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Negotiable Instruments—Restricted Application Of Doctrine Of Forgotten Notice

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Association in its amicus curiae brief to the Court, since the great care normally shown by an institution in such a transaction should prevent recurrence of this situation. The precedents supporting the doctrine of forgotten notice are not overruled but are restricted to application in cases where the lack of diligence of the holder is less evident. The impact of the instant decision is that it redefines the scope of the doctrine of forgotten notice to provide restricted application only as an aid in balancing the interests between the innocent but negligent maker of a note and the innocent but negligent holder, rather than universal protection for that holder.

R. S. M.

PERSONAL AND REAL PROPERTY

LOCAL REAL ESTATE LIEN TREATED AS EXPENSE OF FORECLOSURE SALE DEFEATING PRIOR FEDERAL LIEN

The defendant owned property subject to the plaintiff's mortgage. The federal government acquired a lien on all the real and personal porperty of the defendant including his mortgaged house for unpaid federal taxes. Subsequently, the local government acquired a lien on the house for local real estate taxes accruing after the filing of the federal lien. The plaintiff moved to foreclose the mortgage and asked for summary judgment providing that the property be sold free and clear of the federal tax lien but subject to the local property taxes and assessments. Summary judgment was granted by the lower court but the intermediate court ordered reversal. On appeal, *held*: reversed, two judges dissenting. State procedure determines the property interest to which a lien attaches, and in the present case, the lien attaches to the debtor's or mortgagor's interest, which is solely reflected in the foreclosure surplus. Local taxes however, are expenses of foreclosure, which must be paid before such a surplus exists. *Buffalo Savings Bank v. Victory*, 11 N.Y.2d 31, 181 N.E.2d 413, 226 N.Y.S.2d 382 (1962).[1]

Federal statute provides that the federal government acquires a lien on all real and personal property of the taxpayer for unpaid taxes,[2] and where the debtor is insolvent this federal lien has absolute priority.[3] Where there is no evidence of insolvency, the lien shall not be valid against existing mortgages and becomes valid only when properly filed.[4] New York law provides that local real estate taxes and assessments are expenses of sale,[5] and no surplus shall exist until such expenses are paid.[6] The Supreme Court has consistently stated

1. Reversing 13 A.D.2d 207, 215 N.Y.S.2d 189 (4th Dep't 1961) and reinstating 26 Misc. 2d 443, 206 N.Y.S.2d 518 (County Ct. 1960), cert. granted sub nom. United States v. Buffalo Savings Bank, 370 U.S. 915 (1962).
2. Int. Rev. Code of 1954, § 6321.
3. 31 U.S.C. § 191 (1958).
4. Int. Rev. Code of 1954, § 6323(a).
5. N.Y. Civ. Prac. Act § 1087.
6. N.Y. Civ. Prac. Act § 1082.

that the priority of federal liens over local liens must be determined by federal law.[7]

In *United States v. City of New Britain*,[8] the Supreme Court stated that Congress did not intend antecedent federal tax liens to rank behind any but the specific categories of interest set out in the federal statute.[9] The federal liens in the *New Britain* case attached prior to local tax liens. A Connecticut statute, although not directing that such local taxes were expenses of sale, provided that local tax liens take first preference.[10] The Supreme Court held that the rule "first in time, first in right" was intended by Congress when it enacted the federal statute and that there was no intention that subsequent state liens be allowed priority over properly filed federal liens. The Supreme Court has also held that whether or not a taxpayer has property or sufficient rights in property to which a federal lien may attach is a matter to be determined by state law.[11]

The majority in the instant case distinguished the *New Britain* case on the ground that there the parties were the federal government and the state government as lienholders contesting their rights to surplus funds, whereas in the instant case, it is the mortgagee and the federal government as lienholders contesting what is to be considered surplus.

The majority relies on the right of a state to determine whether the taxpayer has property or rights in property to which the federal lien may attach.[12] The Court reasoned that since the taxpayer has no interest in the property superior to the mortgagee's lien and the local tax lien, the federal liens can only attach to any surplus remaining after the preferred liens are paid.[13] The dissent thought that the distinction the majority makes of the *New Britain* case is meaningless, and since the federal lien is upon all property or rights in property of the taxpayer, whether real or personal,[14] and since the lien attaches at the time the assessment is made,[15] the majority should not look to the equity of the taxpayer after the subsequent mortgage sale, but rather to the time of the filing of the federal lien. The dissent concludes that since the taxpayer had property rights in the land when his federal taxes became due, the federal lien attached and has priority over the subsequent local liens.

7. E.g., United States v. Acri, 348 U.S. 211 (1955); United States v. City of New Britain, 347 U.S. 81 (1954); United States v. Security Trust & Savings Bank, 340 U.S. 47 (1950).

8. New Britain, supra note 7.

9. Int. Rev. Code of 1954, § 6323(a).

10. Conn. Gen. Stat. § 1853 (1949), Conn. Gen. Stat. Rev. § 12-172 (1958).

11. United States v. Durham Lumber Co., 363 U.S. 522 (1960); United States v. Bess, 357 U.S. 51 (1958); Aquilino v. United States, 3 N.Y.2d 511, 146 N.E.2d 774, 169 N.Y.S.2d 9 (1957), rev'd on other grounds, 363 U.S. 509 (1960).

12. Ibid.

13. For other decisions in point see Rikoon v. Two Boro Dress Inc., 9 A.D.2d 783, 193 N.Y.S.2d 302 (2d Dep't 1959) (mem.), leave to appeal denied, 7 N.Y.2d 711, 199 N.Y.S.2d 1026 (1960); Kronenberg v. Ellenville Nurseries & Greenhouses, 22 Misc. 2d 247, 196 N.Y.S.2d 106 (Sup. Ct. 1960).

14. Int. Rev. Code of 1954, § 6321.

15. Int. Rev. Code of 1954, § 6322.

The majority states the question to be "whether the payment of the federal lien filed against the mortgagor should be mandated where there is no evidence that the mortgagor has a financial interest *at the time of the foreclosure.*"[16] (Emphasis added.) Why the Court insists on looking to the "time of the foreclosure" to determine the interest of the mortgagor is never explained. Even if the financial interest of the mortgagor is surpassed by the amount of the debt owing on the land, the mortgagor had and still has title to the land.

It would seem that the dissent is correct in its statement that the federal lien may attach because the mortgagor has an interest in the property and that the subsequent local liens may not take priority. The majority asserts that "the Supreme Court . . . has allowed State law to control the procedure of foreclosure and payment of liens."[17] The case[18] relied on by the Court concerned the federal government as a junior lienor and is distinguishable from the instant case. The procedure of the state law can only determine whether the taxpayer has an interest in the property to which the federal liens may attach.[19] The characterization of local taxes as "expense of sale" is a definite extension of what such expenses are normally considered to include.[20] It is true that expenses are to be paid before federal liens, even in cases where the debtor is insolvent and the federal lien is therefore absolute. But as Justice Storl said long ago, "the expenses of *recovering the money* are first to be deducted from the gross proceeds received by the defendant as a charge thereon."[21] (Emphasis added.) It is open to dispute that the payment of local tax liens is an expense of "recovering the money." The statutes of New York[22] which require local taxes to be paid as expenses of sale are close to being substantive in nature. It is one thing to say that a federal lien will attach to a surplus and quite another to say that such a surplus will not include the amount of local taxes. It may be fair to determine that the local tax lien affects an interest in the property different from that of the federal tax lien, but not to obscure this distinction by claiming procedure requires the liens be treated differently. There is a line of cases in New York which holds that if foreclosure is threatened and the local taxes are paid by the mortgagee, thereby granting the mortgagee a statutory lien for such payment, secured by this mortgage,[23] this lien cannot take preference over a prior federal lien because federal law controls when there is direct conflict between local and federal law.[24] This prior case law, coupled

16. Buffalo Savings Bank v. Victory, 11 N.Y.2d 31, 39, 181 N.E.2d 413, 416, 226 N.Y.S.2d 382, 387 (1962).
17. Id. at 40, 181 N.E.2d at 417, 226 N.Y.S.2d at 388.
18. United States v. Brosnan, 264 F.2d 762 (3d Cir. 1959), aff'd, 363 U.S. 237 (1960).
19. Supra note 11.
20. Abrams v. United States, 274 F.2d 8 (8th Cir. 1960) (attorney's fees); Kennebec Box Co. v. O. S. Richards Corp., 5 F.2d 951 (2d Cir. 1925) (receivership expenses); In the Matter of Stiles, 126 Misc. 715 (Surr. Ct. 1926) (funeral expenses).
21. United States v. Hunter, 26 Fed. Cas. 439 (No. 15,427) (C.C.D.R.I. 1828).
22. N.Y. Civ. Prac. Act §§ 1082, 1087.
23. N.Y. Real Prop. Law § 254(6).
24. United States v. Christensen, 269 F.2d 624 (9th Cir. 1959); First Federal Sav.

with the instant case, means that if the mortgagee voluntarily pays subsequent local taxes, the federal government's lien will take preference over such payments, but if the mortgagee orders foreclosure, local taxes will be paid just as expenses thereby protecting the interest of the mortgagee, although the purpose of the Civil Practice Act Section 1087 is to protect the purchaser at the foreclosure sale.[25] A consideration of the above leads to the conclusion that the controlling authorities support the view of the dissenting judges and that the Supreme Court will adopt their conclusion in reversing the instant case.[26]

R. W. S.

NOTICE BY PUBLICATION—POSTING SUFFICIENT IN CONDEMNATION PROCEEDING

In 1952, the City of New York, pursuant to the Water Supply Act,[1] acquired the right to divert the Neversink River. In accordance with the notice provisions of the Act, defendant published notice of the diversion in two newspapers located in the county in which the affected real estate was situated for the statutory period and posted handbills in the vicinity of the affected land. In 1959, after the three-year limitation in which claims might be filed expired, plaintiff, a riparian owner of a parcel situated twenty-five miles downstream from the diversion, brought an action to enjoin the diversion on the ground that not until 1959 did plaintiff actually learn of the proceedings. Plaintiff asserted a right to file a claim, based on her property damage and lack of notice and challenged the notice provisions as constitutionally inadequate in failing to satisfy due process requirements.[2] Plaintiff appealed from an Appellate Division judgment dismissing the complaint on the ground it was barred by the expiration of the statutory period.[3] *Held,* affirmed with two judges dissenting. Constructive notice provided for by the Water Supply Act satisfied the demands of due process in that it reasonably apprised the interested parties of the pendency of the action and afforded complainant an opportunity to file her claim. Personal service was not necessary in this type of case. *Schroeder v. City of New York,* 10 N.Y.2d 522, 180 N.E.2d 568, 225 N.Y.S.2d 210 (1962).

The type of notice which would satisfy the constitutional requirement of due process is not translatable into a neat, self-defining judicial formula. This was well stated by the Supreme Court in *Mullane v. Central Hanover Bank &*

& Loan Assoc. v. Lewis, 14 A.D.2d 150, 218 N.Y.S.2d 857 (2d Dep't 1961); Metropolitan Life Ins. Co. v. United States, 9 A.D.2d 356, 194 N.Y.S.2d 168 (1st Dep't 1959).

25. Wesselman v. The Engel Co., 309 N.Y. 27, 127 N.E.2d 736 (1955).

26. Cert. granted, sub nom. United States v. Buffalo Savings Bank, supra note 1.

1. Administrative Code of City of New York, ch. 41, tit. K.

2. U.S. Const. amend. XIV, § 1 "Nor shall any State deprive any person of life, liberty, or property, without the due process of law. . . ."; N.Y. Const. art. I, § 6. "No person shall be deprived of life, liberty or property without due process of law."

3. 14 A.D.2d 183, 217 N.Y.S.2d 975 (3d Dep't 1961).