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PURCHASE-MONEY MORTGAGES AND STATE LINES: A STUDY IN CONFLICT- OF-LAWS METHOD

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I

THE PROBLEM

A NORTH CAROLINA STATUTE, enacted in 1933, provides:¹

In all sales of real property by mortgagees and/or trustees under powers of sale contained in any mortgage or deed of trust hereafter executed, or where judgment or decree is given for the foreclosure of any mortgage executed after the ratification of this act to secure payment of the balance of the purchase price of real property, the mortgagee or trustee or holder of the notes secured by such mortgage or deed of trust shall not be entitled to a deficiency judgment on account of such mortgage, deed of trust or obligation secured by the same: *Provided*, said evidence of indebtedness shows upon the face that it is for balance of purchase money for real estate: *Provided, further*, that when said note or notes are prepared under the direction and supervision of the seller or sellers, he, it, or they shall cause a provision to be inserted in said note disclosing that it is for purchase money of real estate; in default of which the seller or sellers shall be liable to purchaser for any loss which he might sustain by reason of the failure to insert said provision as herein set out.

Within limits, it is perfectly clear what this statute means. Mr. V, a citizen and resident of North Carolina, sells North Carolina land to his neighbor, Mr. P, also a citizen and resident of North Carolina. The

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¹ N.C. GEN. STAT. § 45-21.38 (1957).

price is \$10,000, of which Mr. *P* pays \$2,000 in cash. The balance of \$8,000 is represented by *P*'s notes payable to *V*, secured by a deed of trust with power of sale. Upon *P*'s default, the deed of trust is foreclosed, either by exercise of the power of sale or by a proceeding in a North Carolina court. The proceeds of sale available for application in satisfaction of the indebtedness amount to \$5,000. If *V* asks the foreclosure court for a judgment for the deficiency of \$3,000, or, in the case of foreclosure by exercise of the power of sale, if he brings suit in a North Carolina court for the deficiency, his demand will be refused.

This much, at least, the legislature clearly intended; this, indeed, may be all that was consciously visualized by any individual member of the legislature. But situations may arise in which the facts deviate from those of the simple case that has been stated. Suppose, for example, that Mr. *V* is unwilling to finance the transaction by accepting *P*'s notes and deed of trust, and that *P* is required to apply to a bank or some other third party for a loan, giving the deed of trust to the third party and paying *V* the full purchase price in cash. When the deed of trust is foreclosed at the instance of the third party, is he similarly precluded by the statute from obtaining a deficiency judgment? *I.e.*, is the deed of trust in this instance one "to secure payment of the balance of the purchase price of real property"?² Or suppose that *V* sells Blackacre to *P* and, to secure payment of part of the purchase price, takes *P*'s notes secured by a mortgage on Whiteacre.³ Is this a purchase-money mortgage with respect to which the statute denies the right to a deficiency judgment? Or suppose that *V* is not content with *P*'s undertaking alone, but requires a surety on the notes; does the statute give the surety a defense against *V*'s action for the deficiency?⁴ It is the task of the courts to find answers to such questions. The method employed is that of statutory construction or interpretation. It involves an attempt to ascertain what the legislature meant, in part by reference to definitions which have been established in other contexts for terms employed in the statute, and in part by resort to such "legislative history" as may be available; beyond this, it involves an attempt to ascertain the legislative purpose, and to impute to the legislature an "intention" to include the marginal situation or not according to whether

² Cf. *Ladd & Tilton Bank v. Mitchell*, 93 Ore. 668, 184 Pac. 282 (1919).

³ See *Dobias v. White*, 239 N.C. 409, 80 S.E.2d 23 (1954). In this paper, we shall use the term "mortgage" to include deeds of trust.

⁴ Cf. Note, 17 N.C.L. REV. 179 (1939); Comment, 3 U.C.L.A.L. REV. 192, 201 (1956).

analysis indicates that inclusion would serve, or disserve, or be irrelevant to that purpose.⁵

There are other ambiguities in the statute. One of its most noteworthy characteristics is its unqualified generality. It applies to "all" sales of real property by mortgagees and/or trustees under powers of sale contained in "any" mortgage or deed of trust executed after its enactment. The language is quite broad enough to cover the case in which a resident of Virginia sells Virginia land to a Virginia purchaser and sues in a Virginia court to recover the deficiency. Yet we know perfectly well that it was not intended to apply to that case and that it would not be applied by a Virginia court in such a case. Between the extremes of this totally foreign case and the totally domestic case which was first assumed, however, lie an indeterminate number of "mixed" cases—cases in which there are one or more foreign elements that may be significant. Suppose that the parties, the land, and the transaction are all associated with Virginia at the time of the transaction, but that the purchaser then moves to North Carolina, making it necessary for the action for the deficiency to be brought in North Carolina? Or that the case is entirely domestic except that the land is located in Virginia? Or consider the famous case which actually arose a few years after the statute was enacted:

On March 5, 1940, W. H. Bullington, a resident of Virginia, sold to Dr. Furman Angel, a resident of North Carolina, real estate located in Roanoke, Virginia, for \$11,000. On delivery of a warranty deed, Angel paid \$500 in cash, executed sixteen interest-bearing negotiable notes aggregating \$3,100, and assumed an FHA loan for \$7,400, to secure which the vendor had previously encumbered the property. The notes for the balance of the purchase money, payable to the vendor, were secured by a deed of trust with power of sale. The contract was made and the notes were payable in Virginia. Angel defaulted after making only the down payment, and on May 29, 1940, the trustee foreclosed by exercising the power of sale. The vendor bid in the property for \$25, subject to the outstanding indebtedness of \$7,400; he then sued the purchaser in the Superior Court of Macon County, North

⁵ See generally DOWLING, PATTERSON, & POWELL, *MATERIALS FOR LEGAL METHOD* ch. VI (2d ed. (Jones) 1952); CARDOZO, *THE NATURE OF THE JUDICIAL PROCESS* 14 (1921); Landis, *A Note on Statutory Interpretation*, 43 HARV. L. REV. 886 (1930); Chamberlain, *The Courts and Committee Reports*, 1 U. CHI. L. REV. 81 (1933); Jones, *Statutory Doubts and Legislative Intention*, 40 COLUM. L. REV. 957 (1940); Heydon's Case, 3 Coke 7a, 76 Eng. Rep. 637 (Exch. 1584); Sanders & Wade, *Legal Writings on Statutory Construction*, 3 VAND. L. REV. 569 (1950).

Carolina, to recover the deficiency—\$3,100 with interest if the amount bid is considered equivalent to the costs of foreclosure. The purchaser invoked the act of 1933 as a complete defense. Should the statute be applied in this situation?⁶

There was a time, apparently, when the applicability of a law to a situation involving mixed domestic and foreign factors, like its applicability to an atypical domestic situation, was approached in terms of construction or interpretation. Thus, Lord Kames, discussing the practice of the Scottish Court of Session in a work which was familiar to eighteenth-century American lawyers,⁷ said:⁸

Several intricate questions arise from the different prescriptions that are established in different countries. In our decisions upon this head it is commonly disputed, whether a foreign prescription or that of our own country ought to be the rule. This ought never to be disputed; for every case that comes under our own law, must be decided by that law and not by the law of any other country. When the matter is accurately considered, the debate will be found to turn upon a different point, *viz.*, whether the case in question comes under our prescription. This may often be a doubtful point; because many cases come under the words of a statute, that are not comprehended under its spirit and intendment. . . . What only belongs to the present subject, is the effect that ought to be given to foreign prescriptions where our own are not applicable; and the subject thus circumscribed will be found abundantly simple and plain.

Even in modern times, we occasionally find such an approach.⁹ In general, however, this method has fallen into desuetude because of the availability of what purports to be an easier, more efficient, and more scientific method, which, moreover, has the virtue of resolving differences between the laws of various states and nations and tends to promote a general legal order by fostering certainty and uniformity, producing the same result irrespective of where the action may happen to be brought, and hence vindicating the expectations of the parties. The North Carolina statute on purchase-money mortgages is by no

⁶ *Bullington v. Angel*, 220 N.C. 18, 16 S.E.2d 411, 136 A.L.R. 1054 (1941).

⁷ KAMES, *PRINCIPLES OF EQUITY* (1760). See 2 CROSSKEY, *POLITICS AND THE CONSTITUTION IN THE HISTORY OF THE UNITED STATES*, 1339-40 n. 16 (1953); Sack, *Conflict of Laws in the History of English Law*, in 3 *LAW: A CENTURY OF PROGRESS* 342 (1937); Currie, *The Constitution and the Choice of Law*, 26 U. CHI. L. REV. 9 (1958).

⁸ KAMES, *op. cit. supra* note 7, at 283.

⁹ *Lauritzen v. Larsen*, 345 U.S. 571 (1953); *Romero v. International Terminal Operating Co.*, 358 U.S. 354 (1959); see Currie, *The Silver Oar and All That: A Study of the Romero Case*, 27 U. CHI. L. REV. 1 (1959).

means unique in its generality. "Most statutes are formulated with regard to only the ordinary or internal situations and on the problems of Conflict of Laws they are silent. Their sphere of application or use is to be determined through the principles of Conflict of Laws."¹⁰ What are these principles? Did the legislature, at some remote time in the past, lay down a set of rules for determining the application of all its future enactments to mixed cases? Of course not; any such undertaking would assume superhuman powers of prescience. Are they, then, derived from limits which in the nature of things circumscribe the power of a state to affect legal relations? Even first-year law students today would be skeptical of principles so derived. Are they imposed by the Federal Constitution? The Constitution has a significant bearing on such matters. Historically, however, writers on conflict of laws have been indifferent to it, though in recent years they have exaggerated and distorted it, reading the principles of the system into the Constitution by a kind of bootstrap operation.¹¹ But the Constitution, unimplemented by congressional legislation, by no means furnishes a comprehensive set of principles for the solution of conflict-of-laws problems. Are they principles which have been agreed to by the courts, if not the political departments, of states and nations generally, as a matter of mutual deference and restraint, for the sake of a uniform legal order? To some extent, they are precisely that; yet the student, the lawyer, the judge, or the scholar who seeks guidance from the principles on this basis, expecting to find a coherent and reliable system, is doomed to frustration. There is by no means general agreement on the principles of conflict of laws. Moreover, even to the extent that there is agreement on principles, the system is distinguished by its manipulability and by the strong temptations to manipulate which it produces. The principles are frequently so unrelated to those which would be employed in the construction of a statute or the interpretation of a common-law

¹⁰ Cheatham, *Sources of Rules for Conflict of Law*, 89 U. PA. L. REV. 430, 449-50 (1941), ASSOCIATION OF AMERICAN LAW SCHOOLS, SELECTED READINGS ON CONFLICT OF LAWS 133, 140 (1956) [hereinafter cited AALS READINGS]. See also Cheatham & Reese, *Choice of the Applicable Law*, 52 COLUM. L. REV. 959, 961 (1952). Cf. Cook, "Contracts" and the Conflict of Laws: "Intention" of the Parties, 32 ILL. L. REV. 899, 908 (1938), AALS READINGS 639, 648-49.

¹¹ See *infra* pt. VI; Currie, *The Constitution and the Choice of Law*, 26 U. CHI L. REV. 9 (1958); Currie, *The Constitution and the "Transitory" Cause of Action*, 73 HARV. L. REV. 36 (1959). Cf. RESTATEMENT, CONFLICT OF LAWS § 43 (1934); *id.*, ch. 12, topic 4, Note; RESTATEMENT SECOND, CONFLICT OF LAWS 20 (Tent. Draft No. 3, 1956); EHRENZWEIG, CONFLICT OF LAWS 12 (1959); *Kryger v. Wilson*, 242 U.S. 171 (1916).

rule, and to the considerations which lead one to feel that a given decision is just or unjust, that we find courts resorting to all sorts of stratagems and disingenuous devices to rescue the interest of a state from the machinations of the system¹² or to reach what is thought to be a just result.¹³

The relevant principles of conflict of laws consist, in the main, of a body of "choice-of-law" rules, together with ancillary principles which determine the manner in which the choice-of-law rules are employed. Choice-of-law rules have certain characteristics which distinguish them from other rules of law; but one characteristic which they have in common with many, if not most, other rules is that they do not become accessible until a preliminary determination has been made. In the *Restatement*,¹⁴ for example, we find such rules as the following: "The validity and effect of a mortgage on land is determined by the law of the state where the land is";¹⁵ "The law of the place of contracting determines the validity and effect of a promise with respect to . . . the nature and extent of the duty for the performance of which a party becomes bound";¹⁶ "The duty for the performance of which a party is bound will be discharged by compliance with the law of the place of performance of the promise with respect to . . . the sufficiency of performance . . .";¹⁷ and "All matters of procedure are governed by the law of the forum."¹⁸ Just as we cannot know whether the North Carolina statute under discussion is applicable until we have determined that it is a purchase-money mortgage that is involved, so we cannot select among these rules for choice of law until we have determined whether we are confronted with a question of the effect of a mortgage on land, the nature and extent of a contractual duty, the sufficiency of performance, or of procedure. The process of determination is called "characterization," and is one with respect to which the principles of conflict

¹² See Currie, *Survival of Actions: Adjudication versus Automation in the Conflict of Laws*, 10 STAN. L. REV. 205 (1958); *Notes on Methods and Objectives in the Conflict of Laws*, 1959 DUKE L.J. 171.

¹³ Cf. Cavers, *A Critique of the Choice-of-Law Problem*, 47 HARV. L. REV. 173 (1933), AALS READINGS 101; LEFLAR, *CONFLICT OF LAWS* 99-100 (1959); EHRENZWEIG, *op. cit. supra* note 11, at 135; Cheatham & Reese, *Choice of the Applicable Law*, 52 COLUM. L. REV. 959, 980-81 (1952).

¹⁴ RESTATEMENT, *CONFLICT OF LAWS* (1934).

¹⁵ *Id.* § 225.

¹⁶ *Id.* § 332.

¹⁷ *Id.* § 358.

¹⁸ *Id.* § 585.

of laws offer little guidance.¹⁹ Courts characterize pretty much as they please, and there is little in the system on which to base criticism—much less prediction. Criticism is reduced to a rather sterile process of asseveration.²⁰

In *Bullington v. Angel*,²¹ the North Carolina Supreme Court characterized the problem before it—or at least the North Carolina statute—as one relating to procedure, and hence held that the statute supplied a defense to the action.²² The language, “shall not be entitled to a deficiency judgment,” was regarded as a limitation upon the jurisdiction of the courts. It “closes the courts of this State” to plaintiffs seeking deficiency judgments on purchase-money mortgages; it operates upon “the adjective law of the State, which pertains to the practice and procedure, or legal machinery whereby the substantive law is made effective, and not upon the substantive law itself.”²³ Since we are told that “The court at the forum determines according to its own Conflict of Laws rule whether a given question is one of substance or procedure,”²⁴ and since the North Carolina Supreme Court has authoritatively declared that the question in *Bullington v. Angel* was one of procedure, further discussion would appear to be nearly futile. There may be room for inquiry as to whether the court correctly applied North Carolina law in arriving at its decision: *e.g.*, one might seek to determine whether the decision in this case is consistent with North

¹⁹ See ROBERTSON, *CHARACTERIZATION IN THE CONFLICT OF LAWS* (1940); Lorenzen, *The Theory of Qualifications and the Conflict of Laws*, 20 COLUM. L. REV. 247 (1920); LORENZEN, *SELECTED ARTICLES ON THE CONFLICT OF LAWS* 80 (1947); Lorenzen, *The Qualification, Classification, or Characterization Problem in the Conflict of Laws*, 50 YALE L.J. 743 (1941), AALS Readings 115; Falconbridge, *Characterization in the Conflict of Laws*, 53 L.Q. REV. 235 (1937); Cook, “*Characterization in the Conflict of Laws*,” 51 YALE L.J. 191 (1941); COOK, *THE LOGICAL AND LEGAL BASES OF THE CONFLICT OF LAWS* ch. VIII (1942); Pascal, *Characterization as an Approach to the Conflict of Laws*, 2 LA. L. REV. 715 (1940); Cormack, *Renvoi, Characterization, Localization and Preliminary Question in the Conflict of Laws*, 14 SO. CAL. L. REV. 221, 387 (1941); Morse, *Characterization: Shadow or Substance*, 49 COLUM. L. REV. 1027 (1949); Beckett, *The Question of Classification (“Qualification”) in Private International Law*, 15 BRIT. YB. INT’L L. 46 (1934); Cheatham, *Internal Law Distinctions in the Conflict of Laws*, 21 CORNELL L.Q. 570 (1936); GOODRICH, *CONFLICT OF LAWS* 15 (3d ed. 1949); Leflar, *op. cit. supra* note 12, ch. 7.

²⁰ Cf. Sumner, *Choice of Law Governing Survival of Actions*, 9 HASTINGS L.J. 128, 139 (1958): “It is inescapable that the basic problem is one of tort recovery.” See also ROBERTSON, *op. cit. supra* note 19, at 228 n. 24.

²¹ *Supra* note 6.

²² The court’s decision may also be regarded as a rather literal interpretation of the statute.

²³ 220 N.C. at 20, 16 S.E.2d at 412.

²⁴ RESTATEMENT, *CONFLICT OF LAWS* § 584 (1934).

Carolina decisions dealing with similar problems of characterization; but surely little is to be gained by disputation as to whether the question "is" one of the effect of a mortgage, or the extent of a contractual duty, or the sufficiency of performance of a contractual duty, rather than a question of procedure. Such research as might be constructive would be limited to North Carolina materials and would tell us little of how the system of conflict of laws operates to solve such problems. We might attempt to evaluate the decision in terms of the ideals of the system—as by pointing out that the decision does not further the ideal of uniformity of result; but this merely begs the question, since the system tolerates disuniformities which result from differences in procedure. In short, the system provides no resources in aid of a critical examination of the decision.

Yet the decision is a troublesome one, one which cries out for critical analysis. This is true, first of all, because of the unanswered constitutional question posed by the decision. The North Carolina Supreme Court denied that the statute as applied violated the Full Faith and Credit Clause;²⁵ the Supreme Court of the United States in a later stage of the litigation did not rule on the question, treating it as *res judicata*.²⁶ It is true, secondly, because if the system which purports to guide decision in such matters is bankrupt, we certainly need a substitute for it; it would be naïve, however, to expect a great deal in the way of progress toward such a goal. It is true, thirdly, and above all, because lawyers need a basis for predicting how courts will decide such questions. They need it when they are advising the prospective parties to a purchase-money mortgage as well as when they are about to embark upon litigation concerning a deficiency. Much is said in defense of the existing system of conflict of laws about its virtues in terms of certainty and predictability; yet here is an instance in which the system provides no basis at all for prediction.

²⁵ 220 N.C. at 20, 16 S.E.2d at 412.

²⁶ *Angel v. Bullington*, 330 U.S. 183 (1947). After losing in the North Carolina Supreme Court, the plaintiff filed the identical action in the United States District Court for the Western District of North Carolina, which gave judgment for the plaintiff. *Bullington v. Angel*, 56 F. Supp. 372 (W.D.N.C. 1944). The Court of Appeals for the Fourth Circuit affirmed, *Angel v. Bullington*, 150 F.2d 679 (1945). The Supreme Court reversed, holding: (1) that under the *Erie* doctrine, the North Carolina statute, if constitutional, precluded recovery in federal courts in North Carolina as well as in the state courts; and (2) that the issue as to the constitutionality of the statute was *res judicata*, the plaintiff having failed to appeal from the state court's adverse decision on that issue. Fully agreeing with the opinion of the majority of the Supreme Court, we shall concern ourselves with the case in the federal courts only in connection with the constitutional question.

For these reasons, we propose in this paper to resort to the older method of determining the applicability of laws to mixed cases: the method of construction and interpretation. By this method, we hope to ascertain the governmental policy—social, economic, or administrative—expressed in the statute, and the situations in which, though there are foreign elements in the case, North Carolina would have a legitimate interest in, or a reasonable basis for, the application of that policy. By this method also, we hope to throw some light on the unanswered constitutional question. We do not have much hope of undermining the system; despite its lack of utility in the solution of such problems as this, it is pretty well entrenched behind hard covers, and its glib rules and seductive mysticism will continue to create the illusion that it offers an easier and better way than the hard resort to ordinary legal techniques which we propose to employ. We do expect, however, to provide some assistance for the practicing lawyer who must predict how courts will decide questions relating to the applicability of domestic law to mixed cases. For we believe that this kind of analysis provides the best available basis for prediction: courts may sometimes decide conflicts cases merely by mechanical application of the rules and concepts of the system; they may sometimes disregard or manipulate the system for the sake of reaching a “just” or “progressive” result; but the likeliest explanation of a court’s application of domestic law to a mixed case is that the court has perceived—or has been persuaded—that such application is consistent with the legitimate furtherance of domestic policy.

II

THE STATUTE IN CONTEXT

The most superficial interpretation of the policy embodied in the North Carolina statute was one suggested, apparently, in an effort to support the court’s interpretation of it as closing the courts to actions for deficiency judgments: “The purpose for which the statute in the instant case was enacted is not stated by the North Carolina court. Conceivably, it could have been enacted to relieve court dockets.”^{26a} True, docket congestion is a timeless problem;²⁷ yet there is no indication that the problem was especially acute in North Carolina in 1933.²⁸

^{26a} Note, 26 N.C.L. REV. 60, 64 n. 34 (1947).

²⁷ Cf. ZEISEL, KALVEN, & BUCHOLZ, *DELAY IN THE COURT* 19 (1959).

²⁸ Cf. *Proposals for Legislation in North Carolina*, 11 N.C.L. REV. 51 (1932).

There appears to have been no particular concern over actions between nonresidents or foreign corporations; the court had apparently rejected the doctrine of *forum non con-*

Even if it was, why exclude actions to recover mortgage deficiencies? The action is on a written obligation of a commercial character; it typically involves relatively simple issues, or none at all; it involves none of the objectionable characteristics which sometimes lead legislatures to close the doors of the courts in the interest of good judicial administration.²⁹ Why limit the statute to purchase-money mortgages—presumably a small percentage of all real estate mortgages—when the suit for deficiency in connection with such a mortgage must have the same characteristics as the suit for deficiency under any real estate mortgage? And why limit the statute to purchase-money mortgages on real estate? Creditors were still allowed to sue for deficiencies after repossession and sale under conditional sales contracts and chattel mortgages.³⁰ The conclusion is inescapable that the statute was not enacted for the purpose of relieving court dockets, nor, indeed, for any purpose related to court administration. This conclusion is not inconsistent with the court's determination that the statute deprived the courts of jurisdiction; perhaps it did, but we still do not know why the legislature deprived the courts of jurisdiction. The legislature might in so many words have provided that "no court of this state shall have jurisdiction" to grant a

veniens. *McDonald v. McArthur Bros. Co.*, 154 N.C. 122, 69 S.E. 832 (1910); see Barrett, *The Doctrine of Forum Non Conveniens*, 35 CALIF. L. REV. 380, 388 n. 40 (1947). See also, *Miller v. Black*, 53 N.C. 341 (1855).

Of course, there may have been an unusual amount of litigation relating to mortgage foreclosure. Thus, an act of the Arkansas legislature provided: "On account of the congestion of court dockets by foreclosure suits, and to provide time for trying other cases, foreclosure decrees, and decrees confirming foreclosure sales, shall only be rendered during the first three days of the regular term of court as fixed by law." Ark. Acts 47 (1933). But abolishing the right of action when suits become numerous is a drastic way of dealing with docket congestion; moreover, the North Carolina statute, addressed to future mortgages only, could not relieve congestion of the sort with which Arkansas was concerned, since that resulted from the effects of the depression on existing mortgages.

Even this concern over docket congestion is probably disingenuous. The statute appears to have been a moratory device. In Arkansas "... there are only two chancery terms . . . ; moreover, sales may be confirmed only on these days, so that a decree taken at one term provides for a sale which cannot be confirmed until the term six months later; the net result [since the defendant had 90 days to answer] is that no suit can be completed in less than nine months from the date of filing." Eaton, *Deficiency Judgments and Decrees*, 20 VA. L. REV. 743, 746 (1934).

²⁹ Cf. the New York statute abolishing the right of action for alienation of affections, criminal conversation, seduction, and breach of promise to marry, N.Y. CIV. PRAC. ACT. §§ 61a-61i, discussed in Currie, *The Constitution and the "Transitory" Cause of Action*, 73 HARV. L. REV. 36 (1959).

³⁰ *Mitchell v. Battle*, 231 N.C. 68, 55 S.E.2d 803 (1949).

deficiency judgment in connection with purchase-money mortgages on real estate; the question would remain: Why?

Nothing in the way of conventional legislative history is available to shed light on the purpose of the legislation. There are no committee reports and no record of the legislative debates; even contemporary editorial comment is lacking. We are not, however, entirely without evidence on which to base a judgment. The year 1933 was one of deep depression, and North Carolina, along with other states, was concerned with the economic distress associated with wholesale mortgage foreclosures.³¹ The act which has been quoted—chapter thirty-six of the Laws of 1933—was the first in a series of legislative attempts at the same session to deal with the mortgage problem. It was enacted on February 6. On February 9, the legislature approved a joint resolution requesting a voluntary moratorium until November 1, 1934, on all principal payments secured by mortgages on farm lands and homes, so long as interest and taxes were paid.³² On April 18, chapter 275 was enacted, dealing rather comprehensively with the foreclosure problem.³³ Section one empowered the courts, prior to confirmation of any foreclosure sale of real estate, to enjoin the sale or its confirmation on the ground that the amount bid or price offered was inadequate and inequitable and would result in irreparable damage. Section two authorized the courts, prior to confirmation, to order resale upon such terms as might be just and equitable. Section three provided that in suits for deficiency judgments after the exercise of a power of sale, the mortgagor, if the holder of the obligation was the purchaser at the sale, could defend by showing that the property was fairly worth the amount of the debt secured by it at the time and place of sale.³⁴ All of these provisions applied to existing mortgages; they included, without being limited to, purchase-money mortgages. On May 15, the time within

³¹ In 1932, there were 249,000 foreclosures of nonfarm mortgages, with a value of \$1,494,000,000; in 1933, 252,000 foreclosures of mortgages with a value of \$1,512,000,000. In 1932, there were 256,000 foreclosures of farm mortgages with a value of \$768,000,000; the foreclosure rate was 38.8 per thousand farms. 1 GOLD-SMITH, *A STUDY OF SAVING IN THE UNITED STATES* 745-51 tables M-22 and M-28 (1955). For contemporary descriptions of the economic crisis, see Note, 47 HARV. L. REV. 299 (1933); Brabner-Smith, *Economic Aspects of the Deficiency Judgment*, 20 VA. L. REV. 719 (1934); Perlman, *Mortgage Deficiency Judgments During an Economic Depression*, 20 VA. L. REV. 771 (1934); Jennings & Sullivan, *Legal Planning for Agriculture*, 42 YALE L.J. 878, 886 *et seq.* (1933); Comment, 42 YALE L.J. 1236 (1933); Carey, *Mortgage Foreclosures in Cook County*, 19 A.B.A.J. 275 (1933).

³² N.C. Pub. Laws 953 (1933).

³³ N.C. Pub. Laws 401 (1933), now N.C. GEN. STAT. § 45-21.36 (1957).

³⁴ Section 3 applied to personal as well as real property.

which actions for deficiencies might be brought was limited to one year from the date of sale.³⁵

The impact of chapter 275 may be indicated by a brief summary of the changes which it effected in North Carolina law. Under the prior law, if a substantially higher bid was made within ten days after sale, either under power or by court order, the sale was reopened and a resale was required.³⁶ In the absence of an upset bid, the courts had little control over the sale and of the deficiency which might result. North Carolina followed the general rule that the amount realized upon the sale was conclusive of market value, and a deficiency judgment could be recovered for the difference between the debt (plus interest, costs, and taxes) and the amount realized on the sale.³⁷ The courts had a general supervisory authority over foreclosures, especially by proceedings in equity,³⁸ and it may be that the North Carolina courts in the depression years, like other courts, indulged in the practice of refusing to confirm sales because of "fictional irregularities."³⁹ In general, however, the foreclosure satisfied the debt only to the extent of the amount produced by the sale; mere allegations of inadequacy of the price would not justify an order setting aside the sale unless the inadequacy was so great as to suggest fraud or "shock the conscience" of the court.⁴⁰ In *Bolich v. Prudential Insurance Co.*⁴¹ the court held specifically that "mere allegations of general depression before the property has been sold and an unconscionable purchase price established" would not warrant enjoining the exercise of a power of sale in a deed of trust.⁴²

The power of a court of equity to restrain sales of real estate made in pursuance of the terms of a mortgage or deed of trust is undoubted. . . . However, the exercise of the beneficent powers of equity has usually been

³⁵ N.C. Pub. Laws 880 (1933). Two bills relating to a moratorium on foreclosures (S.B. 424 and 432) failed to pass. N.C.S. JOUR. 364, 370, 403 (1933). In addition, various local laws provided for moratoria. See N.C. PUBLIC-LOCAL AND PRIVATE LAWS 48, 303, 480 (1933); Poteat, *State Legislative Relief for the Mortgage Debtor During the Depression*, 5 LAW & CONTEMP. PROB. 517, 521 n. 25 (1938).

³⁶ N.C. CODE ANN. § 2591 (Michie 1931).

³⁷ See Notes, 11 N.C.L. REV. 172 (1932); 82 U. PA. L. REV. 261 (1934).

³⁸ *Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*, 300 U.S. 124 (1937). Cf. N.C. CODE ANN. § 2591 (Michie 1931); *In re Ware*, 187 N.C. 693, 122 S.E. 660 (1924).

³⁹ Note, 82 U. PA. L. REV. 261, 263 (1934).

⁴⁰ *Roberson v. Matthews*, 200 N.C. 241, 156 S.E. 496 (1931); *Weir v. Weir*, 196 N.C. 268, 145 S.E. 281 (1928).

⁴¹ 202 N.C. 789, 164 S.E. 335 (1932).

⁴² 202 N.C. at 792, 164 S.E. at 336-37.

based upon allegations of fraud, restraint, oppression, usury, mistake and other facts disclosing unconscionable advantage. Unless such elements are alleged, the courts have refused to stay the exercise of a power of sale . . . when all the necessary requisites of a valid sale have been observed and pursued.⁴³

Although the *Bolich* case, narrowly construed, held only that the mere prospect of an inadequate price because of depressed conditions would not warrant an injunction, the practice appears to have been to confirm, or to refuse to set aside, sales regardless of allegations as to inadequacy of price.⁴⁴

Thus, prior to 1933, deficiency judgments were obtainable as a matter of course, no distinction being made with respect to purchase-money mortgages; and, apart from the statutory upset bid and the equitable doctrine of unconscionable price, the amount realized at the sale was the amount to be credited against the debt, rather than some alternative measure of the value of the land. By contrast, after the 1933 legislature had done its work, the courts were authorized to enjoin the sale or its confirmation, and to order resale, on the ground that the bid or price was inadequate or inequitable; and, if the sale was pursuant to power rather than court order, and the holder of the obligation became the purchaser, the mortgagor could prove the fair value of the land in defense to the action for the deficiency. In addition, the right to a deficiency judgment was abolished with respect to all *future* mortgages for *purchase-money*.

In *Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*,⁴⁵ the United States Supreme Court unanimously upheld the constitutionality of section three of chapter 275 against the contention that it impaired the obligation of the contract.⁴⁶ The North Carolina Supreme Court had previously upheld sections one and two.⁴⁷

Similar legislation, of course, was being enacted all over the country.⁴⁸ The dominant purpose of all this activity was obviously to relieve

⁴³ 202 N.C. at 791, 164 S.E. at 336.

⁴⁴ See note 40 *supra*.

⁴⁵ 300 U.S. 124 (1937).

⁴⁶ The Court made a confusing reference to "strict foreclosure," 300 U.S. at 130, and attributed to the court in a foreclosure suit in equity a greater degree of control over the sale and the deficiency than can be supported by the North Carolina cases.

⁴⁷ *Woltz v. Asheville Safe Deposit Co.*, 206 N.C. 239, 173 S.E. 587 (1934); *Barringer v. Wilmington Savings Trust Co.*, 207 N.C. 505, 177 S.E. 795 (1935).

⁴⁸ For a comprehensive summary, see Poteat, *supra* note 35, at 538. See also, in addition to the works cited *supra* note 31, Skilton, *Government and the Mortgage Debtor*, 1929-39, 18 TEMP. L.Q. 61 (1943); Friedman, *The Enforcement of Personal Liability on Mortgage Debts in New York*, 51 YALE L.J. 382 (1942); Skilton, *Mort-*

mortgage debtors from the predicament in which they had been placed by the depression. Indeed, the legislation which has been noticed was only a part of a broader legislative movement for the relief of debtors generally.⁴⁹ The specific problem with which we are concerned may be conceived of as lying at the center of a series of concentric circles: The problem confronting the legislatures and the courts, in its broadest outlines, concerned distressed debtors in general. Within this area—and also within the reach of state, as distinguished from national, legislative competence—the problem of the mortgage debtor presented a special case. Within this area, in turn, the problem of the deficiency judgment was particularly acute. The liquidation of mortgage indebtedness, with the ensuing loss of homes, farms, and business establishments, was bad enough without more. When, in addition, as the result of forced sale at depressed prices, the mortgage debtor was burdened with a judgment which could be enforced by sale of his unmortgaged assets, the problem was aggravated. And, finally, when the mortgagee who foreclosed and obtained a deficiency judgment was the vendor who had taken the mortgage to secure payment of the purchase price, concern for the plight of the mortgagor appears to have aroused the greatest concern of all. In this paper, since we are concerned with the policy of the statute relating to deficiency judgments under purchase-money mortgages, we shall deal with the policy of debtor-relief legislation only to the extent necessary to place the immediate problem in context. It will be necessary to consider in some detail laws directed against deficiency judgments, whether limited to purchase-money mortgages or not; we

gage Moratoria Since 1933, 92 U. PA. L. REV. 53 (1943); Stanley, *The Effect of Economic Depression upon Foreclosure*, 27 KY. L.J. 365 (1939); Farage, *Mortgage Deficiency Judgment Acts and Their Constitutionality*, 41 DICK. L. REV. 67 (1937); Eaton, *Deficiency Judgments and Decrees*, 20 VA. L. REV. 743 (1934); Carey, Brabner-Smith, & Sullivan, *Studies in Foreclosures in Cook County: II. Foreclosure Methods and Redemption*, 27 ILL. L. REV. 595 (1933); Chamberlain, *The Legislatures and Relief of Debtors*, 19 A.B.A.J. 474 (1933).

In one famous case, the Wisconsin Supreme Court asserted the power of the courts, without the aid of legislation, to do substantially what was authorized by ch. 275 of the North Carolina statutes: to refuse confirmation for inadequacy of price, to order resale and fix an upset price, and to require the mortgagee to credit against the debt the fair value of the property. *Suring State Bank v. Giese*, 210 Wis. 489, 246 N.W. 556 (1933).

⁴⁹ In 1933, Congress amended the Bankruptcy Act to provide new composition procedures and extensions for noncorporate debtors and farmers. Act of March 3, 1933, 47 Stat. 1467. See Potat, *supra* note 35, at 518; MOORE, *DEBTORS' AND CREDITORS' RIGHTS* 8 (1955). In the same year, Congress passed the "gold clause" act, 48 Stat. 112, The Home Owners' Loan Act, *id.* at 128, and other legislation having debtor-relief aspects.

shall be less concerned with other types of relief for the mortgage debtor, and still less with laws for the relief of debtors in general.

It would be a serious mistake, however, to evaluate chapter thirty-six of the North Carolina statutes simply as a depression measure for the relief of mortgage debtors. This is made clear, in the first place, by the fact that the statute had prospective operation only. It contributed nothing to the alleviation of the typical problem, which was that of mortgagors who had bought, or borrowed, in times of high prices and who had defaulted in times of low prices. The immediate effect of the statute, at least, would be upon transactions in a critically depressed real estate market. In its measures for relief of the typical mortgage debtor, North Carolina made no distinction between purchase-money mortgages and others. Moreover, the statute was designed as a permanent change in the law—not, like much of the legislation of the period, as a temporary emergency measure. Oregon had enacted a statute substantially identical with chapter thirty-six of the North Carolina statutes as early as 1903.⁵⁰ So similar is the operative language of the two statutes that the North Carolina version may well have been modeled on that of Oregon; note particularly the italicized passage:⁵¹

When judgment or decree is given for the foreclosure of any mortgage, hereafter executed, to secure payment of the balance of the purchase price of real property, such judgment or decree shall provide for the sale of the real property, covered by such mortgage, for the satisfaction of the judgment or decree given therein, and *the mortgagee shall not be entitled to a deficiency judgment on account of such mortgage or note or obligation secured by the same.*

That, too, was a time of depression;⁵² yet the statute was preventive

⁵⁰ ORE. REV. STAT. § 88.070 (1953).

⁵¹ *Ibid.* (Emphasis added.) (The phrase, "hereafter executed," is omitted in the 1953 compilation as no longer necessary.) The suggestion that this was the model for the North Carolina statute is reinforced by the proviso in the latter requiring that the evidence of indebtedness show on its face that it is for the balance of purchase-money for real estate. The Oregon statute had been held applicable in an action by a transferee of the note and mortgage without notice that it was for purchase-money. *Wright v. Wimberly*, 79 Ore. 626, 156 Pac. 257 (1916). Evidently the North Carolina legislature knew of this construction and wished to avoid its harsh result.

⁵² "It is a fact of which courts in Oregon should take judicial notice, that in the year 1897 and for some time thereafter, great financial depression prevailed in the Pacific Coast states. Persons who had purchased real property in that territory during the earlier flush times by paying a part of the purchase price and giving a mortgage to secure the remainder, found it impossible, if they had not disposed of the property prior

rather than therapeutic, and was highly selective. At its 1903 session, the Oregon legislature took no other action respecting mortgage foreclosures. Despite the fact that it is in times of depression that legislatures have addressed their attention to deficiency judgments under purchase-money mortgages,⁵³ it seems clear that depression conditions do not entirely account for such legislation, and that something more than "debtor relief" was involved.⁵⁴

to the monetary stagnation, to discharge their legal obligations, whereupon the foreclosure of liens became inevitable. As there was no money then easily to be secured, the creditor, upon a sale of the premises pursuant to the decree, usually became the purchaser for almost a nominal sum and far below the mortgage debt, thereby obtaining a recovery over upon the personal obligation of the mortgagor for the remainder, thus taking all the property the debtor then had and jeopardizing his prospects of ever obtaining any more land. In order to prevent a repetition of such conduct on the part of a creditor, [the 1903 statute] was passed." *Wright v. Wimberly*, 94 Ore. 1, 17, 184 Pac. 740 (1919). Nationally, the period 1898-1903 is rated as one of prosperity, THORP, *BUSINESS ANNALS* 138-39 (1926). *But cf.* 2 *ENCYC. SOC. SCI.* 95 (1933).

⁵³ In addition to North Carolina, three states in the early thirties enacted statutes abolishing deficiency judgments on purchase-money mortgages. California: "No deficiency judgment shall lie in any event after any sale under a deed of trust or mortgage given to secure payment of the balance of the purchase price of real property." Cal. Stats. ch. 642, § 5 (1933), amended in 1935 to read: "No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to secure payment of the balance of the purchase price of real property." CAL. CODE CIV. PROC. § 580b. Montana: "Upon the foreclosure of any mortgage, hereafter executed, to any vendor of real property or to his heirs, executors, administrators, or assigns, for the balance of the purchase price of such real property, the mortgagee shall not be entitled to a deficiency judgment on account of such mortgage or note or obligation secured by the same." MONT. REV. CODES ANN. § 93-6008 (1947). South Dakota: "When judgment or decree is given for the foreclosure of any mortgage, hereafter executed, to secure all or any part of the purchase price of real property, such judgment or decree shall provide for the sale of the real property, covered by such mortgage, for the satisfaction of the judgment or decree given therein, and the mortgagee shall not be entitled to any deficiency judgment on account of such mortgage or note or obligation secured by the same." S.D. Laws ch. 138 (1933), as amended, S.D. CODE § 39.0308 (1939). The South Dakota statute required that the note be endorsed to show that it was for purchase-money, in which case it was nonnegotiable; but absence of the endorsement did not affect the rights of the parties, which were to be "the same as though such note had been properly endorsed." There was also a provision that the statute should not affect "the liabilities of the parties to a contract for sale of real estate prior to the time such contract is merged into a mortgage note and mortgage, and judgment for foreclosure or for the amount due under such contract or any other customary judgment, may be rendered under such contract." *Ibid.* The resemblance of this statute to North Carolina's, and of both to Oregon's, is striking. The South Dakota statute was enacted February 9.

⁵⁴ Washington in 1897 enacted a broad scheme for debtor relief, Wash. Laws 70 (1897), including a provision limiting all future mortgagees to the property mortgaged for the satisfaction of the debt. The provision was held unconstitutional as an unwarranted infringement of liberty of contract. *Dennis v. Moses*, 18 Wash. 537 (1898).

III

THE PURPOSE AND EFFECT OF THE STATUTE

The first step toward understanding the purpose of the statutes abolishing deficiency judgments on purchase-money mortgages is to determine the type of transaction to which they applied. Except in laws relating to deficiency judgments, purchase-money mortgages had been distinguished from others principally in connection with problems of priority: thus, such a mortgage excludes any claim for dower in the land, and, though unrecorded, is superior to the lien of a prior judgment against the mortgagor.⁵⁵ For purposes of such problems, the term was generally held to include any mortgage to secure all or part of the purchase price given as part of a single transaction in which the property was acquired, whether the credit was extended by the vendor or by a third party.⁵⁶ For purposes of the deficiency judgment law, however, Oregon rejected that broad definition. The rule concerning priorities had been devised to give maximum protection to those who supplied credit for the purchase of land; it was broadly applied to effectuate that purpose. The deficiency statute had a different purpose:⁵⁷

A purchase-money mortgage is defined . . . as follows:

"A mortgage given, concurrently with a conveyance of land, by the vendee to the vendor, on the same land, to secure the unpaid balance of the purchase price." . . .

While this definition is not the universal one, it seems to us that in enacting [the deficiency judgment law] the legislature acted with the kind of purchase-money mortgage in view, as defined above; that is, that the purpose of the law was to encourage and protect the purchaser of real estate, which perchance is made for the purpose of obtaining a home; that it was not the intent of the lawmakers to render it more difficult for such a purchaser to obtain a loan and pay the cash for a home, and receive the benefit of any lower price of the realty that might be made on account of such cash payment. That if the law should be so construed that anyone obtaining a loan and giving a real estate mortgage to a third party not the vendor of the land to secure the payment thereof, when it was contemplated that the money borrowed should be used in payment for the real property purchased at the time, would be executing a mortgage "to secure payment of the balance of the purchase price of real property," within the purview of the statute, and that the lender could only look to the property upon a foreclosure proceeding,

⁵⁵ 1 JONES ON MORTGAGES § 582 *et seq.* (8th ed. 1928); MACCHESNEY, PRINCIPLES OF REAL ESTATE LAW 676-77 (1928).

⁵⁶ MACCHESNEY, *loc. cit. supra* note 55; 1 JONES, *op. cit. supra* note 55, § 586.

⁵⁷ Ladd & Tilton Bank v. Mitchell, 93 Ore. 668, 675-76, 184 Pac. 282, 284 (1919).

then the person wishing to purchase a home or other real property, would be hampered and his credit impaired, and it might well be said that: "The last state of that man is worse than the first." In such event, the beneficent purpose of the law would be thwarted. It must be considered that the bank was not speculating in real estate in the transaction; it was doing a banking business. It was not the purpose or the intent of the law to regulate banking business or the loaning of money. The ordinary transactions of a bank do not come within the provisions of the act.

The court's analysis of the legislative purpose is hardly profound; yet the limitation of the statute to the situation in which the credit is furnished by the vendor is highly significant. The North Carolina Supreme Court has never had occasion to determine this question of construction, but it seems in the highest degree likely that it would reach the same result, especially in view of the evidence indicating that the North Carolina legislature was aware of the Oregon statute and the construction placed upon it by the Oregon courts.⁵⁸ For priority purposes, North Carolina adhered to the general rule that a purchase-money mortgage might be given to a third person;⁵⁹ but, like the Oregon court, the North Carolina court would, in all probability, recognize that the meaning given to the term for priority purposes is not controlling. California has followed the Oregon ruling.⁶⁰ Informed opinion in North Carolina is to the effect that the statute does not apply where the creditor is a third party.⁶¹ We shall, therefore, proceed on the assumption that the statute applies only to "a mortgage given, concurrently with a conveyance of land, by the vendee to the vendor, on the same land, to secure the unpaid balance of the purchase price."

If this is a correct interpretation of the statute and an accurate reflection of the legislative intent, it is significantly revealing as to the

⁵⁸ See note 51 *supra*.

⁵⁹ *Moring v. Dickerson*, 85 N.C. 466 (1881). "True it is, that in the case just cited the mortgage was to the vendor of the land, but in point of right and principle it can make no difference whether it be given to the vendor, himself, for the purchase money, or to one who actually advances the means to pay the purchase money to the vendor. . . ." *Id.* at 471-72 (Ruffin, J.).

⁶⁰ *Peterson v. Wilson*, 88 Cal. App. 2d 617, 630-31, 199 P.2d 757, 765-66 (1948).

⁶¹ Letter dated January 10, 1959, from Frank W. Hanft, Professor of Law, University of North Carolina, and member of the General Statutes Commission; letter dated January 29, 1959, from Thomas C. Ruff, Esq., of Whitlock, Dockery, Ruff & Perry, Charlotte; letter dated February 2, 1959, from Mr. Lex Marsh, of the Mortgage Bankers Association of the Carolinas, Charlotte; letter dated February 13, 1959, from Mr. Carlyle McDowell, Vice President, Wachovia Bank & Trust Co., Winston-Salem; letter dated September 16, 1959, from Mr. Claude Currie, President, Security Savings & Loan Ass'n, Durham.

legislative policy. In this light, the statute is one to regulate the relationship of vendor and purchaser when the vendor assumes the financing function. It has no bearing whatever upon what is probably the more common transaction, in which the credit is extended by a third person. It says to the vendor: "If you assume to finance the sale of your own land, you must look solely to the security of the land for your payment; you may not rely upon the personal obligation of the purchaser." It places upon the vendor the entire risk of a decline in the value of the property, while preserving to the purchaser the benefit of any profit that may result from an increase in value. Moreover, it gives the purchaser, in effect, the unilateral option to rescind a bad bargain, losing no more than his down payment and whatever other payments he may have made before rescinding (or defaulting). Except that the purchaser is not given the right to recover such payments, the effect is the same as if all such transactions were conclusively presumed to be fraudulent, or as if the purchaser were an infant. The latter analogy is the better one, since the substantial protection of the statute is afforded to the purchaser even when the notes have been transferred to a holder without notice that they are secured by a purchase-money mortgage. In North Carolina, this result is accomplished at the expense of the vendor.⁶² In other states, it is accomplished at the expense of the innocent transferee.⁶³ In those states, it is literally true that the effect of the statute is the same as if the defense of infancy were made available,⁶⁴ or as if the note were rendered nonnegotiable.⁶⁵ In North Carolina, the purchaser is given substantially the same protection; the only difference is that the legislature accomplished the result more equitably by imposing the loss on the vendor rather than the transferee. If the Oregon statute had given the purchaser the defense of fraud without requiring him to prove fraud in fact, presumably the defense would not have been available against a holder in due course; as the statute stands, the defense is so available; and, under the North Carolina statute, while the defense is not available if the note does not show that

⁶² It will be recalled that if the vendor fails to include in the note a statement that it is so secured he is liable to the purchaser for damages—*i.e.*, for the amount he is required to pay a holder without notice.

⁶³ As to Oregon, see note 51 *supra*; as to South Dakota, see note 65 *infra*.

⁶⁴ Infancy is a defense against a holder in due course. UNIFORM COMMERCIAL CODE § 3-305.

⁶⁵ *Gf.* the South Dakota statute, *supra* note 53, expressly declaring the note non-negotiable. In Oregon, presumably the note would remain negotiable in the sense that other defenses would be cut off, but this is academic since the statute affords a plenary defense.

it is for purchase-money, the purchaser can recoup from the vendor the deficiency he must pay to the holder.

This is fairly drastic handling for a type of transaction which on the surface appears to be a fairly innocuous one. Before we inquire, however, why the legislature should be so antipathetic to vendors who finance their own purchasers, let us inquire into the economic effect of such a statute.

Given certain assumptions, the statute, drastic though it may sound, may have negligible effect. If vendors who take purchase-money mortgages to secure payment of the purchase price do not rely on the personal credit of the purchaser, but solely on the security, and if, consistently with this attitude, they require a down payment sufficient to insure the adequacy of the security despite any foreseeable decline in value, then the absence of the right to a deficiency judgment should be of little interest to them, and the statute should not appreciably affect their business practices. If, on the other hand, such financiers do rely on the personal credit of the purchaser as a safeguard against an unforeseen decline in value, they may be expected to offset in some fashion the loss of this advantage. In particular, if such financiers are willing to accept lower down payments in relation to the value of the land than others consider prudent, and if their willingness to do this is based upon the personal obligation of the purchaser, they will change their practice. They will require a higher down payment, or a higher price, or a higher interest rate,⁶⁶ to compensate them for the lost value of the right to recover the deficiency. In general, assuming that the right to the deficiency is a valuable one, the effect of the statute will be: (1) to induce the vendor to resort, if he can, to some remedy other than foreclosure and suit for deficiency; or (2) to induce the vendor to adopt some form for the transaction other than that of a conveyance and purchase-money mortgage, and not within the reach of the statute; or (3) to induce the vendor to change his business practices in such a way as to offset loss of the right to the deficiency. In the process of changing his business practices, it may be that he will lose such competitive advantages as he may have had over other financiers, especially since financiers other than vendors still enjoy the right to recover the defi-

⁶⁶ In *Dennis v. Moses*, 18 Wash. 537 (1898), *supra* note 54, the mortgagor purported to waive the protections afforded by the statute, including the prohibition against deficiency judgments, and the agreement recited that in consideration of this waiver, a lower interest rate was charged than would otherwise have been required. *Id.* at 556. In holding the statute unconstitutional, the court observed that one of its effects would be to raise interest rates. *Id.* at 557.

ciency.⁶⁷ Thus, a possible effect of the statute would be to discourage financing by the vendor to such an extent that practically all real estate financing would be done by others than the vendor—*e.g.*, by banks, savings and loan societies, insurance companies, or other financial institutions.

A legislature determined to discourage vendor-financing would be well advised to provide against the first two contingencies which have been mentioned: that the vendor might seek a remedy, other than foreclosure and suit for the deficiency, which would secure to him substantially the same benefits that were his under that remedy, or that he might evade the statute by casting the transaction in another form. The North Carolina legislature did not provide against these contingencies. Suppose that Bullington, instead of exercising his power of sale and suing for the deficiency, had simply sued Angel on the notes in North Carolina. He would then have recovered a judgment for the full amount of the unpaid balance, which could be satisfied by execution upon Angel's North Carolina assets.⁶⁸ The Oregon court

⁶⁷ This was unqualifiedly true of the Oregon statute of 1903, which abolished purchase-money deficiency judgments entirely, while leaving other mortgages unaffected. With reference to the North Carolina statute, it must be noted that contemporaneous legislation (N.C. Laws ch. 275 (1933)) required all mortgagees in effect to credit the purchaser with the fair value of the property.

⁶⁸ 3 JONES *op. cit. supra* note 55, §§ 1565, 1572 *et seq.* (8th ed. 1928); Warren v. Herrington, 171 N.C. 165, 88 S.E. 139 (1916); *cf.* Councill v. Bailey, 154 N.C. 54, 69 S.E. 760 (1910). Whether or not this procedure gives the vendor the equivalent of the right to foreclose and recover the deficiency, and entails the same evils against which the statute were directed, is a complex question. If the judgment on the personal obligation is satisfied, the mortgage is, of course, discharged, and the purchaser becomes the owner of the land. Thus, we do not have a basis for the characteristic complaint against the purchase-money deficiency judgment, that the vendor "takes back his land" and recovers the deficiency in addition. But whether the purchaser is any better off because of this circumstance depends upon the value of the land. If the land in *Bullington v. Angel* was not, in fact, worth more than the first mortgage, the advantage to the purchaser in keeping it is dubious, even though he had acquired an apparent "equity" of \$500 by his down payment. The most that can be said is that if ownership cannot in any case be considered a burden to him, he is better off than if there had been foreclosure and deficiency judgment because of the *possibility* that the land may be worth more than the first mortgage. If the judgment on the personal obligation is not satisfied, the question becomes whether execution can be levied on the mortgaged property, with or without the benefit of the mortgage lien, as well as on other assets of the purchaser. If it can be levied on the mortgaged property with benefit of the lien, the situation is indistinguishable from that under foreclosure and suit for deficiency: the mortgaged property can be sold and other assets can be attached for the rest. If the vendor may levy on the mortgaged land, but without benefit of the lien, he is worse off to the extent that there are liens prior to his judgment, but the purchaser is no better off. If the vendor may not levy on the mortgaged land, the most he can do is

refused to hold that such a statute by implication precluded the mortgagee from electing to sue on the personal obligation.⁶⁹ In California, on the other hand, the mortgagee could not elect to sue on the personal obligation; by virtue of statute, there was only one procedure for recovering a debt secured by mortgage, and that required exhaustion of the security as a condition precedent to further recovery.⁷⁰ When the statute abolishing the right to deficiency judgments under purchase-money mortgages was superimposed on this plan, the purchase-money mortgagee was effectively limited to the security. In North Carolina, this result could be reached only by a broad interpretation designed to make the statute effective despite inadequate foresight in its drafting—an interpretation such as was rejected by the majority of the Oregon court.

The vendor-financier might also escape the incidence of such a statute by resorting to the installment land contract instead of the conveyance

satisfy the judgment out of other assets, leaving the purchaser with ownership of the land, as above. If the vendor must levy on other assets before resorting to the mortgaged land, the result will depend on the availability of other assets; if there are none, the result will be the same as in the case of foreclosure and deficiency judgment. North Carolina follows the general rule, 3 JONES, *op. cit. supra* at § 1587, that there may not be execution on the mortgaged property, *Warren v. Herrington, supra*. However, in *Bullington v. Angel*, that property was in Virginia. If Bullington had sued on the debt in North Carolina, then foreclosed in Virginia, then levied on assets in North Carolina to satisfy the judgment, it would have required considerable ingenuity to defeat his scheme to avoid the statute. For this reason, as well as for the reason that the purchaser may be no better off by virtue of being left with ownership of the property, we shall proceed on the assumption that by suing on the debt the vendor obtains substantially the equivalent of a deficiency judgment. He is certainly not limited to the security.

⁶⁹ *Page v. Ford*, 65 Ore. 450, 131 Pac. 1013 (1913). By statute in Oregon, a suit to foreclose could not be maintained during the pendency of an action at law for the debt, "nor thereafter, unless judgment be given in such action that plaintiff recover such debt or some part thereof, and an execution thereon against the property of the defendant in the judgment is returned unsatisfied in whole or in part." *Id.* at 456, 131 Pac. at 1015-16. See also *Wright v. Wimberly*, 94 Ore. 1, 9, 184 Pac. 740 (1919). For the view that the statute should be construed as abrogating the right to recover judgment on the personal obligation while retaining the security of the mortgage, see *id.* at 21-23, 131 Pac. at 746-47 (concurring opinion); for the view that the right to sue on the personal obligation, with waiver of the mortgage security, is not an adequate substitute for the right to foreclose and recover the deficiency, see *id.* at 25, 131 Pac. at 747-48; for the view that the statute should be read as abolishing the right to sue on the personal obligation, and confining the mortgagee to the security, see *id.* at 44 *et seq.*, 131 Pac. at 754 *et seq.* (concurring opinion).

⁷⁰ CAL. CODE CIV. PROC. § 726; *Winkleman v. Sides*, 31 Cal. App. 2d 387, 406, 88 P.2d 147, 156 (1939). The South Dakota statute, *supra* note 53, prohibited suit on the note. See *Federal Deposit Ins. Co. v. Stensland*, 70 S.D. 103, 15 N.W.2d 8 (1944), discussed at note 155 *infra*.

and purchase-money mortgage. This is a form of transaction which has traditionally afforded much less in the way of safeguards to the purchaser than a mortgage.⁷¹ In North Carolina, as in other states, it was possible for the vendor in such a transaction to sue for specific performance, obtain a decree for the purchase price, enforce his vendor's lien on the property, and recover any deficiency by levying execution on other property of the purchaser.⁷² While for some purposes North Carolina had characterized such a proceeding as in substance one to foreclose a mortgage,⁷³ it would be a rather bold feat of construction to hold the deficiency-judgment statute applicable to installment contracts. At the legislative session following that in which its similar statute was passed, California belatedly enacted an amendment extending it to the case of the purchaser who fails to complete his contract of sale.⁷⁴ Thus, California sealed off both of the most obvious ways in which vendor-financiers could evade the statute; the North Carolina legislature left both open.⁷⁵

This kind of draftsmanship, it must be confessed, casts some doubt upon the hypothesis as to the legislative policy. We have tentatively suggested that, since the purchase-money mortgage was singled out for special and rather drastic treatment, the legislature was concerned about the situation in which the vendor finances the sale, and was particularly concerned for the protection of the purchaser in that situation. The question may well be asked: If that was the purpose, why confine the remedial statute to deficiency judgments when the mortgagor could inflict substantially the same injury on the mortgagor simply by suing on the personal obligation, and why confine it to purchase-money mort-

⁷¹ See *Barkis v. Scott*, 34 Cal. 2d 116, 208 P.2d 367 (1949); *Act, Recommendation & Study Relating to Installment Land Contracts*, N.Y.L. REV. COMM'N REP. 343 (1937); *Durfee, Foreclosure of Land Contracts in Michigan*, 7 MICH. ST. B.J. 166 (1927); *Hancock, Installment Contracts for the Purchase of Land in Nebraska*, 38 NEB. L. REV. 953 (1959).

⁷² *Councill v. Bailey*, 154 N.C. 54, 69 S.E. 760 (1910). See also *Morgan v. Lewis*, 203 Ala. 47, 82 So. 7 (1919); *Taft v. Reddy*, 191 Wis. 144, 210 N.W. 364 (1926).

⁷³ *Councill v. Bailey*, 154 N.C. 54, 69 S.E. 760 (1910); *Crawford v. Allen*, 189 N.C. 434, 127 S.E. 521 (1935); *First Nat'l Bank of Johnson City v. Pearson*, 119 N.C. 494, 26 S.E. 46 (1896); cf. *Allen v. Taylor*, 96 N.C. 37, 1 S.E. 462 (1887). See Note, 12 N.C.L. REV. 284 (1934).

⁷⁴ See note 53 *supra*.

⁷⁵ A third possibility of evasion—giving the purchaser a deed without taking a mortgage back, and foreclosing the “vendor's lien” of British equity—was not available in North Carolina, which recognizes no lien for purchase money in favor of the vendor who has conveyed. *Womble v. Battle*, 38 N.C. 161 (3 Ired. 182) (1884). See also *Hickson Lumber Co. v. Gay Lumber Co.*, 150 N.C. 282, 288-89, 63 S.E. 1045, 1048 (1909).

gages and thereby induce the vendor to resort to the relatively oppressive land contract, through which he could still recover the equivalent of a deficiency judgment? The only answer is simply that legislatures do not always see the whole problem, and are not always astute to close all the loopholes. The evidence is strong that the legislature wanted to furnish protection to the purchaser where the vendor did the financing. The only alternative possibility is that there was something distasteful about the action to recover a deficiency under a purchase-money mortgage, as an action, which was not shared by actions on personal obligations, suits for specific performance, and actions to recover mortgage deficiencies brought by third-party mortgagees. This is manifestly absurd.⁷⁶ California's amendment of its statute to plug the installment-contract loophole confirms the conclusion: the policy was one of protecting the purchaser where the vendor did the financing; the North Carolina legislature simply did not do an efficient job of insuring the effectiveness of the policy.

The third general effect of the statute is that it might require the vendor-financier to change his terms and conditions of sale, perhaps to such a point that such financing would be discouraged altogether, to be replaced by third-party financing. It has been suggested that the alternative of third-party financing opens an easy and obvious way for "evasion" of the statute and the legislative policy.⁷⁷ But this assumes that the legislative purpose was to protect the purchaser against a deficiency judgment irrespective of who furnished the credit. It is true that later in the same session the legislature provided for the relief of mortgage debtors generally in connection with deficiency judgments; but in this earlier statute, the legislature singled out the purchase-money mortgage for special and drastic treatment. It may very well be that, for reasons which do not yet appear, the legislature wished to discourage the practice of financing by vendors, and to force a shift to financing by third parties. If so, the substitution of a third party for the vendor as financier would represent accomplishment rather than frustration of the

⁷⁶ Cf. *Wright v. Wimberly*, 94 Ore. 1, 45, 184 Pac. 740, 754 (1919): "The legislature did not look upon a suit in equity as an evil and an action at law as a virtue, for each is only a form of procedure designed to accomplish a result." (Concurring opinion.) Moreover, since the statute was prospective only, the courts of North Carolina would continue indefinitely to entertain suits for deficiencies arising out of mortgages executed prior to its enactment.

⁷⁷ Hanft letter, *supra* note 61: "... [T]he statute is easy of evasion by the usual device of obliging the buyer to borrow the purchase price from some other lender, pay the money to seller, and give the mortgage to the lender. Therefore the statute is a booby trap for the seller who is ill advised."

purpose. It is perhaps for this reason that another North Carolina observer is reluctant to label as "evasion" the arrangement for third-party financing.⁷⁸

We are thus squarely confronted with the question as to why the legislature was so hostile toward transactions in which the sale was financed by the vendor. In order to keep the problem in perspective, however, it will be well, before exploring that question, to examine to some extent the hostility toward deficiency judgments in general.

IV

THE DEFICIENCY JUDGMENT IN GENERAL

The deficiency judgment was a relatively late development in the law of mortgages, and is said to be entirely the creature of statute.⁷⁹ When foreclosure by sale was substituted for earlier methods, theoretically for the purpose of giving the mortgagor the benefit of any excess in the value of the security over the amount of the debt, it was thought that as a corollary the mortgagee should be entitled to recover the amount by which the security failed to satisfy the debt.^{79a} In times of depression, however, the right of the mortgagee to recover the deficiency, superficially a simple matter of equal treatment of the parties, came to be regarded as "an instrument of oppression" whereby "the mortgagee may be treated to a windfall and the mortgagor made to pay his debt twofold."⁸⁰ This attitude is based upon the assumption that, money being scarce and too much land being on the market, there is almost no competitive bidding and the price realized upon the sale will not reflect the "true" value of the property.⁸¹ Despite the analytical difficulties involved in this reasoning,⁸² there is no denying that its

⁷⁸ Marsh letter, *supra* note 61.

⁷⁹ Friedman, *supra* note 48.

^{79a} The statements in the text are based on the development of mortgage law in America. In England, foreclosure by sale was developed in the interest of mortgagees, as an alternative to the unsatisfactory procedure of "strict" foreclosure. Tefft, *The Myth of Strict Foreclosure*, 4 U. CHI. L. REV. 575, 579-80 (1937). Moreover, while the concomitant English law provided for a deficiency judgment, it did not give the mortgagee an effective or practical remedy for reaching unmortgaged assets. *Id.* at 585-86.

⁸⁰ Poteat, *supra* note 35, at 529.

⁸¹ *Ibid.*

⁸² *Suring State Bank v. Giese*, 210 Wis. 489, 491, 246 N.W. 556, 557 (1933). See also Perlman, *supra* note 31 at 804. Generally, though not in North Carolina, there was a substantial reason why the foreclosure sale would not reflect the actual market value:

appeal has induced legislatures to curb the right to the deficiency judgment in order to prevent the creditor from "profiting unreasonably at the expense of a helpless debtor."⁸³ And, interestingly enough, there has been little protest from detached observers or even from the creditor interests who are "adversely" affected by such legislation.⁸⁴

The Model Power of Sale Mortgage Foreclosure Act⁸⁵ provides in section ten that "Foreclosure under the provisions of this act shall fully satisfy the obligation secured by the mortgage foreclosed, regardless of the sale price or fair value, and no deficiency decree or other judgment shall thereafter be obtained on such obligation." In the discussions which led to this draft, Nathan William MacChesney, General Counsel of the National Association of Real Estate Boards, said:⁸⁶

the statutory right to redeem after foreclosure discouraged bidding. North Carolina had, and has, no statutory period of redemption.

For a graphic account of the effect of market paralysis on mortgage foreclosures, see *Federal Title and Mortgage Guaranty Co. v. Lowenstein*, 113 N.J. Eq. 200 (1933).

⁸³ Farage, *Mortgage Deficiency Judgments and Their Constitutionality*, 41 DICK. L. REV. 67, 70 (1937).

⁸⁴ Mild disapproval is expressed in Stanley, *supra* note 48, and a British comment appears to assume the nonexistence of the problem: "If, where the borrower has other assets, the lender takes action on the covenant for the deficiency after sale it is not generally regarded as an undue hardship to the borrower, as the loan has not yet been repaid." Turner, *The English Mortgage of Land as a Security*, 20 VA. L. REV. 729 (1934). The only vigorous protest which we have received in a sampling of opinion is one from Horace Russell, Esq., General Counsel, United States Savings and Loan League, Chicago, in a letter dated February 2, 1959: "We are of the opinion that anti-deficiency judgment laws are unconstitutional, bad public policy, and injurious to the very people intended to be benefited by them, and that the same have been passed from time to time purely for political purposes. . . . To abolish deficiency judgments in mortgage loan transactions would have the effect of depriving individuals of the value of good character and good credit in connection with such transactions."

In 1937, the California Legislature by joint resolution requested advice from federal lending agencies as to whether the enactment of legislation abolishing the right to a deficiency judgment upon foreclosure would hamper lending to Californians. Cal. Stats. 2741 (1937). (Note that the inquiry did not relate to deficiencies on purchase-money mortgages; the California statute abolishing the deficiency judgment in such cases had been passed in 1933.) The Board of the HOLC replied through its general counsel that "such deficiency judgment legislation as you refer to is unwise public policy, puts obstacles in the way of the family deciding to acquire a home, and should be avoided. . . ." See Poteat, *supra* note 35, at 532-33 n. 93. In the Board's view, the only evil associated with deficiency judgments related to sales for nominal bids, and existing legislation requiring that the fair value of the security be credited was adequate.

⁸⁵ National Conference of Commissioners on Uniform State Laws (1940).

⁸⁶ National Conference of Commissioners on Uniform State Laws, Transcript of Proceedings (relating to Uniform Short Form Mortgage Act and Uniform Mortgage Foreclosure Act), 49th Annual Conference, San Francisco, July 3-8, 1939, pp. 61-62.

There is a very substantial opinion in this country that the deficiency decree is economically wrong and socially undesirable and somehow we should do away with it, but the consensus of opinion based upon that debate was that if there is an ascertainment of the value, it should be based upon normal conditions and not upon present fair market values at the time that the action is taken, which would make a very great difference in the question of deficiency judgment. . . .

Somehow in this country we have got to work out the theory of deficiency decrees . . . because this country cannot afford to go through another depression with the wiping out of equity values such as we have witnessed during the last ten years.

I would like to see the Committee . . . give further attention to the question of deficiency decrees. As a matter of fact, in the borrowing of money—and I represent almost wholly lenders of money and not borrowers—in the borrowing of money, the lending institution has sources of information as to values and so forth, greatly superior to the owner of the property, and it would not be any great hardship and would tend to prevent unwise and improvident loans if, as a matter of fact, the lender were limited to the security of the property upon which he advances the money.

We know that while there is a good deal of talk about character loans, there are very few character loans made. The loans, as a matter of fact, are made on the property, and this question of deficiency decree is not taken into consideration, and generally speaking, it catches only the unwary; the people who have had experience in the past do not sign the paper and avoid the personal responsibility which goes with it, so that it is rather the unsuspecting who is caught in this trap.

William C. Prather, Associate Counsel of the United States Savings and Loan League, has dismissed the apparent advantage to the lender of the right to a deficiency judgment as largely illusory.⁸⁷ In part, his attitude is influenced by the obstacles which depression legislation has placed in the way of the remedy;⁸⁸ in part, it is based on the fact that such judgments are seldom satisfied;⁸⁹ in part, it recognizes that the mortgagor may justly complain that the sale price, at least in times of depression, will not reflect the true value: "[T]he mortgagee's control of the bid price at the sale was almost complete, meaning that almost

⁸⁷ Prather, *Foreclosure of the Security Interest*, 1957 U. ILL. L.F. 420, 437-39 (reprinted in United States Savings & Loan League, Legal Bulletin, May 1958).

⁸⁸ Guiliani (Peter Guiliani, counsel for the National Life Insurance Co.), *Some Legal Considerations*, 61 U.S. INVESTOR 846, 848 (1950).

⁸⁹ Hoffman, *Recent Legislation of Interest to Lawyers in General Practice*, 46 ILL. B.J. 20, 28 (1957): ". . . the general experience, that deficiency judgments are seldom of any value." See also, CLARK & SHULMAN, *LAW ADMINISTRATION IN CONNECTICUT* 123-24 (1937).

the entire amount of the debt could be taken in the form of a deficiency judgment."⁹⁰ He observes that, "In several states, Tennessee for one, the right to deficiency judgment is seldom exercised, and many attorneys in Illinois have abandoned the practice except under extraordinary circumstances."⁹¹ The deficiency judgment is listed as one of four factors "tending most to confuse the issue and which are primarily responsible for a major part of the delay, trouble, and burdensome expense in foreclosure proceedings";⁹² only seven per cent of the dollar amount of deficiency judgments is ever realized;⁹³ in 99.3 per cent of "public" sales, the mortgagee is the buyer.⁹⁴ This spokesman for mortgagee interests recommended elimination of deficiency judgments: "Of negligible value to the lender, they can be of incalculable damage to the borrower."⁹⁵ He concluded:⁹⁶

While the deficiency judgment is one of the few advantages bestowed upon the mortgagee, the statistics show clearly that the advantage is one of theory only, the seven per cent listed as salvaged being hardly worth the cost of carrying the total amounts on the books for a period of years and the cost and time involved in sporadic efforts at collection. Furthermore, it can hardly be an advantage to the mortgagee to drive the debtor into bankruptcy as the result of a large deficiency judgment; in such cases the loss may be all the mortgagee's.

Similar sentiments have been expressed by others; it is said that deficiency judgments are practically worthless against even solvent debtors,⁹⁷ and that the principal reason for a deficiency judgment in Illinois in 1933 was that it provided a basis for the appointment of a receiver who could take immediate possession and collect the rents and profits during the redemption period.⁹⁸ A textbook bearing the imprimatur of the American Institute of Banking says: "Because of the innumerable cases in which mortgagees have bid in the property at a fraction of its true value and the mortgagors have been left owing part of the debt which was secured by the property, some states have enacted laws restricting the right to obtain deficiency judgments under certain circumstances and imposing requirements for the protection of the debtor."⁹⁹ Understandably, the mortgage debtor who loses his property and who in

⁹⁰ Prather, *supra* note 87, at 438.

⁹¹ *Id.* at 439.

⁹² *Id.* at 452.

⁹³ *Ibid.*

⁹⁴ *Ibid.*

⁹⁵ *Id.* at 453.

⁹⁶ *Id.* at 454.

⁹⁷ Carey, Brabner-Smith & Sullivan, *Studies in Foreclosures in Cook County: II, Foreclosure Methods and Redemption*, 27 ILL. L. REV. 595, 612 (1933).

⁹⁸ *Id.* at n. 51. See also Brabner-Smith, *Economic Aspects of the Deficiency Judgment*, 20 VA. L. REV. 719 (1934).

⁹⁹ AMERICAN INSTITUTE OF BANKING, HOME MORTGAGE FINANCING 66 (1938).

addition is saddled with a deficiency judgment is bitter and rebellious, and resists payment to the utmost.¹⁰⁰

Not all of this information concerning the deficiency judgment was available in 1933. But much of it was, and, in a situation in which President Hoover's belief, that the practices of mortgagors with respect to foreclosures were "utterly destructive of the interest of debtor and creditor alike," was shared by many mortgage creditors, the action taken by North Carolina to relieve against deficiency judgments generally is quite understandable.¹⁰¹ The deficiency judgment being of relatively little value to the mortgagee and very offensive and burdensome to the mortgagor; the mortgagor being regarded as unjustly impoverished and the mortgagee as unjustly enriched; the true value of the land being thought to be greater than the price realized at the sale; and the deficiency judgment being a "sore spot"¹⁰² in a process of debt liquidation which threatened the peace and economic stability of the community, North Carolina modified the right to obtain deficiency judgments, and made the modification applicable to existing mortgages. While the same considerations probably influenced the special action taken prospectively with regard to deficiencies under purchase-money mortgages, they do not fully explain that action.

V

THE PURCHASE-MONEY MORTGAGE

At the outset of the inquiry into the special reasons which led the North Carolina legislature to abolish deficiency judgments entirely with respect to purchase-money mortgages, it is interesting to note that at an earlier date, legislation for relief against deficiencies gave the opposite treatment to such mortgages; apparently they were regarded as especially deserving claims. An Arkansas statute of 1879¹⁰³ established an appraisal procedure, and provided that if the price bid at the foreclosure sale was less than two-thirds of the appraised value there should be a resale after a lapse of time. A proviso was inserted to the effect that "this act shall not apply to sales of property for the purchase

¹⁰⁰ See Brabner-Smith, *Economic Aspects of the Deficiency Judgment*, 20 VA. L. REV. 719, 722-23 (1934).

¹⁰¹ See Carey, Brabner-Smith & Sullivan, *Studies in Foreclosures in Cook County: II, Foreclosure Methods and Redemption*, 27 ILL. L. REV. 595, 849-50 (1933).

¹⁰² "The evident purpose of the Legislature was to relieve a present condition by applying the poultice of the act to the sore spot of deficiency judgments in foreclosures of mortgages, caused by decline in realty values." *Adams v. Spillyards*, 187 Ark. 641, 650, 656, 61 S.W.2d 686, 690, 692 (1933).

¹⁰³ Ark. Laws 94 (1879). See *Robards v. Brown*, 40 Ark. 423 (1883).

money thereof." The priority given to purchase-money mortgages (in the broader sense) over other liens may also be borne in mind, though that concerns the relation between the mortgagee and other claimants, not that between the mortgagee and the mortgagor; besides, the courts have gone out of their way to explain that priority as being based on conceptual grounds, rather than on any supposed equity in the mortgagee.¹⁰⁴

Two distinguishing features which might account for the special treatment given by the North Carolina legislature to purchase-money mortgages are at once apparent. First, when such a mortgage is foreclosed, the mortgagee, if he is the bidder (as he usually is), gets back the very land which was his before the original sale; in addition, he keeps whatever payments the purchaser may have made. If we are somewhat inattentive to the question of who bears, or should bear, the risk of a decline in the value of the property—as the popular mind is likely to be—it is easy to see the argument that the mortgagee has been made whole by being restored to his original condition, with compensation (by way of the installment payments) for the use of the property in the meantime. By a similar process of reasoning, it may be argued that the mortgagee, having as vendor sold the property for the price agreed upon, is somehow estopped to deny that it was worth the full amount of the debt. If the problem is not that of a real decline in the value of the property, but of the failure of the foreclosure sale to produce a bid resembling the true value, then the feeling that the mortgagee has taken undue advantage and is being unjustly enriched is likely to be particularly intense against the vendor who takes back his own and demands a judgment for the deficiency in addition. Second, the vendor-mortgagee has not parted with any cash; he has merely set his price—perhaps at a figure higher than the value of the land, but that is not necessary to the argument—specified the down payment required, and taken the purchaser's obligation for the balance. It can be said of him that he is not lending money but trading—or even "speculating"¹⁰⁵—in land.

To be contrasted is the position of the third-party financier—say, a bank or building and loan association or insurance company. It has nothing to do with fixing the price; it makes no representations as to value, except such as might be implied from the limit it sets on the

¹⁰⁴ 1 JONES, *op. cit. supra* note 55, § 584; *Moring v. Dickerson*, 85 N.C. 466, 472 (1881).

¹⁰⁵ Cf. the quotation, *supra* note 57.

amount of the loan; it is not particularly interested in promoting the sale of the land; when it buys at the foreclosure sale, it is not taking back something apparently commensurate in value with what it turned over to the mortgagor. It loaned money in cash, and has not been repaid (except to the extent that the true value of the land exceeds the price on the foreclosure sale). As one North Carolina observer has commented: ". . . [The purchase-money mortgage] is a transaction in an entirely different category from that of a voluntary lender in his dealings with a voluntary borrower who has a legal and moral obligation of *paying back the amount of the loan in kind*."¹⁰⁶ It is not easy to argue that, as between the third-party lender and the purchaser, the risk of a real decline in value should be borne by the former; it is much easier to make such an argument against the vendor-financier. "Prior to the sale [the vendor] owns the property outright, he can sell on any terms that he wishes, he can require a purchaser to make an adequate downpayment. If he contemplates that there may be a default with a necessity for a foreclosure, he can protect himself by requiring a sufficient downpayment to save him from loss."¹⁰⁷ Moreover, he "has first claim on the property which he has sold, and in case of default he can *get it back* by going through the usual legal process of foreclosure."¹⁰⁸

In construing the similar California statute, the California Supreme Court has said: "The one taking such a trust deed [*i.e.*, a vendor taking a purchase-money mortgage] knows the value of his security and assumes the risk that it may become inadequate."¹⁰⁹ A commentator has enlarged upon this as follows: "The rationale for thus singling out the purchase money creditor and thus prohibiting him from obtaining a deficiency judgment is said to be that he is in a special position to know the value of his security and should, therefore, assume at least part of the risk that it may become inadequate."¹¹⁰ This is not a particularly convincing explanation of the legislative purpose. Without knowledge as to who vendor-financiers are, and who third-party lenders are, it is, of course, impossible to speak with any kind of accuracy as to their relative positions with respect to knowledge of the value of the security; but the proposition that the average vendor of real estate is

¹⁰⁶ Marsh letter, *supra* note 61. (Emphasis added.)

¹⁰⁷ Ruff letter, *supra* note 61.

¹⁰⁸ Marsh letter, *supra* note 61. (Emphasis added.)

¹⁰⁹ Brown v. Jensen, 41 Cal. 2d 193, 197, 259 P.2d 425, 427 (1953).

¹¹⁰ Comment, 4 U.C.L.A.L. REV. 192, 195 (1956). "This rationale does not appear to apply where the purchase money mortgagee is not the vendor of the property." *Id.* at 195 n. 14.

in better position to know its value as security than the average lending institution, or even private investor, is an implausible one. Lending institutions, at least, have at their command appraisal facilities and information as to market trends which are not easily accessible to the average property-owner who applies to them for a mortgage loan.¹¹¹

It would be enormously helpful in ascertaining the legislative policy if we could know who those vendors are who finance land sales by means of purchase-money mortgages; in what situations the transaction takes this form, rather than that of a loan by a third party; and why it takes this form. If we knew these things it might be possible to identify the type of transaction, and the features of the transaction, which aroused the legislature's desire to discourage it and protect the purchaser. We do not know these things. We have been unable to find any study analyzing the sources of mortgage financing in these terms, or the distinguishing characteristics of the situation in which the vendor finances, or the reasons for his doing so. There are occasional explanations given for the choice of this form of transaction, but little in the way of factual data is available. We can only attempt to reconstruct by deduction the transaction visualized by the legislature, utilizing such bits of information as are available.

An obvious reason for the vendor's taking a purchase-money mortgage is simply that he may find the investment opportunity attractive.¹¹² This, without more, is hardly a reason why the legislature should discourage such transactions. Another reason is that by taking the purchase price in installments rather than in cash he may effect an income-tax saving.¹¹³ This is a motive which can be put aside for purposes of the present inquiry. There is no reason to suppose the legislature desired to discourage such tax savings; the act does not apply to installment land contracts, in which the same kind of saving is possible; and above all, income tax considerations did not enter into the transactions which led Oregon in 1903 to abolish deficiency judgments on purchase-money mortgages.

A priori, it may be assumed that vendors of land are not typically in the business of selling credit, and are not typically in position to do

¹¹¹ See *supra* note 86.

¹¹² MACCHESNEY, *op. cit. supra* note 55, at 676.

¹¹³ *Ibid.* See INT. REV. CODE OF 1954, § 453; AMERICAN BAR ASSOCIATION & PRACTICING LAW INSTITUTE, FUNDAMENTALS OF FEDERAL TAXATION; ACCOUNTING PERIODS AND ACCOUNTING METHODS (1950); Young, *Tax Consequences of Real Estate Financing*, 1957 U. ILL. L. F. 360; Jenks, *How to Make Effective Use of Installment and Other Sales Mechanics to Reduce Taxes*, 6 N.Y.U. TAX INST. 467 (1948).

so.¹¹⁴ On this assumption, the extension of credit by the vendor would be an arrangement resorted to when the necessary credit cannot be obtained from a more normal source.¹¹⁵ If credit is not available from an institution in the business of making loans on real estate, it must be because the terms of the transaction are not acceptable to the lending institution.¹¹⁶ Specifically, the likelihood is that the purchaser is unable to make a down payment sufficient to satisfy the agency's loan-value ratio standards. Thus, if the price agreed on by the parties and the appraised value is \$10,000, and the lending agency is willing to advance no more than sixty per cent of the appraised value, and the purchaser can pay only \$2,000 in cash, there is an obstacle to consummation of the sale which the vendor may overcome by financing it himself—adjusting the terms in such a way as to compensate himself for the risk that the security is inadequate, as by charging relatively high interest, or increasing the price. Implicit in such a transaction is an assumption that the arrangement is unsound, viewed as a secured transaction, since, according to the conservative practices of the lending agency, the security is insufficient. Hence, whatever may be said with respect to the ordinary practice of mortgage lenders,¹¹⁷ it is probable that the vendor in such a transaction does rely to some extent upon the personal obliga-

¹¹⁴ See CASE, MODERN REAL ESTATE PRACTICE 281, 284 (1956). This statement is subject to the important qualification discussed *infra* at note 130.

¹¹⁵ But see BINGHAM & ANDREWS, REAL ESTATE FINANCING 36 (1924): "The usual and customary plan of purchasing real estate, other than lots in a sub-division, is by the payment of part cash and the execution and delivery by the purchaser to the seller of his note or notes for the balance, secured by a purchase-money mortgage on the land." (Emphasis added.) It is difficult to believe that this is true, or ever was in this century. Cf. NORTH, VAN BUREN, & SMITH, REAL ESTATE FINANCING 28 (1928); FISHER, URBAN REAL ESTATE MARKETS 64 (1951); Havighurst & Lawrence, *Forfeitures under Real Estate Contracts in Illinois*, 29 ILL. L. REV. 714 (1935).

¹¹⁶ Or, what amounts to the same thing, the institution may be prohibited by law from making loans on such terms.

¹¹⁷ Cf. the quotation, *supra* note 86. Horace Russell, General Counsel of the United States Savings and Loan League, strongly maintains that mortgage loans generally are based on the personal responsibility of the borrower as well as on the security. Russell letter, *supra* note 61. Mr. Carlyle McDowell, Vice President of the Wachovia Bank & Trust Co., Winston-Salem, says: "It has been my experience that most sellers do not investigate the credit very carefully nor are many sales made on the strength of the credit when purchase-money mortgages are used for financing." McDowell letter, *supra* note 61. Cf. SKILTON, GOVERNMENT AND THE MORTGAGE DEBTOR 128-29 (1944). The short answer to this question would appear to be that as the adequacy of the security decreases, the knowing lender relies increasingly on the personal credit of the borrower, or else takes other steps to compensate himself for the risk of loss. This suggests (although it is not a necessary inference) that loans on inadequate security tend to be usurious. At least if an adequately secured loan is available only at the maximum

tion of the purchaser.¹¹⁸ A fortiori, if the price agreed upon is in excess of the appraised value, and if the property is of a type in which ordinary lending agencies do not like to invest, the probability of financing by the vendor is increased. Thus, in a time of speculation in unimproved lots, there is little likelihood that any substantial credit would be available from normal sources, and something like the purchase-money mortgage may come into common use.¹¹⁹

The assumption that the phenomenon of vendor-financing is likely to occur when more conventional sources of credit are not available is borne out by the history of the installment land contract. It is said that this form of transaction did not come into common use until late in the nineteenth century, and that its principal use has been in connection with the sale of vacant residential building sites and in financing subdivisions.¹²⁰ Emphasis has been placed upon the fact that this device, by virtue of its superiority to the mortgage as a creditor's instrument, enabled vendors to give early possession to purchasers without the means

legal rate, the lender without adequate security is likely to charge more than that rate; and the vendor is in position to raise the rate indirectly by increasing the price. Cf. CASE, *op. cit. supra* note 114, at 301. See *Riley v. District of Columbia Redevelopment Land Agency*, 246 F.2d 641 (D.C. Cir. 1957); Dunham, *Do "Hard Cases" Make Bad Economics?*, 4 How. L.J. 50 (1958).

Federal mortgage insurance has, of course, encouraged many loans on the basis of security which would otherwise be inadequate, the lender relying on the insurance rather than on the credit of the buyer. Since the borrower is liable to indemnify the government, *McKnight v. United States*, 259 F.2d 540 (9th Cir. 1958), the end result, so far as he is concerned, is the same as if, having bought on imprudent terms, he were liable to a deficiency judgment.

¹¹⁸ "Second mortgage credit, in other words, is more like a personal loan." FISHER, *ADVANCED PRINCIPLES OF REAL ESTATE PRACTICE* 182 (1930).

¹¹⁹ *But cf.* 5 ENCYC. SOC. SCI. 65 (1933): "The financing of land speculation is carried on in large part by the same institutions which make possible investment in land."

¹²⁰ MONCHOW, *SEVENTY YEARS OF REAL ESTATE SUBDIVIDING IN THE REGION OF CHICAGO* 142 (1939); FISHER, *ADVANCED PRINCIPLES OF REAL ESTATE PRACTICE* 79-80, 191-92 (1930); BINGHAM & ANDREWS, *FINANCING REAL ESTATE* 37, 178 (1924) ("This method of acquiring real estate enables a person of small means to purchase a lot for a home, for an investment or for speculation. . . . The chief occasion for the use of the land contract in the sale of property is where the purchaser is able to pay down only a small amount, not in excess of twenty per cent of the purchase price." NORTH, VAN BUREN, & SMITH, *FINANCING REAL ESTATE* 11, 191-92, 245, 248, 260-61 (1928); COLEMAN, *THE IMPACT OF GOVERNMENT ON REAL ESTATE FINANCE IN THE UNITED STATES* 51-52 (1950) (pointing out that "Probably the greatest use of land contracts in this country was in connection with the sale of public lands"—in the late eighteenth and early nineteenth centuries); FISHER, *URBAN REAL ESTATE MARKETS* 27-28 (1951); MCMICHAEL & O'KEEFE, *HOW TO FINANCE REAL ESTATE* 11-12 (2d ed. 1953); Fegan, *Tools of Real Estate Financing*, 1957 U. ILL. L.F. 335, 346.

to make substantial down payments and, in the days before government-insured mortgages, made it possible to buy land as well as consumer durable goods on the installment plan, and so contributed to the growth of American cities.¹²¹

Except where, for special reasons, no credit at all is available from conventional sources, the vendor will not necessarily extend all the credit. In almost all circumstances, a lending institution will be willing to advance a conservative percentage of the appraised value on the security of a first lien; and, on our assumption that the vendor is not himself primarily interested in the investment opportunity, it follows that the transaction will be financed so far as possible by a lending enterprise, and the vendor will merely furnish such credit as may be necessary to close the gap between the down payment and the first mortgage. In other words, it may be that the vendor-financier typically is engaged in junior-lien financing, and that purchase-money mortgages are typically second mortgages. There is some support for this assumption in the literature. "Bridging the gap" between the first mortgage and the down payment was referred to in the period preceding the enactment of the North Carolina statute as the "central problem of real estate financing."¹²² According to a more recent account, while the need for junior-lien financing has diminished, "Today the purchase-money mortgage is the most common form of secondary financing."¹²³

On the double assumption that the typical vendor-financier is not in the business of extending credit and is usually a second mortgagee, characteristics of the transaction which might arouse the legislature to regulatory action begin to appear. Both amateur lending and junior-lien financing involve practices which may lead to misfortune. The amateur lender is likely to repeat the mistakes which characterized mortgage financing before the rise of the modern lending institution, and the second mortgagee is likely to aggravate those mistakes. Horace Russell has listed eight such mistakes, of which the following are relevant here:¹²⁴

¹²¹ See *supra* note 120.

¹²² REEP, SECOND MORTGAGES AND LAND CONTRACTS IN REAL ESTATE FINANCING 1 (1928).

¹²³ McMICHAEL & O'KEEFE, *op. cit. supra* note 120, at 62-63. On the private lender generally as a source of junior-lien financing, see NORTH, VAN BUREN, & SMITH, *op. cit. supra* note 120, at 29-30, 249, 260-61.

¹²⁴ RUSSELL, PRIVATE HOUSING LEGAL PROBLEMS, IN HOUSING, THE CONTINUING PROBLEM, 41-42 (1940), quoted in COLEMAN, *op. cit. supra* note 120, at 44-45.

First was the general use of short-term mortgage loans, which had to be refinanced every few years with high commissions and financing charges. Second was the general practice of lending only a small amount on the security of the first mortgage, which necessitated junior financing with all the hazards to the borrower which that practice involved. Third was the use of lump-sum rather than amortized mortgages, which necessitated the borrower repaying the entire amount of the mortgage at one time or refinancing it. Fourth was the prevailing high interest rates generally charged on such loans. . . . Eighth was the absence of proper lending and appraisal practices and procedure.

Moreover, the amateur lender was likely to be difficult about refinancing, and in general unlikely to indulge in the "calculated leniency" which might be expected of responsible professional lenders.¹²⁵ The legislature, as we know, was concerned about deficiency judgments generally. In the ordinary situation, the problem was that the foreclosure sale did not realize the true value of the property at the time of sale. With respect to purchase-money mortgages—considered as junior liens negotiated by amateur lenders exercising the bargaining power of a vendor—there was the additional problem of a foreseeable decline in actual value rendering the security inadequate. It was clearly the legislative policy to place the risk of such a decline on the vendor. Moreover, apart from any decline in value, the security might be inadequate simply because the land was overpriced, in which case also the vendor was to be required to take the loss. The purchase-money mortgage was viewed as an improvident transaction; in order to discourage it, and protect the purchaser against his improvident bargain, the vendor was to be limited to his security.¹²⁶

¹²⁵ Prather, *supra* note 87, at 425. See also NORTH, VAN BUREN, & SMITH, *op. cit. supra* note 120, at 80-82. On the importance of amortization, see also COLEMAN, URBAN REAL ESTATE MARKETS 20 (1951); REEP, *op. cit. supra* note 122, at 90 (1928); BINGHAM & ANDREWS, *op. cit. supra* note 120 at 132.

¹²⁶ Considering ch. 36 in the light of ch. 275, a commentator concluded that "the purchase-money mortgage statute was designed to discourage prospective purchasers from buying land on small cash margins." Comment, 13 U. CHI. L. REV. 195, 197-98 (1946). "In general it is my opinion that the legislation you refer to was enacted basically to protect a purchaser from a transaction in which the seller has made a rather severe bargain with the purchaser. . . . In my opinion, the occasion for the legislation was the over-reaching capriciousness of the seller." Ruff letter, *supra* note 61.

That current national policy encourages the purchase of real estate on small cash margins, see *supra* note 117, does not militate against this interpretation of North Carolina policy in 1933.

The brief for Dr. Angel in the Court of Appeals contains the following passage: The District Court permitted a recovery in the amount of \$3,100.00 with interest thereon at six per cent from the 5th day of March, 1940, which added to the

If this is a reasonably accurate reproduction of the legislature's image of the purchase-money mortgage, there is one situation in particular in which the purchase-money mortgagee should be denied all relief: The vendor having taken a second mortgage to "close the gap," the third party who furnished the principal credit forecloses his first mortgage, exhausting the security. Such a transaction involves both of the assumed evils of the purchase-money mortgage: amateur lending and junior-lien financing; and the exhaustion of the security is precisely the risk which the vendor should bear according to the legislative policy. Yet not one of the statutes abolishing deficiency judgments on purchase-money mortgages is aptly worded to accomplish this result. All speak in terms of the deficiency remaining after foreclosure of the purchase-money mortgage; they do not forbid suit on the personal obligation without foreclosure. California, however, consistently with the view that the purpose of the statute was to confine this type of mortgagee to the security, managed to construe its statute as precluding recovery in this situation.¹²⁷ The situation in which foreclosure of the first mortgage exhausted the security of the second had been an exception to the rule in that state that foreclosure is the mortgagee's only remedy. How North Carolina would decide this question we cannot tell. The California result is obviously necessary in order to effectuate the purpose of the statute; yet we have already noted indications that in the situation in which the vendor is the only mortgagee, North Carolina might allow suit on the personal obligation.¹²⁸ If, in addition, it would allow suit on the personal obligation under a junior purchase-money mortgage

cash payment would give the appellee, the seller, \$3,600.00 and his interest for the use of the property for a period of one month. To prevent such injustices and in order that one party might not unjustly enrich himself at the expense of another, who was so unfortunate as to be unable to meet his obligations when apprised of his *erroneous judgment in agreeing to pay an unwarranted price* for a given piece of property doubtless prompted the legislature of North Carolina to enact Chapter 36 of the Public Laws of 1933 . . . , and thereby publish and declare the public policy of the state. The legislature of North Carolina by enacting the foregoing legislation and thereby declaring its public policy said to the world that from and after the ratification of said Act that sellers of real estate could not thereafter by foreclosure proceedings re-acquire their property and as a further penalty demand "a pound of flesh."

Brief for Appellant 5-6, *Angel v. Bullington*, 150 F.2d 679 (4th Cir., 1945) (No. 5310). (Emphasis added.) "The effect of [the statute] is to limit the creditor to the property conveyed, when for the purchase money, changing in that respect the present statute." *A Survey of Statutory Changes in North Carolina in 1933*, 11 N.C. L. REV. 191, 219 (1933).

¹²⁷ *Brown v. Jensen*, 41 Cal. 2d 193, 259 P.2d 425 (1953).

¹²⁸ See text following note 70 *supra*.

where foreclosure of the first by a third party has exhausted the security, this is further evidence of the imperfection of the statutory scheme. It does not seem to us, however, to impair the conclusions which have been reached as to what the legislative purpose was.

According to our argument, the North Carolina legislature visualized the purchase-money mortgage as one given by an amateur lender, either to furnish all the necessary credit or to provide junior-lien financing; in either case the security was likely to be inadequate, the terms oppressive, and the consequences harsh. There is one major flaw in this picture. When the statute was passed in 1933, there had been thousands of foreclosures, many of them by lending institutions. Normally the mortgagee was the purchaser at the sale. Lending institutions not being—primarily, at least—in the business of managing real estate, their problem was to dispose of the properties acquired by foreclosure. It is hardly to be expected in normal times, much less in periods of depression, that the sale of land can be accomplished without credit. These institutions being in the business of lending money, it was to be expected that they themselves would supply the credit necessary to finance the disposition of the properties, rather than yield this business to a competitor. In short, professional lending institutions perforce became vendors, and, in their role as financiers, would as a matter of course employ the purchase-money mortgage—not for junior-lien financing, but as the first and perhaps the only mortgage. In this situation, there were few, if any, of the evils attendant upon the purchase-money mortgage transaction as we have visualized it. This is not amateur lending; it is not junior-lien financing; the security is not likely to be inadequate; the terms are not likely to be oppressive; the vendor's bargaining position is weaker than in the usual situation, because of the pressure to dispose of the property. North Carolina could have had no conceivable reason to discourage the orderly disposition of foreclosed properties in this manner. The ideal that has always dominated American land policy, including land credit policy, is the ideal of ownership by individuals and by the enterprises which make the land productive;¹²⁹ extensive ownership by financial institutions, with occupants and producers reduced to the condition of tenants, is not the sort of thing a state legislature is likely to contemplate with equanimity.

The disposition of foreclosed properties in this manner by financial institutions is not imaginary; at least in other states, millions of dollars'

¹²⁹ See COLEMAN, *THE IMPACT OF GOVERNMENT ON REAL ESTATE FINANCE IN THE UNITED STATES* 7 (1950).

worth of property was sold by such institutions during the depression on the basis of purchase-money mortgages.¹³⁰ Whether the anti-deficiency judgment statute discouraged such dispositions in North Carolina we do not know. It would tend to do so if, but only if, purchasers of the foreclosed property were unable to make down payments sufficient to satisfy conservative loan-value ratio standards.^{130a}

We are thus again confronted with the question whether our hypothesis as to the legislative policy must be abandoned when we encounter evidence that the statute is ineffective to accomplish the assumed purpose or that the statute might have effects that were probably not intended. Again, our answer is no. The fact that large holdings of foreclosed property were disposed of by lending institutions on the basis of purchase-money mortgages certainly shows that the image of the purchase-money mortgage transaction previously constructed is an inaccurate or incomplete one; it does not show that that image was not the one in the minds of the legislators. We must still do our best to discover what the legislature had in mind, and we can only suppose that the possible effect of the statute on the disposition of foreclosed property by lending institutions was not considered.

There is one thing more. When the case of *Mr. Bullington and Dr. Angel* reached the United States Court of Appeals for the Fourth Circuit, counsel for the purchaser made the following argument:¹³¹

In all probability one of the motives prompting the legislature in adopting its public policy as set forth in said statute was due to the unwarranted speculation and gambling era on the sale and purchase of real estate starting in the State of Florida, perhaps about the year 1925, and reaching Western North Carolina soon thereafter, and finally winding up in the financial destruction of a large per cent of the land owners of Western North Carolina.

Immediately following the era of real estate speculation, foreclosures started,

¹³⁰ See LINTNER, *MUTUAL SAVINGS BANKS IN THE SAVINGS AND MORTGAGE MARKETS* 226 *et seq.* (1948). For tables showing the loss and reforeclosure experience with such mortgages, see *id.* at 512.

^{130a} Available information concerning the situation in North Carolina indicates that the purchase-money deed of trust was used in the disposition of foreclosed properties, and that the statute did not present an obstacle to the practice because the lending institutions, as a matter of established policy, did not seek deficiency judgments either in connection with such transactions or with ordinary mortgages for investment. Letter dated September 16, 1959, from Mr. Claude Currie, President, Security Savings & Loan Association, Durham; letter dated October 1, 1959, from W. F. Conrad, Esq., Assistant Counsel, Law Department, Mortgage Investment Section, The Prudential Insurance Co. of America, Newark, N.J.

¹³¹ Brief for Appellant, *Angel v. Bullington*, 150 F.2d 679 (4th Cir., 1945) (No. 5310).

deficiency judgments were being asked by non-resident speculators in real estate, failures and suicides multiplied, and thereupon the legislature of North Carolina declared its public policy in no uncertain terms by the passage of the foregoing statute which thereafter prohibited the seller from demanding his "pound of flesh". If the statute had been passed a few years earlier speculators would have been stopped when they received back what they had sold, homes would have been saved and perhaps lives would have been saved. The foregoing would be the legislative history in connection with the passage of Chapter 36, Public Laws 1933, if access were available to the committee hearings and debates which took place in the legislature in connection with its passage.

We have been unable to find confirmation of this theory of the statute's purpose, although standing alone, the contemporary opinion of members of the local bar is entitled to respect. Confirmation would be furnished by evidence that the purchase-money mortgage was employed as an instrument of finance in the Florida land boom. We do not know that it was. A lay account of that debacle tells us that "Charles Dickens could have depicted Martin Chuzzlewit buying a lot in a Florida 'development' in 1925, as readily and in the same language as he did eighty-five years earlier."¹³² But Chuzzlewit's purchase of a lot in the "city" of Eden was a cash transaction.¹³³ According to the same account, the typical procedure was for the purchaser to deposit ten per cent of the price, whereupon he received a "binder," or option to purchase. He then hoped to transfer the option at a profit, especially because he usually did not have the cash to make the first payment of one-fourth of the purchase price, due within thirty days from the date of the option.¹³⁴ This does not sound like a purchase-money mortgage transaction. On the contrary, it sounds remarkably like the "canal terms" which had figured in the Chicago speculation of 1836.¹³⁵ In short, boom business seems to have been transacted by means of the installment land contract; if that was the kind of transaction which prompted the legislature to act, it is strange that the statute dealt with purchase-money mortgages and not with installment contracts.¹³⁶

¹³² SAKOLSKI, *THE GREAT AMERICAN LAND BUBBLE* 338 (1932).

¹³³ DICKENS, *MARTIN CHUZZLEWIT* ch. XXI (1840).

¹³⁴ SAKOLSKI, *op. cit. supra* note 132, at 339.

¹³⁵ MONCHOW, *op. cit. supra* note 120, at 143; SAKOLSKI, *op. cit. supra* note 132, at 249. The terms, prescribed by the legislature, were: ". . . one fourth of the purchase money to be paid in advance at the time of purchase, and notes taken for the payment of the residue in three equal annual installments, bearing an interest of six per cent per annum," with summary forfeiture upon default. Ill. Laws 145, 151 (1835-36).

¹³⁶ We are indebted to George H. Ward, Esq., of Ward & Bennett, Asheville, N. C.,

VI

APPLICATION OF THE STATUTE TO CASES HAVING FOREIGN ASPECTS

We have arrived, not without doubts and difficulties, at a working hypothesis as to the policy adopted by the North Carolina legislature. The transaction in which the vendor supplied the credit necessary to finance the sale was viewed with disfavor. The legislature acted to modify the legal relations between the parties to such a transaction in such a way that the vendor must look solely to the security for his satisfaction, and could not rely on the personal responsibility of the purchaser. The parties might arrive at the same result by negotiation; it was perfectly possible for the mortgage not to contain a covenant to pay the price, or for the purchaser to sign no notes, or for the mortgage to contain an express stipulation against personal liability. The purchaser, in the view the legislature took of the matter, could not be relied upon to protect himself in such ways. This, we suggest, was not so much because of his inferior bargaining position—¹³⁷ there being no

for calling our attention to the fact that, early in the depression, Florida enacted a statute curbing the right to deficiency judgments under purchase-money mortgages. The statute that he apparently has in mind provided:

In all suits for the foreclosure of mortgages heretofore or hereafter executed the entry of a deficiency decree for any portion of a deficiency, should one exist, shall be within the sound judicial discretion of the court, but the complainant shall also have the right to sue at common law to recover such deficiency, provided no suit at law to recover such deficiency shall be maintained against the original mortgagor or mortgagors in cases where the mortgage is for the purchase price of the property involved and where the original mortgagee becomes the purchaser thereof at foreclosure sale and also is granted a deficiency decree against the original mortgagor, or mortgagors.

Fla. Laws 121 (1929). Mr. Ward, who was of counsel for the defendant in *Bullington v. Angel*, suggests that the North Carolina statute was patterned on the Florida one. Since the Florida statute seems much more limited in scope, we adhere, with deference, to our view that the Oregon statute is the more probable model. In addition, Mr. Ward describes in some detail the land boom in Western North Carolina in the twenties, indicating that the mechanics were the same as those suggested in connection with Florida: rapid turnover of options, or "binders," at inflated prices. Letter dated August 26, 1959.

The Florida statute was involved in *Battle v. Battjes*, 274 Mich. 267, 264 N.W. 367 (1936).

Another North Carolina observer also attributes the statute to the real estate boom and states that boom transactions were financed by the purchaser's paying a small portion of the price in cash and giving a deed of trust to secure the balance. Letter dated September 16, 1959, from Mr. Claude Currie, President, Security Savings & Loan Ass'n, Durham. This interpretation does not entirely explain the timing of the statute's enactment with reference to the boom period, nor its prospective operation, nor the simultaneous enactment of similar statutes in California, Montana, and South Dakota. See note 53 *supra*.

¹³⁷ Cf. Farage, *supra* note 83, at 71-72.

basis for assuming, a priori, that vendors are in a stronger position than purchasers—as it was because of the fact that many purchasers would be unaware of the extent of their liability, or would not foresee the eventuality of collapse and default, and would not bargain over the matter at all. Therefore, the legislature placed a limitation on the general principle of freedom of contract. It disabled the purchaser in such a transaction to obligate himself for the price; and, especially in view of the assertibility of the defense against a transferee of the obligation, it is not unreasonable to liken the disability to that placed upon an infant.¹³⁸

Plainly, this was a policy for the benefit and protection of purchasers. A right characteristic of the transaction, advantageous to the vendor, was abolished, to the advantage of the purchaser. It may be suggested that this begs the question: the North Carolina Supreme Court has said that the statute only abrogated a *remedy*. But the question remains: Why did it abrogate the remedy? And, as we have attempted to show, it did so not because of concern with the court system, or the volume and type of cases tried therein, but because of concern for purchasers.

The question becomes: With respect to cases involving foreign elements, in what circumstances does North Carolina have a legitimate interest in the application of this protective policy? In what circumstances is there a reasonable basis for its application? When is the case one within the scope of North Carolina's legitimate governmental concern? Under what circumstances does the purchaser come within the legitimate ambit of the North Carolina policy?

That the policy is not one for the protection of all purchasers everywhere, in all circumstances, and that the North Carolina legislature did not care at all what happened in cases wholly domestic to Virginia, is clear. On the assumption that states, like individuals, act primarily for the furtherance of their own interests and the interests of their people, we may reasonably state that the purchasers protected were:

- (1) resident citizens of North Carolina;
- (2) perhaps also nonresident citizens of North Carolina; and
- (3) such other persons as may be entitled under the Constitution, or on the basis of considerations of decency and far-sighted self-interest, to equal treatment with local citizens.

The lawyer who is able to persuade a court that such a statute is for the protection of purchasers, and that the interest of the state is

¹³⁸ See *supra* note 62.

satisfied if, but only if, local purchasers are protected, may be reasonably assured that the court will probably apply the statute in such a way as to effectuate the purpose and further the interest of the state, or in such a way as to approximate that result. He cannot be wholly sure of this. The court may be bemused by conflict-of-laws rules, and insensitive to arguments based on policy and interest. Or, occasionally, a court unsympathetic to the legislative policy may decide conflicts cases in such a way as to frustrate it, and so reach what it deems a just result. Basically, however, we believe that decisions in conflict-of-laws cases are motivated by a desire on the part of the court to effectuate the policy declared by local law—and, to the extent that the state has a legitimate interest in the effectuation of its policy, this is exactly what courts should do. When courts do not follow the rules of the *Restatement*, or when they obviously manipulate those rules to justify a result based on other considerations, or when they employ the broad rules and concepts of the system in unpredictable ways, their behavior will usually be explainable in these terms. It follows that the most reliable way of predicting the decision of a court in such a case is by determining the policy of the law and the extent of the interest, and that the most effective way of persuading the court to reach the desired result is by making clear the policy and the interest and showing how the result can be reached without undue violence to the mechanics of the conflict-of-laws system.

The result in *Bullington v. Angel*, though not the precise form in which it was cast, could have been predicted by such analysis. The purpose of the statute was to protect purchasers; the purchaser was a citizen and resident of North Carolina, obviously within the scope of the protective policy. The decision of the court gave him the protection of the statute. In order to accomplish this result, the court employed a technique well established in conflict-of-laws cases:¹³⁹ Instead of stating forthrightly that the statute was for the protection of North Carolina purchasers, and would be invoked wherever necessary for their protection, it treated the problem in conventional conflict-of-laws terms, but in such a way as to accomplish *approximately* the purpose of the statute by indirection. Probably the North Carolina court reasoned that most actions against North Carolina residents for deficiencies must be brought in North Carolina, and hence that applying the statute to all actions in the local courts would substantially accomplish

¹³⁹ Illustrative cases are *Lams v. F. H. Smith Co.*, 36 Del. 477, 178 Atl. 651 (1935), and *Emery v. Burbank*, 163 Mass. 326, 39 N.E. 1026 (1895), discussed in Currie, *The Constitution and the Transitory Cause of Action*, 73 HARV. L. REV. 36 (1959).

the legislative purpose, although such an application would logically disclaim any interest in a North Carolina purchaser sued elsewhere, and would occasionally give protection to foreign purchasers, in whom North Carolina had no interest, when they happened to be sued in North Carolina. An alternative solution of the same type would have been to hold the statute applicable to all cases in which the land was located in North Carolina, since most mortgagors of North Carolina real estate are presumably local residents.¹⁴⁰ The court is much less

¹⁴⁰ A critic of the decision has suggested that the North Carolina legislature's policy was directed "only against transactions involving North Carolina property," and that "the rights of the parties should have been determined by the law of Virginia." Comment, 13 U. CHI. L. REV. 195, 198 (1946). Further, that "Though the applicability of the 'place of contracting' doctrine may be questionable under some circumstances, it appears that in this case the reasonable expectations of the parties would be that the law governing their transaction would be that of the state in which the notes were executed and the property was situated." See also Note, 24 N.C.L. REV. 267, 269-70 (1946). This is strange reasoning. No basis whatever exists for attributing to the legislature an intention to limit the effect of the statute to transactions affecting North Carolina land, unless it be assumed (a) that the legislature believed it lacked power to accomplish more fully its purpose, recognized by this critic, to protect purchasers, or (b) that the legislature preferred this particular way of approximating its purpose to that adopted by the court. The statement regarding the "reasonable expectation of the parties" is a classic example of question-begging, characteristic of many arguments concerning the conflict of laws. The expectation of the parties that the transaction will be governed by the law of the place in which the notes were executed and the property was situated is not a reasonable expectation unless it is, in fact, the law that that law governs; the argument must be that the conflicts rule should point to the law of the situs because the parties expect it to do so. This is, in fact, the more usual form of the argument, see Note, 38 COLUM. L. REV. 1049, 1056 (1938), but it still begs the question. The vendor may, indeed, assume that the law of the situs will govern; but if the action must be brought in another state, which has an interest in applying its law for the purchaser's protection, his expectation is ill founded, and not particularly reasonable. He has simply not received adequate legal advice.

Assume for a moment that we were able to establish by recourse to committee reports and legislative debates that the evil which gave rise to the statute was similar to one that has been suggested (see note 131 *supra*): Residents of North Carolina had been speculating in the Florida land boom, buying Florida land and giving purchase-money mortgages; after foreclosure, they were sued in North Carolina for the deficiency, with the result that many of them lost their homes and farms. (This is not the evil depicted by counsel for Angel; they were suggesting that the Florida boom spread to North Carolina land.) On this assumption, it is perfectly obvious that the purpose of the legislature would be thwarted by a choice-of-law rule referring to the law of the situs, or of the law of the place of contracting. It should be equally obvious that there is no justification for a system for determining "what law governs" which ignores the purposes of laws, as the traditional conflict-of-laws system does. Cf. *Wood v. Wheeler*, 106 N.C. 512, 11 S.E. 590 (1890), 111 N.C. 231, 16 S.E. 418 (1892). If the purpose of the legislation was what we have assumed in this note, the decision of the North Carolina Supreme Court at least approximated its accomplishment, while a rule referring to the law of the situs or of the place of contracting would have frustrated

likely to make the place of contracting, or the place of performance, the significant factor, since those elements are less likely to approximate the desired protection to a satisfactory degree.

The reason for the indirection is twofold. In the first place, the lexicon of conflict of laws is devoid of such terms as "the policy of the law" and "the interest of the state in applying its policy" (except for the term "local public policy," which is by no means the same thing).¹⁴¹ The system is territorially oriented; for the most part, it is concerned with power over things and transactions, and the procedure in courts, largely ignoring the fact that the dominant concern of law is with people. In those instances in which it acknowledges the interest of a state in people, it speaks only of the technical concept of domicile. In the second place, a forthright statement that the legislature was concerned with North Carolina purchasers would sound selfish and provincial, and would stir up troublesome problems of unconstitutional discrimination. Actually, such a statement means only that the North Carolina legislature was attempting to regulate only matters which are within the sphere of its legitimate concern, and was not attempting to impose disabilities on foreign purchasers, whose welfare is the concern of their home states. But against the backdrop of the conventional system of conflict of laws, which presents a facade of innocent impartiality, the statement seems objectionable. Applying the statute to all cases in the local courts, irrespective of who the parties may be, or applying it to all cases involving local land, creates an illusion of even-handed, impartial, nondiscriminatory justice, and of security against attack on constitutional grounds. Actually, such techniques of indirection and approximation (1) weaken the case for the constitutionality of the statute against attacks based on the Full Faith and Credit Clause, and (2) are increasingly likely to expose the statute to attacks by resi-

it; yet the books on conflict of laws give us nothing but rules such as that "the validity and effect of a mortgage on land is determined by the law of the place where the land is," RESTATEMENT, CONFLICT OF LAWS § 225 (1934), or that "the law of the place of contracting determines the validity and effect of a promise. . . ." *Id.* at § 332. Cf. STUMBERG, CONFLICT OF LAWS 384 (2d ed. 1951); GOODRICH, CONFLICT OF LAWS § 152 (3d ed. 1949).

For a criticism, based on the policy of domestic law, of a case construing a domestic mortgage moratorium as inapplicable to mortgages of foreign land ("The New York state moratorium laws were intended for the *benefit of the citizens* of the state of New York owning real estate in this state, and not for the *benefit of real estate* located without the state." *Harris v. Metropolitan Cas. Ins. Co.*, 282 N.Y.S. 449 (1935) (emphasis added)), see Note, 36 COLUM. L. REV. 487 (1936).

¹⁴¹ See Currie, *The Constitution and the Choice of Law*, 26 U. CHI. L. REV. 9, 28-30 (1958).

dents based on the Equal Protection Clause, and (3) are not necessary in order to withstand attacks by nonresidents based on the Privileges and Immunities Clause of Article IV or the Equal Protection Clause. It is true that a forthright statement of the interest of the state in protecting its own purchasers would bring to light questions of discrimination long obscured by the pietism of conflict-of-laws law, and they are not simple problems; but they ought to be brought to light and resolved, not swept under the rug by formulas which compromise state policy.

Before amplifying these comments, we may note briefly how other states have applied similar statutes abolishing the deficiency judgment under purchase-money mortgages in cases involving foreign elements.¹⁴²

In *McGirt v. Brewer*,¹⁴³ the Oregon court was called upon to determine the applicability of the Oregon statute in a situation of exactly the type presented by *Bullington v. Angel*: i.e., the land was located in Montana; the contract was made and to be performed in Montana; the vendor (presumably) was a resident of Montana;¹⁴⁴ and the purchasers were residents of Oregon. After foreclosure in Montana by judicial sale, the vendor sued in Oregon for the deficiency. The trial court denied relief on the basis of the Oregon statute, and the Supreme Court reversed. The opinion is a rambling affair. After quoting the statement of the statute's purpose from its earlier decision in *Wright v. Wimberly*,¹⁴⁵ the court discussed local public policy, the rule that the law of the place of contracting governs questions of validity, interpretation, and construction, the rule that the law of the forum governs the remedy, and the principles of comity; then, suddenly, it announced that, while each side had adduced valuable authority in support of its

¹⁴² We shall not include cases on anti-deficiency judgment legislation generally. Although such "debtor relief" legislation was also for the protection and benefit of mortgagors, its different purpose (to insure that the fair value of the security was credited against the obligation) and the fact that it was applicable to mortgages in force when it was enacted would require a different analysis. See *infra* note 164. Cf. Comment, 13 U. CHI. L. REV. 195, 197 n. 7 (1946). See also Comment, *The Extraterritorial Effect of Mortgage Moratoria*, 40 COLUM. L. REV. 867 (1940); Bailey & Rice, *The Extraterritorial Effect of the New York Mortgage Moratorium*, 20 CORNELL L.Q. 315 (1935); Note, 38 COLUM. L. REV. 1049 (1938); Note, 36 COLUM. L. REV. 487 (1936); Comment, 25 CALIF. L. REV. 576 (1937); Note, 50 MICH. L. REV. 1097 (1952).

¹⁴³ 132 Ore. 422, 280 Pac. 508 (1929), reversal upheld on rehearing, 132 Ore. 432, 285 Pac. 208 (1930).

¹⁴⁴ If, instead, he was a resident of Oregon, the result reached by the court is even more incongruous. See the discussion below.

¹⁴⁵ 94 Ore. 1, 184 Pac. 740 (1919). See note 52 *supra*.

position, there was no confusion or uncertainty about the issue in the case, quoting a passage from *Corpus Juris*¹⁴⁶ to the effect that "statutes of this nature do not apply where the mortgaged premises are situate in another state." Of course, the quotation was not in point, the Oregon statute being unique at the time; the quotation referred to statutes of the type which provide that an action to foreclose shall be the only remedy upon a debt secured by mortgage. On rehearing, the court further discussed such matters as the *lex fori* and the *lex loci contractus*—"a branch of the law about which there is much contrariety of opinion."¹⁴⁷ Comity and public policy were also revisited. In the end, the court adhered to its former opinion, holding the statute inapplicable where the contract is made and the land is located in another state.¹⁴⁸

It may be said that this law *in a way* operates to protect against purchases of land which have proved improvident, in that they are thereby relieved in many instances from contracts and obligations otherwise enforceable. . . . However, the sister state of Montana has not such a law. The respondents were liable upon their contracts for the amount thereof, without any such modifying features. And, as we have seen, the parties made their contract in the state of Montana, with reference to lands situate in said state, and such obligations are controlled in their enforcement and application by the laws of the state where executed.

The only possible defense of such a holding is that, while the Oregon policy is to protect local debtors, the policy is not so strong that Oregon should assert an interest in its application in the case where the purchaser contracts in another state for land in another state.¹⁴⁹ This is a perfectly legitimate and often laudable way to avoid conflict between state policies.¹⁵⁰ Its wisdom in this situation, however, is doubtful. The policy of the statute was sufficiently strong to lead the court to hold that the defense was available against a transferee of the notes without notice that they were secured by purchase-money mortgages;¹⁵¹ and,

¹⁴⁶ 41 C.J. § 646b.

¹⁴⁷ 132 Ore. at 437, 285 Pac. at 210.

¹⁴⁸ 132 Ore. at 447-48, 285 Pac. at 214. (Emphasis added.)

¹⁴⁹ The court made a telling point concerning the weakness of the policy by citing its earlier holding in *Page v. Ford*, 65 Ore. 450, 131 Pac. 1013 (1913), that the vendor was not denied the right to sue on the obligation. Thus, while we have treated this circumstance as an oversight on the part of the legislature, the court took it as ground for doubting the force of the policy.

¹⁵⁰ Cf. Currie, *The Silver Oar and All That: A Study of the Romero Case*, 27 U. CHI. L. REV. 1 (1959); Currie, *Married Women's Contracts: A Study in Conflict-of-Laws Method*, 25 U. CHI. L. REV. 227, 240-41 (1958).

¹⁵¹ *Wright v. Wimberly*, 79 Ore. 626, 156 Pac. 257 (1916).

while the court quoted with apparent approval a statement that "The act of the parties in entering into a contract at a particular place, in the absence of anything shown to the contrary, sufficiently indicates their intention to contract with reference to the laws of that place . . . ,"¹⁵² it would presumably not permit the purchaser in a domestic transaction to waive the protection of the statute.¹⁵³ The statute so construed creates a discrimination against local purchasers who contract in another state as compared with those who contract locally with reference to local real estate. We do not suggest that this is a denial of equal protection of the laws; the legislature may make reasonable classifications, and this one may be regarded as reasonable on the ground that by not protecting the local resident who contracts elsewhere the legislature avoided conflict with the policy of a sister state. We do suggest that local vendors, on discovering that foreign vendors are thus favored by local law, might justifiably descend upon the legislature and demand either that the law be repealed or that foreign vendors be subjected to its restrictions.

In spite of these observations, it may be that the decision should be regarded as a holding that the legislature did not intend the statute to apply to mixed cases such as that before the court—*i.e.*, that Oregon claimed no interest in the application of its policy in such a situation. Alternatively, the court may simply have been bemused by the mysticism of conflict of laws, finding that the law of the place of contracting (or of the situs) was "applicable" according to some higher law, and treating questions of policy as irrelevant except in so far as some extraordinary aspect of the contract, rendering its enforcement "pernicious and detestable,"¹⁵⁴ might disturb the normal applicability of the foreign law. There is ample basis in the opinion for this interpretation. If it is correct, the decision plainly subordinated the interest of Oregon in protecting purchasers to the interest of Montana in securing to vendors the benefit of the bargain. A third interpretation of the decision, and the one that probably comes closest to the truth (they are not mutually exclusive), is that the court was contemplating a rule for the application of the statute to mixed cases which would approximate by indirection the legislative purpose to protect local purchasers. Despite the empha-

¹⁵² 132 Ore. at 438, 285 Pac. at 210, quoting 13 C.J. 248.

¹⁵³ Agreements to waive the equity of redemption are void. See 2 JONES, *op. cit.* *supra* note 55, § 1326; Ray v. Patterson, 170 N.C. 226, 87 S.E. 212 (1915). Cf. Dennis v. Moses, 18 Wash. 537, 583 *et seq.* (1898) (dissenting opinion).

¹⁵⁴ 132 Ore. at 445, 285 Pac. at 213. Cf. Reconstruction Finance Corp. v. Mercury Realty Co., 97 F. Supp. 491 (D. Mich. 1951), Note, 50 MICH. L. REV. 1097 (1952).

sis on the law of the place of contracting, the case does not hold that that law governs except when it is also the law of the situs. The way was left open for a holding that the statute is applicable where the land is in Oregon, in which case the majority of Oregon purchasers would presumably be protected.

South Dakota, on the other hand, in a case having the same factual pattern, held that, notwithstanding the rule that the law of the place of contracting governs, enforcement of the personal obligation was contrary to the public policy declared by the statute. The purchasers were residents of South Dakota.

It is often said that a contract valid in the state where made and to be performed is valid everywhere. It does not follow, however, from the fact that a contract is valid where made and to be performed, that another state will enforce it by appropriate legal remedy. If the contract is contrary to the public policy of the forum, remedy will be denied. . . . By the Act of 1935, we think it clear that the legislature condemned as inimical to the public good the enforcement of a personal liability upon a purchase money note where such note is secured by a mortgage given upon the purchased real estate and by this Act the legislature closed the courts of this state to the enforcement of a personal liability upon the note. We believe this definitely fixed the policy of this state with respect to actions upon notes of the character described in the law. We notice the fact that the law was passed at a time when actions based upon purchase money notes, deficiency judgments and the like, were causing many citizens of this state great hardship and the drastic effect of such actions on our overall economy was apparent. . . . It follows that if a contract of the type declared odious by the statute is presented to the court in this state for enforcement, it will not here be enforced in contradiction to the declared policy of the law and it is immaterial where the contract was made or originated.¹⁵⁵

Thus, like North Carolina, South Dakota "closed its courts" to such actions; but the South Dakota court made it clear that not considerations of judicial administration, but concern for the welfare of South Dakota citizens dictated this closure as a matter of "public policy."

We have said that such efforts to approximate the legislative purpose to protect local purchasers weaken the case for the validity of the statute against attacks based on the Full Faith and Credit and Due Process clauses. When the United States Supreme Court decided *Angel v. Bullington*, it did not reach the question of the constitutionality

¹⁵⁵ *Federal Deposit Ins. Corp. v. Stensland*, 70 S.D. 103, 107, 15 N.W.2d 8, 10 (1944). The statute was also held to protect the guarantors of the note against liability.

of the North Carolina statute as applied, but treated it as *res judicata*.¹⁵⁶ What would have happened if Bullington had appealed directly from the decision of the North Carolina Supreme Court? That he could have done so is clear; the majority in *Angel v. Bullington*, without intimating any opinion as to the outcome, emphasized that there was a substantial question concerning the constitutionality of the statute as applied, and that the decision was reviewable as a matter of right.¹⁵⁷ Mr. Justice Reed, dissenting, agreed as to the availability of review by appeal and expressly reserved any opinion as to the outcome.¹⁵⁸ Mr. Justice Rutledge, also dissenting, thought that the chances of a successful appeal on the merits were so remote as to be hardly worthy of consideration.¹⁵⁹ If the North Carolina Supreme Court had said forthrightly that the policy of the statute was to protect purchase-money mortgagors, and that the state asserted an interest in applying that policy when the mortgagor was a resident of North Carolina, it is highly probable that the constitutionality of the statute would have been sustained.¹⁶⁰ Nothing in the Constitution requires a state to subordinate its policies and interests to the conflicting policies and interests of another.¹⁶¹ But the North Carolina Supreme Court said nothing about the policy embodied in the statute. It said only that the statute operated to close the doors of the North Carolina courts to such actions. No reasons relating to the administration of the courts were adduced, and none can be plausibly imagined. For all that appears, the closure was simply arbitrary. In such a case two courses are open to the Supreme Court. It may simply hold that, in the absence of any showing that the statute as applied has a reasonable basis in governmental policy, it is a denial of full faith and credit to the public acts and records of a sister state.¹⁶² On the other hand, out of deference to the authority of the state, it may undertake on its own motion to formulate the policy embodied in the statute and determine the circumstances in which the state might reasonably assert

¹⁵⁶ 330 U.S. 183 (1947).

¹⁵⁷ *Id.* at 188-89.

¹⁵⁸ *Id.* at 193, 201.

¹⁵⁹ *Id.* at 204, 205 n. 11, 207, 209.

¹⁶⁰ *Cf. Watson v. Employers Liability Assurance Corp.*, 348 U.S. 66 (1954). See Currie, *The Constitution and the Choice of Law*, 26 U. CHI. L. REV. 9 (1958). *Cf. Note*, 24 N.C.L. REV. 267 (1946).

¹⁶¹ *Alaska Packers Ass'n v. Industrial Acc. Comm'n*, 294 U.S. 532 (1935). We are here speaking, of course, in terms of recognition of the law of another state, not of recognition of sister-state judgments. The North Carolina court correctly enforced a Pennsylvania judgment for a deficiency without inquiring whether the price obtained on the sale was inadequate, *Federal Land Bank of Baltimore v. Garman*, 220 N.C. 585 (1942).

¹⁶² *Broderick v. Rosner*, 294 U.S. 629 (1935). See Currie, *The Constitution and the "Transitory" Cause of Action*, 73 HARV. L. REV. 36 (1959). See note 165 *infra*.

an interest in its application.¹⁶³ While the latter course is preferable, it imposes a difficult and burdensome task upon the Court, and the state court is hardly in position to complain if its decision is taken at face value and the statute treated as simply arbitrary.

Moreover, the statute as construed by the North Carolina court is a denial of full faith and credit as applied to certain fact situations. Suppose a case wholly domestic to Virginia except that the action is brought in North Carolina: both parties are residents of Virginia at the time of the transaction, the land is located there, and the contract is made and to be performed there. The purchaser later moves to North Carolina, where, after foreclosure, he is sued for the deficiency. According to the decision, the action would be dismissed for lack of jurisdiction. But North Carolina has no policy relating to court administration which would justify the dismissal on procedural or jurisdictional grounds, and has no legitimate interest in the application of its policy for the protection of purchasers where the purchaser had no connection with the state at the time of the transaction.¹⁶⁴ The policy of Virginia,

¹⁶³ Cf. Frankfurter, J., dissenting in *Hughes v. Fetter*, 341 U.S. 609, 618-19 (1951).

¹⁶⁴ An argument may be made that North Carolina has an interest in the application of its protective policy, since the purchaser is a resident of the state at the time of the action. No doubt the result that would be produced if that argument were accepted is frequently reached by a court's invocation of "local public policy" or its application of some "procedural" law of the forum. Cf. Currie, *Married Women's Contracts: A Study in Conflict-of-Laws Method*, 25 U. CHI. L. REV. 227, 230 n. 12, 257 n. 55 (1958). In some situations, there is justification for the result, as where there is independent justification for the application of the "public policy" or the rule of procedure, or where the state may reasonably alter pre-existing legal relations in its exercise of the police power. The alteration of pre-existing relations, however, is a delicate matter, and an interest in applying domestic law for the protection of one who entered into a relationship under circumstances such that the state had no interest in regulating it should not be lightly asserted. At this point, the principles determining whether a domestic law should be applied to a foreign situation should be assimilated to those that determine whether the same law should be applied to prior transactions. The effect of an unwarranted application of the law is the same in either case: there is an impairment of the obligation of contract. If the anti-deficiency judgment statute had been intended by the legislature to apply to pre-existing mortgages, and if such an application would not be an unconstitutional impairment of the obligation of contracts, cf. *Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*, 300 U.S. 124 (1937), then it could be applied in the hypothetical case in the text; not otherwise. Thus, the "debtor relief" statute designed to insure that the fair value of the security was credited against the debt, N.C. Laws ch. 275 (1933), validly applicable to pre-existing mortgages, might reasonably be held applicable to a wholly foreign transaction where the mortgagor has become a resident of North Carolina, its purpose being to modify pre-existing legal relations in the interest of the protection of local residents and the economy of the state. We need not assert that retrospective application of the deficiency judgment statute would be an impairment of the obligation of contracts. It is enough that the

on the other hand, is to give the parties freedom of contract and to protect the vendor's right to enforce the covenant to pay the agreed price;¹⁶⁵ and certainly Virginia has an interest in the application of this policy in the circumstances. When no interest of the forum state would be infringed by entertaining an action based on the law of a sister state and applying the foreign law, the Full Faith and Credit Clause requires that the action be entertained and the foreign law applied.¹⁶⁶

We have said that attempts to approximate the legislative purpose by indirection are increasingly likely to expose the statute to attacks by residents based on the Equal Protection Clause. This may be illustrated if we assume that the statute is construed as applying to all transactions involving domestic land, and only to such transactions.¹⁶⁷ On that assumption, suppose that two citizens of North Carolina contract for the sale of land in Virginia. The purchaser would be denied the protection of the statute. Is there a reasonable basis for thus treating him differently from his neighbors? Perhaps, in the present state of the law, it would be said that there is; the magic of "situs" as regulating the incidence of law has not been dissipated. Yet in the case supposed, the location of the land is quite irrelevant to the policy involved, which is for the protection of purchasers. North Carolina would be yielding its policy and interest although there is no conflicting Virginia interest. The denial to the purchaser of a protection afforded other local purchasers is quite arbitrary; the classification is unreasonable; and the purchaser has been denied the equal protection of the laws. Some day this may come to be recognized. Already the Supreme Court has held unconstitutional two state statutes which denied the administrator of a resident the right to sue another resident in the courts of the state for wrongful death solely because the injury and death occurred in another

legislature expressly gave it prospective operation only, thus declaring its intention not to affect pre-existing obligations, and not to protect all residents of the state irrespective of when—and where—the obligation was contracted. *Cf. Aetna Life Ins. Co. v. Dunken*, 266 U.S. 389 (1924), discussed in Currie, *The Constitution and the Choice of Law*, 26 U. CHI. L. REV. 9, 41 (1958).

¹⁶⁵ The right to a deficiency judgment in Virginia may be regarded as statutory, VA. CODE ANN. § 55-59(1), (5) (1950), if that fact is thought essential to the applicability of the Full Faith and Credit Clause. *Cf. Currie, The Constitution and the Choice of Law*, 26 U. CHI. L. REV. 9, 15 (1958).

¹⁶⁶ See note 162 *supra*. See also Nadelmann, *Full Faith and Credit to Judgments and Public Acts*, 56 MICH. L. REV. 33 (1957).

¹⁶⁷ See note 140 *supra*.

state.¹⁶⁸ While the result was attributed to the Full Faith and Credit Clause, the better explanation for it seems to be that the discrimination against residents killed outside the state was arbitrary and was a denial of the equal protection of the laws.¹⁶⁹

The same argument cannot be made against the North Carolina expedient of holding the statute jurisdictional, since under that construction, all residents (and, for that matter, nonresidents) are treated alike by the North Carolina courts. It may be observed, however, that the statute so construed poorly serves the legislative purpose to protect local purchasers. If a North Carolina resident in the situation of Dr. Angel were to be served with process while in Virginia, the Virginia court would probably hold him liable under Virginia law in any event; but the North Carolina court has lent encouragement to such a result by its declaration that the statute does not affect substantive rights, but only the remedy. Presumably the right to the deficiency is still created by North Carolina law; only the remedy has been abolished. The Virginia court might be warranted in saying that in such a situation there is no conflict of laws at all, the laws of the two states being in agreement. The North Carolina court has certainly not asserted any interest on the part of that state in protecting its residents sued elsewhere. The concept of a right without a remedy is not meaningless when a remedy is available in another state.

The inadequacy of the protection afforded by the statute, so construed, is aggravated by the effect of the procedural interpretation upon the operation of the judgment as *res judicata*. A judgment dismissing for lack of jurisdiction is not a judgment "on the merits"¹⁷⁰ such as

¹⁶⁸ *Hughes v. Fetter*, 341 U.S. 609 (1951); *First National Bank of Chicago v. United Air Lines*, 342 U.S. 396 (1952).

¹⁶⁹ See Currie, *The Constitution and the "Transitory" Cause of Action*, 73 HARV. L. REV. 36 (1959).

¹⁷⁰ RESTATEMENT, JUDGMENTS § 49 (1942). We would be better off without this troublesome phrase. The United States Supreme Court held that the judgment of the North Carolina Supreme Court in *Bullington v. Angel* was one "on the merits," in the sense that it precluded the second action in a federal court in *North Carolina* and precluded also relitigation of the constitutionality of the statute. *Angel v. Bullington*, 330 U.S. 183 (1947). The second action was precluded because "For purposes of diversity jurisdiction a federal court is, 'in effect, only another court of the State.'" *Id.* at 187. This and similar problems would be clarified if, instead of discussing whether a judgment is or is not "on the merits," we simply inquired: What did the judgment determine? The judgment in *Bullington v. Angel* determined (1) that the statute deprived all North Carolina state courts of jurisdiction to entertain such actions, and (2) that the statute was constitutional as applied to the case before the court. Because of the *Erie* doctrine, the first of these determinations precluded a second action in a North Carolina federal court, if it was constitutional; and the question of constitutionality was *res judicata*.

will bar a subsequent suit on the same cause of action in another state. If Bullington, after losing in the North Carolina courts, had, instead of resorting to a North Carolina federal court, sued Angel in Virginia, either in a state or a federal court, the judgment in the North Carolina action could not have been pleaded successfully in bar. Indeed, even today, after adverse judgments in both the state and federal courts of North Carolina, Bullington can probably recover if the Virginia limitation period has not expired, or if the statute has been tolled by Angel's absence from the state, provided process can be served in Virginia. The situation would be quite different if the North Carolina court had simply said that the statute was designed to protect North Carolina purchasers, and was applicable to the case at bar. That would have been a judgment "on the merits" precluding another action anywhere; that is, it would have adjudicated that the North Carolina statute was applicable, and that under that statute there was no liability.

We have said that attempts to approximate the legislative purpose by indirection are not necessary in order to guard the statute against attacks by nonresidents based on the Privileges and Immunities and Equal Protection clauses. In order to effectuate the legislative purpose, it is not necessary for the court to assert that the statute will be applied only for the protection of North Carolina purchasers, and for no others. The legislature, we may assume, is quite content to have the protection of the statute afforded to any person who, under the Constitution, is entitled to equal treatment with citizens of North Carolina. Thus, resident aliens would clearly be entitled to the benefit of the statute by virtue of the Equal Protection Clause.¹⁷¹ A full inquiry into the extent to which the protection of the statute must be afforded to persons other than those for whose benefit it was primarily intended would be beyond the scope of this paper.¹⁷² It is very clear, however, that nothing in the Constitution requires a state to apply its laws and its notions of policy indiscriminately to the people of other states; on the contrary, any such evangelical impartiality may be simply officious intermeddling, amounting to a denial of due process of law. Thus, when Missouri applied its statute providing against forfeiture of life insurance policies to a contract which, though made within the state, was made between a non-resident and a foreign corporation, altruistically proclaiming the purpose of the legislature to extend its protective policy to "all persons

¹⁷¹ Cf. *Truax v. Raich*, 239 U.S. 33 (1915); *Takahashi v. Fish & Game Comm'n*, 334 U.S. 410 (1948).

¹⁷² Such an inquiry has been undertaken by the senior author in collaboration with Herma Hill Schreter, J.D. 1959, The University of Chicago Law School.

whether citizens, inhabitants, transients, visitors or sojourners,"¹⁷³ the Supreme Court unanimously reversed on the basis of the Due Process Clause.¹⁷⁴ The difficult question concerns the case in which the vendor is a resident of North Carolina and the purchaser is a nonresident. The purchaser's home state may or may not provide similar protection. Whether, in either or both of these cases, he can successfully assert a right to the same protection which the statute affords to resident purchasers is a question we shall not attempt to answer here. For present purposes, it is enough to state that the existence of this problem should not deter the courts from construing such statutes in such a way as to effectuate fully the legislative purpose to protect local purchasers. If others are constitutionally entitled to the same protection, the courts can afford it cheerfully and directly. Indirection and approximation, prompted by conflict-of-laws dogma and by fears of unconstitutional discrimination, should be abandoned as instruments for effectuating legislative policy.

VII

CONCLUSION

We have endeavored in these pages to consider what is known as a problem in the conflict of laws. The branch of the law which purports to provide solutions for such problems has provided no help. Since the problem is one concerning mortgages, we have turned to the law of mortgages, in which we do not claim expertise, and have sought such enlightenment as is available in works on real estate practice. Experts in mortgage law and real estate finance could have done the job better. The problem turns out to be one of mortgage law and constitutional law. We hope we have demonstrated that this is so, and that it is vain to expect to find, in an oversimplified and mystical specialty, solutions to all the problems that may arise concerning the application of domestic law, in any of its manifold branches, to cases having foreign aspects. We hope also that we have demonstrated that the practicing lawyer's best hope of predicting the decision of a court concerning such application of domestic law, and of persuading the court to reach the desired result, is to ascertain and make clear the policy of the domestic law and the extent of the state's interest in applying that policy.

¹⁷³ *Head v. New York Life Ins. Co.*, 241 Mo. 403, 416, 147 S.W. 827, 831 (1912).

¹⁷⁴ *New York Life Ins. Co. v. Head*, 234 U.S. 149 (1914). *New York Life Ins. Co. v. Cravens*, 178 U.S. 389 (1900), upholding the application of the statute in a mixed case, was distinguished on the ground that there the insurance was on the life of a citizen of Missouri. See Currie, *The Constitution and the Choice of Law*, 26 U. CHI. L. REV. 9, 38 (1958).