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## RIGHTS OF A MORTGAGEE AND CREDITORS UNDER MISSOURI LAW WHEN THE MORT- GAGOR RETAINS POSSESSION.

There are remedies open to the mortgagee, both in law and in equity, that will allow him to recover against his mortgagor who remains in possession of the property. But his remedy in a law court is generally ineffectual in whole or in part. He cannot, of course, bring replevin or trover, because he has never had possession of the property. And an action for damages, which is always open to him, is often not efficacious; for, in the majority of cases, the mortgagor is insolvent, so that damages, although in theory recoverable could not be actually obtained. His remedy in equity is a surer remedy. The basis of his claim there, whether it is considered as a right to demand specific performance of the agreement, or as an equitable lien on the mortgaged property, will bring about the same practical results.

When the mortgagee allows the mortgagor to retain possession of the property he has the same rights against his mortgagor as he would have if he had taken possession. If the mortgagee is specifically designated, has given a valuable consideration and has not used fraud or misrepresentation in procuring the mortgage, he has an equitable lien which he can enforce against the mortgagor. And his rights are in no sense impaired because he allows the mortgagor to retain the property and deal with it in any way he chooses.

But as soon as the rights of a third person are introduced the situation is changed.<sup>1</sup> The cases generally arise when the mortgagor is insolvent and therefore unable to meet the claims set forth by the such a situation both the mortgagee and the third party have just but conflicting rights, and these cases are always difficult of equitable solution. When the third party is a purchaser for value there is no difficulty; such a person gets title to the property upon payment of consideration and the mortgagee cannot divest him of it because of any claim that he may have to the property. But in the case of a mortgagee and one extending credit who shall suffer: the mortgagee who has advanced money on the basis of his security, or the creditor who has extended credit in the belief that the property held by the vendee was free from incumbrance? To force the mortgagee to take possession of the property or lose his lien would greatly interfere with trade, for in many cases (as, for instance, the mortgaging of a stock in trade).

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1. *Embree vs. Roney*, 152 Mo. App. 257.

Such a taking of possession would force the mortgagor to abandon all business. On the other hand, to give the mortgagee entire preference would undermine the credit system.

The states have attempted to meet this conflict by passing statutes requiring mortgages to be recorded. Such statutes in regard to personal property cannot, in the very nature of things, be as effective as are analogous statutes in regard to real estate. In the first place, transactions involving real property are relatively few and involve larger sums of money; therefore time expended in searching the records is well spent. In the case of personal property this is not true. Secondly, land is fixed, while personalty may be taken from one place to another. Furthermore, the mortgagor himself may be in one state one year and another the next. Therefore, whether the statutes require recording in the place where the property is situated or where the mortgagor resides when the transaction takes place, the prospective vendor cannot be certain that there is no lien on the property, even when he takes the time and trouble to look up the records. Some states have further narrowed the risk of subsequent vendors by requiring the mortgage to be recorded anew each year, but Missouri has not gone so far. The Missouri statute simply requires an original recording of the chattel mortgage in the county where the mortgagor is domiciled, unless there is a taking of possession by the mortgagee.<sup>2</sup> If the mortgagor lives outside of the state, then the mortgage must be recorded where the property is situated.<sup>3</sup>

By court decisions a reasonable time is given for the taking of possession. This Missouri statute is based on a like statute of Massachusetts, and the courts have adopted the Massachusetts line of decisions under their statute. It would seem that the only logical reason for requiring the recording of chattel mortgages would be to give notice to prospective creditors of the prior incumbrance so that creditors without actual information might acquire it through the medium of the records. This view was strongly urged in the early cases,<sup>4</sup> counsel basing their arguments on the analogous situation in regard to realty, where actual notice is sufficient. But the courts, adopting the stricter interpretation, decided that actual notice on the part of the creditor cannot help the mortgagee who has neglected to record; that is to say, recording is a condition precedent to the validity of the mortgage and that *actual* notice cannot cure the defect as to third

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2. Mo. R. S. 1919, Sec. 2256.

3. *Ibid.*

4. *Shepherd vs. Trigg*, 7 Mo. 151; *Bryson vs. Penix*, 18 Mo. 13.

parties, even when the latter were in no sense misled in extending credit.<sup>5</sup> It is easy to see how, on a purely logical and technical basis, these decisions are sound; for the statute declares these unrecorded mortgages to be "void" as to third parties and does not except those cases in which the creditors have actual notice. But the results seem inequitable. Since no one has been misled, the loss of the mortgagee's lien would seem to be more or less in the nature of punishment—and a rather heavy punishment at that—for failure to record. Such a line of decisions would also seem rather to open the way for fraud and injustice than to prevent them.

It has been held in Missouri by a long line of decisions that the mere retention of possession by the mortgagor does not render the mortgage void.<sup>6</sup> But if the mortgagor has the power of sale over these goods without being liable to account for the proceeds, then the mortgage is void as to third persons on the grounds of its being a fraudulent conveyance. However, a mere power of sale will not render the mortgage void if there is a provision for an accounting.<sup>7</sup> There is also a distinction drawn between an instrument void on its face and one that can be shown to be void in fact. Thus a mortgage which provides that the mortgagor shall retain possession of the property, "with full rights of enjoyment," was held to be void on its face as to attaching creditors; for the language of the very instrument itself showed that the mortgagor might deal with the property with no supervision by the mortgagee and with no need of informing the latter of his dealings therewith.<sup>8</sup> But in order to be void on its face the instrument must, expressly or by *necessary* implication, give the right of disposition without accounting. A provision that the mortgagor may from time to time add to the stock covered by the mortgage does not of necessity show that the mortgagor has the power to sell and the court cannot infer such a power from this provision.<sup>9</sup>

But the fact that the mortgage is not fraudulent on its face does not dispose of all consideration by the court of fraud: the mortgage may still be fraudulent *in fact* if the mortgagor is allowed, contrary to the mortgage, to deal with the goods as his own. Just what amounts to actual fraud is to be decided upon the facts of each separate case

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5. Bryson vs. Penix, 18 Mo. 13; Bevans vs. Bolton, 31 Mo. 437; Wilson vs. Milligan, 75 Mo. 41; Martin-Perrin Mercantile Co. vs. Perkins, 63 Mo. App. 310; Rawlings vs. Bean, 80 Mo. 614.

6. This has been held from the decision of Sibly vs. Hood, 3 Mo. 290, which involved the mortgaging of negroes, down to the present time.

7. Scudder vs. Bailev, 66 Mo. App. 40.

8. Independent Packing Co. vs. O'Keefe, 128 Mo. App. 592.

9. Voorhis vs. Langsdorf, 31 Mo. 451.

as those facts are brought to light in the trial. For example, in the case of *McCarthy vs. Miller*,<sup>10</sup> a husband mortgaged a buggy and certain horses to his wife, the mortgage providing that the husband should have no power of sale without an accounting. The husband, however, did exchange six of the horses, on one occasion retaining \$20.00 profit made on the exchange. This mortgage was held to be void in fact. But in a later case this same court held that when a mortgage covered a stock of goods and substitution was made in the stock the mortgage was not thereby invalidated, even though one of the partners (mortgagor was a partnership) withdrew certain funds for his private use.<sup>11</sup> It is hard to find a distinguishing element in these two cases unless it be this—that in the later case there was a provision for regular monthly payments on the mortgaged debt which would take this instrument out of the class of fraudulent conveyances. However that may be, the theory at the basis of the case of *Fleisher Bros. v. Hinde* seems to be a just one; that is, that the property through substitution is kept within the reach of attaching creditors and is for that reason no more fraudulent as to such creditors than would be any other mortgage in which the mortgagor retains possession of the property. Even the removal of the property from the state will not invalidate the mortgage unless, of course, there is fraudulent connivance between the mortgagor and the mortgagee to the detriment of creditors.<sup>12</sup>

It has been shown that certain defects in a mortgage will render it invalid as to third parties. Two additional questions present themselves: (1) Can the mortgagee cure such a defect and thereby make his lien a valid one? (2) If he can, then as to what creditors will his lien be paramount? There is no doubt as to the answer to the first question—the mortgagee has an absolute right to perfect his mortgage by curing the defect by recording or by taking possession of the property. The answer to the second question is more complicated. As to those who become creditors *subsequent* to the perfection of the mortgage the mortgagee will have a paramount lien.<sup>13</sup> But when anyone has extended credit *prior* to the perfection of the mortgage the situation is changed. If the defect was merely formal and has not misled creditors it may be remedied by changing the instrument and the

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10. 41 Mo. App. 200.

11. *Fleisher Bros. vs. Hinde*, 122 Mo. App. 218.

12. *McNichols vs. Fry*, 62 Mo. App. 13.

13. *Dobyns vs. Meyer*, 95 Mo. 132; *Bank vs. Powers*, 134 Mo. 432; *Boland vs. Ross*, 120 Mo. 208.

mortgagee will get a paramount lien.<sup>14</sup> Such a situation would arise where a corporation was mortgagee and the signatures of certain officers were required, one of whom had neglected to sign. If the mortgage is valid in all other respects his signature can be added, and the mortgage lien will take preference over prior creditors. But if the defect is a substantial one the reverse is true; the prior creditors have a better claim to the property than the mortgagee. The reason behind this seems to be that a fraud once committed cannot be cured by a later action where the rights of third parties would be diminished or taken away. And for this purpose "fraudulent acts" covers not only those things done with actual fraudulent intent but also those which from their tendency to deceive other persons would be as harmful as if there was actual fraud.<sup>15</sup> An example of the invalidity of such reformation is the case of *Landis v. McDonald*.<sup>16</sup> There it was held that when a mortgage is unrecorded and debts are acquired by the mortgagor in possession, the creditors cannot be defeated by the subsequent taking of possession by the mortgagee but that the mortgage is fraudulent and void as to these creditors. To demand a paramount right such persons need not be specific creditors; if they are general creditors it is sufficient. They will have no rights against the mortgagee until they have acquired a right by legal process; but this right when acquired will relate back to the time when the debt was incurred.<sup>17</sup>

Certain technicalities for making the mortgage valid have been added by the passage of the Bulk Sales Act of 1913. This act covers the "sale, trade or other disposition of the major part in value or the whole of a stock of merchandise . . ." <sup>18</sup> and requires the vendee, at least seven days before the transaction, to get a complete list of the names of creditors of the vendor together with the amount of the indebtedness. These creditors must be notified by the vendee at least seven days before the sale, either by telegraph or registered letter, and failure to comply will render the transaction void as to these creditors.<sup>19</sup> This act covers the mortgaging of property,<sup>20</sup> and if the mortgagee fails to comply therewith such a mortgage will be fraudulent and void as to those who were creditors at the time the mortgage was

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14. *Center Creek Mining Co., vs. Coyne*, 164 Mo. App. 492.

15. *Reed vs. Pelletier*, 28 Mo. 173.

16. 88 Mo. App. 335.

17. *Landis vs. McDonald*, 88 Mo. App. 335.

18. Mo. R. S. 1919, Sec. 2286.

19. *Ibid.*

20. *Semmes vs. Stecher Brewing Co.*, 195 Mo. App. 621.

made.<sup>21</sup> But by further provision of the act<sup>22</sup> and by judicial decision under the act,<sup>23</sup> such a mortgagee will be entitled to be made receiver of the mortgagor in regard to the property covered by the mortgage.

As has been shown the legislature has from time to time imposed additional requirements on the mortgagee with which he must comply in order to get a valid lien on the property. But in view of the hardship on creditors that would exist if they were not protected in this way, these restrictions seem to be justified and result in a more equitable settlement of the conflicting rights of mortgagee and creditors.

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21. Ibid.

22. Mo. R. S. 1919, Sec. 2287.

23. Semmes vs. Stecher Brewing Co., 195 Mo. App. 621.