

NOTES AND COMMENTS

THE RELATION OF THE EQUITABLE DOCTRINE OF SUBROGATION TO VERMONT'S STRICT FORECLOSURE LAWS

INTRODUCTION

From its inception, mortgage law has been characterized by the tensions existing between competing interests — those of the mortgagee (lender) and the mortgagor (borrower). Historically, common law courts, the chancery, and legislatures, as well as public opinion, have alternately favored mortgagors and mortgagees in an effort to develop mortgage procedures beneficial to both.¹ The result, however, has been the accretion of mortgage “safeguards” which are cumbersome, time-consuming, costly, and which benefit neither borrower nor lender.² The best hope is that the operation of mortgage law may strike a balance between the two: “[S]omewhere between the cold fact of law and the sometimes overly lenient expedients adopted by equity lies a solution that will be in the public interest.”³

Efforts to strike this balance, however, are complicated by the growth of increasingly diverse mortgage forms. In Vermont, as elsewhere, rising prices and unstable interest rates have encouraged the growth of “alternative financing” of real estate transactions.⁴ A common method of alternative financing, especially during periods of rising interest rates, is secondary financing. In a

1. These shifts generally occur (often belatedly) in response to economic change. The economic depression of the 1930's, for example, resulted in efforts on the part of courts and legislatures to relieve mortgage debtors. See 3 R. POWELL, *REAL PROPERTY* §§ 471, 472 (1979); Note, *Equitable Relief of Mortgage Debtors — 1932-37*, 24 VA. L. REV. 44 (1937). Economic downturns, even where mild in comparison, have also engendered pleas for mortgage law reform and, more often than not, lenders and borrowers have found themselves in close competition for the same judicial or legislative ear. Compare Lifton, *Real Estate in Trouble: Lender's Remedies Need an Overhaul*, 31 BUS. LAW. 1927 (1976) (advocating reform in favor of mortgagees) with Madway & Pearlman, *Mortgage Forms and Foreclosure Practices: Time for Reform*, 9 REAL PROP., PROB. & TR. J. 560 (1974) (advocating mortgage law reform in favor of mortgagors).

2. Prather, *Foreclosure of the Security Interest*, 1957 U. ILL. L. F. 420, 420-21.

3. *Id.* at 421.

4. Such methods include owner financing, variable interest rates and piggy-back mortgages. For a discussion of alternative financing in one state, see Washburn, *Alternative Mortgage Instruments in California*, 12 AKRON L. REV. 599 (1979).

typical secondary financing scheme, the owner of a mortgaged property conveys the property to a buyer. The buyer often assumes the first mortgage⁵ and gives a second mortgage to the owner. One result of this arrangement is that both mortgages are valid liens against the property. Additionally, three parties have an interest in the land: the first mortgagee (typically a bank), the grantor (the first owner of the land, a mortgagor as to the first mortgage, a mortgagee as to the second), and the grantee (the present owners, a mortgagor as to both mortgages). In event of default each party has numerous options available to protect its particular interest in the property.

This note will explicate the various rights and liabilities of the parties involved in such a secondary financing scheme by focusing on *First Vermont Bank & Trust Co. v. Kalomiris*.⁶ In this recent case the Vermont Supreme Court invoked the equitable doctrine of subrogation⁷ in order to protect the interests of the grantee.⁸ The court's use of equity principles will be analyzed in light of the potentially harsh results of Vermont's strict foreclosure laws, which allow mortgagees to take possession of mortgaged property from defaulting mortgagors. Based upon this analysis of *Kalomiris*, and other recent developments in Vermont mortgage law, the note will make suggestions concerning the future of strict foreclosure in Vermont.

I. DEVELOPMENT OF MORTGAGE LAW

Vermont's strict foreclosure laws are deeply rooted in the past.⁹ A basic knowledge of the history and development of mortgage law is therefore necessary to understand the present law and recent challenges to strict foreclosure.

The history of mortgages extends back to the Saxon and Early Norman concept of gages, the actual transfer of possession of land

5. See *infra* note 91 for a discussion of two methods of secondary financing: assumption mortgages "subject to" mortgages.

6. 138 Vt. at 483, 418 A.2d 43 (1980).

7. Subrogation is "the substitution of one person in the place of another with reference to a lawful claim, demand or right, so that he who is substituted succeeds to the rights of the other in relation to the debt or claim, and its rights, remedies, or securities." BLACK'S LAW DICTIONARY (rev. 5th ed. 1979). For a discussion of subrogation in the context of mortgage law, see *infra* notes 107-14 and accompanying text.

8. 138 Vt. 481 A.2d at 44.

9. See *Dieffenbach v. Attorney Gen.*, 604 F.2d 187, 195-96 (2d Cir. 1979).

or chattel to creditors as security for the payment of debts.¹⁰ The common law view of mortgages developed from the earlier concept of gages. At common law, the mortgage was considered a complete grant of legal title in the mortgaged property to the mortgagee, subject to a condition subsequent whereby the mortgagor, upon performance of the obligation, could revert himself with legal title.¹¹ The procedure was simple and efficient: If the mortgagor performed the obligation by the due date, he was revested with title; if not, the title remained with the mortgagee and the mortgagor lost all rights to the property.¹²

The simplicity of the procedure, however, was matched by its harshness in operation. The actual conveyance of title to the property allowed mortgagees to oust the mortgagor and to take possession at any time, even prior to default on the obligation.¹³ Consequently, the development of mortgages as conditional deeds sparked a major confrontation between the common law courts and mortgagees concerning the nature of the security interest.¹⁴ The courts recognized that the sole purpose of a mortgage was to provide security to the mortgagee for the mortgage debt, and that an outright conveyance of title was a step beyond that required to secure the debt.¹⁵

In spite of their introduction of equity into the law of mortgages, the common law courts placed greater emphasis on the form of the mortgage transaction, the conditional deed, rather than on the intent of the parties to create a security interest.¹⁶ In the face of the limited relief granted to mortgagors at common law, the chancery courts emphasized the mortgagor's beneficial ownership of the land, allowing the mortgagor to remain in possession of the property and recognizing an unlimited right in the mortgagor to redeem¹⁷ the property in spite of a default on the obligation.¹⁸ This

10. W. WALSH, A TREATISE ON MORTGAGES §§ 1, 2 (1934).

11. 3 R. POWELL, *supra* note 1, § 439, at 549.

12. W. WALSH, *supra* note 10, § 2, at 4.

13. 3 R. POWELL, *supra* note 1, § 439, at 549.

14. "At a very early period the courts began to interpose to defeat the strict operation of these conditional deeds, really given for mere security." Chaplin, *The Story of Mortgage Law*, 4 HARV. L. REV. 1, 9 (1890).

15. See W. WALSH, *supra* note 10, § 3, at 6.

16. See *id.* § 3, at 6-7.

17. A mortgagor "redeems" the property from default by paying the amount due on the mortgage including interest and costs, or if the mortgage is secured by a non-monetary obligation, by performing the obligation. The redemption operates as a discharge of the mortgage and thereby, at common law, restores title to the mortgagor. See *id.* § 46, at 189.

right is termed "the equity of redemption."

Soon after developing the equity of redemption the chancery sought to put reasonable limits on the mortgagor's right to redeem by creating the action of foreclosure for the mortgagee.¹⁹ Upon default, the mortgagee petitioned the court for a decree fixing the date before which the mortgagor must exercise his equity of redemption. If the mortgagor failed to redeem by the specified date, he was forever barred from exercising his equity of redemption, effectively extinguishing his rights in the mortgaged property.²⁰

The addition of redemption and foreclosure as mortgage procedures might be viewed as a process of one step forward and one back: "the automatic foreclosure, at a day fixed, of a security by conditional deed may have seemed to our ancestors no more harsh than the abrupt and final cutting off of an equity of redemption after the end of a fixed period allowed after entry, seems to us."²¹ Apparently, the mortgagee still enjoyed the advantage since the mortgage transaction passed legal title, and the mortgagee was entitled to possession following default and foreclosure. The mortgagor, however, had gained a powerful weapon in the equity of redemption.

The chancery courts immediately mitigated the harsh effects of foreclosure by refusing to give it full effect. Courts gave mortgagors every possible opportunity to redeem by permitting final decrees of foreclosure to be reopened at any time against the mortgagee, or even a subsequent purchaser.²² Foreclosure had become "slow, cumbersome and costly,"²³ and it worked imperfectly at best: "The chancellor had been so zealous in his efforts to protect mortgagors and had devised so many safeguards for mortgagors that the remedy of foreclosure did not really foreclose."²⁴

The method of foreclosure developed by the English chancery courts has never been widely accepted in the United States. Surprisingly, while mortgagees in England complained that foreclosure

18. *Id.* § 3, at 9.

19. *Id.* at 9-10. See also, *infra* notes 47-49 and accompanying text for discussion of types of foreclosure currently available to mortgagees.

20. W. WALSH, *supra* note 10, § 3, at 9-10.

21. Chaplin, *supra* note 14, at 10.

22. Tefft, *The Myth of the Strict Foreclosure*, 4 U. CHIC. L. REV. 575, 579 (1937). This made purchase of a previously foreclosed property risky business.

23. *Id.*

24. *Id.* at 577.

was not being given its proper effect, the American assumption was that, "foreclosure was a harsh and inequitable weapon which enabled *mortgagees* to take advantage of luckless *mortgagors*."²⁵ American courts soon applied the epithet "strict" to foreclosure to describe the effect of the action.²⁶ The unpopularity of strict foreclosure was due in part to prejudice against the English chancery courts²⁷ and in part to the fact that foreclosure in the United States had become a more summary proceeding than the English remedy, without the concern for the mortgagors which the English Chancellors had shown.²⁸

The "harshness" of strict foreclosure, which led to equitable restraints in England and prejudice against the method in America, stems from the conveyance of title to secure the mortgage debt. The remedy of strict foreclosure is available only to the titleholder. By barring the mortgagor's equity of redemption beyond the redemption date, strict foreclosure results in the legal title holder's acquisition of all the interests in the property.²⁹ Thus, in jurisdictions which recognize strict foreclosure, the mortgagee may not be required to return to the mortgagor any excess value of the foreclosed property over the mortgage debt.³⁰ The mortgagor is deprived of the equity that may have accumulated in the property, both through payments made prior to default and through rising land value.³¹ Allowing the mortgagee to retain the surplus when the foreclosed property is worth more than the mortgage debt can be viewed as unjust enrichment.³² These inequities led many states to reform mortgage laws in order to eliminate the effects of strict foreclosure.³³ At present, strict foreclosure is the primary method of foreclosure in only three states: Connecticut, Illinois, and

25. *Id.* (emphasis added).

26. *See, e.g.*, *Perine v. Dunn*, 4 Johns. Ch. 140, 143 (N.Y. 1819). *See also*, 2 C. WILTSIE, MORTGAGE FORECLOSURE § 901 (4th ed. 1927).

27. *Tefft*, *supra* note 22 at 588. This aversion to the English chancery courts may be explained by the fact that this period followed, roughly, the American Revolution.

28. American courts were often reticent to allow extensions of the redemption period.

Id.

29. *W. WALSH*, *supra* note 10, § 65.

30. *See, e.g.*, *Aldrich v. Lincoln Land Corp.*, 130 Vt. 372, 375-76, 294 A.2d 853, 855 (1972). The mortgagee already has title, and all its incidents, in such a jurisdiction. All the mortgagor has is the equity of redemption in the property: an equity given — and just as easily taken away through foreclosure — by the courts. *See infra* text accompanying notes 75-76.

31. *See, e.g.*, *Diefenbach v. Attorney Gen.*, 604 F.2d 187, 190-92 (2d Cir. 1979).

32. *See id.* at 195.

33. *See* 3 J. POMEROY, EQUITY JURISPRUDENCE § 1186 (3d ed. 1905).

Vermont.³⁴

States in which a mortgage conveys the legal title to the mortgagee are referred to as "title" states, those in which a mortgage merely creates a lien are known as "lien" states, and those which recognize the mortgage as a lien yet allow the mortgagee possession following default are called "intermediate" states.³⁵ The apparent simplicity of this traditional tripartite division is deceiving. Attempts to classify a given state can be maddening, leaving one with the feeling of having been led "into a thicket of words, conceivings, theories, doctrine and dogma and left there."³⁶ Strict classification has been criticized as unnecessary;³⁷ the better view is that classification is important because, "in a great many instances the result in a case squarely rests upon nothing more than the court's desire for consistency with what it considers the 'fundamental' nature of the mortgage theory obtaining in that state."³⁸

The modern trend appears to be toward recognition of the lien theory of mortgages.³⁹ This trend reflects the growing recognition of the mortgage as a commercial transaction and not as a transfer of land.⁴⁰ Lien theory focuses on the intent of the parties to create a security interest, and not, as title theory would have it, to effect an actual conveyance of land.⁴¹ Characterizing mortgage as debt also avoids the impossible task of defining the interests of the mortgagor in property mortgaged in a title state.⁴² Adoption of lien

34. See *Brand v. Woolson*, 120 Conn. 211, 180 A. 293 (1935); *Great Lakes Mortgage Corp. v. Collymore*, 14 Ill. App. 3d 68, 302 N.E.2d 248. Strict foreclosure in Vermont is prescribed by statute, VT. STAT. ANN. tit. 12, § 4528 (1973), and by the Vermont Rules of Civil Procedure, VT. R. CIV. P. 80.1(a)-(f) (1971 & Supp. 1981). For a fuller discussion of strict foreclosure in Vermont, see *infra* notes 57-66 and accompanying text.

35. G. OSBORNE, G. NELSON & D. WHITMAN, *REAL ESTATE FINANCE LAW* § 1.5 (1979).

36. *Sturges & Clark, Legal Theory and Real Property Mortgages*, 37 *YALE L. J.* 691, 701 (1928). See also 4 *AMERICAN LAW OF PROPERTY* § 16.13 (A. Casner ed. 1952).

37. "We believe that a supreme court of a given state uses or refrains from using one theory in one case and uses or refrains from using that theory or another theory in another case, depending upon the judges' sense of convenience and the matters which stimulate them in the particular case." *Sturges & Clark, supra* note 36, at 709.

38. 4 *AMERICAN LAW OF PROPERTY, supra* note 36, § 16.16.

39. "It ought to be perfectly clear to anyone having any real understanding of what the mortgage relation is and has been since the latter part of the seventeenth century that it does not involve the transfer of any beneficial interest in the mortgaged property other than the right of security." W. WALSH, *supra* note 10, § 18, at 95; "Almost universally the mortgage is regarded merely as security for the payment of a debt or other obligation . . ." Prather, *supra* note 2 at 422.

40. See 3 R. POWELL, *supra* note 1, § 439.

41. *Id.*

42. Failure of the English law courts to recognize the actualities of the mortgage

theory has been widely promoted by commentators as a more rational basis for the disposition of the interests in property created by mortgages:

In view of the fact that a lien on land is a form of interest constantly recognized, familiarly understood, and capable of being clearly expressed, and that a lien voluntarily created by contract, for security, does not necessarily differ in this respect from the familiar statute liens, why would it not be well to abolish by statute the present artificial and obscure forms of mortgage contract, the net result of the operation of which no one can define, and to provide for . . . a brief and simple deed of pledge, such as ingenuity has led us away from?⁴³

II. VERMONT'S FORECLOSURE LAWS

Vermont is a "title" state;⁴⁴ as such, it recognizes a mortgage

relation has resulted in a highly amusing series of quite impossible and conflicting theories as to the legal interest of the the mortgagor in possession. It has been seen how Mansfield and others have stated that he is a tenant at will, not a true tenant at will but like a tenant at will; that he is not a tenant at will because his actual tenancy has legal incidents necessarily inconsistent with such a tenancy; that he is a receiver, but not a true receiver since he keeps what he receives without duty to account to the mortgagee; that he is a tenant at sufferance since the mortgagee has the right to oust him in ejectment without notice just as the landlord has the right to treat a tenant at sufferance as a disseisor at his election. But the spectacle of men of understanding seriously regarding the owner of land in possession of it as a tenant at sufferance merely because he has mortgaged it to secure a loan is about as unreal and fantastic as anything to be found in respectable human thought. Even from the technical standpoint it is quite impossible.

W. WALSH, *supra* note 10, § 4, at 17.

43. Chaplin, *supra* note 14, at 13-14. Chaplin's exasperation with the state of contemporary mortgage law in 1890 is revealed in his discussion of the old common law view of mortgage as conditional deed: "This was precisely our modern mortgage. As it reads upon the records in Boston and in Portland, so it read in England in the thirteenth century." *Id.* at 9. His exasperation would likely be complete today for although Massachusetts is now considered an "intermediate" state, Maine as yet holds firmly to the "title" theory of mortgages. See Prather, *supra* note 2, at 450-51. It should also be noted that, as it reads upon the records in Burlington and in East Barnard, so it read in England in the thirteenth century, for Vermont is considered a "title" state to the extent that a mortgage deed in Vermont purports to convey legal title to the mortgagee. See, e.g., *Lovell v. Leland*, 3 Vt. 581 (1831); see also VT. STAT. ANN. tit. 12, § 4528 (1973); 3 R. POWELL, *supra* note 1, § 439. Although the mortgage deed purports to convey title, the mortgagee in Vermont is not allowed possession until after a condition of the mortgage has been broken. See, e.g., *Hooper v. Wilson*, 12 Vt. 695, 697 (1839). Consequently, Vermont has also been characterized as an "intermediate" state. See G. OSBORNE, *supra* note 35, § 4.3. Perhaps the best answer is that Vermont is a "title" state with "certain barnacle features" attached. See *infra* notes 137-39 and accompanying text.

44. See *supra* note 43.

deed as purporting to convey legal title to the mortgagee.⁴⁵ Only upon satisfaction of the mortgage debt will the mortgagor regain legal title to the property.⁴⁶ If the mortgagor defaults on the loan, three possible remedies are available to the mortgagee, depending on the circumstances and the parties involved: judicial sale,⁴⁷ power of sale,⁴⁸ or strict foreclosure.⁴⁹

Both judicial sale and power of sale are exceptions to the general rule of strict foreclosure. Because Federal law requires that, in any foreclosure action in which the United States is a party, foreclosure must take place by judicial sale,⁵⁰ the Vermont Legislature added this exception to the usual strict foreclosure procedure in 1973.⁵¹ The exception is limited, however, to situations where a federal agency has an interest in the land.⁵² The 1973 Legislature also made power of sale available as a means of foreclosure.⁵³ This remedy may be used, however, only where the parties have in-

45. See *Lovell v. Leland*, 3 Vt. 581 (1831). See *infra* text accompanying notes 67-71.

46. The mortgage is discharged by entries on the margin of the recorded mortgage deed, VT. STAT. ANN. tit. 27, §§ 461-462 (1975), or by a separate instrument placed in the records. *Id.* § 463.

47. In a foreclosure by judicial sale the court determines the period of redemption, the time, manner and notice of sale, and the allocation of the proceeds of the sale among the parties. VT. STAT. ANN. tit. 12, § 4531 (Supp. 1981). The goal of judicial sale is to liquidate the property to the full extent of its market value. This fund is then used to pay the debt, any junior liens, and the costs of the foreclosure proceedings. Any remaining surplus is returned to the mortgagor as payment for any equity which may have accumulated in the property. The necessity for court action means that this method of foreclosure can be expensive and time-consuming. Often the bidder at an enforced judicial sale is the foreclosing mortgagee who is able to obtain the property at sale by bidding merely the amount of the defaulted debt plus other allowed expenses. Thus the full market value of the property is not always realized in a judicial sale. See 3 R. POWELL, *supra* note 1, at § 466; Prather, *supra* note 2 at 429.

48. In a foreclosure by power of sale the court may, after entry of judgment of foreclosure, determine the time and manner of sale. VT. STAT. ANN. tit. 12, § 4531a (Supp. 1981). The mortgagee then provides notice of the sale and sells the property. *Id.* at § 4532. A report on the sale is made to the court which reviews the sale and either confirms the sale, sets it aside, or orders a new sale. *Id.* at § 4533. The goal of power of sale, like that of judicial sale, is to realize the full market value of the property, pay the debt, and return the excess to the mortgagor. Unfortunately, as in judicial sale, the goals are not always realized. See *supra* note 47.

49. VT. STAT. ANN. tit. 12, § 4528 (1973). See also *infra* notes 57-66 and accompanying text.

50. "[A]n action to foreclose a mortgage . . . naming the United States as a party . . . must seek judicial sale." 28 U.S.C. § 2410(c) (1976).

51. 1973 Vt. Acts 47, § 1 (codified at VT. STAT. ANN. tit. 12, § 4531 (Supp. 1981)). Prior to 1973, strict foreclosure was the only statutory method of foreclosure in Vermont.

52. VT. STAT. ANN. tit. 12, § 4531 (Supp. 1981).

53. 1973 Vt. Acts 226, § 1 (Adj. Sess.) (codified at VT. STAT. ANN. tit. 12, § 4531a (Supp. 1981)).

cluded an express power of sale provision in the mortgage instrument. Moreover, the sale must be specifically requested by either party to the mortgage, and will not occur until after the court has entered a judgment of foreclosure.⁵⁴

Despite the availability of judicial sale and power of sale, strict foreclosure remains the primary method of foreclosure. So long as it is an option, the advantages of strict foreclosure to mortgagees will virtually insure its continued use in Vermont. For example, strict foreclosure allows mortgagees full legal title once the period for redemption has expired.⁵⁵ Additionally, the mortgagee need not pay the mortgagor any excess value of the property over the amount of debt owed.⁵⁶ These benefits provide strong incentives for mortgagees to subject mortgagors to the inequities possible under strict foreclosure despite the existence of the other methods of foreclosure.

The procedure which must be followed in an action for strict foreclosure in Vermont is prescribed by statute⁵⁷ and by the Vermont Rules of Civil Procedure.⁵⁸ First, the mortgagee must file a complaint alleging the debt and the default, and requesting that the mortgagor's equitable rights be foreclosed.⁵⁹ If the mortgagor files a defense, there is a trial on the merits; if not, summary judgment is entered in default.⁶⁰ An accounting is made of the amount the mortgagor owes unless there has been a hearing on the matter or the parties have agreed on the sum due.⁶¹ Finally, if warranted, the court enters a judgment of foreclosure⁶² and the mortgagor is given six months to redeem the property.⁶³ If the mortgagor fails to redeem the property, the clerk of the court certifies this failure to the mortgagee and issues a writ of possession to the mortgagee.⁶⁴ The mortgagee's title is absolute when he records the judgment in

54. VT. STAT. ANN. tit. 12, § 4531a (Supp. 1981).

55. See *id.* § 4528. See also *Lovell v. Leland*, 3 Vt. 581 (1831).

56. See *Dieffenbach v. Attorney Gen.*, 604 F.2d 187, 192 (2d Cir. 1979); *Perry v. Ward*, 82 Vt. 1, 5, 71 A. 721, 722 (1909).

57. VT. STAT. ANN. tit. 12, § 4528 (1973).

58. VT. R. CIV. P. 80.1(a)-(f) (1973 & Supp. 1981).

59. VT. R. CIV. P. 80.1(b) (Supp. 1981).

60. *Id.* 80.1(c).

61. *Id.* 80.1(e).

62. *Id.* 80.1(f).

63. VT. STAT. ANN. tit. 12, § 4528 (1973). Motion may be made to shorten the period of redemption. VT. R. CIV. P. 80.1(d) (Supp. 1981).

64. VT. STAT. ANN. tit. 12, § 4528 (1973).

the land records.⁶⁵ If the value of the foreclosed property is inadequate to satisfy the debt, the mortgagee is entitled to bring an action at law for the deficiency.⁶⁶

Despite challenges to various aspects of Vermont's strict foreclosure laws, the federal courts and the Vermont Supreme Court have consistently upheld the procedures. In *Lovell v. Leland*,⁶⁷ the Vermont Supreme Court held that land taken by the mortgagee following foreclosure is taken as satisfaction of the mortgage debt.⁶⁸ The foreclosing mortgagee is "considered as a purchaser of the estate," and the mortgagor who fails to redeem has no further rights in the property.⁶⁹ In addition, the court held that where the value of the property is insufficient to satisfy the debt, the mortgagee may sue for the deficiency.⁷⁰ The *Lovell* decision, handed down in 1831, continues to be followed in Vermont.⁷¹

More recently, strict foreclosure has withstood two attacks in the Vermont Supreme Court⁷² and a constitutional challenge in the Court of Appeals for the Second Circuit.⁷³ In *Aldrich v. Lincoln Land Corp.*,⁷⁴ a case involving foreclosure of a lease-purchase agreement, the mortgagor lost his right of redemption when he failed to meet the payment required by an interim decree in the foreclosure proceedings. At the end of the grace period to which the parties had stipulated, the mortgagor's interests were foreclosed. The mortgagor argued that the foreclosure order amounted to a forfeiture, and that it was contrary to the principles of equitable relief.⁷⁵ In holding for the mortgagee, the court stated that "every foreclosure has as an intrinsic part some sacrifice of value or interest [T]he right of redemption itself is the device that

65. *Id.* §§ 4529-4530.

66. *See, e.g.*, *Perry v. Ward*, 82 Vt. 1, 4, 71 A. 721, 722 (1909); *Devereux v. Fairbanks*, 52 Vt. 587, 590 (1879); *Paris v. Hulett*, 26 Vt. 308, 311 (1854); *Lovell v. Leland*, 3 Vt. 581, 587 (1831).

67. 3 Vt. 581 (1831).

68. *Id.* at 583-84.

69. *Id.* at 587.

70. *Id.*

71. *See, e.g.*, *United Sav. Bank v. Barber*, 135 Vt. 278, 375 A.2d 993 (1977); *Bailey v. Groton Mfg. Co.*, 113 Vt. 288, 34 A.2d 182 (1943); *Northfield Nat'l Bank v. E.B. Ellis Granite Co.*, 100 Vt. 11, 134 A. 595 (1926); *Paris v. Hulett*, 26 Vt. 308 (1854).

72. *United Sav. Bank v. Barber*, 135 Vt. 278, 375 A.2d 993 (1977); *Aldrich v. Lincoln Land Corp.*, 130 Vt. 372, 294 A.2d 853 (1972).

73. *Dieffenbach v. Attorney Gen.*, 604 F.2d 187 (2d Cir. 1979).

74. 130 Vt. 372, 294 A.2d 853 (1972).

75. *Id.* at 375, 294 A.2d at 855.

removes a foreclosure from the condemnation of a forfeiture."⁷⁶

In *United Savings Bank v. Barber*⁷⁷ a mortgagor challenged the allowance of a deficiency judgment.⁷⁸ The mortgagor argued that deficiency judgments should not be permitted and, alternatively, if permitted, notice should be given at the time of foreclosure that such a judgment might be sought.⁷⁹ The Vermont Supreme Court dismissed the mortgagor's arguments as public policy matters more suitable for consideration by the legislature.⁸⁰ Citing *Lovell*, the court noted that obligations secured by a mortgage are not extinguished by foreclosure unless the value of the property is sufficient to cover the debt.⁸¹

Not until *Dieffenbach v. Attorney General*⁸² was the constitutionality of Vermont's strict foreclosure law challenged. The claim in *Dieffenbach* was that strict foreclosure violated the equal protection and due process clauses of the United States Constitution because, although a mortgagee can sue for a deficiency if the property is worth less than the debt, a mortgagor has no right to sue for the refund of any surplus if the property is worth more than the debt.⁸³ The United States Court of Appeals for the Second Circuit, finding that strict foreclosure is rationally related to legitimate state interests, held that Vermont's mortgage foreclosure laws do not violate either the equal protection or due process clauses of the United States Constitution.⁸⁴

Although strict foreclosure has been challenged as inequitable in *Aldrich*, contrary to public policy in *Barber*, and unconstitutional in *Dieffenbach*, it continues to be the primary means of mortgage foreclosure in Vermont. Perhaps it is true that the state's long history of adherence to strict foreclosure "indicate[s] that the people of the state of Vermont have managed fairly well to conduct

76. *Id.* at 375-76, 294 A.2d at 855.

77. 135 Vt. 278, 375 A.2d 993 (1977).

78. A deficiency judgment entitles the mortgagee to sue the mortgagor for the difference between the value of the property and the mortgage debt if the property is worth less than the debt. *See Perry v. Ward*, 82 Vt. 1, 71 A. 721 (1909); *Lovell v. Leland*, 3 Vt. 581 (1831).

79. 135 Vt. at 281-82, 375 A.2d at 994-95. The defendant-mortgagor argued that notice should be given "as a matter of public policy." *Id.* at 282, 375 A.2d at 995.

80. *Id.* at 281, 375 A.2d at 994.

81. *Id.* at 279, 375 A.2d at 994.

82. 604 F.2d 187 (2d Cir. 1979).

83. *Id.* at 195.

84. *Id.*

their commercial affairs despite the allegations of unfairness that can be directed against 'strict foreclosure',⁸⁵ but the recent challenges to the law suggest that it is time to reevaluate Vermont's system of mortgage foreclosure.

Accordingly, Vermont's strict foreclosure laws are currently subject to scrutiny in the Vermont State Legislature. Two bills which would either eliminate or limit the availability of strict foreclosure as a remedy for mortgagees against defaulting mortgagors are under consideration. House Bill 14 purports to eliminate strict foreclosure.⁸⁶ House Bill 410 would allow the court discretion, upon motion by either party, to order foreclosure by power of sale whether or not the mortgage instrument contained a power of sale clause.⁸⁷

III. KALOMIRIS: THE EQUITY OF SUBROGATION AND FORECLOSURE OF ENCUMBERED PROPERTY

Direct challenges to Vermont's foreclosure laws⁸⁸ have failed to advance the interests of mortgagors. They have also failed to shake Vermont's adherence to its strict foreclosure laws. The recent case of *First Vermont Bank & Trust Co. v. Kalomiris*,⁸⁹ however, did advance the interests of mortgagors over mortgagees, even though strict foreclosure was not directly challenged. This was accomplished through the invocation of the equitable doctrine of subrogation. In so doing, the case also suggests that, despite recent vindications, problems with strict foreclosure remain.

The default and subsequent foreclosure action in *Kalomiris* were complicated by the existence of a secondary financing scheme.⁹⁰ In *Kalomiris*, one of the defendants, Thunder Road En-

85. *Id.* at 196.

86. H.R. 14 Vt. Legis. 1980-81 Sess. (1981). The bill provides that mortgages executed after June 30, 1981 which do not contain a power of sale provision may be foreclosed by a decree of sale issued by the court upon the motion of either the mortgagor or the mortgagee. The bill, however, does not specifically repeal the strict foreclosure statute, VT. STAT. ANN. tit. 12, § 4528 (1973). As such, the bill appears to allow the court to decide whether to allow strict foreclosure or order a judicial sale whenever a power of sale is not included in the mortgage instrument.

87. H.R. 410 Vt. Legis. 1980-81 Sess. (1981). For a discussion of the current power of sale provisions, see *supra* notes 53-54 and accompanying text.

88. See *supra* text accompanying notes 72-85.

89. 138 Vt. 481, 418 A.2d 43 (1980).

90. See *supra* text accompanying note 4; secondary mortgages are also termed junior mortgages in the literature (the lenders themselves are second mortgagees, third mortgagees, etc.). This method of financing commonly occurs when money supply is tight and land val-

terprises, Inc. (TRE), owned property on which it gave a first mortgage to the plaintiff in the action, First Vermont Bank & Trust Co. (Bank). Later, TRE conveyed the property to another defendant, Kalomiris, who assumed⁹¹ the first mortgage and gave a second mortgage on the same property to TRE.

Kalomiris' assumption of the first mortgage involved a number of consequences⁹² including his personal liability for the debt to the first mortgagee, the Bank.⁹³ If Kalomiris defaulted, the Bank could enforce its mortgage directly against him. Kalomiris' assumption of the mortgage did not, however, relieve TRE of all liability in relation to the mortgage. For example, the grantor, in this case TRE, becomes as a surety⁹⁴ and may be personally liable to the mortgagee for any deficiency resulting from a default and foreclosure⁹⁵ on the first mortgage. Additionally, upon default by the grantee, the grantor may sue the grantee for breach of assumption contract without having first paid the debt personally.⁹⁶

Kalomiris subsequently defaulted on both mortgages and the

ues are high. These circumstances result in mortgagors seeking more than one lender in order to finance the purchase of property.

91. The usual conveyance of the mortgaged land involves the recital, appearing in the deed, that the grantee (to whom the land is sold) "assumes" or "assumes and promises to pay" the mortgage debt already existing on the land. In this case the grantee becomes personally liable for the mortgage debt and the grantor, the first owner of the land, a mortgagor as to the first mortgage, a mortgagee as to the second, may enforce the assumption contract directly against the grantee. In addition, the mortgagee, typically a bank, may seek to enforce the contract as a third-party beneficiary to the contract (or under equitable principles derived from the mortgagor's rights in the contract). The grantee's assumption of the mortgage debt does not relieve the grantor of all liability. The grantor becomes a surety, liable for any deficiency resulting from foreclosure.

"Assumption" mortgages are distinguished from "subject to" mortgages. When the property is conveyed to the grantee "subject to" the first mortgage (i.e. where grantee does not "assume" the first mortgage) the mortgagee may foreclose the property, holding the grantor personally liable on the debt. He may not, however, hold the grantee personally liable. Although not personally liable, the grantee may choose to pay the debt in order to avoid losing the property at foreclosure. See W. WALSH, *supra* note 10, at §§ 49-51; ABA Subcommittee of Committee on Real Estate Financing, *Assumption and Suretyship in Real Property Financing*, 7 REAL PROP., PROB. & TR. J. 391 (1972); Storke & Sears, *Transfer of Mortgaged Property*, 38 CORNELL L. Q. 185 (1953); Teedell, "Assumption" and "Subject to" Clauses with Reference to Mortgages, 20 BUS. LAW. 447 (1965).

92. The court is silent as to whether this was an actual "assumption" mortgage or a "subject to" mortgage. The court's silence on this, and other, issues makes it difficult to determine the motives of the parties to the action and the reasoning behind the court's holding. See *id.*

93. See W. WALSH, *supra* note 10 § 50, at 210.

94. Storke & Sears, *supra* note 91, at 192-94.

95. See *id.*

96. W. WALSH, *supra* note 10, § 50 at 216.

Bank brought an action to foreclose Kalomiris' equity of redemption in the premises.⁹⁷ The Bank also named TRE as a defendant in the action. The superior court issued a judgment and decree of foreclosure⁹⁸ which provided that Kalomiris was to redeem on or before a specific date or "Kalomiris and all persons claiming under him [would] be foreclosed and forever barred from all equity of redemption on the premises."⁹⁹ The decree further stipulated that, should Kalomiris fail to redeem by the specified date, TRE could redeem on the following day.¹⁰⁰ Kalomiris failed to redeem on his redemption date and, on the following day, TRE redeemed the property by paying the full amount owed on the first mortgage to the Bank.¹⁰¹ The court issued a certificate of redemption which allowed TRE to apply for a writ of possession.¹⁰² Upon a motion by Kalomiris, the court later amended the certificate of redemption, striking that portion of the certificate which allowed TRE a writ of possession of the premises. Thus prevented from assuming possession, TRE appealed the amendment to the order.

The Vermont Supreme Court affirmed the judgment, holding that TRE's redemption of the premises operated as a satisfaction of the judgment of foreclosure.¹⁰³ As second mortgagee, TRE became, by operation of law, subrogated¹⁰⁴ to the rights of First Vermont Bank (the first mortgagee) in the mortgaged property.¹⁰⁵ Consequently, TRE was entitled to a writ of possession only upon its own foreclosure of Kalomiris' (and any other junior lien holder's) equity of redemption.¹⁰⁶

97. 138 Vt. at 482, 418 A.2d at 44. See VT. R. CIV. P. 80.1(b) (1971). See also *supra* text accompanying note 59.

98. 138 Vt. at 482, 418 A.2d at 44. See VT. R. CIV. P. 80.1(f) (Supp. 1981).

99. 138 Vt. at 482, 418 A.2d at 44.

100. See *id.* The holders of junior mortgages may redeem because of their interests in the grantee's equity. These interests are often jeopardized or even destroyed by foreclosure of the prior mortgage, especially in a strict foreclosure state where the first mortgagee would then hold the property — the entire security for the debt. Where several persons have the right to redeem the earlier has the prior right of redemption. See generally W. WALSH, *supra* note 10, at § 49.

101. 138 Vt. at 482, 418 A.2d at 44. A mortgagor might want to redeem for several reasons. Often the property is valued at more than the debt, in which case the mortgagor would certainly not want to lose it. In *Kalomiris*, there were junior lien-holders under TRE. TRE's motive may have been to shut out other lien-holders thus securing the land for itself. If so, it was not successful. See *infra* text accompanying note 124.

102. 138 Vt. at 482, 418 A.2d at 44. See VT. STAT. ANN. tit. 12, § 4528 (1973).

103. 138 Vt. at 483, 418 A.2d at 44.

104. See *infra* text accompanying notes 107-14.

105. 138 Vt. at 483, 418 A.2d at 44.

106. *Id.*

The Vermont Supreme Court, in *Kalomiris*, provided no policy reasons for its decision. It is clear, however, that it did what courts have done throughout the history of mortgage law in order to protect the interests of mortgagors: it invoked equitable doctrine.¹⁰⁷ In general, subrogation is the substitution of one who pays a debt, rightfully belonging to another, into the position of the obligee whose claim he has satisfied. Once subrogated, the subrogee succeeds to all of the rights, priorities, liens, and securities of the former creditor.¹⁰⁸ The reason for subrogation is that — although the grantee may assume the mortgage and become personally liable for the debt, although that promise indemnifies the grantor against the debt, and although the grantor may enforce the contract of indemnity against the grantee at law if forced to pay the debt — the equity of subrogation allows the grantor the benefit of the mortgage security against the land whereas an action at law does not.¹⁰⁹ As such, subrogation exists as a tool of equity to use where justice requires:

Subrogation is an equitable doctrine depending upon no contract or privity, and proper to apply whenever persons other than mere volunteers pay a debt or demand which in equity and good conscience should have been satisfied by another. It is proper in all cases to allow it where injustice would follow its denial, and in allowing it all injustice should be guarded against so far as possible.¹¹⁰

Generally, anyone with an interest in a redemption right jeopardized by foreclosure may pay the mortgage debt and become subrogated to the rights of the mortgagee.¹¹¹ The following elements must exist, however, before subrogation can occur: 1) the party claiming subrogation, the subrogee, has paid the debt; 2) the subrogee has a direct interest in the discharge of the debt, and is not acting as a mere volunteer; 3) the subrogee is secondarily liable for the debt, and; 4) no injustice will result to the other party should subrogation be allowed.¹¹²

The elements necessary for the invocation of subrogation exist

107. See *supra* notes 13-18 and accompanying text.

108. See 4 AMERICAN LAW OF PROPERTY, *supra* note 36, § 16.145.

109. See W. WALSH, *supra* note 10, § 52.

110. 9 G. THOMPSON, REAL PROPERTY, § 4800 (1958) (quoting *Stroh v. O'Hearn*, 176 Mich. 164, 177, 142 N.W. 865, 869 (1913)).

111. 9 G. THOMPSON, *supra* note 110, § 4800.

112. *Id.*

in many situations where a grantee defaults after assuming a mortgage. The grantor will lose the benefits of mortgage security against the land at foreclosure unless the property is redeemed. Consequently, his own indemnity against the mortgage debt may be in jeopardy. If the value of the mortgaged land has fallen, the grantor may also be liable to the mortgagee for any deficiency at a foreclosure sale.¹¹³ The grantor, therefore, has a strong interest in the ultimate discharge of the mortgage debt and will often seek to exercise his own right of redemption to keep the mortgage alive despite the onerous burden of paying off the entire debt at once.¹¹⁴

In *Kalomiris*, TRE claimed that Kalomiris' failure to redeem on the specified date, coupled with TRE's own redemption, extinguished Kalomiris' right, title and interest in the land.¹¹⁵ TRE further claimed that, since Kalomiris had failed to redeem according to the decree of foreclosure, it was entitled to a writ of possession by authority of a Vermont statute which provides: "If the premises are not redeemed agreeably to the decree, the clerk may issue a writ of possession."¹¹⁶ TRE's claim was reinforced by the language of the foreclosure decree which stated that, should Kalomiris fail to redeem by the specified date, he and all others under him were, "foreclosed and forever barred from all equity of redemption"¹¹⁷ The Vermont Supreme Court, however, ignored the language of the decree. Instead the court focused on the fact that the premises *had been redeemed*, although not by Kalomiris, and that this redemption was a satisfaction of the foreclosure judgment.¹¹⁸ The effect of this holding was that the writ of possession could not be issued until *all* equity of redemption in the subject property had been foreclosed. The ruling revived Kalomiris' equity

113. See *supra* note 91.

114. The equitable nature and origin of subrogation are obvious. The operation of subrogation seeks to "compel the ultimate discharge of a debt by him who in good conscience ought to pay it, and relieve him of whom none but the creditor could ask to pay." 9 G. THOMPSON, *supra* note 110, § 4800 (citing *Mathews v. Fidelity & Trust Co.*, 52 F. 687 (1892)). In order to best observe the equitable intent of the doctrine a careful sorting out of the various rights and liabilities of all the parties with an interest in the land is required: "As a practical matter the actual rights and liabilities of mortgagor, mortgagee and grantee are worked out and applied according to equitable principles in the usual foreclosure action in which all are joined as parties" W. WALSH, *supra* note 10, § 52, at 227. Only in such a forum, where the court may examine and weigh the interests of each party, may the court reach the ultimate objective of subrogation: to do equity.

115. 138 Vt. at 483, 418 A.2d at 44 (1980).

116. VT. STAT. ANN. tit. 12, § 4528 (1973).

117. 138 Vt. at 482, 418 A.2d at 44.

118. 138 Vt. at 483, 418 A.2d at 44.

of redemption which arguably should have ended with the foreclosure decree.

The *Kalomiris* holding was based largely upon the result of *Ward v. Seymour*¹¹⁹ in which the court held, on facts similar to those in *Kalomiris*, that a grantor's payment, instead of extinguishing the grantee's interest in the property, operated as "an assignment" of the mortgage held by the first mortgagee to the grantor.¹²⁰ In *Kalomiris*, the court stated that, although the *Ward* decision was framed in terms of assignment, it was actually referring to the equitable doctrine of subrogation.¹²¹ The basis for this interpretation is that there is no formal assignment of the mortgage where a junior interest merely exercises his right to redeem.¹²² TRE's redemption of the property, therefore, had the effect of keeping the mortgage "alive" thus reviving *Kalomiris*' equity of redemption, in spite of TRE's apparent desires and intentions. Only a cross-petition by TRE in the original foreclosure proceeding

119. 51 Vt. 320 (1879). In *Ward*, the orators (the grantees) had failed to redeem subject to the terms of a decree of foreclosure. The following day, however, Martin (the grantor) redeemed the property and procured from the clerk a writ of possession. Martin's theory was that the orators had lost all right of redemption in the property by failing to redeem by the date specified in the decree, and that Martin, having redeemed within the time allotted him by the decree had, acquired full title to the property. *Id.* at 324. The court held that redemption by a grantor following a failure to redeem by a grantee was a satisfaction of the decree of foreclosure, yet the redeeming grantor was not entitled to a writ of possession:

The [grantee's] right, in equity, to redeem said premises would have expired on the 20th day of April, 1877, had not [the grantor] redeemed the same; but when he paid the installment due on said decree as above stated, it was a satisfaction, *pro tanto*, of the decree; and neither [the first mortgagee] nor [the grantor] had any right thereafter to a writ of possession by reason of the omission of the [grantee] to pay said installment. *Id.* at 324.

The *Ward* court addressed the issue of whether the grantee's failure to redeem by the date set by the decree of foreclosure, coupled with the grantor's redemption, had effectively extinguished all of the grantee's right, title and interest in the property. The court held that the later date set for redemption by junior interests is not dispositive: "The fact that a later day was fixed for [the grantor] to redeem than for the [grantee], does not change the effect of payment upon the decree by [the grantor]. Payment by him satisfied and discharged it as effectually as payment by the [grantee] would have done." *Id.*

120. *Id.* at 325.

121. 138 Vt. at 483, 418 A.2d at 44.

122. When a mortgage is paid by one who is entitled to redeem but under no obligation to pay it, although he does not take a formal assignment of it, he is subrogated to the rights of the mortgagee in the mortgaged property, and holds the title so acquired as against subsequent encumbrances, although he had also acquired the equity of redemption. In such a case, no proof of intention on his part to keep the mortgage alive is necessary to give him the benefit of it.

9 G. THOMPSON, *supra* note 110, § 4800, at 610.

(brought by the Bank) where all the parties were joined, or a new foreclosure proceeding instituted by TRE against Kalomiris could have effectively foreclosed Kalomiris and allowed TRE to take full possession of the property.¹²³ Because of the court's holding, Kalomiris remains in possession and makes payments (subject to the terms of both mortgages) to TRE, the present holder of the first and second mortgages.

It is clear, however, that TRE's intent in redeeming the property was to take possession of the land, not to keep the debt alive. TRE wanted nothing more than what all mortgagees in a strict foreclosure state want from defaulting mortgagors — the land, either for itself or for liquidation of the debt. The court's use of subrogation in *Kalomiris* actually thwarted the designs of the mortgagee, TRE, and benefited the mortgagor, Kalomiris, by reviving his equity of redemption in the property. Thus, the court's use of subrogation in *Kalomiris* might seem, initially at least, curious; subrogation is an equity designed to benefit mortgagees.¹²⁴

The benefits to mortgagees which result from the operation of subrogation, however, are derived from its focus on the mortgage as a lien rather than a conveyance of title; subrogation's purpose is to insure the ultimate discharge of a *debt* by one who rightfully owes it. The confusion in *Kalomiris* arises from the conflict which has plagued mortgage law from its inception — the conflict between mortgage as a conveyance of title and mortgage merely as security. The court's decision in *Kalomiris*, therefore, is at least historically consistent because it mitigates the harsh effects of strict foreclosure through invocation of equitable doctrine in favor of mortgagors.¹²⁵

The decision in *Kalomiris* can also be viewed as another mortgage "safeguard" whose addition to the present sum of mortgage law results in cumbersome, time-consuming procedures which ultimately benefit neither mortgagor nor mortgagee.¹²⁶ TRE must now relitigate to oust Kalomiris, the defaulting mortgagor. In any event, the holding in *Kalomiris* signals the scrupulous regard to be given the mortgagor's equity of redemption in foreclosure proceedings in Vermont. The right to redeem is extremely important to

123. 138 Vt. at 483, 418 A.2d at 44; *Ward v. Seymour*, 51 Vt. at 325.

124. See *supra* note 114.

125. See *supra* notes 13-18 and accompanying text.

126. See *supra* note 2 and accompanying text.

mortgagors, particularly in a strict foreclosure state where the mortgagor stands to lose the land and the equity in the land while remaining personally liable for the debt.

TRE, however, could have avoided the revival of *Kalomiris'* equity of redemption by foreclosing on its own in the original foreclosure proceedings. Moreover, TRE may presently foreclose both mortgages since it has been subrogated to every right of the Bank except the right to possession. Alternatively, TRE could have sought the actual assignment of the first mortgage from the Bank. If the assignment of the mortgage had become effective prior to *Kalomiris'* redemption date, the right to possess, in the event that *Kalomiris* and the other junior encumbrancers failed to redeem, would have been among the rights attaching to the assignment.¹²⁷

The options available to the mortgagor facing foreclosure are more limited. Essentially, the mortgagor must pay the entire amount stipulated by the decree of foreclosure before the redemption date or he will lose the property.¹²⁸ During the redemption period the mortgagor may refinance the debt, or liquidate the property to pay the debt. Neither option is likely to be satisfactory under the circumstances of foreclosure. The defaulting mortgagor will face a difficult time convincing other lenders to refinance a bad debt. The mortgagor may also encounter difficulties selling the property for its full value within the six month redemption period.

Although *Kalomiris* does not directly challenge Vermont's strict foreclosure laws, it does demonstrate the confusion which can arise in their application. After over two years, and numerous court actions (including two following the supreme court decision), the mortgaged property in *Kalomiris* is still being contested and *Kalomiris* is still in default.¹²⁹ Strict foreclosure has been chal-

127. See *Frisbee v. Frisbee*, 86 Me. 444, 447, 29 A. 1115, 1116 (1894).

128. See VT. STAT. ANN. tit. 12, §§ 4528-4529 (1973).

129. The highlights of litigation after the supreme court decision are as follows: *First Vt. Bank & Trust Co. v. Kalomiris*, No. S10-79 WRC (Vt. Super. Ct. July 15, 1980) (Bank is denied a writ of possession in its favor against *Kalomiris*); *First Vt. Bank & Trust Co. v. Kalomiris*, No. S245-80 WRC (Vt. Super. Ct. filed July 9, 1980) (TRE joins Bank in filing complaint for foreclosure); *id.* (Vt. Super. Ct. Aug. 12, 1980) (extension granted *Kalomiris*); *id.* (Vt. Super. Ct. Feb. 27, 1981) (additional extension granted *Kalomiris*); *id.* (Vt. Super. Ct. Aug. 6, 1981) (plaintiff's motion for summary judgment of default granted; *Kalomiris* restrained from demolishing or otherwise damaging fixtures and structures); *id.* (Vt. Super. Ct. Nov. 6, 1981) (judgment and decree of foreclosure entered; *Kalomiris'* redemption date set for March 1, 1982). *Kalomiris'* latest redemption date comes a mere three years and three months after the Bank commenced the original foreclosure action.

lenged as inequitable, contrary to public policy, and unconstitutional — all to no avail.¹³⁰ To the list of accusations may now be added those which are, perhaps, more damning: unpredictable, confusing and inefficient.

IV. FUTURE REFORM

Since direct challenges to Vermont's foreclosure laws in both state and federal courts have proven unsuccessful, the only real hope for reform is with the legislature. At present, the courts seem content to provide mortgagors with only limited equitable relief in appropriate circumstances, as in *Kalomiris*. It is unlikely that the courts will expand their use of equitable doctrine to relieve defaulting mortgagors.¹³¹

Hesitancy by the legislature to reform mortgage law is understandable. Property law, in general, has always been conservative and resistive to change.¹³² The "permanence, durability and local significance"¹³³ of real property are reflected in the laws governing property in a particular area — laws which tend to be, quite literally, as old as the hills. A greater obstacle to mortgage law reform is the near impossibility of creating foreclosure procedures which will balance the competing interests of mortgagees and mortgagors in every case, regardless of the economic climate.¹³⁴ Each of the methods of foreclosure (strict, judicial sale and power of sale) will operate efficiently, predictably and equitably in certain circumstances but will fail miserably in other circumstances.¹³⁵ Faced with solutions which will not always yield satisfactory results, legislatures, and courts, "continue to modify outmoded common law

130. See *supra* notes 67-84 and accompanying text.

131. Expansion of equitable relief was attempted by some courts during the Depression with only limited success. See Note, *supra* note 1. The potential, however, for equitable intervention when law does not fit the times, or when the operation of law works harsh and inequitable results, remains.

132. Kratovil, *Mortgage Law Today*, 13 J. MAR. L. REV. 251, 271 (1980).

133. Bruce, *Mortgage Law Reform Under the Uniform Land Transaction Act*, 64 GEO. L.J. 1245, 1246 (1976).

134. Given the long terms of most mortgages, one would almost have to expect at least one dramatic economic reversal during the lifetime of any given mortgage.

135. In spite of its inequities, strict foreclosure can be an efficient and fair means of foreclosure. See Glenn, *A Study on Strict Foreclosure*, 29 VA. L. REV. 519 (1943); Tefft, *supra* note 22.

Judicial sale and power of sale do not always realize their goals of providing a fund to pay the debt and return equity because they do not always realize the full value of the property at sale. See *supra* notes 47-48.

property rules to conform to modern socioeconomic realities"¹³⁶ instead of attempting wholesale reform.

It may well be argued, then, that piecemeal reform of mortgage law is appropriate. In that case, *Kalomiris* stands as a reminder that although a mortgage deed purports to convey legal title to the mortgagee¹³⁷ it "says one thing [and] really means another thing . . . there cling to the net result certain barnacle features, due to what the writing says but does not mean."¹³⁸ The "barnacles" in *Kalomiris* take the form of equitable doctrine which focuses on the lien aspect of mortgages. *Kalomiris* also serves as a reminder that in foreclosure proceedings the court acts in steps and that each step is important.¹³⁹

Wholesale reform of Vermont's foreclosure laws may well be in order in light of the confusion attending *Kalomiris* and the recent direct challenges to the fairness of strict foreclosure.¹⁴⁰ While proposed legislation would eliminate some of the harsh effects of strict foreclosure, it still represents a piecemeal approach to mortgage reform.¹⁴¹ The Vermont Legislature should look to the recently drafted Uniform Land Transactions Act¹⁴² (ULTA) as an aid to reform of Vermont's present mortgage laws. The Act has received considerable attention in recent literature.¹⁴³

The ULTA was drafted by the National Conference of Commissioners on Uniform State Laws. The Act was approved by that group in 1975 and amended in 1977. The Act was drafted to fulfill several purposes: to simplify, clarify, and modernize mortgage law; to promote interstate flow of mortgage funds; to provide for con-

136. Bruce, *supra* note 133, at 1246.

137. See *supra* note 43.

138. Chaplin, *supra* note 14, at 3.

139. TRE should have foreclosed on its own in the original proceeding if it wanted the property. See *supra* notes 126-27 and accompanying text.

140. Even Vermont's Attorney General has raised questions concerning the fairness of present laws. See *Dieffenbach v. Attorney Gen.*, 604 F.2d 187, 195 (2d Cir. 1979).

141. House Bills 14 and 410, see *supra* notes 86-87 and accompanying text, would allow courts discretion to order the sale of foreclosed property. Neither bill, however, directly addresses the problems arising under current law with respect to title theory. See *supra* notes 35-43 and accompanying text.

142. UNIF. LAND TRANSACTIONS ACT (1977) hereinafter cited as ULTA.

143. E.g., Bruce, *supra* note 133; Kratovil, *supra* note 132; Murray, *The Proposed Uniform Land Transactions Act*, 7 REAL EST. REV. Spring, 1977, at 64; Pedowitz, *Mortgage Foreclosure Under the Uniform Land Transactions Act (As Amended)*, 6 REAL EST. L.J. 179 (1978); Comment, *Secured Transactions Under Article 3 of the Uniform Land Transactions Act*, 1976 Wis. L. REV. 899.

sumer protection; and to provide for uniformity of mortgage law among states.¹⁴⁴ The ULTA's structure closely parallels Articles 1, 2, and 9 of the Uniform Commercial Code.¹⁴⁵ Selected portions of Articles 1 (General Provisions) and 3 (Secured Transactions) of the ULTA are most relevant to meaningful reform of Vermont's mortgage law.

Among the more sweeping changes made by the drafters of the ULTA is the substitution of new terminology for established mortgage law jargon.¹⁴⁶ The changes in language were instituted to achieve uniformity and to avoid the confusion caused by differing terminology developed by separate states.¹⁴⁷ Key changes in terminology are "security interests"¹⁴⁸ (replacing mortgage interest and thereby obviating the need to distinguish between lien, title, and intermediate theories of mortgages) and "protected parties"¹⁴⁹ (new terminology for a mortgagor who gives a security interest in his or her residence for an obligation).

The ULTA defines security interest as "an interest in real estate which secures payment or performance of an obligation."¹⁵⁰ The term places emphasis on the intent of the mortgaging parties to create a security interest in property, rather than on the form of the security device. In fact, the rights and duties of the parties under a ULTA security agreement are the same regardless of who holds the title.¹⁵¹ Use of the ULTA terminology may well avoid the confusion evident in *Kalomiris*, and many other cases, arising from the attempt to classify interests in land which result from mortgage agreements. Instead of classifying the interests under lien, title, or intermediate theories, the Act carefully defines the property covered by the security interest,¹⁵² then spells out the rights and duties of the parties to the agreement with respect to that property.¹⁵³ The result is a carefully integrated system of mortgage law

144. ULTA § 1-102.

145. Although closely aligned in language and form with the U.C.C., the drafters of the ULTA did not feel bound to follow either the language or results of the U.C.C. ULTA at vii-viii.

146. See ULTA §§ 1-201, 3-103. For a comparison of the new with the old jargon, see Bruce, *supra* note 133, at 1247-50.

147. See, e.g., Bruce, *supra* note 133, at 1249.

148. ULTA § 3-103 (a) (7).

149. *Id.* § 1-203.

150. *Id.* § 3-103 (a) (7).

151. *Id.* § 3-202, Comment.

152. ULTA § 1-201 (16). See also *id.* § 3-103 (a) (7).

153. See, e.g., *id.* § 3-501 (the rights and remedies of a secured creditor upon default).

which avoids reliance on outmoded common law forms.¹⁵⁴

The ULTA defines a "protected party" as: "an individual who contracts to give a real estate security interest in . . . residential real estate all or a part of which he occupies or intends to occupy as a residence . . ." ¹⁵⁵ The protected party receives preferential treatment under many of the provisions of the Act.¹⁵⁶ Among the more important protections is that strict foreclosure is not allowed against a protected party.¹⁵⁷

Upon default, the ULTA not only provides the traditional range of foreclosure methods, judicial sale,¹⁵⁸ power of sale,¹⁵⁹ or strict foreclosure,¹⁶⁰ but also enables the parties to agree on a method of foreclosure between themselves.¹⁶¹ As stated by the drafters of the ULTA, the principle underlying the foreclosure remedies is to achieve the "realization of the maximum value" of the collateral for the debt.¹⁶² In any mortgage agreement the creditor wants, and deserves, one thing—payment of the debt; the debtor wants and deserves another — the value of the collateral above the debt, his equity. It is logical then, at least to the drafters of the ULTA, that the best way to protect the mortgaging parties is to reduce foreclosure costs and to realize the full value of the property. The variety of foreclosure remedies available invites parties to the security agreement to utilize the most efficient method of foreclosure with respect to their particular circumstances.¹⁶³ In addition to the variety of foreclosure methods available, the provisions of the Act recognize two further aspects of foreclosure which help the debtor realize the value of his equity: availability of adequate notice, and the debtor's ability to realize the value through his own initiative.¹⁶⁴

154. As a cautionary note, however, courts may still resort to the common law to fill in any gaps in the ULTA. Bruce, *supra* note 133, at 1249 n.28.

155. ULTA § 1-203 (a) (1). See also *id.* § 1-203.

156. *Id.* § 1-203, Comment 1.

157. *Id.* § 3-505 (c) (2).

158. *Id.* § 3-509.

159. *Id.* § 3-508.

160. *Id.* § 3-507.

161. *Id.* § 3-505 (a).

162. *Id.* § 3-505, Comment 1.

163. It should be noted again that the ULTA offers "protected parties" preferential treatment in many of the provisions of the Act in an attempt to equalize the relative strengths of the typical mortgage lender (the banks) and the typical mortgage borrower (the homeowner). See *id.* § 1-203.

164. See *id.* § 3-505, Comment 1.

The notice requirements of the Act are stated generally¹⁶⁵ as well as in each of the provisions granting a specific method of foreclosure.¹⁶⁶ These requirements are particularly stringent when a protected party is involved. Notice of intent to foreclose against a protected party must be in writing¹⁶⁷ and must include sufficient information to apprise the debtor of his situation.¹⁶⁸ The required information includes: the nature of the default claim, any acceleration of the debt, the right of the debtor to cure the default, the right of the debtor to any surplus, the liability of the debtor for any deficiency, the intent of the creditor to claim a deficiency, and the method of foreclosure the creditor intends to use.¹⁶⁹

Once apprised of the situation, the debtor may choose from a range of options to protect his equity. For example, he may choose to cure the default or to redeem the property.¹⁷⁰ A protected party may cure the default and avoid acceleration of the debt and foreclosure by paying the amount of the installment due and any expenses incurred by the creditor following notice.¹⁷¹ The protected party may not, however, cure the default if he has exercised the option to cure at any time within the preceeding twelve months.¹⁷² The debtor may choose to redeem the property at any time before final disposition of the property by paying the full amount of the accelerated debt plus reasonable expenses.¹⁷³ Alternatively, the debtor may seek to assign his right to redeem or cure to a third party.¹⁷⁴ The effect of this assignment is to sell the equity in the property.¹⁷⁵ Finally, the debtor may seek the assignment of the debt to a third party designated by the debtor upon payment of either the cure or redemption price.¹⁷⁶ This allows the debtor to refinance under the same conditions of the security agreement with a different party.¹⁷⁷

165. *See id.* § 3-506.

166. *See id.* § 3-305 (b)-(e).

167. *Id.* § 3-506 (a).

168. *Id.* § 3-506 (b).

169. *See id.* § 3-506 (b) (1)-(11). Notice to non-protected parties requires only a reasonable notice of intention to foreclose. *Id.* § 3-506 (c).

170. *See id.* § 3-512.

171. *Id.* § 3-512 (c).

172. *Id.* § 3-512 (d).

173. *Id.* § 3-512 (a).

174. *Id.* § 3-512 (e).

175. *See* § 3-512, Comment 3.

176. *Id.* § 3-512 (f).

177. *See id.* § 3-512, Comment 4; Bruce, *supra* note 133, at 1278.

As can be seen, adoption of provisions of the ULTA offers solutions to some of the problems inherent in current Vermont mortgage law. Its provisions clearly spell out the rights and duties of parties to the mortgage instrument without a misplaced emphasis on questions of title. It offers protection to homeowners from inequities possible under strict foreclosure. Most of all, it offers a thoughtful, integrated approach to mortgage law in which all three methods of foreclosure are available. This availability offers hope for efficient foreclosures as well as adaptability under a variety of economic conditions.

Although enactment of the ULTA may not cure all mortgage ills, it would provide for much-needed reform of present law and would turn Vermont from a straggler to a leader among states in regards to mortgage law.

CONCLUSION

Vermont's strict foreclosure laws have been challenged as unfair, unconstitutional, and against public policy. The courts have, thus far, refused to void the laws. Courts have, however, provided specific relief to defaulting mortgagors in some circumstances through invocation of equitable doctrine. The recent case of *Kalomiris* demonstrates the confusion which can result when equitable relief is provided where outdated common law exists. Reform of present law would eliminate many of the inequities which now exist and would serve to ameliorate current confusion, inefficiency and unpredictability. It is suggested that Vermont legislators look to the Uniform Land Transactions Act as a model for a more thoughtful and integrated approach to mortgage law.

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