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WILL MORTGAGE LAW SURVIVE?

A COMMENTARY AND CRITIQUE ON MORTGAGE LAW'S BIRTH, LONG LIFE, AND CURRENT PROPOSALS FOR ITS DEMISE

Morris G. Shanker[†]

PROLOGUE

Recent reports that mortgage law may soon die are not exaggerated!¹

Present day mortgage law has been with us for four centuries. It originated in the seventeenth century when equity took it over from the common law courts. Equity applied to mortgages its arsenal of equitable principles, particularly those limiting forfeitures of property. It then built upon these principles to develop a set that was unique to mortgages. The foundational principle prohibited the clogging of the debtor's (mortgagor's) equity of redemption.² Essentially, this prohibited the mortgagee from retaining any interest in the mortgagor's property once the underlying debt had been paid.

In the last two or three decades, however, this fundamental equitable principle has been dealt what might be mortal wounds; notably, by the amending of Section 211 of the Uniform Land Security Interest Act ("ULSIA") in 1983, and by the adoption of Sec-

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¹ Obviously, a distortion of Samuel Clemens's (Mark Twain) famous telegram stating that reports of his death were grossly exaggerated.

² Do not be troubled if you do not understand, or, indeed, have never heard of these anti-clogging rules. I suspect that many readers, including the lawyers, have not. At least, this has been my personal perception based on my discussions with many lawyers. Just why this is so is puzzling, particularly since mortgages are so widely used. Query, could it be due to the fact that most lawyers in the last several decades have never taken a mortgage course in law school, at least one directed to a study of the fundamental principles of mortgages as opposed to the mortgage's practical use in land development?

tion 3.1(c) of the Restatement of Mortgages (hereafter Restatement) in 1996.³ Both of these would nullify the basic anti-clogging rule. The arguments used to justify these proposals are, I will argue, seriously flawed and based upon a misunderstanding of the basic purpose and thrust of the anti-clogging rules. The proponents of the proposals have misread the relevant legal history, and failed to consider commercial and societal principles that are still fully accepted. I will also argue that if these proposals become widely adopted by the courts and the legislatures, the unique body of law called mortgages will be dead.

If this bothers or intrigues you, read on. The background that led to all of this will be explicated. This first requires an understanding of the unique historical developments that led to present day mortgage law.

I. SOME HISTORICAL HIGHLIGHTS⁴

A. *What's in a Name?*

What name should be used to describe a device, which has played a major role in improving our economy and society? The device to which I refer has been instrumental in making possible the construction and/or purchase of just about every home. Businesses use the device to obtain property. And when the properties or homes have been obtained, the device is instrumental in obtaining credit needed to operate the business, or to serve the homeowner's personal needs.

How about calling this device a "Dead Pledge"? Surprised? In fact, that is the name which has been given to this valuable device. More precisely, "Dead Pledge" is the literal translation of the French word "mortgage" which, of course, is the device I have been describing.

French was the official language of the English kings following the Norman Conquest, and it was at that time when the word "mortgage" came into being. While English has long since re-

³ See *infra* Part II.A-C.

⁴ More complete histories of mortgage law can be found in many sources. Many are cited or referred to in GEORGE E. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES 2-31 (2d ed. 1970). I have relied extensively upon this treatise in preparing this historical background. Abbreviated histories of mortgage law are also found in many sources. See generally RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. a (1997); Jeffrey L. Licht, *The Clog on the Equity of Redemption and Its Effect on Modern Real Estate Finance*, 60 ST. JOHN'S L. REV. 452, 458-62 (1986); Marshall E. Tracht, *Renegotiation and Secured Credit: Explaining the Equity of Redemption*, 52 VAND. L. REV. 599 (1999); Lou J. Viverito, *The Shared Appreciation Mortgage: A Clog on the Equity of Redemption*, 15 J. MARSHALL L. REV. 131, 144-49 (1982).

placed French as our official language, the use of the name mortgage, literally meaning "Dead Pledge," had become so widespread that the "mortgage" label has been incorporated into our English vocabulary. But why such a morbid, depressing, and seemingly inappropriate word to describe such a useful and needed device?

The explanation is simple. The mortgage transaction in those early days was, indeed, a depressing one from the mortgagor's point of view. To be more specific, lending on the security of property in those early days was by way of pledge – *gage* in French – whereby the property was physically transferred to the creditor. Two different kinds of *gage* (pledge) arrangements were available: one was the "Live Pledge," or in French, the *vif gage*; the other was the "Dead Pledge" – in French, the *mort gage*.⁵ Under the *vif gage* (Live Pledge), the secured creditor (pledgee) in possession was required by the underlying lending contract to use the rents, products, and profits from the pledged property to reduce the debt. However, in the *mort gage*, the secured party had no such requirement.⁶ Rather, he simply kept those rents, products, and profits as his own; and this was in addition to having the right to collect the full amount of the debt.⁷ It was the *mort gage*, the Dead Pledge, which was overwhelmingly used and thus it was that name, *mortgage*, which survived.

One wonders why the *mort gage* rather than the *vif gage* became the dominant transaction. Surely, borrowers would have preferred the *vif gage*. Perhaps we can speculate that it was because the lenders in those early days typically had the superior bargaining power.⁸ (Query, is it much different today?)⁹ It was the lender who had the money which the borrower needed, or wanted. Thus, typically, it was the lender who could dictate the terms of the lending arrangement. Obviously, the lenders pre-

⁵ OSBORNE, *supra* note 4, § 1, at 2-3.

⁶ *Id.* at 3.

⁷ *Id.*

⁸ Professor McGovern cites many authorities for this proposition, going back to the Bible, *Proverbs 22:7*, which states: "[T]he rich rules over the poor, and the borrower is the slave of the lender." William M. McGovern, Jr., *Forfeiture, Inequality of Bargaining Power, and the Availability of Credit: A Historical Perspective*, 74 NW. U. L. REV. 141, 142 (1979). In 1851, the U.S. Supreme Court also noted the "numerous cases reported in the books [where borrowers] . . . have submitted to the dictation of the lender under the pressure of their wants." *Russell v. Southard*, 53 U.S. (12 How.) 139, 152 (1851).

⁹ A modern author, one apparently well-versed in mortgage lending, recently wrote: "Although the vast majority of lenders are ethical and problems involving dishonesty seldom occur, the borrower is, nevertheless, likely to be at a serious bargaining disadvantage. Moreover, negotiations between financial professionals and amateurs rarely produce results favorable to the consumer." Viverito, *supra* note 4, at 142.

ferred and chose the *mort gage*, not the *vif gage*, and thus it became the dominant transaction.

B. *An Anachronism – No More Dead Pledges*

Curiously, while the name “mortgage” has persisted to the present day, most of us, even though much involved in mortgage transactions, have never actually seen a “Dead Pledge,” the arrangement by which the mortgagee who took possession and control of the property could retain the rents, produce, and profits thereof to his own use. Indeed, for the past four hundred years, such a contractual arrangement was illegal, or, more precisely, inequitable. Why? Because a right to the profits produced from property is a partial interest in that property. But, recall, the equitable anti-clogging rules barred contractual clauses that permitted the creditor (mortgagee) to retain any of the debtor’s property interest after the mortgagee had been paid in full.

Thus, since the seventeenth century when equity took over mortgage law, the original Dead Pledge transactions have been illegal; only *vif gages*, not *mort gages*, have been permitted. Stating it otherwise, equity required any mortgagee who took possession or control of the property to strictly account for the rents, produce, and profits of that property;¹⁰ they must be applied either to the necessary expenses of maintaining and preserving the property, or to the reduction of the secured debt. Any attempt by the mortgagee to pocket the rents, profits, or produce for his own personal benefit was not tolerated.¹¹

Dead Pledge arrangements were not the only techniques used by mortgagees to obtain rights in the mortgagor’s property even though the underlying debt was paid in full. There were others. But one technique that became quite common was a contractual arrangement under which the mortgagor entirely forfeited his property to the mortgagee unless the mortgagor paid the underlying debt precisely on the stated due date.¹²

C. *The Common Law Mortgage*

Indeed, this arrangement became the central feature of what evolved into the common law form of mortgage, which existed and was enforced by the common law courts from the fourteenth to the

¹⁰ OSBORNE, *supra* note 4, § 9, at 19.

¹¹ Viverito, *supra* note 4, at 144.

¹² *Id.* at 144-45.

seventeenth century.¹³ In the common law form of mortgage, the mortgagor, at the inception of the transaction, granted an immediate fee title transfer of the collateral to the creditor, which was nullified only if the debt was paid precisely on the due date (which became known as “law day”).¹⁴ The pre-seventeenth century common law courts enforced this term literally. This obviously pleased the mortgagees, particularly since, according to Littleton, payment on the due date was highly doubtful.¹⁵

The fact that the debtor was willing or capable of making payment shortly after the original due date, with appropriate additional interest, was irrelevant to the common law courts. Nor did it make any difference if the debtor’s failure to make payment exactly on the due date was due to circumstances beyond the debtor’s control, such as illness, floods which had washed out the roads, etc. As the common law courts viewed it, freedom of contract was paramount. The parties had “agreed” to their bargain, and the pre-seventeenth century common law courts enforced its terms literally and precisely.

D. Equity Takes Over

Such forfeitures of the debtor’s property began to trouble the chancellors in the early seventeenth century who then wrested mortgage law away from the common law courts in order to give appropriate relief.¹⁶ And, as previously stated, the chancellors then developed a distinct body of equitable principles, most of which still exist, which thereafter governed mortgages.¹⁷

Thus, mortgage law, following the seventeenth century, became a unique and separate body of equity law. In fact, prior to the seventeenth century, there really was no separate body of mortgage law. Lenders and their borrowers were governed by the general principles of conveyance law and general contract law: in other words, bound by the literal terms found in the mortgage contract, which usually meant bound by terms that the party with the superior bargaining power placed in the contract. Typically, that party was the lender, who, under the then existing “freedom of

¹³ *See id.*

¹⁴ *Id.* at 144.

¹⁵ “[I]t is doubtful whether the feoffer [mortgagor] will pay at the day limited * * *; and if he doth not pay, then the land * * * is taken from him for ever . . .” OSBORNE, *supra* note 4, § 1, at 3 (quoting SIR THOMAS LITTLETON, THE TENURES § 332 (Eugene Wambaugh ed., John Byrne & Co. 1903)).

¹⁶ *See OSBORNE, supra* note 4, § 6, at 12.

¹⁷ *See Tracht, supra* note 4, at 600-01.

contract” rules, imposed pretty much whatever terms he wished upon the borrower who wanted the money, and in many cases desperately needed it.

This often brought about what most of us today would consider unconscionable arrangements. These were brought to an end in the seventeenth century by the equity courts through anti-clogging and related rules.

E. Basic Mortgage Jurisprudence

Many explanations have been proposed to explain why equity developed these unique mortgage rules, rules that often ignored and, indeed, overrode the clearly expressed statements found in the mortgage agreement. (This was true despite the parol evidence rule, which normally prohibits one from contradicting the language of a written finalized contract.)¹⁸ In essence, the driving force for these rules was equity’s willingness, unlike the common law courts before them, to look at the substance of the transaction, and not be bound by the language of the mortgage agreement, which often masked its substance. Professor Osborne’s words succinctly captured this central idea when he wrote:

[T]o a modern mind, [there] would seem a perfectly good and obvious reason, namely, that the mortgagee’s right was only to the payment of his debt and the property was merely security for that purpose; and, since that was so, it would be a forfeiture to allow the mortgagee to keep it absolutely if the mortgagor was willing to pay even though the payment was somewhat belated.¹⁹

In other words, equity recognized that, no matter what the mortgage instrument said, the mortgage transaction at bottom was a debtor-creditor relationship; the mortgagor was a debtor who owed money to his creditor, the mortgagee. As a creditor, the mortgagee was entitled to be repaid the amount due him with appropriate interest. Once the mortgagee creditor was paid, then, comparable to full payment by any debtor to his creditor, the relationship between the parties was terminated; the creditor (mortgagee) no longer had any further rights either against the debtor (mortgagor) personally, or to the property which had been collat-

¹⁸ See OSBORNE, *supra* note 4, § 6, at 13-15. For a particularly good explanation for this equitable approach see *Pierce v. Robinson*, 13 Cal. 116, 125 (1859) (allowing parol evidence to show that a deed absolute on its face was intended to be a mortgage).

¹⁹ OSBORNE, *supra* note 4, § 6, at 13.

erally offered by the debtor (mortgagor) for the limited purpose of securing the repayment of the debt.²⁰ Further, any attempt or language in the mortgage contract that sought to violate this fundamental principle was declared illegal and unenforceable. As the equity courts labeled it, these were unlawful clogs on the debtor's equity of redemption, i.e., the debtor's inviolable equitable right to redeem his collateral by full payment of the underlying debt.²¹

To implement this fundamental policy, equity developed several rules to meet the different situations that presented themselves. But, to repeat, the *basic* anti-clogging rule which equity developed was that anything in the mortgage contract which permitted the mortgagee to retain any interest in the mortgagor's property following full payment of the underlying debt was ineffective.

As a necessary corollary, equity also decreed that the mortgagor's right to fully redeem all of his property by paying the debt (including appropriate interest for any late payment) could not be cut off by any language in the mortgage contract. The rubric that was often used to describe this rule was that a mortgagor's equity of redemption could not be made irredeemable.

Chronologically, it was this rule that was first used; that is, the chancellors originally took over mortgage law by permitting a debtor who failed to pay the mortgage debt on its due date (the law day) to do so at a later date and still redeem the property, rather than having it forfeited to the creditor, as was the result under the common law regime.²² It seems fairly obvious, however, that this simply is an application of the *basic* equitable anti-clogging principle, which, although articulated later in time, mandates that no contract clause, whether dealing with payment terms or any other terms, will be allowed if it prohibits the debtor from obtaining his entire property, free and clear of any creditor claim to it following full payment of the debt. Obviously, this basic anti-clogging rule would be meaningless if mortgage clauses prohibited or severely

²⁰ This is hardly a new or novel idea. Indeed, Osborne quotes the words of a law judge writing in 1314: "When a man pledges tenements his intention is not to grant an estate of inheritance, but to give security for the repayment of the money he has borrowed and to redeem the tenements; and in such case, if he repay the money he can enter." *Id.* at 14 (citing 3 W.S. HOLDSWORTH, A HISTORY OF ENGLISH LAW 130 n.5 (3d ed. 1923) (quoting *Anon v. Avon*, 3 Eyre of Kent, 29 Seld. Soc. 85 (1314))).

²¹ See Licht, *supra* note 4, at 459; Tract, *supra* note 4, at 600 n.4 (quoting JOHN NORTON POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 1193 (5th ed. 1941)); Viverito, *supra* note 4, at 145-46.

²² OSBORNE, *supra* note 4, § 6, at 12; Viverito, *supra* note 4, at 145.

restricted the mortgagor's right even to make the payment of the mortgage debt and thereby obtain full redemption of the property.²³

F. Foreclosure – A Benefit for the Mortgagee

Ironically, these anti-clogging rules, when first developed, left the mortgagee in a bind. They seemed to permit the mortgagor to delay payment of the underlying debt for an indefinite period of time and then still exercise his right of redemption by a long delayed payment. Thus, at a later point in time, equity developed a right for the benefit of the creditor (mortgagee) to deal with the debtor (mortgagor) who failed to pay the debt on time. This was the well-known foreclosure proceeding, namely, the right of the mortgagee, following default in payment, to institute a foreclosure proceeding in which the court placed a reasonable end date by which the mortgagor had to exercise his right of redemption by full payment.²⁴ Upon the mortgagor's failure to meet this deadline, his equity of redemption was declared foreclosed, following which the mortgagee could exercise his rights against collateral.

Originally, this permitted the creditor to retain unencumbered title to the property, as set out by the literal words of the common law mortgage contract. Equity then realized the unfairness of these so-called strict foreclosure decrees, particularly where the value of the property exceeded the balance due on the mortgage debt. Accordingly, equity added to the foreclosure decree an order that, if the debt was not paid by the judicially set end date, then the property would be sold. The proceeds of the sale first went to the creditor to retire the underlying debt. Any balance remaining, representing the debtor's equity in the property, could not be retained by the mortgagee and was returned to the debtor. Foreclosure by sale is now the usual decree issued by the equity courts, although strict foreclosure is still occasionally used.²⁵

²³ It strikes me that several of the current commentators have failed to understand and assimilate these two interrelated rules, and this has contributed to our current problem. Most, it seems, recognize the mortgagor's rights to make a late payment and still redeem his property. They then proceed as if this is the *only* essential principle protecting a mortgagor, but ignore, overlook, or downplay the more basic anti-clogging rule that prohibits *any* mortgage clause (whether dealing with time limitations or otherwise) which prevents the mortgagor from redeeming *all* of his property free and clear of the mortgage interest upon full payment.

²⁴ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. a (1997); OSBORNE, *supra* note 4, § 10, at 20; Viverito, *supra* note 4, at 145 n.70; *see* Tracht, *supra* note 4, at 606 n.22.

²⁵ OSBORNE, *supra* note 4, § 10, at 20-21.

G. The Lenders' Counterattack

Mortgagors certainly appreciated this new equitable approach compared to the forfeiture of their property which so often took place under the common law regime. And, it appears that this equitable approach to mortgages has served society well, considering that mortgages have played such an instrumental role in the astonishing economic developments of the past four centuries.²⁶ However, the lenders,²⁷ perhaps not surprisingly, never liked what equity had done to them in the seventeenth century. Throughout these past four hundred years, they have tried to get around the unique equitable mortgage rules through all sorts of ploys in an effort to return to the common law "freedom of contract" regime.

These ploys included the use of clever language in the mortgage agreement that, without expressly saying so, effectively denied the mortgagor's right to redeem. Another ploy was to disguise a mortgage transaction by labeling it something else, such as an absolute deed, or a lease, etc. Notwithstanding, these were declared to be mortgages in equity. The rubric used by the chancellors to reach this result was "once a mortgage, always a mortgage," or, as it is sometimes stated, "a mortgage by any other name is still a mortgage."²⁸

The lenders, however, were pretty much stymied at every turn. In fact, the chancellors took pride in their ability and willingness to vigorously scrutinize any transaction to determine whether it was, in fact, a mortgage. They refused to be bound by the actual language before them if they found it was simply a ploy to defeat or limit the equitable rights of the mortgagor.²⁹ Thus, as

²⁶ See McGovern, *supra* note 8, at 144 ("The last four centuries 'have seen steadily increasing indulgence to delinquent mortgagors, yet this same period has seen amazing growth in the volume of mortgage[s].'" quoting E. DURFEE, CASES ON SECURITY 13 (1951)).

²⁷ The word "lenders" does not necessarily refer to all of the lenders or any particular lender. It is my way of describing those who historically sought to undermine the anti-clogging rules, and in modern times have initiated or supported the proposals made in § 3.1(c) of the Restatement and § 211 of the ULSIA.

²⁸ See, e.g., RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. a (1997) ("Once a mortgage, always a mortgage . . .").

²⁹ The following judicial language was typical:

But it is not to be forgotten, that the same language which truly describes a real sale, may also be employed to cut off the right of redemption, in case of a loan on security; that it is the duty of the court to watch vigilantly these exercises of skill, lest they should be effectual to accomplish what equity forbids; and that, in doubtful cases, the court leans to the conclusion that the reality was a mortgage, and not a sale.

Russell v. Southard, 53 U.S. (12 How.) 139, 150 (1851).

recently as 1999, Professor Tracht in his comprehensive and incisive article wrote:

Every [creditor] effort, however ingenious, has been met by the unyielding resistance of the courts: one may not 'clog the equity of redemption.' The idea that the equity of redemption is an inherent and inseparable part of every mortgage is now so commonplace, so accepted, that it elicits relatively little comment or question.³⁰

When the Commissioners on Uniform State Laws in the second half of the twentieth century began writing proposed statutes to deal with security interests (mortgages), they acknowledged that this firmly established law was maintained – “no mortgage clause has ever been allowed to clog the equity of redemption” – and wrote their proposed statutes to incorporate this well-established principle.³¹ This quoted language was first stated in 1952 in connection with the promulgation of Article 9 of the Uniform Commercial Code dealing with Personal Property Security Interests and continued through all subsequent editions of Article 9. The quoted anti-clogging language was also restated in Revised Article 9 (which became effective in 2001), following which these additional pertinent remarks were added: “The suspicious attitudes of the courts [toward secured parties seeking to avoid the anti-clogging rules] have been grounded in common sense. This section, like former Section 9-501(3), codifies this longstanding and deeply rooted attitude.”³² The anti-clogging language was also found in the Uniform Land Transactions Act,³³ which, in 1975, was the Commissioners’ first attempt to write comprehensive statutes on land transactions.

In the last two decades of the twentieth century (sometimes referred to as the decades of greed), the situation changed and the lenders, for the first time in four hundred years, scored some significant victories against the equitable “anti-clogging” rules. In particular, as noted in the prologue, the lenders in 1983 persuaded the Commissioners on Uniform State Laws to propose legislation to repeal the essential feature of these mortgage principles,

³⁰ Tracht, *supra* note 4, at 600-01; *see* Licht, *supra* note 4, at 459 (describing the historical origin of the idea); *see also* RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. a (1997) (describing the historical common law development of the anti-clogging doctrine); OSBORNE, *supra* note 4, at 12-15 (discussing reasons for and the development of the equity of redemption).

³¹ U.C.C. § 9-501 cmt. 4 (1972).

³² U.C.C. § 9-602 cmt. 2 (2001).

³³ Unif. Land Transactions Act § 3-501 cmt. 2, 13 U.L.A. 160 (1975).

namely, the prohibition against placing clauses in the mortgage contract whereby the mortgagee could obtain or retain an interest in the mortgagor's property even after the underlying debt had been paid in full.³⁴ In 1993, the American Law Institute was also persuaded to "restate" the judicial law of mortgages.³⁵ Indeed, these new proposals are stated in the affirmative; they expressly authorize the mortgagee in the mortgage contract to validly bargain for an interest in the mortgagor's property, in addition to their rights to collect the full underlying debt.

If these recommendations become widely accepted by our legislatures³⁶ and by our courts, then mortgage law as a unique body of law will die; or, to use the French from which, recall, the word "mortgage" was derived, we may be about to witness "La mort du mortgage!"

Note well what I have said. It is *mortgage law* which will disappear. However, lending on the security of property as collateral (which no doubt still will be called a mortgage transaction) will very much continue. And, these secured lending transactions will continue to raise many difficult questions. These will include questions dealing with the correct filing of mortgage instruments, and their priority versus competing interests in the same property. There will be questions of which collateral is subject to the mortgage. Questions will also arise regarding the foreclosure procedure which a mortgagee must follow against a defaulting mortgagor in order to have the collateral applied to the debt (i.e., how to foreclose, etc.). But, in large measure, these questions will be controlled by statutory principles based on general conveyancing and contract law. The relationship between the mortgagor and mortgagee and their rights to the collateral will no longer be governed by those equitable anti-clogging principles that made mortgage law a separate and unique body of law, returning us close to the "freedom of contract" regime that existed in the common law prior to the seventeenth century.

How the lenders achieved this signal victory will now be discussed. Briefly, they were able to sell several theories and arguments, several of which, I submit, are flawed and do not stand up

³⁴ ULSIA § 211, 7A U.L.A. 403 (1985).

³⁵ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. c (1997).

³⁶ At least two states, New York and California, have adopted this principle. In New York, the statutory section validates a mortgagee's option to purchase the collateral where the underlying loan exceeds \$2,500,000. N.Y. GEN. OBLIG. § 5-334 (2001). In California, an option to purchase the collateral is valid in any mortgage of real property other than residential buildings having four units or less. CAL. CIVIL CODE § 2906 (1993).

under analysis. They were also aided by a bit of unexpected help from the United States Congress.

II. WHAT BROUGHT ON THE CURRENT SITUATION

A. *The Catalysts*

There were two isolated legal developments in the twentieth century which seem to have energized lenders to renew their four hundred year quest to overturn the anti-clogging rules which prevented them from retaining any of the mortgagor's property following payment of the underlying mortgage debt.

One was a 1967 decision from the Florida Supreme Court which, contrary to the accepted judicial thinking, upheld an option in the mortgage agreement to purchase the mortgagor's property even though the mortgagee had been fully paid.³⁷ But the persuasiveness and authority of this decision is undermined by the dissenting judges who clearly understood what their judicial brethren had just done. The dissent stated:

Under the rule adopted today, lenders in Florida may legally bargain in mortgage transactions that borrowers give them options to purchase mortgaged property during the period the debt is outstanding. Thus under the rule of this case lenders will be permitted to receive, in addition to repayment of the mortgage loan with interest, the extra advantage of lopping off the equity of redemption by the exercise of an option to purchase. To me, this innovation opens many avenues for overreaching and oppression. The rule against clogging, like laws against usury, should be scrupulously maintained to insure fair dealing in the business community. Rapacious conduct and unequal bargaining in the money lending field should be frowned upon in Florida.³⁸

Notwithstanding, in a critical report to the American Law Institute, which led to the adoption of Restatement Section 3.1(c), this aberrant Florida decision was the only case that the reporters were able to find to support their revolutionary proposal.³⁹ Nevertheless, it set the direction that the American Law Institute then followed. In

³⁷ *MacArthur v. N. Palm Beach Utils., Inc.*, 202 So. 2d 181 (Fla. 1967).

³⁸ *Id.* at 189.

³⁹ RESTATEMENT (THIRD) OF THE LAW PROP.-SEC.: MORTGAGES 132 (Tentative Draft No. 1, 1991).

so doing, the Institute was not "Restating" the law of mortgages. They were "Remaking" it.

B. A Federal Statute

The second and perhaps more important catalyst came from Congress, which in 1982 enacted the Federal Alternative Mortgage Transactions Parity Act.⁴⁰ This statute authorized federally controlled banks to issue shared appreciation mortgages ("SAMS"). These are arrangements providing that if the mortgagor sells his property, then the mortgagee creditor becomes entitled to a certain percentage, e.g., twenty-five percent, of any increased sum over the mortgagor's original purchase price realized at the sale. In other words, the mortgagee shares in the appreciation of the property upon its sale.⁴¹

The idea for shared appreciation mortgages apparently originated with a draft proposal, dated September 30, 1980, by the Federal Home Loan Bank Board, an agency of the federal government that regulated federally chartered savings and loan associations.⁴² It was one of several proposals conceived by this federal agency to deal with credit availability for homeowners during a period of extremely high inflation.⁴³ It was soon recognized that that proposal, if adopted, could very well raise serious anti-clogging problems because it effectively transferred completely to the mortgagee a partial interest in the debtor's property.⁴⁴

C. The Impact of the Shared Appreciation Mortgage

Consider carefully the impact of the shared appreciation mortgage. It permits the mortgagee to *always* collect the full payment of his loan no matter what happens to the value of the property. However, if the property appreciates in value, the mortgagee, in addition, shares in the appreciation. The mortgagee, although having this valuable ownership right, has none of the risks associated with an owner (e.g., he has no responsibility to maintain the

⁴⁰ 12 U.S.C. §§ 3801-3806 (2000).

⁴¹ James Cranberry & Christian Hill, *Some Mortgages Firms Swap Lower Rates for Share in the Gain When Home Is Sold*, WALL ST. J., Aug. 22, 1980, at 4 (describing appreciation participation mortgages); *Variants of Shared Appreciation Mortgages*, WALL ST. J., Feb. 4, 1981, at 25 (describing the different varieties of SAMS).

⁴² See Viverito, *supra* note 4, at 132.

⁴³ See *id.* at 137-38. The idea for SAMS for household mortgages may have been inspired by commercial mortgages, containing "equity kicker" arrangements, which were then also appearing on the scene. These arrangements permitted lenders to "share in the appreciation of the security property." *Id.* at 140 n.49; see also *infra* Part IV.

⁴⁴ Viverito, *supra* note 4, at 137-55.

property, no responsibility to pay taxes assessed against the property, etc.). Furthermore, unlike the typical owner, the mortgagee will not suffer any loss if the property value goes down. Under the mortgage contract, he is still entitled to the full payment of his debt. As a result, the mortgagee gets the benefits of ownership when the property values appreciate, but has no duty to account for this appreciation or to apply this appreciation to the repayment of the debt. In principle, this appears to be not far different from the ancient "Dead Pledges," whereby the mortgagee kept the profits of the property for himself with no duty of accounting for them to the mortgagor, something which has been forbidden for the past four hundred years.⁴⁵

One wonders if Congress had any inkling of what it had done when it authorized SAMS. It appears that this particular statute was never discussed or debated in either house of Congress; nor is there any committee report explaining SAMS. The statute first appeared on the congressional agenda when it was added as a new title, Title VIII, to an entirely different statute, namely, the Garn-St. Germain Depository Institutions Act of 1982.⁴⁶ This amendment was first introduced in the Senate by Senator Garn as an unprinted amendment.⁴⁷ The Senate promptly accepted Senator Garn's request that "reading of the amendment be dispensed with"⁴⁸ and agreed to the unread and unprinted amendment.⁴⁹

Later in the day, Senator Garn received consent that his then unread and unprinted bill be sent to a conference committee, which was to be notified "that the Senate insists upon its amendment."⁵⁰ The Congressional Conference Committee accepted this amendment as Title VIII of the Federal Depository Institution Act.⁵¹ But no committee report discusses the SAMS language, let alone explains it. The Conference Committee Report merely says that the House of Representatives had accepted the Senate amendment.⁵² The conference report, now including this brand new Title VIII (authorizing SAMS), was then enacted by both houses of Congress, apparently without further discussion or debate.⁵³

⁴⁵ See *supra* Part I.B.

⁴⁶ 12 U.S.C. § 1701j-3 (2000).

⁴⁷ 128 Cong. Rec. 25, 144 (1982).

⁴⁸ *Id.*

⁴⁹ *Id.*

⁵⁰ 128 Cong. Rec. 25, 175 (1982).

⁵¹ S. Rep. No. 97-641, 641 (1982); H.R. Rep. No. 97-899, 899 (1982).

⁵² *Id.*

⁵³ *Id.*

One wonders if the congressmen had any idea that they were about to undercut four hundred years of legal history, and bring about a major change in the fundamental anti-clogging principle of mortgage law. This statute, however, was a bonanza to the lenders since they could now point to a federal statute that overrode the state law of mortgages. Thus, it was easy to argue that the states had no choice but to go along with the federal view that had already been imposed on the states.⁵⁴

The lenders, however, went much further than the federal statute, which in authorizing SAMS amounted to only a limited dent in the anti-clogging rules. It applied only to consumer mortgages, and then only under regulations issued by the federal regulatory authorities.⁵⁵ Further, it only gave mortgagees a limited property right in the collateral, namely the right of the lenders, upon the collateral's sale, to share in the increased value of the collateral.⁵⁶ But, using this as their wedge, the lenders then went all the way. Under the Restatement Section 3.1(c) and Section 211 of the ULSIA, lenders are authorized in the mortgage agreement to contract to get any or all of the debtor's property.⁵⁷ Thus, the basic anti-clogging rule is not just somewhat cut back as was true with the federal statute. It is entirely eliminated.

The rather skewed way of writing Restatement Section 3.1 is worth noting. Subsections (a) and (b) actually seem to preserve the debtor's right of redemption until a proper foreclosure, regardless of any language in the mortgage agreement that purports to reduce or eliminate this right.⁵⁸ However, Subsection (c) then validates "any agreement in or created contemporaneously with the mortgage that confers on the mortgagee an interest in mortgagor's real estate [and such an agreement] does not violate [anything in]

⁵⁴ See ULSIA, Prefatory Note, 7A U.L.A. 408 (1985) ("Residential mortgages involving equity kickers may be less vulnerable to the clogging defense than non-residential mortgages because, in 45 states, federal law has already preempted state limitation on the priority and enforceability of 'alternative mortgage transactions', including transactions involving the sharing of equity or appreciation."). The laws of five states were not preempted because the federal statute permitted states for a three-year period to opt out of its provisions. Apparently, five states did so. *Id.*

⁵⁵ 12 U.S.C. § 1701j-3 (2000).

⁵⁶ *Id.*

⁵⁷ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. c (1997); ULSIA § 211, 7A U.L.A. 439-40 (1985).

⁵⁸ See RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1(a) (1997) ("From the time the full obligation secured by a mortgage becomes due and payable until the mortgage is foreclosed, a mortgagor has the right to redeem the real estate from the mortgage"); RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1(b) (1997) ("Any agreement in or created contemporaneously with a mortgage that impairs the mortgagor's right described in Subsection (a) of this section is ineffective.").

this section.”⁵⁹ In other words, mortgagees may contract to obtain the mortgagor’s property rights, and this is made superior to the so-called “inviolable” redemption rules set out in Subsections (a) and (b).⁶⁰ To put it plainly, the mortgagor, by paying the *full* amount of the debt, may redeem what is *left* of the collateral, if anything, following its authorized transfer to the mortgagee under Subsection (c).⁶¹ Some redemption!

D. Denial and Sidestepping by the Lenders

Those who were instrumental in bringing about this major revolution in mortgage law refuse to admit that significant rights of the mortgagor have been affected. The Florida Supreme Court, in its aberrant *MacArthur* decision, insisted that the mortgagor debtor’s equity of redemption had in no way been affected by permitting the mortgagee to exercise its option to purchase the mortgaged land.⁶² According to the court, this was because the mortgagee had originally sold the land to the buyer who then mortgaged it back to the seller, now mortgagee, along with the option to purchase.⁶³ Accordingly, the court “reasoned” that the seller had not sold the entire fee interest in the land to the buyer, but only the fee interest less the option to purchase, which the seller retained. Thus, under fundamental mortgage and property law, the buyer mortgagor could only give a mortgage on his own interest in the land, which in this case was the full fee in the land *less* the seller mortgagee’s right to purchase it back.⁶⁴ With respect to that interest, the equity of redemption remained intact. As the court saw it, the situation was no different than an owner’s purchase of land subject to a pre-existing lease.⁶⁵ The owner could mortgage only his own rights in the land, namely, the fee interest less the lease. Thus, the majority of the Florida Supreme Court “reasoned” that it had not in any way affected the anti-clogging rules or the debtor’s inviolable right to redeem his property.⁶⁶ As previously discussed, the dissent saw through this legerdemain.⁶⁷

Comparably, the official comments to the Restatement (and the ULSIA) also state that their actions will not adversely affect

⁵⁹ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1(c) (1997).

⁶⁰ *See Id.* at § 3.1.

⁶¹ *Id.*

⁶² *MacArthur v. N. Palm Beach Utils., Inc.*, 202 So. 2d 181, 185-86 (Fla. 1967).

⁶³ *Id.* at 186.

⁶⁴ *Id.* at 185.

⁶⁵ *Id.* at 186.

⁶⁶ *Id.*

⁶⁷ *Id.* at 187-90.

long established equitable rights of the mortgagor. And why? Because the official comments boldly assert that "the essence of the equity of redemption is the right of a mortgagor in default to insist on being deprived of the mortgaged real estate only by a foreclosure process that tests its value at a public sale."⁶⁸ As this paper already makes clear, I challenge the conclusion that this was the essential purpose of the equitable anti-clogging rules which, rather, assured that a mortgagor, upon payment of the mortgage debt, shall have his property back free and clear of any mortgage claim to it.

E. An Illusory Limitation

Nevertheless, based upon this stated rationale, the Restatement did place one limitation on the otherwise absolute power of the mortgagee to obtain an interest in the mortgagor's property; namely, that a property transfer to the mortgagee is ineffective if it "is expressly dependent on the mortgagor default."⁶⁹

Even if one accepts (which I do not) the Restatement's conclusion that the essential purpose of the anti-clogging equitable rules is to assure that a defaulting mortgagor can insist upon a public foreclosure sale, the protection given to the mortgagor by the Restatement is illusory. It would be a foolish or uncounseled lender who would not draft around this limitation; that is, lenders will invariably provide in the original mortgage agreement that the lender's right to obtain the debtor's property will arise at some point other than default, very likely from the origin of the loan.

Indeed, the comment to Section 3.1(c) concedes this when it states "of course, it could be argued that Subsection (c) dilutes this right [to insist upon a public foreclosure sale] because it permits a mortgagee to exercise the option to avoid foreclosure in any mortgagor default situation where the option language does not expressly tie exercise to default."⁷⁰ And, if this were not enough, the Restatement's comments then set out several illustrations of language that could be used in the mortgage contract to avoid the limitation in Subsection 3.1(c).⁷¹

⁶⁸ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. d (1997).

⁶⁹ *Id.* at § 3.1(c) (1997); see also ULSIA § 211(2), 7A U.L.A. 440 (1985) (invalidating options to purchase the property if they are tied to the mortgagor's default).

⁷⁰ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. c (1997).

⁷¹ See *Id.* at § 3.1 cmt. d, illus. 6-7.

F. Flawed Reasoning and Misreading of History

The questionable notion that the essence of the mortgagor's equitable rights under mortgage law was to protect the defaulting mortgagor from being deprived of his real estate without a public foreclosure process seems to have originated with the Nelson and Whitman text.⁷² (Professors Nelson and Whitman were also the Reporters for this Restatement of Mortgages.)⁷³ At Section 3.2 of their textbook, they articulate this rationale as the historic reason for developing the debtor's inviolable equity of redemption.⁷⁴ Nelson and Whitman cite no authority for this conclusion and, as I have already indicated in this paper, the essential purpose of the anti-clogging rules was not for the protection of a *non-paying* mortgagor to obtain a fair price at a mortgage sale.⁷⁵ To the contrary, they were developed for the protection of the mortgagor who wishes to *pay* his debt, not the mortgagor who does not or cannot make the payment. The anti-clogging rules permit payment to be made, following which the mortgagor is assured that *all* of his property will be redeemed, that is, returned to the mortgagor free and clear of any mortgagee interest therein. And, the anti-clogging rules guarantee that this shall be the result regardless of language in the mortgage agreement that states otherwise. As stated by Lord Lindley in *Samuel v. Jarrah Timber & Wood Paving Co.*:⁷⁶

Lord Hardwicke said in *Toomes v. Conset*: "This Court will not suffer in a deed of mortgage any agreement in it to prevail that the estate become an absolute purchase in the mortgagee upon any event whatsoever." But the doctrine is not confined to deeds creating legal mortgages. It applies to all mortgage transactions. The doctrine "Once a mortgage always a mortgage" means that no contract between a mortgagor and a mortgagee made at the time of the mortgage and as part of the mortgage transaction, or, in other words, as one of the terms of the loan, can be valid if it prevents the mortgagor from getting back his property on paying off what is due on his security. Any bargain which has that effect is invalid, and is inconsistent with the transaction being a mortgage.⁷⁷

⁷² GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW §§ 3.27-3.30, at 94-116 (4th ed. 2002).

⁷³ *Id.* at v.

⁷⁴ *Id.* at § 3.2.

⁷⁵ See *supra* Part I.E-F.

⁷⁶ [1904] A.C. 323, 326 (H.L. 1904).

⁷⁷ *Id.* at 329.

The Nelson and Whitman theory that the essence of these equitable rules was to protect the defaulting (non-paying) mortgagor during the foreclosure process also overlooks certain historical facts, namely, that the anti-clogging rules were developed by the equity courts even before the foreclosure remedy had been invented. To repeat, the anti-clogging rules were invented to assure that the mortgagor who was prepared, even belatedly, to *pay* his debt, not to *default* in payment, could do so and completely redeem his property free and clear of any mortgagee claim to it. The foreclosure rules came *after* this basic anti-clogging concept had been established; and, recall the foreclosure remedy was originally developed for the protection of the creditor (mortgagee), not the debtor (mortgagor). It was designed to give a remedy to the creditor (mortgagee) to enforce his debt and mortgage rights, if the debtor failed to or refused to pay.⁷⁸

Further, the original foreclosure decree did not even provide for a public sale. Foreclosure by sale remedy came later. This did, indeed, give protection to a *non-paying* mortgagor. It permitted that *non-paying* mortgagor whose right (equity) of redemption had been foreclosed to receive from the sale proceeds the value of his "equity" in the property; that is, the amount over and above the mortgage debt.⁷⁹

To repeat and emphasize, the anti-clogging rules were invented for, and then applied to, the protection of the mortgagor who can and is willing to pay, not the defaulting debtor mortgagee who is unwilling or unable to pay. The protection is essentially that full payment by the mortgagor will redeem his property and cutoff any claims that the mortgagee may assert to it. This is so, no matter what is stated in the original mortgage agreement that seeks to vest some or all of the debtor's property rights in the mortgagee.⁸⁰

III. CONSEQUENCES OF A LENDERS' VICTORY

If the ULSIA and/or Section 3.1 of the Restatement were adopted, it would return lenders close to the freedom of contract

⁷⁸ See *supra* Part I.F.

⁷⁹ See *supra* Part I.F.

⁸⁰ See *supra* Part I.D-F. Nelson and Whitman were aware of this history, and also of the leading authorities discussed in this Article which explain the impact of the anti-clogging rules. See GRANT S. NELSON & DALE A. WHITMAN, *CASES AND MATERIALS ON REAL ESTATE TRANSFER, FINANCE, AND DEVELOPMENT* 106-10, 260-66 (6th ed. 2003). Notwithstanding, their textbook insists that assuring a public foreclosure sale to a defaulting mortgagor constitutes the "essence" of the equity of redemption rules. NELSON & WHITMAN, *supra* note 72, §§ 3.27-3.30, at 94-116.

regime that they enjoyed prior to the seventeenth century, a position that they have been seeking to recapture for the past four hundred years. In particular, it would permit them to do what they have long wished for, namely, to require a mortgagor to transfer some or all of his property to a mortgagee as a condition of receiving the loan. This, of course, can prove quite advantageous to the lender.

To illustrate what can happen in a freedom of contract regime, consider the following two examples that involve commercial loans with equity participation features (equity kickers).⁸¹ Recall that it was these arrangements that apparently inspired proposals for something comparable in consumer loans, and eventually led to the proposals for shared appreciation mortgages (SAMS).⁸² The two examples involve the TIAA-CREF Insurance Company ("TIAA"), a major lender. (1) In March 1991, TIAA reported that a \$10 million loan with an equity kicker resulted in full repayment of the loan (\$10 million) plus close to a \$90 million gain on the sale of the property. Even the report described this as quite a "bonanza."⁸³ (2) In an August 1987 report, TIAA reported that it had made a ten-year, \$9.5 million loan at 15.5% interest and, in addition, had received shares of stock and options to buy stock of the debtor. This loan plus the equity kicker transaction had resulted "in a net gain to TIAA of \$61.2 million [from the sales of the property], not counting interest [at 15.5% per annum] from the loan,

⁸¹ Loans with so-called equity participation (or equity kickers) apparently have been fairly common in the past several decades. See Hertzberg, *supra* note 43, at 41 ("Borrowers are also giving in to lenders' demands for 'equity kickers,' or participation in the ownership and income from mortgaged property At Prudential 'the only mortgages we are doing currently have some form of equity participation' plus a 'a provision to revise rates upward at the end of 5 years,' says [Prudential executive vice president] Mr. Hoenemeyr."). Scholars have noted, by reason of case law, that equity kickers may offend the anti-clogging rules. See, e.g., James D. Cooper-Hill & Joseph J. Slama, *The Convertible Mortgage: Can It Be Separated from the Clogging Rule?*, 27 S. TEX. L. REV. 407, 411 (1986) (recognizing that certain cases pose problems by invalidating purchase options); see also Samuel, [1904] AC at 329 (voiding a condition in a loan allowing the lender to purchase stock of the borrowing company at a reduced price); *Humble Oil & Ref. Co. v. Doerr*, 303 A.2d 898 (1973) (prohibiting mortgagee from taking option to purchase property from mortgagor as part of original mortgage transaction). Notwithstanding, there appears to be little litigation, if any, challenging loans with an equity kicker. Nonetheless, concern that the widespread use of equity kickers was threatened by the anti-clogging rules was, I believe, a major impetus to the lenders to eliminate the anti-clogging rules. See ULSIA, Prefactory Note 8, 7A U.L.A. 408 (1985) (explaining anti-clogging rules and stating "[i]n the modern real estate world of 'equity kickers' and convertible mortgages, the [anti-clogging] doctrine poses some potential difficulties for lenders. Section 211 of this Act resolves these issues by permitting essentially any transaction which meets the 'good faith' test of § 108").

⁸² See *supra* note 43.

⁸³ TIAA-CREF REPORT (TIAA-CREF, New York, N.Y.), Mar. 1991, at 5 (on file with author).

which has eight years remaining to maturity.”⁸⁴ The report conceded that this “investment” had “paid off exceptionally well.”⁸⁵

A. Lenders’ Suggestion for Equity Policing

Notwithstanding, lenders apparently had some concerns that enacting a total freedom of contract regime might go too far, and therefore, some limits ought to be placed upon it. Thus, while the black letter law of Section 3.1(c) of the Restatement gives carte blanche to the lender to obtain any or all of the mortgagor’s property as part of the loan transaction,⁸⁶ the official comments to the Restatement retreat a bit. The comment states:

[I]t may, in rare instances, be desirable to protect residential and small business loan mortgagors, whether in default or not, from inequitable attempts by mortgagees to profit by acquiring appreciated and improved real estate by means of option exercise. Such mortgagors are apt to be unrepresented by counsel and to be less sophisticated negotiators than their large business counterparts. Consequently, close judicial scrutiny in such situations may be justified. . . . It is preferable for courts to deal with such situations by use of their inherent discretion to deny equitable relief under harsh and inequitable circumstances.⁸⁷

Comparably, the prefatory note to the ULSIA also cautions that any transaction under Section 211 must “meet the good faith test of Section 108.”⁸⁸

Similar views are expressed by Jeffrey Licht, one of the early authors to vigorously protest “the rule against clogging the equity of redemption [which] has become a danger to the ordinary transactions of ordinary business deals.”⁸⁹ Nonetheless, he apparently concedes that there are special cases where equitable protection for the mortgagor may be needed. He suggests that this be done under “twentieth century unconscionability law [which] has been maturing into a legal tool that appears better designed to regulate the original target of clogging.”⁹⁰ Indeed, Licht states that the clog-

⁸⁴ PARTICIPANT (TIAA-CREF, New York, N.Y.), Aug. 1987, at 6 (on file with author).

⁸⁵ *Id.* I have not made any exhaustive study of the results of loans with equity kickers included. I happened to receive these reports from TIAA-CREF, since I am a participant in the pension programs which TIAA-CREF administers for many educational institutions.

⁸⁶ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1(c) (1997).

⁸⁷ *Id.* at § 3.1 cmt. d.

⁸⁸ ULSIA, Prefatory Note, 7A U.L.A. 408 (1985).

⁸⁹ Licht, *supra* note 4, at 497.

⁹⁰ *Id.*

ging doctrine essentially is "a type of per se unconscionability."⁹¹ But he believes that modern approaches of unconscionability, apparently applied on a case-to-case basis, are a better tool for identifying those mortgage situations that do need special equitable protection.⁹²

Quite true, the present anti-clogging rules leave no room for wiggle. If a mortgage contains an anti-clogging provision, it is declared invalid. The only factual inquiry is whether a mortgagor/mortgagee relationship exists. If it does, there is no need for further investigation into the fairness or harshness of the particular transaction. And, I submit that there are well-accepted economic, legal, business, and pragmatic principles that justify the unyielding anti-clogging rules in the mortgage situation. These will be discussed later in this paper.⁹³ But, first, a very brief critique of the lenders' proposals for policing unfair mortgage transactions through unconscionability and equity principles.

B. Problems with Using Unconscionability

The literature on unconscionability and good faith doctrines is overwhelming, and I make no attempt in this paper to expose or to analyze all of this literature. Some of the leading ideas and authorities are discussed and/or cited in the Licht article.⁹⁴ But even a brief study of these authorities demonstrates why trying to apply them to the mortgage situation would cause much uncertainty, and, thereby, likely increase significantly the cost of mortgage lending, or, possibly, even the availability of credit.

The problem arises because, as any review of modern equitable and unconscionability cases makes clear, it is difficult to predict when a court will or will not describe certain conduct to be unconscionable and, if unconscionable, to determine what remedy it will impose. Indeed, Licht's article, which contains a major section on the use of unconscionability in the mortgage context, helps prove this point.⁹⁵ He summarizes the "variety of theories" and guidelines that have been proposed to define what unconscionability might be all about.⁹⁶ Selecting the proper theory or guideline applicable to the given facts, and then properly applying it, would

⁹¹ *Id.* at 483.

⁹² *Id.* at 485-86.

⁹³ *See infra* Part IV.

⁹⁴ *See* Licht, *supra* note 4, at 483-85 (discussing the approaches of Leff, Ellinghaus, and Eisenberg).

⁹⁵ *Id.*

⁹⁶ *Id.*

be a challenge enough. But, the problem is aggravated since the various theories are not necessarily consistent with each other.⁹⁷

For example, is it sufficient to conclude that because two business persons are involved in the mortgage transaction, then this necessarily is a fair and conscionable transaction? Some might suggest this, yet there are many cases where unconscionability principles have been used in contracts negotiated between businesses. And, recall, even the comments to the ULSIA mentioned that "in rare instances, it may be desirable to protect . . . small business loan mortgagors."⁹⁸ But, query, how does one determine how small is "small"?

Would an extraordinary gain by the lender for his loan suggest that there may have been unfairness either in the procedural aspects or substantive aspects of this transaction? There are equitable ideas that do suggest this, but again, how does one determine when the gain to the mortgagee is too much to be tolerated by an equity court? And, recall also, there are even equitable theories where equity gives relief merely to protect a party from his own over-optimism or folly.⁹⁹

Thus, if unconscionability and other equitable doctrines proscribing unfair dealings, forfeitures, harsh results, and even equity's duty to protect one from the folly of being overly optimistic about his future success, were substituted for the current anti-clogging rules on a case-to-case basis, it will become almost impossible to predict whether a particular property transfer from mortgagor to mortgagee is valid or not. And, the problem is aggravated since there are few, if any, precedents directly dealing with situations today governed by the anti-clogging rules which, recall, automatically invalidated any clog. Thus, at least for the foreseeable future, each judge will be striking out on his own, making "new" law with each decision. It is likely that results will vary from jurisdiction to jurisdiction. Indeed, there may be disparity even among the judges of the same court.

One wonders whether Lord MacNaughton intuitively perceived the unsatisfactory situation for mortgage law if exceptions were made to the anti-clogging rules. Thus, even though he personally thought that these anti-clogging rules made no sense in

⁹⁷ See generally *id.* at 473-86 (discussing the different theories concerning the clogging doctrine).

⁹⁸ RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. d (1997).

⁹⁹ See Viverito, *supra* note 4, at 148; RESTATEMENT (THIRD) OF PROP.: MORTGAGES § 3.1 cmt. a (1997) ("Equally important is a judicial inclination to protect the mortgagor against misplaced optimism and overconfidence concerning future ability to satisfy commitments.")

business situations, he nevertheless recognized the practical and pragmatic need to uphold them. He stated:

[The anti-clogging rule] seems to have had its origin in the desire of the Court of Chancery to protect embarrassed land owners from imposition and oppression. *And it was invented, I should suppose, in order obviate the necessity of inquiry and investigation in cases where suspicion maybe probable and proof difficult.*¹⁰⁰

Under the equity and unconscionability regime proposed by the lenders, one thing is almost certain. There will be high, maybe prohibitive, transaction costs just to determine if a proposed mortgage transaction with equity participation features will pass judicial muster, and should therefore be entered into by the parties. And, if originally entered into, then the mortgagee's attempt to enforce a property transfer to him very likely will also bring about further high transaction costs. Obviously, when a well-counseled mortgagor has repaid his debt in full and then realizes that he also is about to lose his property, there is a high likelihood that that mortgagor will raise the unconscionability defense in order to prevent the loss of his property. Litigation becomes quite likely.

Because of these many uncertainties, the transaction costs in any mortgage regime which relies upon unconscionability and other equitable principles to police individual cases is likely to be quite high.¹⁰¹

¹⁰⁰ *Samuel v. Jarrah Timber & Wood Paving Co.*, [1904] A.C. 323, 326 (H.L. 1904) (emphasis added).

¹⁰¹ Whenever mortgages (security interests) are subject to risk of loss, it is widely acknowledged that this will increase the cost of the transaction and, indeed, reduce the availability of credit. See, e.g., Letter from K. King Burnett, President, Nat'l Conference of Comm'rs on Unif. State Laws, to Senator Richard Durbin, Judiciary Committee (August 30, 2002), available at <http://www.abiworld.org/ulccresponse.pdf>. He wrote Senator Richard Durbin of the Judiciary Committee

to express my deep reservations concerning certain provisions of the recently introduced Employee Abuse Prevention Act of 2002 Section 103, as currently drafted, goes much further however, and creates huge new risks even for secured parties with legitimate liens created in good faith transactions, entered into in the ordinary course of business. We believe the ultimate effect of these provisions will be to increase massively the risks to secured lenders that their security interests may ultimately be avoided if a bankruptcy occurs, with the attendant consequence being significantly higher cost of borrowing (and a significant reduction in available credit compared to today) to account for this risk.

Id.

C. The Bankruptcy Situation

One further point along this line of high transaction costs is the uncertainty of the status in bankruptcy of mortgages with equity participation features. In their enthusiasm to adopt Restatement Section 3.1(c) and Section 211 of the ULSIA, the American Law Institute and Uniform Law Commissioners may not have fully considered the result in the context of a bankruptcy. Obviously, a secured creditor needs his security most in the bankruptcy situation. (Solvent mortgage debtors typically pay their secured, and even unsecured, debts, and therefore, resort to the collateral is not required.) But what will happen when that “secured creditor” (who has an actual or potential ownership interest in the debtor’s property or enterprise) presents his claim in the bankruptcy proceeding of his mortgagor? Does this not suggest a real possibility that the bankruptcy courts may treat him not as a creditor at all, but as an owner, and, therefore, bar him from creditor status? Or, possibly, to have his creditor status subordinated to other creditors? Either case typically results in no (or little) payment to that subordinated creditor.

Whether that would be the result in the bankruptcy courts is not definitively known.¹⁰² There is, however, a strong argument that this “secured creditor” should not be given creditor status because of his potential or actual ownership position. If that should happen, then when the mortgagee most needs his secured creditor position – that is, in his mortgagor’s bankruptcy proceeding – he faces the possibility that he simply will not get it. In any case, the present uncertainty of the outcome in bankruptcy likely will add even more to the transaction costs of making and enforcing these mortgages containing equity participation features.

¹⁰² There seems to be few cases specifically dealing with this subject. However, in one case, the bankruptcy judge subordinated the creditor’s claim because of the equity participation features in the loan. *In re Pac. Express, Inc.*, 69 B.R. 112, 114 (B.A.P. 9th Cir. 1986). The appellate court reversed, stating that subordination was inappropriate because the lender had acted in “good faith” in making the loan. *Id.* at 118. This reasoning was criticized in a later case which held that although a creditor’s \$300,000 advance to an undercapitalized debtor was cast in the form of a loan, and was properly documented as such with a set rate of interest and maturity date, the transaction had the substance and character of an equity investment, so as to permit recharacterization of the alleged debt when the debtor later filed for Chapter 7 relief, because the creditor was given pervasive control over the debtor’s operation, and the right to convert its advance into a 47% equity interest in the debtor at any time over a ten-year period. *In re Atl. Rancher, Inc.*, 279 B.R. 411, 434-37 (Bankr. D. Mass. 2002).

IV. THE ANTI-CLOGGING RULES ARE BASED ON PRESENTLY ACCEPTED LEGAL AND COMMERCIAL FUNDAMENTALS

I have argued that the basic arguments used to support the recommendations of the Uniform Commissioners and American Law Institute do not hold water. They are based on a misreading of the history of the equitable anti-clogging rules, and a flawed analysis of what was the *raison d'être* for these rules.

Nonetheless, there remains the ultimate question: Do the anti-clogging rules still make sense today? Obviously, the lenders think not. But, it strikes me that many of their arguments are little more than slogan slinging, and that many of these slogans should be taken with a grain of salt.

A. *Slogans with Little Substance*

For example, the slogan most often heard is that the anti-clogging rules were developed to protect the necessitous and impoverished debtor from being overreached by the greedy creditor. Thus, they make no sense in mortgage arrangements between sophisticated and well-counseled parties.

Undoubtedly, the anti-clogging rules have benefited many poor landowners. But, it is naïve to believe that this was the original purpose for developing the rules. Indeed, in the seventeenth century when the anti-clogging rules were first developed, one wonders how many impoverished debtors had sufficient property to make a secured lending transaction even feasible. More likely, the property owners for whom the mortgage transaction made sense were those of title and wealth – the only ones who likely held and owned significant amounts of property. And, indeed, the earliest chancery case to discuss the equity of redemption was a dispute between two titled noble persons, and involved a mortgage loan of 2,500 pounds – a veritable fortune in 1654.¹⁰³

Professor Tracht's research also supports this conclusion. Writing in 1999, he states:

Indeed, the historical timing of the equity of redemption seems to fly in the face of this [necessitous borrower] rational, since it arose in England at a time when loans were in-

¹⁰³ OSBORNE, *supra* note 4, at 13 (referencing *Duchess of Hamilton v. Countess of Dirlton*, 1 Ch. Rep. 165 (1654)).

creasingly being made to wealthy merchants rather than “necessitous men.”¹⁰⁴

The conclusion, therefore, seems clear; anti-clogging rules were not invented just to protect the impoverished, but had other underlying purposes which required that they apply to all borrowers, including the so-called sophisticated borrowers.

Another slogan often used by the lenders is that the dynamics of commerce today are not what they were during the past four centuries, that the anti-clogging rules prevent credit flowing to what are economically useful projects – projects that lenders would be glad to finance if only they could get an interest in the debtor’s enterprise or property.¹⁰⁵

I doubt that these are new insights or new arguments, and suspect that comparable arguments have been made throughout the past four hundred years.¹⁰⁶ Obviously, the commercial and social dynamics of the twentieth century were not the same as those of the nineteenth century, and those of the nineteenth century were not the same as those of the eighteenth century, etc. Indeed, there were major changes within each century. In each era there were quantum leaps forward in the commercial and societal dynamics compared to the preceding eras; and each era undoubtedly had its spokesmen insisting that the “new” societal and business needs required a change from the “archaic” rules of the prior century.

Notwithstanding, the judges, many of whom likely were fully aware of, and indeed, had likely participated in, the “new” business practices of their time, were unpersuaded. They invariably rejected the explicit or implicit arguments that the anti-clogging rules should be abandoned or cut back.¹⁰⁷

¹⁰⁴ Tracht, *supra* note 4, at 612.

¹⁰⁵ The RESTATEMENT (THIRD) OF PROPERTY.: MORTGAGES (1997) states:

An overly dogmatic approach to options granted to mortgagees in loan transactions will unduly discourage the flow of capital to a variety of socially useful projects. The prospect of being able to share in the success of the mortgagor may well induce the mortgagee to consider a variety of techniques that afford it the opportunity to acquire equity ownership in the mortgagor’s real estate.

Id. at § 3.1 cmt. d. Much of the language in this comment seems to be taken from NELSON & WHITMAN, *supra* note 72, § 3.2, at 40.

¹⁰⁶ Professor McGovern states that comparable arguments have been made since Biblical times. McGovern, *supra* note 8, at 143.

¹⁰⁷ One documented example took place early in the twentieth century. Lord MacNaughton urged a change in the anti-clogging rules to permit financing with equity participation features to businesses who presumably would then use these loans for beneficial business projects. He insisted that this change was needed because “the directors of a trading company in search of financial assistance [in the late nineteenth and twentieth centuries] are certainly in a very different position from that of an impecunious landowner in the toils of a crafty money-lender.”

Of course, this lenders' slogan is true. Increase the economic benefits to lenders, whether by way of increased interest or rights to the borrower's property, and they will increase the credit available to those who need (or want) a loan, presumably to be used for some useful social or business activity. But this begs the fundamental question; namely, whether society should place any limits on the quantity and quality of what lenders may demand from their borrowers. Historically, such limits have always existed. Usury and predatory lending laws are two examples. These anti-clogging rules are another example of societal limits. These limits originally served important commercial and social interests,¹⁰⁸ and, as explained later, this still remains true.

B. *The Economic Argument*

Most, but not all, of today's writers support the position of the Restatement and the ULSIA. This includes many who have written on the law and economics of these lending transactions. Much of this writing has argued that a more efficient market would be obtained if freedom of contract were returned to the mortgage situation; the market dynamics will work out the most efficient result. Many of these writings are discussed and commented upon by Professor Tracht in his comprehensive and incisive 1999 article.¹⁰⁹ But Professor Tracht then concludes, contrary to other writers, that market efficiency may result through the current equitable anti-clogging rules because they are "a mechanism for creating efficient incentives for the lender and borrower to renegotiate the terms of their contract should default occur."¹¹⁰

Samuel v. Jarrah Timber & Wood Paving Co., [1904] A.C. 323, 327 (H.L. 1904). Notwithstanding, Lord MacNaughton could not persuade his fellow judges to cut back on these long-standing anti-clogging rules. In fact, in this same decision, one of his colleagues, Lord Lindley, wrote one of the most cogent statements explaining the anti-clogging rules and their underlying purpose. *Id.*; see also Steve H. Nickles, *The Objectification of Debtor - Creditor Relations*, 74 MINN. L. REV. 371, 371-373 (1989) (discussing three decisions where a secured creditor's claims were subordinated in bankruptcy because the secured creditor had overstepped the legitimate role of credit by obtaining managerial rights which in our legal and commercial systems are vested exclusively in the owners).

¹⁰⁸ Professor McGovern cites authorities that indicate that creditors' demands for greater rights against the debtors historically have been rejected for two reasons. He states: "First, some remedies are rejected on grounds of 'justice' even if the result is to reduce the availability of credit. . . . There is a second argument for limiting creditors' remedies, namely that harsh remedies are not in fact needed to assure the availability of credit." McGovern, *supra* note 8, at 143-44.

¹⁰⁹ See Tracht, *supra* note 4, at 613-19.

¹¹⁰ *Id.* at 630. Professor Nickles also challenges "law-and-economic types" who insist that legal rules

However, it is Professor Tracht's concluding remarks that should give all of us pause. He suggests that the current authors may not have a complete or thorough understanding of the market and social dynamics associated with the anti-clogging rules. Here are his very pertinent concluding comments:

Finally, the courts' long-standing and vigorous defense of the equity of redemption presumably reflects a deep-seated intuition that something is wrong with a waiver of redemption rights – even if courts have been unable to articulate the problem in a coherent fashion. As shown in this Article, the common law rule may be rooted in an implicit or tacit understanding of important elements of market dynamics and contractual relationships, even though judges and legal scholars have never been able to offer detailed or convincing models of the processes at work. There is often a gap between what we think we understand about the world, and what we can rigorously explain about it.¹¹¹

C. The Other Dynamic: The Fundamental Debtor-Creditor Relationship

There is, I believe, another dynamic that supports the anti-clogging rules that is rarely discussed by current commentators. It is not a new insight; it has been recognized by the courts throughout these past four hundred years.¹¹² This dynamic stems from the fact that a mortgage situation, at bottom, is a lending transaction – a transaction where a creditor loans money to a debtor. Essentially, the equity courts, in developing the anti-clogging rules, were following the well-accepted principle of law, business, and economics that distinguishes between the position of an owner and a lender, and were insisting that a lender, upon being fully paid, loses all further rights against his debtor and his property.

limiting creditor conduct and creditor control . . . will have the effect, ultimately, of increasing the cost of credit and reducing its availability. . . . [T]hey will flash in front of your eyes an incomprehensible chart or graph that, they say, linearly proves the probable reliability of economic intuition. I have four responses that lead ultimately to the conclusion that objectifying debtor-creditor relations so as to limit creditor control is, to a point, desirable.

Nickles, *supra* note 107, at 382-83.

¹¹¹ Tracht, *supra* note 4, at 643. Professor Tracht thanks his colleague Vern Walker for raising the point.

¹¹² See *supra* Part II.E.

Stating it another way, the equity courts, in developing and then perpetuating the anti-clogging rules, essentially ruled that one with funds (assets) to invest in an enterprise must make a choice: whether, with respect to those funds, to become a lender to, or an owner of, the enterprise. If the choice is to become a lender, then one must be satisfied with the entitlements of the lender, namely, the right to have the loan repaid with appropriate interest. Having elected to receive those creditor entitlements, the mortgagee is barred from also obtaining the entitlements of an owner.¹¹³ This idea was expressed early when Lord Henley (later Northington L.C.) in 1761 declared: “[t]his court, as a court of conscience, is very jealous of persons taking securities for a loan, and converting such securities into purchases.”¹¹⁴

Some two hundred years later, Lord Lindley, in *Samuel v. Jarrah Timber & Wood Paving Co.*,¹¹⁵ likewise stated:

The doctrine ‘Once a mortgage always a mortgage’ means that no contract between a mortgagor and a mortgagee made at the time of the mortgage and as part of the mortgage transaction, or, in other words, as one of the terms of the loan, can be valid if it prevents the mortgagor from getting back his property on paying off what is due on his security. Any bargain which has that effect is invalid, and is *inconsistent with the transaction being a mortgage*.¹¹⁶

And, recall, even a law judge writing in 1314 articulated the very same idea.¹¹⁷

There are similar statements made in the present-day United States. One example comes from the Oklahoma Supreme Court, which stated in 1967 “that upon discharge of the debt . . . the mortgagor is entitled . . . to have the mortgaged premises relieved from the lien and his entire estate restored to the extent which he would have had if the mortgage transaction had never taken place.”¹¹⁸ While many other authorities have expressed the same

¹¹³ Professor Nickles makes the same point. He then explains: “The owner’s investment is at risk in this sense [in an insolvency situation], while the creditor’s is not, because the owner is empowered to share in the direction and management of the enterprise and thus must bear the consequences of her control.” Nickles, *supra* note 107, at 381.

¹¹⁴ *Vernon v. Bethell*, 28 Eng. Rep. 838, 2 Eden 113 (Ch. 1761).

¹¹⁵ [1904] A.C. 323 (H.L. 1904).

¹¹⁶ *Id.* at 329 (emphasis added); *see also* Nickles, *supra* note 107, at 382 (“[C]reditors must use collateral according to its real purpose; must use the control accompanying collateral in line with that purpose; and . . . creditors must not abuse control – use it beyond its purposes – whatever the source of the control and without regard to how it is achieved.”).

¹¹⁷ *See supra* note 20 and accompanying text.

¹¹⁸ *Coursey v. Fairchild*, 436 P.2d 35, 38 (Okla. 1967).

idea, Professor Osborne succinctly captured this basic thought when he wrote:

[T]o a modern mind, [there is] a perfectly good and obvious reason, namely, that the mortgagee's right was only to the payment of his debt and the property was merely security for that purpose; and, since that was so, it would be a forfeiture to allow the mortgagee to keep it absolutely if the mortgagor was willing to pay even though the payment was somewhat belated.¹¹⁹

All of this is based upon a well-established doctrine in law, in commerce, and in economics. One rarely, if ever, can assert that the advancement of a particular sum of money to an enterprise entitles one, at a particular time, to *both* to the status of a creditor *and* an owner. This would seem particularly true where the investor seeks ownership status *only* when the property appreciates, but not when it depreciates in value.

Our tax law insists that the dichotomy between creditor and owner be respected since it determines the tax consequences of distributions to that person.¹²⁰ So does our bankruptcy law since it determines the priority of claimants to the bankruptcy estate's assets. So, I believe, does every other area of law and business where the problem arises.¹²¹

Are we really prepared to blur or indeed eliminate this long established dichotomy? Will secured lending become the first to break this dichotomy, and, perhaps, to set the precedent for doing so in many other contexts? This is a question that the current commentators, until now, have not even discussed. But, I submit that it needs to be discussed.

It strikes me that there have always been and still are good legal, business, and economic reasons for distinguishing between the position of the lender and that of an owner. A lender has a preferred position in the assets of the debtor and the assurance of a known rate of return (interest). His risks upon the insolvency of the debtor are, therefore, minimized.

¹¹⁹ OSBORNE, *supra* note 4, at 13.

¹²⁰ See *Hardman v. United States*, 827 F.2d 1409, 1411 (9th Cir. 1987).

¹²¹ Insurance law prohibits a creditor from insuring his debtor's life for more than the amount of the debt. Seeking to insure a debtor's life for more than this sum is deemed to be an unlawful wagering contract, one which would amount to unjust enrichment to the creditor. See ROBERT H. JERRY, II, *UNDERSTANDING INSURANCE LAW* § 43, 314-16 (3d ed. 2002). Thanks to my colleague, Professor Wilbur C. Leatherberry, for bringing this point to my attention.

On the other hand, an owner has the potential for high, possibly unlimited, profits. In return, the owner also must assume the obligations, risks, and potential losses associated with ownership. However, Section 3.1(c) of the Restatement and Section 211 of the ULSIA are structured to stand the owner's obligations and risks on their head. In effect, these provisions will permit lenders to have their cake and eat it too; that is, to be assured of full repayment of their loans with appropriate interest as a lender. And, if the enterprise prospers, or the property increases in value, then these proposals permit the lender also to enjoy a part of those profits. But, note well, they will be entirely free from the risks and burdens imposed on an owner if the property decreases in value, or the enterprise is not profitable. In 1861, Judge Hargreave also made the point pithily and well:

If the land had fallen in value below £4,000 [the amount of the loan], Mr. Jackson [the mortgagee] would have insisted on being treated as a mortgagee; but, as it has risen, he says he is a purchaser: that is, he gets a collateral benefit over and above his principal and interest, which a Court of Equity never permits.¹²²

A comparable view was expressed in 1973 in *Humble Oil & Refining Co. v. Doerr*.¹²³

By taking such option here, Humble [the mortgagee] put itself in the fortunate position where it had nothing to lose and much to gain – it was not obliged to do anything but it could exercise the option if the value of the property increased sufficiently over the option price to make it financially worthwhile to do so. The Rokitas [the mortgagor] could only lose – the harder they worked to build up the business, and the more the property increased in value, the more it was in the interest of Humble to exercise the option.¹²⁴

To sum up, before we overrule some four hundred years of legal history, we ought to make a better case than that presently stated for doing so. Indeed, we better be sure that we want to make the case.¹²⁵ Are we truly prepared to permit lenders to have

¹²² *In re Edwards*, 11 L.R. 367, 369 (1861).

¹²³ 303 A.2d. 898 (1973).

¹²⁴ *Id.* at 911.

¹²⁵ I suspect that Professor Nickles does not want to make such a case. He states: [I]f I am wrong and these cases that threaten creditor control do have a net economic cost, that alone is not sufficient reason to disapprove of them. Balanced against the economic costs of limiting creditor control is

all the advantages of a creditor and, in addition, the advantages of ownership when that is profitable, but to be subject to none of the burdens or none of the risks of ownership when the enterprise is not profitable?

ADDITIONAL THOUGHTS

So far, the American Law Institute and the Commissioners on Uniform State Laws have limited this dual position (creditor status plus ownership rights if debtor prospers) to the secured creditor, i.e., the one who loans on the security of the debtor's property. But, in principle, why should it end there? If Restatement Section 3.1(c) and Section 211 of the ULSIA make sense for the secured creditor, why not something comparable for the unsecured creditor? Why should not these unsecured creditors, like sellers of goods, people who render service, etc., be entitled to write into their contracts that they be paid the full amount of their debt plus having an interest in the debtor's enterprise if it is profitable?

Indeed, if the principles announced in the Restatement and the ULSIA are acceptable, why would any investor ever purchase ownership (equity) interests in property or an enterprise? To do so subjects that investor to the obligations of ownership, plus the risk of loss if the property loses value or if the enterprise fails. Instead, following the principles of the Restatement and the ULSIA, the investment can be structured as a loan – better still a secured loan – with the right to obtain an ownership interest at little or no additional cost, but only if the property increases in value or the enterprise proves to be profitable.

Thus, if the enterprise fails, the loan, particularly a secured loan, has a very good chance of being repaid in full. On the other hand, if the enterprise succeeds, then the loan is still fully repaid, but the lender now becomes an owner of what is appreciated property of a profitable enterprise that has been obtained at little or no cost. That ownership interest may be immediately liquidated to “lock-in” these additional profits. Or, the appreciated property or profitable enterprise ownership may be retained for potentially

the social cost of allowing it: subjecting debtors to an overt form of economic slavery or, put more mildly, transforming debtor-creditor relations into investment robotization where the debtor's will is subjugated, willy-nilly, to that of the creditor It is undemocratic; it is exploitation; it ensures the concentration of wealth; it is wrong.

Nickles, *supra* note 107, at 385.

even higher gains, but with the assurance that only the minimum cost, if any, to obtain the ownership is at risk.

These are the scenarios that the ideas contained in the ULSIA and the Restatement make possible. They are not hypothetical scenarios. They have already taken place. Recall the TIAA-CREF examples previously discussed. Because of the potentially high gains which are possible, it seems likely that more lenders and investors, unless restrained by the anti-clogging rules, will seek to take this approach. And what then might be the end result of all this? It could be a significant diminishment of our current method of lending and investing funds, where one acts either as a creditor or owner. This will be replaced by the blended creditor equity participation arrangements which are so favorable to the investors, and which the ULSIA and the Restatement could make possible.

EPILOGUE

Are we really prepared to bury those equitable principles that made mortgage law unique, by recognizing that a mortgage, at bottom, is essentially a debtor-creditor relationship, not one of property purchase? Or do we wish now to announce that mortgage law is dead? Or, to use French (where this all started) to announce: *La Mort Du Mortgage!* – the Death of the Dead Pledge?

Will mortgage law survive? The answer to this question is now for us to decide.