University of Miami Law Review

Volume 5 | Number 4 Article 9

6-1-1951

Chattel Mortgages -- Future Advances -- Effect of "Dragnet" Clause on Redemption by Assignee of Mortgagor

CASES NOTED

CHATTEL MORTGAGES — FUTURE ADVANCES — EFFECT OF "DRAGNET" CLAUSE ON REDEMPTION BY ASSIGNEE OF MORTGAGOR

Defendant, a Georgia bank, acquired bills of sale for certain motor vehicles as security for a loan to a debtor. Each bill of sale contained a "dragnet" clause stating that it was given not only as security for the loan but in addition as security for " . . . any and all other indebtedness now due by me to said bank *or hereafter incurred by me*,[1] whether directly or indirectly, as principal, endorser, guarantor, or otherwise." The plaintiff, a Florida corporation, purchased these vehicles from the debtor subject to the amount then due on the bank loan and tendered this amount to the bank to secure clear title. After delaying acceptance, the defendant bank procured a contingent assignment of an unsecured debt owed by the debtor to a fourth party and refused to cancel its bills of sale until the assigned obligation was paid. The plaintiff brings an equitable action for construction of the bills of sale and injunctive relief. *Held*, for defendant on the basis of the comprehensive nature of the "dragnet" clause and in support of the courts' policy of jealously safeguarding contractual rights. *Rose City Foods v. Bank of Thomas County*, 62 S.E.2d 145 (Ga. 1950).

The pledge of title deeds as security for future advances as well as for present loans was not generally accepted as valid in this country until the early part of the last century.[2] But the validity of these so-called "dragnet" clauses in mortgages to secure future advances has not been questioned in recent years,[3] although many courts still tend to regard them with suspicion.[4] Thus, even though the clause purports to include within the security of the lien all subsequent debts of the mortgagor to the mortgagee, it has been

1. Italics supplied by the writer.

2. United States v. Hooe, 3 Cranch 73 (U.S. 1805); 3 GLENN MORTGAGES § 399 (1943).

3. *See* New Orleans National Banking Ass'n v. LeBreton, 120 U.S. 765, 770 (1886); Lawrence v. Tucker, 23 How. 14, 18 (U.S. 1859); United States v. Hooe, *supra* note 2, at 89; Peacock, Hunt & West Co. v. Thaggard, 128 Fed. 1005, 1009 (C.C.S.D. Fla.), *aff'd mem.*, 129 Fed. 1005 (5th Cir. 1904); Griffith v. State Mutual Building & Loan Ass'n, 51 P.2d 246, 248 (Ariz. 1935); Gray v. Brasee, 14 N.Y.S.2d 687, 689-690 (Sup. Ct. 1939); Batten v. Jurist, 306 Pa. 64, 69, 158 Atl. 557, 559 (1932); see 4 POMEROY, EQUITY JURISPRUDENCE § 1197 (5th ed. 1941).

4. *See* Berger v. Fuller, 180 Ark. 372, 377, 21 S.W.2d 419, 421 (1929), "Mortgages of this character have been denominated 'Anaconda mortgages' and are well named thus, as by their broad and general terms they enwrap the unsuspecting debtor in the folds of indebtedness embraced and secured in the mortgage which he did not contemplate, and to extend them further than has already been done would, in our opinion, be dangerous and unwise"; First v. Byrne, 238 Iowa 712, 28 N.W.2d 509, 511 (1947); Corn Belt Sav. Bank v. Kriz, 207 Iowa 11, 18, 219 N.W. 503, 506 (1928).

held not to include an indirect indebtedness,[5] an independent indebtedness,[6] a judgment,[7] or a debt for which the mortgagor was liable as surety[8] or indorser.[9] To a large extent, in construing these clauses as to inclusiveness, the courts attempt to determine the intentions of the parties by the wording of the clauses taken in the light of the surrounding circumstances.[10] Even where the wording of the clause is very comprehensive and unambiguous, however, the import of many decisions has been to exclude from its provisions those obligations of the mortgagor which are held not to have been within the contemplation of the original parties at the time of the transaction,[11] or which did not arise directly out of dealings between them,[12] or which were not of the same nature as those described in the mortgage.[13]

The conflict concerning this type of clause usually arises between the mortgagee and a third party to whom the property has been transferred or to whose lien it has been subjected. Where the making of advances to the mortgagor or acquisition of other indebtedness of the mortgagor is optional with the mortgagee[14] many courts feel that the mortgagee's priority of lien should depend on whether or not he had notice of the subsequent encumbrance.[15] A militant minority still follows the doctrine laid down by Justice

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5. Strong Hardware Co. v. Gonyow, 105 Vt. 415, 168 Atl. 547 (1933).

6. Belton v. Farmers' & Mechanics' Bank & Trust Co., 186 N.C. 614, 120 S.E. 220 (1923).

7. Martin v. Holbrooks, 55 Ark. 569, 18 S.W. 1046 (1892); Poulter v. Weatherford Hardware Co., 266 S.W. 297 (Tex. Civ. App. 1914).

8. Cotton v. First Nat. Bank of Opp, 228 Ala. 311, 153 So. 225 (1934); Lightle v. Rotenberry, 166 Ark. 337, 266 S.W. 297 (1924).

9. Moran v. Gardemeyer, 86 Cal. 96, 23 Pac. 6 (1889). *Contra* Commercial Bank v. Weinberg, 70 Hun. 597, 25 N.Y. Supp. 235 (Sup. Ct. 1893).

10. Monroe County Bank v. Qualls, 220 Ala. 499, 125 So. 615 (1929); Hollywood State Bank v. Cook, 221 P.2d 988 (Cal. 1950); Bank of Cedartown v. Holloway-Smith Co., 146 Ga. 700, 92 S.E. 213 (1917); Wright v. Voorhees, 131 Iowa 408, 108 N.W. 758 (1906); Lamoille County Sav. Bank & Trust Co. v. Belden, 90 Vt. 535, 98 Atl. 1002 (1916); *see* Republic National Bank of Dallas v. Zesmer, 187 S.W.2d 227, 229 (Tex. Civ. App. 1945); Poulter v. Weatherford Hardware Co., *supra* note 7.

11. Wright v. Voorhees, *supra* note 10 at 411, 108 N.W. at 759; Rutherford v. Edward L. Eyre Co., 174 Ore. 162, 148 P.2d 530, 535 (1944); Republic National Bank of Dallas v. Zesmer, *supra* note 10 at 229.

12. Berger v. Fuller, *supra* note 4; First National Bank of Jackson v. Combs, 208 Ky. 763, 271 S.W. 1077 (1925); Lashbrooks v. Hatheway, 52 Mich. 124, 17 N.W. 723 (1883); *see* Peacock, Hunt & West Co. v. Thaggard, *supra* note 3 at 1009; Walker v. Whitmore, 165 Ark. 276, 280, 262 S.W. 678, 679 (1924).

13. Lightle v. Rotenberry, *supra* note 8; Martin v. Holbrooks, *supra* note 7.

14. *See* Shirras v. Caig, 7 Cranch 34, 41 (U.S. 1812), "But it is evident that some bounds ought to be set to this mode of mortgaging on contingencies, especially when the mortgagee retains an absolute unrestrained option whether the mortgagor shall or shall not be his debtor; when he is under no legal or moral obligation to make or assume a liability on his behalf."

15. Continental Supply Co. v. Marshall, 52 F. Supp. 717 (D.C. Okl. 1944), *rev'd on other grounds*, 152 F.2d 300 (10th Cir. 1945), *cert. denied*, 327 U.S. 803 (1945); Davis v. Carlisle, 142 Fed. 106 (8th Cir. 1905); *see* Reidy v. Collins 134 Cal. App. 713, 723, 26 P.2d 712, 716 (1933); Chartz v. Cardelli, 52 Nev. 1, 8, 279 Pac. 761, 763 (1929); Hyman v. Hauff, 138 N.Y. 48, 54, 33 N.E. 735, 737 (1893); Catskill Nat. Bank & Trust Co. v. Saxe, 175 Misc. 501, 502, 24 N.Y.S.2d 82, 83 (Sup. Ct. 1940); *see* 1 WILTSIE, MORTGAGE FORECLOSURE § 254 (5th ed. 1939); 1 JONES, MORTGAGES §§ 452, 453 (8th ed. 1928).

Campbell in the leading case of *Witczinski v. Everman*[16] that *any* indebtedness of the mortgagor acquired by the mortgagee either before or after notice of the secondary lien should take priority over such secondary lien.[17] The rationale is that such a clause is adequate per se to put a transferee or junior creditor on notice of the frailty of his lien,[18] especially where the instrument containing the "dragnet" clause has been recorded.[19] There is strong feeling, however, against the view that the scope of the "dragnet" clause should be judicially extended to cover the deliberate purchase of outstanding unrelated obligations of the mortgagor for the express purpose of bringing them within the mortgage security,[20] unless this is the clear and expressed intention of the parties.[21] Moreover, many of those favoring the *Witczinski* view hold that actual notice by the subsequent encumbrancer to the mortgagee as opposed to mere recordation or constructive notice will prevent effective advances or indebtedness from accruing to the prejudice of the secondary lien.[22]

In the instant case, the refusal of the defendant mortgagee[23] to accept the plaintiff's tender of the amount then due under the bills of sale was based on an obvious pretext. After receiving actual notice of the transfer of the mortgaged cars to the plaintiff, the defendant assumed the disputed debt in consideration for its promise to credit the unsecured debtor's account only when and if collection was made, and asserted that this was secured under the provisions of the quoted "dragnet" clause. Georgia has consistently followed the *Witczinski* case which its supreme court quoted with approval fairly recently.[24] The court in the instant case cited three Georgia cases as authority.[25] In *Hurst v. Flynn-Harris-Bullard Co.*, the mortgagor

16. 51 Miss. 841 (1876); *but see* North v. J. W. McClintock, Inc., 44 S.W.2d 412, 414 (Miss. 1950), which seems to overrule the Witczinski case.

17. Cattle Raisers' Loan Co. v. First National Bank of Decatur, 54 S.W.2d 857 (Tex. Civ. App. 1932); First National Bank v. Zarafonetis, 15 S.W.2d 155 (Tex. Civ. App. 1929); Poole v. Cage, 214 S.W. 500 (Tex. Civ. App. 1919).

18. Witczinski v. Everman, *supra* note 16; *see* Zachry v. Industrial Loan & Investment Co., 182 Ga. 738, 747, 186 S.E. 832, 838 (1936); Hurst v. Flynn-Harris-Bullard Co., 166 Ga. 480, 484, 143 S.E. 503, 506 (1928); Poole v. Cage, *supra* note 17 at 502.

19. *See* Peacock, Hunt & West Co. v. Thaggard, *supra* note 3 at 1010; Atkinson v. Foote, 44 Cal. App. 149, 159-160, 186 Pac. 831, 837 (1919); Bullard v. Fender, 140 Fla. 448, 459-461, 192 So. 167, 171-172 (1939); *see* 4 POMEROY, *op. cit. supra* note 3, §§ 1198, 1199.

20. Provident Mutual Building Loan Ass'n v. Shaffer, 2 Cal. App. 216, 83 Pac. 274 (1905); Moran v. Gardemeyer, *supra* note 9.

21. *See* Lashbrooks v. Hatheway, *supra* note 12 at 129, 17 N.W. at 726; Strong Hardware Co. v. Gonyow, *supra* note 5, 168 Atl. at 548.

22. Atkinson v. Foote, *supra* note 19; Rochester Lumber Co. v. Dygert, 136 Misc. 292, 240 N.Y. Supp. 580 (Sup. Ct. 1930); Hall v. Williamson Grocery Co., 69 W. Va. 671, 72 S.E. 780 (1911); see citations 138 A.L.R. 566, 579-582.

23. Georgia is a "title state" in which a bill of sale may be executed to secure a debt but actually passes no title, being merely in the nature of an equitable mortgage. GA. STAT. ANN. § 67-101 (1933); Merchants' and Mechanics' Bank v. Beard, 162 Ga. 446, 134 S.E. 107 (1926).

24. *See* Zachary v. Industrial Loan & Investment Co., *supra* note 18 at 747, 186 S.E. at 838.

25. Hurst v. Flynn-Harris-Bullard Co., *supra* note 18; Leffler Co. v. Lane, 146 Ga. 741, 92 S.E. 214 (1917); McClure v. Smith, 115 Ga. 709, 42 S.E. 53 (1902).

conveyed a warranty deed to the plaintiff without notification to the mortgagee who held a security deed containing a "dragnet" clause on the same property, and then died insolvent and considerably in debt to the mortgagee as a result of business transactions between them. *Leffler Co. v. Lane* is concerned with an attempt by the plaintiff mortgagee to bring within the scope of the "dragnet" clause the indebtedness to itself of a partnership of which the mortgagor subsequently became a member, the indebtedness having arisen in the course of business between the partnership and the mortgagee. The third case, *McClure v. Smith*, did not involve a "dragnet" clause, but dealt instead with the extension of the security for one loan to cover another loan by an apparent agreement of the parties. Disregarding the *McClure* case, the *Hurst* and *Leffler cases* are readily distinguishable from the instant case by the fact that the indebtedness in question arose out of transactions between the parties, and could therefore be assumed to have been within the contemplation of the parties at the time of the execution of the mortgage containing the controversial clause. The *Hurst* case is further distinguishable by the fact that the mortgagee had no notice of the subsequent conveyance of the warranty deed. In that case, while recognizing that substantial authority was opposed to its views,[26] the court nevertheless felt itself bound by the previous Georgia decisions.[27] In several other fairly recent Georgia cases[28] not cited in the instant case where "dragnet" clauses were broadly construed, the additional indebtedness also arose from transactions between the original parties to the mortgage.

It would seem, therefore, that in the instant case the Georgia Supreme Court has carried the broad construction of "dragnet" clauses rather far in favor of the mortgagee. It is submitted that a court sitting in equity should feel less bound by the strict meaning of contractural verbiage than a court of law and perhaps more influenced by the intention of the parties and the customs of the business community with regard to similar transactions, in order to render truly equitable decisions.

CIVIL PROCEDURE — ABATEMENT FOR FAILURE TO MAKE PROPER SUBSTITUTION

The plaintiff, widow of a naval officer, procured judgment against Rear Admiral Buck, Paymaster General of the Navy, requiring payment of widow's gratuity.[1] After judgment was entered, W. A. Buck was succeeded in office

26. Hurst v. Flynn-Harris-Bullard Co., *supra* note 18 at 483, 166 S.E. at 505, citing annotation to Ann. Cas. 1913C 552, 556 to the effect that advances made after notice of the subsequent liens do not have priority over such liens by the weight of authority.

27. *Ibid.*

28. Zachry v. Industrial Loan & Investment Co., *supra* note 18; Bank of Cedartown v. Holloway-Smith Co., *supra* note 10; Dudley v. Reconstruction Finance Corp., 60 Ga. App. 240, 2 S.E.2d 907 (1939); Albany Loan & Finance Co. v. Tift, 43 Ga. App. 789, 160 S.E. 661 (1931).

1. 41 STAT. 812, 824 (1920), as amended 34 U.S.C. § 943 (Supp. 1949).