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Mortgagability of Rents, Profits, Appointment of Receivers

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MORTGAGABILITY OF RENTS AND PROFITS, APPOINTMENT OF RECEIVERS

I. The Validity of the Mortgage.

The prevailing view,[1] and the one which has always been adopted in Washington, is that a mortgage upon realty creates merely a lien thereon and does not pass title thereto, either before or after condition broken, *Hyde v. Heller*;[2] *Dane v. Daniel*;[3] *Fischer v. Woodruff*;[4] this view being codified by an act of the territorial legislature of 1869[5] providing that

> "A mortgage of real property shall not be deemed a conveyance so as to enable the owner of the mortgage to recover possession of the real property, without a foreclosure and sale according to law."

Prior to the enactment of that statute and at all times since, there has been in effect another statute relating to the grounds for the appointment of a receiver,[6] which, so far as material here, provides that

> "A receiver may be appointed by the court in the following cases.
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> 4. In an action by the mortgagee for the foreclosure of a mortgage and the sale of the mortgaged property, when it appears that such property is in danger of being lost, removed, or materially injured, (or when such property is insufficient to discharge the debt, to secure the application of the rents and profits accruing, before a sale can be had.)"

By its decisions in *Norfor v. Busby*;[7] *Euphrat v. Morrison*;[8] and *Collins v. Gross*;[9] repeatedly followed in later cases, the Supreme Court of Washington held that that portion in parenthesis of the act of 1854[10] was impliedly repealed by the passage of the act of 1869,[11] and that as a consequence a receiver should not be appointed, to secure the application of the rents and profits before a sale could be had, on the ground that the property was insufficient to discharge the debt. That that was the extent of the question then before the Court in the *Norfor* case, and no more, is revealed by an examination of the briefs, which show that *the rents and profits were not specifically pledged, and that the only ground asserted in the affidavits in support of the application for a receiver was the inadequacy of the security.*

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[1] 3 Jones on Mortgages (8th ed.) sec. 1935, 1 Tardy's Smith on Receivers (2d ed. 1920) sec. 239, page 553.
[2] 10 Wash. 586, 39 Pac. 249 (1895).
[3] 23 Wash. 379, 63 Pac. 268 (1900).
[4] 25 Wash. 67, 64 Pac. 923 (1901).
[5] Sess. L. 1869, c. 46 Sec. 498, p. 130; Rem. C. S. 804, P C. 7530.
[6] Sess. L. 1854, c. 13 Sec. 171, p. 162; Rem. C. S. 741, P. C. 8414.
[7] 19 Wash. 450, 53 Pac. 715 (1898).
[8] 39 Wash. 311, 81 Pac. 695 (1905).
[9] 51 Wash. 516, 99 Pac. 573 (1909).
[10] *Supra*, note 6.
[11] *Supra*, note 5.

It is true that in its decision the Court also said "The statute (Rem. C. S. 804, P C. 7530) is also expressive of the public policy of the state vesting the right of possession in the mortgagor *absolutely* until a decree and sale," thereafter quoting portions of the opinions in *Teal v. Walker;*[12] *Couper v. Shirley;*[13] and *Wager v. Stone;*[14] involving statutes similar to the act of 1869.[15] If the opinion, referring to the public policy therein mentioned and the cases quoted, was ever susceptible of a construction that a receiver may never be appointed in a foreclosure action until a decree and sale, and that a mortgagee is never entitled to the rents and profits until he gets possession by such a decree, it was based upon pure *dictum.* This conclusion seems to follow from the opinion expressed in the subsequent case of *Euphrat v. Morrison.*[16]

The same thing may be said of *Teal v. Walker,*[17] which was merely an action to recover damages which the mortgagee claimed he sustained by reason of the refusal of the mortgagor to surrender possession after default. The mortgage did not pledge the rents but merely provided for such surrender. The mortgagee took no effectual steps to regain possession, nor were any equitable principles invoked, the naked question being the relative rights of the mortgagor and mortgagee to rents and profits of the mortgaged properties while they were in possession of the mortgagor, and before the mortgagee, by suit or otherwise, sought to obtain possession. In its decision, the Supreme Court of the United States quotes its opinion in the case of *Kountze v. Omaha Hotel Co.,*[18] as holding that, as the mortgagee was not entitled to possession, (by reason of a Nebraska statute similar to Rem. C. S. 804, P C. 7530), he had no right to the rents and profits. In the *Kountze* case the Court expressed similar views upon the question of public policy as those expressed by the Court in the *Teal* case and quoted in the *Norfor* case by the Washington Court, but further expressly recognized the equitable doctrine that rents and profits might be applied to the satisfaction of a debt, saying:

> "Courts of equity always have the power where the debtor is insolvent, and the mortgaged property is an insufficient security for the debt, and there is good cause to believe that it will be wasted or deteriorated in the hands of the mortgagor to take charge of the property by means of a receiver and preserve not only the *corpus,* but the rents and profits *for the satisfaction of the debt."* (Italics ours)

This excerpt from the *Kountze* case was quoted with approval in *Grant v. Phoenix Life Ins. Co.,*[19] decided subsequently to the

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[12] 111 U. S. 242, 28 L. ed. 415, 4 Sup. Ct. Rep. 420 (1883)
[13] 75 Fed. 168 (1896).
[14] 36 Mich. 364 (1877).
[15] *Supra,* note 5.
[16] *Supra,* note 8.
[17] *Supra,* note 12.
[18] 107 U. S. 378, 27 L. ed. 609, 2 Sup. Ct. Rep. 911 (1882).
[19] 121 U. S. 105, 117, 30 L. ed. 905, 7 Sup. Ct. Rep. 141 (1886).

Teal case.

The opinion in the case of *Wager v. Stone*,[20] also cited in the *Norfor* case by the Washington Court, does not disclose that the receiver's appointment was based upon any equitable principles, nor that the rents were expressly mortgaged, the Court stating that, "The rents and profits of the land do not enter into or form any part of the security" And that same Court in the subsequent case of *Michigan Trust Co. v. Lansing Lumber Co.*,[21] said

> " and while we think it within the power of the parties to stipulate that such possession and management of the business may precede foreclosure yet such power should not be exercised except in a case where the right is clearly given by the engagement of the party "[22]

An examination of the more recent cases decided by the Supreme Court of Washington sheds little light upon this doctrine of public policy as expressed by the earlier decisions. In *Western Loan & Building Co. v. Mifflin*,[23] the mortgage foreclosed covered not only the real estate but also the rents, issues and profits. The contest arose between the general receiver of the mortgagor, and the mortgagee, after a deficiency judgment was taken by the latter, as to which was entitled to the net proceeds of the rentals remaining in the hands of the special receiver appointed in the foreclosure action. The Court held that the provision covering the rents, in the mortgage, and an assignment of the rents taken contemporaneously with the mortgage, being silent as to how they should be applied, was not inconsistent with an intent that the rents should be applied only to maintenance of the property and prevention of waste pending foreclosure, in so far as the rights of the mortgagee were concerned. Then, after quoting that portion of the opinion in the *Norfor* case, wherein this doctrine of public policy is mentioned, the Court said. "Any other construction of these mortgage and assignment provisions, it would seem, should not be favored by the court in the light of the law as above noticed." It should be noted, however, that the Court, in its opinion, also stated that

> "The foreclosure decree did not make any adjudication touching the disposition of the rents and income of the property pending the foreclosure action, *that is, there was no foreclosure against that fund.*" (Italics ours)

In *State ex rel. Allen v. Sup. Court for King County*,[24] a trustee, operating under appointment by the mortgagor and the first mortgagee of hotel property, to collect rents and apply them to certain purposes, including the payment of taxes and interest on a sec-

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[20] *Supra*, note 14.

[21] 103 Mich. 392, 61 N. W 668 (1894).

[22] Cases collected in 4 A. L. R. 1405 and 55 id. 1020.

[23] 162 Wash. 33, 297 Pac. 743 (1931).

[24] 164 Wash. 515, 2 Pac. (2d) 1095 (1931) noted in 6 Wash. Law Rev. 177.

ond mortgage, was held entitled to the rents as against the receiver of an absconding tenant of the mortgagor, the Court expressly stating that under the state of facts there presented, Rem. C. S. 804, (P C. 7530) was not applicable.

Commenting upon the *Mifflin* case, *supra,* the Court said

> "The mortgagee did not, in the foreclosure action, seek to establish its lien upon any funds in the hands of the special receiver, but took simply a decree of foreclosure in the ordinary form. *The case might well have been decided upon the ground that the mortgagee had waived its right to the fund by neglecting to seek to enforce some lien thereon in the foreclosure action and have its rights adjucated by the decree rendered therein.* " (Italics ours)

That statement, concurred in by a majority of the justices, coupled with the strong and terse dissenting opinion of Mr. Justice Millard, might easily lead one to believe that the Supreme Court of Washington is not disposed to regard the public policy of this state as precluding the parties from expressly stipulating for the application of rents and profits to the mortgage indebtedness, at least under certain circumstances, if it were not for the recent case of *State ex rel. Gwinn, Inc., et al. v. Sup. Court For King County et al.,*[25] wherein a mortgage of certain real and personal property, executed to secure the payment of a bond issue maturing at varying dates over a period of years, specifically provided that the rents, issues and profits from the mortgaged property were mortgaged to secure the payment of the mortgage debt, that the mortgagor, until the breach of any of the conditions of the bonds or mortgage, would be permitted to enjoy and use the mortgaged rents, issues and profits, and that upon commencement of judicial proceedings to enforce the rights of the mortgagee and bondholders, the mortgagee would be entitled, as a matter of right, to the appointment of a receiver of the mortgaged property, "and of the earnings, income, rents, issues and profits thereof, pending such proceedings." Upon default in payment on the bonds, the mortgagee commenced an action for the foreclosure of the mortgage and the appointment of a special receiver pending foreclosure and sale, alleging that the rents and profits were being collected and dissipated by defendant mortgagor and that the same would be lost as security unless such receiver was appointed. The superior court entered an order appointing a receiver to collect the rents and profits, apply same upon the necessary charges and expenses incidental to the preservation of the mortgaged property, and hold the balance thereof subject to the further order of the Court. On petition for review, the Supreme Court remanded the cause, with direction to vacate the order, (Tolman, C. J., dissenting), using the following language

> "The facts in the case at bar present the question of

[25] 70 Wash. Dec. 420, 16 Pac. (2d) 831 (1932)

> the enforceability of an executory agreement to place the mortagee in possession of the mortgaged property prior to foreclosure and sale. That question is foreclosed by *Western Loan & Building Co. v. Mifflin,*[26] *supra.*"

On the authority of the *Allen* case, *supra,* and in light of the foregoing discussion, it is conceived that the Court may well have reached a contrary result. In no case cited as authority does it appear that the two controlling elements in the *Gwinn* case were present, these being specific mortgage of the rents, issues and profits, *and* specific attempt to subject them to foreclosure. This contention is further strengthened by a consideration of the dissenting opinion in the *Allen* case which seems nearly the same as the reasoning of the majority in the *Gwinn* case. In his dissent, Justice Millard, after setting forth the provisions of Rem. C. S. 804 (P C. 7530), continued.

> "The foregoing declares as the public policy of this state that the mortgagee has no right by virtue of the mortgage, either prior or subsequent to default, to the possession of the mortgaged property, that the right of possession until foreclosure and sale remains in the mortgagor and his successors in interest. There is no provision in the statute making it optional with the parties whether a mortgagee shall be given the right to possession."

It is stated in Corpus Juris that "Rents and profits are as much property as the estate out of which they arise and as such they are the subject of a mortgage."[27] Clark in his work on Receivers, states that "In New York State and other states where the legal title remains in the mortgagor until foreclosure and sale, the legal right to the rents as well as to the possession continues in the mortgagor until foreclosure and sale. 'But when default has been made in the condition of the mortgage, the mortgagee becomes at once entitled to a foreclosure of the mortgage and a sale of the mortgaged premises. This process requires time, and on general principles of equity, the court may make the decree, when obtained, relate back to the time of the commencement of the action, and where necessary for the security of the mortgage debt, may appoint a receiver of the rents and profits accruing in the meantime, thus anticipating the decree and sale,' "[28] citing *Hollenbeck v. Donnell.*[29] See also, *Lyng v. Marcus;*[30] *In re Brose;*[31] *Moncrieff v. Hare;*[32] *Handman v. Volk.*[33] It has even been suggested that where the mortgagor has covenanted with and

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[26] *Supra,* note 23.
[27] 41 C. J. 375.
[28] 2 Clark On Receivers (2d ed. 1929) 1381.
[29] 94 N. Y. 342, 346 (1884).
[30] 118 N. Y. S. 1056 (1909).
[31] 254 Fed. 664 (1918).
[32] 38 Colo. 221, 87 Pac. 1082, 7 L. R. A. (N. S.) 1001 (1906).
[33] 30 Ky. 818, 99 S. W 660 (1907).

authorized the mortgagee to appoint a receiver, in case of default, of the rents and proceeds of the mortgaged estate, for the better security of the mortgage debt and the interest thereon, the receiver, being appointed by the mortgagee under the power contained in the mortgage, is in possession of the premises as agent, not of the mortgagee, but of the mortgagor, since the mortgagee himself acts in the capacity and sustains the relation of agent of the mortgagor in making the appointment.[34]

II. APPOINTMENT OF RECEIVERS.

Even though it be assumed, however, that a specific pledge of rents and profits might be valid, it does not follow that the refusal of the Court in the *Gwinn* case *to appoint a receiver* was not justifiable. In Tiffany on Real Property, it is said that

> "The general rule, in reference to the appointment of a receiver, in the course of a foreclosure proceeding, to sequestrate the rents and profits, is that this relief will be given when the security is of at least doubtful sufficiency, and the person or persons liable for the debt are insolvent. And conversely that a receiver will not be appointed for this purpose unless both of these conditions exist "[35]

And in *Lich v. Strom,*[36] it appears to be established that to entitle a mortgagee to a receiver, it must be shown that waste is being committed, that the property is an inadequate security for the mortgage debt, and that a deficiency judgment could not be obtained, or that those liable for the mortgage debt are insolvent, while in *Nielson v. Heald,*[37] it is stated that

> "To obtain the appointment of a receiver, the mortgagee must show not only that the security is inadequate and the debtor insolvent, but also that his security is becoming impaired through the wrongful failure of the mortgagor, or his successor in interest, to protect the property from waste."[38]

See also *Newman v. Van Northwick;*[39] *Equitable Savings & Loan Association v. Anderson.*[40] Tested by the foregoing, there was nothing in the facts established to authorize the appointment of a receiver. Defendant, owner and mortgagor, effectually purged itself of the charge of waste. Not only had it paid the taxes due but it had set aside a sum to pay the taxes coming due. It maintained all insurance necessary to protect the property and the bondholders. It maintained the building (an apartment house) and equipment in good repair. Disinterested witnesses testified to the high character of the management service. In *Moore v. Twin City Ice C S. Co.,*[41] it is stated that waste is

[34] High On Receivers (4th ed. 1910) sec. 652, page 803, and cases cited.
[35] 3 Tiffany On Real Property (2d ed. 1920) 2442.
[36] 134 Wash. 490, 236 Pac. 88 (1925).
[37] 151 Minn. 181, 186 N. W 229 (1922)
[38] Cases collected in 26 A. L. R. 33, 36 id. 609 and 55 id. 533.
[39] 95 Wash. 489, 164 Pac. 61 (1917).
[40] 113 Wash. 420, 194 Pac. 387 (1920).

> "an unreasonable and improper use and abuse, mismanagement, or omission of duty touching real estate by one rightfully in possession, which results in substantial injury thereto."

Further, the property appears to have been an entirely adequate security for the indebtedness, even allowing a very substantial amount for depreciation and decreased costs. If the suit results in a decree of foreclosure and sale thereunder the mortgagee will have acquired a property having a value in excess of the mortgage indebtedness. Neither was a charge of insolvency made out. That the mortgagor was a corporation actively engaged in business in Seattle, and entirely solvent, appears from the affidavit of its president. The power of equity to appoint receivers is a discretionary power to be exercised with great caution. It follows, therefore, that a clause in a mortgage authorizing the appointment of a receiver when default is made or otherwise, conveys no absolute right to the appointment by the court. In *Aetna Life Ins. Co. v. Broecker*,[42] it is said that

> "The appointment of a receiver is a remedy, it is part of the procedure of Courts of Chancery to conserve and enforce equitable rights, but it is not an equity in itself, and parties cannot bargain concerning the exercise of its jurisdiction. Such provisions, no doubt, may be entitled to some weight upon the application, but a court of equity will not enforce them where it would be inequitable or unconscionable to do so."

III. Conclusion.

By way of summary, it is submitted that the law in Washington, as presently constituted, is embodied in the following propositions.

1. That a specific pledge of the rents and profits derived from the mortgaged real estate is unenforceable by the mortgagee since it is against the public policy of the state which vests the exclusive right of possession in the mortgagor at all times prior to decree of foreclosure and sale thereunder.

2. That the mortgagee, as against the mortgagor in possession and those deriving title under him subsequent to the mortgage, is not entitled to a receiver, *pendente lite*, to collect the rents and profits and apply same on any deficiency in the mortgage indebtedness arising by reason of the inadequacy of the mortgaged real estate or the insolvency of the mortgagor.

3. That a stipulation in a mortgage that on default, a receiver or a receiver of rents and profits may be appointed, is contrary to the public policy of the state as shown by Rem. C. S. 804 (P C. 7530), and therefore void.

4. That Rem. C. S. 804 (P C. 7530) has the effect only of changing the common law rights and remedies of the mortgagee, without

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[42] 92 Wash. 608, 159 Pac. 779 (1916).
[42] 166 Ind. 576, 77 N. E. 1092 (1906).

affecting his equitable remedies, and that the right, therefore, of a mortgagee to a receiver for the preservation of his security, upon proper cause shown, is in no manner impaired by such statute.

5. That if the mortgagor in possession or those deriving title through him subsequent to the mortgage are permitting or committing waste of a character to impair the security, and the security is inadequate and those personally liable for the debt are insolvent, a proper case has been made out for the appointment of a receiver to take charge of the property and to apply the rents and profits, or so much thereof as may be necessary for that purpose, in protecting it from preventable waste, this being, in effect, a probable exception to Rem. C. S. 804 (P C. 7530)

6. That even though for proper cause shown, a receiver may be appointed, the matter is entirely discretionary with the Court, and that even though the mortgage stipulates otherwise, in no case is a mortgagee entitled, as a matter of right, to the appointment.

In conclusion, it may be said that approval should be given to that enlightened public policy which protects the home owner in the possession of his home, but that there is little reason or justice in extending that public policy for the purpose of enabling the insolvent owner of an apartment house or other business property, who has specifically pledged the rents and income as security for his debt, to avoid his just obligation and pocket such rents and income during the pendency of the foreclosure action.

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RECENT CASES

INSURANCE—CONTEST BETWEEN FIRST AND SECOND MORTAGEES. A owned a tract of land with a dwelling on it, mortgaged to B for $950.00; dwelling insured for $800.00 and mortgage clause in favor of B was attached to the policy· A, desiring to construct a store building on the land, negotiated a $1600.00 loan from C, B releasing his mortgage and taking a 2nd mortgage; C's mortgage provided A should keep the buildings on the property insured for not less than $1600.00 for the benefit of C; C held a $2000.00 policy on the store building; it was agreed between A and C that the insurance on the dwelling should also be changed to make same payable to C, but this was not done, and the dwelling burned. In a contest between B and C: *Held*, that B was entitled to the entire $800.00. *Fireman's Fund Insurance Company v. Edward R. Smith, A. D. Devonshire and Capital Savings & Loan Assn.*, 70 Wash. Dec. 201, 16 Pac. 2d 202 (1932).

An insurance policy is a personal contract between insurer and insured and does not pass with the property insured, *Newark Fire Insurance Co. v. Turk*, 6 Fed. 2d 533, 43 A. L. R. 496 (CCA Penn. 1925) *Fogg v. London & Provincial Marine & General Ins. Co.*, 237 Ky. 636, 36 S. W 2d 44 (1931) *New York Underwriters v. Denson*, 100 Okla. 89, 227 Pac. 124 (1924) *Mercer v. Germania Fire Ins. Co.*, 88 Or. 410, 171 Pac. 412 (1918). However, a contract between mortgagor (insured) and mortgagee whereby the former agrees to insure for the benefit of the latter creates an equitable lien in favor of the mortgagee in the proceeds of insurance on the property at the time of the contract or thereafter procured by the mortgagor, enabling the mortgagee to collect the proceeds even in absence of any mortgage clause on the policy *In re Zitron*, 203 Fed. 79 (D. C. Wisc. 1913) *Stebbins v. Westchester Fire Ins. Co.*, 115 Wash. 623, 197 Pac. 913 (1921) *1st National Bank v. Commercial Union Assurance Co.*, 40 Idaho 236, 232 Pac. 899 (1925)