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Equitable Relief from the Effect of an Acceleration Clause in a Mortgage

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NOTES AND COMMENT

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EQUITABLE RELIEF FROM THE EFFECT OF AN ACCELERATION CLAUSE IN A MORTGAGE.

It is a trite principle of law that a contract entered into fairly will be enforced according to its terms.[1] The enforcement of an acceleration clause in a mortgage is within the purview of the general rule.[2] The agreement of the parties prevails. Judicial sympathy may not temper the enforcement of the bargain. But here, as elsewhere in the field of jurisprudence, general principles must suffer exceptions. The necessity of fair play has created barriers for warring plaintiffs who, in seeking performance of a contract to its letter, betray justice. The doctrine of *de minimis*[3] has been applied to relieve a party from a technical default. Equity has extended its hand to relieve from penalty[4] and forfeiture,[5] from accident[6] and mistake,[7] and from harsh contracts tainted with oppressive and unconscionable conduct on the part of one party to the agreement.[8] The application of equitable doctrines extends to provisions in mortgages as well as to other contract obligations. Indeed, as Cardozo, *J.*, states:

> "There is no undeviating principle that equity shall enforce the covenants of a mortgage unmoved by an appeal *ad misericordiam,* however urgent or affecting. The development

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[1] 2 Williston, Contracts (1924), sec. 769.

[2] 1 Pomeroy, Equity Jurisprudence (4th ed., 1918), sec. 439: "It is therefore settled by the overwhelming weight of authority that if a certain sum is due and secured by a bond, or bond and mortgage, * * * and is made payable at some future date specified, with interest, * * *" that, "* * * in case default should occur in the prompt payment * * * at the time agreed upon, then the principal sum of the debt should at once become payable, and payment thereof could be enforced by the creditor, such a stipulation is not in the nature of a penalty, but will be sustained in equity."

[3] Gammaway v. Street Improvement District, 164 Ark. 407, 262 S. W. 22 (1924); Blos v. Berritz, 190 Ill. 545, 60 N. E. 883 (1901); Freese v. Blos, 248 Ill. 280, 93 N. E. 745 (1910); Workman v. Worcester, 118 Mass. 168 (1874); Colman v. Shattuck, 62 N. Y. 349 (1875); Douglas v. Mainzer, 40 Hun 75 (N. Y., 1886).

[4] *Supra* Note 2, sec. 433 *et seq.*

[5] *Supra* Note 2, sec. 448 *et seq.*

[6] 2 Pomeroy, *supra* Note 2, sec. 830 *et seq.*

[7] *Ibid.*, sec. 844 *et seq.*

[8] *Supra* Notes 4, 5, 6, 7; Valentine v. Van Wagner, 37 Barb. 60 (N. Y., 1862).

of the jurisdiction of chancery is lined with historic monuments that point another course." [9]

The course of decisions in this state affecting acceleration clauses signified a progressive attitude,[10] harmonious with the general progress of our courts during the past two decades. A recent expression of our highest court seemingly has called a halt to this march forward.

Plaintiffs, as executors of Graf, were the holders of two consolidated mortgages forming a single lien on real property, title of which was in the defendant. The mortgage contained an acceleration clause providing that upon default in any instalment of interest the entire debt would become due and payable. A twenty-day period of grace was also made a part of the agreement. An instalment of interest became due on July 1, 1927. Herstein, president and treasurer of the defendant corporation, had sole authority to sign checks on its behalf. Early in June of 1927 he sailed for Europe. Before his departure, a clerical assistant, who was also nominal secretary of the corporation, computed the interest due July 1, and through an arithmetical error incorrectly calculated it.[11] Herstein signed the check for the erroneous amount. Before the due date the secretary discovered the error and, in her letter of transmittal, informed the defendants, stating that a check for the additional amount would be forwarded on Herstein's return. Herstein returned on July 5th. He was not reminded of the error. Plaintiffs stood by for the twenty-day period and on the twenty-first day elected to declare the principal indebtedness due by instituting foreclosure proceedings. Defendant, the same day, on notice, tendered the amount in default to the plaintiff. Its acceptance was refused. The tender was made good by payment into court. These facts being proved, the trial judge held that

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[9] Graf v. Hope Building Corp., 254 N. Y. 1, 171 N. E. 884 (1930). In the dissenting opinion, written by Cardozo, *J.*, the learned judge sets forth some of the instances in which equitable doctrines have been applied: "Equity declines to treat a mortgage upon realty as a conveyance subject to a condition, but views it as a lien irrespective of its form (Trimm v. Marsh. 5 N. Y. 599). Equity declines to give effect to a covenant, however formal, whereby in the making of a mortgage the mortgagor abjures and surrenders the privilege of redemption (Mooney v. Byrne, 163 N. Y. 86, 93). Equity declines, in the same spirit, to give effect to a covenant, improvident in its terms, for the sale of an inheritance, but compels the buyer to exhibit an involuntary charity if he is found to have taken advantage of the necessities of the seller (Pomeroy, Eq. Jr., sec. 953). Equity declines to give effect to a covenant for liquidated damages if it is so unconscionable in amount as to be equivalent in its substance to a provision for a penalty (Kothe v. Taylor Trust, 280 U. S. 224). One could give many illustrations of the traditional and unchallenged exercise of a like dispensing power. It runs through the whole rubric of accident and mistake. Equity follows the law but not slavishly nor always (Hedges v. Dixon County, 150 U. S. 182, 192). If it did there could never be occasion for the enforcement of equitable doctrine (13 Halsbury, Laws of England, p. 68)."

[10] Noyes v. Anderson, *infra* Note 13; *infra* Note 18.

[11] The interest payments varied from time to time. There was due, on July 1, the sum of $4 617.82. The amount computed was $401.87 short of this amount.

there had been a mere mistake against which equity would relieve by refusing to co-operate with the plaintiff in its effort to enforce the accelerated debt. This conclusion was unanimously affirmed by the Appellate Division. On appeal the lower courts were reversed and a foreclosure decree granted. The prevailing opinion declared that the plaintiff was entitled to the benefit of his bargain and the defendant's omission was not of a nature justifying equitable relief. Cardozo, *J.*, writing the dissenting opinion took an opposite view:

> "Equity declines to intervene at the instance of a suitor who after fostering the default would make the court his ally in endeavoring to turn it to his benefit." [12]

The prevailing opinion is not without authority in this jurisdiction albeit the precedents, with one exception, are not recent expressions of our courts.[13] Reliance on the more recent decisions leads us to a different conclusion. In Noyes v. Anderson,[14] the defendant was in default in payment of taxes which continued for more than a year. The mortgage contained the usual acceleration clause. Immediately upon notification of the default payment was made good. Plaintiff mortgagee insisted upon the exercise of his right to foreclose. The decree was denied, the Court stating:

> "The power of equity in cases properly requiring it, will be exercised to relieve against forfeitures and against penalties. And this is upon the principle of equity jurisprudence that a party having a legal right shall not be permitted to avail himself of it for the purpose of injustice or oppression." [15]

Though a statement was made in the case that the rule set forth above did not apply to interest clauses in mortgages, it is, at best, dictum, and we submit that as a practical proposition there is no substantial difference between default in the payment of taxes and default in the payment of interest except as it becomes a test to gauge the measure of hardship brought on by it. This becomes more convincing when we note a statutory provision placing taxes and interest in the same category in this respect.[16] And too, judicial expressions, following in

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[12] *Supra* Note 9 at 15, 171 N. E. at 889.

[13] Ferris v. Ferris, 28 Barb. 29 (N. Y., 1858); Valentine v. Van Wagner, *supra* Note 8; Noyes v. Clark, 7 Paige 179 (N. Y., 1838); Malcolm v. Allen, 49 N. Y. 448 (1872); Bennett v. Stevenson, 53 N. Y. 508 (1873); Hathorn v. Louis. 52 App. Div. 218. 65 N. Y. Supp. 155 (2nd Dept., 1900), *aff'd* 170 N. Y. 576, 62 N. E. 1099 (1902).

[14] Noyes v. Anderson, 124 N. Y. 175, 26 N. E. 316 (1891).

[15] *Supra* Note 14 at 179, 26 N. E. at 317.

[16] N. Y. Real Property Law, sec. 254.

the light of Noyes v. Anderson,[17] have extended the rule to include default in interest payments.[18]

Somewhat analogous to the instant case are those involving payments on contracts for the sale of real property where the contracts provided that all rights therein should be forfeited upon default in the payment of an instalment.[19] Even where it was stipulated that time was of the essence, a vendee obtained specific performance after a failure to pay the necessary payment at the time stipulated, where it appeared that the default was not willful and the defendant was not injured.[20] Similarly, equity has granted relief from a forfeiture of the terms of a lease wherein it was stipulated that the lease will become absolutely void or that the lessor has the right of re-entry for non-payment of rent.[21] The courts here had no hesitancy in employing an equitable doctrine to establish justice. In the instant case the conduct of the defendant, when viewed in its cumulative significance, should have been sufficient justification for the Court to deny the decree on the ground that it was in the nature of a forfeiture [22] and on the strength of the maxim requiring one who seeks equity to do equity.

No treatment of the problem here presented would be complete without regard to a consideration of the modern trend of juristic pronouncements. It is fair to assume that social and economic conditions and the *mores* of the time play an important part in the decisions of the courts. Abstract justice has been sacrificed so that certainty in the performance of contract obligations may be secure.[23] This is strikingly illustrated in property and commercial transactions where nothing short of punctilious performance will suffice. Side by side with it is the demand for relief where the burden is too imposing; the hardship too overbearing. Common sense and substantial justice may not be waived aside without serious consideration. So in the disposition of a case involving the problem presented here, due regard must be given to the rule adopted and its effect. A rule of law, positive in nature, setting a standard of conduct by which parties to contracts are to be guided, must be one which is fair and one with flexibility to allow for judicial distinction (and not nullification) where it is needed. In the instant case the Court chose to adopt a positive rule.

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[17] *Supra* Note 14.

[18] Verplank v. Godfrey, 42 App. Div. 16, 58 N. Y. Supp. 784 (1st Dept., 1899); Trowbridge v. Malex Realty Corp., 198 App. Div. 656, 191 N. Y. Supp. 97 (1st Dept., 1921); Nove v. Schechter, 218 App. Div. 479, 218 N. Y. Supp. 623 (1st Dept., 1926); Besas v. Slobodoff, 129 Misc. 205, 221 N. Y. Supp. 588 (1927).

[19] John v. McNeal, 167 Mich. 148, 132 N. W. 508 (1911); *In re* Dagenheim Dock Co., L. R. 8, Ch. 1022 (1873).

[20] Richmond v. Robinson, 12 Mich. 193 (1864); Griggs v. Londes, 21 N. J. Eq. 494 (1864).

[21] McKean Nat. Gas Co. v. Wolcott, 254 Pa. 323, 98 Atl. 955 (1916).

[22] Noyes v. Anderson, *supra* Note 14.

[23] Sun Printing & Publishing Co. v. Remington Pulp & Paper Co., 235 N. Y. 338, 139 N. E. 470 (1923).

In the dissent, Cardozo, *J.*, sounds the note of distinction between such a rule and one which denies the exercise of the right to foreclose and leaves open the treatment of cases with analogous circumstances. It seems that a better rule would be the one suggested by Cardozo, *J.* Not only would it have accomplished substantial justice in the instant case but it, as well, would allow for a better analysis of future problems unhampered by a precedent of "certainty of obligation." The fear of the Court in the majority opinion that another conclusion would affect this "certainty" is unfounded. The general rule, oft enunciated, still retains its force. There is a limit, however, beyond which the rule serves no useful purpose and is not consonant with the need intended for its application. The fostering of equitable doctrines and decrees in this jurisdiction is well recognized. And the application of equitable principles in the instant case would have advanced a more just as well as practical rule.

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LIABILITY OF TRUSTEES FOR RETENTION OF SPECULATIVE STOCKS.

Society, in its early stages, was devoid of the complicated rules which, today, govern the ownership, use, and disposition of property. Modernity, assailed as it has been by the intricacies of present-day methods and the demands of constantly changing concepts, has taxed jurisprudence to the limit by its plea that old law should not suffocate new principles. The answer of the courts to this supplication is admirably typified in the law of trusts.

With the popularity of corporate trustees established beyond peradventure of doubt, an exhaustive treatment of their duties and liabilities by an authority is regarded as salutary. Such a treatment was accorded a recent case by Surrogate Slater.[1] A comprehension of its conclusions is interesting.

The action was brought to surcharge the trustee for the retention of highly speculative securities, which had declined greatly in value. Appointed as trustee under a clause in the will, permitting the trustee to continue investments made by the testator, without personal liability for so doing, the trust company qualified in March, 1923. For seven years, the trustee, in spite of the fact that the stocks slowly, but surely, were declining in value, continued to hold them. This it did in the face of knowledge that such stocks were poor trust investments —it having so advised others in a booklet, published for that purpose. The objectors charged the trustee with negligence and a breach of trust duty. The trustee sought protection under the permissive clause in the will, and further attempted to defend its position by pleading

[1] Matter of Clark, 136 Misc. 881, 242 N. Y. Supp. 210 (1930).