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The Third Circuit Trilogy: "Is the Collateral Mortgagor Personally Liable?"

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COMMENTS

The Third Circuit Trilogy: "Is the Collateral Mortgagor Personally Liable?"

I. INTRODUCTION

Is the maker of a collateral mortgage note personally liable for the face value of the note when such amount is greater than the value of the property which secures the note via a collateral mortgage? If the maker of the collateral mortgage note is also the principal obligor of the debt which the collateral mortgage note secures, the question is superfluous since the maker of the collateral mortgage note is already personally liable for the principal debt secured. However, the question takes on added importance when the collateral mortgagor secures the debt of a third person. Does the collateral mortgagor take on personal liability by securing the debt of a third party? From the viewpoint of the collateral mortgagor, the answer to this question can mean the difference between relinquishing only a certain portion of his patrimony to the holder of the collateral mortgage note and subjecting the entirety of his patrimony to the claim of such holder. The difference in the two results is significant and hinges on whether the liability created by a collateral mortgage package is in rem or in personam.

Louisiana courts have taken divergent positions, commentators have authoritatively proclaimed the collateral mortgagor is personally bound, and the Louisiana Supreme Court has declined to offer a final and definitive answer. The purpose of this article is to analyze these differing opinions, or lack of opinion, and possibly offer a view that has not been completely articulated in the jurisprudence or commentary. This article will begin with an analysis of the "Third Circuit Trilogy." The "Trilogy" encompasses three Louisiana Third Circuit Court of Appeal decisions in which the court has adopted the position that the maker of the collateral mortgage note does incur personal liability when securing the debt of a third person. An analysis of a contrary position will follow with decisions from two Louisiana Courts of Appeal and a United States District Court. Finally, this article will conclude with a critique of the Louisiana Law Review article which sparked the current split in authority.

II. THE THIRD CIRCUIT TRILOGY

A. Bank of Lafayette v. Bailey

The notion that a collateral mortgagor is personally liable for the debt evidenced by a collateral mortgage note was first recognized by the third circuit in the case of *Bank of Lafayette v. Bailey.*[1] In *Bailey*, a husband and wife

1. 531 So. 2d 294 (La. App. 3d Cir.), *rev'd in part*, 533 So. 2d 5 (1988).

executed a collateral mortgage of immovable community property and executed a collateral mortgage note for $250,000.[2] The collateral mortgage note was secured by the mortgage, payable on demand, and signed by both parties. Two days later, both parties executed a pledge of the collateral mortgage and collateral mortgage note to secure any indebtedness of the husband up to $250,000. The husband subsequently executed a hand note which he defaulted on, resulting in a seizure and sale of the mortgaged property and a deficiency judgment against the wife for the unsatisfied portion of the hand note.

Finding the wife personally liable for such deficiency, the court held that "the collateral mortgage note being pledged for [the hand note] . . . bound both Mr. and Mrs. Bailey, in solido, for payment of the . . . [hand note] up to the full amount of the collateral mortgage note."[3] Although the court did not expressly state that the maker of a collateral mortgage note is subject to personal liability for such note, such a conclusion is inevitable because the wife did not co-sign the hand note. Had the wife co-signed the hand note, a finding of personal liability would not have been problematic.[4]

Furthermore, the court's recognition that the husband and wife were solidarily liable lends support to the view that the maker of a collateral mortgage note is personally liable on the note. Had the court held that the maker of a collateral mortgage note is not bound in personam but only in rem, the court arguably would have been unable to find solidary liability between the parties. This results because "[a]n obligation is solidary for the obligors when each obligor is liable for the whole performance."[5] If the maker of the collateral mortgage note is bound only up to the value of the property which secures the note, she would not be liable for the whole performance of the hand note. In contrast, the maker of the hand note would be liable for the whole performance of his obligation. Likewise, it has been held that where one obligor is bound in rem and the other is personally bound for the same obligation, there can be no solidary relationship between the obligors.[6] Thus, the *Bailey* court's finding of solidary liability between the husband and wife was obviously dependent on its view that the maker of a collateral mortgage note is personally bound to the holder of such note.

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2. *Id.*

3. *Id.* at 298.

4. *See* La. R.S. 10:3-401 which provides in part: "(a) A person is not liable on an instrument unless (i) the person signed the instrument. . . ."

5. La. Civ. Code art. 1794; *but see* Hoefly v. GEICO, 418 So. 2d 575 (La. 1982) (uninsured motorist insurer solidarily liable with tortfeasor up to amount of policy limits but not solidarily liable for damages that exceed policy limits).

6. Genina Marine Servs., Inc. v. Arco Oil & Gas Co., 552 So. 2d 1005 (La. App. 1st Cir. 1990) (statutory lien created only in rem liability so that no solidary relationship existed with obligor who was bound personally).

B. Concordia Bank v. Lowry

With the *Bailey* decision as a backdrop, the third circuit again addressed the personal liability of the maker of a collateral mortgage note in *Concordia Bank v. Lowry*.[7] Six members of the Lowry family executed a collateral mortgage and $100,000 collateral mortgage note in favor of the lender.[8] The note was pledged pursuant to a pledge agreement in which all six family members agreed that the collateral mortgage would secure the indebtedness of any of the mortgagors. A hand note was subsequently executed by one of the family members in the amount of $61,859.67. The maker of the hand note defaulted and the lender obtained a $74,453.14 judgment against the six makers of the collateral mortgage note. In affirming the liability of the six family members for the debt represented by the hand note, the court made the following observation:

> While it is established that the hand note is the debt instrument in a collateral mortgage arrangement, it is equally clear that the maker of the collateral mortgage note is personally liable thereon. A collateral mortgage note, such as the one signed by appellants in the instant case, is a negotiable instrument. . . . Accordingly the collateral mortgage note creates a personal obligation for which the maker is liable. . . . However, such personal liability is limited to the lesser of the face amount of the collateral mortgage note and the amount owed in connection with the hand note.[9]

What was implicated in *Bailey* was clearly expressed in *Lowry*: the maker of a collateral mortgage note is personally liable; his liability is not limited to the value of the property which secures the note.[10] While the court made this seemingly broad statement, it never indicated whether the mortgaged property was sufficient to satisfy the $74,453.14 judgment. Without knowing what the mortgaged property would bring in a sheriff's sale, it would seem the court was premature in speculating on the personal liability of the maker of the collateral mortgage note beyond the value of the mortgaged property.[11] Nevertheless, the

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7. 533 So. 2d 170 (La. App. 3d Cir. 1988), *rev'd in part*, 539 So. 2d 46 (1989).

8. *Id.*

9. *Id.* at 172-73.

10. *Id.*

11. Interestingly, Judge Foret, who authored the majority opinion in *Lowry*, also filed a concurring opinion in *Lowry* in which he questioned the correctness of the *Bailey* opinion and its implication that the maker of a collateral mortgage note be held personally liable on the note. Judge Foret noted in his concurrence that "[t]o hold the maker personally liable over and above the value of the property amounts to personal suretyship, which must be express in no uncertain terms. . . . I doubt that suretyship would be found in this case." 533 So. 2d at 176. On an application for writs to the supreme court, Justice Calogero filed a concurring opinion on a partial granting of writs and recognized that the issue of personal liability of the maker of a collateral mortgage note had not been decided by the Court. While the issue was not before the court on appeal, Justice Calogero stated

court firmly stated its position in relation to the personal liability of the maker of a collateral mortgage note.

C. Merchants & Farmers Bank & Trust v. Smith

To complete the trilogy, the third circuit in *Merchants & Farmers Bank & Trust v. Smith*[12] once again affirmed its position that the maker of a collateral mortgage note is personally liable on the note beyond the value of the mortgaged property. In *Smith*, Rivers and Smith executed a collateral mortgage and collateral mortgage note to secure a hand note executed by Smith and endorsed by Rivers.[13] Smith defaulted on the hand note and the lender sued Rivers on the collateral mortgage note. Rivers denied liability beyond the value of the mortgaged property. Affirming its earlier decisions, the court found that the maker of a collateral mortgage note is personally liable on the pledged note for the obligation created by the hand note.[14]

Unlike *Bailey* and *Lowry*, the court's finding Rivers personally liable was probably correct. Rivers, as the co-maker of the collateral mortgage note, had also endorsed the hand note. Because Smith was unable to pay the hand note when it became due, the note was dishonored.[15] Under Louisiana Revised Statutes 10:3-415, when an instrument is dishonored, an endorser is obligated to pay the amount due on the instrument.[16] Thus, Rivers would have incurred separate personal liability on the hand note as opposed to personal liability on the collateral mortgage note. The court likely avoided this distinction because of contested testimony concerning whether or not the lender and Rivers intended that "he was signing the reverse side of the hand note only to acknowledge the collateral mortgage and collateral mortgage note as security for the hand note."[17]

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that he "would be inclined to favor granting such a writ so that this Court could consider and decide the issue." 539 So. 2d 46, 47 (La. 1989).

12. 559 So. 2d 845 (La. App. 3d Cir. 1990).

13. *Id.*

14. *Id.*

15. *See* La. R.S. 10:3-502, which provides in part:

> (a) Dishonor of a note is governed by the following rules:
>
> (1) If the note is payable on demand, the note is dishonored if presentment is duly made to the maker and the note is not paid on the day of presentment.
>
> (2) If the note is not payable on demand and is payable at or through a bank or the terms of the note require presentment, the note is dishonored if presentment is duly made and the note is not paid on the day it becomes payable or the day of presentment, whichever is later.
>
> (3) If the note is not payable on demand and Paragraph (2) does not apply, the note is dishonored if it is not paid on the day it becomes payable.

16. *See* La. R.S. 10:3-415 (1993).

17. 559 So. 2d. at 848.

III. THE CONTRARY POSITION: NO PERSONAL LIABILITY

A. Commercial National Bank in Shreveport v. Succession of Rogers

Faced with the "Third Circuit Trilogy," the second circuit in *Commercial National Bank v. Rogers*[18] declined to hold the maker of a collateral mortgage note personally liable beyond the value of the mortgaged property. In *Rogers*, Hartsfield, Bennett, and Rogers, along with each of their wives, executed a collateral mortgage and $500,000 collateral mortgage note to secure the $350,000 hand note executed by Hartsfied, Bennet, and Rogers without their wives.[19] The husbands defaulted, the mortgaged property was sold, and the lender sought to recover a deficiency judgment against the husbands and their respective wives. In affirming the trial court's decision that the wives incurred no personal liability, the second circuit held that "under the facts of this case, the makers of the collateral mortgage note who did not execute the hand note have no liability beyond the value of the mortgaged property."[20] The court reasoned that the hand note and not the collateral mortgage note represented the actual debt.[21] Since the wives did not execute the hand note nor express any intention to become personally liable by signing the collateral mortgage and the collateral mortgage note, they incurred no personal liability beyond the value of the mortgaged property.

The court went further to state that if the lender wanted to hold the wives personally liable on the hand note, it could have required the wives to sign the hand note or "execute some other document guaranteeing payment of the underlying debt. . . ."[22] Such a personal guarantee would have amounted to a contract of suretyship which "must be express and in writing."[23] Because no such agreement existed, the lender's recovery against the wives was limited to the value of the mortgaged property.

In contrast to its decision in *Rogers*, the second circuit did find that "some other document guaranteeing payment of the underlying debt" existed in *Ruston State Bank v. Colvin*.[24] In *Colvin*, the collateral mortgagors did not sign the hand note, although they did execute a document in addition to the collateral mortgage and collateral mortgage note. The additional document expressed an intention that the collateral mortgagors be bound in solido with the makers of the hand note for the obligation evidenced by the hand note. Because this document created solidary liability on the principal obligation, the makers of the collateral mortgage note were personally liable beyond the value of the mortgaged

18. 628 So. 2d 33 (La. App. 2d Cir. 1993).
19. *Id.*
20. *Id.* at 36.
21. *Id.* at 33.
22. *Id.* at 37.
23. La. Civ. Code art. 3038.
24. 679 So. 2d 162 (La. App. 2d Cir. 1996).

property. This additional document, along with the intent of the parties, created personal liability on behalf of the collateral mortgagors. While the court did not express an opinion as to whether this additional document was a suretyship contract, such a finding would have been supported by the facts of the case.[25]

B. Pontchartrain State Bank v. Lybrand

In a lengthy criticism of the "Third Circuit Trilogy", the court in *Pontchartrain State Bank v. Lybrand*[26] adopted the position that the liability of the maker of a collateral mortgage note is "limited to the value of the property that stands behind the collateral mortgage."[27] In *Lybrand*, four individuals executed a collateral mortgage and collateral mortgage note to secure the hand note of one of the individuals.[28] Faced with the question of whether or not the maker of a collateral mortgage note is personally liable on the debt represented by the hand note, the court answered in the negative. It reasoned that "the maker of the collateral mortgage and collateral mortgage note who pledges that mortgage and note to secure the hand note of a third party is typically not asked to co-sign the hand note because there is a common understanding that liability is limited to the value of the property that stands behind the collateral mortgage."[29]

The court also echoed the second circuit's view in *Succession of Rogers* that to impose personal liability on the collateral mortgagor would require a finding of a suretyship agreement. The court stated that to "impose personal liability [on a collateral mortgagor who secures the debt of a third person] is, at a minimum, to sanction the circumvention of Louisiana's strict requirement that personal suretyship be express."[30] Because a standard collateral mortgage does not express the unequivocal intent that the collateral mortgagor personally bind himself to the creditor, no suretyship contract exists and thus the collateral mortgagor is not personally liable for the debt of a third person.

C. Bank of New Orleans and Trust Co. v. H.P.B., Jr. Development Co.

Although the United States District Court in *Lybrand* distinguished the "Third Circuit Trilogy" because of a supposed lack of jurisprudence supporting its position, it neglected to analyze the Louisiana Fifth Circuit Court of Appeal's

25. The additional document the collateral mortgagors executed stated in part that "we the signers, endorsers, guarantors, and sureties and each of us in solido, promise to pay. . . ." 679 So. 2d at 164. This language would have been sufficient to create a contract of suretyship under Louisiana Civil Code article 3038 which states that "[s]uretyship must be express and in writing."

26. 799 F. Supp. 633 (E.D. La. 1992).

27. *Id.* at 640.

28. *Id.*

29. *Id.*

30. *Id.* at 641.

decision, *Bank of New Orleans and Trust Co. v. H.P.B., Jr. Development Co.*[31] Like the other decisions discussed above, *H.P.B., Jr. Development Co.* also involved the issue of the personal liability of a collateral mortgagor who secures the debt of a third person. Like the collateral mortgagor in *Merchants & Farmers Bank & Trust v. Smith*, the collateral mortgagor in *H.P.B., Jr. Development Co.* also signed the back of the hand note. However, the court noted that the collateral mortgagor "executed the back of the hand note only to effectuate the pledge of the collateral mortgage, . . . as recited, and [the collateral mortgagor] did not execute or endorse as a co-maker or solidary surety. In other words, [the collateral mortgage] was in rem and [the collateral mortgagor] had no in personam liability. . . ."[32] Although the quoted language was not essential to the court's disposition of the case, the court's position in terms of the personal liability of the maker of the collateral mortgage note was made clear: the maker of a collateral mortgage note is not personally liable on such note when it is used to secure the debt of a third person.

IV. The Birth of the Controversy

While *Bailey* is "the linchpin case for the argument that collateral mortgages do create personal liability for the maker,"[33] Professor Rubin's law review article[34] was the catalyst that sparked the conflict between the circuits. As stated by Judge Foret in his concurrence in *Lowry*, "I based the result in my opinion on the *Bailey* case and on Rubin's law review article."[35] Even Justice Calogero, in his concurrence in the partial granting of writs in *Lowry*, acknowledged Professor Rubin's influence on the position that the maker of the collateral mortgage note is subject to personal liability beyond the value of the mortgaged property.[36]

Professor Rubin's article sets forth two principle arguments to support the view that the maker of a collateral mortgage note is personally liable for the deficiency due after seizure and sale of the mortgaged property. The first argument focuses on the accessory nature of a mortgage while the second is primarily based on the position that the collateral mortgage is not an in rem mortgage.

In relation to the first argument, Professor Rubin states that "[t]he personal liability of the maker of the collateral mortgage note is a necessity because a mortgage is an accessory obligation. . . . If the collateral mortgage note imparted no personal liability to its maker, the mortgage would secure nothing

31. 427 So. 2d 486 (La. App. 5th Cir. 1983).
32. *Id.* at 490.
33. 799 F. Supp. 633, 634 (E.D. La. 1992).
34. Michael H. Rubin, *Work of the Louisiana Appellate Courts for the 1978-79 Term: Security Devices*, 40 La. L. Rev. 572 (1979-80).
35. 533 So. 2d 170, 175 (La. App. 3d Cir. 1988), *rev'd in part*, 539 So. 2d 46 (1989).
36. 539 So. 2d 46, 47 (La. 1989).

and would fall of its own weight."[37] While there can be no argument that the "[m]ortgage is accessory to the obligation which it secures,"[38] the quoted statement fails to recognize that the hand note, and not the collateral mortgage note, is the obligation which the collateral mortgage "indirectly" secures.[39] The "collateral mortgage note does not represent the indebtedness; it is the security that is pledged to secure another note, usually the hand note, which represents the indebtedness."[40] As stated by Louisiana Civil Code article 3297, "[t]he mortgagee's recourse for the satisfaction of an obligation secured by a mortgage may be limited in whole or in part to the property over which the mortgage is established." Under the express language of Louisiana Civil Code article 3297, "obligations secured by a mortgage" is broad enough to encompass obligations "directly" or "indirectly" secured by a mortgage. The code article itself posses no restrictions on the nature of the obligation secured so that a collateral mortgage could indirectly secure the obligation evidenced by the hand, as opposed to the collateral mortgage, note.

Vital to understanding the accessory nature of the mortgage contract, especially in relation to securing the debt of a third person, is the distinction between the obligation which the mortgage itself creates and the obligation created by the hand note which the mortgage indirectly secures. The mortgage contract creates an accessory obligation which is a real, not a personal, obligation: the mortgage burdens the property of the mortgagor, not the person of the mortgagor.[41] As a result, "[a]n agreement that enforcement of the obligation will be restricted to proceeds realized from execution upon the mortgaged property is not contrary to the accessory nature of the security."[42] Whether the mortgagor also incurs personal liability in relation to the obligation which the mortgage secures depends on the "[c]ontracts or agreements limiting the right of recourse of the creditor to the mortgaged property . . . for satisfaction of the principal obligation, . . . not the accessory rights securing it."[43] Even if the mortgagee's recourse is limited, the mortgage continues to be a real right that burdens the property of the mortgagor and secures the obligation of the third person up to the value of the property.

The conclusion that the mortgage would not lose its fundamental characteristic as an accessory obligation if the mortgagor incurred no personal liability is supported by the Louisiana Supreme Court's decision in *Schexnailder v.*

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37. Rubin, *supra* note 34, at 582-83.

38. La. Civ. Code art. 3282.

39. *See* First Guar. Bank v. Alford, 366 So. 2d 1299, 1302 (La. 1978) ("A collateral mortgage indirectly secures a debt via a pledge.").

40. Cameron Brown S., Inc. v. East Glen Oaks, Inc., 341 So. 2d 450, 456 (La. App. 1st Cir. 1976).

41. *See* La. Civ. Code art. 1763 which states, "A real obligation is a duty correlative and incidental to a real right."

42. La. Civ. Code art. 3282, rev. cmt. (a). Such a mortgage which imparts no personal liability is what is referred to as the "in rem mortgage."

43. La. Civ. Code art. 3297, rev. cmt. (b).

Fontenot.[44] In analyzing Louisiana Civil Code article 3285 (1870), which was the predecessor to current Louisiana Civil Code article 3282, the court made the following observation concerning the validity of a mortgage that imported no personal liability on the mortgagor:

> [t]here must be a principal indebtedness or obligation to support the accessory stipulation or lien of the mortgage, but this does not mean that there shall be a personal liability. A mortgage, whether conventional or judicial, imposes a real right or obligation upon the property bound for its discharge.... There is nothing to prevent, and, in fact, it is not uncommon for a mortgage to be given with the stipulation that the mortgagor shall not be personally bound beyond the value of the property so mortgaged.[45]

Limiting a creditor's recourse to the value of the mortgaged property would not violate the fundamental requirement that a principal obligation exist. An obligation exists, but such obligation is real and not personal. However, this leads to the conclusion that the collateral mortgage is an in rem mortgage and as such, runs counter to Professor Rubin's argument that the collateral mortgage is not, and cannot be, an "in rem" mortgage.

Professor Rubin begins his argument by stating that "[t]he collateral mortgage package is not an in rem obligation, and the creditor's rights should not be restricted to the amount the mortgage property brings at a sheriff's sale."[46] Professor Rubin then sets forth three reasons why classifying collateral mortgages as "in rem" mortgages would seriously effect commercial 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. Second, it would alter the usual and customary concept of "in rem" mortgages. Third, it would mean that a collateral mortgage note is non-negotiable.[47]

In regard to classifying a collateral mortgage note as non-negotiable if the note is part of an "in rem" mortgage, Professor Rubin's position may no longer be correct under current Louisiana commercial law. Although a negotiable instrument must still contain an "unconditional promise . . . to pay a fixed amount of money,"[48] a "promise . . . is not made conditional . . . because payment is limited to resort to a particular fund or source."[49] This is a change

44. 85 So. 207 (La. 1920).
45. *Id.* at 210.
46. Rubin, *supra* note 34, at 583.
47. *Id.*
48. La. R.S. 10:3-104(a).
49. La. R.S. 10:3-106(b).

from the former law which made a note conditional, and thus non-negotiable, when recovery was limited to a particular fund or to the value of a particular piece of collateral.[50] Thus, under former Louisiana law, if recovery of a collateral mortgage note was limited to the value of the mortgaged property, the note was not an unconditional promise and non-negotiable.

Because Louisiana courts have not yet defined what is included in "a particular fund or source" under Louisiana Revised Statutes 10:3-106(b), it is arguable that a collateral mortgage note which limits recovery to the value of the mortgaged property may still be classified as a non-negotiable instrument. If an "in rem" collateral mortgage note is non-negotiable, the ramifications of labeling the note as such is two fold according to Professor Rubin. Labeling collateral mortgage notes as non-negotiable would require the overruling of a series of cases that have enforced collateral mortgages pledged by one person to secure the debt of another and would "destroy the utility of collateral mortgages" when used in executory proceedings.[51]

In support of his position that certain cases would require overruling, Professor Rubin cites *Rex Finance Co. v. Cary*[52] and *Baker Bank and Trust Co. v. Behrnes*.[53] Although Professor Rubin did not express why these cases would have to be overruled, one can assume such an overruling would occur as a result of classifying a collateral mortgage note as non-negotiable. Arguably, the two cited cases stand for the proposition that the holder of a collateral mortgage note should be able to enforce such a note as a negotiable instrument in order to facilitate the practice of pledging a collateral mortgage note to secure the hand note of a third person. The creditor who is a holder in due course could enforce the collateral mortgage note as a negotiable instrument, free of the claims and defenses the collateral mortgagor may have against the third person whose debt the mortgagor secured with the collateral mortgage note.[54] If the collateral mortgage note were non-negotiable, the creditor's enforcement of the note against the collateral mortgagor would be subject to the collateral mortgagor's defenses against the third person whose debt was secured. This arguably would defeat the commercial attractiveness of using the collateral mortgage as a device to secure the debts of a third person.

However, just because the classification of a collateral mortgage note as non-negotiable is commercially unappealing does not lead to the conclusion that such classification is not legally sound. In fact, the Louisiana Supreme Court in *First*

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50. *See* La. R.S. 10:3-105(2)(b) (1974); Rubin, *supra* note 34, at 583; La. R.S. 10:3-106(b), cmt. 1 which provides in part: "Under Section 3-106(b) a promise or order is not made conditional because payment is limited to payment from a particular source or fund. This reverses the result of former Section 3-105(2)(b). There is no cogent reason why the general credit of a legal entity must be pledged to have a negotiable instrument."

51. Rubin, *supra* note 34, at 583.

52. 154 So. 2d 360 (La. 1963).

53. 217 So. 2d 461 (La. App. 1st Cir. 1968).

54. *See* La. R.S. 10:3-305 (1993).

Guaranty Bank v. Alford[55] expressed its concern in labeling a collateral mortgage note a negotiable instrument. In *Alford*, a husband and wife executed a collateral mortgage and collateral mortgage note to secure a specified $155,000 hand note signed by the husband.[56] The husband subsequently obtained additional advances on separate promissory notes which were purportedly secured by the original pledge of the collateral mortgage note. In finding that the wife, as pledgor, did not agree to secure the subsequent loans, the court held that the subsequent advances were not secured by the prior pledge of the collateral mortgage note. The court found that although "the collateral mortgage note was in effect a negotiable bearer instrument, a matter which we initially found troubling, is of no moment. It was not a debt instrument but a security device, a pledge instrument."[57]

Important in the court's analysis was the distinction it recognized between a debt instrument and a pledge instrument, a distinction that was overlooked or ignored in *Rex Finance Co. v. Cary*[58] and *Baker Bank and Trust Co. v. Behrnes*.[59] As a true debt instrument, a collateral mortgage bearer note could be transferred to a total stranger who, as a holder in due course, could then enforce the note against the collateral mortgagor.[60] Such enforcement would require no showing of a relationship between the stranger and the collateral mortgagor. The collateral mortgagor's liability would not be limited to the value of the mortgaged property. As stated by the court in *Behrnes*, "we [cannot] accept the argument that the intention of the parties control whether there is a pledge or a negotiation of the note. We have already found that a pledgee of a negotiable instrument is a holder thereof by operation of law."[61] The logical extension of this statement would result in a total disregard of the purpose of the collateral mortgage: an indirect security device for the payment of the hand note which represents the true indebtedness.[62] The view that the collateral mortgage note is a debt instrument, as opposed to a pledge instrument, enforceable independent of the hand note disregards the basic premise that a collateral mortgage is an accessory and not a principal contract. The collateral mortgage note would be enforceable regardless of the status of the principal debt represented by the hand note. However, because the court in *Alford* appeared to reject the position that a collateral mortgage note is a debt instrument, one can argue that the court's language overruled the implication that a collateral mortgage note is a negotiable instrument.

55. 366 So. 2d 1299 (La. 1978).
56. *Id.*
57. *Id.* at 1303.
58. 154 So. 2d 360 (La. 1963).
59. 217 So. 2d 461 (La. App. 1st Cir. 1968).
60. *See* La. R.S. 10:3-305 (1993).
61. 217 So. 2d at 463.
62. *See* Cameron Brown S., Inc. v. East Glen Oaks, Inc., 341 So. 2d 450 (La. App. 1st Cir. 1976).

While classifying a collateral mortgage note as a non-negotiable instrument would support the position that the note is "in rem," Professor Rubin would undoubtedly argue that such a finding would destroy the utility of the collateral mortgage in terms of enforcement through executory process. As stated by Professor Rubin, "[s]uch 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."[63]

Although Professor Rubin's statement was probably correct when he made it, the adoption of Chapter 9 of the Louisiana Commercial Law by the legislature in 1990 leads to a contrary conclusion today.[64] Under current law, there is no longer a "true pledge" of the collateral mortgage note. The Civil Code articles on pledge were displaced by the provisions of Louisiana Revised Statutes 10:9-101 et. seq. and the provisions of the "Collateral Mortgage Act."[65]

Today, a creditor obtains rights to a collateral mortgage note by perfecting a security interest in the collateral mortgage note under the provision of Chapter 9 of the Louisiana Commercial Laws.[66] Once perfected, the assignment or other transfer of the collateral mortgage note can be proven by a private writing without the need of authentic evidence.[67] Under Louisiana Revised Statutes 10:9-508(1)(b), such a private writing is deemed authentic for purposes of executory process.[68] The collateral mortgagor or subsequent transferees can transfer the collateral mortgage note without the need of authentic evidence of such transfer, even where such note is non-negotiable. All that is required for foreclosure on the collateral mortgage and collateral mortgage note is that the collateral mortgage note be subject to a Chapter 9 security interest.

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63. Rubin, *supra* note 34, at 583.

64. *See* Louisiana Nat'l Bank of Baton Rouge v. Heroman, 280 So. 2d 362 (La. App. 1st Cir. 1973). Prior to 1990, the Civil Code articles on pledge controlled the rights of the pledgee and pledgor with respect to the collateral mortgage note.

65. La. R.S. 9:5550-5557 (1991 and Supp. 1999).

66. La. R.S. 9:5551 (Supp. 1999).

67. *See* La. R.S. 10:9-508(1)(b) which provides in part: "the assignment, pledge, or other transfer in whole or in part, of an obligation or of any right therein or thereto secured by a security interest subject to the provisions of [Chapter 9] . . . may be proven by any form of private writing signed by the secured party, or any person entitled to effect such a transfer, and such writing shall be deemed authentic for purposes of executory process."

68. *See also* La. Code Civ. P. art. 2636 which provides in part: "The following documentary evidence shall be deemed to be authentic for purposes of executory process: (1) The note, bond, or other instrument evidencing the obligation secured by the mortgage, security agreement, or privilege, paraphed for identification with the act of mortgage or privilege by the notary or other officer before whom it is executed, with the exception that a paraph is not necessary in connection with a note secured by a security agreement subject to Chapter 9 of the Louisiana Commercial Laws." A collateral mortgage note is an "instrument evidencing the obligation secured by the mortgage", which note is secured by a Chapter 9 security agreement. Thus, a collateral mortgage note is "deemed to be authentic for purposes of executory process."

V. CONCLUSION

The maker of a collateral mortgage note does not incur personal liability when he executes a collateral mortgage and collateral mortgage note to secure the debt of a third person. When the maker of a collateral mortgage note is not a party to the hand note, the maker's liability should be limited to the value of the property subject to the collateral mortgage. Although the third circuit has rendered three opinions imposing personal liability on the maker of a collateral mortgage in such a situation, the second circuit has taken an opposite and more defensible position. The second circuit's approach would not impose personal liability on the maker of a collateral mortgage note when the note is used to secure the debt of a third person.

When a collateral mortgage note secures the debt of a third person, the collateral mortgage note is used as a pledge instrument as opposed to a debt instrument. The debt instrument is the hand note which represents the principal obligation incurred by the third person. Recognition that the hand note is evidence of the principal obligation also reinforces the fundamental principle that a mortgage is an accessory obligation. While the collateral mortgage note is not a mortgage contract in itself, it is a security device that indirectly secures the principal obligation represented by the hand note. The collateral mortgage note simply facilitates the accessory obligation represented by the collateral mortgage contract.

Unless the collateral mortgagor signs a separate instrument evidencing an intent to become a surety or co-signs the hand note,[69] the collateral mortgagor's liability should be limited to the value of the property mortgaged. Because the collateral mortgage note is not evidence of the indebtedness, it should not be independently enforced as a negotiable instrument. These observations result from the conclusion that the collateral mortgage note represents an "in rem" obligation. As an "in rem" obligation, the collateral mortgage note maintains its position as a pledge instrument, avoiding the result of subjecting the entire patrimony of the collateral mortgagor to the claims of a creditor. Although the collateral mortgage note would be non-negotiable as a result of being an in-rem obligation, the collateral mortgage note would still be enforceable under Louisiana's executory process because of the provisions of Louisiana Revised Statutes 10:9-508(1)(b).

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69. *See* Pontchartrain State Bank v. Lybrand, 799 F. Supp. 633, 640 (E.D. La. 1992) ("the maker of the collateral mortgage and collateral mortgage note who pledges that mortgage and note to secure the hand note of a third party is typically not asked to co-sign the hand note because there is a common understanding that liability is limited to the value of the property that stands behind the collateral mortgage.").