

A farmer borrowed \$100,000 from a bank and gave the bank a promissory note secured by a mortgage on the farm that she owned. The bank promptly recorded the mortgage, which contained an acceleration clause and a due-on-sale provision.

A few years later, the farmer borrowed \$5,000 from a second bank and gave that bank a promissory note secured by a mortgage on her farm. The bank promptly recorded the mortgage.

Subsequently, the farmer defaulted on her obligation to the first bank, which then validly accelerated the debt and instituted nonjudicial foreclosure proceedings as permitted by the jurisdiction. The second bank received notice of the foreclosure sale but did not send a representative to the sale. At the foreclosure sale, a buyer who was not acting in collusion with the farmer outbid all other bidders and received a deed to the farm.

Several months later, the original farmer repurchased her farm from the buyer, who executed a warranty deed transferring the farm to her. After the farmer promptly recorded that deed, the second bank commenced foreclosure proceedings on the farm. The farmer denied the validity of the second bank's mortgage.

Does the second bank continue to have a valid mortgage on the farm?

- A. No, because of the due-on-sale provision in the farmer's mortgage to the first bank.
- B. No, because the purchase at the foreclosure sale by the buyer under these facts eliminated the second bank's junior mortgage lien.
- C. Yes, because of the doctrine of estoppel by deed.
- D. Yes, because the original owner reacquired title to the farm.

## Explanation:

### Foreclosure methods

**Judicial sale**      Judicially supervised public sale of mortgaged property

(all states)

**Nonjudicial sale**      Privately conducted public sale of mortgaged property (permitted only if mortgage contains power-of-sale clause)

(half of all states)

**Strict foreclosure**      Foreclosure without sale of mortgaged property

(few states)

About half of all states permit **nonjudicial foreclosure proceedings**—ie, a privately conducted public sale of the mortgaged property (as in this case). The foreclosure sale generally **destroys all interests** that are **junior to the mortgage being foreclosed**. As a result, **junior interest holders** are necessary parties who **must be given notice** of the foreclosure so that they can participate (or send a representative). Failure to notify a junior interest holder results in the preservation of that party's interest despite the foreclosure sale.

Here, the first bank instituted nonjudicial foreclosure proceedings after the farmer defaulted on her mortgage. The second bank (junior interest holder) received notice of the foreclosure sale but did not participate in or send a representative to the sale. This means that when the buyer purchased the farm in the foreclosure sale, the second bank's junior mortgage lien was eliminated. Accordingly, the second bank does not have a valid mortgage on the farm.

**(Choice A)** A due-on-sale provision allows the mortgagee to declare the entire loan balance due and payable if the mortgagor sells the property without the mortgagee's permission. This provision is not implicated here because the farmer never sold the farm.

**(Choice C)** The doctrine of estoppel by deed (ie, after-acquired title) applies when a person conveys *unowned* property to another by **warranty deed**. If that person later acquires title to the property, it automatically passes to the grantee. But this doctrine is clearly inapplicable here since the farmer *owned* the farm when she executed both mortgages.

**(Choice D)** The fact that the farmer reacquired title to the farm would matter only if the buyer and the farmer had been acting in collusion. In that case, the second bank could claim that the foreclosure sale was a fraud intended to eliminate its interest in the farm.

**Educational objective:**

A foreclosure sale destroys all interests that are junior to the foreclosing mortgage, so the junior interest holders are necessary parties who must be given notice of the foreclosure. Otherwise, their interests are preserved post-sale.

**References**

55 Am. Jur. 2d Mortgages § 592 (2019) (requirement to notify junior lienholders of foreclosure action).

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