Mortgages -- Fiduciary Relationship of the Parties

Emmett C. Willis Jr.

therefore, that she did not get the land is to say in substance that she held it to keep it away from Vest's creditors or that she immediately conveyed it to her daughter for the same purpose. It is to be doubted whether she should not be estopped to relieve herself of an obligation by the use of such a plea.

The brief of the appellee-mortgagee reveals no less than six conveyances made by or to Mrs. Booth within some three years' time for the sole purpose of defrauding and hindering her own or the Vests' creditors.[8] In such a situation, created by the mother-in-law as well as the Vests and participated in by the whole family, it would seem that any doubts should be resolved in favor of the creditors.

On the court's interpretation of the facts, the result reached in the principal case is defensible. It would not have been under other interpretations. The opinion does not adequately indicate the problems involved.

PETER HAIRSTON.

Mortgages—Fiduciary Relationship of the Parties.

The defendant operated an automobile sales agency. He borrowed money from the plaintiff acceptance company to purchase a car, delivering to the company his promissory note, a mortgage upon, and a bill of sale to, the car, and a trust receipt. That document stated that the defendant would hold the car in storage as the property of the company and would not dispose of it until the note was paid. While in the defendant's display room, the car was sold without the plaintiff's consent. The defendant failed to remit the purchase price; rather he filed a petition in bankruptcy and received his discharge. The acceptance company had been listed as a creditor in the bankruptcy proceedings. Following the filing of the petition, this action for conversion was instituted. The company contended that the defendant's acts came within section 17(4) of the Bankruptcy Act,[a] which provides that discharge in bankruptcy does not release liabilities created by "fraud, embezzlement, misappropriation, or defalcation while acting in any . . . fiduciary capacity." Judgment was rendered for the defendant.[1]

It may be safely stated that the line of cleavage between those who

[8] Brief filed on behalf of Elizabeth E. Keiffer, Appellee, in the Supreme Court of Appeals of West Virginia in the case of Lawhead v. Booth *et al.*, page 8.

[a] 11 U. S. C. A. 35 (4) (1927).

[1] Davis v. Aetna Acceptance Co., U. S., 79 L. ed. 137, 55 Sup. Ct. 151 (1934) (The problem of whether the defendant had wilfully and maliciously injured the plaintiff's property within the terms of subdivision two of the same sections was also presented. The court decided that the evidence showed a technical but not a malicious conversion); *cf. In re* Burchfield, 31 F. (2d) 118 (W. D. N. Y. 1929).

are and who are not in a "fiduciary capacity" within the meaning of the Bankruptcy Act is clear. That term applies only to expressed or technical trusts as contrasted to those situations where the courts imply an obligation from the trust or confidence reposed in the debtor.[2] It is essential that the relationship exist before the debt from which the cause of action arose was contracted.[3] Thus it has been held that the exception stated in the Act does not apply to a broker,[4] a partner,[5] a mortgagor,[6] or, as in the principal case, to one who gave a trust receipt upon a consignment of cars.[7] If a debtor who has posted security to protect his creditor is not a fiduciary within the meaning of the exception, an interesting problem arises in determining just what, if any, is the extent of the confidential relation existing between these parties.

Where the debtor wrongfully disposes of the security, the injured creditor has a right of action against him.[8] He may even follow the proceeds derived from the sale as long as they can be definitely identified and have not passed into the hands of a *bona fide* purchaser for value.[9] Though these remedies are settled, there exists some dispute as to the theory upon which they are based. In a leading case in Maine,[10] it was said that "the Law *imputes* a trust in the mortgagor." That the application of such a doctrine to the problem under discussion is unnecessary is shown by a more recent decision from Wyoming.[11] There the same result was obtained by treating the mortgagor as an agent of the mortgagee. Still other courts have held that while in using the security in the ordinary course of business the mortgagor is no trustee, he is under a duty to preserve that security intact.[12]

Correspondingly, the courts are faced with the same difficulty of nomenclature in determining the reverse situation—the nature of a credi-

[2] Chapman v. Forsythe, 69 U. S. 202, 11 L. ed. 250 (1844); *In re* Harber, 9 F. (2d) 551 (C. C. A. 2d, 1925).

[3] Upshur v. Briscoe, 138 U. S. 365, 11 Sup. Ct. 313, 34 L. ed. 931 (1891); Clair v. Colmes, 245 Mass. 281, 139 N. E. 519 (1923).

[4] *In re Codman*, 284 Fed. 273 (D. Mass. 1922).

[5] *In re Frazzetta*, 1 F. Supp. 122 (W. D. N. Y. 1932); Karger v. Orth, 116 Minn. 124, 133 N. W. 471 (1911).

[6] Bryant v. Kenyon, 127 Mich. 152, 86 N. W. 531 (1901). But *cf.* Johnson v. Worden, 47 Vt. 457 (1874); Darling v. Woodward, 54 Vt. 101 (1881) (where a different result was reached. However, in neither of these cases does it appear within which specific exception to the Bankruptcy Act the defendant was included.)

[7] Bloomingdale v. Dreher, 31 F. (2d) 93 (C. C. A. 3d, 1929).

[8] Davis v. Virginia Ry. & Power Co., 229 Fed. 633 (C. C. A. 4th, 1915).

[9] Columbia Basin Wool Warehouse Co. v. First Nat. Bank of Fairchild, 290 Fed. 260 (D. Idaho 1923); First Nat. Bank of Auburn v. Eastern Trust & Banking Co., 108 Me. 79, 76 Atl. 4 (1911); *cf.* Texas Moline Plow Co. v. Kingman Texas Implement Co., 32 Tex. Civ. App. 343, 80 S. W. 1042 (1904) (where the question of what constitutes identification is discussed).

[10] McLarren v. Brewer, 51 Me. 402 (1863).

[11] Thex v. Shreve, 38 Wyo. 285, 267 Pac. 92 (1928).

[12] Davis v. Virginia Ry. & Power Co., 229 Fed. 633 (C. C. A. 4th, 1915).

tor's duty toward his debtor. Here, however, a greater number of cases have arisen than in the above situation; thus one has the benefit of the added judicial expression. Roughly the decisions may be divided into two classes: Those that arise in states which treat the mortgagee as having a mere lien upon the debtor's property; and those which hold that the giving of a mortgage transfers legal title to the mortgagee. In North Carolina, which is within the latter class, the mortgagee is deemed to hold the legal title in trust for the mortgagor.[13] Except for taking possession of the property and the institution of foreclosure proceedings on default, he is permitted to do no act detrimental to his debtor's interest.[14] Thus it has been held that he may not extinguish the mortgagor's equity of redemption by a purchase of the security at a tax sale,[15] or at a foreclosure of either a prior encumbrance,[16] or his own mortgage.[17] Nor may he contract to acquire his debtor's equity of redemption without assuming the burden of showing that the transaction was fair.[18] At least one other state that accepts the "title" theory is in accord.[19] A different principle is advanced in those states that consider the mortgagor as having legal title to the security,[20] although even here it has been held that the mortgagee is a trustee.[21] That doctrine was aptly stated in a case arising in New York,[22] where it was said

[13] Taylor v. Heggie, 83 N. C. 244 (1880).
[14] McLeod v. Bullard, 86 N. C. 210 (1882).
[15] Cauley v. Sutton, 150 N. C. 327, 64 S. E. 3 (1909).
[16] Taylor v. Heggie, 83 N. C. 244 (1880).
[17] Dawkins v. Patterson, 87 N. C. 384 (1882); Warren v. Susman, 168 N. C. 457, 84 S. E. 760 (1915).
[18] Pritchard v. Smith, 160 N. C. 79, 75 S. E. 803 (1912); Cole v. Boyd, 175 N. C. 555, 95 S. E. 77 (1918).
[19] Stebbins v. Clendenin, 136 Ark. 391, 206 S. W. 681 (1918). *Contra,* Lee v. Fox, 113 Ind. 98, 14 N. E. 889 (1888).
[20] Waterson v. Devoe, 18 Kan. 223 (1877) (where the mortgagee was purchaser at a tax sale); Threlkeld v. Walker, 141 Ky. 737, 133 S. W. 772 (1911) (where the mortgagee became assignee of a purchaser at the foreclosure of a prior lien); Holliday v. McGraw, 101 Misc. Rep. 661, 176 N. Y. S. 661 (1919) (where the mortgagee's agent sold part of the security on credit); Bailey v. Frazier, 62 Ore. 142, 124 Pac. 643 (1912) (where creditor bought debtor's equity of redemption); see Hennequin v. Clews, 111 U. S. 676, 682, 28 L. ed. 565, 4 Sup. Ct. 576, 579 (1883).
[21] Block Motor Co. v. Melia, 247 S. W. 666 (Tex. Civ. App. 1923).
[22] Ten Eyck v. Craig, 62 N. Y. 406, 421 (1875) (continuing on page 422, the court stated the principle to be this: "A mortgagee is often called a trustee, and in a very limited sense this character may be attributed to him. There may be a duty resting upon a mortgagee in possession to discharge a particular claim against the land. If in such a case he omits to do it, and allows the land to be sold on such a claim, and becomes the purchaser, he would hold the title in trust for the mortgagor. A mortgagee in possession is allowed, and it may be his duty to pay the taxes on the land out of the rents and profits. If he suffers the land to be sold for taxes in violation of his duty, and purchases at the sale, he would upon general principles be deemed to hold title as trustee. . . . A mortgagee in possession is bound to account for rents and profits; and in that respect . . . he may be denominated a trustee. But, except in some special sense, that is not the relation he bears to the mortgagor."

that "There is, in truth, no relation analogous to that of trustee and *cestui que trust* between the mortgagor and mortgagee created by the execution of the mortgage. The mortgagee is not a trustee of the legal title because, under our law, he has no title whatever. . . . He may deal with the mortgagor, in respect to the mortgaged estate, upon the same footing as any other person; he may buy in encumbrances for less than their face, and hold them against the mortgagor for the full amount; he may do what any other person may do, and his acts are not subject to impeachment simply because he is mortgagee."

It may be admitted that both parties occupy a fiduciary relationship toward each other in the sense that each owes the duty of using reasonable means to protect the other's interest; yet to make the unqualified statement that one party is a trustee for the other seems to be grafting upon the law of trusts an extension that may prove dangerous. Is it not both safer and more accurate to say that, like principal and agent, the mortgagor and mortgagee are bound to act fairly in respect to each other and to the property in which they are mutually interested? If the terms trustee and *cestui que trust* must be used to denote the relationship, it should always be remembered that they are not being applied in their technical sense.

EMMETT C. WILLIS, JR.

Mortgages—Suretyship where Grantee of Mortgagor Assumes Mortgage Debt.

The maker of a bond secured by a mortgage sold the mortgaged premises, his grantee assuming payment of the bond. Thereafter the mortgagee dealt directly with the grantee, receiving partial payments on the bond, and agreeing to an extension of time thereon without the mortgagor's consent. In a suit on the bond by the mortgagee against the mortgagor, *held,* as between the mortgagee and the mortgagor the character of the latter was not changed from principal to surety by the fact that his grantee "assumed" the mortgage. The mortgagor was therefore not discharged by the extension of time granted without his consent by the mortgagee to the grantee.[1]

Where the grantee "assumes" the mortgage debt it is generally held that he becomes personally liable therefor.[2] As a corollary to this

[1] Commercial National Bank of Charlotte v. Carson, 207 N. C. 495, 177 S. E. 335 (1934). This case proceeds upon the authority of Brown v. Turner, 202 N. C. 227, 162 S. E. 608 (1932), noted in (1932) 11 N. C. L. REV. 96.

[2] Keller v. Ashford, 133 U. S. 610 10 Sup. Ct. 494, 33 L. ed. 667 (1889); 2 JONES, MORTGAGES (8th ed. 1928) §934. This liability may be based upon either of two theories: first, that the mortgagee is subrogated to the rights of the mortgagor; or second, that the mortgagee, as a third party beneficiary, may sue the grantee directly. N. C. now allows a suit under either theory. Rector v. Lyda,