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MARSHALING ASSETS FOR BENEFIT OF MORTGAGOR

By Benjamin Schwartz,

The doctrine of Marshaling Assets is defined as an equitable principle upon which the legal rights of creditors are controlled in order to accomplish an equitable distribution of funds in accordance with the superior equities of different parties entitled to share therein. It springs from the principle that one who is entitled to satisfaction of his demand from either of two funds shall not so exercise his election as to exclude a party who is entitled to resort to only one of the funds. For example, where one creditor has a mortgage upon two parcels of land upon one of which there is a junior encumbrance not otherwise secured, the first mortgagee may be compelled to exhaust in the first instance that parcel of land which is otherwise unencumbered in order that the security of the junior encumbrances may not be entirely destroyed. In such case, however, the indisposition of equity to interfere with the legal rights of a creditor results in working out the equity of the junior encumbrance through a substitution to the right of the paramount mortgagee as against the other party.¹

The equity of marshaling seems capable of being carried into effect in one of two ways: either, first, by restraining the parties against whom it exists from using a security to the injury of another; or secondly, by giving the party entitled to the protection of this equity the benefit of another security in lieu of the one of which he has been disappointed. In other words, the right may be enforced either by injunction against the paramount creditor, or by subrogation in favor of the junior creditor. In practice, however, the latter of these two methods is the one usually employed and the sounder doctrine seems to be that the first of the two ought not to be resorted to except under very peculiar circumstances: But there are decisions to the contrary; of course, when both funds are in court or under its immediate control, the case is different.²

² Two Leal. Case. EQ. 280.
The general principle on which courts of equity interfere in these cases with the strict legal rights of the prior lien holder, is that without such interference he whose interests are prior would possess an unreasonable power of defeating the rights subordinate to his by satisfying his claim to the exclusion of the junior claimants, so that in fact it would be entirely in his election whether they should receive any satisfaction or not. Now courts of equity treat such an exercise of power as wholly unjust and unconscientious and therefore will interfere 'not indeed to modify or absolutely destroy the prior lien holder's power, but to prevent it from being made an instrument of caprice, injustice or imposition. Equity, in affording redress in such cases, does little more than apply the maxim Nemo ex alterium detrimento ficri debit locurletior.\(^3\)

The doctrine of marshaling assets is not an absolute rule of law,\(^4\) in some jurisdictions the doctrine is recognized by force of statute,\(^5\) such statutes being declaratory of the general equity rule.\(^6\) Marshaling is not founded on contract,\(^7\) nor is it in any sense a vested right or lien,\(^8\) but rests upon equitable principles only and the discretion of the court.\(^9\)

A common application of this doctrine is where mortgaged real property is subject to sale under the mortgage in the inverse order of alienation. The leading English case was Barnes v. Racster,\(^10\) and the rule in that country has been termed the rule of ratable contribution;\(^11\) while the American rule was first settled by chancellor Kent, in Clawse v. Dickinson,\(^12\) where the doctrine exoneration in the inverse order of conveyance was adopted. It has been noted in this case a statement in fact obiter has been generally adopted and followed in the United States.\(^13\) It is decided in Newby v. Norton (133 Pac. 890) that the fact that the mortgagor is a debtor does not prevent securities from being marshalled in his favor.

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\(^3\) Note: 11 Am. Dec. 795.
\(^4\) 182 S. W. 1168 (Tex.).
\(^5\) 58 S. E. 60 (Ga.); 155 N. W. 655 (N. D.).
\(^6\) 155 N. W. 655 (N. D.).
\(^7\) 6 Watts 221 (Pa.); 96 N. Y. 59 (N. Y.).
\(^8\) 39 Wis. 512; 176 Cal. 892.
\(^9\) 39 Wis. 512.
\(^10\) 1 Y and C Ch. 491.
\(^12\) 5 Johns Ch. 332.
\(^13\) See article by J. M. Gest 27 Am. L. Reg. N. S. 739 for a critical for the English and American authorities.
The old idea that securities would not be marshalled at the request of the debtor is no longer unqualifiedly true if ever it was. As far as mortgagors are concerned, the statement that the debtor has no right to have securities marshalled is generally made in such a manner as to suggest that the mortgagor is a person not entitled to any consideration: i.e. he has given a lien on his property, and if he does not pay the debt he is not to be permitted to offer any suggestions to the mortgagee concerning its collection.

But such is not at all the view which equity takes of the mortgagor. On the contrary it regards him with much consideration. It is for example a rule of law that upon a mortgage foreclosure, the mortgagee is entitled to no more than the sale of a sufficient amount of land to pay his claim and costs whether the land is described in the mortgage in parcels or in one piece. Whilsie, Mortg. Foreclosure (paragraph) 573, 574. See also to the same effect under the Louisiana Code, Blanchard v. Naquin. Thus where the statute provided that the property mortgaged or so much thereof as might be necessary for the satisfaction of the debt and costs, be sold, it was held that no more of the mortgaged premises should be sold than sufficient to pay the debt and expenses, otherwise a sale would be set aside. Thomas v. Fewster, The rule is not an arbitrary one, but is to be enforced in the sound discretion of the court when necessary to protect the rights of the debtor, and to insure the best prices that can be obtained for the property. Miller v. Trudgeon, 16 Okla. 337.

One of the most frequently cited cases denying the right of marshalling to debtor is Rogers v. Meyers, holding that where a judgment creditor of the mortgagor has sold mortgaged property the mortgagor cannot prevent the mortgagee from suing him at law, nor if he pays the mortgage can he be subrogated to the rights of the mortgagee against the rights of the judgment creditor who has bought the mortgaged property. The court said: "We do not see that the principle that where a creditor has a lien on two funds, and another creditor has a lien on one of those funds, the former will be required to satisfy his claim

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116 La. 806.
15 95 Md. 446.
16 Okla. 337.
17 68 Ill. 32.
out of the fund upon which the other has no lien can be applied in this case. That is a rule that may be invoked as between different creditors, but has, so far as we are aware, never been applied as between debtor and creditor."

It must be confessed that cases are comparatively rare where it clearly appears that securities were marshalled in favor of a debtor against the objection of the creditor. It would seem that the proposition that securities may be marshalled at the request of the debtor would be supported by cases which hold that where a mortgagor has conveyed part of the mortgaged property to one who assumes the payment of the entire mortgage, the property so conveyed ought to bear the entire mortgage in exonerating the part retained by the mortgagor. But on looking into the cases, it will be seen that most of them simply discuss the question as between the mortgagor and his grantee not discussing the right of the mortgagee to object.

No other case has been found containing the precise situation considered in Newby v. Norton of a sale by the mortgagor of a mortgage on a part of the land, where the question of marshaling securities in favor of the mortgagor has arisen. But this raises practically the same question as a sale of part of the premises with an assumption by the grantee of the entire mortgage. As has been just said the cases on this subject usually do not discuss the question as between mortgagor and mortgagee.

It was held in Halsey v. Reed,\(^18\) that when as between mortgagor and his grantee of a part of the mortgaged premises, the latter has become liable to pay the whole mortgage, upon foreclosure the proper course is for the mortgagor to ask for a decree compelling the owner of the mortgage to exhaust first his remedy by a sale of the property conveyed. So it was said on the authority of this case in Colgrove v. Tallman,\(^19\) that "if a mortgagor conveys part of the mortgaged premises subject to the whole mortgage, the part sold is first liable for the debt, i.e. it becomes the principal debtor; and the mortgagee must exhaust it before he can seek other property of the mortgagor, who has become in equity the surety."

In Waters v. Hubbard,\(^20\) where a mortgagor sold some of the

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\(^{18}\) 9 Pudge 446 (N. Y.).
\(^{19}\) 67 N. Y. 265.
\(^{20}\) 44 Conn. 340.
property, the grantee assuming the payment of the entire mort-
gage, and later making a mortgage to the original mortgagee to
secure the same debt that he has assumed, it was held (the law
in Connecticut being that the mortgagee was entitled to all the
property until his debt was paid) that the original mortgagor
could not claim that his mortgage should be collected first out
of the property which he had conveyed, but that such a claim
would have been just and equitable in a jurisdiction where the
mortgage was collected by a sale of the property and an appro-
priation of the proceeds to the payment of the debt.

Where property had been conveyed to a person who assumed
the payment of a mortgage, which mortgage also covered land
retained by the grantor, it was held, in an action by the grantor
to compel the foreclosure of this mortgage and to have the prop-
erty which he had conveyed sold first, that he was entitled to such
a decree, the mortgagee not objecting. The court stated that
under these circumstances it was not necessary for them to deter-
mine whether an action would lie to compel the mortgagee to

It may be noted that even in Illinois it has been held, where
a mortgagor sold part of the property to a person who assumed
payment of the entire mortgage debt, that upon foreclosure of
the mortgage the mortgagor was entitled to have the property
which he had conveyed sold first. Mead v. Peabody22.

The principle that a mortgagor may have securities mar-
shalled in his favor is illustrated in the cases of mortgages
covering both exempt and nonexempt property. Perhaps the
most frequent cases of this kind arise where the exempt property
is a homestead, and here there is a difference of opinion among
the courts. These homestead cases, while often decided upon
genral principles, depend largely upon the terms of the particular
statutes. It has been held that a judgment creditor who has
bought up a mortgage upon both exempt and nonexempt prop-
erty, in selling under the mortgage, must sell the nonexempt
property first (Baughn v. Allen23, 68 S. W. 207.); and that the
debtor is entitled by injunction to prevent the contrary (Hays v.
Arlow24).

21 137 Mich. 277.
22 183 Ill. 126.
23 68 S. W. 207 (Tex.).
24 98 Miss. 487.
In Miller v. McCarthy\textsuperscript{26} the court stated that in common with some other jurisdictions, it had adopted the rule that a mortgagor is entitled both as against the mortgagee and subsequent encumbrancers to require the mortgagee to collect his debt out of the nonexempt property, if that is sufficient, but in the case itself, it was held that the debtor cannot do this when he has practically abandoned the nonexempt property to the junior creditor, and has permitted him to go to expense in regard thereto.

In Frantz v. Hanford\textsuperscript{26}, where there were two mortgages on both exempt and nonexempt property, and these mortgages had been acquired under the statute by an attaching creditor who, obtaining judgment and issuing an execution, sold the nonexempt property and applied the proceeds first upon the first mortgage, paying it off, secondly upon his judgment, it was held that this he could not properly do, as the money applied upon the judgment ought to have been applied to the second mortgage, for otherwise the exemption would have been destroyed.

In Sanders v. Phillips\textsuperscript{27} it was held that where a creditor holds a mortgage on exempt property, and also another unsecured claim against the debtor and he recovers judgment upon the unsecured claim and issues execution upon part of the mortgaged property which sells for more than enough to pay the mortgage, the mortgage is paid and discharged, that is, that the money must be applied first to the payment of the mortgage, and that this will release the other mortgaged property which is exempt.

In Citizens Sav. Bank v. Wood\textsuperscript{28} the court declined to extend the principle to a debtor whose principal debt was as tenant. Thus, it was held in the case that where a landlord has a lien by statute upon all the crops and personal property, and other creditors have a lien by mortgage upon the other personal property, the tenant cannot object if the landlord stands aside and permits the mortgagees to collect their debts from the mortgaged property, although this results in the landlord being obliged in order

\textsuperscript{26} 47 Minn. 321.
\textsuperscript{26} 87 Ia. 469.
\textsuperscript{27} 62. Vt. 331.
\textsuperscript{28} 111 N. W. 929 (Ia.).
to make his debts sell all the crops, including a part of the corps
which would have been exempt to the tenant from all claims ex-
cept those of the landlord. The court, however said: "Possibly,
if the mortgages had covered exempt and nonexempt property,
the debtor might insist upon the nonexempt property being first
sold. Sanders v. Phillips, supra. See also Frantz v. Hanford,
supra."