Dragnet Clause Ensnares Subsequent Purchasers of Real Property

In *Commercial Bank v. Readd,*[1] the Georgia Supreme Court upheld a foreclosure of subsequently purchased secured property, based on an indebtedness arising from an open-end or dragnet clause within a deed to secure debt. The court reversed the lower court's granting of an interlocutory injunction, holding that the bank was not estopped from foreclosing its security deed to recover the grantor's subsequent indebtedness and that the subsequent purchasers were charged with notice of the security deed by the recitals in their warranty deed, even though they had no actual knowledge of the subsequent loans.

Carl and Cheryl Readd purchased real property from J. L. Bowen in October 1975, which property had been pledged as security four years earlier by Bowen to Commercial Bank when Bowen executed a deed to secure debt. That deed contained an open-end provision securing as well "any other present or future indebtedness or liability"[2] of Bowen to the bank. The Readds were apprised of this security deed by a reference in Bowen's warranty deed, and they agreed to its assumption and payment.

One month after execution of the warranty deed, the bank extended another loan to Bowen of $3,050.28, accepting household furniture as collateral, and three months later, in February, 1976, the bank approved an unsecured loan to Bowen of $792.96. In Octover of 1976, a year after the Readds' execution of the warranty deed, Bowen filed a petition in bankruptcy and the bank, unable to defeat a prior existing lien on the household furniture collateral, sought to foreclose the security deed for the entire indebtedness of Bowen.

In the subsequent equitable action brought by the Readds against the bank, seeking to enjoin the foreclosure and strike the open-end clause of the security deed, the trial judge found issues of fact concerning the bank's conduct and granted a temporary injunction from foreclosure of the deed. On appeal, the lower court's judgment was reversed, the open-end clause was deemed valid, and the bank was allowed to resume foreclosure poceedings.

Because of a statutory requirement that a mortgage must "specify the debt to secure which it is given,"[3] an early Georgia decision did not allow mortgages to secure indefinite future advances.[4] At one period in the pioneer days of Georgia mortgage practice, there was also a judicial intimation that the lender could only make future advances as long as it had no

1. 240 Ga. 519, 242 S.E.2d 25 (1978).
2. *Id.* at 519-520, 242 S.E.2d at 26.
3. GA. CODE ANN. §67-102 (1967).
4. Benton-Shingler Co. v. Mills, 13 Ga. App. 632, 79 S.E. 755 (1913).

actual notice of intervening liens.[5] Present-day mortgage clauses are no longer so strictly construed; there is neither a limit on the amount of the future indebtedness nor a specified time for making future advances.[6] In addition, the purchaser subject to an open-end mortgage of record is charged with notice of its provisions even though he has not received actual notice.[7]

Recent authority relied upon by the court in reaching its decision in *Commercial Bank* is *Courson v. Atkinson & Griffin, Inc.*[8] In *Courson*, plaintiff, the subsequent purchaser of his debtor-grantor son's property, sought to enjoin the judicial sale of that property by the defendant grantee of an open-ended security deed on the property. Defendant's motion to dismiss was sustained on appeal, the court finding that the "rights of the holder of the deed to secure debt were superior to those of the holder of the later executed warranty deed."[9] The court echoed the sentiments of Judge Townsend of the Georgia Court of Appeals, who in an earlier opinion[10] agreed that the tacking on of subsequent debts was indeed a "thorn in the side of title attorneys and title companies" but that nonetheless the principle is one that is well-established in this state. The principle was, in fact, established even earlier in *Rose City Foods v. Bank of Thomas County,*[12] a case involving execution to the bank of two bills of sale naming four subsequently purchased motor vehicles as security for two loans from the bank, each bill of sale containing open-end provisions. The court there refused to look beyond the documents, giving pre-eminence to the parties' freedom of contract.[13]

The lot which befell the subsequent purchasers in each of the foregoing

5. Hurst v. Flynn-Harris-Bullard Co., 166 Ga. 480, 143 S.E. 503 (1928). It is interesting to note therein the foreshadowing of the subsequent concurring opinion of Atkinson, J., that the mortgage lender would have been protected even if he had actual knowledge of subsequent purchaser. 166 Ga. at 487, 143 S.E. at 506.

6. Other states impose statutory restrictions requiring times and amounts of future advances. *See generally* 4 AMERICAN LAW OF PROPERTY §16.77 (G.E. Osborne ed. 1952). The only judicial stricture on open-end clauses in Georgia at present is that the future indebtedness must come within the category of obligations arising *ex contractu* between the original parties to such security instrument. GA. CODE ANN. §67-1316 (1967). *See also* Citizens & Southern DeKalb Bank v. Hicks, 232 Ga. 244, 206 S.E.2d 22 (1974); Tomkus v. Parker, 236 Ga. 478, 224 S.E.2d 353 (1976).

7. Leffler Co. v. Lane, 146 Ga. 741, 92 S.E. 214 (1917) (assumption by individual of copartnership debt subsequently advanced).

8. 230 Ga. 643, 198 S.E.2d 675 (1973).

9. *Id.* at 646, 198 S.E.2d at 677.

10. Vidalia Prod. Credit Ass'n v. Durrence, 94 Ga. App. 368, 94 S.E.2d 609 (1956).

11. *Id.* at 371, 94 S.E.2d at 611.

12. 207 Ga. 477, 62 S.E.2d 145 (1950).

13. "[I]t is a well-established principle of law in this State that a grantor may convey property . . . for the purpose of securing . . . future indebtedness, this being a matter of private contract; and this court has previously said that courts should always guard with jealous care the rights of private contract, and give to them full effect when it is possible to do so." 207 Ga. at 481, 62 S.E.2d at 148.

cases was identical. Each was party to an instrument that explicitly apportioned liability for future indebtedness, and the court consistently maintained that "such provision is comprehensive, certain, and unambiguous, and includes an indebtedness subsequently acquired by purchase."[14] In weighing the Readds' argument that the bank should be estopped from foreclosure because it had knowledge of the sale of the property, the court, relying on *Rose City Foods*,[15] held that even assuming *arguendo* that it had such knowledge, the bank would not be estopped from foreclosure.[16] Further, the court reasoned that the Readds were entitled to only such notice of the foreclosure as was specified in the security deed assumed by them. The question of foreclosure notice as it relates to due process considerations was addressed in *Southern Mutual Investment Corp. v. Thornton.*[17] There, plaintiff-appellee sought as grantee to confirm the sale of defendant-subsequent purchaser's land in order to secure a loan advanced by plaintiff to grantor who had later sold the property to defendant. The court of appeals upheld the foreclosure sale for which only contractually agreed-upon notice had been given, ruling that since the terms of notice of the contract were adhered to, there was "no denial of due process of law because no hearing is required before sale."[18]

The reasoning of the court in *Commercial Bank* is well-founded both in logic and authority. Determining the intent of the parties is an essential task of every dragnet case, since the intent of the parties creates the security interest.[19] Moreover, where the language of the document clearly manifests the parties' intent, its meaning should not be extended by interpretation.[20] Thus, by the execution of a warranty deed, the Readds were charged with notice of an open-end security deed, with the knowledge of any subsequent indebtedness that might accrue, and with notice of the terms of foreclosure should the indebtedness not be repaid.

The court's refusal to allow estoppel in cases where parties are contractually on notice of the condition they later seek to estop is logically sound, for the party claiming estoppel must have relied and acted upon declarations or conduct of the other party and not on his own knowledge or judgment.[21] Since both parties had the same means of ascertaining the facts

14. 94 Ga. App. at 370, 94 S.E.2d at 611.

15. *See* note 13, *supra*, and accompanying text.

16. 240 Ga. at 521, 242 S.E.2d at 27.

17. 131 Ga. App. 765, 206 S.E.2d 846 (1974).

18. *Id.* at 766, 206 S.E.2d at 848. *See also* Ruff v. Lee, 230 Ga. 426, 197 S.E.2d 376 (1973). These cases followed well-established precedent that notice to purchaser from mortgagor is not constitutionally required as part of due process, that holding having been handed down by the U.S. Supreme Court in the earlier Georgia case of Scott v. Paisley, 271 U.S. 632 (1926). *See also* Pindar, *Real Property*, 27 MERCER L. REV. 175, 191 n.106 (1975).

19. Andress, *Union Bank v. Wendland: Interrelation of Dragnet Clauses, the Merger Doctrine and California's Real Property Anti-deficiency Statutes*, 52 CALIF. STATE B. J. 314 (1977).

20. Cordele Banking Co. v. Powers, 217 Ga. 616, 124 S.E.2d 275 (1962).

21. GA. CODE ANN. §38-116 (1974).

regarding the open-end clause of the security deed, the Readds were justly held accountable for the terms of the contract knowingly and voluntarily assumed by them.

From a practical standpoint, however, considering the numerous clauses couched in varying forms of legalese that confront the prospective homeowner at a closing, the need in Georgia for some provision allocating the responsibility of notice between mortgagee and subsequent purchaser becomes apparent.[22] Primarily, by not adopting any form of notice provision, a major policy issue affecting two innocent parties is left unresolved. As a result, the onus is placed on the home buyer and his title attorney, and the outcome of the transaction is controlled by words that "appear in instruments by accident rather than intent,"[23] the natural consequence of using pre-printed bank forms. Thus, once a dragnet provision has been executed by both parties in Georgia, the only recourse is to seek a modification of the provision limiting future advances, with the delay, expense and risk to title attorneys and their clients that such remedial paperwork entails.[24] The practical reality underlying such an alternative is that the tight mortgage market throughout the state in fact affords attorneys little bargaining power with lenders over the provisions of the mortgage document.[25]

Obviously, with no notice provision in the court's arsenal, the principles of contract prevail, and the actual drafting of the mortgage document acquires crucial importance. One recent proposal regarding draftsmanship of open-ended security instruments is a further limitations clause.[26] Since such a measure would be included at the time of drafting the document, it would be entirely within the province of the bank preparing the instrument, and at this writing most banks have not seen fit to include such a

22. The majority of states adopt the view that the recording mortgagee for future advances is protected against intervening lienors for those advances made before he has actual knowledge of the subsequent liens. Proponents of another view deem the mortgagee for future advances charged with notice of any subsequent recorded interests, somewhat ignoring the fact that mortgages to secure future advances are themselves recordable instruments and thus entitled to the protection of the registry acts. A third view, the Vermont doctrine, goes to the opposite end of the continuum and requires the intervening recording lienor to actually inform the prior mortgagee that no further advances are to be made. Note, 21 OKLA. L. REV. 79 (1968). *See generally* 2 M. MERRILL, NOTICE §930 (1952).

23. Field, *Security Transactions—Survey of Georgia Law, 1951-1952*, 4 MERCER L. REV. 153 (1952).

24. G. PINDAR, GEORGIA REAL ESTATE LAW §26-152 (1971).

25. Madway & Pearlman, *Mortgage Forms & Foreclosure Practices: Time for Reform*, 9 REAL PROP. PROB. & TR. J. 560 (1974).

26. "Grantee further agrees that if the property conveyed hereby is sold to a third party and that third party assumes the indebtedness herein described and the obligations of grantor contained herein, then, in that event, any debts or obligations that may be or become owing by the grantor to the grantee after such sale and assumption shall not be secured by the property described in this Deed to Secure Debt, provided that such sale and assumption comply with all provisions of this Deed to Secure Debt." R. BROWN, 6 GEORGIA PLEADING PRACTICE & LEGAL FORMS §67-1316[1] (Supp. 1978).

provision.[27] Another modification, in the form of an estoppel agreement, has been suggested,[28] which the bank theoretically would agree to execute. However, in practice few banks, profit-oriented and cautious by nature, may be willing to execute such an agreement and thus limit the reach of their purposely open-ended indebtedness provisions.

In the event of failure of the foregoing modification attempts, the only remaining alternative for the purchaser is to obtain new financing. This method, besides resulting in increased expense and delay for the homeowner, has the long-run effect of discouraging borrowing because of the added expense and delay, thereby working to the disadvantage of the bank as well.

Any attempts to "contract around" a dragnet clause show little promise, particularly for the purchaser. On the other hand, adoption by the state of some type of notice provision[29] would result in numerous benefits to subsequent purchaser and mortgagee alike: the court would have more leeway to follow a rule of reason and good faith in determining the parties' intent; the deep-seated policy favoring free alienability of land would be better served; the mortgage or subsequent purchaser's title would enjoy increased marketability; and, even more to the point, the dragnet device would better serve the ends of business convenience that originally called the practice into being.

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27. *Id.* at §67-1316[1] (Supp. 1978), comment at 5.
28. *Id.* at §67-1316[2] (Supp. 1978).
29. *See* note 23, *supra.*