle Associated Mortgage Corp. v. Eanes*,[34] the court held that such a claim exists if the subcontractor can establish the amount of the claim attributable to his personal efforts. This is at best doubtful, despite the *Eanes* case.[35] The revised Act appears to be to the contrary. It clearly distinguishes between laborers and subcontractors and gives priority only to "laborers or employees *of the owner*, for the price of work performed at the site of the immovable"[36] or to "laborers or employees *of a contractor or subcontractor* for the price of work performed at the job site of the immovable."[37] The requirement that the claimant be an employee of the owner or contractor and the use of the term "price" to define the debt secured were obviously intended to mean the claim must be for the amount agreed upon by an employer as the price for the "hire" of the services[38] of an employee, not a claim for "quantum meruit" or for an allocated portion of the contract price of a

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31. 406 So. 2d 1 (La. App. 1st Cir. 1981)

32. *Id.* at 4. The exact nature of the activity in question is not disclosed by the opinion, although the court noted that the surveyor apparently was unaware of the previous activity.

33. LA. R.S. 9:4812 (1950) (repealed 1981).

34. 208 So. 2d 346 (La. App. 1st Cir. 1968), *amended and aff'd in part*, 254 La. 705, 226 So. 2d 502 (La. 1969). The question under discussion was not before the supreme court in *Eanes* in its consideration of the case.

35. Under LA. R.S. 9:4812 the priority was given to "a claim for wages of a laborer," not simply for claims for labor performed, as seems to be suggested by the court in *Eanes*.

36. LA. R.S. 9:4801(2) (Supp. 1981) (emphasis added).

37. LA. R.S. 9:4802(A)(2) (Supp. 1981) (emphasis added).

38. *See* LA. CIV. CODE art. 2745.

subcontractor.[39] The official comments to sections 4801 and 4802 of the new Act expressly note that the classification of the claim for priority purposes is to be regulated by the nature of the contract between the claimant and the owner or contractor. The distinction, however, does not prevent a single claimant from enjoying a multiple status if he, *in fact*, has contracted separately with the owner or contractor. Thus, in the case at hand, as one of the claimants had apparently been employed on a monthly salary to guard the project from vandals and also had apparently agreed to perform some sort of repair work for the contractor, the court properly severed the claims and allowed the first as a laborer's privilege.

Seizure of "Progress Payments"

Most building contracts provide for "progress payments" by which the owner is obligated to pay a certain percentage of the contract price to the contractor as he completes specified portions of the work. Serious and difficult questions can arise if the rights to such payments are assigned to or seized by third persons and the contractor thereafter defaults. The rights of a seizing creditor to such payments was the subject of *A. F. Blair Co. v. Mason*,[40] which involved the judgment creditor's garnishment of the right to such payment. Shortly after the interrogatories were served and the seizure was effected, the owner's architect certified, in accordance with the contract, that $44,593 was due the contractor. Apparently thereafter but before the trial of the rule on the garnishment, certain laborers and materialmen filed privileges against the property and the owner resisted paying the garnishment, because of the default of the contractor. The problem was complicated by the fact that a contract and bond had been properly filed under the Private Works Act. This, the court noted, relieved the owner from liability for any privileges against the land and improvements.[41] Had the court based its decision upon the fact that the owner, being protected by the suretyship, was still obligated to pay the contractor the amount due, the case would be of little significance. The court did not so restrict its opinion, but instead based its decision on the broad grounds that the creditor "properly and timely seized a debt that was unconditionally due and owing . . . [to the contractor]. Subsequent events cannot affect rights . . . [of the seizing creditor] . . . previously acquired."[42] The jurisprudence supports the conclusion that if the obligation is due and performable, then the ser-

39. *See* LA. CIV. CODE art. 2756.
40. 406 So. 2d 6 (La. App. 1st Cir. 1981).
41. *Id.* at 13.
42. *Id.* at 11.

vice of the interrogatories fixes the rights of the parties.[43] The court also distinguished two cases[44] in which at the time of seizure, it appeared liens or adverse claims were being asserted against the contractor. In each it was held that the garnishee could retain the sums owed until those claims were satisfied. Finally, the court noted an obligation may be seized even before it is due and the court may order payment to be made to the garnishee "when it becomes due."[45]

On balance the opinion seems correct, although it also appears to be somewhat inequitable to the owner. It can be argued that the thing seized is the obligation of the owner to the contractor and that if before he pays or performs that obligation, an event arises to render it nonperformable, he should be able to resist payment on the grounds that the object seized (the debt) is no longer in existence. Certainly, if the thing seized were a corporeal object that was destroyed pending delivery to the seizing creditor, the garnishee should be excused from liability unless it is shown that his fault contributed to the destruction.

A particular successor to an obligation is ordinarily not entitled to any greater rights to performance than his transferee would have had. The transfer of a nonnegotiable obligation thus does not give to the transferee any right to insist upon its performance unless the obligor is required to perform under the contract giving rise to the obligation. There also must be some point at which events occurring after the transfer will have no effect upon the transferee. Ordinarily performance establishes this time. If the assignee of a conventional obligation is paid by the obligor, he should not be required to return the amount received because of subsequent default by the assignor under the terms of the contract giving rise to the obligation. One may refuse to perform if the other party to a contract is in default. However, until a default occurs he is supposed to perform. The obligor's right to recover from the obligee what the obligor has paid to the transferee of the obligee is not an obligation of the transferee.

If a garnishee admits his obligation is due when garnishment interrogatories are served, it does him no injustice to require him to pay. It may be assumed that he would have paid the obligor as he was obligated had the seizure not intervened. The seizure of that

43. Morehouse Lumber & Bldg. Materials Co. v. Jacob & Walker, 144 So. 190 (La. App. 2d Cir.) (on rehearing), *aff'd*, 177 La. 76, 147 So. 504 (1932), and cases cited therein.

44. Cagle Supply of Lafayette, Inc. v. Hinson, 155 So. 2d 773 (La. App. 3d Cir.), *writ denied*, 245 La. 83, 157 So. 2d 230 (1963); Lindsay v. Brown, 104 So. 2d 211 (La. App. 2d Cir. 1958).

45. LA. CODE CIV. P. arts. 2411 & 2415.

amount at that time places him in no worse position than if he had paid the seizing creditor at the request of his debtor. This would also suggest that if the obligation is not yet due when the interrogatories are served, an order by the court to pay over the amount *when it is due*, should not preclude the debtor from asserting at the time the obligation would otherwise become due that his performance has been excused by an intervening breach or default by the original obligee. *Blair* does place the owner who has not obtained a bond or a surety who has given such a bond in a difficult position. Pragmatically, the risks taken by each are usually based upon the assumption that the funds supplied by the owner will go to the completion of the project.[46] Two solutions suggest themselves. As to the surety, it would seem that he could effectively insulate himself from the claims of seizing creditors by obtaining a pledge by the contractor of the amount due from the owner to secure the surety's right of indemnification against the contractor. The surety could also agree to release from time to time such amounts as may be necessary to pay laborers or materialmen supplying work to the job without jeopardizing his position. As to the owner who does not require a surety, the same purpose could be served by a provision in the building contract that excuses him from making any further payments until full and final completion of the job if at any time the contractor permits a money judgment to be rendered against him. After all, the ability of a contractor to finish the job and pay all of his bills must be in serious doubt when he fails to pay a judgment rendered against him.

MORTGAGES

"Due on Sale" Clauses

The volatile economic conditions of the past few years will continue to put a strain upon the legal system. Rules of law and the contractual arrangements based upon them are invariably founded upon unarticulated assumptions about the activities they will regulate. There is always a predictive element as to how they will operate within a larger framework of activities that are beyond the scope of the rules established. When there are unanticipated changes to that framework the legal regime may prove inadequate or lead to results contrary to the reasonable expectations of the parties. An excellent

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46. In response to a plea of the owner that if an owner could not defend the garnishment on the grounds that the contractor had breached his contract he might be required to pay twice, the court, rather unrealistically, said that the remedy of the owner was to require the contractor to be bonded and that the surety could protect itself by checking the contractor's credit and refusing to bond a "bad risk." 406 So. 2d at 13.

example of this is seen in the efforts of the courts to interpret what are commonly called "due on sale" clauses in mortgages, providing that the sale of the property will permit acceleration of the secured indebtness. As an abstract proposition, particularly as applied to a commercial transaction, there would seem to be no serious objection, either legally or morally, to such a provision. Certainly, in many instances the person of the debtor and the means by which he intends to repay the obligation is important to the creditor. When a merchant borrows money to operate his business, it can hardly be argued that a clause in the loan giving the lender the option to accelerate the maturity if the borrower ceases to conduct the business is unfair, particularly if the parties expect the business to generate the funds needed to repay the loan. Furthermore, "demand" loans which give to the lender the right to ask for payment (and to the borrower the concommitant right to make payment) at any time and for any reason are a necessary and established part of commercial practice.

Different considerations are obviously present when the problem is viewed within the context of the long term residential financing that has become an established part of our societal structure since the end of World War II. Lenders who make such loans with a "due on sale" stipulation actually have two concerns. One is directly related to the loan itself and the other is founded upon the realities of the lending business generally.

The first concern is that a subsequent purchaser of the property be financially responsible and assume the obligation of repaying the loan. Most persons who buy a residence intend to pay for it out of their future salaries or wages. Upon selling their home, they ordinarily expect to purchase another. Few people have sufficient income to pay for more than one residence at a time. The borrower who sells his residence may do so because he is moving to another location—perhaps out of the state or even out of the country. The law ordinarily assumes that the agreement of a third person to pay a debt is of no concern to the creditor because the original obligor remains liable. When the debt assumed has been incurred to finance the purchase of a home, however, such an assumption is usually viewed by the parties as having the practical effect of a novation. For this reason lenders believe they have a legitimate interest in the identity and financial responsibility of the purchaser of the property. Second, the funds loaned by banks and savings associations are not their own but come primarily from their depositors. When such institutions make long term loans they must maintain a financial position adequate to permit them to meet the demands of their customers until their mortgagors are obligated to repay their loans. This may require them to raise the interest rate they pay their depositors above the rate they are receiving from their loans. Historically, experience has shown

that because of the propensity of Americans to move their place of residence and their desire to improve their lot by buying even larger homes, the actual term of the average residential loan is much less than its stated term. In the past, banks and savings associations could expect a "turn over" of their loan portfolio every seven or eight years. As long as interest rates remained stable, such loans could in fact be refinanced, on the average, every few years. This meant that in fixing their interest rates on loans they had only to take into account the risk of fluctuations in their deposits over a relatively short future period. Until the present economic crisis, lenders seldom took advantage of such clauses except to assure themselves of the financial responsibility of the purchasers because interest rates were fairly stable and permitting such assumptions was a cheap and convenient method for keeping their funds loaned out. In short, the protection such a clause afforded to the lender's financial status was not needed because of the source of the funds it was lending.

From the viewpoint of the borrower, however, the matter presents somewhat different considerations. When the average person buys a home by means of a twenty or thirty year loan, there is as mentioned a high probability that he does not expect to completely pay for it. Rather, he will in many cases assume that in a few years, he will sell the home and move to another locality or buy an even larger, more comfortable one. These expectations have been generally encouraged by the housing industry and by governmental policies making possible longer term loans and ever increasing reductions in equity requirements.

An unarticulated premise that made such financing work satisfactorily in the past was that the inflation in land values would increase at a greater rate than the rate of interest being charged by mortgage lenders. This created a continuing increase in the "equity" of the owner despite the physical depreciation of the property and a relatively small decrease in his loan balance. This trend, which generally prevailed for the past thirty years, recently has been reversed. Consequently, many homeowners today find themselves faced on the one hand with the necessity of selling their homes and on the other, a mortgagor who is unwilling to permit it to be sold unless the debt is paid in full (or unless there is a renegotiation of the terms of the loan to reflect current interest rates). The prospective purchaser of the property may be unable or unwilling to pay what the seller considers a fair price—or perhaps even enough to pay the loan—because of the high rates of interest currently sought by lenders. What has happened, over a very short period, is that the "leverage" that was at work making a low equity purchase attractive has been reversed so that an owner, now having to sell, faces the prospect of a loss brought about by risks he did not realize he was taking and that somehow

seem unfair and inequitable. The hardship caused by events such as these are peculiarly appropriate for legislative adjustment and inappropriate for judicial resolution. However, when the legislature does not act or delays in acting, the courts are required to decide the matter, always with inadequate tools to fashion truly equitable results.

On the whole, the courts have exhibited a sympathetic attitude to the homeowner, while also recognizing that there is no basis upon which due-on-sale clauses may be directly struck down. In *Louisiana Savings Association v. Trahan*,[47] the court held that such clauses are not unconstitutional or contrary to public policy. This result certainly was dictated by the fact that Louisiana Revised Statutes 6:837(A) reads into every savings and loan mortgage a statutory "due on sale" clause.[48] Further support for this result can be found in a recent United States Supreme Court decision[49] that upheld a Federal Home Loan Bank Board regulation permitting such clauses even if they were contrary to state law.

Although the law may permit such clauses, it does not necessarily follow that they are *required*, even as to savings and loan associations. While Louisiana Revised Statutes 6:837(A) gives to associations the right to mature the debt if property is sold without their written consent, it does not prohibit such consent being given in advance. Thus, in every contract between the parties purporting to regulate a matter, the interpretation of that contract is of primary consideration and one may expect it to be made in favor of the borrower if there is any doubt as to its meaning. In *Newman v. Troy Savings Bank*,[50] the United States Court of Appeals for the Fifth Circuit, construing a clause that expressly required consent of the mortgagee to such a sale but further stipulated that such consent would not "unreasonably" be withheld, held that the mortgagee could not condition its consent upon the payment of a "transfer fee." This appears to be correct. Louisiana courts have indicated that they will construe similar clauses in leases requiring consent of the lessor to an assign-

47. 415 So. 2d 592 (La. App. 3d Cir. 1982).

48. Whenever property is subject to a vendor's privilege or mortgage in favor of an association and, without the written consent of the latter, the property is sold or transferred, by contract, either with or without the assumption of the association loan, the loan and obligation held by the association shall at the option of the association immediately mature and become at once subject to enforcement according to law and to the terms of the loan contract. In all such cases where the loan was assumed by the purchaser even without the consent of the association, the purchaser will be and remain liable in solido with the original borrower on the loan.

LA. R.S. 6:837(A) (Supp. 1970).

49. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. 3014 (1982).

50. 664 F.2d 52 (5th Cir. 1982).

ment or sublease as evidencing an understanding that the consent will be given unless there are objectively demonstrable reasons, such as the financial irresponsibility of the assignee, that would materially increase the risks to the lessor or otherwise render the contract more burdensome to him.[51]

This then raises a question apparently presented but not discussed in *First Federal Savings & Loan Association of Shreveport v. Bechtol.*[52] In that case the court decided that despite the provisions of Louisiana Revised Statutes 6:837, the mortgagee had in effect wavied the sale without its consent as grounds for accelerating the obligation if it desired to proceed by executory process. The correctness of that holding, which appears doubtful, is beyond the scope of the present discussion. The writer also understands that in the lower court, evidence was presented that the plaintiff association for some years had a "policy" of not objecting to the assumption of its loans if the purchaser met its credit standards, but the association changed this "policy" after the loan in question had been made. If this is true or if a borrower can show in a given case that the prevailing practice or the announced policy of the lender, as represented by resolutions of its board of directors, or its unvarying practice when confronted with such requests was to consent to them if the creditor was a satisfactory credit risk, the question can be raised as to whether this places an interpretation upon the clause by the mortgagee upon which

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51. Gamble v. New Orleans Hous. Mart, Inc., 154 So. 2d 625 (La. App. 4th Cir. 1963). In that case, in construing a clause in a lease prohibiting assignment or sublease "without written consent of the lessor," the court said:

> Here the lessee is simply not permitted to sublet without the written consent of the lessor. This does not prohibit or interdict subleasing. To the contrary, it permits subleasing provided only that the lessee first obtain the written consent of the lessor. It suggests or connotes that, when the lessee obtains a subtenant acceptable or satisfactory to the lessor, he may sublet. At the time the lease was entered into the lessee had every reason to believe that he could sublet upon producing a proper subtenant. Otherwise the provision simply would prohibit subleasing. Under these circumstances the lessor cannot unreasonably, arbitrarily or capriciously withhold his consent.
>
> Our LSA-Civil Code Art. 2725 is the same as Article 1717 of the Code Napoleon. And the words "this clause is always strictly construed" were inserted in Article 1717 by the French (prior to our adoption of the article) in order to give the lessor the right to arbitrarily and absolutely refuse to accept a sublessee when the lease provision prohibited subleasing. We note that under the French jurisprudence the lessor who wished to reserve for himself such an arbitrary right must have expressly so stated. Where the provision, as here, was simply a reservation for the consent of the lessor he did not have the right arbitrarily to refuse the sublessee tendered to him when such person was solvent, honorable and fulfilled the same conditions as the original lessee.

154 So. 2d at 627.

52. 416 So. 2d 633 (La. App. 2d Cir. 1982).

the mortgagor is entitled to rely. If the clause were in the mortgage itself and if the lender, in response to a direct question from the mortgagor at the time the mortgage was given should respond that the clause was intended only to give the mortgage the right to review the financial responsibility of the purchaser, it would seem that a court would be justified in reading into the contract an implicit qualification that the consent would not be withheld except for reasons stemming from the financial responsibility of the purchaser. The mortgagee also might have an action to reform the act on the ground of mutual error. The fact that the law, though a suppletive provision, "writes" such a provision into the contract (much as warranties are implied in sales) should make it no less a matter of contractual construction. Also, there is an established rule that an intentional waiver over a period of time of a contractual provision given for the benefit of one party prohibits a unilateral change in the policy or interpretation to the detriment of the other. Hence given the obviously symphathetic attitude of the courts, the long prevailing practice (and perhaps publically announced policy) by which many lenders granted consent to the assumption of their loans, might well cause a court to hold that such practices are an implicit interpretation by the parties of the meaning of "consent" as applied to individual cases.