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UNPAID RECEIVERSHIP CREDITORS AND THE PURCHASER AT A FORECLOSURE SALE†

*Daniel C. Draper**

During the depression years of the early thirties, the device of foreclosure and sale, upon which the worth of mortgage financing had theretofore ultimately rested, collapsed.[1] Low bids, or in many cases the lack of any bids at all (other than a nominal one by the mortgagee), reflected prevailing economic conditions which particularly affected speculative values. The uncertain legal position[2] of a purchaser at a foreclosure sale rendered and, to a considerable extent, still renders such a purchase peculiarly speculative. This article will discuss the way the courts have attempted to resolve one of these uncertainties.[3]

In foreclosure and bankruptcy sales of real and in some cases personal property, the terms of sale and the title search usually made by purchasers before paying the price and accepting title indicate what they will acquire.[4] Such a search will show only matters of public record. Where a receiver has preceded foreclosure and sale, in the usual case the pur-

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* See Contributors' Section, Masthead, p. 482, for biographical data.

1 Sutherland, "Foreclosure and Sale, Some Suggested Changes," 22 Cornell L. Q. 216 at 217 (1937). For residential property the federal government today in varying degrees supplements, by its own credit, the security furnished by the mortgagee. See Wallace, "Survey of Federal Legislation Affecting Private Home Financing Since 1932," 5 Law & Contemp. Prob. 481 at 492 (1938); Colean, "Changing Attitudes Toward Property Ownership and Mortgage Financing," 12 id. 25 (1947).

2 "It is practically a foregone conclusion in some jurisdictions that technical flaws will be found in titles acquired through judicial sales." Note, 35 Geo. L. J. 376 (1947).

3 Note, 26 St. John's L. Rev. 190 (1951) discusses the problems that sections 500a, 506a and 506b of the N. Y. Real Property Law, concerning faulty foreclosure procedures, seek to resolve. See also Bridewell, "The Effect of Defective Mortgage Loans on Home Financing," 5 Law & Contemp. Prob. 545 (1938).

4 In the absence of any provision to the contrary in the terms of sale in bankruptcy, the sale is made subject to all outstanding liens and encumbrances. See Gotkin v. Korn, 182 F.2d 380 (D.C. Cir. 1950) and Matter of Macklem, 28 F.2d 417 (D. Md. 1928) and cases cited therein. In a number of cases, state courts have held that the purchaser took subject to outstanding liens. See National Cash Register v. Underwood, 56 R.I. 379, 185 Atl. 909 (1936) (conditional vendor's interest); Foster v. Christenson, 67 S.W.2d 246 (Tex. Civ. App. 1934) (vendor's lien in land); Brown v. Thompson, 99 W.Va. 56, 128 S.E. 309 (1925) (judgment lien). See Hollywood Plays Inc. v. Columbia Pictures Corp., 299 N.Y. 61, 85 N.E.2d 865, reversing 274 App. Div. 912, 83 N.Y.S.2d 302 (1st Dep't 1949) (personalty). At the outset, it will be assumed, as it has in most of the decisions, that whether the proceedings are in bankruptcy or equity, the same results would obtain and the decisions could properly be cited interchangeably. The possibility that, in a foreclosure, the result should differ will be discussed infra.

chaser has no way of discovering unpaid receivership obligations which are not of record. If a prospective purchaser knew a receivership debt were unpaid, he normally would advise the receiver whose final account, in the usual case, the court would not yet have settled. The account could thus include the debt and the purchaser would acquire clear title and the creditor be paid.[5] Once the court has settled the account and discharged the receiver, however, the unpaid creditor must proceed either against the discharged receiver, the owner-mortgagor who is likely to be judgment proof, the purchaser at foreclosure, or the mortgagee who procured the receivership (and who may also be the purchaser). Treatises and commentators, strangely enough, have mentioned the problem, if at all, only in passing.[6]

Possible Liability of a Discharged Receiver

Since contractual creditors would have dealt with the receiver, and other creditors would find him in possession of the property, they would normally look first to him for payment rather than to a purchaser, mortgagee or owner-mortgagor. Consequently, we will first discuss the effect of discharge upon the creditor's rights against the receiver.

In the absence of fraud, and unless the decree discharging a receiver provides to the contrary, a creditor cannot successfully proceed against a receiver after his discharge. Thus, in *New York & W.U. Tel. v. Jewett*,[7] a receivership creditor sued a receiver in a mortgage foreclosure who had settled his accounts and been discharged. The creditor insisted that, since he had no notice of the discharge and was not a party to the proceeding, it could not operate to cut off his claim. The Court of Appeals stated that, although

> It is possible that the claims of creditors in such a case as this may be prejudiced, and perhaps, defeated by the discharge of the receiver; . . .
>
> The creditor must have known that these actions and proceedings were running to a termination, and that the time would come when the mortgages would be foreclosed, the property of the railroad company be disposed of and the receiver discharged.[8]

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[5] The opinion in Atlantic Trust Co. v. Chapman, 208 U.S. 360, 373, 375 and 376 (1908), a leading decision on the subject, characterized the claim of receivership debtors as a "charge" against the res. The "charge" for unpaid receivership debts is not a traditionally recordable interest and so the opinions usually treat it as "equitable." If the claim of the receivership creditor were an equitable charge, then a purchaser with notice would take subject to it.

[6] 2 Wiltsie, Mortgage Foreclosure 1260 passim (5th ed. 1939); Walsh, Mortgages 305 et seq. (1934); Gluck and Becker, Law of Receivers 492 et seq. (2d ed. 1896); 1 Clark on Receivers 1008 (2d ed. 1929); 1 Glenn, Mortgages 657 passim (1943); Sutherland, supra note 1.

[7] 115 N.Y. 166 (1889).

[8] Id. at 169. See also Ferguson v. Toledo A.A. & N.M.R.R., 85 App. Div. 352, 83 N.Y. Supp. 283 (1st Dep't 1903); Western New York v. Penn. Refining Co., 137 Fed. 343, 368 (3d Cir. 1905); Note, 112 A.L.R. 142 (1938).

The decision, however, leaves unanswered the due process question as to whether, under these circumstances, a creditor can lose his claim against a receiver without actual notice of the receiver's accounting and the discharge proceedings.[9]

In *Hanover National Bank v. Moyses*,[10] the Supreme Court held that in a bankruptcy proceeding to discharge a debtor personal service is not necessary to bar the rights of creditors where the creditors had notice by publication and mail, stating broadly that "such notice . . . as the nature of the proceeding permits . . . is sufficient."[11] The Court reached this result on the ground that the adjudication of creditors' claims against the bankrupt's estate was "in the nature" of an action *in rem*. In both proceedings to discharge receivers and debtors, the courts have a policy to provide finally for all the creditors' claims against the person to be discharged, and both would seem, for due process purposes, equally "in the nature" of an action *in rem*. The courts have yet to determine whether or not the usual publication of the terms of foreclosure sale constitutes such notice "as the nature of the proceeding permits."[12] Though such publication is primarily intended to attract buyers,[13] it contains all the infor-

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[9] If a court should hold that the creditor had no notice, the owner-mortgagor or mortgagee-purchaser could not set forth the decree of discharge as a ground for cutting off the receivership creditor's claim against them. 3105 Grand Corp. v. City of New York, 288 N.Y. 178, 42 N.E.2d 475 (1942), discussed infra, rejects the defense of a purchaser at foreclosure that the order settling and approving the account of the receiver, discharging him and authorizing his release constituted a bar to a quantum meruit claim. The court stated:

> It is an answer to this contention that these plaintiffs were not parties to the foreclosure proceeding of appellant, nor received any notice either of the payment of the taxes with their funds or of the motion to confirm the receivership accounting, in which proceedings appellant alone was interested.

228 N.Y. at 184, 42 N.E.2d at 478.

[10] 186 U.S. 181 (1902).

[11] Id. at 192. See McRamey v. Riley, 128 Miss. 662, 91 So. 399, cert. denied 260 U.S. 727 (1922) (sustaining the constitutionality of the predecessor of provisions of the present bankruptcy act [52 Stat. 867 (1938), 11 U.S.C. § 94 (1946)] which provides for notice by mail.) The lower federal courts, however, have not construed the notice requirements strictly. See In re Manesfield, 36 F. Supp. 296 (E.D.N.Y. 1941) (debtor used last known address and creditor had moved and received no actual notice, held discharge was effective). See In re Weeks, 4 F. Supp. 558 (N.D. Tex.), aff'd, 77 F.2d 754 (5th Cir. 1933) (notice defective in form, sustained).

[12] Cf. Mullane v. Central Hanover Bank & Trust Co., 339 U.S. 306 (1949) holding, for purposes of a trust fund accounting, notice by publication alone insufficient where notice by mail could be given.

[13] Collier states the chief purpose of advertisement for public sale is "to invite the public to attend and bid." 4 Collier on Bankruptcy ¶ 70.98, p. 1569 (14th ed. 1942). Section 94 of the National Bankruptcy Act requires ten days notice by mail to creditors of "all proposed sales of property." If the notice is not sent, the sale will be set aside. The court may, however, order sale without notice and this would seem to indicate that the drafters of the act did not regard the requirement of notice as raising a constitutional question. See cases cited in 3 Collier on Bankruptcy ¶ 58.09, p. 496 and 6 Remington, Bankruptcy § 2539 1952).

mation necessary to alert an unpaid creditor and might well satisfy constitutional requirements if, indeed, there are any. A court might hold that, since the creditor could proceed against others,[14] he had lost no interest entitled to constitutional protection.

In conclusion, in the absence of fraud or specific provision in the decree of discharge,[15] a creditor who at the time his claim accrued must have known that he was dealing with a receiver cannot successfully maintain a claim arising during receivership against a discharged receiver.[16] In such a case a court would probably find that failure to serve the creditor with notice of the discharge proceeding did not justify a reopening of the proceeding on the creditor's behalf. Other creditors who had no reason to know that they were dealing with a receiver should get some kind of notice, and it is not clear that, as to them, publication of the terms of sale would alone be sufficient.

POSSIBLE LIABILITY OF THE OWNER-MORTGAGOR

The unpaid receivership debtor might proceed against the mortgagor-owner[17] whose property was benefited and whose default gave rise to the foreclosure and sale. In *Texas & Pacific Ry. v. Bloom*,[18] the mortgagor retook the property after voluntary termination of the receivership and the court imposed liability even though a tort of the receiver's employees was involved and no benefit was conferred on the mortgagor.

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[14] See p. 468 infra regarding the liability of the mortgagee.

[15] In Baer v. McCullough, 176 N.Y. 97, 68 N.E. 129 (1903) the New York Court of Appeals held that the receivership creditor could secure a judgment in form against the discharged receiver, where the decree of sale provided that the purchaser should assume, and the receiver failed to substitute the purchaser as a party defendant. Cf. Henry v. Claffey, 189 Ind. 609, 127 N.E. 193 (1920) which found no liability where the purchaser assumed, but where the suit was not pending at the time of discharge. In McNulta v. Lockridge, 137 Ill. 270, 27 N.E. 452 (1892) the court sustained continuing liability where one receiver was discharged and another was substituted in his place on the ground that the judgment was against the receivership res, the identity of which continued despite the change of receivers. For further cases, see Note, 112 A.L.R. 142 (1938).

[16] Davis v. Duncan, 19 Fed. 477 (C.C.S.D. Miss. 1884), rejects the executor-legatee analogy and states, at 482, that a receiver does not occupy "the position of an executor of an estate" whose discharge "does not relieve him from liability from suit when the discharge is granted" and who may in turn claim against the funds passed on to the legatees.

[17] The mortgagor-owner might not have legal title where a statute governs. See Converse v. Hamilton, 224 U.S. 243 (1911). N.Y. Civ. Prac. Act § 1547a enacted in 1935, discussed infra, imposes liability on the mortgagee where the res is insufficient to satisfy receivership debts. The terms of the statute do not necessarily relieve the owner-mortgagor of his underlying liability, if any, for receivership debts, incurred as a result of the owner's default. For cases involving a chancery receiver see Johnson v. Smith, 297 N.Y. 165, 77 N.E.2d 386, cert. denied, 335 U.S. 824 (1948); Stokes v. Hoffman House, 167 N.Y. 554, 60 N.E. 667 (1901). The result would differ in some cases involving personal liability where the debtor conveyed to the creditors. See Chautauqua v. Risley, 19 N.Y. 369 (1859).

[18] 164 U.S. 636 (1896).

If the owner be liable when the receivership terminates without sale because he owns the property, the same result would seem equally to apply even though the owner ultimately lost the property in a judicial sale. The receivership creditor and the owner are not two equally innocent parties. The owner's default caused the receivership and, as the *Texas & Pacific Ry.* decision[19] holds, he should be liable for the expenses that flow from that default. In the usual case, however, the owner-mortgagor is judgment proof so that this alternative is not a very real one.

POSSIBLE LIABILITY OF THE PURCHASER AT FORECLOSURE

If the receiver without fraud omits the claim from his final account, the creditor does not assert it until the court has settled the account and discharged the receiver, and if the owner-mortgagor is judgment proof, the question next arises whether the purchaser at foreclosure takes free and clear of receivership claims. Put another way, which of two innocent parties should bear the loss, the receivership creditor or the purchaser? Most of the decisions on the subject deal with the more difficult situation, where the purchaser is also the mortgagee.[20]

Under the established equity rule applying to both realty and personalty a purchaser of legal title for value and without notice prevails over prior equities.[21] Applied to our situation, this would mean that an independent third party purchasing receivership assets without notice of unpaid receivership debts takes free and clear of any equity[22] asserted by such a creditor.[23] At least where the seller has that minimum interest in

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[19] Ibid.

[20] See p. 468 infra.

[21] See 2 Restatement, Trusts, § 309 (1935) and annotations thereto; American Law of Property, pt. 17, §§ 17.1, 17.9, 17.10 (1952); Gluck and Becker, Law of Receivers § 93, p. 492; Williston, Sales §§ 348, 650, 656 (rev. ed. 1948) and cases cited therein.

[22] "Equity" is herein used to describe the legal rights of a holder of an unrecorded lien or charge against the receivership property. See Note, 16 L.R.A. (N.S.) 1073 (1908) dealing with so-called equities created by unrecorded conveyances. See note 5 supra.

[23] By analogy to this rule, one corporation purchasing assets from another is not liable for the debts of the first in the absence of fraud or other special circumstances. See cases in Note, 149 A.L.R. 788 (1944). In Coral Gables v. Mayer, 241 App. Div. 340, 271 N.Y. Supp. 662 (1st Dep't 1934), a defendant counterclaimed against a corporation suing on notes made by the defendant on the theory that the plaintiff-corporation had taken over all the assets of its seller and was liable for the acts of its predecessor which formed the basis of the counterclaim. The court stated:

> The assets of a corporation are a trust fund for the payment of its debts upon which the creditors have an equitable lien both against the stockholders and all transferees except those purchasing for good faith and fair value.

This case phrased the result in terms of the traditional equity rule. Indeed prior to and aside from the Bankruptcy Act, the traditional equity rule as applied to judicial sales made possible the reorganization device for the flexible adjustment of the claims of conflicting creditors, secured and unsecured. See Kansas City R.R. v. Central Union Trust Co., 271 U.S. 445

the property called "legal title," the courts have felt that, in order to encourage that easy transfer of property which makes modern commerce possible, a purchaser for value without notice must get what he thinks he gets. To make an exception in the case of foreclosure sales would discourage bidding and injure mortgagees by depressing the price bid for the security, and mortgagors by increasing the amount of the deficiency for which they would usually be liable. It would render even more uncertain the position of a purchaser at foreclosure and thus undermine the value of the mortgage device generally. The *caveat emptor* rule to the effect that the buyer at judicial and execution sales[24] gets only the legal title the receiver has to sell and takes subject to all matters of record irrespective of the court's or its officers' representations, already imposes a sufficient burden.[25]

POSSIBLE LIABILITY OF THE MORTGAGEE

As indicated above, a third-party purchaser for value will take title at foreclosure sale subject to matters of record or matters of which it has notice, but free of unrecorded equities or, as they are sometimes called,

(1926); Kansas City R.R. v. Central Union Trust Co., 28 F.2d 177 (8th Cir. 1928), cert. denied, 278 U.S. 655 (1929). For earlier cases, see 15 A.L.R. 1139 (1921); Note, 81 U. of Pa. L. Rev. 979 (1933).

24 Execution sales are proceedings in personam conducted by the sheriff as vendor under a general judgment for a sum of money pursuant to statutory direction and complete on consummation, whereas in a judicial sale, the court is vendor and the proceeding is in rem. See Kleber, Void Judicial and Execution Sales §§ 15-18 (1899); 20 Minn. L. Rev. 557 (1936); 10 Mich. L. Rev. 332 (1912). For purposes of a purchase under the caveat emptor rule, however, the distinction does not seem significant.

25 See Copper Belle Mining Co. v. Gleeson, 14 Ariz. 548, 134 Pac. 285 (1913), 62 U. of Pa. L. Rev. 226 (1914) (defect of title); Freeman, Law of Void Judicial Sales § 48 (4th ed. 1902). Cf. Kirk v. Hamilton, 102 U.S. 68 (1880). For cases in other jurisdictions see Dresser v. Kronberg, 108 Me. 423, 81 Atl. 487 (1911), 12 Col. L. Rev. 179 (1912); 10 Mich. L. Rev. 332 (1912); Keener, Quasi Contracts 396 (1893); Note, 68 A.L.R. 659 (1930). Where a sale is void see N.Y. Civ. Prac. Act § 756; Ohio Gen. Code Ann. § 11703 (1938). Where the court has not yet confirmed the sale a number of decisions have restricted the scope of the caveat emptor doctrine. See, e.g., Lane v. Chantilly, 251 N.Y. 435, 167 N.E. 578 (1929) and Sohn v. Beavis, 200 N.Y. 268, 93 N.E. 935 (1911). In Male v. Atchison, T. & S. F. R.R., 230 N.Y. 158, 129 N.E. 458 (1920), the holder of subordinate bonds sought to hold the newly reorganized Atchison Company (which had purchased the property underlying the bonds at a foreclosure sale of a senior mortgage) liable on the subordinate issue on the theory that the Company had been the sole stock-holder of the original debtor (Atlantic and Pacific), had procured the foreclosure sale and thus should equitably be held to have sold to itself subject to the second mortgage lien. Unlike the receivership creditor situation, this involved a case where the alleged defect was a lien of record against the thing sold. The Court of Appeals stated that the Atchison Company received nothing for the common stock of Atlantic & Pacific, and "[T]itle to its property was acquired by purchase on a foreclosure sale, with no agreement or understanding that [the second mortgagee] . . . was to be benefited directly or indirectly by the reorganization." 230 N.Y. 158 at 166, 129 N.E. at 460.

"charges" of which it has no notice.[26] It remains to be determined whether a mortgagee, either as purchaser at foreclosure or as recipient of the proceeds of sale,[27] will enjoy the same protection.[28]

The difference between a mortgagee-purchaser and a mortgagee who receives proceeds is not such as to justify difference in treatment.[29] If the property is to be burdened, then freeing the proceeds would serve no rational purpose. By the same token, if the property is to be free of charges in the hands of a purchasing mortgagee, the proceeds too should be free. The rule whatever it may be should be the same in both situations.

Applicability of the Bona Fide Purchaser Rule

Phrased in terms of the rule applicable to third-party purchasers, does a mortgagee-purchaser who merely relinquishes his mortgage lien for the property give "value"? Is his purchase "bona fide"?

A conveyance by a referee in foreclosure to a purchasing mortgagee, like a conveyance by the mortgagor in lieu of foreclosure, is a transfer for

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26 See note 5 supra and text discussion infra.

27 Glenn on Liquidation § 233 passim (1935) discusses the claims of creditors in bankruptcy against proceeds.

28 For the purposes of this article, it is assumed that the mortgagee does not bid in excess of his mortgage lien. To the extent that he should so bid, he would probably be treated as a bona fide purchaser. With the possible exception of unjust enrichment decisions to be discussed, what cases there are have not attached liability to the proceeds or property in the hands of the mortgagee because of his knowledge of the receivership which he procured. In Schwartz v. Cahill, 220 N.Y. 174, 115 N.E. 451 (1917), for example, the receiver of a corporation held a lease upon which rent was overdue. The landlord purchased the lease "subject" to the claim for overdue rent and then subsequently as landlord made a claim against the bankrupt estate for this rent. The trustee claimed that by purchasing with knowledge that the claim was outstanding the landlord either waived it or assumed it. The landlord, like the mortgagee in our situation, knew the property he purchased and accordingly was not in fact a stranger. Cardozo, writing for the Court, stated:

> That the purchaser was also the landlord is, of course, a mere accident. To test his obligation we must view him as any stranger. We cannot see that a stranger buying at this sale would bave come under any legal duty to pay the arrears of rent. He might, as a business proposition, have had to do so in order to preserve the value of his investment, but that is another question. . . .

Id. at 178, 115 N.E. at 452. Thus, in the situation involving a receivership creditor and a mortgagee-purchaser at foreclosure, the fact that the purchaser was the mortgagee would seem a "mere accident" and the mortgagee should also apparently be treated "as any stranger." Unlike the landlord in the Schwartz decision, moreover, the mortgagee is usually unaware of the receivership claim when he purchases.

29 In theory, one could argue that freeing the property and burdening the proceeds would encourage mortgagees to bid, thus reducing deficiencies and tending to dispose finally of the mortgagors' obligations. To the extent, however, that the deficiencies would be reduced by the added value given the property by the receivership creditor, an action in the nature of quantum meruit brought by the creditor against the mortgagee would seem to lie, thus leaving the mortgagor with an unpaid obligation. See p. 466 supra, discussing the liability of the mortgagor and p. 473 infra discussing quantum meruit.

a past consideration. In New York, therefore, the mortgagee-purchaser would not be regarded as having given "value." [30] But even if it were "value"—and it is so regarded in some jurisdictions[31]—the courts would be unlikely to hold such a purchase *"bona fide."* In jurisdictions where past consideration is held to be "value," courts frequently find that the purchaser, though having given "value," is one who had, or should have had, notice of the outstanding claims against the property. Such courts would not find it difficult to attribute to a purchasing mortgagee, who had commenced the proceedings, sufficient knowledge of them to cast doubt about his *bona fides.*[32]

Receivership Creditors' Priorities

But even if the mortgagee is not a *bona fide* purchaser for value, may he not claim the priority of his mortgage lien against the claim of the receivership creditor?

Similar to persons who extend new money to corporations in reorganization, creditors of receivers in foreclosure are accorded first priority in claim against the receivership. Statutory provisions requiring receivership creditors to be paid before foreclosing lienors evidence a policy which favors conservation of the receivership *res.*[33] The priority given to receivership creditors is intended to encourage persons to deal with receivers[34] and, by so doing, benefit the receivership property. This policy favors debtor and creditor alike. A mortgagee, therefore, who, prior to the final

30 See Lehnrenkrauss v. Bonnell, 199 N.Y. 240, 92 N.E. 637 (1910); cases cited in United States v. Certain Lands, 41 F. Supp. 636 (E.D.N.Y. 1941) and Ten Eyck v. Witbeck, 135 N.Y. 40, 31 N.E. 994 (1892) involving "value" under N.Y. Real Property Law § 291, cited with approval in Rossiter v. Vogel, 46 F. Supp. 749 (S.D.N.Y. 1942) (involving "value" under the Copyright Act).

31 Britton, Bills and Notes 379 et seq. (1943). For the earlier rule in New York, see Bay v. Coddington, 5 Johns. Ch. 54 (N.Y. 1821) and Coddington v. Bay, 20 Johns. 637 (N.Y. 1822). Cf. Butters v. Houghwort, 42 Ill. 18 (1866) (past consideration sufficient—personal property) and Root v. French, 13 Wend. 570 (N.Y. 1835) (past consideration not sufficient —personal property). For common law cases supporting the New York rule, see Williston, Sales § 620. The New York rule as to real property is probably similar.

32 See Note, 107 A.L.R. 502, 529 (1937). Cf. Schwartz v. Cahill, supra note 28.

33 See Collier on Bankruptcy ¶ 64.102 et seq. discussing § 64a(1) of the Bankruptcy Act which gives priority to costs and expenses of preserving the estate subsequent to the filing of the petition. See 6 Remington on Bankruptcy §§ 2633, 2634 (Supp. 1950). See Gluck and Becker, Law of Receivers § 100, et seq. for older state decisions.

34 For purposes of this study receivers in bankruptcy whose authority is derived expressly from the Bankruptcy Act are treated in the same way as receivers in equity, such as, for example, the receiver in foreclosure. Under the present Bankruptcy Act, a receiver may act as a general receiver or a mere custodian or may temporarily continue the business of the bankrupt. See Hanna, "The Receiver in Bankruptcy: An Introduction to Bankruptcy Reform," 3 So. Calif. L. Rev. 241 (1930). Receivership is no longer an extraordinary remedy. See, e.g., N.Y. Real Property Law § 258.

accounting of the receiver, attempts to assert a claim prior to those who have extended credit during the receivership will receive short shrift from the courts.

On the other hand, since the purpose underlying the priority would not appear to be defeated by cutting off the priority at the final accounting, there is no compelling reason why a receivership creditor would enjoy his priority after the accounting is completed and the proceeds of sale distributed. Without discussing the priority and its bases, the decisions seem to reach this result. In *McColgan v. Maier Brewing Co.,*[35] for example, the court first put the question in terms of whether or not failure to present a claim before discharge bars the claim. In this case the receiver had operated the Maier Brewing Company until reorganization.[36] The State of California thereafter filed a claim for franchise taxes arising during the period of receivership operation. The court held that the Commissioner of Taxes for California by failing "seasonably to present his claim" was guilty of "laches." [37]

The court then stated the rule in terms broader than *laches* and held that "the failure to present known claims [under these circumstances] necessarily results in their preclusion." [38] In the usual situation also, the receivership creditors would know of the existence of the receivership. Thus the receiver, for example, might have signed checks making payments on account in his capacity as receiver. The fact that the claims were "known" to the claimant who failed to assert them before the sale was the apparent basis for the "general rule" that the court found justifying the "preclusion." Without discussing the reasons for the rule, the Court, citing Clark, *on receivers,*[39] then put the rule in broader terms and pointed out that the "property" was not "liable" unless the claim had been made prior to discharge. The purchaser acquires title without "any reservation as to existing claims" and thus, if the traditional rule applied, the property would seem "released" from further liability.[40]

[35] 134 F.2d 385 (9th Cir. 1943).

[36] The reorganization device, originally at least, depended for its validity on the sale device, and thus to a considerable degree presents the same problems involved in the usual mortgage foreclosure sale. See Cohen and Simpson, "Sale Technique in Corporate Reorganization," 16 N.Y.U.L.Q. Rev. 341 (1939). See Note 23 supra.

[37] Supra note 35, at 387.

[38] Citing Chicago Joint Stock Land Bank v. Minnesota L. & T. Co., 57 F.2d 70 (8th Cir. 1932).

[39] Clark on Receivers 1008 briefly states:

> The effect of the discharge of a receiver and surrender of jurisdiction over the trust, without any reservation as to existing claims, is to release not only the receiver, but, also, the property from further liability.

Clark does not discuss the reasons for the rule.

[40] See note 35 supra at 387-388.

The court did not refer explicitly to the policy underlying the priority given receivership creditors or the "benefit" theory, to be discussed.

The fact that a receivership claim may be based on a tort rather than a tax as in the *McColgan* case, does not affect the result. In order to expedite the sale, a court, as in *Shepherd v. St. Louis Public Service Co.*[41] may decide that it should sell before it determines all the receivership liabilities and should make it a condition of the sale that the buyer assume the undetermined liabilities.[42] Even in this situation, the *Shepherd* case limited the assumption to six months and restricted the liabilities to those determined by the federal court. The courts have adopted this policy, however, without discussing the underlying reasons or necessity for it. In the *Shepherd* case, the court thus seemed to adopt the traditional equity rule, and did not give effect to the priority of the receivership creditor after the sale of the property and the settlement of the receiver's account.

Principal and Agent

Although a receivership creditor may relinquish his prior claim against receivership *res* by failure to assert it promptly, may he not proceed against the mortgagee personally on the theory that the receiver, in requesting the services of the creditor, was acting as agent of the mortgagee? For reasons that remain largely unstated in the decisions, a foreclosure receiver is not regarded as an "agent" of either the mortgagee or the mortgagor.[43] He is, instead, thought of as an agent only of the court which appointed him.

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41 64 F.2d 612 (8th Cir. 1933).

42 This accords with the practice frequently adopted in reorganizations of impressing a lien on the property sold to secure payment of items not finally determined at the time of sale. See Lion Bonding v. Karatz, 262 U.S. 77 (1923). See also Johnson v. Central Trust Co., 159 Ind. 605, 65 N.E. 1028 (1903) (dictum). To the same effect, Chicago & O. R.R. v. McCammon, 61 Fed. 772 (7th Cir. 1894) where the proceeds of sale in a mortgage foreclosure were insufficient to pay the receivership debts. The court stated:

> The rights and liabilities of a purchaser at a judicial sale are measured by the terms and conditions of the decree. If the decree directs a sale subject to liens established or to be established, or subject to debts and liabilities incurred by a receiver in the management of the property, the purchaser at the sale takes the property com onere, and liability for the claims so reserved by the decree follows the property in the hands of the purchaser, or his assignee . . . The purchaser conformed to every order in respect to the sale, and paid the whole amount of the bid in the manner provided by the decree. If error intervened in the distribution of the proceeds, or in stating a minimum price insufficient to pay all claims, it was not a fault to be charged upon the purchaser.

Id. at 774-777.

43 Clark, op. cit. supra note 39, at 38, states:

> The receiver, except in cases of agreement between the parties in case of an out-of-court receiver, is appointed by the court. Therefore, it is not possible for him to be the agent of either party to the suit. . . .

Cf. 1 Wiltsie, Mortgage Foreclosure § 126. See McLean v. Gillespie, 130 Ill. App. 356 (1906); Cohen v. Feuerstein, 80 Misc. 398, 141 N.Y. Supp. 267 (Sup. Ct. App. Tm. 1st Dep't 1913). The English rule is similar. Boehm v. Goodall, L.R. 1 Ch. 155 (1911).

The control which a mortgagee may exercise over the actions of a receiver is largely, of course, circumscribed by the court order which directed his appointment,[44] but in Workmen's Compensation and certain automobile tort cases, by statute, legislatures have held "control" of a principal over his agent is not a crucial ingredient in determining the liability of the principal. In theory, a mortgagee may, in applying for the appointment of a receiver and in submitting a proposed form of appointment order, literally write his own ticket; but, as a practical matter, he must give the receiver some authority to act, and thus to a certain extent the "control" ingredient of agency is lacking.

Quantum Meruit

The result might turn on established *quantum meruit* principles.[45] When, as is often the case, the person liable on the mortgage bond (who is almost always the mortgagor) is judgment-proof, the action on the bond for the deficiency would be without substantial value. Under these circumstances, a creditor who enhanced or conserved the value of the security would have benefited the mortgagee and might be reimbursed the amount of the benefit so conferred.

As we have seen, none of the cases discussed above which uniformly reject the receivership creditor's claim, whether against the mortgagee or a third party, make clear the basis for the result that they reach. Neither the *Shepherd* (tort) nor the *McColgan* (tax) decisions above involved a creditor who had "benefited" the property in the usual *quantum meruit* sense. In *Schiff v. L.J.E. Realty Corp.*,[46] the plaintiff, holder of a third mortgage, foreclosed and the defendant purchased. Prior to the sale the plaintiff had procured and paid for fire insurance for the benefit of the first and second mortgages in order to forestall foreclosure under those mortgages. The plaintiff sued for the amount of the premium on the policy from the date of the referee's deed at foreclosure to the expiration of the policy. The Appellate Term briefly held:

> . . . He may not recover on this cause of action because the terms of sale contained no provision of adjustment with respect to insurance and no case of unjust enrichment as such is made out.

[44] See, e.g., Scott v. Silberberg, 251 App. Div. 27, 295 N.Y. Supp. 190 (1st Dep't 1927); Manufacturers Trust Co. v. Seidlas Corp., 250 App. Div. 873 (2d Dep't 1937); Manufacturers Trust Co. v. 339 Stone Ave. Corp., 103 N.Y.L.J. 480, col. 4 (Sup. Ct. Jan. 30, 1940).

[45] As we have seen above, the mortgagee-purchaser is not a bona fide purchaser for value. See 3105 Grand Corp. v. City of New York, 288 N.Y. 178, 42 N.E.2d 475 (1942), a quantum meruit case to be discussed, which states:

> If appellant had been an outside third party purchasing at the foreclosure sale, it would have been an innocent purchaser, not charged with the equities at the sale. . . .

Id. at 185, 42 N.E.2d at 478.

[46] 36 N.Y.S.2d 56 (App. Term 1st Dep't 1942).

The court does not make clear when a "case of unjust enrichment as such" would be "made out." Generally to be enriched, however, one must have received some benefit.[47]

In the *Schiff* case, the purchaser obviously received no benefit from the fire insurance for the period prior to his purchase of the property. The purchaser thereafter probably received no benefit because the insurance policy would not have named the purchaser as an insured and, even if the receiver or mortgagee had named the purchaser, the opinion does not indicate that the purchaser was aware of the change and did not secure other parallel insurance of his own. The published terms of sale apparently did not include apportionment and assignment of the insurance.

3105 Grand Corp. v. New York,[48] involved a suit in equity by a claimant against a receivership to recover money diverted from funds that the plaintiffs beneficially owned. The receiver had wrongfully used the funds to pay real estate taxes on the receivership property. We have earlier pointed out that the Court of Appeals rejected the mortgagee-puchaser's argument that the discharge of the receiver barred the suit and that as a purchaser at a foreclosure sale it was by virtue of that fact alone not charged with the equities of third persons. The court citing the *Restatement of Restitution* held that "appellant has been unjustly enriched at the expense of plaintiffs to the extent that the taxes paid on the property were paid out of funds belonging to the plaintiffs".

The *Grand Corp.* decision does not discuss *Bonner v. Cannon*,[49] which differs from it. In the *Bonner* case, the referee ordered the sale of the bankrupt's property provided the seller paid the fees of the referee and trustee and other attorneys. The Notice of Sale set forth these conditions, but the trustee in his Report of Sale required, in addition to the above, payment of the costs of sale. These included taxes covering a period prior to the date of sale that the trustee had apparently paid. Despite this departure from his earlier order, the referee confirmed the sale in which the plaintiff had bid with his mortgage in the same terms as the Report of Sale. The court rejected the claim of the trustee on the ground that the sales were made pursuant to an order which contained no reference to the purchaser's assuming the cost of the abstracts of title. It indicated that since the mortgagee-purchaser relied on these terms the court should protect it. Unlike the *Grand Corp.* decision, it applied the same rule to the mortgagee as other purchasers.

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[47] See Restatement, Restitution § 1, comment a (1937).

[48] 288 N.Y. 178, 42 N.E.2d 475 (1942). Accord, State v. Martin, 59 Ariz. 438, 130 P.2d 48 (1942). Contra: Home Owners' Loan v. Murdock, 150 Pa. Super. 284, 28 A.2d 498 (1942). See also First National Bank v. Reily, 165 Pa. Super. 678, 67 A.2d 679 (1949).

[49] 60 F.2d 228 (10th Cir. 1932).

Generally purchasers make their bid for the property at foreclosure on the basis of its state immediately prior to the sale when it reflects the benefits which gave rise to the creditor's claim. The decisions above do not discuss the fact that, if the purchaser were the mortgagee under the usual emergency legislation enacted in the early 1930's, it could not secure a deficiency judgment for an amount in excess of the difference between an adequate price for the security and the amount of the debt.[50] In theory, therefore, the mortgagee-purchaser at a foreclosure sale could claim that, by increasing the value of the property to be sold, the claimants had under the legislation referred to above correspondingly reduced the deficiency that the purchaser might secure, and thus, within the doctrine of the *Schiff* and *Grand Corp.* cases, not "benefited" or enriched the purchaser. The reduced deficiency would have benefited the debtor but from the creditor's point of view, a claim against the debtor owner might well be of no practical value and recovery on a *quantum meruit* theory would be without value. If a claim against the debtor were of little value, however, the receivership creditor might claim the loss of a deficiency judgment against such a debtor should not affect its *quantum meruit* claim against the mortgagee.

If the deficiency were valueless and the courts were to treat it as such and apply the *quantum meruit* theory, it would result in a measure of recovery based on the value of the benefit conferred rather than the contract price of the work done. As a practical matter, a court would find it difficult to measure the value of the benefit, for example, of an elevator operator or a watchman. Presumably, building employees could collect the balance of the rent proceeds in the hands of the mortgagee on the theory that the receiver could not have collected rent if an adequate staff had not serviced the property. Since the other expenses of the receivership, however, usually absorb the balance of the rents, the creditors could not often collect on this theory.

In *Welch v. Renshaw,* [51] the receiver operated a mine at a loss under a lease which terminated if the mine was not worked. The lease was the chief asset of the receivership. The creditors who procured the receivership did not object to the receiver's reports which showed he was operating at a loss. The Colorado court held that the creditors should bear the deficit which was largely due to labor. Although in this decision like the *Schiff* case, the work probably did not "benefit" the persons who procured

[50] American Law of Property pt. 16, § 16.196 et seq. (1952). See, e.g., N.Y. Civ. Prac. Act § 1083; 2 Glenn on Mortgages § 153; Pateal, "State Legislative Relief for the Mortgage Debtor During the Depression," 5 Law & Contemp. Prob. 517 (1938).

[51] 14 Colo. App. 526, 59 Pac. 967 (1900).

the receivership;[52] the court still imposed liability. In this unusual situation, the parties who procured the receivership knew it had no substantial asset and so could probably be held to a duty to protect innocent third persons.[53]

A court might extend the *Welch* decision to apply to the different situation where the receivership creditors did not have reason to believe that the liabilities would exceed the receivership assets. Section 1547a of the New York Civil Practice Act overruling prior New York decisions to the contrary[54] in fact reaches this result and makes the petitioning creditor liable in any event to the receiver for his fees and "necessary expenses". It does not deal with other claims against the receivership and does not make clear whether the receiver could make a claim on the basis of the statute after his discharge. In the usual real property mortgage foreclosure, the mortgagee-creditor undoubtedly knows that the receiver will incur liabilities and in general the purposes for which he will incur them. The result would differ in corporate mortgage foreclosures involving many mortgagees where even the petitioning creditors might not know what the potential liabilities of the receivership might be. No reported decisions appear to have made this distinction, however, and to do so would make

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[52] In Berry v. Rood, 225 Mo. 85, 123 S.W. 888 (1910), the court applied the theory to apportion the costs of a receivership improperly procured by the complainant among other creditors who received the benefit of it. See also Ciavatta v. Munn Realty Corp., 106 N.J. Eq. 21, 149 Atl. 809 (Ch. 1930) (receiver of insolvent corporation property for mortgagees and conferred benefits on mortgagees, held they should contribute to the extent of foreclosures expenses they saved). See also Doggett v. Johnson, 79 Mont. 499, 257 Pac. 267 (1927); Mallette v. Ft. Worth Pharmacy Co., 21 Tex. Civ. App. 267, 51 S.W. 859 (1899). Cf. Palmer v. Texas, 212 U.S. 118 (1908) where the fund paid the receivership expenses pending during appeal.

[53] Cohen v. Feuerstein, 80 Misc. 398, 141 N.Y. Supp. 267 (Sup. Ct. 1st Dep't 1913) rejected the claim of a receiver against a plaintiff in foreclosure who stated he made necessary repairs when the defendant who procured the receivership knew that the receivership did not have on hand sufficient assets to pay for the repairs. The Appellate Term rejected the claim on the ground:

> . . . it was certainly the intention of both parties that the expenses should be defrayed from the income of the property and it was not foreseen that the receivership would terminate before sufficient funds were collected.

Id. at 401, 141 N.Y. Supp. at 269. Where the court can foresee the receivership res may be insufficient to cover expenses, it can and should require the party procuring the receivership to post a bond. See Fosdick v. Schall, 99 U.S. 235 (1878).

[54] N.Y. Civ. Prac. Act § 1547a apparently reverses the following decisions which, on their facts, seem to reject the above argument: Title Guarantee & Trust Co. v. Abrams, 248 App. Div. 595, 287 N.Y. Supp. 360 (2d Dep't 1936); Title Guarantee v. Toralek, 247 App. Div. 915, 287 N.Y. Supp. 233 (2d Dep't 1936); Emigrant Industrial Savings Bank v. Feldblum Realty, 238 App. Div. 231, 264 N.Y. Supp. 104 (1st Dep't 1934); Handman v. Madonick, 235 App. Div. 47, 256 N.Y. Supp. 188 (1st Dep't 1932). In Scott v. Silberberg, 251 App. Div. 27, 295 N.Y. Supp. 190 (1st Dep't 1937), despite the statute above, the court rejected the receiver's claim where the order of appointment provided that the receiver should not incur obligations in excess of the moneys in his hands.

the fortuity of the mortgagees' knowledge determine whether the receivership creditors could collect.

If a court were to find the mortgagee liable wherever receivership obligations in fact exceeded assets, then it might also find that the discharge of the receiver and the selling or distributing of the receivership assets would not end this liability even where the assets originally were sufficient to have paid all receivership liabilities. In effect, such a view would hold that the policy underlying the priority given receivership creditors survives a sale of the property and the settling of the receiver's account.

CONCLUSION

The unpaid receivership creditor can claim against the discharged receiver, the owner-mortgagor, the purchaser or the mortgagee. Probably he cannot successfully claim against the discharged receiver if he knew or should have known that he was dealing with or had a claim against a receiver who in the nature of things would ultimately be discharged. Although there are few decisions on the matter, a court would probably hold that the receivership creditor may collect from the owner-mortgagor whose default was responsible for the receivership. The owner-mortgagor, however, is usually judgment proof. The receivership creditor cannot successfully claim against the third party purchaser if he is a *bona fide* purchaser for value who, under established principles, acquires the legal title his seller had free and clear of all claims other than liens of record. In the absence of statute, the problem of claiming against a mortgagee presents a more difficult problem. The courts do not apply the policy underlying the priority given receivership creditors to preserve their claims against mortgagees after discharge of the receiver, perhaps because in most instances the mortgagees would have changed their position before the creditors asserted their claims. In a few situations where, among other things, the deficiency judgment is valueless and the mortgagee has not changed his position, the receivership creditor may have benefited the mortgagee and so be in a position to rely upon established *quantum meruit* principles. Most of the decisions involving mortgagees, insofar as they set forth the reasons for their results, rely on the traditional sales rule that a purchaser of legal title takes free and clear of equities of which he has no notice.

By making clear that in general a foreclosure purchaser does not assume undisclosed liabilities, courts have made such a purchase less speculative. To this extent, courts have improved the foreclosure sale device upon which the value of non-government guaranteed mortgages ultimately depends.