

The Anti-Lien: Another Security Interest in Land*

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The law recognizes various security interests in land, which are designed to provide two distinct advantages over unsecured interests: the right to priority over general creditors in bankruptcy proceedings, and the right to satisfy the debt from a specified parcel of property. This article proposes recognition of an intermediate concept between secured and unsecured debt: an interest in land that secures to some extent the repayment of a debt, but does not possess the twin characteristics of full security interests. This interest in land, the "anti-lien,"¹ is a preventive measure; the debtor's power of alienation and power to grant another security interest are suspended while the debt remains outstanding. The anti-lien creditor has no powers or rights other than this passive remedy; for all other purposes, he is treated as a simple debt creditor.

The few cases that have dealt with contracts containing anti-lien restrictions have limited the analysis to a narrow question: did the contract create an equitable lien (that possesses the characteristics of a traditional security interest) or merely a personal obligation? Framing the question in this way eliminated consideration of the anti-lien alternative—an alternative that is potentially useful when a regular security interest is unavailable or economically impractical. This paper attempts to explain deficiencies in the application of the equitable lien analysis to the anti-lien situation and argues the case for the anti-lien concept.

Just a decade ago, documents evidencing an anti-lien approach were widely used in California. In fact, this California experience is significant for any discussion concerning the anti-lien interest. It illustrates the difficulties in applying an equitable lien approach to the "negative

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¹ The term "anti-lien" has not been used previously to refer to the negative covenant that is the subject of this article. So-called "anti-lien" clauses have been written into maritime charter contracts, *see* 2 G. GILMORE, SECURITY INTERESTS IN PERSONAL PROPERTY, § 38.4, at 1014 (1965), but these clauses are not relevant to the present inquiry.

mortgage" and suggests that there is a need for recognition of the anti-lien interest.

Part I of this article will examine the reaction of the California courts to these negative covenants. In Part II, the conclusions drawn from this historical analysis are used to set forth and discuss the features of the anti-lien interest. The issue is not a parochial one. Although California's strict rules regarding the satisfaction of secured debts may have provided the stimulus to experimentation with the "negative mortgage," the commercial advantages afforded by the proposed device should be of interest in other jurisdictions, especially since several cases indicate that instruments similar to the anti-lien have occasionally been employed outside California.

I. JUDICIAL INTERPRETATIONS OF THE ANTI-LIEN INTEREST

A. Early Interpretations: The "Negative Mortgage" As a Personal Obligation

Prior to 1964, courts considered the "negative mortgage" issue in only three reported cases.² Although the courts faced varying factual situations and applied different legal analysis, they concluded in each case that an absolute negative covenant³ not to transfer or encumber one's land did not create an equitable lien.

In the first case in this series, *Knott v. Shepherdstown Manufacturing Co.*,⁴ the defendant corporation agreed "not [to] give any voluntary lien of any character whatever on any of its buildings, machinery, or grounds so long as [the debt to the plaintiff] remains unpaid."⁵ The plaintiff and another creditor who had known about the agreement obtained judgments against the insolvent defendant, which subsequently conveyed its assets to a trustee for payment of its debts. The plaintiff claimed priority, arguing that the agreement was intended to give him a first lien upon the company's property. The court decided that the covenant "is simply negative; an agreement not to do a particular thing. The creation of a lien is an affirmative act, and the intention to do such acts can not [*sic*] be implied from an express negative."⁶

Since the *Knott* court was primarily concerned with the *express* promise not to transfer, it had little difficulty concluding that an "ex-

² G. GILMORE, *supra* note 1, § 38.3, at 1008.

³ If the restriction is not absolute, an equitable lien will not be recognized. *B. Kupperheimer & Co. v. Mornin*, 78 F.2d 261 (8th Cir. 1935), is an example of the "imperfect restriction" line of cases. See note 16 *infra*.

⁴ 30 W.Va. 790, 5 S.E. 266 (1888).

⁵ *Id.* at 792, 5 S.E. at 266.

⁶ *Id.* at 796, 5 S.E. at 269.

press negative" was not the equivalent of an intention to grant a security interest. Moreover, it was irrelevant that the *Knott* agreement (which did not provide for recordation) was not recorded; for, considered on its face, the agreement, even if recorded, would not have been capable of a different interpretation.

The second case, *Western States Finance Co. v. Ruff*,⁷ was decided 35 years after *Knott*. Ruff sold his land in fraud of his wife's inchoate right of dower. The purchaser, Kaser, agreed to compensate Mrs. Ruff for her dower interest within two years, at which time Mrs. Ruff was to deliver her title deeds to him. Kaser also promised, in a recorded agreement, that he would not transfer the land until he compensated Mrs. Ruff. The covenant was violated when, without first compensating Mrs. Ruff, Kaser transferred the land to the plaintiff. After receiving Mrs. Ruff's demand for payment of the debt, the plaintiff-purchaser brought an action to quiet title. During this time, however, Mrs. Ruff had lost her dower rights through divorce; thus, her last resort was the negative covenant.

The court decided that no equitable lien was created. Citing *Knott*, Judge McCourt explained that, according to the "usual rules of interpretation," the words of the negative clause could not be construed as expressing the intent to create a lien. "It is clear," said the court, "that the defendant had no lien on Kaser's interest, in the event that Kaser held the same but did not pay defendant within two years."⁸ The court seemed to be concerned with the fact that although a mortgage creates a right to satisfy the debt by foreclosing on the collateral, the asserted lien in this case (created by the negative covenant) was not necessarily related to the debt clause—the debtor might default on his promise to pay the debt and yet not violate the terms of the "negative covenant." If that happened, Mrs. Ruff could pursue only the remedies available to unsecured creditors.⁹

After observing that the covenant was drafted in a way that allowed the promisor to transfer an unencumbered title,¹⁰ the court noted that

⁷ 108 Ore. 442, 215 P. 501 (1923), *rehearing denied, opinion modified*, 108 Ore. 455, 216 P. 1020 (1923).

⁸ *Id.* at 451, 215 P. at 504.

⁹ *Id.* Cf. *Kelly v. Central Hanover Bank & Trust Co.*, 11 F. Supp. 497, 507 (S.D.N.Y. 1935), *remanded*, 85 F.2d 61 (2d Cir. 1936) (discussed at note 16 *infra*).

¹⁰ The covenant read: "[S]hould . . . Kaser, at any time during the period of two years . . . desire to sell[,] . . . such conveyance shall not be made . . . until the obligation is fully paid . . ." 108 Ore. at 445, 215 P. at 502. The court concluded that if Kaser had transferred the land after the two years without paying the debt, he would not have breached the covenant not to transfer. Even a conveyance within the two years would not have created a lien. "Prior to such sale and conveyance by Kaser, there was no lien. A conveyance then was required to raise the lien. But then it would be too late, the title

"[t]here was nothing in the relations of the parties or in the subject matter or character of the transaction which charged the words of the contract with a broader, more comprehensive or different significance than they ordinarily and naturally possess The terms of the contract which were intended to secure and protect defendant are found in the arrangement for the deposit of defendant's deed in escrow" ¹¹ Although this language could indicate that in a proper case the court would consider the remedy of reformation of contract, ¹² it is also possible that the court was expressing a willingness to interpret such an agreement as consistent with an intention to grant a lien, ¹³ at least if there were sufficient additional evidence to support this view.

The third case in the series is *Fisher v. Safe Harbor Realty Co.* ¹⁴ Fisher, the plaintiff, received partial payment for the sale of his stock in the defendant company. The company guaranteed the balance of the sale price and secured the guarantee with a recorded promise "that the land owned by the company shall not be encumbered with or by mortgage so long as there are any amounts due." ¹⁵ When two creditors obtained subsequent judgments against the company, Fisher claimed priority in reliance on his "equitable lien." The court cited *Knott* ¹⁶ for

would have passed from Kaser and beyond the reach of any lien" 108 Ore. at 452, 215 P. at 504. *But cf.* G. OSBORNE, MORTGAGES § 42 (2d ed. 1970) (conditional mortgages).

¹¹ 108 Ore. at 454, 215 P. at 505. Dower rights are not legal interests; they are protected only by courts of equity. *See* W. BURBY, REAL PROPERTY § 85, at 190 (3d ed. 1965). The court did not infer the intention to create an equitable lien from the fact that the document was recorded, because the recordation of the agreement was probably only an attempt to give subsequent purchasers notice of the inchoate dower rights.

¹² When proof of fraud or mistake is established, a contract may be reformed and the reformed clauses specifically enforced. *See* 2 A. CORBIN, CONTRACTS § 344 (1950). Since a promise to give a mortgage will be incorporated into the contract, the creditor will have an equitable lien. But the terms that supposedly were agreed upon must be proved by more than a mere preponderance of evidence. *Id.* § 345. In some jurisdictions, courts have refused to enforce a reformed clause, considering it violative of the Statute of Frauds. *Id.* § 340. The typical case in which reformation is ordered for mistake involves an incorrect description of particular items; it differs radically from the case discussed in the text. For a recommendation of caution in rewriting the terms of a contract, *see* H. McCLINTOCK, PRINCIPLES OF EQUITY § 100, at 270 (1948).

¹³ If the latter interpretation is correct, *Ruff* may bridge the gap between the early cases, which failed to find an equitable lien in the anti-lien contractual provisions and *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964), which held that the anti-lien can be interpreted as giving an equitable lien. *See* text and notes at notes 23-25 *infra*.

¹⁴ 38 Del. Ch. 297, 150 A.2d 617 (Sup. Ct. 1959).

¹⁵ *Id.* at 299, 150 A.2d at 618.

¹⁶ *Id.* at 303, 150 A.2d at 620. In addition to *Knott*, the court cited several cases that were not directly on point. *B. Kupperheimer & Co. v. Mornin*, 78 F.2d 261 (8th Cir. 1935), for example, is one of the "imperfect restriction" cases. The debtor promised not to sell or encumber his land, but agreed to pay the creditor from the proceeds if he did sell the land. The court held that this language gave the promissor the privilege and power of conveyancing and mortgaging, and interpreted the clause as a personal promise to pay

the proposition that "a negative covenant not to do a certain thing . . . [is] not an unequivocal manifestation to secure a debt by a lien on land" and decided against "the imposition of an equitable lien to the detriment of subsequent judgment creditors."¹⁷

out of future funds. *Redemptorist Fathers v. Purdy*, 174 Wash. 358, 24 P.2d 1089 (1933), contained an anti-lien clause, but the parties clearly intended a statutory lien.

The court also cited *Kelly v. Central Hanover Bank & Trust Co.*, 11 F. Supp. 497 (S.D.N.Y. 1935), *remanded*, 85 F.2d 61 (2d Cir. 1936), one of the corporate debenture cases. (For a detailed discussion of these cases see 2 G. GILMORE, *supra* note 1, §§ 38.2-38.4; G. OSBORNE, *supra* note 10, §§ 42, 43; Jacob, *The Effect of Provision for Ratable Protection of Debenture Holders in Case of Subsequent Mortgage*, 52 HARV. L. REV. 77, 102-07 (1938). In *Kelly*, the debenture holders were "secured" by the issuing corporation's promise not to give a security interest in its assets unless the debenture debts were secured equally and ratably. The question litigated was whether subsequent security interests given to other creditors who had notice of the debenture terms were subject to the rights promised to the debenture holders. The majority of cases in the corporate debenture series have given an affirmative answer. *E.g.*, *Kaplan v. Chase Nat'l Bank*, 156 Misc. 471, 281 N.Y.S. 825 (Sup. Ct. 1934); *Chase Nat'l Bank v. Sweezy*, 281 N.Y.S. 487 (Sup. Ct. 1931), *aff'd mem.*, 236 App. Div. 835, 259 N.Y.S. 1010, *aff'd mem.*, 261 N.Y. 710, 185 N.E. 803 (1933). But these cases were decided on the ground that there was a breach of trust. Although some commentators have suggested reading the *Kelly* covenant as implying an affirmative promise, G. OSBORNE, *supra* at § 43, at 87, quoting Jacob, *supra*, at 106, this suggestion is hardly applicable to the anti-lien situation.

The district court in *Kelly* took the position that creditors with notice were not subject to the rights promised to the debenture holders. 11 F. Supp. at 508-512, but the court of appeals appears to have rejected this position, 85 F.2d at 63. See 2 G. GILMORE, *supra* at § 38.3, at 1007. The district court's emphasis on the facts that unspecified securities served as collateral for a constantly changing group of people and that there was no prohibition of sale, 11 F. Supp. at 507-8, distinguishes the case from *Minderhout*.

The last two cases cited in *Fisher* dealt with payment from a certain fund and were also not directly on point.

17 38 Del. Ch. at 303, 150 A.2d at 620. Although it may seem from the quoted passages that the decision was based on lack of notice ("unequivocal manifestation" and "detriment of subsequent judgment creditors"), the court assumed *arguendo* that the covenant gave sufficient notice. In another passage, the court stated clearly "that the agreement . . . evinces no intention to create a lien . . ." *Id.*

Some courts have attributed significance to whether the negative promise was violated. See *Browne v. San Luis Obispo Nat'l Bank*, 462 F.2d 129, 134 n.5 (9th Cir. 1972); *Tahoe Nat'l Bank v. Phillips*, 4 Cal. 3d 11, 20-21; 480 P.2d 320, 328, 92 Cal. Rptr. 704, 712 (1971).

The analysis is probably based on a reverse application of the theory of executory mortgages. When a debtor promises to give a security interest in the future, a court of equity will recognize an equitable lien only if the contract is specifically enforceable. G. OSBORNE, *supra* note 10, § 25. In the negative covenant situation, no injunction can be granted if a violation has not occurred or is not about to occur. But if the agreement is breached (for instance, if a contract for sale is signed), the court may intervene and prevent completion of the transaction. Since the right is specifically enforceable, secures the payment of the debt, and relates to specific property, it could be analyzed as a right similar to an equitable lien.

The fact of violation should not be relevant to the equitable lien issue; the sole question should be whether there was an intention to grant a security interest. It should be noted that in two of the three cases discussed in this section, the promises were probably not violated at all.

B. *Coast Bank v. Minderhout*: The Foundation Case for the Equitable Lien Interpretation

1. *The Decision. Coast Bank v. Minderhout*,¹⁸ a 1964 decision of the California Supreme Court, establishes that a negative covenant (in which the borrower promises not to transfer or encumber his land until the debt is paid in full¹⁹) may be construed as an equitable lien. The debtor in *Minderhout*, in violation of a recorded covenant, transferred his land to the defendant, who had actual notice of the agreement. The bank accelerated the debt pursuant to the contract and foreclosed on the land. Since the defendant's general demurrer did not contest the bank's allegation that the parties to the original transaction intended to create a security interest in the debtor's land, the question before the court was not "what meaning appears from the face of the instrument alone," but "whether the pleaded meaning is one to which the instrument is reasonably susceptible."²⁰

The court concluded: "The instrument restricts the rights of the [original debtors] in dealing with their property for plaintiff's benefit; it describes itself as 'For use with Property Improvement Loan,' it specifically sets forth the property it covers, and it authorizes plaintiff to record it. These provisions afford some indication that the parties intended to create a security interest and are clearly sufficient to support the pleaded meaning."²¹ Because the court held that the bank had an equitable mortgage and that the acceleration clause was thus a reasonable restraint on alienation, the validity of the promise not to transfer or encumber, which the court viewed as a separate covenant, became irrelevant to the issue of foreclosure.²²

¹⁸ 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

¹⁹ For a full reprint of the *Minderhout* agreement see *id.* at 312 n.2, 392 P.2d at 266 n.2, 38 Cal. Rptr. at 506 n.2.

²⁰ *Id.* at 315, 392 P.2d at 267, 38 Cal. Rptr. at 507.

²¹ *Id.*

²² This decision was welcomed by some commentators, for example, Hetland, *Real Property and Real Property Security, The Well Being of the Law*, 53 CALIF. L. REV. 151, 171 (1965), and criticized by others, for example, 2 G. GILMORE, *supra* note 1, § 38.4, at 1017; Comment, *Coast Bank v. Minderhout and the Reasonable Restraint on Alienation: Creation of Commercial Ambiguity*, 12 U.C.L.A.L. REV. 954 (1965) [hereinafter cited as *Coast Bank and Reasonable Restraint*]. See also G. OSBORNE, *supra* note 10, § 44; 1A P. COOGAN, W. HOGAN, D. VAGTS, *SECURED TRANSACTIONS UNDER THE UNIFORM COMMERCIAL CODE* § 23.10 (1973) [hereinafter cited as P. COOGAN *et al.*].

The decision revived the dormant issue of the "negative pledge." (In the realm of personalty, there has been a small amount of litigation between creditors who had received a debtor's promise not to transfer or encumber personal property, and subsequent creditors who claimed security interests in the same property. Apparently none has been reported since the debenture cases. See note 16 *supra*; 2 G. GILMORE, *supra* note 1, § 38.2.) *Minderhout* was decided in a period in which Article 9 of the Uniform Commercial Code was being subjected to intensive scrutiny by the legal profession. Although *Minderhout*

The *Minderhout* court did not recognize a novel category of equitable liens; the court apparently believed that the anti-lien agreement fell within one of the traditional categories.²³ The controversy between *Minderhout* and the earlier cases relates, therefore, to the requirement of intention. The California Supreme Court did not suggest that the document by itself established the intention to give a security interest, but rather held that the anti-lien agreement could indicate and be consistent with that intention. Since the written covenant was ambiguous as to intention, the court concluded that oral testimony should be admitted in such a case to determine whether the pleaded intention actually existed. Thus, the court did not interpret the negative covenant as an affirmative act. Instead, it treated the clause, which was a promise restraining the debtor from engaging in certain transactions,²⁴ as a prohibition that could manifest, in conjunction with other evidence, an implicit intention to grant a security interest.

The *Minderhout* court's technique of interpretation is sound. "Equitable lien" is not a term of art,²⁵ and it is neither possible nor desirable to define precisely the requirements for its recognition. A consensual equitable lien can be found not only when a written document specifically establishes the intention to grant a security interest in certain property,²⁶ but also when that intention can be inferred from the agreement and the surrounding circumstances. One line of cases has held, for example, that a conveyance subject to an obligation to support the grantor and to refrain from transferring the land prior to the grantor's death can be construed as creating an equitable lien.²⁷ Thus, any criticism of *Minderhout* must be based on its policy implications.

was a real property case, it called attention to a problem that the draftsmen of Article 9 had (intentionally) not taken into account. *Id.* § 38.5.

²³ *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 314, 392 P.2d 265, 266-67, 38 Cal. Rptr. 505, 506-07 (1964). The relevant categories include a promise to give a mortgage, a promise to hold property as security for a debt, and conveyance of a defective legal "mortgage." G. OSBORNE, *supra* note 10, § 35.

²⁴ *Coast Bank v. Minderhout*, 61 Cal. 2d at 317, 392 P.2d at 268-69, 38 Cal. Rptr. at 508-09. (The court doubted the validity of such a clause in a lien.)

²⁵ See I G. GILMORE, *supra* note 1, § 7.2.

²⁶ 4 J. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE § 1235 (5th ed. 1941):

[E]very express executory agreement in writing, whereby the contracting party sufficiently indicates an intention to make some particular property, real or personal, or fund, therein described or identified, a security for a debt or other obligation . . . creates an equitable lien upon the property so indicated, which is enforceable against the property in the hands not only of the original contractor, but of his . . . voluntary assignees, and purchasers or encumbrancers with notice.

Although a consensual equitable mortgage can also be created by verbal agreement, in the absence of a writing a party usually alleges the existence of a nonconsensual equitable lien or, failing that, one of the exceptions to the Statute of Frauds. G. OSBORNE, *supra* note 10, §§ 51, 53, 57.

²⁷ *Iowa Farm Credit Corp. v. Halligan*, 214 Iowa 903, 241 N.W. 475 (1932); *McClure v.*

2. *Policy Considerations.* The factual context of *Minderhout* differs radically from that in the earlier cases. *Minderhout* involved a commercial practice rather than a homemade mortgage. According to Professor Hetland, the commercial "negative mortgage" was used in California as a security of convenience; the terms of the document were vaguely drafted to enable the lender to choose whether to treat the recorded instrument as either a mortgage or a personal obligation.²⁸ Under certain circumstances, the lender would prefer to treat the loan as unsecured, for example, to avoid the "one form of action" rule²⁹ or the limitations imposed on lending against second mortgages.³⁰ In other cases, when the borrower transferred the property and disappeared without paying his debt or was declared bankrupt, the creditor would obviously prefer to treat the covenant as a lien. Under this interpretation, the debtor was usually unaware of the lender's strategy and assumed that the document imposed only a personal obligation.³¹

Professor Hetland has suggested that the decision in *Minderhout* was designed to turn the option over to the debtor. In his view, it is simply "poetic justice" that the borrower, not the lender, becomes the one to decide whether to treat the agreement as a mortgage or as a void restraint on alienation.³² If the lender chooses to sue on the note, for example, the debtor may treat the covenant as a lien; the personal action will be barred and the creditor's only remedy will be foreclosure.³³

The proof, maintains Professor Hetland, "that the transaction is secured will be, in almost every case, overwhelmingly clear."³⁴ He continues:

To start with, the bank drew the agreement. The agreement describes specific real property and prevents the sale or encumbrance thereof until a certain indebtedness is paid. The indebtedness is

Cook, 39 W. Va. 579, 20 S.E. 612 (1894); cf. *Gallaher v. Herbert*, 117 Ill. 160, 7 N.E. 511 (1886). *But see* cases cited note 145 *infra*.

²⁸ Hetland, *supra* note 22, at 167. *See* *Coast Bank and Reasonable Restraint*, *supra* note 22, at 964 & n.66. The cases cited in the latter, however, dealt only with pledges of personal property.

²⁹ CAL. CIV. PRO. CODE § 726 (West Supp. 1974).

³⁰ CAL. FIN. CODE §§ 1227, 1542 (West Supp. 1974), (Banks and Trust Companies). *See* *Coast Bank and Reasonable Restraint*, *supra* note 22, at 964.

³¹ *Tahoe Nat'l Bank v. Phillips*, 4 Cal. 3d 11, 19-20, 480 P.2d 320, 327, 92 Cal. Rptr. 704, 711 (1971). Hetland, *Real Property Security Devices*, in CALIFORNIA REAL ESTATE SECURED TRANSACTIONS § 2.25, at 28-29 (J. Hetland ed. 1970); Hetland, *supra* note 22, at 167.

³² Hetland, *supra* note 22, at 167.

³³ It should be remembered that the deficiency judgment in California is limited to the difference between the amount due and the fair market value of the mortgaged property at the time of sale. CAL. CIV. PRO. CODE §§ 580a, 726 (West Supp. 1974).

³⁴ Hetland, *supra* note 22, at 168.

subject to acceleration either upon default in payments on the concurrent promissory note or for breach of the agreement, through sale, additional encumbrance, or even failure to pay taxes on the specifically described property. The whole thing is recordable. Simply to describe it is to describe a mortgage [except where the debtor claims that he did not so intend] . . . Furthermore, the creditor would have difficulty in trying to explain what it is if not a mortgage.³⁵

Professor Hetland concludes that institutionalized lenders will probably return to the use of traditional, unambiguous forms of security interests rather than leave the option with the debtor. Moreover, lenders who are prevented by statute from lending against a junior lien³⁶ will have an incentive to terminate use of the anti-lien when it would constitute a junior lien. In fact, earlier anti-lien agreements by such lenders might be considered statutory violations.³⁷

Since the California courts have acknowledged and followed Professor Hetland's explanation, his analysis should be subjected to careful scrutiny. His interpretation of *Minderhout* as an attempt by the court to prevent further use of the negative mortgage is undoubtedly correct. But his justifications for the *Minderhout* decision are not free from difficulty. Professor Hetland stresses the preservation of justice between the contracting parties. But this is certainly not the only concern; strangers to the original transaction may also be affected. Consider the situation of a purchaser from the original debtor. If the courts tend to treat anti-lien agreements as mortgages (which Professor Hetland says they seem on their face to be), the only fair protection for the purchaser is a deduction of the unpaid debt from the purchase price (since the acceleration clause will become effective). The Hetland approach thus fails to provide the debtor with an opportunity to exercise his "option" unless he shifts the liability to an innocent purchaser who believes the original obligation is simply a personal one. On the other hand, if courts tend to treat anti-lien agreements as personal obligations, purchasers may make windfall gains, and creditors' expectations may be defeated.

Under Hetland's interpretation, moreover, litigation between creditors and transferees can be resolved only by a judicial finding concerning the actual intent of the original debtor, who probably either will not appear before the court, or, if he does appear, will testify according to his personal interest in the outcome of the litigation.³⁸ The factual

³⁵ *Id.*

³⁶ See note 94 *infra*.

³⁷ See *Coast Bank and Reasonable Restraint*, *supra* note 22, at 964.

³⁸ The debtor may have transferred the land subject to the existing debt and would

issue of intent will thus foster litigation and promote uncertainty in land transactions.

Professor Hetland's interpretation also fails to preserve justice between the original parties. Because the option will probably be exercised when a suit is brought against the debtor, the "debtor's choice" will be influenced by contemporaneous considerations of self-interest, not by the original intent. The debtor may have been a victim of misrepresentation, but the lender should not be "taught his lesson" in a way that causes even more obscurity and waste.

If the purpose of the court was to eliminate the "negative mortgage" practice, why did it not simply hold that the clause did not confer a security interest? The court's ambiguous hints to institutional lenders could have been overlooked or even misunderstood. Professor Gilmore's criticism seems justified:

Negative covenants should not, it is submitted, be allowed to operate as informal or inchoate security arrangements, even against third parties with notice. If a creditor wants security, let him take a security interest in some recognized form: mortgage, pledge, an Article 9 security interest or whatnot. If he wants protection against third parties, let him take possession of the collateral or file. Nothing is to be gained by giving a shadowy effectiveness to informal arrangements which conform to no recognized pattern.³⁹

The explanation for the California Supreme Court's approach is that the court, undoubtedly aware of the shortcomings of the new rule, was faced with a widespread commercial practice involving millions of dollars of loans secured by *Minderhout*-type documents.⁴⁰ If the ruling of the lower state court,⁴¹ holding that the "securing" obligation was void in toto, had been affirmed, debtors could have transferred their lands with impunity. After making his most recently due installment payment, a debtor could have left California, and his creditor might have had no recourse. Affirmance of the lower court decision could have involved substantial bad debt losses.

Minderhout must be interpreted as a compromise reached in light of the rules of law and commercial practices prevailing in California at

have a motive, therefore, to shift the burden onto the transferee. On the other hand, he may already have been declared bankrupt and might favor the interests of the transferee.

³⁹ 2 G. GILMORE, *supra* note 1, § 38.4, at 1017. See also 1 G. GLENN, MORTGAGES § 17.2, at 104 (1943): "We know at least this, that there is such a thing as a mortgage or pledge; and if people deliberately try to dispense with the use of such device, they cannot obtain relief, at law or in equity, that is based upon any theory of security." (footnote omitted).

⁴⁰ Coast Bank and Reasonable Restraint, *supra* note 22, at 962, citing the California Bankers Association Amicus Curiae briefs.

⁴¹ Coast Bank v. Minderhout, 32 Cal. Rptr. 584 (Dist. Ct. App. 1963).

the time of the decision. Prior to this decision, the California courts enforced a strict interpretation of the civil code's prohibition of restraints on alienation—invalidating contractual restraints as well as power restraints.⁴² The *Minderhout* court avoided a rule that would have declared all reasonable restraints valid—that would have been too great a change⁴³—and instead treated the promise not to transfer as a condition precedent. Although the transfer of the land was presumably permissible, because the prohibition was void, it nevertheless brought the acceleration clause (a “reasonable” restraint) into operation.

On a more practical level, commercial use of anti-lien agreements was widespread, and institutional lenders expected to be able to enforce their rights notwithstanding the transfer of the “encumbered” property. These commercial expectations had to be balanced against the interests of debtors and strangers to the original transaction, and the equitable lien approach was an attractive solution to the court.

It would seem that the California Supreme Court attempted the impossible: preventing the use of anti-lien agreements in the future while providing a remedy in cases of past use. The court apparently utilized a vague rule to encourage compromises and to work out solutions in light of the particular evidence in cases that would eventually reach the courts.⁴⁴ The lien analysis was to be a temporary salvage device to prevent hardship by giving an option not to the debtor but to the court. The court also implied that it might recognize the validity of the contractual provision prohibiting transfer or encumbrance of property if no allegation of an equitable lien were raised.⁴⁵

The primary contribution of the *Minderhout* decision is that it marks the beginning of a new doctrine of restraint on alienation in California,⁴⁶ an innovation that will outlive the concept of an equitable mortgage created by a negative covenant. But much confusion has

⁴² See the cases cited in *Coast Bank v. Minderhout*, 32 Cal. Rptr. 584, 586 (Dist. Ct. App. 1963). The proposed anti-lien interest is a power restraint. The prohibition on transfer and further encumbrance has an in rem effect; prohibited transactions are not merely breaches of contract, they are void.

⁴³ This technique of gradual change to signal an area of transition is not uncommon in opinions of Justice Traynor, who wrote the *Minderhout* opinion. See Hetland, *supra* note 22.

⁴⁴ The determinative factor should be the actual understanding of the parties to the litigation. For example, if the transferee had deducted the debt from the purchase price, it might be proper to infer that the original debtor intended to give a lien.

⁴⁵ 61 Cal. 2d at 314-15, 392 P.2d at 265, 38 Cal. Rptr. at 507.

⁴⁶ See *La Sala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971) (although the restraint was held invalid); *Lazzareschi Invest. Co. v. San Francisco Fed. Sav. & Loan Ass'n*, 22 Cal. App. 3d 303, 99 Cal. Rptr. 417 (Ct. App. 1971); *Sanchez v. Centro Mexican of Sacramento*, 1 Cal. App. 3d 756, 81 Cal. Rptr. 875 (Ct. App. 1969); *Hellbaum v. Lytton Sav. & Loan Ass'n*, 274 Cal. App. 2d 456, 79 Cal. Rptr. 9 (Ct. App. 1969).

resulted from the fact that the transformation of the anti-lien into an equitable lien was not limited to the special situation before the court.

C. From Lien to Contract?: *Minderhout* and Subsequent Cases

The California Supreme Court discussed the "negative mortgage" again in 1971 in *Tahoe National Bank v. Phillips*.⁴⁷ The defendant and others borrowed money from the plaintiff bank to finance a real estate development. The bank received a note, signed by all the borrowers, and a *Minderhout*-type agreement, signed by the defendant and recorded, which provided that the defendant would not convey or encumber her residential property⁴⁸ until the debt was paid. A few months later, the defendant recorded a declaration of homestead on the property.⁴⁹ Upon default on the note, the bank foreclosed on the defendant's land and introduced evidence at trial, without objection from the defendant, to prove an intention to grant a security interest. The trial court thought the evidence was sufficient and granted a decree of foreclosure, but the California Supreme Court reversed, concluding that the agreement was not reasonably susceptible of interpretation as a mortgage.

It is impossible to distinguish *Phillips* from *Minderhout* on their facts. The decisions seem to be in direct conflict since the intention to create a security interest was established and supported in both cases by sufficient evidence.⁵⁰

The majority opinion explained that these types of agreements were used by banks with small, nominally unsecured loans. In *Phillips*, the bank had chosen this form of agreement over the regular trust-deed document. The contract, on the face of it, did not support an intention to give a security interest; consequently, said the court, in accordance with principles of interpretation for contracts of adhesion, the agreement could not be interpreted as providing the bank with a security interest. Parol evidence was therefore irrelevant and could not support the trial court judgment. The court emphasized that a *Minderhout*-type document could lead a borrower who refuses to give a mortgage into believing he is not doing so and concluded: "Legal alchemy cannot convert an assignment into an equitable mortgage, violating the cus-

⁴⁷ 4 Cal. 3d 11, 480 P.2d 320, 92 Cal. Rptr. 704 (1971).

⁴⁸ The agreement did not apply to the property involved in the venture.

⁴⁹ The court held that her act of recording a declaration of homestead did not constitute a breach of her obligation not to encumber her land. 4 Cal. 3d at 21 n.14, 480 P.2d at 328 n.14, 92 Cal. Rptr. at 712 n.14.

⁵⁰ See *Tahoe Nat'l Bank v. Phillips*, 4 Cal. 3d 11, 24, 480 P.2d 320, 330, 92 Cal. Rptr. 704, 714 (1971) (Sullivan, J., dissenting); *Tahoe Nat'l Bank v. Phillips*, 2 Cal. App. 3d 221, 82 Cal. Rptr. 592 (Ct. App. 1970). *But see* 82 Cal. Rptr. at 597 (Friedman, J., dissenting).

tomers' reasonable expectation and bestowing upon the bank the riches of an hypothecation of title."⁵¹

Although the court did not overrule *Minderhout*, it failed to explain why legitimate construction in one case (*Minderhout*) should be considered "legal alchemy" in another (*Phillips*). After pointing out several minor differences between the documents in the two cases, the court explained the significant difference between *Minderhout* and *Phillips*: in *Minderhout*, a breach had actually occurred. The court doubted that specific performance would be granted to undo the transfer in such a case⁵² and concluded that the only way to enforce the agreement in the *Minderhout* situation would be to recognize the creation of a lien that would permit an action against the transferee.⁵³

The court seemed to be influenced by Professor Hetland's analysis. As noted above, however, every decision against the transferee amounts to indirect elimination of the debtor's option. The nature of the transaction should not depend on the type of defendant (original debtor or transferee) who happens to appear before the court.

It can be argued that the policies underlying *Minderhout* seven years earlier were actually implemented by the *Phillips* decision. Since the loans associated with the "negative security" were usually small and of short duration, past violations of prior *Minderhout* agreements should have been taken care of by the time of the *Phillips* decision.⁵⁴ The court made it clear in *Phillips* that institutional lenders who had not followed the suggestion in *Minderhout* to stop the "negative security" practice altogether would not be able to assert in a case against the original debtor that the anti-lien agreement was intended as an equitable lien; they were left with only contractual remedies. The court also implied that banks might encounter difficulties in attempting to enforce their "rights" against a transferee. Moreover, although the original debtor's right to assert the existence of a lien was not expressly considered in *Phillips*, it will nevertheless be more difficult for him to establish as a defense in a personal action that the negative covenant was intended to provide the creditor with a security interest.

⁵¹ 4 Cal. 3d at 20, 480 P.2d at 328, 92 Cal. Rptr. at 712.

⁵² For its doubts about specific performance the court cited *Minderhout*; in that case, however, the court manifested doubts mainly because it had found a lien. Had the lien not been recognized, the way might have been open for this kind of relief. The court in *Phillips* was well aware of this. See text and note at note 56 *infra*. Here again the distinctions were unpersuasive.

⁵³ 4 Cal. 3d at 20, 480 P.2d at 328, 92 Cal. Rptr. at 712.

⁵⁴ The doctrine permitting reasonable restraints on alienations had by then reached California. See cases cited at note 46 *supra*. It is important to note that the agreement in *Phillips* was actually signed about a year after the *Minderhout* decision.

The court's analysis of the terms of the *Phillips* agreement is inconsistent with the self-evident-security-interest interpretation suggested by Professor Hetland. It is closer to the principle announced by Judge McCourt years ago in *Western States Finance Co. v. Ruff*: only in special circumstances will the words of a contract be charged with a different meaning than they ordinarily and naturally possess.⁵⁵ The *Phillips* decision also repeated the suggestion in *Minderhout* that the courts may give effect to the contractual duties agreed upon by the parties if the equitable lien theory is eliminated. The court said the agreement:

provides in part that 'borrower will not create or permit any lien or any encumbrance (other than those presently existing) to exist on said real property . . . without the prior written consent of bank.' . . . [I]ts absolute prohibition on what would be junior encumbrances is inappropriate in a mortgage, and if in fact such a prohibition appeared in a mortgage it might be unlawful as an unreasonable restraint upon alienation. [See *Coast Bank v. Minderhout*.] On the other hand, as unsecured creditor the bank would benefit greatly from an assurance that defendant would not encumber her assets.⁵⁶

Although the decision in *Phillips* was a move in the right direction, it did not guarantee an end to the confusion surrounding the anti-lien. The analysis thus far has considered the anti-lien in at least three different factual contexts, each of which may be governed by different rules of law.⁵⁷ The court in *Phillips* emphasized that the plaintiff was an *institutional lender* using a contract of adhesion. Should there be another category in the analysis for cases in which a home-made negative mortgage is involved? Given the sparse case history prior to *Minderhout*, one would predict that the need for an additional category was almost nonexistent. Nevertheless, a California court of appeal faced that problem in *Kaiser Industries Corp. v. Taylor*,⁵⁸ decided shortly after *Phillips*.

Pursuant to an agreement with his lender, the defendant debtor ordered a title company not to transfer or encumber his interest in land

⁵⁵ 108 Ore. 442, 454, 215 P. 501, 505 (1923). See text and note at note 11 *supra*.

⁵⁶ *Tahoe Nat'l Bank v. Phillips*, 4 Cal. 3d at 18-19, 480 P.2d at 326, 92 Cal. Rptr. at 710. See *La Sala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971). Unfortunately, the court did not elaborate on this statement, and it is difficult to tell whether the court considered only contractual remedies or actually signaled future acceptance of the anti-lien.

⁵⁷ The three situations are: (1) creditor claims a lien in litigation with the original debtor; (2) debtor asserts the "one form of action" defense (the Hetland theory); (3) creditor claims a lien in litigation with the transferee.

⁵⁸ 17 Cal. App. 3d 346, 94 Cal. Rptr. 773 (Ct. App. 1971).

held by the title company without the lender's consent until the promissory note had been paid in full. The title company, in a letter to the lender, acknowledged that it would act in accordance with the debtor's instructions. Upon default, the lender sued on the note, and the borrower raised the "one form of action" defense. The court held *Phillips* inapplicable to cases involving private lenders and homemade mortgages and relied instead on *Minderhout* to bar the action on the note.

Although the result in *Taylor* was fair, the case differs from the negative mortgage cases considered above,⁵⁹ and the court's failure to employ other analogies burdens California law with another category of interests beyond the original scope of *Minderhout*. The interpretation of the court of appeal that *Minderhout* establishes a general principle limited in its application by *Phillips* differs from the view expressed in this article that *Phillips* carried out the policies expressed in *Minderhout*.⁶⁰ *Taylor* therefore proceeds in the direction of ex post facto, obscure security interests.⁶¹

The final case in this review of California law after *Minderhout* is *Browne v. San Luis Obispo National Bank*,⁶² decided by the United States Court of Appeals for the Ninth Circuit.⁶³ Mrs. Browne signed a *Minderhout*-type agreement that was promptly recorded by the bank. One year later, Mrs. Browne filed a voluntary petition in bankruptcy listing the bank as an unsecured creditor and claiming a homestead exemption from bankruptcy for the property covered by the agreement. Nearly two years after the exemption was granted and Mrs. Browne was discharged from all debts, the bank brought suit to foreclose, claiming

⁵⁹ The debtor not only had promised not to transfer his rights, but had actually deprived himself of his power to do so, having caused the trust company to assume fiduciary obligations toward his creditor. The situation was similar to pledging property by giving notice to a bailee. Furthermore, the letter was written in negative form because it dealt only with trust company duties.

⁶⁰ See text following note 53 *supra*.

⁶¹ Just a few months later, another California court dealt with an anti-lien agreement in a dispute between the creditor-lender and the subsequent purchaser of the land. *Orange County Teachers Credit Union v. Peppard*, 21 Cal. App. 3d 448, 98 Cal. Rptr. 533 (Ct. App. 1971). Although the case appeared to be in the *Minderhout* context, the court indicated a disposition to apply *Phillips*. Ultimately, however, the decision for the defendant-transferee rested on a want of sufficient evidence to prove the alleged intent to create a security interest.

⁶² 462 F.2d 129 (9th Cir. 1972).

⁶³ The federal court applied California real estate law. The anti-lien seems not to have been discussed in recent years by courts outside California. The only case that has been found is an Arizona Court of Appeals decision, *Kalmanoff v. Weitz*, 8 Ariz. App. 171, 444 P.2d 728 (1968), in which anti-lien provisions were found not to create an equitable lien. In this case, however, the negative covenant was employed in a very peculiar way: protecting a real estate broker's exclusive right to obtain tenants.

it had an equitable mortgage on the property. The court, citing *Phillips*, decided that the homestead declaration did not constitute a breach of the agreement and that the bank did not have an equitable security interest: "Given [*Phillips*] and the lack of any evidence that Mrs. Browne intended to create a security interest [citing *Coast Bank v. Minderhout*], there can be no doubt that the Bank never obtained any mortgage or lien."⁶⁴

The court in *Browne*, like the court in *Taylor*, was trying to harmonize the decisions in *Minderhout* and *Phillips*. These attempts are undesirable and unnecessary. *Minderhout* contained not only a rule of law, but also the seeds of change; viewed dynamically, *Phillips* fulfilled *Minderhout* by replacing the equitable lien theory with contractual remedies against the debtor. Despite lower court misunderstanding, *Phillips* thus tends to bring California's law back into the national mainstream. Outside California a contract that prohibits the sale or encumbrance of the debtor's land until the debt is discharged is probably valid.⁶⁵ The creditor may therefore enforce his rights by obtaining an injunction or accelerating the debt (if the agreement so provides).

At the same time, however, the decline of the equitable lien approach of *Minderhout* leaves a gap in American law; in California, as elsewhere, if the creditor has neither a lien nor other interest in his debtor's land, he has no rights against a purchaser from the debtor or a subsequent mortgagee. The civil wrong of "causing a breach of contract," which otherwise provides some protection against a third party, is traditionally inapplicable to situations of this kind,⁶⁶ and indeed, there are good reasons not to extend it that far.⁶⁷

Furthermore, it would be difficult for the creditor to prove the purchaser's prior knowledge of the negative agreement. If the contract does

⁶⁴ 462 F.2d at 133. This statement contradicts *Phillips*. There the court ruled categorically that evidence could not be introduced to prove an intention to create a security interest. *Tahoe Nat'l Bank v. Phillips*, 4 Cal. 3d 11, 17, 480 P.2d 320, 325, 92 Cal. Rptr. 704, 709 (1971).

⁶⁵ See *Knott v. Shepherdstown Mfg. Co.*, 30 W. Va. 790, 5 S.E. 266 (1888); *Western States Finance Co. v. Ruff*, 108 Ore. 442, 215 P. 501 (1923); 2 G. GILMORE, *supra* note 1, § 38.4. See also *Kelly v. Central Hanover Bank & Trust Co.*, 11 F. Supp. 497, 513 (S.D.N.Y. 1935), *remanded*, 85 F.2d 61 (2d Cir. 1936) (discussed at note 16 *supra*).

⁶⁶ 2 G. GILMORE, *supra* note 1, § 38.4.

⁶⁷ Usually the vendor, not the vendee, takes the initiative to sell the land, and acceptance of the offer should not create a tort liability. "One does not induce another to commit a breach of contract . . . when he merely enters into an agreement with the other with knowledge that the other cannot perform both it and his contract with the third person." 4 RESTATEMENT OF TORTS § 766(i) (1939). Although the rule has been criticized, see *Developments in the Law—Competitive Torts*, 77 HARV. L. REV. 888, 965 (1964), it has remained unchanged. RESTATEMENT (SECOND) OF TORTS § 766(n) (Tent. Draft No. 14, 1969); W. PROSSER, THE LAW OF TORTS § 129, at 934 (4th ed. 1971).

not create an interest in land, its recordation is unauthorized;⁶⁸ thus, constructive notice will not be established even if it is recorded.⁶⁹ Even if a vigilant purchaser acquires actual notice between the date the contract is signed and the date scheduled for closing, the contract will not be retroactively "tainted" with the purchaser's knowledge. The equitable interest he has purchased is undoubtedly valid, and completion of the transaction is privileged as an action taken to protect acquired rights;⁷⁰ otherwise the purchaser would be under a duty to rescind a lawful contract. The failure to take such positive action has not traditionally constituted a tort for causing a breach of contract, and it is questionable whether the tort action should be extended, at the expense of commercial certainty, to cover the failure to cancel a lawful contract.⁷¹

The contract theory of *Phillips* will probably replace the equitable lien theory of *Minderhout*, leaving the anti-lien creditor without remedies against strangers to the initial anti-lien agreement. The question that remains is whether the anti-lien interest could (and should) afford protection unavailable under other theories.

II. THE ANTI-LIEN INTEREST

A. The Nature of the Anti-Lien Interest

The distinction between secured and unsecured interests, although not always easy to draw, is a necessary one since several rules of law

⁶⁸ See 6 R. POWELL, *THE LAW OF REAL PROPERTY* ¶ 914, at 279 (1968); 4 *AMERICAN LAW OF PROPERTY* § 17.8 (A.J. Casner ed. 1952).

⁶⁹ 4 *AMERICAN LAW OF PROPERTY*, *supra* note 68, § 17.17, at 589-90.

⁷⁰ W. PROSSER, *supra* note 67, § 129, at 944. If completion of the transaction, in the circumstances described in the text, creates tortious liability, the transferee cannot win indemnification for the damages he pays to the vendor's creditor. By definition, his own voluntary act made him liable, and the seller cannot be held responsible. Partial indemnification, based on a theory of joint tortfeasors, would probably not be available either. The seller's liability stemming from his original promise is a contractual one and is not based on any theory of tort. Also, it would be odd to hold the seller liable in tort for cooperating (by encouragement, request, ratification, or the like) in the buyer's wrongful act. Such cooperation would amount to the seller's persuading himself to break the original contract and could not coexist with the purchaser's liability. Furthermore, the law does not recognize a tort of causing the causation of breach of contract.

Theories of unjust enrichment are also not applicable here; after all, the transferor received no more than his money's worth for the property. Even a provision in the (second) contract that secures a marketable title may not help the purchaser. This warranty may be inapplicable (if not waived) since the interest conveyed might have no flaw. *Cf.* text and note at 10 *supra*. (For the definition of marketable title, see 4 *AMERICAN LAW OF PROPERTY*, *supra* note 68, § 18.8, at 673). This potential remedy also presupposes the power to rescind the second contract.

⁷¹ Besides the problems of establishing liability, the plaintiff may face difficulties in proving his damages; for example, the transaction may have saved the debtor from bankruptcy.

apply only to secured interests—interests that provide priority in bankruptcy and a right to foreclose on specific property. The law has always assumed a dichotomy, so that “hybrid creatures” have to be categorized. The issue thus becomes one of characterizing an interest that is designed to secure the payment of a debt but does not possess the two features of traditional secured interests.

The anti-lien interest is *not* a “disguised security interest.” The relationships between the parties are accurately described; the debtor’s payments are not described as rents, compensation for options to repurchase, installments for title to be transferred, or the like. The only effect of the agreement is a deprivation of the debtor’s power to transfer his land or encumber it while the debt is outstanding, without the consent of the anti-lien creditor. Except for these preventive powers, the creditor is like other unsecured creditors. In the event of bankruptcy, he shares (pro rata) in the assets (if any) that remain for distribution among unsecured creditors; upon default, he must rely on the ordinary execution-of-judgment procedures. The conveyance of an anti-lien interest is thus not designed to put the property beyond the reach of the trustee in bankruptcy; the interest cannot even be sold to satisfy the debt.⁷²

Although the anti-lien interest is therefore not the equivalent of a lien, the two interests do bear some resemblance to each other. This section of the paper will explore the precise characteristics of the anti-lien interest and further analyze its points of similarity to an ordinary lien. Two complementary kinds of situations will be considered: first, those in which the debtor abides by the covenant; and second, those in which he breaches it.

1. *Protection When the Debtor Respects the Covenant.* The anti-lien creditor gains several advantages by preventing the debtor from transferring and encumbering his title. In the first place, the debtor cannot lawfully sell his land, possibly his most valuable asset, and leave

⁷² In certain situations, the ownership of this negative right could be a valuable economic asset—for example, an anti-lien prohibiting the transfer of a lot that is important to a developer or to a neighboring, expanding factory. But this right cannot be separated from the lender-borrower relationship and sold to a third party. The reason is obvious: the covenant expires, according to its terms, when the debt is paid. If unrelated to the payment of the debt, it would clearly be a void restraint on alienation. See note 78 *infra*. But it should be possible for the creditor to transfer the negative obligation in conjunction with an assignment of the debt.

An easement may be designed to have the same effect—for instance, a right of way or a profit that is intended to prevent construction on an expensive lot zoned for high rises, and that can be extinguished only upon payment of the debt. Normally, however, this easement is a disguised interest calculated to survive the debtor’s bankruptcy; it is highly vulnerable to various legal attacks.

the jurisdiction with the proceeds. The anti-lien creditor also has the power to prevent new loans to the debtor secured by mortgages on the land, thus assuring additional assets for himself and other unsecured creditors in case of bankruptcy. A debtor who is eager to transfer his land or obtain additional credit secured by a lien has available only two courses of action: he can prepay the debt⁷³ or negotiate with the anti-lien creditor for permission to complete the transaction. In the latter case, the anti-lien creditor will probably demand a "true" security interest or another assurance for the full payment of the debt.

On the other hand, the anti-lien interest can be defeated in several situations. The anti-lien provides no protection in bankruptcy, and it fails to prevent both foreclosures by mortgagees who have obtained their security interest prior to the anti-lien loan, and execution sales initiated by judgment creditors.⁷⁴ A judgment creditor will have priority over the anti-lien creditor,⁷⁵ who will rarely be able to protect his interests under

⁷³ The reference in the text is to contracts that specifically provide that the debtor, at his option, may prepay his debt, with or without (reasonable) prepayment penalties. When there is no such provision, the debtor cannot compel his creditor to accept money that is not yet due. 60 AM. JUR. 2d *Payment* § 8 (1972). Under these circumstances, the creditor might attempt to apply pressures in order to realize windfall gains through, for example, exorbitant prepayment penalties. But then the anti-lien would probably be declared void as an unreasonable restraint on alienation, leaving the creditor unable to prevent or cancel the transfer.

The *Minderhout* agreement itself contained no prepayment clause, and thus could fail to qualify as creating a valid anti-lien interest.

⁷⁴ See *Fisher v. Safe Harbor Realty Co.*, 38 Del. Ch. 297, 150 A.2d 617 (Sup. Ct. 1959). With the exception of spendthrift trusts, 30 AM. JUR. 2d *Executions* § 163 (1967), valid restraints on alienation do not prevent execution sales. 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.35. The judgment creditor's interests are sometimes preferred even over the interests of strangers to the transactions. Thus, tenant's rights are subject to an involuntary sale notwithstanding an explicit prohibition of transfer in the lease. 2 R. POWELL, *supra* note 68, ¶ 246.1, at 372-84; 51C C.J.S. *Landlord and Tenant* § 33, at 86-7 (1968). The same rule applies to trust property and judicial sales. 47 AM. JUR. 2d *Judicial Sales* § 6 (1969). And finally, the rule applies to shares in a close corporation, even where the judgment creditor or purchaser could not have become a shareholder by a voluntary transaction. See, e.g., *Street v. Sugerman*, 202 So. 2d 749 (Fla. 1967), where the court ordered the execution sale of shares in a law corporation owned by attorneys. The result in *Street* rested on statutory interpretation, but the policy is quite sound.

Had the opposite view been adopted, the anti-lien beneficiary would actually have a lien; or he might cause the unsecured creditors to petition for declaration of the debtor's bankruptcy (if the land was the only asset available). It is of interest to note that the late nineteenth century New York cases dealing with after-acquired property clauses in chattel mortgages reached somewhat similar results: the lien was held effective against a subsequent purchaser but ineffective against an execution creditor. See I G. GILMORE, *supra* note 1, § 2.4, at 37. This rule differs from the proper anti-lien rule, however, in both reasoning and result. In the after-acquired property clause situation, only the mortgagee would benefit from asserting his right.

⁷⁵ The general rule is that a judgment regularly entered or docketed has priority as a

these circumstances.⁷⁶ Furthermore, unlike the situation with regular security interests,⁷⁷ the purchaser of the land will probably not be subject to the negative restrictions that had bound the original debtor.⁷⁸

Thus, the anti-lien interest clearly differs from a lien. The advantages of the anti-lien are contingent on certain conditions, such as the debtor's need for additional credit. Moreover, these advantages, unlike ordinary secured interests, are not geared to the moment of default; thus, when the debtor does default, it may be too late for the anti-lien

lien over subsequent judgments against the same defendant. 46 AM. JUR. 2d *Judgments* § 283 (1969).

⁷⁶ He has several possible escape routes. (a) The parties may agree that an execution sale of the land will accelerate the debt. Such an agreement would apparently be valid. The debtor would then probably try to turn over other assets to satisfy the judgment debt. (In some jurisdictions the debtor has the right to decide which of his assets will be subject to an execution sale. 30 AM. JUR. 2d *Executions* § 92 (1967). In any event, the sheriff would probably use his discretion to order that the judgment debt be satisfied from unencumbered property first.)

(b) The doctrine of marshalling assets will probably apply. "[The two-funds rule] is founded on the principle of natural justice, that a man shall not exercise the right which he possesses so as to injure the right of another, if he can fully enjoy his own right without such injury to another." *Keaton v. Miller*, 38 Miss. 630, 635 (1860). The doctrine was applied against a judgment lienor (protecting a junior judgment creditor) in *Boone v. Clark*, 129 Ill. 466, 21 N.E. 850 (1889).

(c) If the judgment was obtained to defraud the anti-lien creditor, he could attack it. See generally RESTATEMENT OF JUDGMENTS § 90, comment *c* (1942).

⁷⁷ "The general rule is that an execution purchaser takes the property purchased subject to a prior mortgage, even if the sale is of the entire property without any mention of the mortgage." 30 AM. JUR. 2d *Executions* § 447 (1967).

⁷⁸ Various arguments based on analogous situations might be offered against this result. Since the anti-lien is basically a property interest, one might argue, it should survive an execution sale, like a lien or an easement. Furthermore, a purchaser of shares or a term of years at an execution sale does not acquire more rights than the judgment debtor had. The law allows a temporary suspension of the other shareholders' or the lessor's rights to facilitate the sale, but thereafter the purchaser has the same rights as his predecessor in title.

These arguments overlook important differences between a lien and an anti-lien. As maintained earlier (note 72 *supra*), the anti-lien should not be recognized if separated from the debt it secures. Unlike a lien, the negative interest does not enable a creditor to trigger foreclosure proceedings. If title is legally transferred, the restriction is no longer capable of tying up an asset that will afford protection in case of default. Moreover, the creditor could not obtain a personal judgment against the purchaser (unless the purchaser guaranteed the debt). The interest thus ceases to be related to the debt. To say that the purchaser could not sell his land until the debtor had paid off his debt would be to sanction a plainly unreasonable restraint on alienation.

If upheld, the restriction would create an intolerable "patience game." If the new owner wanted to sell his property for some reason before the debtor was declared bankrupt (at which time the discharge of the debt would automatically extinguish the restriction), he would have to pay the debt and might not be able to recover from the debtor. Moreover, if we were to allow the creditor to sue when the restriction was violated, he would be hard put to explain which of his interests was harmed, other than his right to apply pressure to force someone to assume the obligation of a stranger.

creditor to exercise his pressures. The anti-lien encourages early payment in many cases, but it fails to guarantee full payment.

2. *Protection When the Debtor Breaches the Covenant.* If the anti-lien debtor transfers or encumbers his land, in violation of his agreement, the creditor has ample remedies. Assuming that the anti-lien interest operates like a disabling restraint,⁷⁹ the debtor will have no power of transfer, and a prohibited transaction will convey no interest in the land. The anti-lien creditor will thus be able to treat the "transferred" property as an asset of the debtor, even though the transferee claims title. The unsecured creditors⁸⁰ will therefore benefit when they put the "transferred" property to an execution sale, or when the trustee in bankruptcy obtains title to the "conveyed" land.⁸¹

The anti-lien does differ from a disabling restraint in several respects. It fails to afford protection against involuntary transfers,⁸² and it permits the landowner to regain his powers of alienation whenever he

⁷⁹ A disabling restraint "is a provision which withholds from the conveyee the power to make a transfer." 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.2, at 412. See also RESTATEMENT OF PROPERTY, §§ 404(1)(a), (2) (1944); note 118 *infra*.

⁸⁰ Strictly speaking, the debtor would not have violated the rights of the other unsecured creditors, and it may seem strange that the assertion of *jus tertii* could improve their rights. It could be argued that the anti-lien should provide only a "relative" property interest, so that the transfer would be void only vis-à-vis the "secured" creditor. Cf. A. KOCOUREK, JURAL RELATIONS 118 (1927). In this author's view, the limited voidness approach should be rejected. The concept has never been recognized; it is not in harmony with the characteristics of the anti-lien and operates (after the transfer) like a lien.

⁸¹ When a disabling restraint is valid, the trustee in bankruptcy can claim title to the land, see 9 AM. JUR. 2d *Bankruptcy* § 1127 (1963), because no "equitable interest" is vested in the transferee. The anti-lien is similar in this respect to an unauthorized sale by an agent prior to ratification, but differs from escrow transactions in which the vendor has the legal power to convey. (Only upon restoration of the transferor's power are certain remedies available to the transferee. See text and note at note 85 *infra*.)

⁸² See text and note at note 74 *supra* (execution sale). The anti-lien likewise would not prevent inheritance of the property by the laws of intestacy. Since the heirs are responsible for the debt, the interest will not extinguish *mortis causa*—which is not true when title is transferred by an execution sale. See text and note at note 78 *supra*.

Could the anti-lien restrict testamentary dispositions if the financing instrument specifically indicated an intention to do so? The answer is not clear. In a somewhat different context, courts have held that an agreement not to make a will is valid. *Foman v. Davis*, 315 F.2d 254, 255-56 (1st Cir. 1963); Annot., 32 A.L.R.2d 370, 372 (1953). The creditor may have a legitimate interest in preventing such dispositions, since the testator might attempt to distinguish in his will between liability for the debt and ownership of the land. If the courts enforce an anti-lien agreement which contains a provision like the one just described, perhaps the person taking the land under the laws of intestacy should be considered a trustee. He would hold the land for the beneficiary mentioned in the will until the debt has been paid. If this proposition is correct, the grantee would probably be able to pay the debt himself (see text and note at note 87 *infra*), obtain an interest in the land, and recover payment of the debt from the new debtor designated in the will.

wishes, simply by prepaying the debt.⁸³ Furthermore, since the debtor-transferor can extinguish the anti-lien, and indeed is under an obligation to do so,⁸⁴ neither he nor his heirs can question the validity of a conveyance, even if the transfer is concluded prior to payment of the debt and without the consent of the creditor. Upon the termination of the anti-lien restriction, the transferee can enforce or protect his interest in the land.⁸⁵

The courts have reached a similar result in the "after-acquired property" line of cases. Although decisions vary as to whether the purchaser obtains legal title, equitable ownership, or protections under the doctrine of estoppel by deed, it is a well settled rule that he acquires certain rights from the date the transferor obtains title that can be properly described as an interest in land.⁸⁶ Similarly, in the anti-lien situation, the expectancy of obtaining an interest in land upon payment of the debt should justify permitting the transferee to pay the debt and thus "redeem" the land.⁸⁷

If courts were to compare the anti-lien to an equitable servitude (a promissory restraint enforced by a court of equity) rather than to a disabling restraint, the prohibited transfer would be voidable only at the option of the creditor, who could sue to revest title with the transferor.⁸⁸ If the anti-lien creditor exercised his option, the equitable servitude and disabling restraint approaches would produce the same results; for example, the creditor could satisfy a judgment debt from the transferred land, or the bankruptcy trustee could use the anti-lien for the advantage of all unsecured creditors.⁸⁹ But if the anti-lien creditor did not enforce his right to set aside the transfer, the other unsecured creditors would be unable to put the land to an execution sale. Moreover, the creditors of the *transferee* could prevent such a sale by first satisfying their judgment debt from the land. Certain difficulties that

⁸³ Cf. note 73 *supra*. Full payment of the debt, when the creditor is obliged to accept, brings the restraint to an end. Cf. G. OSBORNE, *supra* note 10, at § 293. Without the existence of a debt, the restriction would be a void restraint on alienation. See text and note at note 78 *supra*.

⁸⁴ 3 AMERICAN LAW OF PROPERTY, *supra* note 68, § 15.20.

⁸⁵ See *M'Williams v. Nisly*, 2 S. & R. 507 (Pa. 1816) (extinction of disabling restraint); 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.84.

⁸⁶ See 3 AMERICAN LAW OF PROPERTY, *supra* note 68, §§ 15.18-15.24; G. OSBORNE, *supra* note 10, §§ 37-41.

⁸⁷ Cf. G. OSBORNE, *supra* note 10, § 304, dealing, however, with cases in which the payor already had an interest in the mortgaged land.

⁸⁸ Cf. 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.34, at 461.

⁸⁹ Bankruptcy Act § 70(e). 11 U.S.C. § 110(e)(1)-(2) (1970), construed in *Moore v. Bay*, 284 U.S. 4 (1935). It is assumed that the anti-lien creditor would be treated like a general creditor in this context.

exist under the disabling restraint theory would be nonexistent under the equitable servitude explanation; but the latter interpretation would cause the interest to be much more uncertain and vulnerable to various defenses.

Nevertheless, whichever approach ultimately emerges,⁹⁰ the transferee would be well advised to prepay the debt immediately to avoid the serious side effects of the anti-lien.

Whether the anti-lien is a security interest is not a question of semantics and should not be determined by the mechanical application of an a priori definition.⁹¹ In a sense, the anti-lien interest is a "security interest;" it is a property interest given to secure a debt and has some features similar to mortgages and liens. But there are also substantial differences between the anti-lien interest and traditional security interests; a lender who agrees to be treated as an unsecured creditor in bankruptcy proceedings cannot be described as having an interest similar to a mortgagee or a creditor with a lien.

The difficulty in categorizing the anti-lien interest as either a secured or unsecured interest is due to the fact that the anti-lien does not fall within an established conceptual framework, but is a different concept. Courts will therefore have to decide afresh, for each individual situation, whether a particular rule governing security interests should also apply to the anti-lien interest.⁹²

B. Is the Anti-Lien Needed?

The discussion thus far has analyzed the nature of the anti-lien. The obvious question to consider at this point is whether this device is useful; there is no reason to advocate legal innovations that ultimately will not be used.

⁹⁰ See also text and notes at notes 143-60 *infra*.

⁹¹ UNIFORM COMMERCIAL CODE § 1-201(37), for example, defines "security interest" as an "interest in . . . property . . . which secures payment . . . of an obligation." On its face, the definition includes the anti-lien (except that the Code does not deal with real estate security interests, *see id.* § 9-104(j)). There are, however, substantial differences in the methods by which the anti-lien and regular security interests secure payment of an obligation. Article 9 emphasizes the concept of priorities; this concept is irrelevant to the anti-lien situation, where the security does not "secure" in the sense contemplated by the drafters of the Code. *See* 2 P. COOGAN *et al.*, *supra* note 22, § 23.10[1], implying that an anti-lien is not a security interest. Professor Gilmore raises the same question, 1 G. GILMORE, *supra* note 1, § 11.1, at 333-37, but does not answer it, probably because he rejects the conclusion that a negative covenant creates an interest in land, 2 *id.* § 38.4, at 1017, or in personal property, *id.* § 38.5, at 1018-19.

⁹² In some cases, the same rules should apply to both liens and anti-liens—for example, rules concerning requirements for the creation of the interest. In other cases, rules that deal with security interests in land would be inapplicable to the anti-lien—for example, foreclosure proceedings.

The anti-lien interest is far from perfect. In some cases, it gives too little security—it extinguishes at an execution sale; in others, it gives too much—transfers will probably be cancelled to benefit all creditors in bankruptcy. The pressures for prepayment that it may engender and the inevitable initial uncertainties concerning its application also militate against this proposal. The advantages of the anti-lien must be assessed against this background.

This section of the paper will consider the advantages of the anti-lien interest in three contexts: (1) situations in which a traditional security interest is unavailable; (2) jurisdictions with a “one form of action” rule; and (3) jurisdictions with a “two forms of action” rule.

1. *A Traditional Security Interest is Unavailable.* There are situations in commercial life in which no security interest can be given. First, no-security-interest obligations may be imposed by contract. The terms of a lease, for example, may preclude a lessee from using his interest as collateral for a debt. The lessor’s reasons for insisting on such a promise are apparent. But an anti-lien would leave the lessor no worse off than if the debtor obtained an unsecured loan. At the same time, the negative covenant would provide obvious advantages to the anti-lien creditor.⁹³

Second, some lenders are prohibited by statute from lending against a junior lien.⁹⁴ These lenders might well prefer to be secured by an anti-lien interest if the alternative is no security interest at all. If the legal analysis in this paper is correct, no title insurance policy would be issued to cover a transaction that violates the anti-lien. Consequently, a third party (a purchaser or mortgagee) would probably not invest money in the land that secures the debt. Furthermore, the credit extended by the anti-lien creditor, when added to existing lien debts, would probably be less than the value of the property, thus leaving the debtor a margin of owner equity—an incentive not to desert his property and move away. The anti-lien, by securing to some extent the availability upon default of both the defendant and his assets, improves the chances that collection proceedings will not be futile.

The anti-lien also offers advantages in predefault situations. Realisti-

⁹³ Even if the lessee subsequently obtains his landowner’s consent to grant a security interest to another lender, he will not be able to prefer the latter creditor over the former.

⁹⁴ See, e.g., CAL. FIN. CODE §§ 1227, 1542 (West Supp. 1974). Although the courts have not encountered the practice, national banking associations in various parts of the country have occasionally used *Minderhout*-type negative covenants. The main explanation is that 12 U.S.C. § 371 (1970) prevents them from lending against a junior lien. Actually, it is unclear whether an anti-lien loan would be a “real estate loan” within the meaning of section 371.

cally, two important social phenomena will lead a substantial number of debtors to negotiate with their creditor before amortization of the debt. First, the high mobility rate of the American people⁹⁵ suggests that many anti-lien borrowers will seek new places of residence during the loan term. Second, many owners attempt to use regained land equity to acquire financing even before secured debts are paid in full.⁹⁶ In particular, a debtor who faces financial difficulties will commonly try to raise credit on his equity or sell his property to meet his obligations.⁹⁷ Under these circumstances, the anti-lien creditor has an important supervisory and enforcement mechanism with which to protect his interests. He might insist on prepayment before the debtor's financial position is further eroded or agree to the proposed transaction only at the price of additional assurances for himself—for example, a guaranty by the would-be assignee, protected by a new anti-lien.

The anti-lien interest thus aids collection of the debt without significant expense, assures the lender of a virtual first priority position, and, if the creditor agrees to a transfer of the property notwithstanding his anti-lien interest, provides an opportunity to protect his rights with additional assurances.

2. *"One Form of Action" Jurisdictions.* In several states, such as California,⁹⁸ the right to collect a debt secured by a mortgage can be enforced only by an action to foreclose, after which a judgment for a deficiency may be obtained.⁹⁹ The anti-lien offers potential advantages to a lender who would otherwise acquire a junior lien in a "one form of action" jurisdiction.

Assume, for example, that a first mortgage of \$30,000 and a second mortgage of \$5,000 are outstanding on a home with an estimated value of \$40,000. If the debtor defaults, the second mortgagee must foreclose if he intends to collect the debt. If the first mortgagee also forecloses, the second mortgagee, assuming he decides to bid,¹⁰⁰ must pay at least

⁹⁵ Between 1965 and 1970, 47 percent of the American population changed place of residence at least once. 1 U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, SOC. & ECON. STATISTICS ADMIN., CHARACTERISTICS OF THE POPULATION, pt. 1, § 1, Table 72, at 1-365 (U.S. Summary 1972). It is important to note, however, that homeowners are substantially less prone to move than nonowners. See J. LANSING & E. MUELLER, THE GEOGRAPHIC MOBILITY OF LABOR 151-59 (1967).

⁹⁶ The existence of a large second mortgage industry in the United States is evidence of this observation.

⁹⁷ This assumption might be buttressed by the fact that about 75 percent of all straight bankruptcies are no asset cases. V. COUNTRYMAN & A. KAUFMAN, COMMERCIAL LAW: CASES AND MATERIALS 170 (1971).

⁹⁸ See CAL. CIV. PRO. CODE § 726 (West Supp. 1974).

⁹⁹ G. OSBORNE, *supra* note 10, § 334.

¹⁰⁰ 99.3 percent of the parcels of land that are transferred through judicial sales are

\$30,000. If he purchases the property, he then faces several potential financial burdens: he may have to hold the property during the entire statutory redemption period (generally one year¹⁰¹) and thus lose the use of at least \$35,000 in his lending operations during that time; the income from the property during the period may not cover maintenance costs; and at the expiration of the waiting period, there may be additional expenses, such as brokerage fees, before the property is finally sold. When legal expenses are considered,¹⁰² the total collection costs can prove to be prohibitive.

On the other hand, if the second mortgagee decides not to bid, he may not have the right to a deficiency judgment; California law limits the deficiency judgment to the amount by which the outstanding indebtedness exceeds the fair market value of the property, even if the execution sale nets less than the fair market value.¹⁰³ The creditor can overcome the redemption period restriction only if he has a power of private sale—which is accompanied, however, with a loss of the right to a deficiency judgment.¹⁰⁴

Since foreclosure expenses are a significant proportion of the junior loan, it is bothersome to have to use the foreclosure procedure, especially where the debtor has other assets that could satisfy a small debt. The problem created by foreclosure of a senior lien is even more troublesome, since the junior lienor must invest several times the amount of the initial loan if he wants to protect his interest. Although the junior lienor can let his security interest disappear through a senior lien foreclosure and then file a personal action,¹⁰⁵ his chances of collecting the debt then diminish. If the creditor does not enforce his

purchased by mortgagees. Prather, *A Realistic Approach to Foreclosure*, 14 BUS. LAW. 132, 135 (1958).

¹⁰¹ See, e.g., CAL. CIV. PRO. CODE § 702 (West Supp. 1974).

¹⁰² See generally ABA Committee on Real Estate Financing, *Cost and Time Factors in Foreclosure of Mortgages*, 3 REAL PROP. PROBATE & TRUST J. 413, table at 414 (1968).

¹⁰³ CAL. CIV. PRO. CODE §§ 580a, 726 (West Supp. 1974).

The shortcoming of another alternative that may be available, maintaining the payments on the first mortgage and foreclosing on the second, are likewise apparent.

A foreclosure action followed by the fair market value determination is certainly an awkward and expensive way of collecting a small debt, but no more probably than acquiring encumbered property and making additional investment in it during the statutory year of redemption. How much better a simple action on the note would have been.

Hetland, *supra* note 22, at 169.

¹⁰⁴ See, e.g., CAL. CIV. PRO. CODE § 580d (West 1955).

¹⁰⁵ *Roseleaf Corp. v. Chierighino*, 53 Cal. 2d 35, 378 P.2d 97, 27 Cal. Rptr. 873 (1963). (There has been one notorious exception. See *Spangler v. Memel*, 7 Cal. 3d 603, 498 P.2d 1055, 101 Cal. Rptr. 807 (1972).) The "fair market value" limitation is inapplicable in such a case.

rights promptly, the financial situation of the debtor may deteriorate, or he may leave the jurisdiction.¹⁰⁶

Even when a junior lien is merely an additional security for an Article 9 creditor, it can cause mischief. In certain cases, the creditor loses the right to a deficiency judgment; in all other cases, he can claim it only after foreclosing on both the personal property and the real estate collateral.¹⁰⁷

This situation suggests the need for an alternative to the second mortgage. The anti-lien creditor's right to bring a simple action (since there is no collateral to foreclose on) and the additional advantages of the anti-lien¹⁰⁸ justify serious consideration of the anti-lien alternative. Indeed, the fact that negative covenants have been widely used in California supports that conclusion.

Although second mortgages do have some advantages over the anti-lien, it is important to avoid overestimating the practical importance of these advantages. Second mortgages can be wiped out by first mortgages when the latter contain future-advance clauses or terminate in foreclosure and sale at a low price. Moreover, bankruptcies are infrequent in this country,¹⁰⁹ and when they do occur even secured creditors may

¹⁰⁶ Between 1965 and 1970, 4,139,000 Californians, or 22.5 percent of the population, moved out of county, state, or country. Dauer & Gilhool, *The Economics of Constitutionalized Repossession: A Critique for Professor Johnson and a Partial Reply*, 47 S. CAL. L. REV. 116, 188 n.7 (1973).

¹⁰⁷ Walker v. Community Bank, 10 Cal. 3d 729, 508 P.2d 329, 111 Cal. Rptr. 897 (1974).

¹⁰⁸ The particularly high mobility rate in California adds to the attractiveness of the anti-lien. Between the years 1965 and 1970, more than 56 percent of the California population changed residence at least once. 1 U.S. DEP'T OF COMMERCE, BUREAU OF THE CENSUS, SOC. & ECON. STATISTICS ADMIN., CHARACTERISTICS OF THE POPULATION, pt. 6, § 1, Table 45, at 6-382 (Cal. Summary 1972). See also note 106 *supra*.

¹⁰⁹ There were thirty-eight personal bankruptcies per one hundred thousand population in the United States in fiscal year 1957; seventy-two in 1962; ninety-eight in 1967; and eighty-five in 1969. D. STANLEY & M. GIRTH, BANKRUPTCY: PROBLEM, PROCESS, REFORM 29 (1971). Although it might be more fruitful to compare the amount of debt discharged in bankruptcy to the total amount of credit outstanding in each year, the appropriate figures are unavailable.

It might be argued that present bankruptcy rates are not a good indicator of the rates that would prevail if the anti-lien were widely adopted, because secured transactions serve an important function in holding down the rate of bankruptcies. The practice of lending money against a security interest regulates the ratio of credit to assets and thus prevents debtors from overreaching themselves. It could be contended that the anti-lien alternative will foster excessive borrowing, and thus increase the rate of bankruptcies.

For three reasons, however, the anti-lien will probably not upset the balance. First, the anti-lien will have little effect on the first mortgage industry; these lenders will have no incentive to use it. Second, the anti-lien can be recorded, and potential subsequent lenders will shy away from debtors bound by it. Third, one anti-lien may by its own terms prevent the imposition of another, since it suspends the debtor's power to grant interests in land, and the negative covenant is such an interest.

lose the benefits of their priority. These facts should also be assessed in light of the prospect that an anti-lien will be helpful in collecting the debt before bankruptcy—although the weight this consideration should carry is presently only speculative.

Since the “in terrorem” effect of a lien can be achieved by the judgment lien option that is available to the anti-lien creditor, the major disadvantage of the anti-lien, compared to a second lien, is that it risks defeat by the judgment lien of another creditor. If an acceleration clause is included in the anti-lien agreement (a reasonable safeguard since the judgment lien might extinguish the security interest), the danger is actually confined to the possibility that a single action will totally wipe out the owner’s equity in a way that would prevent any later collection from the debtor. What is the probability that there will be no default on the payments of the loan, that the debtor will not attempt to sell or mortgage the property, and that the judgment lien debt will still be unpaid before its execution? Probably about the level of the present bankruptcy rates.

3. *“Two Forms of Action” Jurisdictions.* Although the foregoing analysis has emphasized the utility of the anti-lien interest in a “one form of action” jurisdiction like California, it highlights the considerations that could reasonably prompt lenders in “two forms of action” jurisdictions to use the anti-lien in their small loan business. When default occurs in a “two forms of action” jurisdiction, a creditor secured by a lien has a choice of remedies: he can foreclose on the property or sue the debtor personally on the note.¹¹⁰ But in order to assure an effective foreclosure option, the creditor must take certain precautionary measures in advance. He must insist on a margin of owner equity sufficient to cover the costs of foreclosure (including the effect of redemption periods and antideficiency legislation). If the equity is insufficient, the creditor may well turn down the borrower’s request.

If the creditor grants the loan, he will have to depend on his junior lien as a threatening device and a protection in the event of the bankruptcy of the debtor. In these borderline cases, the choice between the “two forms of action” is practically illusory. If the costs of foreclosure are high, the loan small, the deficiency judgment limited by fair market value provisions, and the owner’s equity insubstantial, the creditor would naturally rely on a personal action to enforce his rights. He might have been just as well off, or better off, if he had given up his priority in exchange for control over the land and protection for the efficacy of his personal action. Where mobility rates are high and

110 G. OSBORNE, *supra* note 10, § 333, at 698–99.

bankruptcy rates low, experimentation with the anti-lien in these close cases may prove to be the best solution.

The anti-lienor's option of passive enforcement should carry a special appeal for creditors who are reluctant to initiate court proceedings. Homeowners' associations, for example, derive their income through assessments that are imposed by covenants and are levied on the members' lots. When a lot owner defaults on his payments, suit rarely follows. The small amounts involved do not justify the expense of litigation; and the administrators, usually residents of the same community, are hesitant to take such action against their neighbors.¹¹¹ Experience indicates that the arrears are most often collected when the land is transferred,¹¹² probably because purchasers are unwilling to buy property encumbered with overdue debts. But if the transferee deducts the amount of the debt from the purchase price and refuses to transfer it to the association, the association's only remedy is foreclosure on its lien,¹¹³ an even more expensive procedure.

It would probably be more efficient to rely on an anti-lien to secure these assessments. Given the mobility rate,¹¹⁴ the chances are that a debtor would try to sell his home before substantial debts accumulated. The debtor would then probably tender the overdue payment himself (if he failed to move out, however, the association could simply wait until the amount of the accumulated debts justified a personal action). The anti-lien would thus relieve the association of the need to undertake costly foreclosure proceedings as a consequence of the transfer of property. In any case, giving up the protection of a lien on residential property should not be considered a great loss, at least where state law provides a substantial homestead exemption and assessment debts are, by agreement, junior to the purchase money mortgage.¹¹⁵

111 URBAN LAND INSTITUTE, *THE HOMES ASSOCIATION HANDBOOK* 230, 314 (T. B. No. 50, 1964). Uncollected assessments are considered one of the major problems facing homeowners' associations. *Id.* at 17 (table 2-6).

112 Asher, *Private Covenants in Urban Development*, in *URBAN REDEVELOPMENT: PROBLEMS AND PRACTICES* 223, 303 n.28 (C. Woodbury ed. 1953).

113 No personal action lies against a transferee for the covenant-debts of his predecessor in title. *Guild v. Wallis*, 150 Ore. 69, 80, 40 P.2d 737, 742 (1935); *Lingle Water Users' Ass'n v. Occidental Bldg. & Loan Ass'n*, 43 Wyo. 41, 56-57, 297 P. 385, 390 (1931). The same result applies when an assignment of a lease is involved. 51C C.J.S. *Landlord & Tenant* § 52 (1968).

114 See note 95 *supra*.

115 The anti-lien would operate in the homeowners' association context somewhat differently than in the regular credit transaction context. When the debt "runs with the land," the negative covenant could also be attached to the land. Cf. 5 RESTATEMENT OF PROPERTY § 540. Since the debts would be recurring, the anti-lien would provide continuous security. Presumably, however, a homeowner who had paid his past due

The anti-lien could also supplement an Article 9 security interest.¹¹⁶ Under the Uniform Commercial Code, a secured lender has priority in bankruptcy, and the collection of the debt is secured by the personal property. The debtor can skip the jurisdiction, however, and thereby eliminate the possibility of either a personal action or a satisfaction of the debt from the collateral. As noted above, the anti-lien might diminish this danger by providing an additional incentive for the debtor to remain with his real property.

The anti-lien could also prove to be less expensive than foreclosing on the land to recover a small debt after the owner's disappearance. Foreclosure costs seem to require a greater margin of equity than the anti-lien would; therefore, the borrower might use his property, on which he might not otherwise be able to raise credit, to provide his lender with an additional incentive to supply him with financing. A caveat must be added: the anti-lien might be considered an unreasonable restraint on alienation when combined with the Code powers over personal property; conversely, remedies available to an Article 9 creditor might be scrutinized by the courts in this situation.¹¹⁷

Once the anti-lien becomes established, interesting variations may appear. A bank making a short-term loan to a developer could impose a negative covenant on the latter's mortgaged lands prior to the initiation of sales. The bank would then have leverage with which to channel a steady proportion of the incoming revenue towards amortization of the debt.

The anti-lien thus furnishes the credit industry with a third alternative, a compromise between a full security interest and no security at all. Legal powers over transfer and encumbrance are the "collateral" that enable the debtor to offer an additional security. Given its chance, this alternative can add greater flexibility to commercial life.

C. Validity of the Anti-Lien

The anti-lien is subject to two major doctrinal objections: first, that it violates the rule against restraints on alienation of property, and sec-

assessments would not be precluded from encumbering his land, even though another debt obligation would be due to mature shortly thereafter.

¹¹⁶ This is particularly true in California. See text and note at note 107 *supra*.

¹¹⁷ Several scholars contend that the possibility that the debtor would leave the jurisdiction is one of the major reasons for permitting repossession clauses. See, e.g., Mentschikoff, *Peaceful Repossession Under the Uniform Commercial Code: A Constitutional and Economic Analysis*, 14 WM. & MARY L. REV. 767 (1973). Since the anti-lien reduces this possibility, it might surface in a determination of the validity of a repossession clause in a particular case. But several other commentators maintain that other, more important considerations justify recognition of the repossession practice. See, e.g., Johnson, *Denial of Self-Help Repossession: An Economic Analysis*, 47 S. CAL. L. REV. 82 (1973).

ond, that it violates the principle that a landowner cannot create new species of property rights at will. Since the anti-lien does not seem to frustrate any other public policy, resolution of these objections should establish the anti-lien's validity as a property interest.

1. *Restraints on Alienation.*¹¹⁸ It has been said of the rule against restraints on alienation that "[p]robably nowhere in the law does one find more resort to dogma than here."¹¹⁹ The application of the rule has turned largely on such considerations as the type of property involved, the quality of the interest, and the form of the restraint.¹²⁰ Opposition to mechanical application of the rule was already pronounced at the beginning of the century¹²¹ and lately has earned growing support. Various commentators have urged adoption of a uniform and more flexible rule that invalidates only unreasonable restraints.¹²² California has recently become the second jurisdiction to embrace the "new" doctrine; the flexible approach has been the rule in Kentucky for many years.¹²³

Moreover, there is dictum favoring a new approach in the decisions of various jurisdictions,¹²⁴ and some courts apparently apply the test of

¹¹⁸ Restrictions on the transfer of land are traditionally grouped into three categories: disabling, forfeiture, and promissory restraints. 4 RESTATEMENT OF PROPERTY § 404 (1944). In the first two categories, there is usually an attempt to use the device of defeasible titles; in the latter case, only a contractual obligation is imposed. The anti-lien may operate as a disabling restraint, but differs in that it is usually not created simultaneously with the transfer of another property interest. For this reason, the anti-lien eludes being placed within the traditional categories. This article does not seek to build its case for the anti-lien by drawing analogies to the favorable treatment that courts give to promissory restraints. See *id.* §§ 406-413.

¹¹⁹ H. CAREY & D. SCHUYLER, ILLINOIS LAW OF FUTURE INTERESTS § 423, at 542 (1941).

¹²⁰ See 6 R. POWELL, *supra* note 68, ¶ 839, at 3, which explains that the attempted restraint "can vary in at least three major particulars: (1) form (2) degree and (3) type of estate subjected thereto." There are three variants as to the form, five as to the degree, and five as to the type of estate. *Id.* at 3-4. Although not all seventy-five variations exist, this illustration suggests the complexity of the subject.

¹²¹ Sweet, *Restraints on Alienation*, 33 L.Q. REV. 236, 246 (1917).

¹²² Bernhard, *The Minority Doctrine Concerning Direct Restraints on Alienation*, 57 MICH. L. REV. 1173 (1959); Manning, *The Development of Restraints on Alienation Since Gray*, 48 HARV. L. REV. 373, 406 (1935); Comment, *Direct Restraints on the Alienation of Property in Mississippi*, 34 MISS. L.J. 333, 342 (1963).

¹²³ 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.22. But the Kentucky courts construe disabling restraints as forfeiture restraints. See *Cooper v. Knuckles*, 212 Ky. 608, 279 S.W. 1084 (1926); Bernhard, *supra* note 122, at 1177.

¹²⁴ See, e.g., *Gale v. York Center Community Cooperative*, 21 Ill. 2d 86, 92, 171 N.E.2d 30, 33 (1960):

[T]he crucial inquiry should be directed at the utility of the restraint as compared with the injurious consequences that will flow from its enforcement. If accepted social and economic considerations dictate that a partial restraint is reasonably necessary for their fulfillment, such a restraint should be sustained. No restraint should be sustained simply because it is limited in time, or the class of persons excluded is not total, or all modes of alienation are not prohibited. These qualifications lessen the degree to which restraints violate general public policy against restraining

"reasonableness" inadvertently. The gap between the two approaches to restraints on alienation is not wide; many recognized exceptions to the majority rule are defined in terms of reasonableness.¹²⁵ Thus, the time may come when the majority rule, watered down by numerous exceptions, will be substantially the same as the present minority rule.

The anti-lien undoubtedly withstands the test of reasonableness. The particular security arrangement is chosen by the parties concerned and gives each of them some commercial advantages. The covenant not to transfer is limited in time and can easily be extinguished by prepayment of the debt. Since the landowner has the option to pay and "redeem" the land, the device does not seriously restrict alienation of property.

Furthermore, the anti-lien may be valid even in jurisdictions that apply the majority rule against restraints on alienation. The anti-lien does not offend the underlying policies of the rule, which was not originally designed to apply to this type of transaction.

There are two common explanations for the origins of the rule. According to one theory, after the disappearance of the right of escheat¹²⁶ restrictions on the right to transfer property became invalid.¹²⁷ To convey a fee and disallow its future alienation was considered to be against the "nature of the right" and against public policy as well.¹²⁸ Restraints on alienation were therefore held void as "repugnant to the fee."¹²⁹

alienation of property and should be considered to that extent; but they are not, in themselves, sufficient to overcome it. In short, the law of property, like other areas of the law, is not a mathematical science but takes shape at the direction of social and economic forces in an ever changing society, and decisions should be made to turn on these considerations.

See Annot., 42 A.L.R.2d 1243, 1254-61 (1955). See also *Mattern v. Hertzog*, 367 S.W.2d 312, 320 (Tex. Sup. Ct. 1963).

¹²⁵ Bernhard, *supra* note 122, at 1175.

¹²⁶ The right was actually defeated by the Statute *Quia Emptores Terrarum*, 18 Edw. I stat. I (1289-1290).

¹²⁷ *De Peyster v. Michael*, 6 N.Y. 467, 500-01 (1852).

¹²⁸ Lord Coke's explanation for the existence of the rule was that "it is absurd and repugnant to reason that he, that hath no possibility to have the land revert to him, should restrain his feoffee in fee simple of all his power to alien [The] condition . . . is void, because his whole interest and propertie is out of him, so as he hath no possibilitie of a reverter, and it is against trade and traffique, and bargaining and contracting between man and man" E. COKE, *THE FIRST PART OF THE INSTITUTES OF THE LAW OF ENGLAND* *233a.

¹²⁹ It is doubtful that this explanation is historically correct. The policy against restraints on alienation was enforced prior to the enactment of the Statute *Quia Emptores*. W. FRATCHER, *PERPETUITIES AND OTHER RESTRAINTS* 2-3 (1954). It has also been suggested that prior to 1217 a rule of reasonable restraints was applied to gifts. I F. POLLOCK & F. MAITLAND, *THE HISTORY OF ENGLISH LAW* 343 (2d ed. 1899). See also J. GRAY, *RESTRAINT ON ALIENATION OF PROPERTY* §§ 19-21 (2d ed. 1895). But the explanation later proved convenient for those who defended the no restraint policy as a protection against "semi-feudal" reverter rights.

The second theory attributes the emergence of the rule to the English courts' attempts to undermine the power (granted by the Statute De Donis Conditionalibus¹³⁰) to convey land subject to a condition that it remain within the family.¹³¹ About two hundred years after the statute's enactment, the courts actually prevented its application¹³² and eventually frustrated attempts to achieve the same object by different devices.¹³³

The rule was therefore originally directed against the accumulation of wealth by a certain class of people (which denied access to ownership of land to the rest of society), against the imposition of onerous restrictions by someone who had died years before, and probably against certain feudal incidents disguised as "consensual" agreements. It is difficult to see the relevance of these policies to the commercial context of the anti-lien.

The purpose of the transaction should determine the applicability of the rule, and the form of the transaction should be at most a minor element.¹³⁴ As Sweet observes, "A restraint on alienation may be good, if it is imposed, not for the purpose of making the property inalienable, but in order to effect an object which is itself lawful."¹³⁵ Thus, unqualified restraints on alienation are commonly declared invalid because "[t]he ordinary purpose of such an unqualified restraint is to keep the property in the family perpetually."¹³⁶ Restraints limited in time are also void if there is evidence that the parties do not intend a purpose other than the restriction on alienation itself. But if these limited restraints serve a commercial purpose—such as granting pre-emptions¹³⁷ or options,¹³⁸ or protecting the interests of tenants in common by pre-

130 13 Edw. I, stat. 1 (1285).

131 The statute provided: "[T]o whom the land was given under such condition, shall have no power to aliene the land so given, but that it shall remain unto the issue of them to whom it was given after their death, or [shall revert] unto the giver, or his heirs, if issue fails . . ." *Id.*

132 See *Taltarum's case*, Y.B. 12 Edw. IV, 19 (1472). For a discussion of the case and a translation of the pleadings, see A. DIGBY, *THE HISTORY OF THE LAW OF REAL PROPERTY* 252-58 (5th ed. 1897).

133 See W. FRATCHER, *supra* note 129, at 25.

134 See 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.20, at 441.

135 Sweet, *supra* note 121, at 246. Manning, *supra* note 122, at 398, supports Sweet's view, to some extent, with American authorities. See also Annot., 42 A.L.R.2d 1243, 1261 (1955).

136 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.15, at 429.

137 4 RESTATEMENT OF PROPERTY § 413 (1944).

138 Sweet, *supra* note 121, at 247. In *Mattern v. Herzog*, 367 S.W.2d 312 (Tex. Sup. Ct. 1963), the court upheld an option unlimited in time.

venting partition¹³⁹—they are upheld.¹⁴⁰ Thus, when the restraint is imposed after arms-length bargaining in a commercial transaction, the intervention of the courts is unnecessary to protect the transferee from an onerous condition imposed by the transferor.

Current arguments against restraints on alienation also fail to support application of the rule to anti-lien restrictions. Commentators have argued that restraints, if allowed, would take property out of commerce, create a shortage, increase land prices, concentrate wealth among a limited group of people, discourage improvements and proper maintenance of the land, produce an inefficient allocation of resources, and perhaps prevent creditors of the transferee from satisfying their debts by putting the property up for execution sale.¹⁴¹ These arguments are not applicable to the anti-lien; since prepayment is possible, the owner of the encumbered land can regain the power to transfer his property by paying his debt.¹⁴²

2. *The Anti-Lien as a Property Interest.* The anti-lien covenants do not violate the rule that new species of property interests cannot be created merely at the will of owners of estates.¹⁴³ Incorporeal fragments

¹³⁹ 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.74; 4 RESTATEMENT OF PROPERTY § 412 (1944).

¹⁴⁰ On the other hand, the fact that the transferee of the title is not seriously restricted by a limitation does not validate the transaction; for example, even if the owner is allowed to give leases for longer periods, the restraint on the transfer of the title may be held void. 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.38. Even restrictions on alienation clothed with commercial justification are not upheld when calculated to achieve windfall gains. A good example is "quarter sales" contracts. *Id.* § 26.68.

¹⁴¹ *Id.* § 26.3; R. POSNER, *ECONOMIC ANALYSIS OF LAW* 13 (1972).

¹⁴² In certain situations the power to prepay may not prevent hardship. When market interest rates rise, the debtor may lose the benefit of the lower interest rate specified in the terms of the anti-lien loan if he wishes to obtain more credit secured by a lien on the same land. Additional liens cannot be created without the consent of the anti-lien creditor. This creditor will therefore be in a position to pressure the debtor into continuing to borrow only from him and renegotiating the initial loan at the new prevailing interest rate.

It could be maintained that this situation is the one courts seek to prevent when they invalidate prohibitions against further encumbrances in mortgages. Indeed, if these restraints were upheld, a debtor's first mortgagee would have an unfair advantage over potential creditors, and access to the money market would be difficult for new lenders.

Nevertheless, the possibility of prepayment limits the bargaining strength of the creditor. The inherent shortcomings of anti-lien interests indicate that they will not be used to secure long term or sizable loans. The analogy to the restrictions on mortgages is therefore not compelling.

Of course, the same creditor should not be able to obtain both a mortgage and an anti-lien on the same collateral—for instance, a mortgage to secure 80 percent of the debt and an anti-lien to secure 20 percent. The two transactions should be viewed as one and the restraint invalidated because a mortgage is involved.

¹⁴³ "[I]t must not . . . be supposed that incidents of a novel kind can be devised and

of ownership rights can qualify as the object of property interests. Furthermore, the rule does not completely prohibit the recognition of new interests in land.

The idea that incorporeal fragments of ownership can be the object of a property interest is not new.¹⁴⁴ Limitations on the right to transfer land are frequently recognized—for example, conveyance of a defeasible title¹⁴⁵ or similar conditions in a lease.¹⁴⁶ Similarly, covenants may restrain a condominium owner from selling or granting his interest unless certain requirements are satisfied.¹⁴⁷ The unfortunate body of case law on racially restrictive covenants provides other examples. In these cases, the basic right of landowners to curtail their power of alienation was assumed; the question went mainly to its breadth.¹⁴⁸ In most juris-

attached to property at the fancy or caprice of any owner. It is clearly inconvenient both to the science of the law and to the public weal that such a latitude should be given." *Keppell v. Bailey*, 39 Eng. Rep. 1042, 1049 (Ch. 1834); see *Eckert v. Peters*, 55 N.J. Eq. 379, 386, 36 A. 491, 493 (Ch. 1897); *Brewer v. Marshall & Cheeseman*, 19 N.J. Eq. 537, 545-46 (Ct. Err. & App. 1868); *Lingle Water Users' Ass'n v. Occidental Bldg. & Loan Ass'n*, 43 Wyo. 41, 51, 297 P. 385, 388 (1931); *Conard, An Analysis of Licenses in Land*, 42 COLUM. L. REV. 809, 826 (1942).

¹⁴⁴ For example, the courts have given full property interest recognition to easements giving permission to cause a nuisance.

The owner's title is no more than a "bundle of privileges" of which the right to be free from harmful activities on other land in the vicinity is but one. The owner may convey the whole bundle, but he is privileged to take one from the bundle and convey it. This has been done times without number.

Pennsylvania R.R. v. Kearnes, 71 Ohio App. 209, 219, 48 N.E.2d 1012, 1016 (Ct. App. 1943). According to this reasoning, powers of conveyance can also be the subject of a transaction.

¹⁴⁵ See 4 RESTATEMENT OF PROPERTY §§ 406, 407 (1944). Some cases have upheld forfeiture restraints securing an obligation to support the grantor. *Hutchinson v. Loomis*, 244 S.W.2d 751 (Ky. 1951) (dictum); *Bank of Hartford v. Buffalow*, 217 Ala. 583, 117 So. 183 (1928). (It is unclear whether *Buffalow* was decided on grounds of constructive fraud or violation of the condition. See *McAdory v. Jones*, 71 So. 2d 526, 528 (Ala. 1954).) Although these cases are in some aspects similar to the anti-lien, the courts have treated "geriatric transfers" as sui generis. *Russell v. Carver*, 208 Ala. 219, 94 So. 128 (1922). See also text and note at note 27 *supra*.

¹⁴⁶ 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.51.

¹⁴⁷ See *Mowatt v. 1540 Lake Shore Drive Corp.*, 385 F.2d 135 (7th Cir. 1967); *Berger, Condominium: Shelter on a Statutory Foundation*, 63 COLUM. L. REV. 987, 1017-19 (1963); *Browder, Restraints on the Alienation of Condominium Units (The Right of First Refusal)*, 1970 ILL. L.F. 231.

If the agreement is not in violation of a constitutional right, public policy, or any other established rule (such as the rule against restraints on alienation), the courts will enforce the restriction among the contracting parties as well as against subsequent transferees.

¹⁴⁸ In a leading Louisiana case, the court explained:

[O]wnership is composed of the rights to use, to enjoy and to dispose of . . . The two first of these elements, the use and the usufruct, are admittedly susceptible of separation from the other elements and of subdivision after having been segregated; why then is not the third, the abusus, the right to dispose of, susceptible of being dealt with in like manner? . . . The right to alienate is but one of the constituent

dictions, prior to the Supreme Court decision in *Shelley v. Kraemer*,¹⁴⁹ completion of a transfer (when the transferee had notice) did not limit the promisee to merely contractual remedies.¹⁵⁰

The specific property interest that neutralizes powers of alienation has been used to secure property values, assure the ability of unit owners to pay their share of common expenses,¹⁵¹ and provide other commercial benefits.¹⁵² There thus seems to be no reason to prohibit the use of this device to secure a debt.

Moreover, the rule against the creation of new species of property interests has been interpreted not as a broad prohibition against the recognition of all new interests in land, but rather as a rule against those rights that serve no social purpose.¹⁵³ In recent years, new easements have been recognized, and covenants have been widely used to provide for the changing needs of the real estate market. At a time when the law of new towns is "legislated" through comprehensive "code covenants,"¹⁵⁴ it seems out of place to argue that new forms of incorporeal interests should not be recognized.

elements of the right to dispose of [T]he said stipulation . . . does not create a mere personal obligation . . . but creates a real obligation.

Queensborough Land Co. v. Cazeaux, 136 La. 724, 736-37, 67 So. 641, 645-46 (1915).

In common law jurisdictions, courts rarely explained the precise effects of these covenants. Some courts took an approach similar to *Cazeaux*, and declared the prohibited transactions null and void. *Hurd v. Hodge*, 162 F.2d 233 (D.C. Cir. 1947); *Cornish v. O'Donoghue*, 30 F.2d 983 (D.C. Cir.), cert. denied, 279 U.S. 871 (1929). Another court considered the forbidden conveyances voidable, so that upon successful suit title would be revested with the transferor. *Swain v. Maxwell*, 355 Mo. 448, 196 S.W.2d 780 (1946). In other cases, the decrees were worded in less precise form. *Mays v. Burgess*, 147 F.2d 869 (D.C. Cir.), cert. denied, 325 U.S. 868 (1945) (transaction "set aside"); *Porter v. Pryor*, 164 S.W.2d 353 (Mo. 1942) (cancelling the deed); *Ridgway v. Cockburn*, 163 Misc. 511, 296 N.Y.S. 936 (Sup. Ct. 1937) (covenant ordered enforced after completion of prohibited transaction); *Linder v. Stapp*, 198 Okla. 366, 178 P.2d 617 (1947) (same); *Hemsley v. Hough*, 195 Okla. 298, 157 P.2d 182 (1945) (cancelling a lease); *Lyons v. Wallen*, 191 Okla. 567, 133 P.2d 555 (1942) (cancelling the deed). In these cases, with the exception of *Swain v. Maxwell*, the courts did not address the question of the correct construction; many simply affirmed the decision of a lower court.

¹⁴⁹ 334 U.S. 1 (1948).

¹⁵⁰ 6 AMERICAN LAW OF PROPERTY, *supra* note 68, § 26.34. The majority view is that an equitable servitude is a property interest. 2 *id.* § 9.24, at 403. The possibility of recording meant that a promisory restraint on alienation could be enforced against an assignee somewhat like a disabling restraint. The technical requirements for the creation of an anti-lien are similar to other security interests in land, and it should therefore operate as a "legal" and not an "equitable" restraint. Since the anti-lien is ineffective against other creditors, the objection expressed in 6 *id.* § 26.34, at 460, to recognizing such restraints is inapplicable here.

¹⁵¹ See also text and notes at notes 111-15 *supra*.

¹⁵² See text and notes at notes 137-39 *supra*.

¹⁵³ See Conard, *supra* note 143, at 826.

¹⁵⁴ See Comment, *Democracy in the New Towns: The Limits of Private Government*, 36 U. CHI. L. REV. 379 (1969).

Not every contractual right can be "attached" to land as a property interest. A new interest in land must have certain characteristics similar to recognized rights in rem. The anti-lien should not be considered an easement, although it restricts the use of the "natural incidents" of ownership and provides, by its negative effect, a benefit to others. The easement analysis is inappropriate because the promisee acquires no actual "use or enjoyment of . . . land;"¹⁵⁵ the anti-lien right is related to a business transaction only remotely associated with enjoyment of land.¹⁵⁶ Since it does not "touch and concern" land, the anti-lien also would not qualify as an equitable servitude, even if the problem of benefit in gross (American courts do not recognize equitable servitudes when the benefit is in gross¹⁵⁷) were somehow resolved.

On the other hand, the anti-lien is similar to covenants creating charges or liens upon property. These interests are created simply by the agreement of the original parties,¹⁵⁸ and the absence of a dominant tenement does not prevent recognition of the property right. The "negative mortgage" is intimately connected with the debt, and transfer of the anti-lien is possible only if the debt is assigned at the same time.¹⁵⁹ The debt does not "run with the land" (indeed, the land is not supposed to "run") but is a condition for the existence of the right.

Differences between a charge or a lien and the anti-lien are due to the different nature of the "collateral" involved. The restrictions of the anti-lien debtor's powers are not an asset to foreclose on or to sell in satisfaction of a debt. But the similarity in the relations between the parties (creditor and debtor) and in the commercial functions that the the property interests serve brings the anti-lien within the formal requirements for the creation of a lien.¹⁶⁰

CONCLUSION

Lenders and borrowers seeking to secure the payment of a debt with an interest in land have long been confined to the traditional alterna-

¹⁵⁵ See 5 RESTATEMENT OF PROPERTY § 450(a) (1944).

¹⁵⁶ Cf. *Hill v. Tupper*, 159 Eng. Rep. 5 (Ex. 1863). Negative easements in gross are generally not recognized, 2 AMERICAN LAW OF PROPERTY, *supra* note 68, § 8.12.

¹⁵⁷ 2 AMERICAN LAW OF PROPERTY, *supra* note 68, § 9.32, at 429-30.

¹⁵⁸ Dunham, *Promises Respecting the Use of Land*, 8 J. LAW & ECON. 133, 147-48 (1965).

¹⁵⁹ See note 72 *supra*.

¹⁶⁰ The operation of the anti-lien can be sustained in an alternative way. An owner can convey a term of years as a security interest; he is transferring a fragment of his ownership to secure a payment of a debt. The same thing is done in the anti-lien case. The parties' purposes are similar, but the rights conveyed are different and provide different kinds of security. It is true that a proprietary restraint on alienation usually has other characteristics (for example, it benefits a neighboring owner or a transferor rather than a creditor), but this deviation is not significant because the anti-lien's only purpose is to secure the payment of a debt.

tives of first and second mortgages. This paper has proposed the recognition of a third alternative. The anti-lien can be a useful security device for a small loan, particularly when a second mortgage is unavailable or its enforcement prohibitively expensive.

Unfortunately, reliance upon equitable lien analysis has distracted the courts from what should have been the real issues concerning the anti-lien. Provisions like the ones discussed in this paper should be read at face value, and traditional doctrines—against restraints on alienation and against the creation of new property interests—should not be invoked to condemn the anti-lien interest. The courts should adopt a new approach that allows lending institutions to experiment with the anti-lien and take advantage of its capacity to enhance the flexibility of credit transactions.