

Broken Commitment: A Modern View of the Mortgage Lender's Remedy

Daniel C. Draper

Follow this and additional works at: <http://scholarship.law.cornell.edu/clr>

 Part of the [Law Commons](#)

Recommended Citation

Daniel C. Draper, *Broken Commitment: A Modern View of the Mortgage Lender's Remedy*, 59 Cornell L. Rev. 418 (1974)
Available at: <http://scholarship.law.cornell.edu/clr/vol59/iss3/3>

This Article is brought to you for free and open access by the Journals at Scholarship@Cornell Law: A Digital Repository. It has been accepted for inclusion in Cornell Law Review by an authorized administrator of Scholarship@Cornell Law: A Digital Repository. For more information, please contact jmp8@cornell.edu.

THE BROKEN COMMITMENT: A MODERN VIEW OF THE MORTGAGE LENDER'S REMEDY*

Daniel C. Draper†

Today, large, long-term mortgage lending is becoming increasingly sophisticated. Major transactions, often involving millions of dollars, move in carefully orchestrated sequences from the issuance of a loan commitment by the lending institution to the loan closing. Since 1951, however, the Federal Reserve Board's attempts to curb inflation have caused unusual fluctuations in interest rates and thus have subjected mortgage commitments to stress in times of falling rates.¹ The fact that the actual conduct of business rather than the reported cases evidences this stress hardly makes it any less real. When a borrower breaches his original commitment for a large, long-term loan at high rates in order to close the loan with another lender at a lower rate, the interest rate differential may involve hundreds of thousands of dollars in present money damages even after discounting to reflect future payments.² Yet institutional lenders, partly for reasons of reputation and partly because of uncertainty as to the remedies available upon breach of a commitment, have generally turned to out-of-court settlements, rather than litigation, as the means of vindicating their rights.

Some measure of protection against breach is provided if the borrower is using the permanent loan to "take out" or refinance a construction loan³ by means of a three-party "buy-sell" agreement among the construction lender, permanent lender, and the bor-

* I am indebted to Messrs. Thomas Moseley, Earl H. Nemser, and Eric Ranney for their assistance in the preparation of this Article and to A. W. Roberts, Esq., for providing material from a parallel study.

† Member of the New York Bar. Chairman, Banking Committee of the New York County Lawyers Association and member of the Committee on Real Property of the Association of the Bar of the City of New York. B.A. 1940, M.A. 1941, West Virginia University; LL.B. 1947, Harvard University.

¹ *Quarterly Economic Report*, 32 THE MORTGAGE BANKER 24B (1972); see 58 FED. RES. BULL. A-9-10, A-34-35, A-53 (1972) (detailed summary of recent fluctuations in lending rates).

² See notes 37-40 and accompanying text *infra*.

³ Construction financing is interim, short-term financing for the construction period under which the funds are usually advanced based on architect's certificates or other certificates as the work proceeds. Permanent financing is financing on completed construction on a long-term basis. As to the relationship between the two, see Draper, *Permanent Mortgage Financing—The Shopping Center*, in REAL ESTATE FINANCING CONTEMPORARY TECHNIQUES 200-02 (C. Goldstein, program director 1973).

rower. As a prerequisite to lending, construction lenders often require that a borrower procure a commitment for permanent financing in order to fund on a long-term basis the short-term construction loan. In substance, the permanent lender agrees to refinance for the benefit of the construction lender, and the construction lender agrees to deliver the loan for the benefit of the permanent lender. However, such an agreement furnishes only some assurance that the loan will in fact be delivered to the permanent lender, for the construction lender, which is often the borrower's bank of deposit, may, at its customer's request (presumably backed up by an indemnity), attempt to avoid its obligation. Moreover, even though the borrower demonstrates his willingness to assume certain obligations by his execution of the documents, he may feel less compelled to honor them than in other situations because the buy-sell agreement is "for the mutual benefit of the construction lender and the permanent lender, and not for the benefit of the borrower."⁴ The use of devices such as refundable fee and liquidated damage provisions in the commitment itself⁵ and other remedies⁶ has thus far proved similarly ineffectual in procuring borrower performance in stress situations. Specific performance would provide the institutional lender with a more certain remedy than damages even though it might necessitate a court compelling the borrower to execute loan documents and to close. Lenders fear that courts would balk at awarding extremely large sums as damages for the breach of a purely executory loan commitment which in some commercial circles or, perhaps more accurately, in the practice of some borrowers, is somehow regarded as

⁴ Melody, *Protecting Loan Commitments*, 33 THE MORTGAGE BANKER 28, 42 (1973).

⁵ See notes 25-36 and accompanying text *infra*.

⁶ For example, a lender may file a *lis pendens* in an action "in which the judgment demanded would affect the title to, or the possession, use or enjoyment, of real property." N.Y. CIV. PRAC. LAW § 6501 (McKinney 1963); see CAL. CIV. PRO. CODE § 409 (West 1973). The claim for specific enforcement of the contract for a loan and mortgage probably meets this requirement. See *J. Henry Small Realty Co. v. Strauss*, 162 App. Div. 658, 147 N.Y.S. 478 (2d Dep't 1914). The title report of a second potential lender would show, as a title exception, the *lis pendens* of the first lender, which would cause most second lenders to refuse to make the loan. Of course, the *lis pendens* may be bonded by the borrower pursuant to statute, cancelled of record, and the title exception thereby removed.

The owner of the realty may move for cancellation of the notice. The court may cancel the notice if the plaintiff's action is not commenced or prosecuted in good faith. N.Y. CIV. PRAC. LAW § 6514(a)-(b) (1963). The courts also have the inherent power to cancel the notice when it is filed in an improper case. See, e.g., *Braunston v. Anchorage Woods, Inc.*, 10 N.Y.2d 302, 222 N.Y.S.2d 316, 178 N.E.2d 717 (1961) (action to abate nuisance found not to affect title, possession, use or enjoyment of property; *lis pendens* cancelled). See also *Chappelle v. Gross*, 26 App. Div. 2d 340, 274 N.Y.S.2d 555 (1st Dep't 1966) (plaintiff made out prima facie case when *lis pendens* filed in bad faith).

not legally binding.⁷ Furthermore, in order to prove damages, the going rate for comparable loans at the time of breach must be established. Although this concept is clear, the determination of the figure may present difficult problems of proof, particularly in the case of large loans for which comparable transactions from which evidence may be drawn are not readily available.

Clearly, the defaulting borrower should not be left free to accept or reject a valid contract as his economic conscience dictates. Nor should the courts effectively provide him with this freedom by dismissing an aggrieved lender's complaint for equitable relief on the ground that the lender's remedy at law is adequate, when in fact it is at best highly uncertain.⁸ Today's procedural system, which fuses law and equity, should provide more imaginative solutions. One possible approach would be for the trial court to retain jurisdiction to grant equitable relief, but submit the issue of damages to the jury and then give the *defendant* the right to elect either damages or specific performance.

The availability of a reliable legal remedy reinforces any commercial transaction. Due to the length of the construction period in many cases, a year may pass between the time the commitment is signed and the loan is closed. In these transactions, the modern long-term mortgage lender must commit itself to making a loan with the sober realization that extensive negotiations incident to the preparation and signing of the loan agreement may yield him only legal uncertainty and disappointed expectations if interest rates decline prior to closing and the borrower refuses to accept the agreed rate. The primary sources of this uncertainty are twofold: First, *Rogers v. Challis*,⁹ a nineteenth century case widely followed in the United States,¹⁰ supports the proposition that equity will not

⁷ See text accompanying notes 25-29 *infra*.

⁸ See text accompanying notes 37-43 *infra*.

⁹ 27 Beav. 175, 54 Eng. Rep. 68 (Ch. 1859).

¹⁰ Although exhaustive research has failed to disclose a single American case in which a lender has sued for specific performance, there are instances in which *Rogers* was invoked to deny a borrower's suit for specific performance. See, e.g., *Kent v. Walter E. Heller & Co.*, 349 F.2d 480 (5th Cir. 1965); *Leach v. Fuller*, 65 Colo. 63, 173 P. 427 (1918); *Hixson v. First Nat'l Bank*, 198 Ia. 942, 200 N.W. 710 (1924); *Kenner v. Slidell Sav. & Homestead Ass'n*, 170 La. 547, 128 So. 475 (1930); *Conklin v. People's Bldg. & Loan Ass'n*, 41 N.J. Eq. 20, 2 A. 615 (1886); *Bradford, Eldred & Cuba R.R. v. New York, L.E.&W.R.R.*, 123 N.Y. 316, 25 N.E. 499 (1890); *Norwood v. Crowder*, 177 N.C. 469, 99 S.E. 345 (1919); *Steward v. Bounds*, 167 Wash. 554, 9 P.2d 1112 (1932); *Gideon v. Putnam Dev. Co.*, 113 W. Va. 200, 167 S.E. 140 (1932); see *Magee v. McManus*, 70 Cal. 553, 12 P. 451 (1886) (*semble*); *Beal v. United Properties Co.*, 46 Cal. App. 287, 189 P. 346 (1920) (*semble*); *Cohn v. Mitchell*, 115 Ill. 124, 3 N.E. 420 (1885); *Hall v. First Nat'l Bank*, 173 Mass. 16, 53 N.E. 154 (1899). See also *Annot.*, 41 A.L.R. 357 (1926).

grant the specific performance of an executory contract to lend money, even though the loan is to be secured by an interest in real property. Second, the paucity of case law on the subject of monetary damages for the borrower's breach makes legal action by the lender an uncertain proposition.

This Article analyzes the adequacy of remedies presently available to an aggrieved lender when a borrower refuses to close at the agreed rate in order to demonstrate that the law of monetary damages for a borrower's breach is not sufficiently developed to provide an "adequate remedy at law" that can be invoked to deny specific performance. As will be shown, the dynamics of modern mortgage lending in certain instances clearly require specific performance, and not damages, as the appropriate remedy. Because few, if any, American cases deal directly with the lender's problem,¹¹ and because the treatises¹² merely refer back to *Rogers v. Challis*¹³ without analysis, this hoary British case must first be examined in some detail to determine the extent to which its major underpinnings remain viable. The particular problems which the ascertainment of money damages pose will then be described. Finally, the possibility of the lender obtaining specific performance of the loan to be secured by an interest in real property is explored, with specific attention paid to those reasons which are still advanced to deny the lender this remedy.

I

THE RULE OF *Rogers v. Challis*

The *Rogers* rule has been summarized as follows: "That specific performance of a contract to lend money cannot be enforced is so well established, and obviously so wholesome a rule, that it would be idle to say a word about it."¹⁴ Like many fixed principles which come to govern difficult and complex situations, this rule had its origins in a simple case. By two letters of December 17 and 18, 1859, the plaintiff *Rogers* agreed to loan the defendant *Challis* £1000, repayable in four monthly installments, with ten percent interest to be paid in advance. As security for the loan, four items were enumerated: a bill of sale of certain furniture and other

¹¹ See note 10 *supra*.

¹² See, e.g., 5A A. CORBIN, CONTRACTS § 1152 (1964); E. FRY, SPECIFIC PERFORMANCE § 54 (6th ed. 1921); 49 AM. JUR. *Specific Performance* § 86 (1943); 81 C.J.S. *Specific Performance* § 80 (1953).

¹³ 27 Beav. 175, 54 Eng. Rep. 68 (Ch. 1859).

¹⁴ *South African Territories, Ltd. v. Wallington*, [1898] A.C. 309, 318.

personal property, a bill for the first installment, a guaranty against the removal of the property specified in the bill of sale, and "a deposit of the lease of *Webb's Hotel, Piccadilly*, and of the assignment of it, which had been made to *Challis*."¹⁵ Before any money passed hands, the defendant found better terms elsewhere, contracting for a loan of £1000 with one Mr. Reddish. Upon the defendant's refusal to accept his funds, Rogers brought a suit in equity to compel specific performance and asked, in the alternative, for monetary damages. Subsequent to the commencement of the action, but prior to judgment, the second loan was consummated.

In dismissing the plaintiff's complaint, the Master of the Rolls based his conclusions on two grounds. First, he emphasized that, should relief be granted, an avalanche of such litigation would ensue because any oral agreement to lend money, however casual, could conceivably give rise to a lawsuit. The Master reached this result by first stating the issue before him in simplified fashion:

The case cannot be put higher than this:—that the Defendant applies to the Plaintiff for the loan of 1,000*l.* upon a security which he specifies, and the Plaintiff assents to the proposal, but on the next day the Defendant says, "I have changed my mind, I do not require your 1,000*l.*, I can get it on better terms elsewhere." Is that a case in which a person can come to this Court for a specific performance, and say, "you, the Defendant, are bound to let me advance . . . the money to you?"¹⁶

The Master found no difficulty in answering his question in the negative, concluding:

*It is very justly said that, the Statute of Frauds does not apply to such a case; therefore, if the Court has jurisdiction in such a case, any conversation may be made the subject of a suit for specific performance: thus if two friends are walking together, and one says, "will you lend me 100*l.*, at 5*l.* per cent, for a year upon good security," and the other says "I will," that conversation might be made the subject of a suit for specific performance in this Court, if on the next day one friend should say "I do not want the money," or the other should say "I will not lend it." Nothing would be more difficult and more dangerous than the task which this Court would have to perform, if it were to investigate cases of that description.*¹⁷

¹⁵ 27 Beav. at 175, 54 Eng. Rep. at 68.

¹⁶ *Id.* at 177-78, 54 Eng. Rep. at 69.

¹⁷ *Id.* at 178, 54 Eng. Rep. at 69 (emphasis added). Although it may be a purely academic point, the Master of the Rolls left some doubt as to whether his statement on the British Statute of Fraud's inapplicability refers to the specific facts of *Rogers* in which an assignment of a hotel lease was offered as security or whether the remarks simply pertained to the general case in which *B* agrees to borrow £1000 from *A*. If no interest in land were

As a practical matter, the fear which this argument expresses amounts to little more than a tempest in a teapot with respect to modern mortgage lending transactions in which every step in a given transaction is reduced to writing.¹⁸ Such loans are simply not

offered as security, the fact that the contract was for the loan of money would not in and of itself have brought the agreement within the British Statute of Frauds, which remained unchanged from 1676 through 1859. See 29 Car. 2, c. 3, § 17, at 386 (1676). Although an argument might be made that the lending of money is within the "sale of goods" section of the Statute, the term "goods" was never construed to include money. 29 H. HALSBURY, LAWS OF ENGLAND § 9 (2d ed. 1938); see Sale of Goods Act, 56 & 57 Vict., c. 71, § 62, at 369 (1893) (incorporates sales of goods provision in 29 Car. 2, c. 3, § 17, at 386 (1676) and expressly excludes "money"). The fact that both British statutes deliberately omit "choses in action" precludes the argument that lending money is within the Statute as a sale of a chose. See UNIFORM COMMERCIAL CODE §§ 2-105(1), Comment 1, 2-201. On the other hand, a mere agreement to loan money may come within the Statute of Frauds if it cannot be performed within one year. See *Hoagland, Allum & Co. v. Allan-Norman Holding Corp.*, 228 App. Div. 133, 239 N.Y.S. 291 (1st Dep't 1930).

In deciding whether the facts of *Rogers* fit within the Statute of Frauds in 1859, it must be recognized that these facts are somewhat ambiguously stated. First, the two letters through which the parties concluded the transaction may have contained a memorandum of the agreement sufficient to satisfy the Statute. If such were the case, then the Master's pronouncement is nothing but dictum. Second, it is not clear whether Challis was the assignee of the lessor's interest or the lessee's interest in the Webb Hotel. Either view is plausible. If Challis was the lessor's assignee, Rogers's security would be based on the rent paid by the lessee of the hotel. If Challis was the lessee's assignee, Rogers's interest would be secured by the rent which all the occupants of the Hotel paid the lessee. This ambiguity is further complicated by the fact that Challis was the second assignee of the interest in question.

If Challis was the assignee of the Lessee's interest, which seems more likely since Rogers wanted a deposit of the lease as well as its assignment, then it is reasonably certain that the agreement was within the Statute of Frauds. First, the *lease* of a *building* does constitute an interest in "lands, tenements or hereditaments," within the meaning of 29 Car. 2, c. 3, § 4, at 385 (1676). See *Horsey v. Graham*, [1869] L.R. 5 C.P. 9; 27 H. HALSBURY, *supra* § 1070. See also Law of Property Act of 1925, 15 Geo. 5, c. 20, § 62, at 601 (amending earlier statute by deleting "tenements and hereditaments" and defining "land" to include "buildings"). Second, 29 Car. 2, c. 3, § 3, at 385 (1676) requires that the assignment of a lease be in writing.

If, on the other hand, Challis was the assignee of the lessor's interest, it is probable that the agreement would also come within the Statute of Frauds because the landlord's rent had been held to constitute an "interest in land" within the meaning of 29 Car. 2, c. 3, § 4, at 385 (1676). *Re Whitting, Ex parte Hall*, [1879] 10 Ch. D. 615; see *Gorringe v. Land Improvement Soc'y*, [1899] 1 Ir. R. 142. Since the *Whitting* decision came subsequent to *Rogers*, it is possible that the right to receive rent was viewed as a chose in action and therefore not within the Statute.

Finally, it should be noted that the subsequent British cases brought by borrowers seeking specific performance involved adequate writings, and the policy advanced by the Master of the Rolls was not relied upon. See *South African Territories, Ltd. v. Wallington*, [1898] A.C. 309; *Larios v. Bonany y Guerty*, [1873] L.R. 5 P.C. 346; *Western Wagon & Property Co. v. West*, [1892] 1 Ch. 271; *Sichel v. Mosenthal*, 30 Beav. 371, 54 Eng. Rep. 932 (Ch. 1862). See also *Gorringe v. Land Improvement Soc'y*, *supra*.

¹⁸ *But see* Sinteniz, *Current Treatment of the Non-Refundable Commitment Fee and Related Problems*, 86 BANKING LAW J. 590, 597-603 (1969) (examples given of careless practice which rendered written commitments unenforceable through omission of material terms).

the result of a casual conversation or correspondence between two acquaintances. Furthermore, it is settled law that an agreement to loan money secured by a mortgage on real property does constitute a contract for the sale of an "interest in land" within the meaning of the Statute of Frauds and therefore *must* be in writing.¹⁹

Second, the Master suggested that the legal remedy available to the plaintiff would be quite adequate because the suit was really

a simple money demand; the Plaintiff says, I have sustained a pecuniary loss by my money remaining idle, and by my not getting so good an investment for it as you contracted to give me. This is a mere matter of calculation, and a jury would easily assess the amount of the damage which Plaintiff has sustained.²⁰

However, the Master expressly declined to voice an opinion as to whether an action at law for breach of contract could be brought in such a case, concluding that the statute²¹ which conferred upon Chancery jurisdiction to assess damages required that the court have before it a valid claim for equitable relief.²² In short, the Master of the Rolls conveniently avoided fashioning a remedy for the plaintiff, leaving him no other alternative but to file an action for damages at law. Modern procedure, of course, would not permit such a disposition of the lender's complaint.

Not only are the facts in *Rogers* far removed from the world of modern mortgage lending, but the court also reveals a view of credit transactions which bears little resemblance to current financial practice. The Master of the Rolls described the contract before him as follows:

This is not an agreement to purchase or sell anything, it is not the case of a contract to buy a particular debt upon certain terms, or a contract for the purchase of a certain quantity of goods, to be paid for by installments and in a particular manner, in which case the Court has held, that these were circumstances which took the transactions out of the rule of this Court, that an ordinary contract for the sale or purchase of goods is not the proper subject of a suit for specific performance in this Court. It

¹⁹ *Driver v. Broad*, [1893] 1 Q.B. 744; *Brižick v. Manners*, 9 Mod. Rep. 284, 88 Eng. Rep. 454 (Ch. 1742). Articulating the principle in *Sleeth v. Sampson*, 237 N.Y. 69, 72, 142 N.E. 355, 356 (1923), Judge Cardozo stated:

One who promises to make another the owner of a lien or charge upon land, promises to make him the owner of an interest in land, and this is equivalent in effect to a promise to sell him such an interest.

For a recent case illustrating this proposition, see *Lambert v. Home Fed. Sav. & Loan Ass'n*, 481 S.W.2d 770 (Tenn. 1972), noted in 39 LEG. BULL. 56 (1973).

²⁰ 27 Beav. at 179, 54 Eng. Rep. at 70.

²¹ The Chancery Amendment Act, 21 & 22 Vict., c. 27, § 2 (1858).

²² 27 Beav. at 179, 54 Eng. Rep. at 69.

is nothing more than this:—a proposal to borrow a certain sum of money, upon certain terms, for a certain time, which is accepted, and the borrower says two or three days afterwards, I do not want the money, and I have got it elsewhere, upon better terms.²³

Today, the right to borrow money at certain terms, like a "call," represents a commodity which is sold; furthermore, the judgments involved in a lender's decision to grant a mortgage loan to a particular borrower involve more subtle and complex factors than a casual agreement between private individuals. Moreover, *Rogers* itself represents a case in which fluctuations in the interest rate played no role in the defendant's decision to breach the loan contract; indeed, the decision came at a time (1859) when the doctrine of laissez-faire predominated in political economy, and government intervention affecting interest rates was minimal.²⁴

Although borrowers generally have been successful in enforcing commitments against lenders,²⁵ borrowers often take the position²⁶ that commitments, even though obligatory in form with respect to them,²⁷ should not bind them because the bargaining position between borrower and lender is unbalanced. These borrowers argue that commitment fees constitute the "price" for their

²³ *Id.* at 178, 54 Eng. Rep. at 69.

²⁴ Before leaving *Rogers*, it is interesting to note that at least two prior British cases indicated a somewhat contrary view. In *Bass v. Clively*, 1 Tamlyn 80 (1829), 48 Eng. Rep. 33 (Ch. 1829), the defendant agreed in writing to borrow £3000 for five years, giving as security a mortgage on her five leasehold properties subject to the plaintiff's inspection of the fee title to those properties. This inspection, the plaintiff averred, had been denied by the defendant. The defendant's bill denied that any such condition had been agreed upon and maintained that the defendant was at all times willing and ready to carry out the agreement. By the time of the trial, the plaintiff had already paid over £600 to the defendant and had received a mortgage on one of the leaseholds.

The court accepted the facts as stated in the defendant's bill, noting that the plaintiff could only obtain specific performance of the agreement as proved. Although the court entered a decree ordering the performance of this agreement, the defendant recovered costs against the plaintiff. This particular fact undermines whatever value *Bass* might have as authority for the proposition that a lender can compel specific performance. Also, the contract here was not executory £600 had already been advanced. At most the case held that specific performance will lie to complete a partially performed loan. *Rogers* distinguishes *Bass* on the basis of defendant's consent to the performance. *Rogers v. Challis*, 27 Beav. 175, 177 n.(b), 54 Eng. Rep. 68, 69 n.(1) (Ch. 1859). See *Hunter v. Langford*, 2 Molloy 272 (Ch. 1828) (*semble*).

²⁵ See notes 32 & 50 *infra*.

²⁶ Letter from Stephen Hochberg, Esq., General Counsel, Lefrak Corp. to Earl H. Nemser, Esq., April 2, 1973 (on file at the *Cornell Law Review*).

²⁷ An example of an obligatory clause follows: "The Loan, which by your acceptance of this commitment you agree to accept from us[,] shall be in the amount of . . ." Draper, *Permanent Mortgage Financing—The Shopping Center*, in *REAL ESTATE FINANCING* 2D, 119 (1972).

“option” to call down the loan and are retained by the lender; but research discloses no case law treatment of this argument. Borrowers further argue that the lender’s commitment conditions mean, in substance, that the borrower is unable to enforce the contract against the lender. However, in light of the competition in the national money market among lending institutions for large loans, the bargaining is not in fact unbalanced,²⁸ and it is only with respect to the large loan that the broken commitment problem is serious for the lender. Well represented borrowers, moreover, preclear title conditions, leases, and other documents, thereby eliminating many of the lender’s conditions, and in the case of new construction, construction lenders usually require such preclearance.

Finally, borrowers and lenders have a well established practice of paying additional charges for what is known as a “standby” (optional) commitment under which, by the terms of the commitment, the borrower is not obligated to borrow.²⁹ The existence of the “standby” device, for which the borrower pays additional consideration, supports the view that commitments which are obligatory by their terms are obligatory at law.

II

THE MEASURE OF DAMAGES FOR BREACH OF A CONTRACT TO LOAN MONEY

Although *Rogers* based its decision to deny specific performance, at least in part, upon the availability of a remedy for damages, research has failed to disclose a single case, either in the United States³⁰ or in Britain³¹ which actually grants such a

²⁸ There are 490 savings banks in the United States, the largest concentration of which is located in the northeastern United States. In New York (see N.Y. BANKING LAW § 235(6) (McKinney 1971)) and in most other states, savings banks are authorized to invest in conventional mortgage investments nationwide.

²⁹ See Draper, *supra* note 3, at 178.

³⁰ Cf. Federal Bond & Mortgage Co. v. Burnstein, 222 Mich. 88, 192 N.W. 549 (1923). In Central Mortgage Co. v. Partello, 132 N.Y.S. 432, 434 (Sup. Ct. 1911), the court stated by way of dictum:

Conceding, without deciding, that the defendant may have been apprised of the fact that plaintiff was accepting the loan for itself, and that defendant agreed to borrow the money from the plaintiff, the damages which plaintiff suffered are the loss of profit which it would have made if the defendant had carried out its agreement.

³¹ See J. MAYNE & H. MCGREGOR, ON DAMAGES (Common Law Library No. 9, 13th ed. 1973).

remedy.³² The only area in which a lender's damages have been recognized judicially lies in the field of commitment fees.³³

Borrowers pay commitment fees at the time they sign the commitment. A nonrefundable fee is consideration to the lender for the issuance of the commitment. Such a fee should not, of course, be applied toward damages, for it represents interest over and above the stated rate which the lender is, by the terms of the commitment, entitled to keep. A refundable commitment fee is designed to assure the lender that the borrower will perform. Some commitments explicitly provide that refundable commitment fees are liquidated damages. In *Boston Road Shopping Center, Inc. v. Teachers Insurance & Annuity Association*,³⁴ for example, the provision for a fee stated that, should the borrower fail to comply

"with all the terms and conditions herein . . . without fault on our part, then the amount so paid as consideration for our agreements shall be retained by us in full satisfaction for our entering

³² A substantial body of case law does exist involving suits by *borrowers* against breaching *lenders*. See Annot., 44 A.L.R. 1486 (1926); Annot., 36 A.L.R. 1408 (1925). Indeed, this is the only aspect of damages with which the treatises deal. See 1 B. CLARK, *NEW YORK LAW OF DAMAGES* § 170 (1925); 5 A. CORBIN, *supra* note 12, at § 1078; *ENCYCLOPEDIA OF NEW YORK LAW DAMAGES* § 695 (J. Fuchsberg, ed. 1965); *RESTATEMENT OF CONTRACTS* § 343 (1932) [hereinafter cited as *RESTATEMENT*]. In this context it is often stated that the borrower can recover only nominal damages for the lender's breach. See, e.g., *Avalon Constr. Corp. v. Kirch Holding Co.*, 256 N.Y. 137, 175 N.E. 651 (1931); *Bond Street Knitters, Inc. v. Peninsula Nat'l Bank*, 266 App. Div. 503, 42 N.Y.S.2d 744 (1st Dep't 1943). See also *Turpie v. Lowe*, 114 Ind. 37, 15 N.E. 834 (1888). This view, however, has simply reflected the fact that the aggrieved borrower could have obtained the money elsewhere at the same rate of interest. In those cases in which the borrower has been compelled to pay a higher rate of interest than that for which he had bargained, he has been allowed to obtain the present value of the difference between the two rates. See, e.g., *Hixson v. First Nat'l Bank*, 198 Ia. 942, 200 N.W. 710 (1924); *Weissenberger v. Central Acceptance Corp.*, 64 Ohio App. 398, 28 N.E.2d 794 (1940); *Farabee-Treadwell Co. v. Union & Planter's Bank & Trust Co.*, 135 Tenn. 208, 186 S.W. 92 (1916). The controversial issues in the area of lender breaches, however, are what incidental and consequential damages a borrower may recover and whether those damages were fairly within the contemplation of the parties. Compare *Turpie v. Lowe, supra*, with *Bond Street Knitters, Inc. v. Peninsula Nat'l Bank, supra*. See also 5 A. CORBIN, *supra* note 12, at § 1078.

³³ See *Walter E. Heller & Co. v. American Flyers Airline Corp.*, 459 F.2d 896 (2d Cir. 1972); *Regional Enterprises, Inc. v. Teachers Ins. & Annuity Ass'n of America*, 352 F.2d 768 (9th Cir. 1965); *Pivot City Realty Co. v. State Sav. & Trust Co.*, 88 Ind. App. 222, 162 N.E. 27 (1928); *White Lakes Shopping Center, Inc. v. Jefferson Standard Life Ins. Co.*, 208 Kan. 121, 490 P.2d 609 (1971); *Continental Assurance Co. v. Van Cleve Bldg. & Constr. Co.*, 260 S.W.2d 319 (Mo. Ct. App. 1953); *Paley v. Barton Sav. & Loan Ass'n*, 82 N.J. Super. 75, 196 A.2d 682 (App. Div. 1964); *Boston Road Shopping Center, Inc. v. Teachers Ins. & Annuity Ass'n of America*, 13 App. Div. 2d 106, 213 N.Y.S.2d 522 (1st Dep't 1961), *aff'd*, 11 N.Y.2d 831, 182 N.E.2d 116, 227 N.Y.S.2d 444 (1962). See also *Sintenis, supra* note 18, at 597-603; *Wolf, The Refundable Commitment Fee*, 23 Bus. Law. 1065 (1968).

³⁴ 13 App. Div. 2d 106, 213 N.Y.S.2d 522 (1st Dep't 1961), *aff'd*, 11 N.Y.2d 831, 182 N.E.2d 116, 227 N.Y.S.2d 444 (1962).

this agreement and holding ourselves ready and willing to make the loan within the aforesaid time, and thereupon this agreement shall become null and void."³⁵

Although the court termed this provision a liquidated damages clause, clearly a clause could be drafted providing that the refundable fee would be applied toward damages in the event of a breach (not in full settlement but on account thereof) thus leaving the parties to their proof.³⁶ If the damages proved exceeded the refundable fee, then the breaching party would have to pay the difference, but if they were less than the fee, the lender would have to refund the difference.

Apart from the difficulties that a lender may encounter in attempting to protect himself by means of a commitment fee, the actual calculation of damages involves certain complexities which a hypothetical example will serve to illustrate. Assume, for the sake of simplicity, a \$10 million loan at 8 percent to be repaid in installments over a ten-year period. Subsequent to the issuance of the commitment letter, but prior to closing, the market rate of interest drops to 7.5 percent.³⁷ Assume that the defaulting borrower takes out another loan at that new rate. Without discounting to present value, it can be seen that the difference in interest between what the lender would have obtained at 8 percent and what he can now obtain at 7.5 percent is \$500,000. With discounting at the contract rate, the difference is \$335,500. Neither sum is insubstantial, and one can imagine the natural reluctance of a court to impose such damages on a defaulting borrower, particularly in view of the rather casual way in which some of the mortgage lending trade regards commitments.

The question of how to discount that figure to present value is one that goes directly to the rationale behind contract damages. Traditionally, in the event of a breach, courts have enforced contracts by granting as damages the amount necessary to give the nondefaulting party the "benefit of the bargain," *i.e.*, to put him in the position in which he would have been had there been no

³⁵ *Id.* at 108, 213 N.Y.S.2d at 524. See Sintonis, *supra* note 18, at 604-12.

But see Walter E. Heller & Co. v. American Flyers Airline Corp., 459 F.2d 896 (2d Cir. 1972) (liquidated damages provision in commitment which also contained *nonrefundable fee* sustained).

³⁶ See, *e.g.*, Draper, *supra* note 27, at 128-29; Melody, *supra* note 4, at 30.

³⁷ Of course, it is not always possible to determine the exact extent of the market rate drop for any equivalent loan. For this reason, it is difficult to determine what constitutes an equivalent loan. See text accompanying notes 53-56 *infra*.

breach.³⁸ To accomplish this, the discounting must be at the rate of interest prevailing at the time of the breach, so that the amount actually received as damages, when invested, will give the non-defaulting party the same return he would have received under the contract.³⁹ This highly speculative element hardly contributes to the adequacy of the contractual remedy at law.

The problem is further compounded if the terms of the loan permit the borrower to prepay in order to reduce his interest burden. In the unlikely event the defaulting borrower demonstrates that by prepaying the loan in accordance with its terms⁴⁰ the lender would have received less than if the loan had run its full term, then that lesser amount, discounted as outlined above, would be the proper measure of damages.

Other interesting and difficult problems also arise in connection with the calculation of damages. First, should the defaulting borrower be allowed to prove that the particular business on which he has based his application for a commitment would in fact be unsuccessful so that the lender would not actually have received the interest (or indeed the return of principal) as specified in the commitment? Second, should the differential between market and contract interest rates be awarded regardless of whether the aggrieved lender has in fact found an alternative borrower? If the interest rate rises to its former level by the time trial of the dispute begins the problem is further complicated. The defaulting borrower might then argue that the lender, as part of its duty to mitigate damages, should have "ridden out" the interest rate fluctuation by investing the money that he would have used for the

³⁸ See UNIFORM COMMERCIAL CODE § 1-106(1); Farnsworth, *Legal Remedies for Breach of Contract*, 70 COLUM. L. REV. 1145, 1147 (1970).

³⁹ Superficially, the legal or judgment rate of interest, which governs the extent of discounting future wages in actions, might seem appropriate. At the high rates of interest currently prevailing in the marketplace, the lender would benefit from a windfall since the damage award could be reinvested at a higher rate of return than the legal rate. In short, the lender would be in a better financial position than he would have been had there been no breach. In the case of a wrongful death award, the judgment rate may be justified on the theory that it is impossible to determine at what rate the claimant will invest the money received as damages. The judgment rate is meant, therefore, to foreclose arguments as to how well the sum will be invested.

A closer analogy may be drawn from the income approach to valuation in condemnation proceedings. There the object is to arrive at an appropriate amount as just compensation by discounting to present value the projected future income of property. There is no one, standardized method of discounting; the methods utilized generally attempt to determine the market rate for such an investment.

⁴⁰ Along with a prepayment penalty, interest must be paid until prepayment is permitted (possibly five years or more).

broken commitment on a short-term basis, awaiting a rise in interest rates to the previous level. This argument overlooks the obvious fact that an institutional mortgage lender fulfills its duty to mitigate damages by acting as would a *reasonable* institutional mortgage lender in the circumstances.⁴¹ Most of these institutions naturally resist speculative ventures and are sometimes required by law to refrain from speculating.⁴² They must act cautiously and invest available funds as best they can, usually in the best available long-term investment. In any event, if the commitment contains a clause stating that the measure of damages for a breach by the borrower is the difference between the contract rate of interest over the life of the loan and the rate for the same period prevailing in the mortgage money market at the time of the breach, there is no reason why the court should not honor such a provision.⁴³

It is apparent that several troublesome and as yet unresolved questions remain concerning the issue of monetary damages. If aggrieved lenders begin to sue upon broken commitments, the courts will be compelled to face and resolve these issues. Only then will it be possible to proclaim in any meaningful sense that a lender should be denied specific performance because it possesses an adequate remedy at law.

III

EQUITABLE RELIEF FOR THE LENDER

As far back as 1936, Professor Sydney Post Simpson surveyed the course of American equity over the preceding fifty years and concluded:

⁴¹ See Farnsworth, *supra* note 38, at 1183.

⁴² Investments for savings banks are limited in general to those relatively safe investments enumerated in section 235 of the Banking Law (N.Y. BANKING LAW § 235 (McKinney 1971)), and savings banks are not generally permitted to enter into speculative contracts. *See Jemison v. Citizens Sav. Bank*, 122 N.Y. 135, 140 (1890).

⁴³ An example of such a clause is:

It is understood and agreed that upon your failure to close the loan or any advance thereunder hereby contemplated for reasons within your control, one of the provable elements of damage sustained by us as a result of such failure shall be the difference between (1) interest at the rate of ____% . . . per annum herein specified for the period from the date of expiration of this commitment to maturity and (2) a sum equal to interest for the same period computed at the rate prevailing in the mortgage money market at the time of your cancellation of this commitment or your refusal to close hereunder. No credit against such damage shall be allowed for any payments made to us by you in connection with this commitment except the nonrefundable commitment fee as provided for [elsewhere herein].

Draper, *supra* note 27, at 136-37.

The law of specific performance is substantially more liberal and better adapted to the requirements of justice than it was fifty years ago. There has been [an] increasing willingness to enforce contracts not relating to land, a tendency which has been assisted by statute, although *some old and arbitrary rules, like that which denies relief where the defendant has agreed to lend money, still persist.*⁴⁴

In the thirty-eight years since that statement was made, specific performance has become even more commonly granted and, in the view of some commentators, it appears to be almost as available as any other remedy.⁴⁵ In other words, the presumption against equitable relief has substantially lessened.⁴⁶ The *Rogers* rule has yielded, in both Britain and the United States, when it has impeded modern commercial practices;⁴⁷ but the cases which have undermined *Rogers* have usually involved suits by lenders. In *South African Territories, Ltd. v. Wallington*,⁴⁸ for example, the House of Lords refused to compel the defendant to purchase the plaintiff's mortgage bonds pursuant to an underwriting contract on the grounds that such an agreement was merely a contract to lend money. Parliament found the result untenable, however, and the case was soon overruled by statute.⁴⁹ In short, the value of specific performance as a remedy which would ensure adequate relief for the parties to an underwriting contract was found to outweigh any need to sustain an inflexible rule about contracts to lend money. Moreover, a notable erosion of what Simpson called the "old and arbitrary rule" has occurred with respect to suits by borrowers.⁵⁰

⁴⁴ Simpson, *Fifty Years of American Equity*, 50 HARV. L. REV. 171, 172-73 (1936) (emphasis added).

⁴⁵ Compare 5A A. CORBIN, *supra* note 12, at § 1136 (remedy of specific enforcement as available as are other remedies), with E. MAITLAND, *EQUITY—A COURSE OF LECTURES* 304 (rev. ed. J. Brunyate 1936) (specific performance applies to agreements for sale or lease of lands as matter of course; its application outside these limits somewhat exceptional and discretionary). Cf. Leach v. Fuller, 65 Colo. 68, 173 P. 427 (1918).

⁴⁶ See Simpson, *supra* note 44, at 173. For a very early expression of judicial support for this position, see *Phillips v. Berger*, 2 Barb. 608, 610-11 (N.Y. Sup. Ct. 1848).

⁴⁷ See *South African Territories, Ltd. v. Wallington*, [1898] A.C. 309. See also *Electric & Eng'r Management Corp. v. United Power & Light Co.*, 19 F.2d 311 (8th Cir. 1927); *Busch v. Stromberg-Carlson Tel. Mfg. Co.*, 217 F. 328 (8th Cir. 1914).

⁴⁸ [1898] A.C. 309.

⁴⁹ "A contract with a company to take up and pay for any debentures of the company may be enforced by an order for specific performance." Companies Act of 1929, 19 & 20 Geo. 5, c. 23, § 76. The Companies (consolidation) Act of 1908, 8 Edw. 7, c. 69, § 105 contained a similar provision.

⁵⁰ See, e.g., *Southampton Wholesale Food Terminal, Inc. v. Providence Produce Warehouse Co.*, 129 F. Supp. 663 (D. Mass. 1955) (exempts construction mortgages from *Rogers* rules); *Cuna Mut. Ins. Soc'y v. Dominguez*, 9 Ariz. App. 172, 450 P.2d 413 (1969); *Camden v. South Jersey Port Comm'n*, 4 N.J. 357, 73 A.2d 55 (1950); *Jacobson v. First Nat'l Bank*, 129 N.J. Eq. 440, 20 A.2d 19, *aff'd*, 130 N.J. Eq. 604, 23 A.2d 409 (1941); *Caplin v.*

Recently, in *Leben v. Nassau Savings & Loan Association*,⁵¹ the New York Appellate Division, Second Department, exercising equitable jurisdiction, reformed the interest rate on a recorded mortgage at the request of a borrower who had been forced to close at a rate higher than that provided in the commitment. Given this trend toward making equitable relief more freely available, especially in underwriting cases, the question of whether a lender may obtain the specific performance of a contract to lend money should no longer be subject to the kind of wooden analysis which simply disposes of the issue by citing the *Rogers* rule.

Assuming that damages are awarded on the basis of the parties' expectancy, the money judgment may afford an aggrieved lender a remedy substantially inferior to specific performance. In short, relief at law could be inadequate⁵² even for the breach of a contract to loan money. Although no sure test has evolved for determining whether and under what circumstances monetary damages are inadequate, the *Restatement of Contracts* enumerates at least two criteria in such an evaluation which are relevant to the area of mortgage lending:

(a) the degree of difficulty and uncertainty in making an accurate valuation of the subject matter involved, in determining the effect of a breach, and in estimating the plaintiff's harm;

...

(c) the difficulty, inconvenience, or impossibility of obtaining a duplicate or substantial equivalent of the promised performance by means of money awarded as damages.⁵³

Both of these factors focus upon the degree of difficulty inherent in substituting money damages for the promised performance. In the mortgage commitment area, such problems arise in calculating the precise monetary amount, as explored above, and making a mere money judgment equivalent to what the defendant had agreed to undertake.

This latter complication is particularly relevant in testing the adequacy of a lender's legal remedies. The interest rate which a lending institution assigns a given borrower represents, within the

Penn Mut. Life Ins. Co., 182 App. Div. 269, 169 N.Y.S. 756 (2d Dep't 1918); *Columbus Club v. Simons*, 110 Okla. 48, 236 P. 12 (1925). See also *Woodruff v. Germansky*, 233 N.Y. 365 (1922); *National Sur. Corp. v. Titan Constr. Corp.*, 26 N.Y.S.2d 227 (Sup. Ct.), *aff'd*, 260 App. Div. 911, 24 N.Y.S.2d 141, *reargument denied*, 260 App. Div. 923, 25 N.Y.S.2d 398 (1940).

⁵¹ 40 App. Div. 2d 830, 337 N.Y.S.2d 310 (2d Dep't 1972).

⁵² RESTATEMENT § 359.

⁵³ *Id.* at § 361.

limits set by the market, a judgment as to the stability, potential, and risk involved in the particular transaction. Although such assessments are routine in deciding whether to loan money to John Doe instead of Richard Doe for the purpose of buying a house in Levittown, the decision to loan millions of dollars for a given commercial project represents a matter of some sophistication.⁵⁴ When the aggrieved lender seeks to obtain another borrower subsequent to the breach of the first commitment, it is doubtful whether the lender can obtain an identical investment or even an equivalent opportunity. The original commitment represents the best available arrangement in terms of risk at the given market rate. Any other available project may present greater risks in obtaining similar loan yields. Assuming that interest rates have fallen below the original market rate, the lender cannot compensate himself for being forced to take on a riskier investment in order to obtain similar loan yields. Monetary damages measured by the difference between the commitment rate and the lower market rate do not compensate the lender for the fact that the breach might force the borrower to undertake a less desirable loan in order to mitigate his damages. Thus, the right to receive interest at an agreed rate from a loan, which, in the lender's judgment, is uniquely favorable, may be worth more than the interest differential between that agreed upon rate and the lower market rate plus the right to receive interest at that lower rate from a less favorable project.

Put another way, from a bank's standpoint, 8 percent in a shopping center with high credit leases may be superior to 7.5 percent plus an interest differential in another shopping center with leases on inferior terms, inferior credits, or both. Although an actual situation is unlikely to present such a clear-cut difference,⁵⁵

⁵⁴ Cf. *Walter E. Heller & Co. v. American Flyers Airline Corp.*, 459 F.2d 896 (2d Cir. 1972). In the *Heller* case, the Second Circuit, in sustaining a liquidated damages clause observed:

The variables inherent in a lender-borrower relationship arising out of the borrower's need for funds to purchase a nine million dollar jet airplane are numerous and uncertain. Such facts as rate of return, duration of the loan, risk, extent and realizability of collateral, and the other obvious uncertainties inherent in this particular contract combined to make it difficult to foresee, at the time the contract was executed, the extent of damages which might arise from the breach of the loan agreement.

Id. at 899-900. The same considerations apply with equal force to modern mortgage lending on a whole range of projects from shopping centers to office buildings.

⁵⁵ *But see City Stores Co. v. Ammerman*, 266 F. Supp. 766 (D.D.C.), *aff'd per curiam* 394 F.2d 950 (D.C. Cir. 1967), *noted in* 11 S. WILLISTON, *supra* note 32, at § 1424. In *Ammerman*, specific performance of an option contract which gave the plaintiff the right to lease space in

the lender should, at the very least, be able to argue the commercial uniqueness of his broken commitment as a basis for obtaining specific performance.⁵⁶

Because a mortgage lender advances money largely on the security of a mortgage in real property, the question that naturally arises is whether a commitment comes within the rule, settled in equity, that contracts to sell or purchase an interest in land are specifically enforceable.⁵⁷ To be avoided at the outset is the morass of formalism which underlies any attempt to determine whether what the mortgagee obtains actually constitutes an "interest in land."⁵⁸ The weight of authority in the United States is that a

a shopping center was granted. The lower court emphasized factors relating to the plaintiff's unique judgment of the value of the particular enterprise:

It is apparent from the nature of the contract involved in this case that even were it possible to arrive at a precise measure of damages for breach of a contract to lease a store in a shopping center for a long period of years—which it is not—money damages would in no way compensate the plaintiff for loss of the right to participate in the shopping center enterprise and for the almost incalculable future advantages that might accrue to it as a result of extending its operations into the suburbs.

Id. at 776. It is significant that the court also alludes to the "incalculable" advantage of extending operations into a new area, in this case the suburbs. A similar element might well be present in the mortgage lender's decision to commit for a permanent loan particularly in those instances when, for example, the borrower is a shopping center for a new community.

⁵⁶ Consideration of unique business judgment also constitutes the rationale for granting specific performance to purchasers of securities which are available from particular vendors only. *See, e.g.,* *Nanfito v. Tekseed Hybrid Co.*, 341 F. Supp. 240, 248 (D. Neb. 1972), *aff'd*, 473 F.2d 537 (8th Cir. 1973).

⁵⁷ *See* RESTATEMENT § 360. The *Restatement of Contracts* provides:

Damages are regarded as an inadequate remedy for the breach of a promise

(a) to transfer an interest in specific land, or

(b) to buy and pay for such an interest, so long as the transfer has not yet been made

Id. A comparatively recent case, *Russell v. Western Nebraska Rest Home, Inc.*, 180 Neb. 728, 732-33, 144 N.W.2d 728, 731-32 (1966), states the principle: "When land, or any interest therein, is the subject matter of an agreement, the power of a court of equity to enforce specific performance is beyond question."

⁵⁸ Although this problem in all its legal and historical ramifications lies beyond the scope of this Article certain explanatory observations are necessary. One may, of course, be tempted simply to agree with Professor McDougal: "A study of the tortuous course of judicial decision could have been used to show that there are mortgages and mortgages and natures and natures." McDougal, *Book Review*, 44 *YALE L.J.* 1278, 1279 (1935). For a discussion of the development of the mortgage in England, see G. OSBORNE, *MORTGAGES* §§ 1-12 (1970). At common law, the mortgagee held a fee simple title to the mortgaged property subject only to the condition subsequent of the mortgagor paying off the underlying indebtedness. Equity, however, came to regard the transaction not as a conveyance of the fee but merely as a security device. In the United States, the treatment of the mortgagee's interest breaks down into three separate lines of judicial decisions which parallel the difference between law and equity in England. *See* G. OSBORNE, *supra* at §§ 13-16. 4 *AMERICAN LAW OF PROPERTY* §§ 16.13-16 (A.J. Casner ed. 1952); 5 H. TIFFANY, *THE LAW OF REAL PROPERTY* § 1380 (B. Jones ed. 1939). Under the "title theory," the mortgagee obtains a fee simple title which entitles him to possession of the mortgaged premises, subject to

mortgagee's interest is merely a lien on the mortgaged premises.⁵⁹ Clearly, a mortgagee does not intend to acquire the fee title to property as does an actual purchaser.⁶⁰ The heart of the difference between the lien theory and the title theory is the extent to which a creditor should be able to exert control over the mortgaged property in order to protect its value as security. On the other hand, the underlying rationale for the specific enforceability of contracts to convey an interest in real property is the unique character of land.⁶¹ There is no logical reason, however, why land should be considered unique for purposes of acquiring the fee but not for the purpose of assessing it as security for a mortgage loan.⁶² There-

defeasance in case of full payment by the mortgagor. Under the "lien theory," the mortgagee merely has a security interest in the mortgaged property, with no right to possession. According to a third or "intermediate" theory, the mortgagee is entitled to possession but only after default by the mortgagor.

This tripartite division constitutes an over-simplification because, apart from the question of possession, the decided cases do not always resolve the issues in a consistent manner. Thus, to cite one example, it is uniformly held in both lien and title states that a judgment creditor of the mortgagor can always obtain an execution against the mortgaged property although a judgment creditor of the mortgagee cannot. *See, Sturges & Clark, Legal Theory and Real Property Mortgages*, 37 YALE L.J. 691, 704-05 (1928). In fact, courts in certain nominally "title theory" states have recognized the mortgagor's equitable rights to a degree that, for all practical purposes, constitutes recognition of the "lien theory." G. OSBORNE, *supra* at § 14. In *Walker v. Wood*, 31 Tenn. App. 196, 203, 213 S.W.2d 523, 526 (1948), the court noted: "All mortgages . . . howsoever drawn, are deemed in equity as mere securities, notwithstanding any stipulations that title is to become absolute on certain conditions; and such conveyances constitute mere liens and must be enforced as such." *But see Lambert v. Home Fed. Sav. & Loan Ass'n*, 481 S.W.2d 770, 772-73 (Tenn. 1972) (mortgage commitment held agreement to transfer "an interest in land" for purposes of Statute of Frauds). *See also note 17 supra*.

⁵⁹ 4 AMERICAN LAW OF PROPERTY §§ 16.14, 16.15 (A.J. Casner ed. 1952); A. AXELROD, C. BERGER & Q. JOHNSTONE, *LAND TRANSFER AND FINANCE* 137 (1971). As pointed out above, the question of whether a particular state is a lien or title state should be approached with some circumspection (*see note 58 supra*); seven states, Alabama, Maine, Maryland, New Hampshire, Pennsylvania, Tennessee, and Vermont could arguably be called title states.

⁶⁰ Of course, a conniving lender can use the mortgage as a means of acquiring the debtor's property by lending him funds that he knows the debtor cannot repay.

⁶¹ Caveat: Although the decided cases have clearly articulated this rationale, the specific enforceability of contracts to sell or purchase land is also grounded in the historical fact that land has always occupied a predominant place in England and the United States. Row after row of suburban plots can hardly be viewed as "unique," however. The element of uniqueness seems more clearly present when property has been singled out for commercial use, and that is precisely the kind of property which is offered as security to a mortgage lender.

⁶² *Southampton Wholesale Food Terminal, Inc. v. Providence Produce Warehouse Co.*, 129 F. Supp. 663, 664 (D. Mass. 1955), recognizes this argument in connection with a suit by a borrower:

Since the law regards land as unique an agreement to buy land can be specifically enforced even though the defendant's sole obligation is to pay money [citation omitted]. Although the question is close, it may not be too great a stretch to include advances under a construction mortgage.

fore, theories dealing with creditors' rights to protect the security should not determine the unrelated question of when specific enforcement should be granted.

Quite apart from the burden of proving the inadequacy of damages, the lender seeking equitable relief encounters certain other doctrines which have traditionally limited the availability of specific performance. The concept of mutuality of remedy has fallen into disrepute,⁶³ and it should pose no obstacle to a lender who demonstrates his willingness to advance the funds in question to the defendant borrower.⁶⁴ Although in the past equity has been reluctant to compel successive performances and has shown a certain sensitivity toward the problems of supervision and of possible hardship upon a defendant, recent decisions have departed from this view.⁶⁵

If the liberal trend toward granting equitable relief continues, lenders may at some point be relieved of the necessity of fitting within the rubric of conveying an interest in land. In *Phillips v. Berger*, 2 Barb. 608, 610 (N.Y. Sup. Ct. 1848) (emphasis added) this view was suggested, the court stating:

The jurisdiction of this court, in compelling a specific performance of contracts relating to lands, is pretty well settled; but not so in regard to personal contracts—that is, contracts for personal acts, or for the sale and delivery of personal property. *The reason for the distinction between the two classes of contracts has long since passed away.* Yet the distinction still, in a measure, remains. Judge [sic] Story, with great propriety, in his commentaries on equity jurisprudence, remarks, that there is no reasonable objection to allowing the party who is injured by the breach to have an election either to take damages at law, or to have a specific performance in equity. *The courts have not yet gone that length; but when they do, they will relieve the subject of specific performance of many of its embarrassments, and remove from this branch of equity jurisprudence many of the artificial distinctions to which the courts have been compelled to have recourse in order to justify their advance toward such a sound general rule.*

⁶³ See Pound, *The Progress of the Law—Equity*, 33 HARV. L. REV. 420, 432 (1920); cf. *Sichel v. Mosenthal*, 30 Beav. 371, 54 Eng. Rep. 932 (1862).

⁶⁴ In its purest form, the mutuality requirement denies specific performance to a plaintiff if such a remedy is not available to the defendant. 11 S. WILLISTON, *supra* note 32, at § 1433. The principle has been largely repudiated in most jurisdictions. *Id.* § 1440. What has emerged in its place is summarized by Williston:

Specific enforcement may properly be refused if a substantial part of the agreed exchange for the performance to be compelled is as yet unperformed and its concurrent or future performance is not well [or sufficiently?] secured to the satisfaction of the court.

Id.

⁶⁵ See 5A A. CORBIN, *supra* note 12, at § 1171; cf. *Langson v. Goldberg*, 298 Ill. App. 229, 18 N.E.2d 729 (1939). Problems of supervision are relevant not only to successive advances by the lender but also to the periodic repayment by the borrower. Yet a court of equity should be able to fashion a decree conditioning a borrower's obligation to accept an advance upon its tender by the plaintiff. Furthermore, the difficulty of supervising successive repayments does not, on examination, appear insurmountable; the lender's counsel should be more than happy to furnish periodic reports. One significant problem does exist. In large mortgage transactions, the developer who signs a commitment is usually undertaking construction financed by a loan from another institution. If the borrower breaches his commitment prior to the completion of this work, the lender could find himself in an

On the other hand, although specific performance for the lender might be considered a form of "equitable mortgage," this particular doctrine generally has been limited to the proposition that equity will grant a mortgage after the lender has advanced money where either the legal formalities for imposing a mortgage have not been met or the borrower simply refuses to execute a mortgage in favor of the lender.⁶⁶ In practice then, this doctrine would be valuable only to those rare lenders who had made advances prior to the execution of a mortgage.

One final problem with specific performance is critical. Suppose the breaching borrower moves quickly and not only walks away from his original commitment but actually closes a loan at the lower market rate with another lending institution. Of course, if the second lender induces this breach of contract it is liable in damages to the original lender.⁶⁷ If the second lender knows of the

anomalous situation because the satisfactory termination of construction is usually a condition precedent to his obligation to advance funds and, conversely, to the borrower's obligation to accept them. It is settled law that a party who prevents the occurrence of a condition precedent is answerable in damages, but equity has been reluctant to require a party to perform or complete construction. However, most breaches occur after the construction has been completed, the borrower using the interval to wait for a drop in the market.

⁶⁶ G. OSBORNE, *supra* note 58, at §§ 22-48.

⁶⁷ The essential elements of an inducement cause of action are (1) the existence of a valid contract between the plaintiff and a third party at the time of the defendant's alleged inducement to breach, (2) the defendant's knowledge of that contract, (3) an intentional and unjustified act by the defendant causing the third party to breach that contract, and (4) damage to the plaintiff by the breach. *See* Hornstein v. Podwitz, 254 N.Y. 443, 447-48, 173 N.E. 674, 675 (1930). *See also* Israel v. Wood Dolson Co., 1 N.Y.2d 116, 134 N.E.2d 97, 99, 151 N.Y.S.2d 1, 5 (1956).

The most common form of commitment constitutes a contract to make a mortgage in force between the dates of execution and closing of the loan. R. KRATOVIL, MODERN MORTGAGE LAW AND PRACTICE § 46 (1972). After the closing date has passed, the second lender can run no risk of liability for acts which would normally be considered inducements for breach, for, after that time the first agreement will have expired. *See* Winer v. Glaser, 3 App. Div. 2d 656, 158 N.Y.S.2d 1016 (1st Dep't 1957). Similarly, a recognized breach occurring during the term of the commitment terminates the contractual relationship between the borrower and the bank, thereby exonerating the second lender from inducement liability for conduct occurring after the breach is recognized. Thus, if the borrower communicates a repudiation of his commitment to lender A (*see* Forward Publications, Inc. v. International Pictures, Inc., 277 App. Div. 846, 98 N.Y.S.2d 139 (1st Dep't 1950); RESTATEMENT § 318) prior to the date of performance specified in the commitment, and lender A recognizes this breach by initiating suit for damages against the borrower (*see* Wester v. Casein Co., 206 N.Y. 506, 515, 100 N.E. 488, 491 (1912) (dictum); Mignon v. Tuller Fabrics Corp., 1 App. Div. 2d 174, 176, 148 N.Y.S.2d 605, 607-08 (1st Dep't 1956) (dictum); Plunkett v. Comstock, Cheney Co., 211 App. Div. 737, 741, 208 N.Y.S. 93, 97 (1st Dep't 1925)), lender B can thereafter negotiate with that borrower without concern for inducement liability. However, the lender to which an anticipatory repudiation has been communicated need not recognize the borrower's breach. Rather, the lender may merely

prior commitment at the time it issues its commitment, even though the second lender does not induce the breach of the first commitment, the second lender should not be entitled, based on general equitable principles, to enforcement of its commitment. The second lender may fairly be said to have knowingly assumed the risk that the first commitment might be specifically enforced. Accordingly, the second commitment would not conflict with the specific enforcement of the first in these circumstances. The second commitment presents a greater difficulty, however, when the second lender is unaware of the first commitment at the time it commits. If the innocent second lender relies upon its commitment, to its substantial detriment, while the first lender suffers no substantial detriment, presumably equity would favor the subsequent lender.⁶⁸ Likewise, if the first lender relies upon its commit-

urge performance of the borrower's obligation without waiving the breach (*see* RESTATEMENT § 320; *cf.* N.Y.U.C.C. § 2-610(b) (McKinney 1964)) or may choose to waive the borrower's breach altogether, keeping the contract in force and binding upon both parties. *Hadfield v. Colter*, 188 App. Div. 563, 577, 177 N.Y.S. 382, 390 (1st Dep't 1919). Thus, unless lender *A* brings suit, it may well be impossible to ascertain whether or not the first lender has recognized the borrower's breach. In such a case, if lender *B* engages in conduct constituting an inducement to breach after the borrower's anticipatory repudiation it may be liable to lender *A* in damages if it were later determined that lender *A* considered the agreement to be in full force and effect.

A lender asserting an inducement cause of action against a second lender must establish that the defendant had "actual knowledge" of the existing contract between the plaintiff and its borrower. *Roulette Records, Inc. v. Princess Prod. Corp.*, 15 App. Div. 2d 335, 338, 224 N.Y.S.2d 204, 207 (1st Dep't), *aff'd per curiam*, 12 N.Y.2d 815, 187 N.E.2d 132, 236 N.Y.S.2d 65 (1962). Case law implies, but does not specifically state, that the defendant (lender *B*) must have been aware that the third party (borrower) had contracted with the particular plaintiff (lender *A*)—knowledge that the party induced to breach had an agreement with someone is not enough. *See State Enterprises, Inc. v. Southridge Coop., Inc.*, 18 App. Div. 2d 226, 283 N.Y.S.2d 724 (1st Dep't 1963). *See also Gold Medal Farms, Inc. v. Rutland County Coop. Creamery, Inc.*, 9 App. Div. 2d 473, 195 N.Y.S.2d 179 (3d Dep't 1959). It is clear, however, that, at least when lender *A* and lender *B* are competitors, knowledge of "the detailed terms of the existing contract" is unnecessary (*id.*), and that the belief that a prior contract, subsequently declared valid, was unenforceable is insufficient as an affirmative defense (RESTATEMENT OF TORTS § 766, comment *e* (1938)).

The requirement that knowledge be "actual" has been literally construed. Thus, even though the evidence indicates that a reasonable man *should* have known of the contract (*Roulette Records, Inc. v. Princess Prod. Corp.*, *supra* at 338, 224 N.Y.S.2d at 207) or that the defendant evinced "a deliberate intent to stay in ignorance of what [he] suspect[ed]" (*Id.* at 339, 224 N.Y.S.2d at 209 (Steuer, J., dissenting)), there can be no recovery for inducement to breach. Moreover, the majority's discountenancing of the latter argument in *Roulette Records*, strongly suggests that lender *B* is under no affirmative duty to inquire whether a contract between the borrower and lender *A* is extant. Indeed, this is so even though it is customary within the industry to inquire of the borrower whether he has existing contractual obligations. *See id.* at 338, 224 N.Y.S.2d at 207. For a further discussion of the elements of an inducement claim, *see* RESTATEMENT OF TORTS § 766 (1938).

⁶⁸ *Cf.* 5A A. CORBIN, *supra* note 12, § 1169.

ment to its detriment while the second lender does not, equity would favor the first lender. Finally, if both lenders suffer substantial detriment, or neither suffers any, then some equitable weight should be given to the prior lender.⁶⁹ In any event, to resolve these cases the courts must strike a balance between the inadequacy of legal damages on the one hand and the difficulty and hardship involved in unscrambling the second transaction on the other.

CONCLUSION

The authority may be somewhat diffuse and obscure, but the time is ripe for the courts to reinforce the certainty of large commercial mortgage transactions by specifically enforcing commitments not only against lenders⁷⁰ but against borrowers as well.

⁶⁹ Where a party has contracted with two equally innocent purchasers for the supply of special materials, the fact of priority in time of contracting may be given *some* weight in enabling the earlier contractor to get a decree for specific performance or an injunction. Other factors, however, are entitled to much greater weight than mere priority. If money damages would be a more nearly adequate remedy to one buyer than to the other, this should be decisive as to which should be given specific enforcement.

Id. at 252 (emphasis added).

⁷⁰ See *Leben v. Nassau Sav. & Loan Ass'n*, 40 App. Div. 2d 830, 337 N.Y.S.2d 310 (2d Dep't 1972) (single family dwelling).