Marquette Law Review

Volume 56
Issue 1 *Fall 1972*

Article 8

1972

Creditor's Rights: After-Acquired Property

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RECENT DECISIONS

Creditor's Rights: After-acquired Property—Questions of creditors' priorities in bankruptcy actions have always raised interesting and debatable issues. Understandably, each creditor feels he should receive a part of the assets; however, situations arise in which the claims are so large, and the assets so small, that the creditor who is placed first will take all the assets.

For instance, which creditor will be first in priority in the following example? *A* is the record title holder of real estate. *B* mortgages *A*'s property to *C*, then *D* dockets judgments against *A*. *C* forecloses the mortgage on *B* and *A* quitclaims the property to *B*. The answer, to those acquainted with priorities, is that *D* will stand first in priority. The authority putting *D* first is grounded in statutory and common law. First, Wisconsin Statutes section 270.79(1) provides in part as follows:

> (1) Every judgment, when properly docketed, and the docket gives the judgment debtor's place of abode and his occupation, trade or profession shall, for 10 years from the date of the entry thereof, be a lien on the *real property* (except the homestead mentioned in section 270.20) in the county were docketed, of every person against whom it is rendered and docketed, *which he has at the time of docketing* or which he acquires thereafter within said 10 years. . . .[1]

The statute states that when the judgment is properly docketed by *D* it attaches to the "real property" *A* owns at that time. Hence *D* stands ahead in time as against *C*, the mortgagee, because the property was not quitclaimed by *A* to *B* until after the judgment was docketed.

Second, the common law rule of after-acquired property also would apply, although Wisconsin has no authority for this position. The doctrine of after-acquired property has long been recognized by the United States Supreme Court[2] and is neatly explained in a federal court decision, *Harris v. Youngstown Bridge Co.*:

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1. WIS. STAT. § 270.79(1), *construed in* Mueller v. Novelty Dye Works, 273 Wis. 43, 78 N.W.2d 881 (1956).

2. Pennock v. Coe, 64 U.S. (23 How.) 117, 129 (1859); Dunham v. Railway Co., 68 U.S. (1 Wall.) 254, 266 (1863); Railroad Co. v. Cowdry, 78 U.S. (11 Wall.) 459, 481 (1870); Dillion v. Barnard, 88 U.S. (21 Wall.) 430 (1874); Fosdick v. Schall, 99 U.S. 235, 251 (1878); Myer v. Car Co., 102 U.S. 1 (1880); Porter v. Steel Co., 122 U.S. 267, 283 (1886).

> . . . one may execute a mortgage, valid at least in equity, upon property not in existence or not owned by him, the lien of which will immediately attach to the property when it shall come into existence, or become the property of the mortgagor, and this whether the title of the mortgagee is legal or equitable.[3]

Therefore, the equitable lien possessed by *C*, the mortgagee, will attach to *A*'s property only after *B* actually acquires it. Since *D* docketed his judgment before *A* quitclaimed the property to *B*, *D* is first in priority. Indeed, the federal court bore out this reasoning when it stated:

> . . . the mortgagee of after-acquired property is not a purchaser for value, and cannot acquire an interest by way of lien greater than that which the mortgagor has himself acquired. *The lien of the mortgage attaches to after-acquired property in the condition in which the mortgagor takes it from his vendor, and subject to all known liens and equities valid against the vendor*, and also subject to all liens or equities valid against the vendee and mortgagor which arise in the act of purchase or acquisition.[4]

Hence, because *C* cannot possess an interest greater than that of *B*, the mortgagor, *C*, takes the property in the same state as *B* acquires it; that is, with *D*'s judgment already attached. In conclusion, then, there are principles placing *D* in the priority position under both statutory and common law.

Without changing the time sequence or ownership set forth above, only one fact will be altered for the second example. *A* will become the sole shareholder and president of *B*, a corporation, the mortgagor, who participates in the mortgage as president of the firm. Does this change alter the priorities of *D* and *C*? The Wisconsin Supreme Court stated that *C*, the mortgagee, rather than *D*, the judgment creditor, has priority in the case of *I.F.C. Collateral v. Commercial Units, Inc.*[5] The court stated that the general rule in Wisconsin is:

> One who obtains an equitable interest for value given, which later ripens into a legal interest is entitled to priority over a judgment creditor who dockets his judgment in the interim period.[6]

This meant that *C*, the mortgagee, obtains an equitable lien

3. 90 F. 322 (6th Cir. 1898).
4. *Id.* at 328 (emphasis added).
5. 51 Wis. 2d 41, 186 N.W.2d 214 (1970).
6. *Id.* at 49, 186 N.W.2d at 217 (1970).

from the mortgage transaction and because *D* docketed between the mortgage date and the quitclaim date his lien attached second in time to *C*'s.

To illustrate how the doctrine applied to defeat the claim of the judgment creditor, *D*, the court used an analogy between equitable conversion in a land sales contract, and an equibable mortgage situation, both occurring under the doctrine of relation back. In the typical installment land sales contract, a seller contracts to deed land to a buyer for a down payment and agreed upon installment payments. The court cited the leading Wisconsin cases that applied equitable conversion and relation back to a claim of a creditor who docketed against the seller before the final payment.[7] The court said the cases showed that at the time at which the contract between the buyer and the seller became enforceable, the buyer possessed the equitable title and the seller held the legal title in trust as a security interest for the purchase price.[8] Furthermore, the court explained, the doctrine of relation back operates on the contract between the parties in such a way that when the purchaser has made the last payment, the legal title vests in him as of the date the contract was entered into.[9] Hence the judgment creditor who docketed against the seller after the contract was made, but before its completion, had no real property in the seller to which the judgment could attach. The court stated:

> The contract, therefore, becomes the principal thing. The completed transaction and every step in the transaction relates back to the date of the contract, and it is of no significance, in determining the interests of each party, that the full purchase price has not been paid before docketing of the judgment, provided the contract itself is a valid binding agreement made between the parties before the docketing of the judgment.[10]

The court categorized the instant case as an equitable mortgage situation, which it defined arose

> . . . when, for value received, one party attempted to convey a security interest *in his land* to another and such attempt failed because of some error or omission in the documents which pre-

7. Blaha v. Borgman, 142 Wis. 43, 124 N.W. 1047 (1910); Lewis v. Banking Comm., 225 Wis. 606, 275 N.W. 429 (1932); G. OSBORNE, LAW OF MORTGAGES 326, 327 (2d ed. 1970); J. POMEROY, EQUITY JURISPRUDENCE 1054-1058 (5th ed. 1941).

8. Mueller v. Novelty Dye Works, 273 Wis. 501, 78 N.W.2d 881 (1956).

9. *Id.* at 507, 78 N.W.2d at 883 (1956).

10. *Id.* at 505, 78 N.W.2d at 883 (1956).

> vented the transaction from being denominated a legal mortgage.[11]

The court explained that the relation back applied here when the error was corrected or the omission supplied.[12] The correction relates back in time to the attempted mortgage and makes it legal as of the date of the original mortgage.[13] This doctrine, as in the previous one of equitable conversion, may only be defeated by a bona fide purchaser for value without notice.[14] The judgment creditor in Wisconsin is not a bona fide purchaser without notice, because he has not parted with anything of value in reliance on the state of the debtor's title.[15] Thus the court held that *C*, the mortgagee, was first in priority, instead of *D*, the judgment creditor, because *D* had docketed after the mortgage date and therefore *A*'s quitclaim deed to his corporation, *B*, corrected the mistake and triggered the doctrine of relation back.[16]

The judgment creditor argued that the doctrines of equitable conversion and equitable mortgage should not operate equally because in the land contract situation the purchaser held an equitable title while the equitable mortgagee held only a security interest.[17] The court recognized the difference, however, and stated that:

> . . . the controlling question in equity at least, is not how big the prior interest is, but rather whether the holder of the prior interest paid value for it, regardless of its size.[18]

This of course means that both the land purchaser in the installment land contract and the equitable mortgagee are bona fide purchasers for value without notice.

Upon analyzing the principles of after-acquired property, and the statutory language of Wisconsin Statute 270.79(1), as used in the first example, along with the court's reasoning under the facts

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11. J. POMEROY, EQUITY JURISPRUDENCE 1054 (5th ed. 1941); G. OSBORNE, LAW OF MORTGAGES § 31 (2d ed. 1970).

12. I.F.C. Collateral Corp. v. Commercial Units, Inc., 51 Wis. 2d 41, 49, 186 N.W.2d 214 (1970).

13. *Id.* at 49, 186 N.W.2d at 217 (1970).

14. Main v. Bosworth, 77 Wis. 51, 236 N.W. 585 (1931); I.F.C. Collateral Corp. v. Commercial Units, Inc., 51 Wis. 2d 41, 49, 186 N.W.2d 214 (1970).

15. Stankiller v. Braves, 97 Wis. 515, 519, 73 N.W. 48 (1897); I.F.C. Collateral Corp. v. Commercial Units, Inc., 51 Wis. 2d 41, 49, 186 N.W.2d 214, 217-18 (1970).

16. I.F.C. Collateral Corp. v. Commercial Units, Inc., 51 Wis. 2d 41, 52, 186 N.W.2d 214 (1970).

17. *Id.* at 52, 186 N.W.2d at 219 (1970).

18. *Id.* at 52, 186 N.W.2d at 219 (1970).

of *I.F.C. Collateral Corp. v. Commercial Units, Inc.*, several points become important.

First, the court, by not denominating the property as after-acquired, treated *B*, the corporation, as the owner throughout the mortgage transaction. Second, this difference in ownership was treated as an error or omission in the original mortgage so that *A*'s quitclaim deed to *B* after *D* had docketed his judgments against *A* merely corrected the mistake and invoked the doctrine of relation back. Third and finally, the court held the equitable mortgagee, *C*, to be a bona fide purchaser for value without notice, even though *B* did not have title to the property when mortgaged.

Objectively comparing these conclusions in turn with the facts and results, it would seem that logic and equity would be on the side of the United States Supreme Court.

First, it is difficult to argue that one lending the amount of money that was lent here ($400,000,000), could or would allow himself not to be absolutely sure of the state of the debtor's title. It is equally difficult to argue that one who mortgages someone else's property merely makes a mistake as to who is the owner.

Second, since *A* was the record owner of the property when *D* docketed his judgment, that lien should have attached to all real property *A* owned at that time, both under Wisconsin Statute 270.79 and the doctrine of after-acquired property. To place *D* second in priority merely because *B* had mortgaged *A*'s property placed a secured debtor of a non-owner ahead of a judgment creditor of the record owner. This would reduce any value in the recording acts, for why should *D* have checked the records under *B* when *A* was the debtor and owner?

Finally, the principle the United States Supreme Court enunciated, stating that an equitable mortgagee is not a bona fide purchaser for value but takes the property subject to all liens and incumbrances that are docketed prior to the mortgagor actually owning it, places all claims against the owner upon the property until he finally deeds it away. Therefore, as long as a person has not mortgaged his own property, that property is subject to the claims of creditors and it would not depend upon a mortgage executed by someone who does not own the property.

The apparent dichotomy of principles can be resolved by recognizing what the court did here without making the fact apparent on the record. The court pierced the corporate veil, it treated *A*, the president, and *B*, the corporation, as one person. According to the court, when *A* entered into the mortgage as president of the corporation, he then also bound himself in his personal capacity.

The court did not recognize the difference between the president and fiduciary of a corporation and a person acting as a private owner. However, without expressly saying so, the reasoning of the decision is not bottomed on sound principles and is open to serious debate.

In the alternative, the court may not have pierced the corporate veil, but developed its own position in this type of creditor's priority situation. It would hold that an equitable mortgagee, because of value given for a security interest, would stand ahead of a mere judgment creditor who dockets in the interim.

In conclusion, the most tenable solution would be to assume that on these particular facts, when a president and sole shareholder owns real property individually and his corporation mortgages it, he will be held to have joined in the mortgage and to have mortgaged his own property.

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Securities: Corporation's Recapture of Insider's Short-Swing Profits—Technical areas of the law can be fascinating. A person unskilled in a complex field, such as securities regulation, has difficulty appreciating the subtlety of the issues buried in the language of a court's opinion. Even the corporate planner often overlooks any esoteric quality amid his contriving to avoid expensive pitfalls for clients. Of particular interest are the problems which have plagued the application of the deceptively simple insider-trader provision, Section 16(b) of the Securities Exchange Act of 1934.[1] In the nearly forty years of the statute's existence, the United States Supreme Court has consistently denied certiorari to every case which turned on a construction of the section. *Reliance Electric Co. v. Emerson Electric Co.*[2] for the first time attempts to set

1. 15 U.S.C. § 78p(b) (1964) hereinafter cited as 16(b).

2. 404 U.S. 418 (1972). The only other 16(b) case which reached the United States Supreme Court did not involve a construction of the terms "purchase and sale," but rather involved the liability of a partner-director. Blau v. Lehman, 368 U.S. 403 (1962). There had been confusion in the lower federal courts as to what policies were to guide the applicability of the statute. *Reliance*, for the first time, attempts to define what types of transactions are "purchases" and "sales" covered by 16(b). The statute has been a fruitful source of litigation, mainly because, although the plaintiff himself recovers nothing directly (the profit recaptured inures to the issuing corporation), the courts have liberally awarded attorney's fees, usually in the form of a percentage of the total recovery. For example, in Blau v. Brown and Western Nuclear, Inc., [1967-1969 Transfer Binder] CCH FED. SEC. L. REP. 92,263