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Security Transactions—Survival of Mortgage-Lien on Conditional Vendee's Interest Following Declaration of Forfeiture

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Statute consensual security will again be returned to its protected status.³¹ Until then it is only possible to conclude that *American Surety* has enabled the federal tax lien to become a more menacing threat in the federal tax authorities' arsenal of weapons. Inherent in this decision is a more basic threat to the security of business transactions. While the decline and possible destruction of the security interest is only a remote possibility, reality dictates that credit will become available only on more onerous terms. After half a century of slumber, perhaps it is time for Congress to re-establish protection for consensual security.

BEVERLY J. ROSENOW

Survival of Mortgage-lien on Conditional Vendee's Interest Following Declaration of Forfeiture. In *Norlin v. Montgomery*¹ the Washington court (1) held that a mortgagee of the vendee's interest under a forfeitable real estate contract has a lien on the equity of the vendee, and (2) implied that the lien survives a default by the vendee and a subsequent declaration of forfeiture by the vendor.

As vendee, defendant Montgomery entered a forfeitable real-estate contract with Schy, the vendor. Vendee Montgomery then mortgaged his equity in the contract to plaintiff-mortgagee Norlin who then recorded the mortgage. Thereafter, defendant Palmer purchased the property from Schy and later loaned \$1,500 to vendee Montgomery, adding that amount to the real-estate contract payment schedule by endorsement. Then vendee Montgomery defaulted, and Palmer gave written notice of forfeiture. Montgomery executed a quitclaim deed to Palmer with a provision which stated that the intention of the deed was to cancel the contract. Mortgagee Norlin then offered to take over the original Schy-Montgomery contract and to continue the original payment schedule not including the loan of \$1,500. After Palmer refused this offer, Norlin brought an action to foreclose his mortgage, and Palmer filed a cross-complaint to quiet title.

Ignoring the issue of Palmer's declaration of forfeiture, the court held:

in Congress: H.R. 7914, H.R. 7915, S. 2305, 86th Cong., 1st Sess. (1959), and H.R. 4319, H.R. 4320, S. 1193, 87th Cong., 1st Sess. (1961). See explanation by Plumb, *supra* note 13.

³¹ Security for obligatory, by contract or by necessity, future advances would be entitled unconditionally to the same priority enjoyed under state law. The standard of "choateness" would not be applied. See A.B.A. Report, *supra* note 30, at 65-67, 86-89.

¹ 159 Wash. Dec. 280, 367 P.2d 621 (1961).

(1) that Norlin, by virtue of his recorded mortgage, had a lien upon the equity of Montgomery in the contract, as that equity existed at the date of the mortgage; (2) that Mrs. Palmer could not abrogate the lien by accepting a quit claim deed to the property from Montgomery for the reason that, when Mrs. Palmer took the quit claim deed from Montgomery, she received no better title to his equity in the contract than he was able to convey, and (3) that the Norlin note and mortgage were in default and Montgomery's equity in the contract was subject to foreclosure and sale under statutory law.²

In addition, the quitclaim deed was held not to have cancelled the contract because Palmer accepted it with constructive notice of Norlin's recorded mortgage, which encumbered Montgomery's equity in the property.

Clearly the court was correct in its conclusion that the quitclaim deed could neither convey away by deed, nor release through mutual rescission, the mortgagee's interest because a quitclaim deed can only convey or release what the grantor had (an interest subject to a mortgage).³ The difficulty, however, results from the court's assumption that it was faced with a mere conveyance problem. Whatever effect the declaration of forfeiture had upon the parties has not been sufficiently presented.

In order to reach the conveyance issue and to find that the lien survived, the court must necessarily have found that the contract had not been forfeited. Otherwise the entire contract would be void,⁴ and there would have been no equity left in the contract upon which to assert the lien. In Oregon it has been stated that the enforceability of a mortgage on the vendee's interest, as a lien against the land, depends on the condition that the contract remain in force by subsequent performance of its terms.⁵

Although no Washington real estate contract cases have been found expressly stating that a forfeiture does take place at the time of declaration and without the aid of a court's decree, one case involving chattels seems to assume that result. The court there stated that on the breach of a conditional sale contract, the vendor has

a choice between inconsistent substantive rights which [it] . . . had as a conditional sale vendor, and over which its vendee had no control. It is an election between . . . a contract and no contract. Plaintiff chose the

² *Id.* at 284, 367 P.2d at 623-24.

³ RCW 64.04.050; Annot., 162 A.L.R. 556 (1946).

⁴ See discussion in following paragraph.

⁵ *Sheehan v. McKinstry*, 105 Ore. 473, 210 Pac. 167 (1922).

former. *This it could do, and create the chosen relation with its vendee, by merely making its desire to do so manifest.*⁶ (Italics supplied.)

The Oregon court has said:

The aid of equity is not required in order to effect a forfeiture and will not be given for that purpose. . . . [A]lthough in a proper suit to quiet title or the like, equity might recognize that a forfeiture at law had been previously effectuated.⁷

Washington is in accord with the majority of states in recognizing strict forfeiture provisions.

The right to declare a forfeiture is derived from the express agreement of the parties. If they choose to make time the essence thereof and provide for a forfeiture in the event of a breach of such covenant, such provision are valid and enforceable [sic].⁸ [W]here time is made of the essence of a contract of sale, the vendor may declare a forfeiture of the contract for the nonpayment of the purchase price or any installment thereof.⁹

Although not articulated by the cases, the theory is that a forfeitable contract becomes null and void according to its own terms at the time a forfeiture is rightfully declared in the proper manner provided for in the contract.

Therefore, in order for the lien to survive, assuming that Palmer had the right to declare a forfeiture, the court in the *Norlin* case must have found that equitable considerations precluded judicial recognition and enforcement of the declared forfeiture. Strict forfeitures are usually explained on a freedom of contract theory or on the proposition that installment payments come to the vendor as his own and that he is justified in treating them as such in making investments and expenditures.¹⁰ Contrary arguments are asserted that forfeiture provisions should be considered as penalty clauses because they are unfair to the vendee whose money is forfeited. The decisions recognizing forfeiture are often rationalized as more properly resting on the still existent right of the vendor to demand specific performance or on the failure to show

⁶ Washington Co-op. Chick Ass'n v. Jacobs, 42 Wn.2d 460, 463-64, 256 P.2d 294, 296-97 (1953).

⁷ Zumstein v. Stockton, 199 Ore. 633, 264 P.2d 455, 459 (1953).

⁸ Moeller v. Good Hope Farms, Inc., 35 Wn.2d 777, 782, 215 P.2d 425, 428 (1950).

⁹ Dill v. Zielke, 26 Wn.2d 246, 252, 173 P.2d 977, 979-80 (1946). See State *ex rel.* Foley v. Superior Court, 57 Wn.2d 571, 358 P.2d 550 (1961); Knoblauch v. Sanstrom, 37 Wn.2d 266, 223 P.2d 462 (1950); Knowles v. Anderson, 37 Wn.2d 212, 222 P.2d 657 (1950); Moeller v. Good Hope Farms, Inc., 35 Wn.2d 777, 215 P.2d 425 (1950).

¹⁰ CORBIN, CONTRACTS §§ 1057, 1133 (1951).

that the vendor's injury was less than the installments forfeited.¹¹ The Washington rule, where time is made of the essence, is that the vendor may declare a forfeiture of the contract for the non-payment of the purchase price or any installment. But forfeitures are not favored in law and are never *enforced* in equity unless the right thereto is so clear as to permit no denial.¹²

If the Washington court in *Norlin v. Montgomery* intended to relieve against strict forfeiture because of unexpressed equitable considerations, then a new mode of relief has been created, survival of a lien in the mortgagee. The usual equitable relief granted has been: (1) extension of a period of grace in which the vendee could bring the payments up to date,¹³ (2) a conditional decree that the contract will be forfeited unless the vendee tenders the contract balance with interest and all costs and expenses within a certain period,¹⁴ or (3) a declaration that the contract is forfeited, but allowance of a reasonable period in which the vendee may *reinstate* the contract.¹⁵ In each case forfeiture results unless the vendee tenders performance. *Norlin* did in fact loosely tender performance by offering to take over the contract, but the court expressly disregarded this possibility for finding a tender when it declared that the offer had no legal significance because *Norlin's* interest could not vest until issuance of a sheriff's deed to him. The legal result of the *Norlin* case is thus an unconditional relief against forfeiture without requiring tender of performance. Such an important change in the law would seem to merit a discussion of the equitable considerations underlying the decision.

In determining whether equity will grant relief from strict forfeiture, the Washington court in the past has balanced the equities, heavily weighting any hardships on the vendee.¹⁶ The most important factor has been a substantial financial loss to the vendee if forfeiture is enforced, with no corresponding loss to the vendor if a period of grace is allowed.¹⁷ Other considerations such as absence of wilful neglect, care-

¹¹ *Id.* § 1133.

¹² *State ex rel. Foley v. Superior Court*, 57 Wn.2d 571, 358 P.2d 550 (1961); *Knoblauch v. Sanstrom*, 37 Wn.2d 266, 223 P.2d 462 (1950); *Knowles v. Anderson*, 37 Wn.2d 212, 222 P.2d 657 (1950); *Moeller v. Good Hope Farms, Inc.*, 35 Wn.2d 777, 215 P.2d 425 (1950); *Dill v. Zielke*, 26 Wn.2d 246, 173 P.2d 977 (1946).

¹³ *Dill v. Zielke*, 26 Wn.2d 246, 173 P.2d 977 (1946).

¹⁴ *State ex rel. Foley v. Superior Court*, 57 Wn.2d 571, 358 P.2d 550 (1961).

¹⁵ *Moeller v. Good Hope Farms, Inc.*, 35 Wn.2d 777, 215 P.2d 425 (1950); *Bruckart v. Cook*, 30 Wn.2d 4, 190 P.2d 725 (1948).

¹⁶ *Dill v. Zielke*, 26 Wn.2d 246, 252, 173 P.2d 977, 980 (1946).

¹⁷ *State ex rel. Foley v. Superior Court*, 57 Wn.2d 571, 574, 358 P.2d 550, 552 (1961); *Dill v. Zielke*, 26 Wn.2d 246, 173 P.2d 977 (1946).

lessness or intentional delay in the default and a vendee's improvements on the land are used as additional make-weights.¹⁸

Before reviewing the basic equities of the case it must be determined whether the mortgagee has standing to assert any equities at all, and if he does, whose equities he may assert. In *Krieg v. Salkovics*¹⁹ forfeiture was granted against a purchaser from a vendee already in default where there was no evidence of the equities in his favor. By analogy and inverse reasoning it would seem that Norlin should, therefore, have been able at least to assert his own equities. However, in *Radach v. Prior*,²⁰ the *Krieg* case was distinguished on the basis that the *Krieg* vendee was a mere nominal party. In *Radach* a purchaser of one half of the vendees' interest before default was allowed to assert the vendees' equities because they were the real parties in interest.²¹ Since the vendee in *Norlin* is not the real party in interest because of the quitclaim deed,²² it follows that Norlin, the mortgagee, may be limited to the assertion of his own equities. Even if Norlin could, it would avail him little to stand on the vendee's equities. Assuming that the quitclaim deed could not be rescinded for mistake, the vendee is discharged from his obligations to Palmer,²³ and the forfeiture could not affect his obligation to the mortgagee since the forfeiture and the mortgage are completely separate transactions.

Based on traditionally recognized equities the positions seem to be about equally balanced between Palmer and Norlin—loss of a lien as security for Norlin as against imposition of a lien on Palmer. Forfeiture would deprive the mortgagee of his mortgage lien and would limit his remedies on the defaulted mortgage to those against the vendee-mortgagor. Opposing this, denial of forfeiture would mean that Palmer, in exchange for a cancellation of the contract and the right to keep the \$2,244 already paid, had subjected his property to a \$1,770 lien, and had given up \$1,500 plus his right to collect the remaining contract sum of \$7,006. In view of the delicate balance between the parties, a deeper analysis of the respective positions must be undertaken.

¹⁸ *Moeller v. Good Hope Farms, Inc.*, 35 Wn.2d 777, 215 P.2d 425 (1950); *Bruckart v. Cook*, 30 Wn.2d 4, 190 P.2d 725 (1945).

¹⁹ 18 Wn.2d 180, 138 P.2d 855 (1943).

²⁰ 48 Wn.2d 901, 297 P.2d 605 (1956).

²¹ Due to the fact that a subsequent sale of the other half interest was conditioned on failure of the forfeiture proceedings.

²² *National Ass'n of Creditors, Inc. v. Menish*, 144 Wash. 150, 257 Pac. 241 (1927) (quit claim deed from vendees in default may be sufficient consideration for the release of their obligation to pay).

²³ *Ibid.*

At first glance it seems odd that the mortgagee, whose interest must be carved out of whatever interest the vendee had, is given a lien which survives a default by the vendee and a declaration of forfeiture by the vendor. Normally a grantee takes no greater interest than his grantor had unless recording statutes or an estoppel are present. Several theoretical approaches are possible.

One element which the court weighted rather heavily was the fact that Palmer took her assignment of the vendor's interest with constructive knowledge of the mortgage. Because it is stated that the mortgage was on the vendee's equity it appears that Norlin must have had notice of the original Schy-Montgomery contract when he made his loan. Therefore Norlin knew that his security was subject to forfeiture if the vendee defaulted. Presumably then, the original vendor, Schy, had rights superior to those of the mortgagee.²⁴ This result obtains because the vendee, by mortgaging his equity to a creditor who had notice of the vendee's limited interest in the contract, could not create a greater interest in a third person than he himself had. The court in *Norlin*, however, seems to indicate that defendant Palmer cannot take full advantage of the vendor's position because she took as an assignee of the vendor's interest with constructive notice of the recorded mortgage.

A second possibility for avoiding forfeiture may have been found by interpreting acceptance of the quitclaim deed as evidence of an intent on the part of Palmer inconsistent with her declaration of forfeiture. Arguably the acceptance of a quitclaim deed would indicate that the vendor (assignee of the vendor here) did not really intend to declare a forfeiture, and therefore the court will relieve against it. Although theoretically it is impossible unilaterally to reinstate a contract after it becomes null and void by declaration of forfeiture, the courts often talk of a vendor having "waived" the forfeiture.²⁵ Usually a "waiver" is found, in order to avoid the unfavored strict forfeiture of a contract, where payments are received after the declaration of forfeiture or where other indulgences are granted.²⁶ The basic element establishing "waiver," however, is later conduct *inconsistent* with an earlier intent to declare a forfeiture. The operation of the quitclaim deed in cancelling the contract is thus treated as essentially a mutual rescission. The participation of Palmer in accepting the quitclaim deed could

²⁴ *Simonson v. Wenzel*, 27 N.D. 638, 147 N.W. 804 (1914) (held that original vendor manifestly had rights superior to those of the mortgagee).

²⁵ *Moeller v. Good Hope Farms, Inc.*, 35 Wn.2d 777, 215 P.2d 425 (1950).

²⁶ *Id.* at 782, 215 P.2d at 428.

have indicated her belief that some rights or interest still remained in the vendee even after declaration of forfeiture. It is more likely, however, that the quitclaim deed was taken in order to increase the marketability of Palmer's title by destroying any possible cloud which the vendee's interest would create. In that case any inconsistency in conduct would obviously disappear as would the above possibility of relief from forfeiture.

Conceivably a third rationalization may be founded on the theory that the declaration of forfeiture was more closely analogous to a mutual rescission. This conclusion would result if the declaration of forfeiture were converted into an acceptance of the vendee's offer to rescind implied from his default. Even though Norlin accepted the mortgage knowing that it was subject to the vulnerability of a forfeitable contract, the fact that Palmer took an assignment of the vendor's interest with notice of the mortgage could result in her having less freedom to declare a forfeiture than the original vendor had. The element of *wilfulness* in the vendee's ability to destroy the security for the mortgage by defaulting in payment of installments, combined with the *voluntary* exercise of Palmer's *option* to declare a forfeiture on default, could have been considered so unfair that an equity court was unwilling to recognize the strict forfeiture *as between Norlin and Palmer*.

Balancing all the equities and considerations discussed above it is at least arguable that relief from strict forfeiture should not have resulted from the court's decree recognizing the survival of the mortgage as a lien. The complete absence of judicial discussion of the forfeiture issue directs the conclusion that the result should at least be re-examined when the opportunity next arises. HARTLEY PAUL

STATE AND LOCAL TAXATION

County-imposed Real Estate Sales Tax—Applicability to Corporate Transfers in Dissolution. Extending the reasoning in *Deer Park Pine Indus., Inc. v. Stevens County*,¹ *Doric Co. v. King County*² holds that a distribution of a dissolved corporation's sole asset to its sole shareholder, who does not assume an existing debt of the corporation,

¹ 46 Wn.2d 852, 286 P.2d 98 (1955).

² 57 Wn.2d 640, 358 P.2d 972 (1961).