UIC Law Review

Volume 15 | Issue 2 Article 5

Spring 1982

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EPILOGUE: *WELLENKAMP v. BANK OF AMERICA*

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In 1979 this author's article on the due-on-sale clause was published.[1] The article was sharply critical of *Wellenkamp v. Bank of America*.[2] This decision involved an attempt by a lender to accelerate a mortgage containing a due-on-sale clause when the parties, upon a sale subject to the mortgage, declined to agree to an increase in the interest rate. The buyer brought an action seeking injunctive and declaratory relief against the lender. The California Supreme Court held that the lender could only exercise the clause upon a showing that it was necessary to protect the lender against an impairment of the lender's security.[3] This thinking was superimposed upon a clause devoid of any such limitation. The decision could have been written without leaving the confines of a modest law library, since it approached the problem by dealing with the venerable doctrine of restraints on alienation.[4] The world outside, the grim world where thrift institutions, the big users of the due-on-sale clause, were and are threatened with calamitous insolvencies, was al-

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1. Kratovil, *A New Dilemma for Thrift Institutions: Judicial Emasculation of the Due-on-Sale Clause*, 12 J. Mar. J. Prac. & Proc. 299 (1979) [hereinafter cited as *Due-on-Sale*]. A question frequently arises concerning the validity in the mortgage of a due-on-sale clause permitting the mortgagee to declare an acceleration of the mortgage debt in the event of a sale of the property by the mortgagor where the buyer does not pay off the old mortgage. The mortgagee's ability to accelerate forces a purchaser either to agree to a higher interest rate or seek alternate financing.

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

3. *Id.* at 953, 582 P.2d at 976-77, 148 Cal. Rptr. at 385-86. In the usual case, the seller is able to obtain full payment and pay off the mortgage because the buyer has secured independent mortgage financing. In *Wellenkamp*, however, tight money precluded new financing. The buyer wanted to pay the seller only the amount of the seller's equity and assume the remaining debt. *See generally Due-on-Sale*, *supra* note 1, at 306-11.

The reasons that lenders hesitate to lend unless the due-on-sale clause can been enforced is at least two-fold: substitution of a mortgagor who is not a good financial risk; and the thrift institution's interest in improving their yield by upgrading loan portfolios. It could be argued that the interest rate on the initial loan would be higher if lenders knew they could not enforce the due-on-sale clause upon a subsequent sale.

4. *Id.* at 948-49, 582 P.2d at 973-74, 148 Cal. Rptr. at 382-83.

most entirely ignored. The author's article made this point: "Surely sound public policy must take account of the need for the continued existence of financial institutions willing and able to finance the purchase of homes."[5]

Since *Wellenkamp* was decided, much has happened. A number of new alternative mortgage instruments have made their appearance, among them the: Adjustable Rate Mortgage;[6] Shared Appreciation Mortgage;[7] Graduated Payment Adjustable Mortgage;[8] and, Price Level Adjusted Mortgage.[9] The terse conjecture in *Wellenkamp* that the old Variable Rate Mortgage (VRM)[10] contained a solution to the lender's portfolio[11] problems appears, therefore, to have been wide of the mark.

An *American Law Reports* annotation addressing the due-on-sale controversy has appeared[12] as well as a collection of all authorities on this subject in the *Legal Bulletin*.[13] Of particular concern is the problem of federal preemption. The focal point of the controversy is whether Federal Home Loan Bank Board (FHLBB) regulations protecting due-on-sale clauses in mortgages by federal savings and loan associations[14] may be overridden by state laws forbidding such clauses. As is evident from the *Legal Bulletin* articles and case references, all the numerous

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5. *Due-on-Sale*, *supra* note 1, at 309.

6. The Adjustable Rate Mortgage is similar to the present fixed mortgage except that the interest rate varies (either without limit or limited to plus or minus two percentage points) per adjustment period. *See* Invitation: FHLMC Adjustable Rate Mortgage Pilot Purchase Program (July 1, 1981).

7. The Shared Appreciation Mortgage allows the lender to share in the appreciation of the property when sold. In return the lender makes a fixed interest loan at a lower than market rate. *See generally* Comment, *The Shared Appreciation Mortgage: A Clog on the Equity of Redemption*, 15 J. MAR. L. REV. 175 (1982).

8. A fixed interest rate mortgage with a modified payment schedule, where the monthly payments start low and increase over the years, presumably with the increased income of the borrower. *See* R. KRATOVIL & R. WERNER, MODERN MORTGAGE LAW AND PRACTICE 463-68 (2d ed. 1981).

9. Fixed interest rate but the outstanding principal varies with some price index. *Id.* at 472.

10. The VRM is similar to the present fixed mortgage except that the interest rate varies within limits per adjustment period to reflect changes in the market rate of interest. One of the main weaknesses of the VRM was that the lender also had to offer the borrower the option of a fixed rate mortgage. *Id.* at 456-60.

11. Wellenkamp v. Bank of America, 21 Cal. 3d at 952 n.10, 582 P.2d at 976 n.10, 148 Cal. Rptr. at 385 n.10.

12. Annot., 69 A.L.R. 3d 713 (1976) (this will enable practititioners to keep up with the decisional law).

13. XLVII LEGAL BULL. 275, 278 (1981) [hereinafter cited as LEGAL BULL.] (published by the U.S. League of Savings Associations).

14. 12 C.F.R. § 545.8-3(f), (g) (1979). The FHLBB has had these regulations in effect since 1976.

federal decisions sustain federal preemption.[15] While some state courts have upheld the validity of the due-on-sale clause,[16] other state courts have chosen to follow *Wellenkamp*,[17] many going so far as to adopt statutes that in one way or another fetter the operation of the due-on-sale clause.[18] Recently, the United States Supreme Court agreed to hear a case which may settle the issue of federal preemption concerning federally chartered savings and loan associations.[19]

In the meantime, the thrift industry continues to wallow in a financial morass. The Federal Home Loan Bank Board (FHLBB) admits that the closings of insolvent savings and loan associations will continue. Many are running in the red; some weak or insolvent associations have been merged into stronger associations. Fears of continued financial trouble continue.[20]

A report was prepared for the Department of Housing and Urban Development (HUD) on the subject.[21] The article reflects

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15. *See* First Fed. Sav. and Loan Ass'n of Gadsden County v. Peterson, 516 F. Supp. 732 (N.D. Fla. 1981); Collins v. First Fed. Sav. and Loan Ass'n of Walla Walla, No. C-80-334 (E.D. Wash. May 14, 1981); Nalore v. San Diego Fed. Sav. and Loan Ass'n, Cir. No. 77-0660-N (N.D. Cal. 1979); Bailey v. First Fed. Sav. and Loan Ass'n of Ottawa, 467 F. Supp. 1139 (C.D. Ill. 1979), as examples of federal cases recognizing federal preemption of due-on-sales clauses. For a more complete listing of federal decisions upholding, and state decisions upholding and rejecting federal preemption *see* LEGAL BULL., *supra* note 13, at 275-86 (1981).

16. *Id.* at 278. For example, decisions in Alabama, Louisiana, Illinois, New Jersey and New York have upheld due-on-sale clauses.

17. *See, e.g.*, Patton v. First Fed. Sav. & Loan Ass'n of Phoenix, 118 Ariz. 473, 578 P.2d 152 (1978); Fidelity Sav. & Loan Ass'n v. De La Cuesta, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981), *prob. juris. noted*, 50 U.S.L.W. 3490 (U.S. Jan. 25, 1982) (No. 81-750) (likely to address the federal preemption question concerning *federal* associations); Nichols v. Ann Arbor Fed. Sav. & Loan, 73 Mich. 163, 250 N.W.2d 804 (1977); First Fed. Sav. & Loan of Engelewood v. Lockwood, 385 So.2d 156 (Fla. D.C.A. 1980). *But see* First Fed. Sav. & Loan Ass'n of Gadsden County v. Peterson, 516 F. Supp. 732 (N.D. Fla. 1981) (recognizing validity of due-on-sale clause and federal preemption). *See also* LEGAL BULL., *supra* note 15, at 279.

18. *See* CAL. CIVIL CODE §§ 711, 2924.6 (West 1979); COLO. REV. STAT. § 38-30-165 (1978); GA. CODE § 67-3002 (1981 Supp.); IOWA CODE § 535.8 (West Supp. 1980); N.M. STAT. ANN. § 48-7-12 (1981 Supp.). *See also* Newsletter by United States Savings & Loan Associations (Jan. 14, 1982) (citing state statutes, and state and federal cases pertaining to due-on-sale clauses).

19. Fidelity Fed. Sav. and Loan Ass'n v. De La Cuesta, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981), *prob. juris. noted*, 50 U.S.L.W. 3490 (U.S. Jan. 25, 1982) (No. 81-750). Regardless of how *Fidelity* is decided with respect to preemption over federally chartered savings and loan associations, Congress would not be precluded, subsequently, from enacting legislation preempting state law. *See supra* notes 14-18 and accompanying text, and *infra* note 23 and accompanying text.

20. Hill & Gigot, *Federal Regulators Are Said to Sanction Mergers Among Ailing Savings and Loans*, Wall St. J., Feb. 18, 1982, at 4, col. 1.

21. B. Preiss and R. Van Order, An Economic Analysis of Due-on-Sale Clauses (1981) (prepared by the Office of Pol'y Dev. and Research, U.S.

the importance of the due-on-sale clause, concluding that fettering of the due-on-sale clause "would have a significant adverse effect on savings and loan earnings and ultimately net worth."[22]

In addition, a bill was recently introduced in Congress that would permit federally chartered thrift institutions to enforce the due-on-sale clause.[23] Speaking to this bill, Paul A. Volcker, Chairman, Board of Governors of the Federal Reserve System, made this comment to the Committee on Banking, Housing, and Urban Affairs, U.S. Senate, October 29, 1981:

> Section 141 would permit depository institutions, state law notwithstanding, to enforce due-on-sale clauses in mortgage instruments. For the majority of Board members, the reluctance to preempt state law is in this instance more than offset by a sense of urgency growing out of the strongly adverse effects on the soundness of thrift institutions of failure to enforce due-on-sale clauses. Inability to enforce contractual due-on-sale provisions, agreed to by the borrower in undertaking the mortgage commitment, has slowed the turnover of low-yielding mortgages in institutional portfolios precisely at the time when earnings pressures are so strong as to threaten the viability of many thrift institutions. Indeed, the net result of failure to enforce due-on-sale clauses may be to restrain the provision of new fixed-rate mortgages more than would otherwise be the case in today's markets.[24]

One could not possibly learn from *Wellenkamp* that its holding would "threaten the viability of many thrift institutions." It is regrettable that in this day and age, when we are encouraging our law students to analyze court decisions in the light of their financial and economic setting and impact, a major court could hand down a decision so totally lacking in insight. The present activity in the legislative and judicial spheres are encouraging indicators that common sense public policy may eventually prevail.

Dept. of Housing and Urb. Dev.). The authors conclude that "there is no compelling reason to . . . prohibit due-on-sale clauses." *Id.* at 2.

22. *Id.* at 18.

23. S. 1720, 97th Cong., 1st Sess. § 141, 127 CONG. REC. 11,257 (1981). In addition to the bill's limitation to federal associations, it also provides the states with an opt-out provisions through state law or voter referendum. *Id.*

24. 67 FED. RES. BULL. 840 (1981).