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## Credit Transactions—Mortgages—Purchase by Life Tenant

In *Morehead v. Harris*,<sup>1</sup> a husband, joined by his wife, had executed a deed of trust on two tracts of land as security for a loan. The husband died intestate with the debt outstanding. At a foreclosure sale pursuant to the terms of the deed of trust, the wife purchased the property for an amount equal to the unpaid balance of the loan plus the cost of foreclosure. She received a deed from the trustee purporting to vest in her a fee simple title to the property, which was worth considerably more than she had paid at the sale. The wife sold one tract of the property and devised the remaining tract to her sisters. Before her death, the children of her mortgagor-husband had begun litigation to recover both tracts of land. In granting a recovery to the children,<sup>2</sup> the North Carolina Supreme Court held that the wife purchased the property to protect her dower interest and, as a life tenant, she held the excess above her life estate in one-third of the property as trustee for the remaindermen.<sup>3</sup> By dictum, the court stated that if the wife, as life tenant, had paid more than her proportionate share, she would be a creditor of the estate for that amount.<sup>4</sup> The case gives rise to two issues that merit discussion: can a life tenant ever purchase mortgaged property free of trust and, when he cannot, how much of the purchase price can be recovered from the remaindermen as the excess above the life tenant's proportionate share?

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<sup>1</sup> 262 N.C. 330, 137 S.E.2d 174 (1964). The case had come before the court once before, but was remanded to the superior court because of an omission of necessary parties. *Morehead v. Harris*, 255 N.C. 130, 120 S.E.2d 425 (1961).

<sup>2</sup> This statement should be qualified in that a recovery was granted to the children as opposed to the wife, but as to the tract conveyed by the wife, the court remanded for a new trial on the grounds that the purchasers of the property may be in the position of bona fide purchasers for value and that the children had done nothing to protect their title. 262 N.C. at 344, 137 S.E.2d at 187.

<sup>3</sup> The wife was also the administratrix of the husband's estate, and the court said that she was acting in a fiduciary capacity. It was stated that when the fiduciary purchased at his own sale, he was a "trustee for the benefit of the estate to prevent loss to the estate." *Id.* at 336, 137 S.E.2d at 180. Even though the wife did not purchase at her own sale (since this sale was conducted by the trustee and not the administratrix of the estate), the rule was said to apply. However, this reasoning is not important since the trust would have been implied even if the wife had not been the administratrix.

<sup>4</sup> *Id.* at 336, 137 S.E.2d at 181.

North Carolina seems to be within the majority rule<sup>5</sup> that the life tenant becomes a trustee for the remaindermen when he purchases directly at the foreclosure sale.<sup>6</sup> However, the court makes a distinction where the life tenant purchases from a third party who bought at the sale. In an earlier North Carolina case,<sup>7</sup> a wife had executed a deed of trust to secure a loan. After her death, her husband, a life tenant by curtesy, allowed a foreclosure.<sup>8</sup> The land was purchased by a stranger who, on the same day, transferred the title to the husband for a consideration equal to the purchase price. When the children of the wife sought to recover the property, the court held that no trust was implied absent a jury finding of fraud or that the stranger acted as agent for the husband. Therefore, the husband received a valid fee simple title to the property.

In considering the rationale and policy in the cases imposing a trust on the life tenant, there seems to be justification for different results when the life tenant purchases directly at foreclosure and when he purchases from a third person. It is clear that any person claiming an interest in the property under the intestate mortgagor may redeem the property until foreclosure, at which time the re-

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<sup>5</sup> *Bullock v. Peoples Bank*, 351 Mo. 587, 602, 173 S.W.2d 753, 759 (1943); *Tindall v. Peterson*, 71 Neb. 160, 98 N.W. 688 (1904); *MaGee v. Carter*, 31 Tenn. App. 141, 148-49, 212 S.W.2d 902, 906 (1948). In *Tindall*, the wife of the mortgagor resigned as administratrix of his estate and purchased the property at the foreclosure sale. Without calling it a trust, the court held that she protected her life interest and the interest of the remaindermen.

<sup>6</sup> See *Farabow v. Perry*, 223 N.C. 21, 25 S.E.2d 173 (1943); *Creech v. Wilder*, 212 N.C. 162, 193 S.E. 281 (1937).

<sup>7</sup> *Miller v. Marriner*, 187 N.C. 449, 121 S.E. 770 (1924).

<sup>8</sup> Even though the life tenant holds the property as trustee for the remaindermen, there are times when the life tenant is justified in allowing a foreclosure on the deed of trust which will terminate the rights of the remaindermen in the property. It has been established in North Carolina that the life tenant is only liable to pay the interest on the encumbrance for the duration of the period in which the interest was due, and then only to the extent of the amount of "rent or actual value" received from the property. Therefore, the life tenant is not a trustee for the remaindermen in that he has to pay the interest to prevent a foreclosure under any circumstances. *Id.* at 455, 121 S.E.2d at 773. See also *Williams v. Williams*, 120 So. 2d 202 (Fla. 1960).

<sup>9</sup> In addition to the situation where the third party is acting as agent for the life tenant or there is fraud, it has been stated that the implied trust will also arise where there is an agreement between the life tenant and the third party that the life tenant provide an opportunity for the remaindermen to reimburse him and claim their interests. *Clark v. Cantwell*, 40 Tenn. 202 (1859).

demption rights are cut off.<sup>10</sup> It is also clear that the wife holds a dower right in the equity of redemption, the interest remaining in her mortgagor husband.<sup>11</sup> Since the wife is entitled to redeem the property before foreclosure, she is in an advantageous position to protect her dower interest from outside purchasers;<sup>12</sup> in saving such interest, she also protects the remaindermen from losing their rights in the property.<sup>13</sup> Therefore, if the wife does not redeem and is justified in allowing a foreclosure,<sup>14</sup> the courts will not allow her to bid in and purchase the property at a price below the fair value to the detriment of others claiming from the husband's estate.<sup>15</sup> In other words, she cannot obtain through a foreclosure purchase any estate in the property greater than she would obtain through redemption, and any attempt to do so will be barred by the court through imposition of a trust.

Aside from the fact that the life tenant will not usually be able to purchase at a price below the fair market value of the property when he buys from a third party who took under the foreclosure sale,<sup>16</sup> the main reason for allowing him to do so is that there is no detriment to the remaindermen. As previously stated, any person claiming under the intestate mortgagor has the power to redeem.<sup>17</sup> If the life tenant is justified in allowing a foreclosure, the rights of the remaindermen are cut off and there is no reason why the subsequent purchase by the former life tenant should be deemed to protect the interests of the remaindermen whose claims to the property are lost through their own inaction.

Assuming that the dowress does purchase at a foreclosure sale giving rise to an implied trust, or redeems the property in which case the mortgagor is entitled to the full amount of the encum-

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<sup>10</sup> *Brown v. Jennings*, 188 N.C. 155, 124 S.E. 150 (1924); I SCRIBNER, DOWER 461 (1867).

<sup>11</sup> *Gay v. J. Exum & Co.*, 234 N.C. 378, 67 S.E.2d 290 (1951), 30 N.C.L. REV. 310.

<sup>12</sup> The heirs could also redeem at any time before foreclosure if they were financially in a position to do so. See note 10 *supra* and accompanying text.

<sup>13</sup> *Brown v. Jennings*, 188 N.C. 155, 124 S.E. 150 (1924).

<sup>14</sup> See note 8 *supra* and accompanying text.

<sup>15</sup> For this basic proposition, see *Tindall v. Peterson*, 71 Neb. 160, 98 N.W. 688 (1904); *Miller v. Marriner*, 187 N.C. 449, 456, 121 S.E. 770, 774 (1924).

<sup>16</sup> Of course, the person bidding in at the foreclosure sale may not always be able to purchase the property for the amount of the encumbrance, but this was the case in both *Morehead* and *Miller v. Marriner*, *supra* note 15.

<sup>17</sup> See note 10 *supra* and accompanying text.

brance,<sup>18</sup> is she entitled to recover anything from the remaindermen for protecting their interests? North Carolina is in accord with the majority rule<sup>19</sup> that the wife is entitled to recover reimbursement from the remaindermen who wish to claim their interest in the property.<sup>20</sup> However, in using the language "if the life tenant pays more than his proportionate share, he simply becomes a creditor of the estate for that amount,"<sup>21</sup> the court in *Morehead* left two questions open: of whose estate is the life tenant a creditor and what is the "proportionate share" of the life tenant that must be determined to decide how much reimbursement he is entitled to?

In tracing the authority cited by the court, it is clear that the life tenant paying the encumbrance redeems from the mortgagee an interest in excess of the life estate and is subrogated to the rights of the mortgagee against this interest.<sup>22</sup> Moreover, the life tenant, having paid an obligation of the mortgagor, is entitled to a claim against his estate for the proportion of the amount paid by him for the interest beyond the life estate.<sup>23</sup>

As to a determination of the "proportionate share" of the wife,

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<sup>18</sup> *McCabe v. Bellows and Another*, 73 Mass. 148 (1856). However, there are certain situations in which the wife does not have to pay the full amount of the encumbrance in order to get her dower allotment in the property. If the holder of the mortgage does not wish to enforce payment of the principal, the wife may be allowed to continually contribute an amount to the mortgagee which is sufficient to pay one-third of the yearly interest on the amount due. *Bell v. Mayor &c. of New York*, 10 Paige 49 (N.Y. 1843). Where the heirs of the deceased mortgagor have redeemed, the widow must make contribution to them "in proportion to the value of her life estate in one-third of the property" in order to redeem such life estate. *Swaine v. Perine*, 5 Johns. Ch. R. 482 (N.Y. 1821).

<sup>19</sup> *Murphy v. May*, 243 Ala. 94, 8 So. 2d 442 (1942); *In re Daily's Estate*, 117 Mont. 194, 159 P.2d 327 (1945); 2 WASHBURN, REAL PROPERTY § 1142 (6th ed. 1902). However, it should be noted that the remaindermen may not be compelled to contribute because he may feel that it is in his best interest not to have the property redeemed. Of course, the remainderman cannot claim his interest free of the mortgage without contributing his proportionate interest. I SCRIBNER, DOWER 461 (1867).

<sup>20</sup> *Farabow v. Perry*, 223 N.C. 21, 25 S.E.2d 173 (1943); *Creech v. Wilder*, 212 N.C. 162, 193 S.E. 281 (1937).

<sup>21</sup> 262 N.C. at 336, 137 S.E.2d at 181.

<sup>22</sup> *Whitney v. Salter*, 36 Minn. 103, 30 N.W. 755 (1886); *Keller v. Fenske*, 123 Wis. 435, 101 N.W. 378 (1904). It has also been held that the wife of the mortgagor husband can redeem the property before the death of the mortgagor husband since she has an interest, although inchoate, in the equity of redemption and can recover reimbursement from the estate because her position is analogous to that of a surety for her husband. *Fitcher v. Griffiths*, 216 MASS. 174, 103 N.E. 471 (1913).

<sup>23</sup> *Whitney v. Salter*, *supra* note 22; *Keller v. Fenske*, *supra* note 22.

however, the authority does not lead to a specific conclusion and the North Carolina court has never decided the question. A review of the case law from other jurisdictions reveals two different views in determining the amount of reimbursement which the life tenant is entitled to recover from the remaindermen exercising their rights to the property. In an early Maine case,<sup>24</sup> the wife's allotted dower included an entire mortgaged tract giving her a life estate in the whole mortgaged premises instead of just one-third of it. The court stated that after payment of the encumbrance on the mortgaged tract by the wife she would hold for her life, and at her death, the remaindermen could claim their interests by paying the wife's estate the *full amount* paid by her in extinguishing the debt.<sup>25</sup> Such a result raises two interesting points: the wife is not entitled to any reimbursement during her life, and when reimbursement is made, the wife's estate is not held responsible for the value of the use of the land during her life since at the time of the reimbursement the remaindermen get the entire property. On the other hand, the New York court<sup>26</sup> discussed the more usual case in which the wife's dower was a life estate in one-third of the mortgaged premises. Having paid the full amount of the encumbrance on the entire property, it was decided that the wife was required to contribute the present value of an annuity attributable to her life estate in one-third of the property and could only recover the excess paid from the remaindermen. The annuity for which the wife was responsible was determined by multiplying one-third of the yearly interest on the sum unpaid at the death of the husband by the number of years in the wife's life expectancy.<sup>27</sup> In contrast to the Maine view, the New York view holds the wife, as between her and the remaindermen, responsible for her proportional part.

In referring to a "proportionate share" in *Morehead*, the court seems to indicate that proportionate contribution would be required from the life tenant, thus following the New York view; it is possible that the New York court's method of determining the proportion to be paid by the dowress and the remaindermen would also be followed. If no interest were due on the loan to the mortgagor,

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<sup>24</sup> *Wilkins v. French*, 20 Me. 111 (1841).

<sup>25</sup> *Id.* at 119.

<sup>26</sup> *House v. House*, 10 Paige 158 (N.Y. 1843).

<sup>27</sup> *Id.* at 165. *Accord*, *Tindall v. Peterson*, 71 Neb. 160, 98 N.W. 688 (1904).

as appears to be the case in *Morehead*, there may be nothing upon which to base the wife's proportionate share under the annuity principle. However, under such circumstances, it seems that the wife's proportion of the mortgage obligation could be derived by using the proportion that the cost of an annuity,<sup>28</sup> equal to the value of the use of one-third of the property for the period of the wife's life expectancy, bears to the whole value of the property.

Even with the abolition of dower under the present intestate law,<sup>29</sup> it is still possible for the *Morehead* situation to arise. Under the election provision,<sup>30</sup> if the widow of an intestate chose to become a life tenant in one-third of the mortgagor-husband's estate, the same problem of proportionate payment would arise. Absent an election, when the husband dies intestate the widow now receives a portion of his property in full fee, her share depending on the number of children surviving him.<sup>31</sup> Of course, her portion of the property would be subject to the mortgage; in order to free the property from debt, she may still be required to pay the full amount of the encumbrance.<sup>32</sup> In doing so, the wife would also be paying the debt on the portion going to the other heirs of the intestate, and she would be able to hold the property as security until she was reimbursed.<sup>33</sup> If the other heirs decided to exercise their rights to their portion of the property, she would then be able to recover from them the amount of the debt attributable to such portion plus interest. There would be no problem of evaluating the proportion which should be paid by the holder of a life estate.

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<sup>28</sup> For a determination of one's life expectancy, see the mortuary table in N.C. GEN. STAT. § 8-46 (Supp. 1963). To calculate the present value of an annuity based on one's life expectancy under the mortuary table, see N.C. GEN. STAT. § 8-47 (Supp. 1963).

<sup>29</sup> N.C. GEN. STAT. § 29-4 (Supp. 1963).

<sup>30</sup> N.C. GEN. STAT. § 29-30 (Supp. 1963).

<sup>31</sup> N.C. GEN. STAT. § 29-14 (Supp. 1963).

<sup>32</sup> See note 17 *supra* and accompanying text.

<sup>33</sup> II JONES, MORTGAGES § 1364 (8th ed. 1928); 2 WASHBURN, REAL PROPERTY § 1142 (6th ed. 1902).