YARBOROUGH SCRUTINIZED: AN ANALYSIS OF THE THEORETICAL FOUNDATIONS OF THE FUTURE ADVANCE MORTGAGE

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I. INTRODUCTION

In 1832, Chancellor Kent wrote in his famed Commentaries on American Law:

> There is no branch of the law of real property which embraces a greater variety of important interests, or which is of more practical application [than the law of mortgages]. The different, and even conflicting views, which were taken of the subject by the courts of law and of equity, have given an abstruse and shifting character to the doctrine of mortgages.[1]

The recent bombshell decision of the Ohio Supreme Court in the case of *Wayne Bldg. & Loan Co. v. Yarborough*[2] constitutes ample evidence of the continuing validity of Chancellor Kent's observation regarding the "abstruse and shifting character" of the doctrines which constitute the theoretical foundations of the law of mortgages. This article consists of an examination and analysis of these theoretical foundations[3] insofar as they relate to mortgage loans which contemplate future advances.[4]

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1 IV J. KENT, COMMENTARIES ON AMERICAN LAW, 135 (2d ed. 1832).

2 11 Ohio St. 2d 195, 228 N.E.2d 841 (1967). *Yarborough* is discussed in Recent Decision, *Mortgages—Lien and Priority—Mortgages and Mechanic's Liens*, 19 CASE W. RES. L. REV. 423 (1968); Comment, *Construction Mortages In Ohio*, 29 OHIO ST. L. J. 917 (1968)

3 For those "practical" lawyers who disdain theoretical discussions, attention is drawn to the following comment made by Oliver Wendel Holmes, Jr.:

> "Theory is the most important part of the dogma of the law, as the architect is the most important man who takes part in the building of a house . . . . It [theory] is not to be feared as impractical, for, to the competent, it simply means going to the bottom of the subject."

Holmes, *The Path of the Law*, 10 HARV. L. REV. 457, 477 (1897).

4 A great deal has been written about future advance mortgages. For the most part, very little, if anything has been said concerning most matters discussed in this article. Major treatises which cover the subject are: 4 AMERICAN LAW OF REAL PROPERTY, Chap. IV (1952); III G. GLENN, MORTGAGES, DEEDS OF TRUST, AND OTHER SECURITY DEVICES AS TO LAND, §§392 *et. seq.* (1943); 1 L. JONES, A TREATISE ON THE LAW OF MORTGAGES OF REAL PROPERTY, §§447 *et seq.* (8th ed. 1928); 4 J. KENT, *supra* note 1, at 135 *et seq.*; G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES, §§113 *et seq.* (1951); D. PINGREY, A TREATISE ON THE LAW OF MORTGAGES OF REAL PROPERTY, §§483 *et seq.* (1893); R. POWELL, THE LAW OF REAL PROPERTY, §442 (1967); 9 G. THOMPSON, COMMENTARIES ON THE MODERN LAW OF REAL PROPERTY, §4747 *et seq.* (1958); 5 H. TIFFANY, THE LAW OF REAL PROPERTY, §1463 *et seq.* (3d ed. 1939).

The works by Osborne and Glenn demonstrate more critical scholarship than is found in the other treatises which often mimic each other. The material which appears in 4 AMERICAN LAW OF PROPERTY, Chap. IV was taken directly from Osborne.

It is rather ironic that the best discussion by far of future advance mortgages appears in Professor Gilmore's treatise on personal property. II G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, Ch. 35 (1965). Gilmore's work is brilliant. It is the logical starting point for any venture into the field of future advance mortgages. A recent student comment in the UNIVERSITY OF CHICAGO LAW REVIEW which analyzes future advance lending under the Uniform Commercial Code (personal property) is also very helpful in understanding similar problems in-

II. THE MECHANICS AND ECONOMICS OF FUTURE ADVANCE LENDING

An appreciation of the mechanics by which a mortgage loan for future advances is created and administered is a necessary prerequisite to a meaningful examination and analysis of the theoretical foundations which underlie such a loan. Accordingly, this article will first discuss the genesis and administration of a typical mortgage loan for future advances.

All future advance mortgages attest to the existence of four economic "facts of life," namely:

1. A borrower who lacks financial stability to such an extent that a lender requires that any loan made to the borrower be secured.
2. A borrower who owns real estate which can secure repayment by the borrower of the amount loaned to him.
3. A lender who requires, for reasons which he need justify only to himself, that the loan proceeds be disbursed on an installment basis and a borrower who can make effective use of the proceeds on such a basis.
4. Real estate which, when mortgaged to the lender by the borrower, will possess, or be capable of possessing, value at least equal to the amount loaned to him.[5]

A multitude of transactions exist in which business desirability and the economic facts of life dictate the use of a mortgage loan for future advances.[6] Financing the construction of a shopping center, a commercial

volving mortgages. See Comment, *Priority of Future Advances Lending Under The Uniform Commercial Code*, 35 U. CHI. L. REV. 128 (1967).

In footnote 1 to Section 35.1 of his treatise, Gilmore cites various A.L.R. annotations and law review articles which serious students of the future advance mortgage might like to consult. Gilmore feels the most useful law review articles are: Blackburn, *Mortgages to Secure Future Advances*, 21 MO. L. REV. 209 (1956); Jones, *Mortgages Securing Future Advances*, 8 TEX. L. REV. 371 (1930); Reddish, *Open-End Mortgage and Priorities in Nebraska*, 38 NEB. L. REV. 172 (1959). Law review material specifically treating Ohio future advance mortgage law can be found in: Note, *Mortgages—Future Advances—Obligatory and Non-Obligatory Advances in Ohio*, 1 U. CIN. L. REV. 348 (1927) and Note, *Ohio Lien Priority Rules Affecting Mortgages, Mechanic's Liens, and Fixture Security Interests*, 18 W. RES. L. REV. 1284 (1967).

Those who wish to verify how little the law of future advance mortgages has developed in the past century should read Redfield, *The Necessity Of Describing The Security Upon the Registry. Mortgages to Secure Future Advances, and Where The Securities Have Been Changed*, 11 AMERICAN LAW REGISTER 1 (1862).

[5] *See* Comment, *Priority of Future Advances Lending Under the Uniform Commercial Code*, 35 U. CHI. L. REV. 128, 129-30 (1967).

[6] Various transactions which give rise to future advance mortgage financing are enumerated in Comment, *supra* note 5 at 130-31, n. 13. It reads:

"Every early 'leading' case in the future advances field shows the use of the future advances mortgage of real estate either to provide or to underwrite working capital for business enterprise. See Shirras v. Craig, 11 U.S. (7 Cranch) 34 (1812) (financing of merchants); Ackerman v. Hunsicker, 85 N.Y. 43 (1881) (indorsing business firm's notes); Robinson v. Williams, 22 N.Y. 380, 383 (1860) (mortgage of bank premises to cover fluctuating balance); Hopkinson v. Rolt, 9 H.L. Cas. 514, 11 Eng. Rep. 829 (1861) (working capital for shipbuilder).

For like use of the future advances device, see Bell v. Radcliff, 32 Ark. 645 (1878) (deed of trust to cotton crop to secure advances of supplies needed by partnership to cultivate a plantation); Tapia v. Demartini, 77 Cal. 383, 19 P. 641 (1888) (mortgage to cover equipment sold to mining partnership); Langerman v. Puritan

housing project or a manufacturing plant are typical examples of transactions involving the use of such a loan. Under a mortgage loan for future advances, the lender may agree, for example, to lend $1,000,000 to the borrower. The borrower, in turn, agrees to use the loan proceeds to construct the facility in question. In order to provide security for repayment of the loan, the borrower executes and delivers to the lender a mortgage deed covering the land upon which the facility is to be constructed. Installments of the loan proceeds are then advanced by the lender to the borrower as the work progresses on the facility. In this manner, the lender minimizes the risk of his investment by insuring that the loan proceeds are in fact used to increase the value of the mortgaged land. At the same time, the borrower is assured of a continuing supply of capital which he may use to pay the debts incurred by him in erecting the facility.

As the preceding example indicates, many advantages inhere in the use of future advance mortgage financing. Every major real property treatise sings the praise of such financing. The borrower pays interest not on the face amount of the mortgage loan, but rather only on the amount of the loan actually disbursed to him (interest is computed on each disbursement from the date thereof).[7] In addition, he is relieved of the economic necessity of securing a proper investment for surplus funds until he is ready to employ them in the loan project. Future advance lending also permits the borrower to avoid the expense and inconvenience of obtain-

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Dining Room Company, 21 Cal. App. 637, 132 P. 617 (1913) (mortgage to seure line of credit to dining room company); Boswell v. Goodwin, 31 Conn. 74 (1862) (mortgage to cover indorsement of paper manufacturer's notes and advances); Weiser Loan & Trust Co. v. Comerford, 41 Ida. 172, 238 P.515 (1925) (mortgage to secure fluctuating balance); Speer v. Skinner, 35 Ill. 282 (1864) (hotel furniture mortgaged by hotel operators to secure advances of working capital); Collins v. Carlile, 13 Ill. 254 (1851) (mortgage by merchant to cover purchases of goods from a St. Louis distributor); Louisville Banking Co. v. Leonard, 90 Ky. 106, 13. S.W. 521 (1890) (mortgage to secure discount of customer notes of furniture manufacturer); Downing v. Palmateer, 17 Ky. (1 T.B. Mon.) 64 (1824) (mortgage of female slave to cover advances of liquor and other necessaries to tavern keepers in Lexington); Hall v. Jay, 131 Mass. 192 (1881) (mortgage to secure purchases of coal by a retail coal-dealer from a wholesaler); Commercial Bank v. Cunningham, 41 Mass. (24 Pick.) 270 (1837) (mortgage to secure future indemnities); McDaniels v. Colvin, 16 Vt. 300 (1884) (mortgage to cover what may be owed "on book"); Brinkerhoff v. Marvin, 5 Johns. Ch.R. 320 (N.Y. 1821); Hendricks v. Robinson, 2 Johns. Ch. 283 (N.Y. 1817). Early cases showing use of future advances for building construction do exist, but their appearance in the reports is infrequent until near the turn of the century. See Crane v. Deming, 7 Conn. 386 (1829) (mortgage to secure advances for construction of a bridge over the Passaic River); Barry v. Merchants' Exchange Co., 1 Sandf. Ch. 280 (N.Y. 1844) (mortgage to construct 'a granite fire-proof building [in New York], which should be commensurate to the wants, as well as honorable to the munificent of the commercial metropolis of the western world')."

[7] As a matter of commercial practice, lenders often do not require the borrower to commence amortizing his loan until the facility erected on the real estate has been completed. At this point, the facility often furnishes a source of income to borrower who uses such income to amortize the loan.

ing a new loan each time he has need of an additional sum; consequently, he often avoids higher interest rates.

The use of future advance financing is not a one-way street. The lender is also benefited by the use of such financing. It promotes additional borrowing since it minimizes the bother and cost of frequent individual loans. In addition, such financing permits the lender to retain the right to disburse the mortgage loan in installments as the value of the mortgaged property increases rather than initially disbursing the entire amount of the loan at a time when the land securing the loan may possess less value than the amount to be disbursed.

III. The Yarborough Rationale

An examination and analysis of any given judicial doctrine presupposes, quite naturally, both the existence of the doctrine and the ability of the examiner to effectively isolate and extract it from the relevant portions of judicial opinions treating the subject with which the doctrine is concerned. Because of the tendency of the judiciary to obscure or mask with legal fictions the considerations which dictate the outcome of a given case, the task of isolation and extraction is far more arduous than the average practicing lawyer might expect.[8] Such is the case with the landmark decision of *Wayne Bldg. & Loan Co. v. Yarborough.*

In July, 1967, the Ohio Supreme Court handed down the *Yarborough* opinion. It is lengthy and complex. Already this decision has prompted many institutional lenders to reassess and restructure their future advance lending procedures and has caused title insurance companies to revamp their standard interim binder forms. It has also generated considerable discussion among members of the bench, the bar and the academic community. One commentator has intimated that *Yarborough* will long be remembered for ". . . its impressive and exhaustive treatment of mortgage law."[9] However, a systematic isolation, extraction and analysis of the theories which support the *Yarborough* decision will reveal that the opinion is impressive primarily for the numerous vital questions which it leaves unanswered and is exhaustive only in the sense that its obscurantism and internal inconsistencies will exhaust anyone who chooses to study it carefully.

While the facts of *Yarborough* are complex, its principal holding is simple: All future advances made pursuant to a mortgage which does not require such advances are subsequent in priority to any liens which attach to the mortgaged premises after the recording of the mortgage but before

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[8] Walter V. Schaefer, a Justice of the Supreme Court of Illinois has remarked: "It may be conceded that judicial opinions are something less than mirrors of the thinking behind the decision . . . ." Schaefer, *Precedent and Policy*, 34 U. Chi. L. Rev. 3 (1966).

[9] Recent Decision, *supra* note 2, at 423.

such advances are made.[10] The *Yarborough* Court gropingly attempted to articulate the theoretical doctrines which supported its holding. Speaking through Judge O'Neil it stated:

> The rationale for holding [optional] future advances to be subject to encumbrances attaching after the recording of the mortgage to secure advances is found in the cases of *Spader v. Lawler* . . . , and *Second National Bank of Warren v. Boyle* . . . . The first and most important part of this rationale is the notion . . . of a mortgage as security for a debt. As said in *Spader v. Lawler* . . . "If nothing ever was advanced, no one would pretend that it was a mortgage. A mortgage is a security for the payment of money. If there was no money due, there could be nothing to secure and consequently no mortgage."
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> The second rationale is the lack of notice furnished to subsequent encumbrances by a prior recorded mortgage securing advances which may or may not be made.
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> Where the mortgagee is, in fact, firmly bound to make advances (*i.e.*, they are "obligatory") for a certain purpose, under definite conditions and in a certain amount, both branches of the preceding rationale are substantially satisfied.[11]

Both "branches" of the Court's rationale will now be examined and analyzed in detail since they constitute the cornerstone of the law of future advance mortgages in Ohio and reveal the existence of various doctrines which, if adopted, will drastically alter the Ohio requirements governing the drafting, validity and priority of such mortgages.

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[10] The *Yarborough* Court qualified its holding as enumerated in the text above to an infinitesimally small extent when it stated that priority will be awarded to an intervening lienor over the original mortagee only if the original mortgagee possesses constructive notice of the intervening lien before he makes his advances, 11 Ohio St. 2d 195, 219, 228 N.E.2d 841, 857. Of course, when the intervening lien is a judgment lien the original mortgagee will always possess constructive notice of such lien since the lien cannot exist unless it is duly recorded in the appropriate county recorder's office, OHIO REVISED CODE ANN. §2329.02-.03. (Page 1953 and Supp. 1968). When the intervening lien is a mortgage, it will nearly always be recorded. Thus here also, the original mortgagee will be charged with constructive notice, OHIO REVISED CODE ANN. §5301.23 (Page 1953). When the intervening lien is a mechanic's lien, the chances are at least good that the lien will be placed of record, OHIO REVISED CODE ANN. §1311.06 (Page Supp. 1968), so as to charge the mortgagee with constructive notice thereof. Moreover, even if the mechanic's lien is not recorded when the original mortgagee makes his advance, courts nearly always hold such facts exist with respect to the mortgaged property (e.g., evidence of construction) as are necessary to charge the mortgagee with notice of the mechanic's lien. Wayne Bldg. & Loan Co. v. Yarborough 11 Ohio St. 2d 195, 219-20, 228 N.E.2d 841, 857-58. Thus as a matter of practicality, the constructive notice requirement is, in most instances, no requirement at all.

[11] 11 Ohio St. 2d, at 216-16, 228 N.E.2d at 855. The future advance mortgage involved in *Yarborough* was a statutory construction mortgage, *See*, OHIO REVISED CODE ANN. §1311.14 (Page 1962). Since the mortgage in *Yarborough* failed to comply with the disbursing requirements of §1311.14, the Court treated Yarborough's mortgage as a non-statutory, common-law future advance mortgage. Because of this treatment, the doctrines of the *Yarborough* case can logically be interpreted as encompassing all future advance mortgages, with the possible exception of the statutory open-end mortgage. See Part VIII *infra*.

IV. The First Rationale — A Mortgage As Security For a Debt

A. The Yarborough Case

As previously pointed out, the *Yarborough* Court states that the first and most important rationale for holding optional "future advances to be subject to encumbrances attaching after the recording of a mortgage to secure advances . . ."[12] is found in ". . . the notion . . . of a mortgage as security for a debt."[13] Thus, the court states:

> As said in *Spader v. Lawler* . . . "A mortgage is a security for the payment of money. If there was no money due, there could be nothing to secure, and consequently no mortgage." This position was reaffirmed in *Second National Bank v. Boyle* . . . wherein it was made clear that a mortgage to secure future advances was not invalid in Ohio, but that it was not a lien until the advances were made on the faith of the mortgage, if they were not obligatory advances.
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> Where the mortgagee is, in fact, firmly bound to make advances (i.e., they are "obligatory") . . . [the rationale of a mortgage as security for a debt is] . . . substantially satisfied. . . . As to the concept of a mortgage as security for a debt, "as the mortgagee is bound from the date of his agreement to make the advance, the obligation to repay him, from his point of view, arises at that time" [Citation omitted]. . . . Furthermore, it would be inequitable not to accord priority to the obligatory advances of the mortgagee. He is bound to make the advances, and he cannot avoid doing so without breaking his contract, and it can, therefore, no longer be urged that it is inequitable for him to make advances after knowledge of the intervening claim. . . . [Citation omitted]. As was declared in the *Kuhn* case . . . "upon what principle, then, of equity or public policy can it be said that such mortgagee must again search the records before making each advance to the mortgagor? The search would be a vain thing, since the advance for further loan would remain obligatory, whatever the state of the title disclosed."[14]

The preceding quotations furnish an excellent example of the obscurantism which abounds in the *Yarborough* opinion. First, the court discusses the concept of a mortgage as security for a debt. Then it abruptly "shifts gears," cites *Second National Bank v. Boyle*[15] and intimates that the debt concept cannot be satisfied by a non-obligatory mortgage for future advances. Finally, it in effect states that the debt concept is satisfied by an obligatory future advance mortgage. At no point does the court attempt to articulate for the bewildered students of the opinion the vitally important relationship between the debt concept and the concept of obligatory and non-obligatory advances.

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[12] 11 Ohio St. 2d at 215, 228 N.E.2d at 855.

[13] *Id.* at 215-16, 228 N.E.2d at 855.

[14] *Id.* at 216-17, 228 N.E.2d at 855-56.

[15] 155 Ohio St. 482, 99 N.E.2d 474 (1951).

B. Historical Evolution of the Debt Concept

The relationship between the debt concept and the concept of obligatory and non-obligatory loan advances can best be explained by examining the historical evolution of certain portions of mortgage law. This examination will reveal how, in the words of Chief Justice Cockburn, the common law of mortgages has ". . . expanded and enlarged so as to meet the wants and requirements of trade. . . ."[16]

The common law concept of a mortgage as security for a debt can be traced back to at least the 12th Century.[17] During the following seven centuries, the concept of a mortgage and accompanying debt were inseparable in the eyes of the law — a mortgage could not exist unless it secured the payment of a pre-existing debt. By the early 1800's, the American economy had developed to a point where the need for secured future advance financing began to manifest itself.[18] As a result, lenders began to record mortgages which required the mortgagee to advance to the borrower the face amount of the mortgage (i.e., the loan proceeds) subsequent to the recording of the mortgage. In short, lenders began to record mortgages which did not, on the date of recordation, secure a debt. Courts which were obviously hospitable to secured future advance financing were thus confronted with the conceptual thorn — a mortgage could not exist unless it secured a pre-existing debt. Therefore, if no debt existed, then a prospective borrower could not create a mortgage, merely by signing a document designated as such.

The early reported opinions which deal with the validity of obligatory future advance mortgages vividly attest to the widely heralded adaptive characteristics of our common law system. These opinions reveal the two methods by which courts skirted the conceptual hurdle of the debt concept. Many courts embraced the "relationback" doctrine — a judicial fiction which permitted them to sustain both the validity and priority of the obligatory future advance mortgage. With deceptive simplicity, these courts stated that each obligatory advance, when made, related back

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[16] Goodwin v. Roberts, L.R. 10 Exch. 337, 346 (1875). Regarding the historical approach in analyzing legal concepts, Cardozo has stated:

> "Let me speak first of those fields where there can be no progress without history. I think the law of real property supplies the readiest example."
> B. CARDOZO, THE NATURE OF THE JUDICIAL PROCESS, 54-55 (1921) [footnotes omitted].

Justice Holmes stated:

> "[The law] . . . cannot be dealt with as if it contained only the axioms and corrolaries of a book of mathematics. In order to know where it is, we must know what it has been . . ." O. HOLMES, THE COMMON LAW 1 (1881).

[17] 4 AMERICAN LAW OF PROPERTY, *supra* note 4, at §16.64. It is unlikely the debt concept existed prior to the 12th century ". . . for the simple reason that in primitive stages of society the institution of credit . . . [was] unknown . . . ." *Id.*

[18] It is stated the need for future advance financing manifested itself in the early 1800's since the author was unable to discover any significant number of future advance cases decided prior to such date.

to the date the mortgage was recorded and thus "obviously" created a debt as of such date.[19] Other courts embraced the more sophisticated "obligation" concept. These courts boldly announced that an obligatory future advance mortgage need not secure a pre-existing debt. They pointed out:

> . . . that the obligation secured by the mortgage for future advances is the legally binding, single promise of the mortgagor, made when the transaction is first entered into, to repay all of those advances within the scope of the agreement which actually are made then and later. The obligation secured does not consist of a series of separate and independent promises by the mortgagor, each one requiring its own consideration, but of one promise covering the entire group of specified present and subsequent transactions.[20]

Courts in a few jurisdictions, including Ohio, seemed reluctant in cases involving future advance mortgages to employ any fiction which would result in scrapping the citadel of debt.[21] In this regard, the landmark Ohio case is *Spader v. Lawler*.[22] In *Spader*, the Ohio Supreme Court intimated that the existence of any mortgage for future advances (obligatory or otherwise) dates not from the moment of its execution or recordation, but rather from the future date when the loan advances are made — apparently on the theory that at the moment such advances are made, a debt is created which permits the mortgage to spring into existence.[23]

In 1920, in *Kuhn v. The Southern Ohio Loan & Trust Co.*[24] the Ohio Supreme Court for the first time discussed the differing legal consequences which attached to obligatory and non-obligatory future advance mortgages. In *Kuhn*, the court first pointed out that the mortgagee in question had obligated itself to make certain future loan advancements. The court then held that due to the obligatory nature of the advancements, the priority of the mortgage dated from its recording. Nearly half of the court's opinion was devoted to distinguishing the off-cited *Spader* opinion which had failed to differentiate between obligatory and non-obligatory future advance mortgages. The court stated:

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[19] See Brinkmeyer v. Browneller, 55 Ind. 487 (1876). Gilmore points out one risk in counsel's advocating the court's adoption of the relationback doctrine:

> ". . . there can be no mortgage without a debt; if there is ever a moment when there is no debt, then there is no mortgage; if there is no mortgage, there is nothing to which the future advances can "relate back." It cannot be guaranteed that some court in an aberrant moment will not be persuaded by the conceptual argument; the wise mortgagee will see to it that there is always an outstanding obligation. . . ."

II G. GILMORE, *supra* note 4, at 924.

[20] 4 AMERICAN LAW OF PROPERTY, *supra* note 4, at 133-35. *Also see*, 4 J. POMEROY, EQUITY JURISPRUDENCE, 595 (4th ed. 1918); R. POWELL, *supra* note 4, at 564-65; 5 H. TIFFANY, *supra* note 4, at 144 (Cum. Supp. and cases cited.)

[21] *E.g.*, Pettibone v. Griswald, 4 Conn. 158, 10 Am. Dec. 106 (1822).

[22] 17 Ohio 371 (1848). The best discussion of *Spader* appears in Note, *Mortgages—Future Advances—Obligatory and Non-Obligatory Advances in Ohio*, 1 U. CIN. L. REV. 348 (1927).

[23] Note, *supra* note 22, at 354.

[24] 101 Ohio St. 34, 126 N.E. 820 (1920).

> Certain it is, the actual decision in . . . [*Spader v. Lawler*] was made with reference to future advances, neither the amount nor the purpose of which was specified in the instrument. Moreover, there was not involved in that case the question of future advances which the mortgagee was under obligation to make.
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> In the instant case, the situation is radically different. The record of the earlier mortgage [given to The Southern Ohio Loan & Trust Co.] was notice to the world that the mortgagee therein had obligated itself to loan the mortgagor a certain sum upon the faith of the title as it then was. Upon what principal, then, of equity or public policy, can it be said that such mortgagee must again search the records before making each advance to mortgagor? The search would be a vain thing, since the advance or further loan would remain obligatory, whatever the state of the title disclosed.[25]

The court in *Kuhn* did not specifically disapprove of the frightening intimation set forth in the *Spader* decision (i.e., a mortgage cannot exist unless it secures a debt). Nevertheless, the import of *Kuhn* was relatively clear — courts will treat an obligatory future advance mortgage which on the date of recordation does not secure a debt exactly like a mortgage which, on the date of recordation, secures a pre-existing debt.

The *Yarborough* opinion has removed any doubts which may have lingered with respect to *Kuhn's* effect. *Yarborough* unequivocally states though by way of dicta:

> Where the mortgagee is, in fact, firmly bound to make advances (i.e., they are "obligatory") . . . [the rationale of a mortgage as security for a debt is] . . . substantially satisfied.[26]

Thus, thanks to *Yarborough* it can be said with confidence that Ohio, like her sister states, recognizes that an obligatory mortgage for future advances can peacefully co-exist with the debt concept.

C. *The Role of Debt and Obligation In Determination of Mortgage Priority*

Now that the preceding examination of the historical evolution of mortgage law has explained the relationship between the debt concept and the concept of obligatory and non-obligatory loan advances, attention can be focused directly on the following question: Why was the *Yarborough* Court so interested in ascertaining whether the mortgagee was obligated to advance to the mortgagor the face amount of the mortgage (i.e., the loan proceeds)? The answer to this question lies, of course, in the fact that the sole function of the obligatory — non-obligatory concept is to determine the priority which will be accorded to any given future advance mortgage. That is to say, an obligatory future advance mortgage

[25] *Id.* at 37, 126 N.E. at 821.

[26] 11 Ohio St. 2d 195, 216, 228 N.E.2d 841, 855 (1967).

will be accorded the same priority (priority from the date of recordation) as a so-called "normal" mortgage[27] since the mortgagee's obligation to disburse under such a mortgage and the consequential obligation to repay on the part of the mortgagor is, as has been previously shown, the legal equivalent of the pre-existing debt under the "normal mortgage." On the other hand, the priority of each future advance under a non-obligatory mortgage dates not from the time of recordation, but from the date of the advance since it is only from such date that a debt is created.[28]

The preceding analysis reveals the court's reasoning process in *Yarborough* was, with respect to the first rationale, considerably more sophisticated than the opinion itself indicates.[29] In this regard, the analysis indicates the Court took the following mental steps in formulating its holding that each loan advance under a non-obligatory future advance mortgage takes priority only from the date of such advance:

1. When a "normal mortgage" is recorded, the mortgagor owes a debt to the mortgagee and the mortgage serves as security for the payment of the debt (this is the court's "first rationale"). Because the mortgage secures payment of a pre-existing debt, the law has long recognized that it is only equitable that the priority of the mortgage date from the moment of its recordation.[30]

2. When a future advance mortgage is recorded, the mortgagor owes no debt to the mortgagee and therefore the mortgage cannot, at such time, secure the payment of a pre-existing debt.

3. A recorded future advance mortgage may obligate the mortgagee to thereafter advance to the mortgagor the loan proceeds. If so, it necessarily follows that the mortgage note obligates the mortgagor to repay to the mortgagee those proceeds which he will thereafter receive. Since the obligation of the mortgagor will eventually ripen into a debt, a court is justified in equating the obligation concept with the debt concept. This, in turn, dictates the conclusion that in determining priority, an obligatory future advance mortgage which is predicated upon the obligation concept must be treated exactly like a normal mortgage which is predicated on the debt concept (i.e., the priority of both mortgages dates from the moment of their recordation).

4. A recorded future advance mortgage may not obligate the mortgagee to thereafter advance to the mortgagor any proceeds. If the mortgagee is not obligated to advance proceeds to the mortgagor it necessarily

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[27] A "normal" mortgage is a mortgage which on the date of its recordation secures the payment to the mortgagee of an amount owed by the mortgagor. The most common example of a "normal" mortgage is a purchase-money mortgage.

[28] See text accompanying note 23 and the authority cited therein.

[29] See Schaefer, *supra* note 8, at 7 who states:

"Many an opinion, fair upon its fact and ringing in its phrases, fails by a wide margin to reflect accurately the state of mind of the court which delivered it."

[30] As between two unrecorded mortgages, the one first in time prevails.

follows as a matter of definition that no debt can, at the date of recordation, exist with respect to optional advances which the mortgagee may thereafter choose to make. In this instance, it also follows that the legal equivalent of the debt concept (the obligation of the mortgagee to advance loan proceeds and the corresponding obligation of the mortgagor to repay proceeds so advanced) does not then exist. Thus, the priority of advances under an optional future advance mortgage will date from the moment of each advance since it is only at this moment that a debt is created.

Unfortunately, the *Yarborough* Court articulated only a few of the above mental steps taken by it.[31] The Court's failure to articulate the other steps in its reasoning process has and will continue to create confusion in an area of the law which is already thoroughly confusing.[32] Accordingly, at the earliest possible moment, the Court should set forth in full the reasons which support the various statements made in *Yarborough* about the debt concept and the priority of obligatory and non-obligatory future loan advances.

D. Future Articulation of Priority Rules

When and if the Supreme Court eventually chooses to articulate the exact reasons why the priority of an obligatory future advance mortgage dates from its recordation, the Court will, in all likelihood, embrace either the relationback fiction or the obligation concept. The relationback fiction has been sparcely employed in recent years. This sparceness of use is probably attributable to increased judicial sophistication which refuses to tolerate the continued employment of such a patent fiction. Because the Ohio Supreme Court is no less sophisticated than other appellate courts in this country, it seems reasonable to predict that it will not employ the relationback fiction.

If the Ohio Supreme Court jettisons the relationback fiction, it will be compelled to embrace the obligation concept and its attendant fiction.

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[31] Those who seek to mitigate or justify the Court's failure to clearly articulate the "mental steps" taken by it with respect to the debt concept, its significance and impact will find support in the writings of Justice Schaefer. He states:

> "William James said, 'When the conclusion is there we have already forgotten most of the steps preceding its attainment.' And, when I have tried to carry on simultaneously the process of decision and of self-analysis, the process of decision has not been natural. I suspect that which is lacking is not candor but techniques and tools which are sensitive enough to explore the mind of men and report accurately its conscious and subconscious operations." Schaefer, *supra* note 8, at 23 [footnotes omitted].

[32] A court's articulation of each step in its legal reasoning process does more than eliminate confusion. It also (a) tends to reduce arbitrariness in the judicial process and (b) furnishes a steady target for those who wish to attack the rule which the reasoning process supports. Because of this, judicial failure to clearly articulate significant steps in the reasoning process cannot be justified by invoking the admitted presence of deep subconscious forces, namely ". . . the likes and the dislikes, the predilections and the prejudices, the complex of instincts and emotions and habits and convictions, which make the man, whether he be litigant or judge." B. CARDOZO, *supra* note 16, at 167.

The obligation concept compels courts to pretend that a mortgage can exist before any loan advances are made thereunder. It is submitted that if the term "mortgage" is defined to reflect economic realities which exist between a borrower and lender, one is justified in asserting that no mortgage for future advances can exist until the first advance is, in fact, made thereunder. At this juncture, courts and scholars alike would do well to heed Justice Holmes' injunction that "[w]e should think things . . . not words . . . if we are to keep to the real and the true."[33] If we think "things" and not "words," it becomes much easier to see that notwithstanding the recordation of a so-called mortgage for future advances, the so-called mortgagee then possesses none of the "bread and butter" rights which a properly drafted mortgage always extends to its holder — e.g., the right to foreclose, the right to compel the mortgagor to insure the mortgaged premises, etc. Since a so-called mortgagee under a so-called future advance mortgage initially enjoys none of the "bread and butter" rights which a mortgagee normally makes available to the holder, it is submitted that courts should candidly state that even though a mortgage instrument may be recorded, no mortgage exists until the so-called mortgagee possesses the "bread and butter" rights described above (such possession will, of course, commence with the first advance since at this point the mortgagee possesses an insurable interest in the premises and a debt exists with respect to which foreclosure proceedings may, if necessary, be initiated).

One example will illustrate my contention that courts should candidly admit that a mortgage for future advances does not spring into existence merely because it is, without more, placed of record. Assume that on May 1, X signs and delivers to Y an obligatory future advance mortgage in the amount of $500.00. The mortgage relates to Blackacre, a parcel of real estate owned by X. Y records the mortgage on May 2. On May 10, Z loans X $1,000. To secure the repayment of the loan, X signs and delivers to Z a second mortgage which also relates to Blackacre. Z records the second mortgage on May 11. On May 30, before Y makes any loan advances to X, the latter is adjudicated a bankrupt. A Referee in Bankruptcy orders X's trustee to sell Blackacre at a public auction free and clear of all mortgage liens. The auction is conducted and Blackacre is sold to Mr. B.F.P. for $2,000. The Referee then orders the trustee to marshall all mortgage liens on Blackacre and to distribute the auction proceeds accordingly. The trustee then determines that even though Y's mortgage lien dates from the time of recordation, since it is obligatory, (a) Z, as the second mortgagee, is entitled to receive the first $1,000 of the auction proceeds, (b) X's general creditors are entitled to receive the remaining $1,000 of the proceeds, and (c) Y, as the so-called first mort-

[33] Holmes, *Law In Science and Science in Law*, 12 HARV. L. REV. 443, 460 (1899).

gage lienor, is entitled to receive nothing. The Referee then quite rightfully approves the trustee's determination. This example illustrates the awkwardness of pretending a mortgage exists prior to the time any advances are made thereunder and dictates the conclusion that no mortgage exists if the so-called mortgage instrument can, as in the example, be ignored with impunity.[34]

Neither the case law nor the relevant literature explains why nineteenth century courts stubbornly refused to admit that the future advance mortgage is not really a mortgage at all until an advance is made thereunder. The explanation probably lies in the prevalent nineteenth century attitude toward the judicial process. In this regard, the nineteenth century judiciary obviously desired to accord the same priority to an obligatory future advance mortgage as it did to a normal mortgage (i.e., priority measured from the date of recordation). However, the judiciary felt that it could justifiably accord such priority to the future advance mortgage only by employing the relationback doctrine or the obligation concept — both of which were predicated upon the unwarranted assumption that a mortgage exists when the mortgage instrument is executed and recorded even though no advances have been made thereunder. Apparently, the judiciary never openly considered the possibility of holding that while the existence of an obligatory future advance mortgage dates from the first advance, its priority dates from the recordation of the paper which embodies the loan terms (i.e., the "mortgage" deed). Why the judiciary refused to openly consider such a possibility seems relatively clear — to have extended priority to a mortgage from a date when the mortgage itself did not exist would have offended the theoretical symmetry then prevailing in the law of mortgages.[35] Even more importantly, the admission that the priority of an obligatory future advance mortgage could precede the existence of the mortgage would have constituted an open acknowledgment that the courts were formulating new rules so that the law of mortgages would remain attuned to newly developing financial tools. For a court to acknowledge that it was formulating new rules (i.e., making new law) instead of merely discovering pre-existing rules would have constituted an almost unforgiveable heresy in an era when the teachings of Blackstone reigned supreme. Thus, judges who

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[34] A Michigan opinion over a century old best sums up my attitude:

"[T]he mortgage instrument without any [present] debt, liability or obligation secured by it can have no present legal effect. . . . It is but a shadow without a substance . . . ."

LaDue v. Detroit & M.R.R., 13 Mich. 380, 397 (1865).

[35] "The 'nineteenth century theory' was one of eternal legal conceptions involved in the very idea of justice and containing potentially an exact rule for every case to be reached by an absolute process of logical deduction."

B. CARDOZO, *supra* note 16, at 77-78 [footnotes omitted]. For general discussion of the symmetry of the law in the eighteenth and nineteenth centuries, see D. BOORSTIN, THE MYSTERIOUS SCIENCE OF THE LAW, 20-25, 122-127 (First Beacon Paperback ed. 1958).

were perhaps wiser than their writings indicate, took the "easy way out" and created the relationback fiction and the obligation concept with its attendant fiction. The employment of these devices permitted judges to develop new and needed rules, though in a manner which rather effectively concealed their development.

The fiction which attends the obligation concept (i.e., a mortgage can exist before an advance is made thereunder) has, to the best of my knowledge, not yet been questioned by either courts, the bar or scholars. Thus, even in our day when legal realism reigns virtually unchallenged, the legal community continues to ignore economic reality by pretending a mortgage exists before any loan advancements are made by the lender. In view of this refusal to acknowledge economic reality many of today's practitioners, judges and scholars should carefully examine their own "legal household" before smiling quite so knowingly over their nineteenth century counterpart's employment of such real property fictions as John Doe, the lessee of the plaintiff in an ejectment action and Richard Roe, his adversary, the casual ejector.[36]

Of course, to state that "intellectual honesty" (whatever that means) dictates the recognition that a future advance mortgage does not spring into existence until the first loan advance is made does not solve the conceptual problems generated by such mortgages. One such conceptual problem has already been discussed — the problem of according priority to an obligatory future advance mortgage from a date which precedes the existence of the mortgage. Assuming that first problem is overcome (i.e., assuming courts will accord priority to an obligatory future advance mortgage from the date when the so-called mortgage deed is recorded) a second conceptual dilemma immediately arises: If the so-called mortgage deed is not yet a mortgage, how can such instrument be legally recorded in the mortgage records? Questions like these which often cannot be "logically" answered, inevitably arise to plague most legal theories, for the simple reason that the law is organic and the theories which underly it are static. This is merely one manner of stating that theories formulated for the legal exigencies of today cannot always adequately anticipate what legal demands the morrow will bring. In view of this, it suddenly seems important not that the law should be made theoretically pure, but only that it should keep pace with society. This, the law has done by creating the relationback doctrine and the obligation concept — two devices which justify a court in treating an obligatory future advance mortgage exactly like a normal mortgage for priority purposes. From a practical standpoint, we should ask no more of it.

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[36] For an interesting discussion of the functions of the fictitious John Doe (Mr. Doe was known as "Jackson" in New York) and Richard Roe in real actions at common law, see MILLAR, COMMON-LAW PLEADING, 35-39 (1912).

V. The Second Rationale — The Notice Concept

A. What Is the Notice Concept?

The *Yarborough* Court stated that the debt concept is "[t]he first and most important . . ." rationale insofar as future advance mortgages are concerned. From the standpoint of the practicing lawyer and his client (whether borrower or lender), the Court could not be more wrong. In the first rationale set forth in *Yarborough*, the Court has adopted a legal rule which in one form or another has been rigorously and unanimously followed since the early 1800's. On the other hand, the second *Yarborough* rationale tends to indicate the Ohio Supreme Court is about to rewrite (if it has not already done so) a large segment of Ohio mortgage law and thereby sanction several new legal rules which most jurisdictions have consistently refused to adopt.

The *Yarborough* Court states:

> The second rationale [for holding optional future advances to be subject to encumbrances which attach to the premises after the recording of the future advance mortgage] is the *lack of notice* furnished to subsequent encumbrances by a prior recorded mortgage securing advances which may or may not be made.[37]

Study of the *Yarborough* opinion and, in particular, the above-quoted language raises the question: "Lack of notice of what?" Most certainly the Court does not intend to refer to a subsequent encumbrancer's lack of notice of the non-obligatory nature of the recorded future advance mortgage even though the opinion so states since a subsequent encumbrancer always takes priority over all advances thereafter made pursuant to the optional future advance mortgage irrespective of whether or not he knows (i.e., has "notice") of the non-obligatory nature of the recorded mortgage. The lack of notice to which the Court refers is obviously the failure of most recorded future advance mortgages to notify subsequent encumbrancers of the obligatory nature of the mortgage.[38] Such an assumption is supported by the following language contained in the very

[37] 11 Ohio St. 2d at 216, 228 N.E.2d at 855 (1967).

[38] When the *Yarborough* Court states that non-obligatory mortgages do not furnish to intervening encumbrancers notice of the non-obligatory nature of the mortgage, 11 Ohio St. 2d at 210, 228 N.E. 2d at 855, it seemingly implies that an obligatory mortgage furnishes the requisite notice to intervening encumbrancers. Of course, the court is incorrect in its implication — an obligatory future advance mortgage ordinarily furnishes no notice to an intervening lienor of the mortgagee's obligation to disburse loan proceeds just as a non-obligatory mortgage furnishes no notice concerning the absence of a disbursal obligation on the mortgagee's part. Perhaps this inapplicability of the second rationale to the world of reality explains the court's curious and criptic comment concerning "the better practice" since if "the better practice" was followed by mortgagees the court's second rationale would be given vitality. Regarding the better practice, the *Yarborough* Court states 11 Ohio St. 2d at 220, 228 N.E.2d at 858:

> "Although the better practice would seem to be for the mortgage papers filed for public record to contain or refer to the obligation to advance, for such would furnish notice to the respective mechanic or materialmen that there is a prior lien in the amount specified, it is not necessary to decide that question for the present."

recent Ohio Supreme Court case of *Akron Savings & Loan Co. v. Ronsom Homes*:

> In *Yarborough*, two bases were asserted in support of the holding that non-obligatory future advances were subject to encumbrances attaching after the recording of a mortgage, but before the advances were made. [The second basis was] . . . that prejudice results to subsequent encumbrancers from lack of notice of the *obligatory* nature of the advances contemplated by the mortgage.[39]

The above being true, it is evident that the second "rationale" advanced by the *Yarborough* Court (i.e., an obligatory future advance mortgage should give notice to subsequent encumbrancers of its obligatory nature) completely failed to support the holding (i.e., subsequent encumbrancers take priority over later optional future advances made under a prior future advance mortgage). Thus, the Court's statements regarding "lack of notice" constitute mere dicta even though they are disguised as rationale. However, this dicta as set forth in *Yarborough* and in *Akron Savings & Loan Co.* is dicta which no prudent mortgagee dare ignore. For this reason, it is hereinafter analyzed in depth.

As pointed out, *Akron Savings & Loan Co.* states ". . . that prejudice results to subsequent encumbrancers from lack of notice of the *obligatory* nature of the advances contemplated by the mortgage."[40] It seems clear that "prejudice" would result to a subsequent encumbrancer only under the following fact situation:

A records an obligatory future advance mortgage which relates to real estate owned by B. However, the recorded mortgage deed does not contain or refer to A's obligation to make the required loan advances. Thereafter prospective encumbrancer C searches the mortgage records and discovers the future advance mortgage given by B to A. C "justifiably" assumes the mortgage is non-obligatory. Therefore, C loans B $10,000 and "takes back" a purchase-money mortgage on the real estate owned by B. At this moment C assumes that his mortgage takes priority over A's supposedly non-obligatory future advance mortgage except to the extent that A has made advances to B prior to the recording of his (C's) mortgage. A then advances B $10,000 pursuant to the terms of the first mortgage. B later defaults in repaying the $10,000 to A and A initiates foreclosure proceedings. B's real estate is sold to X for $15,000. The court determines that A's mortgage is entitled to first priority since it was obligatory. The court thus awards A $10,000 of the sale proceeds. The remaining $5,000 of the proceeds is awarded to C, who is thereby "prejudiced" by his "justifiable" reliance on the failure of the first mortgage deed to contain or refer to A's obligation to advance the $10,000.

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[39] 15 Ohio St. 2d 6, 12, 238 N.E.2d 760, 764 (1968).

[40] *Id.*

Prior to *Yarborough* no subsequent encumbrancer (*e.g.*, C) was "justified" in relying on the failure of the obligatory future advance mortgage ". . . to contain or refer to [the mortgagee's] obligation to advance . . ."[41] the loan proceeds since the mortgage law of Ohio did not require an obligatory future advance mortgage to contain or refer to such obligation. As the subsequent encumbrancer was not justified in his reliance, his reliance was not, therefore, legally prejudicial. By stating that a subsequent encumbrancer will be prejudiced by the failure of an obligatory future advance mortgage to contain or refer to the mortgagee's obligation to make the loan advances, the Ohio Supreme Court in effect intimates that such encumbrancers may now justifiably rely on such failure (*i.e.*, they may justifiably rely on the absence in the mortgage of either the obligation to make advances or a reference thereto). This means, of course, that since the subsequent encumbrancer's reliance is justifiable, the court will not permit the "prejudice" described in the above example to occur. That is to say, as a result of *Yarborough* and *Akron Savings & Loan Co.*, it now appears that an obligatory future advance mortgage must contain or refer to the mortgagee's obligation to make the loan advances.[42]

B. Reasons For the Notice Requirement

With a few isolated exceptions,[43] every jurisdiction which has considered the issue has refused to hold that an obligatory future advance mortgage must notify prospective encumbrancers of the mortgagee's obligation to advance the loan proceeds to the mortgagor.[44] In addition, only a few scholars have conducted any serious flirtation with the notice requirement.[45] In view of this patent, widespread and longstanding anathema to the notice requirement, one may legitimately question whether any valid reasons exist which justify its adoption by the Ohio Supreme Court.

The ostensive reason supporting the notice requirement revolves

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[41] Wayne Bldg. & Loan Co. v. Yarborough, 11 Ohio St. 2d 195, 220, 228 N.E.2d 841, 858 (1967).

[42] The article will not discuss the potential liability of a mortgagee to the mortgagor and third persons when the mortgagee is not required to advance loan proceeds, but nevertheless records a mortgage which indicates he is so required.

[43] *E.g.*, Connecticut. See Collimare, *Comparison of Real Property Mortgages and Security Interests in Chattels To Secure Future Advances*, 36 CONN. B. J. 463 (Student Note 1962); Recent Decision, *Security Law—Mortgage To Secure Future Advances—Are Mortgages Which Do Not Reveal That They Are To Secure Future Advances Wholly Invalid Against Subsequent Incumbranceers*, 31 CONN. B. J. 173 (1957) and cases cited.

[44] See 1 L. JONES, *supra* note 4, at § 459; G. OSBORNE, *supra* note 4, at §120 and cases cited.

[45] 4 J. KENT, *supra* note 1, at 176 (emphasis added):

"It is necessary that the [mortgage] agreement, as contained in the record of the lien, should, however, give all requisite information as to the extent and *certainty* of the [mortgage] contract . . . ."

Also see II G. OSBORNE, *supra* note 4, at 295-96 n. 55.

around the model prospective encumbrancer: He is the person who has "justifiably relied" on the absence of an obligation to disburse in a recorded future advance mortgage. The notice requirement functions to protect him by legitimating his reliance.[46] Unfortunately, the above reasoning completely fails to explain why the Ohio Supreme Court has embraced the notice requirement. It fails because it does not in the least explain why the court should bother to legitimate (i.e., protect) the above described reliance of the model encumbrancer.

The *Yarborough* Court did not, of course, articulate the reasons which prompted it to protect the prospective encumbrancer by sanctioning the notice requirement (in fact, it did not even clearly articulate the requirement itself). In view of this judicial silence, one must conclude that in its formulation of the notice requirement the Court was motivated more by its own value judgments[47] than by strict logic.[48]

The court may have concluded that certain considerations of social utility[49] dictate that it is better to compel a mortgagee to bear the burden of placing the requisite obligatory language in a future advance mortgage executed by his debtor than to compel a prospective encumbrancer to bear the burden of contacting and questioning the mortgagor and mortgagee named in the recorded future advance mortgage to ascertain whether the mortgage is, in fact, obligatory.[50]

It seems undeniable that the burden placed upon a mortgagee by the notice requirement is not as great (i.e., harsh) as the burden placed upon a prospective lienor by the failure to adopt the notice requirement. In short, it is easier and cheaper for mortgagees to insert the requisite obligatory language in their mortgage instruments than for prospective en-

[46] The model prospective encumbrancer is called into being by the *Yarborough* Court's language concerning the subsequent encumbrancer who justifiably relies on the absence of an obligation to disburse in a recorded obligatory future advance mortgage. At this point, one might note that the "model prospective encumbrancer" is not a very "normal" encumbrancer. He always studiously and accurately checks the mortgage records of the County Recorder's Office; his normal counterparts, on the other hand, often fail to check such records and some of them are not even aware of their existence. He assumes that all recorded future advance mortgages viewed by him which do not contain the requisite obligatory language will be treated for purposes of priority exactly like a non-obligatory mortgage — in fact he assumes they are non-obligatory; his "normal" counterparts, assuming they have found the path to the Recorder's Office, will, even after *Yarborough*, most likely continue to indulge in the opposite assumption. The failure of a subsequent encumbrancer to function exactly like the model prospective encumbrancer may preclude him from reaping the benefits of the notice requirement. See Part V-C *infra*.

[47] Holmes, *supra* note 3, at 467.

[48] "The felt necessities of the time, the prevalent moral and political theories, intentions of public policy, avowed or unconscious, even the prejudices which judges share with their fellow men, have a good deal more to do than the syllogism in determining the rules by which men should be goverened." O. HOLMES, *supra* note 16, at 1.

[49] For the non-sophisticated law review reader, it is best to point out the phrase "considerations of social utility" means, of course, nothing more than "personal preferences of the court."

[50] In other words, the court's failure prior to *Yarborough* to adopt the notice requirement in effect compelled each prospective encumbrancer who wished to protect himself to contact the mortgagee or mortgagor in order to determine whether the recorded future advance mortgage was obligatory.

cumbrancers to make the above described inquiries. Considerations of relative magnitude and cost are given weight by the courts because the holders of future advance mortgages are ordinarily powerful commercial lending institutions, large insurance companies and other persons of considerable wealth and sophistication while prospective encumbrancers are likely to be less sophisticated small businessmen on whom the courts will look with favor and seek to protect e.g., the prospective laborer or materialman (i.e., mechanic's lienor).[51]

Other considerations of social utility which the *Yarborough* Court may have considered include the desirability of preventing fraud and the necessity of maintaining and promoting the integrity of the recording system. The landmark Connecticut case of *Pettibone v. Griswold*[52] articulates the role of the notice requirement in preventing fraud. In *Pettibone*, the court states:

> It is the object of . . . [the recording] law to prevent fraud . . . .
> . . . [T]he encumbrance on the property must be so defined as to prevent the substitution of everything which a fraudulent grantor may devise to shield himself from the demands of his creditors.
> The creditor [intervening lienor] could know nothing from an examination of the [mortgage] record and must be cast on his debtor for information, to the very person who would be least inclined to give it; and successive obligations, fictitious or actual, might be made, to lock up his land, in defiance of every claim against him.[53]

The use of the notice requirement maintains and promotes the integrity of our well-entrenched recording system. In this respect, the recording system is designed to disclose to a prospective encumbrancer all information necessary to protect his interests and to obviate the need for such encumbrancer ". . . to make inquiry *in pais* concerning the liens on the property of his [prospective] debtor."[54] It is manifest that this dis-

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[51] "Mortgages have never the objects of public sympathy or words of the court. Some large corporations, insurance companies and public carriers particularly feel that they are special objects of punishment by courts and juries, but, NOT SO! When they were in their swaddling clothes, courts were taking 'the hide with the hair from money lenders.'" Spradling, *Legal Hazards Of Construction Lending*, 23 BUS. LAW. 221 (1963).

[52] 4 Conn. 158, 10 Am. Dec. 106 (1822).

[53] *Id.* at 162, 10 Am. Dec. at 107-08.

[54] *Id.* at 162, 10 Am. Dec. at 107. *Pettibone* also states that mortgage deeds which do not comply with the notice requirement are ". . . at war with the policy of the recording system." *Id.* at 162, 10 Am. Dec. at 108. Two of the possible reasons which may have prompted the *Yarborough* Court to impose the notice requirement [(1) eliminate the need for the prospective encumbrancer to contact the mortgagor or mortgagee and (2) promote the recording system] are defeated insofar as the notice requirement provides the mortgage may merely "refer" to the mortgagee's obligation to disburse the loan proceeds. If the mortgage in question contains a mere reference to the mortgagee's obligation, a prospective encumbrancer must still contact the mortgagor or mortgagee in order to ascertain that the mortgage is, in fact, obligatory. Moreover, since the recorded mortgage does not contain the obligation itself, but only a reference thereto, a prospective encumbrancer does not procure from the recorded mortgage document all information "necessary to protect his interests" and he must, therefore, make an inquiry "*in pais*."

closure design is at least partially frustrated if the notice requirement is not adopted — hence one reason which may have motivated the Court to adopt the requirement.

Each consideration discussed above furnishes a reason which justifies the imposition of the notice requirement in order to protect the model intervening encumbrancer. It is submitted that a consideration which has absolutely nothing to do with protecting the model encumbrancer may have been the primary factor which influenced the Court to adopt the requirement. The Court may have adopted the notice requirement in order to preclude or limit arbitrary actions on the part of powerful mortgagees (i.e., to protect mortgagors).[55] In states which have not adopted the notice requirement, a mortgagee may, for example, orally obligate himself to disburse loan proceeds and then pre-emptorily decide, for any number of reasons, to cease making disbursements. In such an instance, any action by the mortgagor against the mortgagee may well fail for lack of proof, inability to prove damages or other reasons.[56] Imposition of the notice requirement requires mortgagees to "nail themselves down" in the recorded future advance mortgage. That is, it compels them to openly obligate themselves to make the disbursements in question. Thus, the requirement tends from both a legal and a business standpoint to eliminate arbitrary action of the type described above.

If the *Yarborough* Court imposed a notice requirement to discourage arbitrary action by mortgagees under future advance mortgages, it will find some manner to sweep aside the otherwise valid defenses which mortgagees will hereafter invoke to excuse their failure to comply with the requirement. These defenses will now be discussed.

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[55] Gilmore points out that cases involving abuse of mortgages for future advances ". . . keep coming along in numbers just sufficient to keep fresh in judicial mind the ease with which the future advance device can be exploited by the overreaching mortgagee to crush the impoverished but no doubt honest debtor." II G. GILMORE, *supra* note 4, at 917-18.

[56] Gilmore states:

> "It is universally held that a contract to lend money will never be specifically enforced: Money and Blackacre are at opposite polls. Damages for breach of such a contract are restricted to any additional interest which the borrower may have to pay if he borrows the money from another source. If the first lender (who has breached its contract) has agreed to lend at the going rate of interest, and the borrower procures another loan at the same rate, there will be no damages. If he is unable to procure such a loan, the reason will be that he is an unsatisfactory financial risk: In ninety-nine cases out of a hundred, that fact will (if the matter ever comes to litigation) serve to discharge the first lender from his contractual commitment. Even if the lender is not technically discharged, the damages the buyer may have suffered in not getting the loan when he expected it will not be, under standard contract theory, the direct and natural result of the lender's breach: They will be the result of the borrower's own deteriorated credit standing and hence not recoverable. The contract to lend money is thus a most peculiar animal: maybe it is not a contract at all; if it is, it is a contract which may be breached with impunity."
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> II G. GILMORE, *supra* note 4, at 926 [footnotes omitted].

One eminent authority has disputed Gilmore's contention that a lender may, with impunity, breach his binding commitment to advance mortgage loan proceeds. See Coogan, *Intangibles as Collateral under the Uniform Commercial Code*, 77 HARV. L. R. 997, 1031 (1964).

C. Defenses To The Notice Requirement

As has already been pointed out, the notice requirement is ostensively imposed to protect the intervening lienor who has relied on the absence in a recorded future advance mortgage of an obligation to disburse or a reference thereto. Given this assumption, it necessarily follows that failure to comply with the notice requirement (i.e., to insert the requisite obligatory language in the mortgage) should be excusable in those instances where the intervening lienor does not rely on such failure. Three such instances in which such non-compliance should be excused are discussed below.

First, an intervening lienor must fail to rely, indeed will be incapable of relying, on the absence of the requisite obligatory language in a recorded future advance mortgage in those instances when he "knows" the mortgage is obligatory. In such instances the courts should, perhaps, apply the well-established general rule that a given person is bound not only by the facts made available to him through recorded documents but also by unrecorded facts of which he has knowledge.

Of course, the principal problem which courts must cope with in regulating the knowledge defense is articulating the type of knowledge which will excuse the mortgagee's non-compliance with the notice requirement. Knowledge of obligatory terms not contained in a recorded future advance mortgage may be of two types — actual or constructive. The legal effect of the intervening lienor's possession of one or the other of these types of knowledge will most likely be determined by two factors, namely: (1) the extent to which the courts will want to compel future advance mortgagees to comply with the notice requirement, and (2) the extent to which the courts will want to protect intervening lienors from their own failure to make a reasonable inquiry concerning mortgage terms after receiving facts which would normally dictate an inquiry. If courts decide either that they should compel strict adherence to the notice requirement or that intervening lienors should be permitted to "close their eyes" to facts which dictate further investigation concerning the obligatory nature of the mortgage, they will hold that failure to comply with the notice requirement is excusable only if the intervening lienor possesses actual knowledge of the obligatory terms of the mortgage. On the other hand, if the courts feel that strict adherence to the notice requirement is not essential in every instance, and that the law should require of intervening lienors at least that inquiry which business prudence dictates in such a situation (*i.e.*, a reasonable inquiry), then the courts will hold, as they should, that the mortgagee's failure to comply with the notice requirement is excused even though the intervening lienor possesses only constructive knowledge of the obligatory terms of the future advance mortgage.

Second, an intervening lienor will not rely on the failure of a recorded future advance mortgage to contain the requisite obligatory language in those instances when he does not bother to check the mortgage or the mortgage records.[57] The intervening lienor cannot possibly rely on the failure of a mortgage to contain certain obligatory language if he has never examined the mortgage itself.

Third, even if a prospective lienor examines a recorded future advance mortgage which does not comply with the notice requirement, he may nevertheless assume that the mortgage will take priority over any lien thereafter acquired by him. That is, he may not, in fact, rely on the failure of the mortgage to contain the requisite obligatory language for the simple reason that he is ignorant of the legal rule which permits him to so rely.

It seems clear that if the defenses discussed above (particularly the second and third defenses) are given judicial recognition, they will substantially narrow the impact of the notice requirement since they will, as has been pointed out, excuse the mortgagee's failure to comply therewith.[58] Of course, those theoreticians who value legal symmetry above all else will raise their standard objection to any widening of the notice defenses — they will point out that the recognition of any additional defense will constitute an attack upon the integrity of the notice requirement and that such attacks will eventually subvert the requirement in toto. I disagree. Most future advance mortgagees are commercial lending institutions. These institutions tend to act in an extremely conservative manner as indeed they should when lending their depositors funds. As a result they will not decline to place the requisite obligatory language in their standard mortgage deeds on the mere assumption that an intervening lienor might not, for any of the reasons discussed above, rely on the failure of the mortgage to fulfill the notice requirement. In view of this, it becomes apparent that the defenses will, for the most part, function to permit courts to render equitable decisions in those relatively few instances when unsophisticated mortgagees have failed to comply with the notice requirement and the intervening lienor has not relied on such failure. In short, the failure of our courts to recognize the notice defenses will more

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[57] " . . . it has been repeatedly stated that in practice, lenders seldom check public records for claims on the borrower's assets." Comment, *supra* note 5, at 143. Of course, if the intervening lienor has examined the future advance mortgage prior to its recordation, his failure to examine the mortgage as recorded cannot be invoked by the mortgagee to excuse his failure to comply with the notice requirement.

[58] Technically the mortgagee is not charged by the law to comply with the notice requirement. In this regard, the requirement is satisfied whenever the mortgage itself contains the requisite obligatory language irrespective of whether the mortgagee or the mortgagor inserted such language. However, from a practical standpoint, the mortgagee is saddled with the requirement since it is he who will be penalized if the requirement is not met. Also, while the mortgage deed is technically the mortgagor's document, the deed is nearly always drafted by the mortgagee.

likely create a trap for the unwary mortgagee than provide a needed safeguard for the average intervening lienor.

D. Viability of the Notice Defenses

As has been pointed out, the notice defenses "make sense" only if we assume the notice requirement was imposed, as the *Yarborough* opinion intimates, to protect the reliance of the intervening lienor. If the notice requirement was actually imposed, as I believe, to discourage arbitrary action by future advance mortgagees, Ohio courts will reject the notice defenses. This rejection will assume one of two forms. First, the courts might candidly acknowledge the "real reason" which motivated the imposition of the notice requirement (*i.e.*, their "gut" feeling that the requirement would compel future advance mortgagees to act less arbitrarily). If such acknowledgment is made, the courts should then forthrightly explain that they will not permit future advance mortgagees to invoke the notice defenses since such defenses are incompatible with the rationale which supports the notice requirement. Or, second, the courts might continue to pretend the notice requirement is designed to protect the reliance of the intervening lienor. However, if they should continue to engage in such pretension, they will have to create judicial fictions for the sole purpose of destroying the notice defenses.

Given the present obscuristic qualities of recent Ohio Supreme Court decisions relating to mortgage law, it seems likely any rejection of the notice defenses will assume the second form. Accordingly, this article will next touch upon some of the judicial devices which the courts may embrace in order to negate or limit what might otherwise be the forceful impact of the notice defenses.

The device which courts will employ to negate or limit the scope of the notice defenses will depend upon which of the defenses is invoked. If the first notice defense is invoked — mortgagee asserts that the intervening lienor "knew" of the obligatory nature of the mortgage — the court will likely limit this defense to those instances when the intervening lienor possesses actual as distinguished from constructive knowledge of the obligatory loan advancements. Of course, all doubts regarding the intervening lienor's absence of knowledge will be resolved in his favor.

If the second notice defense is invoked — the intervening lienor did not check the mortgage records and hence did not rely upon the failure of the mortgage to contain the requisite obligatory language — the courts will negate this defense by invoking the hallowed rule that an intervening lienor, like all other persons, is automatically charged by the law with "knowledge" of all recorded documents and their contents. The courts can then freely take the next dubious step by ruling that since the intervening lienor is charged by the law with knowledge of the contents of the

recorded future advance mortgage, the mortgagee cannot be permitted to invoke the second defense, a defense which allegedly ignores the force of the recording statutes.

As will be recalled, the third notice defense will be invoked in those instances when an intervening lienor "knows" of the mortgage but fails to rely on its failure to contain the requisite obligatory language because, for example, the intervening lienor is ignorant of the legal rule which permits him to so rely. This third defense will be the easiest defense to "torpedo." The courts need only reason as follows:

> It is the law in Ohio that an intervening lienor is permitted to rely on the failure of a recorded future advance mortgage to contain the requisite obligatory language. It is also the law in Ohio that everyone is conclusively presumed to know the law. Thus, the intervening lienor is conclusively presumed to have known that he was permitted by our law to rely on the failure of the mortgage to contain the requisite obligatory language. In view of this conclusive presumption, the mortgagee cannot be permitted to invoke a defense which is predicated upon the intervening lienor's ignorance of the law. [Hypothetical Opinion].

The most cursory analysis of the reasons which support the "conclusive presumption" regarding one's knowledge of the law reveals, of course, that a court's use of this presumption to negate the third notice defense will be completely devoid of merit. In this regard, when a court states that everyone is conclusively presumed to know the law, it is merely stating that ignorance of the law cannot be invoked by a person to excuse illegal action taken by him. Thus, the conclusive presumption as to knowledge of the law is predicated upon the assumption that evasion of the law would be facilitated and the successful administration of justice would be defeated if defendants accused of legal wrongs could successfully plead plaintiff's ignorance of the illegality of their acts. It is clear that a court's recognition of the third notice defense would not constitute an attack upon the assumption discussed above since such defense would not impede the successful administration of justice. Thus, one must conclude that the presumption, if invoked, will constitute merely a handy device used by the courts to squelch the third notice defense.

To summarize, if the Ohio Supreme Court adopted the notice requirement to protect the intervening lienor who actually relies on the failure of a recorded future advance mortgage to contain the requisite obligatory language, it will permit invocation of the three notice defenses since none of these defenses undermine the reasons which gave birth to the notice requirement. On the other hand, if the court adopted the requirement to limit arbitrary action by mortgagees it will either severely limit or refuse to permit the invocation of the notice defenses. The manner in which the court will accomplish this goal cannot be predicted. Hopefully, in this event, the court will candidly acknowledge that the notice

defenses will not be recognized since they infringe upon the basis of the notice requirement (i.e., a need to limit arbitrary action by mortgagees). If the court lacks candor, it will limit the first defense by requiring actual knowledge of the lender's obligation to disburse and will destroy the second and third defenses by invoking inappropriate conclusive presumptions regarding one's knowledge of the contents of recorded documents and one's knowledge of the law.

VI. The Notice Requirement — The Priority Problem

Thus far, in addition to the debt concept, this article has discussed (1) factors which may have prompted the *Yarborough* Court to adopt the notice requirement, (2) the nature of the requirement and (3) possible defenses which a mortgagee may invoke to excuse his failure to comply with the requirement. At this point, this article will discuss the most crucial question which arises in connection with the notice requirement: What legal consequences attach to the failure of a future advance mortgagee to refer to or to set forth in his mortgage his obligation to disburse the mortgage loan proceeds to the mortgagor? This is merely one manner of asking: What rules of priority apply to obligatory loan disbursements made by a future advance mortgagee who has not complied with the notice requirement? The *Yarborough* opinion completely fails to answer this important question.

It appears the Ohio Supreme Court is free to adopt one of three priority rules when an obligatory future advance mortgage does not contain or refer to the mortgagee's obligation to disburse:

1. All obligatory disbursements made by a future advance mortgagee take priority over an intervening lien which attaches to the mortgaged real estate even though some of such disbursements are made subsequent to the time of attachment of the intervening lien.

2. All obligatory disbursements made by a future advance mortgagee take priority over an intervening lien to the extent that such disbursements are made prior to the time when the future advance mortgagee acquires constructive knowledge of such lien.

3. All obligatory disbursements made by a future advance mortgagee take priority over an intervening lien to the extent that such disbursements are made prior to the time when the future advance mortgagee acquires actual knowledge of such lien.

It seems clear the Ohio Supreme Court will reject the first priority rule since its adoption of such rule would render the notice requirement nugatory. That is, under the first rule, no penalty attaches to a mortgagee's failure to comply with the requirement. Disbursements made by him are for purposes of priority treated exactly like disbursements made by a mortgagee who has complied with the requirement. Clearly, such a mockery of the requirement will not be tolerated by the court.

The second priority rule is identical to the priority rule now applied by the Ohio Supreme Court to optional disbursements made by a future advance mortgagee. Because of the nature of "constructive knowledge" a mortgagee will nearly always possess constructive knowledge of an intervening lien the moment it attaches to the mortgaged real estate.[59] Thus, if the court adopts the second priority rule, obligatory future advances made pursuant to a mortgage which does not comply with the notice requirement will, in most instances, take priority only if they are made prior to the time the intervening lien attaches. This rule is extremely harsh.[60] Hopefully therefore, it will be rejected by the Supreme Court. Otherwise, the rule will result in the following non-sequitur: All obligatory disbursements made after any intervening lien attaches to the mortgaged real estate will be treated for purposes of priority exactly as if they were optional disbursements. Clearly, such treatment is justified neither by economic considerations or by legal logic.

If the Supreme Court insists upon adopting the notice requirement, it should adopt the third priority rule. This rule which requires actual knowledge by the future advance mortgagee of the intervening lien best harmonizes the conflicting interests of the mortgagee and the intervening lienor.[61] For purposes of priority, it treats obligatory disbursements made after an intervening lien attaches to the mortgaged real estate exactly like the majority of jurisdictions (but not Ohio) treat optional disbursements made after an intervening lien attaches to the mortgaged real estate.

A careful consideration of either of the two priority rules which the notice requirement is likely to invoke dictates the conclusion that the notice requirement will, at best, compel Ohio courts to treat obligatory future advances like most states treat optional future advances. At worst, the requirement will compel Ohio courts to treat obligatory future advances like a few states, including Ohio, treat optional future advances.

It is obvious that future advance mortgagees will be unhappy with

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[59] See note 10, *supra.*

[60] In fact the rule is not applied in a majority of jurisdictions even to regulate priority between intervening lienors and optional disbursements made by a mortgagee.

[61] Osborne has set forth arguments in support of the assertion that an optional advance mortgagee should take priority over all intervening liens until he acquires actual knowledge of such liens. These arguments also support the third priority rule discussed above. He states:

> "The arguments for the majority view are that the operation of the recording laws are prospective, not retrospective, and therefore should constitute no notice to the first mortgagee who should not have to keep on examining records after he has satisfied all of the laws requirements as to his own mortgage; that it is unjust for a man to lose his security by the mere registration of a subsequent lien, i.e., by no act of his own; that as a practical matter the majority rule is better calculated to subserve the business convenience which called the practice into being; that this especially true where continuous dealings with frequent advances are contemplated; that the hardship on the first mortgagee through having to make new examinations of title before each later advance, added to these considerations, more than balance any hardship on the later encumbrancer . . . ."

G. OSBORNE, *supra* note 4, at 293-94 [footnotes omitted].

either priority rule since each represents a formidable inroad upon the priority bastion heretofore accorded future advance mortgagees in Ohio. However, since in the "thinking" of the *Yarborough* Court legitimate reasons in support of the notice requirement exist, it is probable that the requirement, though presently supported only by way of dicta, will withstand any assaults launched against it by zealous mortgagees.

VII. Drafting The Future Advance Mortgage

Many Ohio lenders have long drafted as purchase-money mortgages those mortgages which contemplate future advances (i.e., they have used a mortgage which names a given sum as a present loan when in fact the sum merely represents the total amount which the mortgagee will eventually advance to the mortgagor). This portion of the article discusses the manner in which the notice requirement will affect the practice of disguising a future advance mortgage as a purchase-money mortgage.

As the reader will recall, the notice requirement is theoretically imposed to protect the intervening lienor who has relied on the absence in a recorded future advance mortgage of an obligation to disburse. Thus, in those instances when a future advance mortgage is drafted as a purchase-money mortgage, an enterprising mortgagee might make the following argument. Reliance on the absence of an obligation to disburse loan funds can arise only in those instances when the mortgage indicates to the intervening lienor that future disbursements are contemplated (i.e., when the future advance mortgage is drafted as such). When a future advance mortgage is drafted as a purchase-money mortgage, the intervening lienor assumes quite naturally that no future advances are contemplated for the simple reason that a purchase-money mortgage has been given to secure a loan advance which has already occurred. If the intervening lienor who reads a future advance mortgage which has been drafted as a purchase-money mortgage assumes that no future loan advances are contemplated, he obviously does not rely on the absence in such mortgage of an obligation to disburse. Since the intervening lienor does not rely on the absence of an obligation to disburse, no court need invoke the notice requirement to protect a reliance which does not exist. Because the notice requirement is not invoked, the "normal" priority rule will govern the obligatory disbursements made under the mortgage, namely all disbursements will be accorded priority from the date of the recording of the requisite future advance mortgage even though it is drafted as a purchase-money mortgage.

Of course, if Ohio courts accept the strict but absurd logic inherent in the purchase-money mortgage defense, they will be confronted with the following rather embarrassing anomaly. Disbursements made by a mortgagee under an obligatory future advance mortgage which is drafted as

such but which does not include the requisite obligatory language will be treated more harshly for purposes of ascertaining priority than will disbursements made by a mortgagee under an obligatory future advance mortgage even though such mortgagee has deliberately distorted the facts and perverted the recording system by drafting his future advance mortgage as a purchase-money mortgage. The presence of the anomaly dictates one conclusion — Ohio courts will reject the purchase-money mortgage defense and will therefore require all future advance mortgages to be drafted as such.[62] To those who have not been schooled in the mysterious science of the law, the statement that Ohio courts will not permit a future advance mortgage to be drafted as a purchase-money mortgage must indeed seem unexceptional.[63] However, those familiar with the vagaries of the law and, in particular, mortgage law, will at once appreciate and recognize the radical deviation of the new requirement from the standard common law rule which has long governed the use of purchase-money mortgage forms in connection with future advance loans.

Most jurisdictions have consistently held that a future advance mortgage drafted as a purchase-money mortgage is valid not only between the parties, but is also valid against subsequent encumbrances.[64] As one commentator points out, the courts have held ". . . that the deception of creditors and encumbrancers [which a future advance mortgage drafted as a purchase-money mortgage makes possible] can be overlooked because . . . [creditors and subsequent encumbrancers] do or should expect to reach the mortgaged property only after the expressed maximum claim [i.e., the face amount of the mortgage] is satisfied. When they find out the truth, i.e., that there is more of the property unencumbered than they thought, they are just that much better off than they expected to be and should have no complaint."[65]

To date, only a small handful of jurisdictions have dared to require

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[62] In holding that Ohio mortgages must indicate on their face whether future advances are contemplated, our courts will bring mortgage law "into line" with the Uniform Commercial Code which appears to require an express provision for future advances in security agreements if such advances will, in fact, be made. UCC 9-204(5); OHIO REVISED CODE ANN. §1309.15(E) (Page 1962). II G. GILMORE, *supra* note 4, at 932-33.

It should be pointed out that if a secured party under a future advance loan elects to file a financing statement instead of the security agreement, nothing contained therein will indicate to a prospective encumbrancer that future advances are contemplated. Since most secured parties file financing statements instead of security agreements the position of a prospective encumbrancer with respect to personal property is, in most states, identical with his position with respect to real property when a future advance mortgage is drafted as a purchase-money mortgage.

[63] "A clear mind might determine at once what the law ought to be, but actual inspection alone can determine what the law is." T. WALKER, INTRODUCTION AMERICAN LAW 19 (1845).

[64] Shirras v. Craig, 7 Cranch (11 U.S.), 34, 3 L. Ed. 260 (1812), opinion by Chief Justice Marshall, is the leading case. Also see the cases cited in III G. GLENN, *supra* note 4, at 1598-1601; G. OSBORNE, *supra* note 4, at 281-284; 9 G. THOMPSON, *supra* note 4, at §4749; 5 H. TIFFANY, *supra* note 4, at 467-68.

[65] G. OSBORNE, *supra* note 4, at 282-83.

mortgagees to draft a future advance mortgage as such.[66] Quite naturally, these jurisdictions have been strongly impressed with the obvious dangers inherent in the use of future advance mortgages drafted as purchase-money mortgages (e.g., misrepresentation of the nature and size of the mortgagor's debt).[67] As a result, they require either by statute or judicial decision a full disclosure of the nature of the secured indebtedness.[68] Many benefits flow from such a disclosure. For example, the disclosure: (1) tends to actively and forcefully discourage a creditor's temptation to misrepresent the worth of his assets [This temptation most certainly has no need of the "shot in the arm" given it by a legal rule which sanctions the drafting of a future advance mortgage as a purchase-money mortgage]; (2) relieves subsequent creditors and encumbrancers of the concern that the incumbrance of the mortgage might be other than stated therein; (3) relieves prospective creditors and lienors of the burden of contacting either the lender or the debtor to ascertain the true nature of the debt incurred by the debtor; and (4) promotes the integrity of the recording system.[69]

Given the many evils inherent in the practice of drafting future advance mortgages as purchase-money mortgages, it is difficult to understand why so many courts have so consistently sanctioned the practice. Clearly it is not dictated by any significant legal or business considerations and it fully deserves the burial which *Yarborough* appears, by implication, to have given it.

Assuming from the above that *Yarborough*, by implication, justifiably requires all future advance mortgages to be drafted as such, Ohio courts will eventually be compelled to answer the following question: What

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[66] Connecticut, Georgia, Maryland and New Hampshire. See discussion in G. OSBORNE, *supra* note 4, at §122. The North Dakota Supreme Court has stated:

> "It is always better, however, for obvious reasons, that the mortgage should be drawn so as to show the true object of the transaction, for suspicion is engendered by misrepresentation but disarmed by a statement of the truth." *Scofield Implement Co. v. Minat Farm Grain Assn.*, 31 N. Dak. 605, 154 N.W. 527, 528 (1915).

[67] RECENT DECISION, *supra* note 43, at 175. Osborne, citing cases, states that: "When . . . [a future advance mortgage is drafted as a purchase-money mortgage] there is a false representation of fact which is in itself, on well established rules, some evidence of actual fraud." G. OSBORNE, *supra* note 4, at §116.

[68] Arkansas: Patterson v. Ogles, 152 Ark. 395, 238 S.W., 598 (1922); Connecticut: Pettibone v. Griswold, 4 Conn. 158, 10 Am. Dec. 106 (1822); Matz v. Arick, 76 Conn. 388, 56 A. 630 (1904); Sadd v. Heim, 143 Conn. 582, 124 A.2d 522 (1956); Georgia: Allen v. Lathrop, 46 Ga. 134 (1872); Maryland: MD. CODE PUB. GEN. LAWS, 1951 (Supp. 1956), Art, 66, §2; Groh v. Cohen, 158 Md. 638, 149 A. 459 (1930); Baltimore High Grade Brick Co. v. Amos, 95 Md. 571, 52 A. 583, 53 A. 148 (1902); New Hampshire: N.H. REVISED STATS. ANN. (1955) C. 479, §3, 4, 5. *Cf.* 1949 REV. STAT. CONN., §7279 which provides: "Any person who shall loan money upon a note secured by mortgage upon personal property, in which the sum of money loaned is stated to be greater than the amount actually loaned . . . shall be fined not more than fifty dollars or imprisoned not more than three months or both; and, the mortgage and note secured thereby shall be void." For an interesting case which resulted in a strict application of §7279 see In Re Metal Products Co. v. Weiss, 276 F. 2d 701 (2d Cir., 1960).

[69] RECENT DECISION, *supra* note 43, at 175-76.

penalty should be levied upon a mortgagee who drafts a future advance mortgage as a purchase-money mortgage?[70] This question can best be answered by examining the penalties levied in other jurisdictions.

With one exception, every jurisdiction which prohibits the drafting of a future advance mortgage as a purchase-money mortgage levies a severe penalty upon any future advance mortgagee who utilizes the form of a purchase-money mortgage. In this regard, these jurisdictions hold that a disguised future advance mortgage is completely invalid as against subsequent lienors. These jurisdictions reason that a future advance mortgage drafted as a purchase-money mortgage ". . . does not tell the truth; therefore, it is not entitled to recordation and should not be held effective against encumbrancers subsequent in time."[71] Scholars who have carefully studied the problem have reached identical conclusions.[72]

One jurisdiction which prohibits the drafting of future advance mortgages as purchase-money mortgages (Connecticut) has imposed a penalty which substantially deviates from the majority penalty. In the leading case of *Matz v. Arick*,[73] the Supreme Court of Connecticut held that all advances made under an obligatory future advance mortgage drafted as a purchase-money mortgage take priority over subsequent encumbrancers to the extent that such advances are made prior to the time the subsequent encumbrances attach to the mortgaged premises. Thus, to the extent that such advances are not made prior to the time the subsequent encumbrances attach to the premises, then such advances do not acquire priority over such encumbrances. As one authority has aptly remarked:

> . . . [*Matz*] contains all of the disadvantages and none of the advantages of both the majority [future advance mortgage may be drafted as a purchase-money mortgage] and minority [future advance mortgage must be drafted as such] positions insofar as a defective mortgage capable of deception was held valid for the present advancement, and the practice of concealing assets was not prevented, or even discouraged.[74]

The priority rule (i.e., penalty) enunciated in *Matz* has also been soundly and justifiably criticized by other authorities.[75] Consequently, it

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[70] For one discussion of this question see G. OSBORNE, *supra* note 4, at 288-290.

[71] RECENT DECISION, *supra* note 43, at 176.

[72] *E.g.*, Osborne.

> "A third rationale [for prohibiting the drafting of a future advance mortgage as a purchase-money mortgage] is that it is necessary in order to prevent the device from being used as a vehicle of fraudulent or at least preferential arrangements. . . . If this were the reason for the doctrine it would seem that the concealed . . . mortgages for future advances should be invalidated completely rather than merely ending their priority as to later advances." G. OSBORNE, *supra* note 4, at 290-91.

[73] 76 Conn. 388, 56 A. 630 (1904).

[74] RECENT DECISION, *supra* note 43, at 178.

[75] Hewitt, *The Rule in Matz v. Arick*, 2 CONN. B. J. 237 (1928); Goldman, *Formation of Construction Loan Mortgage Deeds*, 15 CONN. B. J. 240 (1941).

is submitted that Ohio courts should, when confronted with the issue, reject the *Matz* penalty in favor of the sounder majority penalty.

VIII. The Notice Requirement and the Open-End Mortgage

Many lenders view the statutory open-end mortgage as a vehicle which negates the need to comply with the notice requirement. Accordingly, the open-end mortgage statute should be examined to ascertain whether this view has merit.

Section 5301.232 of the Ohio Revised Code provides that a mortgage will constitute an open-end statutory mortgage if it: (1) indicates in substance or effect that it secures future loan advances, if any, made by the mortgagee to the mortgagor; (2) states the maximum amount of unpaid loan indebtedness, exclusive of any interest thereon, which may be outstanding thereunder at any time; (3) contains at the beginning thereof the words "OPEN-END MORTGAGE." Section 5301.232 also provides that if a mortgage, as drafted, meets all of the requirements set forth therein, all obligatory future advances made under such mortgage take priority over all intervening liens which attach to the mortgaged premises after the mortgage is recorded. It should be noted that the statute nowhere requires the statutory open-end mortgage, if it is obligatory, to contain or refer to the mortgagee's obligation to disburse to the mortgagor the loan proceeds. In spite of this statutory silence, a prudent lender must ask himself: Can the notice requirement which is articulated in *Yarborough* and which the Supreme Court apparently made applicable to all types of obligatory future advance mortgages existing when the *Yarborough* dispute arose be extended to the statutory open-end mortgage even though the statutory authority for such a mortgage followed the *Yarborough* dispute? Given the intricacies of Ohio mortgage law and the Ohio Supreme Court's apparent hostility to mortgagees as well as its probable hostility to statutory as distinguished from judge-made law,[76] the question is not as open and shut as one might initially surmise.

Since Section 5301.232 neither requires nor intimates that an obligatory statutory open-end future advance mortgage must contain or refer to the mortgagee's obligation to disburse to the mortgagor the face amount of the mortgage, it is reasonable and nearly mandatory that one conclude all obligatory advances under a statutory open-end mortgage take priority from the date of such mortgage's recordation even though it does not contain or refer to the mortgagee's obligation. However, a zealous Ohio Supreme Court would experience no appreciable difficulty in "grafting" the notice requirement onto the statutory open-end mortgage. For example, the court might reason by analogy as follows:

[76] Schaefer, *supra* note 8, at 18 (footnotes omitted).

> Section 5301.23 of the Ohio Revised Code provides that mortgages take effect from the time they are delivered to the recorder for record. In spite of the plain meaning of Section 5301.23, this court has stated that a future advance mortgage and the disbursements made thereunder do not take effect (i.e., possess priority) from the time such mortgage is delivered to the recorder for record unless such mortgage is obligatory and the requisite obligatory language is set forth or referred to therein. *Wayne Building & Loan Co. v. Yarborough*, 11 Ohio St. 2d, 195, 228 N.E.2d 841 (1967). If this court can provide that certain case law prerequisites must be met (i.e., the notice requirement must be complied with) before a mortgagee is entitled to invoke the priority rule of Section 5301.23, it necessarily follows that this court can likewise provide that a mortgagee under an obligatory statutory open-end mortgage must comply with the same case law prerequisites before he will be entitled to invoke the priority rule set forth in the open-end mortgage statute. [Hypothetical Opinion].

Of course, the conclusion set forth in the preceding hypothetical opinion does not "necessarily follow" at all since the analogy set forth therein is strained at best. It is logical and proper to assert that a court may require a common law mortgage (i.e., a non-statutory mortgage) to meet a given prerequisite (e.g., the notice requirement) before it will be entitled to the benefits of the priority rule set forth in the recording statute, § 5301.23. This is logical and proper since courts have always judicially defined the attributes a common-law instrument must possess in order to constitute a mortgage which is entitled to the protection of the recording statutes. However, it is quite another matter to assert that a court may validly impose an additional requirement (e.g., the notice requirement) upon a statutory form of mortgage, where the attributes are defined by the legislature, before such mortgage is entitled to the priority benefits granted by the statute to such mortgage. In view of this, it is submitted the Ohio Supreme Court should restrain any temptation it might have to extend the notice requirement to statutory open-end mortgages.

IX. Summary and Conclusion

A. Summary

The *Yarborough* opinion, which may be aptly characterized as a legal jigsaw puzzle, is dominated by a discusssion of two concepts: (1) the concept that a mortgage secures repayment of a debt (the "debt concept"); and (2) the concept that an obligatory future advance mortgage should notify perspective lienors of the mortgagee's obligation to disburse to the mortgagor the face amount of the mortgage loan (the "notice concept").

History explains the relationship between the debt concept and the future advance mortgage. Originally, a mortgage could not exist unless it secured payment of a pre-existing debt. Thus, when lenders began to employ future advance mortgages, no mortgage technically existed since each such mortgage, when recorded, did not secure payment of a debt.

Courts which were hospitable to future advance mortgages, traveled two routes to avoid the snare of the debt concept. Those courts which sought to harness the debt concept to the future advance mortgage adopted the relation back doctrine. Under this doctrine, courts held that each obligatory loan advance when made by the mortgagee related back to the date the future advance mortgage was recorded and thus such mortgage obviously secured repayment of a debt. Other courts were somewhat more sophisticated and sought to eliminate the debt concept insofar as it pertained to the future advance mortgage. These courts held that under an obligatory future advance mortgage the mortgagor's obligation to repay all amounts disbursed to him is the legal equivalent of the debt concept and as such it replaced the debt concept. By employing the relation back doctrine or the obligation doctrine, the courts insured that, for purposes of priority, obligatory future advance mortgages (which did not secure a debt when recorded) were treated exactly like purchase-money mortgages (which did secure a debt when recorded).

The second concept discussed in *Yarborough* is not technically a concept. It is a requirement — the requirement that an obligatory future advance mortgage notify perspective lienors of the mortgagee's obligation to disburse to the mortgagor the face amount of the mortgage loan. This requirement has been rejected by most courts as well as scholars who have studied it closely. *Yarborough* strongly intimates that the notice requirement is imposed to protect an intervening lienor who has relied on the absence in a recorded future advance mortgage of an obligation to disburse. This explanation does not explain since no reason is given as to why a court should protect the intervening lienor's reliance. To ascertain the real reason for the Supreme Court's adoption of the notice requirement, one must look beyond the "reliance" reason since it may well be merely a makeweight.

Considerations relating to the nature of the relationship between mortgagees, mortgagors and intervening lienors may have prompted the *Yarborough* Court to sanction the notice requirement. For example, the court may have felt that: (1) it is fair to impose the notice requirement upon mortgagees since it is easier and cheaper for them to comply with such requirement than for intervening lienors to contact the mortgagor and the mortgagee in order to ascertain whether the mortgage is obligatory (such contact would be necessitated only if the notice requirement was not imposed); and (2) the notice requirement tends to prevent fraud.

The *Yarborough* Court may have adopted the notice requirement in the belief that the requirement would strengthen our recording system. When other factors which may have prompted the Court to adopt the requirement are considered, this factor does not seem particularly potent.

It is submitted the prime reason the *Yarborough* Court adopted the

notice requirement can be found in its desire to preclude or limit arbitrary and unlawful action of powerful mortgagees. The notice requirement compels each mortgagee to "nail himself down" in the mortgage instrument. Thus it tends to reduce the vast bargaining disparity which normally exists between mortgagee and mortgagor.

If the notice requirement was imposed to protect the reliance of intervening lienors on the absence in a future advance mortgage of the requisite obligatory language, three instances will exist when the mortgagee's failure to comply with the requirement might be excused. These instances will occur when the intervening lienor: (1) knows the mortgage is obligatory, (2) fails to examine the mortgage in question or (3) is ignorant of the legal rule which permits him to rely on the absence in the mortgage of an obligation to disburse.

If the notice requirement was imposed not to protect the reliance of the intervening lienor, but to discourage arbitrary action on the part of mortgagees, the courts will find methods of destroying or limiting the scope of the notice defenses. The destruction or limitation of these defenses will assume one of two forms. Either the courts will candidly acknowledge the real reason which motivated the imposition of the notice requirement and then explain they cannot permit mortgagees to invoke notice defenses which are incompatible with such reason. Or, on the other hand, the courts will continue to pretend the notice requirement is designed to protect the reliance of the intervening lienor and at the same time they will create devices to destroy or limit the scope of the notice defenses.

The Ohio Supreme Court is likely to adopt one of two priority rules with respect to loan advancements made under a future advance mortgage which does not contain the requisite obligatory language. Under the first rule, all obligatory advances made by a mortgagee will take priority over intervening liens to the extent that such advances are made prior to the time when the mortgagee acquires constructive knowledge of the intervening liens. Under the second rule, all obligatory advancements made by the mortgagee will take priority over intervening liens to the extent that such advancements are made prior to the time when the mortgagee acquires actual knowledge of the intervening liens. The first rule is extremely harsh and should be rejected in favor of the second rule which best harmonizes the conflicting interests of the mortgagee and the intervening lienor.

A desirable byproduct of the notice requirement is the requirement that all future advance mortgages be drafted as such and not as purchase-money mortgages as has often been the practice in the past. Although only a few jurisdictions require future advance mortgages to be drafted as such, the *Yarborough* Court is to be commended for structuring its de-

cision in a manner which will logically compel it and other Ohio courts to eventually adopt this requirement. Ohio courts may choose to impose one of two penalties upon a mortgagee who drafts a future advance mortgage as a purchase-money mortgage. They can hold, as do most jurisdictions which prohibit such action, that a disguised future advance mortgage is completely invalid as against subsequent lienors. Or, they can hold, as does one jurisdiction, that only those advances which are made subsequent to the attachment of the intervening lien are subsequent in priority to such lien. It is hoped that Ohio courts will adopt the first penalty.

Many lenders feel that a mortgagee under a statutory open-end mortgage need not comply with the notice requirement since the open-end statute nowhere requires the insertion in the mortgage of the requisite obligatory language. Only time will tell whether this view is correct. In this regard, Ohio courts should, for a number of reasons, resist any temptation which they might possess to graft the "judicially created" notice requirement onto the "legislatively created" open-end mortgage.

B. Conclusion

For the most part, *Yarborough* is a desirable development to the extent, and only to the extent, that it will compel the bench, bar and the financial community to critically re-examine and re-assess doctrines of mortgage law which have reigned without significant challenge for over a century. Because of the immense commercial utility of the future advance mortgage, and because each judicial decision involving such a mortgage is the potential progenitor of many future decisions, each judicial re-examination and re-assessment of the rules governing such mortgages must be conducted with the greatest care. Each such re-examination and re-assessment, as well as any reformulation of the rules governing future advance mortgages will be governed by one or an amalgamation of the following three basic policies.

The first policy which a court may wish to implement in cases which involve future advance mortgages is the adoption of that rule or those rules which will result in awarding priority between the litigants ". . . on the basis of the fairest solution."[77] One eminent scholar has openly approved such a policy. He states:

> Only a very wise or a very foolish man would be willing to state, categorically, where truth lies [in the law of future advance mortgages] and to propose a rule for application in all possible situations. There is, then, much to be said for having no rule at all, or only a make-believe rule, and for letting the judges decide: judges are not necessarily wiser than other people, but they are paid to decide things.[78]

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[77] Comment, *Priority of Future Advances Lending Under The Uniform Commerical Code*, 35 U. CHI. L. REV. 128, 140 (1967).

[78] III G. GILMORE, *supra* note 4, at 930.

Clearly, Ohio courts must avoid any flirtation with this first policy since it constitutes a negation of the rule of law (i.e., it fosters decisions based upon the personal preferences of the judge instead of upon pre-existing, ascertainable rules)[79] and adds uncertainty to an area of the law where the need for stability is acute. The first policy also might encourage arbitrariness on the part of the judiciary. To the extent that it does, such arbitrariness will eventually impair future advance lending and, thus, will in turn and in time, equally harm both borrower and lender, as well as the public. Hence, the first policy should be rejected.

The second policy consists of the adoption of those rules which will loosen the future advance mortgagee's grip upon the mortgaged property. This policy is based upon the assumption ". . . that secured credit is basically to be avoided since secured lenders [i.e., mortgagees] already possess too much power over the economically disadvantaged borrowers. . . ."[80] Given the multitude of economically vital entreprenurial activities which are supported by funds advanced under future advance mortgages, it is manifest that Ohio courts should reject any temptation to adopt the second policy.

The third policy consists of adopting those rules which most promote secured future advance lending. This policy is based upon the assumption ". . . that the future advances lending device [i.e., the future advance mortgage] is basically a beneficial mechanism which promotes the infusion of capital into business enterprises which otherwise could not exist."[81] It is submitted that Ohio courts should, for the most part, adopt the third policy.[82] If they do, they will openly embrace the theory that the mortgagor's obligation under an obligatory future advance mortgage to repay to the mortgagee all loan proceeds advanced to him is the legal equivalent of the debt concept. They will also, if they adopt the third policy, reject the notice requirement. If the requirement is adopted, they

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79 Those who advocate judicial adoption of the first policy would do well to heed Lord Mansfield's statement:

"In all mercantile transactions the great object should be certainty . . ." *Vallejo v. Wheeler*, 1 Cowp. 143, 153, 98 Eng. Rep. 1017 (1774).

When I state that judicial decisions should be based upon "pre-existing, ascertainable rules" I do not mean to imply that judges do not and should not "legislate law" since I, like Justice Cardozo ". . . take judge-made law as one of the existing [and necessary] realities of life." B. CARDOZO, *supra* note 16, at 10. I do mean to imply, however, that judges should, in the words of Justice Holmes, legislate ". . . only interstitially . . . ." Southern Pacific Co. v. Jensen, 244 U.S. 205, 221 (1916).

80 Comment, *supra* note 77, at 140.

81 *Id.*

82 If Ohio courts adopt the third policy, which at the present does not seem likely, they will return to the position assumed by their mid 19th century predecessors who did much to promote the use of future advance mortgages. See *e.g.*, Kramer v. Bank, 15 Ohio 253 (1846); Hurd v. Robinson, 11 Ohio St. 232 (1860). One early commentator described *Hurd* as the leading case ". . . which has been the foundation of much of the American law in favor of relaxing [future advance] . . . mortgages." Thompson, *What Description Of the Debt Is Sufficient In A Recorded Mortgage*, 44 CENT. L.J. 490, 494 (1897).

will (a) permit the invocation of the notice defenses, (b) adopt the "third priority rule" discussed herein and (c) hold the requirement inapplicable to statutory open-end mortgages.

The adoption of the third policy will not, if tempered with "common sense," preclude Ohio courts (1) from ruling that future advance mortgages may not be drafted as purchase-money mortgages and (2) from severely penalizing the violators of such rule.

In adopting specific rules which are consonant with the third policy, Ohio courts should carefully examine, not only today's economic needs, but also those relevant legal precedents which embody the wisdom of the past. Such an examination should adequately equip our courts to formulate rules which will eliminate the "obstruse and shifting character" of future advance mortgage concepts which have, since the day of Chancellor Kent, plagued the law of real property.