• Assume D owns a home subject to 2 mortgages
  – First mortgage: Bank1 ($200,000)
  – Second mortgage: Bank2 ($50,000)
• D offers, and Bank1 accepts, a deed in lieu
• Bank2 argues: (1) b/c Bank1 now has legal title and mortgage, mortgage merges into legal title; (2) Bank2 thus now has first lien
• Is this argument correct?

• Weight of authority: in this situation, merger would not apply to extinguish senior mortgage (thus, junior is not elevated to 1st priority)
  – Restatement: Bank1 would not intend for merger to apply if title is subject to junior lien [p. 584]
  – Bank1 would retain its senior mortgage (and could thus foreclose itself to extinguish junior lien!)

Clogging the Equity of Redemption

• Any purported transfer or agreement that constitutes a “clog” on the mortgagor’s equity of redemption is invalid (contrary to public policy)
• E.g., Bank takes mortgage from D, requires D to sign a “deed in escrow,” to be recorded if D defaults
  – Bank is using title to land to secure a debt, and thus should have to enforce that right via foreclosure

• Uphoff borrows $200K from Lambert to pay his gambling debts, and grants Lambert a mortgage on Uphoff’s home, worth $300K
  – Mortgage says: “If Uphoff defaults, Lambert has the option to buy the premises for a price = outstanding balance of the debt + $1.”
• Can Lambert get specific performance of this option?
• Common law: “option” to buy mortgaged land, taken contemporaneously with the mortgage, is a “clog on the equity of redemption” [p. 273]
  – B/c option is exercisable only upon default, its only purpose is to circumvent foreclosure process and trigger a forfeiture of Uphoff’s equity w/out sale
• Instead, Lambert must conduct a foreclosure of the mortgage (this protects Uphoff’s equity in home)

• Wells borrows $300K from Lambert
  – Payments based on 30-year amortization, with balloon payment after 5 years
  – Wells grants mortgage on her home to Lambert
  – At the same time, in the mortgage, Wells grants Lambert an option to buy the home for a price = loan balance at time the option is exercised
  – But, ability to exercise option is NOT tied to default
• 3 years later, Wells defaults; can Lambert exercise the option (assume loan balance = $280K)?

§ 3.1. The Mortgagor’s Equity of Redemption and Agreements Limiting It
(a) From the time the full obligation secured by a mortgage becomes due and payable until the mortgage is foreclosed, a mortgagor has the right to redeem the real estate from the mortgage ....
(b) Any agreement in or created contemporaneously with a mortgage that impairs the mortgagor’s right described in Subsection (a) of this section is ineffective.
(c) An agreement in or created contemporaneously with a mortgage that confers on the mortgagee an interest in mortgagor’s real estate does not violate this section unless its effectiveness is expressly dependent on mortgagor default.

Clog, or Valid Option?
• Option would allow Lambert to acquire the land w/out foreclosure
• But, option isn’t expressly tied to default, so could Lambert be exercising the option for a reason unrelated to the status of loan?
• What additional information, if any, would help resolve this question?
Common Law vs. Restatement

• Common law: any purchase option in favor of mortgagee, taken contemporaneously w/ granting of mortgage = invalid clog on equity of redemption
• Restatement §3.1(c) — Option is not clog on equity of redemption “unless its effectiveness is expressly dependent on mortgagor default”
• Does applying §3.1(c) mean Lambert can enforce the option, no matter what?

• Suppose FMV of Wells’s land, at time loan is made, was $600,000
  – Wells wouldn’t have rationally agreed to sell the land for $300,000 or less in an arms-length exchange
  – In that circumstance, it seems likely that the “option” was intended to be exercisable only upon default (so Lambert did not have to foreclose); Lambert may have structured the transaction so as to hide its true substance [i.e., so he could argue this wasn’t a “per se” clog under the Restatement]
  – Court should allow extrinsic evidence of any “side deal” that Lambert would exercise option only upon default

• Suppose instead that at the time of the loan, Wells’s land was worth only $250,000
• Now, the deal looks more like a bona fide option
  – Lambert was essentially making a loan with a high loan-to-value ratio, i.e., 120% (very risky)
  – If FMV of Wells’s land increased by > $50,000 or more during 5-year loan term, Lambert could then exercise the option as a means to earn an additional profit on this “riskier” loan
  – Restatement: court should be willing to grant Lambert specific performance of this option

• Lambert loans $50,000 to Wells
  – Wells does not sign a mortgage; instead, she executes and delivers to Lambert a deed purporting to convey Blackacre to Lambert (Lambert records the deed)
  – Lambert agrees: “If you repay the loan on time, I’ll deed the land back to you.”
• When Wells defaults, Lambert files unlawful detainer suit. Can he do so?
Absolute Deed or Equitable Mortgage?

• Did Lambert really buy ownership of the land (“sale”), or was he just using title to the land to secure Wells’s obligation to repay the loan?
  – If latter is proven by clear/convincing proof, Lambert’s “deed” is deemed in equity to be a mortgage, and he has to foreclose to obtain Wells’s legal title
• What info is relevant in making this judgment?

• Relevant Restatement factors [p. 286]
  – Statements of parties (“This is a loan.”)
  – *Substantial disparity between loan amount and the fair market value of the land*
  – *Grantor (Wells) remained in possession of the land even after deed was executed/delivered to Lambert*
  – Grantor (Wells) paid taxes or made improvements after delivery of deed to Lambert

• Case law factors:
  – Was Wells was in financial distress at the time?
  – Did Wells have legal counsel?

• If Wells kept possession, and FMV of land >>> $200,000, argument to recharacterize the deed as an equitable mortgage is compelling
  – Parties are using title to secure Wells’s debt (substance over form)
  – Why would Wells rationally “sell” the land for $50,000?
  – Argument is more compelling where borrower is in financial distress (as in Perry, p. 278), where “grantor of the deed” is looking for “rescue” from imminent potential foreclosure

• Prior to April 1: Wells owns Greenacre
• April 1: Lambert pays $160K to Wells, who conveys Greenacre to Lambert by deed
• In a separate writing, Lambert agrees to convey Greenacre back to Wells, if she pays Lambert $168K by August 1 (K: “Time is of the essence of the contract.”)
• Wells tenders payment on Sept. 1 (late) and demands that Lambert reconvey Greenacre to her
• Lambert brings unlawful detainer action. Result?
Lambert’s Argument

“Wells has no legal obligation to pay me $168,000; she can choose to pay, or not; she has no liability if she doesn’t pay”

“As a result, there is no ‘debt’ or ‘obligation’ (and if there’s no debt, there can’t be a mortgage)”

Is this argument compelling, or should the court characterize this deal as a mortgage?

Restatement of Mortgages § 3.3

“[O]bligation ... need not be the personal liability of any person.” But how can there be a debt if no one is personally liable?

Best example: nonrecourse mortgage loans
– Under nonrecourse loan, lender agrees to look solely to land, not borrower, in case of default
– Lender can foreclose against land, but can’t recover personal judgment vs. borrower

Conditional Sale/Equitable Mortgage

Thus, even if Wells isn’t personally liable to repay Lambert, the parties may have intended for the land to serve as security for repayment of the money (e.g., an in rem obligation)
– If so, that’s a debt, and Lambert’s “title” is merely an equitable mortgage securing the debt (Perry v. Queen)

As disparity between FMV of land and “option” price increases, Wells’s argument for an “obligation” becomes more forceful

E.g., if FMV of land is $400K, it seems silly to say Wells isn’t “obligated” to buy it back
– Wells is economically compelled to pay the $168K “option price”
– Lambert would expect Wells to pay back the $168K to protect her title, unless she can’t
– Thus, Lambert is just using title to secure the repayment he expects Wells will make
**Downs v. Ziegler**

- Ziegler bought apt. bldg. from Downs, granting them a purchase money mortgage
  - Ziegler also owed $30,000 to Bank (2d mortgage)
  - Mortgage to Downs was in default, foreclosure
- 3 doctors agreed to make $21,000 of credit available to Ziegler, and to assume the mortgage obligations
  - In exchange, Ziegler deeded apt. bldg. to the doctors
  - Ziegler could “buy back” land by reimbursing the doctors and paying them an additional $10,000

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- Doctor/Ziegler agreement: “this agreement is not a mortgage”
- Later: When Ziegler defaulted, the Downs foreclosed and sought to get a judgment for any deficiency from the doctors
- Now, the doctors are asking the court to recharacterize the agreement as a mortgage. Why? Should the court do so?

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- If transaction was bona fide sale, then doctors were “assuming buyers,” are thus personally liable on mortgage debt owed to Downs
- If transaction was a mortgage, doctors are not liable to Downs (b/c doctors, as holders of only a mortgage, did not give consideration to the Downses for their assumption)

**Questions**

- Did the Downses actually provide consideration for the doctors’ assumption of the senior mortgage debt?
- Should the court have recharacterized this transaction as a mortgage?
• Lambert signs installment contract to buy a flat-screen TV (12 payments @ $350 each) from “Tiger John” Cleek
  — Contract: Tiger John retains title to the TV until all payments made
• Lambert makes first 11 payments, but he fails to make 12th payment
• Can Tiger John declare a forfeiture, take back TV, and keep all of Lambert’s past payments as damages?

UCC: “Security Interest”
• § 1-201(b)(35) defines “security interest” as “an interest in personal property ... which secures payment or performance of an obligation.”
• “… The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer ... is limited in effect to reservation of a security interest.”

UCC Installment Sale Contracts
• Tiger John is deemed to have a security interest in the TV, which he must foreclose by sale of TV
  — Balance of debt = $350 remaining payment + Tiger John’s costs of collection
  — Prior to the sale, Lambert can redeem TV from SI by paying off remaining balance of the debt
  — If sale price >> balance of debt, any surplus must be returned to Lambert [§§ 9-610, 9-615, 9-623]