Michigan Law Review

Volume 32 | Issue 6

1934

LANDLORD AND TENANT - LIABILITY OF A MORTGAGEE IN POSSESSION OF MORTGAGED LEASEHOLD FOR RENT

LANDLORD AND TENANT — LIABILITY OF A MORTGAGEE IN POSSESSION OF MORTGAGED LEASEHOLD FOR RENT — On default of payments under a mortgage of a leasehold, the mortgagor and mortgagee agreed that the latter was to go into possession of the premises and manage them with a view to meeting the requirements of the mortgage. The mortgagor also executed a warranty deed of the premises to the mortgagee.[1] On default of rent payments the landlord sued the mortgagee. *Held*, the defendant mortgagee was in possession merely as agent of the mortgagor and as such was not liable for the rent. *Cleveland v. Detroit Trust Co.*, 264 Mich. 253, 249 N. W. 842 (1933).

The holding in the instant case is an excellent example of the possibility of obtaining a result consistent with "fireside equity" or "natural justice" by adopting a rationalization insuring a predetermined politic result. Under settled principles of law, the burden of the rent covenant runs with the leasehold; it binds

[1] The agreement provided *inter alia* that:

" . . . [the mortgagees] shall have full power and authority to manage, control, lease and operate [the premises]. . . . "

" . . . all moneys remaining on hand hereunder shall be paid to [mortgagors] and any lands described in said deed hereto attached remaining unsold shall be conveyed as directed by [mortgagors]. . . . "

"The intent and purpose hereof is to provide a method whereby . . . [payments due under the mortgage] will be paid without foreclosure or other publicity."

The deed providing *inter alia*:

" . . . the said parties of the first part [mortgagors] . . . alien . . . all the right, title and interest of the obligors in and to a certain lease. . . . "

the assignee thereof who is said to be in privity of estate with the landlord as a result of the assignment.[2] The transactions between the parties, especially the deed purporting to transfer all the mortgagor's interest in the premises, could naturally have been construed as an "assignment" [3] or "agreement allowing the mortgagee to go into possession," [4] and either construction would have justified holding the defendant liable for the rent.[5] However, the circumstances under

[2] See 1 TIFFANY, LANDLORD AND TENANT, p. 888 n. 111, p. 968, sec. 158a(1), p. 972 (1912) (necessity of a legal assignment for the burden to fall on transferee).

Since there was no express agreement on the part of the mortgagee to assume the burden of the rent covenant, no problem of suit based on privity of contract on the theory of the landlord being a third party beneficiary arises. Bonnetti v. Treat, 91 Cal. 223, 27 Pac. 612, 14 L. R. A. 151 (1891); 1 TIFFANY, LANDLORD AND TENANT 989-991 (1912). Nor was there an agreement between plaintiff and defendant so as to render defendant liable on the theory of privity of contract. Mann v. Ferdinand Munch Brewery, 225 N. Y. 189, 121 N. E. 746 (1919); Chase v. Oehlke, 43 Cal. App. 435, 185 Pac. 425 (1919).

[3] In absence of special equities operating in the defendant's favor it is clear, considering the terms of the agreement coupled with the attached deed (see note 1, supra), that there was an assignment of all the mortgagor's interest. Proceeding under the theory that instruments given contemporaneously are to be construed as one instrument, Parks v. Comstock, 59 Barbour (N. Y.) 16 (1865); Davis v. Claxton, 82 Mont. 574, 268 Pac. 787 (1928), the substance of the transaction was this: mortgagor expressly agreed to transfer all his interest (by virtue of the deed); mortgagee agreed to a defined management of the premises and a contingent reconveyance (see note 1, supra). See Threlkeld v. Conway, 121 Wash. 624, 209 Pac. 1088 (1922) (absolute conveyance coupled with an agreement to reassign). There being no attempt at reservation of an interest to the mortgagor, this must be construed an assignment: Craig v. Summers, 47 Minn. 189, 49 N. W. 742, 15 L. R. A. 236 (1891) ("Where all of the lessee's estate is transferred the instrument will operate as an assignment."); Stewart v. Long Island Ry., 102 N. Y. 601, 8 N. E. 200 (1886); Taylor v. Marshall, 255 Ill. 545, 99 N. E. 638 (1912); 14 L. R. A. (N. S.) 155 n. (1908); 1 TIFFANY, LANDLORD AND TENANT 907-8 (1912); 1 ST. JOHNS L. REV. 62 (1926); 8 MINN. L. REV. 609 (1924); 34 YALE L. J. 913 (1925); Davidson v. Minnesota Loan and Trust Co., 158 Minn. 411, 197 N. W. 833, 32 A. L. R. 1418 (1924); Davis v. First Nat. Bank, (Tex. Civ. App. 1924) 258 S. W. 241; Springs v. Atlantic Refg. Co., (N. C. 1933) 171 S. E. 635.

[4] A technical argument against this construction is possible: the terms of the deed seem to contemplate a formal assignment rather than a quasi-assignment. See Ann. Cas. 1916E 788 at 813. Obviously this is not a formidable objection.

Illustrations of mortgagees in possession of leaseholds: North Chicago St. R. R. v. Le Grand Co., 95 Ill. App. 435 (1900); Cockrell v. Houston Packing Co., 105 Tex. 283, 147 S. W. 1145 (1912); Northwestern Mutual Life Ins. Co. v. Security Savings and Trust Co., (C. C. A. 9th, 1919) 261 Fed. 575; Ireland v. United States Mortgage & Trust Co., 72 App. Div. 95, 76 N. Y. S. 177 (1902).

[5] Liability of assignee for rent: Darmstaetter v. Hoffman, 120 Mich. 48, 78 N. W. 1014 (1899); Weber v. Van Blerck Motor Co., 186 Mich. 449, 152 N. W. 1036 (1915); Buhl Land Co. v. Franklin Co., 258 Mich. 377, 242 N. W. 772 (1932); Shaffer v. George, 64 Colo. 47, 171 Pac. 881 (1918); 14 L. R. A. 151 n. (1892); Ann. Cas. 1916E 788 at 797-822; 1 TIFFANY, LANDLORD AND TENANT 1126, sec. 181b (1912); see note 3, supra.

Liability of mortgagee not in possession: where legal title passes to the mortgagee

which the defendant mortgagee went into possession of the mortgagor's leasehold clearly precluded any actual intention on the part of the parties to create a relationship imposing such liability for rent.[6] Of course if one accept an assignment he may be deemed to intend the legal consequences of his act; therefore the defendant's liability might be said to depend on whether or not the legal effect of the deed and agreement was to establish a privity of estate between the litigants, and not on their intentions. But the court did not adopt this attitude — it proceeded on what it supposed the parties desired; it adopted a theory of "agency" and rendered this plausible through some slight indulgence in logical acrobatics.[7] A fourth construction, also making for non-liability, that of "sub-

by virtue of the mortgage it operates to make the mortgagee liable for rent even when he is not in possession of the leasehold. Williams v. Bosanquet, 1 Brod. and Bing. 238, 129 Eng. Repr. 714 (1819); Abrahams v. Tappe, 60 Md. 317 (1883). *Cf.* Trustees of Donations v. Streeter, 64 N. H. 106, 5 Atl. 845 (1886); 1 TIFFANY, LANDLORD AND TENANT 976, sec. 158a(2)f (1912).

Where the effect of the mortgage is to give an equitable lien the mortgagee becomes liable only if he takes possession: Astor v. Hoyt, 5 Wend. (N. Y.) 603 (1830); Walton v. Cronly's Adm'r, 14 Wend. (N. Y.) 63 (1835); McKee v. Angelrodt, 16 Mo. 283 (1852); Levy v. Long Island Brewing Co., 26 Misc. 410, 56 N. Y. S. 242 (1899); North Chicago St. R. R. v. Le Grand Co., 95 Ill. App. 435 (1900); Ann. Cas. 1916E 788 at 813 n.; 1 TIFFANY, LANDLORD AND TENANT 976, sec. 158a(2)f (1912).

In two jurisdictions the mortgagee is not liable for the rent even though he take possession on the theory that legal title remains in the mortgagor and the mortgagee has obtained an assignment of the rents from sub-tenants by way of security. Johnson v. Sherman, 15 Cal. 287, 76 Am. Dec. 481 (1860); Cargill v. Thompson, 57 Minn. 534, 59 N. W. 638 (1894). See also Northwestern Mutual Life Ins. Co. v. Security Savings and Trust Co., (C. C. A. 9th, 1919) 261 Fed. 575.

[6] The lease was mortgaged as part security of a bond issue of $1,700,000. This was in default. Rental under the lease was $1750 a month.

The following is a quotation from a deposition of a representative of the defendant:

> "The income on this property had been steadily declining and as the whole object of the agreement was to get moneys with which to take care of the requirements of the mortgage . . . we felt that the continued paying of rent would not be accomplishing the purpose of looking after payments required under the mortgage."

[7] Apart from the deed in this case, the theory of agency, although a strained construction, would not be difficult to accept.

Agency as distinguished from a tenancy: Fiske v. Framingham Mfg. Co., 31 Mass. (14 Pick.) 491 (1833); Stewart v. Putnam, 127 Mass. 403 at 407 (1879); Ragsdale v. Meridan Land and Industrial Co., 71 Miss. 284, 14 So. 193 (1893); State v. Page, 1 Spears' Law (S. C.) 408, 40 Am. Dec. 608 (1843); Petteway v. McIntyre, 131 N. C. 432, 42 S. E. 851 (1902).

Mortgagee in possession of mortgaged leasehold as agent: Ireland v. United States Mortgage & Trust Co., 72 App. Div. 95, 76 N. Y. S. 177 (1902); Ireland v. United States Mortgage and Trust Co., 175 N. Y. 491, 67 N. E. 1083 (1902) (Contract under which mortgagee went into possession provided that he collect rents and apply the collections first to the rent and other payments under the lease, the balance to be applied on the mortgage. Held, an agency.); Mulcahy v. Weber, 98 Misc. 266, 162

lease," though probably approximating the actual intent of the parties, would necessitate a departure from basic principal[8] or a reformation of the deed and

N. Y. S. 985 (1917); *cf.* Cockrell v. Houston Packing Co., 105 Tex. 283, 147 S. W. 1145 (1912) (Contract provided that agent of mortgagee was to go into possession and manage the business carried on on the leased premises until the mortgage was satisfied. Agreement expressly provided that the mortgagee was to be the agent of the mortgagor and was to acquire no interest in the premises. Held, an assignment and the mortgagee liable for the rent.)

But even granting that the agreement aside from the deed creates an agency relation, what is to be done with the deed? If it is to be given full effect there is clearly an assignment. See note 3, supra. It must either be held non-operative by saying that interpreted in connection with the terms of an agency agreement its terms are thereby limited, an obviously strained construction, or it must be treated as a separate transaction, as an absolute deed given by way of mortgage. Crawford v. Osmun, 70 Mich. 561, 38 N. W. 573 (1888); Teal v. Walker, 111 U. S. 242, 4 Sup. Ct. 420 (1883); In re Bennett, 168 Ill. App. 658 (1912), with the mortgagee going into possession by virtue of the agreement. This latter rationalization, though completely coherent from the logical point of view, smacks of the facetious in view of the pre-existing mortgage on the same premises. See particularly Northwestern Mutual Life Ins. Co. v. Security Savings and Trust Co., (C. C. A. 9th, 1919) 261 Fed. 575 at 582.

A distinction could be drawn between defendant's managing the premises and its holding of the estate. Its being an agent as to the former is in no way inconsistent with its holding the estate in its own right. See Cockrell v. Houston Packing Co., 105 Tex. 283, 147 S. W. 1145 (1912).

[8] Barring a possible concealed hope on the part of the mortgagor, there can be no questioning the fact that the actual intent of the parties was to substitute the mortgagee for the mortgagor so far as rights of enjoyment were concerned but without his becoming liable on covenants in the lease. See note 6, supra. This could have been accomplished through the mortgagor's formally reserving a portion of his term. Defendant would then be a sublessee and not in privity with the reversioner by virtue of the mortgagor's intervening estate. Sexton v. Chicago Storage Co., 129 Ill. 318, 21 N. E. 920, 16 Am. St. Rep. 274 (1889); First State Bank of Keota v. Wadley, 103 Okla. 147, 229 Pac. 582 (1924); Indian Rfg. Co. v. Roberts, (Ind. App. 1932) 181 N. E. 283; Ann. Cas. 1916E 788 at 823-4; for a collection of cases see 1 TIFFANY, LANDLORD AND TENANT 1133 (1912).

Where a dispute arises between the contracting parties, the question whether an agreement constitutes an assignment or sublease is a matter of intention according to some courts (see Davidson v. Minnesota Loan and Trust Co., 158 Minn. 411, 197 N. W. 833, 32 A. L. R. 1418 and note (1924)), and it has been urged that this should be the rule in every case. W. W. Ferrier, Jr., "Can There Be A Sublease For the Entire Unexpired Portion of A Term?," 18 CAL. L. REV. 1 at 19 (1929) ("If the fundamental distinction between assignment and sublease is to be recognized, as it seems desirable that it should be, the category into which a particular transfer is to be placed should depend . . . upon the intention of the parties to the transfer."). See also 1 ST. JOHNS L. REV. 62 (1926); 34 YALE L. J. 913 (1925); 8 MINN. L. REV. 609 (1924). The argument is based on the hardship imposed on an occupant of premises who enters into what he supposes is an agreement rendering him liable only for covenants contained in the *transfer*, only to find he is an assignee and liable on covenants in the *lease*. In absence of fraud he would have no recourse against his assignor if the landlord enforced performance of those covenants. The force of this argument

agreement on the hypothesis of mistake.[9] The result reached by the court, since it involved an attenuation of established doctrine as to assignments, is indicative of the importance of commercial policy and practical exigencies as catalyzers in the judicial process.

L. H. W.

is aptly brought out by what would have been the result had the court held the defendant liable in the principal case. See note 6, supra.

To the extent that the landlord is deprived of a responsible debtor there may be said to be hardship on him. But this argument is apparent rather than real when one considers that he has no equity as a bona fide purchaser, not having parted with value on the strength of apparent title in the defendant; that the mortgagor, by a mere formal reservation of so small a part of his term as one day could have prevented him from having any color of claim on the defendant; and that the original lessee continues liable on his contract.

The formal reservation of an intervening estate seems in reality to be nothing more than an expressed intent of the parties that the occupant be not held for rent. It is submitted that such should be the holding when the intent of the parties is apparent although not explicitly stated.

[9] Had the case been before the court as a bill for reformation of a deed or of a written agreement, probably a decree for the complainant would have been entered under the prevailing view that a mistake of law is sufficient basis for reformation of a written agreement. Plaintiff, although not a party to the agreement and deed, has no prior equity as a bona fide purchaser might have to bar equitable relief. Trusdell v. Lehman, 47 N. J. Eq. 218, 20 Atl. 391 (1890); Stedwell v. Anderson, 21 Conn. 139 (1851); Marine Savings Bank v. Norton, 160 Mich. 614, 125 N. W. 754 (1910); Pitcher v. Hennessey, 48 N. Y. 415 (1872); Crodle v. Dodge, 99 Wash. 121, 168 Pac. 986 (1917).