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Minutes of Meeting of August 2 and 3, 1957

B. Study No. 24 -- Mortgages for Future Advances. The

Commission considered the Research Consultant's report and the minutes of the meeting of the Northern Committee of May 4, 1957 containing its recommendations on Study No. 24. The question whether any legislative changes in the law relating to mortgages of real property for future advances are necessary or desirable was discussed at some length. It was decided to request the research consultant, Professor Merryman, to send copies of his study to a limited number of people working in the field of property security transactions with a request for an expression of their views concerning the study and his conclusions and particularly requesting comment on the following questions:

1. Whether any change in the law relating to real property mortgages for future advances is desirable.
2. Whether his interpretation of the meaning of Civil Code Sections 2974 and 2975 relating to personal property mortgages for future advances is correct.
3. Whether the proposed repeal of Section 2974 and proposed revision of Section 2975 are sound. (In this connection Professor Merryman should be requested to submit as his draft the draft appearing in the minutes of the meeting of the Northern Committee).
4. Whether any other legislative change in the law relating to personal property mortgages for future advances is desirable.

Minutes of Meeting of August 2 and 3, 1957

Mr. Kleps raised a question concerning footnote 44 of Professor Merryman's study, which relates to Art. 9 of the Uniform Commercial Code. It was agreed that Professor Merryman should be asked to submit a brief memorandum expanding on the point made in footnote 44, that the provisions of the Uniform Commercial Code relating to mortgages for future advances ought not to be adopted in California unless Art. 9 itself is adopted.

Study No. 24 was re-referred to the Northern Committee, to receive Professor Merryman's report on the matters stated above and take further action in light thereof.

JUL 9 1956

MINUTES OF MEETING

OF

NORTHERN COMMITTEE

July 7, 1956  
San Francisco

PRESENT

Members

Mr. Thomas E. Stanton, Jr.  
Mr. Bert W. Levit  
Mr. Samuel D. Thurman

Research Consultants

Professor John H. Merryman  
Professor Lowell Turrentine

Staff

Mr. John R. McDonough, Jr.  
Mrs. Virginia Nordby

ABSENT

Mr. John Harold Swan

1956 STUDY NO. 6 - MORTGAGES FOR FUTURE ADVANCES

The committee discussed with Professor Merryman, the research consultant on 1956 Study No. 6, the general scope of the study. Professor Merryman reported that his preliminary study of the matter indicated that the present California law respecting real property mortgages for future advances is well developed, sound, and in conformity with the general law on the subject. He reported that the same is true as to personal property mortgages save for certain problems created by Sections 2974 and 2975 of the Civil Code. He stated that he thought these latter code sections and the problems then present

should be thoroughly studied and that the sections should then be redrafted. Professor Merryman indicated his intention to discuss these problems with representatives of lending institutions and farmers' organizations (since livestock, crop, and farm production mortgages are apparently importantly involved).

It was agreed that Professor Merryman should proceed along the lines indicated and prepare a report covering the ground outlined in his discussion.

#### STUDY NO. 1 - RULE AGAINST SUSPENSION

The committee discussed with Professor Turrentine the report which he had prepared on this study. The committee commended Professor Turrentine for his report and determined to recommend that the commission accept the recommendations made therein, with the possible exception that it consider recommending a statute relating to the period for which a private trust may be made nonterminable in the event that the rule prohibiting suspension of the absolute power of alienation is repealed.

The Executive Secretary was directed to prepare a draft report and recommendation of the commission to the Legislature embodying Professor Turrentine's recommendations and also to work with Professor Turrentine in attempting to draft a statute relating to the duration of nonterminability provisions in private trusts for the commission's consideration.

The committee also discussed whether a statute relating to the power of the trustee and all of the beneficiaries of a private trust to terminate it should be recommended to forestall the possibility that the rule laid down in Estate of Walkerly and succeeding cases might be followed even though the rule

prohibiting suspension of the absolute power of alienation were repealed.  
The Executive Secretary was directed to draft a statute for this purpose  
for the commission's consideration.

There being no further business, the meeting was adjourned.

Respectfully submitted,

John R. McDonough, Jr.  
Executive Secretary

5/17/57

MINUTES OF MEETING  
OF  
NORTHERN COMMITTEE

May 4, 1957  
San Francisco

Members

Mr. Thomas E. Stanton, Jr.  
Professor Samuel D. Thurman

Staff

Mr. John R. McDonough, Jr.

STUDY NO. 24 - MORTGAGES FOR FUTURE ADVANCES

The Committee discussed with Mr. Merryman his report, the recommendations made therein, and the revision of Civil Code Sections 2974 and 2975 proposed by him. The Committee makes the following recommendations:

1. That Mr. Merryman's study be accepted and approved for publication by the Commission.
2. That the Commission determine whether a field study of real property mortgages for future advances should be made for the purpose of determining whether the Commission should recommend to the Legislature:
  - (a) That all advances be given the priority presently accorded obligatory advances;
  - (b) That all advances be given the priority presently accorded optional advances; or

(c) That if the present distinction between obligatory and optional advances is retained, a mortgage for future advances be required to state that advances to be made thereunder are obligatory in order to have the priority presently accorded to such advances.

3. That the Commission determine whether a similar field study should be made with respect to personal property mortgages for future advances.

4. That if no field study is undertaken the Commission recommend no revision of existing law relating to mortgages for future advances except the following:

(a) That Civil Code Section 2974 be repealed.

(b) That Civil Code Section 2975 be revised to read as follows: \*

2975. Mortgages of personal property or crops may be given to secure future advances. If the maximum amount to be secured is stated in the mortgage, the lien for all advances to that amount, whether optional or obligatory, has the same priority as that originally established by the mortgage. If the maximum amount to be secured is not stated, the lien for all optional advances made after actual notice of intervening liens is inferior to them in priority.

The stated maximum amount means the maximum amount secured at any one time, and does not include amounts already

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\* The proposed revision is shown in strike-out and underline following this statement of Section 2975 as it would read if revised as recommended.



repaid or discharged. Repayment in full of amounts owing under the mortgage does not extinguish the mortgage.

Necessary expenditures made by the mortgagee to preserve the security constitute liens having the same priority as that originally established by the mortgage.

Within the meaning of this section, future advances means sums to be paid in the future by the mortgagee to the mortgagor or for his account pursuant to the terms of the mortgage.

The following shows the revision of Section 2975 in strike-out and underline:

2975. A-mortgage Mortgages of personal property or crops may be given to secure future advances. ~~the repayment of sums that may be advanced, expenditures that may be made, or indebtednesses or obligations that may be incurred subsequent to the execution of such mortgage.~~ If the maximum amount the ~~repayment of which is proposed~~ to be secured by such is stated in the mortgage, is expressed therein (whether the creation of debts in such amount or any part thereof be optional with, or obligatory upon the mortgagee or assigns), such mortgage (subject to the provisions of sections 2911, 2941, 2968, 2969 and 2972 of the Civil Code) shall be and constitute a the lien for all advances to that amount, whether optional or obligatory, has the same priority as ~~or encumbrance of rank, effect, status~~

and-standing-equal-to that originally established by the mortgage.  
If the maximum amount to be secured is not stated, the lien for  
all optional advances made after actual notice of intervening liens  
is inferior to them in priority. thereby-initially-and-as-it-may  
thereafter-obtain,-as-security-for-the-repayment-of-any-sums,  
expenditures,-indebtednesses-and-obligations,-owing-or-due-or  
becoming-owing-or-due-thereunder,-up-to-and-including-such-expressed-  
maximum-amount-which-shall-be-considered-only-as-a-limit-of-the  
debts,-sum,-expenditures,-indebtednesses-and-obligations-that-may  
be

The stated maximum amount means the maximum amount secured  
thereby at any one time, and does not to include such-as-may-have  
existed amounts already and-been repaid or discharged thereunder.  
Repayment in full of amounts owing under the mortgage does not  
extinguish the mortgage. A-mortgage-of-personal-property-or-crops  
shall-also-constitute-a-lien-or-encumbrance-of-rank,-effect,-status  
and-standing-equal-to-that-established-initially-or-thereafter  
obtained-thereby,-as-security-for-the-repayment-of-all-sums-or  
amounts-that-are-necessarily-advanced-or-expended-by-the-mortgages-  
or-assigns,-for-the-maintenance-or-preservation-of-the-property,  
or-any-part-thereof,-described-in-such-mortgage.

Necessary expenditures made by the mortgagee to preserve  
the security constitute liens having the same priority as that  
originally established by the mortgage.

Within the meaning of this section, future advances means sums to be paid in the future by the mortgagee to the mortgagor or for his account pursuant to the terms of the mortgage.

Bill Tentatively Proposed by California  
Law Revision Commission to be Introduced  
at 1959 Session of the Legislature.

An Act to repeal Section 2974 and to amend Section 2975 of  
the Civil Code, both relating to mortgages of personal property  
to secure future advances.

The people of the State of California do enact as follows:

SECTION 1. Section 2974 of the Civil Code is repealed.

SEC. 2. Section 2975 of the Civil Code is amended to read:\*

2975. Mortgages of personal property or crops may be given to secure future advances. If the maximum amount to be secured is stated in the mortgage, the lien for all advances to that amount, whether optional or obligatory, has the same priority as that originally established by the mortgage. If the maximum amount to be secured is not stated, the lien for all optional advances made after actual notice of intervening liens is inferior to them in priority.

The stated maximum amount means the maximum amount secured at any one time, and does not include amounts already repaid or discharged. Repayment in full of amounts owing under the mortgage does not extinguish the mortgage.

Necessary expenditures made by the mortgagee to preserve the security constitute liens having the same priority as that originally established by the mortgage.

Within the meaning of this section, future advances means sums to be paid in the future by the mortgagee to the mortgagor or for his account pursuant to the terms of the mortgage.

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\*The proposed amendment of Civil Code Section 2975 is not shown in ~~strikeout~~ and underline as it would be in a bill introduced in the Legislature.

Law Offices of  
MORRISON, FOERSTER, HOLLOWAY, SHUMAN & CLARK

Crocker Building

San Francisco 4

November 19, 1957

Professor John H. Merryman  
c/o School of Law  
Stanford University  
Stanford, California

Dear Professor Merryman:

As you know, copies of your study on optional advances in real and personal property mortgages were sent to all the banks in California by the California Bankers Association with the request that they study the question and advise the Association whether they favored a change in the statutes of California whereby optional future advances in mortgages on real estate would be put on the same basis as optional future advances in personal property mortgages; specifically, whether Sections 2974 and 2975, Civil Code, should be made to apply to real property mortgages.

The Association to date has received answers from sixteen banks, including several of the large metropolitan banks, and I have seen copies of the letters of counsel for the Bank of America and Security First National Bank of Los Angeles to you on the subject.

The opinion is practically unanimous that so far as real estate mortgages are concerned there should be no change from the present rule and statutes; no bank favored making Sections 2974 and 2975 Civil Code applicable to real property mortgages. Several banks expressed the view that perhaps the subject should have further investigation, but no bank recommended any change for the present in the rules applicable to real estate mortgages.

I am satisfied the views expressed by these sixteen banks represent the views of our banks at the present time; they came from both large and small banks, from those in the larger cities and from banks in the smaller communities. I am sure they represent the complete view at this moment.

Yours very sincerely,

/s/ J. F. Shuman

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J. F. Shuman

JFS/cb

1/13/58

Memorandum to Law Revision Commission

Subject: Mortgages for Future Advances

A. Revisions in the Study.

1. The following footnote should be added at the point marked 2a in the attached copy of the study:

2a. Following the completion of this study the 1957 California Legislature enacted Chapter 1146, amending Code of Civil Procedure §1188.1 by adding the following paragraph:

A mortgage or deed of trust which would be prior to any of the liens provided for in this chapter to the extent of obligatory advances made thereunder in accordance with the commitment of the lender shall also be prior to the liens provided for in this chapter as to any other advances, secured by such mortgage or deed of trust, which are used in payment of any claim of lien as provided for in this chapter, if any, which is recorded at the date or dates of such other advances and thereafter in the payment of all or any part of the costs of any work of improvement on the property which is subject to such mortgage or deed of trust; provided, that the priority of such mortgage or deed of trust shall not exceed in total for both obligatory advances made in accordance with the commitment of the lender and other advances the amount of the original obligatory commitment of the lender as shown in said mortgage or deed of trust.

This legislation makes mechanics' liens inferior to subsequent advances, whether optional or obligatory, if the advances are used to pay for construction or improvement of the property mortgaged. This is the only existing legislation specifically applicable to mortgages of real property to secure future advances.

2. The following paragraph should be added to footnote 12:

The 1957 amendment to the California Code of Civil Procedure, n. 2a, supra, has created an important exception to this rule.

3. The same paragraph should be added to footnote 21.
4. The following footnote should be added at the point marked 34a in the attached copy of the study:

The 1957 amendment to Code of Civil Procedure §1188.1 (see n. 2a, supra) has made this change by giving the mortgagee priority to the extent that the advances, even though optional, are used in improving the land. In commenting on this legislation a banking official has stated: "This rule seems fair since the holder of the mechanic's lien participates in the increased value of the property even though his participation is subject to that of the lender." Letter of Sept. 4, 1957, from Kenneth M. Johnson, Vice-President and Counsel, Bank of America. Prior to this amendment the lienor, if the advance were optional, would have had an interest which was not subject to that of the lender.

5. The following footnote should be added at the point marked 43a in the attached copy of the study:

43a. Copies of this study were distributed to a number of qualified persons for their comments. They uniformly agreed with the conclusions here stated. At the same time members of the California Bankers Association were asked by their Counsel, Mr. J. F. Shuman of the firm of Morrison, Foerster, Holloway, Shuman & Clark, to examine this study and express their views concerning the desirability of extending the principle of Civil Code §§2974 and 2975 to real property mortgages. In his letter of Nov. 19, 1957, Mr. Shuman reported that: "The opinion is practically unanimous...; no bank favored making Sections 2974 and 2975 of the Civil Code applicable to real property mortgages. Several banks expressed

the view that perhaps the subject should have further investigation, but no bank recommended any change for the present...."

6. In footnote 44, delete the second paragraph and substitute the following:

Article 9 of the Uniform Commercial Code, dealing with commercial security transactions, includes two sections (9-204 and 9-312) applicable to chattel security for future advances. Legislation based on Article 9 was before the 1957 Legislature (S.B. 1402) but failed to pass. It can be expected that similar bills will be introduced in the future.

Because Article 9 embodies an integrated approach to security transactions different from that of the present California law it seemed unwise to consider §§9-204 and 9-312 as possible models for revising §§2974 and 2975 of the Civil Code. Piecemeal adoption of bits and pieces of Article 9 would tend toward confusion, rather than clarity. See generally American Law Institute and National Conference of Commissioners on Uniform State Laws, Uniform Commercial Code: Final Text Edition, Art. 9 (1951); Cooper, New Wines and New Bottles: The Uniform Commercial Code and the California Law of Chattel Security, 27 So. Calif. L. Rev. 265 (1954).

B. Criticisms of Proposed New Section 2975.

1. Comments on the statute have included serious doubts about the last paragraph (defining future advances) and queries whether any definition is needed. I recommend that it be dropped, rather than try to meet the substantive objections to its present



form. See letters from Johnson, Landels and Shuman.

2. Smith, Richter and Corbin all believe there should be express reference in the statute to C.C. § 2941, giving the mortgagor a right to a discharge of the mortgage on demand after satisfaction. We had previously discussed this matter and decided that no such reference was necessary. I now am inclined to go along with these suggestions and suggest adding the following sentence to the second paragraph of the proposed statute:

All such mortgages shall be discharged on demand of the mortgagor, in conformity with the provisions of Section 2941 of the Civil Code.

3. While approving of the express provision that amounts spent by the mortgagee in order to preserve the security should be given priority Johnson, Shuman and Landels wish us to add that this should be so for interest also (it probably is under existing law). They also argue that this priority should exist even if the total of principal, interest and expenditures to preserve the security exceeds the maximum amount stated in the mortgage. While this seems reasonable enough, the existing statutes make no such provision and there is no law on the subject. I hesitate to adopt their suggestion even though I believe a court confronting the problem would probably accept this view. It just does not seem to me to be within the scope of the study.
4. Corbin (see his letter) thinks the rewording too narrow in that it restricts operation of the statute to loans to, and excludes advances made on behalf of, the mortgagor (for example, discharge of an obligation collaterally owed to the mortgagee). I think he is right in saying that the former language of 2975 was broad

enough to include such cases. The question is whether the new language excludes them. I think not, as a legal matter, and doubt that there really is a problem. This is enforced to some extent by the language of the study which, I suppose, is legislative history if the statute is enacted. I refer to the statement on page 25 that "This appears to convey the meaning of the first sentence of the statute in fewer words."

5. On the whole there seems little question about the desirability of repealing Section 2974. Only Smith opposes this, and I believe that whatever merit there is to his opposition is adequately met by incorporating express reference to Section 2941 concerning discharge. The letters from Corbin, Shuman and Landels contain statements illustrating varying degrees of concern about completely rewriting Section 2975 which, as they point out, has existed for a number of years without causing a great deal of litigation. To some extent their fears will be eased by the changes I have proposed in the statute. Beyond this it seems clear enough that most favor the kind of wholesale revision we recommend.