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Recommended Citation
Available at: https://uknowledge.uky.edu/klj/vol35/iss4/4

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NOTE

MORTGAGES ON AFTER-ACQUIRED PROPERTY IN KENTUCKY

This note is principally concerned with the law in Kentucky applicable to mortgages on after-acquired property when there is a conflict of interests between the mortgagee and third parties. After-acquired property, as the subject-matter of a mortgage, is property which at the time of execution of the mortgage thereon is either (1) not yet acquired by the mortgagor, or (2) not yet in existence. Any kind of property of which a present interest could be mortgaged, whether corporeal or incorporeal, might conceivably be the subject-matter of a mortgage executed before the property is acquired or comes into existence.

After-acquired property mortgages are uniformly held effective between the parties—even if they are regarded only as contracts to mortgage when the property is acquired; but as to intervening claims of third parties there has been dispute. Judge Story is credited with first enforcing such mortgages against third parties in the United States. In Mitchell v. Winslow,1 from the federal circuit bench, he decided that where an unincorporated manufacturing concern had executed a mortgage which included all machinery to be purchased by the mortgagor within the ensuing four years, the lien of such mortgage was enforceable in equity, and was valid against attaching creditors, even though nothing had been done by the mortgagee to perfect his lien after the machinery was acquired by the mortgagor.

The Kentucky Court of Appeals in 1857 decided in Phillips v. Winslow2 that where the charter of a railroad corporation authorized pledges of its property, franchises, rights, and credits, mortgages on future property were within such charter powers and were valid against subsequent judgment creditors.2 Here, as in Mitchell v. Winslow, the mortgagee had done nothing to perfect his lien.

No cases concerning mortgages on after-acquired property of an earlier date than Phillips v. Winslow have been found in the reports of Kentucky decisions with the exception of Hughes v.

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17 Fed. Cas. 527, No. 9,673 (C.C.D.Me., 1843).
Graves (1822), and Forman v. Proctor (1848). In Forman v. Proctor, a leading case, a mortgage on farm livestock was held to cover the produce or increase of the female animals, as an incident following the condition of the principal, even though there was no mention of such increase in the mortgage contract. The mortgage lien was held to have priority over the lien of subsequent judgment creditors of the mortgagor. Hughes v. Graves deals with a mortgage on a slave woman. The mortgagor sold the slave to a purchaser for value without notice of the mortgage, and it was held that the mortgage lien applied not only to the woman but also to two children born after execution of the mortgage. One of the children was born after the woman was sold, but it does not appear whether that child had been conceived at the time of the sale.

These cases represent the doctrine of "potential existence" as applied in Kentucky. This doctrine was born in an effort by the English courts to escape the rigorous application of the common-law maxim that "a man cannot grant or charge that which he hath not." In the parent case of Grantham v. Hawley a lessor, in making a twenty-one year lease, covenanted and granted that the lessee should have the corn growing upon the ground at the end of the term. This was held to grant the lessor's present interest in the corn to be grown twenty one years thereafter, and therefore to be effective against the grantee of the lessor's reversion. In the words of the court:

"And though the lessor had it not actually in him, nor certain, yet he had it potentially; for the land is the mother and root of all fruits. Therefore he that hath it may grant all fruits that may rise upon it after, and the property shall pass as soon as the fruits are extant o o o."

The doctrine was extended to include the increase of female animals, but has not been carried farther. In Kentucky it has been applied to the progeny of animals but denied in the instance of future crops without discussion in either case of the historical origin of the rule or the reason for the partial departure therefrom.

In Kentucky the rules developed by the cases set out have marked, in general, the extent to which future property mortgages have been enforced against third parties. The court has frequently stated the general rule as being that a mortgage of after-acquired property is void against the mortgagor's creditors or purchasers for value, subject to exception (1) with regard to the increase of female animals, and (2) where a corporation mortgages property acquired under its charter powers.

It is desirable to pause in our discussion of decisions and con-

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sider the variety of factors and situations involved in the problem of mortgages on future property. First, the mortgagors fall into three well defined groups, namely: quasi-public corporations, private corporations, and individuals. Entirely apart from any doctrinaire approach there is sound reason based on practical economics for carrying this distinction into the judicial decisions. Some writers take the position that after-acquired property mortgage provisions should be enforced only where the mortgagor is a quasi-public corporation; but, although the law at one time tended in that direction, it is true today that the general rule gives effect to after-acquired property clauses in the mortgages of private as well as quasi-public corporations. Undoubtedly the numerous future property mortgages executed by public service corporations made apparent to the courts the practical necessity of giving them effect, and thus served as an opening wedge for introduction of the practice of giving like effect to like instruments executed by private corporations. As well said in a 1904 Kentucky opinion:"

"Where negotiable bonds have been issued, secured by a mortgage of a railroad company on property then on hand or thereafter to be acquired, the mortgage is upheld, in favor of the bondholders, as to after-acquired property; otherwise the long-term bonds could not be issued, and money raised upon them."

In Moulder-Halcomb Co. v. Glasgow Cooperage Co. a private manufacturing corporation executed to a trustee a mortgage on all assets then owned and thereafter to be acquired, to secure payment of negotiable bonds of the corporation. A creditor attached certain subsequently acquired assets of the insolvent corporation prior to an assignment for benefit of creditors being made, and the court held the mortgagee-trustee had a lien superior to that of the attaching creditor. This case extended the rule, previously applied to public service corporations, to a mortgage executed by a private corporation. It was said that an exception to the general rule against mortgages of future property occurs where property is acquired "by a corporation, in the exercise of powers conferred by its charter."

See Hamilton, Future Property Clauses in Corporate Mortgages (1930) 4 Temp. L. Q. 131, for a discussion beyond the scope of this note.


173 Ky. 519, 191 S.W. 275 (1917.)

Ibid, p. 524.
The next case on the topic, *United States Cast Iron Pipe and Foundry Co. v. Henry Vogt Machine Co.*, 1918, involved a mortgage executed by the Providence Water and Utilities Co., a public service corporation. The mortgage on future property, it was held, gave rise to a lien on certain essential water pumping machinery superior to the lien of the vendor for unpaid purchase money.

It was said that in the case of a public service corporation an after-acquired property mortgage is valid as to property “which composes an integral, indispensable, or necessary part of its machinery or fixtures, to perform things which it is empowered by its articles of incorporation to do.” On such property it displaces a lien for materials furnished, for purchase money, or where a vendor sells to the mortgagor under a contract to retain title until payment in full is made. The only reason given by the court for the rule is that when a prior lien-holder is dealing with a public service corporation he has notice of the prospective lien of the general mortgage. The rule is limited to public service corporations, the court saying that in other cases where a mortgage on future property is valid the lien attaches to the property in the condition in which it comes into the ownership of the mortgagor, and the general mortgage does not displace prior liens, even though they be junior.

The rule of future property mortgages has been substantially broadened since *Phillips v. Winslow*. In that case the charter was construed as authorizing the company to mortgage property which it had not yet acquired, and the decision was based on this charter power. However, in the *Moulder-Halcomb* case and the *Foundry Co.* case the rule is given that a mortgage of future property is valid as to any property acquired by a corporation in the exercise of its charter powers. Under this statement of the rule any mortgage of future property by a corporation would be effective against third parties, whether the corporate charter authorized mortgages on future property or not, so long as the property was acquired within

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14 162 Ky. 473, 206 S.W. 806 (1918).
15 Ibid., p. 482.
16 Accord: Columbia Finance and Trust Co. v. Kentucky Union Ry. Co., 60 Fed. 794 (C.C.A. 6th, 1894); Westinghouse Electric Mfg. Co. v. Citizens Street Railway Co., 24 Ky. L. Rep. 334, 68 S.W. 463 (1902); But cf. United States v. New Orleans Railroad, 12 Wall. 362 (U.S. 1870), a case arising in Kentucky, saying that a mortgage by a railroad covering all future acquired property attaches only to such interest therein as the company acquires, subject to any liens under which it comes into the company's possession, and holding a purchase money lien on rolling stock, though junior, superior to the lien of the general mortgage. A distinction is made that the rolling stock did not become “affixed to and a part of the principal thing.” In Galveston Railroad v. Cowdrey, 11 Wall. 459 (U.S. 1870), the court reached a contrary result as to railroad rails. These distinctions are made in the efforts of the courts to synthesize the doctrine of accession with the law applicable to encumbrances on future property, with the additional factor of a tendency to favor such encumbrances where executed by public service corporations.
the charter powers. This statement of the rule is given substance in the *Foundry Co.* case because the mortgagor there was a foreign corporation and neither its charter nor its franchise, nor a statement of the contents of either, was before the court. It is interesting that this extension of the rule was first stated as dictum in a case involving a mortgage on future farm crops executed by an individual, where it is said that an exception to the general rule against mortgages on after-acquired property is where property is "acquired under certain circumstances by a corporation in the exercise of powers conferred by its charter," citing *Phillips v. Winslow*, supra.

Although in many jurisdictions mortgages on future property executed by individuals have been enforced, Kentucky has not gone so far, extending enforcement of such clauses, with the exception of the increase of female animals, only to mortgages executed by corporations. It is altogether likely our court once felt there would be no adequate means of protecting third parties if individuals were permitted to mortgage future property, but that such mortgages were a business necessity in the case of many corporations; and third parties, being presumed to know the law, would be on notice when dealing with corporations.  

A second approach to the factors involved in the problem of mortgages on future property leads to a consideration of the various kinds of property on which such mortgages have been executed. The principal subjects are stock in trade, fixtures, machinery, farm crops, real estate, and the rents, issues, and profits of mortgaged real estate. Differing rules have developed as to the different kinds of property mortgaged.

In a recent opinion Judge Thomas quoted from Corpus Juris the following rule as to mortgages on stock in trade not yet acquired, and applied the rule in the case at bar:

"Under another line of authorities a mortgage is fraudulent and void which permits the mortgagor to sell from stock from time to time, although he agrees to replace any stock sold with stock of equal value; and a mortgage which is valid on its face is invalidated by collateral permission to this effect."

In this case a grocery store proprietor had executed mortgages on his stock in trade. The mortgagee did not obtain any preference, with respect to subsequent general creditors, as to funds in the hands

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17 Cheatham v. Tennell's Assignee, 170 Ky. 429, 186 S.W. 128 (1916).


19 *Sandy Valley Grocery Co. v. Patrick*, 267 Ky. 768, 103 S.W. 2d 307 (1937).

20 11 C. J. 581, sec. 275.
of the mortgagor's receiver. The stocks had completely changed since execution of the mortgage. This case represents the consistent holding of the Kentucky court. However, in Kentucky the mortgagor of a stock in trade does receive preferential treatment as to property on hand at the time of execution of the mortgage.

After quoting the rule Judge Thomas, giving the opinion of the court, attacks it as follows:

"Were the question one of first impression—and if it were less universally approved—we would be more inclined to follow our inclination to say that a mortgage of the kind here being dealt with, if duly recorded so as to furnish constructive notice, would prevail over all creditors who became such thereafter—the same as the acquiring of actual knowledge of the fact of an unrecorded lien. The basis of such inclination is that we are unable to perceive any fraud lurking therein, and therefore no invasion of any public policy principle arising from such an encumbering transaction, if it is made in good faith and bona fide observed thereafter. It is difficult to see any greater objections thereto than to a lien put upon existing property which continues to remain in the same, or practically the same, condition until the time of enforcement of the lien. If third parties dealing with the mortgagor possess either actual or constructive notice of such prior bona fide transaction, we fail to see wherein they should not be bound by the mortgage when with such knowledge they consent to the creation of their subsequent debts. But, however that may be, the stare decisis rule, so overwhelmingly adopted and approved by this and all courts, admonishes us that we should not depart therefrom, it involving a rule of property."

In Zaring v. Cox's Assignee, not mentioned by Judge Thomas in the opinion discussed, the court said the lien of a mortgage on stock in trade, containing a future property clause, attached as soon as any stock was added, and, being good between the parties, was good as to antecedent creditors, unless attacked for fraud. This "budding heresy" was quickly suppressed in the next case on the subject to reach the court. In Loth v. Carty, 1887, the court rationalized the statement of the Zaring case as meaning merely that

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24 Patterson v. Louisville Trust Co., 17 Ky. L. Rep. 234, 30 S.W. 372 (1895); Rosenberg v. Thompson, 10 Ky. L. Rep. 332, 8 S.W. 895 (1888); Loth v. Carty, 85 Ky. 591, 4 S.W. 314 (1887); Ross v. Wilson, Peter & Co., 70 Ky. (7 Bush) 29 (1869); Pindell v. Brown, 6 Ky. Opin. 302 (1873); Lucas v. Temple & Barker, 1 Ky. Opin. 259 (1866); all involving mortgages on future stock in trade, with contesting creditors; cf. Robinson v. Woodward, 20 Ky. L. Rep. 1142, 48 S.W. 1082 (1899), holding a deed of trust of future stock in trade, executed by an individual, ineffective against attaching creditors.

25 Ross v. Wilson, Peter & Co., 70 Ky. (7 Bush) 29 (1869); see Sandy Valley Grocery Co. v. Patrick, 267 Ky. 768, 103 S.W. 2d 307 (1937).
26 78 Ky. (1 Rod.) 527 (1880).
27 85 Ky. 491, 4 S.W. 314 (1887).
a mortgage of future property, being constructively fraudulent, was valid until attacked by another creditor, and that an averment by such creditor that the mortgage was executed before the property was acquired would constitute an attack on the lien for fraud. However, in the Zaring case it appears that the contesting creditors claimed under an assignment for benefit of creditors, and would therefore be in no better position than the assignor-mortgagor. Thus the case is distinguished on its facts, and the statement of the court, even if taken literally, is without force.

The rigor of the common-law rule was relaxed somewhat by our legislature in 1934. An act then adopted provided that chattel mortgages on after-acquired property were to be valid "against the mortgagor, existing or subsequent creditors of the mortgagor, subsequent purchasers, subsequent lienors and/or incumbrancers, and any and all third persons . . . .", where such mortgages were executed on "tools, machinery, farming instruments of any and all kinds," on crops planted "or to be planted within one year from the date of such mortgage," and on "livestock . . . including the increase, issue, progeny and/or produce thereof . . . ."

As to the increase of animals this enactment was substantially a statement of the law as theretofore applied in Kentucky, but as to crops and machinery the rule was materially altered, for mortgages on future crops and machinery had previously not been enforced against third party claimants.

The question of mortgages by individuals on future acquired real estate has not come before our court, but there has been nothing said by the court to indicate that the general rule against such mortgages would not be applied, nor that any exception thereto would be made.

What Judge Thomas calls a "modified exception" to the general doctrine against mortgaging future property applies to liens on future rents, issues, and profits of mortgaged real estate. In Bank of Louisville v. Baumeister four mortgages were placed on a city lot, only the fourth providing for a lien on the rents, etc., thereof. The fourth mortgagee was held entitled to such rents over the three prior mortgagees, the court saying that such future interests might be mortgaged incident to the mortgage of the present interest in the real estate.

The "modification" became apparent in other decisions on the topic. In Watt's Admr. v. Smith unsecured creditors contested the
lien of a "rents, issues, and profits" clause in a mortgage of farm real estate, as applied to tobacco raised thereon by the mortgagor. It was held that the mortgagee had a lien on all rents, etc., accrued or thereafter accruing as of the date the mortgagee sought to subject them to the mortgage, so long as liens of third parties thereon had not intervened. As to intervening liens, the court said the issue had never been decided by our court, and it did not arise in this case.

Two years later (1935), in Southern Trust Co. v. First City Bank and Trust Co. of Hopkinsville the question came before the court. In this case a farm mortgage provided for a lien on the rents, issues, and profits, further providing that upon action to foreclose the mortgagor should have the right to have a receiver appointed to collect such rents. The court found that the latter stipulation disclosed an intent not to subject the income and usufruct to the potential lien of the mortgage until possession was taken and the lien perfected by appointment of the receiver. Therefore a chattel mortgage on livestock and crops, executed before initiation of foreclosure proceedings, gave rise to a lien on such livestock and crops superior to that of the real estate mortgage.

Since 1935 two cases have involved the question of liens on rents, issues, and profits. In Title Insurance and Trust Co. v. Clark it was held that an assignment for benefit of creditors, executed before initiation of action to foreclose the mortgage and appoint a receiver for the rents, etc., did not give rise to any such intervening lien as would take priority over the inchoate lien of the mortgage. In substantially the same situation it was held by the federal court that, under Kentucky law, appointment of an equity receiver of the property and assets of a public service corporation did not create any lien on rents, issues, and profits superior to the unperfected lien of the mortgage. In the Clark case it was said:

"Where the mortgagor, before any action brought to enforce the mortgage or to appoint a receiver, sells or disposes of the rents, issues, and profits of the property mortgaged, or mortgages same to third parties, or where the property in his hands is attached by other creditors, the lien of the intervening lienholders becomes superior to the inchoate right which the mortgagee had to the same property by virtue of its mortgage."

The Clark case and the American Fuel case are to be distinguished from the Southern Trust case in that an assignee for

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271 Ky. 22, 111 S.W. 2d 409 (1937).

benefit of creditors or an equity receiver takes the property of an insolvent debtor not only for the benefit of general creditors, but as well for creditors holding a mortgage thereon, whether such mortgage be inchoate or not. With reference to the assignee or receiver, all the creditors stand upon the same footing as though the property remained in the hands of their debtor.

With reference to the law of the several states, there is such confusion that only the broadest generalizations can be made. Courts have attempted to draft general rules in cases concerning a particular type of mortgagor or property, and subsequently have been placed in untenable positions when confronted with cases falling within the rules but greatly different as to facts and interests involved. The result has been the introduction of meaningless distinctions and exceptions in an attempt to make too general rules fit situations vastly different in substance.

The Massachusetts rule, followed throughout New England and in some other states, most closely approximates the common-law. In Massachusetts a mortgage on future property is valid against third parties where, and only where, the lien is perfected by the mortgagee taking possession of the mortgaged property before the rights of third parties are asserted. New York follows the Massachusetts rule as to third party creditors, but applies the so-called equity rule when the third party is a purchaser. The equity rule, based on the decision of Judge Story in Mitchell v. Winslow, supra, interprets a mortgage on after-acquired property not as passing any title, but as creating an equitable interest in the property at the time of its acquisition by the mortgagor, secondary to any equities then existing, whether junior or senior to the general mortgage.

Several Western states have enacted general statutes in attempts to clear the atmosphere. Representative is that of Montana, which reads:

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34 Rochester Distilling Co. v. Rasey, 142 N.Y. 570, 37 N.E. 632 (1894); Kribs v. Alvord, 120 N.Y. 519, 24 N.E. 811 (1890); WALSH, MORTGAGES (1934) sec. 10; Stone, The "Equitable Mortgage" in New York (1920) 20 Col. L. Rev. 519, 526-7.


56 CALIF. CIV. CODE (Deering, 1941) sec. 2883; IDAHO CODE ANN. (1932) sec. 44-107; MONT. REV. CODE ANN. (1935) sec. 8227; N. D. COMP. LAWS (1913) sec. 6706; OKLA. STATS. (1941) tit. 42, sec. 8; S. D. CODE (1939) sec. 39.0105.
"An agreement may be made to create a lien upon property not yet acquired by the party agreeing to give the lien, or not yet in existence. In such case the lien agreed for attaches from the time when the party agreeing to give it acquires an interest in the thing, to the extent of such interest."

Many states follow the equity rule without benefit of statute, particularly as to land, but have made exceptions as to various types of property; the most frequent exception being a refusal to hold valid against third parties a mortgage on after-acquired stock in trade.

Some states have a statutory provision, similar in effect to Kentucky's, limiting mortgages on future crops to those to be grown within one year; while a Georgia statute provides that such mortgages are valid only where made to secure advances for the "purpose of making and gathering crops embraced by the mortgage." Such statutes have the laudable purpose of preventing the reduction of tenant farmers and sharecroppers to a state of peonage, to which condition they might well be reduced were it within their power to encumber the more remote fruits of their labors.

An Ohio statute has preserved for that state the distinction between the power of a quasi-public and a private corporation to mortgage future property, and Pennsylvania apparently has followed the same distinction without a governing statute.

Thus we see that Kentucky has tended to give less efficacy to future property mortgages than have most of her sister states. Mortgages by individuals on future real estate, stock in trade, and fixtures have not yet been enforced and, barring legislation, it is not to be expected that they will be. Such mortgages are enforced against third parties (1) when executed by corporations and (2) when the subject matter is crops to be grown within one year, machinery, farm tools, or the increase of female animals. Where a mortgage of present real estate provides for a lien on the future rents, issues, and profits thereof, there is an inchoate lien, which, if perfected, will precede the liens of subsequently intervening third parties.

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7 Jones, Chattel Mortgages (5th ed. 1908) sec. 415; Cohen and Gerber, The After-Acquired Property Clause (1939) 87 U. of Pa. L. Rev. 635, 650 and n. 82.