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Freeing Mortgages of Merger

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I. Introduction

Change in real property law often occurs with glacial speed. This rate of change in part reflects the normal inertia of established law. A more complete explanation, however, is the innate conservatism connected to a commodity that once was the primary source of wealth and power. That this conservatism is innate should not prevent application of Ockham's razor as needed. The relationship of the doctrine of merger to the burgeoning law of mortgages is one such area. "If the law has to bear these medieval shackles the time surely has come to examine them carefully. They may have rusted away."[1]

The modern doctrine of merger is easily stated: When a person holds two estates in property in the same right and without an intervening estate, the two estates will coalesce to one estate unless a beneficial reason exists for keeping them distinct.[2] For example, a life tenant who acquires the reversion immediately following his life estate usually will be deemed to own the fee simple title rather than a separate life estate and reversion.[3] Similarly, a tenant for years who acquires the landlord's interest in the leased property usually will be deemed to own the fee simple title.[4] The doctrine of merger operates in these cases as a technical, nonsubstantive rule concerning property titles. If the holder of the interests is not benefited in any way by keeping the estates distinct, they will merge to simplify the state of title.

Although the application of merger to separate estates in land is generally straightforward, the application of the doctrine to lesser property rights is far from clear. Indeed, with respect to questions involving title to property and a mortgage encumbering that property, merger has been described as "one of the most complex and confusing areas of the law of mortgages."[5] Examination of

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1. Industrial Properties (Barton Hill) Ltd. v. Associated Elec. Indus. Ltd., [1977] 1 Q.B. 580, 613.

2. 4 American Law of Property § 16.142 (A. Casner ed. 1952) [hereinafter Am. L. Prop.]; 3 R. Powell, The Law of Real Property ¶ 459 (P. Rohan rev. ed. 1984); 5 H. Tiffany, Real Property § 1479 (B. Jones 3d ed. 1939).

3. *See, e.g.*, Citizens Bank & Trust Co. v. Watkins, 215 N.C. 292, 296, 1 S.E.2d 853, 856 (1939). Merger will not apply if the interests are held in different "rights." Therefore, if the trustee of a life estate acquires the reversion immediately following the life estate in his individual capacity, the life estate and reversion will not merge because the life estate is held in trust and the reversion is held in the owner's individual capacity.

4. *See, e.g.*, Buell v. Simon Newman Co., 61 F. Supp. 157, 160 (N.D. Cal. 1945); Thomas v. Farr, 380 Ill. 429, 431, 44 N.E.2d 434, 435 (1942).

5. G. Nelson & D. Whitman, Real Estate Finance Law § 6.15 (2d ed. 1985). Other

the historical developments of merger and of mortgages reveals why their union has created theoretical and practical problems: the modern mortgage does not create an interest in land to which merger should apply.[6] Furthermore, modern title and finance practices have obviated the need for merger.

The doctrine of merger and the practice of using land as security for the repayment of loans, integral parts of English land law since the feudal period, originated when the common law of property was in its infancy. The advantages of the abstract concept of title had not been discovered; recognized interests in land consisted primarily of the right to possess or to receive feudal incidents as an overlord. With the increase in property transactions, merger and mortgages developed as transactional devices. Despite substantial alterations in title forms and practices since the inceptions of merger and of mortgages approximately seven hundred years ago, courts continue to apply merger largely unchanged to the modern mortgage, a property interest that bears only one feature in common with its feudal counterpart—the existence of a debt.

If the continued application of merger to mortgages created no problem other than a problem of theory, even such a thoroughgoing theorist as a legal scholar might be willing to ignore the problem as a harmless anachronism. Continued application of merger to mortgages, however, often has adverse and occasionally devastating economic effects without serving any beneficial purpose. Courts' rote applications of merger to mortgage interests have unnecessarily destroyed valuable property rights and have wrongfully created others. Additionally, as bad law begets worse, misperceptions concerning the doctrine have caused many courts to apply the doctrine not only to interests in property, but also to debts secured by property as if debt were a new variety of real

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commentators have described the topic as "[o]ne of the most perplexing incidents of title," G. WARVELLE, ABSTRACTS AND EXAMINATIONS OF TITLE § 347 (4th ed. 1921); and as "a fearsome title, because it invokes the fine points that attend the law of real property." 1 G. GLENN, MORTGAGES § 45.2 (1943).

6. Throughout this Article, the term "mortgage" will be used to refer to all types of real property security instruments, including deeds of trust and deeds to secure debt. Although the various types of real property security instruments differ in some respects, the issues raised in this Article concerning the applicability of merger apply with equal force to each type of instrument. *See generally* 1 G. GLENN, *supra* note 5, § 1.

Similarly, although this Article focuses on real property security interests, merger applies with equal force to personal property security interests. *See, e.g.*, Wilhelmi v. Leonard, 13 Iowa 330 (1862); Food City, Inc. v. Fleming Cos, Inc., 590 S.W.2d 754 (Tex. 1979).

property interest.

With respect to mortgages, the merger issue typically arises when a secured lender agrees to accept title to the encumbered property from the defaulting debtor in lieu of foreclosing its mortgage on the property. In this way, the borrower and lender avoid the time and expense of a foreclosure action. As described in this Article, if a court holds that the lender's mortgage lien thereby merged into its fee title, the lender usually will be an unsecured, rather than a secured, creditor if the debtor's conveyance to it is voided, such as in connection with the debtor's subsequent bankruptcy. Furthermore, the lender will be unable to clear the title of junior liens although the law is well established that the lender could have done so if its lien did not merge. These merger-related problems are not outweighed by any beneficial effect of merger.

As the number of loan defaults and foreclosures occurring nationwide has increased to the greatest level since the Great Depression of the 1930s,[7] the problems created by the misapplication

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7. During 1985, delinquencies on debts secured by one to four unit residential properties ranged from 6.19% during the first quarter to 5.72% during the fourth quarter, which is more than double the rate during the 1950s. Foreclosure actions were commenced during 1985 against .92% of all one to four unit residential properties encumbered by mortgages, as contrasted with .59% just five years earlier. *See* MORTGAGE BANKERS ASSOCIATION OF AMERICA, ECONOMICS DEP'T, JUNE 1985 REPORT. *See also* STATISTICS AND ANALYSIS DIVISION, OFFICE OF POLICY AND ECONOMIC RESEARCH, FED. HOME LOAN BANK BD., REPORT ON MORTGAGE FORECLOSURES BY FSLIC-INSURED SAVINGS AND LOAN ASSOCIATIONS (1984).

During fiscal year 1985, the Department of Housing and Urban Development (HUD) acquired approximately 38,000 houses through foreclosure and, after selling all but 16,700 properties, estimated the value of its holdings to be $627,500,000. The agency's deputy assistant secretary for single family housing estimates that HUD may acquire more than 40,000 additional properties during 1986. At the end of January 1986, the Veterans Administration owned 18,783 properties as a result of loan defaults, with an estimated aggregate value of $787,000,000, and acquisition procedures had been commenced for an additional 14,809 properties as a result of loan defaults. By mid-1985, federally insured savings and loan companies owned or were foreclosing against properties with an aggregate value of $7,700,000,000. Three-quarters of the properties were residential. Two of the largest secondary mortgage market purchasers, Federal Home Loan Mortgage Corporation and Federal National Mortgage Association, owned more than 3,400 homes and 7,700 homes, respectively, at the end of 1985. Because of the large volume of properties held by these lenders and participants in the secondary mortgage market, they have had to sell the properties by conducting auctions, rather than continuing their practice of selling through real estate brokers. *See* Minneapolis Star & Tribune, Mar. 22, 1986, at 3S, col. 2.

The rapidly increasing number of defaults and foreclosures has had a serious impact on the mortgage insurance industry. In 1984 mortgage insurance companies paid $472,000,000 in insurance losses, which is five times the amount paid in 1981. The severity of the impact on the insurance industry is demonstrated by the fact that the companies paid 73.8% of all premiums collected in 1983, as contrasted with 18.9% in 1980. Greenhouse, *The Mortgage Insurers Woes: Defaults at Record High*, N.Y. Times, Sept. 18, 1985, at D8, col. 2.

Comparison of current foreclosure rates with those during the Great Depression of the of merger to mortgages have assumed increased importance. High interest rates, coupled with a downturn in property prices, have contributed to a record number of property owners' defaulting on their mortgage payments. The recent popularity of graduated payment mortgages has fueled the problem. Default rates for these types of mortgages are five times the default rates for conventional fixed rate mortgages, as borrowers' incomes fail to keep pace with increases in the interest rates on their loans.[8] Additionally, the agricultural economy has suffered and continues to suffer massive blows. Record numbers of farm loans are in default. Penny auctions and other desperation tactics are occurring in agricultural areas as farmers try to save their farms and farm communities.[9] Finally, states with economies dependent on oil, such as Texas, have suffered the effects of a downturn in oil prices.[10] In light of the fact that more than 2.25 trillion dollars in debt is secured by mortgages,[11] the importance of the merger problem is manifest.

Despite the problems created by merger as applied to mortgages, this topic has not been analyzed extensively since 1821, when an English lawyer devoted a volume of his conveyancing treatise to merger.[12] The application of merger to mortgages merits

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1930s illustrates the severity of the current financial crisis. During the depths of the Great Depression, the foreclosure rate on mortgages encumhering nonfarm properties ranged from approximately 1.06% to 1.16%. By 1936, the rate decreased to .86% and steadily decreased thereafter. By 1941, the foreclosure rate was down to .27%. *See* BUREAU OF CENSUS, U.S. DEP'T OF COMMERCE, HISTORICAL STATISTICS OF THE UNITED STATES, COLONIAL TIMES TO 1970, BICENTENNIAL EDITION, 1975; J. MORTON, URBAN MORTGAGE LENDING: COMPARATIVE MARKETS AND EXPERIENCE 95-98 (1956). Although the foreclosure rate on nonfarm properties was not suhstantially greater than the current rate, the percentage of residential loans that were in default in 1933 was estimated to he 25%. *Home Owners' Loan Act: Hearings Before a Subcomm. of the Senate Comm. on Banking and Currency*, 73rd Cong., 1st Sess. (1933) (statement of Horace Russell, General Counsel, Federal Home Loan Bank Board, Atlanta, Georgia).

8. Greenhouse, *supra* note 7, at D8, col. 6.

9. Minneapolis Star & Tribune, Mar. 22, 1986, at 3S, col. 1; Greenhouse, *supra* note 7.

10. Minneapolis Star & Tribune, Mar. 22, 1986, at 3S, col. 1; Greenhouse, *supra* note 7.

11. As of the fourth quarter of 1985, $2,250,370 in debt was secured by mortgages and similar security interests. Telephone interview with Kitty Sydnor, Statistical Assistant, Federal Home Loan Bank Board (Apr. 1986). *See* ECONOMIC REPORT OF THE PRESIDENT, 21 WEEKLY COMP. PRES. DOC. 134 (Feb. 5, 1985).

12. 3 R. PRESTON, CONVEYANCING (3d ed. 1821). Mr. Preston devoted a substantial portion of his career to the study of merger and found it to be particularly edifying.

> [T]he law of merger is in itself a curious and interesting learning, scattered in the books, and not collected with scientific skill, or in a detailed manner in any work: also, as this subject will be found worthy of notice, in proportion as it is thoroughly understood, the first and a large part of this volume will be devoted to a review of the learning applicable to merger. This will be done from the fullest conviction, that its impor-

re-examination in light of the growth and importance of real estate financing to the national economy, to local economies, and to individuals' personal economies. To assess the continued applicability of merger to mortgages, this Article first will trace the historical developments of merger and of mortgages in England and in America. Examination of their developments will demonstrate that merger was not designed to affect property interests adversely. This analysis also will demonstrate that a modern mortgagee's interest in secured land is not the type of interest to which merger should apply. After focusing on the origins and natures of merger and mortgages, this Article will analyze the modern status of merger as applied to mortgages and, distressingly, as applied to debts. This analysis will demonstrate that merger is an obsolete doctrine in the mortgage context, though it continues to generate a significant amount of litigation.

II. Historical Development

A. Doctrine of Merger

By the time of the earliest English language legal reports, the doctrine of merger was well established. Early judicial decisions involving the doctrine and early commentators' works usually yield no clue of the origins of merger or of the reasons underlying its creation and application.[13] The origin apparently has become shrouded in the mists of time. The leading nineteenth century authority on the doctrine states: "An endeavor to refer the learning of merger to any precise principle of policy, or of reason, and to support it with certain exclusive pretensions, on that ground,

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> tance, illustrated as it will be with observations leading to practical conclusions, will engage the attention, and invite the study of those for whose use this work is designed. No subject has engaged more of the author's attention for the last twenty-five years, or received a greater portion of his research.
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> . . . The necessity then of studying a head of law, involving so many important considerations, is too obvious to require a recommendation enforced in strong terms. Perhaps it may be advanced, that few subjects are more deserving of investigation; and it is well known, that few have received a smaller portion of attention.

Id. at 1-4.

Mr. Preston's work was well received. Kent comments that the merger treatise "is the ablest and most interesting discussion in all his works. It is copious, clear, logical and profound." 4 J. Kent, Commentaries on American Law 104 n.b (J. Gould 14th ed. 1896).

13. *See, e.g.*, Platt v. Sleap, Cro. Jac. 275 (1611), 79 Eng. Rep. 236 (1907); Hughes v. Robotham, Cro. Eliz. 302 (1593), 78 Eng. Rep. 554 (1907); Case #5, Gouldsborough 93 (1588); Bracebridge v. Cook, 2 Plow. 416, 419 (1578-79), 75 Eng. Rep. 626, 631 (1907); XVII Mich., 4 Eliz., 3 Leonard 7 (1562).

appears to be a vain attempt. The subject does not admit of any historical deduction."[14]

This commentator is correct to the extent that early courts and commentators did not ground the doctrine on any one policy or rationale. This fact hardly is surprising, however, because the doctrine evolved concurrently with the law of estates in land. As the universe of legally recognized estates, with their particular attendant rights and obligations, has emerged during the last several centuries, merger necessarily also has undergone profound, yet parallel, changes, and the explanations for its application have changed accordingly. Courts and commentators, however, have overlooked this process of evolution in attempting to determine the reasons for the existence and scope of merger. Instead, they have uprooted earlier explanations of merger from their historical contexts and have attempted to transplant those explanations to a more modern legal environment that is significantly different.

Conflicting applications of the merger doctrine by the English courts of law and of equity have compounded the difficulty in identifying a policy or policies underlying the doctrine. The law courts applied the doctrine mechanically, which incorrectly extended the reach of merger. The courts of law applied the doctrine whenever a person held consecutive estates in the same right, regardless of the resulting injury to the ownership interests of the holder and to others with interests in the parcel. In contrast, the court of equity profoundly affected the evolution of merger in the seventeenth century when it intervened to prevent destruction of property interests by application of merger. Examination of the development of merger, however, will reveal its correct purpose and application.[15]

The most frequently cited explanation of the reason for the doctrine of merger is contained in the maxim *Nemo potest esse dominus et tenens*.[16] Some early legal commentators cite this maxim as the basis for merger.[17] Later courts and commentators, bound to primitive concepts of title, broadly construed this aphorism to mean that, as a conceptual matter, a person cannot hold title to consecutive possessory estates in land unless an equitable

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14. 3 R. PRESTON, *supra* note 12, at 15.

15. Useful compilations of early merger cases are contained in 13 MEW'S DIGEST OF ENGLISH CASE LAW TO 1924 and in VINER'S ABRIDGMENT (1742-53).

16. No man can be both tenant and lord.

17. *See, e.g.*, 4 J. KENT, *supra* note 12, at 99; 3 R. PRESTON, *supra* note 12, at 15.

reason exists for keeping them distinct.[18] Although this construction of the aphorism is accurate when applied to the interests in land existing when merger originated in the common-law system, its viability as an overarching rationale for modern courts' application of merger is limited by two factors: (1) it goes beyond the original meaning of the maxim by requiring merger regardless of the owner's best interests and of the resulting destruction of property interests; and (2) it is an inadequate statement of policy to deal with the diverse property interests that can be created today.

The origin and rationale of merger cannot be dismissed with a simplistic maxim. Instead, they must be examined against the legal environment in which they arose. Merger originated during the feudal period in England, which began approximately with William the Conqueror's victory at the Battle of Hastings in 1066.[19] After his victory, William installed himself as monarch of England. Because the English had refused to recognize him as monarch until he took the monarchy by force, William ignored land titles as they existed before the Battle of Hastings and claimed title to all lands in England.[20]

Because of difficulties of standardization, widespread counterfeiting, and the threat of debasement, coins and other forms of currency were disfavored. Instead, land and cattle were the primary media of exchange and were sources of both wealth and power.[21] Rather than conveying all interest in a parcel of land, William and subsequent feudal monarchs provided for the needs of their courts by transferring only the right to hold land in fee in exchange for the tenant's agreement to perform stated services for the monarch. To the modern mind, these services partake of con-

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18. *See, e.g.*, Miehling, *Merger or Extinguishment in the Law of Mortgages of Real Estate*, 26 ALB. L.J. 506 (1982).

19.

> Whether the English feudal system which matured in his reign was largely a Norman importation or whether William merely modified an Anglo-Saxon feudalism which he found in process of development, is not easy to say. It is generally agreed, however, that the advent of William the Conqueror to the English throne marks the beginning of the most important period in the development of feudalism in England.

1 AM. L. PROP., *supra* note 1, § 1.3, at 5-6.

20. G. CHESHIRE, THE MODERN LAW OF REAL PROPERTY 12 (9th ed. 1962).

21. *Id.* at 14. According to Milsom:

> From the earliest settlements until the industrial revolution, the economic basis of society was agrarian. Land was wealth, livelihood, family provision, and the principal subject-matter of the law. To begin with, moreover, land was also government and the structure of society.

S. MILSOM, HISTORICAL FOUNDATIONS OF THE COMMON LAW 99 (2d ed. 1981).

tractual duties. At the time, however, the services were attendant to the sovereign's interest in land. The most important forms of service, or tenure, by which land was held included the following: (1) military service, which obligated the tenant to provide military service and related services;[22] (2) frankalmoin, which obligated the tenant to provide spiritual services for the monarcb; (3) sergeanty, which obligated the tenant to provide personal services, such as performing ceremonial services, managing estates, or even cooking;[23] and (4) socage, which obligated the tenant to perform agricultural services or to pay rent.[24]

This method of linking possession by the junior interest holder with duties to the senior interest holder was not exhausted by the transfer from the monarch. Instead, a tenant in fee could convey to a subtenant the right to hold a portion of the tenant's land in fee for as long as the subtenant in turn provided specified services to the tenant. This process, termed subinfeudation, initially was unlimited and could continue through several transfers of the right to possess in exchange for the performance of services.[25] This system governed land ownership throughout England and continued to do so, at least as a technical matter of title, until 1925, when Parliament converted all anachronistic forms of tenure into tenure by socage and abolished tenurial incidents.[26]

In this feudal context, *Nemo potest esse dominus et tenens* states a correct—indeed, an unassailable—legal conclusion. As stated above, during this era property rights consisted primarily of the corresponding rights to possess and to receive tenurial inci-

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22. Military tenure originally was the most important form of tenure. This fact is attrihutable to the societal forces that gave rise to feudalism. Feudalism generally arises in the absence of a government strong enough to protect its citizens. In the absence of governmental protection, people may be willing to surrender title to their lands and a portion of their personal liberty to a powerful person in exchange for that person's agreement to provide protection. Obviously, the lord's ability to provide protection was dependent on the ability to raise a military force. Therefore, military tenure initially was the most important and imperative form of service that the lord required. 1 AM. L. PROP., *supra* note 2, § 1.4; S. MILSOM, *supra* note 21, at 102-03. Although military tenure declined in importance relatively early, Parliament did not abolish it until 1660 and then only to convert lands held by military tenure into tenure by socage. Statute of 1660, 12 Car. 2, ch. 24; 1 AM. L. PROP., *supra* note 2, § 1.35, at 9.

23. Pollock and Maitland describe a situation in which land was held in "the serjeanty of finding three arrows when the king should hunt on Dartmoor." 1 F. POLLOCK & F. MAITLAND, THE HISTORY OF ENGLISH LAW 335 (2d ed. 1898 reissued 1923).

24. For a more detailed discussion of the forms of tenure and their incidents, see 1 AM. L. PROP., *supra* note 2, § 1.4; S. MILSOM, *supra* note 21, at 99-103.

25. G. CHESHIRE, *supra* note 20, at 14.

26. Law of Property Acts, 1922 & 1925; G. CHESHIRE, *supra* note 20, at 26-7.

dents. The ownership of consecutive estates would not be enhanced by holding them separately. A duty owed to oneself is a nullity, and possession cannot be divided among one.[27] In light of the fact that the interests holder was not benefited by holding the two estates separately, merger was the tool for combining the estates, which simplified the state of title. Rather than describe ownership of the property through four levels of subinfeudation, for example, it could be described through only three levels.

As the courts of law recognized new types of interests in land, however, the courts inexorably applied the doctrine of merger to these interests with strict literalness, ignoring the nonsubstantive purpose for merger. The paradigmatic example of the substantive intrusion of merger is the doctrine of destructibility of contingent remainders. After the courts of law had recognized contingent remainders as a valid interest in the fifteenth century,[28] the courts applied merger to destroy those remainders when the holder of the possessory estate acquired the reversion following the contingent remainder or when the reversion holder acquired the possessory estate, even when the sole purpose for the conveyance was to destroy the intervening contingent remainder.[29] This result devolved

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27. The owner of the consecutive estates still was entitled to receive the tenurial services to be rendered in connection with any subinfeudation of his junior estate and was obligated to perform the services to be rendered in connection with the creation of his senior estate. Obviously, however, his continued enjoyment of the benefits flowing from his interest in the land no longer depended on his performance of the services to be rendered in connection with creation of the junior estate because he was the person entitled to the performance of those services.

Littleton describes this process as an "extinguishment" because it does not enlarge the owner's holdings.

> [R]eleases which enure by way of extinguishment against all persons, are where he to whom the release is made, cannot have that which to him is released. As if there he lord and tenant, and the lord release to the tenant all the right which he hath in the seigniory, or all the right which he hath in the land, . . . this release goeth by way of extinguishment against all persons, because that the tenant cannot have service to receive of himself.
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> . . . In the same manner is it of a release made to the tenant of the land of a rent charge . . . because the tenant cannot have that which to him is released . . . so such releases shall enure by way of extinguishment in all ways.

LITTLETON'S TENURES §§ 479, 480 (E. Wambaugh ed. 1903) (footnotes omitted).

28. 7 W. HOLDSWORTH, A HISTORY OF ENGLISH LAW 81 (2d ed. 1937).

29. In the famous case of Purefoy v. Rogers, 2 Wms. Saund. 380 (1671), 85 Eng. Rep. 1181 (1908), for example, a woman held a life estate, followed hy a remainder to her son if one should be born. Before the life tenant gave birth to a son, the reversion holder conveyed the reversion to her spouse and her. Because a son had not been born, the grant to a son was a contingent remainder. The court held, therefore, tbat the life estate merged into the reversion to create a fee simple estate, thereby destroying the contingent remainder.

Courts also applied merger to destroy a contingent remainder in the converse case. In from the courts' categorization of contingent remainders as mere expectancies of an interest in land upon the happening of a stated event rather than as estates in land. Because these remainders were not intervening estates, the courts reasoned that merger validly applied and thus united the currently possessory estate with the reversion, which completely bypassed the grantor's intended contingencies.[30]

Pressure for increased alienability of land is the policy normally cited for the doctrine of destructibility of contingent remainders. Today, we would argue that such radical treatment of contingencies should be left to the legislature. It is especially unfortunate that a device developed merely to facilitate transactions was transformed by judicial fiat into a substantive device. Although the courts' application of merger to destroy contingent remainders increased the alienability of land, it defeated the grantor's express intent and destroyed the interests of the contingent remainder holders.[31] The recognition of contingent remainders as a valid

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Thompson v. Leach, 2 Vent. 198 (1691), 86 Eng. Rep. 391 (1908), a person owned a life estate in a parcel of land, followed by contingent remainders in tail, then by a vested remainder in tail, and finally by a remainder in fee. Before the contingency occurred on which the contingent remainders depended, the life tenant surrendered his interest in the land to the holder of the vested remainder in tail. The court held that the intervening contingent remainders would have been destroyed by the life tenant's surrender of his estate but for the fact of his mental incompetence. *See* C. FEARNE, ON THE LEARNING OF CONTINGENT REMAINDERS AND EXECUTORY DEVISES (1772), in CLASSICS OF ENGLISH LEGAL HISTORY IN THE MODERN ERA (1979).

30. Some commentators have theorized that the operation of merger to destroy contingent remainders is the basis for the infamous Rule in Shelley's Case. The Rule is named for the case Wolfe v. Shelley, 1 Co. Rep. 88b, 93h (1581), 76 Eng. Rep. 199, 206 (1907), though it originated in Abel's Case, Y.B. Edw. 2, 577 (1324). The Rule operates to convert a conveyance "to A for life, remainder to bis heirs" or "to A for life, remainder to the heirs of his body" into fee simple or fee tail estates, respectively, in A. If a testator owned fee simple title to a parcel of land and devised it to his oldest son for life with a remainder to the son's heirs, the son would receive a life estate by the terms of the will and the reversion in fee simple by descent. If the intervening remainder to the son's heirs was contingent, which it must be if the son were still alive, the life estate and reversion would merge to destroy the contingent remainder and to vest the son with fee simple title. Similarly, if the owner of a parcel of land conveyed it *inter vivos* to his oldest son for life with a remainder to tbe son's heirs, the oldest son would acquire not only a life estate, but also the next vested estate of inheritance. If the son was alive when this conveyance became effective, the remainder in his heirs was contingent and was destroyed by operation of merger. 7 W. HOLDSWORTH, *supra* note 28, at 109-10. Other possible explanations for the origin of the Rule are set forth in 4 J. KENT, *supra* note 12, at 215-18, and in L. SIMES, LAW OF FUTURE INTERESTS §§ 20, 21 (2d ed. 1966).

31. Ironically, while the law courts used merger to destroy property interests, those courts held that merger had not occurred in one situation in which merger would not have affected property rights significantly. Some of the earliest merger cases involved the situation in which the lessee of land married the owner of the reversion following the leasehold.

interest precluded the transactional simplification of title. The simplification of title instead should have depended on whether the contingency occurred and not on the application of merger.

Although courts at this time rarely explained the reason for merger or for the court's application of merger in a particular case, when a court of law did explain its application of merger to destroy an otherwise valid property interest, its reasoning was superficially similar to that employed with respect to the earlier feudal estates. For example, in *Hecker's Case*,[32] a 1523 decision, a church leased certain church lands to a person who subsequently was appointed parson of the church while the lease term was in effect. At this time, a parson was treated as being in full possession of the rights and obligations of his parish. The court held, therefore, that the tenancy merged into the reversion retained by the church because "[t]he same person at the same time, cannot have an assise[33] and an ejectione firmae[34] . . . ."[35] As described in a case decided sometime during the period between 1548 and 1579, *Hecker's Case* turned on the fact that a parson was viewed as holding the fee interest, as well as the leasehold interest, in his individual capacity.[36]

During tbis era in the development of real property law, a husband was treated as the owner of his wife's real property. His use of the land was unfettered by any claim by his wife. For example, he bad the right to collect and to use all rents and profits from his wife's lands without any obligation to account to her. Despite this fact, tbe courts of law held that the husband did not acquire fee simple title to the land upon marriage by operation of merger because the husband held one interest in his own right and the other interest *in autre droit*. *See, e.g.*, Thorn v. Newman, 3 Swans. App. 603 (1673), 36 Eng. Rep. 992 (1904); Platt v. Sleap, Cro. Jac. 275 (1611), 79 Eng. Rep. 236 (1907); Bracebridge v. Cook, 2 Plow. 416, 418-19 (1548-79), 75 Eng. Rep. 626, 629-32 (1907). Coke states that merger did not occur only if the husband owned the freehold in his own right and the term for years *in autre droit*. According to Coke, merger would occur in the reverse situation. Coke Litt. 338.b. This statement confiicts with the holding in Platt v. Sleap.

32. 14 Hen. 8, 2 Jenk. 200 (1523).

33. An assise is an action for possession available to the holder of the fee.

34. An *ejectione firmae* is an action for possession available to a tenant.

35. Littleton broadly stated the same result when a tenant acquires the reversion. In his treatise on tenures in land, Littleton describes a merger of title, though he does not refer to it as such, when the holder of the fee lets lands "to one for term of years, by force whereof he is in possession, and after" the owner releases the reversion to the tenant and his heirs. In this case, the tenant is treated as owning fee simple absolute title. LITTLETON'S TENURES, *supra* note 27, § 465.

36. Bracebridge v. Cook, 2 Plow. 416, 420 (1548-79), 75 Eng. Rep. 626, 632-33 (1907). This view of the law applicable to *Hecker's Case*, however, was not accepted universally. At least one justice stated that merger should not destroy the leasehold because the parson held the fee and leasehold interests in different capacities. He owned the leasehold in his individual capacity and the fee in his capacity as parson. *Id.* Even accepting that the parson in *Hecker's Case* held the interests in different rights, the interests would have merged

As stated by the court, the reason for applying merger was virtually identical to that expressed by the feudal maxim *Nemo potest esse dominus et tenens*. The court updated the maxim to reflect the court's recognition of a tenancy for years as an estate in land and of the attendant causes of action that had developed with respect to that estate. By unthinkingly adopting the form of the feudal maxim, however, the court's statement of its reason for applying merger converted merger from a transactional aid for simplifying property titles into a compulsory rule to be applied regardless of the owner's best interests. By 1523, interests in land had evolved beyond the bare right to possess or to receive feudal incidents, which were the primary rights in land when merger originated. By neglecting to focus on the reason for merger rather than on the words used to explain the application of merger at an earlier stage in the evolution of estates in land, the court extended merger beyond its appropriate scope and committed the same error that other courts had committed by applying merger to destroy contingent remainders. If the tenant in *Hecker's Case* had obtained a lease for one hundred years, for example, the court's application of merger destroyed that portion of the tenancy interest that still would have existed at the tenant's death.

The reported opinion in *Hecker's Case* does not include sufficient facts to determine whether the court's application of merger to the facts in that case was harmful. This lack of information concerning the legal, social, political, and economic issues involved in that case has two results: (1) a decision comprehending a particular complex of facts may be applied in its reduced form in wholly inappropriate ways; and more selfishly, (2) the legal historian's job is rendered more difficult, if not impossible. Indeed, the danger created by the coupling of the court's incorrect description of merger in that case with the somewhat cryptic statement of its reasoning is demonstrated by its infectious effect in other cases decided during the same era.

For example, during this time period courts of law held that when a landlord borrowed money from his tenant and granted the tenant a mortgage on the reversion following the tenancy, the tenancy interest merged into the reversion and was extinguished.[37] If the landlord paid the loan in full on the specified day, which released the mortgage, the tenant had no further interest in the land

according to Coke. Coke Litt. 338.b. *See also* 4 J. KENT, *supra* note 12, at 102.

37. Case #5, Gouldsborough 93 (1588); XVII Mich., 4 Eliz., 3 Leonard 7 (1562).

even if the lease term had not expired according to its terms. The courts treated the tenancy as having been merged into the reversion when the mortgage was given, even though the term of the tenancy was longer than the mortgage term. This application of merger resulted in an obvious destruction of the leasehold interest, which defeated the parties' expectations, without creating any transactional or other benefits. Indeed, the courts' application of merger in this context created transactional costs by necessitating the negotiation and execution of another lease.

Similarly, Coke, in his *Commentaries on Littleton*, stated that merger operates to destroy a term for years when the lessee acquires a life estate in the same land even if the term for years would have lasted longer than the life estate.[38] Because a term for years, categorized as a chattel real, was considered at law to be an inferior estate to the life estate, the courts of law applied merger, although this application potentially reduced the grantee's rights in the land. Indeed, by applying merger to destroy the term for years, the law courts ignored not only the purpose for the merger doctrine, but also the grantor's purpose. The grantor probably conveyed the term for years in addition to the life estate to ensure that the grantee or his heirs would have the right to possess the property for a minimum number of years, as specified in the term for years.[39] The grantor's and grantee's intent, however, could not prevent the courts of law from applying merger to destroy the term for years.

The courts of law also distorted merger when considering situations in which ownership of a fee title and a mortgage encumbering that title united in a single entity. The courts of law merged these interests for the stated reason that the same person cannot be debtor and creditor.[40] Again, this rationale for applying merger

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38. "[I]f a man make a lease to one for 21 yeares, the remainder to him for terme of his life, the lease for yeares is drowned." Coke Litt. 54.b.

39. 3 R. PRESTON, *supra* note 12, at 44-45.

40. A possible explanation for this result is that application of merger in this context ensured that the entire title to a parcel of property would descend to one set of heirs, rather than the interests "becom[ing] split and divided between the personal and real representatives." J. POWELL, A TREATISE ON THE LAW OF MORTGAGES 487-88 (1st Am. ed. 1807). For example, if a borrower granted a term for years to secure a loan and subsequently acquired the term, a court of law would merge the interests to avoid the term descending to the borrower's personal representatives upon his death and the reversion descending to his real representatives. This problem largely has been obviated today because a property owner can execute a will specifying to whom title will devolve. This right was created by the Statute of Wills, which was adopted by Parliament in 1540. Furthermore, even if the owner dies intestate, modern intestate succession statutes normally do not distinguish between real and per-

is similar to that expressed by *Nemo potest esse dominus et tenens*. Like the statement expressed by the court in *Hecker's Case*, however, the maxim that the same person cannot be debtor and creditor is a fine adage, but a poor and overly broad statement of the situations to which merger should apply. When a lender acquires fee title to land on which he holds a mortgage, the lender often has a legitimate, beneficial reason for preventing merger.[41] The courts of law, however, applied merger regardless of the owner's best interest.

The law courts may have extended merger out of a misplaced desire to increase alienability of land,[42] or they simply may have been mesmerized by the thaumaturgy of words (Latin having proven to be especially magical to lawyers). Eventually, however, the court of equity, which was more firmly rooted in the world than in the law, was petitioned to effectuate a grantor's and grantee's intent by refusing to apply merger.[43] In response, during the seventeenth century[44] the court of equity began to decline to apply merger when the court believed the application would cause an unjust result. In *Thorne v. Newman*,[45] for example, Baker acquired a ninety-nine year term in a parcel of land, which he assigned to secure a debt. His wife subsequently acquired the freehold, so that he became seised of the freehold *in autre droit*. Baker then argued that the term had merged into the freehold estate, which extinguished the lender's interest in the property. Although the court of equity stated that the legal doctrine of merger was applicable according to its terms, the court declined to apply it. Lord Nottingham stated that on the facts of the case, "whatever the law be, it ought to be no merger in equity."[46] Thus, by using its equitable power, the court prevented a destructive application of merger.

In an attempt to restore merger to its original nonsubstantive character, the court of equity subsequently adopted a broader strategy than using its general equitable powers. Having no power to overrule the law courts, the court of equity instead created an

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sonal property in specifying the descent of title to the decedent's property.

41. *See infra* notes 182-211 and accompanying text.

42. 7 W. HOLDSWORTH, *supra* note 28, at 111; L. SIMES, *supra* note 30, § 22, at 48.

43. 7 W. HOLDSWORTH, *supra* note 28, at 295; 4 J. KENT, *supra* note 12, at 103-04; 3 R. PRESTON, *supra* note 12, at 45.

44. 7 W. HOLDSWORTH, *supra* note 28, at 110-11.

45. 2 Ch. R. 71 (1672-73), 21 Eng. Rep. 619 (1902).

46. Thorn v. Newman, 3 Swans. 603 (1673), 36 Eng. Rep. 991 (1904).

exception to the doctrine: Merger would apply only if the holder of the property interests intended them to merge. If the holder of the interests had a beneficial reason for holding them separately, she could do so by expressing that intention. This exception operated to eliminate the destructive aspect of merger as applied by the courts of law and to restore merger to its original nonsubstantive transactional use.

The equitable exception originated in a 1696 Chancery opinion, *Thomas v. Kemeys*,[47] though the opinion gives little indication of that fact. In *Thomas* a girl's parents conveyed a term for years in a parcel of land to trustees to raise a specified amount of money for her. The parents then created a fee tail male in the land subject to the term, with a remainder to the father's heirs. The parents' only children were the daughter and a son, who died in his infancy. The daughter, therefore, inherited the land upon her father's death. She then died, devising the land to her mother. When her mother went into possession of the land, the trustees filed an action in ejectment to recover possession pursuant to the term for years.

The mother argued in defense to the action that the daughter's interest in the term had merged into the fee and that, in any event, the purpose for the trust, to provide for the daughter, terminated upon the daughter's death. The trustees countered that the daughter's interests could not merge because she did not own them in the same right. That is, she owned the fee—subject to the term—in her own right, whereas she owned only the equitable title to the term. The trustees further argued, however, that,

> [w]here an infant hath two rights in her, this court which is to take care of infants will always preserve that right, which is most beneficial to the infant; and in this case, it was for the interest and advantage of the infant, that the portion should be looked upon as a continuing and subsisting charge,and not sink into the inheritance . . . .[48]

The trustees buttressed this argument with cases in which Chancery had exercised its equitable powers to protect a child or a mentally incompetent person. That the child was dead when suit was brought indicates the trustees were focusing on whether the interests coalesced when acquired.

The Lord Chancellor held in *Thomas* that the interests had not merged. The one sentence holding concerning the issue of

47. 2 Vern. 348 (1696), 23 Eng. Rep. 821 (1902).
48. *Id.* at 352, 23 Eng. Rep. at 822.

merger is conclusory, but indicates that the basis for the holding was that the daughter held the interests in different rights: "[A]s the term in law was not merged, so neither was the trust determined or extinguished in equity, but remained still a subsisting charge upon the estate . . . ."[49] The court did not indicate that its holding was grounded on a policy of affording children special protection. Instead, the court found no equitable reason for altering the basic rule of law that merger will not occur when the owner has legal title to one interest and only equitable title to another interest in the same land.[50]

Despite the limited holding in *Thomas* quoted above, the court of equity later seized upon *Thomas* as the vehicle for creating the equitable exception to merger. *Compton v. Oxenden*[51] was the first reported decision in which the court discussed and extended *Thomas*, if only in unequivocal dictum. In that case, which was decided in 1793, a mentally incompetent person who owned a parcel of land subject to two trust terms subsequently inherited the trust terms. The court held that the trusts had terminated because the purpose for the trusts no longer existed and recited the legal maxim that merger occurs when the same person becomes the creditor and the debtor with respect to the same debt. Citing *Thomas*, however, the court then stated: "But it is true in equity, though there may be that, which if all was reduced to a legal right, would of necessity operate as a merger, this Court acting upon the trust will on the intent express or implied preserve them distinct . . . ."[52]

The court described the *Thomas* result as turning on the daughter's "supposed intent."[53] Moreover, the court focused its examination on the benefit or detriment merger would confer on the owner of the rights in question. The court reasoned that the daughter in *Thomas* benefited at the time of her father's death by retaining the trust term separate from the fee title because the daughter could use and dispose of the trust term, which was an

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49. *Id.* at 354, 23 Eng. Rep. at 823.

50. The court readily could have found an equitable reason for holding that the interests had merged. Because the daughter was dead, she could not be benefited by the term for years. The court's refusal to merge the interests may be attributable to the fact that tbe issue of merger was determined for all purposes at the moment when the daughter acquired the second interest. This interpretation is consistent with some commentators' descriptions of the operation of merger.

51. 2 Ves. Jr. 261 (1793), 30 Eng. Rep. 624 (1903).

52. *Id.* at 264, 30 Eng. Rep. at 625.

53. *Id.*

item of personal property, before she became twenty-one years old, whereas she had no disposable interest in the land until she became twenty-one. Although the daughter in *Thomas* had not expressed any intent concerning merger, the court in *Compton* stated that the court of equity would act upon the supposed intent an infant would have could she express it. Essentially, the court acted on a presumption based on the intent a rational person would have if possessed of the same property interests.

The *Compton* court's description of the holding in *Thomas* is surprising for two reasons. First, the result in *Thomas* was logically unnecessary to the holding in *Compton.* Second, the *Thomas* holding ostensibly was based on traditional legal doctrine rather than on equitable concepts of the daughter's intent or of what was most beneficial to her. Indeed, the inclusion of this dictum at this time might indicate that the ambit of merger was a contested issue of the day. The court's strongly stated dictum concerning merger, however, was not without precedent.

Although *Compton* was the first published opinion in which a court of equity clearly stated an "intent" exception to merger, an earlier, unpublished opinion cited in the *Compton* decision undoubtedly influenced the court. In *Gwillam v. Holland*[54] the owner of a charge against a parcel of land subsequently inherited the land from her brother. Her brother had mortgaged the land after the charge attached to it, thereby conveying the legal estate in the land to the mortgagee. Because the owner of the charge had inherited only her brother's remaining equitable estate in the land, even a court of law would have held that the interests did not merge, and the court of equity so held. The *Gwillam* court further stated, however, that the holder of the interests was benefited by keeping the charge distinct so as to avoid giving priority to the mortgagee.[55] As in *Compton,* this observation concerning the benefit to the holder was unnecessary to the holding in the case; both cases were governed by the traditional legal rule of merger.

These dicta coalesced into a judicially recognized and approved equitable exception in *Forbes v. Moffatt,*[56] decided eighteen years after *Compton.* In that case, a mortgagee subsequently acquired title to the mortgaged property. Unlike the previous cases, no rule of law operated to keep the estates distinct and,

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54. *Cited in* Compton v. Oxenden, 2 Ves. Jr. 263, 264-5, 30 Eng. Rep. at 625-26 *and in* Forbes v. Moffatt, 18 Ves. Jr. 384, 393-94 (1811), 34 Eng. Rep. 362, 366 (1903).
55. Compton v. Oxenden, 2 Ves. Jr. at 264-65 (1793), 30 Eng. Rep. 624 (1903).
56. 18 Ves. Jr. 384, 34 Eng. Rep. 362 (1811).

therefore, they would have merged at law despite the obvious advantage to the holder in retaining the priority of his lien over junior liens encumbering the property when he acquired it. The *Forbes* court, citing *Thomas, Compton,* and *Gwillam,* held in broad language that the mortgage had not merged into the fee:

> It is very clear that a person, becoming entitled to an estate, subject to a charge for his own benefit, may, if he chooses, at once take the estate, and keep up the charge. Upon this subject a Court of equity is not guided by the rule of law. It will sometimes hold a charge extinguished, where it would subsist at law; and sometimes preserve it, where at law it would be merged.[57]

The *Forbes* court clearly stated its refusal to apply the legal doctrine in determining issues of merger, and it was successful in permanently altering the course of merger, especially as applied to mortgages. Indeed, the equitable exception stated in *Forbes* essentially swallowed the legal doctrine of merger. Rather than blindly applying the doctrine regardless of the injury to or destruction of property rights, courts, from that point on, focused on the real world effect merger would have on ownership interests.

The *Forbes* court's touchstone for merger application became the owner's "intent." After stating that equity could refuse to merge interests that law would merge, the court announced that the application of merger would turn on the effects of merger on the owner rather than on estate theory.

> The question is upon the intention, actual or presumed, of the person in whom the interests are united.
>
> . . . .
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> . . .Where no intention is expressed, or the party is incapable of expressing any, I apprehend the Court considers what is most advantageous to him.[58]

Earlier Chancery decisions, such as *Thomas,* had indicated that the owner of the interests could prevent their merger only by expressly stating that desire. This burden on the owner was quite onerous if the owner was an infant, mentally incompetent, or a person otherwise afforded special protection by Chancery. In such situations, the court *sub silentio* presumed that the owner would desire the result most beneficial to him, hence the fictional "supposed intent" in *Thomas.* The property owner in *Forbes,* however, suffered from no disability and had not expressed any intention concerning merger. The *Forbes* formula for the requisite intent thus envisioned a much broader role for the equitable exception to merger: The court of equity would not hold that interests had

57. *Id.* at 390, 34 Eng. Rep. at 364.
58. *Id.* at 390-92, 34 Eng. Rep. at 364-65.

merged if the owner's property rights would be injured.

This focus on the effect of merger on the owner is the appropriate method for analyzing merger problems. Merger originated before detailed written records of land transactions were maintained in England and before land conveyances were effectuated by writings. It was merely a tool to simplify property titles before alternative methods, such as recording a release in the public property records, existed. By simplifying titles, merger facilitated property transactions. The law courts' applications of merger, however, hampered property transactions by defeating conveyancers' expectations and by destroying valuable property interests. The increasing dominance of the equitable exception after the *Forbes* decision, therefore, is not surprising. Indeed, Parliament ultimately ratified the exception. In 1873 Parliament adopted the Judicature Act, which provides in part: "There shall not after the commencement of this Act be any merger by operation of law only of an estate, the beneficial interest of which would not be deemed to be merged or extinguished in equity."[59]

The American doctrine of merger firmly embraces the equitable exception. From the earliest reported American cases involving merger, courts have stated that merger will apply only if the owner so intends. As in England, courts generally equate the owner's "intent" with the result most beneficial to him.[60] Indeed, the notion of protecting existing property rights, such as security priorities, from merger is now so firmly embedded in American property law that many courts do not treat interests as merged even when the owner originally expressed an intention that his interests merge but subsequently had a nonfraudulent reason for holding them distinct.[61]

Despite the adoption of an expansive equitable exception to merger, the doctrine continues to plague property owners. The continuing impact of the English law courts' merger doctrine is demonstrated by the fact that at least one American jurisdiction has not recognized the equitable exception and accordingly has destroyed property interests without regard to the owner's best interests.[62] A more insidious aspect of the development of merger is

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59. 36 & 37 Vict., ch. 66, § 25(4) (1873).

60. *See, e.g.,* Lockwood v. Sturdevant, 6 Conn. 373, 388-90 (1827); Baldwin v. Norton, 2 Conn. 161, 163-64 (1817); James v. Johnson, 6 Johns. Ch. 416, 422-24 (N.Y. Ch. 1822); Gardner v. Astor, 3 Johns. Ch. 53, 55-56 (N.Y. Ch. 1817).

61. *See infra* notes 213-14 and accompanying text.

62. *See infra* notes 240-42 and accompanying text.

modern courts' rote applications of the simplistic and obsolete maxims developed by law courts for explaining the reason for merger. For example, the statement that "a person cannot be the debtor and creditor with respect to the same debt" simply does not comprehend modern financing methods and notions of title. Modern courts, however, still recite this and other similarly outdated maxims in cases involving a person who holds fee title to a parcel of property and a mortgage encumbering it. As demonstrated in the following sections of this Article, that maxim does not apply to modern mortgages and should not be used to destroy them or their attendant security priorities. Furthermore, widespread adoption of the equitable exception, coupled with the universal existence of title recording systems in America, virtually has destroyed the utility of merger as a title simplification device. Instead, merger has become a trap for the unwary purchaser.[63]

B. Mortgages

1. English Development

As discussed above, post-feudal merger properly applies only when the owner of two or more consecutive estates in land holds them in the same right and has no beneficial reason for holding them separately. Theoretically, therefore, merger should apply to mortgages only if they constitute an estate in land. Examination of the forms of land security from their medieval origins to their current form demonstrates that although some early mortgage counterparts did convey an estate in land to the lender, the modern mortgage does not do so.[64] Like the mechanics' lien, judgment lien, or other forms of debt lien, the modern mortgage empowers its holder to sell, under circumscribed conditions, the encumbered land to satisfy the secured debt, but does not vest its owner with any of the normal attributes of ownership of an estate in land. Therefore, as a matter of title theory, merger should not apply to mortgages because estates in land simply are not involved.

The history of mortgages is at least as ancient as our written records, though relatively little detailed information is available

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63. *See infra* notes 255-59 and accompanying text.

64. Although a few states still describe mortgages as conveying an estate in land, examination of the law and practices in these states reveals that tbe mortgage is a mere appurtenance of the secured debt rather than a title conveyance. *See infra* notes 148-68 and accompanying text.

concerning the methods used before 1066.[65] Because land was central to the predominantly agrarian medieval economy and because of the permanence and immovability of land, it has been an attractive form of security for as long as private property rights have been recognized and protected. Furthermore, the availability of land as security made loans available on less stringent terms than otherwise might have existed.[66] At the same time that the doctrine of merger was evolving into its present form, English medieval conveyancers were grappling with the problem of securing loans of money with the borrower's land. As with the doctrine of merger, the forms of land security first were shaped by the theories of the courts of law, but did not assume the forms recognized today until the more practical court of equity had ameliorated the strictness of the legal forms.

During the earliest part of the English feudal period, from approximately 1066 through 1250, a possessor of land was not free to use it as security for a debt. Because written conveyancing records did not exist, possession was the primary method by which a property interest holder, including a secured lender, manifested and protected his interest. As discussed above, however, possession of property inextricably was linked to personal services to be rendered to superior interest holders.[67] The importance of these services cannot be overestimated: the tenant was the person obligated to provide services for the lord "in war and peace."[68] During this time, therefore, a possessor of land was not free to convey the right

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65. In his treatise on mortgages, Jones states that mortgages have existed since antiquity. 1 L. JONES, THE LAW OF MORTGAGES OF REAL PROPERTY § 1 (8th ed. 1928). A reference to mortages is included in the Old Testament:

> Now there arose a great outcry of the people and of their wives against their Jewish hrethren. For there were those who said, "With our sons and our daughters, we are many; let us get grain, that we may eat and keep alive." There were also those who said, "We are mortgaging our fields, our vineyards, and our houses to get grain hecause of the famine." And there were those who said, "We have borrowed money for the king's tax upon our fields and our vineyards. Now our flesh is the flesh of our brethren, our children are as their children; yet we are forcing our sons and our daughters to be slaves, and some of our daughters have already been enslaved; but it is not in our power to help it, for other men have our fields and our vineyards.

Nehemiah 5:1-5. *See also* G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES § 1, at 2 (2d ed. 1970); Hazeltine, *The Gage of Land in Medieval England*, 17 HARV. L. REV. 549, 552 (1904); Kratovil, *Mortgages—Problems in Possession, Rents, and Mortgagee Liability*, 11 DEPAUL L. REV. 1, 1 (1961).

66. F. POLLOCK, THE LAND LAWS 132-33 (3d ed. 1896).

67. J. POWELL, *supra* note 40, at 3-4; 3 J. STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 1348 (14th ed. 1918).

68. J. POWELL, *supra* note 40, at 3-4.

to possess unless the lord of the manor agreed to performance of these essential and personal services by the new tenant.

A dramatic change occurred when license to alienate interests in land was granted at about the time of Henry III.[69] The earliest form of common-law real estate security, the gage, was introduced almost immediately.[70] Our information about the gage comes from Glanville,[71] who described two primary types of gage in use at this time, the *vif gage* or *vivum vadium* ("living pledge") and the *mort gage* or *mortuum vadium* ("dead pledge"). According to Glanville, under both types of gage the gagor authorized the gagee to take possession of the encumbered land and to collect the rents and profits from it.

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69. W. Holdsworth, An Historical Introduction to the Land Law 102-09 (1927); 1 F. Pollock & F. Maitland, *supra* note 23, at 329-49; 1 J. Powell, *supra* note 40, § 1, at 4 (1799). The historical records do not provide a clear picture of restraints on alienation during the feudal period. The existing records do indicate, however, that significant restraints existed before enactment in 1290 of the statute Quia Emptores, 18 Edw. 1. Before enactment of Quia Emptores, a tenant could convey his interest in land and could suhstitute a new tenant in his place as the person to perform the feudal incidents connected with the estate only with the lord's permission. This process was called "suhstitution." The tenant also could convey the right to possess the land in exchange for the new tenant's agreement to perform tenurial services for the conveying tenant rather than for the lord. This process, called "subinfeudation," created a new feudal relationship and may not have required the lord's consent.

As describhed above, a particular parcel of land might be transferred several times by subinfeudation. Although each tenant in the chain of subinfeudations continued to be responsible for performance of the obligations to which he agreed in connection with his acquisition of his interest in the land, subinfeudation might substantially affect the value of the tenurial incidents associated with the land. Pollock and Maitland cite as an example the situation in which A enfeoffed B to hold by knight's service and then B enfeoffed C to hold for rent of a pound of pepper. If B dies survived by a child, A still is entitled to wardship of the child, but the wardship is worth substantially less after the subinfeudation to C. Instead of being able to take possession of the land before the child is an adult, A will be entitled only to the rent of pepper. 1 F. Pollock & F. Maitland, *supra* note 23, at 330-31.

Because of the importance of the tenurial incidents, the monarch agreed to a compromise with the tenants. The statute Quia Emptores provided that a tenant in fee simple could substitute another tenant in his place without the lord's consent, which gave the tenant a free right of alienation by substitution. In exchange, the statute was construed to forbid future subinfeudations, thereby protecting the lord's tenurial incidents.

70. 3 J. Story, *supra* note 67, § 1348. Pollock and Maitland state that the gage may have been used as early as the twelfth century. 2 F. Pollack & F. Maitland, *supra* note 23, at 118-19.

71. Ranulph De Glanville was Chief Justiciar of England under Henry II and was one of the earliest English legal commentators. He described the *vif gage* and the *mort gage* in A Treatise on the Laws and Customs of the Kingdom of England, bk. X, ch. 6-11 (J. Beames trans. 1900), which was published between 1187 and 1189 (although legal scholars have questioned wbether Glanville actually authored the treatise). *Id.* at xiii-xvi. The treatise is the earliest systematic treatise on law written in modern times. *Id.* at xvi. *See* 1 G. Glenn, *supra* note 5, § 2, at 3 n.2; 3 R. Powell, *supra* note 2, § 438.

Depending on the type of gage given, however, the financial consequences were vastly different. Pursuant to a *vif gage*, the gagee was required to apply the rents and profits to reduce the outstanding debt. The pledge was "living" because it reduced the debt. Glanville described this form of security as "just and binding."[72] Glanville denounced the *mort gage*, on the other hand, as "unjust and dishonest"[73] because the gagee was not required to apply the rents and profits to reduce the debt.[74] The pledge was "dead" because the pledged property was not generating any benefit for the gagor.

In addition to being disfavored as "unjust," the *mort gage* was considered a type of usury because the gagee received the rents and profits as "interest."[75] Although the courts of law did not prohibit lenders from charging interest on loaned money on the basis that the courts should not interfere with private contracts,[76] the English Church prohibited interest as a form of usury. Indeed, a Christian lender who died while holding a *mort gage* died as a sinner, and his personal property was forfeited to the monarch.[77] As an illustration that human nature has changed little since the medieval period, the short term economic gain apparently outweighed the possibility of a long term penalty in the afterlife, and the *mort gage* was the predominant form of gage employed by Christian and Jewish lenders alike.[78]

No reported case or commentator discusses the applicability of merger to the *vif gage* or to the *mort gage*. The legal treatment of the gagee's interest, however, was inconsistent with an interest in land and, therefore, also with the applicability of merger. Although the gagee's possession of the land pursuant to either type of gage

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72. R. GLANVILLE, *supra* note 71, at bk. X, ch. 8.

73. *Id.*

74. "A pledge is designated by the Term Mortgage, when the fruits and rents, which are received in the interval, in no measure tend to reduce the demand for which the pledge has been given." *Id.* at bk. X, ch. 6.

75. *Id.* at bk. X, ch. 8; 1 L. JONES, *supra* note 65, § 5, at 6; R. TURNER, THE EQUITY OF REDEMPTION 17 (1931). Although the holder of a *vif gage* also might charge interest, that action alone did not constitute usury. As long as the gagee was to be repaid only from the income and profits generated by the pledged land, a risk existed that the loan would not be repaid. Pursuant to a *mort gage*, on the other hand, the gagee was entitled to collect the loan from the gagor, as well as to collect the income and profits from the land. Therefore, the *mort gage* correctly was considered to be usurious. 1 G. GLENN, *supra* note 5, § 2, at 5.

76. A. SIMPSON, AN INTRODUCTION TO THE HISTORY OF THE LAND LAW 132 (1961).

77. R. GLANVILLE, *supra* note 71, at bk. X, ch. 8; Hazeltine, *supra* note 65, at 552.

78. G. OSBORNE, *supra* note 65, § 1, at 4; 2 F. POLLOCK & F. MAITLAND, *supra* note 23, at 119.

was characterized as *seisina et de vadio* ("seisin by way of pledge"), the gagee did not have actual seisin or a recognized estate in land but only the right to possession until the debt was paid. As a consequence, if a stranger to the title ousted the gagee from possession of the property, the gagee could not bring a possessory action; because the gagor retained seisin, only he had the right to bring the action. Even if, in total derogation of the gage relationship, the gagor ousted the gagee or refused to deliver possession of the land, the gagee had no cause of action to obtain possession.[79]

Glanville attributed the inferiority of the gagee's interest to the distinction between rights in the land and rights in the debt. That is, the gagee enjoyed no rights in the land but only in the debt, albeit secred by the land.[80] Later commentators, however, have attributed the absence of protection for the gagee's interest to the embryonic stage of development of the possessory forms of action, such as the assise of novel disseisin. Because the gagee's *seisina* was not a freehold estate, the king's justices did not believe that the courts should protect it.[81] The gagee also may have been denied protection because of the connection between the *mort gage* and usury.[82] The forms of possessory actions then available were designed to protect the owners of recognized freehold estates only,

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79.

> If the Creditor lose his Seisin, either by means of the Debtor, or any other person, he cannot recover it through the assistance of the Court; not even by a Recognition of Novel Disseisin.
>
> For if he was unjustly and without a judgment disseised of his pledge, by any other person than the Debtor himself, the Debtor may have an Assise of Novel Disseisin. If, however, the Creditor was disseised by the Debtor himself, the Court will not assist him against the Debtor, in recovering his pledge, or in giving him a Re-entry, unless through the Debtor himself; for the Creditor should resort to an original Plea of Debt, in order that the Debtor may be compelled to render bim satisfaction for his Debt.

R. GLANVILLE, *supra* note 71, at bk. X, ch. 11. *See also* 2 F. POLLOCK & F. MAITLAND, *supra* note 23, at 120-21; Chaplin, *The Story of Mortgage Law*, 4 HARV. L. REV. 1, 7 (1890); Hazeltine, *supra* note 65, at 555.

80. R. GLANVILLE, *supra* note 71, at bk. X, ch. 11.

81. 2 F. POLLOCK & F. MAITLAND, *supra* note 23, at 120-21. Another source states:

> As pointed out by Pollock and Maitland, tbe king's justices in the time of Glanville are experimenting with the new possessory actions. They are agreed that the freeholder shall have the assize of Novel Disseisin; but they are not quite sure whether the gagee really and truly has a *seisina* that calls for protection. Influenced perhaps by theories of the Italian glossators as to possessory protection, they end in refusing the gagee a remedy.

Hazeltine, *supra* note 65, at 555. *See also* R. GLANVILLE, *supra* note 71, at bk. X, ch. 8 (footnotes omitted).

82. A. SIMPSON, *supra* note 76, at 133.

not usurers.

Despite the lack of legal protection afforded the gagee's possession, possession was a necessary element of the gage: *"[S]i non sequatur ipsius vadii traditio, curia domini regis hujusmode privatas conventiones tueri non solet."*[83] Possession was the primary means by which a gagee was able to manifest his interest in the property. Furthermore, the gagee's possession prevented subsequent pledges of the property because his presence would alert potential subsequent lenders of the gagee's prior interest.[84] Granting the gagee possession also may have been a response to the early stage of development of the legal system: "As long as the administration of justice is slow, weak and formal, the creditor will secure himself by that possession which is said of old to be nine points in the law."[85] Of course, this rationale has survived in the form of certain types of pledges of personal property.

Possession also facilitated the gagee's remedy upon default. The gage contract might include a forfeiture clause, specifying that the lender would acquire title to the pledged land if the debtor defaulted in repayment of the loan. If the gage included that provision, title immediately vested in the lender upon default without the necessity of a court action. Even if the gage did not include a forfeiture clause, the lender could acquire title to the pledged land. After default, the lender would institute a court action against the debtor. If the court determined that the gage was valid and that the gagor was in default, the court would issue a writ ordering the debtor to pay the debt within the time specified by the writ. If the debtor failed to pay, the court's writ decreed that title to the pledged land would pass to the lender.[86] Because the lender

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83. "If delivery of the pledge itself do not follow, the king's court is not accustomed to take cognizance of privato agreements of this kind." 2 W. BLACKSTONE, COMMENTARIES ON THE LAWS OF ENGLAND 160 n.38 (W. Lewis ed. 1902); 1 G. GLENN, *supra* note 5, § 2, at 4. Osborne cites authority for the proposition that the gagor might retain possession of the pledged land but questions the validity of that authority. G. OSBORNE, *supra* note 65, § 1, at 2-3.

84. W. BLACKSTONE, *supra* note 83, at 160, in which Blackstone states: "[T]he frauds which have arisen since the exchange of these public and notorious conveyances for more private and secret bargains, have well evinced the wisdom of our ancient law." *Id. Accord* 1 G. GLENN, *supra* note 5, § 2, at 9.

85. Lloyd, *Mortgages—The Genesis of the Lien Theory*, 32 YALE L.J. 233, 235 (1923).

86.

> [W]hen a thing is pledged for a definite period, it is either agreed between the Creditor and Debtor, that if, at the time appointed, the Debtor should not redeem his pledge, it should then belong to the Creditor so that he might dispose of it as his own; or no such agreement is entered into between them. . . . [I]n the latter [case], the Term being unexpired without the Debtor's discharging the Debt, the Creditor may complain of

already was in possession of the property, no additional legal action was necessary to enforce the forfeiture clause or the court writ that vested title in the lender.

Therefore, although the gagee had the right to possess the pledged property, his possession was not incident to an estate in land to which merger would apply. Rather, the gagee's possession served the functions of preventing subsequent pledges of the same property and of facilitating the gagee's remedy upon default. The necessity for a writ of a forfeiture clause to transfer title to the lender strongly indicates that the lender did not acquire title to the pledged land merely by the debtor's execution of the gage. Similarly, the court's grant to the debtor of additional time to pay the debt after default reflects the fact that the lender owned only the debt and not an interest or estate in the pledged land. This conclusion is confirmed by the absence of protection for the lender's possession of the land. Therefore, because the gage did not convey to the gagee an estate in the pledged land, the inference is reasonable that merger did not apply if the gagee acquired the gagor's interest in the property or if the gagor acquired the gage.[87]

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him, and the Debtor shall be compelled to appear in Court, and answer by the following writ. . . .

"The King to the Sheriff, Health. Command *N*, that justly and without delay, he redeem such a thing which he has pledged to *R*, for a hundred Marks, for a Term which is past, as he says, and of whicb he complains that he has not redeemed it; and, unless he does so, & c."

. . .But when the Debtor appear in Court, he will either confess, that he pledged the thing in question for the Debt, or he will deny it. If he confess it, as he has in so doing confessed the Debt, he shall be commanded at a reasonable period to redeem his pledge; and, unless he should comply, liberty shall be given to the Creditor, from that time, to treat tbe pledge as his own property, and do whatever he chuses with it. . . . [I]f a thing be pledged indefinitely, and without any period being fixed, the Creditor may, at any time he chuses, demand the Debt.

R. GLANVILLE, *supra* note 71, at bk. X, chs. 6-8 (footnotes omitted). 1 G. GLENN, *supra* note 5, § 2, at 5-6; A. SIMPSON, *supra* note 76, at 133; Hazeltine, *supra* note 65, at 554. Thus, despite the usual requirement at this time for livery of seisin to convey title to land, the forfeiture clause alone was held sufficient to convey title to the gagee. 2 F. POLLOCK & F. MAITLAND, *supra* note 23, at 120; Chaplin, *supra* note 79, at 8.

The court's grant of additional time within which the gagor could pay the debt and could recover his property is an early counterpart of the equity of redemption created by Chancery in the seventeenth century. *See infra* note 112 and accompanying text. During the reign of Edward I, Longshanks (1272-1307), the law court eliminated this right to pay the debt after the due date. G. OSBORNE, *supra* note 65, § 1, at 5.

87. Some commentators might disagree with this inference because of their disagreement with the description of the basic structure of the Glanvillian gage. Consistent with the description in this Article, Osborne has characterized the gagee's interest in the pledged land as subject to a condition precedent. He states that nonpayment was a condition prece-

The succeeding form of security device adopted by medieval conveyancers was susceptible to merger. The absence of protection for the lender's possession under the Glanvillian gage was an acknowledged and substantial defect in the commercial utility of that gage.[88] To ensure protection of the lender's possession and, by inference, his security, conveyancers recast the security transaction to provide the lender a recognized and, therefore, protected estate in land.[89] Using the limited estates in land recognized at this time, the Glanvillian gage was replaced in the thirteenth century by a grant to the lender of a long term of years, such as five hundred or one thousand years, subject to the condition that the conveyance would be void upon repayment.[90] This new form of security is today called the Bractonian mortgage, in recognition of the thirteenth century commentator, Bracton,[91] who described this security device in his treatise on English law and customs.

As with the Glanvillian gage, the lender's interest in a Bractonian mortgage was treated as a conveyance of the right to

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dent to the gagee's acquisition of title to the land. G. OSBORNE, *supra* note 65, § 1, at 3. *Accord* Hazeltine, *supra* note 65, at 553. Other commentators, however, have described the gagee's interest as a determinable fee or a fee subject to a condition subsequent. These commentators view the gagee as having acquired an estate in the pledged property by virtue of the gage transaction, which estate would revert to the gagor upon payment in accordance with the terms of the gage. *See, e.g.*, 1 COOTE, TREATISE ON THE LAW OF MORTGAGES 1 (R. Ramsbotham 9th ed. 1927); 1 L. JONES, *supra* note 65, § 3, at 5. Glenn characterized the gage in modern terms "as a lease which ripened into a fee simple upon default." 1 G. GLENN, *supra* note 5, § 2, at 6. *See also* Chaplin, *supra* note 79, at 7. In light of the absence of protection for the gagee's interest and the other factors stated in the text preceding this footnote, however, the gagee's interest in the pledged land could not have been an estate in land. Therefore, merger would not have applied to the gagee's interest.

88. A. SIMPSON, *supra* note 76, at 133; Hazeltine, *supra* note 65, at 556. The gage also was objectionable to the gagor because he was deprived of his right to possess the pledged property and because, with respect to the *mort gage*, the gagee could retain all rents and profits generated by the pledged land even if the gagor repaid the loan in full according to its terms.

89. 2 F. POLLOCK & F. MAITLAND, *supra* note 23, at 121-22; Hazeltine, *supra* note 65, at 556.

90. 3 H. BRACTON, ON THE LAWS AND CUSTOMS OF ENGLAND F. 268 (G. Woodbine ed. 1977). This security device also might take the form of a long term lease to the lender, such as a lease for 500 years, coupled with a release to the borrower for a slightly shorter period, such as 499 years. The release to the borrower was subject to the condition that the release would be void if the borrower did not repay the debt on the specified date. The security device also sometimes consisted of a lease to the lender subject to the condition that the lender's interest would be void on payment and subject to the covenants that the borrower would retain possession until default and that, upon default, the borrower would convey the freehold to the lender. G. OSBORNE, *supra* note 65, § 4, at 7; J. POWELL, *supra* note 40, at 11-14.

91. Bracton was a royal judge from approximately 1245-57. G. RADCLIFFE, REAL PROPERTY LAW xxvii (1933).

possess the land until the debt was repaid. Additionally, according to the terms of the agreement, the lender's interest ripened into a fee estate if the borrower defaulted.[92] Unlike the Glanvillian gage, however, the term for years was a protectible estate in land. Because the borrower also retained an estate in land, a reversion following the term for years, the borrower's and lender's interests—both legally recognized estates in land—could be merged when held by the same person, as described by Powell in his 1799 treatise on mortgages.[93] Therefore, if a lender who held a Bractonian mortgage on a parcel of land subsequently purchased or otherwise acquired the reversion, the lender's term for years would merge into the reversion, and, in the absence of intervening interests, the lender would have the fee estate in the land.

Although the Bractonian mortgage successfully provided the lender with a protected right to possession during the life of the loan, this mortgage eventually proved to be an unsatisfactory form of security. As real property law developed from its feudal origins to strict notions of seisin and to formally defined estates in land, courts experienced increasing conceptual difficulties with the Bractonian mortgage. Courts could not logically justify the transformation of a term for years, which was characterized as a chattel

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92.

Antecessor quidem ille tenementum illud pignori supposuit creditori ad certum diem sub tali condicione, quod nisi pecunia tali die solveretur quod tenementum illud remaneret in feodo creditori. Et unde videndum, utrum dies solutionis praeterierit vel nondum advenerit. Et si praeterierit, tunc videndum erit utrum solutio facta, fuerit vivente debitore vel post mortem vel non. Si autem facta fuerit solutio vel pecunia oblata suo die sub bonorum virorum testimonio, procedet assisa in modum iuratae de solutione facta, et recuperabit heres per iuratam. Si autem soluta non fuerit nec oblata, tunc cadit assisa, et remanebit tenementum creditori, quia non est satisfactum condicioni. Si autem dies nondum praeterierit, tunc suspenditur assisa usque, ad diem, et secundum quod solutio facta fuerit ad diem suum vel non, procedet assisa in crastino vel remanebit.

[An ancestor pledged a tenement to a creditor until a certain day, subject to the condition that if the money was not paid on that day that the tenement should remain to the creditor in fee. We must (then) see whether the day of payment has passed or has not yet arrived. If it has passed, then whether payment was made in the lifetime of the debtor, or after his death, or not at all. If it was made, or the money was proffered on the day, as attested by the evidence of reputable men, the assise will proceed in the manner of a jury as to the payment made, and the heir will recover by the jury. If payment has not been made nor proffered, the assise falls and the tenement will remain to the creditor, because the condition was not satisfied. If the day has not yet passed, the assise is then suspended until the day, and, depending upon whether payment is or is not then made, will proceed on the morrow or remain.]

3 H. BRACTON, DE LEGIBUS ET CONSUETUDINIBUS ANGLIAE F. 268b; 2 F. POLLOCK & F. MAITLAND, *supra* note 23, at 122.

93. 1 J. POWELL, *supra* note 40, at 13 (1799).

real, into a fee estate without a further conveyance from the borrower. The primary difficulty with this result was that a term for years was not created by the formal requisite of livery of seisin, which was a necessary element of a fee estate.[94] Therefore, courts concluded that the lender's interest upon the borrower's default was only that of a termor rather than that of a fee owner.[95]

Lenders responded to this development by including in the document creating the term for years a covenant that the borrower would convey the freehold to the lender upon default.[96] Although this simple addition of a covenant was a solution, it was not an entirely satisfactory solution for lenders. The task of enforcing the covenant against a borrower who had lost a parcel of land potentially worth several times more than he had received from the lender could be onerous. To remedy the remedy, Littleton introduced a new form of security in about 1475 that became the most commonly used security device and was the direct forerunner of the modern common-law mortgage.[97]

Littleton began by adopting the terminology of the Glanvillian gage; real property security interests again were named *mort gages*.[98] Unlike the Glanvillian gage, however, the borrower conveyed not merely possession when the loan was made, but rather the fee title by formal livery of seisin.[99] This fee estate was created subject to the borrower's right to re-enter if he paid the loan according to the terms of the gage. If the borrower failed to perform in full on the specified day, which, ironically, was termed "law day,"[100] the lender's fee estate became absolute regardless of the value of the property in relation to the amount of the outstanding debt. Moreover, the borrower had no judicially recognized

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94. LITTLETON'S TENURES, *supra* note 27, § 59; A. SIMPSON, *supra* note 76, at 133; Hazeltine, *supra* note 65, at 556.

95. 2 F. POLLOCK & F. MAITLAND, *supra* note 23, at 122-23; J. POWELL, *supra* note 40, at 11-12. *See* Coke Litt. 216-8.

96. J. POWELL, *supra* note 40, at 11-14.

97. 1 G. GLENN, *supra* note 5, § 2, at 6; G. OSBORNE, *supra* note 64, § 5, at 8-9; A. SIMPSON, *supra* note 76, at 133-34.

98. The lender's right to possession carried with it the right to collect the rents and profits from the property. This right continued to be important because, at this time, it still was viewed as usury to charge interest on a loan. Although at this time, the rents and profits the lender collected were to be applied to reduce the debt, Osborne states that the lender "almost certainly . . . made a surreptitious profit. The ability thus to circumvent the mandate against taking interest doubtless was a potent factor in the popularity of this form of security." G. OSBORNE, *supra* note 65, § 5, at 8 (footnote omitted).

99. LITTLETON'S TENURES, *supra* note 27, § 332. *See* 2 W. BLACKSTONE, *supra* note 83, at 157-58.

100. Kratovil, *supra* note 65, at 2.

right of redemption to ameliorate the consequences of default, which is in marked contrast to the Glanvillian gage.[101] Because the borrower's right of re-entry did not constitute an estate in land,[102] the Littletonian gage was not subject to the operation of merger.

The differences in lenders' and borrowers' rights between the Glanvillian gage and the Littletonian gage demonstrate the different foci of the gages. The Glanvillian gage focused on the debt and whether income from the land reduced the debt. In contrast, title was central to the operation of the Littletonian gage. It is telling that Littleton's discussion of the *mort gage* in his famed treatise on tenures is contained in the section on estates in land. Unlike Glanville's explanation for the term *mort gage*, that income from the land would not reduce the debt, Littleton's explanation of the term focused on ownership of the fee.[103] Littleton opined that the term referred to the consequences of payment or default; the borrower lost title to the land and, therefore, it was dead to him. Symmetrically, if the borrower did pay on law day, the title to the land was lost, or dead, to the lender.[104]

At this stage in the development of real estate security, the courts and Parliament virtually ignored the loan relationship in determining the borrower's and lender's rights in the land. In part, this can be explained as a concomitant of the formality of real property law. To the early theorists, seisin was a basic and indivisible category. Because the lender was seised of the fee title, he was

101. G. OSBORNE, *supra* note 65, § 5, at 9.

102. Coke Litt. 218.a; R. TURNER, *supra* note 75, at 11.

103. LITTLETON'S TENURES, *supra* note 27, §§ 332-44. Osborne states that the reason for Littleton's change in the explanation for the term *mort gage* from that given by Glanville is that the holder of a Littletonian gage normally did not take possession of the pledged land though he was entitled to do so according to the terms of the gage. G. OSBORNE, *supra* note 65, § 1, at 3. *Accord* 2 W. BLACKSTONE, *supra* note 83, at 159. Because the gagee did not take possession and did not collect the rents and profits from the land, Glanville's explanation concerning the gagee's application of collected rents and profits no longer applied. Therefore, Littleton invented a new explanation.

104.

> Item, if a feoffment be made upon such condition, tbat if the feoffor pay to the feoffee at a certain day, &c., 40 [pounds] of money, that then the feoffor may re-enter, &c., in this case the feoffee is called tenant in mortgage, which is as much to say in French as *mort gage*, and in Latin *mortuum vadium*. And it seemeth that the cause why it is called mortgage is, for that it is doubtful whether the feoffor will pay at the day limited such sum or not: and if he doth not pay, then the land which is put in pledge upon condition for the payment of the money, is taken from him for ever, and so dead [to him upon condition, &c. And if he doth pay the money, then the pledge is dead] as to the tenant, &c.

LITTLETON'S TENURES, *supra* note 27, § 332. *See also* 2 W. BLACKSTONE, *supra* note 83, at 158.

treated as the owner of the land for all purposes regardless of the reason for conveyance of the fee. Of course, he was entitled to possession and to collect the rents and profits. Moreover, as a result of this categorical logic, the lender's creditors could seize the land; his wife had a dower interest in the land; the land passed to the lender's heirs or devisees upon his death; the lender was entitled to compensation if the land was taken by eminent domain; and the lender's title could escheat.[105] Furthermore, the passage of title had ramifications beyond the economic. Because the franchise was limited to freeholders at this time, the lender had the right to exercise the franchise.[106] These results prompted Maitland to criticize the Littletonian gage as being "one long *suppressio veri* and *suggestio falsi*."[107]

Although the law courts must have been aware of the true character of the borrower's and lender's relationship,[108] the courts strictly enforced the terms of the Littletonian gage regardless of the value of the land in relation to the debt amount and regardless of the borrower's reason for default. Indeed, law courts enforced the default even if it devolved from the borrower's simple inability to find the gagee on law day for tender. The burden on the borrower was as onerous as it was artificial. Littleton stated that to pay the debt on law day, the gagor "is bound to seek the feoffee if he be then in any . . . place within the realm of England."[109] In light of this legal rule, to facilitate tender and to avoid losing their properties, Littleton counsels gagors to specify a place for payment, such as "at the rood loft [of the rood] of the north door within the [church of St. Paul's in London], or at the tomb of Saint Erkenwalld, or at the door of such a chapel, or at such a pillar, within the same church."[110]

Mortgage law remained in this state of arrested development until the latter part of the sixteenth century, when the court of

105. G. OSBORNE, *supra* note 65, at 9-10; Lloyd, *supra* note 85, at 239-40. *See* LITTLETON'S TENURES, *supra* note 27, § 357.

106. G. OSBORNE, *supra* note 65, § 5, at 10.

107. F. MAITLAND, EQUITY 269 (1909). Pollock also criticizes this form of land security: "It must be difficult for any one but a lawyer to believe that so clumsy an operation is to this day the regular means of securing a debt on land in England." F. POLLOCK, *supra* note 66, at 134.

108. Osborne quotes a statement made by a law judge in 1314: "When a man pledges tenements his intention is not to grant an estate of inheritance, but to give security for the repayment of the money he has borrowed and to redeem the tenements; and in such case, if he repay the money he can enter." G. OSBORNE, *supra* note 65, § 6, at 14.

109. LITTLETON'S TENURES, *supra* note 27, § 340.

110. *Id.* § 342.

equity initiated a new epoch. Historically, the court of equity, like the courts of law, had intervened to prevent a lender from refusing to surrender possession of property when the loan had been paid in full on law day.[111] During the late sixteenth century and early seventeenth century, the court of equity went further, however, and broke from the law courts' treatment of the mortgage relationship. Just as the court of equity had intervened to restore merger to its appropriate jurisprudential role, the court intervened to reflect the equities between the borrower and lender.

The court of equity now forced a lender to reconvey the encumbered property if the borrower tendered payment within a reasonable time after law day. This relief, which must have appeared extraordinary to the ancients, was called the equity or right of redemption.[112] Its evolution was gradual. The court of equity first granted the equity of redemption only when the borrower could establish traditional equitable grounds for its failure to pay on law day, such as bad faith conduct by the lender.[113]

This response to fraudulent evasion soon gave way to substantive relief. By the early part of the seventeenth century, the court of equity granted the right to redeem any time the borrower tendered the debt amount within a reasonable time after law day.[114] In effect, the court replaced a time certain with a reasonableness standard. This protection for the borrower extended not only to the lender's interest in the land, but also to the interest of anyone claiming through the lender, including the lender's creditors or spouse or a purchaser of the land.[115]

Chancery's creation of the right of redemption may be attributable primarily to equity's usual practice of refusing to enforce a penalty or forfeiture when the injury can be compensated by payment of money. The value of the land the lender attempted to retain under the terms of the gage almost always far exceeded the amount of the outstanding debt. One commentator has stated, on

111. G. Osborne, *supra* note 65, § 6, at 12.

112. 2 W. Blackstone, *supra* note 83, at 158-59; Lloyd, *supra* note 85, at 235. Chancery even extended this protection to the next Protestant heir of a Popish mortgagor. Jones v. Meredith, Comyns Rep. 661 (1739). As stated by Lloyd, creation of the equity of redemption was not received warmly in all quarters. He quotes Lord Chief Justice Hale as stating that "by the growth of equity the heart of the common law is eaten out." Lloyd, *supra* note 85, at 235.

113. G. Osborne, *supra* note 65, § 6, at 13.

114. *See, e.g.*, Hamilten v. Dirlten, 1 Ch. Rep. 165 (1654); Emanuel College v. Evans, 1 Ch. Rep. 18 (1625), *cited in* 1 G. Glenn, *supra* note 5, at 12-13.

115. Croft v. Powell, Comyns Rep. 603 (1738); J. Powell, *supra* note 40, at 11-12.

the other hand, that Chancery's creation of the equity of redemption is attributable primarily to the struggle for power waged during this period between the courts of law and of equity.[116] Equity's action also is fairly attributable to its recognition that payment on the exact date specified in the gage was not so vitally important as to justify forfeiture of land. As discussed above, courts had recognized and acted upon this fact as early as the era of the Glanvillian gage.

At this point in the evolution of mortgage law, equity merely had given the borrower some additional time to repay the debt. The court apparently had not yet recognized, or at least had not yet acted on, a fact that is obvious to the modern mind: The lender's only right is to repayment of the debt, not to retention of the land that is mere security for the debt. After creating the right of redemption, the court of equity initially continued to adhere to the theory and wording of the Littletonian gage, treating it as conveying the fee estate to the lender.[117]

Evolution of the mortgage relationship gained momentum, however, because it was fueled by Parliament as well as by Chancery.[118] Chancery's creation of the equity of redemption dovetailed with a 1623 statute[119] that permitted lenders to charge interest to work a major change in mortgage practice; by the mid-seventeenth century, the borrower typically retained possession of the property unless and until the lender exercised its retained right to possess upon default.[120] In addition to modernizing the character of the debt by permitting lenders to charge interest, Parliament modernized the mortgage relationship in 1696 by restoring to the borrower who retained possession of his land the right to exercise the franchise with respect to the encumbered land.[121]

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116. G. OSBORNE, *supra* note 65, § 6, at 13; Lloyd, *supra* note 85, at 235.

117. 1 G. GLENN, *supra* note 5, § 2, at 9.

118. Lloyd has suggested that this process of evolution is partially attributahle to dicta of eminent eighteenth century jurists describing mortgages as conveying a mere security interest. More important, however, was the common perception among laypersons tbat mortgages conveyed only a security interest. This perception resulted from the mortgagor's retention of possession of the mortgaged premises. Lloyd, *supra* note 85, at 237-38.

119. 21 Jac. 1, ch. 17, § 2, *made permanent*, 3 Car. 1, ch. 4, § 5 (1627).

120. Blackstone states that the lender might take possession also if the security is "precarious or small." 2 W. BLACKSTONE, *supra* note 83, at 159; 3 R. POWELL, *supra* note 2, § 438, at 547.

121. One commentator has stated that Parliament adopted legislation preventing lenders from exercising the franchise with respect to land they held in mortgage because this aspect of mortgage law disqualified "a vast number of voters." Lloyd, *supra* note 85, at 239. *See* R. TURNER, *supra* note 75, at 183-85.

Finally, in recognition of the true nature of the mortgage transaction, Chancery elevated the borrower's equity of redemption from a mere right to pay after the specified due date to an equitable estate in the mortgaged land.[122] As an interest in land, the borrower's right to redeem could be conveyed *inter vivos* and by devise, could be mortgaged, was subject to the curtesy interest of the borrower's husband,[123] was divisible into smaller estates, and was subject to the operation of merger.[124] The pendulum had swung so far that even if the lender took possession of the land upon default, pursuant to his retained legal estate in the land, the borrower's estate was not destroyed in equity until sufficient time had elapsed to create a presumption of the borrower's abandonment of the estate. Some courts extended the redemption period for as long as twenty years from the time of default.[125]

Equity's recasting of the mortgage relationship into its proper role as a security transaction represents a major breakthrough in English real property law. Substance triumphed over form, and the court successfully had made the leap from primitive conceptions of title to the abstract notion of security. Thereafter, when a lender exercised its right to possess the mortgaged property, the lender was subject to the borrower's equitable rights. For example, equity held the lender liable to account strictly to the borrower for all income collected from the property and to apply all such amounts to reduce the debt.[126] The swing of the pendulum had not stopped, however.[127]

Although recognition of the borrower's estate more accurately reflected the substance of the mortgage relationship, the equity of redemption threatened to destroy the utility of land as security for debts because the lender had no means of terminating the bor-

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122. Chaplin, *supra* note 79, at 10.

123. The borrower's right to redeem, however, initially was not subject to the dower interest of the borrower's wife. Parliament subsequently changed this result. G. OSBORNE, *supra* note 65, at 16-17.

124. 3 F. HARGRAVE & C. BUTLER, NOTES ON LORD COKE'S FIRST INSTITUTE OR COMMENTARY UPON LITTLETON § 332 n.96 (1809); G. OSBORNE, *supra* note 65, § 7, at 16.

125. 3 F. HARGRAVE & C. BUTLER, *supra* note 124, § 337 n.106; 2 W. BLACKSTONE, *supra* note 83, at 158-59 n.29; G. OSBORNE, *supra* note 65, § 5, at 11.

126. F. POLLOCK, *supra* note 66, at 134. Pollock states that at this time "the plight of a mortgagee in possession is one of the most unenviable known to the law." *Id.* (footnote omitted).

127. Pollock decried the development of English mortgage law to this time: "Beginning with fictitious and impracticable stringency, our practice has ended in a wide and dangerous laxity, which breeds doubtful titles and litigation, and is no small encouragement to fraud." *Id.* at 133.

rower's equitable interest without his consent. If the borrower conveyed his interest to the lender, merger would operate to merge the borrower's estate into the lender's estate and thus to vest the lender with the full fee estate because the legal and equitable interests were held by the same person. In the absence of the borrower's agreement to convey, however, the lender had to attempt to establish that the borrower had abandoned his interest.

To conserve the utility of land as security for debts and to facilitate the lender's ability to alienate the land after default, the court of equity began according lenders an equitable cause of action to clear title of the borrower's equity of redemption. Upon proof of default, the court would issue a decree that the borrower fulfill the terms of the debt within a specified time. Upon proof of the borrower's failure to do so, the court terminated his interest in the encumbered land by a decree of foreclosure, which "foreclosed" his equitable estate.[128] This procedure concerned only interests in land. Neither the sufficiency of the value of the land to answer the debt nor any value in excess of the debt was considered. Thus, this action was, and today is, called a "strict foreclosure," because it operates to vest full fee title in the lender regardless of the value of the land in relation to the amount of the outstanding debt.[129]

At this point in the evolution of mortgages, the lender still retained an estate in the encumbered land. Chancery and Parliament, however, directly or indirectly had caused the lender to lose almost all indicia of ownership, including the rights to possess and to retain income from the property. The right to strict foreclosure, which enabled the lender to eliminate the borrower's property interest, was the primary continuing indicium of the lender's ownership interest. During the 1800s, however, even this indicium of ownership largely disappeared. Surprisingly, lenders voluntarily gave up this right.

Because strict foreclosure operated without regard to the value of the foreclosed land in relation to the outstanding debt amount, equity began permitting borrowers to redeem property after strict foreclosure. The court of equity extended this redemption right to permit redemption even years after the strict foreclosure and from subsequent purchasers of the encumbered land. The court granted this right to redeem even when the lender had not acted fraudu-

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128. 2 W. BLACKSTONE, *supra* note 83, at 159; F. POLLOCK, *supra* note 66, at 134-35.

129. 1 G. GLENN, *supra* note 5, § 59.1, at 401. The court, however, could reopen a strict foreclosure if the borrower could establish an equitable reason for doing so. *Id.* § 61.

lently or otherwise inequitably.[130] As a result, lenders began inserting in mortgages a clause permitting the lender to sell the encumbered land to repay the debt rather than requiring strict foreclosure.[131] Upon exercising this right, the lender could retain only so much of the sale proceeds as were necessary to pay the debt, with the surplus being paid to the former owner or to junior lienors. These "power of sale" foreclosures, named for the mortgage clause authorizing the lender to sell the encumbered land on default, soon became the predominant mortgagee remedy.[132] The effect of the widespread use of this remedy was to dilute further the notion that a mortgage conveys an ownership interest in the encumbered land to the lender.

Although security devices and the foreclosure process have changed with varying forms of land finance, the mortgagee's legal status with respect to the encumbered property firmly was established by 1800 as being a mere security interest,[133] rather than any form of ownership interest. Thus, the history of the mortgage in England has been the relaxation of the formalism of real property law and the concomitant recognition of the primacy of the debt relationship between the parties. The American history of mortgages has followed a similar track.[134] The courts of both countries, however, have not freed mortgages of merger, which is an anomalous vestige of an earlier day.

2. American Development

As with other aspects of the common law, the colonists brought with them the law of mortgages as it existed in England at the time of their departure in about 1600.[135] Mortgage instruments were worded in terms of a conveyance of title to the mortgagee, and some early American courts routinely held the mortgagee's

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130. *Id.* § 61, at 405.

131. R. Turner, *supra* note 75, at 121.

132. *Id.* at 121-22.

133. 3 F. Hargrave & C. Butler, *supra* note 124, § 332, at n.96.

134. This process of evolution is not unique to the common law legal system.

> In all legal systems there seems to be in the law of mortgages an evolution from a forfeiture idea in which the res is given as conditional satisfaction of some act for which there is no personal duty . . . to a security idea. Although it is not a necessary consequence of this development, there goes along with it a change from creditor-possession of the res to debtor-possession.

G. Osborne, *supra* note 65, at 23.

135. Lloyd, *supra* note 85, at 240.

interest to be an estate in land.[136] In contrast to the English experience, however, the pervasive perception of the lender's interest from earliest American history was that of a lien. Consistent with this view, the borrower usually retained possession of the land despite the wording of the mortgage instrument.[137] One commentator has stated that the borrower's retained possession resulted from popular hostility to the creditor class.[138] Of equal importance, however, was the fact that American mortgage law, unlike English mortgage law, was not burdened with the centuries of mortgage practice during which lenders took title to and possession of the land. As all real property practitioners know, a practice with a so-called rich tradition has an inertia all its own. Although American mortgage law originated in the English law, American law rapidly evolved away from the concept of a mortgage conveying an estate in land. The parties to a loan transaction were freer than their English counterparts to act in accordance with the substance of the transaction rather than with the wording of the documents.

Even with the advantage of a relatively clean slate, the proper categorization of the parties' interests crystallized slowly. The borrower's retained possession, for example, initially provided conceptual difficulties for some early courts and commentators. These courts and commentators responded to these difficulties by distorting available legal categories. Thus, for lack of a better label, they characterized the borrower as a tenant.[139] Other courts and some early state legislatures, however, reflecting early American pragmatism, recognized the lender's interest as akin to a lien, rather than an estate in land.

South Carolina is justly honored by the enemies of empty formalism as the first state to enact legislation reflecting the popular, though historically and formally incorrect, understanding of the effect of a mortgage.[140] In 1791 the South Carolina legislature defined mortgages as merely creating security for debts. Any estate in land was expressly denied. The relevant legislation provided in part:

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136. Chaplin, *supra* note 79, at 12; Lloyd, *supra* note 85, at 240 and accompanying notes.

137. Chaplin, *supra* note 79, at 12; Lloyd, *supra* note 85, at 240-41.

138. Lloyd, *supra* note 85, at 240-41.

139. G. Osborne, *supra* note 65, § 13, at 23; J. Powell, *supra* note 40, at 205-06; 3 R. Powell, *supra* note 2, § 439, at 549-50.

140. "It is quite significant that this undertaking was part of the reform legislation that followed the constitutional convention of 1790." Lloyd, *supra* note 85, at 241.

> [N]o mortgagee shall be entitled to any possessory action for the real estate mortgaged, even after the time allotted for the payment of the money secured by the mortgage is elapsed, but the mortgagor shall still be deemed owner of the land and the mortgagee as owner of the money lent or due.[141]

The South Carolina Supreme Court correctly identified the purpose of this legislation as changing the common-law treatment of the mortgage from a conveyance of title to security for a loan.[142]

Although South Carolina was the first state to cast mortgages in their appropriate light through legislative action, widespread recognition of mortgages as security for an obligation traces its lineage from early nineteenth century decisions of the New York Supreme Court.[143] In *Runyan v. Mersereau*[144] the court confronted for the first time the issue of fee ownership of property encumbered by a mortgage. The case involved an action of trespass *quare clausum fregit.* The plaintiff claimed title to and the right to possess the disputed land as the purchaser at a sheriff's sale on a judgment against the former owner. The sale was subject to a mortgage granted by the judgment debtor. The defendant claimed that the mortgagee had given him permission to enter the property. To determine who had the right to possess, the court had to determine whether the plaintiff or the mortgagee owned the fee estate. In unequivocal language the court held that mortgagors retain the freehold estate and that, therefore, the plaintiff was entitled to possession.

> Courts of law, both here and in *England,* have gone very far towards, if not the full length of, considering mortgages, at law, as in equity, mere securities for money; and the mortgagee as having only a chattel interest. Lord *Mansfield* . . . says, a mortgagee, notwithstanding the form, has but a chattel, and the mortgage is only a security; that it is an affront to common sense to say the mortgagor is not the real owner . . . . The debt is considered the principal, and the land is an incident only.[145]

Despite the absence of legal support for the court's holding, the court applied it as controlling precedent in subsequent cases.[146]

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141. Act of 1791, 5 S.C.L. (1 Brev.) 174 (1814).

142.

> It is clear beyond all dispute that one of the primary objects of the act of 1791, as appears from its express terms, was to deprive a mortgage of real estate of its common law feature as a conveyance of an estate, and to convert it into what it was really intended for, a mere security . . . .

Navassa Guano Co. v. Richardson, 26 S.C. 401, 406, 2 S.E. 307, 309 (1886). *See also* Verree v. Verree, 4 S.C.L. (2 Brev.) 211 (1807).

143. Lloyd, *supra* note 85, at 241.

144. 11 Johns. ch. 534 (N.Y. ch. 1814).

145. *Id.* at 538.

146. *See, e.g.,* Bryan v. Butts, 27 Barb. 503 (N.Y. App. Div. 1857).

The New York legislature followed the court's lead in 1828 by enacting a statute providing that mortgagees did not have an action for ejectment with respect to mortgaged lands.[147]

Over the years, with near unanimity, the other states have joined New York in characterizing mortgages as creating a lien only, even when the instrument is worded in terms of a conveyance of title to the lender. In the course of this development, commentators have categorized states according to one of three theories concerning the effect a mortgage has on title to the encumbered land. The states that cling to common-law or title nomenclature and theory are denominated title theory states. Those states that treat a mortgage as conveying no title to the mortgagee but as creating only the right to sell the property to satisfy the secured debt in the event of default are denominated lien theory states. The remaining states, those that follow the intermediate theory, treat a mortgage as conveying to the mortgagee the right to possess the encumbered land and to collect the rents and profits only upon the mortgagor's default.[148]

A 1902 survey of the states' mortgage laws characterized sixteen states as following the title theory of mortgages and twenty-three states and territories as following the lien theory.[149] By 1965, only eight states—Alabama, Georgia, Maine, Maryland, Massachusetts, New Hampshire, Pennsylvania, and Rhode Island—still adhered to the title theory, and twenty-eight states accepted the lien theory.[150] Alabama,[151] Georgia,[152] Maine,[153] Maryland,[154] Mas-

147. 2 N.Y. REV. STAT. 1828, pt. 3, ch. 5, tit. I, § 57, *cited in* Lloyd, *supra* note 85, at 244 n.54.

148. G. NELSON & D. WHITMAN, *supra* note 5, at 142-51. The theoretical explanation sometimes given to justify the intermediate theory is that the mortgagor retains legal title until default, at which point the mortgagee acquires the title. Other courts have not attempted to explain this result on the basis of title but have held that the mortgagee is entitled to possession only if the loan agreement has been breached. *Id.* at 149-50.

149. W. BLACKSTONE, *supra* note 83, at 158 n.24. By 1923, the "New York view" bad been adopted in "considerably more than a majority of states, although in New England and some of the older communities there is a more or less close adherence to the common law." Lloyd, *supra* note 85, at 244. A commentator writing in 1928 listed 17 states as following title theory. 1 L. JONES, *supra* note 65, § 67, at 59. A 1957 survey prepared by in-bouse counsel for a national bank identified eight states as still following the title theory, 13 states following the intermediate theory, and 28 states as following the lien theory. Prather, *Foreclosure of the Security Interest*, 1957 U. ILL. L.F. 420, 423.

150. Note, *Proposed Changes in Minnesota Mortgage Law*, 50 MINN. L. REV. 331, 339 n.22 and accompanying text (1965). This Note characterizes Massachusetts as an intermediate theory state because the mortgagee does not have the right to possess until default in the mortgage or secured note. *Id.* at 340 n.28. This conclusion is erroneous. Massachusetts is a title theory state because it characterizes mortgages as conveying to the mortgagee legal

sachusetts,[155] New Hampshire,[156] and Rhode Island[157] continue to

title to the mortgaged property. The mortgagor retains only an equity of redemption. Araserv, Inc. v. Bay State Harness Horse Racing & Breeding Ass'n, 437 F. Supp. 1083, 1092 (D. Mass. 1977). A Massachusetts statute alters one effect of this mortgage characterization by providing that, absent a contrary agreement in the mortgage, a mortgagor is entitled to retain possession of the mortgaged property until default. MASS. GEN. LAWS. ANN. ch. 183, § 26 (West 1987).

151. *See* ALA. CODE § 35-10-26 (1975) ("The payment of the mortgage debt . . . divests the title passing by the mortgage."); Southern Bank of Lauderdale County v. Commissioner, 770 F.2d 1001 (11th Cir. 1985), *cert. denied,* 106 S. Ct. 2890 (1986); Trauner v. Lowrey, 369 So. 2d 531, 534 (Ala. 1979) ("Alabama classifies itself as a 'title' state with regard to mortgages. Execution of a mortgage passes legal title to the mortgagee.").

152. GA. CODE ANN. § 44-14-60 (1982):

> Whenever any person in this state conveys any real property by deed to secure any debt . . . the conveyance of real . . . property shall pass the title of tbe property to the grantee until the debt or debts which the conveyance was made to secure shall be fully paid. Such conveyance shall be held by the courts to be an absolute conveyance, with the right reserved by the grantor to have the property reconveyed to him upon payment of the debt . . . .

Regante v. Reliable-Triple Cee, Inc., 251 Ga. 629, 630, 308 S.E.2d 372, 373 (1983) ("Regante, as the assignee of the security deed, has legal title to the property, subject to the right of [the grantor] to have the realty reconveyed to him upon payment of the debt."). *Accord* Turner Advertising Co. v. Garcia, 252 Ga. 101, 311 S.E.2d 466, *cert. denied,* 469 U.S. 824 (1984). *But see* GA. CODE ANN. § 44-14-30 (1982) ("A mortgage in this state is only security for a debt and passes no title."); Cole v. Cates, 110 Ga. App. 820, 823, 140 S.E.2d 36, 39 (1964) (quoting Loftis v. Alexander, 139 Ga. 346, 349, 77 S.E. 169, 170 (1913)) ("In this state, a deed to secure a debt is not the same as a mortgage. Such a deed conveys title. A mortgage is only a lien.").

153. ME. REV. STAT. ANN. tit. 33, § 502 (1964):

> A mortgagee . . . may enter on the premises or recover possession thereof, before or after breach of condition, when tbere is no agreement to the contrary. In such case, if the mortgage is afterwards redeemed, the amount of the clear rents and profits from the time of taking possession sball be accounted for and deducted from the sum due on tbe mortgage.

Martel v. Bearce, 311 A.2d 540, 543 (Me. 1973) ("This State has accepted the doctrine that a mortgage is regarded as a conditional conveyance vesting the legal title in the mortgagee. All that remains in the mortgagor is the equity of redemption."). *Accord* Pettengill v. Turo, 159 Me. 350, 193 A.2d 367 (1963).

154. Williams v. Safe Deposit & Trust Co., 167 Md. 499, 503, 175 A. 331, 332 (1934) ("At common law, a defeasible legal estate vested in the mortgagee, that became absolute upon default. The mortgagee is entitled to immediate possession upon the execution of a mortgage, unless there is some other agreement of the parties.").

155. Araserv, Inc. v. Bay State Harness Horse Racing & Breeding Ass'n, 437 F. Supp. 1083, 1092 (D. Mass. 1977) ("In Massachusetts, the mortgagee has legal title to the mortgaged property and the mortgagor retains an equity of redemption."). *Accord* Carpenter v. Suffolk Franklin Sav. Bank, 362 Mass. 770, 775, 291 N.E.2d 609, 613 (1973); *cf.* Negron v. Gordon, 373 Mass. 199, 204, 366 N.E.2d 241, 244 (1977).

156. Furbush v. Goodwin, 29 N.H. 321, 332 (1854) ("The mortgage, immediately upon its execution, vests in the mortgagee, and those claiming under him, the seizin as well as the title, and, as against the mortgagor, he is regarded in law as the owner of the estate."). *Accord* Brown v. Cram, 1 N.H. 169 (1818); *cf.* Ellison v. Daniels, 11 N.H. 274 (1840).

157. R.I. GEN. LAWS § 34-11-20 (1984). The short form mortgage is deemed to include covenants:

describe a mortgage as conveying title to the mortgagee.[158] Relatively recent decisions indicate that Pennsylvania may be shifting to the lien theory, though Pennsylvania courts also have rendered contrary decisions relatively recently.[159]

Despite the different labels—title theory and lien theory—that states use to describe mortgage practice, examination of the laws and practices in the title theory states reveals that the labels are the primary distinction between title theory and lien theory states' treatment of mortgages.[160] In some title theory states, statutes alter or remove the very legal incidents that once denoted title theory treatment of mortgages.[161] For example, one category of statutes provides that the mortgagor retains the right to possess the encumbered property until default or until her interest in the property has been eliminated.[162] Additionally, security instrument forms commonly used in many title theory states provide that the

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> [T]hat mortgagor . . . has good right, full power, and lawful authority to sell and convey the same to the mortgagee and his heirs and assigns; that the mortgagee and his heirs and assigns shall at all times hereafter peaceably and quietly have and enjoy the mortgaged premises and that the mortgagor will, and his heirs, executors, and administrators shall, warrant and defend the same to the mortgagee and his heirs and assigns forever against the lawful claims and demands of all persons . . . .

First Nat'l Bank v. Dispeau, 32 R.I. 396, 79 A. 945 (1911) (mortgagee has rigbt to possess as soon as mortgage executed); Doyle v. Mellen, 15 R.I. 523, 8 A. 709 (1887).

158. Of the eight title theory states, six were among the original thirteen states and, therefore, were more likely than later states to have adopted the English common law rule. Furthermore, all title theory states are eastern states, whereas the lien theory has been adopted almost uniformly in the western and midwestern states.

159. *Compare* Hahnemann Medical College v. Commonwealth, 52 Pa. Commw. 558, 564, 416 A.2d 604, 607 (1980) ("A mortgage is in essence a defeasible deed, requiring the grantee to reconvey the property held as security to the grantor upon satisfaction of the underlying debt or the fulfillment of established conditions.") *with* Mancine v. Concord-Liberty Sav. & Loan Ass'n, 299 Pa. Super. 260, 266, 445 A.2d 744, 747 (1982) ("A mortgage, although in form a conveyance of title, is only security for the payment of money or the performance of another collateral contract.") *and with* Myers-Macomber Eng'rs v. M.L.W. Constr. Co., 271 Pa. Super. 484, 489, 414 A.2d 357, 359-60 (1979) ("When a mortgagee goes into possession, he does not become the owner of the real estate . . . . Rather, he becomes a quasi trustee, managing the property for the benefit of the mortgagor, but at the same time protecting his own interest."). *See* Lloyd, *The Mortgage Theory of Pennsylvania*, 73 U. PA. L. REV. 43, 44 (1924) (There is "conflicting dicta on the nature of a mortgage in Pennsylvania.").

160. 3 R. POWELL, *supra* note 2, § 439. *See, e.g.*, Stevens v. Turlington, 186 N.C. 191, 119 S.E. 210 (1923).

161. *See* G. NELSON & D. WHITMAN, *supra* note 5, § 4.1, at 144; 3 R. POWELL, *supra* note 2, § 439, at 552; Kratovil, *supra* note 65, at 5.

162. *See, e.g.*, MASS. GEN. LAWS ANN. ch. 183, § 26 (West 1987) (mortgagor retains right of possession until default); VT. STAT. ANN. tit. 12, § 4772 (repealed 1971) (current version at V.R.C.P. § 80.1). Pierce v. Brown, 24 Vt. 165 (1852) (estate and right of possession given to mortgagee by statute after condition broken).

mortgagor has the right to possess the property until default or until her interest in the property has been eliminated.[163] Moreover, courts in title theory states have held that a mortgage does not convey title to the property to the lender, but only certain rights to possess and to sell the property to satisfy the loan in the event of default.[164] Finally, even in title theory states, when a lender exercises its right to possess the property, it is not entitled to retain the benefits of the property; it must apply all rents and other income from the property to reduce the outstanding indebtedness.[165] Thus, even in title theory states, the mortgage is recognized as the appurtenance of the secured debt rather than as a title conveyance.

Title theory states' treatment of the nonpossessory incidents of the mortgage relationship confirms the practical and essential similarity of mortgages in title theory and in lien theory states. Thus, real property taxes are not assessed against the mortgagee's interest.[166] Neither dower nor curtesy are created in a mortgagee's interest.[167] The mortgagee can convey its interest without a deed

163. G. NELSON & D. WHITMAN, *supra* note 5, § 4.1, at 144; Kratovil, *supra* note 65, at 5-6. *See* Williams v. Safe Deposit & Trust Co., 167 Md. 499, 503, 175 A. 331, 333 (1934) ("[T]here is usually incorporated in a mortgage of a leasehold estate, as was incorporated in the mortgage at bar, a provision whereby the mortgagors, their personal representatives and assigns, may continue to hold and possess the mortgaged premises, and to receive the rents and profits thereof . . . .").

164. *See, e.g.*, Malamut v. Haines, 51 F. Supp. 837 (M.D. Pa. 1943); Turner Advertising Co. v. Garcia, 252 Ga. 101, 102, 311 S.E.2d 466, 468 (1984); Mancine v. Concord-Liberty Sav. & Loan Ass'n, 299 Pa. Super. 260, 445 A.2d 744 (1982).

165. Nettles v. First Nat'l Bank, 388 So. 2d 916, 920 (Ala. 1980); Williams Realty & Loan Co. v. Simmons, 188 Ga. 184, 187, 3 S.E.2d 580, 583 (1939); ME. REV. STAT. ANN. tit. 33, § 502 (1964); Hubbard v. Safe Deposit & Trust Co., 172 Md. 645, 650, 192 A. 592, 594 (1937); Landau v. Western Pa. Nat'l Bank, 445 Pa. 217, 223, 282 A.2d 335, 339 (1971); Koury v. Sood, 74 R.I. 486, 492, 493, 62 A.2d 649, 652, 653 (1948); Kratovil, *supra* note 65, at 5.

166. *See* ALA. CODE § 40-5-12 (1975) (lists property that is subject to taxation; mortgages are not included); Hood & Wheeler v. Clark, 141 Ala. 397, 37 So. 550 (1904); GA. CODE ANN. § 48-5-9 (1982) (requires possession); Decatur County Bldg. & Loan Ass'n v. Thigpen, 173 Ga. 363, 160 S.E. 387 (1931); ME. REV. STAT. ANN. tit. 36, § 551 (1964) (lists property that is subject to taxation yet excludes mortgages); Williams v. Hilton, 35 Me. 547 (1853); MD. TAX-PROP. CODE ANN. §§ 6-101 to 6-104 (1986) (lists property that is subject to taxation; refers to interest of a mortgagor or grantor under a deed of trust as taxable, § 6-102(d)(3)); N.H. REV. STAT. ANN. § 73-10 (1970) (property is taxed to person claiming or in possession); R.I. GEN. LAWS § 44-4-5 (1980) ("The mortgagor shall be deemed to be the owner of mortgaged real estate, so long as the same is in his possession.").

167. *See, e.g.*, ME. REV. STAT. ANN. tit. 6, ch. 65, § 32 (1884); LaGrange Mills v. Kener, 121 Ga. 429, 435, 49 S.E. 300, 303 (1904); Knox v. Stamper, 186 Md. 238, 245, 46 A.2d 361, 365 (1946). Dower has been abolished in all the title theory states. ALA. CODE § 43-5-1 (1975); GA. CODE ANN. § 53-1-1 (1982); ME. REV. STAT. ANN. tit. 18-A, § 2-113 (1964); MD. EST. & TRUSTS CODE ANN. § 3-202 (1974); N. H. REV. STAT. ANN. § 560-3 (1974); R.I. GEN.

or other formal instrument of conveyance. The mortgagee can assign its interest by an instrument of assignment and can eliminate its interest by a simple release.[168]

Perhaps the most telling sign that modern American mortgages do not convey an estate in land to the lender is the virtual abolishment of strict foreclosure of mortgages in all but two states.[169] By 1800, foreclosure by sale had become the established means in America of satisfying a defaulted loan.[170] Strict foreclo-

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LAWS § 33-25-1 (1984).

168. ALA. CODE § 35-10-27 (1975); Turner v. Flinn, 72 Ala. 532 (1882); GA. CODE ANN. § 44-14-3 (Supp. 1986); Frost v. Gazaway, 122 Ga. App. 244, 176 S.E.2d 476 (1970); ME. REV. STAT. ANN. tit. 33, § 551 (1964); Allard v. Lane, 18 Me. 9 (1840); MD. REAL PROP. CODE ANN. § 3-105 (Supp. 1986); Baker v. Otto, 180 Md. 53, 56-57, 22 A.2d 924, 926 (1941); N.H. REV. STAT. ANN. § 479:7 (1983 & Supp. 1986); R.I. GEN. LAWS § 34-26-3 (1984).

169. G. OSBORNE, *supra* note 65, at 661, 726.

170. Several states permit strict foreclosure in very limited circumstances, as described below. Three states, Connecticut, Vermont, and Illinois, permit strict foreclosure in less narrowly defined situations. In Connecticut, a court may decree a strict foreclosure after default if the borrower fails to repay the loan within the time set by the court. Any party to the foreclosure proceeding, however, may petition the court for foreclosure by public sale, and the borrower has a right to redeem after a strict foreclosure. *See* CONN. GEN. STAT. ANN. §§ 49-15, 49-16, 49-19, 49-20, & 49-24 (West 1958 & Supp. 1986). In recognition of the fact that Connecticut is one of the few states to provide for strict foreclosure, the Connecticut Supreme Court, in City Sav. Bank v. Lawler, 163 Conn. 149, 157, 302 A.2d 252, 256 (1972), described its provisions for strict foreclosure as "somewhat unique."

Although Vermont statutorily provides for strict foreclosure, V.C.R.P. § 80.1 (1984 cum. supp.), foreclosure by sale is available if the foreclosing lienor is a federal agency or other person that federal law prevents from using strict foreclosure, VT. STAT. ANN. tit. 12, § 4531 (supp. 1986); if the mortgage to be foreclosed includes a power of sale clause and the mortgagor or mortgagee requests in its initial pleading a power of sale foreclosure, VT. STAT. ANN. tit. 12, § 4531 (1973); or to foreclose a judgment lien if the outstanding amount of the debt is greater than the fair market value of the encumbered land. One treatise describes strict foreclosure as the "predominant remedy" in Vermont. G. NELSON & D. WHITMAN, *supra* note 5, at 502.

In Illinois, strict foreclosure is a common-law, rather than a statutory, remedy. It is available only if tbe mortgagor or owner of the equity of redemption is insolvent, the value of the encumbered property is less than the outstanding debt amount plus outstanding property taxes, and the mortgagee waives its right to a deficiency judgment. Great Lakes Mortgage Corp. v. Collymore, 14 Ill. App. 3d 68, 71, 302 N.E.2d 248, 250 (1973).

The commentators disagree concerning the availability of strict foreclosure in the other states. Osborne lists sixteen states, in addition to Connecticut, Vermont, and Illinois, that permit strict foreclosure in certain circumstances. G. OSBORNE, *supra* note 65, at 651 n.38. Glenn indicates that strict foreclosure may be available in every state under certain circumstances. Glenn, *A Study on Strict Foreclosure*, 29 VA. L. REV. 519 (1943). Strict foreclosure normally is available in states other than Connecticut, Vermont, and Illinois only when a junior lienor has been omitted from a foreclosure by action in which the encumbered property was worth less than the amount of the foreclosed lien. G. NELSON & D. WHITMAN, *supra* note 5, at 504-05. In this case, the junior lienor would not be benefited by participating in a foreclosure sale because it could not generate sufficient proceeds to pay the debt secured by the junior lien.

Strict foreclosure generally is not available in this country because it operates "summasure did not disappear in this country, as in England, because lenders sought a more efficacious means of eliminating a borrower's interest in encumbered land. Instead, American legislatures have acted to eliminate strict foreclosure almost completely. The legislatures have taken this action in recognition of the fact that, in America, a lender's only interest should be in repayment of the debt, rather than in the land. Generally, strict foreclosure is available today only in those exceptional circumstances in which a foreclosure sale would not benefit any holder of an interest in the property. Title theory states' treatment of mortgages thus demonstrates that these states actually do not understand the mortgagee's interest to be an estate in land despite the nomenclature they use to describe the interest.

Comparing a mortgagee's interest with that of other creditor lien claimants also militates in favor of treating the mortgage as a species of lien, which is a personal property interest, rather than as a real property interest. A judgment lien, for example, does not constitute an estate in the encumbered land; the lien creates only the right to foreclose the lien to satisfy the outstanding judgment.[171] Similarly, many courts characterize mechanics' liens as creating only a personal property interest.[172] Those courts that

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rily, harshly, and oppressively." Tefft, *The Myth of Strict Foreclosure*, 4 U. CHI. L. REV. 575, 595 (1937), *cited in* G. OSBORNE, *supra* note 65, at 652; Atlantic Oceanic Kampgrounds, Inc. v. Camden Nat'l Bank, 473 A.2d 884, 889 (Me. 1984) ("[I]t is entirely fair to assume the Legislature regarded strict foreclosure as working an unjust and inequitable result, namely the forfeiture of the excess of the value of the land over the amount of debt remaining. It is noteworthy that the majority of sister jurisdictions do not recognize strict foreclosure."). Furthermore, the predominance of the lien theory has prevented widespread adoption of strict foreclosure. "Strict foreclosure is thought of as not creating any new rights in the mortgagee, but as merely destroying all interest of the mortgagor in the property, leaving the mortgagee's title to it free and clear. A requirement, therefore, is that the mortgagee must have legal title." G. OSBORNE, *supra* note 65, at 653 (footnotes omitted).

In addition to strict foreclosure, a limited number of New England states permit a mortgagee to take possession of the encumbered property and eventually acquire title by specialized procedures called Entry Under Process or Entry and Publication, N.H. REV. STAT. ANN. § 479:19 (1983), Foreclosure by Entry or Action, MASS. GEN. LAWS ANN. ch. 244, §§ 1-10 (West 1959 & Supp. 1986), or Entry Without Process, R.I. GEN. LAWS §§ 34-23-3, -23-4 (1984). Nelson and Whitman state that these procedures are "at most only sporadically used." G. NELSON & D. WHITMAN, *supra* note 5, at 503. Furthermore, each of these methods provides the borrower a redemption period ranging from one to three years.

171. Lee v. Keech, 151 Md. 34, 133 A. 835 (1926); Farrow v. American Eagle Fire Ins. Co., 192 N.C. 148, 134 S.E. 427 (1926). Unfortunately, courts have applied merger to judgment liens, committing the same analytical error that causes them to apply merger to mortgages. Watson v. Strohl, 220 Ind. 672, 46 N.E.2d 204 (1943); Gardner v. Coker, 184 S.C. 190, 192 S.E. 151 (1937); George v. Crim, 66 W. Va. 421, 66 S.E. 526 (1909).

172. Sorsby v. Woodlawn Lumber Co., 202 Ala. 566, 81 So. 68 (1919); Gray v. McKinley, 34 Ala. App. 630, 43 So. 2d 421, *cert. denied*, 253 Ala. 199, 43 So. 2d 424 (1949); James

have characterized mechanics' liens as creating a real property interest attribute that characterization to the fact that the lienor increased the value of the subject property. In the case of materials suppliers, for example, the materials often have become affixed to and part of the property.[173] The mechanic lienor in these states, however, does not have the right to possess the land or any other incident of ownership, but merely obtains a lien in the improved property.[174] Therefore, like mortgages, characterization of mechanics' liens as creating a real property interest is a matter of legal verbiage rather than substance.[175]

Title theory states characterize mortgages differently from other forms of creditor liens only because mortgages came into existence during an early era in the development of land laws. As described above, land became widely used as security for loans when the recognized categories of rights in land were the right to possess and to receive feudal incidents. In the absence of paper records and the right to charge interest on loaned money, lenders took possession of encumbered land to protect their security and to receive the only possible economic profit. Because property jurisprudence had not evolved to the stage of recognizing the concept of a lien, the lender's interest was characterized as an estate in land, except during the earliest stage of development—the Glanvillian gage—and during the most recent incarnation of the mortgage. Physicists have yet to quantify the inertia of legal theory, but its qualities have frustrated practitioners and commentators for centuries.

An American commentator writing almost one hundred years ago remonstrated:

> [W]hile a mortgagee's interest in land has for a long period, in this country, been a mere chattel estate, and has amounted in substance to a mere pledge of the land, and is constantly characterized as such, we still . . . permit to cling to the contract, like a lichen growth, certain embarrassing features of real-estate title.[176]

Drywall, Inc. v. Europa Dev. Corp., 116 N.H. 619, 365 A.2d 1047 (1976).

173. Fleming v. Kirkland, 226 Ala. 222, 225, 146 So. 384, 385 (1933); Canvasser Custom Builders, Inc. v. Seskin, 38 Mich. App. 643, 647, 196 N.W.2d 859, 861 (1972); B.&F. Concrete Co. v. Colton Realty Corp., 17 N.Y.S.2d 593 (1939).

174. *See generally* G. Nelson & D. Whitman, *supra* note 5, § 12.4.

175. As with judgment liens, courts generally apply merger to mechanics' liens. Title Guar. Co. v. Wrenn, 35 Or. 62, 56 P. 271 (1899); North Texas Bldg. & Loan Ass'n v. Overton, 91 S.W.2d 429 (Tex. Civ. App. 1936). By applying merger to mechanics' liens, courts obviously have failed to recognize that a mechanics' lien is not the type of interest to which merger applies.

176. Chaplin, *supra* note 79, at 4.

Application of merger to mortgages is one of those "embarrassing features," and by now courts should recognize that merger is inapplicable to mortgages. Merger is a procedural device that applies only when a person acquires consecutive estates in land in the same right. Because the modern mortgage, the mere ancillary of the secured debt, does not create an estate in land, the rights created by the mortgage should be unaffected by operation of merger. Although property law usually changes with glacial speed to avoid upsetting owners' expectations, legislatures' and courts' treatment of merger has evolved even more slowly than the law of mortgages. These bodies should change the merger doctrine now. If not, a commentator writing in 2087 may be quoting this Article as support for a similar reform.

III. Modern Context

As demonstrated in the previous section of this Article, merger, as a title simplification device, is inapplicable to mortgages as a matter of title theory. This conclusion, however, rests on more than theory. As will be demonstrated in this section, merger should not be applied to modern mortgages because of modern title and finance practices. When a mortgagee acquires encumbered land, such as when a mortgagee accepts the land in satisfaction of the secured debt, several reasons exist to keep the mortgage lien distinct from the fee title,[177] and no real gain results from the title simplification. Therefore, a court should not destroy the mortgage lien regardless of whether any intent concerning merger has been expressed. Nevertheless, courts have injured, and continue to injure, mortgagees by applying merger to cut off their liens even when the mortgagees had a valid need for them.

On the other hand, courts have injured property purchasers by refusing to apply merger when the public records indicated that one person owned the fee and mortgage interests. Therefore, even as a title simplification device, merger rarely has benefited a prospective purchaser who has relied on the public property records. On the contrary, the doctrine has proven to be a trap for unwary purchasers. Because courts' applications of merger have been overinclusive and their refusals to apply it have been underinclusive, elimination of the doctrine would prevent wrongful destruction of a mortgagee's otherwise valid interests and would eliminate the trap for a purchaser who assumes that merger has occurred.

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177. *See infra* notes 182-211 and accompanying text.

Consigning merger to history also would remove two major analytic errors committed by some courts. First and most surprising, many courts have applied merger to determine the continued existence of a debt.[178] Because merger essentially is a title clearing device, the results of courts' applications of merger to debts simply are unsupportable in terms of coherent legal analysis. Moreover, the apparent simplicity of merger as a title device has produced patently absurd results. Some courts have seized on merger and have applied it in cases involving a property owner's "purchase" of a senior mortgage encumbering the property when junior liens exist.[179] Rather than recognizing this transaction to be payment of the secured debt and no more, courts have fallen into the merger trap and have permitted owners to wipe out junior liens encumbering the property. As will be shown, these harmful effects of merger in the mortgage context greatly outweigh any positive functions. Therefore, legislatures should abolish merger just as they have abolished other outmoded common-law title rules.

In this section the Article first will examine the continued viability of merger as applied to mortgage interests. Because of the very different considerations governing a mortgagee's acquisition of the encumbered land and the mortgagor's purported acquisition of the mortgage, these situations will be examined separately. This Article then will review the situations in which courts have applied merger to the debt contract and will set forth the proper mode of analysis in that context. The applicability of merger to the mortgage interest normally concerns the state of title to the encumbered land, whereas issues concerning the debt contract normally arise in the context of determining personal liability for the debt.

A. Merger and Mortgages

The modern merger doctrine as it exists in the mortgage context is indistinguishable from that of the seventeenth century when Chancery established the equitable exception to merger. Mortgages, however, both in theory and in practice, have evolved into a very different animal from what existed when merger solidified into its current state. As described in the previous section of this Article, a mortgage is now only a debt interest that is a lien against land, rather than an estate in land. Furthermore, property law has evolved from a primitive system of a few inflexibly defined

178. *See infra* notes 283-322 and accompanying text.
179. *See infra* notes 272-82 and accompanying text.

estates in land. Merger, unfortunately, has not kept pace with these changes. As applied by some courts, merger is an "all or nothing" doctrine as dogmatic as the medieval laws. For example, if a court applies merger to deny the enforceability of a mortgage in one context, it destroys the mortgage lien, although the security priority should have endured. Other courts, although more sensitive to the historical position of merger, also have confused the area by introducing a variety of factors that simply are unnecessary to the task.

In the modern age, courts have applied merger in two different mortgage contexts: (1) when a mortgagee acquires title to the encumbered property; and (2) when a property owner purports to acquire a mortgage encumbering the property. Although courts sometimes apply case precedent across categorical lines, the two categories are legally distinct and are governed by different considerations.

1. Mortgagee Acquires Title to the Encumbered Property

A mortgagee may acquire title to the encumbered property by voluntary or involuntary conveyance. The property owner voluntarily may convey the property to the mortgagee as a gift having no relationship to the loan or, as is the more usual case, as full or partial satisfaction of the debt to avoid foreclosure. A mortgagee also may acquire the encumbered property by purchase at an involuntary sale conducted to foreclose a lien held by it or by a third party. Although courts occasionally discuss these essentially factual variations as governed by different rules, the basic issue is the same in each case: Does a legally cognizable reason exist for keeping the lien distinct from the fee title?[180] In every legally relevant way, the analyses of these cases are alike, and, therefore, they will be considered together.

A mortgagee often has strong inducements to acquire title to the encumbered property. For example, the mortgagee is benefited in several ways by accepting title in satisfaction of the secured debt. The mortgagee's acceptance of this so-called deed in lieu of foreclosure typically occurs when the loan is in default and is an attractive alternative to foreclosure. By immediately receiving title to the property, the lender may realize on the loan more quickly than if it had to await the conclusion of foreclosure proceedings.

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180. A few relatively insignificant differences exist among these cases, which will be stated where necessary.

Most significantly, the deed in lieu cuts off the borrower's equity of redemption and any statutory right of redemption, including the borrower's attendant rights to possess the property during the redemption period and to collect any income from the property. Furthermore, because some jurisdictions have limited or abolished the lender's rights to sue on the note or to employ post-foreclosure remedies or because the borrower may be judgment proof, the lender, by accepting a deed in lieu, is not forfeiting any remedies.[181]

Much of the benefit of accepting a deed in lieu or otherwise acquiring title is lost, however, if a court merges the mortgage into the lender's newly acquired fee title. Every lender that acquires title to the encumbered property has important reasons for keeping the mortgage distinct from the fee title. As discussed below *seriatim*, the mortgagee must retain its lien to use offensively or defensively against junior lienors. Additionally, the mortgagee must retain its mortgage lien separate from the fee in case its acquisition of the encumbered property is overturned should the borrower subsequently go into bankruptcy or challenge the validity of the conveyance to the mortgagee. Unless the mortgagee has prevented merger of its lien in these situations, the mortgagee will occupy the unenviable position of an unsecured creditor or will hold only a lien inferior to its mortgage lien in priority and in terms.

a. Junior Liens

A primary reason a mortgagee that acquires title to the encumbered property wishes to prevent merger of its mortgage lien

181. A deed in lieu also can be an attractive alternative to foreclosure for the borrower. As additional consideration for delivery of the deed in lieu, the borrower normally negotiates for the lender's release of further liability for the debt or covenant not to sue. The alternative for the borrower, a foreclosure sale, generally would entitle the lender to sue the borrower for a deficiency judgment if the foreclosure sale proceeds were insufficient to pay the debt in full. This threat can be of paramount importance to the horrower because foreclosure sale prices normally are substantially less than the fair market value of the encumbered property. Although a deficiency judgment currently might he uncollectible against the borrower, the lender can enforce it at any time during the statute of limitations period, so the judgment remains a real and continuing liability for the borrower. Furthermore, by delivering a deed in lieu, the borrower reduces its potential liability. A deed in lieu eliminates the expense of a foreclosure sale, which is a significant factor in those jurisdictions that have not authorized power of sale foreclosures. Borrowers normally are liable to the lender for the cost of foreclosing a mortgage, either by statute or by agreement of the parties, and interest continues accruing on the outstanding debt until it is paid. Finally, the borrower may wish to avoid the embarrassment and trouble of a foreclosure action. *See* P. BASYE, CLEARING LAND TITLES § 281 (2d ed. 1970).

is to protect its interest in the property if junior liens exist. A viable mortgage lien can be used offensively, by foreclosing it to eliminate junior liens.[182] Moreover, if the junior lienor initiates foreclosure to enforce its lien, the senior mortgagee is best served if the sale is subject to its lien. In this way, although the foreclosure sale deprives the senior mortgagee of fee title, the senior mortgagee will retain its mortgage lien, which it can foreclose to recover the secured debt. Because the necessity of priority is so apparent in this context, courts usually apply the equitable exception to the merger doctrine and hold that the senior lien did not merge.[183] Courts reach this result even if the senior lienor apparently waived the protection of the equitable exception, such as by recording a lien release.[184] Despite this near unanimity of treatment, litigation between junior lienors and the senior lienor/owner forms the great bulk of merger litigation.

A holding that priority is not lost upon acquiring the fee correctly preserves the relationship between the junior and senior lienors. By permitting the senior lienor the option to foreclose its lien in this situation, the court in no way alters the position occupied by the junior lienor. When the junior lienor agreed to extend credit against the security of the property, he had actual or constructive notice[185] of the senior lien and, therefore, of the possibility of his lien's being eliminated by a foreclosure of that lien. Indeed, some lenders are prohibited from making loans secured by a junior lien because of obvious security difficulties.[186] Moreover, lenders routinely charge higher interest rates on loans secured by a

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182. When a lender extends credit against the security of a parcel of land, the lender's mortgage interest attaches to the title as it exists when the lender perfects its mortgage interest. Therefore, when the lender forecloses its mortgage, the sale eliminates not only the mortgage, but also all property interests junior to it. G. NELSON & D. WHITMAN, *supra* note 5, § 7.12, at 507.

183. *See, e.g.*, Lampert Yards, Inc. v. Thompson-Wetterling Constr. & Realty, Inc., 302 Minn. 83, 223 N.W.2d 418 (1974). *Cf.* Miles Homes, Inc. v. Harrah Plumbing & Heating Serv. Co., 408 N.E.2d 597, 599 (Ind. App. 1980).

184. *See, e.g.*, Richardson v. Hockenhull, 85 Ill. 124 (1877); Eldridge v. Salazar, 81 N.M. 128, 464 P.2d 547 (1970); Fowler v. Carter, 77 N.M. 571, 575, 425 P.2d 737, 740 (1967).

185. One of the purposes for land title recording acts is to provide potential purchasers with notice of previous encumbrances and conveyances. Even if the purchaser does not check the property records, she will be deemed to have constructive notice of all properly recorded documents. 3 R. POWELL, *supra* note 2, § 904(3).

186. This restriction for national banks and savings and loan associations recently has been repealed but still may affect state chartered institutions. G. NELSON & D. WHITMAN, *supra* note 5, § 12.9, at 904-05; Spellmen, *A Banker's Tour Through the Second Mortgage Market*, 148 BANKER'S MAG., No. 2, 19, 19 (1965).

junior lien[187] and often take extra precautions to protect their security interests.[188] When the senior lienor/owner forecloses its lien, the junior lienor is entitled to participate in the foreclosure sale to try to drive up the bidding so that sufficient sale proceeds will be generated to pay off its secured debt, as well as the debt secured by the foreclosed lien. This participation is the only right to which junior lienors are entitled. Therefore, if merger eliminated the senior lien, the junior lienor would enjoy an undeserved windfall.[189]

That the senior lienor/owner should be permitted to hold the fee and mortgage interests separately is demonstrated most convincingly when the senior lienor acquires title to the fee by a deed in lieu of foreclosure. The very fact of the deed in lieu transaction indicates that the debt secured by the senior lien was, or soon would be, in default. Rather than accept the deed, the senior lienor immediately could have foreclosed its lien, and all junior liens thereby would have been eliminated from the title. If the senior lienor instead agrees to accept a deed in lieu, the senior lienor has fully or partially surrendered its right to enforce the debt against anyone personally liable for it, but has the senior lienor altered its

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187. *See* Spellmen, *supra* note 186, at 22.

188. For example, junior lienors often include in their security instruments a provision that the junior lienor may cure any default in the terms of the senior lien. Junior lienors also often include in their security instruments a "cross default" clause, which provides that a default in the senior lien also constitutes a default under the junior lien. In this way, the junior lienor can exercise its remedies as soon as the borrower defaults in any of its obligations. For a description of additional covenants often required by junior lienors, see *id.* at 24. Furthermore, several states have adopted statutes permitting junior lienors to cure a default in a senior lien, *see, e.g.*, CAL. CIV. CODE § 2924(c) (West 1974); Ill. Ann. Stat. ch. 95, § 57 (Smith-Hurd 1985); MINN. STAT. ANN. § 580.30 (West 1945), or granting junior lienors a statutory right to redeem the property after foreclosure of a senior lien. G. NELSON & D. WHITMAN, *supra* note 5, § 8.4, at 616.

189. Lowman v. Lowman, 118 Ill. 582, 9 N.E. 245 (1886); Quality Fin. Co. v. Bourque, 315 So. 2d 656 (La. 1975); Ross v. Loyola Fed. Sav. & Loan Ass'n, 245 Md. 507, 226 A.2d 553 (1967); Citizens Sec. Bank v. Courtney, 572 P.2d 1302 (Okla. App. 1977). *Cf.* Shaffer v. McCloskey, 101 Cal. 576, 36 P. 196 (1894); Note, *Remedies of Junior Lienors Omitted from Prior Foreclosure*, 88 U. PA. L. REV. 994 (1940).

When a senior lienor has acquired fee title, junior lienors also have argued that a foreclosure sale on the junior lien is free of the senior lien because the latter merged into the fee. A holding that the senior lien had merged would grant the junior lienor a similarly unjust windfall. When the junior lienor agreed to extend credit against the security of the property, that decision was made with actual or constructive knowledge of the senior lien. Even if after the junior lienor made the loan the value of the encumbered property decreased to less than the amount of outstanding debts secured by the property, the junior lienor is not entitled to sell the land free of the senior lien. Like any other secured creditor, the junior lienor, when it agreed to make the loan, gambled that the value of the collateral would not decrease to less than the amount of the junior debt and all debts senior to it.

rights against any junior lienors? The answer should be uniformly "no," because all the junior lienors' expectations have been preserved, and the lien holders remain in *status quo ante*.

Junior lienors have argued that mere acceptance of a deed in lieu connotes acceptance of the state of title, including the junior liens. If, as is the usual case, the senior mortgagee accepted the deed in lieu without actual knowledge of junior liens, the senior lien should not merge into the fee even if the senior mortgagee had constructive notice of the junior liens by virtue of the public property records. Although the senior mortgagee might have been incautious in failing to ascertain the state of title before accepting the deed in lieu, a thorough title check will not always protect the mortgagee from accepting a deed to property subject to a junior lien. A mechanics' lien, for example, might not be recorded until after the senior mortgagee accepted the deed in lieu. By operation of a mechanics' lien statute, however, the lien may attach retroactively to the property title as of a date before the senior mortgagee accepted the deed, such as when the mechanic rendered its services.[190] Regardless of the senior mortgagee's diligence in checking title, however, a junior lienor should not benefit from conveyance of a deed in lieu because the junior lienor's expectations upon extending credit still will be satisfied.[191]

Furthermore, application of merger to eliminate the senior lien potentially would deprive the senior lienor/owner of all interest in the property. The junior lienor, upon becoming the senior lienor as a result of merger of the former senior lien, could foreclose its lien, and the original senior mortgagee, whose lien merger previously will have destroyed, would lose his fee title by operation of the foreclosure sale. If, in consideration of the former owner's conveyance of the property to the senior lienor, the latter released liability for the debt or covenanted not to sue on the debt, he also will have lost the right to enforce the debt. Thus, a lienor who acquires title to the encumbered property obviously is best served by keeping his lien distinct from the fee title.[192]

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190. *See* G. NELSON & D. WHITMAN, *supra* note 5, § 12.4, at 864.

191. Fowler v. Carter, 77 N.M. 571, 575, 425 P.2d 737, 740 (1967).

192. One court, although recognizing the applicability of this principle, gutted it by placing unperformable conditions on the lienor's right to foreclose. In American Sav. & Loan Ass'n v. Eidelberg, 283 N.Y.S.2d 255 (1967), the borrower had executed two mortgages encumbering the same property. After defaulting on the senior mortgage debt, the horrower conveyed the property to the senior mortgagee. The deed, evidently prepared by a knowledgeable lender, expressly provided that the parties did not intend the mortgage lien to merge into the fee title. The case arose when the senior mortgagee commenced foreclosure

b. Former Owner's Bankruptcy

Bankruptcy often awaits the owner who loses title to encumbered property. Therefore, in addition to retaining its lien to use against junior lienors, every mortgagee that acquires title to encumbered property must retain its lien to protect itself if the former owner goes into bankruptcy within one year of the conveyance. In this event, the bankruptcy trustee may challenge the mortgagee's acquisition of title as a fraudulent transfer pursuant to section 548 of the Bankruptcy Code,[193] a preference pursuant to section 547 of the Code,[194] or a violation of any other federal or

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proceedings on the lien, presumahly to eliminate the junior mortgage lien.

The court's analysis reflected a misplaced solicitude for the junior lienor. Although the court correctly stated the ground rules for analysis, the parameters of accord and satisfaction and the dispositive character of the stated intent to prevent merger, the court misperceived the nature of the security interest. Unaccountably, the court held that the senior mortgagee, in foreclosing the mortgage, must do so "in a manner which will not prejudice the holder of the second mortgage." *Id.* at 257. The court compounded its error by holding that the foreclosure action was available only if the deed in lieu did not completely retire the mortgage debt. The court reasoned that the senior mortgagee was not entitled to "appropriate the security and then enforce the debt without regard to the value of the security." *Id.* at 257.

The court's analysis, though premised on correct principles, went seriously awry. Foreclosure was the first legal principle to suffer. Whenever a senior lienor exercises its right to foreclose, any junior lienors will be "prejudiced" because such sales always operate to eliminate junior liens. This result follows more from the nature of the mortgage than from the suhsequent decision to foreclose. When the senior lienor agreed to extend credit based on the security of the mortgaged property, the title was unencumbered by the junior liens. This is the status that the foreclosure sale is designed to preserve. This normal, indeed basic, incident of a foreclosure sale would be eliminated if the court's analysis were generally accepted.

In addition to distorting foreclosure, the court mischaracterized the substance of the suit. Rather than attempting to "enforce the debt," the senior mortgagee sought to enforce its security interest. The complaint neither prayed for a deficiency judgment nor otherwise requested recovery against those personally liable for the debt. The gravamen of the action was elimination of the junior lien by foreclosure of a senior lien.

Finally, the decision amounts to a windfall for the junior lienor. Should the evidence establish that the senior lienor accepted the property in complete satisfaction of the debt, the former junior lien will be advanced to first priority. In contrast, if the senior mortgagee had not accepted the deed, which it was not bound to do, the junior lienor could have foreclosed and sold the fee title, but only subject to the senior mortgage. According to the court in *Eidelberg*, however, the junior lienor may convey title free and clear of the senior mortgage, although the junior lienor never held a security interest in unencumbered property. In contrast, the senior mortgagee's economic interest in the property has vanished: The borrower's personal liability is extinguished, the senior mortgagee will lose the fee title as a result of the junior's foreclosure sale, and its mortgage lien is extinguished. The court's holding substantially diminishes the utility of deeds in lieu of foreclosure.

193. 11 U.S.C. § 548 (1982 & Supp. II 1986).

194. *Id.* § 547.

state law pursuant to section 544 of the Code.[195] If the trustee is successful, the mortgagee will lose title to the property. Additionally, if a court is persuaded that the mortgage merged into the fee, the mortgagee will have lost all its interest in the encumbered property.[196]

i. Fraudulent Transfer

Every means by which a mortgagee acquires fee title, whether by voluntary or involuntary transfer, potentially is subject to challenge as a fraudulent transfer pursuant to section 548 if the transfer occurred within one year before the debtor filed for bankruptcy.[197] A gift of the fee title to the mortgagee is particularly susceptible to challenge under section 548 even if the debtor did not intend to commit a fraud, because the mortgagee gave no value for the property. A mortgagee's acquisition of title by deed in lieu is similarly subject to challenge. If the outstanding amount of the secured debt was less than the property value, the transfer clearly will be voided.[198] Therefore, an appraisal prepared in connection

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195. *Id.* § 544.

196. Virtually no case law exists concerning the mortgagee's ability to revive its lien in this circumstance. The decision in *Matter of* Apex Carpet Finishers, Inc., 585 F.2d 1323 (5th Cir. 1978), indicates that the lien may revive only in limited circumstances. In that case, the bankruptcy trustee and creditors' committee determined that the debtor had no equity in a parcel of land to which it held title. At the debtor's suggestion and to save expense, tbe bankruptcy court authorized the debtor to deliver a deed in lieu of foreclosure to the holder of the second mortgage encumbering tbat land. The deed in lieu did not include an expression of intent to keep the second mortgage separate from the fee. When the third mortgagee attempted to enforce its lien, the third mortgagee convinced the bankruptcy court and the district court that the second mortgage had merged into the fee, thereby enabling the tbird mortgagee to sell the land free of tbe second mortgage. The appellate court reversed the lower courts on the issue of merger. In stating this holding, however, the appellate court did not state the generally accepted rule that a lienor that accepts a deed in lieu retains its lien priority for the purpose of eliminating junior liens. Instead, the appellate court, like the bankruptcy and district courts, apparently viewed the factual circumstances as a special case. The appellate court based its holding on the fact tbat the deed-in-lieu transaction was "done as an accommodation to the debtor estate," *id.* at 1325, indicating that the court was using its discretionary power to revive the lien. Thus, a substantial possibility exists that a court would not permit revival in the more usual situation in which the lienor accepted a deed in lieu before the debtor went into bankruptcy.

197. Pursuant to § 548(a), the trustee can avoid any transfer made by the debtor on or within one year before the bankruptcy petition was filed if the debtor made the transfer with "actual intent to hinder, delay, or defraud" any creditor. The trustee also can avoid a transfer if it was constructively fraudulent. That is, the trustee can avoid a transfer if the debtor received less than a "reasonably equivalent value" for the transfer and was or thereby became insolvent, was engaged in a business with unreasonably small capital, or intended to incur debts beyond his ability to pay.

198. *See In re* Castillo, 7 Bankr. 135, 137-38 (Bankr. S.D.N.Y. 1980); Busby v. United

with the conveyance of the deed in lieu will be a necessary component of the mortgagee's case before the bankruptcy court. The bankruptcy trustee, however, is free to counter with contrary appraisals or other evidence of value. Furthermore, even if the outstanding debt amount exceeded the property value, the court will void the transfer if it finds actual intent to defraud. In light of the inexact art of real estate appraisal and the vagaries of factfinding in general, this "safe harbor" simply does not provide the certainty that most mortgagees, as lenders, desire. Moreover, even acquisition of title at a validly conducted foreclosure sale may trigger a fraudulent transfer challenge.[199]

States Steel Corp., 237 F. Supp. 602 (E.D. Okla. 1965).

199. Whether the trustee's power extends to challenging a validly conducted foreclosure sale as a fraudulent transfer currently is uncertain. Section 548(a) broadly permits the trustee to challenge any "transfer" of the bankrupt's property that satisfies the other statutory criteria. In Durrett v. Washington Nat'l Ins. Co., 621 F.2d 201 (5th Cir. 1980), the Fifth Circuit construed a similar provision of the former Bankruptcy Act to include foreclosure sales. The court's holding was based on the Act's broad definition of a "transfer," which neither expressly included nor excluded a purchase at a foreclosure sale. Because the foreclosure sale purchaser in that case paid only 57.7% of the fair market value of the foreclosed property, thereby acquiring for substantially less than its value an asset that otherwise might have been included in the bankruptcy estate, the court held that the purchase constituted a fraudulent transfer and directed the district court to rescind the transfer. Several courts have adopted the *Durrett* reasoning. *See, e.g., In re* Hulm, 738 F.2d 323 (8th Cir. 1983), *cert. denied sub nom.* First Fed. Sav. & Loan v. Hulm, 469 U.S. 990 (1984); *In re* Frank, 39 Bankr. 166 (Bankr. E.D.N.Y. 1984); *In re* Carr, 34 Bankr. 653 (Bankr. D. Conn. 1983), *aff'd*, 40 Bankr. 1007 (D. Conn. 1984); *In re* Wheeler, 34 Bankr. 818 (Bankr. N.D. Ala. 1983); *In re* Berge, 33 Bankr. 642 (Bankr. W.D. Wis. 1983); *In re* Bates, 32 Bankr. 40 (Bankr. E.D. Cal. 1983); *In re* Richardson, 23 Bankr. 434 (Bankr. D. Utah 1982); *In re* Smith, 21 Bankr. 345 (Bankr. M.D. Fla. 1982).

Other courts, however, have rejected the *Durrett* rationale. In *In re* Madrid, 21 Bankr. 424 (9th Cir.), *aff'd*, 725 F.2d 1197 (9th Cir. 1982), *cert. denied sub nom.* Madrid v. Lawyers Title Ins. Co., 469 U.S. 833 (1984), the Ninth Circuit held that a foreclosure sale is not a transfer subject to avoidance under § 548(a). The court held that the "transfer" of the bankrupt's property occurred when the deed of trust was perfected under state law. Because the trust deed had been perfected more than one year before the debtor filed her bankruptcy petition, the court held that the transfer was not voidable and expressly declined to find whether the foreclosure sale price was a reasonably equivalent value for the property in that case. The court also expressed its concern that subjecting foreclosures to avoidance under the bankruptcy laws would interfere unduly with state law and lending practices. Like *Durrett*, *Madrid* has acquired a camp of followers. *See, e.g., In re* Strauser, 40 Bankr. 868 (Bankr. N.D. Ohio 1984); *In re* William, 39 Bankr. 678 (D. Minn. 1984); *In re* Gilmore, 31 Bankr. 615 (E. D. Wash. 1983).

Congress apparently chose *Durrett* over *Madrid* when it amended the Bankruptcy Code in 1984, Pub. L. No. 98-353, 98 Stat. 333 (1984), but questions remain. The definition of "transfer" was amended to include "foreclosure of the debtor's equity of redemption." 11 U.S.C. § 101 (1979), *amended by* 11 U.S.C. § 101 (48) (Supp. II 1986). On its face, that language establishes when the transfer occurs and equates foreclosure sales with other transfers as to the possibility of avoidance. Whether Congress intended to resolve the issue in the 1984 Amendments Act, however, remains at issue. In the course of its deliberations, the

Should a court void the mortgagee's acquisition of the encumbered property as a fraudulent transfer, revival of his mortgage lien if it has merged into the fee title is problematic. Section 548(c) of the Code provides that, if the transfer of title to the mortgagee constituted a fraudulent transfer, the mortgagee "that takes for value and in good faith has a lien on . . . or may retain any interest transferred . . . to the extent that such transferee . . . gave value to the debtor in exchange for such transfer." Courts and commentators construing this statutory provision rarely have considered whether the mortgagee's former lien is revived. At least one federal appellate court expressly has held that the lien will not be revived in any form.[200] Instead, courts and commentators generally construe section 548(c) as authorizing the creation of a new lien in favor of the mortgagee.[201] Presumably, this lien, which is consid-

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House adopted not only the amendment to the definition of "transfer" set out above, but also an amendment to § 548 providing that a foreclosure sale purchaser pays a reasonably equivalent value if he pays the full amount of the debt secured by the foreclosed lien. When the Senate considered the House's version of the Amendments Act, however, it apparently decided to sidestep the issue and dropped the amendment to § 548. The Senate, however, failed to drop tbe complement to the § 548 amendment, the amendment of the "transfer" definition. The failure to eliminate the "transfer" amendment only can be considered an oversight. *See* Andrew, *Real Property Transactions and the 1984 Bankruptcy Code Amendments*, 3 MINN. REAL EST. L.J. 1, 11-13 (1986); *see also* G. NELSON & D. WHITMAN, *supra* note 5, § 8.16, at 663; Ehrlich, *Avoidance of Foreclosure Sales as Fraudulent Conveyances: Accommodating State and Federal Objectives*, 71 VA. L. REV. 933, 938 n.14 (1985).

Courts have yet to decide whether to follow the letter of the law or to alter it based on the legislative history. Although courts can disregard statutory language when necessary to effectuate the legislative intent, some courts have refused to do so when the language is clear and consistent with the remaining language. *See, e.g.*, Christopherson v. Federal Land Bank, 388 N.W. 2d 373, 374 (Minn. 1986). 2A J. SUTHERLAND, STATUTES AND STATUTORY CONSTRUCTION § 47.37 (Singer 4th ed. 1984). If courts defer to the statutory language, they still must grapple with the issue of what is a reasonably equivalent value. Foreclosure sales are conducted as public auctions, thereby avoiding the possibility of the mortgagee's overreaching that exists with private arrangements, such as the deed in lieu. Foreclosure sales, however, are notorious for the inadequacy of the price paid in relation to the value of the foreclosed property. The *Durrett* court indicated that 70% of fair market value might constitute reasonably equivalent value. At least one court has required a lender to pay a bankruptcy trustee the entire difference between the fair market value and the price paid by the lender at the foreclosure sale, which was the outstanding amount of the debt. *In re* Hulm, 45 Bankr. 523 (Bankr. D.N.D. 1984). In determining the fair market value, the court took into account the adverse impact of the foreclosure sale on the property value. The issue, however, is far from a resolution.

200. Crawford v. Broussard, 260 F. 122, 127 (5th Cir. 1919), *cert. denied*, 251 U.S. 560 (1920) ("A fraudulent purchaser of property is not entitled to have it subjected to the satisfaction of a lien on it which existed in his favor prior to his purchase.").

201. *See, e.g., In re* Carr, 34 Bankr. 653, 657 (Bankr. D. Conn. 1983), *aff'd*, 40 Bankr. 1007 (D. Conn. 1984); *In re* Jones, 20 Bankr. 988, 994-95 (Bankr. E.D. Pa. 1982); 2 W. NORTON, BANKRUPTCY LAW AND PRACTICE § 34.07 (1984); Ehrlich, *supra* note 197, at 968. *But see* 4 W. COLLIER, BANKRUPTCY ¶ 548.07[4], at 548-83 (L.P. King 15th ed. 1979).

ered a new and different lien, would have priority only as of the date it attached to the property by the bankruptcy court's order. Therefore, a mortgagee that had enjoyed senior priority may now become the most junior, thereby significantly decreasing the probability that its debt will be paid in full. If this is the penalty for accepting a deed in lieu or for purchasing at a foreclosure sale, it is strong medicine indeed.[202]

ii. Preference

If the mortgagee acquired title to the encumbered property by a deed in lieu or at a foreclosure sale on its mortgage, the conveyance may satisfy the statutory test for a preference.[203] A finding

202. Furthermore, a mortgagee who acquires title to the encumbered property will not always be entitled to the relief granted by § 548(c). Pursuant to the terms of § 548(c), if the mortgagee's acquisition of the land constitutes a preference as well as a fraudulent transfer or if the court determines that the mortgagee did not acquire the property in good faith, he is not entitled to the relief provided in § 548(c). Courts generally have held that a mortgagee's purchase at a foreclosure sale does not constitute bad faith even if the price he paid was less than the reasonably equivalent value because the mortgagee merely exercised his rights under state foreclosure laws. *See, e.g., In re* Carr, 34 Bankr. 653, 657 (Bankr. D. Conn. 1983), *aff'd,* 40 Bankr. 1007 (D. Conn. 1984). If the mortgagee acquired the land by gift or by deed in lieu of foreclosure, however, the court may deem his acquisition to be in bad faith if he knew or had reason to know of the debtor's insolvency or that the property value exceeded the outstanding debt amount. A noted commentator has stated: "The unpredictable circumstances in which the courts may find its presence or absence render any definition of 'good faith' inadequate, if not unwise." 4 W. Collier, *supra* note 201, ¶ 548.07 [2], at 548-68. In these cases, unless the mortgagee preserved his mortgage lien, he may lose his secured creditor status and find himself in the unenviable position of an unsecured creditor. Furthermore, if the lender is guilty of misconduct, the trustee may seek to subordinate the lender's claim to other claims or to transfer the lender's lien to the estate pursuant to § 510(c) of the Code. 11 U.S.C. § 510(c) (1982 & Supp. II 1986). *See* Jones, *Structuring the Deed in Lieu of Foreclosure Transaction,* 19 Real Prop. Prob. & Tr. J. 58, 64-65 (1984).

203. Pursuant to § 547(b) of the Code, a bankruptcy trustee may void a transfer of the bankrupt's property as a preference if it was: (1) to or for a creditor's benefit; (2) made on account of an antecedent debt; (3) made while the debtor was insolvent; (4) made on or within 90 days before the filing of the bankruptcy petition or between 90 days and one year before the filing if the creditor was an insider; and (5) gives the creditor more value than if the bankruptcy were under Chapter 7 of the Code and the transfer had not been made. 11 U.S.C. § 547(b) (1982 & Supp. II 1986). By its very nature, a deed-in-lieu transaction satisfies the first two elements of the preference test. The debtor obviously delivered the deed to benefit the mortgagee, and the deed constitutes full or part payment of the outstanding debt. The third element also often will be satisfied when the mortgagee is not an insider of the debtor, as evidenced by a statutorily created presumption that the debtor was insolvent for the 90 days preceding the date the petition is filed. 11 U.S.C. § 547(f) (1982) ("For the purposes of [§547], the debtor is presumed to have been insolvent on and during the 90 days immediately preceding the date of the filing of the petition.").

The final element in the preference test usually is the most crucial element in determining whether a deed in lieu can be voided. This single element requires a two-part analysis. The court must determine the value of the property the mortgagee received and the value it that the conveyance constitutes a preference carries a potentially greater penalty than that provided for a fraudulent transfer. Unlike the fraudulent transfer provisions of the Code, the preference provisions provide no security for the outstanding debt if the deed in lieu is voided. Therefore, if the mortgagee permitted its mortgage lien to merge, the mortgagee will be an unsecured creditor. Because secured creditors are paid first from their collateral in bankruptcy proceedings,[204] an unsecured creditor's chance of receiving full or even significant payment for its debt normally is minimal.

iii. Other Federal or State Laws

In addition to powers devolving from provisions governing fraudulent transfers and preferences, section 544 of the Code grants the bankruptcy trustee additional powers to void a property transfer. Section 544 empowers the trustee to void any transfer that could be voided under state or federal law by a judgment lienor, an unsatisfied execution creditor, a bona fide purchaser of real property, or an unsecured creditor.[205] As with the preference provisions, section 544 does not provide the mortgagee a lien if the transfer is voided. Again, if the mortgagee permitted the mortgage lien to merge into the fee, the mortgagee may occupy the inferior

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would have received in a liquidation case if the transfer had not occurred. Thus, the secured creditor is afforded a safe harbor of sorts. If the outstanding amount of the debt held by the mortgagee is greater than the value of the transferred property, the transfer will not be deemed a preference. Because secured creditors are the first creditors entitled to be satisfied from the collateral, the mortgagee will not have received more than would have been provided by a liquidation proceeding. If the outstanding debt amount was less than the property value, however, the trustee is authorized to void the transfer as a preference. *See In re* Castillo, 7 Bankr. 135, 136-37 (Bankr. S.D.N.Y. 1980); Busby v. United States Steel Corp., 237 F. Supp. 602 (E.D. Okla. 1965); *In re* Hygrade Envelope Corp., 393 F.2d 60, 63-64 (2d Cir.), *cert. denied sub nom.* Gibralter Factors v. Baranow, 393 U.S. 837 (1968); 2 W. NORTON, *supra* note 201, § 32.07, at 19; *id.* § 32.09, at 28; Jones, *supra* note 202, at 59-63.

At least two courts have held that a foreclosure sale constituted a preference. *In re* Wheeler, 34 Bankr. 818 (Bankr. N.D. Ala. 1983); *Matter of* Fountain, 32 Bankr. 965 (Bankr. W.D. Mo. 1983). In each case, the court's bolding was based on the foreclosing mortgagee's purchase at the sale for an amount significantly less tban the fair market value. Each court held that tbe mortgagee's acquisition of title constituted a preference because the mortgagee received more than it would have if the bankruptcy were under Chapter 7 and if tbe transfer had not been made. The court in *Fountain* erroneously based its holding on a passage in *Collier on Bankruptcy* dealing with a bankruptcy trustee's ability to challenge the granting of a mortgage as a preference. *Id.* at 965. For a discussion of the trustee's power to challenge tbe sale as a preference, see G. NELSON & D. WHITMAN, *supra* note 5, § 8.16, at 667-69.

204. *See* 11 U.S.C. § 541 (1982 & Supp. II 1986); 4 W. COLLIER, *supra* note 201, ¶ 541.01; 3 W. COLLIER, *supra* note 201, ¶ 507.02[2].

205. *See* Jones, *supra* noto 202, at 63-64.

position of an unsecured creditor. The possibility that the transfer to the mortgagee may be voided as a fraudulent transfer, a preference, or an otherwise illegal transfer under federal or state law thus provides a substantial cause for the avoidance of merger.

c. *Validity of the Deed-in-Lieu Transaction*

In addition to the possibility of the borrower's bankruptcy or the existence of junior liens, a lender that accepts a deed in lieu of foreclosure must be concerned with merger because, in light of the usual inequality of bargaining power between lenders and borrowers, courts often view such deeds with suspicion. Although deeds in lieu of foreclosure are used with increasing frequency,[206] especially with the increased number of foreclosures occurring nationwide, if a borrower challenges the deed in lieu transaction, the court generally will be solicitous of him and will closely scrutinize the transaction and its surrounding circumstances to determine whether the lender's conduct was oppressive or otherwise unconscionable.[207] Generally, unless the lender can satisfy the court that the value of the property was substantially equivalent to or less than the debt amount, the court will void the title conveyance. An appraisal prepared on the lender's behalf, certifying that the property was worth no more than the debt amount on the date of the conveyance, may lead to nothing more than an evidentiary battle with the

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206. P. Basye, *supra* note 181, § 281, at 605; 3 R. Powell, *supra note* 2, ¶ 459, at 696.26 n.5 ("The use of this device as a substitute for foreclosure is widespread . . . . With delays [in foreclosure proceedings] amounting to between twenty-three days and twenty-five months per mortgage . . . the incentive to avoid . . . loss by procuring a deed from the mortgagor is apparent."); Pease, *The Acceptance of Quit-Claim Deeds in Lieu of Foreclosure of Real Estate Mortgages*, 2 J. Mar. L.Q. 252, 252 (1936) ("This topic has become more and more important to banks, insurance companies and private mortgagees as the costs in connection with foreclosures have increased . . . .").

207. Peugh v. Davis, 96 U.S. 332 (1877); Villa v. Rodriguez, 79 U.S. (12 Wall.) 323, 339 (1870):

> The law upon the subject of the right to redeem where the mortgagor has conveyed to the mortgagee the equity of redemption, is well settled. It is characterized by a jealous and salutary policy. Principles almost as stern are applied as those which govern where a sale by a *cestui que trust* to his trustee is drawn in question. To give validity to such a sale by a mortgagor it must be shown that the conduct of the mortgagee was, in all things, fair and frank, and that he paid for the property what it was worth. He must hold out no delusive hopes; he must exercise no undue influence; he must take no advantage of the fears or poverty of the other party. Any indirection or obliquity of conduct is fatal to his title. Every doubt will be resolved against him . . . . The form of the instruments employed is immaterial. That the mortgagor knowingly surrendered and never intended to reclaim is of no consequence.

See also G. Nelson & D. Whitman, *supra* note 5, § 6.19, at 474-75.

borrower's appraisals. Once again, the operation of merger may leave the lender as an unsecured creditor if the court voids the deed in lieu.

A deed-in-lieu transaction need not be completely voided for the mortgagee to have beneficial reasons for keeping its mortgage interest distinct from the fee. Based on the borrower's allegations, a court might determine that the conveyance was intended as additional security for the debt. The borrower may attempt to establish, for example, that the lender agreed to extend the time for repayment in exchange for the borrower's title conveyance. Then, if the borrower defaulted, no foreclosure proceeding would be necessary. Instead, the lender would own the land outright pursuant to the deed and could dispose of it in a manner more likely than a foreclosure sale to return the fair value of the property. Additionally, the lender would avoid the time and expense of a foreclosure.

Should the court accept the borrower's argument, the court will hold that the deed in lieu is an equitable mortgage rather than a title conveyance.[208] As a result, the lender's position will be impaired seriously if merger has occurred. The deed in lieu, because it is a deed, will not contain the provisions for the lender's

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208. *See, e.g.*, Peugh v. Davis, 96 U.S. 332 (1877); Sutphen v. Cushman, 35 Ill. 186, 196-97 (1864):

> We are of the opinion that the deed . . . should be regarded as a mortgage . . . . The appellant was indebted to the appellee at the time the conveyance was made, and there is no evidence whatever of the discharge of tbat indebtedness. The bond and note by which the greater portion of it was evidenced, were retained by the appellee, as well as the . . . notes which had been pledged as security; and the payment of the indebtedness might bave been enforced at any time thereafter. Until the contrary is shown, the presumption is that the indebtedness was not satisfied by the conveyance; and absolute certainty in regard to the fact takes the place of presumption, in case the creditor retains the evidence of the indebtedness, the securities pledged for its payment, and collects the money due upon sucb securities . . . . It is sufficient for us to know that when [the appellee] took the conveyance on account of a preexisting indebtedness, without in any manner canceling or discharging it, that equity will regard the deed as a mortgage, whether he so regarded it or not.

See also Wallace v. Greenman, 321 Ill. 423, 430, 152 N.E. 137, 140 (1926); Burton v. Perry, 146 Ill. 71, 114, 34 N.E. 60, 71 (1893); G. NELSON & D. WHITMAN, *supra* note 5, at 475; Pease, *supra* note 206, at 259-60. The adverse impact of these decisions on the utility of deeds in lieu prompted at least one state legislature to enact a statute creating a presumption that the deed does not constitute new security.

> No conveyance absolute in form between parties sustaining the relation of mortgagor and mortgagee, whereby the mortgagor or his successor in interest conveys any right, title or interest in real property theretofore mortgaged, shall be presumed to have been given as further security, or as a new form of security, for the payment of any existing mortgage indebtedness, or any otber indebtedness, or as security for any purpose.

MINN. STAT. ANN. § 559.18 (West 1984).

protection normally included in mortgages.[209] Furthermore, the equitable mortgage will have priority only as of the date of its recording. The possibility of a challenge to the deed as an equitable mortgage looms particularly large for lenders because the statute of limitations to challenge a deed in lieu can be as long as fifteen years.[210] Therefore, to retain its senior lien status and the rights and powers it has pursuant to the originally executed mortgage instrument, the lender is best served by preventing merger.

Finally, if a property owner who executes a deed in lieu is not personally liable for the secured debt, the deed may be challenged for failure of consideration. For example, if the property owner is not the original borrower and did not assume personal liability for the debt, the lender's release of that person from any liability on the debt in exchange for the deed in lieu does not constitute consideration and creates the possibility that a court will void the transaction.[211] Similarly, if the debt is nonrecourse, even the original borrowers are not personally liable, and the deed-in-lieu transaction is subject to invalidation for failure of consideration. Therefore, in this case, as in the previously described cases, application of merger is inimical to the lender's best interests.

In light of the above considerations, it is not surprising that, from the earliest American merger cases, courts have recognized, implicitly or explicitly, that the obvious and important benefits a mortgagee enjoys by keeping the mortgage and fee interests distinct outweigh the slight benefit derived from merging them to simplify the state of title. Frequently citing *Forbes v. Moffatt*, the early American courts usually declined to apply merger when a mortgagee acquired title to the encumbered property.[212] Therefore, compared to the common-law history, the American doctrine of merger began at a relatively mature stage of development.

The American courts' treatment of merger, however, now has evolved substantially beyond *Forbes*. Rather than focusing analysis

209. For example, the deed will not provide for foreclosure by advertisement in those states where permitted; will not obligate the debtor to maintain the property, to pay the property taxes, and to keep the property insured; and will not permit the lender to inspect the property. Therefore, the lender will have less control over the property during the life of tbe loan and will have a more difficult time realizing against the property in case of default.

210. MINN. STAT. ANN. § 559.19 (West 1984).

211. G. NELSON & D. WHITMAN, *supra* note 5, § 6.19, at 475.

212. *E.g.*, Baldwin v. Norton, 2 Conn. 161, 163-64 (1817); Lockwood v. Sturdevant, 6 Conn. 373, 389-90 (1827); Freeman v. Paul, 3 Me. 260 (1825); Gibson v. Crehore, 20 Mass. (3 Pick.) 475 (1826); Hunt v. Hunt, 31 Mass. (14 Pick.) 374 (1833); James v. Morey, 2 Cow. 246 (N.Y. 1823). *Contra* James v. Johnson, 6 Johns. ch. 416 (N.Y. cb. 1822).

on the mortgagee's express or implied intent upon acquisition of the title, modern courts normally permit the mortgagee to assert the mortgage lien if she has a beneficial reason for doing so even if she previously expressed an intent that the interests merge. Courts now routinely hold, for example, that a mortgagee can retain and enforce her lien despite unequivocal statements in the deed by which she acquired title or in the accompanying documents that the fee and mortgage interests merge.[213] Courts even have permitted enforcement of a mortgage lien though the mortgagee recorded a mortgage release in the public property records[214] or the statute of limitations has expired for enforcement of the debt.[215] Although these holdings violate the common-law merger rule that the holder's intent when she acquires the consecutive interest controls, courts have disregarded the rule when it would harm the holder's interests. Not surprisingly, then, courts usually do not merge the fee and mortgage interests in the common fact situation in which the mortgagee manifests no intent. In these cases, courts merely repeat the well-worn rote that merger will occur only when it is in the owner's best interest. The effect of these holdings is to destroy the value of merger as a title clearing device.

Small v. Cunningham[216] is a fairly typical example of a court's refusal to hold that merger has occurred despite an initially expressed intent to merge. In that case, decided by the North Dakota Supreme Court in 1963, a judgment creditor perfected a judgment lien against property already subject to a mortgage. After the judgment lien attached, the mortgagee accepted a deed in lieu to the property and recorded a mortgage release. The judgment lienor then asserted its right to sell the property to satisfy its lien and claimed the property would be free of the mortgage because the mortgage had merged into the fee title. In rejecting the judgment lienor's claim of merger, the court stated: "[E]quity assumes it was

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213. Crosby v. Chase, 17 Me. 369, 369 (1840). *Contra* 200 E. 64th St. Corp. v. Manley, 37 N.Y.2d 744, 337 N.E.2d 133, 374 N.Y.S.2d 621 (1975).

214. Shaffer v. McCloskey, 101 Cal. 576, 36 P. 196 (1894); Quality Fin. Co. v. Bourque, 315 So. 2d 656 (La. 1975); Eldridge v. Salazar, 81 N.M. 128, 464 P.2d. 547 (1970); Fowler v. Carter, 77 N.M. 571, 575, 425 P.2d 737, 740 (1967); Small v. Cunningham, 120 N.W.2d 13 (N.D. 1963); Sullivan v. Saunders, 66 W. Va. 350, 353, 66 S.E. 497, 498 (1909).

215. Hardin v. Boyd, 113 U.S. 756, 765-76 (1885); Austin v. Edwards, 201 Ala. 532, 533, 78 So. 886, 887 (1918); Allen v. Glenn, 87 Ga. 414, 13 S.E. 565 (1891); Katz v. Obenchain, 48 Or. 352, 358, 85 P. 617, 620 (1906). *Contra* Ford v. Nesbitt, 72 Ark. 267, 269, 79 S.W. 793, 794 (1904); Kern Valley Bank v. Koehn, 157 Cal. 237, 239, 107 P. 111, 112 (1910); McGovney v. Gwillim, 16 Colo. App. 284, 287, 65 P. 346, 347 (1901); Jenks v. Shaw, 99 Iowa 604, 610, 68 N.W. 900, 902 (1896).

216. 120 N.W.2d 13 (N.D. 1963).

not the intention of the holder of a greater and a lesser estate which meet in his person to merge the same when an intermediate estate intervenes."[217] Far from requiring a mortgagee who acquires fee title to express an intent to keep the interests distinct, as was required at earlier common law, the court created a presumption that merger does not apply. This presumption survived even a recorded release of the mortgage, which is a clear manifestation of intent to release the lien.

Similarly, in *Eldridge v. Salazar*,[218] a 1970 New Mexico Supreme Court case, a mortgage and a subordinate deed of trust encumbered title to a parcel of property. After the property owner declared bankruptcy, the bankruptcy trustee conveyed the property to the mortgagee, and the mortgagee recorded a mortgage release. The holder of the deed of trust then commenced foreclosure proceedings and, based on merger, asserted the right to sell the property free and clear of the mortgage lien. Despite the recorded mortgage release and testimony by an officer of the mortgagee that the bankruptcy trustee's deed had satisfied the secured debt, the court held that the mortgage had not merged. The court's analysis was similar to that used with respect to a waiver argument. The court stated that because the mortgagee had been unaware of the trust deed when it agreed to accept title to the property, the mortgagee "could not have had an intent to take title subject to the prior lien . . . . [N]o intent to act to its own detriment can be presumed from the recording of the release . . . . It is the intent with which the release is made, not the making of the release, which controls."[219] Essentially, the mortgagee did not waive its lien priority because it was unaware of the trust deed.

In contrast, courts generally hold that merger has eliminated a mortgage interest in two clearly defined situations. First, in the unusual case in which a senior mortgagee assumes personal liability for the debt secured by a junior lien when the senior mortgagee acquires the encumbered property, the mortgagee cannot later claim that its mortgage interest remained distinct and enforceable to eliminate the junior lien.[220] This situation can occur when the junior lienor is entitled to require assumption as a condition of a

217. *Id.* at 15.

218. 81 N.M. 128, 464 P.2d 547 (1970).

219. *Id.* at 131, 464 P.2d at 550.

220. Kneeland v. Moore, 138 Mass. 198, 199 (1884); Drew v. Anderson, Clayton & Co., 120 Okla. 250, 252, 252 P. 64, 66 (1926); Bolln v. La Prele Live Stock Co., 27 Wyo. 335, 343-44, 196 P. 748, 749-50 (1921).

property conveyance or when the borrower conditions its offer to convey on the senior mortgagee's assumption. Second, similarly, if the senior mortgagee acquired title by a deed in lieu of foreclosure with actual knowledge, rather than just constructive notice, of a junior lien and clearly expressed an intent that its mortgage interest merge, the senior mortgagee cannot later claim the right to foreclose the mortgage to eliminate the junior lien.[221] A senior mortgagee would accept a deed in lieu and record a release under these circumstances only if the value of the property subject to the junior lien was at least equal to the outstanding amount of the senior debt. In these cases courts have reasoned that the holder's clear expression of intent, coupled with its knowledge of the consequences of merger, is sufficient to take the case outside the equitable exception.

The courts' characterization of these two types of cases as exceptions to the merger exception is false and misleading. The results in these cases sharply contrast with the body of merger jurisprudence. The courts apply merger in the first type of case, in which the senior mortgagee assumes the junior debts, regardless of whether the senior mortgagee intended to keep its mortgage and fee interests distinct and regardless of the mortgagee's best interests. In light of the fact that these cases typically arise when the senior mortgagee is attempting to enforce its lien, it obviously did not intend the interests to merge and was best served by keeping the mortgage alive. Nevertheless, the courts hold that merger has occurred, which is in sharp contrast to the usual merger case. The contrast is drawn even more sharply when compared to those cases in which a court holds that merger has not occurred despite the interest holder's originally expressed intent that it should. Similarly, in the second type of case, in which a senior mortgagee expresses an intent to merge with actual knowledge of junior liens, the courts apply merger though they do not in other cases in which the holder originally expressed an intent to merge. Therefore, merger is not the key to these cases, although the courts state it as the basis for their holdings.

Waiver is the key to these cases. Re-examination of these holdings in light of the waiver doctrine reveals that courts have reached the right result in most, though not all, such cases by ap-

221. Commonwealth Bldg. & Loan Ass'n v. Martin, 185 Ark. 858, 863, 49 S.W.2d 1046, 1048 (1932); Sheldon v. La Brea Materials Co., 216 Cal. 686, 692, 15 P.2d 1098, 1101 (1932); Beacham v. Gurney, 91 Iowa 621, 625-26, 60 N.W. 187, 188 (1894); Errett v. Wheeler, 109 Minn. 157, 163-67, 123 N.W. 414, 415-17 (1909).

plying merger. In the first type of case, the courts have been correct in prohibiting an assuming senior mortgagee from enforcing its lien to eliminate junior liens. The senior mortgagee's assumption of the junior debts has a twofold significance. First, the assumption constituted a portion of the consideration for the borrower's conveyance of the property to the senior mortgagee. Second, the senior mortgagee thereby became primarily liable for the debt, and the borrower a mere surety.[222] Thereafter, if a junior lienor sued the borrower to recover the debt, the borrower would be subrogated to the junior lienor's rights to sue the person primarily liable, the senior mortgagee, and to exercise the junior lienor's security rights, including the right to foreclose. If the senior mortgagee were permitted to foreclose its mortgage and thus eliminate the junior liens, the borrower would be deprived of its right to enforce the lien by subrogation. Therefore, the senior mortgagee, by assuming primary liability for the debts secured by the junior liens, waived the right to eliminate the security for those debts.

Similarly, when a senior mortgagee has accepted title to the encumbered property with actual knowledge of junior liens, that decision was based on the encumbered value of the property. Although the senior mortgagee did not assume personal liability for the junior debts, its acquisition of the title subject to the liens rendered the property the primary source for payment.[223] Thereafter, if a junior lienor recovers against the borrower, the borrower is subrogated to the lien and can sell the land to satisfy the debt. If the senior mortgagee is permitted to foreclose its lien and thus eliminate the junior liens, however, the borrower will have no recourse against the land. Furthermore, the senior mortgagee would be enriched unjustly because it then would own the land free and clear of the junior liens.

By focusing on merger, the courts have defined this second type of case too narrowly. In tune with usual merger analysis, courts have defined this group of cases to include only mortgagees that express an intent to merge. As the above analysis demonstrates, however, the senior mortgagee should be prohibited from exercising its lien in this situation regardless of whether it has manifested any intent concerning merger. Each time a deed in lieu transaction is negotiated with the understanding that the mortgagee will acquire title subject to junior liens, the senior mortgagee

222. G. Nelson & D. Whitman, *supra* note 5, § 5.10.

223. *Id.* § 5.3.

has waived its right to eliminate those liens. Courts' focus on merger diverts them from focusing on the substance of the transaction.

Moreover, by focusing on merger, the courts use a butcher's knife when a scalpel is required. Although the senior mortgagee waived its right to eliminate junior liens by foreclosure in the circumstances outlined above, the senior lienor has other valid reasons for retaining its lien. For example, if the conveyance to the senior mortgagee is successfully voided as a result of the borrower's bankruptcy, the senior mortgagee can be restored to *status quo ante* only if its lien has survived. By applying merger in these cases, however, the courts have held that the senior mortgage is extinguished. The application of waiver analysis, on the other hand, requires the court to focus on exactly what rights have been waived. In these cases, the senior mortgagee has waived only the right to foreclose the lien to eliminate junior lienors.

This line of anlysis, then, like the line of analysis followed in the first part of this Article, has brought us to the same end point: Merger is inapplicable to the modern mortgage. As described above, courts normally do not apply merger to destroy mortgage liens. The two situations in which courts do apply merger are correctly analyzed based on waiver rather than on merger. Therefore, merger no longer serves a useful function. Much more than complete lack of utility, however, requires the elimination of merger from the body of mortgage law. Merger has several pernicious effects.

A particularly objectionable effect of merger is the amount of litigation it spawns. Although junior lienors generally are unsuccessful in asserting merger of a senior mortgage, merger is an issue in a significant number of cases each year. After all, if frankalmoin had not expressly been abolished, zealous advocates undoubtedly still would be arguing it in any case to which it conceivably could apply. In addition to further crowding already grossly overcrowded court dockets, merger litigation is particularly troublesome because it clouds property titles. Furthermore, the mere existence of merger and of the threat of litigation over the issue, especially with the specter of a court's wrongful application of the doctrine, decreases the utility of deeds in lieu of foreclosure. Although a practitioner representing a lender that has agreed to accept a deed in lieu can counsel certain precautionary actions,[224] acceptance of a

224. The most important precaution is to ensure that the deed in lieu includes lan-

deed in lieu always will implicate merger under the current state of the law. The results are that quiet title actions are required to resolve the merger issue and that more foreclosures are conducted by judicial process, which further crowds the courts.[225]

In addition to concerns about the quantity of litigation created by merger are concerns about the quality of the resulting law. Merger has become ensnarled in a byzantine body of case law. In deciding merger cases, courts have focused on a large variety of factors. Different courts have considered, for example:

(1) whether the lienor assumed or took subject to the debt secured by its lien or by the junior liens;[226]

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guage clearly stating that the lender intends the fee and mortgage interests to remain distinct. Additionally, the lender's attorney should require the borrower to execute an estoppel certificate certifying that the transaction is fair, that the value of the property is less than the amount of the outstanding debt, and that the transfer is genuine and equitable. The certificate should be buttressed by an independent appraisal that states that the property value is less than the debt, if true. If necessary, the lender should give the borrower a covenant not to sue rather than a release of liability. Assuming that the land value is less than the outstanding debt, the covenant not to sue leaves the debt in existence, although the lender has agreed not to sue the borrower for it. If the lender executes a release, on the other hand, the debtor's liability is extinguished, in turn subjecting the mortgage to possible extinguishment on the basis that it is unsupported by a debt. P. BAYSE, *supra* note 181, at 717-25; Jones, *supra* note 202, at 66-72. *Cf.* RESTATEMENT (SECOND) OF CONTRACTS §§ 284, 285 (1981); E. FARNSWORTH, CONTRACTS § 4.24, at 289 (1982). The lender also can attempt to obtain title insurance insuring that merger has not occurred. *But see* M. FRIEDMAN, CONTRACTS AND CONVEYANCES OF REAL PROPERTY § 4.8(a), at 347-48 (4th ed. 1984). Finally, the mortgagee could acquire title in the name of a nominee, R. KRATOVIL & R. WERNER, MODERN MORTGAGE LAW AND PRACTICE 540-41 (2d ed. 1981), though this action is not always effective to avoid merger. Cook v. American States Ins. Co., 150 Ind. App. 88, 275 N.E.2d 832 (1971).

Of course, the above precautions will come to naught if a court voids the deed in lieu on one of the grounds described above. Therefore, merger always must be a concern for the lender. Even if a lawyer is successful in preventing merger of the mortgage lien by inserting a clause in the deed in lieu, this procedure is a legally required instance of exalting form over substance. If the merger doctrine is legislatively or judicially eliminated, on the other hand, a lender would never jeopardize its lien interest by acquiring title to the encumbered property. Elimination of merger will not protect the lender who has acted unconscionably or otherwise has acquired property worth more than the amount of the outstanding debt; that transaction still can be voided under the bankruptcy laws or on the other grounds specified above. Merger operates only to injure the unwary in the deed-in-lieu transaction or the unlucky in a legal proceeding.

225. 2 R. PATTON & C. PATTON, LAND TITLES § 564, at 454 (2d ed. 1957). Of course, the lender is required to foreclose by judicial action only if the jurisdiction in which the property is located does not authorize foreclosure by advertisement. Foreclosure by advertisement is legislatively authorized in approximately 25 states. G. NELSON & D. WHITMAN, *supra* note 5, § 7.19. To enhance the utility of deeds in lieu, a few state legislatures have enacted statutes creating a presumption that the deed is valid, MINN. STAT. ANN. § 559.18 (West 1984); WIS. STAT. ANN. § 706.09 (West 1981 & Supp. 1986), and title standards have been adopted in some states for the same purpose. *See* P. BASYE, *supra* note 181, at 606-07.

226. Fouche v. Delk, 83 Iowa 297, 299-300, 48 N.W. 1078, 1079 (1891); Nebraska Cent. Bldg. & Loan Ass'n v. H.J. Hughes & Co., 121 Neb. 266, 268-69, 236 N.W. 699, 700 (1931);

(2) whether the statute of limitations has expired on enforcement of the secured note or mortgage;[227]

(3) whether the lienor was aware of the existence of the junior liens when he acquired the encumbered property;[228]

(4) whether the lienor was negligent in failing to discover the junior liens;[229]

(5) whether the lienor received or gave consideration in addition to the property;[230]

(6) whether the lienor acquired title from the owner or at an involuntary sale;[231]

(7) whether the involuntary sale at which the lienor acquired title was conducted on a lien held by the lienor or by a third party;[232]

(8) whether the lienor had assigned the lien to secure its obligation to a third party;[233]

(9) whether the lien or encumbered land is owned in tenancy by the entirety or in another form of concurrent ownership;[234]

Waff Bros., Inc. v. Bank of North Carolina, N.A., 289 N.C. 198, 206-09, 221 S.E.2d 273, 278-80 (1976); Senter v. Senter, 87 Ohio St. 377, 101 N.E. 272 (1913).

227. Mortgage can be enforced: Hardin v. Boyd, 113 U.S. 756, 765-66 (1885); Austin v. Edwards, 201 Ala. 532, 533, 78 So. 886, 887 (1918); Allen v. Glenn, 87 Ga. 414, 13 S.E. 565 (1891); Katz v. Obenchain, 48 Or. 352, 358, 85 P. 617, 620 (1906). Mortgage cannot be enforced: Ford v. Nesbitt, 72 Ark. 267, 269-70, 79 S.W. 793, 794 (1904); Kern Valley Bank v. Koehn, 157 Cal. 237, 239, 107 P. 111, 112 (1910); McGovney v. Gwillim, 16 Colo. App. 284, 287, 65 P. 346, 347 (1901); Jenks v. Shaw, 99 Iowa 604, 610, 68 N.W. 900, 902 (1896).

228. Commonwealth Bldg. & Loan Ass'n v. Martin, 185 Ark. 858, 863, 49 S.W.2d 1046, 1048 (1932); Lowman v. Lowman, 118 Ill. 582, 586-87, 9 N.E. 245, 257 (1886); Overland-Wolf, Inc. v. Koory, 183 Neb. 611, 162 N.W.2d 889 (1968); Eythe v. Commercial Bank & Sav. Co., 40 Ohio App. 150, 178 N.E. 425 (1930); Katz v. Obenchain, 48 Or. 352, 358, 85 P. 617, 619 (1906).

229. Lien merged: Maulding v. Sims, 213 Ill. App. 473, 477-78 (1919); Fort Dodge Bldg. & Loan Ass'n v. Scott, 86 Iowa 431, 434, 53 N.W. 283, 284 (1892); Rice v. Winters, 45 Neb. 517, 531-34, 63 N.W. 830, 834-35 (1895); Bohn Sash & Door Co. v. Case, 42 Neb. 281, 290-98, 60 N.W. 576, 578-81 (1894). *Contra:* Home Owners' Loan Corp. v. Collins, 120 N.J. Eq. 266, 269-70, 184 A. 621, 623 (1936); McCraney v. Morris, 170 S.C. 250, 256-62, 170 S.E. 276, 278-80 (1933).

230. Mortgagee gave additional consideration: Gray v. Nelson, 77 Iowa 63, 67-68, 41 N.W. 566, 567 (1889); McCraney v. Morris, 170 S.C. 250, 170 S.E. 276 (1933). Mortgagee received additional consideration: Campbell v. Carter, 14 Ill. 285, 290-91 (1853).

231. Schnell v. Schroder, 8 S.C. Eq. (Bail. Eq.) 328, 332-33 (1831); Southworth v. Scofield, 51 N.Y. 513, 517 (1873).

232. Toston v. Utah Mortgage Loan Corp., 115 F.2d 560, 562-63 (9th Cir. 1940); *In re* Bogue, 19 F. Supp. 348, 349 (W.D. Pa. 1937); Hospes v. Almstedt, 83 Mo. 473, 474-75 (1884), *aff'g*, 13 Mo. App. 270 (1883).

233. International Bank v. Wilshire, 108 Ill. 143, 148-50 (1883).

234. Wallach v. Wallach, 107 N.Y.S.2d 255, 257 (1951); Sparrow v. Mowers, 315 Pa. 460, 173 A. 273 (1934).

(10) whether the lien is a deed of trust or a mortgage;[235]

(11) whether the lienor holds one or more liens encumbering the property;[236]

(12) whether the lienor acquired all or only a portion of the mortgaged land;[237] and

(13) whether the lienor acquired full fee title or only an undivided interest in the mortgaged land.[238]

By focusing on these extraneous factors, courts lose sight of the basic issue presented in the garden variety merger case: Should the mortgagee be permitted to enforce its lien? Focusing on these extraneous factors also causes courts to apply merger mechanically without considering the real issue, which normally is preservation of security. If the facts of the case involve one or more of the factors listed above, a court reacts rather than deliberates, and the result is categorical. Courts should recognize that the answer to the question of merger depends on the purpose for which the question has been asked. Elimination of merger would focus attention on the substance of a security dispute rather than on its artificial categorization.[239]

Elimination of merger also would remove other sources of judicial error. As demonstrated in the next section of this Article, some courts have extended the usual presumption against application of merger to the completely inapposite case in which a property owner "acquires" a mortgage encumbering its property and then forecloses the mortgage to eliminate junior liens. Equally surprising is that some courts wrongfully have applied merger when considering the continued enforceability of a secured debt, as will

235. Deed of trust is equivalent to mortgage for merger analysis: Landoff v. Garfinkel, 467 S.W.2d 298, 300 (Mo. Ct. App. 1971); Sheldon v. La Brea Materials Co., 216 Cal. 686, 690, 15 P.2d 1098, 1100 (1932). *Contra* Hospes v. Almstedt, 13 Mo. App. 270, 273 (1883), *aff'd on other grounds*, 83 Mo. 473 (1884).

236. Maulding v. Sims, 213 Ill. App. 473, 475-76 (1919); Wright v. Anderson, 62 S.D. 444, 448-49, 253 N.W. 484, 486-87 (1934).

237. *Ex parte* Powell, 68 S.C. 324, 325, 47 S.E. 440, 440 (1904); Trimmier v. Vise, 17 S.C. 499, 501-04 (1882); Aladdin Heating Corp. v. Trustees of Cent. States, 93 Nev. 257, 563 P.2d 82 (1977); Souther v. Pearson, 28 A. 450, 451 (N.J. Ch. 1894).

238. Cole v. Beale, 89 Ill. App. 426, 432 (1900); Chase v. Van Meter, 140 Ind. 321, 333, 39 N.E. 455, 459 (1894); Haggerty v. Byrne, 75 Ind. 499, 508 (1881); Thebaud v. Hollister, 37 N.J. Eq. 402, 405 (N.J. Ch. 1883); Jemzura v. Jemzura, 36 N.Y.2d 496, 330 N.E.2d 414, 369 N.Y.S.2d 400 (1975).

239. *See, e.g.*, Miles Homes, Inc. v. Harrah Plumbing & Heating Serv. Co., 408 N.E.2d 597 (Ind. Ct. App. 1980). Despite the usual analytic rigidity of the early common law with respect to estates in land, even some early common law courts and commentators recognized that merger might apply to extinguish a property interest for some, but not all, purposes. Ferrers v. Fermor, Cro. Jac. 643 (1622), 79 Eng. Rep. 554 (1907); Coke Litt. § 338.b.

be described in the final section of this Article. Moreover, despite the completely nonsubstantive purpose for merger, some courts have applied it wrongfully to eliminate valuable mortgage rights.

For example, in *Floorcraft Distributors, Inc. v. Horne-Wilson, Inc.*,[240] a 1971 Florida appellate court case, a first mortgagee accepted a deed in lieu of foreclosure apparently without knowledge of a junior lien encumbering the property. After discovering the junior lien, the first mortgagee brought suit to eliminate it. The court held that the first mortgagee could not eliminate the junior lien because the first mortgage had merged into the fee title. As a result, the first mortgagee either must pay the debt secured by the junior lien or must risk losing the property if the junior lienor forecloses.[241]

Unaccountably, the court in *Floorcraft* did not mention the equitable exception to the merger doctrine, which should have controlled. Instead, the court relied on language from a Florida Supreme Court decision:

> When a mortgage on land and the equity of redemption in the same lands become united in the same person, ordinarily the mortgage is merged and the same ceases to be an incumbrance and the owner will hold the lands with an unincumbered title, if there be no other mortgage or lien.[242]

Taken out of context, this language is subject to the construction that the mortgage will not merge if another lien encumbers the title. Of course, that would be the appropriate result under the almost universally applied equitable exception. The opinion from which this language was quoted, however, involved a case with facts very similar to those in *Floorcraft*, and that court reached the same incorrect result as the court in *Floorcraft*. Because courts are not infallible, merger should be eliminated to avoid such results.

The most telling objection to courts' continued application of merger, however, is that modern title recording acts and title practices have rendered the doctrine obsolete. Every state has a title recording act.[243] The acts are designed to provide a record of land ownership so that a prospective purchaser will be put on notice of

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240. 251 So. 2d 138 (Fla. Dist. Ct. App. 1971).

241. The plaintiff in *Floorcraft*, however, was not completely without recourse. If the deed in lieu contained title covenants that did not except the junior lien, the mortgagee who accepted the deed will have a cause of action against the former owners. The value of this right probably will be negligible, however, because the necessity of giving a deed in lieu normally is precipitated by the former owners' financial distress.

242. 251 So. 2d 138, 140 (Fla. Dist. Ct. App. 1971), *quoting from* Alderman v. Whidden, 142 Fla. 647, 195 So. 605 (1940).

243. 4 AM. L. PROP., *supra* note 2, § 17.4; 6A R. POWELL, *supra* note 2, ¶ 905[1].

previous conveyances of any interest in the property.[244] To effectuate this purpose, recording acts generally provide that an otherwise valid property interest is enforceable against a subsequent purchaser only if the earlier purchaser recorded an acceptable identification of his ownership interest.[245] In this manner, states have created a substantial incentive for grantees of a property interest to record proof of their ownership. Failure to do so may result in loss of the interest and the ownership of a lawsuit.

To accomplish this goal of providing information to prospective purchasers, state legislatures have abrogated many common-law rules concerning property titles. The common law followed the common sense approach that "first in time is first in right." That is, if a property owner conveyed the property and then purported to convey it to another person, the second conveyance was a nullity. According to common-law title theory, because the owner already had parted with title, he had no title to convey to the second grantee. This result followed no matter how reasonable were the second purchaser's expectations and actions.[246] The recording acts, however, change this result. Unless the first grantee complies with the terms of the recording act, the second grantee will own the property if he complies.

In addition to abrogating the common-law rule that "first in time is first in right," the recording acts also vitiate the necessity for the common-law doctrine of merger. Before the modern recording acts existed, merger was a convenient tool for describing the process by which a person who held fee and lien interests in a parcel of property could be characterized as owning only the fee; merger was a tool for simplifying the state of title. Given the embryonic state of legally recognized property interests, merger was an appropriate device. With the multiplicity of currently recognized interests, however, merger never can be the automatic procedural device it was in the past. Indeed, to avoid penalizing an owner who did not express an intent that the interests remain distinct, courts often have resorted to fictions to find an intent to keep the interests distinct. This necessity of factfinding, requiring a judicial action, severely reduces the usefulness of merger.

The recording acts have eliminated the need for fictions concerning the owner's intent and for simplification where simplicity

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244. 4 AM. L. PROP., *supra* note 2, § 17.5; 6A R. POWELL, *supra* note 2, ¶ 904[3].

245. *See* 4 AM. L. PROP., *supra* note 2, § 17.5, at 538-42.

246. J. CRIBBET, PRINCIPLES OF THE LAW OF PROPERTY 279-80 (2d ed. 1975).

does not exist. An owner of the fee and lien interests clearly can express her intent concerning the continued existence of the lien by recording *vel non* on the public records a release of the lien. Indeed, to avoid a prospective purchaser's objection to her title, the owner must record a release of the mortgage interest. Failure to do so generally renders her title unmarketable, a result so contrary to her interests as to ensure near universal compliance.[247]

Courts' rejection of merger in the marketable title context confirms the inefficacy of merger in modern practice. Courts have rejected arguments that merger operates to clear the title of a mortgage that has not been released of record. Thus, the existence of an unreleased mortgage on the property records normally will cause title to be unmarketable even though the same person appears from the record to own the fee title and the mortgage lien. The reason is that the operation of merger has become primarily a matter of the holder's intent and, hence, is incompatible with a system of recorded documents. As stated by the Wisconsin Supreme Court in *Thauer v. Smith*:

> The recording act was not passed for the purpose of enabling a prospective purchaser to judge for himself whether there has been a merger of two outstanding estates . . . . Whether there is a merger or not oftentimes depends upon considerations extraneous [to] the record . . . . To permit the prospective purchaser to conclusively decide for himself whether a merger of the two interests resulted from the execution and delivery of a deed from the original mortgagor to the apparent record holder of the mortgage is going farther than was intended by the recording act.[248]

Some courts have ameliorated the harshness of this rule by finding equitable grounds for eliminating a mortgage lien from the record title. In a few cases, for example, the courts have presumed that the owner of the fee and mortgage interests intended them to merge because he had not attempted to collect the debt or to enforce the lien for a substantial length of time.[249] Similarly, other

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247. Modern title theory and practice emphasize a property buyer's right to receive a marketable title, a title that is free of question and that does not require any action to clear a real or apparent cloud on the title. 4 AM. L. PROP., *supra* note 2, § 18.7. The concept of marketable title has become so dominant that an agreement for the sale of property includes an implied covenant that the owner will convey marketable title unless the parties expressly agree otherwise. *Id.* § 18.7, at 670. Moreover, lenders contemplating loaning money against the security of a parcel of property generally require that the owner have marketable title, and a commonly used form of title insurance expressly insures the marketability of an owner's title. *E.g.*, AMERICAN LAND TITLE ASSOCIATION TITLE INSURANCE POLICY FORM B-1970.

248. 213 Wis. 91, 96, 250 N.W. 842, 844 (1933). *Accord* G. WARVELLE, *supra* note 5, at 374-75.

249. Clody v. Sothard, 57 Misc. 242, 246, 109 N.Y.S. 411, 413-14 (1907); Greenfield v.

courts have held that a mortgage lien merged into the fee title despite the absence of a mortgage release or other recorded expression of intent when the owner of the fee and mortgage conveyed the property by a warranty deed that did not expressly except the lien from its title covenants.[250] The courts' rationale is that the failure to except the lien from the deed covenants is sufficient and conclusive evidence of an intention to merge. Thus, the courts appear to be relying on estoppel, as they do in estoppel by deed cases.

In *Lyman v. Gedney*,[251] for example, a person obligated to purchase certain property attempted to avoid the purchase by objecting to the quality of the owner's title. Among the purchaser's objections was the claim that a mortgage lien against the title had not been released of record. The court responded that the mortgage had been extinguished when a previous owner of the property, who concurrently owned the mortgage lien, had conveyed the property without excepting the lien from the deed covenants. The court's holding that merger had occurred, however, was colored by its belief that the purchaser simply was attempting to avoid its obligation to perform under the contract.

> [I]t is worthy of note that in respect of the many objections of incumbrances on the property, not a single instance is shown where one is threatened to be enforced. They are hunted up and magnified by the [purchaser] as after-discovered excuses for a previous refusal to perform his contracts.[252]

Some courts have extended this estoppel rationale to eliminate a mortgage lien in more ambiguous circumstances. In *Bridgman v. Johnson*,[253] for example, a mortgagee foreclosed after a default on one of three notes secured by the mortgage and purchased the property at the foreclosure sale. The mortgagee then conveyed the property by a warranty deed that apparently failed to exclude the mortgage from the title covenants. In a subsequent suit to enforce one of the remaining notes against two endorsers, the court held that the mortgagee could not recover on the notes because her delivery of the warranty deed extinguished the mortgage, thereby destroying the endorsers' rights of subrogation. If the law presumes

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Mills, 123 A.D. 43, 44, 107 N.Y.S. 705, 706 (1907).

250. Lyman v. Gedney, 114 Ill. 388, 406, 29 N.E. 282, 286 (1885); Clody v. Southard, 57 Misc. 242, 244-45, 109 N.Y.S. 411 (1907); Greenfield v. Mills, 123 A.D. 43, 44, 107 N.Y.S. 705, 705-06 (1907); Krekeler v. Aulbacb, 51 A.D. 591, 592, 64 N.Y.S. 908, 909 (1900), *aff'd*, 169 N.Y. 372, 62 N.E. 416 (1902).

251. 114 Ill. 388, 29 N.E. 282 (1885).

252. *Id.* at 411, 29 N.E. at 288.

253. 44 Mich. 491, 7 N.W. 83 (1880).

that a mortgagee will intend what is in her best interest, the court in *Bridgman* acted in obvious disregard of the mortgagee's presumed intent. Furthermore, the mortgagee had not recorded a mortgage release or otherwise evidenced any intent to merge the lien. Despite these facts, the court merged her lien out of existence, thereby preventing destruction of the new owner's interest.

Thus, although the rule remains that courts will not disturb the public record with presumed merger, in certain factual circumstances the courts will find an intent to merge. This reaction to equities in certain cases, however, is by no means a vindication of the relationship of merger with the recording act. The result that a mortgage is merged despite the absence of a recorded release is attained only through litigation. The avoidance of litigation, however, is one of the purposes underlying the universal adoption of recording acts. Any doctrine that is vindicated only through judicial factfinding is anathema to the basis of the recording acts.

Furthermore, even when a court ignores the owner's intent and the recorded documents or absence of such documents to hold that the owner's interests have merged, the court could have reached the same result without recourse to the uncertain merger doctrine. In the paradigmatic case in which the mortgagee/owner conveys the fee title by a warranty deed that does not reserve the lien, the deed itself prevents enforcement of lien rights against the land. The delivery of the deed transfers all the owner's interests in the property. Moreover, the use of a warranty deed buttresses this rather obvious result with estoppel based on the title covenants. That is, as a matter of warranty theory, as contrasted with title theory, a seller cannot convey title, warranting it to be free of the mortgage lien, and then attempt to assert the lien against the property.

Similarly, recourse to merger is unnecessary in those cases involving a lengthy lapse of time since any attempted enforcement of the lien or the note secured by it. If the statute of limitations for enforcement of the lien has expired, the court readily can dispose of the merger issue by reference to the statute. Even if the statute of limitations has not yet run, laches can prevent enforcement of the mortgage lien. Application of laches requires findings that a person failed to assert his rights for an unreasonable length of time and that, as a result, another person has been injured.[254] In those

254. 4 R. CALLMAN, LAW OF UNFAIR COMPETITION, TRADEMARKS AND MONOPOLIES, § 22.21, at 109-10 (L. Altman ed. 4th ed. 1983):

cases in which a lapse of time influenced the result, the court readily could find that the mortgagee's delay in enforcement was unreasonable and that the purchaser would be injured as a result of the mortgagee's delay if the mortgage were now enforced. These alternatives to merger are litigation related rather than devolving from property recording systems. Merger as applied in these circumstances, however, also is a litigation device. Therefore, no increased procedural costs are incurred by supplanting merger with other more specific legal instruments. Thus, merger is unnecessary in these cases.

Again, however, merger is worse than a mere anachronism. Merger has exercised a rigor mortis-like grip on some courts, causing them to hold in accordance with the terms of the merger doctrine although the relevant recording act would require a different result. This result is particularly surprising because, in other contexts, courts have destroyed a property interest when necessary to protect the integrity of a recording act.[255] Furthermore, merger is a trap for the unwary property purchaser who relies on the appearance of merger in the public property records. In *Aiken v. Milwaukee and St. Paul Railway Co.*,[256] for example, a mortgagee recorded its mortgage and subsequently assigned it. The assignee, however, failed to record the assignment instrument. The original mortgagee then acquired title to the property, recorded its deed, and sold the property. Because the property records showed the seller to own the fee and mortgage interests, the purchaser believed that it acquired title free of the mortgage. When the mortgage assignee subsequently brought suit to foreclose the mortgage, however, the court held that the assignee's lien was still alive and

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> It is a well-established principle that courts of equity may deny relief to those who have delayed the assertion of their claims for an unreasonable time; they are thereby penalized for want of due diligence in having failed to institute timely proceedings . . . . an aggrieved party may become a victim of his own inertia.
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> . . . [L]aches equals unreasonable delay plus circumstances leading to an equitable estoppel.

See also Halstead v. Grinnan, 152 U.S. 412, 416 (1894).

255. Courts have reached this result when dealing with chain of title problems, such as the late recorded deed, the "wild deed," after acquired title, and a reciprocal negative covenant that is included in the deed for only one affected lot. In each case, courts have held tbat a bona fide purchaser was not bound by an earlier recorded document because it fell outside the chain of title and, therefore, was virtually undiscoverable by the purchaser. The courts' reason has been to preserve the integrity of the recording system by protecting the purchaser's reliance on that system. *See* J. CRIBBET, *supra* note 246, at 290-93; G. NELSON & D. WHITMAN, REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT 203-09 (2d ed. 1981).

256. 37 Wis. 469 (1875).

enforceable. Because the original mortgagee had assigned the mortgage before acquiring the fee, the court held that the interests had not merged. Therefore, the assignee was entitled to foreclose the mortgage and to destroy the purchaser's ownership interests.

The court's holding is in derogation of the property recording system. The court held in favor of a party that took no action to comply with the terms of the recording act to the detriment of a party who relied on the information included in the property records. Because recording acts are drafted broadly enough to include most types of instruments affecting property titles, including mortgages and mortgage assignments,[257] the court should have held that the assignee's failure to record the assignment instrument caused it to lose its interest in the property to a bona fide purchaser from the person who appeared from the property records to own the mortgage. The court did not consider that a mortgage interest could be conveyed by a deed to a purchaser of the land, as well as by an instrument of assignment to a purchaser of the mortgage, thereby calling into play the priority provisions of the recording act.[258] Instead, the court ignored the purpose and substance of the recording act and applied common-law merger analysis, which has been abrogated by the recording acts. The court's holding results in purchasers' uncertainty, the necessity for litigation to establish the state of title, and a diminution of the credibility of the recording system itself.[259]

A few courts, however, have reached a conclusion different from the *Aiken* court, particularly when the purchaser had addi-

257. 4 AM. L. PROP., *supra* note 2, § 17.8, at 549-50. A few jurisdictions have enacted statutes in addition to the general recording statute, specifically providing for recording mortgage assignments. Section 2934 of the California Civil Code provides that recording a mortgage assignment will provide "constructive notice of the contents thereof to all persons." CAL. CIV. CODE § 2934 (West 1984). *Accord* N.J. REV. STAT. §§ 46:18-3 to 18-4 (1982). MO. REV. STAT. § 44305 (1981).

258. 4 AM L. PROP., *supra* note 2, § 18.89, at 828 n.18.

259. A New York court took a different approach to reach the same improper result as the court in *Aiken*. The mortgagee in Curtis v. Moore, 152 N.Y. 159, 46 N.E. 168 (1897), assigned the mortgage, but again the assignee did not record the assignment. The original mortgagee then acquired the fee title and conveyed it by a deed that did not disclose the mortgage assignment. Despite the absence of notice to the purchaser of the assignment, the court held that the purchaser acquired title subject to the mortgage. The court reasoned that the mortgage assignee had to record the assignment to protect its interest only from a subsequent purchaser of the mortgage interest but not from a subsequent purchaser of the fee. By adopting this unduly restrictive view of the recording act, the court impaired the integrity of the state's property recording system. The court protected a person who did not comply with the terms of the recording act to the detriment of a person who relied on the state of title shown by the property records.

tional reasons for believing that the property records accurately reflected the state of title. In *Ames v. Miller*,[260] the Nebraska Supreme Court held that a property purchaser acquired title free of a mortgage lien that the property records showed was held by the seller, even though the seller had assigned the mortgage before purchasing the encumbered property. In reaching this holding, the court noted that the purchaser had paid the full unencumbered value of the property, that the note secured by the mortgage was long past due, and that the seller and an attorney had assured the purchaser that the mortgage no longer encumbered the property. Concern for the reliability of the property records, however, properly was of primary concern to the court:

> The registry act should mean something, and he who would claim an interest in real estate should comply with the letter and spirit of its provisions and thus prevent injury and damage to those who deal with respect to such property relying on the record as they find it, and as they of right may and should do. The [assignee] has failed to take ordinary business-precaution to protect his mortgage lien . . . and he alone should suffer because of such neglect.[261]

Even in this case, however, the court felt compelled to deal with the merger doctrine and, in the process of doing so, significantly distorted it. Despite the fact that the original mortgagee's ownership of the mortgage and of the fee title never overlapped in time, the court held that merger applied to coalesce those interests because "every fact and circumstance shows an intention on the part of the [original mortgagee] that the two estates should merge."[262] The court cited the deed to the purchaser's failure to except the mortgage from the title covenants as evidence of the original mortgagee's intent to merge the interests. Of course, the original mortgagee's intent and the form of deed he delivered to the purchaser are irrelevant under the merger doctrine because the most crucial factor, concurrent ownership of two estates, was absent. Yet the court apparently felt obligated to harmonize its holding with the merger doctrine regardless of the transparent absurdity of its attempted conciliation. Instead, the court should have recognized that the recording act superseded conflicting common-law doctrines such as merger.

At least one state partially has solved the purchaser's dilemma with respect to an unreleased mortgage. When a person holds both the fee title to encumbered property and the mortgage encumber-

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260. 65 Neb. 204, 91 N.W. 250 (1902).
261. *Id.* at 213, 91 N.W. at 253-54.
262. *Id.* at 211, 91 N.W. at 253.

ing it and subsequently sells the property, Nebraska statutes provide that the lien interest will be deemed to have merged into the fee unless the deed expressly states otherwise.[263] Although the Nebraska legislature is to be commended for rescuing the purchaser and the recording system from the necessity of litigation in this situation, this same purpose and result could have been accomplished more directly without reference to merger at all. A statute would provide merely that the lien is extinguished under the circumstances specified in the statute, just as statutes specify when judgment liens and other forms of lien will be extinguished. This method undoubtedly would please John of Ockham because reference to merger is unnecessary and because the method would bring treatment of mortgages in line with the treatment of other liens. Furthermore, the Nebraska statutes are underinclusive because they do not address the problem created when the property records indicate that one person owns both the fee and lien interests although in reality different people own these interests.

Although not statutory in nature, title standards have been adopted in a few states to set forth circumstances in which a title examiner may treat the mortgage lien as merged into the fee title.[264] These title standards, however, are underinclusive; the standards deal only with the situation in which the mortgagee owned both the fee and the mortgage interests at the time of the conveyance or with otherwise limited circumstances. Furthermore, title standards are not binding on a court. The standards merely are criteria that associations of title examiners or bar associations adopt to evaluate property titles.[265] Even in those states with title standards providing a presumption of merger in some circumstances, courts apply the common-law equitable exception to merger regardless of the title standards. Thus, title standards have not yielded the answer to the problem of merger. Elimination of merger is the answer.

As demonstrated above, the modern recording act has supplanted merger as a title simplification device. In this context, merger operates only as a trap for the unwary, including the unwary court that is deflected by merger from following the dictates of the recording act. Elimination of merger and renewed reliance

263. NEB. REV. STAT. §§ 76-274 to 275 (1981).

264. *See, e.g.*, Maine Standards for Title Examination, Standard No. 603 (1983); Minnesota Standards for Title Examination, Standard No. 34 (5th ed. 1973); Ohio Standards of Title Examination § 3.14 (1981). *See also* P. BAYSE, *supra* note 181, at 608-09.

265. 4 AM. L. PROP., *supra* note 2, § 18.9, at 676.

on the recording system will increase the incentive and necessity for recording mortgage assignments and releases and will create greater certainty of title. Eliminating merger will mean simply that a bona fide purchaser will take free of a mortgage lien if the mortgagee has recorded a release. If the mortgagee has not recorded a release, the buyer is put on notice of the existence of an outstanding claim. Therefore, the retirement of merger as a legal doctrine will encourage property owners to obtain and to record written releases to ensure that title is marketable.

Furthermore, rejection of merger and reliance on the recording system will not affect the rights of a mortgagee who acquires fee title to the encumbered property. If the mortgagee wishes to retain the lien, this can be accomplished without fear of merger: the mortgagee simply does not record a release. Even if the mortgagee records a release, he remains protected against any junior liens that existed before the release was recorded. Just as any other purchaser, the mortgagee acquires title free of any unrecorded junior lien of which the mortgagee had no notice. Even if the junior lien was recorded when the mortgagee recorded the release, the mortgagee will retain his r ight to eliminate the junior lien because the mortgage lien was first in time and of record when the junior lienor recorded its lien. Recording acts normally provide that a recorded instrument gives notice, and the concomitant right to rely, only to subsequent purchasers of an interest in the property.[266] Because the junior lienor would have acquired its interest in the property before the release was recorded, the junior lienor cannot claim that the subsequently recorded release prevents foreclosure of the senior lien. Therefore, this result is the same as that achieved by applying the equitable exception to merger and eliminates unnecessary law suits filed by junior lienors who claim that the senior lien merged into the fee title. For these reasons, merger as applied to mortgages should be given the rest it has long deserved and should be allowed to join frankalmoin in the history books.

2. Property Owner Acquires Lien

The body of law dealing with merger when a property owner purports to "acquire" a mortgage encumbering the property is far less substantial than that involving a mortgagee who acquires the encumbered property. Merger is completely inapplicable to the enforceability of a mortgage after the property owner "purchases"

266. *Id.*, § 17.9.

it. The owner's payment to the mortgagee, the alleged purchase, only constitutes payment of the debt supporting the mortgage with a resulting extinguishment of the mortgage lien. Therefore, because payment of a senior obligation necessarily advances junior obligations in priority, the owner never should be permitted to use the mortgage to clear the property title of junior liens. This conclusion follows whether the owner is the original borrower, a grantee of the borrower, or a grantee further removed in the chain of title.

Despite the obviousness of this conclusion, courts have considered a great variety of factors in dealing with this issue. Courts have held, for example, that resolution of the issue of merger depends on the following factors:

(1) whether the owner is the original borrower, an assuming grantee of the original borrower, or a grantee who did not assume personal liability for the debt;[267]

(2) whether the owner acquired an undivided interest in the debt;[268]

(3) whether a third party loaned the owner the money to discharge the mortgage;[269]

(4) whether only one co-maker pays the debt;[270] and

(5) whether the payor owned all or only a portion of the mortgaged property.[271]

These factors are only representative of the spectrum of variables that courts have considered in determining the continued existence of the mortgage lien. Taking these factors into account, however, clouds the true nature of the transaction.

When the owner is the original borrower or a grantee who assumed personal liability for the secured debt, courts generally recognize that the consideration paid to the mortgagee constitutes payment of the debt rather than purchase of the security.[272]

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267. Barnett & Jackson v. McMillan, 176 Ala. 430, 58 So. 400 (1912); Fouche v. Delk, 83 Iowa 297, 48 N.W. 1078 (1891); Hussey v. Hill, 120 N.C. 312, 26 S.E. 919 (1897); 3 R. Powell, *supra* note 2, ¶ 459, at 696.29-.30; 5 H. Tiffany, *supra* note 2, § 1482.

268. Clark v. Clark, 56 N.H. 105, 113-14 (1875).

269. Elmora & W. End Bldg. & Loan Ass'n v. Dancy, 108 N.J. Eq. 542, 155 A. 796 (1931); French v. Grand Beach Co., 239 Mich. 575, 215 N.W. 13 (1927); Martin v. Hickenlooper, 90 Utah 150, 59 P.2d 1139 (1936); Von Bernuth v. Sutton, 6 N.Y.S. 377 (Sup. Ct. 1889).

270. Bronner v. Walrath, 208 A.D. 758, 758, 202 N.Y.S. 577, 578 (1924); Saint v. Cornwall, 207 Pa. 270, 272, 56 A. 440, 441 (1903).

271. Duncan v. Drury, 9 Pa. 332 (1848).

272. Theisen v. Dayton, 82 Iowa 74, 76-77, 47 N.W. 891, 892 (1891) (grantee); Androscoggin Sav. Bank v. McKenney, 78 Me. 442, 6 A. 877 (1886) (grantee); Hussey v. Hill, 120 N.C. 312, 315-17, 26 S.E. 919, 920 (1897) (original borrower); Jeffrey v. Bond, 498 S.W.2d 31,

Therefore, when the owner claims he expressed an intent to prevent merger of the fee and lien interests, thereby enabling him to foreclose the mortgage, he simply is attempting to use the equitable exception to merger to overreach. Courts are more receptive to the property owner's elimination of junior liens, however, when the property owner is not personally liable for the debt. In some cases, the court's misapprehension may have been caused by the owner's structuring the transaction as a "purchase" and assignment of the note and mortgage rather than as a cancellation and release of these instruments.[273] In other frankly unaccountable cases, however, the owner did not characterize his payment as a purchase.[274] Apparently, the owner attempted to enforce the mortgage lien only

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35 (Tex. Civ. App. 1973), *rev'd on other grounds*, 509 S.W.2d 563 (Tex. 1974) (original borrower); 5 H. TIFFANY, *supra* note 2, § 1482.

This result is by no means universal, as evidenced by the decision in Commonwealth Bldg. & Loan Ass'n v. Martin, 185 Ark. 858, 49 S.W.2d 1046 (1932). In that case, the purchaser acquired title to a parcel of property and assumed personal liability for a loan secured by it. Subsequently, the purchaser retired the debt and had the mortgage cancelled of record. When she later discovered the existence of a judgment lien encumbering the property that had been junior to the mortgage, she commenced foreclosure proceedings based on the cancelled mortgage to eliminate the judgment lien. Even though the purchaser was primarily liable for the mortgage debt because of the assumption, the court reached the surprising and incorrect conclusion that she was subrogated to the lender's rights under the mortgage and could foreclose it to eliminate the judgment lien.

Apparently because the suit involved a mortgage foreclosure, the court immediately focused on the merger *vel non* of the mortgage into the fee title. Reciting the familiar refrain that merger will occur only when the owner's best interests would be served, the court held that the mortgage lien had not merged and, therefore, was enforceable. The court failed to consider that the vitality of the lien ceased when the debt it secured was retired. Instead, the court relied on cases concerning a mortgagee that acquired fee title to the mortgaged property and subsequently foreclosed the mortgage to eliminate junior liens on the title. These cases are inapposite to the instant situation in which the person primarily liable for a debt purports to acquire and to exercise the mortgage lien securing the debt. *See supra* notes 182-92 and accompanying text.

The *Commonwealth* court's decision was based in part on the purchaser's ignorance of the judgment lien when she acquired the property. Actual notice is irrelevant, however, because the judgment lien was recorded in the appropriate public records. The purchaser thereby had constructive notice of its existence, and it remained a lien on the title after she acquired the property. The purchaser does have a cause of action against her grantor based on the title covenants in the deed by which she acquired title, but she does not have the right to eliminate the judgment lien by foreclosing the mortgage. Any damages resulting from the purchaser's lack of actual notice of the judgment lien should be borne by the purchaser's grantor; the judgment lienor cannot be put at risk because of events beyond its knowledge and control.

273. Von Bernuth v. Sutton, 6 N.Y.S. 377 (Sup. Ct. 1889); Hussey v. Hill, 120 N.C. 312, 315-17, 26 S.E. 919, 920 (1897); Duncan v. Drury, 9 Pa. 332, 333 (1848).

274. Kelly v. Weir, 243 F. Supp. 588 (E.D. Ark. 1965); Shaffer v. McCloskey, 101 Cal. 576, 36 P. 196 (1894); Becker v. Snowden Dev. Corp., 66 Misc. 2d 1060, 323 N.Y.S.2d 79 (1971). *Contra* Moore v. Olive, 114 Iowa 650, 87 N.W. 720 (1901).

after discovering the existence of junior liens on the title. Once this type of plaintiff succeeds in arguing the court onto the merger treadmill, the court automatically responds by reciting the basic rule of modern merger that the interests will merge only if the holder so intends and that equity will presume the intent most beneficial to the interest holder. The Pavlovian court then upholds the owner's right to foreclose the lien, and the conditioned response to merger is complete.

Kelly v. Weir,[275] a 1965 federal district court decision, provides a striking example of this automatic response to merger. In that case, the plaintiffs acquired a farm as a result of a foreclosure sale on a junior lien.[276] Their acquisition of title was subject to a senior mortgage lien and to certain dower and homestead rights. Although the unencumbered value of the farm was more than 200,000 dollars, they paid only 61,639.34 dollars for it. The plaintiffs subsequently invested an additional 22,843.82 dollars to "purchase" the senior mortgage and then instituted a foreclosure action on the mortgage to eliminate the dower and homestead rights. The court held that these "purchasers" could foreclose because the mortgage had not merged into the fee. To justify its holding, the court recited the ubiquitous principle that merger occurs only if so intended.

The court's superficial analysis of the case caused it to violate the doctrine of merger, economic common sense, and all concepts of fairness. The invocation of merger requires a union of consecutive interests. In *Kelly* the plaintiffs never actually purchased the mortgage lien, but rather extinguished it by discharging the debt it secured. Before the equitable exception to merger can come into play, the requisites of the merger doctrine obviously must be satisfied.

Moreover, by mechanically stating and applying the equitable exception to merger, the court reached a result that violated the most basic economic common sense. The unencumbered value of the farm was more than 200,000 dollars, but the plaintiffs invested less than half that amount to buy it and to pay the senior mortgage debt. Yet the court's holding permits them to foreclose the mortgage to eliminate all the junior interests, thereby giving the

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275. 243 F. Supp. 588 (E.D. Ark. 1965).

276. The plaintiffs did not buy the farm at the foreclosure sale on the junior lien. Rather, the successful bidder at that sale sold the plaintiffs the certificate of purchase he received at the sale. *Id.* at 591. Therefore, for all purposes relevant to this analysis, they occupied the same position as a foreclosure sale purchaser.

plaintiffs an unencumbered title. Even the most consumer-oriented advocate would have trouble justifying this result, but the *Kelly* court accepted this argument.

Finally, the court permitted the plaintiffs to eliminate the dower and homestead interests although the court expressly had found that the plaintiffs' purchase price was "fair" only if the farm was encumbered by those interests.[277] Ironically, the court bootstrapped the plaintiffs' desire to foreclose into evidence of an intent to prevent merger, though the plaintiffs previously had not expressed any such intent. Thus, from an intent to engage in sharp dealing, the court fashioned a right for the plaintiffs to foreclose. This result is objectionable particularly in light of the social policies underlying the creation of marital and homestead interests. Distressingly, the *Kelly* decision is not a rare anomaly.[278]

In some cases courts are motivated to hold that the purchaser can enforce the lien it "acquired" because the purchaser was unaware of the existence of the junior lien. In *Shaffer v. McCloskey*,[279] for example, the two owners of a parcel of property executed a mortgage encumbering the property. When payment was due on the debt secured by the mortgage, one cotenant conveyed his property interest to the other cotenant in consideration of the latter's agreement to pay the entire debt. The conveying cotenant did not reveal that he had executed a junior trust deed encumbering his interest in the property, but the trust deed was validly recorded.

The acquiring cotenant discharged the debt secured by the mortgage, and the mortgagee released the lien of record. When the owner cotenant discovered the existence of the trust deed, he brought suit to revive the mortgage in his hands so he could foreclose it to destroy the lien of the trust deed. The holders of the trust deed argued that the mortgage interest had merged into the

277. "No one has ever contended that $60,000 would have been a fair price for the unencumbered fee simple title to the farm. Indeed the record reveals tbat plaintiffs bave executed an option covering the property which calls for a price of more than $200,000." *Id.* at 592 n.1.

278. *See, e.g.*, Nebraska Cent. Bldg. & Loan Ass'n v. H.J. Hughes Co., 121 Neb. 266, 236 N.W. 699 (1931). In that case, the plaintiff acquired title to a parcel of property by a deed that expressly stated that the conveyance was "subject to existing mortgage to Nebraska Central Building & Loan Association and all other liens of record." *Id.* at 267, 236 N.W. at 700. When the plaintiff accepted the deed, the title was encumbered not only by the mortgage, but also by a judgment lien junior to the mortgage. After tbe plaintiff discharged the mortgage by payment, he initiated a foreclosure action to eliminate the judgment lien. The court permitted this result because "it is clear that there was no merger intended by [him]." *Id.* at 269, 236 N.W. at 700.

279. 101 Cal. 576, 36 P. 196 (1894).

fee. Reciting the equitable exception to the merger doctrine, the court held that the mortgage had not merged into the fee. The court reasoned:

> [The junior lienors] took the deed of trust while the mortgage was in full legal existence, recorded and unsatisfied, and with perfect understanding that it was a valid prior lien, and they are merely seeking to take an advantage offered by an inadvertence or mistake of [the payor].
>
> . . .
>
> [The payor] clearly intended that his payment of the mortgage should inure to his own benefit, and not to the benefit of [the junior lienors]; and there is no equitable ground upon which [the junior lienors] can object to it so inuring.[280]

As the sole legal support for its reasoning, the court cited a case involving the wholly inapposite fact situation in which a senior lienor who accepted a deed in lieu of foreclosure subsequently was permitted to foreclose the lien to eliminate a junior lien.[281]

The reasons described above for permitting a senior mortgagee that accepts a deed in lieu to foreclose its lien simply do not exist in the facts presented in *Shaffer*. First, the plaintiff in *Shaffer* was primarily liable for the debt secured by the senior lien. Therefore, as described above, his payment extinguished the debt and accompanying mortgage. He could not acquire and hold the mortgage distinct from the fee because he never acquired the mortgage. Second, he acquired the property title subject to the junior lien because the lien was properly recorded, which caused the land to become the primary fund for payment of the debt secured by the lien. Therefore, the court should not have permitted the plaintiff to destroy the junior lienors' rights in the land, which, in light of the borrower's financial difficulties, presented the lienors' best opportunity for recovery of the debt.

Unquestionably, the plaintiff in *Shaffer* was wronged in the economic sense. His recourse and the proper direction of legal analysis, however, should not be against the junior lienors, who are innocent of any wrongdoing. Instead, the plaintiff's proper recourse is against his cotenant. If the plaintiff acquired the cotenant's interest by warranty deed, the plaintiff has an action based on the title covenants. If he unwisely accepted a quitclaim deed, however, he will have to establish a representation concerning the state of title that survived delivery of the deed. Furthermore, the owner cotenant could have avoided this difficulty by checking the prop-

280. *Id.* at 579, 36 P. at 197.
281. *Id.*

erty records. The junior lienors, on the other hand, had done nothing to create the owner's problem and, more important, had no way of protecting their lien. Because the court's attention was focused on merger, however, the court concerned itself only with the result that would best serve the plaintiff's interests.[282]

As stated above, courts generally recognize that a property owner who is personally liable for a debt cannot pay the debt and then foreclose the lien securing it to eliminate junior liens. Many courts, however, such as the courts that decided *Kelly* and *Shaffer*, treat a property owner who is not personally liable differently. This different treatment is illogical and unjust. Distinctions based on whether an owner is personally liable for a debt are valid when considering enforceability of the debt. That distinction is irrelevant, however, when considering the property title. Regardless of whether the owner is personally liable for the secured debt, he acquired title to the property subject to the lien securing it. Many courts, however, have not recognized this fact. Instead, they recite the equitable exception to merger and, of course, hold that the owner is benefited by being able to foreclose the senior lien. Other courts blindly apply cases involving mortgagees who accept a deed in lieu, although that fact situation is completely inapposite. By eliminating merger as applied to mortgages, courts will not be drawn onto the merger treadmill and will avoid unjustly destroying junior creditors' liens.

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282. Two authors of case notes have argued for the result reached by the *Shaffer* court in cases involving assuming grantees. *See* Note, *Mortgages—Subrogation—Right of Assuming Grantee to be Subrogated to Senior Mortgage Paid by Him as Against an Unknown Recorded Junior Mortgage,* 24 MINN. L. REV. 121 (1939) [hereinafter "Minn. Case Note"]; Note, *Mortgages—Right of Assuming Grantee to be Subrogated to First Mortgage Paid by Him in Ignorance of Recorded Second Mortgage,* 87 U. PA. L. REV. 1012 (1939) [hereinafter "Pa. Case Note"]. Both authors reasoned that, "[i]f the grantee had known of the junior lien he could have protected himself by purchasing the mortgagor's interest in the land, without assuming the senior mortgage, and then procuring an actual assignment of the latter upon its payment," thereby enabling the grantee to eliminate the junior lien by foreclosure. Minn. Case Note at 123. *See* Pa. Case Note at 1013. Although the noted cases involved grantees who assumed personal liability, rather than the original borrower as in *Shaffer,* the same analysis applies. The grantee in each case was primarily liable for the senior debt by virtue of the assumption agreement. Therefore, as described above, tbe grantee's payment extinguished the debt and accompanying mortgage. Even if the grantee had acquired title subject to the junior lien without assuming liability for it, the grantee would have no right to eliminate it except by payment because the land would have become tbe primary fund for payment.

B. Merger and Debts

Some courts and commentators, misapprehending the proper role of the doctrine of merger, have applied it to analyze the continued enforceability of a debt when one person holds a mortgage and the encumbered land. As discussed above, merger is absolutely inapplicable to the debt aspect of the mortgage transaction. The debt relationship, if evidenced by a negotiable instrument as defined by the Uniform Commercial Code,[283] is governed by Article 3 of the Code and by supplemental contract principles. If the debt relationship falls outside the ambit of the Uniform Commercial Code, it is governed by contract law. Because merger is concerned only with matters of title, application of merger to the contractual debt relationship can cause obviously incorrect results, as will be demonstrated in this section.

Understanding these incorrect results is facilitated by first examining the appropriate methods of analysis, as contrasted with the merger-related attempts. The question of the continued existence of the debt can arise in several different factual contexts, but its resolution is governed in every case by contract principles. As will be shown, many courts fail even to consider contract law in their analyses of these cases. The most backward of these approaches focuses exclusively on the issue of merger. As a result, courts using this analysis hold that the debt is enforceable only if the mortgage has not merged into the fee. Other courts, while recognizing that contract principles are at least relevant, either have ignored the real estate context or have treated the debtor's conveyance of the mortgaged property to the lender as irrelevant to the debt though the parties intended otherwise. Each type of error leads to unsupportable results.

In general, courts err by failing to recognize that the enforceability of the debt and of the mortgage usually are independent questions. When a lender makes a secured loan, it has two different methods of recovering the debt. A lender can enforce personal liability on the note or foreclose the mortgage and sell the land. Although under modern theory a borrower retains the absolute right to convey fee title to the encumbered property, the conveyance will not adversely affect the lender's right to enforce its security interest if the lender has complied with the applicable recording act or, less commonly today, if the purchaser otherwise has

283. U.C.C. § 3-104 (1977).

notice of the lender's interest.[284] Therefore, unless the borrower discharges the debt before conveying title to the purchaser, the title will remain encumbered by the mortgage lien. In real estate parlance, the purchaser has acquired title "subject to" the mortgage.

Although the property is encumbered, the purchaser does not become personally liable for the debt solely by reason of acquiring the land. Personal liability occurs only if the purchaser assumes liability for the debt. Upon assumption, the purchaser becomes primarily liable and the original borrower secondarily liable.[285] In recognition of the purchaser's assumption of the original borrower's primary liability, the purchaser's price for the property is reduced by the outstanding debt amount. For example, if the fair market value of the property unencumbered by any liens is 100,000 dollars and if the purchaser assumes an 80,000 dollar debt secured by the property, the purchaser should pay 20,000 dollars, which represents the market value of the property encumbered by the mortgage. In case of default on the note or the mortgage, the lender may proceed directly against the assuming purchaser based on the assumption agreement or may foreclose the mortgage.[286] Additionally, if the lender has not released the borrower, the lender retains its right to sue the borrower for the debt.

When the purchaser has assumed, courts treat the original borrower as a surety for the debt. Thus, if the borrower retires the debt, either voluntarily or in satisfaction of a judgment against her on the note, she is subrogated to the lender's rights in the note and in the mortgage and, therefore, has recourse against both the purchaser and the land, respectively.[287] Although the borrower paid the debt, the debt is not extinguished, but continues to exist for the purpose of enforcing the borrower's subrogation rights. According to subrogation theory the debt is not extinguished until the person or property that is primarily responsible for it has satisfied

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284. G. NELSON & D. WHITMAN, *supra* note 5, §§ 5.1-5.2. Although the borrower retains the right to convey title to the property, the conveyance may trigger the lender's right to enforce a due-on-sale clause if the mortgage contains one. *See* 12 C.F.R. §§ 591.1-.6 (1986). If the lender exercises the due-on-sale clause, the loan must be repaid, and the lien securing it will be extinguished.

285. E. FARNSWORTH, *supra* note 224, § 10.5, at 735; G. NELSON & D. WHITMAN, *supra* note 5, § 5.10.

286. E. FARNSWORTH, *supra* note 224, § 10.5, at 735; G. NELSON & D. WHITMAN, *supra* note 5, § 5.11.

287. E. FARNSWORTH, *supra* note 224, § 10.5, at 735; G. NELSON & D. WHITMAN, *supra* note 5, § 5.10.

that responsibility.[288]

Nothing in the law requires the debt to be assumed, of course; the decision is the result of negotiation. If the purchaser does not assume the debt, title to the land remains encumbered by the lien, but no personal liability attaches to the purchaser. Therefore, in case of default on the debt or the mortgage, the lender can sue the original borrower for payment of the debt or can foreclose the mortgage and recover any deficiency from the borrower. The lender, however, has no recourse against the new owner in his personal capacity. All that the purchaser risks is title to the property.

If a purchaser acquires title subject to a mortgage, the common practice is for the purchase price to be reduced by the amount of the outstanding debt even though the purchaser does not assume the debt. The parties expect that the purchaser will make the required payments for as long as he owns the land to protect his title from foreclosure. Because the purchaser's cash payment for the property is reduced to reflect the outstanding debt and because of the practical assumption of the duty to pay, the purchaser's obligation may be described as quasi-contractual. Unlike the actual assumption scenario, however, the borrower cannot be subrogated to any rights in the note against the purchaser because of the absence of personal liability.

As when the purchaser assumes, the borrower remains liable for the debt, unless the lender has released her. The borrower, however, no longer is the ultimate source for satisfaction of the debt. The mortgaged property effectively becomes primarily liable. Therefore, if the borrower satisfies the obligation, she is subrogated to the lender's rights in the land and can foreclose the mortgage to recover her payment. As in the case of the purchaser's assumption of liability, the borrower's payment does not extinguish the debt, at least up to the value of the property. The debt remains to support the borrower's subrogation rights in the mortgage.[289]

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288. *Cf.* U.C.C. § 3-601(3) (1977).

289. Although the statement that property, an entity without legal capacity, can be liable for a debt, primarily or otherwise, appears to be conceptually illogical, it is merely a descriptive shortband for the correct result. By selling the property for an amount equal to the unencumbered fair market value less the amount of the outstanding debt, the borrower essentially has transferred ultimate liability for the debt. Rather than selling the property subject to tbe lien, thereby permitting the purchaser to defer payment of a portion of the value of the property, the borrower might have sold the property free of the lien by charging the full unencumbered value and using the sale proceeds to pay the debt. Therefore, a borrower wbo discharges the loan or any portion of it after selling property subject to the loan

The result is different in the fairly unusual case in which the purchaser acquires title subject to the mortgage lien but the borrower agrees to remain primarily liable for the debt. In exchange for this agreement, the purchaser pays the full unencumbered value of the property. Again, neither the lender nor the borrower can sue the purchaser on the note since he did not assume liability, but the property remains liable to foreclosure pursuant to the mortgage. If the borrower who remains primarily liable defaults and the purchaser discharges the debt to protect his interest in the property, the purchaser may pursue the borrower based on both counts: the transfer agreement and under subrogation to the lender's rights against the borrower pursuant to the note. Similarly, if the lender forecloses the mortgage, the purchaser can sue the borrower based on their agreement for damages for the loss of the property.[290]

The results in cases deciding the continued enforceability of a debt are well accepted and conform to the parties' expectations and to the economic realities. When one person holds the fee and mortgage interests, however, many courts either have misapplied these basic contractual principles or, not having recognized their applicability, improperly have applied merger. Commentators describing this body of case law have divided it into several different factual contexts: (1) the mortgagee acquired title to the property from the mortgagor, with further distinctions based on whether the mortgagee assumed the debt; (2) the mortgagee acquired title to the property from the mortgagor's grantee, with further distinctions based on whether the grantee or the mortgagee assumed the debt; (3) the mortgagee acquired title to the mortgaged property at a foreclosure sale conducted pursuant to its mortgage with further distinctions based on whether the mortgagee owned only that mortgage or also owned other liens encumbering the property; (4) the mortgagee acquired title to the mortgaged property at an involuntary sale conducted by a third party, such as an execution sale on a tax lien; (5) the mortgagor acquired the note and mortgage from the mortgagee or the mortgagee's assignee; and (6) the mortgagor's grantee acquired the note and mortgage from the mortgagee or the mortgagee's assignee, with further distinc-

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is entitled to be subrogated to the lender's rights to prevent unjust enrichment of the purchaser and to compensate the borrower for, essentially, a double payment on the loan. *See* Franklin Mortgage Co. v. McDuffie, 43 Ga. App. 604, 604-05, 159 S.E. 599, 600 (1931).

290. *See* 2 G. GLENN, *supra* note 5, § 258.1, at 1159; 5 H. TIFFANY, *supra* note 2, § 1435, at 365.

tions based on whether the mortgagor's grantee asumed the debt.[291] Such fact specific and categorical descriptions are unnecessary, however, The only relevant distinctions, which will be examined separately below, are between a lender who acquires the property by voluntary or by involuntary conveyance and betweeen an acquiring lender and an acquiring owner.

1. Effect of Mortgagee's Property Acquisition on Debt Enforceability

a. Voluntary Conveyance

Because debt devolves from a contractual relationship completely separable from the security aspect of the mortgage, only contractual analysis is appropriate to determine debt enforceability. Therefore, when a property owner, whether the original mortgagor or a subsequent grantee, conveys encumbered property to the mortgagee, the mortgagee's subsequent right to enforce the debt depends only on whether the mortgagee and the property owner intended the conveyance to be in full or partial satisfaction of the debt. If satisfaction was intended and if the owner conveyed the property on or before the performance date specified in the note, the conveyance constitutes substituted performance.[292] If the owner conveyed title after the due date, on the other hand, the doctrine of accord and satisfaction governs.[293] The parties' mutual intent is primary in substituted performance and in accord and satisfaction analyses;[294] the parties' intent concerning the debt,

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291. *See, e.g.*, 4 AM. L. PROP., *supra* note 2, § 16.143; G. NELSON & D. WHITMAN, *supra* note 5, § 6.16; 9 G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY §§ 4798-4799 (1958).

292. RESTATEMENT (SECOND) OF CONTRACTS § 278 (1981); E. FARNSWORTH, *supra* note 224, at § 4.24, at 283-84.

293. RESTATEMENT (SECOND) OF CONTRACTS § 281 (1981); E. FARNSWORTH, *supra* note 224, § 4.24 at 285-86.

294. Ideally, the parties' intent is evidenced by express cancellation of the note, by a written release of the owner's liability, or by a writing of similar effect. In the absence of such an expression of intent, however, other facts can evidence the parties' intent. If the mortgagee assumes the debt in connection with the conveyance, for example, the mortgagee becomes primarily liable for the debt. Because the mortgagee also is entitled to payment of the debt, the debt is extinguished. Similarly, if the deed to the mortgagee states that the conveyance is subject to the mortgage, the property becomes the primary fund for payment. Therefore, the debt is extinguished at least to the value of the land. On the other hand, if the owner conveyed the property to the mortgagee as a gift or in full or partial satisfaction of another debt held by the mortgagee, the debt that is the subject of the mortgagee's enforcement action will not be extinguished because the parties did not so intend. Therefore, the mortgagee can sue anyone who is personally liable for the debt even though the mortgagee owns the property that secures it.

however, is unrelated to the mortgagee's unilateral intent concerning merger and the continued enforceability of the mortgage lien.

Despite the clear applicability of these contractual doctrines, some courts have not applied them, with the astounding result that the conveying owner receives no credit against the debt in exchange for the property conveyance.[295] Other courts inexplicably have applied merger analysis. Some of these courts base their hold-

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295. These cases demonstrate most clearly the complete breakdown of legal analysis and economic common sense when courts become enmesbed in merger. Some courts apply merger in a manner that completely obscures the payment aspect of the borrower's conveyance to the lender, as illustrated by Morton v. Rifai, 339 So. 2d 707 (Fla. Dist. Ct. App. 1976). In that case, the plaintiffs sold the defendants a parcel of property, and the defendants executed a note and mortgage in favor of the plaintiffs as part of the purchase price. After defaulting on the note, the defendants reconveyed the property to the plaintiffs. The plaintiffs then sued the defendants for the entire preconveyance balance owed on the note.

In deciding the case, the court began correctly, holding the issue of merger of the mortgage lien into the fee to be irrelevant to determining whether the defendants were still liable on the note. Unfortunately, tbe court grounded its holding on another irrelevant principle: A creditor is not required to satisfy a debt from the collateral securing it but, rather, enjoys the option to sue on the note or to enforce its rights in the collateral. Incorrectly disregarding the conveyance as an exercise of rights against the collateral, tbe court compounded its error by reasoning that "when the [defendants] reconveyed the property to the [plaintiffs], there may have been a merger insofar as the second mortgage was concerned, but the promissory note, constituting a separate and distinct agreement, was unaffected by the reconveyance." *Id.* at 708.

The court's conclusion that the conveyance had no effect on the debt is incredible. The connection of the debt and the conveyance was unambiguous. No evidence existed that the plaintiffs held any other debts for which the defendants were liable to justify a conclusion that the value of the defendants' equity in the property was to be credited to another debt. Furthermore, no evidence existed that the value of the defendants' equity in the property was insufficient to repay the debt in full. By refusing to credit the debt with the value of the property, the court made a gift to the plaintiffs of the defendants' equity in the property. The parties' intent concerning the effect of the conveyance, the dispositive issue in the case, vanished with the appearance of merger.

Unaccountably, the court expressly rejected the argument that the reconveyance constituted an accord and satisfaction. *Id.* Because the plaintiffs were suing to enforce the full amount of the debt, the court reasoned that the plaintiffs did not intend the conveyance to constitute an accord and satisfaction. Accord and satisfaction, however, is a more versatile tool than the court recognized. The court's analysis ignored the existences of an implied accord and satisfaction and of a partial accord and satisfaction. Thus, even if the parties had not expressly agreed on the effect of the reconveyance, the necessary implication furnished an agreement because the reconveyance was not referable to any cause otber than satisfaction of the debt. Moreover, even if the property had declined in value to less than the amount of the debt, the conveyance constituted at least partial payment.

Accord Ellsworth v. Homemakers Fin. Serv., Inc., 424 N.E.2d 166 (Ind. Ct. App. 1981). After the lender accepted a deed in lieu of foreclosure, the value of the property decreased. The lender then sued to foreclose its mortgage and to obtain a deficiency judgment. The court held that the mortgage had not merged into the fee and that the conveyance had not affected the borrowers' note obligation. Therefore, in calculating the amount of the deficiency, the borrowers received a credit only for the foreclosure sale price rather than for the greater value of the property on the date they conveyed title to the lender.

ings on whether the debt merged into the mortgage,[296] which these courts do not recognize as legally impossible; a contract right cannot merge into a property right. Other courts hold that if the mortgage and fee interests merged, the debt is unenforceable. Conversely, if the interests did not merge, the debt is enforceable. Once a court dons the merger blinkers, it is oblivious to the economics of the case.

In *Johnson v. Gammill*,[297] for example, the court was misled by merger to produce a result that not only was theoretically incorrect, but also failed to conform either to the mortgagors' or mortgagee's best interest or to their intent concerning the transaction. In *Johnson* a lender held several notes executed by the borrowers. In partial satisfaction of the aggregate debt, the borrowers conveyed to the lender property that secured an outstanding debt of 6,000 dollars held by the lender. The issue in the case was the amount to be credited against the borrowers' total debt in exchange for the title conveyance. The lender testified that the parties had agreed to a 4,500 dollar credit. The borrowers testified that they had agreed to a 6,500 dollar credit. Rather than simply making the evidentiary choice, the court unaccountably quoted and applied two passages from *Corpus Juris Secundum* concerning merger of mortgage and fee titles. Based on this superficial review of the law, the court concluded that, because the lender had conveyed the property to a third party by a deed that did not expressly reserve the mortgage lien, the mortgagee intended to merge the mortgage lien into the fee title. Because the mortgage lien had merged, the 6,000 dollar debt secured by the property was extinguished, thereby resulting in a 6,000 dollar credit.

The court's approach could not help but obfuscate the real issue. The borrowers' conveyance was mutually intended as partial payment. The only question was the amount of the payment. That issue is separate and distinct from the mortgagee's unilateral intent concerning merger of the mortgage lien. Obviously, a security can be released without affecting the debt obligation. Indeed, the court's analysis is a classic example of the tail wagging the dog. By determining the continued enforceability of the debt based on the enforceability of the lien securing the debt, the court reversed the relationship of dependency between the debt and its security.

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296. *See, e.g.*, Cook v. American States Ins. Co., 150 Ind. App. 88, 101, 275 N.E.2d 832, 839 (1971); *see also* 4 AM. L. PROP., *supra* note 2, § 16.143, at 336-37; G. OSBORNE, *supra* note 65, § 272, at 547, 549; 5 H. TIFFANY, *supra* note 2, § 1483, at 516-18.

297. 231 Ark. 1, 328 S.W.2d 127 (1959).

Finally, and outside the realm of the theoretical, no evidence supported a credit in the amount of 6,000 dollars. The only evidence concerning the parties' understanding was the mortgagee's testimony that the agreed credit was 4,500 dollars and the mortgagors' testimony that the agreed credit was 6,500 dollars. Clearly, the court did not consider either party's intent concerning the effect of the conveyance on the debt, which is the determinative factor for accord and satisfaction. Unfortunately, *Johnson* is not an isolated case.[298]

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298. By focusing on merger of the fee and mortgage interests rather than on the parties' intent and the economics of the debt relationship, courts create the potential for unjustly enriching lenders. As discussed earlier, a firmly established aspect of the doctrine of merger is that it will occur only if that result is most beneficial to the interest holder. Obviously, a mortgagee always will enjoy the greatest benefit by holding title and by retaining the right to enforce the secured debt. Analysis of the debt relationship, however, requires that the court focus on the parties' mutual intent concerning the effect of the conveyance, rather tban on the lender's best interest.

The potential problem created by a court's analytically incorrect focus on the lender's best interest is illustrated by Sheehan Bldg. & Loan Ass'n v. Scanlon, 310 Pa. 6, 164 A. 722 (1933). In *Sheehan,* the borrower, after defaulting on his loan, conveyed the mortgaged property to the lender. To accommodate the borrower, the lender agreed to hold title to the property indefinitely and to reconvey it to him upon satisfaction of the loan. The lender had obtained a judgment on the outstanding debt but never attempted to enforce the judgment. The case arose when the borrower attempted to reopen the judgment on the debt or to have it marked as satisfied based on bis conveyance of the property to the lender.

In the course of analyzing the merits of the case, the court apparently began debt analysis by observing that a property conveyance constitutes payment of the secured debt only if the parties so intended. In the next sentence of the opinion and for the rest of its analysis of the applicable law and facts, however, the court detoured from debt analysis to merger analysis. Rather than focusing on the parties' intent concerning the effect of the borrower's conveyance to the lender, the court repeated the familiar rules that merger is a question of the lender's unilateral intent and tbat merger will occur only if it is in the lender's best interest. After concluding that the lender did not intend the mortgage to merge into the fee, the court held that the conveyance did not extinguish the borrower's note liability.

Merger analysis was completely unnecessary to decide the case. In light of the lender's agreement with the borrower to hold title pending payment of the debt, the evidence was clear that the parties did not intend the conveyance to constitute payment of the debt. The siguificance of this agreement apparently escaped the court and the parties. Instead, they focused on merger. Despite its inappropriate focus on merger, the court reached the correct result. Its analysis, however, created misleading precedent.

Although courts usually decide the issue of merger in accordance with the holder's best interests, as in *Sheehan,* courts occasionally have applied merger in a manner detrimental to the holder's best interests. In Jensen v. Burton, 117 Cal. App. 66, 3 P.2d 324 (1931), for example, the court had to determine whether a mortgagee who accepted a deed in lieu of foreclosure could recover the debt from the grantee. The court framed the issue raised by the case as: "Is there any evidence that would support a finding that such transaction resulted in a merger and consequent satisfaction of the note sued on here?" *Id.* at 69, 3 P.2d at 326. Based on the mortgagee's actions in dealing with the property, the court concluded that he had intended merger of the fee and mortgage interests, thereby preventing him from recovering on the note.

b. *Involuntary Conveyance*

If the mortgagee acquired title to the property through an involuntary conveyance, the mortgagee and former property owner obviously will not have formed a mutual intent concerning the continued enforceability of the debt. Instead, the result turns on whetber the mortgagee acquired title subject to the lien securing the debt. Like any other property purchaser, if the lender acquires title subject to a lien, including one that it owns, it cannot enforce personal liability for the debt secured by that lien. If, on the other hand, the lender acquires title free of its lien, it can enforce the related debt.

When a lender buys land at an involuntary sale, such as a foreclosure sale, it acquires title to the encumbered property cleansed of the lien for which the sale is conducted and of any junior liens.[299] Therefore, if a mortgagee buys the encumbered property at a foreclosure sale conducted on its mortgage, the mortgagee acquires title cleared not only of all junior liens, but also of its mortgage lien. In this case, tbe mortgagee retains the right to sue anyone personally liable for the debt to collect any deficiency remaining after the sale.[300] Because the foreclosure sale eliminated any further security rights in the property, the mortgagee's only recourse for a deficiency is against those liable on the note.

The court's invocation of merger was completely inappropriate. The post-conveyance viability of the debt depended on the parties' contractual intent concerning the purpose of tbe conveyance and its effect on tbe debt. If the parties intended the conveyance to satisfy the debt, the debt was satisfied and extinguisbed. The mortgagee's unilateral decision to merge the mortgage lien into the fee was entirely separate from his agreement with the debtor concerning tbe effect of tbe conveyance on the debt. Merger of the mortgage lien and the enforceability of tbe debt are distinct issues, one involving the state of title to the property and the other involving contractual liability for the debt.

Altbough the court in *Jensen* erred analytically, its holding was correct. First, the circumstances of the case indicated that the parties intended the conveyance to satisfy the debt in full. The value of the property at the time of the conveyance exceeded the amount of the debts it secured. Moreover, after the conveyance, the mortgagee made no further attempts to collect the debt until he filed suit. Because the court did not limit its holding to tbe facts before it, however, its analysis would have deprived the mortgagee of the right to enforce the debt even if the property value had been less than the outstanding debt amount. *Accord* Commercial Merchants Nat'l Bank & Trust Co. v. Le Tourneau, 137 F.2d 87, 89 (7th Cir.), *cert. denied*, 320 U.S. 779 (1943) ("Under Illinois law, if there were a merger, the mortgage debt was extinguished."); Toston v. Utah Mortgage Loan Corp., 115 F.2d 560 (9th Cir. 1940); Friedman v. Pohnl, 143 So. 2d 690 (Fla. Dist. Ct. App. 1962); Baxter v. Redevco, 279 Or. 117, 122-23, 125, 566 P.2d 501, 503, 505 (1977); *see also* 4 AM. L. PROP., *supra* note 2, § 16.143, at 336; 9 G. THOMPSON, *supra* note 291, § 4798, at 585; 5 H. TIFFANY, *supra* note 2, § 1479, at 506.

299. *See* G. NELSON & D. WHITMAN, *supra* note 5, § 7.12.

300. *See id.* § 8.1.

Similarly, if the mortgagee owns more than one lien on the property, forecloses the most senior lien, and buys at the sale, the mortgagee can enforce the debt secured by each of its liens to the extent that the debt was not satisfied from the foreclosure sale proceeds.[301] Again, unless the lender is permitted to sue on the debt, the lender will have no means of recovering the debt because the foreclosure sale eliminated its right of recourse against the land. The reasoning and result are the same if the mortgagee purchases the property at a sale conducted to satisfy a lien held by someone other than the mortgagee. Because the mortgagee's lien interest is extinguished, its ownership of the land has no impact on liability for the debt.

Despite this relatively straightforward analysis, at least one court recently has stated the doctrine of merger so broadly as to indicate that it would apply merger to prevent a lender from obtaining a deficiency judgment though the foreclosure sale extinguished its lien. In *Southern Bank of Lauderdale County v. Commissioner*[302] two mortgagees foreclosed their mortgages, and each purchased at its sale. When the mortgagees subsequently discovered that the foreclosure sales failed to eliminate junior tax liens because the mortgagees had not given the statutorily required notice, the mortgagees attempted to reforeclose their mortgages after giving the required notice. In holding that the mortgagees could not reforeclose, a panel of the Eleventh Circuit stated: "When a mortgagee forecloses on property, the doctrine of merger generally operates to extinguish the mortgage indebtedness and the lien held by the mortgagee."[303] Because the suit concerned the existence of a mortgage lien after a foreclosure sale, the court's overinclusive statement concerning extinguishment of the debt is dictum. The dictum is troubling, however, because the mortgagees alleged that the fair market values of the properties were less than the amounts of the outstanding debts that were the bases for the foreclosures. The court's statement suggests that, if presented with the issue of the availability of a deficiency judgment, the court would deny recovery based on the doctrine of merger because the "merged" indebtedness would be deemed extinguished.[304]

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301. *See id.* § 6.16, at 467.

302. 770 F.2d 1001 (11th Cir. 1985), *cert. denied sub nom.* Mid-State Homes, Inc. v. United States, 106 S. Ct. 2890 (1986).

303. *Id.* at 1007.

304. Besides incorrectly stating that the debts were subject to the operation of merger, the court also was incorrect in holding that the liens merged into the fee titles, thereby

Courts commit an equally serious analytic error when they apply merger to determine the enforceability of a debt after the lender acquires the collateral for it subject to the lender's lien. A court that has fallen into the merger trap reasons that the debt is enforceable if the lien securing it has not merged into the fee. Because the lien normally will not merge when it is in the holder's best interest to keep it alive, the court accordingly holds that the lien did not merge and, therefore, that the debt is enforceable. This approach to the issue ignores the economic aspects of the case and usually results in a windfall to the lender as is strikingly demonstrated in *Londoff v. Garfinkel*.[305]

In *Londoff* a property owner encumbered his land with two deeds of trust to secure loans to him. After default on the debt secured by the junior lien, the junior lienor foreclosed on the encumbered property, bought the property at the sale for one hundred dollars, and collected the entire deficiency on the junior note from the borrower. After paying the debt secured by the senior lien, the junior lienor/owner foreclosed the senior lien, bought the property at the sale for less than half the amount of the senior debt, and sued the borrower for the deficiency on the senior debt.[306] Contrary to reason, the court's analysis and the parties'

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preventing reforeclosures. When a junior lien is not eliminated by a foreclosure because of an oversight by the foreclosing senior lienor, such as failing to give the junior lienor required notice or to join the junior lienor in a judicial foreclosure action, courts revive the liens that were eliminated by the senior foreclosure sale and treat those liens as having been acquired by the foreclosure sale purchaser. As the holder of the revived liens, the foreclosure sale purchaser can reforeclose the most senior lien. In this way, the junior lienor is returned to *status quo ante*. Its lien occupies the same priority position as before the sale, and it is entitled to participate in the sale to stimulate bidding or to purchase the property and to exercise the other rights available to a junior lienor. G. NELSON & D. WHITMAN, *supra* note 5, § 7.15. By preventing the senior lienors in *Southern Bank* from reforeclosing, on the other hand, the junior tax liens at issue became the only lien against the properties they encumbered, resulting in a substantial and unjust windfall for the Internal Revenue Service. Based on this incorrect decision, the Service has taken the position in at least one other case that a tax lien it holds on a parcel of property became the first lien because it did not receive the statutorily required notice of a foreclosure of the first mortgage on the property.

305. 467 S.W.2d 298 (Mo. Ct. App. 1971).

306. The facts of the *Londoff* case given in the text are distilled from a more complex set of facts. The borrower had executed the first and second notes and two trust deeds to secure them in favor of a straw person acting on the lender's behalf. The lender, acting through this straw person, then sold the first note and trust deed and guaranteed payment. Subsequently, the borrower defaulted on the second note, and, at the lender's direction, the trustee of the second trust deed foreclosed it. The foreclosure sale purchaser was another of the lender's straw persons. The trustee's deed stated that it was subject to the first trust deed. After the sale, the lender retired the first note, and the holders delivered the note and trust deed to the lender although the instruments were not endorsed over to the lender. The lender's straw person who purchased at the foreclosure sale then conveyed the property to

arguments revolved solely around whether the junior lienor had intended the senior lien to merge into the fee title when he paid the senior debt. The borrower argued that the junior lienor's reason for paying the senior debt was to eliminate the senior lien as an encumbrance on the title and, therefore, that the senior lien merged into the fee title rendering the debt unenforceable. The junior lienor argued that, because he did not intend to extinguish the senior lien, the debt was enforceable.

Accepting the issue as framed by these arguments, the court scrutinized the facts to determine whether the junior lienor/owner actually had intended the interests to merge. The court concluded that the junior lienor's best interests were served by holding that merger had not occurred, although no evidence existed of an express intent to prevent merger of the trust deed. As a result of this determination, the court held that the borrower was liable for the deficiency on the senior note. Thus, the junior lienor obtained the land, all but one hundred dollars of the junior debt, and more than half of the senior debt, which had an aggregate value substantially greater than the junior lienor's investment in the property. The court's failure to apply contract principles thus resulted in an obviously unjust windfall to the junior lienor.[307]

Those courts that do not get caught up in merger analysis, unlike the court in *Londoff*, normally recognize that the lender's purchase subject to its lien renders the property the primary fund for payment and that the purchase price usually reflects that fact. These courts then reason that, like a third party purchaser who bought subject to a lien, the purchasing lender would be enriched

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the lender and his spouse, and the lender directed the trustee of the first trust deed to foreclose it. Yet another straw person acting for the lender bought the property at the sale. The lender then commenced the subject suit for an alleged deficiency on the first note. The lender testified that he satisfied the first debt in fulfillment of his guaranty. That fact, even if true, does not entitle him to recover on the debt because of his acquisition of the primary fund for repayment. Additionally, the lender's payment while title to the land was held by the lender's straw person was irrelevant to the court's reasoning; the court treated the lender as the owner while the straw person held the property. *Id.* at 298-300.

307. The court attempted to justify its incorrect holding by citing evidence indicating that the fair market value of the property had decreased from the time the borrower purchased it. *See id.* at 302. This conclusion is suspect because no evidence was presented concerning the value of the property when the lender acquired it at the foreclosure sale on the second trust deed, which is the relevant date for valuation. The lender acquired title in November 1966. The court, however, relied on evidence of the property value in April or May 1969. The logical, but unstated, effect of the court's analysis is to render the borrower an indemnitor for the lender's benefit for any decrease in the property value after the lender acquires it.

unjustly if it could collect the debt secured by that lien.[308] Although this conclusion ignores the debtor's subrogation rights in the mortgage, by which the debtor could foreclose and recover its payment from the sale proceeds, the result in any given case normally is correct. By holding that the lender cannot recover the debt, transactional costs are decreased and lenders are prevented from retaining the debtor's personal liability as a hedge against declining land prices.[309] By failing to recognize the differences between a purchasing lender and a third party purchaser, however, at least one court has extended this rule beyond its proper scope.[310]

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308. *See* Belleville Sav. Bank v. Reis, 136 Ill. 242, 26 N.E. 646 (1891); McDonald v. Magirl, 97 Iowa 677, 66 N.W. 904 (1896); Board of Trustees v. Ren-Cen Indoor Tennis & Racquet Club, 145 Mich. App. 318, 377 N.W.2d 432 (1985); Baxter v. Redevco, 279 Or. 117, 566 P.2d 501 (1977).

309. If the lender were permitted to sue on the debt after acquiring the property, which is the primary fund for payment of the debt, the payor would be subrogated to the lender's rights in the mortgage, including the right to foreclose. If the property is worth at least the deht amount, the final result is essentially a wash. The lender will collect the deht but will lose the property as a result of the payor's foreclosure sale. The payor will recover her debt payment from the foreclosure sale, either in cash if a third party buys at the sale or in kind if she purchases at the sale. To avoid the transaction costs associated with this scenario, the lender should be forced to elect initially between suit on the debt or acquisition of the primary fund for its payment. This result is accomplished by the courts' usual rule that prevents a lender from suing on the debt after acquiring property subject to the lien securing the debt.

Furthermore, this rule prevents lenders from shifting to debtors the risk of declining property values. If the property value decreases to less than the outstanding debt amount after the lender acquires it, the lender should not be permitted to shift the loss by suing on the note and leaving the debtor with subrogation rights insufficient to recoup the debt payment. The correctness of this result is highlighted by the fact that, by purchasing at the foreclosure sale subject to the lien, the lender eliminated the possibility of the property being sold to a third party who would have reduced the outstanding amount of the debt by making payments on it to protect his title.

310. Unlike third party purchasers, a lienor sometimes has valid reasons for buying at a foreclosure sale even if tbe property is worth less than the outstanding debts encumbering it. For example, the lender may foreclose and buy at the sale if the owner is mismanaging the property. The lender justifiably may believe that, if properly managed, the property will sufficiently increase in value or will generate sufficient income to repay the debt. The lender also might acquire the property if it believes the borrower to be judgment proof, indicating that the property is the only asset available for the lender's recovery. Therefore, the rule preventing a purchaser who buys land subject to a lien from enforcing the related debt should be a presumptive, rather than a *per se*, rule. Two courts have adopted that view. *See* Clark v. Jackson, 64 N.H. 388, 11 A. 59 (1887); Lydecker v. Bogert, 38 N.J. Eq. 136 (N.J. Ch. 1884).

At least one court, however, has applied the rule despite the obvious equities of the case. In Wright v. Anderson, 62 S.D. 444, 253 N.W. 484 (1934), the holder of the first and second mortgages bought at the foreclosure sale on the second. She bid the full amount of the second note because she believed the debtor to be judgment proof. Although the South Dakota Supreme Court was "quite satisfied" that the mortgagee paid more for the property

Although the courts that recognize the inapplicability of merger to these cases normally reach the correct result, the superficiality of their rationale for reaching the result is matched by their superficial focus on the facts specific to each case. Courts' analyses traditionally have focused on the type of sale at which the lender acquired the encumbered property. Courts have analyzed separately cases in which a lender purchased at a tax sale,[311] a trustee's sale in connection with the mortgagor's insolvency or liquidation,[312] a sale by a deceased mortgagor's estate,[313] an execution sale on a judgment held by a third party[314] or by the lender,[315] and a foreclosure sale.[316] The law and policy affecting each type of case are the same, however, so that such distinctions are analytically meaningless. The almost uniform denial of the lender's claim in each type of case evidences the lack of a need for separate analyses. The primary issue in each case is whether the lender in fact would be enriched unjustly if it were permitted to enforce the debt.

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at the second mortgage foreclosure sale than its *unencumbered* value and that the mortgagee was unaware of the legal consequences of buying subject to the senior lien, the court held these facts to be irrelevant. The court stated that in the ahsence of fraud or of similar equitable grounds "a purchaser who was willing to pay money for the equity of redemption will not be heard to say . . . that the land (the primary fund for the discharge of the prior encumbrance) is not worth the amount thereof." *Id.* at 450, 253 N.W. at 487.

The difference between *Wright* and *Clark* and *Lydecker* possibly is that *Wright* was decided in 1934 in a state particularly hard hit by droughts and the economic depression, so that the court was particularly solicitous of borrowers who lost property in foreclosure sales. *See* First State Bank v. Ihringer, 217 N.W.2d 857 (N.D. 1974). Tbe effect of the court's holding, however, is to excuse the borrower from the senior debt although the lender received substantially less than the outstanding debt amounts. Of course, a unilateral mistake of law or of fact normally does not entitle a person to relief. In *Wright*, however, the mistake unjustly enriched another. For this reason, the rule prohibiting a lender from enforcing a debt after buying property subject to the lien securing it should be presumptive only.

311. *See* Devereux v. Taft, 20 S.C. 555 (1883).

312. *See* Savings Bank v. Grant, 41 Mich. 101, 2 N.W. 1 (1879); Clark v. Jackson, 64 N.H. 388, 11 A. 59 (1887); Cock v. Bailey, 146 Pa. 328, 23 A. 370 (1892).

313. *See* Findlay v. Hosmer, 2 Conn. 350 (1817); Walker, Smith & Co. v. Baxter, 26 Vt. 710 (1854).

314. *See* Biggins v. Brockman, 63 Ill. 316 (1872); McClain v. Weise, 22 Ill. App. 272 (1887); Greensburg Fuel Co. v. Irwin Natural Gas Co., 162 Pa. 78, 29 A. 274 (1894).

315. *See* Lydecker v. Bogert, 38 N.J. Eq. 136 (N.J. Ch. 1884); Stevenson v. Black, 1 N.J. Eq. 338 (N.J. Ch. 1831); McLure, Brawley & Co. v. Wheeler, 27 S.C. Eq. (6 Rich. Eq.) 343 (1854).

316. *See* Board of Trustees v. Ren-Cen Indoor Tennis & Racquet Club, 145 Mich. App. 318, 377 N.W.2d 432 (1985); Baxter v. Redevco, 279 Or. 117, 566 P.2d 501 (1977).

2. Effect of Property Owner's Note and Mortgage Acquisition on Debt Enforceability

Despite contrary judicial opinions, when a property owner purports to acquire a mortgage encumbering his property and the debt it secures, merger is completely inapplicable to determine whether the debt remains enforceable. Apparently misled by the owner's purported ownership of two property interests, the mortgage and fee, many courts have focused on merger and have held that the debt is enforceable if the mortgage has not merged.[317] Pre-

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317. *See, e.g.*, Kelly v. Weir, 243 F. Supp. 588, 598 (E.D. Ark. 1965) ("When the doctrine of merger is applied to . . . an acquisition [of the fee hy the mortgagee or of the mortgage by the fee owner], the result is normally to extinguish the mortgage debt."); Wilhelmi v. Leonard, 13 Iowa 330, 338 (1862); Flanigan v. Sable, 44 Minn. 417, 46 N.W. 854 (1890); Citizens Trust Co. v. Going, 288 Mo. 505, 517-18, 232 S.W. 996, 1000 (1921); 3 J. STORY, *supra* note 67, § 1385, at 39; Note, *The Effect of Merger Upon Mortgage Debts*, 15 HARV. L. REV. 740 (1902).

Flanigan is a classic example of a court ignoring every consideration other than merger. The mortgagors in the case executed first and second mortgages in favor of different mortgagees. After default on the second loan, the second mortgagee foreclosed and bought the property at the sale subject to the first mortgage. The second mortgagee then paid the debt secured by the first mortgage and instituted the instant action against the borrowers to recover the debt. In holding that the second mortgagee could enforce the first note, the court focused solely on whether the second mortgagee intended the first mortgage to merge into the fee. The court held that the interests had not merged because:

> The [second mortgagee] was not under any obligations to pay the first mortgage; neither is it alleged that the sale on [the second] mortgage was made subject to it. When [the second mortgagee] foreclosed she was not the owner of the first mortgage. In fact it is not alleged that she then had any notice, actual or constructive, of its existence.

44 Minn. at 418, 46 N.W. at 854. Although the court is correct on the facts of this case that the first mortgage lien did not merge into the fee, the court's analysis misses the mark. The gravamen of the suit is enforceability of the debt. Merger is irrelevant to that analysis. This conclusion follows regardless of notice of the lien or of the other factual findings recited by the court to support its holding.

Furthermore, some of the court's findings are incorrect. First, the court broadly states that the second mortgagee was not obligated to pay the first mortgage debt. Although the second mortgagee was not personally liable for the first debt, that fact is insufficient to support the court's conclusion that she was entitled to reimbursement for payment of the debt. By buying the property subject to the senior lien, the land became the primary fund for payment of the related debt, and the purchase price should have reflected that fact. Second, the court's statement that no allegation had been made that the foreclosure sale was subject to the first mortgage is senseless. If the first mortgage had not been recorded on the public records, the second mortgagee would have acquired title free of that lien, and her payment of the first mortgage note would have been unnecessary to protect her interest in the property. Indeed, she would have been an officious intermeddler, who would not be entitled to any subrogation rights. Finally, ownership of the first mortgage on the date of the second mortgage foreclosure sale is irrelevant. As described above, with very limited exception, a person who purchases subject to a lien, regardless of whether he owns the lien, cannot be subrogated to the lender's rights in the note secured by it. *See supra* notes 308-10 and accompanying text.

dictably, the results in these cases often are at odds with the correct result because these cases are quintessential subrogation cases. The basic issue raised is whether a person who pays a debt can recoup that payment from someone else who had been liable for it. If a property owner is primarily liable for a debt secured by the property because she is either the original mortgagor or a purchaser who assumed personal liability, she cannot enforce the debt after paying it. Pursuant to established subrogation doctrine, a person who is primarily liable for a debt never can be subrogated to the lender's rights in the note or mortgage.[318] This result devolves from the very nature of primary liability. When the owner paid the debt, it was extinguished, even if she characterized the payment as a purchase.

If the property owner acquired title subject to the mortgage but without assuming personal liability, however, her right to enforce the debt depends on the price paid for the property; if the price reflected the outstanding mortgage debt, she cannot enforce the debt after purporting to purchase it. As discussed above, the property in this case is the primary fund for payment, and the price reduction represents a quasi-contractual obligation to pay the debt for as long as she owns the property.[319] Therefore, by discharging the debt, the owner, as the primary obligor in fact, simply is fulfilling her obligation and cannot be subrogated to the mortgagee's rights in the note.[320]

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318. *See* 5 H. TIFFANY, *supra* note 2, § 1482, at 512-13; Note, *Subrogation of Purchaser to Rights of Senior Mortgagee Against Junior Encumbrances*, 48 YALE L.J. 683, 687 (1939). *Cf.* U.C.C. § 3-601(3) (1977).

319. In one unusual case, the owner may successfully sue the seller for the difference between the outstanding debt amount and the property value. If the property value has decreased to less than the outstanding debt amount and if the mortgagee assigns the debt and related mortgage to the owner as a gift, the owner may be able to collect the difference from the seller. G. NELSON & D. WHITMAN, *supra* note 5, § 6.16, at 469-70.

320. 5 H. TIFFANY, *supra* note 2, § 1482, at 514. Courts have not always recognized this principle and have reached the economically unsound result of permitting a "subject to" purchaser to be subrogated to the lender's rights in the note. Even when a court recognizes the applicability of the U.C.C. and contractual principles, it can reach a result opposite to the correct result. In Ryan v. Stearns, 135 Vt. 385, 376 A.2d 728 (1977), for example, the court relied on a provision of the U.C.C. that is meaningless in the real property security context to reach a result diametrically opposed to the correct result. In *Ryan* the plaintiff acquired title to a parcel of property subject to a mortgage, thereby rendering the property the primary fund for payment of the debt. After paying the debt, the plaintiff instituted the instant suit against the note makers to recover her payment. Surprisingly, the court held that she could recover. Equally surprising was the court's reasoning. The court held that the plaintiff was a holder in due course under the terms of the U.C.C. because "she had given value in good faith without notice of any possible defense." *Id.* at 388, 376 A.2d at 730. This obvious misuse of the U.C.C. highlights the court's failure to apprehend the legal effect of

On the other hand, if the owner acquired title subject to the

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buying property subject to a mortgage. Furthermore, actual notice of a lien is irrelevant and has been since recording acts were enacted. As long as courts refuse to accept the concept of constructive notice, recording acts will not achieve their full potential.

The court's holding also was economically unsound. The price the plaintiff paid for the property, plus the amount she paid to "purchase" the debt, was $16,542.89. She sold the property for $16,500, thereby making her economically whole without recourse against the note makers. Furthermore, the debt she paid had been secured by two parcels of property, only one of which she owned. Because she took an assignment of the mortgage lien with respect to the parcel she did not own, a valuable interest in its own right, she actually paid $16,542.89 for the property she owned, plus a mortgage interest in another parcel, thereby recovering more than her economic outlay.

The court's analysis was further confused by its mixing of security issues with contractual liability issues. The court observed, for example: "By the time [plaintiff] became the holder of the note, none of the parties liable thereon had any interest whatever in the parcel in question. Its utility as a security device for the note was effectively terminated." *Id.* at 389, 376 A.2d at 731. This observation is irrelevant in determining liability for the debt because security rights and debt liability are different legal animals. In virtually every case in which a purchaser acquires title subject to a mortgage and subsequently "acquires" a note secured by the property, the original note makers no longer own an interest in the property. Therefore, the court's statement served only to obfuscate, rather than to clarify.

Another court, though it properly focused on subrogation as the controlling contractual principle, reached the same incorrect result as the court in *Ryan*. In Hazle v. Bondy, 173 Ill. 302, 50 N.E. 671 (1898), the Illinois Supreme Court held that a purchaser who bought land encumbered by a trust deed could be subrogated to the lender's rights against the note makers because:

> The debt is [the note makers'], and they are primarily liable to pay it, by the terms of their contract. Having failed to do so, if . . . their remote grantee, is compelled to pay the debt in order to protect his property, no reason is perceived why he should not have his remedy against them.

Id. at 314-15, 50 N.E. at 676. The reason is the purchaser acquired title subject to the trust deed, thereby rendering the property the primary fund for repayment of the loan.

One treatise cites *Hazle* for the reasonable proposition that if a purchaser pays the full unencumbered price of the property in reliance on the seller's agreement to remain primarily liable for the debt, the purchaser can be subrogated to the lender's rights in the note against the seller. G. NELSON & D. WHITMAN, *supra* note 5, § 10.2, at 709. The facts in *Hazle* belie that proposition, however. First, the trust deed appeared in the chain of title for the purchaser's lot. The deed by which the purchaser's seller acquired title expressly stated that the conveyance was subject to the lien. Although a second deed conveying the same lot to the seller failed to specify the lien, that failure was an oversight as demonstrated by the fact that the purchase price was not increased in exchange for delivery of the second deed. Second, when the purchaser acquired the property, he paid only $85 more for it than his seller had paid, although the debt secured by the purchaser's lot was substantially greater than $85. Third, the seller sold the lot to the purchaser within a few days after acquiring it. Therefore, the property value and the outstanding debt amount could not have changed substantially enough to believe that the purchaser paid the unencumbered value of the property. Finally, no evidence existed that would take this case outside the usual rule that applies when a purchaser acquires title subject to a lien. No evidence existed that the seller agreed to remain primarily liable for the debt or that he affirmatively misrepresented the state of the title to the purchaser, although the deed by which the purchaser acquired title did not mention the trust deed. The purchaser is not without remedy, however. He can sue his seller based on the title covenants in his deed for failure to disclose the existence of the lien. He has no right, however, to sue the original note makers based on subrogation to the mortgage but paid the full unencumbered value of the property, she would be subrogated to the mortgagee's rights in the note if she retires the debt. By agreeing to pay the debt in exchange for the purchaser's payment of the unencumbered value of the property, the seller remained primarily liable for the debt.[321] Therefore, if the purchaser pays the debt to protect her possessory interest in the property, she is subrogated to the mortgagee's rights and can enforce the note against the seller, as well as enforce her rights based on the seller's agreement to pay the debt.

Despite the obvious applicability of the contractual analyses recommended in this Article for deciding debt enforceability, many courts, by applying merger, reach results diametrically opposed to the correct result. Courts' applications of merger in this context are particularly perplexing because merger, a property title device, is manifestly inapplicable to issues of debt enforceability. Ridding modern law of merger will eliminate this problem. By diverting courts from an incorrect focus on merger, courts are more likely to focus on the economics of the cases raising this issue and on the parties' expectations in dealing with the debt and the encumbered land.

IV. Conclusion

Merger, as it applies to mortgages, has not been comprehensively reviewed since 1821, when Richard Preston published his merger treatise. Merger still is, as Preston described it, "a curious and interesting learning."[322] That description, however, no longer is commendatory. After approximately seven hundred years, a labyrinth of analysis has developed about merger that provides the grist for a litigation mill. Despite fairly regular rejection of merger claims and lawyering practices designed to eliminate any claim that merger has occurred, courts decide a significant number of cases involving merger as it applies to mortgages every year.

Modern courts' application of the merger doctrine to mortgages primarily results from the fact that at certain points in the early common law the paths of their legal development crossed. Because some early mortgage counterparts legitimately were subject to the operation of merger, it has clung tenaciously to mortgages ever since, although mortgages have evolved beyond the form

lender's rights in the note.

321. *See supra* note 300 and accompanying text.

322. 3 R. Preston, *supra* note 12, at 1.

to which merger applied. The law has grown up around merger, developing systems, such as the title records, that reflect modern practices and obviate the need for merger. Elimination of merger will strengthen this infrastructure.