2/21/01

SUPREME COURT OF LOUISIANA

NO. 2000-C-0469

DIAMOND SERVICES CORPORATION

versus

DOLORES N. BENOIT

ON WRIT OF CERTIORARI TO THE COURT OF APPEAL, THIRD CIRCUIT, FIFTEENTH JUDICIAL DISTRICT COURT

VICTORY, J., concurring in the result.

I concur in the majority's holding that Dolores Benoit is not personally liable in this case, but not for the reasons stated by the majority. In my view, the maker of a collateral mortgage note is personally liable beyond the value of the mortgaged property when the collateral mortgage note is pledged to secure the debt of a third party.[1] However, in this case, Ms. Benoit, the maker of the collateral mortgage notes, is not personally liable due to mutual error regarding her personal liability.[2]

The majority goes to great lengths, ultimately resorting to "equity," to reach their holding that the maker of a collateral mortgage note is not personally liable beyond the value of the mortgaged property. However, this is not a difficult case. It is a contracts case and this Court need look no further than the language of the

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[1]Such personal liability is, of course, limited to the lesser of the face amount of the collateral mortgage note and the amount owed in connection with the third party's debt.

[2]The trial court found that the intent and understanding by all parties when Ms. Benoit signed the documents was that she would not be personally responsible for the debts evidenced by the collateral packages. The trial court stated, upon ruling in favor of Benoit on her motion for summary judgment, that "Mrs. Benoit, when she signed the collateral mortgage packages, was informed by Gerald Listi, who was a bank officer of MC Bank at the time, and all others present at the loan closing, that the papers which she was presented with to be signed, that she would not be personally responsible and that only her property would be subject to seizure in the event the amount loaned by the bank was not paid."

contracts, which the majority never once mentions, to determine the rights and obligations of the parties.

First and foremost, both the MC Bank and Diamond Services collateral mortgage notes are personal obligations because they contain unconditional promises to pay $350,000.00 and $300,000 respectively to the bearer. Nothing in these instruments say or imply that there is no personal liability or that Ms. Benoit's liability is limited to the value of the property used to secure the notes. The notes, executed by Ms. Benoit, contain the same language, as follows:

> ON DEMAND, I, jointly, severally and solidarily promise to pay to the order of MYSELF the sum of [$350,000 and $300,000, respectively], for value received, with interest thereon at the rate of twelve (12%) per cent per annum from date until paid. . . .
>
> . . . .
>
> The maker(s) of this Note and all endorsers, . . . , hereby binding themselves jointly, severally and solidarily, unconditionally and as original promisors, for the payment hereof, in principal, interest, costs and attorney's fees. Furthermore, no discharge or release of any collateral securing this Note or any delay on the part of the holder hereof in exercising any rights hereunder shall operate as a waiver of such rights, or to otherwise diminish or release such collateral.

The written pledge agreement for the MC Bank note signed by Ms. Benoit as "Grantor" specifically gives the creditor the right, if Davenport defaults, to collect payment under Ms. Benoit's collateral mortgage note and apply the proceeds to pay Davenport's debt:

> PLEDGEE'S RIGHT TO ACCELERATE PAYMENT UPON DEFAULT: [If default occurs, Pledgee can accelerate any] Indebtedness secured by the aforesaid Note. Pledgee shall have the additional right, again at its sole option, to declare the aforesaid Note to be immediately due and payable, in principle, interest, costs and attorney's fees.

In addition, the pledge agreement provides:

> EFFECT OF WAIVERS. . . . Grantor has further waived, and/or does by these presents waive, all pleas of division and discussion with regard to the Indebtedness, and agrees that Grantor shall remain liable together with Borrower and any and all guarantors, endorsers and sureties of the Indebtedness on a "joint and several" or "solidary" basis.

The security agreement between Ms. Benoit and Diamond Services likewise gives the latter the right to collect on the collateral mortgage note if Davenport defaults. The agreement describes the "collateral" as Ms. Benoit's collateral mortgage note. It gives Diamond Services the right to collect on any promissory note pledged as collateral, apply the proceeds to Davenport's debt, and return the surplus (if any) to Ms. Benoit:

> Default Rights and Remedies: I agree that you may do any or all of the following should I (or borrower) default under any indebtedness secured by this Agreement or should I default under any of my obligations under this Agreement:
>
>> Accelerate Indebtedness: Declare all of my (and Borrower's) indebtedness to be immediately due and payable without further notice or demand.
>>
>> . . . .
>>
>> Collection of Collateral. Collect any of the Collateral which consists of securities or obligations for the payment of money in the manner provided above and apply any amounts received first to your reasonable expenses of collection and attorney's fees, and then to the payment of my (or Borrower's)indebtedness in such order and priority as you may determine.

So why is it that the majority finds no personal liability in the face of this clear and express language to the contrary? Why, it is because "for well over a hundred years, . . . the collateral mortgage and the subsequent pledge of the collateral mortgage note, has customarily not, absent some additional agreement, brought into play the personal liability of the maker . . . ." Slip. Op. at 23. That's quite a statement, considering that (1) the notes contain unconditional promises to pay; (2) the majority of the noted commentators on the subject, including the professors of security rights

at both LSU and Tulane law schools, have expressed their views that the collateral mortgage note imparts personal liability;[3] (3) the majority of Louisiana cases have explicitly[4] or impliedly[5] held that the maker of a collateral mortgage note is personally liable on that note; and, (4) contrary to the majority's conclusion that "[a] collateral mortgage note standing alone is virtually meaningless, as it has no intrinsic value and evidences no debt or obligation actually owed by or to anyone," the collateral mortgage is defined by statute as "a mortgage that is given to secure a written obligation, such as a collateral mortgage note, negotiable or nonnegotiable instrument, or other written evidence of a debt, that is issued, pledged, or otherwise used as security for another obligation." La. R.S. 9:5550(1) (emphasis added).

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[3]Max Nathan, Jr. & Anthony P. Dunbar, The Collateral Mortgage: Logic and Experience, 49 La. L. Rev. 39, 41- 42 (1988); Michael H. Rubin, The Work of the Louisiana Appellate Courts for the 1978-1979 Term--A Faculty Symposium: Security Devices, 40 La. L. Rev. 572, 582 (1980). Rubin and Stephen P. Strohchein, Developments in the Law 1993-1994: A Faculty Symposium: Security Devices, 55 La. L. Rev. 611, 635, n.115; Rubin, David S. Willenzik & Maria A. Moore, Is the Collateral Mortgage Obsolete?, 41 La. B.J.529, 530 (April 1994).

[4]*See* ***Merchants & Farmers Bank & Trust v. Smith***, 559 So. 2d 845 (La. App. 3 Cir.), *writ denied,* 563 So. 2d 865 (La. 1990); ***Concordia Bank & Trust Co. v. Lowry***, 533 So. 2d 170 (La. App. 3 Cir. 1988), *rev'd in part on other grounds*, 539 So. 2d 46 (La. 1989); ***Bank of Lafayette v. Bailey***, 531 So. 2d 294 (La. App. 3 Cir.), *writ granted in part*, 533 So. 2d 5 (La. 1988); ***Central Bank v. Bishop***, 375 So. 2d 149 (La. App. 2 Cir.), *writ denied*, 378 So. 2d 435 (La. 1979)(holding that the collateral mortgage notes creates a personal obligation for which the maker is liable); *but see* ***Commercial Nat'l Bank v. Succession of Rogers***, 628 So. 2d 33 (La. App. 2 Cir. 1993); ***Bank of New Orleans & Trust Co. v. HPB, Jr. Development Co.***, 427 So. 2d 486 (La. App. 5 Cir. 1983) (holding that the maker of a collateral mortgage note is not personally liable on such a note when it is used to secure the debt of a third party).

[5]***Kaplan v. University Lake Corp.***, 381 So. 2d 385 (La. 1979) (holding that a collateral mortgage note can prescribe); ***First State Bank & Trust Co. v. Seven Gables, Inc.***, 501 So. 2d 280 (La. App. 1 Cir. 1986),*writ denied*, 502 So. 2d 103 (La. 1987) (holding that the defendant, who had assumed "all of the obligations" under a collateral mortgage note and collateral mortgage, was personally liable); ***Louisiana Nat'l Bank v. O'Brien***, 439 So. 2d 552 (La. App. 1 Cir.), *writ denied*, 443 So. 2d 590 (La. 1983) (holding that the use of phrases like "sole and absolute security," "sole security," and "*in rem*" throughout both the note and pledge agreement at least create ambiguity as to the parties' intent about personal liability); ***Central Bank v. Bishop,*** *supra* (holding a collateral mortgage note bears interest from its date); ***Central Progressive Bank v. Doerner,*** 365 So. 2d 263 (La. App. 1 Cir. 1978) (holding a collateral mortgage package secured the creditor to the lessor of (a) principal plus interest on the principal obligation or (b) principal plus interest on the pledged note; the parties can by agreement and with specific language create an *in rem* note, but this requires specific language). These holding confirm that a collateral mortgage note has the same legal effects as any other promissory note and is thus a written obligation enforceable according to its terms.

What "additional agreement" would the majority require in order to impose personal liability on the maker of the collateral mortgage note? The unconditional agreement that "On demand, I, jointly, severally and solidarily promise to pay" is obviously not enough. Maybe the maker of the collateral mortgage note needs to say "I really, really, really promise to pay."

Finally, the majority seems to transform this *in personam* obligation into an *in rem* obligation simply because the collateral mortgage notes are secured by mortgages. However, consider the following example by Professor Rubin, which belies this theory:

> Nephew goes to Lender to obtain a $100,000 loan. Lender wants security. The only security Nephew has to offer is help from his rich Uncle X. Uncle X refuses to sign Lender's continuing guaranty document but is agreeable to giving a separate negotiable note for $100,000. Uncle X will not co-sign or become an accommodation endorser on Nephew's note. The separate note given by Uncle X to Lender is valid and enforceable, although it does not represent money the lender has advanced or will advance. It is given for value. It has been given for consideration. If Nephew defaults, Lender has two options. First, it could sue Nephew on Nephew's note. Second, it could sue Uncle X on Uncle X's note. Clearly Uncle X has personal liability under his note.
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> Now, assume Lender asks Uncle X not merely for his own note but for additional security. Uncle X now gives the same $100,000 note, but this time it is paraphed for identification with an act of mortgage on Uncle X's property and the mortgage is properly recorded. The only difference now is Uncle X's note has been paraphed for identification with an act of mortgage. No other change has been made. It is submitted that Uncle X's note is not somehow transformed magically from an in personam obligation to an in rem obligation merely because of the paraph. Uncle X's note is negotiable and remains negotiable. Lender still has several options if Nephew defaults. First, Lender can sue Nephew on Nephew's note. As a second alternative, Lender can sue Uncle X and Uncle X's note. Third, as an additional option, Lender can sue Uncle X to seize and sell the mortgaged property and obtain a privilege on the proceeds of the sale. The proceeds of the sale would then be applied to Uncle X's note. If the proceeds of the sale are insufficient to pay off Uncle X's note (assume, for example, the proceeds of the sale bring only $80,000), then Uncle X's note is extinguished only to the extent of the value obtained at the sheriff's sale ($80,000). Therefore, $20,000 remains extant on Uncle X's note and

> Uncle X can be sued for the difference, just as Uncle X could be sued for the $100,000 before the paraph was put on the note, or in lieu of pursuing the mortgaged property. It is submitted that cases finding collateral mortgages are in rem by nature misconstrue the collateral mortgage device. Perhaps it is the name "collateral mortgage" that causes the problem. If it were referred to as a "security-interest-in-a-note-secured-by-a-mortgage," maybe the analysis would be easier to see. Nonetheless, its form demonstrates that a collateral mortgage package is primarily one of a security interest in a note, with additional rights against mortgaged property.

Rubin, 55 La. L.Rev. at 634-635.

For all of the above reasons, I believe that the majority erred in holding that the maker of a collateral mortgage note pledged to secure another debt is not personally liable on the collateral mortgage note.