The Doctrine of Merger

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Most first year law students are familiar with the doctrine of merger which states that when one entity obtains both a greater and a lesser interest in land to the same piece of real property, the lesser interest merges into the greater interest and is thereby extinguished. While many practitioners apply this doctrine without pause, this author has seen many cases where it is truly inapplicable, it is adverse to the intention of the parties or otherwise creates an unjust result for a third party. This article will briefly discuss the history of the doctrine of merger, its application under the majority rule and from a title insurance underwriter's perspective.

HISTORY

According to one commentator, the doctrine of merger arose shortly after William the Conqueror claimed title to all land in England. Burkhart, *Freeing Mortgages of Merger*, 40 Vand. L. Rev. 283, 290 (1987). (Citing G. Cheshire, The Modern Law of Real Property 12 (9th ed. 1962)). For a variety of reasons existing at that time, the primary items of value were land and cattle. Because there were few, if any, written land records in existence, possession was the method of establishing protecting, and evidencing ownership to real property. In order to simplify the various ownership interests in real property, the doctrine of merger came into existence. For example, if A owns Blackacre together with an appurtenant easement over Greenacre and later acquires fee simple title to Greenacre, A's easement interest in Greenacre would merge into his fee simple interest in Greenacre and be extinguished. If A were later to sell Greenacre, such an easement appurtenant to Blackacre might not be readily apparent to the purchaser. Using The doctrine of merger to extinguish it and thereby simplify the status of title, A would need to reserve said easement as an appurtenance to Blackacre if and when he later conveys Greenacre to a third party.

Because interests in title are now memorialized in writing and are required to be of record in most states in order to be respected vis a vis third parties, one commentator suggests that its application creates absurd results in today's environment and furthermore, that it should not apply to mortgage for the following reasons. *40 Vand. L. Rev. at 304*.

First, the mortgage is not an interest in land from a historical perspective and second, the doctrine of merger creates many onerous results. For the reader who is interested in a detailed analysis of the history of mortgages, the doctrine of merger and the reason the doctrine should not apply to mortgages, this author highly recommends the *Vanderbilt Law Review* article cited herein. Regardless, the following is a condensed synopsis. The term "mortgage" comes from the French word "gage", meaning a pledge of one's property to secure an obligation, and the Latin word "mort." Originally, a mortgage was known as a mort gage, in other words a dead gage. This term was used because the lender had possession of the property pledged by the debtor and the right to collect all of the crops and other profits derived from the property as interest. None of the profits were used to reduce the principal amount of the debtor's obligation. Although interest was not prohibited by law at this time, the English church prohibited interest as a form of usury. Accordingly, "a Christian lender who died while holding a mort gage died as a sinner, and his personal property was forfeited to the monarch." *40 Vand. L. Rev. at 306.* It is likely that this sentiment toward usury coupled with the fact that the gagee was not considered to have actual seisen to, or a recognized estate in land meant that the courts would not recognize an action brought by the gagee to regain possession of the land if ousted by third party or even if ousted by the gagor himself. *40 Vand. L. Rev. at 304*.

As the form of mortgages evolved, many lenders included a forfeiture clause in the gage. If the debtor did not pay the debt, his title to the land was forfeited to the lender. By having possession to the land already, the lender avoided the need to go to court to enforce the forfeiture clause. As time when on, the character of a mortgage was altered further to include a grant of a term of years interest (usually a very long one) subject to the condition that said conveyance would be void upon repayment of the debt. Unlike the earlier form of gage, this Thirteenth Century form of mortgage created an interest in land for the lender. Accordingly, the doctrine of merger could apply. The mortgage as we know it today went through numerous other modifications to satisfy feudal law concepts and goals that at times would or would not permit an interest in a mortgage to be subject to the doctrine of merger. By the middle of the Twentieth Century in the United States, only eight states – Alabama, Georgia, Maine, Maryland, Massachusetts, New Hampshire, Pennsylvania, and Rhode Island – still adhered to the theory that a mortgage conveys title to the mortgagee and are thus appropriately subject to the doctrine's application. *40 Vand. L. Rev. at 323, 324*.

APPLICATION

Disregarding whether a mortgage creates an interest in land to which the doctrine of merger is applicable, which is frequently the case when litigated, its application can create unduly harsh and often absurd results. Unduly harsh results frequently occur when the doctrine is applied to merge a lender's mortgage interest into its fee interest that was acquired via a deed in lieu of foreclosure. If the deed in lieu of foreclosure is later set aside by a trustee in bankruptcy, the lender's mortgage interest is no longer in existence and he finds himself in the unenviable position of an unsecured creditor. Similarly, to the extent junior liens have attached to the property, the lender will be unable to clear title of these junior liens, a benefit the lender would have enjoyed had it foreclosed on its mortgage interest. If a property owner executes a deed in lieu and was not personally liable on the note secured by the mortgage, the deed in lieu may be challenged for failure of consideration. Similarly, if the note was non-recourse, a deed in lieu may be attacked due to the failure of consideration. Without the property or an obligation for which the borrower is personally liable, the lender will be left with nothing in the event such a conveyance is set aside.

Granted, these unduly harsh results can be prevented by the lender if he is willing to proceed with a foreclosure rather that accepting a deed in lieu, but is that a desired result when it will cost more money and a deed in lieu can achieve the outcome desired by the parties absent the doctrine of merger? Most would think not. The application of the doctrine of merger can produce an equally adverse effect on an innocent third party. For example, if the holder of a leasehold interest in real property grants that interest as security for a debt, later acquires the underlying fee simple interest which thereby extinguishes his leasehold interest, the leasehold interest pledged to his lender no longer exists and the lender has nothing. Similarly, merger might operate to destroy a term for years when the lessee acquires a life estate in the same land, even if the term for years would have lasted longer than the life estate. Since courts of law would apply the doctrine of merger to reach the absurd results described previously, in the late 1600's the courts of equity started to hold that the doctrine of merger applies only if the holder of the two property interests intend them to merge.

Today, the majority of the states in the United States follow the historical lead of England's court of equity. The intention of the party controls whether or not the doctrine of merger applies. Thus, it is wise to state the intention of the party receiving the second interest in the instrument conveying said interest. Unfortunately, some more modern court decisions have disregarded the stated intention to produce results that both defy and support a logical intention. *40 Vand. L. Rev. at 345*. (Citing Crosby v. Chase, 17 Me. 369, 369 (1840); Hardin v. Boyd, 113 U.S. 756, 765-76 (1885); Allen v. Glenn, 87 Ga. 414, 13 S.E. 565 (1891); Shaver v. McCloskey, 101 Cal. 576, 36 P. 196 (1894); Jenks v. Shaw, 99 Iowa 604, 610, 68 N.W. 900, 902 (1896); McGovney v. Gwillim, 16 Colo. App. 284, 287, 65 P. 346, 347 (1901); Contra Ford v. Nesbitt, 72 Ark. 267, 269, 79 S.W. 793, 794 (1904); Katz v. Obenchain, 48 Or. 352, 358, 85 P. 617, 620 (1906); Sullivan v. Saunders, 66 W. Va. 350, 353, 66 S.E. 497, 498 (1909); Kern Valley Bank v. Koehn, 157 Cal. 237, 239, 107 P. 111, 112 (1910); Austin v. Edwards, 201 Ala. 532, 533, 78 So. 886, 887 (1918); Small v. Cunningham, 120 N.W.2d 13 (N.D. 1963); Fowler v. Carter, 77 N.M. 571, 575, 425 P.2d 737, 740 (1967); Eldridge v. Salazar, 81 N.M. 128, 464 P.2d 547 (1970); Contra 200 E. 64th St. Corp. v. Manley, 37 N.Y.2d 744, 337 N.E.2d 133, 374 N.Y.S.2d 621 (1975); Quality Fin. Co. v. Bourque, 315 So. 2d 656 (La. 1975); Floorcraft, 251 So. 2d 138 (Fla. Dist. Ct. App. (1971)).

Many of these cases include fact patterns where a lender has a mortgage interest in the property and then acquires the fee simple interest via deed in lieu of foreclosure. When the lender later sells or conveys the property to a third party in an arms length transaction, the courts conclude that the lender intended its interest to merge and thereby to convey to said third party fee simple title unencumbered by the mortgage. Since there are cases where the court has applied the doctrine of merger notwithstanding the express intention of the parties otherwise, and vice versa, it is prudent in all jurisdictions to obtain a cancellation of any mortgage not being assumed rather than relying on the doctrine of merger. In those states that have adopted formal title practice standards that specifically state a title examiner may treat the mortgage lien as merged into the fee title when the mortgagee owns both the fee and the mortgage at the time of the conveyance, such a cancellation or release is not necessary. As of 1987, the states which had adopted such standards included Maine, Minnesota and Ohio. Burkhart, Freeing Mortgages of Merger, 40 Vand. L. Rev. at 361 (1987).

TITLE INSURANCE UNDERWRITER’S PERSPECTIVE

Due to the uncertainty of how courts will interpret the doctrine of merger, most title insurance underwriters are reluctant to eliminate lesser interests reflected on the public record based upon the application of this doctrine. Accordingly, it is best to report all lesser interests not specifically canceled or released of record. If the proposed insured has one interest and wishes the doctrine of merger to apply when acquiring a second interest, this author recommends that the title lawyer communicate this desire to the title insurance underwriter. Thereafter, the title insurance company can take exception to the lesser interest and include a note which reads as follows: "Upon receipt of satisfactory confirmation that the proposed insured has acquired fee simple title to [both the benefited and burdened parcel] [both the leasehold interest and fee simple interest] [description of interests to be merged] and the document conveying said interest expresses the parties’ intention to have the lesser interest merge into the greater interest, this exception shall be deleted in its entirety."

In any event, title lawyers should remember that it is best to first consult their title insurance underwriter or at a minimum use caution when applying the doctrine of merger as the basis for determining the status of title.