Security Devices - Ranking of Collateral Mortgage Securing Reissued Mortgage Note

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more protection than subsequent purchasers, as Louisiana apparently does.

With the law in its present state, it seems apparent that recordation is essential to give mortgages effectiveness against third persons. If it is desirable to place mortgages on the same footing as conveyances and give them effect against third persons from the time of filing, whether or not they are ever recorded, it seems that this will have to be accomplished through the appropriate constitutional processes. Until the constitutional barrier is overcome, mortgages should be effective against third persons from the time of filing only if the filing is followed by timely recordation.

Carl H. Hanchey

SECURITY DEVICES—RANKING OF COLLATERAL MORTGAGE SECURING REISSUED MORTGAGE NOTE

Defendant was indebted to one Morgan for $114,000, a sum secured by the pledge of four collateral mortgage notes bearing the face amount of $220,000. Subsequent to the recordation of the collateral mortgages defendant had granted various other duly recorded mortgages on the same property. Later plaintiff paid defendant's indebtedness to Morgan, and defendant reissued the collateral mortgage notes to plaintiff in pledge to secure its promissory note for $120,000. Plaintiff instituted proceedings to enforce the collateral mortgage, and holders of the notes secured by the mortgages granted subsequent to recordation of the collateral mortgage but prior to reissuance of the collateral mortgage notes intervened asserting priority over plaintiff. The trial court upheld the interveners' claims, and on appeal the Fourth Circuit Court of Appeal affirmed that portion of the judgment. Held, inter alia, a collateral mortgage, in competition with other mortgages, is ranked from the date of issuance or reissuance of the note secured by it and not from the date of recordation of the collateral mortgage. Odom v. Cherokee Homes, Inc., 165 So. 2d 855 (La. App. 1st Cir. 1964), writs denied, 246 La. 867, 167 So. 2d 677 (“no error of law”).

As the Louisiana conventional mortgage is an accessory security device,¹ it must be founded on a principal debt² which it

1. LA. CIVIL CODE art. 3284 (1870).
2. Id. art. 3285.
is intended to secure, and when the principal debt is extin-
guished the mortgage likewise disappears. If the mortgage
has been given for a specific debt, and the debt is extin-
guished, no reissue of the mortgage note or later advance on the note can revive the mortgage. Obviously, the commercial possibili-
ties of this type of mortgage are very limited, primarily because a single mortgage cannot secure transactions where the amount advanced fluctuates and frequently is totally paid, or where different persons make advances from time to time to the same mortgagor. This commercial void left open by the ordinary
conventional mortgage is filled in Louisiana by two closely re-
lated security devices: the mortgage for future advances, and the collateral mortgage.

Where continuous dealings between the same parties are an-
ticipated, and the security of a mortgage is desirable, the mort-
gage to secure future advances is available for use. As a con-

3. The methods of extinguishing obligations are set forth in La. Civil Code art. 2130 (1870). Note, however, that when the debt is extinguished by novation it is possible to preserve the mortgage which secured the original obligation. Id. art. 2195.

4. Id. arts. 3285, 3411 (4).


7. However, the maker and his succession can be liable on the reissued note as for an ordinary debt. Succession of LeBesque, 159 La. 1087, 72 So. 745 (1916); Hill v. Hall, 4 Rob. 416 (La. 1843); cf. Taylor v. Rous, Mann. Unrep. Cas. 331 (La. 1880). See also Schepp v. Smith, 35 La. Ann. 1, 7 (1883), where a dis-
senting Justice takes the position that when a mortgage note is returned to the maker and by him reissued, the note may be an enforceable negotiable instrument, but that the mortgage once attached to the note is now dead.


9. This Note attempts to use the terms "mortgage for future advances" and "collateral mortgage" in the sense defined at notes 10 through 19 infra, and notes 20 through 25 infra. However, it must be admitted that the jurisprudence has not always made such a distinction, and frequently it is difficult to discern what type mortgage exists in a given case.

10. At least two common transactions fall within this area: the first is where the parties seek to secure a single agreement for cumulative advances up to a cer-
tain sum, usually for a specified purpose; the second is where the parties seek to secure the balance of an open account, upon which periodic debits and credits are contemplated. The use of the mortgage device to secure these two transactions may not be equally in accord with the principle of accessory, and perhaps it could be argued that the Code does not so clearly allow the second type as it seems to sanction the first. La. Civil Code arts. 3292-3293 (1870). However, no case has ever attempted such a distinction; in fact the jurisprudence has been con-
sistent in equating the mortgage for obligations which have not yet risen into
cession to commercial needs this type of mortgage is expressly sanctioned by the Civil Code, though it may depart somewhat from the accessory principle of the ordinary conventional mortgage. It is not necessary that any primary obligation be in existence at the date of the mortgage, and it is not essential that the mortgage state on its face that it is given to secure future advances. Whether the mortgage is classified as one to secure existence with the mortgage to secure the balance of an open account. See, e.g., In re York, 30 Fed. Cas. 811 (No. 18,138) (D. La. 1870), which involved a mortgage given to secure the balance of an open account. The mortgage was drawn in the amount of $25,000, over $50,000 in total advances were actually made, and somewhat over $25,000 had been repaid, leaving a balance of slightly more than $25,000. It was held that the mortgage was good for its face amount and was not extinguished by reimbursement of the first $25,000. See also Alex Hutchinson & Son v. Riggs-Terrell Lumber Co., 133 La. 355, 70 So. 324 (1915); cf. Edward J. Gay & Co. v. Deynoot, 27 La. Ann. 249 (1875); Durrire v. Key, 20 La. Ann. 154 (1888).

Additionally, today the future advance mortgage has found special uses, and received statutory recognition in relation to other transactions. See LA. R.S. 6:767-767.1, 6:835.1-835.2 (Supp. 1964) (advance on outstanding mortgage by homestead association for taxes and other purposes); id. 9:4801 (mortgage for future advances recorded before labor begun or material furnished on construction project). Peculiar problems may be introduced by these special statutes. See text of these statutes at note 30 infra.

11. LA. CIVIL CODE arts. 3292-93 (1870). The French Civil Code contains no corresponding articles, however, it is generally conceded that a mortgage for future advances is valid in France. See 2 PLANIOL, CIVIL LAW TREATISE (AN ENGLISH TRANSLATION BY THE LOUISIANA STATE LAW INSTITUTE) no. 2652 (1959); In re York, 30 Fed. Cas. 811 (No. 18,138) (D. La. 1870); Walmsley v. Resweber, 105 La. 522, 535, 30 So. 5, 12 (1899) (concurring opinion); Pickersgill & Co. v. Brown, 7 La. Ann. 297 (1852); cf. Alex Hutchinson & Son v. Riggs-Terrell Lumber Co., 133 La. 355, 70 So. 324 (1915).

12. This possible departure from the principle of accessory lies in the fact that it is arguable some vitality is accorded to the mortgage before the principal obligation comes into existence—a retroactive effect for ranking purposes after the advance is made. The French commentators have explained a similar result there by arguing that actually the contract to make the advances or to sell on open account serves as the principal obligation and that the later execution is only the fulfillment of the obligation. Where the future advance is not obligatory from the terms of the original contract, this theory may not offer a complete explanation. However, the same result has been rationalized even under the optional advance agreement on the ground that modern business practices prevent the obligations from being purely potestative. See generally Comment, 34 Tul. L. REV. 800, 806 (1960), where the French position is thoroughly investigated. From the terms of LA. CIVIL CODE art. 3293 (1870) the same explanation may be plausible: "... The fulfillment of the promise ... shall impart to the mortgage a retroactive effect to the time of the contract." (Emphasis added.) It may be possible from the terms of the Code to fully reconcile the mortgage for future advances with the principle of accessory. The mortgage must state a maximum sum on its face, LA. CIVIL CODE art. 3309 (1870), and it could be contended that when the total advances made equalled the maximum amount secured by the mortgage, then subsequent payments, reducing the balance due, would only cause the mortgage to be extinguished pro tanto—later advances would thus be unsecured. However, this rationale has not found approval in the jurisprudence.


future advances is determined solely from the intention of the parties,\(^{15}\) and to be secured by the mortgage the advances must be within the contemplated life of the mortgage.\(^{15}\) Of course, until the advances are actually made, the mortgage is totally unenforceable.\(^{16}\) It is yet unclear what effect will flow if the mortgagor is not obligated to make the future advance, or the mortgagor is not actually obligated to borrow from the mortgagee. Some cases have indicated that such an arrangement is equivalent to an obligation contracted on a potestative condition, and have concluded that the mortgage could only take effect from the date of the advance.\(^{17}\) Other cases, while purporting to rest on the fact that the Code expressly allows mortgages for future advances, have still found it necessary to conclude that the mortgagee was bound to make the advances if so requested.\(^{19}\)

On the other hand, where the mortgagor anticipates his future borrowing may be from different persons he may choose to draw his security in the form of a collateral mortgage, a creature of practice which has been sanctioned by the jurisprudence. Usually, the mortgage is drawn in favor of future holders and recorded in the name of a nominal mortgagee.\(^{20}\) The note identified with the mortgage\(^{21}\) may then be pledged as collateral security for obligations, and though the obligation be extinguished and the mortgage note returned to the maker, the existence of the mortgage remains unaffected.\(^{22}\) Subsequently, contrary to

\(^{15}\) Ibid.
\(^{16}\) Flower v. O’Bannon, 43 La. Ann. 1042, 10 So. 376 (1891).
\(^{17}\) See 2 Planiol, Civil Law Treatise (An English Translation by the Louisiana State Law Institute) no. 2652 (1959). At the time the credit comes into being, a principal obligation is created to which the mortgage then attaches.
\(^{20}\) See generally Comment, 34 Tul. L. Rev. 800, 808 (1960). Whether the mortgagor was indebted to the nominal mortgagee is immaterial. Richardson v. Cramer, 28 La. Ann. 357 (1876).
\(^{21}\) To give mortgage rights to note holders, the note must be identified in the act of mortgage, and it must be clear that the notes are secured by the mortgage. Durrive v. Key, 20 La. Ann. 154 (1868).
\(^{22}\) Lacoste v. Hickey, 203 La. 794, 14 So. 2d 639 (1943) (dictum); Hammond State Bank & Trust Co. v. Broderick, 179 La. 693, 154 So. 739 (1934); Industrial Loan Co. v. Hendricks, 179 La. 342, 154 So. 18 (1934); Buckeye Cotton Oil Co. v. Amrhein, 168 La. 120, 121 So. 602 (1929); Citizens’ Nat’l Bank v. Loranger, 163 La. 868, 113 So. 129 (1927); Hollingsworth v. Ratcliff, 162 La. 281, 110 So. 422 (1926); Commercial Germania Trust & Savings Bank v. White, 145 La. 54, 51 So. 753 (1919) (dictum); Succession of Phillips, 49 La. Ann. 1019, 22 So. 202 (1897); Herber v. Thompson, 47 La. Ann. 700, 17 So. 318 (1895); Levy v. Ford, 41 La. Ann. 873, 6 So. 671 (1889); Rex Finance Co. v. Cary, 145 So. 2d 672 (La. App. 4th Cir. 1962), aff’d 244 La. 675, 154 So. 2d 360 (1963); Lampton Reid & Co. v. Fortenberry, 168 So. 36 (La. App. 1st Cir. 1936).
the result of a similar transaction based upon the ordinary conventional mortgage, the mortgagor is free to reissue the mortgage note as security for other obligations. The mortgagor could accomplish the same result by issuing separate mortgages to secure later debts after paying earlier debts or otherwise extinguishing other mortgages; the collateral mortgage allows him to accomplish the same thing at much less expense and trouble. At any given time, the pledgee of the mortgage note is allowed to enforce the mortgage only to the extent of the outstanding obligation for which the mortgage note is then pledged.

In competition between creditors holding ordinary conventional mortgages, the competing mortgages will rank from date of filing in the recorder's office, at least if timely recorded thereafter. In relation to the mortgage for future advances, the Code provides that the "fulfillment of the promise . . . impart[s] to the mortgage a retrospective effect to the time of the contract," and the jurisprudence generally agrees that when the principal obligation is actually fulfilled, the mortgage securing it will rank from recordation. Thus, if another mortgage is granted after the mortgage for future advances is recorded, and the advance is subsequently made, the other mortgage will be junior in rank. Special statutory provisions on future ad-

23. See cases cited in note 22 supra.
25. LA. CODE OF CIVIL PROCEDURE art. 696 (1960): "... The pledgee may enforce the entire right judicially, unless it is an obligation of the pledgor, in which event it may be enforced only to the extent of the indebtedness secured by the pledge." See, e.g., Crowley Bank & Trust Co. v. Hurd, 137 La. 787, 69 So. 175 (1915).
26. See LA. CIVIL CODE arts. 3329, 3342, 3358 (1870), as modified by LA. R.S. 9:5141 (1950). Compare LA. CONST. art. XIX, § 19. See also Kinnebrew v. Tri-Con Production Corp., 244 La. 879, 154 So. 2d 433 (1963), noted 25 LA. L. REV. 783 (1965), holding that where the recordation is timely made after filing, the mortgage will rank from date of filing. Though Kinnebrew reflects the current rule, most of the cases in the area under consideration were decided prior to the enactment of the statutory basis for Kinnebrew and at a time when recordation date was the rule. To simplify the text discussion, the term "recordation" will be utilized to indicate the effective date for ranking purposes in the light of Kinnebrew.
27. LA. CIVIL CODE art. 3293 (1870).
vance mortgages in certain situations also indicate a similar result. When an earlier recorded collateral mortgage comes into competition with another mortgage recorded prior to the pledge of the mortgage notes, the result is less clear. Language may be gleaned from several cases indicating that the recordation date of the collateral mortgage determines its rank, just as the rank of the ordinary conventional mortgage and the mortgage for future advances is determined. These cases obviously draw upon the strong analogy between the collateral mortgage and the mortgage for future advances. However, when an intervening mortgage is involved, the courts have refused to rely on these broad statements, and they have instead ranked the collateral mortgage from the date of the obligation for which it was pledged or replugged.

In the instant case little more than a determination of fact was required, and once it was resolved that the collateral mort-

30. La. R.S. 6:767 (Supp. 1964): "During the existence of any ... mortgage any association may advance to the borrower money for the payment of taxes, insurance premiums, special assessments on, repairs, additions and improvements to and remodeling and maintenance of, the property on which the original loan was made, provided that the aggregate of such advances when added to the balance due on the amount of the original loan shall not exceed the original amount of said loan. These advances ... shall be secured by the same ... mortgage securing the original note. . . ." (Emphasis added.) Id. 6:767.1 provides that if the advance is made for any purpose other than those listed in the above statute then the advance shall not prime any encumbrance recorded between the time of recordation of the original mortgage and the date of the advance. Otherwise, the advances are effective from the date of the original mortgage’s recordation. See also id. 6:835.1-835.2.

Id. 9:4801C: "When a mortgage note has been executed by the owner of the immovable for the purpose of securing advances to be made in the future, and the mortgage has been recorded and the note delivered to the lender before any work or labor has begun or material been furnished, or before the recordation of a building contract, the amount of the advances made thereafter shall be deemed secured by the mortgage in precedence to and with priority over any of the claims had under the privileges conferred by Sub-Section A of this Section, except as stated in Sub-Section D hereof [dealing with laborers’ privilege]."

See also id. 3:207 (1950).


33. E.g., Walmsley v. Resweber, 105 La. 522, 532, 30 So. 5, 9 (1899): "To illustrate, A. executes a mortgage in favor of B. to secure the payment of six notes of $500 each. He delivers two of the notes to B., and retains the four others in his own possession. Some time after, he executes a mortgage in favor of C. He cannot, after he has executed this mortgage in favor of C., place the four notes in circulation to the prejudice of C.’s mortgage." Cf. Hammond State Bank & Trust Co. v. Broderick, 179 La. 698, 154 So. 739 (1934) (intervening attachment of homestead rights); Richardson v. Cramer, 28 La. Ann. 357 (1876); D’Meza v. Generes, 22 La. Ann. 285 (1870); Rex Finance Co. v. Cary, 145 So. 2d 672 (La. App. 4th Cir. 1962), aff’d 244 La. 675, 154 So. 2d 360 (1963); Scallan v. Simmesport State Bank, 129 So. 2d 49 (La. App. 3d Cir. 1961).
gage note had been repledged to the plaintiff rather than pur-
chased by him, the case called for application of established rules
concerning reissued collateral mortgages. The determination of
fact by the court can hardly be questioned. Yet the case serves
as a particularly good illustration of the incongruity between
the ranking dates of the mortgage for future advances and the
collateral mortgage.

Though theoretical distinctions\textsuperscript{34} may be urged between the
collateral mortgage and the mortgage for future advances, the
two security devices are strikingly similar in function, and it
has even been assumed that there is no real distinction between
the two.\textsuperscript{35} Though never clearly expressed, perhaps the under-
lying reason for the later ranking date of the collateral mortgage
is a fear that it could be readily utilized to defraud creditors
through the simple expedient of executing and recording a col-
lateral mortgage in the hope of later pledging it to a friendly or
collusive creditor who could then prime all intervening mort-
gagees. Certainly the collateral mortgage could be used for any
purpose germane to the mortgage for future advances,\textsuperscript{36} though
the latter may not be used for the entire range of purposes
served by the collateral mortgage. Any fear that collateral mort-

\textsuperscript{34} The prime difference lies in the fact the mortgage for future advances
could be drawn in such a fashion that there would be an obligation to make the
advance on the part of the mortgagee and a corresponding obligation in the mort-
gagor to utilize the mortgage, thus abrogating any possible argument based on
potestative conditions, see text accompanying notes 18 and 19 \textit{supra}, while the
collateral mortgage would always arguably be based on a potestative condition,
since the mortgagor would never be obligated to utilize it as security, even if he
Ann. 297 (1852), \textit{with} Walmsley v. Resweber, 105 La. 522, 30 So. 5 (1899) and

\textsuperscript{35} See Comment, 34 \textit{TUL. L. REV.} 800, 808 (1960).

290, § 1: "... [W]henever a pledge of any instrument ... listed in this article
[promissory notes, bills of exchange, bills of lading, stocks, bonds, etc.] is made
to secure a particular loan or debt, or to secure advances to be made up to a cer-
tain amount, and, if so desired or provided, to secure any other obligations or
liabilities of the pledger to the pledgee, then existing or thereafter arising, up to
the limit of the pledge, and the pledged instrument ... remains ... in the hands
of the pledgee, the instrument ... may remain in pledge to the pledgee or, with-
out withdrawal from the hands of the pledgee, be repledged to the pledgee to
secure at any time any renewal or renewals of the original loan or any part there-
of or any new or additional loans, even though the original loan has been reduced
or paid, up to the total limit which it was agreed should be secured by the pledge,
and, if so desired or provided, to secure any other obligations or liabilities of the
pledger to the pledgee, then existing or thereafter arising, up to the limit of the
pledge, without any added notification or other formality, and the pledge shall be
valid as well against third persons as against the pledger thereof, if made in good
faith; and such renewals, additional loans and advances or other obligations or
liabilities shall be secured by the collateral to the same extent as if they came into
existence when the instrument ... was originally pledged. ..." (Emphasis added.)
gages could be used for purposes of fraud surely must overlook the fact that the mortgage for future advances could likewise be used for fraudulent purposes, and in spite of this possibility the legislature decided to grant the latter the benefit of a retroactive operation for its ranking date. If the collateral mortgage's existence is to be supported by analogy to the mortgage for future advances, it is arguable that the policy behind the latter should weigh toward granting the former a similar retroactive effect. Further, fraud arguments ignore creditors' remedies under both state and federal law.

In both types of mortgages the existence of the claim or potential claim and its maximum amount are inscribed on the public records. While a prospective creditor may not be able to determine from the public records whether a given mortgage is an ordinary conventional mortgage or a mortgage intended by the mortgagor and mortgagee to secure future advances, the standard form for collateral mortgages will carry notice of the instrument's character. Thus, whether the mortgage be one for future advances or for collateral security, in neither case may a creditor logically argue that he was misled about the potential existence of claims against the mortgagor's property. Based on the information acquired from the public records, the potential lender is free to decide whether to accept a later recorded mortgage as security for an obligation. It seems plausible that beyond this information about potential claims, it is none of the potential creditor's concern whether there is an outstanding obligation for which the mortgage is presently security. Protection against abuse of either type of mortgage is afforded, since the mortgagor risks a great deal by allowing recordation of an unused mortgage: the amount he could obtain on any subsequent mortgage is considerably reduced.

It may be seriously contended that to rank the collateral mortgage from date of recordation of the mortgage rather than pledge of the mortgage note would be too gross a deviation from the principle of accessory — a deviation not sufficiently countenanced by analogy to the mortgage for future advances. Cer-

tainly it must be conceded that the principle of accessory is basic to civilian mortgage law; on the other hand, the mortgage for future advances does not constitute the sole departure from the accessorial theory of mortgage. For example, both the private building contract law and, to a lesser extent, the law governing homestead associations recognize use of a mortgage in situations which could not be covered by the ordinary conventional mortgage because of its accessory nature, and in the Civil Code the whole system of tacit mortgages operates with a retroactive date similar to the mortgage for future advances.

Ranking the collateral mortgage from recordation would probably simplify its repledge and somewhat reduce the cost of furnishing security, particularly in the case of relatively small loans on which the normal costs of insuring security would otherwise be prohibitive. As far as the rank of the collateral mortgage in competition with later recorded mortgages is concerned, it may be surmised that many lenders would be satisfied with a title opinion of a reputable attorney or a mortgage certificate rendered at the time of recordation. However, the careful attorney would likely insist upon a new examination at time of repledge of the collateral mortgage notes in any event, to ascertain whether security devices which prime mortgages have attached to the property subsequent to the original examination or certificate.

Perhaps the gravest indictment of the present rule on the ranking of collateral mortgages is illustrated in the Odum case. Both the pledgor and the pledgee were apparently acting under

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42. Id. 676-676.1 (Supp. 1964).
43. See 2 Planiol, Civil Law Treatise (An English Translation by the Louisiana State Law Institute) no. 2652 (1959).
44. E.g., federal tax liens. See Dainow, Security Devices 207 (1956).
45. One difficulty with the present rule is illustrated in Scallan v. Simmesport State Bank, 129 So. 2d 49 (La. App. 3d Cir. 1961), where a collateral mortgage was recorded in 1949, and the mortgage note was either issued or reissued in 1956 to secure payment of a note. In the interim the mortgagor and his wife were divorced, and he conveyed the property against which the mortgage was inscribed to the latter in settlement of her community property rights. The pledgee sought to enforce the mortgage, and the transferees from the wife succeeded in obtaining an injunction. "[T]he mortgage remained dormant and imperfect until the notes were reissued on which date it revived and took effect but could not do so to the prejudice to the intervening right of Mrs. Scallan who had acquired record title to the property." Id. at 52-53. The change suggested in this Note would require a reversal in the Scallan decision; yet it can hardly be argued that transferees would be prejudiced for the potential claim would clearly appear from the public records. It would thus be up to the transferee to refuse title until the inscription was erased.
professional advice, and it is clear there was an intent to preserve the rank of the collateral mortgage over the mortgages of the interveners. This rank could have been preserved by novating the debt, coupled with an express reservation of the mortgage right, or by having the plaintiff purchase the mortgage note. Notwithstanding these possibilities, very similar action of the parties here failed to accomplish the intended result. Can such subtle distinctions as exist in this area of the law be defended in light of their operation to defeat the clear intent of contracting parties who act under professional advice?

Probably it would have been inappropriate for the Odom court, as an intermediate appellate court faced with precedents of the Supreme Court, to rule that the collateral mortgage ranks from date of recordation instead of date of pledge or repledge of the mortgage notes. Since the rule is one of the jurisprudence rather than of the legislature, the Supreme Court could certainly make a change, though its likelihood of so acting is greatly reduced by the well-known reluctance to tamper with prior holdings upon which persons may have relied in acquiring rights in and against immovable property. In spite of this recognized judicial self restraint, in dissenting from refusal to grant writs in Odom, the Chief Justice may have indicated dissatisfaction with the rule when he stated that the judgment was "not only erroneous but most inequitable." It is thus submitted that the legislature should consider extending the rule of retroactivity to provide that the collateral mortgage, like the mortgage for future advances, will be ranked from date of recordation.

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46. LA. CIVIL CODE art. 2195 (1870).
47. See Lampton Reid & Co. v. Fortenberry, 168 So. 36, 38-39, on rehearing, 168 So. 711, 712 (La. App. 1st Cir. 1936).
49. In light of the Odom holding, any such change would probably have to operate only prospectively to avoid constitutional difficulties. However, consideration of this point is beyond the scope of this Note.