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Private Law: Security Devices

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SECURITY DEVICES

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SURETYSHIP

In 1975 the Louisiana Supreme Court set forth what appeared to many to be a new rule of law. In *Louisiana Bank and Trust Co. v. Boutte*,[1] a surety signed a continuing guarantee agreement that contained language making him solidarily liable with the maker of a note. The creditor released the maker of the note and the other guarantors, reserving its rights against the defendant, the remaining surety. The court held that the defendant was liable for a portion of the obligation[2] because the solidary language of the continuing guarantee agreement gave the creditor a right to treat all of the sureties as solidary obligors with the debtor. Left open was the question of what law regulated the rights between the sureties and the debtor on one hand, and among the sureties on the other.[3]

Most of the issues not settled by *Boutte* have now been resolved in *Aiavolasiti v. Versailles Gardens Land Development Co.*[4] The facts in *Aiavolasiti* read like a law school examination question. There were three separate notes involved. On one note five shareholders gave continuing guarantees (with solidary language) to secure the loan made to the corporate defendant. Six shareholders signed a second note of the corporation as accommodation endorsers. The six shareholders also signed a third note as makers. The plaintiff, a shareholder who had signed all of the documents and paid the debt, brought suit against the corporation and his co-sureties to recover what he had paid.

The court held that, if the debtor and the sureties are bound "in solido," the creditor is entitled to treat the debtor and sureties as solidary obligors and to apply the Civil Code articles on solidary

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1. 309 So. 2d 274 (La. 1975).

2. Whether the defendant's virile share was to be calculated by counting the maker of the note as one of the virile shares, rather than by counting only the sureties, was not before the court.

3. The *Boutte* case has been subject to criticism. *See The Work of the Louisiana Appellate Courts for the 1974-1975 Term—Security Devices*, 36 LA. L. REV. 437 (1976); Note, *Suretyship—Release of Principal Debtor Does Not Discharge Solidary Surety*, 49 TUL. L. REV. 1187 (1975); Note, *Rights of the Solidary Surety: Louisiana Bank & Trust Co. v. Boutte*, 36 LA. L. REV. 279 (1975).

4. 371 So. 2d 755 (La. 1979). *See* Note, *Aiavolasiti: A Conflict Resolved, A Conflict Ignored*, 40 LA. L. REV. 483 (1980).

obligations; however, even though the sureties are bound "in solido" with the debtor, as between themselves they remain sureties and the suretyship provisions of the Civil Code apply *inter se.*[5]

Louisiana courts have been inconsistent in ruling which law applies to accommodation endorsers.[6] Some courts have applied only the articles under the Negotiable Instruments Law (NIL);[7] other courts have applied the Civil Code articles on suretyship[8] or the articles on solidary obligations.[9] The matter is not clarified by the tendency of most lenders to use boiler plate forms providing that endorsers are liable "in solido" with the makers.

Aiavolasiti was decided under the NIL; the court did not indicate whether the result would be different under articles 1 and 3 of the Uniform Commerical Code (U.C.C.). It is submitted that the proper approach would be to apply the U.C.C. to accommodation endorsers if the commmercial laws contain an express provision on point.[10] Only if the problem is not directly dealt with by the commercial laws should the courts look to the Civil Code articles on suretyship and solidary obligations.[11]

While the *Aiavolasiti* opinion does clarify many of the questions raised by the *Boutte* decision, it may encourage sureties to be litigious. The supreme court refused to award Mr. Aiavolasiti at-

5. This holding implicitly overrules other decisions that did not use the suretyship articles to determine contribution between co-sureties bound "in solido" with the debtor. Whitney Nat'l Bank of New Orleans v. Ben Dev. Co., 364 So. 2d 1076 (La. App. 4th Cir. 1978); Gauthier v. Scott, 327 So. 2d 702 (La. App. 1st Cir. 1976).

6. *Cf.* Comment, *Suretyship Law and Negotiable Instruments Law: The Liability of an Accommodation Party to a Negotiable Instrument in Louisiana*, 24 LOY. L. REV. 251 (1978).

7. *See, e.g.*, Barnes v. Park Place Homes, Inc., 289 So. 2d 859 (La. App. 4th Cir. 1974).

8. *See, e.g.*, C.I.T. Corp. v. Rosenstock, 205 So. 2d 81 (La. App. 4th Cir. 1967).

9. *See, e.g.*, Gisclair v. First Nat'l Bank of Lafayette, 180 So. 2d 595 (La. App. 3d Cir. 1965).

10. Compare, for example, the rights of an accommodation endorser to contribution from other endorsers under Revised Statutes 10:3-414(2) with the rights of contribution accorded to sureties under Civil Code article 3058 and to solidary obligors under Civil Code article 2103.

11. LA. R.S. 10:1-103 (Supp. 1974) provides: "Unless displaced by the particular provisions of this Title, other laws of Louisiana shall apply."

The official comments of the Louisiana State Law Institute following Revised Statutes 10:1-103 state:

> The original U.C.C. text was rejected because it refers to concepts and terms either unknown to Louisiana or having different meaning in Louisiana. The thrust of the section is that the rest of Louisiana law implements the commercial law if a situation is not covered by the commercial law. The Louisiana version says this without limitations.

torney's fees and costs because it found that the surety's payment to the creditor had extinguished the negotiable instruments, thus relegating his right of recovery to contribution under Civil Code article 3058. This holding will discourage a "solidary surety" who has any doubts about his co-sureties' willingness to contribute their virile shares from paying a creditor voluntarily. If the surety who pays voluntarily must later sue his co-sureties, and if he cannot recover attorney's fees and interest as provided for in the note, then the surety will have no motive to pay outside of court. The surety would be better off refusing to pay voluntarily, waiting to be sued, and then bringing in his co-sureties as third party defendants.

Fortunately, with the adoption of Louisiana Revised Statutes 10:3-415(5),[12] a different result should occur. An accommodation endorser who pays the holder may still pursue the other endorsers and the maker on the instrument and recover whatever attorney's fees, costs, and interest the note provides.

PLEDGE AND "ASSIGNMENT"

The drafter of documents is frequently confronted with the problem of whether to label a proposed security interest a "pledge" or an "assignment." For historical reasons,[13] and perhaps because of inertia, many practitioners routinely label as "assignments" the pledge of life insurance, of bank accounts, and of the right to receive rents under a lease. A true assignment, however, involves a transfer of title. If the "assignment" is actually security for a loan, then it is a security device.[14]

Peoples Bank and Trust Co., Natchitoches v. Harper[15] stands as a reminder that, in security devices as in taxation, substance and not form controls. The court ruled that an "assignment" of an interest in a savings certificate was, in fact, an attempted pledge and not a transfer of ownership. Because possession of the certificate was not transferred, the requirements of pledge were not met and the creditor's loan was unsecured.

In *Associates Financial Services, Inc. v. McClendon*,[16] the debtor executed a document by which he purported to "pledge and/or

12. LA. R.S. 10:3-415(5) (Supp. 1974) provides: "An accommodation party is not liable to the party accommodated, and if he pays the instrument has a right of recourse *on the instrument* against such party." (Emphasis added.)

13. *Compare* Caffin v. Kirwan, 7 La. Ann. 221 (1832), *with* LA. R.S. 9:4321-24 (1950 & Supp. 1978), *especially* LA. R.S. 9:4324, *added by* 1978 La. Acts, No. 703, § 1.

14. Scott v. Corkern, 231 La. 368, 91 So. 2d 569 (1956).

15. 370 So. 2d 1291 (La. App. 3d Cir.), *cert. denied*, 371 So. 2d 1330 (La. 1979).

16. 367 So. 2d 91 (La. App. 4th Cir. 1979).

assign, transfer, set over and deliver" to a bank monies owing to him under an employment contract. When the debtor's wages were then garnished by another creditor the bank claimed priority by virtue of the "assignment." The fourth circuit ruled in favor of the bank but side-stepped deciding what type of security device was created. The court found that the bank was entitled to priority because the contract was "either" a pledge or an assignment.

The court need not have equivocated. There is no such thing as "pledge and/or assignment"; a contract is either one or the other, but not both.[17] It was clear from the facts that the document was intended to secure a loan; therefore, it was a pledge.

Three types of movables are susceptible of being pledged: corporeal movables;[18] incorporal movables evidenced in writing, the document itself giving the holder a particular right;[19] and incorporeal movable rights, whether represented by a document or not, when the document does not give any superior claim to the one who possesses it.[20] An example of this last category would be a lease. Possession of the contract of lease itself does not confer the right to collect rent. The rent is due to the person who gives possession of the property, not to the one who holds the document.[21] Similarly, the right to receive payment for work performed under an employment contract, as in *McClendon*, does not belong to the person who physically holds the employment papers. Although the court did not set forth all the details of the "assignment," the document in *McClendon* appears to have met all the requirements of a proper pledge under Louisiana Revised Statutes 9:4321-24.

The *McClendon* court also ruled that an employee cannot "assign" wages under the Accounts Receivable Act.[22] The Act, however, allows one to "assign"

17. Scott v. Corkern, 231 La. 368, 91 So. 2d 569 (1956); Peoples Bank and Trust Co., Natchitoches v. Harper, 370 So. 2d 1291 (La. App. 3d Cir.), *cert. denied*, 371 So. 2d 1330 (La. 1979).

18. LA. CIV. CODE arts. 3135 & 3154.

19. LA. CIV. CODE arts. 3158 & 3160. An example of this type of document would be a negotiable instrument. The holder of that document has certain rights simply because he possesses the instrument.

20. LA. R.S. 9:4321-24 (1950 & Supp. 1978).

21. *Cf.* LA. CIV. CODE arts. 2681-82; Spence v. Lucas, 138 La. 763, 70 So. 796 (1916); Evangeline Ref. Co. v. Nunez, 153 So. 2d 886 (La. App. 3d Cir. 1963).

22. The court stated, without analysis or citation of authority, that the Assignment of Accounts Receivable Act, LA R.S. 9:3101-09 (Supp. 1952 & 1964), "was not intended to include wages earned by the assignor as an employee in the *employer's* business or undertaking." 367 So. 2d at 93 (emphasis in original).

> any indebtedness . . . arising out of, or . . . in connection with any business, profession, occupation, or undertaking.[23]

This language seems broad enough to include wages earned by an employee, for work is surely an employee's "profession" or "occupation."

ASSIGNMENT OF ACCOUNTS RECEIVABLE

Unfortunate *dicta* was used in *Air Compressors, Inc. v. Big Chief Construction Co.*[24] The court indicated, without citing authority or delineating its rationale, that it entertained "considerable doubt" whether there could be an assignment of future accounts receivable.

There is nothing in the Act that would prohibit the "assignment" of future accounts. If the "assignment" is to secure a debt (*i.e.*, if it is to be a pledge), then the debtor may well want to be able to secure financing by giving the creditor a security interest in accounts opened after the loan is made. For example, a retailer who maintains a large number of open accounts has new customers every day. It would seem both wasteful and unnecessary to require, as a condition of securing the loan, that he execute a new "assignment" every time a new account is opened. This is particularly true in the case of a merchant who may have hundreds of new customers over the course of a month.

Third parties are not necessarily prejudiced by the "assignment" of future accounts; in fact, the formal document to be recorded in the conveyance records must state that the debtor "has assigned and intends to continue assigning accounts receivable."[25]

Considering the fact, however, that security rights are *stricti juris*, and that civilian theory is inimical to secured rights in general,[26] the cautious practitioner may wish to avoid assigning future accounts receivable until the legislature has expressly amended the Act.

23. LA. R.S. 9:3101(1) (Supp. 1952), *as amended by* 1964 La. Acts, No. 511, § 1.

24. 367 So. 2d 413 (La. App. 1st Cir. 1978), *cert. denied*, 369 So. 2d 465 (La. 1979). In denying writs, the supreme court stated: "While we disagree with the rationale and reasons assigned by the Court of Appeal in its interpretation of R.S. 9:3101-3109, this result is correct on the grounds of the facts found by the trial court."

25. LA. R.S. 9:3103 (Supp. 1952).

26. LA. CIV. CODE art. 3183 states: "The property of the debtor is the common pledge of his creditors, and the proceeds of its sale must be distributed among them ratably, unless there exist among the creditors some lawful causes of preference."

PLEDGE—INTERRUPTION OF PRESCRIPTION

Kaplan v. University Lake Corp.[27] confirms what most practitioners have understood the law to be. The pledge of a collateral mortgage note interrupts prescription on the handnote, making it "virtually imprescriptible"; interruption of prescription continues even if the collateral mortgage note itself prescribes.

While the *Kaplan* holding is based on jurisprudential precedent,[28] the rule's rationale is open to attack. The basis of the rule is that "it is not the contract or act of pledge that interrupts prescription but rather the detention by the pledgee of the thing pledged, such possession serving as a constant acknowledgment of the debt and hence a constant renunciation of prescription."[29]

If possession by the pledgee "serves as a constant acknowledgment of the debt," it can only be because the pledgor has relinquished control of something valuable, something he wants returned. The pledge of a valueless item is useless to the creditor as security for a loan, for such an item, at a sale, will bring no funds on which the pledgee may obtain a privilege.[30] Yet, the courts have consistently ruled that the pledge of items that later become valueless serves to interrupt prescription on the principal obligation.[31] Blind adherence to this rule elevates what should be an indicium of a meaningful pledge of a valuable object to a rubric having an existence all its own, a precept of value to the creditor even if the pledge is worthless. Under the jurisprudence, it is possible for a pledged prescribed note to interrupt prescription on the principal obligation whether the pledged note had prescribed after it was pledged,[32] as in *Kaplan*, or even if it had prescribed before it was pledged.[33] That the rule needs reexamination is clear when one contemplates whether the

27. 369 So. 2d 1107 (La. App. 1st Cir.), *aff'd*, No. 64,328 (La. Oct. 8, 1979) (on original hearing). Rehearing was granted in part; the case was reargued and resubmitted on Jan. 28, 1980.

28. *See, e.g.*, Succession of Picard, 238 La. 455, 115 So. 2d 817 (1959); Scott v. Corkern, 231 La. 368, 91 So. 2d 569 (1956).

29. Scott v. Corkern, 231 La. 368, 379, 91 So. 2d 569, 573 (1956), quoted with approval in Kaplan v. University Lake Corp., No. 64,328, slip op. at 4 (La. Oct. 8, 1979) (on original hearing).

30. LA. CIV. CODE arts. 3157, 3165 (*as amended by* 1872 La. Acts, No. 9), & 3220.

31. *See* the cases cited at note 28, *supra*. Indeed, the court in *Kaplan* held that the pledge of a collateral mortgage note (that prescribed while it was in pledge) nevertheless interrupted prescription on the principal obligation.

32. LA. R.S. 9:5807, *added by* 1970 La. Acts, No. 354, § 1, *as amended by* 1975 La. Acts, No. 119 § 1, is specifically designed to keep pledged notes from prescribing if certain conditions are met.

33. Succession of Picard, 238 La. 455, 115 So. 2d 817 (1959).

pledge of a dollar bill or a peppercorn would interrupt prescription on a million dollar debt.[34]

Perhaps a better approach would be to relegate the aspects of interruption of prescription to a rule accessory only to the pledge of a valuable object. If the pledged item *ceased* to be of value, prescription would resume on the principal obligation. The courts could then decide, on a case-by-case basis, the issue of prescription rather than allowing an otherwise unsecured creditor (unsecured because his pledge had ceased to be of value) to maintain an action on an otherwise prescribed principal obligation.

COLLATERAL MORTGAGES

In *First Guaranty Bank v. Alford,*[35] a husband had borrowed money from a bank; the loan was represented by a $155,000 promissory note. The wife executed a collateral mortgage note and collateral mortgage on her separate property. She then, by a written act, pledged her note specifically to secure the $155,000 promissory note.

The husband paid off the $155,000 promissory note by borrowing other funds from the bank; eventually, his loan was "rolled over" several times. During this period the bank maintained possession of the wife's collateral mortgage note.

When the bank tried to collect on the husband's outstanding indebtedness by foreclosing on the wife's collateral mortgage the wife objected, claiming that the bank had no security interest in her property because the husband's original $155,000 promissory note had been paid off. The supreme court sustained the wife's position.

The court stressed that a collateral mortgage package is, in essence, a pledge of a promissory note (the "collateral mortgage note"). The pledged note, in turn, is secured by a mortgage (the collateral mortgage); however, the pledge provisions of the Civil Code govern whether a creditor is secured.

The court explained that, while a collateral mortgage note may be pledged to secure future obligations,[36] it also may be pledged to secure a specific obligation. Determining what obligation the pledge secures depends upon ascertaining the intent of the parties at the time the pledge is given.[37] Because the collateral pledge agreement

34. Of course, a court might refuse to extend the interruption of prescription rule if it determines the *sole* purpose of the pledge was only to interrupt prescription and circumvent the prohibition in Civil Code article 3460 against renouncing a prescription "not yet acquired."

35. 366 So. 2d 1299 (La. 1979).

36. *See* LA. CIV. CODE art. 3158.

37. LA. CIV. CODE art. 3133.

in *Alford* showed that the wife's collateral mortgage package was meant specifically to secure only the husband's original $155,000 promissory note, once that note was paid, the principal obligation was extinguished and the pledge fell, leaving the bank without a security interest in either the wife's collateral mortgage note or her collateral mortgage. Because intent plays such an important role in determining what obligation a collateral mortgage secures, it would seem advisable for creditors to obtain a written pledge agreement as part of their standard procedure.[38]

Mara v. McCoy[39] follows the supreme court's ruling in *Alford* that a creditor has no right to sue on a pledged collateral mortgage note when the obligation that the pledge secures has been paid.[40]

Caballero v. Wilkinson[41] involved the pledge of a handnote (rather than the pledge of a collateral mortgage note).[42] Mr. Cerdes and his wife[43] executed two handnotes representing loans from American Budget Plan, Inc. The loans were secured by the pledge of the Cerdes' collateral mortgage note and collateral mortgage. American Budget Plan then pledged one of the Cerdes' handnotes to another creditor. When American Budget defaulted on its payments, its creditor attempted to hold the Cerdes liable under the handnote.

The court held that one need not be an owner of a negotiable instrument to sue on it; being the holder of "bearer" paper is sufficient. Nevertheless, because the Cerdes had no knowledge of the pledge by American Budget, and because the Cerdes continued to pay American Budget, the court found that American Budget was the agent of the creditor. Therefore, when the Cerdes paid the handnote through American Budget, the handnote was extinguished and the creditor had no right to sue on it. The court was careful to point out that "this suit is by the holder whose agent received payment.

38. Of course, a written pledge agreement is not always required for the validity of the pledge. Civil Code article 3158 provides that a pledge of a negotiable instrument is effective both as between the parties and as to the world merely by delivery.

39. 369 So. 2d 246 (La. App. 4th Cir.), *cert. denied*, 371 So. 2d 835 (La. 1979).

40. To the same effect *see* Guitreau v. Kinchen, 361 So. 2d 316 (La. App. 1st Cir. 1978).

41. 367 So. 2d 349 (La. 1979).

42. A collateral mortgage package consists of the note paraphed for identification with the collateral mortgage (the so-called "Ne Varietur" or collateral mortgage note); the collateral mortgage itself; and the handnote, the principal obligation which the pledge of the collateral mortgage note secures. First Guar. Bank v. Alford, 366 So. 2d at 1302. *See also* Nathan & Marshall, *The Collateral Mortgage*, 33 LA. L. REV. 497 (1973); Nathan & Marshall, *The Collateral Mortgage: A Reassessment and Postscript*, 36 LA. L. REV. 973 (1976).

43. The defendants were "Flora Wilkinson, wife of and Julius W. Cerdes."

It is not a suit by a holder who has not received payment directly nor through an agent."[44]

The issue of how much the holder of a collateral mortgage note may collect upon foreclosure was before the first circuit in *Central Progressive Bank v. Doerner.*[45] The Doerners executed a collateral mortgage note in the amount of $10,500 and pledged it as security for a $17,472 handnote. They defaulted on their payments on the handnote, and the property brought $18,600 at the sheriff's sale. Central Progressive Bank (the holder of the handnote) claimed it was entitled, as a secured creditor, to the balance due on the handnote, although the balance due was in excess of the $10,500 collateral mortgage note. Cumberland Capital Corporation, the holder of a second mortgage on the property, intervened and asserted that it was entitled to any funds realized from the sale of the property in excess of the amount of the collateral mortgage note. The court sustained Cumberland's position, ruling that, from the sale's proceeds, the holder of the collateral mortgage note could collect as a secured creditor only the amount of the collateral mortgage note since that was less than the balance due on the handnote.

This analysis is sound. As the supreme court recognized in *Alford,*[46] a collateral mortgage is, in essence, a pledge of a promissory note. The rights of a pledgee should be the same regardless of the type of movable pledged. For example, assume *X* pledges his watch to *Y* to secure a loan of $100. If *X* defaults and *Y* sells the pledgor's watch, *Y* may not collect more than the $100 owing to him; any funds in excess of the debt must be returned to the pledgor.[47] If the watch sells for only $50, however, *Y* is entitled to keep the full amount and is an unsecured creditor of the balance owing to him.

The same rationale should apply to a collateral mortgage package. The creditor is able to sell the mortgaged property only because he holds the collateral mortgage note in pledge. The collateral mortgage note, being a demand note, can be enforced by the creditor.[48] In enforcing his rights against the collateral mortgage note, the creditor is entitled to seize and sell the property that secures the collateral mortgage note, to apply the proceeds of the property's sale to the collateral mortgage note, and to apply the

44. 367 So. 2d at 352.
45. 365 So. 2d 263 (La. App. 1st Cir. 1978).
46. 366 So. 2d 1299 (La. 1979).
47. LA. CIV. CODE arts. 3166 & 3170.
48. LA. CIV. CODE art. 3170 provides: "If the credit which has been given in pledge becomes due before it is redeemed by the person pawning it, the creditor, by virtue of the transfer which has been made to him, shall be justified in receiving the amount, and in taking measures to recover it . . . ."

amounts received on the collateral mortgage note to the payment of the principal indebtedness (*i.e.*, the handnote). Therefore, as *Doerner* held, once the proceeds from the sale of the property equal the amount of the collateral mortgage note, the creditor is no longer secured; the surplus over the amount of the collateral mortgage note must go first to other secured creditors of the property, if any, with the remainder being remitted to the pledgor.

There are three possible variations on the situation posed in *Doerner:*

(1) $17,000 handnote; $10,000 collateral mortgage note; property sells for $18,000.[49] In this situation, because the collateral mortgage note is less than the outstanding balance on the handnote, the holder of the handnote is unsecured for any sum in excess of the amount of the collateral mortgage note, and the surplus funds go to secondary mortgage holders on the property (or, if there are none, to the owner of the property). This is precisely the holding of *Doerner.*

(2) $17,000 handnote; $10,000 collateral mortgage note; property sells for $5,000. The holder of the handnote should receive the entire $5,000 because it is less than both the outstanding balance on the handnote and the amount of the collateral mortgage note.

(3) $10,000 handnote; $17,000 collateral mortgage note; property sells for $18,000. In this situation, the creditor can collect only the amount of the handnote ($10,000) because that is the extent of the principal indebtedness due him. He is not entitled to receive any additional amounts, either on a secured or unsecured basis, because the obligation is now extinguished.[50]

Therefore, it would appear that, in a collateral mortgage situation, the creditor is entitled to collect *as a secured creditor* from the proceeds of the sale the *lesser* of the amount of (1) the handnote or (2) the collateral mortgage note.[51] Of course, to the extent that there is a deficiency left on the handnote, the creditor would have a personal right of action against the debtor.

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49. These are not the exact sums at issue in *Doerner*, but the numbers are easier to use rounded off than $17,472, $10,500, and $18,600.

50. "Louisiana Civil Code Article 3170 permits the mortgagee to collect the full amount of the pledged mortgage note, subject to an accounting to the debtor for an excess over and above the actual indebtedness. *Allen v. Commercial National Bank in Shreveport*, 138 So. 2d 252 (La. App. 2d Cir. 1962)." Fuller v. Underwood, 355 So. 2d 62, 64 (La. App. 2d Cir.), *cert. denied*, 357 So. 2d 1153 (La. 1978).

51. *Cf.* Nathan & Marshall, *The Collateral Mortgage: A Reassessment and Postscript*, 36 LA. L. REV. 973 (1976).

In none of the three situations posited above is it necessary to decide explicitly whether there is personal liability on the collateral mortgage note because one person is the maker of both the handnote and the collateral mortgage note. What would be the result, however, if the collateral mortgage note were pledged to secure the obligation of a third party? Assume *P* is indebted to *Q* for $17,000. *R* pledges a $10,000 collateral mortgage note, secured by a collateral mortgage, to *Q* as security for *P*'s debt. Further assume *P* defaults and *Q* forecloses on *R*'s property which brings $5,000 at a sheriff's sale. Can creditor *Q* continue to pursue *R* personally for the remaining $5,000 deficiency on the collateral mortgage note itself?

The suggestion that there may be personal liability on the collateral mortgage note raises the spectre, in some practitioners' minds, of potential double liability on the part of the maker of the two notes. It is submitted that there is no double liability, but that, nevertheless, when a person executes a collateral mortgage note, he does undertake personal liability on that note itself.[52]

The maker of a handnote secured by the pledge of a collateral mortgage package need not fear double liability. A creditor who holds an item (such as a collateral mortgage note) in pledge cannot collect an amount in excess of the principal obligation.[53] To reiterate, the creditor is entitled to collect (as a secured creditor) only the *lesser* amount of either (1) the outstanding balance on the handnote or (2) the amount of the collateral mortgage note.[54] Paraphing a note for identification with an act of collateral mortgage does not alter the fact that it is a negotiable instrument. It remains a personal obligation of the maker enforceable by any holder.[55] The personal liability of the maker of the collateral mortgage note is a necessity because a mortgage is an accessory obligation.[56] A mortgage cannot stand "by itself." If the collateral mortgage note imparted no per-

52. The author hopes his views are not influenced by the fact that he is counsel for creditors in several lawsuits in which this position is being taken.

53. LA. CIV. CODE arts. 3170 & 3172. *Cf.* Steeg v. Codifer, 157 La. 298, 102 So. 407 (1924).

54. Likewise, the maker of a collateral mortgage note need not fear double liability if the holder transfers it to a third person without the maker's knowledge or consent. If the collateral mortgage note is "sold" without transferring the handnote or the principal obligation, then "a sale of collateral divorced from the debt it is pledged to secure would amount to a conversion." Odom v. Cherokee Park Homes, Inc., 165 So. 2d 855, 864 (La. App. 4th Cir. 1964). Furthermore, because the collateral mortgage note would contain a paraph indicating it was identified with an act of collateral mortgage, any person who took the note apart from a transfer of the handnote would be put on notice of a possible claim or defense and could not be a holder in due course. LA. R.S. 10:3-302(1)(c) (Supp. 1974).

55. LA. R.S. 10:3-301 & 3-413(1) (Supp. 1974).

56. LA. CIV. CODE arts. 3278 & 3284.

sonal liability to its maker, the mortgage would secure nothing and would fall of its own weight.[57]

The collateral mortgage package is not an *in rem* obligation, and the creditor's rights should not be restricted to the amount the mortgaged property brings at a sheriff's sale. To hold that a collateral mortgage note creates no personal liability for the maker, to hold that, in essence, it is an "in rem" mortgage, would have serious effects on commerical transactions in Louisiana. First, it would require overruling a series of cases that have enforced mortgages and collateral mortgages pledged by one person to secure the debt of another.[58] Second, it would alter the usual and customary concept of "in rem" mortgages.[59] Third, it would mean that a collateral mortgage note is non-negotiable.[60] For these reasons it is submitted that a collateral mortgage note does impose personal liability on the maker, and, in answer to the hypothetical posed above, *Q* may continue to pursue *R* personally for the remaining deficiency.

THE PUBLIC RECORDS DOCTRINE

To say that a person is not affected by any interest in immovable property unless something is recorded in the parish mortgage or conveyance records is to misconstrue the public records doc-

57. *Cf.* Bernheim v. Pessou, 143 La. 609, 79 So. 23 (1918). In *Bernheim* the creditor released the debtor from personal liability on a note; the court held that the mortgage was unenforceable.

58. *See, e.g.,* Rex Finance Co. v. Cary, 244 La. 675, 154 So. 2d 360 (1963); Jennings v. Vickers, 31 La. Ann. 679 (1879); Baker Bank and Trust Co. v. Behrnes, 217 So. 2d 461 (La. App. 1st Cir. 1968).

59. *Cf.* Tennent v. Caffry, 170 La. 680, 129 So. 128 (1930). *See also* Nathan, *The "In Rem" Mortgage*, 44 TUL. L. REV. 497 (1970).

60. To be negotiable, an instrument must contain an "unconditional promise" to pay a sum certain in money. LA. R.S. 10:3-104(1)(b) (Supp. 1974). To the extent that recovery on a note is limited to a particular fund, or is limited to the value of a particular tract of property, the promise is not unconditional and the note is not negotiable. LA. R.S. 10:3-105(2)(b) (Supp. 1974). Such a note, being non-negotiable, could not be transferred by mere delivery; authentic evidence of the transfer would be necessary in order to bring about executory proceedings. LA. CODE CIV. P. arts. 2636-37; Louisiana Nat'l Bank of Baton Rouge v. Heroman, 280 So. 2d 362 (La. App. 1st Cir.), *cert. denied*, 281 So. 2d 755 (La. 1973). A requirement of authentic evidence of transfer would effectively destroy the utility of collateral mortgages, because the collateral mortgage note is always phrased in terms of "bearer" paper precisely because any holder may enforce it by executory proceedings without further evidence of how he became the holder. Slidell Bldg. Supply, Inc. v. IDS Mortgage Corp., 273 So. 2d 343 (La. App. 1st Cir. 1972), *cert. denied*, 274 So. 2d 708 (La. 1973); First Nat'l Bank v. Gaddis, 250 So. 2d 504 (La. App. 3d Cir. 1971); Allen v. Commercial Nat'l Bank, 138 So. 2d 253 (La. App. 2d Cir. 1962). *Cf.* Thrift Funds Canal, Inc. v. Foy, 261 La. 573, 578, 260 So. 2d 628, 630 (1972).

trine.[61] There is no need to record a document on the public records to affect either the parties to the document or those who are not expressly considered "third persons" within the meaning of Civil Code articles 3342-44 and Louisiana Revised Statutes 9:2722.

In *King v. Peoples Bank and Trust Co.*,[62] the court held that a bank could not take the position of a "third party" and rely on the public records to enforce a mortgage against the record owner of property when the bank's attorney had acted as notary for the act of sale to the record owner and was aware that: (a) there was a counter letter between the buyer and the sellers; (b) the purpose of the sale was to allow the buyer to obtain financing for a home he was building on the lot for the sellers; (c) the property was to be transferred back to the sellers as soon as financing was obtained and the house constructed; and (d) the sellers would not have entered into the act of sale had they known that the buyer would mortgage the property for his other debts.

LaCour v. Crais[63] applied the public records doctrine to protect the purchaser from the claims of a creditor who contended that his mortgage had been released fraudently. The holding is limited to its facts, the court finding that the creditor had intended that some property would be released from the mortgage and, through its own negligence, had failed to discover the allegedly fraudulent release of the property at issue.

JUDICIAL MORTGAGES

Credit Service Corp. v. Bagley held that "with respect to the debtors' homestead . . . a lien on the property, created by the recordation of a judgment at a time when the judgment debtor is insolvent within four months of the filing of a petition in bankruptcy, may be cancelled by a state court upon the petition and proper showing by the judgment debtor who is personally discharged of the debt in the bankruptcy proceedings."[64]

RANKING CHATTEL MORTGAGES AND PRIVILEGES

Arenson International, Inc. v. Shelving Systems Corp.[65] involved

61. LA. R.S. 9:2721-24 (1950); McDuffie v. Walker, 125 La. 152, 51 So. 100 (1910). For further clarification of some of the misconceptions of the public records doctrine, *see* Redmann, *The Louisiana Law of Recordation: Some Principles and Problems*, 39 TUL. L. REV. 491 (1965).

62. 371 So. 2d 257 (La. 1979).

63. 367 So. 2d 1203 (La. App. 4th Cir. 1978), *cert. denied*, 369 So. 2d 141 (La. 1979).

64. 364 So. 2d 624, 627 (La. App. 3d Cir. 1978).

65. 369 So. 2d 1212 (La. App. 2d Cir. 1979).

a ranking problem between a chattel mortgagee and the holder of a vendor's privilege. The chattel mortgage was for inventory kept at a warehouse at a particular location. The chattel mortgage was recorded prior to the sale of office furniture by the vendor. The chattel mortgagee claimed that he outranked the vendor under the theory that a chattel mortgage outranked all subsequently arising privileges.[66]

The first issue faced by the court was whether the chattel mortgage applied at all to office furniture when the mortgage was on "all the masses or assemblages of inventory" of a shelving company. The court found it did, even though furniture was not shelving; the office furniture was "inventory" kept at the location described.

The second issue was whether the chattel mortgage arose at the time of filing or at some later date. Reasoning that an inventory chattel mortgage cannot arise until the goods are actually at the location indicated, the court found that the chattel mortgage did not affect third parties until the concurrence of both filing and the arrival of the goods on the premises. Because the vendor's privilege arose at the moment of the perfection of sale and prior to delivery to the warehouse, the vendor's privilege outranked the chattel mortgage.

For the court to have held otherwise would have opened the door for unscrupulous creditors to gain security interests not intended by the parties or by law. For example, assume that the holder of an inventory chattel mortgage discovers that the debtor is in financial straits. The creditor might attempt to move all of the debtor's merchandise into the warehouse in order to defeat the rights of vendors or of those holding later recorded (non-inventory) chattel mortgages on specific floor merchandise, even though this merchandise was not originally intended to be placed in the warehouse. This could lead to an unseemly "race to the warehouse."

The court's reasoning should extend to all forms of chattel mortgages and not be limited only to those on inventory. The vendor's privilege arises at the moment of sale, and that is at the concurrence of the thing, price, and consent.[67] It would appear that, when the buyer becomes owner of the property, it is already encumbered by a vendor's privilege. The chattel mortgagee should take the buyer's title as he found it, *i.e.*, subject to the vendor's privilege.

66. LA. R.S. 9:5354 (1950 & Supp. 1954), *as amended by* 1978 La. Acts, No. 572, § 2.

67. LA. CIV. CODE art. 2439.

RANKING FEDERAL LIENS WITH STATE SECURITY INTERESTS

Federal law is preemptive in the area of federal tax liens, and federal law determines the ranking of these liens.[68] Whether a separate federal common law applies to non-tax liens was addressed by the United States Supreme Court in *United States v. Kimball Foods, Inc.*[69] Specifically dealing with SBA and FHA loan programs, the Court held that, while federal law determines whether the federal lien exists at all, state law determines the ranking of the liens as against state-created security interests. Although the Court's opinion is specifically limited to FHA and SBA loan programs, its rationale appears broad enough to encompass any consensual programs by which "the United States acts as a lender or guarantor."[70]

PRIVATE WORKS ACT

The Private Works Act[71] is not a model of clarity in legislative drafting. *Lambert Brothers, Inc. v. Ziegler*[72] involves a materialman who had timely filed his affidavit in the public records but who had not timely mailed a copy of the claim to the owner by registered mail. The court held that timely mailing of the claim to the owner is not a prerequisite for obtaining the lien; the materialman was granted his privilege. The court indicated, in dicta, that mailing a copy of the affidavit to the owner is a "prerequisite only to the owner's personal liability."[73]

Sam Marrs Equipment Co. v. C. & J. Painting and Sandblasting Co.[74] is one of the few cases to interpret the privilege on immovables that the Private Works Act grants to lessors when leased movables are used on the site.[75] The evidence being inconclusive, the court upheld the lessor's privilege on the basis that there is a strong presumption that property, once located on the premises, is actually being used. The court rejected the landlord's pleas of estoppel and waiver, indicating that, had the landowner wished to prevent the

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68. *See* I.R.C. §§ 6321-25 (which includes the Federal Tax Lien Act of 1966, Pub. L. No. 94-455, 80 Stat. 1125 (amending I.R.C. § 6323)); Capital Sav. Ass'n v. Runnels, 361 So. 2d 458 (La. App. 1st Cir. 1978).
69. 99 S. Ct. 1448 (1979).
70. *Id.* at 1462.
71. LA. R.S. 9:4801-21 (1950 & Supp. 1976).
72. 361 So. 2d 948 (La. App. 4th Cir.), *cert. denied*, 364 So. 2d 121 (La. 1978).
73. *Id.* at 951.
74. 365 So. 2d 592 (La. App. 1st Cir. 1978).
75. LA. R.S. 9:4801.1 (Supp. 1975).

lien from attaching, he should have followed the procedure set forth in the statute.[76]

PUBLIC WORKS ACT

Slagle-Johnson Lumber, Inc. v. Landis Construction Co.[77] continued the narrow jurisprudential interpretation of the Public Works Act[78] and refused to grant a lien to a supplier of materials that were not directly incorporated into the work.[79] The court held that, unless materials are actually incorporated into the construction or "directly consumed" by the work (like dynamite),[80] they do not fall within the scope of the Act. Writs have been granted.[81]

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76. LA. R.S. 9:4801.1 (Supp. 1975).
77. 366 So. 2d 206 (La. App. 2d Cir. 1978).
78. LA. R.S. 38:2241-48 (1950).
79. The materials consisted of plywood, lumber, and nails used to build forms for concrete and steel.
80. *See* Long Bell Lumber Co. v. S.D. Carr Constr. Co., 172 La. 182, 133 So. 438 (1931).
81. 367 So. 2d 379 (La. 1979).