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SECURITY DEVICES

*Gerald Le Van**

COLLATERAL MORTGAGES

After more than a century of considerable confusion about mortgages to secure future advances and collateral mortgages, much of the mist has been cleared away this year by two decisions, *Thrift Funds Canal, Inc. v. Foy*[1] and *New Orleans Silversmiths, Inc. v. Toups*.[2]

The decision of the court of appeal in *Foy* was discussed at length in this *Symposium* last year in connection with a brief review of mortgages to secure future advances and collateral mortgages.[3] In 1963, Foy executed a note in the amount of $10,000 secured by a first mortgage on an unimproved lot in Jefferson Parish. Three years later, he executed a note to the same creditor in the amount of $3,000, the second note reciting that it was also secured by the 1963 mortgage. In 1968, Foy executed a third note, this time in favor of Thrift Funds Canal, Inc., secured by a second mortgage on the same lot. The original mortgage had not been extinguished by payment of the $10,000 note at the time the $3,000 note was executed. Upon foreclosure of the second mortgage by Thrift Funds, the Fourth Circuit[4] held that since the original act of mortgage did not *recite* that it was given to secure future advances, the second note (for $3,000) was not secured thereby; or, in other words, a mortgage granted to secure future advances must so state.

In the course of affirming the Fourth Circuit (for different reasons), the opinion of the supreme court written by Justice Sanders treats a number of issues which could have been omitted in resolving *Foy* on its rather peculiar facts. However, it appears that four members of the court selected *Foy* as a vehicle for resolving, at least in dictum, a number of issues involving future advances-collateral mortgages about which lawyers have debated

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1. 261 La. 573, 260 So.2d 628 (1972).

2. 261 So.2d 252 (La. App. 4th Cir. 1972), *writs denied*, 262 La. 309, 263 So.2d 47 (1972).

3. 32 LA. L. REV. 233 (1972).

4. 242 So.2d 253 (La. App. 4th Cir. 1970).

for years. For this reason, *Foy* is probably one of the most important Louisiana decisions in the area of secured transactions.

The opinion begins by classifying all conventional mortgages into three categories: (1) mortgages to secure specific debts, (2) mortgages to secure future advances, and (3) collateral mortgages. The latter is defined as follows:

> "A collateral mortgage is a mortgage designed, *not to directly* secure an existing debt, but to secure a mortgage note pledged as collateral security for a debt or a succession of debts. The mortgage is usually drawn in favor of future holders, represented by a nominal mortgagee. For convenience in pledging, the companion promissory note is usually payable to bearer on demand. The maker may reissue the note from time to time."[5] (Citations omitted.)

The court refused to classify the *Foy* first mortgage as a collateral mortgage since it secured a specific debt and possessed "none of the formal characteristics of a collateral mortgage." It rejected the argument that reference in the printed act of mortgage to multiple notes contemplated anything other than the possibility that the specific debt might be represented by multiple notes or that the printed reference to "any future holder" of such notes contemplated anyone other than the transferee by negotiation of the specific note described in the mortgage. Nor was the court impressed that the mortgage form referred to "other indebtedness secured hereby," which referred to nothing more than advances for taxes, insurance premiums, and attorney fees which are customarily secured by the act of mortgage.

The supreme court rejected the Fourth Circuit's position that in order to secure a future advance, the act of mortgage must so recite. According to the opinion:

> "It may be phrased as security for an existing debt, when no debt in fact exists, and yet secure a later debt *in accordance with the intention of the parties.* . . . We find nothing in the present record, however, to show that, *when the first mortgage was executed*, the parties intended that it secure future advances. Quite to the contrary, the record reflects that it was designed only to secure an existing debt, a loan made

5. 261 La. 573, 579, 260 So.2d 628, 630 (1972). (Emphasis added.)

> contemporaneously with the execution of the mortgage. . . . We conclude that the present mortgage is one for a specific debt."[6] (Emphasis added.)

Justices Hamlin, Dixon, and Summers dissented. Justice Hamlin found evidence in the record satisfactory to him that Foy and his original mortgagee had agreed that the first mortgage would secure future advances and that the agreement was broad enough to cover the note in question. He seemed to place great reliance in the mortgage form provisions referred to above. Justice Dixon felt that *Walmsley v. Resweber*[7] should control and that the intent for the mortgage to secure future advances should be reflected in its face. He stated: "Our holding implies that these loans are unsecured in absence of *parol evidence* to establish the intent of the parties at the time the mortgage was executed."[8] (Emphasis added.)

The majority opinion makes clear that whether or not a mortgage may secure money yet to be lent need not be disclosed by the public records. To the title examiner, this means that every mortgage must be assumed to secure the maximum amount stated therein. To the lender who utilizes a mortgage which does not recite the parties' contemporaneous intention to secure future loans, it means that he must preserve or obtain evidence of that intention. To the cautious practitioner, the *Foy* decision means, as always, that the better part of wisdom is to recite the intention to secure future advances in the act of mortgage. The decision is a welcome relief to those practitioners who have omitted such recitals in existing mortgages as well as a warning that they had best change their ways or be prepared to bear a rather heavy burden of proof. I must join Justice Dixon in questioning the desirability of permitting parol evidence to vary a mortgage which, on its face, may look like it secures only a single specific indebtedness. The temptation to confect such evidence in retrospect should be discouraged.

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6. *Id.* at 582-83, 260 So.2d at 631. The court specifically rejected as dictum a statement to the contrary in *Walmsley v. Resweber*, 105 La. 522, 30 So. 5 (1901); "In *Walmsley*, the basic question was one of priority as between a 'collateral' mortgage and a third person's mortgage that attached while the collateral mortgage notes were in the hands of the maker." *Id* at 583-84 n.3, 260 So.2d at 632 n.3.

7. 105 La. 522, 30 So. 5 (1901).

8. 261 La. 573, 604, 260 So.2d 631, 639 (1972).

New Orleans Silversmiths, Inc. v. Toups dealt with competing collateral mortgages, each of which fit the definition of "collateral mortgage" set forth in *Foy*. Toups borrowed $75,000 from the Hibernia National Bank secured by the pledge of a collateral mortgage note in the amount of $150,000. The collateral mortgage affected lots in the City of New Orleans. The pledged note secured the initial loans and any other indebtedness due the bank up to $150,000. Later in the year, he executed a second collateral mortgage affecting the same property securing a collateral mortgage note for $50,000, which note he pledged to Silversmiths as security for a $35,000 loan. Thereafter, a corporation in which Toups was interested borrowed $95,000 from the Hibernia Bank. Toups personally guaranteed the corporate loan, and the original collateral mortgage note, which had remained in the bank's possession, likewise secured its repayment. Toups defaulted on his loan from Silversmiths and the latter foreclosed. The bank intervened, claiming the first $150,000 of proceeds of foreclosure as pledgee of the collateral mortgage note both to secure Toups' personal debt of $75,000 and to secure $75,000 of the $95,000 corporate debt. Silversmiths admitted that the bank primed as to the original loan to Toups but claimed that its second mortgage primed the Hibernia as to the corporate loan. In essence, counsel for Silversmiths argued:

(1) that a collateral mortgage becomes effective as to third persons only from the time it is recorded or from the time the collateral mortgage note is pledged, whichever is later;
(2) that the collateral mortgage note given the bank could not have been pledged to secure the loan to the corporation until the corporate loan was made;
(3) that the corporate loan was made subsequent to the recordation of the collateral mortgage note which Silversmiths held; and thus
(4) that the Silversmiths mortgage must necessarily prime the bank mortgage insofar as the latter secured the corporate loan.

On the other hand, counsel for the bank argued that its collateral mortgage note had been pledged once and for all on the date of original delivery to the bank (the mortgage having been previously recorded) and that the date of original delivery fixed the

rank of its mortgage regardless of the date of any actual loans which it might secure.

In the case of the classical mortgage to secure future advances, article 3293 of the Civil Code[9] gives the mortgage "a retrospective effect to the time of the *contract.*" Apparently, the "contract" referred to is the act of mortgage itself which, of course, is not effective as against third persons until properly recorded. However, it is doubtful that this article was drafted in contemplation of the collateral mortgage device as we know it. In 1952, article 3158 of the Civil Code, dealing with the formalities of *pledge*, was amended to give retroactive effect to a *pledge* to secure future advances so long as the thing pledged remained in the hands of the pledgee to secure

> "a particular loan . . . or to secure advances to be made up to a certain amount, and if so desired to secure any other obligations or liabilities of the pledgor to the pledgee then existing *or thereafter arising* . . . 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 or item *was originally pledged* . . . ." (Emphasis added.)

By design or accident, the term "shall be secured by the same *collateral*" could refer not only to a pledged note, but also to whatever "collateral" secures the payment of that note. From this premise, one can plausibly reason that if the collateral mortgage note is to be given retroactive effect, like effect is to be given to the rank of the collateral mortgage itself. This is the way the Fourth Circuit resolved the ranking problem.

Judge Lemmon dissented, principally on the ground that article 3158 could not affect the rank of the collateral *mortgage* but only the rank of the pledged note. Writs were refused by the supreme court on the basis that the result was correct. Justice Tate concurred in the refusal, acknowledging that although article 3158 did not

"regulate the extent of the mortgage and the necessity for a

9. "But the right of mortgage, in this case, shall only be realized in so far as the promise shall be carried into effect by the person making it. The fulfillment of the promise, however, shall impart to the mortgage a retrospective effect to the time of the contract."

> principal debt secured thereby. . . . Taking into consideration the jurisprudential development of the 'collateral mortgage' security device, based upon the pledge of the collateral mortgage note, I think the court of appeal majority ascribed an appropriate legislative intent to the 1962 amendment of Article 3158."[10]

Perhaps we should ask what would have happened had Toups repaid his personal loan in full prior to the recording of the Silversmiths mortgage and the bank retained the collateral mortgage note until the corporate loan. The Fourth Circuit answered this question in dictum:

> "The retroactive effect created by this statute [article 3158] may, by mutual consent, be made applicable not only to renewal of the primary loan but to new or additional loans, *even though the original obligation has been fully paid.*"[11] (Emphasis added.)

Considering the origin and widespread usage of the collateral mortgage device, the result in *Silversmiths* is not surprising. Prior cases established that the collateral mortgage would rank as of the time the collateral mortgage note was pledged. So long as the collateral mortgage note remains in the pledgee's possession, article 3158 deems each new loan secured by the pledged note as though such loan had been made simultaneously with its initial delivery in pledge. Thus, if the collateral mortgage ranks effective with the delivery of the collateral mortgage note, and if subsequent advances are deemed secured by the collateral mortgage note as of its original delivery, then, in effect, each subsequent advance is also secured by the collateral mortgage, which likewise ranks from the time of delivery of the collateral mortgage note. To those not familiar with this practice, the collateral mortgage device may sound strange and circuitous. To those of us who are accustomed to using it, the *Foy* and *Silversmiths* decisions bring a new measure of comfort.

JUDICIAL MORTGAGES

United States Fidelity & Guaranty Co. v. Ballard[12] involved

10. 262 La. 309, 263 So.2d 47 (1972).
11. 261 So.2d 252, 255 (1972).
12. 250 So.2d 217 (La. App. 1st Cir. 1971).

a judicial mortgage affecting property subject to the Louisiana homestead exemption. The judgment debtor was adjudicated bankrupt following the recordation of the judgment. The trustee in bankruptcy, recognizing the homestead exemption, disclaimed the property in favor of the bankrupt, whereupon the bankrupt sued for the erasure of the judicial mortgage, claiming that the trustee's disclaimer was binding on all other creditors including the plaintiff. The First Circuit refused to order cancellation of the inscription. In its view, the actions of the bankruptcy trustee bound neither the plaintiff nor the court. Citing its earlier decision in *Jaubert Bros., Inc. v. Landry*,[13] the court observed that, had the bankrupt proved that the homestead was worth no more than the balance due on the purchase price, he would have been entitled to a judgment declaring the homestead free of the judicial mortgage.

PRIVATE WORKS ACT

As usual, the Private Works Act (R.S. 9:4801-42) has prompted considerable litigation. However, space limitations allow mention of only a few cases.[14] In *Long Leaf Lumber, Inc. v. Svolos*,[15] a material supplier filed a lien but could prove only

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13. 15 So.2d 158 (La. App. 1st Cir. 1943).

14. *See, especially*: D'Aubin v. Mauroner-Craddock, Inc., 262 La. 350, 263 So.2d 317 (1972) (construction lender with knowledge of contractor's diversion of construction loan proceeds to repay loan by law firm of which lender's chairman of the board was a partner—to be noted in subsequent issue of this Review); McNeely v. Barron Constr. Co., 261 So.2d 333 (La. App. 4th Cir. 1972) (no failure of consideration for performance bond issued for 1% of the contract price but surety agreed to pay 15% attorney fees in the event of default); State Lumber & Supply Co. v. Gill, 259 So.2d 639 (La. App. 1st Cir. 1972) (personal action by material furnisher against owner survives peremption of lien where supplier in privity with owner's representative); Magnon Elec., Inc., v. J. P. Van Way Eng'r Contr., Inc., 256 So.2d 851 (La. App. 3d Cir. 1972) (lien claimant's failure to object to solvency of surety within 10 days after concursus proceeding filed under R.S. 9:4804 absolves owner from liability—liens properly cancelled; surety became insolvent subsequent to contestability period); Fireman's Fund Am. Ins. Co. v. Milstid, 253 So.2d 571 (La. App. 1st Cir. 1971) (owner's statutory obligation to furnish performance *and lien* bond does not create any obligation to lien claimants where bond by its terms secures performance only—suretyship strictly construed); Jeffers' Trust v. Justice, 253 So.2d 234 (La. App. 4th Cir. 1971) (work "completed" under unrecorded contract notwithstanding lack of required approval of work by municipal and parochial inspectors); Walters Air Cond. Co. v. Fireman's Fund Ins. Co., 252 So.2d 919 (La. App. 2d Cir. 1971) (payment of subcontractor impairing surety's right of subrogation); Calandro Dev., Inc. v. R. M. Butler Contr., Inc., 249 So.2d 254 (La. App. 1st Cir. 1971) (surety on performance bond subrogated to contractor's tort action against negligent design engineer).

15. 258 So.2d 121 (La. App. 2d Cir. 1972).

a part of his alleged deliveries to the job site by signed receipts. To establish the balance, he called a reconstruction expert to testify as to the amount of like materials actually used in construction. The court found such testimony "helpful" but insufficient to establish that the lien claimant had supplied materials in excess of that reflected by signed invoices.

The supplier further claimed interest at the rate of eight per cent from date of delivery as stipulated in his agreement with the contractor. The court refused, pointing out that the owner was not a party to that contract, and limited the claim for interest to the legal rate from the date the lien was perfected by filing.[16]

In *I-10, Inc. v. Justice*,[17] a motel construction job was shut down and a notice of default recorded by the owner. The general contractor filed a lien affidavit in the amount of the entire contract price less payment received to date, his claim covering not only the balance due him but also for "potential or contingent liability to subcontractors." The Fourth Circuit rejected his claim that the lien secured contingent claims and ordered a partial erasure to that extent. His notice of suit also claimed that the "potential or contingent liability to subcontractors" was due in *quantum meruit*. This was viewed as a non-contractual claim, which was not secured by liens created by the PWA.

PRESCRIPTION

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Due to restricted budgets and corresponding reduction in pages for printing the LAW REVIEW, these comments are necessarily limited to those which are important and necessary. Under the circumstances, the more important comments are the critical ones; this should not be misunderstood as a generalization because, on the contrary, I find there has been a marked improvement in the way in which civil law problems are being handled and in the way that opinions are being written. With this observation, it is hoped that the comments which follow will be considered seriously and will serve a constructive purpose.

16. *See* Pringle-Associated Mtg. Corp. v. Eanes, 254 La. 705, 226 So.2d 502 (1969), for the proposition that the lien claimant's personal right against the owner does not arise unless *and until* the lien is filed.

17. 260 So.2d 89 (La. App. 4th Cir. 1972).

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