

Question 4

Jane owned a machine shop. It had one slightly buckled wall. It had been built years prior to Town's adoption of a zoning ordinance that permits office buildings and retail stores, but not manufacturing facilities.

Ira purchased the machine shop from Jane for \$500,000. He gave her \$50,000 in cash and a promissory note for an additional \$50,000 secured by a deed of trust. He borrowed the other \$400,000 from Acme Bank (Acme), which recorded a mortgage. Acme was aware of Jane's promissory note and deed of trust prior to the close of escrow.

Donna owns a parcel adjoining Ira's machine shop. She recently began excavation for construction of an office building. Ira complained to Donna that the excavation was causing the shop's wall to buckle further, but she did nothing in response.

Shortly thereafter, Ira's machine shop collapsed. Ira applied to Town for a building permit to rebuild the shop, but Town refused. He then defaulted on his obligations to Jane and Acme.

Ira has sued Donna seeking damages, and he has sued Town seeking issuance of a building permit. Acme has filed a foreclosure suit against Ira, and Jane has demanded a proportionate share of the proceeds from any foreclosure sale.

1. How is the court likely to rule on Ira's claim for damages against Donna? Discuss.
2. How is the court likely to rule on Ira's request that Town issue a building permit? Discuss.
3. How is the court likely to rule on Jane's claim for a proportionate share of the proceeds from any foreclosure sale? Discuss.

QUESTION 4: SELECTED ANSWER A

1. Ira's Claim for Damages against Donna

Ira owned the machine shop that adjoined Donna's parcel of land. When Donna excavated her parcel it caused Ira's machine shop to collapse. Ira has many multiple causes of action that he may pursue against Donna in attempt to recover from the collapse of his machine shop. They include a strict liability claim based on lateral support principles, or based on negligence.

Strict Liability and Lateral Support:

Landowners have a right to the support of the surface of their property. When an adjoining landowner engages in action that causes the adjoining property to subside, the owner who caused the subsidence may be strictly liable for the damage caused. In order for strict liability to apply, the injured party whose property has subsided must show that the actions of the adjoining landowner caused the subsidence, and that the subsidence would have occurred even if no structures were built on the injured party's land. If the subsidence would not have occurred but for the weight of the structure built on the land, then strict liability will not attach and the injured party will have to pursue another cause of action to recover.

Here, Donna began excavation for construction of an office building on her parcel that was adjacent to Ira's machine shop. Despite complaints from Ira, Donna continued her planned excavation. Based on Ira's statements that the excavation was causing the wall of his machine shop to "buckle further," which eventually led to the collapse of the machine shop, it seems clear that the excavation is what actually caused the structure to fall. Ira can recover for strict liability as long as the subsidence would have occurred even if the machine shop were not built on the land. This is likely where Ira's cause of action will fail. Facts stipulate that the wall of the machine shop was slightly buckled, and the excavation caused the wall to "further buckle." Facts do not indicate that the

land on which Ira's shop actually subsided, only that the action caused the machine shop to collapse. It does not appear that the land would have been damaged or lost lateral support if the machine shop was not built on the land.

In conclusion, Ira cannot recover based on his right to lateral support in strict liability because the collapse of the structure and the land likely would not have occurred if the structure was not built. No facts indicate the land would have subsided despite the shop. Ira must look to another cause of action.

Negligence:

Ira may attempt to assert a negligence claim against Donna. Negligence occurs when a party breaches a duty owed to another and the breach is the actual and proximate cause of damages suffered by another party.

Duty:

Donna has a duty to act as a reasonably prudent landowner who adjoins other parcels with structure on them. Ira is an owner of an adjoining parcel, she had a duty to act as a reasonably prudent landowner to the adjacent owners.

Foreseeable plaintiff:

Under the majority view of Cardozo, a party only owes a duty to foreseeable plaintiffs. Foreseeable plaintiffs are those that reside within the zone of danger of the defendant's actions. Here, Ira was the adjacent landowner to Donna. When Donna began excavation all adjacent landowners were foreseeable plaintiffs because it is foreseeable that construction could cause injury to the adjacent land or landowners. Ira was a foreseeable plaintiff.

Breach:

Donna possibly breached her duty to act as a reasonably prudent landowner when she continued excavation despite the fact that she was informed it was causing a wall of Ira's to buckle and was likely going to cause damage. Facts do not indicate whether or not the excavation was executed with reasonable care or not, but the fact that Donna continued after being informed that her actions were causing damage may mean that she breached her duty of care to Ira.

Actual Cause:

Actual cause is also termed the "but for" cause. The issue is whether but for Donna's actions the building would have collapsed. Ira informed Donna that the construction was causing the wall to buckle further, and the continued excavation led to the collapse of the building. Donna's actions were the but for cause of the collapse.

Proximate Cause:

Proximate cause is called the legal cause and the issue is foreseeability. Here, it is foreseeable that a person doing excavation may end up causing damage to the structures of adjoining parcels. Ira will argue that Donna's actions were completely foreseeable. Donna on the other hand will argue that the proximate cause was not her excavation, but rather the fact that the machine shop already had a "slightly buckled wall." Donna will argue that it is not foreseeable that adjacent landowners have improperly supported structures that will collapse during excavation of adjoining parcels. Donna's argument that the buckled wall makes the collapse unforeseeable probably will not work, but it may be effective as a defense (discussed below.) Moreover, Donna knew that her actions were causing the wall to buckle more after Ira told her, so ultimately her actions were foreseeable because she was informed of them.

Damages: Damages must be causal, foreseeable, certain, and unavoidable.

Here, Donna's actions caused the entire shop to collapse, and it is very possible that a court will find that she breached her duty to Ira and that her actions were the actual and proximate cause of Ira's damages. Absent any defenses, Donna will be required to pay Ira for either the cost of repair of the building (which is substantial), or the reduced value of Ira's property now that the shop has collapsed.

Defenses: Comparative Negligence

Donna has a good argument that Ira was himself negligent and she should be absolved of liability or that her liability should be substantially reduced. Ira knew that the machine shop had a slightly buckled wall that would likely reduce its structural soundness. Ira had a duty to investigate the structural integrity of the building, and insure that it was not at risk for collapsing easily. This is a very strong argument and Donna will likely have her damages reduced by the amount of Ira's negligence, which is significant.

In conclusion, Ira may recover from Donna under a negligence theory but Donna's damages will be offset by the amount of Ira's own negligence.

2. Ira's Request to have Town Issue a Building Permit.

Here, Ira's machine shop has been destroyed, and he wishes to rebuild it. Because of the current zoning ordinance, Ira's machine shop is not permitted in the area where he wants to build it. The issue is whether Ira should be granted a permit to operate the machine shop.

Zoning Ordinances:

Zoning ordinances are an effective way for states and localities to regulate the land use of their jurisdiction. However, a person who seeks to violate a zoning ordinance may

seek a variance that will be granted or denied in the form of a permit.

Variance:

A variance is an individual exception to a zoning ordinance. There are two types, area variances and use variances. Area variances are more likely to be granted because it is simply an exception given to allow a building to exist in dimensions that slightly violate the zoning ordinance. Use ordinances are less likely to be granted — a use variance is a permit allowing a person to operate a structure for a purpose that is not permitted by the zoning ordinance. Here, Ira wishes to get a permit to allow him to use his property for manufacturing, which is a use that is not permitted. In order to get a use permit, Ira must show that he will (1) suffer a hardship without the ordinance, (2) that the variance would not damage or harm the neighborhood, and (3) that he is not at fault or a bad actor in his request.

(1) Suffer a hardship

Here, Ira has paid a substantial amount of money in order to purchase the machine shop and operate it at the location where it currently resides. But for the fact that the machine shop collapsed, Ira would still be able to operate it most likely as a nonconforming use (discussed below). Preventing Ira from being able to rebuild and operate the shop as he had previously would cause him significant injury and he will surely suffer an economic hardship if not allowed to resume his business.

(2) Won't Harm the Neighborhood

Here, the neighborhood permits office buildings and retail stores, just not manufacturing. If the neighborhood were zoned only for residential use by families, it is likely that granting such a variance would cause harm to the neighborhood because families would have to deal with the constant manufacturing noise. But, because the area allows offices and retail stores, it is unlikely that the manufacturing would likely

cause significant harm to the neighborhood, unless the manufacturing involved toxic materials or chemicals. This factor weighs in favor of Ira.

(3) Ira is not at Fault

Here, Ira was operating the machine shop until Donna's excavation caused the shop to collapse. Ira did not buy the property knowing about the ordinance and now seeks a variance to benefit knowing all along such action would be in violation. And, but for the collapse of the structure, Ira likely would have been able to continue to run the business as a nonconforming use. Ira is not at fault in seeking the variance.

Conclusion:

In conclusion, the court should rule that the Town should issue a building permit because all of the elements required for a proper use variance are satisfied, and Ira is not a bad actor.

Nonconforming Use:

The other argument that Ira may present is that his operation of the machine shop is a nonconforming use because it was in existence prior to the change of the ordinance. Nonconforming uses that are in effect prior to an ordinance change are allowed to continue unless they cause harm to residents or adjoining property. Even then, an amortization period is generally allowed to allow the owner to find a new location for the activity. Here, Ira was properly operating the manufacturing business prior to the ordinance, and the fact that the building collapsed should not deprive him of being able to rebuild a similar structure and continue with the nonconforming operation he had prior to the collapse. There is no evidence the manufacturing is causing harm to other residents.

In conclusion, the court also should have the Town issue a building permit because Ira's prior nonconforming use should still be considered in effect.

3. Jane's Claim for Proportionate Share of the Proceeds from Foreclosure.

Deed of Trust and Mortgage:

When Ira purchased the property from Jane, he gave her a 50K promissory note secured by a deed of trust. He borrowed the other 400K from Acme which recorded a mortgage. Mortgages and Deeds of Trust operate similarly.

A Deed of Trust is an arrangement where a third party holds a deed in a trust to stand as collateral for a debt owed. With a deed a trust, if the debtor (Ira) fails to make payments and ends up in default on the loan, the party that made the loan, Jane, can initiate foreclosure and execute a private sale of the property.

A Mortgage is an arrangement where a party who has or is buying property gets a loan and has the property itself stand as security for the debt. If a debtor fails to make the loan payments and ends up in default, then the holder of the mortgage, the mortgagee, may initiate public foreclosure proceedings against the property.

Here, Ira failed to make payments on the loan and was thus in default. Acme was within its right to initiate foreclosing proceedings against the property to recover for the debt owed. The order of payment from a foreclosure sale is determined by a number of factors, including whether the loan was a purchase money security interest.

Priority:

Upon a foreclosure sale, how proceeds from the sale are distributed is determined by the priority of the creditor's interest. Priority is determined by (1) whether or not the loan was a purchase money security interest and (2) when the interest or mortgage was

recorded. All purchase money security interests have priority over other creditor interests executed at the same time.

Here, Jane executed a valid deed of trust, and Acme executed a valid mortgage. The mortgage was recorded and had notice of the deed of trust secured by Jane. Because both loans were provided in order for Ira to obtain the purchase of the property, both interests should be considered purchase money security interests. If Acme had recorded the mortgage on the property without notice of the deed of trust secured by Jane, Acme would have had priority over all other creditors. However, because Acme had notice of the deed of trust, and because both loans will be considered purchase money security interests, Jane's Deed of Trust will have priority.

Order of Payment:

Foreclosure proceeds are not distributed in proportion. So, the court will not rule that a proportionate share of the foreclosure proceeds should be given to her. However, that does not mean that Jane's interest will necessarily be adversely affected. When a creditor forecloses on a property and provides notice to any junior interest, at the sale of the property the junior interest is extinguished. Here, Acme initiated the public foreclosure sale, and had Jane's deed of trust been a junior interest, then Jane was required to notice, but her interest would be extinguished at the end of the sale, whether or not she received proceeds. A senior interest remains intact on the property when a junior interest initiates the foreclosure. When a foreclosure is executed, the priority of payment is that (1) all fees are paid for the foreclosure, (2) Senior creditor interests are paid first and in order to the junior interests, and (3) anything left over is given the debtor, or owner of the property.

Here, Jane's interest in the property has priority to Acme's because her deed of trust was executed first, Acme was aware of the deed of trust, and both interests are purchase money security interest. Accordingly, Jane's interest will not be extinguished by the foreclosure sale by Acme. If the proceeds from the sale produce enough to pay

both the debts of Acme and Jane, then both will be paid, and any remainder will be given to Ira. If not, Acme's foreclosure sale will be subject to Jane's deed of trust, and the sale will not extinguish that interest. Jane will be able to foreclose on the property regardless of who purchases the shop during the public foreclosure sale.

CONCLUSION:

In conclusion, though the court will not order Acme to split the proceeds from the foreclosure sale with Jane proportionally, Jane's deed of trust is superior to Acme's mortgage, and the public foreclosure would not extinguish her interest in the machine shop.

QUESTION 4: SELECTED ANSWER B

1. Ira v. Donna

The first issue is establishing what obligations, if any, Donna owes to Ira as a neighboring property owner.

Ira is claiming damages against Donna for the damage caused by Donna's excavation for the construction of an office building. Duties between neighboring property owners can arise in several ways, namely, through contract or tort law. Under contract law, if parties enter into covenants with each other to do something or refrain from doing something on their land, they may be obligated under contract law to fulfill those obligations. Another way in which neighboring property owners may owe each other a duty is through tort law. If Donna and Jane (Ira's predecessor) or Donna and Ira had created a covenant not to interfere with one another's sublater support, Ira may have a claim for damages under that theory. However, it does not appear that they have an explicit agreement.

Tort law will also impose duties on neighboring property owners in some instances. For example, if one property owner's use of the property is in a way that causes a nuisance, that may give rise to liability under tort law. Likewise, neighbors have a general obligation to refrain from engaging in hazardous or inherently dangerous activities on their property that may interfere with others outside of their property. Additionally, property owners may have a duty under either a strict liability or negligence theory for interfering with a property owner's sublater support.

Inherently Dangerous Activities

Ira may argue that Donna's use of the neighboring property (using an excavator) constitutes an inherently dangerous activity. When a property owner engages in an inherently dangerous activity she will be held strictly liable for injuries resulting as a

consequence of that activity's inherently dangerous propensities. In order to be considered inherently dangerous, an activity must be: 1) unusual for the community; 2) one that cannot be made safer by safety measures; 3) one whose utility is outweighed by the danger it is likely to cause.

In this case, Donna is excavating her property to build an office building. Donna is doing so in a zone that specifically permits office buildings. One may assume that if office buildings are allowed in the zone, their construction is also a usual activity for that area. Further, there is utility in developing a community for business and thus, there is utility in building office buildings. Further, the construction of office buildings can be made safer by taking safety precautions, by having licensed contractors, putting up warning signs, etc. Therefore, using an excavator will likely not constitute an inherently dangerous activity and Ira does not have a cause of action under this theory.

Interference with Sublateral Supports

An alternative theory will arise by asserting that Donna has interfered with Ira's subadjacent property rights. In cases where a neighbor excavates and causes a disturbance in their neighbor's sublateral support for their property, the neighbor whose property was damaged may have a cause of action under either a negligence theory or a strict liability theory. Which theory applies depends on whether or not the neighbor (Ira) can show by clear and convincing evidence that her property and the weight of his buildings did not contribute to the damage. That is, there would have been damage regardless of whether or not the buildings were constructed. If the plaintiff (Ira) cannot show that his buildings did not contribute to the ultimate injury, then he must make out a case in negligence. If he can, then he may make out a case in strict liability.

In this case, when Jane owned the machine shop it already had a slightly buckled wall. Therefore, when Ira took the building, the wall was likely still buckled or even made worse with the passing of time. Because of this, the unsecured nature of the construction likely contributed in some way to the building's ultimate destruction.

Therefore, strict liability is not available to Ira because he cannot demonstrate that the buildings on his property in no way contributed to the damage.

Therefore, Ira must make out a case in negligence. In order to make out a case in negligence, a plaintiff must show that: 1) defendant had a duty to the plaintiff; 2) defendant breached that duty; 3) the breach was the actual and proximate cause of the damage; 4) there were damages.

In this case, a duty has already been established under the sublateral support doctrine. The standard of care is an objective, reasonable person standard. Negligence causes of action incentivize individuals to act in a reasonable way in their interactions with others. The standard of care in this case would be what a reasonable person excavating property next to a neighbor's property would do.

The next issue is whether or not the defendant breached that duty. In this case, it appears as though Donna initially was acting as a reasonable person; as discussed, she was excavating property to build an office building in an area zoned for that use. However, Ira complained to Donna that the excavation was causing the shop's wall to buckle further. After Donna was put on notice of creating this damage, the question becomes whether a reasonable person would have done something to attempt to avoid the damage. In this case, Donna did nothing at all. It seems that a reasonable person would have assessed whether it was possible to move the location of the excavation or adjust construction in some other way to avoid the damage. Because there is no evidence that Donna did this, a court may find that she breached her duty toward Ira.

The next issue is whether her breach was the actual cause and proximate cause of the damage. Actual cause is but-for cause: but for the breach, would the damage have occurred? Actual cause may also be substantial cause if there are two or more contributing causes, either one of which may have been sufficient to cause the damage. In this case, it appears as though Donna's actions were the but for cause of the building's collapse. Ira complained to Donna that the excavation was causing the

building to further buckle. While it may ultimately be an issue of fact regarding whether it was the buckling of the wall or the excavation, for the purposes of getting the question to a jury a court would likely assume this element was met.

The next question is whether the excavation was the proximate cause of the injury. Proximate cause is the philosophical nexus between the act taken and the damage done -- it requires more than just actual cause and requires that the cause be something foreseeable from the defendant's actions such that it comports with notions of common sense and justice to hold the defendant liable for his actions. Under *Palsgraf*, the relevant question is whether the injury was foreseeable to the actor. A minority view would hold any damage is foreseeable if it resulted from the action. In this case, because Donna had notice of the damage the excavation was causing, and the excavation was occurring right under the building, it seems foreseeable the damage to the building was likely. Therefore, the proximate cause element is likely met.

Finally, Ira must show there was damage resulting from the breach. In this case, there was actual destruction of his building, resulting in substantial damage, so this element is also met.

Note, most jurisdictions would reduce the amount of damages that Ira receives based on a pure comparative negligence standard, which reduces the amount of recovery that plaintiff receives by her amount of fault. In a traditional comparative negligence state, the recovery would be reduced entirely if the plaintiff was at all at fault. In this case, it does seem as though Ira was partially to blame for not strengthening his wall or doing anything to avoid the damage. Therefore, his damage award will likely be reduced based on the findings of a jury.

2. Ira v. Town

Is the ordinance valid under the Constitution?

Ira's case against the town arises from the Town's refusal to permit him to rebuild a machine shop in a zone that permits office buildings and retail stores, but not manufacturing facilities.

The first issue is whether or not the town's adoption of a zoning ordinance is permissible under the Constitution. The Constitution permits state actors to take or incur on a private citizen's property rights for the public good provided they are given just compensation, measured by the value to the property owner, not the benefit conferred to the government. Generally, zoning ordinances, although they are not complete takings under the Constitution, are analyzed under this framed work.

The general rule is that if the government possesses a private actor's property, no matter in what degree, it will constitute a taking under the Constitution and the property owner will be entitled to compensation. In this case, because the Town has not physically possessed Ira's property, this does not constitute a complete taking.

However, a regulatory regime that destroys all economic viability will also constitute a complete taking under the Constitution and will require the property owner be justly compensated. In this case, the zoning ordinance is a regulation. However, it does not completely destroy the value of Ira's property because he could still build an office building, retail store, sell the property, etc. Therefore, it is not a complete taking under this theory either.

Finally, a partial taking may also require compensation under the Penn Central balancing test if a property owner's property interests are interfered with and his property value decreased. Courts look at: 1) the investment-backed expectations of the property owner; 2) the nature of the government action; 3) the benefit to the public and harm to the individual property owner and what the owner should rightfully have to bear for the benefit of the public. In this case, it is unclear whether Ira's property rights decreased. Clearly, he cannot do what he wants with the property, but that does not

mean it does not have other values. Therefore, a court would likely find the Town's refusal to issue a building permit proper under the Constitution.

Is a variance warranted?

The question becomes then, whether or not Ira is entitled to continue using the facility pursuant to a zoning variance for prior use. A zoning variance may be granted if the owner of property can show that the use of their property in the manner previously used will cause undue hardship to the owner and would not cause significant harm to the community if the variance was granted. Notably, when the zoning ordinance is valid, as this one is (see previous discussion), a Town has some discretion in balancing the harms to the application and to the community.

In this case, the zoning ordinance permits office buildings and retail stores, but not manufacturing facilities. The reasoning behind this ordinance seems apparent: manufacturing facilities are generally larger, more disruptive, more likely to emit noise, debris, etc. A town has a reasonable basis for preferring to have a community comprised of stores and office buildings, where people can shop and work without distraction and interference. Therefore, the harm to the community if the variance were granted seems great.

However, Ira does have an argument that because of the pre-existing use of the machine shop by Jane, he is entitled to a variance under the theory that he was grandfathered into the ordinance. However, there are three problems with this argument. First, as previously discussed, the Town has good reason for not wanting manufacturing facilities in the retail/office area of town and variances are discretionary. Second, there are privity issues between Jane and Ira and the Town. It was Jane, not Ira that had been using the building as a machine shop (presumably a manufacturing facility, though Ira might raise a classification argument), when the ordinance was passed. Third, the pre-existing use generally must be consistent if a variance is granted for pre-existing use. When the machine shop collapsed, it was no longer used as a

manufacturing facility and Ira likely lost his ability to claim any sort of entitlement to use the property as a manufacturing facility under the pre-existing use doctrine.

In conclusion, a court will likely deny Ira's request that the Town issue a building permit.

3. Jane v. Bank (re: proportionate share of the foreclosure proceeds)

The issue this question raises is how to be characterize the security interests that Jane and Acme have in the machine shop property and what the priority of those interests are.

Generally, mortgages are security interests in property, used by a mortgagee to secure a debt that she has issued to a mortgagor. In this case, Ira purchased the machine shop from Jane for \$500,000, but as he clearly did not have that much money, he took out loans. A loan may be either secured or unsecured. An unsecured loan is one that does not have any collateral that a lender may use as compensation in the event of default. A secured loan is one that has property of some sort as collateral for the repayment of a loan. Unsecured loans take a second seat to secured loans when property is foreclosed upon.

Generally, mortgages are prioritized in the order they were made. A bank that loans money to a home purchaser will take a first mortgage on that home. If the purchaser later borrows more money, that lender may also secure the repayment with a mortgage on the home, but it will be subject to the first lender. Once the first lender is paid in full, the second lender will be entitled to proceeds. This is why second mortgages often have higher interest rates or are otherwise on less favorable terms -- they are less secure because they are subordinate to another's interests in the property. The proceeds come from a foreclosure sale, which occurs when the property securing the debt is sold to pay off the lenders.

Finally, there are special types of loans/mortgages called "purchase money mortgages". The mortgages occur when the money lent to a mortgagee is used for the purchase of the item itself. This typically occurs with owner financing -- if a homeowner sells her home and loans money to the purchaser to buy it, there is a purchase money mortgage in the house. These types of mortgages will take priority, even if there is a primary lender that attached prior to the purchase money mortgage being issued.

In this case, Ira purchased the machine shop from Jane for \$500,000. Obviously Ira did not have that cash up front. Instead, he paid \$50,000 in cash to Jane, which is hers to keep and is not up for grabs at the foreclosure sale. Next, he gave her a promissory note for an additional \$50,000 secured by a deed of trust. Then he borrowed another \$400,000 from Acme Bank, which recorded a mortgage.

If the \$50,000 from Jane was secured by an interest in the machine shop, the very property the loan was made to purchase, this loan will take priority and Jane will be entitled to the first \$50,000 received in the foreclosure sale.

Acme will argue that it is the primary lender and that it is entitled to all the money from the foreclosure sale, until it exceeds its \$400,000 loan, at which case it may spill over to secondary lenders. There are two problems with this argument: 1) First, as discussed above, Jane's loan to Ira was a purchase money mortgage and takes priority over the Bank's loan. Even if it were not a purchase money mortgage, Jane was still the first lender. 2) Second, Acme knew of Jane's promissory note and deed of trust prior to the close of escrow. Notably, although Jane did not appear to record her mortgage, a recording is not required to secure an interest. Rather, a recording system serves to give subsequent mortgagees and purchasers notice, something Acme already had.

The issue then becomes, what is the effect of Acme's knowledge on its mortgage in the property? Generally, in order to take priority, a mortgagee must be a holder in due course, or a bona fide mortgagee, who takes without knowledge of any other interests in the property. In this case, because Acme knew about Jane's deed of trust, Acme was

not a bona fide mortgagee or holder in due course; therefore, Acme's mortgage could be subordinated on this ground.

Note: Generally the holder in due course requirements are intended to protect a subsequent mortgagee who takes from a first mortgagee. A holder in due course will be protected if he takes a negotiable instrument, made out to the holder, without notice of impediments, for valuable consideration and in good faith. A holder in due course will be free from personal defenses raised by the mortgagor (e.g., lack of consideration, waiver), but will take subject to non-personal defenses (e.g., duress). In this case, Acme did not take the mortgage from another mortgagee, but rather was the first mortgagee. Therefore, this doctrine does not apply, but its principles still do. Generally, courts do not reward mortgagees or other property holders who take knowing of another's interest in land.

In sum, Acme, although it was the first to record, under either a notice or race-notice jurisdiction, Acme is not entitled to bona fide purchaser/mortgagee status because it took knowing of Jane's mortgage. Further, Jane is protected by her status as a purchase money mortgagee. Therefore, a court will likely rule that she is entitled to \$50,000 from a foreclosure sale.