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THE DUE-ON-SALE CLAUSE IN FLORIDA: A POTENTIAL BATTLEGROUND FOR BORROWERS AND LENDERS

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INTRODUCTION

The most common means of financing the transfer of private family dwellings in the State of Florida is through use of a mortgage.[1] In Florida existing mortgages are assumed in approximately 30 percent of residential property sales.[2] For example, in Dade County in February of 1978, the dollar volume representing the assumptions of mortgages was $42.5 million as compared to $23.3 million for new mortgages.[3]

The mortgagee-lender is usually not in privity with the parties contracting to sell and generally has no legal means to prevent a sale. He often seeks additional protection of his investment through his contract with the mortgagor-borrower.[4] An accepted method of protection is to include an acceleration clause in the mortgage or in the note which it secures.[5] Acceleration clauses often provide that upon default, usually defined as failure to make an installment payment, the entire unpaid balance becomes due and payable.[6]

Acceleration clauses based on default are generally upheld.[7] However, there is dissension among courts concerning the legality of "due-on-sale clauses."[8] A due-on-sale clause in a mortgage or a deed of trust commonly

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1. Markham, *Catch 22—Loophole Delays Home Sales*, Miami Herald, April 12, 1978 §H at 1, Col. 4.

2. *Id.* at 6, Col. 4.

3. *Id.* at 6, Col. 5.

4. The general rule is that the legal owner of property, absent a provision to the contrary, does not need the approval of the mortgagee to alienate his land. The mortgagee is powerless to prevent the assumption of the mortgage by a purchaser because the consent of the mortgagee is not necessary. However, the mortgagee is not required to accept the obligation of the purchaser in lieu of the mortgagor. The mortgagee may look to either party to satisfy his debt, but if he agrees to accept the new buyer, the one making the assumption becomes the principal obligor and the original maker the surety. *See* 2 R. BOYER, FLORIDA REAL ESTATE TRANSACTIONS, §32.14 (1977).

5. G. OSBORNE, HANDBOOK ON THE LAW OF MORTGAGES, §326 (2d ed. 1970).

6. *See, e.g.*, Treb Trading Co. v. Green, 102 Fla. 238, 242-43, 135 So. 510, 512 (1931); Federal Home Loan Mortgage Corp. v. Taylor, 318 So. 2d 203, 205 (Fla. 1st D.C.A. 1975).

7. The prevailing view appears to be that such a provision constitutes a valid contract and that in the event of a breach, enforcement will be accorded. However, a court of equity may refuse to enforce the provision by foreclosing the underlying mortgage if acceleration of the debt would be inequitable or unjust. *See* Treb Trading Co. v. Green, 102 Fla. 238, 242-43, 135 So. 510, 511-12 (1931).

8. An idea of how controversial the "due-on-sale" clause has become may be discerned from the following excerpt taken from a response to an inquiry concerning the clause: "The

provides for the acceleration of the entire outstanding balance of the debt upon sale of the property by the mortgagor without the prior consent of the mortgagee.[9] Thus, the due-on-sale clause is a specialized type of acceleration clause.[10]

The inclusion and exercise of due-on-sale clauses has become more prevalent in recent years for two basic reasons. Primarily, the clause provides an opportunity for the lender to raise the interest rate to the current market rate as waiver of acceleration is usually conditioned upon the buyer's acceptance of a higher interest rate.[11] Secondly, the provision enables the lender to protect his security interest by requiring prior approval before a prospective buyer assumes the note and the mortgage.[12] However, the due-on-sale clause has disadvantageous aspects for the seller-mortgagor. The absence of such a clause insures the continuance of the fixed interest rate which is usually lower than the current market rate, making the property more attractive to a prospective buyer.[13] Additionally a recent Florida Supreme Court decision which exempts federal savings associations from usury limitations,[14] taken in

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[Federal Home Loan Mortgage] Corporation anticipates becoming involved in litigation matters that concern the questions that you raise. Under these circumstances, I do not believe that it would be appropriate for the Corporation to express any views on the subject. I regret that I cannot be of assistance, but I am sure that you understand the contested nature of the topic you have chosen." Letter from Henry L. Judy, Vice President, General Counsel of The Federal Home Loan Mortgage Corporation to Brian O'Connell (July 6, 1978). States where legal challenges of such clauses have taken place are: Alabama, Arizona, Arkansas, California, Colorado, Florida, Illinois, Michigan, Mississippi, Montana, New Jersey, New York, North Carolina, Ohio, Oklahoma, Tennessee, Utah, Washington, and Wisconsin.

9. See the provision in the Federal National Mortgage Association (FNMA)/Federal Home Loan Mortgage Corporation (FHLMC) form which provides: "If all or any part of the property or an interest therein is sold or transferred by borrower without Lender's prior written consent . . . Lender may, at Lender's option, declare all the sums secured by this Mortgage to be immediately due and payable." FNMA/FHLMC Uniform Instrument 6175, para. 17. A due-on-encumbrance clause may be utilized by some lenders. It is usually encompassed within a generalized due-on-sale clause which provides for acceleration of payments upon the sale, transfer or further encumbrance of the property, in whole or in part, or any interest therein. *See, e.g.*, LaSala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 869, 97 Cal. Rptr. 849, 851, 489 P.2d 1113, 1115 (1971).

10. *See* Comment, *The Due-on-Sale Clause as a Reasonable Restraint on Alienation — A Proposal for Texas*, 8 ST. MARY'S L.J. 514, 515-16 (1976).

11. *See* Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 170-74, 250 N.W.2d 804, 807-09 (1977). In the *Nichols* case, the court discussed the use of due-on-sale clauses as leverage for increasing the interest rate on an existing mortgage. Such leverage takes on special importance in view of the sharp rise in the interest rates on home mortgages. *See* Bonnano, *Due on Sale and Prepayment Clauses in Real Estate Financing in California in Times of Fluctuating Interest Rates — Legal Issues and Alternatives*, 6 U.S.F. L. REV. 267, 267-71 (1972).

12. *See* Continental Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013, 1017 (Okla. 1977), where the court in refusing to enforce a due-on-sale clause stated that the underlying rationale of such clauses was the right of the lender to be assured of the safety of his security. *Id.*

13. *See, e.g.*, Gunther v. White, 489 S.W.2d 529, 532 (Tenn. 1973).

14. Catogas v. Southern Fed. Sav. & Loan Ass'n, 369 So. 2d 922 (Fla. 1979).

conjunction with steadily rising interest rates, will further polarize these interests of lenders and borrowers.[15]

An example of the factual setting of the typical due-on-sale clause controversy would be as follows:

> A seller has found a buyer for certain real property. This real property is encumbered by a mortgage which contains a due-on-sale clause. The seller wishes to have the buyer assume the mortgage obligation. The lender is then contacted by the seller who requests that upon the assumption, the lender accept the buyer's obligation on the mortgage in lieu of the seller's obligation. However, the lender directs the seller's attention to the due-on-sale clause and the necessity for the lender to consent to the sale to prevent triggering an acceleration of the loan. The lender agrees to give this consent only if the interest rate of the mortgage is raised to the current market rate. The buyer refuses to go through with the sale because of the imposition of a higher interest rate. In the absence of successful negotiating between the seller and the lender, litigation over the validity of the clause ensues.

This article examines judicial approaches to due-on-sale clauses in conjunction with underlying policy considerations. First, the contention that these clauses constitute a restraint on alienation is explored. Second, the equity role of a court in enforcing the clause is discussed. Third, an examination of existing Florida law is made. Fourth, the important, related federal law is examined. Finally, these legal principles are integrated with some practical problems in enforcing the due-on-sale clause.

DUE-ON-SALE CLAUSES AS RESTRAINTS ON ALIENATION

Under traditional case law analysis, three basic approaches have been formulated to determine what constitutes a restraint on alienation.[16] The majority's approach at common law holds restraints on alienation *per se*

15. Skyrocketing mortgage rates mean that the older mortgages with lower rates will become even more attractive to a prospective purchaser. In contrast, while a lender's cost of obtaining money has also increased, he will still be receiving the older and lower interest rates on many of his loans. *See* LeSar, *Your Dream Home May Become a Nightmare,* Miami Herald, November 5, 1978 §H at 6, Col. 3. The following illustration should indicate the concerns of the Seller, the original borrower, and the Buyer with the raising of the interest rate upon the sale of property. Assume a sale price of $60,000, the land is encumbered by a 30-year mortgage which has a balance of $48,000 and the interest rate on the loan is 9%. A $12,000 payment to the Seller is made. The monthly payments on the mortgage at this rate, including $100 for taxes and insurance, would be $486.21. By raising the interest rate to 13%, the monthly payments would increase by 27.9% to $630.88.

16. *See* Bernhard, *The Minority Doctrine Concerning Direct Restraints on Alienation,* 57 MICH. L. REV. 1173, 1174-79 (1959). This article by no means attempts to fully explore the doctrine of restraints on alienation, except as it relates to due-on-sale clauses. For a more detailed discussion of the doctrine in this area, see Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests,* 58 IOWA L. REV. 747 (1973). The modern rationale for the restraint on alienation doctrine is that such restraints violate public policy, as opposed to the old common law rationale that restraints are repugnant to a fee title. *See* Manning, *The Development of Restraints on Alienation Since Gray,* 48 HARV. L. REV. 373, 401-06 (1935). Under the modern view public policy is protected by the restraint doctrine in that commerce and productivity are not limited, "dead hand" control of property is limited, the impeding of debt collection is avoided, and the concentra-

invalid unless they fall under certain recognized exceptions.[17] Under a second approach, however, restraints on alienation are valid if reasonable under the circumstances of the particular case.[18] Under this approach a court would utilize a balancing test, to weigh the interests served by the particular restraint against the social evils flowing from its enforcement.[19] A third approach utilizes the balancing test in one situation, and then applies that finding of validity or invalidity to all future cases *per se*.[20]

Early cases generally hold that only a direct restraint can violate any of the doctrines.[21] Conversely, an indirect restraint would not be considered violative of any of the doctrines.[22] Direct restraints are generally categorized as either disabling,[23] forfeiture,[24] or promissory,[25] and these three directly penalize or prohibit the transfer of property. An indirect restraint, on the other hand, exists where a restraint attempts to accomplish a purpose other than to discourage alienation. However, the practical effect is that alienation is restrained, if the instrument is enforced.[26] The due-on-sale clause does not precisely fit any one of these categories, inasmuch as the clause does not provide for blanket prohibition of the transfer of mortgaged property. Rather it permits acceleration of the debt if the property is transferred without the prior consent of the mortgagee.[27]

Nevertheless, the clause appears most similar to the direct[28] promissory restraint, which is typically a covenant or a contract in which the promissor agrees not to alienate the property.[29] The due-on-sale clause is a contractual

tion of wealth is prevented. In some respects, the rationale is similar to that of the rule against perpetuities. *See* Baker v. Loves Park Sav. & Loan Ass'n. 21 Ill. App. 3d 42, 44, 314 N.E.2d 306, 308 (1974).

17. Bernhard, *supra* note 16, at 1174-75. While the recognized exceptions vary, substantial agreement exists as to many, such as, trusts and powers of appointment, the spendthrift trust, and forfeiture restraints on a life or lesser estate. *Id.* at 1175.

18. *Id.* at 1176.

19. *See, e.g.*, Sanders v. Hicks, 317 So. 2d 61, 63-64 (Miss. 1975).

20. Bernhard, *supra* note 16, at 1179.

21. A direct restraint on alienation is a provision which expressly or by implication attempts to prohibit or penalize the exercise of the power of alienation. 3 L. SIMES & A. SMITH, THE LAW OF FUTURE INTERESTS §1112 (2d ed. 1956).

22. *Id.*

23. *Id.* A disabling restraint attempts to withhold the power to convey from the grantee of the property subject to the restraint. *See, e.g.*, Dukes v. Crumpton, 233 Miss. 611, 620, 103 So. 2d 385, 388 (1958).

24. A restraint which purports to create a version or a gift over to a third person if alienation is attempted is a forfeiture restraint. *See* 3 L. SIMES & A. SMITH, *supra* note 21, at §1131. *See also* Falls City v. Missouri Pacific R.R., 453 F.2d 771, 774 (8th Cir. 1972).

25. *See, e.g.*, Genet v. Florida East Coast Ry., 150 So. 2d 272, 275 (Fla. 3d D.C.A. 1963).

26. 3 L. SIMES & A. SMITH, *supra* note 21, at §1112.

27. See note 9 *supra*.

28. *See* Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 224 S.E.2d 580, 595 (1976) (Lake, J., dissenting). The dissenter adopts the view that a due-on-sale clause was a direct restraint on alienation. The majority, however, classified the due-on-sale clause as an indirect restraint on alienation. *See id.* at 584-85. *But see* Occidental Sav. & Loan Ass'n v. Venco P'ship, 206 Neb. 469, — N.W.2d — (1980) (such clauses are not direct or indirect restraints as a matter of law).

29. *See* Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 166, 250

provision which pragmatically hampers the transfer of property. The clause in time of rising interest rates may make low interest loans impossible to assume and homes harder to sell.[30]

However, cases which consider the due-on-sale clause as a possible restraint on alienation ignore the direct/indirect classification.[31] A majority of courts test the validity of the due-on-sale clause by a reasonableness test instead of the *per se* invalidity test used with other restraints on alienation.[32]

Due-on-Sale Clause Litigation

The validity of the due-on-sale clause has been extensively litigated in California. These decisions have generally been followed in other jurisdictions. Examination of these California decisions and similar decisions from other states illustrates the development of judicial treatment of due-on-sale clauses as unreasonable restraints on alienation and underscores the present confusion in the area.

The 1964 decision of the California Supreme Court in *Coast Bank v. Minderhout*[33] is regarded as the landmark case upholding the due-on-sale clause validity. It was one of the first decisions to consider the validity of the clause and to adopt the "reasonableness" test for restraints on alienation in general.[34] In that case, Coast Bank made several loans (secured by promissory notes) to the Enrights. In a separate instrument, the Enrights agreed not to sell or further encumber the land until the entire debt was paid. If such sale or encumbrance took place, the bank had the right to accelerate the entire debt. Upon sale to the defendants, the bank accelerated the entire debt due from the original owners.[35] Justice Traynor, writing for the majority, stated:

> In the present case it was not unreasonable for plaintiff (lender) to condition its continued extension of credit to the Enrights (borrower) 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 transferred the property.[36]

N.W.2d 804, 805 (1977). The due-on-sale clause "directly and fundamentally burdens a mortgagor's ability to alienate as surely and directly as the classical promissory restraint. As such, the due-on-sale clause is truly a direct restraint insofar as the category of direct restraint can be articulated." *Id.*

30. Markham, *supra* note 1, at 1, Col. 5.

31. *See, e.g.*, Malouff v. Midland Fed. Sav. & Loan, 181 Colo. 294, 509 P.2d 1240 (1973); Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 333 N.E.2d 1 (1975).

32. *See, e.g.*, First Commercial Title, Inc. v. Holmes, 92 Nev. 363, 550 P.2d 1271 (1976); Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 87 Wash. 2d 437, 553 P.2d 1090 (1976).

33. 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

34. *See* Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 300, 509 P.2d 1240, 1243-44 (1973).

35. Unable to obtain full payment of the balance of the loan, the bank sought to foreclose on an equitable mortgage which the court held was created. Although *Minderhout* did not involve the standard due-on-sale clause, the decision has never been distinguished on that basis. The clause also allowed for acceleration if the property was encumbered, yet the sole issue before the court was the due-on-sale provision. 61 Cal. 2d at 313 n.2, 392 P.2d at 266 n.2, 38 Cal. Rptr. at 506 n.2.

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

The court concluded that the due-on-sale provision constituted a reasonable and, therefore, valid restraint on alienation.[37] However, the decision is unfortunately ambiguous as to whether the due-on-sale clause is automatically enforceable as "reasonable" or whether the individual circumstances of each case determine the "reasonableness" of the clause.

In *Crockett v. First Federal Savings & Loan Association*,[38] the North Carolina Supreme Court relied on *Coast Bank* to hold that a due-on-sale clause is a *per se* reasonable restraint on alienation.[39] Similarly, the Colorado Supreme Court in *Malouff v. Midland Federal Savings & Loan Association*[40] upheld a due-on-sale clause as a reasonable restraint on alienation, citing *Coast Bank*. However, the Colorado court described the relevant test as reasonableness under the circumstances of the particular facts of the case.[41] Later cases generally assumed that the due-on-sale clause was valid in California. Various lower court decisions merely cited the *Coast Bank* cases and offered no independent reasoning for the conclusion that the due-on-sale clause was valid.[42]

The validity of the due-on-sale clause in California was expressly affirmed in *Cherry v. Home Federal Savings & Loan Association*[43] which held that the lender was not required to act reasonably in its use.[44] The California Court of Appeal in *Cherry* rejected the argument that the due-on-sale clause constituted an invalid restraint on alienation, citing *Coast Bank*,[45] and went on to give two justifications for the use of due-on-sale clauses. First, the court recognized the risks to the security from an unknown party assuming the original borrower's position.[46] The new owner may allow or cause the security to deteriorate or depreciate in value. The possibility of deterioration would justify acceleration of the debt upon the transfer of the property. The court's second justification, strictly a matter of economics, was that the due-on-sale clause was a legitimate protection against the lender's "double risk." Loan agreements frequently allow a borrower to pay off a loan before it is due;[47] therefore, if interest rates drop, the lender faces the risk of the borrower repaying the

37. *Id.*

38. 289 N.C. 620, 224 S.E.2d 580 (1976).

39. *Id.* at 627, 224 S.E.2d at 587.

40. 181 Colo. 294, 509 P.2d 1240 (1973).

41. *Id.* at 299, 509 P.2d at 1243.

42. *See, e.g.*, Jones v. Sacramento Sav. & Loan Ass'n, 248 Cal. App. 2d 522, 527 n.3, 56 Cal. Rptr. 741, 745 n.3 (1967) (which merely assumed in a footnote that the clause was valid).

43. 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969).

44. *Id.* at 579-80, 81 Cal. Rptr. at 138. The court stated that the bank had discretion in the use of its money and could insist upon performance of the terms of the acceleration clause without conforming to an external standard of "reasonableness." *Id.*

45. *Id.* at 580, 81 Cal. Rptr. at 139.

46. *Id.* at 578-79, 81 Cal. Rptr. at 138.

47. *Id.* Prepayment penalties appear to be more common than the court in *Cherry* suggests. *See, e.g.*, Century Fed. Sav. & Loan Ass'n v. Madorsky, 353 So. 2d 868, 869 (Fla. 1st D.C.A. 1978) (prepayment penalty in mortgage held valid). A prepayment fee is a standard clause in a loan agreement providing for a sum of money exacted from the borrower as a charge for the right to prepay the obligation.

loan in order to secure a loan elsewhere at a lower rate.[48] On the other hand, the court noted that when money is loaned at low rates with no mechanism for adjustment to meet increased market rates, the lender loses the benefit of a later rise in interest rates.[49] The decision, in effect, held that both the lender's concern for the safety of his security and his interest in protecting the profit motive are valid reasons for the imposition of a restraint on alienation.[50]

The most controversial aspect of the court's decision in *Cherry* was its consideration of the lender's economic position in evaluating the validity of the due-on-sale clause.[51] This economic rationale was followed by the New Jersey Superior Court in *Century Federal Savings & Loan Association v. Van Glahn*.[52] It held that an attempt to accelerate a mortgage debt on the basis of a due-on-sale clause for the sole purpose of maintaining the mortgage portfolio of the lender at current interest rates was completely proper, and was not a restraint on alienation.[53] The *Cherry* decision was also followed by the Supreme Court of Nevada in *First Commercial Title, Inc. v. Holmes*.[54] The court determined that the due-on-sale clause was a reasonable restraint on alienation and was automatically enforceable.[55] However, the court's sole justification for the clause was the safety of the lender's security and no mention was made of the right of the lender to protect his economic interest.[56]

In contrast to the *Cherry* case, *Sanders v. Hicks*[57] restricted the enforceability of the due-on-sale clause. The Supreme Court of Mississippi adopted a reasonableness balancing test, to be utilized in considering the facts of each particular case.[58] In addition, a threat to the lender's security was viewed as a legitimate interest of the lender. However, the court did not include purely economic considerations in this category.[59]

At this juncture the California courts apparently had adopted an automatic enforcement rule for the use of the due-on-sale clause as *per se* reason-

48. 276 Cal. App. 2d at 579, 81 Cal. Rptr. at 138.

49. *Id.*

50. *See* Century Fed. Sav. & Loan Ass'n v. Van Glahn, 144 N.J. Super. 48, 53-55, 364 A.2d 558, 562-63 (Super Ct. App. Div. 1976).

51. *See* Note, *Due-on-Sale and Due-on-Encumbrance Clauses in California*, 7 LOY. L.A. L. REV. 306, 310 (1974).

52. 144 N.J. Super. 48, 364 A.2d 558 (1976).

53. *Id.* at 561. In Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 509 P.2d 1240 (1973), the court also approved of the lender raising the interest on a sale in exchange for not exercising a due-on-sale provision. Imposition of this condition was viewed as protecting a valid interest of the lender and was not a restraint on alienation. *Id.* at 303, 509 P.2d at 1245.

54. 92 Nev. 363, 550 P.2d 1271 (1976).

55. *Id.* at 365, 550 P.2d at 1271.

56. Therefore, the argument could be made that where no impairment to the lender's security was present, the court's holding would not apply.

57. 317 So. 2d 61 (Miss. 1975).

58. *Id.* at 64.

59. *Id.* at 63-64. The court explicitly left open for future litigation what would constitute a "threat to the legitimate interest of the mortgagee." *Id.* It is unlikely that a desire to raise the interest rate in order to increase the yield on a loan, would constitute a "threat" as stated by the court.

able.[60] Later cases, however, began to encroach upon these precedents. In *LaSala v. American Savings & Loan Association*[61] a due-on-encumbrance clause was at issue.[62] The due-on-encumbrance clause substitutes a further encumbrance of the property for a sale as the event which can trigger the acceleration of the first mortgage debt, if the lender's consent is not obtained.[63] The due-on-encumbrance clause is not as common as the due-on-sale clause and is primarily utilized in California.[64] The *LaSala* court expressly distinguished the due-on-sale clause from the due-on-encumbrance clause, affirming the validity of the former but limiting enforcement of the latter.[65] The California Supreme Court described the central rationale of the *Coast Bank* and *Cherry* cases as upholding the interest of the lender in refusing to accept a person upon the transfer of the encumbered property who was a new and unknown credit risk.[66] The same justification however was determined not to apply to the encumbrance[67] because the first encumbrance would have priority over the second.[68]

For these reasons, the court held that the exercise of the due-on-encumbrance clause was legitimate only when the security of the lender was patently threatened.[69] However, no specific situation which might constitute a threat to the security of the lender was offered.[70] The use of the due-on-en-

60. *See* First Commercial Title, Inc. v. Holmes, 92 Nev. 363, 365, 550 P.2d 1271, 1272 (1976). In the *Holmes* case, the court found a due-on-sale clause to be a reasonable restraint on alienation and automatically enforceable upon its breach, relying in part on the *Cherry* and *Coast Bank* cases. *Id.*

61. 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

62. The clause provided for acceleration if a further encumbrance was placed on the land. The named plaintiffs in the class action had executed a second deed of trust in favor of a different lender. After executing the second encumbrance, the plaintiffs were informed by the defendant of its right to accelerate the first deed of trust. However, the lender offered to waive the acceleration option in exchange for a fee and the payment of a higher rate of interest, from a 6% rate to a 9% rate. The plaintiffs and others in a similar situation then brought the class action. *Id.* at 868-70, 489 P.2d at 1114-15, 97 Cal. Rptr. at 850-51.

63. *See* Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 631 n.1, 526 P.2d 1169, 1170 n.1, 116 Cal. Rptr. 633, 634 n.1 (1974).

64. *See, e.g.*, Tahoe Nat'l Bank v. Phillips, 4 Cal. 3d 11, 14 n.2, 480 P.2d 320, 323 n.2, 92 Cal. Rptr. 704, 707 n.2 (1971).

65. 5 Cal. 3d at 883-84, 489 P.2d at 1126, 97 Cal. Rptr. at 861.

66. *Id.* at 879-80, 489 P.2d at 1123, 97 Cal. Rptr. at 859. The court also discussed *Cherry*'s economic rationale, describing it as "appealing" in regard to the outright sale of property. This statement was based on the reasoning that in most sales the borrower-vendor receives sufficient cash to pay off his obligation, and merely denies by operation of the clause a "fortuitous" advantage of a low interest rate to the prospective buyer. *Id.* at 880 n.17, 489 P.2d at 1123 n.17, 97 Cal. Rptr. at 859 n.17.

67. *Id.* at 880, 489 P.2d at 1123, 97 Cal. Rptr. at 859.

68. *Id.*

69. *Id.* at 881-82, 489 P.2d at 1124-25, 97 Cal. Rptr. at 860-61.

70. The court did mention some general situations that might affect the security of the lender. First, in some cases, the giving of a possessory security interest in which the second mortgagee took possession could pose the same dangers of waste and depreciation as an outright sale. Second, the giving of a second mortgage might be employed as a disguise for an actual sale of the property. Third, a second mortgage might leave the borrower with little or no equity in the property. *Id.* at 881, 489 P.2d at 1124, 97 Cal. Rptr. at 860.

cumbrance clause as a means of increasing the yield on a lender's mortgages was explicitly rejected.[71]

Similarly, the California Supreme Court severely limited the application of the economic rationale of the *Cherry* case in the sale of the encumbered property by installment contract in *Tucker v. Lassen Savings & Loan Association.*[72] In the instance of a conveyance by land sale installment contract, automatic acceleration of the principal obligation was not permitted.[73] As in *LaSala,* the legitimate interests sufficient to justify acceleration were limited to preservation of the security from waste or depreciation.[74] The court also adopted a test which required a reasonable exercise of the clause to be based on the facts of each case, with special emphasis on the clause's actual restraint on alienability.[75] The effect of restraints on alienation in a sale by installment contract was distinguished from an outright sale because in the typical sale the borrower-seller received enough cash to satisfy the obligation.[76] In the typical installment sale only a small down payment is received. Automatic enforcement of a due-on-sale clause when a substantial balance remains on the debt would effectively preclude such sales, because a contract vendor might be unable to substitute a new loan for the one being called due.[77]

Under similar facts, the Supreme Court of Arizona in *Patton v. First Federal Savings & Loan Association*[78] explicitly followed the *Tucker* decision. In *Patton* the borrower had entered into a contract for deed with a buyer, when the seller's lender sought to either accelerate the mortgage on the property or obtain buyer agreement to pay a higher interest rate.[79] The court held that the due-on-sale clause could not be enforced in the absence of a showing that the lender's security was jeopardized by the transfer.[80] In *Nichols v. Ann Arbor Federal Savings & Loan Association,*[81] the Court of Appeals of Michigan determined that where a conveyance had taken place pursuant to an installment contract, the sole basis for enforcement of a due-on-sale clause could not be the lender's economic interest in maintaining its portfolio at current rates.[82] Instead, the clause was held to be an unreasonable

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71. *Id.*

72. 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

73. *Id.* at 638-39, 526 P.2d at 1175, 116 Cal. Rptr. at 639. In *Tucker,* four plaintiffs jointly purchased a parcel of residential property for investment. A deed of trust with a due-on-sale provision was executed in favor of the defendant. Several months later, the plaintiffs sold the property under an installment land contract. When the lender-defendant learned of the sale, it sought to enforce the due-on-sale clause which ultimately resulted in a financial loss to the plaintiffs. *Id.* at 632-33, 526 P.2d at 1170-71, 116 Cal. Rptr. at 634-35.

74. *Id.* at 639, 526 P.2d at 1174, 116 Cal. Rptr. at 638.

75. *Id.* at 636, 526 P.2d at 1173, 116 Cal. Rptr. at 637.

76. *Id.* at 637, 526 P.2d at 1174, 116 Cal. Rptr. at 638.

77. *Id.*

78. 118 Ariz. 473, 578 P.2d 152 (1978).

79. *Id.* at 475, 578 P.2d at 154.

80. The court also relied upon an Arizona statute which prohibited limitations on a borrower's right to transfer his interest in the encumbered property. *Id.* at 479, 578 P.2d at 158.

81. 73 Mich. App. 163, 250 N.W.2d 804 (1977).

82. *Id.* at 171, 250 N.W.2d at 809.

restraint on alienation, because the lender's security would not be impaired, wasted or lost.[83]

Other jurisdictions did not follow the *Tucker* lead. For example, the Montana Supreme Court decision in *Dobitz v. Oakland*,[84] involving enforcement of a due-on-sale clause upon an installment sale, did not follow the *Tucker* court's reasoning. The court upheld the clause emphasizing that the restraint was on a mere executory contract interest and not the ownership interest.[85] Thus, it could be inferred from this decision that the clause might not be enforced in the outright conveyance situation. However, there was conflict on this point as well. The New Jersey *Century Federal* decision also involved an attempted acceleration because of a transfer of the property by contract.[86] In adopting the *Cherry* court's economic rationale in allowing the acceleration, the court in *Century Federal* expressly refused to follow *Tucker*.[87]

Finally, in the recent case of *Wellenkamp v. Bank of America*,[88] the California Supreme Court expressly held a due-on-sale clause unenforceable by an institutional lender upon an outright sale, unless the lender could demonstrate that enforcement was necessary to protect its security from deterioration or default.[89] Unfortunately, the *Wellenkamp* court did not specify any guidelines as to what would constitute a reasonable threat to the lender's security. Questions involving the buyer's credit rating, the likelihood of default or commission of waste by the buyer would apparently be considered.[90] The court applied the test utilized in *Tucker* by requiring that justification for the restraint outweigh its practical effect.[91] Recognition was given to the interests of the lender in preserving the security from waste and in preventing transfer of the security to an uncredit-worthy buyer; however, the court refused to view these as justifying automatic acceleration.[92] While the majority specifically rejected the lender's interest in maintaining its loan portfolio at current rates as a justification for the restraint,[93] the effect of financing arrangements and economic conditions on the seller were discussed. The court

83. *Id.* at 165, 250 N.W.2d at 805.

84. 172 Mont. 126, 561 P.2d 441 (1977).

85. *Id.* at 131, 561 P.2d at 443.

86. 144 N.J. Super. at 50-51, 364 A.2d at 559-60.

87. *Id.* at 53, 364 A.2d at 561. The court attempted to distinguish *Tucker* by referring to a California Statute which merely prohibited unreasonable restraints on alienation that had been considered in *Tucker*. *Id.*

88. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

89. *Id.* at 953, 582 P. 2d at 976-77, 148 Cal. Rptr. at 385-86.

90. *See* Comment, Wellenkamp v. Bank of America: *California Adopts the "Due When Reasonably Necessary Clause,"* 7 SAN FERN. V. L. REV. 173, 183-84 (1979).

91. 21 Cal. 3d at 948-49, 582 P.2d at 973-74, 148 Cal. Rptr. at 382-83.

92. Instead the court stated that whether acceleration would be allowed depended upon the circumstances of each case. 21 Cal. 3d at 952, 582 P.2d at 977, 148 Cal. Rptr. at 385.

93. The court recognized the increasing costs of doing business which the lenders faced. However, the court found that the purpose of the due-on-sale clause was to protect against impairment of the security of the lender, not against economic risks. To place these risks on property owners was unfair in the court's view, especially when alternatives such as variable interest rate mortgages were available. 21 Cal. 3d at 952 & n.10, 582 P.2d at 976 & n.10, 148 Cal. Rptr. at 385 & n.10.

found that the inability of the prospective buyer to assume a mortgage at its fixed rate might effectively prohibit a transfer, and thus be an unreasonable restraint on alienation.[94] *Wellenkamp* therefore, marks the end of a ten year transition in California law from automatic enforcement to limited enforcement of the due-on-sale clause.[95]

Analysis of the Interests Involved in Due-on-Sale Clauses

The courts which have considered the validity of the due-on-sale clause as a restraint on alienation have weighed several factors. In the initial consideration of the clauses some type of judicial balancing is inevitably involved. Some courts find the clauses valid *per se* and are willing to decree automatic enforcement, with limited exceptions.[96] On the other hand, several courts require a balancing of interests to be performed in each individual fact situation.[97] It is critical to determine which factors merit consideration and how they will be applied in each jurisdiction.

The first factor considered by many courts is the concern of the lender for preserving his security interest.[98] This interest can be divided into two areas: interest in the mortgaged premises itself[99] and interest in the creditworthiness of the person assuming the loan.[100] The lender bears the risk of

94. Under economic conditions where loan money is readily available, the prospective buyer can easily obtain a new loan, and thus satisfy the first mortgage of the seller. However, when new financing is difficult to obtain, the prospective buyer will generally assume the existing mortgage. If the lender consents to the transfer but seeks a higher interest rate, an inhibitory effect still exists. The buyer will be less eager to purchase, and the seller might have to lower the purchase price or even abandon the sale. 21 Cal. 3d at 950, 582 P.2d at 974, 148 Cal. Rptr. at 383-84.

95. The dissenter in *Wellenkamp* felt that restraint should not be found upon merely hypothetical economic conditions. He further stated that the owner of encumbered property with an unenforceable due-on-sale clause was now placed in a better position than the seller of unencumbered property. *Id.* at 957-58, 582 P.2d at 979-80, 148 Cal. Rptr. at 387-88 (Clark, J., dissenting). The economic rationale of the court in *Wellenkamp* seems no more inappropriate than the rationale of decisions like *Cherry*. Even if an economic rationale is improper, the security interest remains, which the court in *Wellenkamp* recognized and sought to protect.

It is interesting to note that a California court of appeal has given an extremely narrow interpretation of *Wellenkamp*. The court limited the *Wellenkamp* decision to loans by institutional lenders, when the encumbered property being transfered is single family residential property and the buyer assumes the loan. Medovoi v. American Sav. & Loan Ass'n, 89 Cal. App. 3d 875, 152 Cal. Rptr. 572, 580-81 (Ct. App. 1979).

96. *See, e.g.*, Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 333 N.E.2d 1 (1975). In *Baker* the court found a due-on-sale clause to be automatically enforceable unless traditional equitable defenses could be successfully asserted. *Id.* at 126-27, 333 N.E.2d at 5.

97. *See, e.g.*, Sanders v. Hicks, 317 So. 2d 61 (Miss. 1975) where the court held that a due-on-sale clause was a valid restraint on alienation only if its exercise by the lender was reasonable under the circumstances.

98. *See, e.g.*, La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 880-81, 489 P.2d 1113, 1123, 97 Cal. Rptr. 849, 859 (1971).

99. The "physical" interest represents concern for the depreciation, waste, depletion or destruction of the property. *See, e.g.*, First S. Fed. Sav. & Loan Ass'n v. Britton, 345 So. 2d 300, 303 (Ala. Civ. App. 1977).

100. The "moral" interest includes the lender's determination of the sense of re-

the reduction in value of the property, because if the buyer defaults, the lender may not recover upon foreclosure the full investment represented by his loan.[101]

This security interest rationale for the due-on-sale clause can be challenged on several grounds. Most mortgages contain a covenant requiring the preservation and upkeep of the property to prevent waste or deterioration.[102] Furthermore, because of today's inflationary economy, it is unlikely that any lender would fail to recover the full amount of his loan upon a foreclosure.[103]

A second factor considered by several courts involves the economic interests of the lender.[104] As discussed in regards to the *Cherry* case, the basic argument is that a lender is entitled to a fair return on his money.[105] The due-on-sale clause is a mechanism to protect against cyclical swings in the money market, so that a lender is not locked into a long term loan at a low fixed rate.[81] Since the lender bears the risk of a rise or fall in the interest rates, it is legitimate for him to use the due-on-sale clause to obtain a higher interest rate if the property is transferred.[106] Various arguments can be made against this reasoning; for example, the borrower should not be penalized by the operation of a due-on-sale clause because of a lender's inability to properly project future economic conditions, *i.e.*, rising or falling interest rates.[107] Even if interest rates were to fall rather than rise, few borrowers would take advantage of a prepayment option in their loan and refinance at a lower rate.[108]

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sponsibility or financial security of the borrower, considerations which may have been influential in the granting of the original loan. *See, e.g.*, People's Sav. Ass'n v. Standard Indus., Inc., 22 Ohio App. 2d 35, 38, 257 N.E.2d 406, 407-08 (Ct. App. 1970).

101. If the property were sold and the debt assumed by a new party, the lender could not be assured that the new owner would be as financially stable or conscientious about the upkeep of the property as the original owner. *Id.*

102. *See, e.g.*, FNMA/FHLMC Uniform Instrument 6175, ¶6. *See also* United States v. Angel, 362 F. Supp. 445, 447 (E.D. Pa. 1973).

103. Interview with Doris L. Wisner, Mortgage Loan Officer for The Lewis State Bank, in Tallahassee, Florida (Sept. 14, 1978). In regard to the lender's overall interest in the security for his debt, it is interesting to note that his security often improves upon a mortgage assumption because the lender now has two sources from whom to collect. Also, if the lender approves an assumption, the new debtor becomes the principal obligor and the initial mortgagor becomes a surety. *See* 2 R. BOYER, *supra* note 4. *See generally* Note, *supra* note 51.

104. *Compare* First S. Fed. Sav. & Loan Ass'n v. Britton, 345 So. 2d 300, 303-04 (Ala. Civ. App. 1977) (which refused to recognize a lender's economic interests as a legitimate factor) *with* Century Fed. Sav. & Loan Ass'n v. Van Glahn, 144 N.J. Super. 48, 53, 364 A.2d 558, 561-62 (1976) (which viewed such interests as highly relevant).

105. *See* Stith v. Hudson City Sav. Inst., 63 Misc. 2d 863, 866, 313 N.Y.S.2d 804, 808 (Sup. Ct. 1970).

106. *See* Malouff v. Midland Fed. Sav. & Loan Ass'n, 181 Colo. 294, 301-03, 509 P.2d 1240, 1244-45 (1973).

107. This double risk argument states that if the loan was made when interest rates were low, the borrower cannot be forced to pay a higher rate as long as he keeps the property. If, on the other hand, the original loan was made when rates were high the borrower is free to pay off the balance of the loan and refinance elsewhere. *See* Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 579, 81 Cal. Rptr. 135, 138 (Ct. App. 1969).

108. The cost of refinancing, and the lack of buyer understanding of its advantages, would militate against such a situation working only to the borrower's advantage. The standard prepayment penalty which, in effect, limits the right to prepay by charging an

A third factor considered by some courts independent of, or in comparison with, the first two factors is the degree of practical restraint on alienation.[109] One argument advanced by lenders is that due-on-sale clauses increase the overall alienability of property by equalizing mortgage interest rates between old borrowers and new buyers.[110] The opposing argument emphasizes the borrower's interest in being free to sell his property without practical or direct restraint.[111]

Determining whether the lender or the borrower should benefit from a rise in interest rates is difficult in the absence of empirical data detailing the need for lenders to be protected against such fluctuations. The same lack of information exists in determining whether the due-on-sale clause increases the availability of mortgage money. Even if this information were available, it is doubtful if a clear conclusion could be gleaned from it. Therefore, these factors should be evaluated on simpler, but no less important bases. Contract law should be utilized to decide which party, if any, contracted for one or both of these contingencies.[112] Where a clause provides notice that upon transfer of the property the interest rate may be raised, the clause should be enforced.[113] However, where the lender's sole concern is raising the interest rate on a transfer, the clause should not be enforced when it provides no notice of this intent.[114] Without economic considerations to justify the restraint on

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interest penalty is another reason to question any risk existing on the part of the lender. *See, e.g.*, FLA. JUR. FORMS §5:61 (1975). However, savings and loans are prohibited from charging a prepayment fee in conjunction with the use of a due-on-sale clause. 12 C.F.R. §541.6-11(g)(2) (1979).

109. *See, e.g.*, Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 637, 526 P.2d 1169, 1173, 116 Cal. Rptr. 633, 637 (1974); La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 880-81 & n.16, 489 P.2d 1113, 1124-25 & n.17, 97 Cal. Rptr. 849, 859-60 & n.17 (1971).

110. The use of the clauses helps to equalize mortgage interest rates between old borrowers and new buyers. If buyers were allowed to assume mortgages at a low interest rate — one below current market value — buyers seeing new financing would be charged higher rates to make up the economic loss to the lender. Interview with Vince Elhilow, Senior Vice President, Fidelity Federal Savings and Loan, in West Palm Beach (Sept. 6, 1978). The *Crockett* case adopted this argument stressing, however, the fact that the mortgage being litigated contained no prepayment penalty. Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 625, 224 S.E.2d 580, 585 (1976).

111. Obviously the availability of a lower interest mortgage for a potential buyer to assume makes the property easier to sell. Also, the necessity for the borrower to be free to sell his property without the consent of the lender is evident when circumstances such as a change in employment or the need for ready cash for sudden expenses occur. *See* Jurisch v. Arlington Heights Fed. Sav. & Loan Ass'n, No. 77C-4024 (N.D. Ill. filed May 26, 1978).

112. *See, e.g.*, Continental Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013, 1019 (Okla. 1977). In its consideration of the validity of a due-on-sale clause, the Oklahoma Supreme Court discussed some traditional rules for the interpretation and enforcement of contracts. The court strictly construed the clause involved in that case, because it was a form contract and had been prepared by an experienced party. *Id.*

113. *See* Miller v. Pacific First Fed. Sav. & Loan Ass'n, 86 Wash. 2d 401, 405, 545 P.2d 546, 549 (1976).

114. *See* First S. Fed. Sav. & Loan Ass'n v. Britton, 345 So. 2d 300, 303 (Ala. Civ. App. 1977). *Contra*, Tierce v. APS Co., 382 So. 2d 485 (Ala. 1979). In *Tierce*, the majority of a divided court overruled *Britton*, holding that the clause was not *per se* invalid and that use of the clause solely to increase interest rates was ordinarily not inequitable.

alienation imposed by the due-on-sale clause, the relevant inquiry would be whether the protection of the lender's security will be impaired.[115]

A final consideration is the impact that consistency as to the validity or invalidity of the due-on-sale clause has on the stability of real estate titles.[116] Arguably, a title examiner should be able to reasonably predict whether a restraint will be enforced and, therefore, the clause should be *per se* valid.[117] However, if the clause were found to be *per se* invalid, then giving only prospective effect to the court's decision would preserve the stability of titles.[118] In any event, the due-on-sale clause should have little or no effect on the stability of titles. As a practical matter, the encumbrance on the real property remains valid whether the clause is enforceable or not. Generally, any uncertainty which is caused by the evaluation of the due-on-sale clause as reasonable under the circumstances could easily be eliminated. If lenders drafted their clauses explicitly stating the conditions under which the clause will be exercised, the confusion caused by the search for the proper factors to evaluate the validity of the due-on-sale clause will be lessened. Most of the clauses as presently worded belie their intended use, *i.e.*, to increase the interest rate on sale.

Obviously, a number of complex and competing interests are involved in a court's consideration of the validity of the exercise of the due-on-sale clause. Despite these important interests, only a few states have enacted legislation concerning the use of the clauses.[119] The remaining state legislatures have apparently been content to leave the matter in the hands of the courts. Because of the tremendous uncertainty surrounding the legal validity of the due-on-sale clause, in view of the possible application of the federal preemption doctrine any legislation should be adopted with great caution.

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115. *See id.* at 303-04. The Alabama court refused to enforce a due-on-sale clause finding that the wording of the clause gave no indication that the financial interest of the lender could be the sole basis for exercising the clause. Finding no risk from the proposed sale to the security, the court held the clause could not be utilized. *Id.*

116. In its consideration of the due-on-sale clause as an invalid restraint on alienation, the Supreme Court of Illinois viewed the stability of real estate titles as having paramount importance. The court stated that an attorney in examining titles should be able to reasonably predict if a restraint will be enforced. Thus, the court held that the clauses were *per se* valid, in order to avoid a case by case review for validity which would lead to uncertainty of titles to property. Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 126, 333 N.E.2d 1, 5 (1975).

117. *Id.*

118. Wellenkamp v. Bank of America, 21 Cal. 3d 943, 954, 582 P.2d 970, 977, 148 Cal. Rptr. 379, 386 (1978).

119. California has enacted legislation which, for residential dwellings, prohibits the exercise of a due-on-sale clause in certain situations. CAL. CIV. CODE §2924.6 (West Supp. 1978). Arizona has gone farther and enacted a statute that makes the exercise of a due-on-sale clause an unlawful restraint on alienation, unless the security is jeopardized. Limits are placed also on any increase in the interest rate in conjunction with such a clause. ARIZ. REV. STAT. ANN. §33-806.01 (1974). Colorado has adopted legislation which basically limits any increase in mortgage interest rates to 1%. In addition, acceleration of the entire indebtedness is permitted only where the lender reasonably determines that the transferee of the property is unable to pay the mortgage debt. COLO. REV. STAT. §38-30-165 (*construed* in Von Ehrenkrook v. Midland Fed. Sav. & Loan Ass'n, No. 27928 (D. Colo., filed August 21, 1978)).

EQUITY AND DUE-ON-SALE CLAUSES

As an alternative to the claim that the due-on-sale clause constitutes an invalid restraint on alienation various equitable principles may be invoked to prevent its enforcement. Courts of equity have historically been the final arbiters of foreclosure suits[120] and the protectors of the rights of mortgagors.[121] The exercise of a due-on-sale clause is no exception to this general rule where the clause is evaluated solely under equitable doctrines or along with the restraint of alienation claim.[122]

Due-on-Sale Clauses as Unconscionable or as Penalties

In a series of cases in Florida,[123] Arizona,[124] and Arkansas[125] courts of equity have refused automatic enforcement of due-on-sale clauses in certain situations.[126] In a Florida case, *Clark v. Lachenmeier*,[127] a foreclosure action by the mortgagee was based on the alleged breach by the mortgagor of a mortgage provision which stated that in the event of transfer of ownership of the encumbered property: "Mortgagee has the right and privilege of accepting or rejecting or passing on the credit, etc. of such successor in ownership . . . ."[128] However, the mortgagee failed to allege any impairment of security or to voice any objection to the transfer.[129] The Second District Court of Appeal recognized that prior Florida law allowed for acceleration of the debt upon default of conditions directed to preservation of the security.[130] Additionally, the court stated that a court of equity may refuse to foreclose a mortgage when acceleration of the debt would be unconscionable.[131] The court then refused foreclosure because of the lack of harm to, or depletion of, the

120. J. POMEROY, A TREATISE ON EQUITY JURISPRUDENCE, §240, at 450 (Symons rev. ed. 1941).

121. Note, *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, 488 (1973).

122. Continental Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013, 1019 (Okla. 1977).

123. Clark v. Lachenmeier, 237 So. 2d 583 (Fla. 2d D.C.A. 1970).

124. Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971), *cert. denied*, 108 Ariz. 192, 494 P.2d 1322 (1972).

125. Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 252 Ark. 849, 481 S.W.2d 725 (1972).

126. *See, e.g.*, Clark v. Lachenmeier, 237 So. 2d 583 (Fla. 2d D.C.A. 1970). In *Clark* the court refused foreclosure despite the failure to obtain the mortgagee's consent to transfer the encumbered property in accordance with a due-on-sale clause. *Id.* at 584.

127. 237 So. 2d 583 (Fla. 2d D.C.A. 1970).

128. *Id.* at 584.

129. *Id.*

130. *Id.*

131. *Id.* at 584-85. In Florida, relief has been sought and granted from accelerations declared for technical violations of the mortgage agreement. Courts of equity are concerned with the consequences of enforcing the acceleration provision. *See* Comment, *Debt Acceleration on Transfer of Mortgaged Property*, 29 U. MIAMI L. REV. 584, 586 (1975). Unfortunately, there are no concrete principles or rules concerning an acceleration clause being unreasonable or harsh other than the "equities" of the particular case. *See* Lieberbaum v. Surfcomber Hotel Corp., 122 So. 2d 28, 29-30 (Fla. 3d D.C.A. 1960). *See also* Campbell v. Werner, 232 So. 2d 252, 256-57 (Fla. 3d D.C.A. 1970) where the court listed some of the situations in which relief from acceleration provisions was granted.

security and held that a consent clause to transfer property was not a ground for acceleration when no harm resulted to the mortgagee from the sale.[132]

The doctrine of equitable relief was also applied by an Arizona Court of Appeals in *Baltimore Life Insurance Co. v. Harn*,[133] in which the defendants executed a mortgage and a note to a mortgage company, both of which contained due-on-sale clauses.[134] The two instruments were later assigned to the plaintiff insurance company. Subsequently, the land was sold to a third party and the plaintiff accelerated the debt and initiated foreclosure proceedings.[135] The court focused on the equitable concept of enforcing a penalty or a forfeiture.[136] As in *Clark*, the court regarded the due-on-sale clause as intended by both parties to deter the mortgagor from making a transfer that would impair the mortgagee's security.[137] Because the mortgagee would not risk a loss, the court in *Harn* refused to enforce the clause.[138]

The decisions of the courts in *Clark* and *Harn* were followed by the Arkansas Supreme Court in *Tucker v. Pulaski Federal Savings & Loan Association*.[139] The defendant, Tucker, had executed a mortgage containing a due-on-sale clause.[140] After he asked for but was refused,[141] the consent of the mortgagee to transfer the encumbered property, the defendant sold the property. The mortgagee sued, claiming breach of the due-on-sale clause and requesting foreclosure.[142] Reversing the automatic enforcement of the clause by the trial court, the Arkansas Supreme Court stated that equity would prevent acceleration based on inequitable conduct.[143] Emphasizing the importance of showing an impairment of security, the court required a demonstration of legitimate grounds before a lender could impose the burden of acceleration.[144] The court denied foreclosure[145] because there was no impairment of security nor reasonable grounds for not accepting the new transferee.[146] Nonetheless, transfer of

132. Clark v. Lachenmeier, 237 So. 2d 583, 585 (Fla. 2d D.C.A. 1970).

133. 15 Ariz. App. 78, 486 P.2d 190 (1971).

134. *Id.* at 79-80, 486 P.2d at 191-92.

135. *Id.* Part of the opinion dealt with the contention that the due-on-sale clause was a restraint on alienation. It apparently followed the *Coast Bank* rationale that reasonable restraints on alienation are *per se* valid. *Id.* at 81, 486 P.2d at 193.

136. The court's reasoning was that the substance of the agreement was to prevent the mortgagee's security from being jeopardized. Lacking such a showing, an extreme penalty would be placed on the borrower. *Id.* at 81, 486 P.2d at 193.

137. *Id.*

138. *Id.*

139. 252 Ark. 849, 481 S.W.2d 725 (1972).

140. *Id.* at 849-50, 481 S.W.2d at 726.

141. *Id.*

142. *Id.*

143. *Id.* at 853, 481 S.W.2d at 728. The court in *Pulaski* relied on the *Harn* decision concerning the possibility of the imposition of a penalty if there was no legitimate basis for enforcement of the clause. *Id.* at 853-54, 481 S.W.2d at 728-29.

144. *Id.*

145. *Id.* at 858, 481 S.W.2d at 730-31. The dissent contended that all that was required of the lender was that he act in good faith in using the clause. *Id.* at 861, 481 S.W.2d at 737 (Fogleman, J., dissenting).

146. The court appeared to approve of the idea of "moral" waste as grounds for enforcement of the clause. *Id.* at 855, 481 S.W.2d at 729. *See generally* Comment, *supra* note 131.

the property to a person who was either a poor credit risk or had a record of allowing property to deteriorate would probably constitute an impairment.[147]

A number of cases, involving the validity of the due-on-sale clause in which equitable principles were considered, have rejected the limitations imposed by the three preceding cases.[148] While containing no common rationale, the underlying theme of these decisions is that the clause is a valid contract term.[149]

For example, in *Stith v. Hudson City Savings Institution*[150] a New York appellate court found that enforcement of a due-on-sale clause was not a forfeiture or a penalty. The court viewed the clause as a traditional acceleration provision, designed to protect the mortgagee and his security.[151] The Supreme Court of Tennessee found a due-on-sale clause to be *per se* valid in *Gunther v. White*.[152] The clause was considered a valid contract provision. However, the court went on to justify the use of the clause by utilizing the economic grounds previously discussed.[153]

Other Equitable Defenses

In *Mutual Federal Savings & Loan Association v. Wisconsin Wire Works*,[154] the Wisconsin Supreme Court held that the enforceable use of a due-on-sale clause is dependent on the particular fact situation and whether the invocation of the acceleration clause would be inequitable under the circumstances.[155] The court recognized a broad type of equitable balancing to prevent or allow enforcement of acceleration clauses.[156] One important aspect of the case was the consideration by the court of the right of the borrower to utilize the equitable defense of laches in resisting the acceleration, although this idea was ultimately rejected.[157] Such a defense could be important since, unlike

147. 252 Ark. at 855, 481 S.W.2d at 729.

148. *See, e.g.*, Mutual Real Estate Inv. Trust v. Buffalo Sav. Bank, 90 Misc. 2d 675, 678-79, 395 N.Y.S.2d 583, 585-86 (Sup. Ct. 1977).

149. *See* Gunther v. White, 489 S.W.2d 529, 530-31 (Tenn. 1973).

150. 63 Misc. 2d 863, 313 N.Y.S.2d 804 (Sup. Ct. 1970).

151. *Id.* at 866, 313 N.Y.S.2d at 808. In People's Sav. Ass'n v. Standard Indus., 22 Ohio App. 2d 35, 38, 257 N.E.2d 406, 407-08 (1970), the court reached a result similar to that reached in *Stith*. The due-on-sale clause under consideration was determined to be valid on equitable grounds. The court's rationale for its holding was the right of the mortgagee to protect its security. *Id.*

152. 489 S.W.2d 529, 529 (Tenn. 1973).

153. *Id.* at 532.

154. 71 Wis. 2d 531, 239 N.W.2d 20 (1976).

155. *Id.* at 540, 239 N.W.2d at 24. It is important to note that the mortgage in *Wire Works* secured a commercial loan between two corporations in contrast to the more usual home finance loan. *Id.* at 533, 239 N.W.2d at 21. When a commercial o rsophisticated borrower is involved, it appears that a court will be more willing to enforce the clause. *See id. See also* Note, *Mortgages — Use of Due on Sale Clause by a Lender is Not a Restraint on Alienation in North Carolina*, 55 N.C. L. REV. 310, 315 (1977).

156. Among the factors balanced were: (1) laches, (2) rising interest rates, and (3) impairment of security. 71 Wis. 2d at 538, 239 N.W.2d at 23. This type of test appears to represent an uneasy compromise between the economic interests of lenders and the freedom of alienation interest of borrowers.

157. *Id.* at 538, 239 N.W.2d at 23-24. The mortgagor sought to base a laches defense on

some acceleration clauses, the due-on-sale clause is not self-executing; that is, the option must be exercised before the provision becomes effective.[158]

The traditional equitable defenses of waiver, estoppel, bad faith, and fraud would also seem to be applicable to the due-on-sale clause.[159] Waiver of the acceleration could be a viable defense when a mortgagee accepts payments from the new buyer at the old rate and only subsequently attempts to accelerate.[160] Estoppel could occur when the lender first approves of a transfer or remains silent, and then repudiates the sale and accelerates after the borrower-seller has relied upon the apparent consent.[161] Finally, a general claim by the borrower of inequitable conduct on the part of the lender might be utilized when the lender seeks to raise the interest rate excessively through use of a due-on-sale clause[162] or when he seeks to obtain collateral benefits such as "transfer fees" for a waiver of the clause's enforcement.[163]

Due-on-Sale Clauses as Unconscionable Contracts or Clauses

The typical due-on-sale clause may be misleading to borrowers because it does not put the mortgagor on notice that the lender may have the right to raise the interest charge when the property is transferred.[164] Lack of notice to the typical mortgagor concerning the true effect of the clause could exacerbate the inherently unequal bargaining power between the institutional lender and the ordinary borrower.[165] An unconscionability defense against the opera-

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constructive notice to the mortgagee of the sale of the property to a third party. This notice was allegedly provided by the recording of the land sale contract. *Id.* at 538, 239 N.W.2d at 23.

158. *See* Mutual Fed. Sav. & Loan Ass'n v. American Medical Servs., Inc., 66 Wis. 2d 210, 216, 223 N.W.2d 921, 924 (1974). In that case, a laches defense was successful. The court also applied the equitable balancing test described in *Wire Works*. *Id.* at 215-20, 223 N.W.2d at 924-26.

159. First Commercial Title, Inc. v. Holmes, 92 Nev. 363, 365, 550 P.2d 1271, 1272 (1976).

160. *See* Medovi v. American Sav. & Loan Ass'n, 62 Cal. App. 3d 317, 133 Cal. Rptr. 63, 68-69 (1976). In *Medovi*, waiver was argued by the seller and was considered to be a viable defense by the court. However, it was ultimately rejected on the facts of that case. *Id.*

161. *See* Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 87 Wash. 2d 437, 442-43, 553 P.2d 1090, 1093 (1976). The court stated that estoppel was a good defense to the enforcement of a due-on-sale clause, but that the facts in that case did not support it. *Id.*

162. In the *Baker* case, the court stated that raising the interest rate to a level 1% above the old rate was reasonable and not inequitable. Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, 126-27, 333 N.E.2d 1, 5 (1975).

163. In *Fetter*, the lender attempted to exercise a due-on-sale clause upon the seller's refusal to pay a fee to the lender after the sale of the property. The court refused to enforce the clause on this basis. 564 P.2d 1013, 1019 (Okla. 1977). In *La Sala*, the court refused to enforce a due-on-encumbrance clause when the lender's security was not impaired and the lender wanted to exact collateral benefits from the borrower, *i.e.*, excessive waiver fees. 5 Cal. 3d at 880-81 & n.17, 489 P.2d at 1123-24 & n.17, 97 Cal. Rptr. at 859-60 & n.17.

164. *See* First S. Fed. Sav. & Loan Ass'n v. Britton, 345 So. 2d 300, 303-04 (Ala. Civ. App. 1977). The intent by the lender to use the clause to increase the rate of interest on transfer would probably be unknown to the average borrower who would in most instances assume the clause is only to provide protection for the security. *Id.*

165. It is unlikely that the average borrower is in a position to bargain with the lender. He is likely to think that the only way for him to receive the loan is to agree to the

tion of a due-on-sale clause by a borrower might be tenable.[166] An unconscionability standard is a commonly used device for judicial policing of commercial transactions.[167] For example, in the *LaSala* case, an allegation was made that the mortgages which contained due-on-encumbrance clauses were contracts of adhesion or unconscionable.[168]

While an unconscionability defense is possible, it seems unlikely to be accepted by most courts. One possible reason for the limited use of an adhesion contract defense is that many of the due-on-sale clause decisions involved commercial or sophisticated borrowers.[169] Also, most courts appear reluctant to apply the adhesion contract theory.[170] However, it remains an important contention in any equitable argument and, given the number of jurisdictions which use balancing tests to determine the validity of the due-on-sale clause, it should be an influential factor.[171]

FLORIDA LAW

The contention that a due-on-sale clause is an invalid restraint on alienation has never been squarely presented before a Florida court. Nevertheless, some basic principles indicate the position which the Florida judiciary may adopt. In other jurisdictions, it appears that the reasonableness of the restraint caused by the due-on-sale clause is critical.[172] Existing Florida case law appears to have adopted a variant of the "reasonableness" test in evaluating the validity of a restraint on alienation, through use of a two-part analysis.[173] The overall purpose of the Florida test is apparently to preclude unlimited or absolute restraints on alienation.[174] First, the courts consider the duration of the restraint, the type of alienation that is prevented, and the class precluded from taking.[175] Second, the courts consider the reasonableness of the restraint by

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standard terms. Interview with Doris L. Wisner, Mortgage Loan Officer for the Lewis State Bank, in Tallahassee (Sept. 15, 1978).

166. *See generally,* Note, *Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability,* 27 STAN. L. REV. 1109 (1975).

167. *See* Fort, *Understanding Unconscionability: Defining the Principle,* 9 LOY. CHI. L.J. 765, 765 (1978).

168. On remand, the California Supreme Court ordered the trial court to consider the unconscionability defense which it had previously dismissed. La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d at 876, 489 P.2d at 1120, 97 Cal. Rptr. at 856.

169. *See, e.g.,* Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. at 224 S.E.2d at 589 (Lake, J., dissenting); People's Sav. Ass'n v. Standard Indus. Inc., 22 Ohio App. 2d at 35-36, 257 N.E.2d at 407.

170. *See* Note, *Consumer Protection in Florida: Inadequate Legislative Treatment of Consumer Fraud,* 23 U. FLA. L. REV. 528, 529 (1971).

171. *See, e.g.,* Mutual Fed. Sav. & Loan Ass'n v. American Medical Servs., Inc., 66 Wis. 2d 210, 223 N.W.2d 921 (1974) (application of a test requiring a balancing of the equities).

172. *See, e.g.,* Sanders v. Hicks, 317 So. 2d 61 (Miss. 1975). In that case, the court explicitly adopted a balancing test of "reasonableness under the circumstances" to determine the validity of due-on-sale clauses. *Id.* at 64.

173. *See, e.g.,* Blair v. Kingsley, 128 So. 2d 889, 891 (Fla. 2d D.C.A. 1961).

174. *See* Davis v. Geyer, 151 Fla. 362, 369, 9 So. 2d 727, 729 (1942); Seagate Condo. Ass'n v. Duffy, 330 So. 2d 484, 485 (Fla. 4th D.C.A. 1976).

175. Seagate Condo. Ass'n v. Duffy, 330 So. 2d 484, 485-86 (Fla. 4th D.C.A. 1976). Applica-

weighing its social utility against the impairment of the individual's freedom to convey.[176] Because of the uncertain nature of this test, no firm conclusion can be reached on the general validity of the due-on-sale clause.

Despite the paucity of Florida case or statutory law directly concerning the due-on-sale clause as a restraint on alienation, *Clark v. Lachenmeier* is the forefront case developing an equitable approach to the validity of the due-on-sale clause.[177] The court, as previously discussed, held that proof of harm to the mortgagee must exist before a due-on-sale clause would be enforced.[178] However, the decision was that of a district court of appeal, and there has been no subsequent analysis of the equitable test announced therein. While implicit approval has been given by the Florida Supreme Court to the *Clark* case,[179] this position is by no means certain.

The next Florida case to construe the due-on-sale clause was *Home Federal Savings & Loan Association v. English*.[180] The opinion of the district court was ambiguous, but basically required a strict literal satisfaction of the terms of the due-on-sale clause before it could be enforced.[181] The decision achieved the same result as *Clark*, non-enforcement of the clause, but without expressly following the reasoning of that decision.[182]

An analogous case, *Stockman v. Burke*[183] was a Second District Court of Appeal case involving a suit on a promissory note rather than a mortgage foreclosure. The court held that the note, secured by a mortgage containing a due-on-sale clause, allowed acceleration upon transfer of the property under an incorporation by reference theory.[184] The court did not

tion of these rather limited and strict requirements would not appear to be violated by the typical due-on-sale clause.

176. *Id.* at 486-87.

177. See text accompanying notes 130-135 *supra*.

178. Clark v. Lachenmeier, 237 So. 2d 583, 585 (Fla. 2d D.C.A. 1970). The clause in *Clark* did not provide for acceleration of the debt upon a breach of the covenant's provisions. Nevertheless, subsequent case law interpreting the *Clark* decision has ignored this factor. *Report of the Subcommittee on "Due-on" Clauses of the Committee on Real Estate Financing, Enforcement of Due-on-Transfer Clauses*, 13 REAL PROP. PROB. & TR. J. 891, 905 (1978) [hereinafter referred to as *Report on "Due-on" Clauses*].

179. *See* Delgado v. Strong, 360 So. 2d 73, 75 (Fla. 1978). In *Delgado*, the *Clark* decision was favorably cited to support the proposition: "It is well-established that courts of equity may refuse to foreclose a mortgage when an acceleration of the due date would render the acceleration unconscionable and the result would be inequitable and unjust." *Id.*

180. 249 So. 2d 707 (Fla. 4th D.C.A. 1971).

181. The court held that because of the conjunctive wording of the mortgage two conditions were needed for a valid acceleration. First, the conveyance must not be made without the written consent of the mortgagee. Second, an invalid assumption of the mortgage indebtedness must occur. Because the mortgage had in fact been assumed, although without consent, the court denied acceleration for failure to meet the second condition. *Id.* at 709.

182. The court affirmed the trial court's dismissal of the complaint, for failure to alleged impairment of security, but did not consider this ground as the basis for its decision. *Id.* at 708-09.

183. 305 So. 2d 89 (Fla. 2d D.C.A. 1974).

184. The court stated that the terms of the mortgage, including the due-on-sale clause, became part of the terms of the note. This was because the two were executed contemporaneously and referred to each other. *Id.* at 90.

apply equitable principles to the clause, and left open the question of whether the mortgage could be accelerated and foreclosed upon sale of the property without a showing of impairment of the security.[185]

As illustrated by *Stockman*, due-on-sale clause enforcement by suit on the note at law may be more expeditious than mortgage foreclosure in which the equitable considerations of the *Clark* decision can be raised. This would be especially so if the courts were to determine that section 671.208, Florida Statutes (U.C.C. §1-208) governed the use of the clause, because it restricts the exercise of an acceleration provision only where the borrower can establish the lender's lack of good faith.[186] The problem is that the U.C.C. generally does not apply to real estate transactions.[187] Nevertheless, a mortgage note might be subject to section 1-208 because that section applies to every U.C.C. article including those applicable to notes.[188] In the Arkansas *Pulaski Federal* opinion, the dissent's argument was that Section 1-208 should be a governing factor.[189] However, this view was explicitly rejected by a majority of the North Carolina Supreme Court in the *Crockett* case previously mentioned. The *Crockett* court determined that Section 1-208 was drafted to cover "at will" or "insecurity" acceleration clauses, whereas the typical due-on-sale clause is more of a default clause predicated upon the occurrence of a certain event.[190] Thus, the applicability of section 1-208 remains open to question.[191]

In Florida, the next analogous case to arise concerning the due-on-sale clause was *Chopan v. Klinkman*,[192] a Fourth District Court of Appeal case. In

185. The court's opinion distinguished *Clark* on the basis that *Stockman* involved a suit at law on a promissory note, while *Clark* was an equitable proceeding to foreclose a mortgage. *Id.*

186. Section 1-208 of the U.C.C. states: "A term providing that one party or his successor in interest may accelerate payment or performance . . . 'at will' or 'when he deems himself insecure' or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party *against* whom the power has been exercised." U.C.C. §1-208 (1972 version) (emphasis added).

187. The U.C.C. is limited to dealings in personal property. *Id.* §§2-106, 9-104(j).

188. *Id.* §3-104.

189. The dissenter in *Pulaski* was of the view that the lender was limited in his exercise of a due-on-sale clause only by the good faith described in U.C.C. §1-208. 252 Ark. at 861, 481 S.W.2d at 732 (Fogelman, J., dissenting). Section 1-208 has been held applicable to an acceleration provision in a promissory note secured by a mortgage on real property. Seay v. Davis, 246 Ark. 201, 202-03, 438 S.W.2d 479, 480, *aff'd on rehearing on other grounds*, 246 Ark. 627, 628, 438 S.W.2d 479, 481 (1969). The court in *Seay* stated, without articulating its reasoning, that an acceleration provision in a note was within the scope and intent of §1-208. *Id.* However, in a situation in which the acceleration clause is found in the *mortgage* only, it is doubtful that any court would find the U.C.C. to be more than persuasive authority.

190. Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 628, 224 S.E.2d 580, 588 (1976).

191. Nevertheless, one could argue that the typical due-on-sale clause which is not self-executing, is enforceable at the option of the mortgagee and thus is similar to the "at will" clause covered by §1-208. *See* Walker Bank & Trust Co. v. Neilson, 26 Utah 2d 383, 385, 490 P.2d 328, 329 (1971).

192. 330 So. 2d 154 (Fla. 4th D.C.A. 1976).

Chopan the lender was attempting to exercise a due-on-sale clause upon the sale of the property by an agreement for deed.[193] The court held that the agreement for deed did not constitute a sale within the meaning of that particular clause.[194] The court's rationale was that a court of equity required a showing of a clear and unequivocal right to accelerate.[195]

A 1980 Second District Court of Appeal decision, which is discussed in a subsequent section,[196] has injected a new element into the Florida due-on-sale clause controversy, the claim that federal law governs the validity and exercise of the clause by federal savings institutions. In addition, the 1980 Florida legislature passed legislation which indirectly regulates the use of the clause by state savings institutions.[197] In general, therefore, despite the one concrete use of the equitable approach in *Clark*, the validity of the due-on-sale clause in Florida remains unsettled.[198]

PREEMPTION OF STATE LAW BY FEDERAL LAW

Controversy concerning the use by federal lending institutions[199] of the due-on-sale clause may be resolved by operation of the federal preemption doctrine.[200] Arguably, Congress has preempted state law concerning the clauses through the issuance of regulations governing the enforcement of due-on-sale clauses by the Federal Home Loan Bank Board (FHLBB), pursuant to its congressionally delegated authority.[201] Even if these regulations do not warrant invocation of the preemption doctrine, preemption may occur upon general federalism principles.[202]

Federal savings and loans are chartered, organized, and operated under

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193. *Id.* at 154-55.

194. *Id.* at 156.

195. *Id.*

196. See text accompanying notes 264-271 *infra.*

197. See text accompanying notes 272-274 *infra.*

198. Two influential groups in the property area, attorneys and realtors, have indirectly expressed their disapproval of the due-on-sale clause. In the uniform contract promulgated by The Florida Bar and Florida Association of Realtors, the use of the due-on-sale clause in a purchase money mortgage given by the buyer to the seller has been prohibited. The Florida Bar and the Florida Association of Realtors Contract For Sale and Purchase, Standard C, (1975).

199. In Florida, it is estimated that 60 to 70% of the home loans are made by federal savings and loans with the balance supplied by mortgage companies and state banks. Interview with Christopher Cook, Counsel for Fidelity Federal Savings and Loan Association, in West Palm Beach (Sept. 6, 1978).

200. The doctrine of federal preemption is derived from the supremacy clause of the Constitution. U. S. CONST. art. 6, cl. 2.

201. 12 C.F.R. §545.6-11(g) (1979).

202. *See, e.g.*, Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145, 1147 (9th Cir. 1974). When preemption applies, state law is inapplicable to issues which arise in the preempted area. A specific regulation can suspend state law. Parker v. Brown, 317 U.S. 341, 350 (1943). Preemption may also occur by implication from the nature and subject matter of the congressional legislation. *See* Bethlehem Steel Co. v. New York State Labor Relations Bd., 330 U.S. 767, 772 (1947). *See generally* Comment, *The Due-on Clause: A Preemption Controversy*, 10 LOY. L.A. L. REV. 629, 631 (1977).

the Home Owners' Loan Act of 1933.[203] This Act established the FHLBB which has supervisory and regulatory authority over these associations.[204] In May of 1976, the FHLBB promulgated a regulation effective July 31, 1976, which authorized the use of due-on-sale clauses by federal associations with certain limitations.[205] Promulgation of this regulation may have preempted state law concerning the due-on-sale clause.

Procedural Problems

Both the lender and the borrower have an interest in which court, state or federal, decides the preemption issue.[206] The lender would perceive a federal court as the one more attuned to its concerns, since it would be more predisposed to invoke the federal preemption doctrine. On the other hand, the borrower would be likely to consider a state forum more desirable, as a state court usually would be more inclined to apply favorable state law instead of utilizing the preemption doctrine.

The unreported decision of *Jurisch v. Arlington Heights Federal Savings & Loan Association,*[207] which concerned the proper forum for a borrower's challenge of a due-on-sale clause, is illustrative of the procedural problems which will arise in preemption litigation regarding the law governing the due-on-sale clause. In *Jurisch,* the plaintiff was seeking a state forum for his claims that the due-on-sale was unconscionable and a restraint on alienation. Simultaneously, the defendant sought the removal of the case to a federal court, claiming that state law had been preempted. The federal district court held that the preemption issue was a defense only, and that a federal court lacked jurisdiction since the plaintiff's case was based on state law.[208]

A similar result was reached by the federal district court in *California v. Glendale Federal Savings & Loan Association.*[209] The state of California sought

203. 12 U.S.C. §§1461-1468 (1976).

204. 12 U.S.C. §1464(a), (d) (1976).

205. 12 C.F.R. §545.6-11(g) (1979). The regulation provides in part: "A Federal Association continues to have the power to include . . . a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable all the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's written prior consent . . . [and] exercise by an association of such an acceleration option . . . shall be governed exclusively by the terms of the contract . . . and all rights and remedies . . . thereto shall be fixed and governed by said contract." *Id.* §545.6-11(f). Among the exceptions to the operation of the clause are: creation of a subordinate encumbrance, transfer upon death, or a lease for less than three years if there is no option to purchase. *Id.* §545.6-11(g). As a matter of policy, certain family transfers or hardship cases may constitute exceptions. *Id.* §556.9(c). In addition, the FHLBB expects the increase in the interest rate that may be made to be to the prevailing rate and not in excess of it. *Id.* §556.9(d). Finally, the clause cannot be exercised in conjunction with a prepayment penalty. *Id.* §545.6-11(g)(2).

206. In Jurisch v. Arlington Heights Fed. Sav. & Loan Ass'n, No. 77C-4024 (N.D. Ill., filed May 26, 1978) and Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139 (C.D. Ill. 1979), both of the borrowers challenging due-on-sale clauses sought a state court forum, while both federal lenders desired a federal forum.

207. No. 77C-4024 (N.D. Ill., filed May 26, 1978).

208. *Id.* at 5-7.

209. 475 F. Supp. 728 (C.D. Cal. 1979).

an injunction under state law against a federal lender's exercise of due-on-sale clauses. The FHLBB was allowed to intervene in the action. The suit was removed to federal district court, but the plaintiff sought to have the action remanded to state court. The district court held that the defense of federal preemption did not create federal jurisdiction, where the plaintiff's complaint was based on state law.[210] In addition, the court determined that the intervention of the FHLBB was not a sufficient basis for creating federal jurisdiction.[211] However, on nearly identical facts, the federal district court in *Bailey v. First Federal Savings & Loan Association*[212] determined that the court did have jurisdiction. The borrower in *Bailey* was resisting the removal to federal district court of his state law challenge of a due-on-sale clause. The district court determined that the complaint disclosed a controversy in an area in which federal law had preempted state law and therefore, a federal question was implicit in the complaint.[213] The reasoning of the court in *Bailey* can be criticized on two grounds. First, while ostensibly ruling upon a procedural issue its language involves what is tantamount to a decision on the merits of the case, *i.e.*, state law has been preempted by federal law.[214] Second, it is against the weight of authority.[215]

Assuming that the *Jurisch* reasoning will be followed, a borrower may demand a state court hearing when he brings an action to invalidate a due-on-sale clause. Thus, an important tool in the borrower's selection of a favorable forum may be to quickly seek a declaratory judgment to challenge a due-on-sale clause. Several state court decisions have explicitly approved the use of a declaratory judgment action in such instances.[216] A federal lender would find it more beneficial, however, to bring an action in federal district court alleging preemption of any state law relating to the clause.[217] It is now conceivable that a "race to the courthouse" might take place in order for a party to obtain the desired forum.

Substantive Law Post-1976

The first decision, nationally, to squarely confront the preemption issue was *Glendale Federal Savings & Loan Association v. Fox*.[218] Several California

210. *Id.* at 731.

211. *Id.* at 733.

212. 467 F. Supp. 1139 (C.D. Ill. 1979).

213. *Id.* at 1141-42.

214. In *Jurisch*, the court had stated that the existence of preemption was by no means clear. No. 77C-4024 at 6 (N.D. Ill., filed May 26, 1978).

215. Generally, to permit removal of a case to federal court, a federal issue must appear in the complaint; a defense of federal preemption is not sufficient. *See, e.g.*, Home Fed. Sav. & Loan Ass'n v. Insurance Dept. of Iowa, 571 F.2d 423 (8th Cir. 1978); Washington v. American League of Professional Baseball Clubs, 460 F.2d 654 (9th Cir. 1972); Borzello v. Charles D. Sooy & C. Darrell Sooy, 427 F. Supp. 332 (N.D. Cal. 1977); Johnson v. First Fed. Sav. & Loan Ass'n, 418 F. Supp. 1106 (E.D. Mich. 1976).

216. Amos v. Norwood Fed. Sav. & Loan Ass'n, 47 Ill. App. 3d 643, 365 N.E.2d 57 (1977); Holliday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 271 N.W.2d 445 (Minn. 1978).

217. *See* Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 906 (C.D. Cal. 1978).

218. *Id.*

officials refused, pursuant to California law, to permit the lender to make loans for a condominium development, because of the lender's use of due-on-sale clauses in its mortgages.[219] The savings and loan association then sought a declaratory judgment which would determine that federal law exclusively governed the validity and exercise of the clause in the association's mortgages.[220] The United States District Court for the Central District of California held: "The language, history, structure, and purpose of the Home Owner's Loan Act evidence a clear congressional intent to delegate to the Bank Board complete authority to regulate federal savings and loan associations and to preempt state regulation."[221]

With regard to the due-on-sale clause regulations, the district court determined that the FHLBB had properly enacted regulations governing savings and loan associations' operations. These regulations exclusively governed and therefore preempted any state regulation[222] relating to due-on-sale clauses beginning June 8, 1976.[223] The court's decision in *Fox*, which is currently on appeal to the Ninth Circuit, is consistent with the majority of case law concerning preemption of state law by explicit FHLBB regulations.[224] Apparently, use of this same clause by federal loan associations in their loan instruments after July 31, 1976 is free from the strictures of state law.

Substantive Law Pre-1976

The FHLBB due-on-sale clause regulation does not appear to be retroactive in its effect.[225] FHLBB regulations have the force and effect of statute.[226] Thus, they are subject to the general rule of statutory construction that statutes are presumed not to operate retroactively.[227] However, preemption of state law prior to the due-on-sale clause regulation's effective date may take

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219. *Id.* at 906.

220. *Id.*

221. *Id.* at 910.

222. *Id.*

223. The district court stated that the effective date of the regulations was June 8, 1976. *Id.* at 904. However, the regulations refer to July 31 as the effective date. 12 C.F.R. §545.6-11(f) (1979). No explanation was given by the court for the use of the June date.

224. *See, e.g.*, Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145 (9th Cir. 1974); Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819 (N.D. Ill. 1975); People v. Coast Fed. Sav. & Loan Ass'n, 98 F. Supp. 311 (S.D. Cal. 1951). The holding in each of these decisions was basically that Congress had lawfully delegated broad regulatory authority to the FHLBB and that regulations issued pursuant to this authority preempted any related state law.

225. The "continuing authority" language in the regulation could be used as an argument for retroactive application, by claiming the clause has always been approved. 12 C.F.R. §545.6-11(f) (1979). However, the existence of an effective date lends support to a prospective application. *Id.* In addition, two decisions have given the regulation prospective effect only. Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. at 1141; Glendale Fed. Sav. & Loan Ass'n v. Fox. 459 F. Supp. at 907.

226. City Fed. Sav. & Loan Ass'n v. Crowley, 393 F. Supp. 644 (D. Wis. 1975).

227. Greene v. United States, 376 U.S. 149, 160 (1964). In *Greene*, the Court held that an administrative regulation that interferes with antecedent rights will not be given retroactive effect, unless the intent to do so is clear and manifest.

place by the application of another FHLBB regulation. In *Fox*, the contention was made that a regulation, in effect since 1948, authorized due-on-sale clauses. This regulation required each "loan contract" of a savings and loan to "provide for full protection to the Federal Association."[228] However, the district court explicitly refused to decide the issue.[229] It would be unfortunate if this vague regulation is interpreted to authorize pre-1976 due-on-sale clauses, because it is arguable whether the due-on-sale clause "protects" the federal lender or merely serves as a revenue raising device.

Preemption may be found upon another theory, specifically by congressional "occupation of the field." Occupation of the field is a legal term of art in the preemption area.[230] With reference to a due-on-sale clause, it can best be defined as an explicit or implicit congressional declaration of intent that the states are prohibited from regulating the loan instruments of federal lending institutions.[231] In general, the case law involving preemption has recognized several factors by which an intent of Congress to occupy the field may be identified. The most important of these factors are: (1) if the scheme of federal regulations is so pervasive that Congress has left no room for states to act; (2) if the field is one which the federal government is so dominant that state action is precluded; or (3) if enforcement of state law would present serious conflicts with the objectives and purposes of a congressional program.[232]

While federal savings and loans are highly regulated, courts have differed on whether the scheme is so pervasive as to occupy the field. Several decisions do contain language which assert that federal law has occupied the entire field with regard to savings and loans thus precluding any state regulation.[233] However, these statements were merely dicta in all but one decision.[234]

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228. 12 C.F.R. §545.6-11(g) (1979).

229. Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 907 (C.D. Cal. 1978).

230. *See* Note, *The Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 COLUM. L. REV. 623, 624-25 (1975).

231. *See* Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 910 (C.D. Cal. 1978). *See also* Lockheed Air Terminal, Inc. v. Burbank, 457 F.2d 667 (9th Cir. 1972). In *Lockheed*, preemption in the air commerce area was at issue. The court determined that whether federal law preempts the authority of state or local government to regulate in a certain area was a matter of congressional intent. *Id.* at 671.

232. Ray v. Atlantic Richfield Co., 98 S. Ct. 988, 994 (1978).

233. Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145, 1147 (9th Cir. 1974); Greenwald v. First Fed. Sav. & Loan Ass'n, 446 F. Supp. 620, 623 (D. Mass. 1978); Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819, 823 (N.D. Ill. 1975); Lyons Sav. & Loan Ass'n v. Federal Home Bank Bd., 377 F. Supp. 11, 17 (N.D. Ill. 1974); People v. Coast Fed. Sav. & Loan Ass'n, 98 F. Supp. 311, 316 (S.D. Cal. 1951); Kaski v. First Fed. Sav. & Loan Ass'n, 72 Wis. 2d 132, 240 N.W.2d 367, 372 (1976). The weight, if any, to be accorded these statements is open to question when the authority for them is examined. Typically, a quotation from *Coast Bank* is relied upon for support: "The Board has adopted comprehensive rules and regulations concerning the powers and operations of every Federal Savings and Loan Association from its cradle to its corporate grave." 98 F. Supp. at 316. *See, e.g.*, Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819, 823 (N.D. Ill. 1975).

234. Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145 (9th Cir. 1974); Greenwald v. First Fed. Sav. & Loan Ass'n, 446 F. Supp. 620 (D. Mass. 1978); Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819 (N.D. Ill. 1975); Lyons Sav. & Loan Ass'n

The decision of the Wisconsin Supreme Court in *Kaski v. First Federal Savings & Loan Association*[235] provides the strongest support for the argument of complete preemption of state law concerning savings and loan associations. In *Kaski*, the plaintiff had brought an action alleging that an interest rate escape clause was invalid under state law because it was unconscionable, vague and indefinite.[236] The *Kaski* court stated that Congress had "substantially" occupied the field concerning the regulation of federal lenders and that the scheme of federal regulation was pervasive.[237] The plaintiff's action was remanded to the trial court with instructions to decide solely upon federal law.[238] Upon close examination, however, the court's broad finding of preemption should be questioned. The actual holding of the court apparently depended on its characterization of the plaintiff's action as involving an internal affair of a federal association.[239] In disputes involving internal affairs, courts have found preemption of state law *per se*.[240] However, an internal affair usually involves a matter which relates to the control functions of the association, such as removal and replacement of officers[241] or the duties of officers and directors.[242] It would be difficult to place the due-on-sale clause in this category. A contractual provision between the association and a third party does not have the effect on the management of the association which the cases involving an internal affair connote. Thus, the court's decision in *Kaski* may have little precedential value concerning the preemption of state law regarding the due-on-sale clause.[243]

In addition, the Supreme Court of Oregon reached the opposite conclusion in regard to preemption of state law concerning federal associations in *Derenco*

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v. Federal Home Loan Bank Bd., 377 F. Supp. 11 (N.D. Ill. 1974); People v. Coast Bank Fed. Sav. & Loan Ass'n, 98 F. Supp. 311 (S.D. Cal. 1951).

On appeal, the First Circuit in *Greenwald* expressly refused to follow the district court's finding that a FHLBB regulation precluded all state regulation of federal savings and loan associations. First Fed. Sav. & Loan Ass'n v. Greenwald, 591 F.2d 417, 426 n.16 (1st Cir. 1979). The court based its preemption finding on the narrower ground of a conflict between a specific federal regulation and state law. *Id.*

235. 72 Wis. 2d 132, 240 N.W.2d 367 (1976).

236. The clause allowed for an increase in the interest rate of the loan, upon proper notice. *Id.* at 369.

237. *Id.* at 372.

238. *Id.* at 373.

239. According to the court: "The regulation of loan practices directly affects the internal management and operations of federal associations and therefore requires uniform federal control." *Id.* at 373.

240. *See, e.g.*, Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819, 826 (N.D. Ill. 1975) (fiduciary duties of directors and officers).

241. *See, e.g.*, Pearson v. First Fed. Sav. & Loan Ass'n, 149 So. 2d 891, 894-95 (Fla. 2d D.C.A. 1963).

242. *See, e.g.*, Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609, 612 (2d Cir. 1967).

243. Washington Fed. Sav. & Loan Ass'n v. Balaban, 281 So. 2d 15, 17 (Fla. 1973) contains language similar to that in *Kaski* concerning the complete preemption of state law regulating federal savings and loans. However, *Balaban* clearly involved an internal affair. The issue involved the power of a state court to enjoin a federal association from attending a FHLBB meeting. *Id.* at 16.

v. Federal Savings & Loan Association.[244] The fact situation in *Derenco*, which involved a FHLBB regulation requiring the payment of interest on escrow accounts, is somewhat analogous to the due-on-sale clause controversy.[245] The regulation was effective in 1975, and held not to be retroactive.[246] Nonetheless, the lender argued that state law prior to the effective date of the regulation was preempted. The court, responding to this claim, determined that: "Neither do we believe the field has been entirely occupied. Congress is always capable of saying if it intends to occupy the field exclusively and so are federal regulators."[247]

The position of the court in *Derenco* appears to be the most defensible. Finding an absolute preemption of state law relating to federal savings and loans is unnecessary to insure that the associations could continue to function normally.[248] To allow the complete preemption, as suggested by the dicta in some decisions, regarding items such as contracting with third parties would be extreme.[249]

Turning to other preemption theories, the questions of preemption due to dominant federal interests or the conflict between state and federal programs are largely a matter of speculation in the savings and loan area. An important, and possibly dominant, interest could be found in the need of federal savings and loans to exercise the clauses. Basically, a savings and loan borrows money on a short-term basis but lends it on a long-term basis.[250] If the "price" it must pay for money goes up, to meet operation costs the "price" it receives for its money (generally from mortgages) must be even higher.[251] The due-on-sale clause is a means of increasing the yield of the mortgage portfolio of the lender, thereby leading to a profit.[252] When the cost of money increases substantially, such leverage may be important.[253] However, there are no firm statistics available to substantiate this claim.[254]

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244. Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 281 Or. 533, 577 P.2d 477 (1978).

245. *Id.* at 481-82.

246. *Id.* at 483.

247. *Id.* at 487.

248. *Cf.* Pearson v. First Fed. Sav. & Loan Ass'n, 149 So. 2d 891, 894-95 (Fla. 2d D.C.A. 1963) ("It is a well-established rule that federal savings and loan associations are subject only to state law which does not interfere with the purposes for which it was created, does not destroy its efficiency, and does not conflict with paramount federal law.")

249. *Cf.* Buchanan v. Century Fed. Sav. & Loan Ass'n, 393 A.2d 704, 713 n.19 (Pa. Super. Ct. 1978) (preemption in the savings and loan area of the common law of trust and contract is highly unusual).

250. Interview with Vince Elhilow, Senior Vice President, Fidelity Federal Savings and Loan in West Palm Beach (Sept. 6, 1978).

251. This problem is termed disintermediation. It can be illustrated by the use of high yield investment certificates with interest rates of 10% or higher while there may be mortgages with interest yields of only 7%. Kratovil, *A New Dilemna for Thrift Institutions: Judicial Emasculation of the Due-on-Sale Clause*, 12 J. MARSH. J. 299, 311-12 (1979).

252. Letter from Jerome S. Plapinger, Associate General Counsel, Federal Home Loan Bank Board, to Brian O'Connell (July 18, 1978).

253. Interview with Christopher Cook, Counsel for Fidelity Federal Savings and Loan in West Palm Beach (Sept. 6, 1978).

254. In several areas of Florida, mortgage rates are *not* being raised on sale of the

Additional conflict between state law and important federal interests may occur in the operation of the secondary mortgage market.[255] This is the process by which state and federal associations sell mortgages to increase their cash flow.[256] If state law governed due-on-sale clauses and limited their operation, loans would be less marketable since the primary agencies in the secondary market require the clause to be in loans which they purchase.[257] Therefore, savings and loans would suffer a loss in revenue, forcing them to alter their operations.

These arguments, however, are vulnerable to a criticism raised in the *Derenco* case. There the court found that: "[W]e do not believe that preemption occurs simply because under some imaginable set of economic facts the application of state law could impede the efficient execution of a federal statutory purpose."[258] Thus, the burden should appropriately be placed on the federal savings and loans to justify, either in terms of economic or banking policy, the need for exercising due-on-sale clauses. With the average life for a loan being seven years,[259] at which time it must be refinanced at the prevailing interest rate, it might not be possible for the associations to meet this burden.

In any event, several principles should be considered in resolving the preemption issue for due-on-sale clauses executed prior to 1976. The Supreme Court has held that conflicts between state and federal law are not to be sought out.[260] This policy would militate in favor of allowing state law to continue to apply to pre-1976 due-on-sale clauses. Another consideration is that at the time the loan was made the expectations of the parties, if any, would have been that state law was to apply.[261] The tendency of the present Supreme Court to accommodate state and federal law should also be noted.[262] Finally, the lack of retroactivity of the due-on-sale regulation and the silence of the FHLBB on the subject[263] support a requirement that a convincing showing be made by the federal associations if preemption is to occur for pre-1976 due-on-sale clauses.

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property, as is the case in states such as California; yet, these institutions continue to function normally. Interview with Adam G. Adams, II, Counsel for Duval Federal Savings and Loan Association in Jacksonville, Florida (Sept. 22, 1978).

255. *See* 12 *U.S.C.* §§1716-1723(d) (1976).

256. *Id.*

257. Interview with Adam G. Adams, II, Counsel for Duval Federal Savings and Loan Association in Jacksonville (Sept. 22, 1978).

258. Derenco, Inc. v. Benjamin Franklin Sav. & Loan Ass'n, 281 Or. 533, —, 577 P.2d 477, 483 (1978).

259. Interview with Vince Elhilow, Senior Vice President, Fidelity Federal Savings and Loan Association in West Palm Beach (Sept. 6, 1978).

260. Joseph E. Seagram & Sons, Inc. v. Hostetter, 384 U.S. 35, 45 (1966).

261. In Florida, as well as in other jurisdictions, federal lenders' due-on-sale clauses have been litigated under state law without any claim of preemption being raised. *See, e.g.*, Home Fed. Sav. & Loan Ass'n v. English, 249 So. 2d 707 (Fla. 4th D.C.A. 1971).

262. Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass'n, 577 P.2d at 487.

263. *See* Durnin v. Allentown Fed. Sav. & Loan Ass'n, 218 F. Supp. 716, 719 (E.D. Pa. 1963). In evaluating a preemption argument, the court held that more than silence of the regulations would be required to overcome a common law right. *Id.*

Florida Law

In *First Federal Savings & Loan Association v. Lockwood*,[264] the Second District Court of Appeal was urged to apply the FHLBB's due-on-sale clause regulation to a mortgage executed before 1976. Apparently assuming the regulation to be retroactive, the court nevertheless determined that the regulation established no procedure for the enforcement of the clause.[265] Therefore, a state court foreclosure action remains necessary to enforce the due-on-sale clause, and this action would continue to be subject to state law equitable restrictions.[266] As a result of the *Lockwood* case, a federal lender will be required to prove an impairment of its security in order for the clause to be enforced.[267]

Several observations can be made concerning the *Lockwood* decision. First, as previously discussed, the due-on-sale clause regulation does not purport to apply to mortgages executed prior to 1976.[268] Second, the district court's finding that the FHLBB regulation has no effect on the procedure for enforcing a due-on-sale clause is not entirely certain. In general, state law governs foreclosure actions brought by federal savings and loans.[269] State law would also apply to the interpretation of a particular due-on-sale clause.[270] While it can be argued that the due-on-sale clause regulation is subject to state law equitable principles,[271] the intent of the drafters of the regulation was to provide for automatic enforcement of the clauses.[272] The regulation itself states that the "exercise" of the clause by a federal lender and "all rights and remedies" of the parties are governed "exclusively" by the terms of the

264. No. 79-2124 (Fla. 2d D.C.A. filed May 16, 1980).

265. *Id.* at 6.

266. *Id.*

267. *Id.* at 7. In effect, the *Lockwood* decision is a reaffirmation of *Clark v. Lachenmeier*. However, the rationale for the court's decision in *Lockwood* was more explicit. The district court found no notice in the due-on-sale clause which would alert the borrower to its possible use as a revenue raising device. *Id.* at 8 nn.7, 8. Without such notice, the court viewed the use of the clause as being limited to the protection of the lender's security. *Id.* at 5-6. Overall, the *Lockwood* court placed little emphasis on the preemption issue, primarily drawing upon state case law where federal preemption was not involved.

268. The regulation provides that "with respect to loans made after July 31, 1976," the use of the clause is to be governed solely by the loan contract. 12 C.F.R. § 545.6-11(f) (1979).

269. *See* West Side Fed. Sav. & Loan Ass'n v. Roll, No. 77-1309, Slip Op. at 3 (S.D.N.Y. Jul. 19, 1977) (foreclosure of real estate mortgage is ordinarily an action based solely on state law); First Fed. Sav. & Loan Ass'n v. Zequeira, 288 F. Supp. 384, 387 (D.P.R. 1968) (validity, effect and construction of a mortgage lien is determined by the law of the state in which the mortgaged property is located).

270. See notes 281-282 and accompanying text, *infra*.

271. *Cf.* Ricks v. United States, 434 F. Supp. 1262, 1265-67 (S.D. Ga. 1976). *Ricks* involved an equitable action by a mortgagor to enjoin a mortgage foreclosure brought by the Small Business Association, a federal agency. The issue in the case was whether federal common law applied rather than state statutes which protected the mortgagor. The district court held that the determination of whether state or federal law would apply was to be made by examining the loan documents to ascertain the intent of the parties. *Id.*

272. 41 Fed. Reg. 18286, 18287 (1976).

mortgage.[273] Thus, the substance-procedure interpretation[274] of the FHLBB regulation utilized by the *Lockwood* court may be criticized as creating an artificial distinction concerning the meaning of the regulation. Without automatic enforcement, the application of the clause is effectively limited, contrary to the language of the due-on-sale clause regulation. On the other hand, the FHLBB regulation may not be sufficiently explicit to negate the usual application of state law to a foreclosure proceeding.[275]

In an apparent response to the due-on-sale clause preemption problem, the Florida legislature enacted a 1980 statutory amendment pertaining to the use of the clause by state savings and loan associations. The new statute prohibits the use of a due-on-sale clause by state lenders if federal lenders in Florida "lose the right to include such a provision in a real estate loan contract."[276] In the absence of a change in the FHLBB regulations, it is doubtful that a federal association would ever lose the right to merely place such a clause in a mortgage.[277] Therefore, the statute may never become operative.[278]

Problems in the Use and Exercise of Due-on-Sale Clauses

Utilizing the example of the typical due-on-sale controversy given in the introduction,[279] an application of the law previously discussed will be made. In addition, some new issues will be considered with the purpose of aiding

273. 12 C.F.R. § 545.6-11(f) (1979).

274. In *Lockwood*, the district court of appeal stated that the validity of the FHLBB regulation and its authorization of the due-on-sale clause was an issue which was independent of the procedures governing the enforcement of the clause. First Fed. Sav. & Loan Ass'n v. Lockwood, Slip Op. at 6.

275. *See* Home Owners' Loan Corp. v. Wilkes, 130 Fla. 492, 498, 178 So. 161, 163 (1938) (in a mortgage foreclosure action, a federal savings and loan association has the same status as any other mortgagee). *Cf.* United States v. Willis, 593 F.2d 247, 251-54 (6th Cir. 1979). A state law defense was asserted by a borrower in *Willis* against a collection suit brought by the Small Business Association. The government claimed that the guaranty executed by the borrower was absolutely enforceable and was governed solely by federal law. The Sixth Circuit agreed that the guaranty was subject only to federal law because of the wording of a specific regulation and the language of the guaranty. However, in fashioning a federal common law rule to apply to the case, the relevant state law was made the federal rule. One argument used by the government to resist the adoption of state law was a loss of uniformity needed for the smooth functioning of the Small Business Association. A similar policy argument is likely to be raised concerning the application of state law to federal lenders' use of the due-on-sale clause. See text accompanying notes 250-257 *supra*.

276. Fla. S. 348, §42 (Reg. Sess. 1980, to be codified as 665.073(8)).

277. There is no apparent basis for invalidating the FHLBB regulation which approves of federal lenders' inclusion of due-on-sale clauses in their mortgages. Even the *Lockwood* case explicitly avoided this issue. First Fed. Sav. & Loan Ass'n v. Lockwood, Slip. Op. at 6.

278. The statute has no immediate effect. The use of a due-on-sale clause is simply prohibited on the occurence of a certain contingency. Accordingly, the little existing case law will presumably continue to govern the use of the clause by state lending institutions. In addition, the statute does not seem to be retroactive and would therefore apply only to those mortgages executed after its effective date. *See* Foley v. Morris, 339 So. 2d 215, 216-17 (Fla. 1976) (in Florida, statutes are presumed not to operate retroactively unless the contrary intent is specifically stated).

279. See text accompanying note 17 *supra*.

the practitioner in handling a due-on-sale clause problem. Initially, the lender's status as a federal lending institution needs to be established.[280] If a non-federal lender is involved, the state law discussed earlier will control. Assuming a federal lender is involved, the preemption problem needs to be confronted, along with the choice of forum consideration. Whether the mortgage was executed prior or subsequent to July 1976 will then determine which preemption cases should be consulted.

Regardless of the time of the execution of the mortgage or the nature of the lender, the wording of the particular due-on-sale clause needs to be carefully examined. State contract law principles arguably apply to due-on-sale clauses contained in federal lenders' mortgages. This seems to have been made explicit for those mortgages which are issued subsequent to the July 31, 1976 effective date of the applicable FHLBB regulation. The regulation provides that the enforcement of these due-on-sale clauses is both a matter of contract and is to be governed exclusively by the terms of the clauses.[281] Even if federal preemption of the validity of the due-on-sale clause was found, its interpretation would continue to be a matter of state contract law.[282]

In Florida, the interpretation given to a particular clause by a court may be an important factor in allowing the clause to be exercised. The intent of the contracting parties appears to be a potent argument when considering the enforcement of a due-on-sale clause.[283] Since their inception, due-on-sale clauses have been worded in a variety of ways.[284] The enforcement of the clause, through foreclosure, is an equitable proceeding; therefore a court is likely to attempt to construe the clause in favor of the borrower.[285] This tendency for strict and literal construction of due-on-sale clauses has already been demonstrated in Florida.[286]

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280. The due-on-sale clause regulation only applies to "federal associations" as defined in 12 C.F.R. §541.2. 12 C.F.R. §545-11(f)-(g) (1979).

281. 12 C.F.R. §545.6-11(f) (1979).

282. *See* Gobel v. First Fed. Sav. & Loan Ass'n, 83 Wis. 2d 668, 670-71, 266 N.W.2d 352, 354 (1978).

283. Fidelity Land Dev. Corp. v. Rieder & Sons, Bldg. & Dev. Co., 151 N.J. Super. 502, 510-11, 377 A.2d 691, 695 (1977). In *Rieder*, the court's construction of the parties intent relating to a due-on-sale clause resulted in a denial of enforcement of the clause.

284. Interview with Christopher Cook, Counsel for Fidelity Federal Savings and Loan in West Palm Beach (Sept. 6, 1978).

285. Interview with M. Julian Proctor, Jr., Counsel for Tallahassee Federal in Tallahassee (Sept. 14, 1978).

286. *See* Stockman v. Burke, 249 So. 2d 707, 709 (Fla. 4th D.C.A. 1971). For example, Uniform Covenant 17, which is now widely used by federal lenders, provides for the option of accelerating the mortgage indebtedness upon the transfer of the property. Unfortunately, a right to increase the interest rate is not explicitly tied to the property's transfer. The right of the lender to increase the interest rate is instead addressed as one of two circumstances under which a lender will waive its privilege to accelerate the loan. Thus, some courts may narrowly construe the covenant to allow acceleration only where the lender's security interests are threatened. A possible rationale for this position might be that an increase in the loan's interest rate is not an affirmative right which is fully disclosed by the wording of the covenant, but is merely one exception according to which the loan will not be accelerated. *See* First S. Fed. Sav. & Loan Ass'n, 345 So. 2d 300, 303-04 (Ala. Civ. App. 1977); Crockett v. First Fed. Sav. & Loan Ass'n, 289 N.C. 620, 629-30, 244 S.E.2d 580, 589-90 (1976)

Various disclosure requirements are also relevant. At the threshold, the practitioner should ascertain whether the due-on-sale clause was disclosed to the borrower in accordance with the Federal Truth in Lending Act,[287] if the Act was operative at the time of execution. The FHLBB has enacted a statement of policy requiring some disclosure of the due-on-sale clause to borrowers.[288] The fact that it is a policy statement,[289] is worded permissively,[290] and does not mandate what information is to be disclosed leaves open the effect of the application of the Truth in Lending Act. Also, while most savings and loans make some disclosure of the clause, there are others which do not.[291]

The only two known cases to have construed the application of the Truth in Lending Act to the due-on-sale clause held that the Act did not apply.[292] However, neither decision considered the FHLBB statement of policy concerning the disclosure of the clause. Nor did they consider the provision in the implementing regulations calling for a description of the type of security,[293] coupled with the broad requirement for meaningful disclosure,[294] which

(Lake, J., dissenting); Gobel v. First Fed. Sav. & Loan Ass'n, 83 Wis. 2d 668, 673-77, 266 N.W.2d 352, 355-56 (1978). *See also Report on "Due-on" Clauses, supra* note 178, at 932.

287. 15 U.S.C. §§1601-1666 (1976). Congress gave the Federal Reserve Board rulemaking ability to implement the provisions of the Act, which has been applied to general consumer credit transactions through Regulation Z. 15 U.S.C. §1604 (1976); 12 C.F.R. §226.1-.13 (1979). Also, the Act empowers the FHLBB to require compliance with provisions of the Act by the savings and loan industry. 15 U.S.C. §1607(a)(2) (1976).

288. 12 C.F.R. §556.9(a) (1979).

289. Just what binding effect a "statement of policy" has, if any, is uncertain. One case held that: "They represent a codification by the Board of those activities which directors and officers of federal associations may not engage in. Having been published in the Federal Register, these statements of policy are tantamount to regulations, having full force and effect." Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819, 825 (N.D. Ill. 1975). It is not clear whether the court is speaking in terms of a general rule concerning statements of policy or just the one involved in that case.

290. The regulation states: "The Board *expects* associations to adopt procedures sufficient to ensure that . . . the rights and obligations of the contracting parties under these provisions are fully and specifically disclosed to borrowers." 12 C.F.R. §556.9(a) (1979) (emphasis added).

291. Interview with Adam G. Adams, II, Counsel for Duval Federal Savings and Loan Association in Jacksonville (Sept. 22, 1978); Interview with Vince Elhilow, Senior Vice President, Fidelity Federal Savings and Loan in West Palm Beach (Sept. 6, 1978); Interview with Ben Willis, Vice President, Tallahassee Federal in Tallahassee (Sept. 14, 1978).

292. Croysdale v. Franklin Sav. Ass'n, 601 F.2d 1340 (7th Cir. 1979); Bartlett v. Commercial Fed. Sav. & Loan Ass'n, 433 F. Supp. 284, 287-89 (D. Neb. 1977). The court in *Bartlett* recognized that there was a split of authority on whether acceleration clauses in general were covered by the regulation which called for disclosure of "a default, delinquency or similar charges." 12 C.F.R. §226.8(b)(4) (1979). Still the court held that the due-on-sale clause need not be disclosed, as long as no additional penalty was assessed or additional charge made. 433 F. Supp. at 287-89. In *Croysdale,* the Seventh Circuit held that a lender was under no duty to disclose a due-on-sale clause in a mortgage either under Regulation Z or the Truth in Lending Act. The court reasoned that the exercise of the clause, under the facts in that case, had no bearing upon the costs or terms of financing as required by the regulation and the Act. 601 F.2d at 1343-44.

293. 12 C.F.R. §226.8(b)(5) (1979). The argument can be made that the importance of a due-on-sale clause in a mortgage makes it a basic provision that should be discussed in any type of disclosure.

294. 12 C.F.R. §226.6(a) (1979). *See* Woods v. Beneficial Fin. Co., 395 F. Supp. 9, 16 (D. Or.

could be interpreted to bring the clause under the Act. If a violation of the Act were found, the mortgage would still be valid,[295] but civil liability for certain monetary penalities provided in the Act could arise.[296] Ultimately, negotiation with the lender should be vigorously pursued. So far, few lenders in Florida have been willing to engage in highly speculative litigation to obtain enforcement of the clause.[297] Therefore, a compromise can usually be reached, due to the purely financial nature of the problem, which may be fair to both parties.

In addition to enforcement problems, the possibility exists that borrowers may attempt to avoid the clause by use of an agreement for deed, instead of transferring the property outright. Some reliance may be placed upon the *Chopan* case, where an agreement for deed was held not to be a "sale" which would violate that particular due-on-sale clause.[298] It is important to note, however, that the language in the mortgage used by most federal lenders is extremely broad regarding sales under the clause. The clause becomes operative when an "interest" in the property is sold or transferred.[299] Therefore, even though the seller retains legal title in the installment sale the purchaser does obtain an equitable interest which may bring the transfer within the clause.[300] Nevertheless, a possible conflict in the FHLBB regulations governing the enforcement of the due-on-sale clause may offer the borrower a tenable argument to prevent enforcement of the clause.[301]

Under one provision, a due-on-sale clause may not be exercised when its exercise is based upon the creation of an encumbrance subordinate to the lender's mortgage.[302] Florida case law has determined that an agreement for deed is deemed to be a mortgage.[303] In addition, an agreement for deed would be subordinate to a prior mortgage.[304] It could be argued that an agreement for deed is an encumbrance within the exception described above. A last resort attempt to avoid enforcement of the due-on-sale clause might be the lease of the property with an option to purchase. The FHLBB regulations, however,

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1975). In *Woods*, disclosure of an acceleration provision for late payment was at issue. The court held that such a right was of obvious concern to the buyers and must be disclosed under the regulation mandating "meaningful disclosure." *Id.*

295. *See* Grandway Credit Corp. v. Brown, 295 So. 2d 714, 715 (Fla. 3d D.C.A. 1974).

296. 15 U.S.C. §1640 (1976).

297. Letter from H. L. Cooper, Jr., Esq., to Brian O'Connell (July 10, 1979).

298. Chopan v. Klinkman, 330 So. 2d at 155. *See* Martyn v. First Fed. Sav. & Loan Ass'n, 257 So. 2d 576, 578-79 (Fla. 4th D.C.A. 1971). The district court of appeal in *Martyn* defined a sale as involving the transfer of title, apparently legal title.

299. FNMA-FHLMC Uniform Instrument 6175, ¶17.

300. *See* H & L Land Co. v. Warner, 258 So. 2d 293, 295 (Fla. 2d D.C.A. 1972).

301. *See* Comment, *Mortgages — Due-on-Sale Clause: Restraint on Alienation — Enforceability*, 28 CASE W. RES. L. REV. 503, 510 n.40 (1978).

302. "[A] Federal association may not exercise a due-on-sale clause based on any of the following: (i) creation of a lien or other encumbrance subordinate to the association's security instrument . . . ." 12 C.F.R. §545.6-11(g)(l)(i) (1979).

303. *See, e.g.*, Torcise v. Perez, 319 So. 2d 41, 42 (Fla. 3d D.C.A. 1975); Hoffman v. Semet, 316 So. 2d 649, 651 (Fla. 4th D.C.A. 1975).

304. *See* Baron v. Aiello, 319 So. 2d 198, 199 (Fla. 3d D.C.A. 1975). According to the court, a purchase money mortgage takes priority over any subsequent lien. *Id.*

specifically allow use of the clause where a lease-option agreement is executed.[305] In addition, the use of a "wrap-around mortgage"[306] may not avoid the operation of a legally enforceable due-on-sale clause, as it is the transfer of title which triggers the operation of the clause.[307]

CONCLUSION

The federal approach to the due-on-sale clause is likely to have the greatest overall effect. The variable rate mortgage, an alternative mortgage form which has been approved by the FHLBB,[308] should be widely publicized and used. This new mortgage form directly and realistically satisfies the need for lenders to cope with tight money conditions. The use of the due-on-sale clause should be restricted to the standard fixed rate mortgage[309] and should only be used in loans made to commercial borrowers. Most importantly, for both present and future loan transactions, the FHLBB should mandate specific and understandable disclosure of the use and possible effect of a due-on-sale clause in a mortgage. Following these procedures will enable a borrower to intelligently choose among the available mortgage forms and uniformity of instruments will be maintained.

Because of the paucity of Florida case law, legislation based on analogous Arizona, California, and Colorado statutes should be considered to regulate the use of the clause.[310] However, any legislation should exempt those mortgages executed pursuant to the 1976 FHLBB regulation approving the use of the due-on-sale clause. Otherwise, the legislation would be ripe for challenge by a federal lender. Absent any legislation, the equitable approach of the *Clark* decision should be followed with particular attention paid to the flexibility demonstrated in dealing with the varied fact situations that may occur. Finally, the routine of an attorney handling a real estate transaction should include an examination of a mortgage for a due-on-sale clause and the discussion of the clause with the client.

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305. "[A] Federal association may not exercise a due-on-sale clause based on any of the following: . . . Grant of any leasehold interest of three years or less *not* containing an option to purchase." 12 C.F.R. §545.6-11(g)(l)(iv) (1979) (emphasis added).

306. *See, e.g.*, Mindlin v. Davis, 74 So. 2d 789, 790-91 (Fla. 1954).

307. *See* Comment, *The Wraparound Mortgage, A Critical Inquiry*, 21 U.C.L.A. L. REV. 1529, 1539-47 (1974).

308. 12 C.F.R. §545.6-2 (1979). The interest rate on a variable rate mortgage is tied to an index which reflects interest rate changes. The mortgage rate is subject to yearly adjustment of plus or minus 0.5 percent a year and 2.5 percent for the life of the loan. *Id.* As might be expected, there are conflicting views concerning the relative advantages of the variable rate mortgage. Notably there is a concern with the shift of the risk to the borrower of a climb in interest rates. CONSUMER REPORTS, Jan. 1979 at 17.

309. Despite the interest raising features of the variable rate mortgage, the FHLBB still intends to use the due-on-sale clause to maximize the return on a loan. Letter from Jerome S. Plapinger, Associate General Counsel, Federal Home Loan Bank Board to Brian O'Connell (July 18, 1978).

310. See note 119 *supra*. Use of the Law Revision Counsel to study possible legislation is more likely to obtain an objective result than would subjecting the proposals to the various special interest groups in the legislature. *See* FLA. STAT. §13.96 (1979).