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THE DUE-ON-SALE PERSPECTIVE IN CALIFORNIA FROM EARLY 1982 TO LATE 1983: FROM THE "DAWN" OF THE CURRENT ERA TO THE "SUNSET DATE" AND BEYOND

*By Joseph M. Cobert

I. INTRODUCTION

1982 and 1983 were enlightening years for followers of the up and down history of the due-on-sale clause in California. From the California Supreme Court’s dawning opinion on this subject during its 1982 term¹ to Congress’ eleventh hour passage of legislation establishing a comprehensive statutory framework (the first express due-on-sale action by the federal legislature, rather than by a judicial or administrative body, since the 1930’s), a whole new era in real estate financing had begun.

Yet the framework created by Congress last year was not totally dispositive of all due-on-sale controversy; in some particulars the legislation, known as the Garn-St. Germain Depository Institutions Act of 1982 (the Act),² was only skeletal. In fact, Congress expressly indicated in such legislation³ that

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3. The due-on-sale provisions of the Act were concentrated in section 341 thereof, which now appears at 12 U.S.C. § 1701j-3 (1982). Hereafter, all references to section 341 or to any of its subdivisions shall be understood to refer to the correspondingly numbered provision of the Act. The delegation of authority to the Board described in the text appears in subsection (e)(1) of section 341, which points out
the Federal Home Loan Bank Board (the Board), the main regulatory arm of federal thrift institutions, would promulgate interpretative and clarifying rules and regulations to "flesh out" certain remaining features of the skeleton. After circulating an earlier proposal this past January, on May 13, 1983 the Board promulgated its final regulations (which, together with extensive supplementary information and certain statements of policy published therewith, it termed the "Final Rule"). That administrative package has proved to be fairly restrictive and lender-oriented and will likely add only pallor to the faces of real estate professionals cheeky enough to conclude that the worst in due-on-sale was behind them.

At the same time, the California state courts, in the past predominantly more borrower-oriented in many controversial due-on-sale areas, addressed at rest, some of the open issues in cases like West v. Buffo and Tan v. California Federal Savings and Loan Association, both decided within the first three months of this year. In light of these developments, it now appears that 1983 will prove to have been as colorful for followers of due-on-sale as were the preceding twelve months.

In order to appreciate the remarkable difference between the late 1983 perspective and that existing as 1982 began, one must look beyond the actions of the courts and the Board and recognize the enormous change that has taken place in the general business environment in that brief time span. Looking back to early 1982, for instance, one would scarcely have imagined the current California real estate acquisition scenario. Interest rates were quite high at that point; and the economy, both in this state and nationwide, was very sluggish. Inflation had been roaring at a double-digit pace for much of the

that the Board was to consult the Comptroller of the Currency and the National Credit Union Administration Board before issuing the final regulations.


preceding calendar year. A substantial percentage of the sales in the then weakening real estate market depended upon existing financing, with buyers seeking to take over properties subject to loans already in place rather than obtaining new financing with interest rates near the highest levels in recent history.

In that climate, on February 4, 1982, the California Supreme Court announced its decision in the case of Dawn Investment Co. v. Superior Court. Broadening its 1978 ruling in Wellenkamp v. Bank of America to include "private" (non-institutional) lenders, the court simultaneously clari-

12. 30 Cal. 3d 695, 639 P.2d 974, 180 Cal. Rptr. 332 (1982). The decision was unanimous.
14. The term "private lenders," referring to private persons and to entities not classified as "institutional lenders," harkens back to the famous 9th footnote in the Wellenkamp case, where the California Supreme Court tantalized private parties by saying: In the instant case the party seeking enforcement of the due-on clause is an institutional lender. We limit our holding accordingly. We express no present opinion on the question whether a private lender, including the vendor who takes both secondary financing, has interests which might inherently justify automatic enforcement . . . in his favor upon resale. Id. at 962 n.9, 582 P.2d at 976 n.9, 148 Cal. Rptr. at 385 n.9.
It appears to this author that Dawn Investment really left very little uncertainty in its language, the state supreme court indicating there as follows: Whether private lenders are vendors who sought to enhance sale of their property by taking back financing, investors who sought return on their capital, or both vendors and investors [the same financing considerations apply and] no substantial reason has been shown to treat private lenders differently from institutional lenders in respect to the restraint on alienation resulting from enforcement of due-on-sale clauses.
30 Cal. 3d at 702, 639 P.2d at 977-78, 180 Cal. Rptr. at 335. Accord Wilbute v. Cali,
15 Cal. App. 3d 295, 185 Cal. Rptr. 215 (1982), see infra note 189. This conclusion is further enhanced by the California Supreme Court's handling of West v. Buffo, 139 Cal. App. 3d 93, 188 Cal. Rptr. 535 (1983), see supra text accompanying note 6. That case was accepted for review (as Case No. SF 24318) on July 29, 1981, but then was remanded to the First District Court of Appeal in April of 1982, after the Dawn Investment decision. After remand, the appellate court confirmed the applicability of the Wellenkamp and Dawn Investment doctrine to a single family homeowner "who sells her home and takes back a promissory note and deed of trust." 139 Cal. App. 3d at 94, 188 Cal. Rptr. at 535 (1983). But see Pas v. Hill, 87 Cal. App. 3d 521, 151 Cal. Rptr. 177 (1983)—that Dawn Investment did not really intend to
fied another controversial issue by stating that loans on all types of property—commercial, industrial, residential or otherwise—were subject to the restrictions on enforcement
cover the situation of the purchase money first trust deed seller or at least that “a logical and readily distinguishable difference lies in the status of the owner/financier (vendor/lender) who engages in an isolated credit sale” and the hard money lender or seller who takes back secondary financing. Caron, “Due-on-Sale”: After Dawn Investment and after de la Cuesta, 3 REAL PROP. NEWS 5, 23 (1982). 

One commentator in 1982 summarized the major due-on-sale issues remaining to be litigated in California prior to Dawn Investment as follows:

Following Wellenkamp, the remaining due-on-sale issues were whether there could be automatic enforcement if: 1) the beneficiary was a private lender, i.e., a lender whose normal business was not to lend money for purposes of profit; 2) the beneficiary was a vendor who in selling real property took back a note and deed of trust, as such a vendor-beneficiary did not lend money, but rather made an installment sale whereby the vendor-beneficiary agreed to a delayed receipt of the monetary consideration; 3) the beneficiary was a junior lienholder, as the justification for the enforcement of a due-on-sale clause in a junior deed of trust was arguably greater than with respect to a senior lien and the quantum of restraint was correspondingly smaller; 4) the security for the note was investment-commercial real property, as Wellenkamp specifically referred to protecting the equities of residential real property owners, and because the quantum of restraint was arguably smaller and the justification for enforcement arguably greater as to commercial property than residential real property; 5) there was an involuntary transfer of the secured real property, as there was no restraint on alienation when a trustor abandoned the property, allowed foreclosure, and there was a resulting involuntary transfer by trustee’s deed; and 6) the beneficiary was a federal savings and loan association, i.e., whether California law as contrasted to federal law was applicable to a federal savings and loan association.


The fifth issue has not yet been fully resolved, although a related issue was considered in the 1981 case of Garber v. Fullerton Sav. & Loan Ass’n, 122 Cal. App. 3d 423, 176 Cal. Rptr. 49 (1981). See infra note 40. See also Fine, supra at 35 n.4, 47, 49, 58; Pas v. Hill, 87 Cal. App. 3d 521, 151 Cal. Rptr. 98 (1978); infra note 109.

The sixth issue was the subject of the United States Supreme Court’s de la Cuesta decision. See infra notes 19 & 37-92 and accompanying text. See also Jennings & McGuire, Due-on-Sale Clauses: What’s Due? Plenty!, 11 REAL EST. L.J. 291 (1983); Lockyer, supra note 11; and Note, Fidelity Federal Savings & Loan Association v. de la Cuesta: Does Preemption Really Apply?, 19 CAL. W.L. REV. 161 (1982).

15. See Garfinkle v. Wells Fargo Bank, 135 Cal. App. 3d 514, 517 n.3, 185 Cal. Rptr. 401, 403 n.3 (1982). In Dawn Investment, the state supreme court considered and rejected three arguments for limiting Wellenkamp to residential property. One was that non-residential property, typically acquired for investment, entails different acquisition considerations:
enunciated in Wellenkamp.\(^{16}\)

It is urged that because the investor purchases for economic reasons and not for personal reasons, lenders and investors who are both concerned with business considerations should be free to agree to automatically enforceable due-on-sale clauses without regard to the resulting restraint on alienation. Civil Code section 711 prohibiting restraints on alienation does not contain any language warranting an exemption for investment property. In determining the validity of the restraint, the quantum of restraint . . . must be balanced against the justification for it.

Measuring the quantum of restraint, it is apparent that enforcement of the clause in periods of tight money may preclude sale or require reduction of sale price of investment property just as it does with residential property. While an investor may plan to meet his cost of acquisition and maintenance through potential income, this does not serve to reduce the quantum of restraint. Despite the potential income, the cost of financing a purchase in periods of tight money may be as determinative of the alienability of investment property as it is of residential property.

30 Cal. 3d at 703, 639 P.2d at 978, 180 Cal. Rptr. at 336.

Secondly, the lender argued that non-residential property is sold for different reasons than residential property:

It is also urged that because the investor ordinarily sells for business reasons rather than personal ones, he is in a better position to defer a sale during periods of tight money. The argument, if accepted, would not show that the quantum of restraint resulting from enforcement of a due-on-sale clause is less for investment than residential property, but to the contrary indicates that the quantum of restraint, if anything, is greater for investment property.

Nor do the investor's business considerations furnish justification for the restraint. Whether the property is residential or investment, the new purchaser may make a substantial down payment, and there is no substantial reason to assume that he is a worse credit risk than his seller. Moreover, the income potential of investment property tends to reduce the importance of the purchaser's creditworthiness. While some investment property loans are based in part on the borrower's management experience, there is no reason to assume that management ability of a purchaser who invests his funds and time in the property and its management will impair the security or increase the risk of default.

\(^{16}\) "[A] due-on clause contained in a promissory note or deed of trust cannot be enforced upon the occurrence of an outright sale unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default." 21 Cal. 3d at 963, 582 P.2d at 977, 148 Cal. Rptr. at 385-86. In so deciding, the California court made it clear that an "outright sale" for Wellenkamp purposes was "any sale by the trustor of property wherein legal title . . . is transferred," rather than limiting the concept only to transactions where the seller "cash[es] out." \(\text{Id.}\) at 949-50, 582 P.2d at 974, 148 Cal. Rptr. at 383.

Moreover, in Wellenkamp the court rejected the lender's contention that its interest in "maintaining its loan portfolio at current interest rates justifies the restraint imposed by exercise of a due-on clause upon transfer of title in an outright sale." \(\text{Id.}\) at 952, 582 P.2d at 976, 148 Cal. Rptr. at 385. So, too, the same court rejected the like "portfolio" argument for non-institutional lenders, even though it recognized that a
This article will not discuss the *Dawn Investment* case in any detail; however, it is fair to say that, at the time it was decided, it appeared to close the last avenue for any lenders in California, other than possibly certain federal thrifts, to automatically accelerate loans because of property transfers (that is, without showing impairment of the lender’s security). And even the position of the federal thrifts regarding enforcement of due-on-sale clauses in California was somewhat weaker than it had been in the few years before. This resulted from the fact that, after some inconsistency, the last California appellate level case in favor of automatic enforcement of acceleration clauses by federal thrifts had been accepted for review late in 1981 by the United States Supreme Court.

From that point to the present, both the thrift industry and the guidelines applicable to due-on-sale have undergone an incredible transformation. In fact, even as the *Dawn Investment* case was being considered in California, an inexorable trend had begun on the national level which was to lead to major changes respecting the enforceability of due-on-sale clauses. On January 28, 1982, the Court had agreed to hear the case of *Fidelity Federal Savings & Loan Association v. de la Cuesta.* This case finally brought before the nation’s highest tribunal the question of whether federal savings and loan associations (federal S&L’s) were exempt from *Wellenkamp* because of the existence of a preemptive administrative regulation (the Regulation) first issued in 1976 by the Board pursuant to the Home Owners’ Loan Act of 1933 (HOLA).

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private lender, unlike its institutional counterpart, “is not [necessarily] in the business of making loans and is ordinarily not in a position to make projections of economic conditions.” 30 Cal. 3d at 701, 639 P.2d at 977, 180 Cal. Rptr. at 335.

17. See supra note 14.


19. 102 S. Ct. 3014 (1982). Since California’s courts were not totally in agreement and the majority of prior decisions in other jurisdictions were in support of preemption, the Court noted probable jurisdiction when requested to hear the *de la Cuesta* case. 102 S. Ct. at 3021-22.

20. Such federal S&L’s are private mutual savings associations chartered by the Board under § 5(a) of the Home Owners’ Loan Act of 1933.

21. 12 C.F.R. § 545.8-3(f) (January 1, 1982).

22. When originally issued on June 8, 1976, it was codified at 12 C.F.R. § 545.6-11(f). It became effective July 31 of 1976.

and reissued early in 1982. The Court reached its decision\textsuperscript{24} only five months after it agreed to review the case. In so doing, the Court may have hastened the end of, if not culminated, the lengthy and inconsistent series of decisions involving the rights of federal S&L's to automatically exercise due-on-sale clauses—a sequence of cases which had been proliferating in state and federal courts in the last few years.\textsuperscript{25}

Supreme Court's \textit{de la Cuesta} opinion.

\textsuperscript{24} The decision was by a six to two vote. Justice Blackmun wrote the majority opinion, in which he was joined by Chief Justice Burger and Associate Justices Brennan, White, Marshall, and O'Connor (although Justice O'Connor expressed her views in a separate concurring opinion). Justice Rehnquist wrote a short dissenting opinion, with which Justice Stevens expressed his agreement.

\textsuperscript{25} Prior to \textit{de la Cuesta}, a number of jurisdictions had at some point concluded that automatic enforcement of due-on-sale clauses of federal savings and loan associations was impermissible under applicable state law notwithstanding the lender's contentions of federal preemption. In note 9 of that opinion, the majority mentioned the leading state court cases of California and Minnesota. 102 S. Ct. at 3021 n.9. The Minnesota case, Holiday Acres v. Midwest Fed. Sav. and Loan Ass'n, 308 N.W.2d 471 (Minn. 1981), was heavily relied upon by the California appellate tribunal in \textit{de la Cuesta}.

For a brief but comprehensive summary of the reported cases constituting California's due-on-sale experience with federal lenders—including decisions of both the state and federal courts—see Caron, "Due-on-Sale": After Dawn Investment and \textit{de la Cuesta}, 3 Real Property News 5 (No. 2, Spring/Summer 1982) (federal summary located at 27-29). Also see Gerro, The Due-On-Sale Clause—An Unsettled Issue, appearing in both 4 L.A. Law. 6 (Feb., 1982) and 3 Real Prop. News 2 (No. 1, Winter, 1982).


Another source stated that before June 28 the number of states (including California, Minnesota and Florida) which, "by state law or state court ruling, . . . refused to enforce some or all federal due-on-sale clauses [before \textit{de la Cuesta}]," totalled 18. The Wall Street Journal, June 29, 1982, at 3, col. 1. But see the Court's reference to a state case supporting "the Board's approach" in Colorado, 102 S. Ct. at 3030 n.22, and federal cases in Colorado and Illinois, \textit{id.} at 3021 n.9.

In S. Rep. No. 97-536 [hereinafter cited as Committee Report], the Senate Banking Committee made the following conclusions about the limitation upon due-on-sale enforcement in the various states:

To the best of the Committee's knowledge, the following states have adopted laws restricting the enforcement of due-on-sale clauses: Colorado, in 1975; Iowa, in 1979; New Mexico, in 1978; and Utah, in 1981. Georgia and Minnesota also have adopted laws on the subject, but it is unclear from reading them just what restrictions, if any, they impose on
Last fall, the second profound change went into effect as the Congress passed, and the President signed into law, the Garn-St. Germain Depository Institutions Act of 1982. Section 341 of this sweeping legislation deals directly with enforcement of alienation clauses and has significantly reduced the amount of borrower-lender confrontation in the due-on-sale area. Even more noticeably, the Act has already had an unmistakable effect on institutional lending in other ways as well—primarily by permitting tremendous diversity in the lending field which in effect makes banks, savings and loans, brokerage houses, and other entities with loan operations almost interchangeable. As a result of this increased flexibility, depositors began in mid-December of 1982 to pump enormous amounts of funds into various money market and similar accounts at such institutions. Almost simultaneously, federal

the enforcement of due-on-sale clauses. The highest courts in those states could be the final arbiter of the impact of those laws . . . .

To the best of the Committee's knowledge, the highest courts in the following states have placed restrictions on the enforcement of due-on-sale clauses in their states: Arizona, in 1978; Arkansas, in 1972; California, in 1978; and Michigan (by appellate court with statewide jurisdiction), in 1977.

The Supreme Courts of Illinois and Mississippi appear to leave the door open not to enforce due-on-sale clauses under some circumstances. The Committee has not discovered court decisions in any other states that would appear to trigger a window period. In several states, such as New York and Florida, appellate courts whose jurisdiction is not statewide have imposed restrictions on due-on-sale clauses, but the window period in this bill is not triggered by lower court decisions, as the Committee was concerned with respecting the integrity of decisions that had statewide impact.

Of course, just what the state law is in any particular state would be determined by the highest court of that state.

The Committee has not formed an opinion with respect to the decision taken by the Supreme Court of the State of Wisconsin in 1973.

*Id.* at 22 nn.2-3.


26. The President's signing of such legislation into law once it passed both houses of Congress was never in doubt. The Administration had strongly supported the measure "as part of its long-range program to remove federal restrictions on the activities of banks and savings and loan associations." L.A. Times, Sept. 30, 1982, pt. I, at 1, cols. 1-2.


28. *E.g.*, id. at cols. 1-2; L.A. Times, March 17, 1983, pt. I, at 1, col. 6; The Wall
monetary policy was relaxed;\textsuperscript{29} and, although Federal Reserve Board Chairman Paul Volcker has occasionally made comments about tightening such policy if necessary, it has remained moderate.\textsuperscript{30} Inflation has slowed.\textsuperscript{31} All of these factors have contributed to an extraordinary increase in lender liquidity\textsuperscript{32} and the rapid reduction of the previously stratospheric interest rates.\textsuperscript{33}

While section 341 of the Act is but a few paragraphs, in that short space Congress extended prospectively to national banks, state banks, state savings and loans, federal credit unions, and all other lenders (including private parties) essentially the same benefits as the Regulation confers upon federal S&L's and, presumably, federal savings banks.\textsuperscript{34} Literally read, the legislation effectively gives any lender the automatic right to exercise a due-on-sale clause, if such a clause is contained in its loan documents with the borrower,\textsuperscript{35} in the event of any post-Act transfer (1) not subject to the "window period" restrictions as discussed below and (2) not falling into one of nine categories of exempt transfers where it was viewed as unfair to consumers to permit loan acceleration.\textsuperscript{36}

The passage of the Act, following closely on the heels of the \textit{de la Cuesta} decision, resulted in a significant narrowing of the areas of due-on-sale controversy. Nevertheless, that enactment and \textit{de la Cuesta} still left some unresolved issues, most of which appear to have been settled by the Final Rule (although that administrative promulgation is somewhat controversial and may itself be the subject of future constitutional challenge). This article will seek to analyze the due-on-

\textsuperscript{30} Id., Aug. 29, 1983, at 3, col. 2; id., June 13, 1983, at 1, col. 6.
\textsuperscript{31} Id., June 13, 1983, at 1, col. 6.
\textsuperscript{32} Time, May 23, 1983, at 38.
\textsuperscript{33} E.g., id.; L.A. Times, March 17, 1983, pt. I, at 1, col. 6.
\textsuperscript{34} The Committee Report, \textit{supra} note 25, at 24, states that the \textit{de la Cuesta} case upheld due-on-sale rights of "federally chartered savings and loan associations and federal savings banks . . . ." (Emphasis added).
\textsuperscript{35} Section 341(b)(2), \textit{supra} note 3.
\textsuperscript{36} It is not the intention of the Committee that Section 341(d) [the exemption portion] of the bill facilitate financing arrangements which are designed to circumvent the legitimate right of a lender to enforce a due-on-sale clause, rather, the purpose of this section is to provide protections for consumers by prohibiting the enforcement of due-on-sale clauses where such enforcement will be inequitable.
sale picture as it exists in late 1983; however, in order to best understand that picture, it will first review the history and content of the de la Cuesta opinion, the Act and the Final Rule.

II. THE FACTS AND HISTORY OF THE DE LA CUESTA CASE

There were actually three cases consolidated as part of the de la Cuesta matter. In each case the loan involved originated with Fidelity Federal Savings and Loan Association (Fidelity) at a time when Fidelity was a federal S&L. All three loans remained with Fidelity throughout the entire period in question prior to the start of litigation and were still in its portfolio when the Court rendered its decision on June 28, 1982. One loan was made in 1971, another in 1972, and the third in 1978; the real property security for the 1971 loan was transferred by grant deed in 1977, and the real property securing the other two loans was transferred (also by grant deed in each case) in 1978. All of the deeds of trust involved contained due-on-sale clauses and were apparently of a standardized nature. The latter two additionally possessed “choice of law” provisions reciting that the deed of trust was to be “governed by the law of the jurisdiction in which the property is located.”

Fidelity was not advised in advance in any of the three transfers but learned of each shortly after deed recordation, apparently finding out through its own information channels. Fidelity nevertheless agreed to permit the transfer in each case without acceleration provided that the buyer, the transferee, would agree to a new interest rate at the then prevailing market level (and, although the Court did not say so, presumably on the condition that the transferee would execute some type of assumption agreement). Each transferee refused to pay the stepped-up rate and hence rejected Fidelity’s approach—resulting in Fidelity’s accelerating the maturity of each loan and, as to each, recording a notice of default when the accelerated balance was not paid per demand. Each transferee then filed suit in the Superior Court of California for

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37. The plaintiffs in one of the three actions were the Moores, in another the Whitcombes, and in the third the de la Cuestas. 102 S. Ct. at 3019-20.
38. See infra Section III D for a full discussion of the “choice of law” provisions in de la Cuesta.
Orange County asking for a declaration that the due-on-sale clause was unenforceable under Wellenkamp as an unreasonable restraint on alienation. The suits also sought injunctions and damages. Under Wellenkamp, of course, restraints on transferability of real property are unreasonable and thus prohibited by California law with “unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default.”


40. 21 Cal. 3d at 963, 582 P.2d at 977, 148 Cal. Rptr. at 386. See supra note 16. Several specific statutory exceptions to Wellenkamp were added in 1979. One such exception is contained in CAL. CIV. CODE § 711.5 (West Supp. 1982), which deals with housing purchase or rehabilitation loans provided directly or indirectly by state or local public entities (notably including CHFA and Cal-Vet). The Cal-Vet program,
The superior court consolidated the three actions and granted summary judgment to Fidelity. The Court of Appeal for the Fourth Appellate District reversed in July of 1981, citing with approval and quoting liberally from a similar ruling made a few months earlier by another California state court of appeal, the First Appellate District, in the case of *Panko v. Pan American Federal Savings and Loan Association*. The California Supreme Court denied Fidelity's petition for review in August of 1981, just as it had refused to review *Panko* a week earlier. Then on January 28, 1982, the United States Supreme Court accepted the de la Cuesta case for its next Fall Term, October 1982; however, calendar priority resulted in an earlier hearing date of April 28, 1982 and a ruling two months later in June.

established under the Veterans' Farm and Home Purchase Act of 1974, *Cal. Mil. & Verr. Code* § 987.50 (West 1974), contained limitations on assignment of Cal-Vet land contracts, the most noteworthy being a due-on-sale provision. *Id.* at § 987.73. Recently, a state appellate court held that *Wellenkamp* did not apply to Cal-Vet land contracts. *Dept. of Veterans Affairs v. Duerksen*, 138 Cal. App. 3d 149, 187 Cal. Rptr. 832 (1982). Similarly, in March of this year the Ninth Circuit Court of Appeals upheld a due-on-sale provision in a federal loan made by the Farmers Home Administration pursuant to the Emergency Agricultural Credit Adjustment Act of 1978. *United States v. Med 0 Farm*, 701 F.2d 88 (9th Cir. 1983).


The only pre-Act judicial exception in California as to situations involving purely real property security and non-federal lenders appears to have been that of the involuntary transfer. See *supra* note 14. In *Garber v. Fullerton Sav. & Loan Ass'n*, 122 Cal. App. 3d 423, 176 Cal. Rptr. 49 (1981), a state-chartered institutional lender was permitted to automatically accelerate upon the transfer to subsequent purchasers following an involuntary sale to their grantor conducted to satisfy an unpaid tax lien of the United States against the original trustor. In *Garber*, the appellate court also suggested that the *Wellenkamp* doctrine would not have protected the tax lien sale purchaser either, since he had "no consensual relationship to either party (to the original loan transaction] and [was] unrelated to the debt or the security instrument." 122 Cal. App. 3d at 428, 176 Cal. Rptr. at 53.

The three year old decision of *Guild Wineries & Distilleries v. Land Dynamics*, 103 Cal. App. 3d 966, 163 Cal. Rptr. 348 (1980), permitted automatic enforcement where the security was *primarily personal property* subject to removal and/or deterioration.


42. No. 25 Official Advance Sheets, California Supreme Court Minutes, at 6.

43. The *Panko* case was accepted for hearing by the United States Supreme
III. WHAT THE COURT ACTUALLY STATED IN DE LA CUESTA

A. The Preemption Doctrine: The Intent of the Board

The major focus of attention in de la Cuesta and the basis for Fidelity's asserting that federal S&L's possess the right to accelerate loans under due-on-sale clauses was the Regulation, which stated as follows:

An association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable 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 prior written consent. Except as provided in paragraph (g) of this section with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by that contract.44

With the benefit of briefs from several amici curiae as well as the parties to the litigation itself, the Court considered in de la Cuesta not only the words of the Regulation but also the extensive congressional history surrounding the Board's

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44. See supra notes 21-22 and accompanying text. When reissued, the first word of the Regulation ("An") was inserted instead of the words "A Federal" as had appeared in the 1976 text.
enabling legislation, substantial administrative and other commentary \(^{45}\) and additional sources as to whether the Regulation was intended by the Board to preempt state law in the due-on-sale area. \(^{46}\) Moreover, the Court gave considerable attention to the preamble to the Regulation drafted when the Regulation was first promulgated in 1976 and dated on April 28 of that year. \(^{47}\) The preamble has always recited that the Board intended due-on-sale provisions of federal S&L's to be governed "exclusively by Federal law" \(^{48}\) and "not [to] be bound by or subject to any conflicting State law which imposes different . . . due-on-sale requirements." \(^{49}\)

The Court noted that, in 1981, the Board "reiterated its long-standing policy" \(^{50}\) of authorizing federal S&L's to enforce due-on-clauses "subject only to express limitations imposed

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45. See the Board's Advisory Opinion, Resolution No. 75-647, quoted in Schott v. Mission Fed. Sav. & Loan Ass'n, No. Civ. 75-366, at 13-15 (C.D. Cal. 1975) (Board Advisory Opinion), interpreting a 1948 Board regulation requiring constituent organizations' loan instruments to "provide for full protection to the federal association" as permitting such lenders to enforce due-on-sale clauses irrespective of any state law limitations. Apparently, no evidence was adduced to demonstrate that in 1948 the Board had any concept of a due-on-sale clause; no specific mention has been located in any Board pronouncements before the Regulation.

46. The Court stated that "even the Court of Appeal recognized [that] the Board's intent to preempt the Wellenkamp doctrine is unambiguous." 102 S. Ct. at 3023. At the appellate level, the tribunal quoted Panko in stating that "it is clear that the Board has manifested its unqualified intention that the adopted regulations and implementing policy relating to due-on-sale clauses shall occupy a preemptive position over conflicting state law provisions." 121 Cal. App. 3d at 339, 175 Cal. Rptr. at 473 (quoting 119 Cal. App. 3d at 922, 174 Cal. Rptr. at 244).

47. The Court pointed out that, prior to the Board's issuance of the Regulation in 1976, as the Board became aware of "the increasing controversy" regarding the authority of federal lenders to exercise due-on-sale clauses, it stated that "elimination of the due-on-sale clause will benefit only a limited number of home sellers, but generally will cause economic hardship to the majority of home buyers and potential home buyers." 102 S. Ct. at 3019, (quoting 41 Fed. Reg. 6283, 6285 (1976)).

48. 41 Fed. Reg. 18,286, 18,287 (1976). The Board has stated that federal lenders' due-on-sale practices "shall be governed exclusively by the Board's regulations in preemption of and without regard to any limitations imposed by state law on either their inclusion [sic] or exercise (including, but not confined to, state law prohibitions against restraints on alienation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers)." 12 C.F.R. § 556.9(f)(2) (1982).


by the Board." And the majority further recognized in its opinion that, in 1982, the Board expressed "confirmation" of its intent to give the Regulation preemptive effect.

Fidelity argued that this Board policy could not be reconciled with Wellenkamp. In fact, Fidelity contended that the Wellenkamp restrictions would directly conflict with the need of a federal S&L for flexibility. For example, Wellenkamp expressly rejects as a justification for acceleration a lender's desire to upgrade its portfolio. Yet the option of calling a loan

51. 46 Fed. Reg. 39,123, 39,124 (1981). According to the majority opinion, the only restrictions the Board intended to place on the scope of the Regulation are those contained in 12 C.F.R. § 545.8-3(g) (1982). In actuality, those restrictions were codified (with somewhat different wording) in 1976 as 12 C.F.R. § 545.6-11(g). Regarding the current version, the Court stated:

12 CFR § 545.8-3(g), which applies to loans made after July 31, 1976, and secured by a home occupied or to be occupied by the borrower, prohibits the exercise of a due-on-sale clause in the same four circumstances listed in § 17 of the uniform mortgage instrument; . . . when a lien subordinate to the lender's security instrument is created; when a purchase money security interest for household appliances is created; when a transfer occurs by devise, descent, or operation of law on the death of a joint tenant; or when a leasehold interest of not more than three years is granted with no option to purchase. Section 545.8-3(g) also bars the association from imposing a prepayment penalty when a loan is accelerated by means of a due-on-sale clause, and provides that, under specified circumstances, the lender waives its option to exercise a due-on-sale provision.

102 S. Ct. at 3023 n.11.

While these restrictions are far more narrow than those of Wellenkamp (which barred due-on-sale in all cases except where security was impaired or the risk of default heightened), in a companion promulgation to the re-issued Regulation the Board has made several further "suggestions" to its associations respecting certain practices:

(c) The Board believes there may be (in addition to the circumstances prescribed in § 545.8-3(g) . . .) situations in which it will be appropriate for a Federal association to waive its contractual right to accelerate a loan. Those situations include transfer of title to members of the borrower's immediate family, including a former spouse in connection with a divorce, who occupy or will occupy the property (to the extent not covered by § 545.8-3(g)). Associations also should consider waiving, in cases of extreme hardship to the existing borrower, any right to require an increase in interest under a due-on-sale clause.

(d) Even though a Federal association may increase the interest rate as a condition of loan assumption, the Board expects that no association will request such an increase to a rate exceeding the then prevailing rate on comparable new loans by the association applying its normal lending standards.


52. 12 C.F.R. § 556.9(f)(2) (1982).

53. The "portfolio" justification was expressly rejected as to outright sales in
due upon a transfer is one the Board found to be economically sound, and such state limitation thus creates "an obstacle to the accomplishment and execution of the full purposes and objectives" of the Regulation.

The appellees in de la Cuesta suggested that the Regulation and Wellenkamp could be harmonized on another basis. They asserted that the second sentence of the Regulation, which provided that exercise of the due-on-sale clause was "exclusively governed" by the loan contract and which further stated that the contract fixed all rights and remedies of the lender and borrower, required incorporation of state contract law—including those restrictions imposed by statute or judicial decision. This meant, the appellees urged, that a loan contract in California necessarily incorporated the Wellenkamp doctrine. In rejecting that means of circumventing the federal S&L problem, the Court reasoned that federal law was still applicable because "the Constitution, laws, and treaties of the United States are as much a part of the law of every State as its own local laws and Constitution." What the second sentence of the Regulation signified, the Court determined, was that the due-on-sale clause would only be utilized if it were in the loan documents and subject to the express limitations, if any, prescribed by those documents.

On the basis of the foregoing, the majority concluded that the Board’s Regulation "was meant to preempt conflicting

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Wellenkamp. 21 Cal. 3d at 952-53, 582 P.2d at 976, 148 Cal. Rptr. at 386. See supra note 13. In emphasizing that such an objective (improving a lender’s portfolio) is specifically one of the goals of the Board, the court stated as follows: "Wellenkamp explicitly bars a federal savings and loan from exercising a due-on-sale clause to adjust a long-term mortgage’s interest rate towards current market rates—a due-on-sale practice the Board has approved and views as critical to ‘the financial stability of the association.’" 102 S. Ct. at 3024 (quoting Board Advisory Opinion at 27) (emphasis added).

What is interesting is that the Wellenkamp case dealt with a national bank (Bank of America), not a federal lender; and the California Supreme Court opinion in Wellenkamp made no "explicit" reference to a federal lender nor did it contain any indication of a federal question at all.

54. See infra notes 61-63 and accompanying text.
55. 102 S. Ct. at 3024, (quoting Hines v. Davidowitz, 312 U.S. 52, 67 (1941)).
56. 102 S. Ct. at 3024, (quoting Hauenstein v. Lynham, 100 U.S. 483, 490 (1879)). Yet if federal law were applicable, why was no federal preemption argument raised in Wellenkamp by the Bank of America, a national bank? This very question was posed by another author in analyzing de la Cuesta. Lockyer, supra note 11, at 9-10.
57. 102 S. Ct. at 3023.
state limitations on the due-on-sale practices of federal savings and loans, and that the California Supreme Court's decision in Wellenkamp creates such a conflict.\(^5\)

**B. The Board's Authority**

The second major issue decided by the Court was that the Board acted within its statutory authority in issuing the Regulation. Reviewing the legislative history of HOLA, from which came the congressional delegation of authority to the Board in this particular field, the Court determined that Congress had as one of its distinct purposes in such delegation "creating and regulating federal savings and loans so as to ensure that they would remain financially sound institutions, able to supply financing for home construction and purchase."\(^5\)

The Court found the Regulation consistent with state limitations on the due-on-sale practices of federal savings and loans, and that the California Supreme Court's decision in Wellenkamp creates such a conflict.\(^5\)

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5. Id. at 3025. At the appellate level, the Federal Home Loan Mortgage Corporation ("FHLMC" or "Freddie Mac"), appearing as amicus curiae, urged a finding of federal preemption in order to accomplish "national uniformity" as to loan practices and instruments. It contended, as did Fidelity, that a state regulatory scheme, whether legislative or (as in California under Wellenkamp) judicial in its foundation, could not co-exist with the federal Regulation. Nevertheless, giving great weight to the fact that the Regulation only permitted and did not compel federal savings and loans to include due-on-sale clauses in their loan contracts and to enforce them, and relying heavily on Minnesota's Holiday Acres case, the appellate tribunal deciding the de la Cuesta matter in California rejected the preemption claim. That panel also reasoned that HOLA, as a Depression-era enactment for the benefit of borrowers, property owners and consumers, should not be construed for the lenders in a way to be adverse to those originally intended as beneficiaries of the legislation. 121 Cal. App. 3d at 342, 175 Cal. Rptr. at 475. By way of contrast, the Court found a conflict in the two regulatory frameworks and stated in restricting state limitations under Wellenkamp:

The Board consciously has chosen not to mandate use of due-on-sale clauses "because [it] desires to afford associations the flexibility to accommodate special situations and circumstances." 12 CFR § 556.9(f)(1) (1982) . . . . Although compliance with both § 545.8-3(f) and the Wellenkamp rule may not be "a physical impossibility," [citation omitted] the California courts have forbidden a federal savings and loan from enforcing a due-on-sale clause solely "at its option" and have deprived the lender of the "flexibility" given it by the Board.

102 S. Ct. at 3023.

In de la Cuesta, the Court found an express conflict. Therefore, as the majority mentioned in its footnote 14, it did not have to rule on the alternative basis for maintaining preemption, that of the federal Regulation being so pervasive in effect in the due-on-sale area as to have entirely "occupied the field" that state law (in the form of Wellenkamp) would otherwise cover. 102 S. Ct. at 3025 n.14.

59. 102 S. Ct. at 3029-30. "In promulgating the due-on-sale [R]egulation, the Board reasonably exercised the authority given it by Congress, so as to ensure the financial stability of 'local mutual thrift institutions in which people . . . invest their
such purpose, since the Board had concluded, as a matter of
policy, the following about due-on-sale clauses: (1) They help
alleviate the problem facing lenders who borrow on a short-
term basis and lend long-term; (2) they help maintain the sta-
bility and earning potential of lenders; (3) they are necessary
in order to make loans saleable by lenders in the secondary
market; and (4) they may help lower mortgage interest rates.60

The Court acknowledged that such conclusions of the
Board may not comport with those of certain economists or
other prognosticators, including perhaps some experts, and
certainly differed from the findings of a few tribunals; indeed,
it stated candidly that "the wisdom of the Board's decision is
not uncontroverted."61 However, the Court determined that
its role as to this issue was not to decide which experts were
right—those relied upon by the Board or others with whom
the Board's conclusions were at odds—but only to decide if
the Board had been "arbitrary or capricious."62 Deciding that
the Board had not been arbitrary or capricious, the Court re-
marked: "As judges, it is neither our function, nor within our
expertise, to evaluate the economic soundness of the Board's
approach."63

Pointing out that no express limits on Board authority to
regulate federal lenders are apparent from HOLA,64 and re-
emphasizing the fact that the Board was directed back in 1933

60. It is possible that the Act has significantly contributed to the sizeable re-
duction of interest rates from the fall of 1982 to the present time. But see Blevins,
Deregulation—Round 2, 5 FIRST TUESDAY 21 (1983). The largest reason, of course,
has been the enormous influx to lenders of investors' funds spurred by renewed inter-
est in various money market and other accounts. Id. at 22.
61. 102 S. Ct. at 3030.
62. Id. In the dissent, Justices Rehnquist and Stevens took the position that the
Board, if it found a due-on-sale practice of California unsound, should not have at-
ttempted to preempt the state's domain but should have simply "with[he]ld or limit[ed] the operation" of the HOLA system in that jurisdiction. Id. at 3032-33.63. Id. at 3030-31.
64. Id. at 3026. Likewise, the Court rejected appellees' assertion that Board au-
thority should be limited to those powers expressly granted by HOLA. However, the
majority acknowledged that "the Board's power to promulgate regulations exempting
federal savings and loans from the requirements of state law may not be boundless." Id. at 3029. And Justice O'Connor felt strongly about the fact that the Board's power was "not limitless." Id. at 3031-32.
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to consider and adopt the "best practices" of all local institutions,\textsuperscript{66} the Court reasoned that "the statutory language suggests . . . Congress expressly contemplated, and approved, the Board's promulgation of regulations superseding state law."\textsuperscript{66} In the case of the due-on-sale clause, the Court concluded, such an effort to supersede state law occurred because the Board intended to preempt conflicting state restrictions "like the California Supreme Court's Wellenkamp doctrine."\textsuperscript{67}

C. The 1976 Date

Prior to the United States Supreme Court decision in de la Cuesta, many real estate professionals and investors were of the view that the date of effectiveness of the Regulation, back in 1976, might be held to be a "cut-off" date, so that due-on-sale clauses in loans made by federal lenders prior to the effective date of the Regulation would be treated differently from those in post-Regulation loans.\textsuperscript{68} In fact, a sort of "vested rights" theory\textsuperscript{69} along these lines was espoused by the

65. "By so stating, Congress plainly envisioned that federal savings and loans would be governed by what the Board—not any particular state—deemed to be the 'best practices.'" \textit{Id.} at 3026. However, very few lenders were calling loans due on a sale or on similar transfers in 1933. \textit{See Pacific Comment, supra} note 39, at 1088; Bonnano, \textit{supra} note 39, at 271-73; Annot., 69 A.L.R. 3d 713, 722 (1976). It seems, in fact, that such a practice would have been contrary to the goals of HOLA, considering its Depression-era context. \textit{See supra} notes 23 & 58.

66. 102 S. Ct. at 3026. "Congress invested the Board with broad authority to regulate federal savings and loans so as to effect the statute's purposes, and plainly indicated that the Board need not feel bound by existing state law." \textit{Id.} at 3027.

67. \textit{Id.} at 3031.


In the next key California federal court case on the preemption issue, dealing with an anti-redlining statute in the state, Conference of Fed. Sav. & Loan Ass'ns v. Stein, 604 F.2d 1256, 1260 (9th Cir. 1979), \textit{aff'd mem.}, 445 U.S. 921 (1980), \textit{rev'd}, 663 F.2d 1078 (9th Cir. 1981), another trial court suggested that HOLA had a broader reach. Earlier California federal court cases had likewise not drawn any distinction as to when a federal guideline preempted California's prerogatives regarding lender's loan practices and operations. \textit{E.g.}, Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145 (9th Cir. 1974) (prepayment of real estate loans); People v. Coast Fed. Sav. & Loan Ass'n, 98 F. Supp. 311 (S.D. Cal. 1951) (establishing branches of federal thrifts in the state).

69. Vested rights have been defined generally as those:

which have so completely and definitely accrued to or settled in a person

that they are not subject to be defeated or cancelled by the act of any
transferees in *de la Cuesta*. However, the United States Supreme Court apparently dismissed this contention with a tone of finality by ruling that the due-on-sale clauses appearing

other private persons, and which it is right and equitable that the government should recognize and protect, as being lawful in themselves, and settled according to the then current rules of law, and of which the individual could not be deprived arbitrarily without injustice, or of which he could not justly be deprived otherwise than by the established methods of procedure and for the public welfare.


Neither the federal Constitution nor the Constitution of California prohibit[s] the enactment of retrospective laws . . . . In California a statute is not invalid merely because it is intended to operate retrospectively. It may, however, be invalid if it deprives one of vested rights which are bound to be respected or protected by the state, or if it impairs the obligations of a contract. (emphasis added).

See, e.g., Dawson, *Pre-regulation loans*, 4 FIRST TUESDAY 6, 7 (1982):

Even if the regulation or the new federal statute is construed to have retroactive effect, the U.S. Constitution may prevent such provisions from retroactively impairing vested contract rights. The controversial aspect of the newly enacted Garn Bill is that it appears Congress has retroactively impaired vested contract rights in preregulation loans originated by federal S&L's.

*Id.* at 7. Thus, any "vested rights" analysis is essentially a constitutional matter. *Id.*

The types of real property vested rights herein considered are essentially created by the judiciary and have their origin in the doctrine of stare decisis and in accordance with the constitutional precepts limiting ex post facto laws and impairments to the obligations of contracts. Such vested rights have previously had their most extensive treatment in California real property law in the zoning area. There these rights have been held to exist in a use; see generally D. Hagman & R. Volpert, 8 CAL. REAL ESTATE LAW & PRAC. § 260.43 (1982) and cases cited therein; and in a permit. *Id.* at § 260.44, citing various cases. Occasional reference to vested rights has appeared in other real property cases, usually as to tax enactments or liens. E.g., Texas Co. v. County of Los Angeles, 52 Cal. 2d 55, 64, 338 P.2d 440, 445 (1959); County of Los Angeles v. Faus, 48 Cal. 2d 672, 681, 312 P.2d 680, 685-86 (1957); Estate of Taitmeyer, 60 Cal. App. 2d 699, 709, 141 P.2d 504, 510 (1943); Sunset Nut Shelling Co. v. Johnson, 49 Cal. App. 2d 354, 358-59, 121 P.2d 849, 851-52 (1942); see Doctors Gen. Hosp. v. County of Santa Clara, 188 Cal. App. 2d 280, 10 Cal. Rptr. 423 (1961). The term is discussed more frequently as to personal property rights, usually those of administrative employees facing dismissal or punishment or regarding business or professional licenses. E.g., Rosenblatt v. California State Bd. of Pharmacy, 69 Cal. App. 2d 69, 158 P.2d 199 (1945). However, to date, no reported due-on-sale decision in the state has purported to define the full scope and extent of such vested rights, and indeed this author is unaware of express reference thereto in a due-on-sale opinion prior to the Court's *de la Cuesta* decision.

70. But see Crane, *De la Cuesta: Hard economic facts rain on lenders' parade*, 4 FIRST TUESDAY 15, 22 (1982) where the author, Fred Crane, trial attorney for the transferee parties in *Wellenkamp, de la Cuesta, Tan* and many of the other leading California due-on-sale cases, writing after *de la Cuesta* but before the Act, stated that all loans dated on or after July 31, 1976 were "controlled by the Rule of Wel-
in the 1971 and 1972 deeds of trust were equally enforceable as that appearing in the 1978 security instrument. The Court stated, in so ruling, that the Regulation was not the difference, since that administrative pronouncement was only "reinforcing" the lender's already existing right to exercise its due-on-sale prerogatives. 71

In a footnote ("Footnote 24"), 72 the last in the case and the most controversial, the Court traced what it believed to be the key decisions in California's due-on-sale history and concluded that "[n]ot until Wellenkamp was decided in 1978 was a lender's right under California law to accelerate a loan in response to an outright transfer limited to cases where the security was impaired. 73 Prior to the Tan case, a number of commentators expressed their belief that the Court mischaracterized California law, 74 since there is at least a sugges-

71. See infra note 73 and accompanying text.

72. Footnote 24 was the only footnote in the case quoted in the Committee Report, Committee Report, supra note 25, at 22 n.1, or the Tan case, 140 Cal. App. 3d at 806-07, 189 Cal. Rptr. at 779-80. And it was given the most emphasis in the Final Rule. 48 Fed. Reg. at 21,556.

73. 102 S. Ct. at 3031 n.24. The Court did not supply its reasoning, but arguably relied on the fact that Wellenkamp was the first decision to actually apply limits to due-on-sale in the outright transfer context and on Wellenkamp's overruling or expressly disapproving, to the extent inconsistent, of prior cases seemingly sanctioning automatic enforcement. Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964); Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969); Hellbaum v. Lytton Sav. & Loan Ass'n, 274 Cal. App. 2d 456, 79 Cal. Rptr. 9 (1969). The Wellenkamp court omitted to mention one other significant early California case upholding a due-on-sale clause, Jones v. Sacramento Sav. & Loan Ass'n, 248 Cal. App. 2d 522, 56 Cal. Rptr. 74 (1967).

74. E.g., Dawson, supra note 69, at 7-8; Graham, Nellis & Schiff, Fidelity Fed. Sav. & Loan Ass'n. v. de la Cuesta: The U.S. Supreme Court Decides a Major Due-on-Sale Clause Case but Unanswered Questions Remain, 5 CEB REAL PROP. L. REP. 105, 107 (1982). Professor John Hetland, author of one of the amicus curiae briefs in de la Cuesta, is one leading commentator who believes that the Court failed to focus on the fact that, as early as 1974 in Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974), the California Supreme Court had begun to express its disapproval of due-on-sale as to outright transfers. Remarks at Continuing Education of the Bar presentation at University of California at Los Angeles (August 14, 1982). In footnote 7 of Tucker, the court stated as follows, presaging Wellenkamp's disapproval of Coast Bank:

We are, of course aware that the interpretation of Coast Bank which we advanced by way of dictum in La Sala v. American Savings and Loan Association, 5 Cal. 3d 864, 97 Cal. Rptr. 849, 489 P.2d 113 (1971) has been the subject of critical commentary [citations omitted]. However, we do not believe that the instant case—which involves the
tion in the 1974 *Tucker* case that due-on-sale would be restricted even on outright sale. By now, most commentators agree with the Court on the fact that the later *Wellenkamp* case was the turning point. Several post-*de la Cuesta* occurrences have caused this exception. First, the September 3, 1982 Committee Report of the Senate Committee on Banking, Housing and Urban Affairs (Senate Banking Committee), in a footnote, found the Court's analysis in Footnote 24 "instructive" on this issue. Next a California appellate panel in the *Tan* case this past March concurred with the Court's view as set forth in Footnote 24. Most recently, the Final Rule has purported to dispose of this issue in deciding upon the 1978 date at least for institutional lenders.

Particularly because of the importance the Act ascribes to "the date on which the highest court of [the] State has rendered a decision . . . prohibiting [automatic] exercise" of due-on-sale clauses, such date being the start of the "window period" carved out by the Act, it was at first envisioned by the commentators the California Supreme Court would decide once and for all whether the restriction existed in any cogniza-

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operation of a “due-on” clause in the context of a subsequent installment land contract—provides a proper occasion for considering the broad implications of the arguments there advanced. Such consideration must await a case involving the attempted exercise of a “due-on” clause upon outright sale by the trustor.

12 Cal. 3d at 634-35 n.7, 526 P.2d at 1172 n.7, 116 Cal. Rptr. at 633 n.7.

The Court viewed *Tucker* and *La Sala* as having "permitted the unrestricted exercise of due-on-sale clauses [upon] outright transfers of the security." 102 S. Ct. at 3031 n.24.

75. See supra note 74.

76. One early comment was as follows: "Under [F]ootnote 24 an argument could be made that due-on-sale clauses in loans made before *Wellenkamp* may, depending on the circumstances of the sale, be enforceable." Graham, Nellis & Schiff, supra note 74, at 107. Remarkably, Fred Crane, attorney for the borrowers or transferees in *de la Cuesta* and *Tan*, has now apparently conceded this issue as to all loans. Crane, *Grace period assumptions of window period loans*, 5 First Tuesday 23 (1983). It seems to this author that this issue is not resolved as to private lenders. See infra notes 134 and 145-48 and accompanying text.

77. Committee Report, supra note 25, at 22 n.1. See supra note 73 and accompanying text.

78. 140 Cal. App. 3d at 806-07, 189 Cal. Rptr. at 779-80.

79. 48 Fed. Reg. at 21,556. See supra note 76 and infra Section VII.

80. Section 341, supra note 3, at (c)(1).

81. "In states with judicial restrictions which purport to retroactively restrict due-on-sale enforcement, the window period will not begin until the date of the judicial decision." Committee Report, supra note 25, at 22.
ble way prior to August 25, 1978. The Tan case would have seemed a potential vehicle to do so, although that possibility ended when the California Supreme Court denied a hearing in that matter late in June. Furthermore, the state court's view on such issue may arguably have been preempted by adoption in May of the Final Rule.

While the other aspects of Footnote 24 in de la Cuesta have received the most attention, additional confusion was created by the inclusion therein of the following two sentences:

Because we find the Wellenkamp doctrine preempted by a previously promulgated federal regulation and therefore inapplicable to federal savings and loans, appellees are deprived of no vested rights if Fidelity is permitted to enforce the due-on-sale clauses in the two pre-1976 deeds: the savings and loan had the right to accelerate the loans, pursuant to California law when the deeds were executed, and that power was never diminished by state law. We have no occasion, therefore, to consider whether [the Regulation] may be applied so as to give a savings and loan broader authority to enforce a due-on-sale clause than it had when the deed of trust was executed, or to address appellants' contention that [the Regulation] effected no change in the law.

The first sentence so quoted leaves it unclear whether "vested rights" have a place in due-on-sale law, while the
second seems to be mere academic commentary by the Court. What effect, if any, the Final Rule has had on these items is likewise unsettled.

D. The Choice of Law Provision

The Court in *de la Cuesta* also rejected one final argument of the transferees that had been persuasive at the appellate level and in *Panko.* That final argument related to the choice of law provision appearing in two of the deeds of trust. Under such a provision, the parties to the deed of trust involved agree, for themselves and their successors-in-interest, to be governed by the law of the situs of the property involved. In *de la Cuesta* all three properties were located in California. The transferees therefore contended that such contractual choice of law mandated deference, in the due-on-sale area, to the principles of *Wellenkamp* since that case represented the prevailing law of the situs.

Again in a footnote, the Court rejected such contention by reasoning that the law of the local jurisdiction necessarily "includes federal as well as state law." Specifically making reference to the choice of law language contained as paragraph 15 in the Uniform Mortgage Instrument required by *Katz, Fidelity Federal: The U.S. View, 5 L.A. Law. 34, 38 (1982).*

The author of the quoted article, Andrew G. Katz, was one of Fidelity's lawyers before the Court in *de la Cuesta.* In furtherance of his contentions that such "vested rights" do not exist, Mr. Katz analyzes the way the *Wellenkamp* majority treated the *County of Los Angeles v. Faus* and *Texas Co. v. County of Los Angeles* cases, described in note 69 supra, in rejecting the lender's argument that it had expectations as to its loan portfolio and adds:

[B]orrowers from . . . converted associations will undoubtedly argue that they had no opportunity to object to the conversion and application of federal regulation to their existing loans (many of which may have been made after *Wellenkamp* and with the expectation that *Wellenkamp* would apply to the loan) would defeat their expectations and vested interest. It would seem, as set forth above, that the California Supreme Court has already answered those arguments, holding that economic expectations arising out of the due-on-sale clause are not the type of interests that are to be shielded from retroactive changes in the law applicable to those contracts. *Id.* at 42 & 51.

86. See supra Section II.
87. 102 S. Ct. at 3024 n.12. See supra note 56 and accompanying text.
88. "This Deed of Trust shall be governed by the law of the jurisdiction in which the Property is located." 102 S. Ct. at 3019 n.5. The appellate court had reasoned that use of a standardized paragraph 15 "persuasively evidences a recognition by the Board and federal savings and loan associations that state law would govern
the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association, actually utilized in the Moore and Whitcombe loans, the Court determined that such language was added "not to elevate state law over federal law, but to provide a uniform choice of law provision to be used when interstate disputes arose regarding the interpretation of a mortgage." That is, these choice of law rules were to be considered only in disputes where the laws of more than one state were involved. Moreover, since federal law was incorporated into the parties' contract, the due-on-sale posi-

102 S. Ct. at 3018 n.2. The text of paragraph 17 of the Uniform Mortgage Instrument tracks almost verbatim the wording of 12 C.F.R. § 545.8-3(g) (January 1, 1982).

90. Also known by the abbreviated designations "FNMA" and "Fannie Mae," the Federal National Mortgage Association is the "largest single purchaser of home mortgages in the secondary market." Kinzler, supra note 39, at 452.

91. The de la Cuestas' deed of trust did not contain the language of Uniform Mortgage Instrument paragraph 15, or apparently any other choice of law clause. The appellate court ascribed no real significance to the fact that this deed of trust lacked the choice of law language. 102 S. Ct. at 3021 n.8.

92. Id. at 3024 n.12.
tion of the Regulation was, if anything, further reinforced by the choice of law provision rather than precluded thereby.

IV. THE ACT: ITS HISTORY AND SCOPE

At least since early 1981, Utah’s Republican Senator Jake Garn, head of the Senate Banking Committee, struggled to find a way to end the due-on-sale controversy by federal legislation.93 Last year, by obtaining passage of the Act, he finally succeeded in obtaining a comprehensive federal enactment on the subject94 although the due-on-sale provisions of the stat-

94. In late summer, the House of Representatives had passed a version of banking reform legislation, H.R. 6267, which was entitled the “Net Worth Guarantee Act.” That was much simpler legislation than the more comprehensive Senate bill. The Wall Street Journal, Sept. 27, 1982, at 4, col. 1; L.A. Times, Sept. 30, 1982, pt. 1, at 1, col. 2. The Senate had before it, since September 3, 1982, S2879 (received for review by the full Senate on September 8, 1982 as a result of the Senate Banking Committee’s Committee Report filed under authority of Senate order dated August 20). 128 Cong. Rec. S11,142 (daily ed. Sept. 8, 1982). The Senate, facing conclusion of the session at month’s end, scheduled hearings on September 21 and 22 of the Banking Committee’s Subcommittee on Financial Institutions Supervision, Regulation and Insurance. 128 Cong. Rec. D1200 (daily ed. Sept. 17, 1982). Testimony was taken from public witnesses on the 22nd of September. Id. at D1235. And S2879 was passed with certain amendments on the 24th. Id. at D1254 & D1256. The legislators repeatedly commented on the monumental effort it had taken to obtain support for such legislation, Senator Garn proudly remarking prior to the 67-11 vote in favor of the Senate bill as follows:

I am very well aware that many of our colleagues are anxious to catch airplanes and it is a Friday afternoon. But, this is an extremely important bill. The Banking Committee has been working to resolve many of these issues for the last year and a half. It has been a difficult task because the issues are very complex and very controversial. Id. at S12,212 (daily ed. Sept. 24, 1982).

The meetings of the joint conference took place on September 29 and 30, with testimony from among others, Chairman St. Germain of the House’s Committee on Banking, Finance and Urban Affairs. Id. at D1297-98 (Sept. 29, 1980) and D1311-12 (daily ed. Sept. 30, 1982). On the 30th, a “Conference Report,” H.R. Rep. No. 899, 97th Cong., 2nd Sess. and S. Rep. No. 97-641, 97th Cong., 2nd Sess., was prepared on H.R. 6287, considered by the House and agreed to by the Senate. Id. at D1301, D1303, D1306 & S12,711. Senator Garn, trying to avoid an ego battle over which measure received top billing, urged acceptance of the Conference Report, restating as follows on the 30th: “The conference report essentially is in major part the Senate bill. The major provisions of the Senate bill that was passed last Friday have been incorporated in the conference report and the changes that were made in conference yesterday were minor.” Id. at S12,709 (daily ed. Sept. 30, 1982).

The House agreed to the Conference Report on the last day of the session, October 1, 1982, by an overwhelming 294-59 vote, clearing the measure for the President’s signature. Id. at D1324, D1327-28 & H8431 (daily ed. Oct. 1, 1982). The final Confer-
ute as enacted were considerably changed from his 1981 bills, and even slightly modified from S.2879 (the proposal which was approved by the Senate Banking Committee on September 3, 1982) by reason of certain compromise wording agreed to by the joint conferees of the House and Senate during the last hectic days of the session in the final week of September. Curiously, although the final conference report was


When it returned from vacation, the lame-duck Senate was advised of the fact that the legislation had been prepared for the President's signature as follows, some five days after the measure had been enacted into law:

Under the authority of the order of the Senate of October 2, 1982, the Secretary of the Senate on October 12, 1982, during the recess of the Senate, received a message from the House of Representatives announcing that the Speaker had signed the following enrolled bills and joint resolutions:

H.R. 6267. An act to revitalize the housing industry by strengthening the financial stability of home mortgage lending institutions and insuring the availability of mortgage loans . . . .

Id. at S13,414-15 (daily ed. Oct. 20, 1982).

95. Senator Garn stated that the final legislation was "quite different [in] form than it was originally enacted [sic] in S1720." Id. at S12,213 (daily ed. Sept. 24, 1982). S1720 was one of the two original bills (the other being S1703) introduced by Senator Garn in 1981, both commonly associated with the Utah legislator by designation as "The Garn Bill." See Callahan, The 'Garn Bill' becomes law, 4 FIRST TUESDAY 11 (1982).

96. A year and a half of working on this bill has produced a very fragile coalition of those who would agree on it. In fact, we reach a point a lot of people thought was never possible, as controversial as some of the issues were, such as due on sale . . . . I believe, that unless we can keep the bill as reported by committee intact we would probably lose it and not be able to enact it this year.


And one observer stated: "After being stalled for months, the legislation moved to quick approval . . . after contending financial interests reached a compromise." L.A. Times, Sept. 30, 1982, pt. I, at 1, cols. 1-2. In the House, one legislator who wanted the compromise to say intact went so far as to say that "[t]he realtors are happy about the due-on-sale language." 128 CONG. REC. H8428 (daily ed. Oct. 1, 1982) (statements of Representative Wylie). It seems more likely that the realtors accepted the compromise wording as the best they could get. See, e.g., L.A. Times, Sept. 30, 1982, pt. IV, at 1, col. 1; id., Sept. 28, 1982, pt. I, at 6, col. 1 (the "real estate industry is likely to make for further changes in the bill during the House-Senate conference, trying to widen the 'window' to permit transfer of more loans. . . ."); cf. 128 CONG. REC. S12710 (daily ed. Sept. 30, 1982) (Senator Garn said that "eight different trade associations, including the homebuilders, realtors, ABA, and U.S. Savings and Loan League, agreed to a due-on-sale compromise, put it in writing and a memorandum and signed it").
formally approved by both houses by October 1, the Act was not signed into law by President Reagan until October 15, 1982, after Congress had adjourned to allow time for its members to do some pre-election campaigning. This is significant because the date the President signed the Act into law helped define the close of the "window period." The enactment of the Act, and particularly its due-on-sale provisions, represented a tremendous victory for the beleaguered thrift industry, which has already begun to see enormous economic improvement; however, the due-on-sale features of the legislation also produced some benefits for realtors and investors by limiting retroactive enforcement of acceleration clauses as to certain lenders and by effecting a unique compromise as to window period loans. A review of just the due-on-sale provisions of the Act reflects the broad scope and applicability of the legislation.

97. See supra note 94.

98. When he signed, however, in a White House Rose Garden ceremony, the President called the legislation "historic reform" and "the most important legislation for financial institutions in 50 years." L.A. Daily Journal, Oct. 18, 1982, at 3, col. 1. He added: "When combined with recent sharp declines in interest rates, it means help for housing, more jobs and growth for the economy. All in all, I think we hit the jackpot." Id. at cols. 1-2; The Wall Street Journal, Oct. 18, 1982, at 6, cols. 2-3.

99. The Act itself does not use the term "window period." The Committee Report states that "[t]he window period ends on the date of the enactment of this legislation." Committee Report, supra note 25, at 22. However, the term "window period" is utilized in and its duration addressed in the Final Rule. 48 Fed. Reg. at 21,555-59. The term "window-period loan" is actually defined in the latest addition to the due-on-sale segment of the Code of Federal Regulations (new 12 C.F.R. § 591.2(p)(1)) (1983),

A "window-period loan" is a real property loan, not originated by a federal association, which was made or assumed during a window-period created by state law and subject to that law, which loan was recorded at the time of origination or assumption, before October 15, 1982, or within 60 days thereafter [December 14, 1982]. and it reflects closing of the window period before the date the legislation was enacted. See Crane, supra note 76, at 23. This addition reflects the position in the Final Rule that unrecorded transfers which took place before the Act do not result in window-period treatment, regardless of the lender, unless there was an instrument recorded by December 14, 1982 (the so-called "sunset date") to substantiate the timing as having been in the window period. 48 Fed. Reg. at 21,557. No such limitation or condition appeared in the Act itself.

100. For example, on November 15, 1982, at the annual convention of the 4,000 member United States League of Savings Associations, chairman Roy G. Green stated: "In years to come, I also believe this will be viewed as our turnaround year . . . . There are now a good many more reasons for optimism about the future of our business than we have had in a long time." L.A. Times, Nov. 16, 1982, pt. IV, at 1, col. 4.
First, except where otherwise indicated,\textsuperscript{101} the due-on-sale provisions of the Act affect all lenders, including, for example, the following: Federal S&L's, federal savings banks, state and national banks, state savings and loans, mortgage brokers and other lenders approved by the Department of Housing and Urban Development ("HUD"), federal credit unions, government agencies, finance companies, manufactured home retailers, and private individuals and entities.\textsuperscript{102} It also applies to successors and transferees of such lenders, most notably Freddie Mac and Fannie Mae but also other private parties and institutions (whether they acquire notes by purchase, entity merger or other means).\textsuperscript{103}

Second, the types of financial transactions which can now trigger acceleration under a due-on-sale clause if such a clause appears in the pertinent loan documents—the note, deed of trust or the like—include loans, mortgages, advances, and credit sales (selling real property and carrying back paper, presumably whether in the form of a note or an installment land contract.)\textsuperscript{104} The security involved naturally must be real property; and mobile homes and stock cooperatives are classified as real property in the Act, as are single-family houses,

\textsuperscript{101} Section 341(c)(2)(C) points out that the "window period" provisions contained in section 341(c) do not apply "to a loan which was originated by a federal savings and loan association or federal savings bank." See also supra notes 76 and 79 and Section VII infra for a discussion of the private lender issue.

The Federal Housing Administration (FHA) and the Veteran's Administration (VA) were not specifically excluded; however, the FHA insists on loans it insures and the VA requires on loans that it guarantees that the due-on-sale clause be deleted, waived or otherwise not enforced while the insurance (or guarantee, as the case may be) is in effect. See, e.g., Graham, Nellis & Schiff, supra note 74, at 108; \textit{Florida State Comment}, supra note 39, at 646-48.

\textsuperscript{102} Section 341(a)(2) defines "lender" for purposes of the due-on-sale provisions of the Act as "a person or government agency making a real property loan or any assignee or transferee, in whole or in part, of such a person or agency . . . ." According to the Committee Report, all of the lenders listed in the text are covered as are their transferees. Committee Report, supra note 25, at 56-57. At least as to window period loans, this resolves the questions raised after \textit{de la Cuesta} as to whether the assignee of a loan or successor by merger would have the ability to enforce a due-on-sale clause. See, e.g., Graham, Nellis & Schiff, supra note 74, at 106. The Final Rule points out that the list "is intended to be representative and not exclusive." 48 Fed. Reg. at 21,555.

\textsuperscript{103} See supra note 102.

\textsuperscript{104} Section 341(a)(3) defines the term "real property loan" as "a loan, mortgage, advance, or credit sale secured by a lien on real property, the stock allocated to a dwelling unit in a cooperative housing corporation, or a residential manufactured home, whether real or personal property . . . ." Committee Report, supra note 25, at 57. See infra note 109.
raw land, apartment buildings, condominiums, and commercial and industrial properties.\textsuperscript{106}

Third, the Act "encourages" lenders to permit assumptions at the rate contained in the loan documents or at a "blended rate" (the average between the rate in the loan documents and prevailing market rates).\textsuperscript{106} However, there is no mandatory language in the Act on this point,\textsuperscript{107} only an expression of "encouragement."

\section{V. The Specified Exemptions to The Act}

There are nine "exempt" categories, types of transfers as to which the Act seemed rather broadly to indicate that "a lender may not exercise its [acceleration] option."\textsuperscript{108} They include:

\begin{enumerate}
\item \textit{Id.} The Act further explains that the term "residential manufactured home" as used in section 341(a)(3) "means a manufactured home as defined in section 603(b) of the National Manufactured Home Construction and Safety Standards Act of 1974 which is used as a residence . . . ." Section 341, \textit{supra} note 3, at (a)(4). The Final Rule states that "the legislative history clearly indicates that the due-on-sale preemption applies to mobile homes, regardless of whether they are designated as real or personal property" and cites the Committee Report for that authority. 48 Fed. Reg. at 21,557 (citing the Committee Report, \textit{supra} note 25, at 57).
\item Section 341, \textit{supra} note 3, at (b)(3). In this part of the Act, Congress made it clear that "nothing [contained in Section 341] shall be interpreted to prohibit any such assumption." \textit{Id.} See also Committee Report, \textit{supra} note 25, at 57.
\item The Final Rule eliminates any doubt.
The Board believes that the statutory language of the Act section 341(b)(3) is permissive; a lender, at its discretion, may offer blended rates to the borrower, upon the exercise of the lender's option under a due-on-sale clause, but the Act imposes no mandatory obligation upon lenders to offer such blended rates. Therefore, the [Final Rule] imposes no such condition.
\item 48 Fed. Reg. at 21,558.
\item \textit{Id.} Section 341, \textit{supra} note 3, at (d). According to the Senate Banking Committee, "all loans, including window period loans, and all lenders, including federally chartered thrifts, are subject to the limitations set forth in Section 341(d)." Committee Report, \textit{supra} note 25, at 25 (emphasis added). That Committee further emphasized the breadth of these exemptions as follows:

These restrictions apply to the enforceability of any due-on-sale clause after the date of enactment of this legislation, regardless of the nature of the lender or the time the loan was originated. Thus, any action of a State legislature, the Comptroller of the Currency, or the National Credit Union Administration Board with respect to window period loans pursuant to subsection (c) would not override these consumer protections.

\textit{Id.} at 58. Nothing in the Act or in the Committee Report specifies that such restrictions are limited to borrower-occupied home loans, the position espoused in the Final Rule. See infra note 120.
\end{enumerate}
(1) the creation of a lien or other encumbrance subordinate to the lender's security instrument which does not relate to a transfer of rights of occupancy in the property [a junior lien];

(2) the creation of a purchase money security interest for household appliances;

(3) a transfer by devise, descent, or operation of law on the death of a joint tenant or tenant by the entirety;

(4) the granting of a leasehold interest of three years or less not containing an option to purchase;

(5) a transfer to a relative resulting from the death of a borrower.

109. Section 341, supra note 3, at (d)(1); Committee Report, supra note 25, at 58. See notes 120-22 and accompanying text; see also infra note 237 and accompanying text. It is not clear whether the equivalent of such a junior lien situation will be exempted. This is important in California because of the case of Pas v. Hill, 87 Cal. App. 3d 521, 151 Cal. Rptr. 98 (1978). The appellate court in Pas analogized the property owner's giving of a deed in lieu of foreclosure to a junior lienor to such owner's executing a junior encumbrance itself, an action which La Sala recognized to be insufficient to warrant the exercise of an alienation clause. In so doing, the court observed: "[I]f a junior encumbrancer is not permitted to foreclose and sell the property upon default in performance of the obligation secured by the junior encumbrance without accelerating the due date of the senior debt, few, if any, would choose to become a junior encumbrancer." 87 Cal. App. 3d at 529, 151 Cal. Rptr. at 104. See Dawson, "Garn" and junior liens, 5 FRST TUESDAY 24, 25 (1983) [hereinafter cited as Dawson II]. Whether other bidders at the foreclosure sale would be similarly insulated from due-on-sale enforcement in the usual (state lender) context is also unsettled; if not, bidding would likely be artificially low and limit the effectiveness of the foreclosure process.

The Final Rule does not specifically address the subject of due-on-sale on foreclosures. Since it recites that the exemptions of section 341(d) are limited to borrower-occupied single family dwellings, the Final Rule has already restricted some of the scope of cases like Pas. Whether it reflects an implied Board intention to preempt California law in its entirety in this area is not clear. As one author opined shortly before promulgation of the Final Rule: "Should future Garn regulations provide for due-on-sale enforcement when a junior lender forecloses, the regulation would directly contravene California law, which does not permit acceleration under this circumstance. [Pas ...]" Dawson II supra, at 28.

It is now clear from the Final Rule that a contract-for-deed transfer does not fall within this exemption. 48 Fed. Reg. at 21,559. Apparently, any transfer pursuant to one of the commercially circulated installment land sale contracts, subject of "window period" analysis in the Final Rule as well, is categorized as a contract-for-deed so as to be excluded from the section 341(d)(1) exemption.

110. Section 341, supra note 3, at (d)(2); Committee Report, supra note 25, at 58.

111. Section 341, supra note 3, at (d)(3); Committee Report, supra note 25, at 58.

112. Section 341, supra note 3, at (d)(4); Committee Report, supra note 25, at 58.

113. Section 341, supra note 3, at (d)(5); Committee Report, supra note 25, at 58.
(6) a transfer where the spouse or children of the borrower become an owner of the property;\textsuperscript{114}

(7) a transfer resulting from a decree of a dissolution of marriage, legal separation agreement, or from an incidental property settlement agreement, by which the spouse of the borrower becomes an owner of the property;\textsuperscript{115}

(8) a transfer into an inter vivos trust in which the borrower is and remains a beneficiary and which does not relate to a transfer of rights of occupancy in the property;\textsuperscript{116} or

(9) any other transfer or disposition described in regulations prescribed by [the Board].\textsuperscript{117}

The first four of those exemptions had previously been required by the Board as part of the Regulation analyzed in \textit{de la Cuesta}\.\textsuperscript{118} The last five were added by the Act in order to protect consumers from acceleration in certain additional situations where Congress felt it would be inequitable for lenders to exercise due-on-sale rights.\textsuperscript{119} By purporting to restrict the application of these exemptions to borrower-occupied home loans,\textsuperscript{120} which it acknowledged to be a modifica-

\textsuperscript{114} Section 341, \textit{supra} note 3, at (d)(6); Committee Report, \textit{supra} note 25, at 58.

\textsuperscript{115} Section 341, \textit{supra} note 3, at (d)(7); Committee Report, \textit{supra} note 25, at 58.

\textsuperscript{116} Section 341, \textit{supra} note 3, at (d)(8); Committee Report, \textit{supra} note 25, at 58. To make sure that these trusts were not used to circumvent the basic due-on-sale guidelines, the Senate Banking Committee added as follows in the Committee Report: "If subsequent transfers of beneficial interest within such trust involve transfer of rights of occupancy in the property, the lender has the right to enforce its rights under the due-on-sale clause." \textit{Id}.

\textsuperscript{117} Section 341, \textit{supra} note 3, at (d)(9); Committee Report, \textit{supra} note 25, at 58 (where this provision is explained as giving the Board the opportunity to "use its rulemaking authority to provide additional consumer protections for circumstances when the enforcement of due-on-sale would be inequitable, which the Committee has not foreseen [sic]"). Moreover, section 341(e)(1) authorizes the Board, in consultation with the Comptroller of the Currency, to issue rules, regulations and interpretations for the implementation of section 341 generally and subsection (d) in particular. Committee Report, \textit{supra} note 25, at 58-59.

\textsuperscript{118} See \textit{supra} note 56 and accompanying text.

\textsuperscript{119} Committee Report, \textit{supra} note 25, at 24-25.

\textsuperscript{120} While the Board has carefully evaluated comments objecting to this limitation, it has determined to retain this principle in accordance with its belief that this approach is most consistent with the Congressional purpose of restricting due-on-sale exercise to protect consumers . . . . A structural and historical analysis of the exemptions also supports the Board's interpretation that they apply only to borrower-occupants. To a
tion of the Act’s "statutory scheme," the Board in the Final Rule may have limited the utility of these exempt categories in areas such as divorce and estate planning. And in California, where there finally appeared to be harmony between local law and the federal guidelines on due-on-sale exemptions,

large extent, the exemptions in the Act are extracted directly from the Board’s existing due-on-sale regulations and statements of policy in which the exemptions were intended only to apply to borrower-occupants. In light of the Board’s pre-existing interpretation and expressed intent regarding these exemptions and the subsequent restatement of those exemptions in the Act, the Board believes that applying the restrictions only to borrower-occupied home loans is most consistent with the intent of Congress. Accordingly, loans on all property other than borrower-occupied homes are not subject to the restrictions set out in [the Final Rule].

48 Fed. Reg. at 21,559. This includes loans made on homes “occupied or to be occupied” by the borrower. Id. “This limitation is intended to prevent a transferee from withdrawing from occupancy and using the property for investment purposes.” Rader, The Federal Home Loan Bank Board Issues Final Regulations to Implement the Due-on-Sale Provisions of the Garn-St. Germain Act, 6 CEB REAL PROP. L. REP. 93, 96-97 (1983).

121. 48 Fed. Reg. at 21,559. At least one author has questioned whether this modification is within the scope of the Board’s authority:

The rule-making power granted to the FHLBB [the Board] is not the power to make law, but rather to adopt regulations to implement the will of Congress as expressed by the statute. See Santa Fe Indus., Inc. v. Green (1977) 430 US 462, 472. The Act itself states that the FHLBB is authorized to issue regulations “governing the implementation of this section.” [Citation omitted] However, despite the FHLBB's statement that it is modifying the Act, it is not entirely certain that a court would find that the FHLBB is making law rather than merely interpreting the Act. The fact that the due-on-sale restrictions contained in the Act unambiguously apply to all borrowers may not necessarily preclude the FHLBB from looking to legislative history when formulating appropriate rules and regulations to implement Congress’ goals. See Board of Educ. v. Bell (May 17, 1982) 50 USLW 4501, 4503 n.12, 102 S. Ct. 1912, 1918 n.12, 72 L Ed 2d 299, 208 n.12. If, however, the courts do uphold the FHLBB’s action in limiting the protections of § 341(d) to owner-occupied properties, it would be a significant extension of previous case law validating administrative agency actions in implementing congressional acts and would extend far beyond even recent cases such as Board of Educ. v. Bell. It must also be noted that, although there is legislative history to support the FHLBB’s interpretation that the due-on-sale restrictions should not apply to commercial real property loans, the language of the statute does not in any way suggest this consumer limitation on due-on-sale restrictions.

Rader, supra note 120, at 97.

122. For several years, California has had a statutory provision restricting acceleration of loans on residential real property with one to four housing units if arising only by reason of any one or more of the following:

(1) A transfer resulting from the death of an obligor where the
the Final Rule has re-opened an area of conflict.

Even under the Act and before the narrowed interpretation provided by the Final Rule, certain common types of transfers, such as those among family members or with closely-owned corporations or partnerships, were omitted from the exempt list. Similarly, long-term leases of more than

transfer is to the spouse who is also an obligor.

(2) A transfer by an obligor where the spouse becomes a co-owner of the property.

(3) A transfer resulting from a decree of dissolution of the marriage or legal separation or from a property settlement agreement incidental to such a decree which requires the obligor to continue to make the loan payments by which a spouse who is an obligor becomes the sole owner of the property.

(4) A transfer by an obligor or obligors into an inter vivos trust in which the obligor or obligors are beneficiaries.

(5) Such real property or any portion thereof is made subject to a junior encumbrance or lien.

CAL. CIV. CODE § 2924.6(a) (West Supp. 1982).

Under a companion provision, these protections are made non-waivable for public policy reasons. Id. at § 2924.6(b).

For example, in Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903 (C.D. Cal. 1978), 481 F. Supp. 616 (C.D. Cal. 1979), rev'd, 663 F.2d 1078 (9th Cir. 1981), the plaintiff obtained a declaratory judgment on the preemption issue at the trial level (which was reversed by the Ninth Circuit and the case removed to state court on procedural grounds) after the California Department of Real Estate threatened to deny a developer a final subdivision public report on a residential project because the federal lender involved planned to utilize a uniform mortgage instrument without adding limitations on acceleration to the pre-printed restrictions. Because of the conflict with Civil Code § 2924.6, the lower court had to address the preemption issue and came to the same conclusion as the Court in de la Cuesta, emphasizing many of the same authorities.

After the Court's decision in de la Cuesta, however, some commentators expressed the opinion that the circumstances contained in 12 C.F.R. § 545.8-3(g) (January 1, 1982) were to be read as the sole list of situations where, by express administrative language, state laws which restrict or proscribe enforcement of federal due-on-sale clauses are not preempted. "[S]tate laws such as [Civil Code] § 2924.6 . . . would, under de la Cuesta, apparently be unenforceable as to federal [lenders] to the extent they restricted the enforcement of due-on-sale clauses in situations where the . . . [R]egulation permitted enforcement." Graham, Nellis & Schiff, supra note 74, at 108.

Of the 5 categories of transfers exempted by Civil Code § 2924.6, one (the fifth) is the same as appears in 12 C.F.R. § 545.8-3(g) relating to liens for junior financing. The other types of transfers sanctioned by the California statute were not necessarily permitted by the Regulation or its companion administrative pronouncements. For example, while the Civil Code provision applies to parcels with up to four units, the same types of properties covered by the Uniform Mortgage Instrument required by FHLMC and FNMA, the restrictions on enforcement of 12 C.F.R. § 545.8-3(g) are narrower and deal only with certain single-family dwellings. No statement appears in 12 C.F.R. § 556.9 to indicate which type of property it pertains to.
three years, and any leases containing options to purchase (regardless of duration), are omitted and subject to due-on-sale enforcement. Leases with options to renew are not mentioned in the Act nor in the Final Rule, so it is possible that a loophole may exist for leasehold transfers of three years or less with multiple renewals for periods of like duration. Finally, there is an express provision in the Act to the effect that reverse annuity mortgages are not exempted, as they are intended to be personal to the borrower/annuitant.

VI. THE ACT PRESERVED FOR FEDERAL LENDERS MOST OF THEIR DUE-ON-SALE RIGHTS RECOGNIZED IN DE LA CUESTA

Except for the fact that the number of exemptions enumerated in Section V was expanded by the Act, it did not alter the effect of de la Cuesta as to loans originated by federal S&L's. In addition, whether or not the Committee Report is correct in stating that de la Cuesta also applies to federal savings banks, it appears for due-on-sale purposes to have categorized their loans together with those originated by the federal S&L's. Subject to a constitutional attack of the Act itself, and except as modified by the Final Rule, the ac-

123. "[T]he Board has defined a 'leasehold interest with a term greater than three years' as a 'sale or transfer' for 'due-on-sale' purposes." 48 Fed. Reg. at 21,559. "Both the Act ... and the regulations ... make it clear that a leasehold interest in excess of three years can be considered a 'sale or transfer' as contemplated within the definition of due-on-sale clause in the Act." Rader, supra note 120, at 98.

124. Section 341, supra note 3, at (e)(2). This provision was one of two amendments reported on the floor of the Senate the day it voted approval of S2879. 128 Cong. Rec. S12220 (Sept. 24, 1982).

125. Committee Report, supra note 8, at 24 (de la Cuesta described as having upheld certain due-on-sale practices of federally chartered savings and loan associations and federal savings banks); but see Committee Report, supra note 25, at 21 (de la Cuesta described only as having upheld such rights of federal savings and loan associations). It would seem that the reference in the Committee Report to federal savings banks relates to the fact that they are classified together with federal S&L's in section 341(c)(2)(C), discussed in supra note 101, even though the Regulation refers only to an "association" and Fidelity, the only lender involved in de la Cuesta, was a federal S&L. And the Final Rule, in referring to the revisions of prior regulations which it effected, purported to "restate the preemption of state laws with respect to all federally chartered institutions . . . ." 48 Fed. Reg. at 21,554 (emphasis added). But note that "service corporations of federal associations are not necessarily exempted from the window-period provisions [of the Act], as are federal associations . . . ." Id. at 21,558.

126. See, e.g., sections 341(c)(1)(A) and 341(c)(2)(C), supra note 3.

127. See supra note 69.

128. Since the Final Rule recites that it is to take effect as of May 10, 1983, 48
celeration rights of the federal S&L's and federal savings 
banks (hereinafter federal thrifts) would appear to be exercis-
able retroactively as to any loans originated by such institu-
tions upon a transfer not specifically exempted by the terms 
of the Act; consequently, in situations where they originated 
the applicable loans, it would seem that federal thrifts can go 
back to past transfers made without lender approval and ac-
celerate based thereon. Alternatively, federal thrifts may, as a 
condition to assumption and a waiver of acceleration of a 
given loan, demand back interest from the dates of the uncon-
sented to transfer(s), plus loan fees, an increase in interest 
rate prospectively, and the like. In the last twelve months, 
federal thrifts have certainly been far more aggressive in pur-
suing their rights than they were in the days before de la 
Cuesta and the Act, when the strength of their position was in 
considerable doubt.

VII. Lenders Other Than Federal Thrifts

Somewhat different rules were set out in the Act with re-
spect to loans originated by lenders other than federal thrifts. 
As to these loans, the major issue is whether they are subject 
to “window period” limitations. Such “window period 
loans” are described in section 341(c)(1) of the Act, although 
the term “window period” itself is not used therein.

A window period loan is one where the loan itself was 
originated or assumed, or where the secured property was 
simply transferred subject to the loan, during the window

Fed. Reg. at 21,560, its changes will apparently not apply to transactions occurring 
prior to that date except as otherwise specifically stated in the language of the Final 
Rule itself. Only one provision seems to so state, the provision defining the “sunset 
date.” See supra note 99.

129. Graham, Nellis & Schiff, supra note 74, at 106; Green, Retroactive interest 
differential, 5 FIRST TUESDAY 11 (1983). The Final Rule explains that the Act “does 
not prohibit a lender from imposing any non-contractual term as a condition of waiv-
ing a due-on-sale clause, if state law governing enforcement of the contract would 
permit such a requirement.” 48 Fed. Reg. at 21,558.

130. Only those states which had imposed constitutional, statutory or statewide 
judicial restrictions on enforcement of due-on-sale clauses before enactment of the 
Act qualify for “window period” treatment. Committee Report, supra note 25, at 22-
23. States whose judicial decisions on this issue were not statewide, such as New York 
and Florida, are not window period states. Id. at 23.

131. Id. at 22. It includes “transfers of the liened property by assumptions, inst-
allment land sales contracts, wraparound loans, contracts for deed, transfers subject 
to the mortgage or similar liens, and other like transfers.” Id.
period—a time beginning with the date a state first restricted automatic exercise of due-on-sale clauses on outright transfers and ending on the date immediately preceding the effective date of the Act in October 1982. The beginning date in California, originally a matter of extensive controversy, was addressed in Tan in what appears to be a holding rather than dictum. This is important because, the Final Rule suggests that for a state court decision to be selected as the start of a window period such decision should have been one “expressly holding a due-on-sale clause unenforceable, rather than merely commenting on unforceability in dicta.”

Nevertheless, since the State Supreme Court did not accept Tan for a hearing, this left open theoretical arguments that the legislation could be interpreted as giving rise to several beginning dates, based upon the type of transfer involved.

For “institutional lenders,” the beginning date would most likely be August 25, 1978, the date Wellenkamp was

132. Id. The Final Rule clarifies the fact that, if due-on-sale restriction was based upon a statute in a given state, “the date upon which a window-period commences in [that] state is the later of the date upon which [such] statute becomes effective or is adopted . . .” 48 Fed. Reg. at 21,557. California’s restriction appears to be created by case law, so that this would not apply. But see Callahan, supra note 95, at 12-13.

133. See supra note 99.

134. See supra note 7. In Tan the Fourth District Court of Appeal upheld a pre-Regulation due-on-sale clause of a federal thrift pursuant to de la Cuesta and the Act, but denied the lender the right to collect a prepayment penalty after acceleration under such clause. That tribunal isolated as the sole issue it had to resolve to permit acceleration “whether or not prior to July 31, 1976, the effective date of the [Regulation], California law permitted automatic enforcement of a due-on-sale clause in the case of an outright sale accompanied by transfer of title.” 140 Cal. App. 3d at 806, 189 Cal. Rptr. at 779. Reviewing all of the state authorities, the Court unanimously concluded that such automatic enforcement was allowed as of July 31, 1976 and, in fact, until the date of the Wellenkamp decision by the California Supreme Court. Id. at 806-07, 189 Cal. Rptr. at 779-80. Interestingly, another panel of the same Fourth District Court of Appeal declined nine days later to rule on the window period issue and made no mention of Tan, stating: “We reserve ruling on whether the window period was opened by any pre-Wellenkamp enactment or judicial decision for a case factually requiring such determination.” Miranda v. Macias, 141 Cal. App. 3d 188, 192 n.1, 191 Cal. Rptr. 177, 179 n.1 (1983). A more recent case in the same district, like Miranda, reserved ruling on the opening date of the window period, but held that it was no later than August 25, 1978. Lucas v. Jones, 83 Daily Journal D.A.R. at 3220, 3220 n.4.


136. See supra note 14.

137. Some commentators argued before Tan that the window period for California began in 1872, since that is the date of adoption of Civil Code § 711, which is the statutory foundation for limiting restraints on alienation in this state. See, e.g., Calla-
decided by the California Supreme Court, which was the first decision of the state's highest tribunal expressly restricting due-on-sale on outright transfers. Some still might urge that the beginning date was September 24, 1978, the effective date of Wellenkamp, 30 days after its decision.8 Previous support for the date of October 10, 1974, when the California Supreme Court decided Tucker,148 and expressly declined to comment on the applicability of such rule to "outright" sales and November 9, 1974, the effective date of Tucker141 has waned. While the Committee Report specifically indicates that it "[did] not intend that the . . . Board analyze and interpret various state laws to determine the beginning dates for the window periods of states which presently restrict the enforcement of due-on-sale clauses,"148 the Final Rule, after discussing the land contract anomaly in California, emphasizes the earlier of the 1978 dates.148 And this is certainly an issue of state law, rather than one for determination by Congress, or the Senate Banking Committee or even the federal
judiciary.\textsuperscript{144}

For "private lenders,"\textsuperscript{146} the beginning date will probably be determined to be one of the four alternative dates above. While the California Supreme Court has not yet commented on the issue, two appellate tribunals have now concluded that the commencement date was no later than August 25, 1978,\textsuperscript{148} even though some writers have theorized that the proper choice is actually one of the following: (1) February 4, 1982, the date *Dawn Investment* was decided,\textsuperscript{147} which was the first

\textsuperscript{144} The Senate Banking Committee attempted, however, to avoid being or specifying the arbiter:

Certainly, it was not the intent of the Senate Banking Committee or the Senate to take sides by trying to find what the window period in this particular compromise was for a particular State.

So I want to put into the RECORD a statement indicating what my intention was and again state that it was not the intent of the legislation to define the window period in any given State. As noted in the committee report, determination of the date which triggers the beginning of the window period could be, in some instances, ultimately decided by State courts construing State constitutional provisions, statutes, and State judicial decisions, or Federal courts construing State constitutional provisions, statutes, and judicial decisions.

Again, that says that the committee is neutral. We are not going into States and taking one side or the other. Statutory language is just what was agreed to. No changes. The report language does not say anything else.

The reason I am repeating this over and over again is that somebody reading the footnote will not miss it. The committee intended to remain neutral. The committee is neutral. The Senate intended to remain neutral. The Senate is neutral.

Of course State courts could make a decision. Any attorney in this country should recognize that. Some of them undoubtedly will go to court, but we are not taking a side.

I hope I have been understood as plainly as it is possible to be on the intention of staying neutral, and that I do not feel that this footnote means anything except to some attorneys who are trying to make their living by supplying their employers with bits and pieces of non-sensical information.


\textsuperscript{145} See supra note 14.

\textsuperscript{146} See Miranda v. Macias, 141 Cal. App. 3d 188, 191 Cal. Rptr. 177 (1983), and Lucas v. Jones, 83 Daily Journal D.A.R. 3219 (1983), a case involving private lender and non-residential property, where the issue was left unresolved.

\textsuperscript{147} See supra note 138. See also Grayson & Silver, The Window Period Exception to The Enforcement of Due-On-Sale Clauses under the Garn Act, 26 SAN FERN. BAR BULL. 8 (1983). The authors of that article, while stating that the selection of an eight-month "window period" for private lenders seems unlikely from a practical perspective, add that Gwen Hibbs, Deputy Director of the Office of General Counsel of the Board "has stated that this is the approach the [Board] is intending to take." Id. at 9.
decision of the California Supreme Court restricting automatic enforcement of due-on-sale clauses by private party lenders; or (2) March 6, 1982, the effective date of Dawn Investment. 148

VIII. WINDOW PERIOD LOANS OF LENDERS OTHER THAN FEDERAL THRIFTS, NATIONAL BANKS AND FEDERAL CREDIT UNIONS

Because of the aforementioned choices as to the applicable commencement date of the window period, the period for institutional lenders would seemingly be either four or eight years—depending on how California courts interpret the language in the Act. The window period for private lenders may span that same amount of time unless the Dawn Investment date governs for these loans, whereupon this window period would be only seven or eight months.

These determinations are significant because window period loans have special advantages: During the three years starting with the date of the Act, window period loans of lenders other than federal thrifts, national banks and federal credit unions cannot be called because of transfers to credit worthy transferees except if so decided by the state legislature in the state where the property is located. 149 During that three-year period (ending October 14, 1985), the Act appears

Note also the following discussion by one other author quite recently:

Because both the Act and the regulations define the start of the window period as the date on which a decision was rendered, rather than the first decision, prohibiting unrestricted exercise it can be argued that the window period may have multiple starting dates if the highest state court decided the outright sale issue in more than one decision, as in California. In light of the California Supreme Court’s express disclaimer in Footnote 9 of Wellenkamp concerning noninstitutional lenders, it can be argued that it was not until Dawn Investment in 1982 that borrowers could reasonably expect that the due-on-sale clause in their mortgage or deed of trust in favor of a private lender was held unenforceable under California law. Dawn Investment may also mark the beginning of the window period for commercial loans. The court began its analysis in Dawn Investment by stating: “In the instant case we conclude that the Wellenkamp rule applies to noninstitutional lenders and to commercial property.” (citation omitted).

Rader, supra note 120, at 96.

148. “Private lenders say March 6, 1982. On this date the California Supreme Court’s decision in Dawn became final.” Callahan, supra note 95, at 12.

149. Section 341, supra note 3, at (c)(1); Committee Report, supra note 25, at 23, 57.
to allow the state legislature to take different possible courses of action relative to window period loans, reciting that with respect to loan contracts falling into such category the legislature "may otherwise regulate such contracts" so that the due-on-sale restriction applies "only if such state law so provides . . ."150

The Committee Report suggested that four courses of action really existed: (1) to eliminate due-on-sale restrictions entirely; (2) to shorten the 3-year time frame for legislative decision; (3) to extend the 3-year time frame for legislative decision; or (4) to require the borrower and lender to agree to step up interest on a transfer to a blended rate, with the loans callable if the borrower will not so agree.151 Yet the Final Rule seems to indicate that the states have only the first two options.152

If the state legislature takes no action during the three years—and more than an entire year has been passed so far without such action—the window period loan becomes fully subject to due-on-sale as to any transfer on or after October 15, 1985.153

While it poses some problems, the window period concept at least mitigates a bit of the potential unfairness to certain borrowers or transferees who accepted property relying on full assumability, the result of the court decisions in California which restricted exercise of due-on-sale clauses before de la Cuesta. Congress apparently felt a compromise approach was the most sensible, giving both the competing lender and borrower lobbies something, and at the same time returning to the states a little authority to compensate for otherwise having preempted the field.

IX. WINDOW PERIOD LOANS OF NATIONAL BANKS AND FEDERAL CREDIT UNIONS

Loans made by national banks and federal credit unions are subject to similar window periods as those provided for

150. Section 341, supra note 3, at (c)(1)(A).
151. Committee Report, supra note 25, at 23.
153. Section 341, supra note 3, at (c)(1); Committee Report, supra note 25, at 23.
the “other” lenders. However, according to the Act, the future of the assumability of loans made by national banks and federal credit unions was to be determined by regulations promulgated by the Comptroller of the Currency (Comptroller) and by the National Credit Union Administration Board (NCUAB) respectively, rather than by a vote of the state legislature. The question of whether or not those federal agencies would be allowed to regulate retroactively was specifically “not addressed” in the Act.

The NCUAB acted promptly in issuing final regulations of its own, effective November 18, 1982, permitting “the exercise of due-on-sale clauses in long term first mortgage loans . . . in the case of transfers [taking] place on or after November 18, 1982.” The Comptroller has acted more slowly in regard to window period loans of national banks, having withdrawn a proposed regulation on May 31, 1983 and replaced it with a new proposed regulation this summer.

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154. Committee Report, supra note 25, at 23-24. See supra Section VIII.
155. Section 341, supra note 3, at (c)(1)(B); Committee Report, supra note 25, at 23-24. See Green, Credit unions and the due-on clause, 5 FIRST TUESDAY 28 (1983).
156. Committee Report, supra note 25, at 24. Perhaps the emphasis given in the Final Rule to the fact that states cannot retroactively extend the window period implies that the contrary is true as far as actions by the Comptroller or the NCUAB. See supra note 152.
158. The proposal which was withdrawn in May had been out for consideration since September of 1981 and was originally published at 46 Fed. Reg. 14 (1981). The withdrawal was published at 48 Fed. Reg. 24,089 (1983). The proposal circulated this summer was published at 48 Fed. Reg. 31,232 (1983) and has just become final. See L.A. Times, Nov. 27, 1983, pt. IX, at 7, cols. 1-3. The 1983 proposal would permit full enforcement of due-on-sale clauses for all transfers occurring after April 14, 1984 except for sale completed by Dec. 8, 1983 where the due-on-sale is in a “window period” loan. Id. That proposal would, however, allow transfers of loans which had been originated or assumed during the “window period” specified in the proposal for one-to-four family residential dwellings, provided that the transferee met “customary credit standards” and assumed the loan with a “blended” interest rate which “shall be any rate less than or equal to the average (arithmatic mean) of the rate specified in the original loan contract and the most recently available value on the date the loan is assumed of the monthly national average contract interest rate charged by all major lenders on mortgage loans for previously occupied homes, as published by the Federal Home Loan Bank Board in its Journal.” Id. The “window period” specified by the 1983 proposal, as to loans made in California is August 25, 1978 to October 15,
the California State Legislature has not yet voted on any measure dealing with the “window period” loan matter.\footnote{159}

In order to establish certainty in California, it would be desirable that this state’s legislature promptly address the window period loan issue and that the Comptroller quickly implement his recently adopted regulatory guidelines. Understandably, the state legislature is probably loath to take a position on such a controversial topic, particularly where inaction until October 15, 1985 will result in the decision having been made by Congress (by the terms of the Act). Nevertheless, in the interim, there is a risk that some potential transfers will be postponed or deals lost because of the uncertainty as to when, if at all, the affected loans would become non-assumable.

X. CREDITWORTHINESS

For all window period loans, there is at least one restriction to assumption that will exist, regardless of action by the legislative or regulatory body empowered to consider the future of such loans. The lender will be able to require the transferee or successor of an approved borrower to meet the lender’s “customary credit standards applied to loans secured by similar property.”\footnote{160} These standards are not further defined by the Act, although the Final Rule attempts to establish criteria\footnote{161} so that some uniformity and fairness in applica-

\footnote{159} One item of proposed legislation, Senate Bill 494, originally contained some language on the window period issue. As introduced on February 22, 1983, that legislation would have added a new Civil Code section 711.1 and amended Civil Code section 2924.6 to conform state law to the Act, specifying that assumability would be permitted on window period loans for three years only (until October 15, 1985). On April 20, 1983, the bill was amended to delete the prior subject matter and, instead, would add new Civil Code section 2954.10, which would prohibit lenders from receiving prepayment penalties upon acceleration under a due-on-sale clause.

\footnote{160} Section 341, \textit{supra} note 3, at (c)(2)(A).

\footnote{161} 48 Fed. Reg. at 21,558. The Final Rule recognizes that “private persons . . . not in the business of making real estate loans, . . . will not have credit-worthiness standards which they usually apply to loans secured by similar property (the standard provided for an institutional lender) because they will not deal in a volume of transactions sufficient to establish any ‘customary’ standards.” \textit{Id.} Consequently, the Final Rule “permits a private seller or lender to impose the credit standards customarily applied by other similarly situated lenders or sellers in the geographic market within which the transaction occurs.” \textit{Id.} The standards shall be those in effect at the time the loan transfer occurs, rather than at the earlier time of origination of such loan. \textit{Id.} The Final Rule anticipates both borrower and lender cooperation and puts
tion of the creditworthiness restriction will exist. Since any unpermitted transfer theoretically would permit lender acceleration, it is hoped that this creditworthiness provision, as clarified by the Final Rule, will not be abused by window period or other lenders.

Even with the Final Rule, many questions remain. For example, are there to be applications for approval where only one of several co-owners transfers his interest? Certainly it is safe to be sure that the successor in interest or transferee meets such "customary credit standards." What if the borrower is a partnership and it adds new partners, a trust which has a change of beneficiaries, or a corporation that sells stock to new shareholders? Will qualification be required as if the loan was going to be assumed at the old rate or the current market rate (which may well be considerably higher)? What standards are to be utilized if there are no comparable transactions from which to develop industry credit standards? These questions and many others about creditworthiness are unfortunately not answered by the Act or the Final Rule.¹⁶²

XI. FREDDIE MAC POLICY

Freddie Mac had circulated a policy memorandum on July 2, 1982 to the effect that, after August 2 of that year, it would not permit assumptions of any conventional mortgages it owned, whether the loans were for one-to-four family units, multi-family units or for home improvement. This was to be the case even if the offeree were willing to pay interest at the market or some other increased rate, unless the lender from which Freddie Mac bought the loan would repurchase it.¹⁶³

¹⁶² Id. at 21,559. Conversely, a lender must "respond in good faith to a credit application by acting to approve or disapprove the transfer within 30 days of receiving the credit application and any credit information it may have requested." Id.

¹⁶³ The Senate Banking Committee only mentioned the supplying of "customer credit information" and the "completion of [the lender's] customer credit application upon transfer of a window period loan . . . ." Committee Report, supra note 25, at 24.

1. Any loan subject to an enforceable due-on-sale clause will be automatically accelerated upon transfer of the property, with no option for rate increase unless Seller [the assigning lender] elects to repurchase the loan from the corporation.
This policy would seem to have the potential of inhibiting the sale of certain types of loans in the secondary market. For that reason, and because of the prospect of future state court litigation in certain cases, an exception was specified by Freddie Mac in the policy memorandum with respect to loans in jurisdictions where state law restricted due-on-sale exercise.\(^{164}\)

Subsequently, in late summer of 1982 Freddie Mac yielded to pressure and voluntarily postponed implementing the entire policy until the earlier of January 1, 1983 or the date of passage of congressional due-on-sale legislation.\(^{166}\) The Act, however, extended that postponement, requiring Freddie Mac to forego implementation of this policy until July 1, 1983 at the earliest.\(^{166}\) Curiously, the Act did not specify any similar restrictions applicable to Fannie Mae.

Freddie Mac recently announced that it will adhere to its intended policy.\(^{167}\) At this point, Freddie Mac has been willing to allow many assumptions so that the full impact of the policy has not been fully ascertained. It will be interesting to see

2. When Seller's ability to comply with this policy is restricted by state law, an assumption will be allowed at the original note rate, subject to the creditworthiness of the prospective assumptor. FHLMC Policy Memorandum (July 2, 1982).

This inflexible stance would require the lender to buy back the loan in order to negotiate, since paragraph 1 indicates that—even if the borrower and lender could agree to a mutually acceptable rate increase—FHLMC would not participate in that process.

164. Id.
165. Crane, supra note 70, at 18.
166. Section 341, supra note 3, at (f).
167. FHLMC policy letter to loan servicers dated May 27, 1983 (FHLMC Seller/Servicer Letter). That letter was actually an expansion and clarification of earlier correspondence from FHLMC to its loan seller/servicers dated December 15, 1982 as well as an update of a “Fact Sheet” and a news release both issued last October. The FHLMC Seller/Servicer Letter analyzed the Act and the Final Rule and their effect on FHLMC’s due-on-sale policy, excepting from its categorical requirement of enforcement (or servicer repurchase) only those loans where the security instrument contained no due-on-sale clause or the clause was in some way unenforceable, including clauses in documents appearing in “window period” loans, or a transfer exempted under section 341(d) of the Act. FHLMC Seller/Servicer Letter, at 1-2. FHLMC included only ten states among its “window period” jurisdictions, setting forth what FHLMC deemed the appropriate “window period” for each. Id. at 2-3. For California, FHLMC specified the period August 25, 1978-October 15, 1982. Id. at 3. A special provision of the FHLMC Seller/Servicer Letter deals with multi-family mortgages and provides that any originated on an FNMA/FHLMC Uniform Mortgage Instrument before July 1, 1983 may be assumed by a creditworthy transferee; loans originated thereafter, or loans utilizing other security instruments, will not be assumable. Id. at 5. However, the Federal Housing Administration is still permitting full assumability of its loans. The Wall Street Journal, Aug. 22, 1983, at 2, cols. 3-6.
if the ultimate effect, however, is as harsh as was predicted in
late 1982 when the lending market was far less favorable and
funds were less plentiful.

XII. OTHER BORROWER AND TRANSFEREE DEFENSES TO DUE-
ON-SALE ENFORCEMENT: ARE THEY STILL VIABLE AFTER THE
FINAL RULE?

This section focuses on the various defenses to due-on-
sale enforcement which were utilized in certain cases prior to
the Final Rule. Those defenses fell into two basic categories.
The first were *statutory* or *administrative* exceptions or limi-
tations which existed before the Final Rule modified the ear-
lier regulatory framework.\(^{168}\) The second consisted of certain
*contractual*, *equitable* or other judicially-recognized limita-
tions to enforcement occasionally raised by borrowers or
transferees. What effect the Final Rule has had on these limi-
tations has yet to be determined.

A. Statutory or Administrative Limitations on Enforcement

1. Maximum Interest Rate Increase

Prior to the Act, the Board had placed some minimal
guidelines on enforcement by federal thrifts. For example, ac-
cording to a companion provision to the Regulation in effect
until the promulgation of the Final Rule, the Board “ex-
pect[ed]” a federal thrift to self-impose a “cap” on its ability
to raise interest rates on old loans, such “cap” to be that
lender’s current rate for comparable new
\(^{1}\) loans.\(^{169}\) As with
most of the other restraints on lenders imposed by the Regu-
lation (except those repeated in the Act itself), this adminis-
trative limitation appears to have been removed by the Final
Rule. In truth, even if it were still enforceable as a limitation,
this “cap” would probably be of little practical value anyway
except in the special circumstance when the terms for new
loans from the particular lender involved are cheaper than
those available throughout the rest of the industry.

The Act contained a provision which “encourage[d]”

\(^{168}\) “The proposed regulations [which led to the Final Rule] restated and clari-
\(^{169}\) \(12\) C.F.R. § 556.9(d) (1982).
lenders, federal thrifts and all others, to permit assumptions at the existing contract rate or at a blended rate. The Act did not state what would happen if the lender involved ignored such "encouragement" and refused to proceed with a blended rate; nor did it specify whether there is a remedy available to the borrower in such a case, although the absence of any mandatory language suggested the contrary. Now, under the Final Rule, the Board has taken a firm stance, saying that the language is permissive only and "imposes no mandatory obligation to offer . . . blended rates."  

2. "Extreme Hardship" Cases

Prior to the adoption of the Final Rule, the Regulation contained language to the effect that the Board contemplated that federal thrifts would occasionally find it "appropriate" to waive their acceleration rights in "extreme hardship" situations. However, the Board never defined "extreme hardship," and at least one commentator suggested that every case would have to be reviewed separately to decide if there was a "hardship" involved, what its nature was and whether it was "extreme." Consequently, this possible defense was never easily understood nor did conservative counsel urge their clients, principals to transactions involving federal thrifts, to rely extensively thereon. Moreover, as with the interest rate increase limitations, the Final Rule appears to have eliminated any remaining viability of the "extreme hardship" defense.

170. See supra note 105 and accompanying text.

171. 48 Fed. Reg. at 21,558. Some commentary has suggested that this position exceeds the Board's authority and "flies in the face of congressional intent." See Note, 5 FIRST TUESDAY 26 (1983).

172. 12 C.F.R. § 556.9(c) (1982).

173. See Savage, Hardship to the borrower, 4 FIRST TUESDAY 29, 32 (1982).

174. Id. That commentator describes the potential cases as falling into three categories: seller hardships, borrower hardships and market hardships. Id.

The same writer has interpreted the exemption language of section 341(d)(9), which pertains to "any other transfer or disposition described in regulations prescribed by the . . . Board," as seemingly including the "extreme hardship" defense. Id. at 31. However, the Senate Banking Committee did not tie the two concepts together, suggesting instead that the types of circumstances which might be covered by section 341(d)(9) had not yet been foreseen by the members of that body. Committee Report, supra note 25, at 59.

175. See supra note 171 and accompanying text.
3. Transfers to Members of the Immediate Family

Prior to the Final Rule, a companion section to the Regulation also indicated that a waiver of the due-on-sale clause was "appropriate" for transfers of title to members of the borrower's immediate family who will occupy the property.\textsuperscript{178} This was designed to cover, among other things, the common situation in today's socioeconomic environment where parents and their children, or one child and the child's spouse, qualify for a loan and take title to a residence which is to be the first house for the younger grantees. The parents then promptly relinquish their interest by deed to the younger parties. Literally, the Act would now also exempt such a transfer, although the Final Rule provides that the Act's exemption for transfers to offspring would be limited to single family dwellings and then only if the transferee is currently occupying or will within ninety days after the transfer occupy the property in question.\textsuperscript{177}

The Act also exempted transfers to spouses\textsuperscript{178}—but \textit{not} conveyances to parents, siblings or other relatives—irrespective of the type of property involved. By contrast, the Regulation had employed the term "immediate family" in order to identify further the other types of "appropriate" family waiver situations;\textsuperscript{179} but this provision has now seemingly been eradicated by the Final Rule.\textsuperscript{180}

\textsuperscript{176} 12 C.F.R. § 556.9(c) (1982).
\textsuperscript{177} 48 Fed. Reg. at 21,559. See supra note 114.
\textsuperscript{178} See supra note 114 and accompanying text.
\textsuperscript{179} Some commentators had interpreted this provision as limited to single family dwellings. \textit{E.g.}, Crane, \textit{supra} note 70, at 22. It is noteworthy that the first sentence of § 545.8-3(f) made no mention of type of property, and the second sentence did so only in referring to the limits on exercise set forth in § 545.8-3(g). That section prescribed limits only on borrower-occupied, single-family dwellings. By contrast, § 556.9(c) and § 556.9(d), which dealt with waiver, did not specify any restrictions to the type of property to which they applied. However, since the de la Cuestas' property was commercial and the Court made no comment about any residential/commercial (or other, such as single-family/multi-family) distinction, it seems that the Justices did not perceive limits to the scope of the Regulation based upon the type of property.
\textsuperscript{180} 48 Fed. Reg. at 21,559. Under the newly promulgated rule, a "sale or transfer" which will permit acceleration includes a conveyance of real property or "any right, title or interest therein, whether legal or equitable, by outright sale, deed, installment sale contract, land contract, contract for deed, leasehold interest with a term greater than three years, lease-option contract or any other method of conveyance of real property interests." 12 C.F.R. § 591.1(b) (January 1, 1982) (emphasis added).
It is submitted that the Final Rule—by eliminating the older regulatory defenses and restricting the exemptions to owner-occupied, single family dwellings—is unreasonable since it technically allows acceleration upon any transfer of title to investment property however innocuous. The extent to which the Final Rule will hinder creative tax and estate planning or even divorce planning is not known. Certainly, commonplace devices such as conveyances into family trusts, marital settlement agreements and wills must now be reviewed with great care. However, the breadth of the Final Rule is such that even a transfer by intestate succession would be an event permitting acceleration if the decedent died owning property of investment character which passed by law to his heirs. Whether this is the result intended by Congress in passing the Act remains open to question.

B. Contractual, Equitable or Other Judicially Recognized Limitations on Enforcement

The Regulation, the Act and the Final Rule have all stated that exercise of a due-on-sale clause is exclusively governed by, and the parties’ remedies are determined with reference to, the loan contract between the lender and borrower. Therefore, careful review must be made of the security instrument and/or evidence of indebtedness containing the due-on-sale language as well as any other documents, such as disclosure statements. In other words, any loan document which might have constituted a portion of the understanding of the parties or upon which the borrower relied in taking the loan must be closely scrutinized. Obviously, any assumption papers between the lender and a subsequent grantee who has substituted liability, as well as any modification or extension agreements with the original borrower or a successor, would warrant analysis as to the various rights of the parties. So, too, would documents “merely acknowledging” a transfer of the property to a successor of the original borrower on a “subject to” basis, without substituted liability—whether just to

181. In California, the due-on-sale language must be included in both the note and deed of trust to be enforceable for properties of one-to-four units. CAL. CIV. CODE § 2924.5 (West 1974). Under de la Cuesta, such state restriction would presumably be inapplicable to federal lenders on loans they originate. Whether the Act or the Final Rule would similarly preempt the effect of such legislation as to other lenders is an open question.
change names on a file or to acknowledge a "reservation of
rights." 182

In a few rare cases, these documents have been found to
contain factual information which can be used to support a
viable waiver or estoppel defense to a lender's enforcement
efforts. Of course, there have been cases where such papers have
had the opposite effect, strengthening a lender's bargaining
position rather than weakening it. For example, reservation of
rights agreements, which were widely circulated before the
Court decided de la Cuesta, provided essentially that, if the
lender prevailed, the borrower would have to pay all of the
interest claimed by the lender from the date of an uncon-
sented to transfer. The interest charged might be at the mar-
ket rate or some other stipulated rate in excess of the stated
rate in the obligation involved (back interest). 183

1. Adhesive Contract

One defense which has been raised in past California due-
on-sale cases involving institutional lenders, 184 though specifi-
cally not considered by the state supreme court in Wel-
lenkamp or Tucker, 185 has been that the lender's loan docu-

182. The typical reservation of rights agreement which circulated in the last few
years arose after a lender found an undisclosed transfer, whether by deed or by some
other vehicle (often an installment land contract). Usually, such reservation of rights
agreement was signed essentially in the form drafted by lender's counsel and con-
tained language preserving the status quo, each party acknowledging that neither was
waiving any rights but allowing payments to be made at the same rate as before the
transfer until terminated by notice or by final decision in de la Cuesta or some other
designated federal lender case. See Note, A Case for Preemption: Wellenkamp v.

183. Nothing was stated in the de la Cuesta opinion about a federal lender's
right to demand "back interest" as a condition to reinstating a loan accelerated on a
due-on-sale basis. If the lender's right is either to call the loan or else to name its
terms (including interest increase) for foregoing exercise of such right, then even back
interest is realistically within the lender's grasp in certain cases where the borrower
will not walk away from the property. However, the companion promulgations to the
Regulation propose a maximum on interest increases. See supra note 51 and accom-
panying text. Perhaps collection of back interest would be limited if the federal
lender also stepped the prospective interest up to market rate.

184. E.g., Dawn Inv. Co. v. Superior Court, 30 Cal. 3d 695, 639 P.2d 974, 180
Cal. Rptr. 332 (1982); La Sala v. Am. Sav. & Loan Ass'n, 5 Cal. 3d 864, 97 Cal. Rptr.
849, 489 P.2d 113 (1971); Wilhite v. Callihan, 121 Cal. App. 3d 661, 175 Cal. Rptr. 507
Rptr. 215 (1982).

185. "[T]he Wellenkamp decision is based on the policy against restraints on
mentation is adhesive and unreasonably worded. The borrower has no independent bargaining power, especially in the "tight money" market prevalent in the recent past. California courts have looked to this bargaining position of the parties in other types of cases, usually with unfair insurance policies, and found that adhesion exists where the parties are substantially unequal in power even if the documentation is clear and understandable. 186

This is still an untested defense as to federal thrifts. If this defense is asserted against them, they will undoubtedly argue that California policy regarding adhesion contracts is preempted by the Act and/or the Final Rule and other federal legislation in this area. It is submitted that most federal thrifts would probably have prevailed as against this defense even before passage of the Act. Now, because the Act has the effect of putting all lenders on more or less equal footing 187 (except as to "window period" loans), it is doubtful that the adhesion contract defense will be effective in cases involving any lenders—whether private parties, state lending institutions or federal thrifts.

2. Fraud and Mistake

Certainly, if the facts in any way so warrant, fraud or mistake claims should be considered. 188 The problem with

alienation and not adhesion considerations." 30 Cal. 3d at 702 n.2, 639 P.2d at 977 n.2, 180 Cal. Rptr. at 335 n.2. See also Maxwell, supra note 39, at 213-14.


187. The Wall Street Journal, Sept. 27, 1982, at 4, col. 2; see Committee Report, supra note 25, at 21 (preemption of state due-on-sale restrictions to place all lenders on a "more competitive footing"). But see Lucas v. Jones, 83 Daily Journal D.A.R. at 3220 n.6 and 48 Fed. Reg. at 21,560 regarding the limitation of the Final Rule to certain depository institutions and all other government or corporate entities described as "lenders" in section 341(a)(2) of the Act.

188. Some writers have also suggested the defense of "unconscionability." E.g., Kinzler, supra note 39, at 454-55; Stanford Note, supra note 39, at 1129. "Even those jurisdictions holding that 'due on sale' clauses are ordinarily enforceable have held that such enforcement is subject to equitable defenses such as estoppel and unconscionability." Great Northern Sav. Co. v. Ingarra, 66 Ohio St. 2d 503, 507, 423 N.E.2d 128, 131 (1981). While California did not adopt the Uniform Commercial Code "unconscionability" defense per se, its courts have utilized other rubrics to "avoid enforcement of an 'unconscionable' bargain." B. Witkin, Summary of California Law 5265 (8th ed. 1974). See generally Cal. Com. Code § 2-302, comment (West 1963).
these two defenses is that the court might determine that the remedy should be rescission of the loan, a cure which is as bad as the disease.

3. Waiver

The three standard equitable defenses of waiver, estoppel, and laches offer a much more meaningful hope for sellers and buyers struggling to find negotiating leverage in order to salvage a transaction which seems shipwrecked on the shoals of a due-on-sale clause and a lender's insistence on hefty interest increases. Waiver has been defined as the "intentional or voluntary relinquishment of a known right." Although waivers can be implied from conduct, it will be difficult in most cases, other than those involving formal assumption or letters from a loan officer to the parties or an escrow, to establish proof of the lender's intended relinquishment of the right to call the loan or demand higher interest. If the transfer was not openly disclosed by the parties, the lender cannot be charged with that knowledge, let alone intent to acquiesce in the transfer, absent proof of discovery of the event by the lender's internal machinery. Even then, it may not be sufficient to prove that a mere loan clerk knew about the title change (for example, if a clerk received notice of an added insured on the casualty insurance policy), especially if the parties themselves consciously tried to hide the fact of conveyance.

189. Black's Law Dictionary 751 (4th ed. 1968). See also Miller v. Elite Ins. Co., 100 Cal. App. 3d 739, 753, 161 Cal. Rptr. 322, 330 (1980); A.J. Industries, Inc. v. Ver Halen, 75 Cal. App. 3d 751, 759, 142 Cal. Rptr. 383, 388 (1978). Waiver may be express or implied. E.g., Johnson v. Kaeser, 196 Cal. 686, 698, 239 P. 324, 329 (1925); Jones v. Sunset Oil Co., 118 Cal. App. 2d 668, 673, 258 P.2d 383, 388 (1953). It may be shown by conduct, especially where the act is "so inconsistent with the intent to enforce the right in question as to induce a reasonable belief that such right has been relinquished." Howard J. White, Inc. v. Varian Associates, 178 Cal. App. 2d 348, 355, 2 Cal. Rptr. 871, 875 (1960). In the due-on-sale cases, most of the fact situations of which this author has been made aware are those where the waiver is asserted to have been implied by lender conduct.

190. E.g., Callahan, Waiver and estoppel in closed sales, 4 First Tuesday 9, 10 (1982).

191. Id. at 9; see id. at 11, where that writer states: "The lender must have been actually informed of the transfer before accepting payments, if waiver is to exist. Hidden transfers undisclosed to the lender do not give rise to waiver." However, lenders who accept disputed payments "are deemed to know the consequences" thereof. Id. at 10. This may constitute an accord and satisfaction and a waiver of both the right to call the loan and the right to terminate the loan contract for default.
The more interesting situation, and the one likely to spur the greatest debate, is where the lender receives a beneficiary statement or is told to change names and addresses on a file and takes no action. When does the burden shift to the lender to prove it did not waive? Again these are facts counsel should discuss carefully with their clients.

4. Estoppel and Laches

While the waiver defense may be limited in utility to those circumstances where the lender openly acknowledged its awareness of the ownership change and either executed papers accepting such a transfer or else did nothing to contest it, many times the lender moves very slowly and the parties cannot tell what its position is. This is especially the case with certain institutional lenders. Nevertheless, the parties typically perceive that they must go forward because of escrow closing deadlines.

Estoppel and laches both depend on a finding of reliance by the party asserting them, that such party suffered prejudice or detriment because of the inaction of the lender.192

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192. The elements of the estoppel doctrine, also known as “equitable estoppel,” are: (a) that the party to be estopped must intend his conduct to be acted upon or so act that the party asserting estoppel has a right to believe that it was so intended; (b) that the other party must be ignorant of the true state of facts; and (c) that the party asserting such estoppel have relied to his injury or detriment. E.g., Strong v. County of Santa Cruz, 15 Cal. 3d 720, 543 P.2d 264, 125 Cal. Rptr. 896 (1975). In the due-on-sale context, the most important questions would seem to be whether the borrower and/or transferee (for this analysis, collectively referred to as the “resisting parties”) have the right to treat a lender’s failure to serve a notice of default immediately upon a transfer as its intent to approve the transfer, whether the resisting parties are ignorant of any contrary position on the lender’s part and whether the resisting parties have relied with any real justification on the lender’s failure to act promptly against them or the property. The estoppel defense usually holds more promise for the resisting parties because it involves consideration of the conduct of both sides, not just that of the lender. And estoppel may arise from silence. E.g., Elliano v. Assurance Co. of Am., 3 Cal. App. 3d 446, 83 Cal. Rptr. 509 (1970). In fact, this estoppel defense is frequently asserted by resisting parties when a federal lender has made no effort to call the loan or to demand payment until considerably after the transfer has occurred.

Laches is different from waiver or estoppel. Laches requires unreasonable delay plus either (1) acquiescence or (2) prejudice to the complaining party. E.g., Conti v. Bd. of Civil Serv. Comm’rs, 1 Cal. 3d 351, 461 P.2d 617, 82 Cal. Rptr. 337 (1979). As with estoppel, a showing must be made that the party guilty of laches knew or, having been put on notice, should have known the necessary facts (such notice including awareness of circumstances that should have persuaded him to make appropriate inquiry). McNulty v. Lloyd, 149 Cal. App. 2d 7, 307 P.2d 706 (1957). In the due-on-sale area, this defense has been asserted in a wide range of situations—where notice of
Such reliance is not an element of the waiver defense. As a result, harm occurring because of a justifiable reliance on a lender’s inaction (and the fact question of whether reliance was justifiable is always determined on a case-by-case basis) can substitute for the element of lender intent required to find a waiver.

Is it enough that the lender remains silent for a long period after the transfer and sends no notice of acceleration of the debt or records no notice of default? Not always. Only a court can decide, and a few federal S&L cases are still awaiting trial on this and related issues. If there are any opportunities left in this area, counsel should devise a game plan with the parties in advance.

One thing is certain: even after passage of the Act and adoption of the Final Rule, if negotiations in various individual cases fail and enough money is in issue, these equitable defenses will eventually be tested by way of borrower and/or transferee damage actions, as well as with injunctive or declaratory relief proceedings. Such cases in California can, and should, be brought in the state courts, not federal district

transfer is clearly given by one of the parties or when, for example, the notice is obscure as in the case where the lender receives a copy of an insurance policy endorsement showing a new name (that of the transferee). If the lender begins enforcement after a period of delay and prejudice is claimed by the resisting parties, the court must then decide, as trier of fact, whether laches has taken place.

193. “Good faith reliance by the buyer is a case-by-case thing.” Callahan, supra note 190, at 11.

194. See, e.g., Nalore v. San Diego Fed. Sav. & Loan Ass’n, 663 F.2d 841 (9th Cir. 1981), cert. denied, 102 S. Ct. 2904 (1982); Glendale Fed. Sav. & Loan Ass’n v. Fox, 459 F. Supp. 903 (C.D. Cal. 1978), 481 F. Supp. 616 (C.D. Cal. 1979), rev’d, 663 F.2d 1078 (9th Cir. 1981), cert. denied, 50 U.S.L.W. 3998.24 (1982); Conference of Fed. Sav. & Loan Ass’n v. Stein, 604 F.2d 1256, 1259 (9th Cir. 1979). See also Guinasso v. Pacific First Fed. Sav. & Loan Ass’n, 656 F.2d 1364 (9th Cir. 1981), cert. denied, 102 S. Ct. 1716 (1982), another removal case decided also by the Ninth Circuit two days earlier, although the subject matter of the suit was recovery of interest on impound accounts rather than due-on-sale. Guinasso began as a state case and was removed to the federal district court by reason of the preemption claim of the defendant, a federal lender. Id. at 1365. The court reasoned as follows: “The state claim asserted here contains no federal ingredient . . . . At most [federal law] foreclosed state regulation, in which case it would be a complete defense to the plaintiffs’ claim, but still only a defense.” Id. at 1367. In Nalore, the Ninth Circuit stated that “Guinasso presented virtually identical jurisdictional issues [even though the substantive claims differed]” 663 F.2d at 842, and accordingly rejected the lender’s claims for removal to the federal court system. The appellate tribunal commented that the transferee’s complaint “presents a basis for relief that is entirely under state law [and, therefore, the lender’s preemption defense] fails as a ground for removal jurisdiction.” Id.
courts, even where the lender is a federal thrift, since state tribunals have typically been more sympathetic than their federal counterparts to borrowers and transferees.\textsuperscript{195} Several decisions pre-dating the Act held that federal S&L's could not remove these types of cases to the federal forum,\textsuperscript{196} because these matters were within the jurisdiction of state judges; and it does not seem that such analysis would be altered by the subsequent passage of the Act. The effect of the Final Rule in this area is unclear.

C. Loans Made by Lenders Which Were Not Federal Thrifts When the Loans Originated: The "Converted Lender" Problem and Other Related Issues

The Court made no statement in \textit{de la Cuesta} about those lenders who had by then converted, or would thereafter convert, from state to federal charters. This raised the obvious question as to whether any of the loans made by these "converted lenders" were covered by the umbrella of \textit{de la Cuesta} or whether, instead, all of those loans of converted lenders which were secured in whole or in part with California real estate remained within the doctrine enunciated in \textit{Wellenkamp}.\textsuperscript{197} A corollary inquiry based upon Footnote 24 of \textit{de

\textsuperscript{195} Every reported case in the California state courts involving federal lenders' claims of preemption on the due-on-sale issue has been decided against the lenders except those decided by Division Two of the Second District Court of Appeal. And the state appellate courts were more inclined to urge favorable procedural rulings. \textit{E.g.}, Hummell v. Republic Fed. Sav. & Loan Ass'n, 133 Cal. App. 3d 49, 183 Cal. Rptr. 708 (1982) (bond alone sufficient during pendency of pre-\textit{de la Cuesta} due-on-sale case, and requirement of paying increased interest as well viewed as too onerous).

\textsuperscript{196} \textit{See supra} note 194.

\textsuperscript{197} The commentators are divided sharply. \textit{Compare} Katz, \textit{supra} note 85, at 51 (where counsel for a federal S&L stated that it was probable that converted lenders were entitled to exercise of due-on-sale rights "to the full extent permitted all other Federal associations") \textit{with} Hesse, \textit{New federal S&L's can't put back the clock, 4 FIRST TUESDAY 22, 24} (1982) ("newly-converted federal S&L's can only benefit from the preemption as to loans issued \textit{after} the conversion"). The policies of converted lenders were similarly divided. Some began aggressively calling loans on pre-\textit{de la Cuesta} transfers or on transactions not completed by the \textit{de la Cuesta} decision date. Others (such as Great Western Savings and Loan Association) decided "not to touch any transaction completed or in progress" before \textit{de la Cuesta}. Daily Commerce, Sept. 21, 1982, at 4B, col. 2.

While the Court in \textit{de la Cuesta} specifically did not address the converted lender issue, it did mention that four years ago, as part of the Financial Institutions Regulatory and Interest Rate Control Act of 1978, Pub. L. 95-630, 92 Stat. 3641, Congress specifically amended § 5 of HOLA "to permit state mutual savings banks to obtain federal charters." 102 S. Ct. at 3027 n.19.
The issue of converted lenders in California between the Court's *de la Cuesta* decision and the passage of the Act was also the subject of a brief but amusing historical episode. To end the parade of California state lenders converting to federal charters, Linda Tsao Yang, the outspoken California Savings and Loan Commissioner, attempted to push for parity by regulation, acting in an especially vigorous manner after *de la Cuesta* was finally decided. California possessed some legislation relative to parity at that time. One provision, in the Civil Code, becomes effective by its terms on December 31, 1983. That provision states in pertinent part as follows:

(a) The Legislature finds that the economic environment of financial institutions has become increasingly volatile as a result of regulatory revisions enacted by the United States Congress and federal agencies . . . . It is the purpose of this section to maintain the quality of competition between state-licensed and federally regulated financial institutions in the field of mortgage lending, as well as promote the convenience, advantage and best interests of California residents in their pursuit of adequate and available housing. In order to remain competitive and provide the optimum housing environment for the citizens of California, state institutions require the ability to respond in a timely manner to changes in mortgage lending parameters initiated at the federal level. Local regulatory guidelines must promote continued parity between the state and federal levels in order to avoid creation of discriminatory burdens upon state institutions and to protect interests held by California citizens. It is the intent of the Legislature to eliminate past and prevent future inequities between state and federal financial institutions doing business in the State of California by creating a sensitive and responsive mortgage parity procedure.

(b) The Secretary of the Business, Transportation and Housing Agency, or the secretary's designee as defined by subdivision (c) of Section 1918.5 of the Civil Code, shall have the authority to prescribe rules and regulations extending to lenders who make loans upon the security of residential real property any right, power, privilege or duty relating to mortgage instruments that is equivalent to authority extended to federally regulated financial institutions by federal statute or regulation.

(c) In order to grant equivalent mortgage lending authority to state financial institutions to that which has been extended to federal financial institutions, the secretary or the secretary's designee shall adopt such regulations within 60 days of the effective date of the statute or regulation extending the comparable right, power, privilege or duty to federally regulated financial institutions by federal statute or regulation.


Whenever by statute or regulation there is extended to federal institutions doing business in this state whose accounts are insured by the Federal Savings and Loan Insurance Corporation or its successor any right, power, privilege, or duty not authorized herein to domestic associations, the commissioner may by regulation extend to domestic associations such right, power, privilege, or duty. Any such regulation shall expire on January 1 of the second succeeding year following the end of the calendar year in which such regulation was promulgated.


However, the California Association of Realtors threatened suit under Wellenkamp if the Commissioner promulgated such parity regulations; and in July of last year, before she was placed on suspension, Ms. Yang turned to the California Attorney
to such loans in California, and if so, did such vested rights pertain only to loans originated on or after the date of the California Supreme Court's Wellenkamp decision or at one of the other alternative dates.

These and various other issues discussed below have been addressed in the Act and/or the Final Rule. In the Committee Report, the following is stated:

The identity of the lender at the time the loan was originated determines whether or not a loan is subject to window period restrictions. For example, a loan originated by a state chartered savings and loan association which subsequently converted to a federally chartered thrift will be subject to state due-on-sale restrictions for three years, unless state action provides other treatment for such loan. Similarly, a loan originated by a state chartered bank, which subsequently converted to a national bank, will be subject to state due-on-sale restrictions for three years unless the state acts, and Comptroller of the Currency regulations concerning due-on-sale

General's office and requested a formal opinion on the legality of such regulations if she were to issue them pursuant to her authority under the California Financial Code. The Attorney General had indicated in a similar circumstance in 1981, when asked for an opinion that state lenders could have a parity position with federal lenders as to what their variable interest rate loans could provide, that the Commissioner could not make such a regulatory pronouncement without further legislative authority or direction. 64 Op. Cal. Att'y Gen. 439 (1981). On August 17, 1982, the Attorney General's office replied in a consistent fashion by opining that no such regulation as Ms. Yang sought to promulgate could properly be issued by the Commissioner's office. The opinion stated, in pertinent part, as follows:

[W]e are asked the narrow legal question of whether the commis-sioner can adopt regulations pursuant to [Financial Code § 5500.5] to obviate Wellenkamp and permit domestic associations, like their federal counterparts, to enforce "due-on-sale" clauses in their loan contracts. We conclude that section 5500.5 does not authorize the commissioner to take such action.

Opinion of the California Attorney General No. 82-703 (Aug. 17, 1982), at 3. The Attorney General found "no appreciable difference between the question presented here and that [on the variable interest rate loan issue] addressed last year." Id. at 6.

See also News Release of Office of Attorney General, Deukmejian Opinion Says S & L Commissioner Has No Legal Authority to Permit State Associations to Exercise Due-On-Sale Clauses in Loan Contracts (Aug. 17, 1982).

Ironically, a new rush is on a year later to start state savings and loans in California. The Wall Street Journal, Aug. 23, 1983, at 29, col. 3. This results in large measure from the fact that deregulation of state thrifts took effect on January 1 of 1983. Id.

198. "As to pre-conversion loans, the federal preemption cannot change vested property rights." Hesse, supra note 197, at 24.

199. See supra notes 69 and 85 and accompanying text.
will not affect this loan.\textsuperscript{200}

Moreover, the Act specifically exempts pre-Act transfers of window period loans.\textsuperscript{201}

Based upon the quoted passage from the Committee Report, the major issues relating to due-on-sale rights of converted lenders would seem to be settled "unless state action provides other treatment for such loan." It is, therefore, not surprising that all but a few of the scores of converted lender cases which were pending prior to passage of the Act have been settled. Indeed no reported decisions have been rendered in California as to any pre-Act converted lender cases. However, in Bassett \textit{v}. Fidelity Federal Savings and Loan Association,\textsuperscript{202} a case filed before (but decided after) the Court ruled in \textit{de la Cuesta}, and issued between the dates when Congress passed the Act and President Reagan signed it into law,\textsuperscript{203} a trial judge in Orange County held that converted lenders were indeed "subject to the rule in \textit{Wellenkamp}."\textsuperscript{204} Ironically, the losing party in \textit{Bassett} was Fidelity, the winner in \textit{de la Cuesta}.

At least one other type of converted lender action still appears viable even after the Act: a case \textit{for damages} for a lost deal.\textsuperscript{205} A lawsuit of that nature, \textit{Halter \textit{v}. World Savings and

\textsuperscript{200} Committee Report, \textit{supra} note 25, at 24.

\textsuperscript{201} Section 341, \textit{supra} note 3, at (c)(2)(B); Committee Report, \textit{supra} note 25, at 24.

\textsuperscript{202} No. 366395 (Orange County Super. Ct.). See also a federal trial decision in New York, Bleecker Assoc. \textit{v}. Astoria Fed. Sav. & Loan Ass'n, 544 F. Supp. 794 (S.D.N.Y. 1982), where the judge stated in dictum that a converted lender could not enforce a due-on-sale clause on a transfer if the loan was originated at the time the institution was state-chartered.

\textsuperscript{203} The judgment was rendered on October 7, 1982. \textit{L.A. Times}, Oct. 8, 1982, pt. IV, at 1, col. 5. Although only a trial level case, it may have added significance since it dealt with a transfer occurring \textit{before Wellenkamp} (in 1977). This may have been the first California decision on the vested rights issue left in doubt by Footnote 24 of \textit{de la Cuesta}. It prompted one newspaper writer to say that the judge "tentatively ruled that loans made between 1974 and 1978 by state-chartered savings and loans that later switched to federal charters may still be assumable by home buyers despite the U.S. Supreme Court's controversial De la Cuesta [sic] decision." \textit{L. A. Times}, Oct. 6, 1982, pt. IV, at 1, col. 5.

\textsuperscript{204} \textit{L.A. Times}, Oct. 8, 1982, pt. IV, at 1, col. 6.

\textsuperscript{205} A few exist at the trial level. See, \textit{e.g.}, \textit{Arnstein \textit{v}. World Sav. & Loan Ass'n}, No. 506096 (Santa Clara Super. Ct., Aug. 1982) (seeking damages on behalf of the proposed seller and by the brokers and salespersons who lost a commission on a post-\textit{de la Cuesta} transaction which was not completed by reason of a converted lender's threatened acceleration). \textit{See infra} note 206 and accompanying text.
Loan Association, was filed in Los Angeles on July 20, 1982, after the Court's de la Cuesta opinion was published, but before the Act. Dealing with a post-Wellenkamp transfer, one which clearly fell within the "window period" under the Act, Halter was not mooted by passage of that legislation since the Act took effect too late to rescue the transactional opportunity involved. While a claim for damages, if any, still appears to be a viable means of recourse under the right fact pattern, the Halter case was dismissed in May of this year.

XIII. UNCONVENTIONAL TRANSFERS: ARE ALL THE "LOOP-HOLES" CLOSED?

Many parties have attempted in the past to circumvent due-on-sale enforcement with imaginative conveyancing docu-

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206. No. C 418533 (Los Angeles County Super. Ct., May 6, 1983) Both the deed of trust and the note secured thereby contain the following printed due-on-sale language:

Beneficiary shall have the right, at its option, to declare any indebtedness and obligations secured hereby, irrespective of the maturity date specified in any note or agreement evidencing the same, due and payable within 30 days after such declaration if (1) Trustor sells, enters into a contract of sale, conveys, further encumbers or alienates said property or any part thereof, or suffers his title or any interest therein to be divested or encumbered, whether voluntarily or involuntarily, or leases with an option to sell, or changes or permits to be changed the character or use of said property, or drills or extracts or enters into a lease for the drilling for or extracting of oil, gas or other hydrocarbon substance or any mineral of any kind or character on said property, or (2) Trustor is a partnership and the interest of a general partner is assigned or transferred, or (3) Trustor is a corporation and more than 25% of the corporate stock thereof is sold, transferred or assigned during a 12-month period, or (4) Trustor is a trust and there is a change of beneficial interest with respect to more than 25% of said property.

Such language is slightly different from that appearing as paragraph 17 in the Uniform Mortgage Instrument which was utilized as the deed of trust in the Moore and Whitcombe deeds of trust at issue in de la Cuesta. See supra note 89.

In Halter the complaint alleged, among other things, that the defendant, then a state-chartered lender, made a loan in October of 1978 (after Wellenkamp), which was secured by a deed of trust containing a due-on-sale clause; that in 1981 the lender converted to a federal charter; that the lender, by a letter dated June 21, 1982 (7 days before the Court rendered its decision in de la Cuesta), responded to the request of an escrow in connection with plaintiffs' possible sale of the secured real property to certain third parties by indicating that the prospective purchasers could take title "subject to" the lender's deed of trust upon compliance with certain minor formalities; and that, presumably irrespective of the ability of such prospective purchasers to comply with those designated formalities, the lender thereafter decided (on or about July 7) to "flex [its] muscles" by demanding that the prospective purchasers negotiate a new loan at an increased interest rate.
ments, sometimes to hide or disguise the occurrence itself and sometimes to utilize an approach which might be defended as “not really transferring” an interest that would trigger the alienation clause. Installment land contracts were in the forefront of this approach. However, they are clearly no longer “loophole” items for loans originated by lenders covered by the Final Rule, and the wording of the various mortgage instruments now in circulation tends to be broad enough to cover them.

Likewise, long-term leases or rental agreements with options to purchase, though still marketed after the Act by a few brokers, are not a solution. Moreover, they are specifically mentioned in the Uniform Mortgage Instrument utilized by federal thrifts as being transfers in violation of the due-on-sale clause, as well as being covered by the Final Rule. In fact, the Act and the Final Rule adopted the exact same standard for leases as was contained in the Regulation—permitting acceleration on a transfer by reason of a lease with a greater than three year term or an option to purchase. Investors and practitioners need to be careful of

207. See generally Bernhardt, supra note 39, at 63-64. Apparently, even after de la Cuesta, at least one court was still entertaining a number of land contract cases. Additionally, of the more than 1600 federal lender due-on-sale cases transferred to that court (more than 100 being added on since the high court de la Cuesta decision), many involved due-on-sale clauses of “pre-Reg” loans which the borrower or transferee litigants apparently were still claiming to be unenforceable despite de la Cuesta. Telephone interview with Judge Leonard Goldstein, Superior Court for the County of Orange (September 1, 1982).

208. 48 Fed. Reg. at 21,556.

209. Paragraph 17 of the Uniform Mortgage Instrument makes it an event of acceleration if the transfer in question is of “an interest” in the subject property. See supra note 89. And Tucker acknowledged that the transfer of the vendee’s equitable position is such an interest. 12 Cal. 3d at 637, 526 P.2d at 1173-74, 116 Cal. Rptr. at 637-38. While not within the scope of this article, it should be noted that recent cases have revealed some of the risks to the parties created by these land contracts, risks that do not exist in standard deeds of trust. See, e.g., Koloff v. Castle, 115 Cal. App. 2d 369, 171 Cal. Rptr. 308 (1961) (vendee’s equitable interest may, on breach, be reclassified and sums theretofore paid the vendor treated as mere reasonable rental).

210. One broker was quoted as saying, even after passage of the Act, that “nothing in trust deeds and notes . . . prohibits options . . . and if a federal or state savings and loan wanted to take it to task, they would lose because (with an option) we have [not] alienated title . . . .” L.A. Times, Oct. 24, 1982, pt. VIII, at 2 & 11. The arrangement this broker utilized, with a 5-year escrow, certainly seems to this author to permit acceleration under the Regulation and the Act, each of which suggest that the grant of the option to purchase is sufficient to trigger a due-on-sale clause. See supra notes 51, 109-17 and accompanying text.

211. 48 Fed. Reg. at 21,559.
these restrictions on leasehold transfers.

Other vehicles for circumventing due-on-sale clauses that came into use subsequent to de la Cuesta included title-holding trusts and some unique and as yet untested documents involving unconventional seller and purchaser legal relationships. It is unlikely that any of these will accomplish the goal of avoiding acceleration clauses, since the Final Rule is very precise in limiting the types of exempt transfers. These trusts and other forms of conveyance should therefore be avoided.

Similarly, creation of partnership or corporate structures for ownership, so that the beneficial interest in an ownership entity rather than the real estate interest may be conveyed, were touted by many brokers after the Act. Here, too, the indiscriminate use of entity buyers can lead to substantial tax and business risks that may wipe out any advantage to the deal. Lenders have been re-drafting their deeds of trust and notes so that even these "change of entity ownership" loop-

212. In the summer of 1982, at least one attorney in Orange County was marketing this type of vehicle. Letter from Bernard J. Koerselman (July, 1982) (a copy of which is on file with the Santa Clara Law Review). See also Crane, "Garn" assumption agreement, 4 First Tuesday 6, 11 (1982). Section 341(d)(8) of the Act now clearly details what types of trust transfers to "third parties" (or even family members except those covered in one of the other specific exemptions) are free from the risk of triggering an acceleration clause. Section 341, supra note 3, at (d)(8). And the Final Rule even authorizes lenders to accelerate on a transfer to an inter vivos trust "if a borrower refuses to provide reasonable means acceptable to the lender by which the lender will be assured of timely notice of any subsequent transfer of the beneficial interest or change in occupancy." 48 Fed. Reg. at 21,559.

213. For example, such tax risks would include having to comply with the requirements of filing and reporting in the name of the given entity and sometimes difficulties in obtaining the tax benefits desired at the individual level because of the structure employed to hold title.

214. For example, such business risks would include the possibility of the entity having liabilities other than those pertaining to the real estate involved, liabilities which would not be disclosed by or insurable under any title policy. Some realtors have suggested an unrecorded conveyance, again subjecting the purchaser (and seller, if there is to be an unrecorded junior deed of trust securing a deferred portion of the purchase price) to the risks of an uninsured position in the chain of title.

215. Not all deeds of trust overlook these types of entities (trusts, partnerships and corporations). Some expressly provide that a transfer of a significant beneficial interest (such as a general partner interest or 25% equity interest) in such an entity is a triggering event. See supra note 206. And, within a month after de la Cuesta, FHLMC developed and began circulating a new "Due-on-Transfer" Rider to its uniform mortgage instrument. That Rider provides, among other things, that changes of 49% or more of the beneficial ownership of the borrower (inclusive of prior changes) will trigger the due-on-sale clause. This is consistent with forms FNMA and FHLMC have stockpiled since 1977. See Kratovil, A New Dilemma for Thrift Institutions: Judicial Emasculation of the Due-On-Sale Clause 12 J. MAR. J. PRAC. & PROC. 299
holes are rapidly disappearing.

XIV. PREPAYMENT PENALTIES AND DUE-ON-SALE

A final topic of controversy in the due-on-sale area has been whether or not a lender can demand a prepayment penalty while accelerating a debt under an alienation clause. To borrowers, this is like a "double whammy." 1983 has seen some clarification of the law on this topic, but several issues in this area are still unsettled.

Of course, the basic rule in California is that, absent applicable state statute or federal regulation, a lender may demand that a loan be paid according to its terms, although the lender may offer (if the lender chooses) an option to the borrower to prepay provided that the borrower tenders any prepayment charge or penalty specified in the loan documentation. Prior to the Act, California passed legislation limiting lenders' prepayment penalty rights as to certain kinds of properties and certain types of borrowers.

In Tan, the controversy was addressed for the first time by a state appellate tribunal. Transferees of property encumbered by a trust deed with a due-on-sale clause brought an action primarily seeking declaratory and injunctive relief against a federal S&L which not only accelerated the loan on transfer but also demanded a prepayment penalty under a provision in the note. The lower court sustained the

217. CAL. CIV. CODE § 2954.9 (West Supp. 1979); CAL. BUS. & PROF. CODE § 10242.6 (West Supp. 1980).
219. The Tan note provided that:
The undersigned [promissor] reserve(s) the privilege of prepaying all or any part of the principal of this Note on any regular payment date; provided, however, that when the aggregate amount prepaid in the prior twelve (12) month period plus the amount of the present prepayment exceeds twenty percent (20%) of the original principal amount of this Note, the undersigned agree(s) to pay the Association concurrently with and in addition to such prepayment an amount equivalent to six (6) months' interest on the amount by which such aggregate amount prepaid (including the present prepayment) exceeds twenty percent (20%) of the original principal amount of this Note at the rate of interest prescribed herein.

Id. at 802 n.1, 189 Cal. Rptr. at 777 n.1.
lender's demurrer. On review of the order of dismissal, the Fourth District Court of Appeal, as part of the same opinion wherein it upheld the lender's right to accelerate under the pre-Regulation due-on-sale clause contained in the note and deed of trust, refused to permit the lender to collect the prepayment penalty on top of the remaining loan balance: "California Federal having exercised the due-on-sale clause, accelerated the due date of the loan and demanded full payment, the entire unpaid balance was due under the note itself and there was no prepayment to which the prepayment penalty would attach." 220

Analyzing the wording of the prepayment penalty involved, 221 the Tan court observed that the language "clearly [made] a prepayment penalty payable only upon the debtor's exercise of the reserved privilege to prepay." 222 Where, at least according to the pleadings, the plaintiffs paid or proposed to pay because of the loan acceleration under the due-on-sale clause rather than as a voluntary exercise of their prepayment privilege, 223 "no prepayment penalty or premium was payable under the terms of the note." 224

Because the loan documents in that case pre-dated the 1976 Regulation, the court in Tan did not discuss the portion of the Regulation which prohibited a lender from collecting a prepayment penalty when accelerating under an alienation clause on owner-occupied property. 225 As it turns out, the Final Rule changed that part of the Regulation. The Board de-

220. Id. at 809, 189 Cal. Rptr. at 782.
221. Id. at 809-10, 189 Cal. Rptr. at 782.
222. Id. at 809, 189 Cal. Rptr. at 782.
223. Id. at 809-10, 189 Cal. Rptr. at 782.
224. Id. at 810, 189 Cal. Rptr. at 782. In so deciding, the court also rejected the lender's contention that it could collect the penalty under a "default provision"—authorizing lender acceleration of "the entire principal balance, interest and other charges (including prepayment charges) relating thereto" if a payment was in default—where there was no payment default but solely a transfer triggering the due-on-sale clause. Id.
225. See 12 C.F.R. § 545.8-3(g)(2) (January 1, 1982). Nor, interestingly enough, did the court discuss the regulatory provision which stated that the Board "look[ed] with disfavor" on the use of a prepayment penalty together with a due-on-sale clause in pre-Regulation loans. Id. at § 556.9(b)(1). See generally Callahan, Prepayment penalties after due-on-sale enforcement, 5 First Tuesday 27, 29 (1983). By way of comparison, one recent California case found that this state could impose rules against even federal associations as to pre-Regulation loans. Garrett v. Coast Fed. Sav. & Loan Assoc., 136 Cal. App. 3d 266, 186 Cal. Rptr. 178 (1982) (liquidated damages limitations).
terminated to eliminate a provision of its proposed rule totally precluding the imposition of prepayment penalties and decided instead to limit the imposition of prepayment penalties to "loans originated by federal associations after July 31, 1976, and prior to the [May 10, 1983] effective date of the [final rule]."227

After only two months, the Board had received such extensive criticism of the May version of the Final Rule's prepayment language that it reconsidered the May pronouncement and decided to forbid the imposition of prepayment penalties or acceleration by any lender except those lenders who relied on the pronouncement and actually imposed prepayment charges between May 13 and July 13 of this year.228

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227. Id. This now appears in the regulatory framework of new 12 C.F.R. § 591.5(b)(2)(i) (1983). The Final Rule added two restrictions. First, all lenders seeking to collect such prepayment charges in a due-on-sale context must comply with the pre-disclosure requirements related thereto as imposed on federal associations. 48 Fed. Reg. at 21,559-60, introducing new 12 C.F.R. § 591.5(b)(2)(ii) (1983). Such requirements are contained in 12 C.F.R. § 545.33(f)(1)(ii) (1983). Secondly, "lenders must consult state law to determine the validity of [their prepayment] practices [in connection with loan acceleration]," because the Board did not elect to preempt state practices on that subject. 48 Fed. Reg. at 21,560. The new regulatory material makes it clear that the term "lender" as used in this provision of the Final Rule applies to all individuals and entities who would be lenders under the Act. 12 C.F.R. § 591.2(g) and (1) (1983).


229. Id.

230. The July regulation terms this two month time frame a "grace period." Id. at 32,162. In the May promulgation, the Board had stated:

The Board notes that . . . when mortgage instruments contain both a prepayment penalty and a valid due-on-sale clause, the courts have denied enforcement of the prepayment penalty upon a sale by a mortgagor . . . . The rationale is that the lender's election to accelerate [in such cases] renders the payment a "postpayment"—one made after maturity of the loan—that by definition is not a "prepayment" of the mortgage debt.

Id. at 21,560. This was, of course, the rationale in Tan. See supra notes 218-24 and accompanying text. The July pronouncement noted this language and, without citation of authority, came to a conclusion that "the courts have denied enforcement of a prepayment penalty" on this basis in the due-on-sale context. 48 Fed. Reg. at 32,161.
XV. PLANNING FOR TRANSACTIONS WITH POSSIBLE DUE-ON-SALE PROBLEMS: STRATEGY, HINTS, AND PRACTICAL SUGGESTIONS

A. Counsel Should Review the Note, Deed of Trust and/or Other Applicable Loan Documents

Most notes and deeds of trust now utilized by institutional lenders and many drafted for private parties include alienation clauses, typically worded quite broadly. A careful review should be made in each instance, since the applicable provision not only must be in the loan documents to be effective231 but must be phrased so as to encompass the transfer involved. Moreover, under California statutory law, a due-on-sale clause is not effective in a note/deed of trust context unless it is in both such documents,232 although that legislation may now be viewed as preempted by the Act and/or the Final Rule as to all lenders except possibly on certain window period loans.

B. Counsel Should Urge Brokers and Principals to Document in Complete Detail All Future Communications With Lenders

In order to support their position in any future litigation and to enhance their position in negotiating with lenders, both brokers and principals should make it a practice to write down the details of, and keep complete files on, all communications with lenders. Counsel should explain that the facts needed to establish defenses (or, for example, to persuade the trial courts of the degree of lender knowledge or of borrower reliance) must be proven. Therefore, in cases where the decision may turn on a finding of the parties' intent or awareness of a given event and its implications, detailed record-keeping may result in preservation of the documents that carry the day.

C. Brokers' and Escrowholders' Standard Documents

Most listing agreements, deposit receipts, and standard general escrow instructions in use in California in recent years

231. Section 341, supra note 3, at (b)(2).
232. See supra note 181.
have included substantial pre-printed sections with terms commonly repeated in documenting the respective relationships of seller/broker, buyer/seller, and buyer/seller/escrowholder. Many of those standard documents have been modified in recent years to include, in the boilerplate or by express addition of the contracting parties, provisions warning of the general risks that a due-on-sale clause “may exist” in an instrument of record, sometimes accompanied by a general recommendation that the principals consult with legal counsel on any due-on-sale issues. After de la Cuesta, the Act and the Final Rule—which have heightened the risk factors—the role of the broker, and perhaps also the escrowholder, as a fiduciary to the principals may have expanded so that the caveats in the documents such an agent prepares should be clear and tailored to the exact problem involved. This is particularly true now that Assembly Bill 3531,83 enacted late in 1982 but delayed in effectiveness to July 1, 1983, has by statute imposed on real estate licensees and other “arrangers of credit”234 a whole new series of “creative financing” disclosures for certain transactions in one to four unit properties.

If potential window period loans are involved in a transaction, the deposit receipt or purchase and sale contract, and perhaps escrow instructions, should state explicitly that the exact beginning of the window period in California has yet to be finally determined by the courts of this state; and as a consequence, which loans are included in that category remains unclear. Likewise, such documents should recite that subsequent action by the state legislature or other applicable regulatory body could preclude future assumability by a possible purchaser from the present buyer. The parties should signify in writing their understanding of this specific problem, perhaps by initialling such language on the deposit receipt and also initialling copies of any beneficiary statements received pertaining to the affected loans, as well as by signing any disclosure statements235 required to be prepared by the “arranger of credit” under Assembly Bill 3531.

A vague warning is not enough. Indeed, while brokers and escrowholders have inserted, sometimes innocuously and

234. Id. at § 2967.
235. Id. at § 2969.
sometimes more glaringly, disclaimers of responsibility and hold harmless language in order to protect themselves from later criticism by the principals relative to the due-on-sale issue, such disclaimers may prove to be less effective now unless these fiduciaries document further the fact that they have explained in detail the types of risks involved, even if the principals had independent counsel review the transaction expressly with due-on-sale concerns in mind. 236

Counsel should also point out to their clients that many transactions which do not customarily proceed through sale escrows will now be subject to due-on-sale concern. Long term leases or those with options to purchase, various family transfers and, quite possibly, many junior encumbrances 237 create

236. One author suggests that both buyer and seller sign the lender's beneficiary statement to signify that they have read it (and, presumably, that they comprehend the risks signified by the due-on-sale clause in the loan documents to which it pertains). Crane, supra note 70, at 24.

237. With respect to the risk of acceleration on a junior encumbrance, one author has remarked:

Although the FHLBB has attempted to withdraw the protections of § 341(d) from commercial borrowers, the restrictions against enforcement on creation of a junior encumbrance (§ 341(d)(1)) may still be available to borrowers with respect to California property. The Act only preempts state law with respect to the enforcement of a due-on-sale clause. (Emphasis added) . . . Although the FHLBB has adopted an expansive definition of "sale or transfer" in the regulations, even this definition appears to be limited to sales or transfers of the type usually associated with a transfer of possession rather than a transfer of an interest only for the purpose of financing.

If the definition of a due-on-sale clause in § 341(a)(1) is correctly construed as not extending to further encumbrances, then the question arises why Congress felt it was necessary to enact § 341(d)(1) to prohibit acceleration on further encumbrance. There are two possible explanations. One is that Congress, although believing that the definition in § 341(a)(1) was broad enough to include further encumbrances, wanted to create a uniform national rule that no lender could accelerate a loan merely because of a junior encumbrance, regardless of any state laws permitting such acceleration. The second possible explanation is that Congress intended the definition in § 341(a)(1) not to extend to further encumbrances but enacted § 341(d)(1) only as a safeguard to make it clear that the Act did not intend to permit acceleration on further encumbrances, regardless of the interpretation that might be placed on the due-on-sale definition in § 341(a)(1).

If the definition of due-on-sale in § 341(a)(1) does not extend to further encumbrances, then the Act would not preempt state law restrictions on due-on-encumbrance clauses and, even without the protections of § 341(d), California borrowers would still be protected by the restrictions enunciated by the California Supreme Court in La Sala v. American Sav. & Loan Ass'n (1971) 5 C3d 864, 97 CR 849.
distinct risks of loan acceleration.

D. Who Bears the Risks: It Should Be Clearly Spelled Out in the Contract Documents between Buyer and Seller

Far too often in the past, the fiduciaries limited their documentary references to due-on-sale to the aforementioned disclaimers and nothing was set out in the parties' paperwork specifying what would happen, and who would bear the risks, if lenders attempted to enforce alienation clauses on the immediate or subsequent transfers. Some advisors were later sued for not adequately explaining such risks,\textsuperscript{338} risks which became fully evident to all concerned only after the lender de-

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The possibility does exist, however, that § 341(b) will be construed broadly enough to cover further encumbrances. If such an interpretation prevails, and the regulations are upheld in restricting § 341(d) protections to owner-occupied properties, then any junior financing on commercial properties could cause the senior loan to be accelerated, assuming the actual due-on-sale clause in the senior deed of trust is broad enough to cover further encumbrances. Consequently, it is now necessary for attorneys immediately to review the due-on-sale provisions for their clients with commercial property in order to determine whether the clauses do contain such language. If the clauses do contain further encumbrance language, and refinancing is contemplated, the attorney must advise his client that, if the regulations are valid and if § 341(b) can be construed to preempt state law even as to due-on-encumbrance clauses, the lender may call the loan.

Rader, \textit{supra} note 120, at 97-98.

238. Some brokers have also been named as defendants or cross-defendants when lenders pursued borrowers for back interest on "undisclosed" transfers and the borrowers asserted reliance on their advisors' assurances that such "hidden" conveying was safe. Crane, \textit{supra} note 70, at 24. Suits against realtors increased significantly as the "creative financing" phenomenon, which was developed in large measure in Southern California with broker involvement, began to decline during the last two years, notably the same time period as the economic recession reduced values and \textit{de la Cuesta} and the Act improved the lenders' due-on-sale position. See The Wall Street Journal, Sept. 1, 1982, at 19, col. 1. In reference to many types of problems, particularly balloon payments that cannot be met, agents "are being sued for negligence and, in a few cases, fraud." \textit{Id.} What is even more noteworthy about these problems in California is the fact that this state imposes broad fiduciary obligations upon brokers and agents. \textit{Id.} While no reported case has yet held a broker liable for improperly advising principals how to deal with a lender's due-on-sale clause, the risk is growing. In Pepitone v. Russo, 64 Cal. App. 3d 685, 134 Cal. Rptr. 709 (1976), a broker was held liable to the purchasers of a motel on a fraudulent breach of fiduciary duty theory for failing to disclose the existence of "an acceleration clause" in a second deed of trust which encumbered the motel at the time of acquisition by said purchasers. One treatise has described the clause as a "due-on-sale" clause. C. GRAHAM & C. SCOTT, \textit{CALIFORNIA REAL PROPERTY SALES TRANSACTIONS} § 2.100, at 142 (CEB 1981). Although the court in \textit{Pepitone} did not have to so rule, it seems that damages could also have been awarded in that case on a negligence theory.
manded full payment or a stiff hike in the interest rate. These actions have proliferated as the "creative financing" bubble has begun to burst. To avoid such disastrous results in future transactions, brokers should be sure to spell out before the deal closes—in deposit receipts, escrow instructions and/or carryback land contracts or notes and deeds of trust—their joint answers to at least the following types of questions:

1. If the lender accelerates, who will decide whether to litigate, arbitrate or negotiate and who will pay the costs (including all attorney fees that might be involved, by contract or by court award)?

2. If a modification of the note or other evidence of indebtedness in controversy is agreed to, who will pay the increased interest, if any, and who will pay the other loan charges involved?

3. If a refinance is required, who will pay the loan fees and who will pick up the cost of any additional interest charged on the new loan over that resulting on the replaced loan?

4. If another party of record has a deed of trust which would have to be discharged or subordinated to accommodate a refinance, who will negotiate with and pay any consideration demanded by such party?

5. If the seller is "carrying back paper" by way of equity in a land contract or in a junior deed of trust (all-inclusive or otherwise), will the seller agree to subordinate to refinancing as necessary to replace the accelerated senior lien and, if so, will this be true for subsequent transfers during the entirety of the carryback period?

6. What other items of, and rules for, cooperation will be mandated when the due-on-sale problem surfaces; and

7. What remedies will be available against the party who breaches his promises in this area?

Moreover, in long-term leases or those with purchase op-

241. Assembly Bill 3531 provided that such disclosure was mandatory commencing on July 1, 1983 as to dwellings for not more than four families where an all-inclusive trust deed is utilized. Cal. Civ. Code § 2963(f) (West 1982). Remarkably, while land sales contracts are mentioned in other disclosure provisions of that law, for some reason they are not referenced in the segment dealing with due-on-sale. (e.g., Cal. Civ. Code § 2963(h)).
tions, possible due-on-sale problems should now be addressed. And consideration should be given to the risks created by junior financing, at least until California law regarding the effect of the Act and the Final Rule on this issue is made clear.

E. Private Lender Due-On-Sale: Parameters of Consent Should Be Clearly Outlined in Advance

Where a due-on-sale clause in carryback or other private financing is of the type in which the lender agrees to render credit or otherwise analyze a prospective assumption and/or not to unreasonably withhold consent to a transfer, specific examples of what is acceptable should be set out in the documents to avoid ambiguities and to prevent abuses. For example, it would be beneficial to agree in writing as to what actually comprise such lender’s “customary” standards or what the parties believe to be the “credit standards customarily applied by other similarly situated lenders or sellers in the geographic market within which the transaction occurs.” 482 Advi- sors to buyers should make sure that their clients are warned accordingly, and advisors to sellers should clarify just what credit practices their clients follow or deem appropriate.

XVI. Conclusion

The de la Cuesta decision and the Act, two events of substantial effect on real estate financing occurring within a short time span, already have had enormous impact on the marketing of real property in California and throughout the United States. The Final Rule seems destined to follow suit. The short-term perspective resulting from these developments is that certain types of encumbered property, those with existing loans clearly within the window period (and especially if the lenders originating those loans or individuals or other parties not covered by the Final Rule), have been favored over others, even if the encumbrances on each contain due-on-sale language. The long-term perspective is less clear, since the future direction of real property financing will depend on a combination of factors—including general economic conditions and the outcome of possible lawsuits challenging the validity of the due-on-sale features of the Act and/or the Final Rule and

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addressing the few issues as yet left unsettled.

Probably the single most troublesome due-on-sale issue for the practitioner at this time is analyzing the effect of the Final Rule on his practice. Since that regulatory action limits the exemptions of section 341(d) of the Act to owner-occupied single family dwellings, will counselors be compelled to have their clients seek waivers from lenders on every estate plan, trust, marital agreement, entity buy-out, long-term office lease or other circumstance where real property or a significant interest therein is an asset to be transferred? Will it amount to malpractice for an attorney to do otherwise? Similarly, when a client seeks to place a junior lien on his property, must counsel insist on disclosure to and a waiver from the lender? The answers to these practical questions will take some time to evolve.

Meanwhile, as new financing instruments become more prevalent and gain acceptance—most entailing earlier maturity dates, short-term call privileges for the lender, variable or renegotiable interest rates and other substitutes for due-on-sale clauses as the means by which lenders can maintain the bulk of the loans in their portfolios at relatively current interest rate levels—it seems likely that these concerns as well as the problems dramatized in de la Cuesta and responsible for the passage of the Act will reduce in intensity and notoriety.2

243. Perhaps the most serious economic problems facing the lending and real estate industries in the last couple of years were “tight” money, the high cost of funds when available and weakness of the institutional lending community. Justice Clark in his dissenting opinion in Wellenkamp ironically predicted many of these economic woes, warning that “tight money” would be more likely as a result of the approach sanctioned by the majority opinion in that case:

We have thus come full circle. In attempting to take away contractual rights of lenders in order to assist borrowers in selling encumbered properties, the majority opinion has devised a scheme which affords yesterday’s borrowers a clear advantage over today’s seller who comes to the marketplace with his property free from encumbrance. But our beneficence may be shortsighted [as] the majority opinion must necessarily restrict if not dry up mortgage funds . . . .

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

Numerous authors have analyzed the effects of California’s due-on-sale law in light of Justice Clark’s comments and the reasoning of the majority in Wellenkamp. Some of the better analyses are contained in HUD Office of Policy Development and Research, An Economic Analysis of Due-on-Sale Clauses (1981); Monograph No. 14, Krannert Graduate School of Management, Purdue University Credit Research Center (1979); Task Force Report on Due-on-Sale, Economics of Due on Sale,
that alternative instruments of financing, other than conventional, assumable, fixed-rate, 30-year loans do work fairly well, and properties can be marketed with such alternative financing.

Yet American homebuyers and investors have an undeniable partiality for the fixed, long-term mortgage; and the majority of borrowers will continue to opt for that traditional vehicle rather than alternative financing whenever offered. The availability of both choices will depend in large measure on lender liquidity, their overall fiscal condition, the general economic climate and the reasonableness of lenders in acting under the Final Rule.

At the same time, it seems fairly clear that the “creative financing” phenomenon which dominated the late 1970’s and early 1980’s will also be redirected. Seller agreements to carryback loans will no longer “plug the gap” for every faltering deal. Instead more and more realistic valuations will be ascribed to properties than were assumed to be applicable in the highly optimistic but perhaps overheated days of the last few years. Such valuations will be based less upon Welenkamp rights than upon traditional factors such as location and income potential. Parties will, with increasing frequency and hopefully increasing clarity, define their rights and obligations relative to the risks associated with senior lienors calling loans pursuant to due-on-sale clauses. Inevitably, more carry back financing will itself contain due-on-sale language.

As a result of these monumental changes in due-on-sale and the new realities of the marketplace, real estate financing is beginning to assume a fresh set of guidelines. Long-term holding of properties instead of rapid turnover is again likely to be the norm. The expectations of the real estate profession and the general public have been revised and, in many instances, moderated after the exaggerated successes of real property investments in the late 1970’s. The secondary mortgage market lenders and mortgage bankers have expanded their roles. As part of this picture, a sense of cooperation

FHLBB J.16 (March 1982); USC Monograph, The Economic Effects of Due-on-Sales Clause Invalidation (Feb. 1982).


245. See, e.g., Blevins, Mortgage lending in transition, 5 First Tuesday 21
and balance, rather than antagonism, between lenders and the rest of the real estate community has begun to be evident.

As the economic recovery continues,\(^{246}\) housing starts\(^{247}\) and investor attraction to office building investment\(^{248}\) once again attain significant levels, and federal monetary policy has become relatively moderate,\(^{249}\) it is apparent just how enormous the change of perspective has been over the last year and one half. The improvement of lenders' due-on-sale rights, although having substantial short-term impact in the California market, has actually caused far fewer difficulties than might have been the case had *de la Cuesta* been decided in the earliest days of the current recession or had the due-on-sale features of the Act not been combined with the further deregulation of the lending system which was part of the Act. With reduced assumability, prices could have plummeted had there not simultaneously been some general economic recovery in the non-real estate sector.

While few have buoyantly predicted another imminent real estate boom, and while many analysts are understandably hedging about the size and timing of the next growth phase for the industry, guarded optimism certainly seems justified.\(^{250}\) In all events, however, one conclusion is unmistakable: in real property finance in general and in the due-on-sale area in particular, we are truly witnessing the "dawn" of a whole new era.

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248. 5 *REAL ESTATE OUTLOOK* 1, col. 2 (1983).

249. See supra note 30 and accompanying text.
