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NOTES

REDEMPTION FROM JUDICIAL SALES: A STUDY OF THE ILLINOIS STATUTE

The bar is said to regard statutory schemes of redemption from judicial sales as a baffling complex of pitfalls. Perhaps it is not, then, surprising that so important an institution has received little critical attention in secondary legal literature.[1] Since a consideration of the variations between the legislation of various states would unduly complicate the analysis, the present discussion will confine itself to an examination of the Illinois statute. Such a limiting of

[1] Becker and Harbert, Redemptions from Judicial Sales under the Laws of Illinois, Chicago-Kent Rev., May 1929, reprinted in Chicago-Kent Rev. extra volume, 124 (1931); Durfee and Doddridge, Redemption from Foreclosure Sale—The Uniform Mortgage Act, 23 Mich. L. Rev. 825 (1925); Harbert, Recent Problems Concerning Redemption from Judicial Sales by Judgment Creditors, 3 John Marshall L.Q. 335 (1938); Carey and Brabner-Smith, Studies in Foreclosures in Cook County II, 27 Ill. L. Rev. 595 (1933); 2 Reeve, Illinois Law of Mortgages and Foreclosures, c. 35 (1932).

scope has perhaps an additional utility because proposals to reform the Illinois law are again current.[2]

Since the way of reform of mortgage law has traditionally been to add to the then existing law rather than to attempt a fresh start, it is advisable, in order to understand the present scheme, to repeat briefly some mortgage history.[3] In America foreclosure by sale was substituted at an early date for "strict" foreclosures. It is not clear whether the impetus to such a change came primarily from the mortgagor who sought a possible surplus over the mortgage debt or from the mortgagee who sought a deficiency.[4] But in any event it was hoped that by enabling the competitive market to set the value of the land the imprecise operation of strict foreclosure could be avoided.

It soon became clear that this hope was invariably to be disappointed because the presence of the mortgagee at the sale invariably eliminated any competition. In order that he might protect himself against an outsider's getting the land too cheaply the mortgagee was allowed to bid at the sale. Since it was his sale and since the purchase money would go to pay off his debt, to avoid circuity he was allowed to bid by offering to cancel his debt *pro tanto*. The mortgagee[5] thus had a distinct advantage. He did not have to raise cash to bid and, what is more important, although he was bidding a depreciated debt he was treated for purposes of competition as though he were bidding cash.[6] It might be noted that the mortgagee enjoyed no such advantage if the land were worth more than the debt because the debt on hypothesis was worth the face value and hence the mortgagee could not bid more than the land was worth by using depreciated money. But even in such a case the mortgagee would not have to raise as much ready cash as an outsider. The result was that outsiders rarely came to sales in any case; and the mortgagee, as the sole bidder, was in a position to arbitrarily set the figure at which he would take the land on his debt. And the only check was the danger of a failure of confirmation by the court if the bid were nominal.[7]

[2] Rothschild, The Proposed Illinois Mortgage Act, Annual Report of the Illinois State Bar Association, 1937, 138.

[3] Hanna, Cases and Other Materials on Security 499–508 (1932).

[4] Tefft, The Myth of Strict Foreclosure, 4 Univ. Chi. L. Rev. 575 (1937).

[5] The same position is occupied by a judgment creditor at his execution sale. Most of what is said of the mortagee is equally applicable to the judgment creditor.

[6] For example, if the debt were $1,000 and the land worth $500 and the debtor without assets, the $1,000 debt would be worth only fifty cents on the dollar. To compete with a bid of $600 by the mortgagee an outsider would have to pay $600 in cash which on hypothesis is more than the land is worth whereas the mortgagee was surrendering only $300 of present value.

Compare Helvering v. Midland Mut. Life Ins. Co., 300 U.S. 216 (1937); noted 5 Univ. Chi. L. Rev. 677 (1937) where, on the question of the income tax of the mortgagee, the Supreme Court refused to recognize that the dollars bid by the mortgagee were depreciated.

[7] Ballantyne v. Smith, 205 U.S. 285 (1907).

The situation could have been remedied by denying to the mortgagee the power to bid at the sale.[8] But instead a statutory redemption period was added after the sale as a way of forcing the mortgagee to bid the value of the land,[9] despite the absence of competition. The mortgagor and certain others were given the right to redeem during a specified period after the sale, not by paying off the mortgage, but by paying the mortgagee *what he had bid at the initial sale*. Although this is, as will be seen shortly, an oversimplified version of the statute, it is clear that the mortgagee by making a low bid ran the risk of being forced to surrender the property for less than he thought it was worth; consequently, if informed, he would, it was felt, bid what he thought was the value.

This brief summary is sufficient to call attention to two striking characteristics of the legislation. First, the statute, if successful, was intended to operate only as a threat.[10] It was not desired that redemption actually take place but that the mortgagee bid adequately at the first sale. In fact, if redemption did actually occur in a given case, it was a sign that the statute had failed to work. Second, the success of the statute depended on a precise knowledge of the law by all parties concerned and on the mortgagee predicting what others would do if he made a given bid. It is well to keep this point in mind in estimating the complexity of the statute as it now stands.

Our concern is primarily with sections 18 and 20 of the Illinois statute on judgments, decrees and executions.[11]

Section 18 provides for redemption by "any defendant, his assigns or any person interested in the premises, through or under the defendant." Such redemption must occur within twelve months after the sale. If no redemption is made within twelve months, section 20 provides for redemption by a judgment or decree creditor within fifteen months after the sale. Where there are several judgment or decree creditors, section 24 provides for preferences to redeem based on the seniority of the judgments. Sections 21, 22 and 23 are also relevant. Section 21 deals with the situation in which only the redemption money is bid; section 22 with when more than the redemption money is bid; section 23 with the further redemption period that then results.

This discussion will first consider redemption within the twelve to fifteen month period and then redemption within the twelve month period, first by creditors and then by the debtor. It will be convenient to refer subsequently

[8] This is the English solution. Law of Property Act (1925), 15 Geo. V, c. 20 § 91 (2). See Tefft, *op. cit. supra* note 4, at 580 n. 28.

[9] On the history of statutory redemption see Durfee and Doddridge, *op. cit. supra* note 1, at 825–842.

[10] It is true that the statute has at least one other purpose—to give the debtor additional time to enjoy the property. But most mortgages now contain pledges of rents and profits; and even in the absence of a pledge, a receiver may be appointed. See Tefft, *op cit. supra* note 4, at 591. It is sometimes said that the statute is designed to give other creditors an opportunity to get their debts paid from the property. *Cf.* note 15 *infra*.

[11] Ill. Rev. Stat., 1937, c. 77 §§ 18–24.

to the twelve-fifteen month period as the secondary redemption period and to the twelve month period as the primary redemption period. After considering the adequacy of the threat provided by creditor and debtor redemption, the discussion will take up the position of the post-foreclosure grantee of the mortgagor who does not assume the mortgage debt. It will then shift to the operation of the statute in cases of bond issue foreclosures.

I

At first reading secondary redemption would seem to be the main threat to the mortgagee contemplated by the statute. The procedure for redemption, although in form an execution sale, really has no common law parallel. The redeeming creditor deposits with the sheriff the amount bid at the foreclosure sale together with a writ of execution which the sheriff levies on the property. The sheriff thereupon advertises the property for sale; the redemption money deposited is considered a bid of that amount by the redeeming creditor;[12] if no higher bid is made, a deed is executed to the redeeming creditor conveying the interest that the original purchaser would have taken had there been no redemption, and this is the final disposition of the property under the statute.[13] But if a higher bid is made, either by the redeeming creditor or by anyone else, only a certificate of purchase is given the successful bidder; the excess is paid to the creditor who redeems and his debt is *pro tanto* discharged. Judgment creditors are then given an additional sixty day period to redeem. If no such redemption occurs, the holder of the certificate of purchase will be given a deed; and again there is a final disposition of the property.[14] If redemption does occur, the same procedure is repeated.

It is to be noted that the significant thing about this procedure is that it gives the dominant position occupied by the mortgagee at the original sale to the redeeming creditor. If there is no bid over the redemption price, he gets the mortgagee's bargain free and clear and yet retains his judgment;[15] perhaps what is more important, he leaves the debtor subject to the same number and amount of debts. To give the redeeming creditor the same advantage that the mortgagee had is explainable only in light of the purpose of the redemption statute to avoid actual redemption.

The only check on the redeeming creditor is that the use of the device of a public sale creates the possibility of a higher bid by an outsider or other creditors. Since the redeeming creditor can bid his debt, the same disadvantages are present as in the case of the original foreclosure sale. *Prima facie* it would seem that there is no more reason for competitive bids here than at the former sale. But a "competitive" bid here serves an entirely different function. If no bid is made title vests with finality in the redeeming creditor. The purpose of a sub-

[12] § 20. [13] § 21. [14] §§ 22, 23.

[15] His position is even stronger than that of the mortgagee at the sale; he has an incentive not to bid any more than the amount of the redemption money until an outside bid is made.

sequent bid is to force the redeeming creditor *either* to bid the amount of his debt (or at least the value of the land) *or* to leave the land open to further redemption at a slightly stepped-up bargain price. If he does the former, his debt in *pro tanto* discharged by his own bid, thus increasing the share of the remaining creditors in the unmortgaged assets of the debtor. And an informed creditor will not risk doing the latter. In either event, the possibility of further redemption then exists and the procedure indicated would be repeated.

In so far as the statute is designed to provide a check on the redeeming creditor, it is too complicated to work. Further even if creditors should understand the re-redemption process, they have a decreasing incentive to redeem as the process continues because each new redemption is from a higher bid. But at this point it must be remembered that the statute fails in its purpose if redemption from the mortgagee actually takes place. Hence the statute depends not on the threat of the other creditors to the redeeming creditor but on the threat of the redeeming creditor to the foreclosing mortgagee. The effectiveness of this threat will be evaluated subsequently.[16]

It will be recalled that the redeeming creditor occupies a highly desirable position. Consequently, the statute provides that creditors have preferences to redeem in the order of their judgments or decrees.[17] There are two unusual features of this priority scheme as it now stands. First, junior mortgagees, since priorities are based on the order of judgments or decrees rather than liens, are entitled to redeem within the secondary period only if they have obtained a decree.[18] This seems curiously unfair although the unfairness is somewhat academic since if the statute works no redemption takes place. Second and more important, is the effect of *Crowder v. Scott State's Bank.*[19] There, two creditors reduced their claims to judgment within five days of each other. The first creditor levied execution on his lien, and bid in at the sale at a nominal figure. No redemption was made within twelve months, and on the first day of the secondary period both creditors attempted to redeem. The court held that the creditor who had foreclosed had the prior right to redeem because of the priority of his original judgment. This decision, in a large class of cases, has a disastrous effect on the policy of the statute. Wherever the lien foreclosed is a judgment lien, as contrasted with a mortgage, the threat of redemption to the foreclosing creditor is negligible since he has the first right to redeem. In brief his dominance during the redemption period is as great as it was during the initial foreclosure sale. However, the *Crowder* case would not apply to the case of a mortgage, since the mortgagee does not become a judgment creditor until the deficiency decree is entered and hence the deficiency decree is not prior to existing judgments.

[16] See Part III *infra*.

[17] § 24.

[18] Whitehead v. Hall, 148 Ill. 253, 35 N.E. 871 (1893); Heinroth v. Frost, 250 Ill. 102, 95 N.E. 65 (1911); 2 Reeve, *op. cit. supra* note 1, at 833.

[19] 365 Ill. 88, 5 N.E. (2d) 387 (1936).

II

Secondary redemption is, as we have just seen, reserved exclusively for judgment or decree creditors. It is not at once apparent that creditors were also intended to have a right to redeem within the primary period. It might seem that the phrase "any defendant . . . . or any person interested in the premises, through or under the defendant," was intended to be limited to the debtor or his successor and to persons claiming through or under the defendant who could not redeem after the twelve month period.

But the statute has been construed to give judgment creditors joined as defendants an opportunity to redeem within the primary period.[20] Joinder is normal because the liens of judgment creditors who are joined as defendants are not enforceable against the purchasers;[21] joinder is desirable to the mortgagee whether he intends to buy in, or whether he intends to attract outsiders to the sale. The interpretation of *any defendant* to include judgment lienors who are joined seems unfortunate since such lienors are specifically provided for in the twelve-to-fifteen month section. This conclusion is reinforced by the further wording in the twelve month section that persons interested through or under *the defendant* may redeem. This seems to indicate that the phrase "any defendant" as used earlier in the section refers to the mortgagor or his successor, and not to any other person who may happen to have been joined. Such an interpretation of the statute need not have prevented junior mortgagees joined as defendants from redeeming within the twelve months since they are not specifically provided for elsewhere in the statute.

The striking characteristic of redemption within the primary period as contrasted with that within the secondary period is that the redeeming creditor is treated as redeeming for the debtor. Title revests in the debtor[22] and the liens of the outstanding judgment creditors attach precisely as they would to after-acquired property of the debtor.[23] An example will be useful here. The debtor's

[20] Easter v. Holcomb, 221 Ill. App. 485, 490 (1921); Harbert, *op. cit supra* note 1, at 336. It is to be noted that Mr. Harbert suggests that lien creditors, even though not joined as defendants, may redeem within the primary period. This must depend upon the theory that creditors who have obtained their liens by force of the judgment statute are parties "interested in the premises, through or under the defendant." The cases cited are of doubtful authority on this point.

[21] Heinroth v. Frost, 250 Ill. 102, 95 N.E. 65 (1911). See Hack v. Snow, 338 Ill. 28, 169 N.E. 819 (1930).

[22] The statute says simply that the sale becomes null and void. Nothing short of an involved discussion could describe the interests of the debtor and the purchaser before and after redemption. All that is meant here is that after redemption the land *again* becomes reachable by creditors. This is so strikingly similar to the debtor's acquiring property that it is convenient to talk in terms of after-acquired property.

[23] No Illinois case as to priorities of judgment liens on after-acquired property has been found. It is believed that under the wording of the Illinois statute judgments become liens upon after-acquired property with priority and not as simultaneous liens. *Cf.* Hulbert v. Hulbert 216 N.Y. 430, 111 N.E. 70 (1916). Even if the Hulbert case is followed, the present situation can be distinguished since here the original priority, which is to be restored, was based originally on diligence.

property worth $10,000 is subject to A's first mortgage of $10,000 and B's judgment lien of $10,000. A forecloses, serving B as a defendant, and buys in for $2,000 at the sale. If B redeems within twelve months he pays A $2,000 and acquires a first lien for $2,000.[24] In addition he still has a judgment for $10,000 which is prior in time to A's deficiency of $8,000 and these two judgments attach to the debtor's "newly acquired" property in their temporal order. In the case where B is a second mortgagee the result is exactly the same although the rationale is less clear.[25]

The result is that B now has a $12,000 first lien and A an $8,000 second line. Had B not redeemed he would have had merely a $10,000 judgment to be satisfied out of whatever other assets the debtor had. Hence the advantage to the creditor of redeeming within twelve months *over not redeeming at all* is quite decided. But providing for redemption by creditors within twelve months adds nothing to the threat presented by allowing them to redeem within the secondary period. If the creditor had redeemed within the primary period in the above example he could then have realized on his $12,000 lien only by foreclosing and subjecting himself to a fifteen months redemption period. And since he is a judgment creditor he can under the *Crowder* case[26] redeem from himself twelve months after his foreclosure sale.[27] There is little difference between his doing this and his redeeming from the original sale within the secondary period. If anything primary redemption adds additional steps with attendant increases in time, expense, and possibility of error. Consequently, the creditor will normally redeem within the secondary period. Since the only result of permitting creditor redemption within the primary period is to add a functionless complexity to an already complicated statute, the much preferable construction is that suggested above, denying this right.

No problem of comparable difficulty is presented by the case of debtor redemption. He can only redeem within the twelve month period[28] and the

[24] Ogle v. Koerner, 140 Ill. 170, 29 N.E. 563 (1892); Ill. Nat'l Bank v. Trustees of Schools, 211 Ill. 50, 71 N.E. 1070 (1904).

[25] To treat the second mortgage exactly like a judgment lienor seems to be the soundest view and is the one adopted by the commentators. Becker and Harbert, *op. cit. supra* note 1, at 134–137. The matter is complicated, however, by the tendency of the Illinois courts to treat the second mortgagee as an assignee of the debtor and to speak of him as taking free of the deficiency. Ogle v. Koerner, 140 Ill. 170, 29 N.E. 563 (1892); Seligman v. Laubheimer, 58 Ill. 124 (1871). But even if the second mortgagee is called an assignee, as a result perhaps of the title theory of the mortgage, the debtor still has an equity of redemption from the second mortgage and this interest in the property would be subject to the deficiency and other liens against the debtor. *Cf.* the position of the assignee of the mortgagor's entire interest discussed in part IV *infra*.

[26] See p. 629 and note 19 *supra*.

[27] This is not true of the second mortgagee since, under present law, he cannot redeem within the secondary period unless he is a decree creditor. See note 18 *supra*. Hence, he would have to redeem within the primary period; but the failure to provide for redemption by junior mortgagees within the secondary period has been criticized.

[28] § 18.

effect of his redeeming is quite obviously to revest title[29] in him. Consequently, the outstanding liens attach in their original order and the mortgagee's deficiency is demoted.[30]

III

So far we have seen that the possibility of redemption by either creditors or the debtor is the means provided by the statute to induce the mortgagee to bid the value of the land. But the mortgagee need never fear redemption by the debtor. First, it is highly unlikely that the debtor will have recouped financially during the year redemption period. Further even if he does have money he has only slight incentive to redeem. The only effect of his redemption is to pay off the first lien to the extent of the redemption money since the deficiency and the other liens re-attach. Where the debtor has the most incentive to redeem, namely, where the mortgagee is the only creditor and redemption will effect a desirable delay, the mortgagee has the least to fear since his deficiency is still a first lien. If there are other creditors so that redemption by the debtor would demote the deficiency lien, there is no likelihood of the debtor's redeeming since the property remains encumbered with the outstanding liens including the deficiency.

The failure of debtor redemption to provide an effective threat would seem to rest the success of the statute on creditor redemption. It is clear, then, that the statute must fail in the cases where there are no creditors other than the mortgagee. Further, where the foreclosing lienor has a judgment lien as distinguished from a mortgage, the *Crowder* case in giving him the first opportunity to redeem in the secondary period destroys the effectiveness of the statute since he presents no threat to himself. Under the same doctrine, there is no probability of redemption in the primary period since the senior lien is not demoted thereby. And in any case creditor redemption as a device has its weaknesses. Creditors are notoriously hesitant to put up money presently as a way of getting their debt paid in the future. Further, it is obvious that the threat to the mortgagee of the possible appeal of the land to the limited class of creditors at the *purchase price* is less than the threat of the appeal to the public at large. Even a grossly inadequate bid may appear to be the value of the land to the fixed and small group of creditors although it would be tempting to outsiders if they might be solicited by the ordinary technique of salesmanship.

IV

This does not complete the picture. Perhaps the most important person in the statutory scheme is the post-foreclosure assignee who does not assume the mortgage debt. The statute does provide for the assignee either as an "assign" of the defendant or as "a person interested, through or under the defendant."[31] Conceivably, however, the statute was intended to include only

[29] See note 22 *supra*. [30] Becker and Harbert, *op. cit. supra* note 1, at 130.

[31] Rubin v. Chicago Title and Trust Co., 249 Ill. App. 486, 490 (1928). See Lawn View Bldg. Corp. v. Winstock, 288 Ill. App. 320, 6 N.E. (2d) 276 (1937).

assignees as of the date of the foreclosure sale. But the significant thing is not in the court's sanctioning assignments after foreclosure but in their generous treatment of such an assignee. The assignee takes the property free and clear of all liens that are foreclosed and *provided for in the decree*, an important qualification to be discussed presently. Since his assignor, the debtor, would not take the property so unencumbered, the assignment in a sense gives the assignee greater rights than the assignor had. But if the mortgagee is the only creditor, the effect of redemption by the mortgagor is to revest title in the mortgagor subject to the lien of the deficiency decree. The debtor has simply re-acquired the property and still has a deficiency outstanding, which, as is normal, attaches to all realty that he acquires.[32] But in the case of the assignee redeeming, the assignee and not the debtor acquires the property; and the deficiency does not attach since it is not his debt.[33] The effect of the assignment is not only to transfer the debtor's power to redeem but to transfer the property interest giving rise to this power. The case of the post-foreclosure grantee is, in terms of mortgage theory, precisely the same as that of the pre-foreclosure grantee of the mortgagor who does not assume the debt.[34]

Where there are liens in addition to the mortgage a complicating factor is added by the procedures for dealing with the junior interests. If the junior lienors are not joined as parties, the foreclosure proceeding has no effect on their liens.[35] It is clear that the assignee would take subject to the liens. If the lienors are served with process and thereupon file a cross-bill to foreclose their own liens, their liens are provided for in the decree and like the mortgage disappear from the land; consequently, as we have already seen the assignee takes the land unencumbered. Finally, where the junior lienors do not want to foreclose their liens, but are brought into the foreclosure as defendants,[36] the liens are good against the assignee just as in the case where the lienors are not served at all. A seeming inconsistency arises because in this last case the liens are not good against a purchaser at the foreclosure sale. But unless the purchaser were given this protection, foreclosure would achieve nothing whenever lienors would be unwilling to foreclose.

V

Redemption by the assignee is potentially the most effective threat under the statute. The statute in order to work requires not merely the possibility but the probability that someone will redeem *unless* the mortgagee bids the value of the land. The more people who have a chance to redeem if the bid is

[32] § 18.

[33] Rubin v. Chicago Title and Trust Co., 249 Ill. App. 486 (1928); Barney v. Harnesberger, 148 Fed. 346 (C.C.A. 7th 1906).

[34] See generally on the problems attending a transfer of the mortgagor's interest, 4 Univ. Chi. L. Rev. 469 (1937).

[35] Strang v. Allen, 44 Ill. 428 (1867); Hodgen v. Guttery, 58 Ill. 431 (1871).

[36] Where the foreclosing lienor is a judgment creditor, there is no formal action preceding the sale to which other lienors may be made parties.

low, the more probable it is that someone will in fact redeem; and so the more probable it is that the mortgagee will initially bid what he thinks is the value of the land. It is clear that the assignee device has the advantage of offering redemption to the largest possible class of prospective redeemers. Further, creditor redemption has the disadvantage of not only restricting redemption to a limited class but also of restricting it to those who may be least interested in the property.

But under the present state of the law these advantages of the assignee device have not been fully realized. It has been pointed out that creditor redemption fails utterly where there are no creditors other than the mortgagee. It is clear that the assignee device adequately covers such a case. But where there are junior liens, the assignee, as we have noted, takes subject to them except where the lienors have filed cross-bills to foreclose. While it is true that creditor redemption[37] does not have this defect, nevertheless it does not work because of defects inherent in appealing to a limited class. Thus if the assignee were permitted to take free of all liens, the device would be superior to creditor redemption and would in all cases provide a clearly defined threat to the mortgagee. It would not be too unorthodox to free the property from liens of junior lienors who have been joined as defendants. It must be remembered that they are at present deprived of their liens as against the purchaser at the foreclosure sale. Much the same reason operates to justify the further limiting of the liens as suggested. It is ironic to note that in *Hack v. Snow* an Illinois appellate court did just that,[38] only to be reversed by the Supreme Court,[39] after criticism by commentators.[40]

One final observation is in order as to the effectiveness of assignee redemption. It is clear that the device depends upon the debtor having an incentive to assign. There is little incentive for the debtor to seek out an assignee unless the proceeds from the sale of his redemption right are exempt. To provide such an exemption here raises most sharply the criticism that the assignment device itself effects a fraudulent conveyance. If the debtor has given away his interest in the property, the transfer can be viewed simply as a gift by an insolvent. Correlatively, if the debtor has been paid for his interest, the transaction can be viewed as one in which cash is paid to a debtor who is anxious to change his assets into a form easily concealed from his creditors.[41] It can be objected that this is not a fraudulent conveyance because the debtor has only transferred property which the creditors could not reach—namely, his statutory redemption right. This perhaps requires a word of explanation. The right

[37] This refers only to redemption in the secondary period.

[38] 252 Ill. App. 51 (1929).

[39] 338 Ill. 28, 169 N.E. 819 (1930).

[40] Becker and Harbert, *op. cit. supra* note 1, at 132.

[41] Green v. Tantum, 19 N.J. Eq. 105 (1868); Glenn, The Law of Fraudulent Conveyances 406 (1931).

to redeem is a residual right of the debtor, remaining after property has been involuntarily sold. It is the personal right of the debtor against his creditors; and to permit them to reach it would be obviously inconsistent with granting it.[42] But it does not follow that property which cannot be reached by creditors cannot be fraudulently conveyed.[43] And finally it must be admitted that the assignment plus the redemption does put the property beyond the reach of the creditors.

But it is not enough that a transfer cuts off the rights of creditors to render it a fraudulent conveyance. The disadvantages of so cutting off creditors must be weighed against the possible advantages to the debtor and to the creditors themselves. It would seem that all the creditors have in fact lost are their statutory rights to redeem. These rights were given to the creditors to force the mortgagee to bid adequately at the foreclosure sale and thus increase the share of other creditors in the remaining assets of the debtor. But it is to achieve precisely this purpose more effectively by means of the assignee device that it is suggested that the rights of creditors to redeem be cut off from the time of redemption by the assignee. The statutory right to redeem was granted to creditors only to achieve a given end; if this same end can better be achieved by limiting these rights, there can be little objection.

It might be noted that the suggestion of Professor Durfee and Mr. Doddridge[44] that the judgment debtor be permitted to redeem free and clear of all liens goes even further than the scheme here proposed. There are, however, some disadvantages in treating the debtor so generously. First, there is the old difficulty of the debtor not having enough money to redeem unless he has concealed money from his creditors. It would be shocking to give him so excellent an opportunity to benefit from such tactics. It is true that an honest debtor could borrow the redemption money by giving a mortgage on the property "cleansed" through the foreclosure process. There are some striking parallels between this suggestion and the schemes proposed in our discussion. In both resort to an outsider either as lender or assignee is necessary. In both an exemption is given to the debtor—in the one case in the form of unencumbered property—in the other in the form of exempt proceeds. It is submitted, however, that there is greater unfairness to creditors in the Durfee-Doddridge proposal.

The exemption they would give is unusual since new creditors can reach the property while old and *unpaid* creditors cannot. This would actually induce creditors to avoid getting liens on the property once encumbered—a peculiar form of creditor relief. Nor could the discrimination between pre- and post-

[42] Hill v. Blackwelder, 113 Ill. 283 (1885); Commerce Vault Co. v. Barrett, 222 Ill. 169, 78 N.E. 47 (1906).

[43] The problem is raised in connection with the transfer of future interests not reachable presently. See 5 Univ. Chi. L. Rev. 144 (1937).

[44] Durfee and Doddridge, *op. cit. supra* note 1, at 860.

redemption creditors be cured by making the property exempt from both since such an exemption is obviously absurd. It must be admitted that exempting the proceeds from the assignment, as herein suggested, has some of the same quality but limits on the amount of the exemption could be easily imposed. It must be remembered however that under either scheme it is not intended that such redemption actually take place. The unfair advantage is offered to the debtor only to induce the creditor to bid adequately at the original sale. If the statute works *as intended* the debtor will never actually enjoy this advantage.

Some limitation must be put on the use of the assignment device by the foreclosing creditors. Traditional rules against clogging the equity of redemption would prevent a contract to assign or an assignment prior to foreclosure.[45] There remains the possibility that the foreclosing creditor may safely bid low at the sale relying on his ability to reach the debtor first and secure an assignment. The debtor may not realize the strength of his bargaining position and, even if informed, may prefer the exempted proceeds to cutting down the deficiency, especially if bankruptcy is imminent. To protect the uninformed debtor or to protect the share of the other creditors in the unmortgaged assets, it is suggested that the foreclosing creditor be permitted to obtain an assignment only on condition of his waiving the deficiency judgment.

VI

The problems of assignment have been most widely discussed in connection with the reorganization of bond issues. Two factors distinguish this situation from that heretofore discussed. First, the beneficial interest in the mortgage is held by many people, and second, the mortgagor is generally incorporated. As a result of the first factor we no longer have the single mortgagee bidding in at his own sale. Where all the bondholders do not agree to buy at the sale, the problem of paying off the dissenters arises and the bid assumes additional significance. As before, the bid serves to determine the extent to which the land goes to pay the debt; its additional function is to determine the cash distributive share of the dissenters. It is now old learning that the higher the bid, the more difficult it is to reorganize since the amount of cash that must be raised to pay off each dissenter increases and what is more serious the number of dissenters increases.[46] The reorganizers have thus far solved their dilemma by a resort to the assignment devices to achieve a so-called "quick redemption."[47] Generally, the assignment is procured by waiving the deficiency and by giving cash or securities to the mortgagor or the old stockholders. Under the suggested

[45] Jennings v. Ward, 2 Vern. 520 (1705); Wyman, The Clog on the Equity of Redemption, 21 Harv. L. Rev. 459 (1908). Under § 18a of the Illinois statute a corporation can waive its statutory right.

[46] Katz, The Protection of Minority Bondholders in Foreclosures and Receiverships, 3 Univ. Chi. L. Rev., 517, 524–32 (1936).

[47] *Id.* at 541.

reinforcement of the assignment device,[48] the quick redemption would be even more effective because junior lienors who did not file cross-bills would be cut off. Paradoxically, then, the assignee device which operated in the ordinary mortgage case to force a high bid is used here to protect a low bid. Encouraging the low bid here is not, however, impolitic so long as the assignment is conditioned on a waiver of the deficiency, as suggested above.[49] Where the debtor is a corporation the waiver of the deficiency, it might be noted, serves only to protect the share of other creditors in the unmortgaged assets. But the low bid does have a disadvantage since the deficiencies of the dissenters, measured by the low bid, will remain.

The transfer of the equity by the corporation and the payment to the stockholders have been frequently called a fraudulent conveyance.[50] But it is submitted that this is no more a fraudulent conveyance than is a transfer of the right to redeem to an outsider. In this latter case the justification for cutting off the creditor's rights by the transfer was to provide a threat to the mortgagee and to compel him to bid in his debt. In the present case the creditors are similarly protected by the waiver of the deficiency. Further, the payment to the stockholders may be explained as necessary to obtain the assignment since they are not interested in the deficiency against a corporate debtor. This corresponds to making the proceeds exempt in the case of the simple mortgage as suggested.

The objections to the assignment device as used in reorganization cases arise not because it is unfair to the dissenting bondholders and other creditors but because it puts an uneconomical burden on the bondholders who are reorganizing. It is not unfair to other creditors as long as the deficiency is waived (but it must be remembered that the deficiency of the dissenters is not waived); it is not unfair to the dissenters so long as the opportunity to participate in a fair plan is given.[51] But it is unfair to make reorganization feasible to the sal-

[48] P. 634 *supra*.

[49] P. 636 *supra*.

[50] Levi and Moore, Bankruptcy and Reorganization: A Survey of Changes, 5 Univ. Chi. L. Rev., 1,232 (1938); and see First Nat'l Bank of Chicago v. Bryn Mawr Beach Bldg. Corp., 315 Ill. 409, 6 N.E. (2d) 654 (1937); noted 4 Univ. Chi. L. Rev. 675 (1937). Since under the assignment device the stockholders are given something before intervening creditors are paid, it might be thought that the doctrine usually associated with Northern Pacific Ry. v. Boyd, 228 U.S. 482 (1913) would render participation by the stockholders bad. The *Boyd* case has been variously explained. Levi and Moore, *op. cit. supra* note 50, 233–236 and note 151. But it probably reduces to the notion that value always being guess-work, it is fairer and safer to give the superior class a chance to enjoy any advantage arising from the property ahead of the inferior class. There is, however, no way of offering unsecured creditors a first chance at selling the corporation's redemption right. The payment by the bondholders to the stockholders is necessary to carry out the reorganization. A requirement that they also pay the intervening creditors would simply irrationally increase the amount of "blood money" they now have to pay because of the strategic position the present statute gives the stockholders.

[51] Forcing the dissenter into a "fair" plan is only fair to him if liquidation is not a genuine alternative to reorganization. But if liquidation is feasible, he has as much right to force

vaging bondholders only at the cost of paying off the stockholders for their nuisance position. Two means of eliminating this nuisance value of the stockholder's position have been suggested; (1) removing the statutory redemption in corporate reorganization cases;[52] (2) measuring the cash distributive of the dissenters on a basis other than the bid at the sale.[53] These suggestions reduce to fundamentally the same thing—a scheme to force the dissenters to join the plan. Under the first suggestion the reorganizing group, no longer afraid of redemption, could bid low enough to make dissent unattractive and yet would not have to pay off the stockholders to protect against possible redemption. If in fairness to other creditors, provision is made for the deficiency, the plan amounts to strict foreclosure of the reorganizing bondholders interest. Under the second suggestion of using two bids, one to measure the deficiency of the purchasing bondholders, the other to measure the cash distributive share of the dissenters, it is clear that the latter bid must still be set low enough to render dissent unattractive unless, as we have seen, reorganization is to be impossible. Thus, under either suggestion the bondholders are given a choice between an admittedly inadequate cash share[54] or joining the plan. If, then, they can be forced to join the plan indirectly it is submitted that it would be better to abandon the sale theory here and directly force all bondholders to join the plan.[55] Of course, this would be proper only if the court by supervision of the plan would provide a check on the fairness of the plan. And if it is agreed that the sale theory be abandoned as a way of determining dissenters' rights, it is but a short step to discard the sale altogether and recognize that the problem is one of reorganization and not of liquidation.[56] Perhaps use of the federal bankruptcy and reorganization statutes should be made compulsory or special state legislation provided.[57]

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the reorganizing group to liquidate as they have to force him to reorganize. The prevalent antipathy toward the dissenter is explainable in that reorganization generally is the only expedient course of action.

[52] 4 Univ. Chi. L. Rev. 675 (1937).

[53] Katz, *op. cit. supra*, note 46, at 546–548 suggests the converse: letting the bid determine the dissenter's share and adjusting the deficiency on some other basis. It is believed that the above suggestion is more consonant with the theory of the statute.

[54] Apparently in Illinois the bid in a bond issue foreclosure must be more than nominal. In Straus v. Anderson, 366 Ill. 426, 9 N.E. (2d) 205 (1937) a bid of $35,000 on property valued at $150,000, with annual income of $6,300, and with first mortgage of $230,000 was held inadequate.

[55] The federal court went this far without the aid of a statute. Phipps v. Chicago R.I. and P. Ry. Co., 284 Fed. 945 (C.C.A. 8th 1933).

[56] Levi and Moore, *op. cit. supra* note 50, at 405.

[57] Representative Benson introduced a bill for a state reorganization act into the Illinois House of Representatives on Feb. 24, 1937. See H.B. 263. It is understood that the bill is being revised.