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"DUE-ON" CLAUSES: A TREND TOWARD EQUITABLE ENFORCEMENT

*James D. Hill**

Contemporary lenders presently utilize at least two types of clauses in a security instrument (mortgage or deed of trust) to generate additional income. Due-on-sale clauses accelerate the balance of the obligation upon the sale or transfer of the subject property,[1] and due-on-encumbrance clauses accelerate the balance of the obligation upon the placing of an additional burden or encumbrance on the property. Such acceleration allows adjustment of interest to current rates whenever encumbered property is sold. In a second type of clause, prepayment penalty, lenders charge a penalty for early payment of a loan prior to its maturity date. Because of these kinds of limitations on the mortgagor, it can be said that these provisions are restraints on alienation, although permissible ones in most jurisdictions.

California courts and other courts across the country have had difficulty balancing the need for acceleration clauses in an inflationary economy with the traditional prohibition against restraints on alienation. This article analyzes the cases which have dealt with acceleration clauses and the solutions which have been formulated.

I. Historical Background

Restraints on alienation of land were imposed at common law by feudal lords with appropriate sanctions such as forfeiture or fine imposed for violation.[2] While land was held tenurially and feudal incidents were due the lords, harsh penalties were needed to preserve the land in the hands of those familiar to the lords and, even more important, to prevent lands upon which the lords were dependent from falling into the hands of strangers or enemies. Certain transfers were absolutely prohibited, while other alienations of the fee were permitted, but only after payment of a fine to the lord.[3]

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1. Berhardt, *The Obligation* in J. Hetland, California Real Estate Secured Transactions 182 (1970) suggests the following model due-on-sale clause:

> In the event the herein described property or any part thereof, or any interest therein, is sold, agreed to be sold, conveyed or alienated by the trustor, or by the operation of law or otherwise, all obligations secured by this instrument, irrespective of the maturity dates expressed therein, at the option of the holder thereof, and without demand or notice shall immediately become due and payable.

2. A. Casner & W. Leach, Cases and Text on Property 227 (2d ed. 1969).
3. C. Moynihan, Introduction to the Law of Real Property 21 (1962).

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A present day restraint on the transfer of encumbered land, imposed by a lender, is not unlike the restraint imposed by feudal lords who retained an interest in the land which for practical purposes served as security for the satisfaction of an obligation, although not a debt in the modern sense of the word. The oath of fealty has been replaced today by the financial statement and credit application; however, the desire to maintain the stability of the lord's relationship to the one obligated remains unchanged. Just as the lords were concerned about the performance of feudal incidents, so are modern lenders concerned that the payment of the debt be made promptly and that waste not be allowed to occur on the encumbered land.

In feudal times restraints on alienation, however, became repugnant to the concept of fee simple. In 1290 the Statute Quia Emptores was enacted bringing about a drastic change in the law regarding transfer of land. This statute allowed "freemen" to transfer land without payment of a fine to their lords and was the first step in disallowing restraints on alienation. While it has been urged that repugnancy alone is not sufficient to forbid restraints,[4] the rule against restraints on alienation continues to exist today. Exceptions to the rule prohibiting restraints have so eroded the rule, however, that the precise status of restraints in particular circumstances may be impossible to determine. Justification for a restraint may occur, according to the *Restatement of Property*, due either to its social utility or because it is insignificant.[5]

Because they may be considered restraints on alienation, acceleration clauses[6] have not been used frequently until relatively recent times. An 1823 Louisiana case provides the earliest mention of a sanction imposed upon mortgagors in the United States.[7] It involved a doctrine known as the *pact de non alienando.* While there has been

4. Manning, *The Development of Restraints on Alienation Since Gray,* 48 HARV. L. REV. 373, 402 (1935).

5. RESTATEMENT OF PROPERTY § 410, comment a (1944) provides:

Restraints on the alienation of property interests are justified if the objectives behind the imposition of the restraint are sufficiently important to outweigh the social evils which flow from the enforcement of the restraint or if the interference with the power of alienation is so insignificant that no appreciable harm results from the enforcement of the restraint.

6. Today, a typical acceleration clause will include both due-on-sale and due-on-encumbrance provisions: "Should Trustor sell, convey, transfer, dispose of or further encumber said property or any part thereof,. . . without the written consent of Beneficiary being first obtained, then Beneficiary shall have the right, at its option, to declare all sums secured hereby forthwide due and payable." LaSala v. Am. Sav. & Loan Ass'n, 5 Cal. 3d 864, 869, 489 P.2d 1113, 1115, 97 Cal. Rptr. 849, 851 (1971).

7. Nathan v. Lee, 2 Mart (N.S.) 32 (La. 1823).

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some commentary on this doctrine,[8] it does not appear to have been used outside Louisiana.[9]

II. Prepayment Penalties

One kind of restraint clause used today by institutional lenders is the prepayment penalty. It is analogous to the common law fine levied in order to obtain the consent of the feudal lord to convey the property. Institutional lenders are limited in the amount of prepayment penalty they can charge: the typical penalty is six months' unearned interest on prepayments in excess of twenty percent of the original principal balance paid in any calendar year.[10]

Prepayment cases are rare. To the extent that it has considered the issue, the California Courts of Appeals have approved the prepayment penalty as a permissible restraint on alienation. In one case, *Lazzareschi Investment Company v. San Francisco Federal Savings and Loan Association,*[11] the court compared the prepayment penalty to the due-on-sale clause:

> [I]t has been held that reasonable restraints made in protection of justifiable interest of the parties are sustainable. (Coast Bank v. Minderhout, 61 Cal.2d 311, 316-317 . . .) The *Coast Bank* case involved a due-on-sale provision, but it was pointed out in the opinion that several other kinds of restraints on alienation are recognized as lawful. The prepayment charge by no means constitutes an absolute restraint and because we do not regard it as an exorbitant burden, . . . and because there are legitimate interests of the lender to be protected, . . . we do not discern any unlawful restraint on alienation.[12]

It is obvious that a lender's right to refuse to approve a transfer of property or to accelerate payment on sale of property or to collect a prepayment penalty is a power which may be abused. One state has taken steps to avoid potential abuse. The New York legislature in 1972 enacted a statute which prohibits a lender from collecting a prepayment penalty when it refused to consent to the transfer of

8. Comment, *The Pact de Non Alienando in Louisiana,* 21 Tul. L. Rev. 238 (1946).

9. The *pact de non alienando,* when included in a mortgage allowed a mortgagee to proceed against a mortgagor without notice to subsequent purchasers who did not assume the mortgage. *Pact de non alienando* differs from the typical due-on-sale clause in that it is used against defaulting mortgagors to protect the lender's security. It is not a direct result of merely a sale of the encumbered property. The use of *pact de non alienando* became common as a means of avoiding the technicalities of Louisiana's complicated hypothecary actions. Its use is comparable to non-judicial foreclosure in common law jurisdictions.

10. 12 C.F.R. § 545.6-12(b) (1976).

11. 22 Cal. App. 3d 303 (1971).

12. *Id.* at 311.

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property encumbered with a mortgage containing a due-on-sale clause.[13] The constitutionality of this statute was upheld in *Rogers v. Williamsburgh Savings Bank.*[14] The court found justification for the statute in the soaring cost of housing and high mortgage interest rates.

Not all courts have been as sympathetic as the *Rogers* court toward the small borrower. Typically, courts have based their decisions on the lender's justifiable interests.[15] The Colorado Supreme Court, quoting the affidavit of a savings and loan institution vice-president, has presented most concisely the fundamental basis for the existence of due-on-sale clauses, other than for the protection of the lender's security:

> The two primary ways that [an institutional lender] may make the interest rate adjustments essential for it to protect the depositors against inflation are by making variable interest rate loans or by employing a "due-on-sale" clause to adjust interest rates on assumptions of existing loans where circumstances warrant an adjustment. . . . The variable interest rate option may reflect the trend in the industry, but the due-on-sale provision is probably the most advantageous to the borrowing public.[16]

While this author would disagree that due-on-sale clauses are advantageous to the borrowing public, it is apparent that they are used to the lender's advantage to adjust interest rates in an inflationary economy.

III. THE *Coast Bank* DECISION

The earliest appellate decision to consider a clause permitting acceleration upon transfer of the subject property occurred in California in 1964. That case, *Coast Bank v. Minderhout,*[17] became the leading case in the United States and continues so today. While *Coast Bank* has been followed in several jurisdictions[18] as authority for the proposition that a lender could accelerate the due date of an obligation, the case did not arise out of a conventional mortgage or

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13. N.Y. REAL PROP. LAW § 254-a (McKinney Supp. 1976-77).

14. 79 Misc. 2d 852, 361 N.Y.S.2d 531 (Dist. Ct. 1974).

15. *See, e.g.,* Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

16. Malouff v. Midland Fed. Sav. and Loan Ass'n, 181 Colo. 294, 302, 509 P.2d 1240, 1244 (1973).

17. 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

18. Malouff v. Midland Fed. Sav. and Loan Ass'n, 181 Colo. 294, 509 P.2d 1240 (1973); Baker v. Loves Park Sav. and Loan Ass'n, 21 Ill. App. 3d 42, 314 N.E.2d 306 (1974), *modified,* 61 Ill. 2d 119, 333 N.E.2d 1 (1975); People's Sav. Ass'n v. Standard Industries, Inc., 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970).

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deed of trust utilizing a due-on-sale clause. Rather, *Coast Bank* involved an equitable mortgage on certain real property created by the recordation of a document entitled "An Agreement Not to Encumber or Transfer Property." Similar documents had been held not to create security interests in several other jurisdictions at that time.[19] The type of instrument in *Coast Bank* was commonly used in California where certain lenders are prohibited from lending funds which would create a junior lien.[20] By utilizing "An Agreement Not to Encumber or Transfer Property" rather than a conventional deed of trust, California lenders are able to place loans which could be construed as either a secured interest or an unsecured interest so as not to violate the prohibition against a junior security. The advantage to the lender in such a situation is obvious. In the event of a foreclosure by the senior lienor on the property in question or in the event the subject property appears overencumbered, the lender holding the "Agreement Not to Encumber or Transfer Property" may treat the debt as unsecured; and in the event of a bankruptcy by the mortgagor, the junior lender may treat the debt as secured, although in a junior position.[21] The supreme court in *Coast Bank* found that the provisions of the instrument afforded some indication that the parties intended to create a security interest in the property and allowed foreclosure of the equitable mortgage.[22] While *Coast Bank* did not present a clear-cut case involving a due-on-sale clause,[23] it did allow the court to consider the issue of whether such an instrument created an unlawful restraint on alienation. The court mentioned several justifiable and reasonable restraints on alienation which have been permitted: spendthrift trusts, leases for a term of years terminable upon alienation, life estates terminable upon alienation, corporate restrictions on transfers of shares, and restraints on alienation in executory land contracts.[24] The court held:

> In the present case it was not unreasonable for plaintiff [Coast

19. B. Kuppenheimer & Co. v. Mornin, 78 F.2d 261 (8th Cir.), *cert. denied*, 296 U.S. 615 (1935); Fisher v. Safe Harbor Realty Co., 38 Del. Ch. 297, 150 A.2d 617 (1959); Western States Finance Co. v. Ruff, 108 Ore. 442, 215 P. 501 (1923); Knott v. Shepherdstown Mfg. Co., 30 W. Va. 790, 5 S.E. 266 (1888).

20. CAL. CIV. CODE § 711 (West).

21. The ambiguous status of the instrument in *Coast Bank* was not entirely clarified due to the fact that the defendants' demurrer was overruled and judgment entered subsequent to defendants' failure to answer.

22. 61 Cal. 2d at 315, 392 P.2d at 267, 38 Cal. Rptr. at 507.

23. The case was not clear-cut because it involved an equitable mortgage rather than a standard mortgage or deed of trust.

24. 61 Cal. 2d at 316-17, 392 P.2d at 268, 38 Cal. Rptr. at 508.

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> Bank] to condition its continued extention of credit to the Enrights on their interest in the property that stood as security for the debt. Accordingly, plaintiff validly provided that it might accelerate the due date if the Engrights encumbered or transfered the property.[25]

The language of Justice Traynor, who wrote the decision, is significant. He did *not* determine that due-on-sale clauses were reasonable; instead, he held simply that requiring the borrower's retention of an interest in the subject property was "not unreasonable." Subsequent decisions interpreting *Coast Bank*, however, have assumed that the case provided blanket approval for the use of due-on-sale clauses.[26]

IV. California Cases Following *Coast Bank*

Following *Coast Bank*, the California Courts of Appeals considered three cases involving due-on-sale or due-on-encumbrance clauses.[27] In all three decisions, the courts, relying on *Coast Bank*, simply assumed (incorrectly in light of more recent decisions) the universal validity of these clauses in California.[28]

In 1971 in *LaSala v. American Savings and Loan Association*,[29] the California Supreme Court reviewed a decision in which a clause provided for acceleration upon either sale or further encumbrance.

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25. *Id.* at 317, 392 P.2d at 268, 38 Cal. Rptr. at 508 (emphasis added).

26. *See* cases cited note 18 *supra*. Other authors feel that Justice Traynor was announcing a rule giving blanket approval to due-on-sale clauses. *See* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 Iowa L. Rev. 747, 774 (1973). *See also* Hetland, *Real Property and Real Property Security: The Well Being of the Law*, 53 Calif. L. Rev. 151, 171 (1965).

27. Hellbaum v. Lytton Sav. and Loan Ass'n, 274 Cal. App. 2d 456, 79 Cal. Rptr. 9 (1969); Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969), *overruled sub nom.* Tucker v. Lassen Sav. and Loan Ass'n, 12 Cal. 3d 629, 640, 526 P.2d 1169, 1176, 116 Cal. Rptr. 633, 640 (1974); and Jones v. Sacramento Sav. Ass'n, 248 Cal. App. 2d 522 (1967).

28. In Hellbaum v. Lytton Sav. and Loan Ass'n, 274 Cal. App. 2d 456, 458, 79 Cal. Rptr. 9, 11 (1969), the court held:

> It is settled that an agreement not to encumber or transfer property, exacted by a lender to protect his security interest, is not an invalid restraint on alienation. That is so because the restraint is reasonably designed to protect the creditor's justifiable interest in maintaining the direct responsibility of the parties on whose credit the loan was made. (Coast Bank v. Minderhout).

274 Cal. App. 2d at 458, 79 Cal. Rptr. at 11.

In Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969), the plaintiff paid an assumption fee and was subjected to higher interest. The court held that the sale to plaintiff enabled the savings and loan association to charge the assumption fee and the higher rate of interest as consideration for its forebearance in not enforcing the due-on-sale clause. However, *Cherry* was overruled by Tucker v. Lassen Sav. and Loan Ass'n, 12 Cal. 3d 629, 640, 526 P.2d 1169, 1176, 116 Cal. Rptr. 633, 640 (1974).

29. 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

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A further encumbrance was placed on the subject property by the mortgagor, and defendant American Savings and Loan Association invoked the acceleration clause. A class action challenging the validity of the due-on-encumbrance clause was commenced. American offered to waive the right to accelerate, and the trial court dismissed the action.

The California Supreme Court applied a rule of reasonableness on the due-on-encumbrance clause and refused to allow the lender to exercise an uncontrolled power with respect to the clause.

> In those few instances previously discussed, in which the enforcement of that provision the due-on-encumbrace clause is reasonably necessary to avert danger to the lender's security, the restraint on alienation remains lawful under the principles established in *Coast Bank* v. *Minderhout* (1964) 61 Cal.2d 311, 317. . . . When such enforcement is not reasonably necessary to protect the security, the lender's use of the clause to exact collateral benefits must be held an unlawful restraint on alienation.[30]

The court continued, distinguishing between due-on-sale and due-on-encumbrance clauses:

> Following our ruling upholding reasonable restraints on alienation, we have distinguished the due-on-sale from the due-on-encumbrace clauses; we have concluded that the lender may insist upon the automatic performance of the due-on-sale clause because such a provision is necessary to the lender's security. We have decided, however, that the power lodged in the lender by the due-on-encumbrance clause can claim no such mechanical justification. We sustain it only in the case of the trial court's finding that it is reasonably necessary to the protection of the lender's security; to repose an absolute power in the creditor to enforce the clause under any and all circumstances could lead to an abusive application of it and in some cases an arbitrary exaction of a *quid pro quo* from debtors.[31]

The above quotations illustrate this author's contention that the courts, including the California Supreme Court, assumed a virtually universal validity of the due-on-sale clause. The supreme court applied a rule of reasonableness to the enforcement of due-on-encumbrance clauses where the lender's security is jeopardized. Justice Traynor, the author of the *Coast Bank* decision, was no longer sitting on the California Supreme Court when the *LaSala* opinion was handed down. It would appear that the California Supreme Court, as the lower courts had done before it, had in *LaSala*

30. *Id.* at 882, 489 P.2d at 1124-25, 97 Cal. Rptr. at 860-61.

31. *Id.* at 883-84, 489 P.2d at 1126, 97 Cal. Rptr. at 862.

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extended the scope of *Coast Bank* and had given the rule promulgated in Traynor's opinion a broader interpretation than Traynor would have intended.

V. *Coast Bank* in the Decisions of Other Jurisdictions

In the decade following *Coast Bank,* several other jurisdictions encountered the classic mortgage due-on-sale clause. Those courts which relied on *Coast Bank* misinterpreted its scope as the California courts had done—citing it for the general, but erroneous, proposition that due-on-sale clauses are universally valid.

People's Savings Association v. Standard Industries, Inc.[32] involved a mortgage containing a clause accelerating the entire principal, at the option of the lender, upon "any change in ownership of the premises covered by this mortgage."[33] The validity of this clause was challenged in a judicial foreclosure proceeding. The court held that "a significant element in the mortgage contract is the mortgagor himself, his financial responsibility and his personal attitudes."[34] In so holding, the court relied on a section from *Ohio Jurisprudence Second*[35] which dealt with acceleration upon default but not specifically with due-on-sale clauses. In support of its holding, the court also cited the case of *Nixon v. Buckeye Building and Loan Company,*[36] which likewise did not deal with due-on-sale acceleration clauses. The Ohio court further cited *Coast Bank,* stating: "Justice Traynor, in a thorough opinion, held that a similar provision is a reasonable restraint designed to protect justifiable interests of the parties."[37] The interpretation by the Ohio Court of Appeals failed to distinguish between the reasonableness of due-on-sale clauses in general and the reasonableness of *Coast Bank's* position in particular.

The Colorado Supreme Court in *Malouff v. Midland Federal Savings and Loan Association*[38] relied on both *Coast Bank* and *People's Savings Association.* The court stated the law concisely and accurately in its holding: "We subscribe to the view that the question of the invalidity of the restraint depends upon its reasonableness in view of the justifiable interests of the parties."[39] The

32. 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970).
33. *Id.* at 36, 257 N.E.2d at 406.
34. *Id.* at 38, 257 N.E.2d at 407-08.
35. 37 Ohio Jur. 2d *Mortgages* § 80 (1959).
36. 18 Ohio L. Abs. 261 (App. 1934).
37. 22 Ohio App. 2d at 38, 257 N.E.2d at 407.
38. 181 Colo. 294, 509 P.2d 1240 (1973).
39. *Id.* at 300, 509 P.2d at 1243.

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Colorado court, however, misinterpreted the import of *Coast Bank* when it stated: "*Coast Bank*, . . . considered a landmark decision in the area of due-on-sale clauses, upheld generally the validity of such a clause and in effect rejected the view that such a clause in a security instrument is per se an invalid restraint."[40]

The effect of the above cases was carried further in *Baker v. Loves Park Savings and Loan Association*.[41] The case was one of first impression in Illinois and the intermediate appellate court said: "Other jurisdictions, under varying rationale, have held that it was reasonble for a lender to condition a continued extension of credit upon the basis that the borrower retain his interest in property securing the debt,"[42] citing *Malouff* and *People's Savings Association*. The Illinois Supreme Court, in affirming the decision of the intermediate appellate court, rejected any rule of reasonableness and said: "[T]he valid and accepted purpose sought to be achieved by the restraint in this mortgage, that is, the protection of the lender's security interest, must determine the validity of the restraint and not the circumstances of each particular case. See Coast Bank v. Minderhout."[43]

While Colorado, Illinois, and Ohio were relying upon *Coast Bank*, New Jersey,[44] Utah,[45] and Tennessee[46] cases involving due-on-sale clauses were decided without reference to *Coast Bank*.

In *Shalit v. Investors Savings and Loan Association*,[47] the plaintiff had paid a fee in excess of $14,000 in return for a waiver by the savings and loan association of its rights to accelerate payment upon the change of ownership of the mortgaged property. Plaintiff sued for return of the fee. The court used duress and usury as the basis of its decision, and it made no mention of restraints on alienation. The court concluded that the savings and loan association had a right to receive payment of money in exchange for waiving its acceleration of the obligation. Reasonableness was not considered, but the court stated that the right to payment in exchange for waiver was "at least incidental and necessary to the business of the savings and loan association and the attainment of its purpose as such."[48]

40. *Id.*
41. 61 Ill. 2d 119, 333 N.E.2d 1 (1975).
42. 21 Ill. App. 3d 42, 45, 314 N.E.2d 306, 309 (1974).
43. 61 Ill. 2d at 126, 333 N.E.2d at 5.
44. Shalit v. Investors Sav. and Loan Ass'n, 101 N.J. Super. 283, 244 A.2d 151 (1968).
45. Walker Bank & Trust Co. v. Neilson, 26 Utah 2d 383, 490 P.2d 328 (1971).
46. Gunther v. White, 489 S.W. 2d 529 (Tenn. 1973).
47. 101 N.J. Super. 283, 244 A.2d 151 (1968).
48. *Id.* at 000, 244 A.2d at 151.

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A Tennessee case, *Gunther v. White,*[49] sought to restrain a lender from enforcing an acceleration clause triggerd by the conveyance of the subject property. The court considered the validity of such a clause in light of the lender's admitted motive for accelerating—a desire to increase the rate of interest on the funds loaned. The court's holding may be interpreted to validate any due-on-sale clause unless the clause was unconscionable:

> It is generally accepted that a court of equity has the power to relieve a mortgagor from the effect of an operative acceleration clause in a mortgage where the condition of making the option operative is the result of some *unconscionable* or *inequitable* conduct of the mortgagee. . . .
>
> No case has been found, however, which holds that the exercise of the option to gain the benefit of the current interest rate falls into these categories. And, upon reflection, we can think of no reason why such exercise should be characterized as either unconscionable or inequitable.[50]

The *Gunther* case makes no mention of *Coast Bank* but cites *People's Savings Association* and cases subsequent to *Coast Bank.*[51]

Walker Bank & Trust Company v. Neilson[52] is the first case in which foreclosure was not permitted, although the acceleration clause at issue was not held void. The case, however, offers little clarification as to the status of due-on-sale clauses in Utah. The Supreme Court of Utah refused to reverse the trial court's holding that an acceleration clause was void as against public policy; the trial court's conclusion was held to be harmless error. The foreclosure was disallowed, however, since the delinquent payments had been tendered through the clerk of courts.

Some jurisdictions have treated due-on-sale clauses differently than California and those states which interpreted *Coast Bank* as blanket authority for the validity of such clauses. Wisconsin,[53] Ari-

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49. 489 S.W.2d 529 (Tenn. 1973).

50. *Id.* at 531 (emphasis in original).

51. Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969), *overruled sub nom.* Tucker v. Lassen Sav. and Loan Ass'n, 12 Cal. 3d 629, 527 P.2d 1169, 116 Cal. Rptr. 633 (1974); LaSala v. Am. Sav. & Loan Ass'n, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

52. 26 Utah 383, 490 P.2d 328 (1971).

53. Mutual Fed. Sav. and Loan Ass'n v. Wisconsin Wire Works, 58 Wis. 2d 112, 205 N.W.2d 762 (1973). The Wisconsin court held:

> We find nothing unreasonable in respect to the clause that accelerates the payment of the entire balance upon a conveyance without the consent of the mortgagee. Whether, under the circumstances, the invocation of the condition is in accord with

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zona,[54] and Florida[55] backed away from a strict enforcement of due-on-sale clauses.

Beginning in 1970 a line of cases developed in Florida which took a more subjective look at the facts of each case in determining whether to allow foreclosure based solely on unauthorized transfer. *Clark v. Lachenmeier*[56] presented an almost perfect set of circumstances for a court to utilize its equitable power to refuse to allow foreclosure. The due-on-sale clause in *Lachenmeier* was not a typical one in that it did not automatically accelerate upon transfer of the subject property; rather it required that the mortgagee receive notice of any transfer and reserved the right to approve or disapprove the credit standing of the proposed transferee. A foreclosure action was brought following a transfer made without notice to the mortgagee and without the required approval. There was no allegation that the mortgagee's security had been impaired by the transfer. The lower court dismissed the complaint, and the Florida Court of Appeals affirmed, stating:

> The Florida decisions recognize the right of a mortgagee to accelerate upon default of conditions directed to the preservation of the security, such as the payment of interest, installments of principal, taxes and insurance "because an investor may very properly insist that his security shall be kept intact or that the loan shall mature."
>
> . . .
>
> A Court of equity may refuse to foreclose a mortgage when an acceleration of the due date would render the acceleration unconscionable and the result would be inequitable and unjust.[57]

The Florida court recognized that acceleration upon breach of a condition of the mortgage was permissible but was not universally mandatory.

Subsequently, the Florida Court of Appeals considered a more

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equitable principles must abide further factual determinations and decision by the trial judge.

58 Wis. 2d at 112, 205 N.W.2d 762 at 770.

54. Baltimore Life Ins. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *petition for review denied*, 108 Ariz. 192, 494 P.2d 1322 (1972). Although the court allowed acceleration clauses as part of a mortgage transaction, it refused to enforce them across the board: "it is not enough to allege merely that the acceleration clause has been violated. Absent an allegation that the purpose of the clause is in some respect being circumvented or that the mortgagee's security is jeopardized, a plaintiff cannot be entitled to equitable relief." 15 Ariz. App. at 00, 486 P.2d at 193.

55. Clark v. Lachenmeier, 237 So. 2d 583 (Fla. App. 1970); Stockman v. Burke, 305 So. 2d 89 (Fla. App. 1974).

56. 237 So. 2d 583 (Fla. App. 1970).

57. *Id.* at 584.

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typical due-on-sale clause. In *Stockman v. Burke*[58] the court allowed the foreclosure, indicating that there was no basis upon which to nullify the provision for payment upon resale of the property. However, the court, citing *Clark v. Lachenmeier,* left undecided the question of strict enforcement of a due-on-sale clause: "We leave open until another day the question of whether a mortgage with a similar provision can be accelerated and foreclosed upon the sale of the property without a showing that the mortgagee has been prejudiced by reason of the conveyance to the new owner."[59] Although the result in *Stockman* is consistent with *Clark v. Lachenmeier,* there is no mention in *Stockman* of any breach other than a sale of the subject property, nor is there any allegation that the mortgagee was in any way prejudiced by the transfer. From the court's comment quoted above, however, it is possible to assume that there must have been some evidence of prejudice to the mortgagee as a result of the transfer. What is prejudicial to the mortgagee or jeopardized the security is a subjective matter of fact to be determined by the trial court.

Reading these two Florida decisions together, it appears that Florida has reached a solution to the problem of enforcing due-on-sale clauses; that is, each transaction will be viewed on a case-by-case basis giving consideration to whether enforcement will produce an inequitable or unjust result.

VI. The *Tucker* Decision

In its decision in *Tucker v. Lassen Savings and Loan Association,*[60] the California Supreme Court appeared to be reaching the same practical solution with respect to due-on-sale clauses that the Florida courts had reached several years earlier. The *Tucker* decision shows a willingness to consider the enforcement of due-on-sale clauses on a case-by-case basis rather than giving such clauses the blanket approval that *Coast Bank* was thought to provide. This author believes that *Tucker* was not a departure from Justice Traynor's logic in *Coast Bank* but rather was a proper application of the rule that, in the narrow circumstances of *Coast Bank,* the lender was justified in imposing a restraint on alienation by means of a type of due-on-sale instrument.

The importance of *Tucker* is twofold: first, it indicates that subjective criteria would be used to determine whether to allow

58. 305 So. 2d 89 (Fla. App. 1974).
59. *Id.* at 90.
60. 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

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enforcement of due-on-sale clauses; secondly, it advances the possibility that the decision in the case might be applied in cases with different facts.

Tucker did not involve the usual conveyance by deed; rather, it concerned an installment contract. The contract, until paid in full left title but not possession in the vendor. The deed of trust provided for acceleration if the borrower should " 'sell, convey or alienate the property . . . or any part thereof, or any interest therein.' "[61] There should be no question that the execution of a land installment contract which provides for transfer of possession and ultimately, transfer of record title, is in fact the conveyance of an interest in the subject property. The court considered the factual differences between a transfer by deed and conveyance of equitable interest by an installment land contract, and concluded that the vendor-obligor had a considerable interest in maintaining the property until the total proceeds under the contract were received.[62] The court did not permit the automatic enforcement of the due-on-sale clause when the only basis for acceleration was the conveyance of an equitable interest by the installment land contract. Although one author has argued persuasively that the court's reasoning was fallacious because the vendor's interest in the subject property diminished as the balance due the vendor decreased,[63] the California court's logic was that the vendor in a land installment contract would continue to have concern for the maintenance of the property until the entire purchase price was paid.[64] Even though the vendor's interest would diminish as payments were made, the lender still must look to the subject property, regardless of the proportion of the balance due. In this respect the vendor under an installment land contract is no different from the typical mortgagee.

The court in *Tucker*, in considering the difference between what it called an outright sale and an installment sale,[65] commented that the vendor in the former transaction usually sells for cash and has the funds available to pay off the existing encumbrance. In the typical installment sale, on the other hand, the vendor receives a low down payment and retains legal title. Although the court observed the financial differences between these transactions, it overlooked a third possibility or middle position: an outright sale in

61. *Id.* at 632, 526 P.2d at 1170, 116 Cal. Rptr. at 634.
62. *Id.* at 638, 526 P.2d at 1174-75, 116 Cal. Rptr. at 638.
63. Ashley, *Use of "Due-On" Clauses to Gain Collateral Benefits: A Common Sense Defense*, 10 U. TULSA L.J. 590, 602 (1975).
64. 12 Cal. 3d at 638, 526 P.2d at 1174-75, 116 Cal. Rptr. at 638-39.
65. *Id.* at 637, 625 P.2d at 1174, 116 Cal. Rptr. at 638.

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which the vendor carries back a second mortgage for a substantial portion of the purchase price. In that case the vendor would receive a low down payment and would continue to maintain an interest in the subject property since it is to that security that he must look in the event of default. How does this third alternative differ from an installment contract? This author is of the opinion that it is a matter of form rather than of substance. By failing to consider this third possibility, the court left the door open to new litigation concerning the right of a lender to accelerate the balance upon sale if the lender's security is not truly jeopardized by the transfer. If a vendor-mortgagor could show that the security was not impaired and that the vendor continued to maintain an interest in the property, would it be reasonable for a senior lienor to accelerate its balance based solely upon the transfer? If the courts were to follow the logic of both *Coast Bank* and *Tucker,* they could find such acceleration unreasonable and could therefore prevent foreclosure by a senior lienor.

The potential for resolution of any conflict between *Coast Bank* and *Tucker* as to the enforcement of due-on-sale clauses now exists since there are presently before the California Supreme Court two cases whose holdings are contradictory on the point.[66] In *Demey v. JouJon-Roche*[67] a sale of encumbered property was frustrated when the mortgagees announced their intent to exercise the due-on-sale clause. When the pending sale collapsed, the mortgagor stopped making payments on the debt. Foreclosure followed causing the mortgagor to lose the property. Suit was filed for the damages resulting from the loss of the sale of the property. Judgment was entered for the plaintiff and affirmed by the court of appeals. The proposed sale, which prompted the foreclosure and ultimate litigation, called for the vendees to take title subject to defendant's existing first deed of trust and further subject to a purchase money second mortgage in favor of plaintiffs. This fact situation is the "middle" position alluded to above[68] which the court in *Tucker* failed to consider. The *Demey* transaction, although in form an outright sale, was very similar to an installment contract (which was the subject of *Tucker).* The decision in *Demey* appears to follow the philosophy of *Tucker,* relying on the substance of the transaction

66. Demey v. JouJon-Roche, 63 Cal. App. 3d 178 (1976); Medovi v. Am. Sav. and Loan Ass'n, 62 Cal. App. 3d 317 (1976). Petition for hearing was granted by the California Supreme Court as to both cases on January 5, 1977. The authority on which both cases relied was Tucker v. Lassen Sav. and Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

67. 63 Cal. App. 3d 178 (1976).

68. *See* discussion at p. 000 *supra.*

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rather than its form, for the court states: "In *Tucker* v. *Lassen Savings and Loan Association* . . . the Supreme Court considered the validity of such clauses in cases where, *as here,* the proposed resale was by way of an installment land purchase with the original buyer remaining liable on the original trust deed note."[69] The court in *Demey* also points out that the land in question was unimproved desert land not subject to waste and that vendor-mortgagors still retained a substantial interest in the property involved.[70]

Notwithstanding the court's categorization of the sale in *Demey* as an installment land purchase, it is not the typical installment sale where title remains in the vendor until the purchase price is entirely paid. However, the fact that the purchase price was not to be paid in cash left the vendors in virtually the same position as if the property was to be sold by way of an installment contract; the vendors retained an interest in the land even though both title and possession were to pass to the vendees. The court based its reliance on Tucker in the fact that it found the substance of the transactions to be similar although the form was different.

The decision in *Medovi v. American Savings and Loan Association*[71] is much less compelling. There, the holder of a second deed of trust had accepted a deed in lieu of foreclosure from a mortgagor in default. Subsequently the property was transferred to a new buyer. The holder of the senior lien, *American Savings and Loan Association,* gave notice of exercise on the due-on-sale clause. When the balance was not paid in full, foreclosure was commenced with the savings and loan association collecting rents from the six unit appartment house on the property under a rents and profits clause. Ultimately the property was lost in foreclosure, and an action for wrongful foreclosure was commenced. In affirming the judgment for *American Savings and Loan Association,* the court of appeals relied on *Tucker*, noting the distinction in that decision between installment sales and outright sales.[72] The court in *Medovi* appears to assume that enforcement of due-on-sale clauses is automatic in an outright sale but permitted in a land installment sale only when there is a showing that the lender's security is in jeopardy, and *Tucker* is cited for that proposition.[73]

The conflict between *Demey* and *Medovi* obviously arises from differing interpretations of *Tucker, Medovi* basing its reliance on

69. 63 Cal. App. 3d at 182 (emphasis added).
70. *Id.*
71. 62 Cal. App. 3d 317 (1976).
72. *Id.* at 331.
73. *Id.* at 330-31.

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form and *Demey* on substance. The California Supreme Court now has the task of resolving the conflict between these two decisions.

VII. Conclusion

If the Florida cases[74] and *Tucker*[75] signal a trend on the part of the courts to look to subjective criteria in determining the enforceability of due-on-sale clauses, lenders will no longer be able to protect their security or increase the interest rates at every sale. Alternatives to due-on-sale clauses must therefore be considered. One author has suggested that lenders increase interest rates but allow the periodic payments to remain the same as under the lower rate by extending the term of the loan.[76] Another has proposed variable interest rates.[77] If enforcement of due-on-sale becomes less predictable, lenders may resort to shorter term loans with balloon payments at the end of the term. This would allow the lender to keep the payments at the same level as those of longer term financing but would assure readjustment of the interest rate at the end of the short term. This could be considered simply a variation of variable interest rates.

It is apparent that enforcement of due-on-sale clauses is no longer as simple as it once was immediately after *Coast Bank.* Strict enforcement has been avoided by some states. California, where the issue was first litigated, now appears likely to adopt strictly equitable, subjective criteria for enforcement.

The economic impact of case-by-case enforcement is almost incalculable. Lenders whose assets are long term and whose liabilities are short term will be in an extremely difficult situation without this readily available means of adjusting interest rates upward. Notwithstanding this fact, it appears that most courts will take a position which will not permit universal enforcement without regard to the safety of the security. The current judicial and legislative trend toward protecting the borrower instead of the lender may also cause

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74. Clark v. Lachenmeier, 237 So. 2d 583 (Fla. App. 1970); Stockman v. Burke, 305 So. 2d 89 (Fla. App. 1974).

75. Tucker v. Lassen Sav. and Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

76. Philip Ashley, referring to Federal Home Loan Bank Board Regulation T-56, points out that the maturity date of a loan could be extended while increasing the interest rate so that the monthly payment would not increase. He further notes, however, the conflict between this proposition and the maximum term limit of thirty years. Ashley, *Use of "Due-On" Clauses to Gain Collateral Benefits: A Common Sense Defense*, 10 U. Tulsa L.J. 590, 607 (1975).

77. Myers, *Acceleration Clauses as a Protection for Mortgagees in a Tight Money Market*, 20 S.D. L. Rev. 329 (1975).

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serious difficulty to the lending industry. Only innovative methods of finance and congressional legislation will now protect the institutional lender.

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