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James E. Saloga

MORTGAGE CONSENT TO SALE CLAUSE: A REASONABLE RESTRAINT ON ALIENATION?

INTRODUCTION

From the beginning of its Anglo-Saxon origin, American jurisprudence has adhered to the proposition that restraints on alienation of real property are void.[1] The rule is based on social policy which recognizes that such restraints take property out of commerce. It attempts to rectify the undesirable consequences of concentration of land in the hands of a few, unnatural increases in land values, and waste by those who no longer have need to improve the property or put the land to beneficial and productive use.[2] With the passage of time it became apparent that some restraints on alienation were socially desirable and some exceptions were permitted.[3] Though exceptions developed to accommodate acceptable social goals, the rule remained otherwise firm. What developed was a pigeonhole application of the rule: if a restraint could be shown to fall within one of the recognized exceptions, it would be sustained; otherwise the restraint would be void.

Until recently, the mortgage consent-to-sale clause has been held void as a restraint on alienation.[4] Such a clause simply requires that before a mortgagor can alienate the mortgaged property, he must obtain the consent of the mortgagee. The clause is employed by mortgagees to further protect their security interest. If the property is alienated in violation of the clause, the mortgagee seeks to void the transfer. When the consent-to-sale clause is used in connection with an acceleration clause, the mortgagee attempts to void the transfer and accelerate payment. The past failure of attempts to enforce a mortgage consent-to-sale clause can be attributed to the axiom that a mortgagor may at any time dispose of his title held in fee.[5] The consent-to-sale clause attempts to prohibit transfer of the property title.

This conflict raises the issue of whether such a clause meets with the goals of social policy and thus should be adopted as another exception to the rule against restraints on alienation.

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1. H. CAREY & D. SCHUYLER, ILLINOIS LAW OF FUTURE INTERESTS 538-41 (1941) [hereinafter cited as CAREY & SCHUYLER].
2. Bernhard, *The Minority Doctrine Concerning Direct Restraints On Alienation*, 57 MICH. L. REV. 1173, 1179-80 (1959) [hereinafter cited as Bernhard].
3. *See* text accompanying notes 14-33 *infra*.
4. Bernhard, note 2 *supra*, at 1176.
5. 59 C.J.S. *Mortgages* § 389 (1949).

Perhaps the emphasis should be shifted from consideration of new exceptions to consideration of whether a test of reasonableness should be applied to the restraint. The issue then becomes whether a test weighing the reasonableness of the restraint would better serve the rule than having the rule itself engulfed by its many exceptions. Based on such a proposition, the rule would be implemented as the rule against *unreasonable* restraints on alienation.

To the mortgagee seeking to validate a consent-to-sale clause, the effect of the conceptual differences between a rule with exceptions and an exclusionary test removing conduct from the parameters of the rule is negligible: either way the benefits of the clause obtain. Nevertheless, by applying the reasonableness test, the courts would have greater flexibility in assessing both the establishment of or implementation of new restraints. Attorneys would be able to argue their cases under the broader concepts of reasonableness and fairness rather than be restricted to showing that a restraint falls within the technical bounds of some pre-established exception.

At present, the rule-with-exceptions approach is exercised by the majority of jurisdictions. Such an approach is limited to a class-by-class application. Once a factual situation falls within or without one of the exceptions, the law is strictly applied. On the other hand, the minority doctrine applying the reasonable restraint test allows for case by case implementation. Between the two, the latter tends to operate as a rule of exclusion, denying relief where it otherwise might be warranted. Until very recently, only Kentucky applied the reasonable restraint test.[6]

While the mortgage consent-to-sale clause could be fashioned as a new exception under the rule-with-exceptions approach, the better argued position is that validation be based on the premise that such a restraint is not socially unreasonable. The courts would retain flexibility to ascertain the reasonableness of the restraints as applied to the circumstances in the cases before them. As an exercise in legal reasoning, a rule prohibiting unreasonable restraints on alienation settles on more solid foundation that does a rule which first strips all restraints of their validity and then begins mending its error of exclusivity by creating exceptions to itself, especially where such restraints are reasonable as determined by social policy.

The scope of this comment is to examine the nature of restraints on alienation, with a view toward the application of a

6. Bernhard, note 2 *supra*, at 1176.

test of reasonableness and the suitability of the mortgage consent-to-sale clause in meeting this test. To this end a survey will first be made of the rule and the exceptions allowed under it. This survey is to be followed by an historical tracing of the rule against restraints as applied in Illinois, including the recent rise of the reasonableness doctrine in Illinois. Further, the interest sought to be protected by the mortgage consent-to-sale clause will be considered. Finally, judicial balancing of that interest with the interests to be protected by the rule against restraints will be explored to determine the way the scales of justice are tilting.

NATURE OF THE RULE AGAINST RESTRAINTS ON ALIENATION

To ensure freedom of alienation at common law, two devices evolved: the rule against perpetuities and the rule against restraints on alienation. Both deal with suspension of the power of alienation but in different ways.[7] The rule against perpetuities is a rule against remoteness and voids any limitation which postpones the vesting of interest in property beyond lives in being plus twenty-one years.[8] The rule against restraints on alienation operates on interests already vested and voids provisions which prohibit alienation.[9] These concepts are often confused. In the case of mortgage agreements and consent-to-sale clauses it should be understood that they do not affect the vesting of the property interest, but take effect upon an interest already vested. Thus, they do not offend the remoteness doctrine characteristic of the rule against perpetuities. This distinction is important because the rule against perpetuities is sometimes used to limit one of the exceptions to the rule against restraints.[10]

Generally, restraints may be classified into three categories: disabling restraints, forfeiture restraints and promissory restraints. Under a disabling restraint, any attempt at alienation contrary to the restraint is void and title never moves from the restrained party.[11] Such restraints are generally ineffective[12] as

7. Goddard, *Non-Assignment Provisions In Land Contracts*, 31 MICH. L. REV. 1, 2-4 (1932) [hereinafter cited as Goddard].

8. *See generally* T. BERGIN & P. HASKELL, PREFACE TO ESTATES IN LAND AND FUTURE INTERESTS 183-230 (1966).

9. Goddard, note 7 *supra*, at 2-4.

10. *See* text accompanying notes 14-19 *infra*. An acknowledged exception to the rule against restraints on alienation deals with restraints qualified as to time wherein an otherwise acceptable restraint is voided for extending beyond the rule against perpetuities. Manning, *The Development Of Restraints On Alienation Since Gray*, 48 HARV. L. REV. 373, 381-91 (1935) [hereinafter cited as Manning].

11. Bernhard, note 2 *supra*, at 1173. For example, where a party attempts to transfer title to a member of the Negro race, in violation of a disabling restraint, title never passes to the vendee. The injustice done

applied to real estate because of their arbitrary nature and the injustices worked on bona fide purchasers. Under a forfeiture restraint, any attempt at alienation contrary to the restraint causes the property to be forfeited to the party claiming equitable rights under the restraint. A promissory restraint exists when a party has promised not to alienate the property. This type of restraint is enforceable by contract remedies and has no direct impact on the title to the property. Further, disabling restraints are absolute, whereas forfeiture and promissory restraints may be eliminated by agreement of the parties.[13] Under the disabling restraint, the party imposing the restraint does not retain any interest thereby in the property and, therefore, cannot alter the terms of the restraint. Under the forfeiture or promissory restraint the party imposing the restraint thereby retains an interest in the property and, therefore, may join with the restrained party to alter the terms of the restraint.

Many exceptions to the rule against restraints have sprung up under forfeiture and promissory restraints. Only a few will be treated here to show the nature of the restraints which the courts have allowed. These will give clues as to the considerations which will influence the development of the reasonable restraint test.

Restraints as to Time

A restraint as to time prohibits further conveyance for a specified period of time. In Illinois restraints upon alienation of a fee, though limited as to time, are invalid.[14] However, such limited restraints have been allowed elsewhere.[15] Generally, the maximum amount of time over which a restraint may last is that set forth in the rule against perpetuities: lives in being plus twenty-one years.[16] Although there are no decisions sustaining a restriction otherwise unqualified for a period of that length, the adoption of this time limitation by text writers has been taken from dicta claiming such restraints valid.[17] It should be noted, however, that in voiding restraints as to time for being too long, a court would be applying the law prohibiting restraints on alienation, not the rule against perpetuities. The latter would simply be used as a measuring stick because the rule itself ap-

is that the vendee may not discover this until some later date. Under the forfeiture or promissory restraint, there is some third party who has an interest to protect and who will come forward immediately.

12. *Id.*
13. *Id.* at 1174.
14. McFadden v. McFadden, 302 Ill. 504, 135 N.E. 31 (1922).
15. Manning, note 10 *supra*, at 381.
16. *Id.* at 383-91.
17. *Id.* at 386-87.

plies to remoteness in vesting not to restraints on vested rights. Nevertheless, caution dictates that terms within the bounds of the rule against perpetuities be used. Restraints so limited are not viewed in a vacuum, but rather consideration is given to the reasons for using such restraints. It is clear that such restraints will not be sustained simply because they are present and within the time span of the rule against perpetuities.[18] Carey and Schuyler in *Illinois Law of Future Interests* warn:

> While it is true that time restrictions are thus capable of judicial control, if recognized, it is not at all apparent that temporal restrictions have, as a rule, the socially desirable objectives that so frequently motivate the creation of personal as distinguished from temporal restraint. This the same writer concedes to be true and upon this assumption it is not difficult to understand and, indeed, to justify the decisions which nullify temporal restraints completely.[19]

Nevertheless, it seems that temporal restraints have gained wide acceptance and when combined with other acceptable restraints may themselves be a tool in meeting the elements of the reasonable restraint test.

Restraints as to Persons

Restraints as to persons or classes of persons are generally recognized in most of the United States.[20] Professor John Chipman Gray stated the rule in its most general terms to be that conditions not to alien to a particular class are good, while conditions forbidding alienation except to a particular class are void.[21] The true test to be used is one of reasonableness as to the size of the class to be excluded. Carey and Schuyler noted:

> The conclusion is therefore inevitable that restrictions of this character should be sustained whenever they are reasonably designed to attain accepted social and economic ends.[22]

Thus, it can be seen that the reasonableness test is in fact being used to create this exception. It is difficult to determine whether the test or the exception is the standard, or why the latter is necessary.

Applying a limitation as to persons in a consent-to-sale clause would be impractical and in many instances would involve too large a class. However, some sort of exclusion as to a class of persons designated as high credit risks, when combined with a reasonable restraint clause as to time, would compel courts to

18. *Id.* at 386-91.
19. CAREY & SCHUYLER, note 1 *supra*, at 543.
20. Manning, note 10 *supra*, at 375.
21. J. GRAY, RESTRAINTS ON THE ALIENATION OF PROPERTY 74 (1898).
22. CAREY & SCHUYLER, note 1 *supra*, at 549.

take note of the limited restraints being used and consider these factors in ruling on the clause.

Restraints as to Mode

This exception to the rule against restraints is narrowly limited where accepted.[23] For example, a restraint that further transfer may be by sale alone does not appear to fall within this exception.[24] Instead, it seems to be limited only to restraints in conveyances to tenants in common which prohibit partition during a given period.[25] However, the limitations on this exception do not foreshadow the demise of the arguments applied to the consent-to-sale clause because that clause does not relate to mode of transfer.

Spendthrift Trust

A spendthrift trust is one in which, either because of a direction by the settlor or because of statute, the beneficiary is unable to transfer his right to the property while it remains in the control of the trustee. The restraint is against present transfer of property to be received by the beneficiary in the future. Once the property is transfered from the trustee to the beneficiary, the spendthrift clause ceases to be effective and the beneficiary is free to further convey the property.

This device, as a restraint on alienation, enjoys the broadest support of all the exceptions to the rule against such restraints. Spendthrift trusts do not involve fee interests in land, but they nevertheless demonstrate the judicial support which a restraint on alienation can obtain once it is determined to be reasonable. The spendthrift trust is designed to protect and provide for the beneficiary. This benevolent goal has won for the trust its wide acceptance.

Pre-emption Rights

Another type of restraint on alienation which has gained recognition is that containing pre-emption provisions which require that before land can be sold, it must be offered to the grantor or other specified party. This accepted restraint may serve as a model for the courts to rely upon in holding the consent-to-sale clause to be a reasonable restraint. Pre-emption rights are widely accepted if reasonable.[26] In validating such

23. Manning, note 10 *supra*, at 391-94.
24. *Id.*
25. *Id.* at 393.
26. RESTATEMENT OF PROPERTY § 413(2) (1944). The rule against restraints on alienation is applicable to pre-emption rights. However, an

restraints the courts have displayed the ability to discern the reasonable from the unreasonable, and this tendency of the courts should be a source of confidence to those seeking to validate the consent-to-sale clause.

Normally, a pre-emption clause contains a formulation to establish a repurchase price and has been sustained.[27] If, on the one hand, the repurchase price is fixed at the time of the initial sale, it is voided as unreasonable.[28] Similarly, formulations which give the repurchaser control over the price are usually held invalid.[29] On the other hand, it appears that formulations based on objective standards or within the control of the owner would be sustained.[30] The courts have been willing in this area to weigh the interests of both parties and, when reasonably balanced, have sustained the restraints.[31]

If the courts have fashioned a set of rules applicable to pre-emptive restraints, it seems that a similar set of rules could be fashioned regarding consent-to-sale clauses. Such a set of rules under a reasonableness standard would only have to insure that the written clause does not violate the time limitation of the rule against perpetuities, that it does not offend limitations as to class and that it does not otherwise restrict mode of alienation. If these conditions are satisfied, the courts could then explore the reasonableness of the restraint by balancing the interests of the mortgagor against the interests of the mortgagee and society.

Non-assignment Provisions in Land Installment Contracts

In the land installment contract the vendor finances the sale by retaining legal title while the vendee makes installment payments and retains equitable title in the land. *Sloman v. Cutler*[32] established that a stipulation that the vendee not assign his interest without vendor's consent is valid. It should be noted, however, that the land installment contract differs from a mortgage

exception has been created as to conditional fees. Where the pre-emptive rights arise under conditions subsequent to the property transfer, they are held invalid as violations of the rule against restraints on alienation. Libby v. Winston, 207 Ala. 681, 93 So. 631 (1922). *See* Annot., 40 A.L.R.3d 920, 931 (1971).

27. Beets v. Tyler, 365 Mo. 895, 290 S.W.2d 76 (1956).

28. Kershner v. Hurlburt, 277 S.W.2d 619 (Mo. 1955) (court found restraint to be "substantial").

29. Concannon v. Haile, 81 Pa. D.&C. 480 (1952).

30. *See* Annot., 40 A.L.R.3d 934 (1971).

31. Missouri State Highway Comm'r v. Stone, 311 S.W.2d 588 (Mo. App. 1958). There, the court looked to, (1) the purpose for which the restraint is imposed, (2) the duration of the restraint, (3) the method of determining the price to be paid.

32. 258 Mich. 372, 242 N.W. 735 (1932).

situation in that the vendor has legal title and vendee equitable title. Thus, the restriction is upon the equitable title. In a mortgage arrangement the mortgagee has equitable claims and tries to restrain the mortgagor's right of alienation of his legal title. Despite these reversed roles, the rationale used to support the non-assignment clause is applicable to the consent-to-sale clause. There is no undue restraint on alienation. The restrained party may, by full performance in accordance with the agreement, secure full legal and equitable title with right to free disposal of the land. Further, the parties may join together and alienate the property at any time.

From this historical review it can be seen that the development of the rule against restraints on alienation has been riddled with exceptions. An examination of these exceptions reveals that the foundation for each exception has rested on the principle that the restraint sought to be enforced was reasonable. In fact, some of the exceptions apply the reasonable restraint test to determine if a particular restraint falls within the exception.[33] Courts have begun to recognize this anomaly and have taken steps to make reasonableness of restraint the sole test. A closer inspection of this shift in judicial posture as it relates to Illinois law deserves consideration.

Illinois Interpretation of the Rule Against Restraints on Alienation

Illinois has long been a haven for the strict application of the rule against restraints on alienation. Exceptions widely applied elsewhere have not been recognized in Illinois. In *McFadden v. McFadden*[34] a conveyance of property was made by a father to his son with a condition subsequent that the son not further convey the property for twenty years following the father's death. The court found that the clause restraining alienation was repugnant to the estate conveyed and void as against public policy. Similarly, in *Jenne v. Jenne*[35] the court struck a clause restraining alienation as to persons. Here, a devise of property was made with the stipulation that no interest in the property shall be given to Samuel Sean or his wife. The court held that if a testator makes an absolute gift of property, he cannot by another clause restrict the fee use or disposition.

Restraints as to mode of transfer met a similar fate in *Noth v. Noth*.[36] Anna Noth devised certain real estate to her children

33. *See* text accompanying notes 14-19 *supra*; Bernhard, note 2 *supra*.
34. 302 Ill. 504, 135 N.E. 31 (1922).
35. 271 Ill. 526, 111 N.E. 540 (1916).
36. 292 Ill. 536, 127 N.E. 113 (1920).

with the restriction that further transfers be conditional upon the death of a certain third party without issue. The court held such restraint to be void. Finally, in *McNamara v. McNamara*,[37] the court again concluded that restraints upon a fee are void. Here a devise to testator's children was sustained as to the fee with the court removing the restraint prohibiting further transfer for fifteen years. The court held that where the restraints on alienation of land in fee are invalid, the devise nevertheless continues and the devisee takes an absolute fee.[38]

Although Illinois has consistently refused to apply exceptions which are recognized in other jurisdictions, the Illinois Supreme Court, in *Gale v. York Center Community Cooperative, Inc.*,[39] chose to view the rule as voiding "unreasonable" restraints on alienation. The court reviewed the rule and found that "the crucial inquiry should be directed at the utility of the restraint as compared with the injurious consequences that will flow from its enforcement."[40] This expression of the issues raised by the rule against restraints on alienation forebodes a shift from traditional applications of the rule. At this juncture, the court was free to abandon its previous restrictive attitude. In so doing, the court adopted a more precise version of the rule: that the rule prohibited *unreasonable* restraints on alienation. The court formulated this version of the rule by stating:

> If accepted social and economic considerations dictate that a partial restraint is reasonably necessary for their fulfillment, such a restraint should be sustained.[41]

Gale was an action by a co-operative housing association against members to whom the association had deeded properties pursuant to the membership agreement. The purpose of the membership agreement was to convey a fee title and thus allow the members to obtain their own mortgage financing. The particular restraint argued was that the co-operative was to have a twelve-month option to repurchase the property if a party desired to sell. After this period lapsed, the party would be free to sell. Applying the rule quoted above, the court directed the members to reconvey their properties to the association pursuant to the agreement. The restraint was held to be necessary to the existence of the co-operative enterprise.[42]

The matter was not again litigated until 1974 when, in *Baker v. Loves Park Savings and Loan Association*,[43] the Illinois Appel-

37. 293 Ill. 54, 127 N.E. 130 (1920).
38. *Id.*
39. 21 Ill. 2d 86, 171 N.E.2d 30 (1960).
40. *Id.* at 92, 171 N.E.2d at 33.
41. *Id.*
42. *Id.* at 93, 171 N.E.2d at 33.
43. 21 Ill. App. 3d 42, 314 N.E.2d 306 (1974).

late Court, Second District, remanded a mortgage consent-to-sale clause case to the circuit court for application of the reasonable restraint test. Loves Park, as mortgagee, had issued a mortgage to Robert and Laurie Baker on their home in Rockford, Illinois. The mortgage agreement contained a standard acceleration clause:

> 'We further agree that upon any default upon this obligation, or the instrument securing it, interest at the rate of 1 percent (1%) per annum above the original rate provided herein on the unpaid balance of this indebtedness may be charged for the period of such default. Upon any default under this obligation, or the instrument securing it, at the option of the holder of this note, the unpaid balance of this note, and any advances made under it, or the instrument securing it, together with interest, shall become due and payable. . . .'[44]

It also contained a consent-to-sale clause which in relevant part stated:

> 'A. THE MORTGAGOR COVENANTS DURING THE TERM OF THIS MORTGAGE:
> (8) Not to suffer or permit without the written permission or consent of the Mortgagee being first had and obtained. . . .
> (d) A sale, assignment or transfer of any right, title, or interest in and to said property or any portion thereof. . . .'[45]

The Bakers sold their house on installment contract to a third party without first obtaining the mortgagee's consent. Loves Park notified the plaintiffs that it would not consent to the sale and that the note was therefore in default. The bank opted to enforce the 1% penalty of the acceleration clause. However, the circuit court granted summary judgment for plaintiffs by holding the consent-to-sale clause to be an unlawful restraint on alienation.

On appeal, the appellate court took issue with the trial court's holding that the restraint was unlawful because that court neglected to first ascertain whether the restraint was unreasonable. In setting forth this test, the appellate court adopted language similar to that used in *Gale*:

> Consequently, only where a restraint in [*sic*] alienation is reasonably designed to attain or encourage accepted social or economic goals will it be sustained.[46]

Thus, the *Baker* case affirmed the reasonable restraint test enunciated in *Gale*. It is not clear from the *Gale* decision whether the test requires a showing of both economic and social reasonableness or whether a showing of one or the other is suf-

44. *Id.* at 43, 314 N.E.2d at 307-308.
45. *Id.*
46. *Id.* at 44, 317 N.E.2d at 308.

ficient. The *Gale* court used the words "social *and* economic."[47] The *Baker* court, on the other hand, used the phrase "social *or* economic."[48] It is safe to assume that demonstrating both would meet the elements of the test. Also, a showing of accepted social considerations would probably meet with judicial approval, since many of the recognized exceptions under that theory are based on social considerations.[49]

Because Illinois courts have consistently rejected the exception-to-the-rule approach, compelling social considerations have gained independent recognition as a prelude to application of the reasonable restraint test. In *Swannell v. Wilson*[50] a restraint on alienation incorporated into a divorce decree was upheld because of the protection the clause provided to the wife. Like spendthrift trusts, restraints which protect the interests of the immediate family are apparently sustainable if not in conflict with the rule against perpetuities. The court in *Swannell* refused the proposition that restraints on alienation were, per se, against social policy and void. Instead, the court concluded that a violation of public policy must first be shown in order to sustain a finding that the restraint was void. This theory was the embryo of the reasonable restraints test.

In *Dickenson v. City of Anna*[51] the Illinois Supreme Court allowed a restraint upon alienation of property given to charity. The *Gale* court cited both *Swannell* and *Dickenson* in support of its own decision to apply the reasonable restraint test.[52] While *Gale* used the conjunction "and" in its statement of the test, its reliance on cases sustaining restraints which had only social foundations gives weight to the proposition that social matters which meet the reasonable restraint test will be sustained. Finally, the appellate court's change of conjunction to "or" in *Baker* lends strong support to this thesis.

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47. 21 Ill. 2d at 92, 171 N.E.2d at 33 (emphasis added).
48. 21 Ill. App. 3d 42, 44, 314 N.E.2d 306, 308 (1974) (emphasis added).
49. Bernhard, note 2 *supra*. Consider, for example, the spendthrift trust.
50. 400 Ill. 138, 79 N.E.2d 26 (1948). Plaintiff and her husband entered into a property settlement agreement as part of their divorce settlement. It was therein provided that as to property held jointly by them, neither party could sell their interest without the consent of the other. Thus, the surviving party would take full title under right of survivorship. The property in question was income producing. The husband attempted to convey the property to his second wife. The court found that the agreement was designed to protect each party's respective interest in the property. As part of the divorce decree, the settlement had been given the sanction of the courts. The court held that the restraint was not one restricting alienation in the sense of the general rule against restraints, but was to protect interest already held.
51. 310 Ill. 222, 141 N.E. 754 (1923).
52. 21 Ill. 2d at 92, 171 N.E.2d at 33.

Uncertainty, however, surrounds the economic element. No Illinois case can be found where economic factors alone were recognized by a court to be sufficient to justify a finding that the restraint was reasonable. Based on the facts, *Gale* certainly approaches a result based solely on economic results. The real benefit to be derived by the York Center Cooperative, Inc. was economic control over its co-operative property. Benefits to society were negligible and related only to the stability maintained in the community. Yet, it must be remembered that it was the *Gale* court which used the conjunction "and" in creating social and economic elements to be used in applying the reasonable restraint test. It appears that restraints which are only economically reasonable would not be sustained without a showing of at least some social benefit. The more the economic considerations stabilize or benefit society, the more likely it is that sufficient social gain will be found and together the two elements meet the test of reasonableness.

THE INTERESTS TO BE PROTECTED BY THE MORTGAGE CONSENT-TO-SALE CLAUSE

Developing the reasonable restraint test and gaining judicial cognizance of it is only a beginning in the process of its application. The application requires that the interest sought to be protected be clearly defined and then weighed against the social policies that support the rule against restraints on alienation. In the field of mortgages, the interest sought to be protected is that of a security interest. When a consent-to-sale clause is incorporated into a mortgage agreement, the document attempts to protect two secured interests: the mortgage establishes the land as security against default by the mortgagor, and the consent-to-sale clause establishes the mortgagor's credit standing as security against continued diminution of value in the property beyond such time as the mortgagor is unable to himself pay the mortgage installments. These cross-security interests are designed to protect the mortgagee's loan.[53]

Land sales may be executed in a variety of ways. The simplest and most conclusive is the direct sale whereby the buyer pays the seller and receives title. The transaction is then at an end. Another direct sales method is employed in the installment sales contract in which the seller retains title while the buyer makes payments on the contract. When an agreed upon sum is paid, the legal title is transfered to the buyer. Under this

53. *See* text under sub-heading entitled, *Continued Diminution in Mortgage Property Value Through Financed Installments, infra.*

arrangement, the buyer has equitable title throughout the payment period and has immediate right to possession and use. In contrast, mortgage transactions are indirect. The buyer finances his payments by obtaining a mortgage. The seller transfers the deed and legal title to the buyer while the mortgagee obtains equitable title. Generally, the mortgagor can freely convey his legal title to anyone. A purchaser of mortgaged property may take the property and assume the mortgage, thereby becoming liable on the mortgage along with his seller; or the buyer may take the property subject to the mortgage, incurring no additional liability on the mortgage beyond the property. In all of these methods the land serves as security against the mortgagor's default in payment, but the land does not secure other risk factors sought to be protected by a mortgagee when he accepts the mortgage. This difference is crucial to the mortgagee.

Continued Diminution in Mortgage Property Value Through Financed Installments

Under the methods of property financing described above, if in a time of decreasing land values the mortgagor cannot make his payments, he can sell the land and extend his ability to make the mortgage payments in hopes of avoiding further depletion of his personal assets. The risk to the mortgagee is that the land value will fall below the value of the outstanding debt. Because the mortgagor has extended his ability to make payments, default proceedings are not available to the mortgagee. He must sit idly by as his security decreases in value. Then, when the land becomes worthless and the third-party buyer is unable to pay the mortgagor, he, the mortgagor, will become financially disabled and will default. It is at this point that the mortgagee can foreclose, but he may get only a worthless piece of property and a cause of action against a bankrupt mortgagor.

The above represents an extended diminution of mortgaged property value through financed installments, or "continued diminution." It is precisely this risk which is sought to be protected against by the restraint on alienation through the consent-to-sale clause. By use of the consent-to-sale clause in conjunction with an acceleration clause, the mortgagee can assess and bargain with the prospective third-party buyer. Upon breach of the consent-to-sale clause, the mortgagee can declare a default, accelerate payment and, if necessary, foreclose before the value of the land falls further than it would if the mortgagor were allowed to make payments financed by the prohibited transfer of the property.

Interest Rates as a Function of Supply and Demand And as Compensation for Assumed Risks

In addition to protection against continued diminution in value, some courts have found that the consent-to-sale clause is justified to protect a mortgagee's right, in a climate of rising interest rates, to use the clause to bargain with the third-party purchaser for a new rate of interest. For example, in *Cherry v. Home Savings and Loan Association*,[54] a consent-to-sale clause was upheld in an action against a mortgagor who attempted to sell in violation of the clause. The court pointed out that a lender places some value on the reliability of the person to whom it loans money. A lender may be willing to loan money to a credit-worthy party at one rate of interest, while as to a person who represents a grave credit risk he may want to increase the rate of interest charged. The court found the consent-to-sale clause to be a legitimate method of reaching that goal.

The Consent-To-Sale Clause As a Reasonable Restraint

Since 1964, several courts have determined that it is reasonable for a lender to condition a granting of credit upon an agreement that the borrower retain his interest in the property securing the debt—in order to avoid the continued diminution risk.[55]

In *Coast Bank v. Minderhout*,[56] Burton and Donald Enright executed notes on several loans made at Coast Bank. By separate agreement, the Enrights sold the property to the defendants. The bank accelerated the due date, and upon failure to collect the unpaid balance, it brought an action to foreclose on the property. The court recognized that the consent-to-sale clause constituted a restraint on alienation. Nevertheless, the court sustained the consent-to-sale clause. After reviewing the rule against restraints and some of the exceptions to the rule, the court found that:

> In the present case it was not unreasonable for plaintiff to condition its continued extension of credit to the Enrights on their retaining 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 Enrights encumbered or transfered the property.[57]

54. 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969). This case has been followed by courts in other jurisdictions. Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240 (Colo. 1973); Gunther v. White, 489 S.W.2d 529 (Tenn. 1973); Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works, 58 Wis. 2d 99, 205 N.W.2d 762 (1973).

55. The condition that the borrower retain his interest in the property is set forth in a consent-to-sale clause.

56. 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

57. *Id.* at 317, 392 P.2d at 268, 38 Cal. Rptr. at 508.

It is important to note that the consent-to-sale clause was not part of a mortgage. Instead, it was a separate agreement providing security on prior notes. The court sustained the clause on the basis that the clause itself created an equitable mortgage. The actual case for foreclosure was based upon the execution of the acceleration clause contained in the notes. The crucial link between the two agreements was that the default which executed the acceleration clause was the transfer of the property —not a failure to meet installment payments. Also noteworthy is the court's expression of doubt that the consent-to-sale clause could be specifically enforced in light of the availability of foreclosure as a remedy.[58] From this statement the consent-to-sale clause became characterized as a forfeiture restraint rather than a promissory restraint. It had been suggested that the interest to be protected was the "continued extension of credit"[59] and that the restraint was reasonable because commercially compelling.[60]

The *Minderhout* decision is significant not only for having applied the reasonable restraint test, but also for suggesting a new drafting tool to mortgage underwriters. All that remained to be done after *Minderhout* was for the consent-to-sale clause to be incorporated in mortgage agreements along with, or directly as part of, the acceleration clause.

The new drafting measure met with wide acceptance. In 1970 the courts in Ohio[61] and New York[62] sustained the mortgage consent-to-sale clause. In *Peoples Saving Association v. Standard Industries, Inc.*,[63] a conveyance in breach of the clause was treated by the bank as a default invoking an acceleration clause. The Ohio appellate court held the bank's interest to be "justifiable"[64] and said:

> The right of the mortgagee to protect its security by maintaining control over the identity and financial responsibility of the purchaser is a legitimate business objective and is not illegal, inequitable or contrary to the public policy. . . .[65]

In *Baltimore Life Insurance Co. v. Harn*,[66] a 1971 case, the Arizona appellate court penetrated the consent-to-sale clause by

58. *Id.*
59. Comment, *Coast Bank v. Minderhout And The Reasonable Restraint On Alienation: Creature Of Commercial Ambiguity*, 12 U.C.L.A. L. REV. 954, 960 (1965).
60. *Id.*
61. Peoples Sav. Ass'n v. Standard Indus., Inc., 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970).
62. Stith v. Hudson City Sav. Institution, 63 Misc. 2d 863, 313 N.Y.S.2d 804 (1970).
63. 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970).
64. *Id.* at 38, 257 N.E.2d at 407.
65. *Id.* at 38, 257 N.E.2d at 408.
66. 15 Ariz. App. 78, 486 P.2d 190 (1970).

insisting that reasonableness in invoking the clause must be apparent from the pleadings:

> The acceleration clause in this case is clearly a restraint on the mortgagors' ability to dispose of their property. We believe that so long as an acceleration clause does not purport to restrict absolutely the mortgagors' ability to dispose of their property there is not the type of restraint on alienation that would render the clause void. It follows that the invocation of the clause must be based on grounds that are reasonable on their face.[67]

This decision demonstrates the flexibility of using the reasonable restraint test. Magic words and phrases do not alone bring the matter within the bounds of some artificial exception to a rule and automatically confer validation upon it. Instead, a restraint which is reasonable and offends no social policy against alienation can be scrutinized to ensure that its use is proper. The court's burden in such instances can be lessened by leaving it to the parties to show reasonableness in their pleadings.[68]

In *Mutual Federal Savings and Loan Association v. Wisconsin Wire Works*,[69] an action was brought to foreclose a real estate mortgage after the defendant had conveyed the property in violation of the consent-to-sale clause. The 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.[70]

Finally, in *Malouff v. Midland Federal Savings and Loan Association*[71] the court sustained a "due-on-sale" clause.[72] But more importantly the court discussed the reasonable restraint test at length:

> The common law doctrine of restraints on alienation is a part of

67. *Id.* at 82, 486 P.2d at 193.

68. The *Harn* court devoted most of its effort to weighing not the reasonableness of the clause, but rather the manner in which it was used. Thus, by applying the reasonable restraint test to consent-to-sale clauses, the courts are free to sustain their use where social policy is found to support it and also, the court can void the clause where its use traverses the limits set by social policy. *See* Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 252 Ark. 849, 481 S.W.2d 725 (1972).

69. 58 Wis. 2d 99, 205 N.W.2d 762 (1973).

70. *Id.* at 112, 205 N.W.2d at 770.

71. 509 P.2d 1240 (Colo. 1973).

72. A due-on-sale clause is identical to the consent-to-sale clause in operation. Like the consent-to-sale clause, a due-on-sale clause operates to activate an acceleration clause when the sale clause is violated. The difference between the two clauses is merely conceptual. Under the consent-to-sale clause, the mortgagee consents to, or withholds consent from, the sale and upon violation of the clause invokes the acceleration clause. Under the due-on-sale clause, consent to any sale is withheld automatically by the clause, but consent may be given by agreement or waiver of the due-on-sale provision. Again, upon violation of the clause, the mortgagee may invoke the acceleration clause. The practical difference is that where the consent-to-sale clause is used, the mortgagee must take an additional step by first withholding its consent before invoking the acceleration clause.

> the law in Colorado. . . . In determining what restraints are invalid, some legal scholars have declared that all restraints on alienation are invalid unless they fall within certain recognized categories of exceptions. . . .
>
> In contrast to this rigid approach is the view that holds a restraint on alienation may or may not be invalid, depending upon the reasonableness of the restraint. . . . [T]he rule against restraints on alienation relates to unreasonable restraints. . . .
>
> We subscribe to the view that the question of the invalidity of a restraint depends upon its reasonableness in view of the justifiable interest of the parties.[73]

Thus it can be seen that since *Minderhout* the reasonableness of an attempted restraint is gaining widespread recognition as applied to consent-to-sale clauses. No appellate court has yet invalidated the clause on the basis that it is unreasonable.

Conclusion

Balancing the Interest

Public policy is the reason most cited for the rule against restraints on alienation. Conflicting with that doctrine are considerations of freedom of contract and economic vitality through secured transactions. All of these doctrines are giants in the law, constituting the premises and presuppositions called upon daily, almost unwittingly, by the student and practitioner of the law. When such giants meet head on, mediation appears hopeless. Here, however, the use of the reasonable restraint test can reconcile considerable conflict.

Under the strict rule against restraints on alienation, social policy demands such restraints be treated as void. Such restraints tend to take property out of commerce with the undesirable consequences that a natural increase in value will occur, that improvements will be discouraged and that property will not be put to its most beneficial use. In the case of the mortgage consent-to-sale clause, the concerns of public policy are protected, even fostered. By giving lenders proper security on their investments, money used to mortgage real estate transactions is more readily available at lower costs. Availability of funds facilitates land ownership by more people, thereby increasing the frequency of alienability. Also, persons liable for large sums on a mortgage have sound reason to maintain and improve their property because such improvements will increase values and insure against financial loss. Finally, the increased availability of mortgages will provide incentives for increasing the effective use of property.

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73. 509 P.2d 1240, 1243 (Colo. 1973) (emphasis by court).

In addition to the public policy objections, the doctrine of repugnancy is sanctimoniously expounded. This doctrine is aimed at preventing any demise of the fee simple—an estate which by definition contains no restraints. It is argued that any restraint of freedom of the right of alienability so crucially a part of the fee simple is repugnant to the very concept of fee simple. However, the consent-to-sale clause does not prevent alienation, for the parties may join and alienate the property at any time. Also, why not conceptually create another estate in land, lesser than the fee simple, which will allow for proper restraints?

In conclusion, alienation of property is more likely to flourish when mortgagees can adequately secure their loans. Strict application of the rule against restraints on alienation, to the exclusion of the consent-to-sale clause, may decrease the willingness of mortgagees to loan money and, ironically, be its own restraint on alienation.

James E. Saloga