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## EXTINGUISHMENT OF PERSONAL LIABILITY ON MORTGAGE NOTES BY MERGER

GLEN W. MCGREW<sup>1</sup>

**P**ERSONAL liability of one who makes notes secured by a mortgage on real estate and who later transfers the fee title subject of the mortgage, has been a matter of intense personal concern to many individuals during the recent period of steadily declining real estate values. Every possible avenue of escape from this liability is now being explored by worried and harassed debtors and their attorneys. Many have taken the bankruptcy route. Others have been fortunate enough to find that extensions of the time of maturity have been given to the grantee for a consideration, without the maker's consent, which relieves the maker of his obligation to pay the mortgage notes. A few other fortunate mortgagors are able to pass the burden on to a grantee who assumes and agrees to pay the debt and who is solvent, or to one who, though taking only subject to the debt, later conveys to a second grantee who assumes and agrees to pay the debt. It is the purpose of this discussion to examine one avenue of escape which is open, under Illinois decisions, to the maker of notes in a situation such as the following:

A mortgagor sells his equity in the premises; the purchaser then procures a second mortgage loan thereon and defaults in payments due on this junior encumbrance,

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which is thereupon foreclosed. The owner of the second mortgage bids in the property at the foreclosure sale and eventually procures a master's deed. He then purchases the first mortgage and starts suit at law against the maker of the first mortgage notes. The latter, against whom judgment is rendered, is of course subrogated to the rights of the plaintiff, owner of the land by foreclosure of the second mortgage, against the land pledged as security for payment of the first mortgage notes on which judgment was rendered and can foreclose his lien.<sup>2</sup> This is in many instances small consolation, however, for the land obviously is now worth less than the amount of the first mortgage: if this were not so, the plaintiff in the suit at law knowing that a foreclosure by the defendant would immediately follow judgment in the plaintiff's favor, would not have sued. The plaintiff would gain nothing by his judgment at law, for he could recover only what he paid for the notes, unless he purchased them at a discount. But the real purpose of the suit at law is not to recover the purchase price of the notes; it is to compel the maker of the first mortgage notes to reimburse the second mortgagee for all or part of his foreclosure costs, by making the defendant purchase the title from him. The defendant would meet the plaintiff's terms to avoid the necessity of financing his own foreclosure suit with its attendant delay in acquiring the title.

It is apparent that there should be some relief, in equity if not at law, from such "sharpshooting" tactics. From the facts, at first impression, an adequate defense at law would hardly be expected. Yet one exists in Illinois, for the Supreme and Appellate Courts in several suits at law which have been reviewed by them, have said that the acquisition of the mortgage notes by one who also owns the land pledged as security for the payment of those notes, results in a merger which extinguishes the personal liability of the maker of the notes. This defense is good at law.

<sup>2</sup> Howard v. Burns, 279 Ill. 256.

An early case on the subject is that of *Mines v. Moore*,<sup>3</sup> which was an action of assumpsit on four promissory notes—part of an original series of fourteen notes—all secured by a mortgage. The other ten notes had furnished the basis for a previous foreclosure, in which the decree expressly directed that the sale was to be made subject to a lien to secure the payment of the four notes not yet due. The case was tried on a plea of the general issue by the court, a jury having been waived by agreement. The lower court gave judgment for the defendant, holding the sale was a satisfaction of the entire indebtedness. The Supreme Court affirmed the judgment of the lower court, and based its decision on the case of *Weiner v. Heintz*.<sup>4</sup> In answer to the argument that the case of *Weiner v. Heintz* was in equity on a bill to redeem and did not decide that an action at law on the notes would not lie, the court said:

Nor can it be objected that the defense cannot be made at law. When the purchase was made, the bidder, in view of the terms of the decree, would first ascertain the sum he would have to pay on these notes, and then determine how much the land was worth above that sum. Appellant, being purchaser in this case, would of course determine how much he could give for the premises after satisfying the notes, and he no doubt bid with that view, and thus became the purchaser, and satisfied the notes. And in an action of assumpsit, almost any defense, showing the satisfaction or discharge of the debt, may be shown under the general issue. And we think this defense [that the notes were extinguished by operation of law] might clearly be relied on in this case.

This case is cited in *Kelly v. Fahrney*<sup>5</sup> as authority for the admission under the general issue in assumpsit of anything that shows payment. The same case also cites *Wilson v. King*,<sup>6</sup> where it is held that the defendant

<sup>3</sup> 41 Ill. 273.

<sup>4</sup> 17 Ill. 259.

<sup>5</sup> 123 Fed. 280.

<sup>6</sup> 83 Ill. 232.

may give in evidence, under the general issue, any matter which shows he was not indebted to the plaintiff when the action was brought, whether he never was indebted, or the liability was extinguished after it was incurred. That the debt was extinguished by merger of the title to the land and notes certainly shows there is no liability at the time of the suit.

Yet *Mines v. Moore* seems to have been overlooked by both court and counsel in the case of *Hester v. Frary*.<sup>7</sup> This also was a suit in assumpsit upon mortgage notes purchased by the owner of the fee title two days before they were due. He claimed to have purchased them as an investment for the plaintiff, although the plaintiff, at the time of purchase, had no knowledge of the notes nor funds in the hands of his supposed agent, the owner of the fee, with which to purchase them. The court called attention to the apparent motive of the owner of the fee in making the purchase and the absence of any adequate motive for the plaintiff to purchase, as an investment, paper which would mature in two days. It proceeded to consider the case as if the owner of the fee were the owner of the notes, and held that a merger of the debt and the fee title resulted, extinguishing the notes. A merger is presumed under such circumstances, unless, in equity, there is shown a contrary intention on the part of the owner of the fee. This intention did not exist here, nor would it avail if it did, for this was an action at law. The Court said:

For this purpose, we are of opinion that the intent to prevent a merger could not be presumed even in a suit in equity, and certainly not in an action at law, from a mere lack of any intention expressed that there should be a merger.

The doctrine of prevention of merger is a rule of equity jurisprudence, and this action is at law. Appellant is no party to the note sued on by reason of having executed or indorsed it. The only ground upon which this action in assumpsit could lie

against him is that he has assumed the indebtedness evidenced by the note. But the debt is extinct if there was a merger, and the recovery could not in that event be had.

The principle is also clearly set forth in *Donk et al. v. Alexander et al.*,<sup>8</sup> where appellant company had purchased property subject to certain attachments and later purchased a judgment upon which one of the attachments was based.

It [appellant] occupied, to the extent of the amount of that judgment, the position of both debtor and creditor, and in such cases, there is a merger of the qualities of debtor and creditor, extinguishing both. Abbott, in his Law Dictionary, vol. 2, title, "Merger," says: "Merger is the equivalent of *confusion* in the Roman Law, and (when used with reference to demands), indicates that where the qualities of debtor and creditor become united in the same individual, there arises a confusion of rights which extinguishes both qualities; whence, also, merger is often called extinguishment." Bouvier, in his Dictionary, vol. 2, title, "Merger," under the head of "Rights," says: "Rights are said to be merged when the same person who is bound to pay is also entitled to receive. This is more properly called a confusion of rights, or extinguishment. When there is a confusion of rights, and the debtor and creditor become the same person, there can be no right to put in execution." The same rule is recognized in Pomeroy's Equity, vol. 2, secs. 789, 790. The extinguishment is complete at law, though in equity, under certain circumstances, a merger or extinguishment will be prevented.

The case of *Lily v. Palmer*<sup>9</sup> summarizes the matter thus:

The status of the plaintiff then, was this: By the conveyance from Backer, and from Hall, the first mortgagee, the estates of both mortgagor and mortgagee became vested in him.

The deed from Palmer to Backer made the land the primary fund for the payment of the notes to Hall, of which the note

<sup>8</sup> 117 Ill. 330.

<sup>9</sup> 51 Ill. 331.

in suit was one, and when the plaintiff took the deed from Backer, he became the owner of that fund, and he then stood in the attitude of a mortgagee who had effected a strict foreclosure.

In *Maulding v. Sims*,<sup>10</sup> after quoting at length from the two Supreme Court cases of *Donk v. Alexander* and *Lilly v. Palmer*, the court says:

These last-mentioned cases are all law cases and we think are directly in point, and if the doctrine laid down in these cases is the correct one, there can be no right of recovery in the cases here involved. So far as the record discloses, appellant purchased at the foreclosure sale the premises covered by the mortgage to him, subject to the mortgage indebtedness to the trustee of schools and Wilson. After the sale to him, appellant took an assignment of the notes and these mortgages, and in law it amounted to a payment therefor, it being a matter of indifference whether the indebtedness be paid directly, or whether an assignment is taken to the person who holds the fee.

To the same effect is the recent case of *Grossman v. Lifshitz*.<sup>11</sup>

Although these decisions clearly indicate that there is a good defense at law in such suits, other Illinois decisions have held that the defendant may secure an injunction in a court of equity against the prosecution of the suit at law and have the notes sued upon surrendered and cancelled. The earliest case on the subject is that of *Weiner v. Heintz*,<sup>12</sup> in 1855. Weiner had given a mortgage of lands to secure the payment of two notes, one payable in ten months, the other in five years and ten months. Heintz, as assignee of the original mortgagee, foreclosed the mortgage as to the first note, and the sale thereunder was specifically decreed to be made subject to the lien of the mortgage for the payment of the remaining note; Heintz purchased at this sale and received

<sup>10</sup> 213 Ill. App. 473.

<sup>11</sup> 261 Ill. App. 523.

<sup>12</sup> 17 Ill. 259.

a deed expressly subject to the lien of the mortgage for the amount of the remaining note, which was owned by Heintz. Weiner's bill in equity prayed that he be let in to redeem (the period of redemption had expired), and for an injunction restraining Heintz from a suit at law which he had instituted against Weiner on the remaining note.

The right to redeem was denied, but the mortgagor was held to be entitled to relief against the collection of the note not due at the time of the rendition of the foreclosure decree.

The land was sold to pay the note then due, and subject to the incumbrance of the mortgage, to the extent of the amount of the note, not then due. Such are the provisions of the decree under which the sale was made, and of the deed to the purchaser.

The purchaser took the land subject to the incumbrance, became mortgagor to the extent of that note, and the land continued subject to the payment of the note, whoever should be the holder of the note or the owner of the fee, and equity would enforce payment out of the land. The purchaser is presumed to have bought the land at its value, less the amount of this note, and equity will not permit him to hold the land and collect the note from Weiner. Besides, the note is paid by operation of law. Heintz owned the mortgage debt, and got the fee of the land by his deed, under the decree, thereby becoming substantially mortgagor and mortgagee.

The mortgage, and, with it the debt, therefore, merged in the fee, and could no longer exist. Where two titles or interests in land become united in the same person, in the same right, and at the same time as that of mortgagor and mortgagee, the lesser will merge in the greater estate and become extinct; unless there be some interest or intention to the contrary, or the merger would work an injury to some one. . . .

Here no motive could exist to keep the debt alive; for in equity the land would be made to pay the debt, and the owner of the debt was, at the same time, the owner of the land.



It is to be noted that the merger is not that of the legal estates of mortgagee and owner of the fee, but of "titles or interests" in land. This is better illustrated by the case of *Belleville Savings Bank v. Reis et al.*,<sup>13</sup> where the bank owned a first mortgage, and also a junior encumbrance secured by a trust deed on the same property. The trust deed was foreclosed by the bank and the property was bid in at the master's sale by the president of the bank and a certificate of sale issued to him, but no master's deed was issued within five years from the expiration of the period of redemption, and the right to a deed had therefore expired. The fee title therefore never vested in the purchaser at the sale, or in any assignee of said purchaser, but the court nevertheless said: "We do not think it makes any difference in the application of these principles to the case in hand that no master's deed has ever been issued to the holder of the certificate of purchase."

No case has been found in this state wherein the holder of a certificate of sale has been enjoined from prosecuting a suit at law on notes secured by a mortgage or trust deed on the land purchased, and to the lien of which the purchase was expressly subject. But if, as the court said in the decision last above quoted, it makes no difference whether a master's deed is ever issued to the holder of the certificate after the expiration of the period of redemption, it likewise cannot be said that it makes any difference that the holder of the certificate is not yet entitled to a deed because the period of redemption has not yet expired. Regardless of the anomalous character of the property right which the holder of such a certificate has,<sup>14</sup> if he also becomes the holder of notes secured by a prior lien on the premises, and subject to which lien his purchase was made, no reason appears why a court of equity should not enjoin a suit at law by the holder of the certificate of sale on such notes. He has acquired such notes for his own protection; he is both debtor and

<sup>13</sup> 136 Ill. 242.

<sup>14</sup> *Bradley v. Lightcap*, 202 Ill. 154.

creditor, and the two qualities should be held to have merged, with the result that all personal liability on the notes is thereby extinguished.

In the comparatively recent case of *Sleichert v. Turek*,<sup>15</sup> it does not appear from the decision as reported whether the defendant had assigned his certificate of sale before or after he purchased the first mortgage notes upon which the suit at law which was enjoined had been brought, but a tender of the amount due on the notes having been made and brought into court, it was ordered that the defendant accept the sum so tendered and surrender the notes, and that he be perpetually enjoined from prosecuting his suit at law and from impairing, discharging, or releasing the notes. This decision is of course based on the complainant's right to be subrogated to the lien of the trust deed securing the payment of the notes sued upon. None of the cases that we have discussed are cited in the decision, nor by counsel in their briefs. An examination of the briefs discloses that the defendant had purchased the first mortgage notes and started suit thereon before his second mortgage foreclosure had gone to decree. He bid in the property himself and the master's certificate of sale was issued to him; at the time when he received the certificate, he was also the owner of the first mortgage notes on which he had previously started suit at law. The court indicates that to have the suit at law enjoined a tender of the amount due should be made.

But it is submitted that even if no tender is made, the suit at law should nevertheless have been enjoined, upon the authority of the cases above discussed. The rights of the parties are determined at the sale, not at the expiration of the period of redemption, when the master's deed issues. By bidding at the sale, the bidder in effect says that the property is worth the amount of the first mortgage, plus the amount of his bid. He has bought the property, subject, it is true, to the right of redemption, but his bid is made with full knowledge of that right, and the fact that he does not become the absolute owner until

<sup>15</sup> 259 Ill. App. 467.

that right has been extinguished by the running of the period of redemption should not give him the right to acquire notes secured by a lien to which his purchase was subject, and sue at law thereon. If the right to enjoin such a suit only exists after the plaintiff in the suit has received the master's deed, then he need only refrain from taking such deed until he has recovered judgment on the notes.

The case of *Rogers v. Meyers*,<sup>16</sup> requires some comment. It was cited in *Sleichert v. Turek*, by the appellant, as authority for the denial of the injunction sought, but the court attempted to draw a distinction by pointing out that no tender had been made in *Rogers v. Meyers*. A careful reading of the case shows, however, that the real ground for distinction is that in *Rogers v. Meyers*, the plaintiff in the suit at law was a bona fide assignee of the original mortgagee and neither of them had ever purchased the mortgaged premises, subject to the lien of the mortgage securing the note sued upon, at judicial sale or otherwise.

The increase during the past two years in the volume of mortgage foreclosures, and the decline in the value of real estate, both of which are without precedent, at least in this generation, will doubtless result in the near future in additional Appellate and Supreme Court decisions which will clarify the law of Illinois upon the questions involved.

<sup>16</sup> 68 Ill. 92.