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Lisa Marie Broman
University of Nebraska College of Law

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The Due-on-Sale Clause: Enforcement Standards

Occidental Savings and Loan Association v. Venco Partnership, 206 Neb. 469, 293 N.W.2d 843 (1980).

I. INTRODUCTION

Faced with an issue of first impression in Nebraska and a confusing body of law from other states, the Nebraska Supreme Court recently stopped just short of giving carte blanche approval to the enforceability of a due-on-sale clause¹ in a real estate mortgage.² With *Occidental Savings and Loan Association v. Venco Partnership*,³ Nebraska joined a growing majority of states which enforces mortgage clauses that accelerate the maturity of a note upon the transfer of the mortgaged property.⁴

1. A due-on-sale clause (sometimes called a due-on-transfer clause) accelerates the maturity date of a mortgage upon the transfer of the property underlying the mortgage. The mortgage note is generally due within 30 days of notice of transfer. Often the mortgagee will waive his right to accelerate if the mortgagor's buyer consents to an increase in the lending rate.
2. *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).
3. *Id.*
4. Two general lines of authority have emerged regarding the enforceability of a due-on-sale clause. Nebraska is now aligned with the first, which favors automatic enforcement without regard to whether the mortgagee's underlying security has been impaired. Cases following this trend are: *First Commercial Title, Inc. v. Holmes*, 92 Nev. 363, 550 P.2d 1271 (1976); *Century Fed. Sav. & Loan Ass'n v. VanGlahn*, 144 N.J. Super. 48, 364 A.2d 558 (1976); *Shalit v. Investors Sav. & Loan Ass'n*, 101 N.J. Super. 283, 244 A.2d 151 (1968); *Mutual Real Estate Inv. Trust v. Buffalo Sav. Bank*, 90 Misc. 2d 675, 395 N.Y.S.2d 583 (Sup. Ct. 1977); *Stith v. Hudson City Sav. Inst.*, 68 Misc. 2d 863, 313 N.Y.S.2d 804 (Sup. Ct. 1970); *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, 224 S.E.2d 580 (1976); *Gunther v. White*, 489 S.W.2d 529 (Tenn. 1973); *Miller v. Pacific First Fed. Sav. & Loan Ass'n*, 86 Wash. 2d 401, 545 P.2d 546 (1976); *Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works*, 58 Wis. 2d 99, 205 N.W.2d 762 (1973), *aff'd on rehearing*, 71 Wis. 2d 531, 239 N.W.2d 20 (1976).

The other view of enforceability requires the mortgagee to show that his or her security for the loan will be jeopardized if transfer is allowed. More than theoretical impairment must be shown, as courts look to the materiality of the breach. Courts applying this test generally disallow acceleration when

Although the due-on-sale clause is of relatively recent origin,⁵ it already has become a major economic tool enabling savings and loan associations to balance their loan portfolios.⁶ Its use as an economic weapon cannot be overstated, as market analysts insist that use of the due-on-sale could mean the difference between continued loan availability and the eventual loss of long-term mortgages altogether. Analysis of the due-on-sale clause sheds light on its place in the real estate world and highlights the age-old conflict between property and contract rights. This note addresses the Nebraska due-on-sale opinion, studies its possible ramifications, and draws comparisons to the law in other jurisdictions. It is important to note that a simple listing of jurisdictions, classifying their stance on due-on-sale enforceability is an oversimplification at best. The issues are complex and thus require careful examination.

A. Facts

On August 18, 1975, Occidental Savings and Loan Association (plaintiff/appellee) extended a mortgage to Venco Partnership (defendant/appellant) on a piece of vacant property in Omaha, Nebraska. The terms of the promissory note were principal of \$48,000,

the mortgagee's refusal to consent to transfer is based on a purely economic motive. Cases following this trend include: *First S. Fed. Sav. & Loan Ass'n v. Britton*, 345 So. 2d 300 (Ala. Civ. App. 1977); *Patton v. First Fed. Sav. & Loan Ass'n*, 118 Ariz. 473, 578 P.2d 152 (1978); *Baltimore Life Ins. Co. v. Harn*, 15 Ariz. App. 78, 486 P.2d 190 (1971); *Tucker v. Pulaski Fed. Sav. & Loan*, 252 Ark. 849, 481 S.W.2d 725 (1972); *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978); *Tucker v. Lassen Sav. & Loan Ass'n*, 12 Cal. 3d 629, 116 Cal. Rptr. 633, 526 P.2d 1169 (1974); *La Sala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 97 Cal. Rptr. 849, 489 P.2d 1113 (1971); *Clark v. Lachenmeier*, 237 So. 2d 583 (Fla. Dist. Ct. App. 1970); *Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n*, 73 Mich. App. 163, 250 N.W.2d 804 (1977); *Continental Fed. Sav. & Loan Ass'n v. Fetter*, 564 P.2d 1013 (Okla. 1977).

5. Only a few cases dealing with acceleration upon transfer occurred in the United States prior to 1964, the date of the landmark case of *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 38 Cal. Rptr. 505, 392 P.2d 265 (1964) (overruled by *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978)). Although *Coast Bank* was overruled, its importance today remains unquestioned. The policies behind the case, which held that a reasonable due-on-sale clause was entitled to automatic enforcement, remain persuasive in several other jurisdictions. See note 4 & accompanying text *supra*.
6. The due-on-sale clause is often used by the lender as a mechanism for increasing the interest rates on its current loans in order to keep up with increasing market rates. This is done by conditioning consent to transfer upon the exaction of an increased lending rate or an assumption fee from the transferee. For statistics and further data on the use of the due-on-sale by savings and loan companies, see UNITED STATES LEAGUE OF SAVINGS ASSOCIATIONS, SAVINGS AND LOAN FACT BOOK '79 (1979).

with interest at 9½% per annum payable in monthly installments of \$447.43 over twenty years.

The mortgage contained a clause which conditioned transfer of the mortgaged property upon the written consent of Occidental.⁷ Without such consent, the principal balance would be accelerated and become due within thirty days.⁸ Upon learning of Venco's desire to transfer the property, Occidental offered to waive its right of acceleration in return for the payment of an assumption fee by Venco's transferee.⁹

Venco transferred the property to Midwest Crating and Packing Services without Occidental's written consent, and Midwest refused to pay the assumption fee. Occidental then exercised its right of acceleration and instituted an action to foreclose the mortgage. Venco and Midwest appealed from a summary judgment in favor of Occidental, which sustained the validity of the due-on-sale clause. The Nebraska Supreme Court affirmed.¹⁰

B. Decision

In affirming the trial court's order of foreclosure, the Nebraska Supreme Court, speaking through Chief Justice Krivosha, said the due-on-sale clause was entitled to automatic enforcement in Nebraska.¹¹ In so holding, the court rejected arguments used in other jurisdictions to invalidate similar clauses and established that the enforceability of a due-on-sale clause in Nebraska is governed by principles of equity.¹² Other appellate courts, in determining when a court's equity powers should be invoked to order relief,

7. The Occidental-Venco clause is reproduced in note 22 *infra*.

8. The note can be accelerated upon lender's option without notice, at any time after lender receives notice of a transfer. Acceleration clauses have been held enforceable in Nebraska upon default of interest, installment, or tax payments. See note 112 *infra*. The enforceability of such a clause upon transfer of property was first tested in *Occidental*.

9. In its brief, *Occidental* noted:

It was the custom and policy of Occidental Savings as well as other savings and loan associations to increase loan mortgage yields to the then prevailing rate by conditioning waiver of right to acceleration on payment of an assumption fee and/or an increase in the interest rate of the mortgage.

Brief of Appellee at 8. The assumption fee demanded was \$455.55. *Id.*

10. 206 Neb. 469, 293 N.W.2d 843 (1980).

11. *Id.* at 471-73, 293 N.W.2d at 845.

12. Courts which have refused to enforce due-on-sale clauses have done so for three major reasons. First, courts applying the common law restraint on alienation test have found that a due-on-sale substantially impairs the borrower's ability to sell his property and thus is void as a restraint on its free marketability. With regard to this argument, the *Occidental* court said, "In our view, the 'due on sale' clause is not a restraint on alienation as that concept is legally defined." 206 Neb. at 471, 293 N.W.2d at 845.

have articulated several factors which must be weighed, including the relative bargaining positions of the parties,¹³ the motivation for note acceleration,¹⁴ and the harshness of enforcement.¹⁵ In contrast, under the *Occidental* case, due-on-sale enforceability in Nebraska need only be tested by principles of equity and need not be subjected to further analysis. The court unconditionally excluded the clause from both restraint-on-alienation¹⁶ and impairment-of-security analyses.¹⁷ The level of scrutiny is to be that applied to other mortgage acceleration clauses.¹⁸ Enforcement may be denied only when the court believes injustice or inequity may result.¹⁹

The second justification for denying enforcement has been that a purely economic motive for accelerating the clause is not proper. These courts require proof that the lender's security has been impaired. In response, the *Occidental* court said, "Balancing portfolio return with cost of money is an important factor in the survival of lending associations. The 'due on sale' clause is an important device in maintaining that balance." *Id.* at 480, 293 N.W.2d at 849.

Third, courts have simply voided the due-on-sale as against public policy. In striking down this argument, the Nebraska Supreme Court said, "Generally, a 'due on sale' clause contained in a mortgage contract is not contrary to the public policy of this jurisdiction and is, therefore, valid and enforceable." *Id.* at 481, 293 N.W.2d at 849.

13. The respective bargaining positions of the parties is important, as the due-on-sale has been labeled a "classic contract of adhesion." Comment, *Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1125 (1975). Although surprisingly little case law has developed along these lines, an excellent discussion of the equities involved can be found in *La Sala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 97 Cal. Rptr. 849, 489 P.2d 1113 (1971).
14. Several courts absolutely deny due-on-sale enforcement unless the lender's security is impaired. See note 4 *supra*. But other courts allow enforcement for any motive, so long as inequity does not prevail. The California Supreme Court said that every contract is subject to an implied covenant of good faith and fair dealing and that inquiry was necessary to determine if the lender had been reasonable in refusing to consent to a transfer of the mortgage. The court concluded:

There is no inequity visible from such a provision. Thus, if a note is executed with a due date of January 31, that is one of its terms, and a borrower cannot be heard to urge that the inferred provisos of good faith and fair dealing permit him "reasonably" to pay at a later date.

Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 579, 81 Cal. Rptr. 135, 138 (1969).

15. A discussion of equity and the consumer can be found in Note, *Wellenkamp v. Bank of America: A Victory for the Consumer?* 31 HASTINGS L.J. 275 (1979).
16. 206 Neb. at 471, 293 N.W.2d at 845.
17. *Id.* at 480, 293 N.W.2d at 849.
18. 206 Neb. at 481, 293 N.W.2d at 849. See also note 112 *infra*.
19. 206 Neb. at 481, 293 N.W.2d at 849.

II. COMPARATIVE ANALYSIS

The purpose or motivation for accelerating the mortgage, pursuant to the due-on-sale provision, often determines whether a court will order enforcement. Although only one case to date has expressly stated when and under what conditions the provision will be enforced,²⁰ the lack of a stated purpose has caused courts to strike the due-on-sale from a mortgage.²¹ Typical due-on-sale language is contained in the Occidental-Venco mortgage.²²

While the Occidental mortgage failed to specify purposes for or conditions precedent to acceleration, its obvious effect was either to prevent transfer of the property entirely or at least to condition its transfer. A due-on-sale mortgagee often conditions consent to a transfer upon an agreement to increase the lending rate or the payment of an assumption fee.²³ Additionally, consent to transfer may be conditioned upon assumption by a financially suitable transferee. The central issue in most due-on-sale cases has been whether the lender can accelerate the mortgage for purposes of pure economic gain, or whether the right of acceleration should be limited to situations where there is doubt as to the financial stability of the mortgagor's transferee.²⁴

Although no case to date has invalidated the due-on-sale in the abstract, three major limitations on its enforcement have evolved. Courts have invalidated the acceleration clause when: (1) it was found to be either a direct or an indirect restraint on alienation;²⁵

20. See *Miller v. Pacific Fed. Sav. & Loan Ass'n*, 86 Wash. 2d 401, 545 P.2d 546 (1976). The absence of a stated motive for acceleration has carried significant weight in several opinions. In *Lane v. Bisceglia*, 15 Ariz. App. 269, 272, 488 P.2d 474, 476 (1971), the court refused to enforce a due-on-sale upon which the lender conditioned approval of assumption on an increase in the interest rate. The court held enforcement inequitable in the absence of a provision in the contract so conditioning transfer.

21. See *Continental Fed. Sav. & Loan Ass'n v. Fetter*, 564 P.2d 1013 (Okla. 1977).

22. The due-on-sale clause provides as follows:

In the event of a sale of said premises without the written approval of said association, then the whole indebtedness hereby secured, shall, at the option of said association, immediately become due and collectible without further notice and this mortgage may then be foreclosed to recover the amount due on said note or obligation.

Brief of Appellee at 14, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 649, 293 N.W.2d 843 (1980).

23. See note 6 & accompanying text *supra*.

24. Compare ABA Committee on Real Estate Financing, *Enforcement of Due-On-Transfer Clauses*, 13 REAL PROP., PROB. & TR. J. 891 (1978) [hereinafter cited as ABA Committee], with Comment, *Mortgages—A Catalogue and Critique on the Role of Equity in the Enforcement of Modern-Day "Due-on-Sale" Clauses*, 26 ARK. L. REV. 485 (1973), and Note, *supra* note 15.

25. Cases which have held the due-on-sale to be a restraint on alienation include:

(2) the security of the mortgagee would not be impaired by the transfer;²⁶ or (3) the court deemed the clause inequitable or unconscionable under the circumstances.²⁷

A. Restraint on Alienation

The notion of a restraint on alienation comes from the common law principle that all property should be freely transferable.²⁸ Any restriction on this fundamental property right is void as against public policy.²⁹ It is unclear why many courts have, without explanation, voided the due-on-sale as a restraint on alienation. The clause does not directly prohibit the transfer of property; a mortgagor can always extinguish the debt upon transfer, and thus avoid the necessity of obtaining written consent or assenting to an assumption fee.³⁰

Courts frequently cite the *Restatement of Property*³¹ as author-

Wellenkamp v. Bank of America, 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978); Clark v. Lachenmeier, 237 So. 2d 583 (Fla. Dist. Ct. App. 1970); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 250 N.W.2d 804 (1977).

26. The California Supreme Court said, "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." *La Sala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 882, 97 Cal. Rptr. 849, 861, 489 P.2d 1113, 1125 (1971). *Accord*, *Baker v. Loves Park Sav. & Loan Ass'n*, 61 Ill. 2d 119, 333 N.E.2d 1 (1975); *Bellingham First Fed. Sav. & Loan Ass'n v. Garrison*, 87 Wash. 2d 437, 553 P.2d 1090 (1976).
27. Several courts test due-on-sale enforcement by its reasonableness: "It follows that the invocation of the clause must be based on grounds that are reasonable on their face." *Baltimore Life Ins. Co. v. Harn*, 15 Ariz. App. 78, 81, 486 P.2d 190, 193 (1971). *Accord*, *Malouff v. Midland Fed. Sav. & Loan Ass'n*, 181 Colo. 294, 509 P.2d 1240 (1973); *Mutual Real Estate Inv. Trust v. Buffalo Sav. Bank*, 90 Misc. 2d 675, 395 N.Y.S.2d 583 (1977).
28. An excellent discussion of the common law principle concerning restraint on alienation can be found in Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747 (1973).
29. *Id.*
30. One commentator noted:
Obviously, the due-on clause does not prohibit transfer, and cannot be enforced to prevent the transfer. The clause first requires consent to transfer, but the borrower is able to avoid obtaining that consent by paying the debt. Any forfeiture or loss of the property can be avoided by "redemption," the payment of the debt then due.
ABA Committee, *supra* note 24, at 898.
31. The RESTATEMENT provides that:
A restraint on alienation, as that phrase is used in this Restatement, is an attempt by an otherwise effective conveyance or contract to cause a later conveyance
 - (a) to be void; or
 - (b) to impose contractual liability on the one who makes the later conveyance when such liability results from a breach of an agreement not to convey; or

ity for striking down the due-on-sale as a restraint on alienation. But the analysis generally stops with the citation and leaves unanswered the question of how the due-on-sale fits within its prohibition on restraints. A Michigan appellate court decision, *Nichols v. Ann Arbor Federal Savings and Loan Association*,³² is illustrative of this cursory approach. The *Nichols* court concluded: "If the mortgage clause defendant seeks to enforce can be labeled as a restraint on alienation only by expanding the restatement definition, we do not hesitate to *stretch* the term to include *this 'due-on-sale' clause*."³³ Such a justification for finding the due-on-sale to be a restraint led the *Occidental* court to state: "The oft-repeated assumption that a 'due-on-sale' clause restrains the alienation of property is without satisfactory proof."³⁴ The Nebraska court held as a matter of law that the clause was neither a direct nor indirect restraint on alienation within the meaning of the common law principle.³⁵ While no court has stated that a due-on-sale is a direct restraint on alienation, many have denied its enforcement on the grounds that it indirectly restrains the transferability of property.³⁶ The notion of an indirect restraint is that the clause is a restraint in its practical effect. Due-on-sale critics suggest the clause fits this category even though the transfer of property is not absolutely prohibited.³⁷ They suggest that the total liquidation of

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- (c) to terminate or subject to termination all or a part of the property interest conveyed.

RESTATEMENT OF PROPERTY § 404 (1944).

[A] restraint on the alienation of a legal possessory estate in fee simple which is, or but for the restraint would be, indefeasible is valid if, and only if,

- (a) the restraint is a promissory restraint or a forfeiture restraint, and
- (b) the restraint is qualified so as to permit alienation to some though not all possible alienees, and
- (c) the restraint is reasonable under the circumstances, and
- (d) if the restraint is a forfeiture restraint, the requirements of the rule against perpetuities are satisfied.

Id. § 406.

32. 73 Mich. App. 163, 250 N.W.2d 804 (1977).

33. *Id.* at 166-67, 250 N.W.2d at 806 (emphasis added).

34. 206 Neb. at 478, 293 N.W.2d at 848.

35. *Id.* at 479, 293 N.W.2d at 848.

36. One common test for an indirect restraint is as follows:

To uphold restraints on the alienation of such estates it must appear that the objective sought to be accomplished by the imposition of the restraint is of sufficient social importance to outweigh the evils which flow from interfering with the power of alienation or that the curtailment of the power of alienation is so slight that no social danger is involved.

RESTATEMENT OF PROPERTY § 406, Comment a (1944).

37. One author has suggested that judicial reasoning which enforces the due-on-sale ignores the realities of the residential real estate market. Comment,

the debt and subsequent transfer is not a viable alternative because few people could afford to pay off their mortgage in a lump sum.³⁸ Thus, given the current money situation, a mortgagee's refusal to consent to a transfer is a practical restraint on the salability of property.³⁹

In *Wellenkamp v. Bank of America*,⁴⁰ the California Supreme Court, overruling its earlier position on due-on-sale clauses, abandoned all notions of automatic enforcement and laid down a new and stringent test for enforceability.⁴¹ The court held that a due-on-sale contained in a mortgage or deed of trust cannot be enforced unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment of his security or the risk of default.⁴² The *Wellenkamp* court struck down a clause which conditioned consent for transfer upon an increase in the interest rate even though the transferee was financially suitable and the risk of default was not increased.⁴³ The court reasoned that the due-on-sale in this situation was unreasonably burdensome to the consumer-mortgagor in tight money market situations.⁴⁴ The

supra note 13, at 1113. The author argued: "Exercise of the mortgagee's option to demand payment of the outstanding debt may interfere with the mortgagor's right to sell as effectively as issuance of an injunction directly barring the sale." *Id.*

38. *See id.*

39. *Id.*

40. 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978).

41. *Wellenkamp* overruled *Coast Bank v. Minderhout*, 61 Cal. 2d 311, 38 Cal. Rptr. 505, 392 P.2d 265 (1964) and *Cherry v. Home Sav. & Loan Ass'n*, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969), insofar as those opinions allowed for automatic enforcement of the due-on-sale. *Cherry* and *Coast Bank* held the due-on-sale clause to be per se valid unless unreasonable.

42. 21 Cal. 3d at 953, 148 Cal. Rptr. at 385-86, 582 P.2d at 976-77.

43. *Id.*

44. The *Wellenkamp* court explained the positions in which a due-on-sale placed the parties to the contract:

The availability of new financing often depends upon general economic conditions. In times of inflation, when money is "tight" and funds available for real estate loans are in short supply, new financing may be difficult, if not impossible to obtain. The same result may occur when interest rates and the transactional costs of obtaining new financing are high, making it economically unfeasible for the buyer to acquire a new loan. When economic conditions are such that new financing is either unavailable or economically unfeasible, the seller and buyer will normally agree to a form of financing arrangement wherein the buyer will assume the seller's loan. In such circumstances, if the lender is unwilling to permit assumption of the existing loan, and instead elects to enforce the due-on clause, transfer of the property may be prohibited entirely, because the buyer will be unable to substitute a new loan for the loan being called due, and the seller will not receive an amount from the buyer sufficient to discharge that loan, particularly when the balance due is substantial. . . . [T]he result in terms of a restraint on alienation is clear.

effect of the clause, according to the California court, was to eliminate the possibility and opportunity for transfer of property.⁴⁵ In essence, the *Wellenkamp* court based its holding on the *presumed* restraining effect upon *possible* borrowers under *theoretical* economic conditions.⁴⁶ In a strong dissent, Justice Clark said: "In attempting to take away contractual rights of lenders in order to assist borrowers in selling encumbered properties, the majority opinion has devised a scheme which affords yesterday's borrower a clear advantage over today's seller who comes to the marketplace with his property free from encumbrance."⁴⁷

Clark explained his position by emphasizing that in tight money markets financing is often unavailable, so if the due-on-sale is not enforced, the mortgagor-buyer would receive financing not otherwise available.⁴⁸ As an added bonus, the mortgagor would receive financing at a lower-than-market rate.⁴⁹ Clark added, "[t]he loan has thus become not a restraint on alienation but a factor making salable what before could not be sold."⁵⁰

Applying this rationale, the *Occidental* court theorized that "[t]he effect of a rising interest market [combined with an] invalid 'due-on-sale' clause would be to permit a seller to obtain a premium for the sale of its property at the expense of the lender."⁵¹ The court said neither law nor equity should permit such a result.⁵²

Courts which have adopted the *Wellenkamp* position first assume that the clause is a restraint on alienation and then condition its enforcement on proof of reasonableness.⁵³ A lender must es-

21 Cal. 3d at 950-51, 148 Cal. Rptr. at 383-84, 582 P.2d at 974-75 (footnotes omitted).

45. *Id.*

46. A critic of *Wellenkamp* noted:

It does not appear that any other due-on decision has based its conclusion on similar economic theory, or even contemplated the possibility that a transfer by outright sale *may* enhance the lender's position. It is observed that both subjects are treated in speculative and nonfactual terms. Theoretical justifications offered by a lender that transfer is inherently a threat to security is thus met by equally theoretical response.

ABA Committee, *supra* note 24, at 915.

47. 21 Cal. 3d at 954, 148 Cal. Rptr. at 386, 582 P.2d at 977.

48. 21 Cal. 3d at 957, 148 Cal. Rptr. at 388, 582 P.2d at 979.

49. *Id.*

50. *Id.*

51. 206 Neb. at 479, 293 N.W.2d at 848.

52. *Id.*

53. Proof of reasonableness was required in the following cases: *Patton v. First Fed. Sav. & Loan Ass'n*, 118 Ariz. 473, 578 P.2d 152 (1978); *Tucker v. Lassen Sav. & Loan Ass'n*, 12 Cal. 3d 629, 116 Cal. Rptr. 633, 526 P.2d 1169 (1974); *La Sala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 97 Cal. Rptr. 849, 489 P.2d

establish that acceleration of the principal is not only reasonable under the circumstances, but also necessary to serve a legitimate interest.⁵⁴ Most courts applying this test refuse enforcement when the motive for accelerating the mortgage is increasing the lending rate.⁵⁵

Fashioning a test of reasonableness, the California Supreme Court in *Tucker v. Lassen Savings and Loan Association*⁵⁶ stated that a due-on-sale was enforceable only when the lender could prove that its motivation for acceleration was either to preserve the security from waste or depreciation or to assure that the mortgagor's buyer was at least as good a credit risk as was the mortgagor.⁵⁷ A critic of this approach suggests it "causes a court to consider along sharply defined lines whether certain conduct is or is not reasonable, and avoids looking to the circumstances of the conduct."⁵⁸

The *Occidental* court joined the critics of this reasonableness approach, noting the burden which a case-by-case determination

1113 (1971); *Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n*, 73 Mich. App. 163, 250 N.W.2d 804 (1977); *Bellingham First Fed. Sav. & Loan Ass'n v. Garrison*, 87 Wash. 2d 437, 553 P.2d 1090 (1976).

54. A legitimate interest was defined by the California Supreme Court as follows:

Such legitimate interests include not only that of preserving the security from waste or depreciation but also that of guarding against what has been termed the "moral risks" of having to resort to the security upon default. . . . Thus, for example, if the beneficiary can show that the party in possession . . . is, or is likely to be, conducting himself with respect to the property in a manner which will probably result in a significant wasting or other impairment of the security, he may properly insist upon enforcement of the "due-on" clause. Similarly, if the beneficiary can show that the prospects of default . . . are significantly enhanced in the particular situation, such circumstances might constitute a sufficient justification for enforcement of the clause despite its restraining effect. Other legitimate interests of the lender may have a similar effect.

Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 639, 116 Cal. Rptr. 633, 639, 526 P.2d 1169, 1175 (1974) (footnotes omitted).

55. *See, e.g.*, *La Sala v. American Sav. & Loan Ass'n*, 5 Cal. 3d 864, 880 n.17, 97 Cal. Rptr. 849, 859 n.17, 489 P.2d 1113, 1123 n.17 (1971) ("In any event, a restraint on alienation cannot be found reasonable merely because it is commercially beneficial to the restrainer. Otherwise one could justify any restraint on alienation upon the ground that the lender could exact a valuable consideration in return for its waiver . . .").

56. 12 Cal. 3d 629, 116 Cal. Rptr. 633, 526 P.2d 1169 (1974).

57. *Id.* at 639, 116 Cal. Rptr. at 639, 526 P.2d at 1175.

58. *Bernhard, The Minority Doctrine Concerning Direct Restraints on Alienation*, 57 MICH. L. REV. 1173 (1959). *Bernhard* suggested a more flexible approach with regard to restraints: A restraint that is reasonable under the circumstances should be valid. Reasonableness is tested by whether the purpose behind the restraint outweighs its effect in terms of the actual hindering of alienability of the property in question. *Id.* at 1177.

of reasonableness would place on the court system.⁵⁹ It also argued that calling upon the courts to be periodic arbitrators would unduly burden the real estate world.⁶⁰ Case-by-case analysis would lend uncertainty to real estate titles in a field where certainty is vital. Without some framework in which to deal, both buyer and seller can never know, absent litigation, whether the due-on-sale will be enforced.⁶¹

The court, in *Occidental*, noted the possibility of courts applying this reasonableness test to other solutions to varying market problems.⁶² The court said financing could be eliminated altogether if any market hindrance imposed by the lender could be held invalid.⁶³ If the due-on-sale were to be eliminated, the court reasoned, all other inflation-fighting solutions, such as the short-term rollover and variable interest mortgage,⁶⁴ would also fail.⁶⁵ In essence, invalidation of the due-on-sale clause could begin a dom-

59. 206 Neb. at 477-78, 293 N.W.2d at 847-48.

60. *Id.*

61. *Id.* Another court rejecting a case-by-case approach said, "Since stability of real estate titles is of paramount importance it is necessary that the court follow a policy in construing restraints on alienation which will produce a reasonable degree of certainty." *Baker v. Loves Park Sav. & Loan Ass'n*, 61 Ill. 2d 119, 126, 333 N.E.2d 1, 5 (1975). *Baker* held that the due-on-sale was unenforceable without a showing of impairment of security.

62. 206 Neb. at 477, 293 N.W.2d at 847.

63. Noting the possible effect of invalidating the due-on-sale clause, the *Occidental* court said:

If any market hindrance imposed by the lender can be held to be a practical restraint on alienation and, therefore, invalid, no solution to varying market conditions can ever be validated and, ultimately, no one will be able to secure satisfactory financing.

If we conclude that a "due-on-sale" clause is an unreasonable restraint on alienation and is, therefore, void, it may follow that mortgages of short duration (less than 3 or 4 years) with variable rates are likewise invalid as indirect restraints on alienation. Certainly, whatever arguments are made about the inability to convey property because of a "due-on-sale" clause, may also be made with regard to a mortgage that must be renegotiated within 2 or 3 years after the sale at a price which the subsequent buyer may not be able to determine.

Id. at 477, 293 N.W.2d at 847-48.

64. Examples of such inflation-related devices are:

1. *Variable Rate Mortgage (VRM)*. The interest rate on a VRM varies with some referenced index that reflects changes in market rates of interest. Although future monthly payments are not known at the time the loan is originated, restrictions on the VRM rate and other safeguards can limit the uncertainty involved. . . .
4. *Roll-over Mortgage (ROM)*. The ROM (currently used in Canada) is in effect a short-term loan with a long-term amortization period, with periodically renegotiated interest rates, and payments according to then current market conditions.
5. *Price Level Adjusted Mortgage (PLAM)*. The interest rate on a PLAM is fixed, but the actual principal amount due and the monthly payments are adjusted according to some price index.

ino effect which would negate solution after solution until both lender and borrower were placed at the mercy of the market.⁶⁶ Thus, the court concluded that the due-on-sale clause is not a restraint on alienation within the meaning of the common law doctrine.⁶⁷

B. Impairment of Security

As previously noted, courts looking to the reasonableness of the clause often condition its enforcement upon a proper motive. And such a motive has almost always been interpreted as protection from the impairment of security.⁶⁸ Some courts, which have denied that the due-on-sale is a restraint on alienation and have looked to the equity of enforcement, have also placed great weight on whether the lender's motive for acceleration is security oriented.⁶⁹ In *Baltimore Life Insurance v. Harn*,⁷⁰ an Arizona appellate court said:

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. Otherwise the equitable powers of the trial court would be invoked to impose an extreme penalty on a mortgagor with no showing that he has violated the substance of the agreement, that is, that he would not make a conveyance that would impair the security.⁷¹

Once again, the lender's motive for acceleration was a determi-

Cowan & Foley, *New Trends in Residential Mortgage Finance*, 13 REAL PROP., PROB. & TR. J. 1075, 1078 (1978).

65. 206 Neb. at 477, 293 N.W.2d at 847-48.

66. *Id.*

67. The *Occidental* court admitted that a possibility of acceleration impedes the ability of the owner to sell his property as he wishes, but stated that not every impediment to sale should be construed as a restraint on alienation or as repugnant to public policy. The court noted, "It is a fact that zoning restrictions, building restrictions, or public improvements may impede the sale and substantially affect the ability of an owner to realize a maximum price." *Id.* at 473, 293 N.W.2d at 845. The court asserted that no one would suggest that these restraints (zoning, etc.) should be struck down as a restraint or voided for policy reasons. *Id.*

68. ABA Committee, *supra* note 24, at 898-900.

69. *See, e.g.*, *Bellingham First Fed. Sav. & Loan Ass'n v. Garrison*, 87 Wash. 2d 437, 553 P.2d 1090 (1976); *Mutual Fed. Sav. & Loan Ass'n v. American Medical Serv.*, 66 Wis. 2d 210, 223 N.W.2d 921 (1974); *Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works*, 58 Wis. 2d 99, 205 N.W.2d 762 (1973), *aff'd on rehearing*, 71 Wis. 2d 531, 239 N.W.2d 20 (1976).

The Wisconsin Supreme Court said that impairment of security was not a condition precedent to enforcement, but that "an absence of impairment of security is a factor that a trial court may put on the scales in weighing the equities involved." 66 Wis. 2d at 217, 223 N.W.2d at 925.

70. 15 Ariz. App. 78, 486 P.2d 190 (1971).

71. *Id.* at 81, 486 P.2d at 193.

native factor in the court's decision whether or not to enforce the due-on-sale. It is not clear from *Baltimore* or subsequent court opinions applying its test whether the clause would be enforced if the express terms of the contract provided for the exaction of added interest upon transfer. However, nothing in these opinions would seem to be contradicted if acceleration were based on an expressly bargained-for element of the contract.

In a dissenting opinion of a North Carolina case which held a due-on-sale enforceable regardless of motive, Justice Lake warned that any attempt to use the clause to exact additional interest could result in a "loan shark's trap for the unwary borrower."⁷² Justice Lake labeled the due-on-sale a "sleeper" provision⁷³ tucked away in a mortgage or deed of trust, ready to be pulled out when the market conditions warranted. He said that a lender's ability to use the clause solely for economic gain would not catch the attention of the average mortgagor or subsequent purchaser.⁷⁴ He asserted that if the purpose of the clause is to increase interest rates when the market requires such a purpose should be expressly stated in the contract.⁷⁵ Contrary to Justice Lake's opinion, due-on-sale clauses are no longer the sleeper clauses they once were, as their placement in modern mortgages is routine. To say that they are beyond the contemplation of the general public is naive at best.

In this same vein, the Illinois Supreme Court in *Baker v. Loves Park Savings and Loan Association*⁷⁶ determined the purpose of the due-on-sale was to protect the lenders' security and thus conditioned enforcement on proof of its impairment.⁷⁷ Applying the

72. *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, 634, 224 S.E.2d 580, 589 (1976) (Lake, J. dissenting).

73. *Id.*

74. Justice Lake explained how the due-on-sale could trap an unwary borrower, as follows:

In the present instance, the accelerating event, as now construed by the money lender, is a "sleeper" provision, tucked away in the printed portion of the deed of trust so that its meaning, as now asserted by the money lender, would not readily catch the attention of a mortgagor, or a subsequent purchaser of the property, reading the deed of trust. A moderately alert and wary reader could easily assume the provision contemplated that the mortgagee's assent to a subsequent conveyance would not be unreasonably withheld and that the provision was intended only to protect the mortgagee's security.

Id. at 633, 224 S.E.2d at 589.

75. *Id.* at 634, 224 S.E.2d at 589.

76. 61 Ill. 2d 119, 333 N.E.2d 1 (1975).

77. Illinois courts assume that the due-on-sale clause is a restraint on alienation. In *Baker*, the court upheld the clause because it was a reasonable restraint: "It is a restraint imposed for the purpose of protecting the security interest of

same test, the Washington Supreme Court⁷⁸ held that the lender had met its burden of proof by showing that the mortgagor's prospective transferee had a bad overall credit rating, including delinquency on six outstanding mortgages.⁷⁹

Short of such an obvious risk of default, courts have failed to definitively state when the lender's security is impaired to the extent of allowing acceleration.⁸⁰ However, courts have been quick to place the burden of proof of impairment on the lender.⁸¹

Courts which refuse to view the enforceability of the due-on-sale in terms of its restraining effect or its purpose of protecting lenders' security generally allow automatic enforcement.⁸² The rationale rests generally on either economic necessity or the sanctity of the contract. *Occidental's* proclamation for automatic enforcement rests on both.⁸³

1. *Economic motive*

Courts which have upheld the due-on-sale solely for the purpose of allowing lenders to maintain interest portfolios at current lending rates⁸⁴ have generally justified such a result on the grounds of protecting lenders from the varying economic conditions of the money market and of protecting borrowers from the

the lender, a recognized valid purpose for which a restraint may be imposed." *Id.* at 125, 333 N.E.2d at 4.

78. *Bellingham First Fed. Sav. & Loan v. Garrison*, 87 Wash. 2d 437, 553 P.2d 1090 (1976).

79. *Id.* at 441, 553 P.2d at 1092.

80. ABA Committee, *supra* note 24.

81. The following cases held that the due-on-sale was not enforceable unless and until the lender could prove his failure to consent to transfer was based on a greater risk of default by the mortgagor's transferee: *Baltimore Life Ins. Co. v. Harn*, 15 Ariz. App. 78, 486 P.2d 190 (1971); *Tucker v. Pulaski Fed. Sav. & Loan Ass'n*, 252 Ark. 849, 481 S.W.2d 725 (1972); *Bellingham First Fed. Sav. & Loan Ass'n v. Garrison*, 87 Wash. 2d 437, 553 P.2d 1090 (1976).

82. See note 4 & accompanying text *supra*.

83. 206 Neb. at 480-81, 293 N.W.2d at 849.

84. Twenty of the 23 due-on-sale cases have concerned the propriety of accelerating the mortgage for a strictly economic purpose. Four cases concern prepayment or assumption fees, and 16 concern interest-rate adjustments. The nine cases which specifically allow the lender to increase the interest rate are: *Cherry v. Home Sav. & Loan Ass'n*, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969); *Malouff v. Midland Fed. Sav. & Loan Ass'n*, 181 Colo. 294, 509 P.2d 1240 (1973); *Century Fed. Sav. & Loan Ass'n v. VanGlahn*, 144 N.J. Super. 48, 364 A.2d 558 (1976); *Stith v. Hudson City Sav. Inst.*, 63 Misc. 2d 863, 313 N.Y.S.2d 804 (Sup. Ct. 1970); *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, 224 S.E.2d 580 (1976); *People's Sav. Ass'n v. Standard Indus., Inc.*, 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970); *Gunther v. White*, 489 S.W.2d 529 (Tenn. 1973); *Miller v. Pacific First Fed. Sav. & Loan Ass'n*, 86 Wash. 2d 401, 545 P.2d 546 (1976); *Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works*, 58 Wis. 2d 99, 205 N.W.2d 762 (1973), *aff'd on rehearing*, 71 Wis. 2d 531, 239 N.W.2d 20 (1976).

possibility of not being able to obtain financing.⁸⁵ Proponents of the due-on-sale suggest it is necessary to assure that savings and loan associations will continue to be able to finance the American housing market.⁸⁶ As one commentator stated: "Elimination of the due-on-sale clause may potentially work as great an economic hardship on mortgage lending institutions as complete license in the enforcement of such devices may work on mortgagors attempting to sell their property."⁸⁷

The assets of savings and loan companies consist primarily of long-term home mortgages. Funds necessary to make new loans and to maintain liquidity on existing mortgage portfolios are raised primarily by short-term and demand savings accounts and certifi-

85. The ABA Committee on Real Estate Financing noted that only recently have federal or state regulations allowed for interest adjustment during the life of a long-term loan. ABA Committee, *supra* note 24. The use of variable rate, roll-over, and price-level-adjusted mortgages, capable of responding to economic pressures, have only recently developed. See note 64 & accompanying text *supra*. In support of the due-on-sale clause, the ABA noted that the clause currently represented "the principal, and likely only, means by which a lender could attempt to increase the interest rate during the amortization period." ABA Committee, *supra* note 24, at 897.

86. In an amicus curiae brief in support of due-on-sale enforcement, the Nebraska League of Savings Associations said the due-on-sale clause was a critical and necessary device in order to preserve savings and loan associations in Nebraska. The League noted that the savings industry is faced with a rapidly increasing cost of funds and at the same time is saddled with long-term mortgages which yield much less than current interest rates.

This differential is not a trifling matter. The appellants imply that savings and loans are seeking windfall profits in their attempt to keep mortgage portfolio yields reasonably current. In fact, charging current prices for money which the savings and loan must pay current rates to obtain is merely avoiding losses, not reaping profits. These losses can only be sustained so long as there is net worth to absorb them. The average nationwide net worth of savings and loan associations was 5.5% of assets in 1978. A differential of only 1% in portfolio yield and cost of funds would completely deplete this net worth in five years. But the institutions would go out of business much sooner than that as liquidity was impaired or net worth failed to meet regulatory requirements.

These figures are, of course, averages and are variable. Enforcement of due-on-sale clauses will not keep mortgage yields completely current. The annual turnover ratio of mortgage loans has varied from approximately 12% to 18% since 1971. This means that the average mortgage life has varied from 8½ to 5½ years. But the difference between five or eight years on the one hand and 25 or 30 years on the other is apparent. *Balancing portfolio return with cost of money is the single most important factor in the survival of a mortgage lending institution.* Enforcement of due-on-sale clauses is an indispensable tool to help reach that goal.

Brief of Amicus Curiae, Nebraska League of Savings Associations, at 7-8, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980) (emphasis added) (footnotes omitted).

87. Volkmer, *supra* note 28, at 799.

cates.⁸⁸ Savings and loan associations ordinarily invest eighty percent of their assets in long-term mortgages at fixed rates of interest, while their liabilities consist of highly liquid short-term deposits. Lenders must maintain sufficient income to pay the interest on their deposits and negotiate new loans. As interest rates rise, so must the lender's income. When the lender carries old loans with lower interest rates, a corresponding increase on new loans must be made to balance. This disparity causes a magnifying effect, forcing new buyers to partially subsidize old borrowers. Thus, if an old loan can be renegotiated to current lending rates, new borrowers will receive loans at lower rates.⁸⁹

The savings and loan industry is particularly harmed in times of inflation because depositors withdraw their funds in favor of more advantageous investment possibilities.⁹⁰ Savings and loan associations are prevented from raising interest yields on deposits because of a federal ceiling.⁹¹ This squeeze on lenders is bound to have an adverse effect on the housing market, including: (1) higher rates to new borrowers; (2) a shrinkage in funds available for financing; and (3) a possible end to long-term mortgages.⁹²

Recently, in response to the *Wellenkamp* decision, the Bank of America in California announced that it no longer would issue long-term mortgages.⁹³

The severity of today's economic situation is demonstrated best by a 1979 congressional bill which pre-empted state law and eliminated all usury ceilings on home mortgage loans through March 31, 1980.⁹⁴ Lenders need some relief. Possibly, as the availability and use of alternative mortgage devices increase,⁹⁵ the need for the due-on-sale clause to increase the interest rate during the amortization period will not be so acute. But until such devices are made readily available through legislative action, the courts will continue to struggle with balancing the equities between lenders and borrowers.

Due-on-sale advocates have at least intimated that if the due-on-sale is not enforceable, the consumer might win today, but lose

88. Brief of Amicus Curiae, Nebraska League of Savings Associations, at 4, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

89. See Note, *Due-On Clauses: Restraints on Alienation And the Legitimacy of Portfolio Maintenance*, 14 WILLAMETTE L.J. 295 (1978).

90. Cowan & Foley, *supra* note 64, at 1081.

91. 12 C.F.R. § 526.2 (1980).

92. Cowan & Foley, *supra* note 64, at 1093.

93. Van Wallach, *The Demise of Due-On-Sale?*, FORBES, Jan. 19, 1981, at 51.

94. Act of Dec. 28, 1979, Pub. L. No. 96-161, § 105 (codified at 12 U.S.C. §§ 1730a, 1735f-5, 1735f-7, 1752 (Supp. III 1979)).

95. See note 64 & accompanying text *supra*.

tomorrow.⁹⁶ If today's savings and loan associations are forced to absorb the brunt of today's rising interest market, they will be forced to make up those losses by charging higher interest rates to tomorrow's borrowers. The more practical policy would favor enforcement of the due-on-sale today to minimize the effects of the market on future mortgagors. The equities balance in favor of lenders, especially when the borrower is not subject to a prepayment penalty.⁹⁷

A due-on-sale was lauded in *Crockett v. First Federal Savings and Loan of Charlotte*⁹⁸ as the best way to balance the ability of both lender and borrower to take advantage of or minimize damages from fluctuations in interest rates.⁹⁹ The North Carolina court noted that the borrower has the best of both worlds in that he or she has: (1) the security of being able to pay off the long-term mortgage at the original low interest rate upon maturity; or (2) the ability to pay the loan off early in order to take advantage of market-rate declines by refinancing at the lower rate. The lender is protected, according to the court, because it can increase the rate in proportion to the market rate upon transfer.¹⁰⁰ As noted earlier, the *Wellenkamp* dissent¹⁰¹ argued that precluding enforcement of the due-on-sale clause for economic reasons made alienable what otherwise would not have been alienable because of tight financing. In this situation, a borrower is in essence *selling a low interest rate* along with the property,¹⁰² and he or she obtains a market advantage at the expense of lending institutions.

96. Note Justice Clark's dissenting opinion in *Wellenkamp*, 21 Cal. 3d 943, 956-57, 148 Cal. Rptr. 379, 387-88, 582 P.2d 970, 978-79, which speculates as to the long-term effects of invalidation of the due-on-sale clause.

97. This was true in the Occidental mortgage, which contained the following clause: "This obligation may be paid in full at any time before maturity, without notice, provided interest is paid to the end of the calendar month in which such payment is made." Brief of Appellee at 15, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

98. 289 N.C. 620, 224 S.E.2d 580 (1976).

99. *Id.* at 626, 224 S.E.2d at 585.

100. The court concluded that the borrower, not the lender, would hold the upper hand if the clause were enforced, as he or she would not even have to wait for alienation of the property to take advantage of changed interest rates. If the due-on-sale were not enforced, an even more superior position for the borrower would result because a bargained-for element of the contract would be excluded, and thus not available to the lender. *Id.* at 626, 224 S.E.2d at 585.

101. 21 Cal. 3d at 957, 148 Cal. Rptr. at 388, 582 P.2d at 979.

102. Because loans are not readily available in tight money markets, a borrower with an unenforceable due-on-sale clause can offer a loan to a transferee that might not otherwise be available. In addition to being able to offer the loan, the borrower/mortgagee can offer that loan at his original interest rate (generally lower than the current market rate). For this reason, borrower/mortgagee has a highly salable piece of property. For further discussion, see ABA Committee, *supra* note 24, at 925-28.

The New Jersey Superior Court¹⁰³ stated that savings and loan associations are obliged to include the due-on-sale clause in all mortgage loans because of their fiduciary duty to obtain the best lawful yield on their mortgage portfolios.¹⁰⁴ In *Occidental*, the court stated: "The potential failure of savings and loan associations and the loss of their depositors' funds should be of no less a concern to the courts than the inability of a property owner to transfer its mortgage at a premium when selling its property."¹⁰⁵ The court explained that balancing interest portfolios is essential to the survival of savings and loan associations in Nebraska, and the due-on-sale is an important device in maintaining that balance.¹⁰⁶

2. Sanctity of contract

Several courts, in attempts to assign the risk of varying market conditions to either borrowers or lenders, examine the contract's express provisions.¹⁰⁷ In *Crockett v. First Federal Savings and Loan Association of Charlotte*,¹⁰⁸ the majority opinion emphatically stated: "It is the simple law of contracts that 'as a man consents to bind himself, so shall he be bound.'"¹⁰⁹ While most courts take a more flexible approach, the consensus is that the mortgagee's contract rights are no less important than the mortgagor's.¹¹⁰

In *Occidental*, the court compared the due-on-sale clause to any other acceleration clause contained in a mortgage and declared it to be subject to the same rules of enforcement.¹¹¹ Generally, Ne-

103. Century Fed. Sav. & Loan Ass'n v. VanGlahn, 144 N.J. Super. 48, 364 A.2d 558 (1976).

104. The court held, "Calling a loan in order to get the full benefit of current interest rates is a legitimate and reasonable business practice—one which protects the Association member . . . as well as fulfilling the statutory purpose of the association." 144 N.J. Super. at 54, 364 A.2d at 561.

105. 206 Neb. at 480, 293 N.W.2d at 849.

106. *Id.*

107. The issue in these cases is whether or not there has been a breach of an agreement not to sell the property without the consent of the mortgagee. If such breach is found, the mortgagee is allowed to accelerate. Courts adhering to this view include: *First Commercial Title, Inc. v. Holmes*, 92 Nev. 363, 550 P.2d 1271 (1976); *Century Fed. Sav. & Loan Ass'n v. VanGlahn*, 144 N.J. Super. 48, 364 A.2d 558 (1976); *Gunther v. White*, 489 S.W.2d 529 (Tenn. 1973).

108. 289 N.C. 620, 224 S.E.2d 580 (1976).

109. *Id.* at 630, 224 S.E.2d at 587 (citing *Troitino v. Goodman*, 225 N.C. 406, 414, 35 S.E.2d 277, 283 (1945)).

110. *Century Fed. Sav. & Loan Ass'n v. VanGlahn*, 144 N.J. Super. at 55, 364 A.2d at 562.

111. The *Occidental* court noted that it found nothing so extraordinary about the due-on-sale clause that should remove it from the scrutiny test applied to all other acceleration clauses. Generally, a stipulation in a mortgage calling the loan upon default of principal, interest, or another contract condition is per-

braska courts have not viewed acceleration clauses with disfavor; they have construed them according to the intent of the parties and have subjected them to other rules applicable to contracts.¹¹² Hence, *Occidental* refused to strike down the due-on-sale as a contract clause repugnant to public policy. The Nebraska court said the use of the clause to exact a greater interest rate, and thus to encourage the balancing of interest portfolios, was an eminently proper motive for enforcement.¹¹³

In response to the lender's demand for an increased interest rate upon transfer, the court in *Gunther v. White*¹¹⁴ said that "equity should not depart from the law which requires it to enforce valid contracts"¹¹⁵ *Gunther* further established that the clause should not be struck down merely because the lender, and not the borrower, would profit from the increased cost of money.¹¹⁶

Generally, commentators have viewed financing as a contract rather than a property right, with the responsibility on the parties to bargain for the uncertainties of the market.¹¹⁷ *Occidental* made it clear that courts should not remake contracts unless the preservation of the public welfare so demands.¹¹⁸ The Nebraska court emphasized its strong adherence to the policy of allowing parties to freely contract within the parameters of the law and public policy.¹¹⁹ Applying Nebraska case law, the court stated: "We are cited to no authority, nor are we able to find any, which would legally justify declaring a contract provision such as the one in the instant case, generally referred to as a 'due on sale' clause, to be

fectly legal and enforceable and is not in the nature of a penalty or forfeiture which a court of equity will refuse to enforce. 206 Neb. at 480-81, 293 N.W.2d at 849.

112. Nebraska cases upholding acceleration clauses include: *United Benefit Life Ins. Co. v. Holman*, 177 Neb. 682, 130 N.W.2d 593 (1964); *Matthews v. Guenther*, 120 Neb. 742, 235 N.W. 98 (1931); *Moorehead v. Hungerford*, 110 Neb. 315, 193 N.W. 706 (1923); *McCarthy v. Benedict*, 89 Neb. 293, 131 N.W. 598 (1911); *Plummer v. Park*, 62 Neb. 665, 87 N.W. 534 (1901); *National Life Ins. Co. v. Butler*, 61 Neb. 449, 85 N.W. 437 (1901); *Hartsuff v. Hall*, 58 Neb. 417, 78 N.W. 716 (1899); *Northwestern Mut. Life Ins. Co. v. Butler*, 57 Neb. 198, 77 N.W. 667 (1898); *Lowenstein v. Phelan*, 17 Neb. 429, 22 N.W. 561 (1885); *Beisel v. Artman*, 10 Neb. 181, 4 N.W. 1011 (1880).

113. 206 Neb. at 480, 293 N.W.2d at 849.

114. 489 S.W.2d 529 (Tenn. 1973).

115. *Id.* at 532.

116. *Id.*

117. ABA Committee, *supra* note 24, at 907.

118. Citing *E.K. Buck Retail Stores v. Harkert*, 157 Neb. 867, 887, 62 N.W.2d 288, 301 (1954), the *Occidental* court said, "It is not the province of courts to emasculate the liberty of contract by enabling parties to escape their contractual obligations on the pretext of public policy unless the preservation of the public welfare imperatively so demands." 206 Neb. at 480, 293 N.W.2d at 849.

119. 206 Neb. at 480-81, 293 N.W.2d at 849.

contrary to public policy and void."¹²⁰

Analyzing the *Occidental* opinion from a savings and loan perspective, one must admit a great victory. With this opinion, the Nebraska Supreme Court has removed the due-on-sale from both the restraint-on-alienation and the public policy limitations imposed on the clause's enforcement by several other jurisdictions. Not only are these major stumbling blocks to enforcement removed from judicial scrutiny, but so is the lender's motivation for accelerating the clause. *Occidental* allows lenders to accelerate upon breach for any reason, including purely economic considerations. This overall license for automatic enforcement of the due-on-sale may have been carried to extremes, unless the court relies heavily on its equity powers to curtail possible abuse by lenders.¹²¹

C. Equitable Protections

Occidental preserves for the borrower one defense against automatic mortgage acceleration: traditional equitable relief. Just how viable this defense will be is left to further judicial determination, due to the opinion's lack of specification. In announcing its standard for borrower relief, the court merely stated: "If permitting the lender to exercise the 'due-on-sale' clause in a particular case would be inequitable, a court of equity is not helpless to fashion appropriate relief."¹²²

While this language suggests that a court may hear proof of inequitable or unconscionable conduct, the exact burden a borrower must meet to obtain equitable relief is unknown. A look at other Nebraska cases defining a court's equity powers in fashioning appropriate relief is not helpful for resolving this question. However, a recent opinion, *Redding v. Gibbs*,¹²³ may be helpful. In *Redding*, the court granted a mortgagor relief from the effect of an otherwise enforceable acceleration clause when default was the result of unconscionable or inequitable conduct of the lender.¹²⁴ Citing *Domus Realty Corp. v. 3440 Realty Co.*,¹²⁵ the court stated: "Tested by ordinary definition and by common understanding, 'oppressive' means conduct that is unjustly burdensome, harsh or merciless and 'unconscionable' means conduct that is monstrously harsh,

120. *Id.*

121. The Nebraska court noted that absolute enforcement of the due-on-sale was subject to the rules enforcing any other acceleration clause, including the protection of equitable defenses. *Id.* at 481-82, 293 N.W.2d at 849-50.

122. *Id.*

123. 203 Neb. 727, 280 N.W.2d 53 (1979).

124. *Id.* at 736, 280 N.W.2d at 58.

125. 179 Misc. 749, 40 N.Y.S.2d 69 (1943).

that is shocking to the conscience."¹²⁶

Noting its own test for relief, the *Redding* court said "the gravity of the fault must be compared with the gravity of the hardship."¹²⁷ In *Redding*, the mortgagee predicated acceleration upon the inadvertent default of the mortgagor. Instead of inquiring into the reasons for the default, the mortgagee waited for the grace period to elapse and then brought the action to foreclose. The court held that the mortgagee had a duty to inquire about the default because it had knowledge that the default was inadvertent. Thus, the court held the action subject to equitable relief.

Under *Redding*, a Nebraska court would presumably strike down the due-on-sale clause when the lender's inequitable or unconscionable conduct occurred either in the formation of the contract, or as in *Redding*, in the case of the lender taking advantage of the borrower's inadvertent default. As an example of the first situation, inequitable conduct would occur when a lender promises to consent to a transfer upon the finding of a financially suitable transferee, but instead demands an assumption fee upon actual transfer.

In his dissent in *Graf v. Hope Building Corp.*,¹²⁸ Chief Justice Benjamin Cardozo set the standard for equitable relief in America. He stated: "Equity follows the law, but not slavishly nor always. . . . If it did, there could never be occasion for the enforcement of equitable doctrine."¹²⁹ Further expanding this explanation, the Chief Justice stated: "Let the hardship be strong enough, and equity will find a way, though many a formula of inaction may seem to bar the path."¹³⁰

Several other courts have fashioned similar tests, but, like Nebraska, none have affirmatively stated when equity will provide relief.¹³¹ The Colorado Supreme Court,¹³² however, hypothesized an occasion when equity would deny enforcement: equity would re-

126. *Id.* at 757-58, 40 N.Y.S.2d at 73.

127. 203 Neb. at 739, 280 N.W.2d at 60.

128. 254 N.Y. 1, 171 N.E. 884 (1930).

129. *Id.* at 9, 171 N.E. at 887.

130. *Id.* at 13, 171 N.E. at 888.

131. For example: "[T]his kind of clause is enforceable except in situations where its operation 'would be inequitable under the circumstances' and thus would justify the exercise of the court's equitable powers." *Miller v. Pacific First Fed. Sav. & Loan Ass'n.*, 86 Wash. 2d 401, 406, 545 P.2d 546, 549 (1976). "[D]efendant's refusal to consent to the sale of the mortgaged property to a financially responsible purchaser does not constitute, in and of itself, an unconscionable or inequitable exercise of its option to accelerate the balance due pursuant to the due-on-sale clause, which option is accordingly entitled to judicial enforcement." *Mutual Real Estate Inv. Co. v. Buffalo Sav. Bank*, 90 Misc. 2d 675, 679-80, 395 N.Y.S.2d 583 (1977).

132. *Malouff v. Midland Fed. Sav. & Loan Ass'n*, 181 Colo. 294, 509 P.2d 1240 (1973).

lieve a borrower from a due-on-sale in which the lender attempted to exact excessive interest.¹³³

III. STATUTORY CONSIDERATIONS

Although the *Occidental* opinion did not consider the relevancy of certain state and federal statutes which bear on the enforceability of the due-on-sale clause,¹³⁴ an argument for enforceability could be based entirely upon statutes.¹³⁵

Federal authority for the enforcement of the due-on-sale clause lies in a Federal Home Loan Bank Board (FHLBB) regulation.¹³⁶ Pursuant to its congressional authority, the FHLBB promulgated rules and regulations governing and authorizing the use of due-on-sale clauses by federal savings and loan associations in all federal mortgages.¹³⁷ In its policy statement, the Board noted the necessity of using the due-on-sale to balance interest portfolios in order that a flow of new funds would continue to be available for future home loans.¹³⁸ The Board argued that the elimination of the clause would cause a substantial reduction in the cash flow and net income of federal associations, causing an increased interest rate in all future home loans.¹³⁹ Elimination of the due-on-sale, the Board continued, would benefit only a limited number of home sellers at the expense of the majority of home buyers and potential home buyers.¹⁴⁰

The FHLBB regulations temper extreme use of the clause by allowing enforcement only when an actual transfer of an interest

133. *Malouff* limited its holding of the per se enforceability of the due-on-sale clause in order to increase interest by warning that any attempt to exact an excessive rate unrelated to the current market rate would require that the court order relief for the borrower. *Id.* at 303, 509 P.2d at 1245.

134. Federal regulations, authorize the use and enforcement of due-on-sale clauses in all federal savings and loan association mortgages. 12 C.F.R. § 546.6-11(b) (1980). NEB. REV. STAT. § 8-355 (Cum. Supp. 1978) gives Nebraska-chartered savings and loans all rights and privileges of federal savings and loans. Read together, an argument could be made that the due-on-sale clause is authorized in all Nebraska mortgages.

135. This argument, including state and federal statutes was fully briefed by the parties in *Occidental*. See Brief of Appellee at 39-41; Brief of Amicus Curiae, Nebraska League of Savings Associations, at 3-13; Reply Brief of Appellants at 3-6.

136. The Federal Home Loan Bank Board is responsible for the regulation of federal savings and loan associations. It was created as an independent agency of Congress pursuant to 12 U.S.C. § 1464(a) (1976 & Supp. III 1979), as amended by Act of Mar. 31, 1980, Pub. L. No. 96-221, § 304 (1980) (to be codified in 12 U.S.C. § 1464(a)).

137. 12 C.F.R. § 545.8-3(f)(g) (1980).

138. 41 Fed. Reg. 6285 (1976).

139. *Id.*

140. *Id.*

in property takes place, thus eliminating acceleration upon further encumbrance or lease.¹⁴¹ The regulations also limit acceleration to clauses which do not provide for prepayment penalties.¹⁴² Occidental argued that a Nebraska statute incorporated these federal regulations into state law and thus mandated the use of due-on-sale clauses in all mortgages.¹⁴³ The Nebraska statute gives all savings and loans incorporated in Nebraska all rights, privileges, benefits, and immunities which may be exercised by federal savings and loans.¹⁴⁴ Occidental further argued that the federal regulations specifically provide for the enforceability of due-on-sale clauses and have thus pre-empted any contrary state rule with regard to due-on-sale clauses affecting federal savings and loan associations.¹⁴⁵

Finally, Occidental argued that the entire area of due-on-sale clauses was pre-empted—federal savings and loans by the FHLBB regulation and Nebraska-chartered savings and loans by Nebraska statutes.¹⁴⁶

In its *amicus curiae* brief, the Nebraska League of Savings Associations explained the relation between the federal and state law in this area:

State Associations must directly compete with federals. They must survive in a market dominated by financial and monetary decisions made at the federal level. However desirable we may think it would be to make decisions affecting state mortgage lending on a state level, the legislature

141. 12 C.F.R. § 545.8-3(g) (1980) provides as follows:

(g) *Limitations on the exercise of due-on-sale clauses.* With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association: (1) Shall not exercise a due-on-sale clause because of (i) creation of a lien or other encumbrance subordinate to the association's security instrument; (ii) creation of a purchase money security interest for household appliances; (iii) transfer by devise, descent, or operation of law on the death of a joint tenant; or (iv) granting of a leasehold interest of three years or less not containing an option to purchase; (2) shall not impose a prepayment charge or equivalent fee for acceleration of the loan by exercise of a due-on-sale clause.

142. *Id.*

143. Brief of Appellee at 38, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

144. NEB. REV. STAT. § 8-355 (Cum. Supp. 1978) states in part:

Notwithstanding any of the provisions of Chapter 8, article 3, or any other Nebraska statute, any association incorporated under the laws of the State of Nebraska and organized under the provisions of such article shall have all rights, powers, privileges, benefits, and immunities which may be exercised as of July 22, 1978 by a Federal savings and loan association doing business in Nebraska

145. Brief of Appellee at 39-40, *Occidental Sav. & Loan Ass'n v. Venco Partnership*, 206 Neb. 469, 293 N.W.2d 843 (1980).

146. *Id.*

has stated, in unambiguous terms, that it shall not be.¹⁴⁷

Thus, the Nebraska League's argument is that the legislature's purpose in enacting the savings and loan statute was to equalize state and federal savings and loan associations so that state associations would not be disadvantaged by federal law.¹⁴⁸

The federal pre-emption issue was tested in *Glendale Federal Savings and Loan Association v. Fox*.¹⁴⁹ The court held that federal regulations specifically authorized the enforcement of due-on-sale clauses in federal savings and loan associations and that any contrary state law was pre-empted.¹⁵⁰ The *Glendale* court stated: "Federal associations shall not be bound by or subject to any conflicting State law which imposes different . . . due-on-sale requirements . . ." ¹⁵¹ *Glendale* implicitly overruled *Wellenkamp* in so much as it affected use of the due-on-sale by federal savings and loan associations.¹⁵²

IV. CONCLUSION

Decisions such as *Wellenkamp*,¹⁵³ which have invalidated the due-on-sale clause on the basis of *presumed* social need and the *presumed effect* of the due-on-sale on the marketplace, have given property owners a short-lived victory. A legislative counter-offensive has already begun, giving mortgagees access to other inflation-fighting mortgage devices.¹⁵⁴ The use of variable-interest mortgages is at least as, if not more, oppressive to the mortgagor as the due-on-sale clause.¹⁵⁵

The varying circumstances of the marketplace often dictate use of undesirable methods of control, but this does not mean that they should be stricken as against public policy. *Occidental* took a

147. Brief of Amicus Curiae, Nebraska League of Savings Association, at 13.

148. *Id.*

149. 459 F. Supp. 903 (C.D. Cal. 1978).

150. *Id.* at 907.

151. *Id.* at 912 (citing 41 Fed. Reg. 18287 (1976)).

152. *Id.*

153. 21 Cal. 3d 943, 148 Cal. Rptr. 379, 582 P.2d 970 (1978).

154. See CAL. CIV. CODE § 1916.5 (Deering 1971 & Supp. 1980).

155. One critic of the *Wellenkamp* decision noted the minimal differences between a due-on-sale and the variable-interest mortgage by concluding:

The economic effect of the variable-interest rate mortgage and the exercise of the due-on clause to achieve an interest rate increase cannot be vastly different. While the court [*Wellenkamp*] approves of use of the variable rate mortgage, it declares illegitimate the use of the due-on clause to achieve the same purpose. Why it is unjust to burden the property owner with the effect of changing economic conditions under a due-on clause, but "attractive and viable" to do so under a variable rate mortgage, is unexplained.

ABA Committee, *supra* note 24, at 930 (footnotes omitted).

reasonable approach to a complex problem in Nebraska. By authorizing the due-on-sale in Nebraska, the court has allowed lenders and, in the long run, borrowers to be protected from the fluctuations of the market interest rates. Until the legislature corrects the problem statutorily, the due-on-sale appears to be the best way to balance the equities between lender and borrower.¹⁵⁶

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156. It is interesting to note that the 1980 Unicameral virtually eliminated the usury ceilings on home mortgage loans. NEB. REV. STAT. § 45-101.04 (Cum. Supp. 1980) provided a total exemption from interest rate ceilings on loans from any single institution over \$25,000. If due-on-sale clauses can be used to allow savings and loan associations to balance interest portfolios, maybe lenders will be more likely to resist the temptation of charging excessive interest rates on new loans.