Enforceability of Mortgage Due-On-Sale Clauses – An Update*

By John C. Murray**

Introduction

The Garn-St Germain Depository Institutions Act of 1982[1] (the "Act"), provides for the federal preemption of any limitations on the exercise of due-on-sale clauses imposed by state law.[2] Since the passage of the Act, mortgage lenders generally have assumed that they no longer need to concern themselves with potential legal challenges to the validity or enforceability of such clauses in their mortgage loan documents because of the Act's preemptive effect. However, this complacence may be misplaced. This article will discuss and analyze those situations where mortgagors may still attempt to challenge -- and perhaps limit or even avoid -- the enforceability of due-on-sale provisions in mortgage-loan documents.

Exemptions – Land Contracts v. Outright Transfer

When Congress preempted state limitations on due-on-sale clauses, it was concerned that some types of transactions, although they were technically transfers of interests in the security property, were not outright sales and therefore should not be permitted to trigger acceleration of the loan. Hence, in § 1701j-3(d) of the Act, Congress provided a list of exempt types of transfers. They include such transactions as transfers to a spouse or children of the borrower, transfers at divorce or death, the granting of a leasehold interest of three years or less not containing an option to purchase, and the like.[3]

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These exemptions are preemptive (in the sense that they apply even in the face of any contrary state law) but they apply only to loans on one-to-four-family residences. (Presumably Congress believed that commercial borrowers could negotiate their own exemptions without the assistance of the statute.) One of these exemptions is for "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."[4] Under this language, for example, a homeowner can obtain a home equity line-of-credit (“HELOC”) or other loan secured by a junior lien without worrying that doing so will trigger the due-on-sale clause in the first mortgage. This exemption is perfectly sensible. However, sometimes aggressive real-estate attorneys and brokers and their clients have attempted to apply the exemption to a sale of the property by real estate installment contract (referred to hereinafter as “land contract” or “contract for deed”), on the ground that such a contract does indeed create a lien or encumbrance subordinate to the first mortgage -- namely, the lien that the contract creates in the borrower-vendor to secure payment of the contract's selling price This ploy may become popular again if interest rates begin to rise.

Fortunately (at least for first-mortgage lenders), the law is settled that a land contract transfer constitutes a violation of a due-on-sale clause. The final regulations issued in connection with the Act define a "sale or transfer" as the conveyance of real property "or any right, title or interest therein, whether legal or equitable . . .," which includes “outright sales, deeds, installment sales, land contracts, 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.”[5] The final regulations also confirm that a sale of the property by land contract does not fall within the exemption for subordinate liens discussed above.[6]

The Federal Home Loan Bank Board ("Board") felt that this clarification was necessary for the reason that if a transfer by land contract were considered to be a subordinate lien or encumbrance under this section, a loophole might be created enabling sellers of residential property to avoid the enforcement of due-on-sale clauses by use of a land contract to sell the property instead of an outright conveyance.

In the normal land contract situation, the right to occupancy of the property would be granted to the purchaser at the time the contract was executed. Apparently the Board was concerned about the situation where, e.g., the borrower transfers all or part of the property to a purchaser by use of a land contract and the original borrower retains occupancy until the contract for deed is paid off, or agrees to transfer occupancy of the property upon the fulfillment by the purchaser of certain

conditions, such as the receipt of a stipulated portion of the payments due. The Board apparently also was concerned that a transfer of an interest in the property in this manner could be construed as a secondary lien or encumbrance and not as a transfer that would trigger enforcement of the due-on-sale clause.

For an interesting discussion and analysis of this issue, *see Darr v. First Federal Sav. & Loan Ass'n. of Detroit*.[7] In this case, the Michigan Supreme Court reversed the Michigan Court of Appeals and held that a land contract sale did not create a "lien or encumbrance subordinate to the mortgage" within the exclusion provision of the applicable due-on-sale clause in the standard FNMA/FHLMC mortgage, and therefore such a sale was subject to the clause. (The due-on-sale clause in the mortgage specifically excepted liens or encumbrances subordinate to the mortgage).The court noted that the fact that the land contract constituted a sale of the security was not disputed, and that even though an encumbrance may be adverse to the interest of the landowner when created in connection with a conveyance of real property, it does not conflict with the landowner's conveyance of the land in fee. The court also noted that the "lien or encumbrance" exception to the due-on-sale provision in the Act did not include liens created only as a result of the execution of a land contract that has as its primary purpose the transfer or sale of the secured property. Although the land-contract vendees in this case did not immediately assume the vendor's mortgage, this was only because the lender threatened to, and did, enforce the due-on-sale clause, and the land contract was in fact the instrument that created the obligation to assume the mortgage.

In 1985, Michigan enacted a statute that provides, with respect to a residential mortgage, that any licensed professional who "knowingly . . . aids or assists a person in evading the enforcement of a due-on-sale clause . . . shall be liable for a civil fine not to exceed $5,000.00 for each offense and shall be subject to revocation of his or her license."[8] Thus, real estate brokers and attorneys in Michigan who participate in concealing transfers of real property subject to a mortgage due-on-sale clause could be open to potentially substantial liability.

In *Moon v. Wilson*,[9] the Michigan appellate court held that the plaintiff broker was entitled to a commission even though the land-contract vendor argued that the land-contract sale violated the due-on-sale provision in the mortgage and that the broker assisted in the violation of the clause and was liable under the aforementioned Michigan statute, M.C.L.A. § 445.1628(2). The court, after noting that the vendor acknowledged that it was aware of no Michigan case law regarding the statute, rejected these arguments and concluded that:

> The fact that a mortgage lender is entitled to enforce a due-on-sale clause, MCL 445.1622, does not relieve defendant of the particular contractual obligation entered into in this case to pay the commission. In any event, defendant has failed to present evidence that plaintiff [broker] conspired with his counsel and defendant's

attorney to evade the enforcement of a due-on-sale clause in violation of MCL 445.1628(2).[10]

In an interesting (and unusual) decision, *Community Title Co. v. Roosevelt Federal Sav. & Loan Assoc.*,[11] the Missouri Supreme Court held that the mortgagee could not be held liable for tortious interference with a contract by rejecting title insurance from a title insurance company that encouraged the use of contracts for deed in order to avoid the enforcement of due-on-sale clauses. The court found that the mortgagee, as the beneficial party to the title insurance policy, had an economic interest in the proposed policy, and an economic interest in identifying those who sold or transferred an interest in property upon which the mortgagee held a deed in trust containing a due-on-sale clause.[12]

Due-on-Sale and Prepayment

A frequently litigated issue involves whether the mortgagee may charge a prepayment premium if it accelerates the loan as the result of the mortgagor's violation of the due-on-sale provision in the loan documents. The regulations that were issued in connection with the Act state that "[a] lender shall not impose a prepayment penalty or equivalent fee when the lender or party acting on behalf of the lender . . . [d]eclares by written notice that the loan is due pursuant to a due-on-sale clause or [c]ommences a judicial or nonjudicial foreclosure proceeding to enforce a due-on-sale clause or to seek payment in full as a result of invoking such clause."[13] Although the introductory comments to the regulations seem to make this language applicable to all loans, the language was placed in the section of the regulations limiting the enforcement of due-on-sale clauses only "[w]ith respect to any loan on the security of a home occupied or to be occupied by the borrower."[14]

Although this federal prohibition with respect to prepayment premiums would not appear to apply with respect to commercial loans, mortgage lenders nonetheless must still be careful to draft their prepayment-premium provisions to specifically state that the premium will be payable if the loan is accelerated by the mortgagee as a result of the mortgagor's default under any of the provisions of the loan documents (including violation of the due-on-sale clause). If the prepayment provision does not specifically provide that the mortgagee may collect a prepayment premium upon acceleration of the loan, a court may not permit the mortgagee to collect this charge. For example, in *Slevin Container Corp. v. Provident Federal Savings. & Loan Association*,[15] the Illinois appellate court held that in the context of a commercial loan, no prepayment premium may be imposed when the loan is accelerated for violation of a due-on-sale clause. Similarly, in *McCausland v. Bankers Life Ins. Co*.,[16] the Washington Supreme Court held, in a case involving acceleration of the debt as the result of the mortgagor's violation of the due-on-sale clause, that "[i]t is only fair that the

lender be prohibited from demanding prepayment fees upon acceleration of the debt since . . . it is the lender who is insisting on prepayment").[17]

On the other hand, a comprehensively drafted due-on-sale clause should enable the mortgage lender to avoid this issue (at least in a commercial loan). For example, in *Eyde v. Empire of America Fed. Sav. Bank*,[18] decided by the federal district court for the Eastern District of Michigan, the mortgagors argued that the mortgagee had accelerated the debt not because of a default in the payment of principal and interest, but as the result of the mortgagors' alleged violation of the due-on-sale provision in the loan documents. The court held that it was immaterial whether the loan had been accelerated for either reason, because the "clear intent" of the parties, as expressed in the prepayment-premium provision in the mortgage note, was that the mortgagee had the right to collect a prepayment charge in the event the debt was accelerated for any reason. The court, in distinguishing cases such as *Slevin Container Corp., supra*, found that the prepayment-premium provision was valid and enforceable because the parties had contractually agreed to allow the mortgagee to collect a prepayment premium in the event of any acceleration of the debt upon default by the mortgagor.[19]

Federal associations may, in any event, include prepayment premium clauses in commercial loan documents and enforce such clauses according to their terms regardless of any state law to the contrary (including equitable principles) because C.F.R. §§ 545.2 and 545.34(c), as amended at 49 F.R. 43044, authorize a Federal association to include a prepayment penalty clause in any loan it makes and to enforce such a clause in accordance with its terms regardless of any state law - including equitable principles in a foreclosure action - which purports to prohibit the collection of a prepayment premium under certain circumstances. The preemptive effect of these regulations applicable to Federal associations is subject only to the limitations with respect to loans secured by borrower-occupied homes found or referred to in 12 C.F.R. 545.34(c) (governing disclosure and the imposition of a prepayment premium after notice of an adjustment of an adjustable-rate mortgage) and the final rule regarding prepayment penalties with respect to residential property set forth in 12 C.F.R. 501(b). However, other federal legislation has limited or prohibited prepayment premiums or fees in connection with FHA loans.[20]

The Alternative Mortgage Transactions Parity Act of 1982[21] (“AMTPA”) preempted state with respect to certain “alternative mortgage transactions,” by which is meant virtually all manner of mortgage instruments that do not conform to the traditional fully-amortized, fixed-interest-rate mortgage loan. AMPTA, as originally adopted, regulated residential loans made by "housing creditors," permitted covered lenders to preempt state law restrictions on prepayment premiums and provided for the insertion and enforcement of prepayment premiums in "alternative mortgage" instruments such as adjustable-rate and balloon mortgages. At the time of enactment, states were allowed to opt out of

the preemption by enacting legislation within a three-year period, but only six did so: Arizona; Maine; Massachusetts; New York; South Carolina; and Wisconsin.

But pursuant to changes made by the Dodd-Frank Act,[22] enacted in 2010 in response to widespread disruption in the mortgage markets and the larger economy, AMPTA does not preempt "any State constitution, law, or regulation that regulates mortgage transactions generally, including any restriction on prepayment penalties or late charges."[23] The Dodd-Frank Act expanded a limitation already put in place by the Office of Thrift Supervision in 2003 with respect to national banks, which provided that AMPTA no longer preempts the applicability of state laws limiting prepayment premiums and late fees to state-chartered housing creditors.[24] Alternative mortgage transactions were defined under AMPTA to include adjustable rate mortgages, shared equity or shared appreciation mortgages, balloon mortgages, and negative amortization loans; however, the Dodd-Frank Act narrowed the scope of AMPTA to cover only adjustable-rate mortgage loans.[25] In addition to narrowing the scope of "alternative mortgage transaction" under AMPTA, the Dodd-Frank Act explicitly narrowed the scope of preemption under AMPTA, by limiting the scope of preemption to a law "that prohibits an alternative mortgage transaction" and by explicitly stating that a law "that regulates mortgage transactions generally" shall not be considered such a law that for preemption purposes.[26]

Mortgage lenders that are not subject to specific and exclusive Federal regulations regarding prepayment premiums should consult applicable state statutory and case law with respect to the enforceability of a prepayment-premium provision in connection with the breach by the borrower of a due-on-sale clause.

Agreement Not to "Unreasonably" Withhold Consent

The enforcement of a due-on-sale clause is always subject to contractual limitations contained in the mortgage provision. There is an area where tinkering with the contractual language that otherwise prohibits any unauthorized conveyance or transfer can get a mortgage lender in trouble; i.e., where the provision contains language that the mortgagee will not "unreasonably" withhold its consent. Does the use of such language prohibit the mortgagee from charging a transfer fee or an increase in the loan interest rate as a condition to giving its consent, or from withholding consent for a reason other than impairment of the security or failure of the proposed purchaser to meet the lender's creditworthiness standards?

The cases are divided as to whether the addition of language to the due-on sale clause providing that the mortgagee's consent will not be unreasonably withheld prohibits the mortgagee from imposing such additional requirements if they are not specifically stated in the provision. Cases have held that the language in the

due-on-sale clause that the mortgagee's consent "shall not be unreasonably withheld" did not preclude the mortgagee from withholding consent for a reason other than impairment of the mortgage security.[27] These cases often occur in connection with attempts by mortgage lenders to raise the interest rate of the loan as a condition of consent to the sale. For example, in *Torgerson-Forstrom H.I. of Wilmar, Inc. v. Olmstead Federal Savings. & Loan Association*,[28] the due-on-sale clause contained language that the mortgagee's consent to a transfer of the property would not be unreasonably withheld. The mortgagee conditioned its consent to a proposed transfer on a two-percent increase in the interest rate to the current market rate. The mortgagor alleged that the proposed purchaser was creditworthy, and that the proposed rate increase constituted a breach of contract and tortious interference with contract. The mortgagor conceded, however, that the interest-rate increase would cause the interest rate for the loan to equal the current market rate for similar loans. The Minnesota Supreme Court held that under the circumstances, the required increase in the interest rate was not an "unreasonable" condition to the mortgagee's consent to the transfer. The court, relying on a prior decision, *Holiday Acres No. 3 v. Midwest Federal Savings & Loan Association,*[29] found that it was a fact of life that mortgage lenders raise interest rates upon the transfer of the mortgagor's interest in the property.[30]

However, other cases have held that where the due-on-sale clause provides that consent shall not be unreasonably withheld, the mortgagee may not raise the interest rate or charge a transfer fee in the absence of specific language permitting the mortgagee to do so. For example, in *Newman v. Troy Savings Bank*,[31] the court held that it was unreasonable for the mortgagee to exact a transfer fee of one percent where consent was not to be unreasonably withheld or denied and there was no language in the mortgage providing for the payment of such a fee.[32]

In a recent case, *Saravia v. Benson*,[33] the due-on-sale clause in the deed of trust stated that:

> The Property may be sold to a subsequent buyer who assumes the Note with no change in interest rate or terms; provided the subsequent buyer obtains prior written consent from [the mortgagee]. Consent will be based on the subsequent buyer's credit history, and shall not be unreasonably withheld.

The lender, which did not seek to lift the automatic bankruptcy stay, argued that the property was never part of the borrower's bankruptcy estate because of the due-on-sale clause, and thus the bankruptcy court could not prevent the lender's pending foreclosure of the property. The Texas appellate court noted that due-on-sale clauses are valid and enforceable in Texas, but concluded that the due-on-sale clause does not prevent the transfer of title; it merely "provides that a sale of the property accelerates the debt, so that any outstanding amount is due and owing at the time of the sale."[34] The court ruled that:

> While a due-on-sale clause provides a basis for foreclosing a lien when the property is transferred to a bankrupt debtor without tender and a basis for lifting a bankruptcy stay, nothing in this record shows that [the mortgagee] sought to lift the automatic stay to allow the foreclosure to proceed. Because the bankruptcy court had not lifted the automatic stay, some evidence supports the trial court's finding that [the mortgagee's] first attempted foreclosure was invalid.[35]

The obvious solution to avoid a legal challenge is to draft the clause so that the "unreasonably withheld" language does not prohibit the mortgagee from raising the rate, charging a fee, or conditioning its consent on the approval of certain factors other than, or in addition to, the proposed purchaser's creditworthiness. For a drastic example of what can happen to a mortgagee when a due-on-sale clause contains only an agreement by the mortgagee not to unreasonably withhold its consent to an assignment and nothing more, *see Patel v. Gingrey*.[36] In this case, the Georgia appellate court held that an agreement by the lender merely not to "unreasonably" withhold its consent in the future with respect to a sale of the property, with no standards of reasonableness, was so uncertain, indefinite, and vague that it was subject entirely to conjecture and did not constitute an enforceable contract.[37]

Waiver and Estoppel

There are also cases that focus on whether the lender has delayed an unreasonable period of time after discovering the transfer but before accelerating the debt (whether or not the due-on-sale clause contains language that consent shall not be unreasonably withheld). Waiver or estoppel may also apply against the lender based on its statements or course of action before (or even after) the transfer of the property by the mortgagor, such as knowingly receiving and accepting mortgage payments from the transferee for a period of time after the unpermitted transfer.[38.]

Change in Entity Ownership, Equity or Control

Although most mortgage lenders do not choose to deliberately restrict or limit the application of a due-on-sale-or-encumbrance clause in a mortgage, these clauses are sometimes negotiated - especially in connection with commercial loans - to contractually exempt certain conveyances, such as estate-planning transfers, leases, and easements, or to permit certain "one time only" transfers or encumbrances (usually for a stipulated fee).

Furthermore, with the advent of securitized and conduit financing and the use of bankruptcy-remote borrowing entities to comply with rating-agency requirements, it has become more common for mortgage due-on-sale clauses to contain a "change of control" provision, i.e., a prohibition against certain "direct or indirect" changes in the equity ownership, control or management structure of the mortgagor (usually a limited partnership or limited liability company). This provision usually provides that if certain principal individuals or entities at any time own less than a specified percentage of the management, ownership, membership, general partnership, or voting interests of the borrowing entity, or if the borrowing entity sells, conveys, or assigns more than a specified percentage of such interests, a default will have occurred under the loan documents and the mortgagee may accelerate the loan. The parties of course heavily negotiate permitted transfers. Assuming that a senior mortgage note is securitized, rating agency affirmation may be required, even for permitted conveyances and transfers. Also, the lender on a junior note in a securitized transaction may want a separate approval right.

Provisions that prohibit or limit the change in ownership or control of the debtor have been enforced in the leasehold context. For example, in *In re Washington Capital Aviation & Leasing,*[39] the Virginia bankruptcy court held that language in the lease requiring the lessee-debtor's principal to control the lessee-debtor prevented a sale of stock in the debtor-lessee as a method of transferring its interest in the lease. Courts also will generally uphold an anti-assignment provision in a lease (or other agreement) where the language can be construed to apply to subsequent entity mergers and transfers "by operation of law."[40]

If the mortgage lender does not draft the due-on-sale clause specifically to include these types of equity and control transfers, a court may determine that such transfers do not constitute a violation of the clause. For example, in *Fidelity Trust Co. v. BVD Associates*,[41] the Connecticut Supreme Court held that a change of membership occasioned by the withdrawal of general partners of a limited partnership, which was a distinct legal entity and remained so after the change in the general partnership interests, was not sufficient to constitute a "sale or conveyance" under the applicable due-on-sale clause. And in *Hodge v. DMS Co.*,[42] the Tennessee appellate court held that in the absence of express language covering such a transfer, the withdrawal of two of the partners of the partnership mortgagor, while the business was continued in lieu of liquidation, did not amount to a sale or transfer of the secured property even though the entity had changed by operation of law, and did not activate the due-on-sale clause.

But where the language in the due-on-sale provision is clear with respect to equity and control transfers, courts generally have upheld enforcement of the clause. *See, e.g., Davis v. Vecaro Development Corp.*[43] In this case, the North Carolina appellate court held that while the transfer of a common interest in a condominium unit was between tenants in common, the clear language in the deed of trust provided that such a transfer invoked the due-on-sale clause, which

provided for an increase in the contract interest rate of 12%. The court noted that "Plaintiff does not argue and we find no authority supporting such argument that transfers between co-tenants do not trigger due on sale clauses."[44] *See also Auernheimer v. Metzen*[45] (Oregon appellate court held that defendant borrowers breached due-on-sale clause by giving third party an option to buy the mortgaged property without first obtaining plaintiff lender's permission in accordance with due-on-sale clause).[46]

However, the Act defines a due-on-sale clause as a clause permitting acceleration "if all or any part of the *property*, or an interest therein, securing the real property loan is sold or transferred without the lender's prior written consent."[47] What this means is that a clause providing for acceleration if an interest in the owning entity is transferred (e.g., stock in the owning corporation, a membership interest in the owning partnership or LLC, etc.) is not a due-on-sale clause at all. It simply isn't within the statutory definition. Hence, arguably there is no federal preemption of such a clause at all. This, in turn, means that a state court (or even a federal court under *Erie Railroad Co. v. Tompkins*[48]) is perfectly free to find that such a clause is unenforceable under state-law principles. It would be hard for the court to treat it as a restraint on alienation (since what is being alienated isn't an interest in the real estate, but rather an interest in the entity owning the real estate), but the court might nonetheless find some other equitable argument for not enforcing the clause.[49] It appears possible that if a court were inclined to go this route, no federal preemption would stand in its way.

Enforceability Against Non-Assuming Transferees

In recent years, transferees who obtained title to the mortgaged property pursuant to a deed whereby the conveyance was made subject to the existing mortgage, with no assumption of the underlying debt or the mortgage by the transferee, have occasionally challenged the ability of the mortgagee to enforce the due-on-sale provision against them. They argue that because they did not assume any of the obligations or liabilities under the original mortgage, they cannot be personally responsible for any violation of the clause or any debt deficiency.

In deciding this issue, the courts have considered whether a due-on-sale clause is a mortgage covenant that runs with (or "touches and concerns") the land, or whether it is instead a condition that grants the mortgagee the option to accelerate the loan upon any unpermitted transfer. If the due-on-sale clause is determined to be a condition (as most such clauses are drafted) and not a covenant, then this provision cannot be "assumed" by the transferee. However, most commercial mortgages contain a "boilerplate" provision stating that each provision of the mortgage is binding upon the parties' respective successors and assigns. This language would seem to favor the continued applicability of each of the mortgage provisions (including the due-on-sale clause) in the event of a

transfer subject to the mortgage. *See, e.g., Esplendido Apartments v. Metropolitan Condominium Association of Arizona II* [50] (Arizona Supreme Court ruled that due-on-sale clause runs with the land and binds nonassuming grantee; mortgagee's remedy is acceleration and foreclosure, not damages against grantee). *But see In re Ormond Beach Associates Limited Partnership*[51] (Second Circuit Court of Appeals held that mortgage due-on-sale clause did not run with the land under Florida law; mortgagor's grantee, which did not assume the existing mortgage when it acquired the property, was therefore not bound by, and did not breach, the clause).

Section 1701j-3(c) of the Act provides that a lender may enter into or enforce a contract containing a due-on-sale clause with respect to a real property loan "notwithstanding any provision of the constitution or laws (including the judicial decisions) of any State to the contrary." The Act does not provide examples of what "laws to the contrary" are preempted. However, Section 591.5(a) of the Regulations states that "due-on-sale practices of Federal associations and other lenders shall be governed exclusively by the Office's regulations, in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise including, without limitation, state law prohibitions against restraints on alienation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers." It is likely that this preemption provision of the Act would not apply in connection with transfers to nonassuming grantees of the mortgaged property, because the mortgagee would not in any event be prevented from accelerating the loan as a result of the unpermitted transfer; it would simply be prohibited from obtaining a personal deficiency judgment against the transferee.

Modification or Elimination of Due-on-Sale Clause in Bankruptcy

A bankrupt debtor subject to a mortgage containing a due-on-sale clause may file a Chapter 11 bankruptcy plan that seeks, pursuant to section 1123(a)(5) of the Bankruptcy Code ("Code") to modify or delete the due-on-sale clause. Section 1123(a)(5) lists several means available to a debtor for plan implementation, including waiving of any default, extension of the maturity date or a change in the interest rate. However, section 1123(a)(5) does not provide for the modification of non-monetary terms of a secured creditor's loan documents.

Because the deletion of the due-on-sale clause alters the legal, equitable and contractual rights to which the mortgagee is entitled under the mortgage, such deletion most likely renders the mortgagee's class impaired under the Code (assuming, as is customary in single-asset bankruptcy cases, that the mortgagee's claim is placed in a separate class by itself). The primary consequence of such a determination is that the mortgagee will be entitled to vote on behalf of such class to accept or reject the plan.[52] *See, e.g., In re Barrington Oaks General Partnership*.[53] Pursuant to the debtor's Chapter 11

bankruptcy plan in this case, the property was to be sold to a third party in violation of the due-on-sale clause. The Utah bankruptcy court concluded that the mortgagee bank was impaired under § 1124 of the Code, stating "The bank is impaired because the sale to [the third party], even without a due on restriction, changes obligors and therefore alters rights under the instruments memorializing the loan."[54]

Although the mortgagee's class may be impaired for purposes of cramdown under the Code, some bankruptcy courts have nonetheless allowed the modification of creditor loan documents, including the deletion of due-on-sale clauses. For example, in *In re Real Pro Financial Services, Inc.,*[55] the Florida bankruptcy court found that the creditor's argument that the court had no power to modify or alter a mortgage with a due-on-sale clause to be "wholly without merit."[56]

Under section 1111(b)(2) of the Code, an undercollateralized secured creditor is permitted to continue to be treated as a fully secured creditor under a plan that provides for the debtor's retention of the collateral. The election is advantageous in those situations where a creditor does not wish to incur an immediate loss and has confidence in the success of the debtor's reorganization or believes that its collateral will increase in value with the passage of time. A creditor making the election should attempt to assure that the restructured note and loan documents contain a due-on-sale clause providing for accelerated payment of the claim if the collateral is subsequently sold. The right to include a due-on-sale clause in the restructured agreement is enhanced if the clause was contained in the original note and mortgage. Alternatively, the mortgagee can argue that a due-on-sale clause is a customary provision intended to promote the liquidity of institutional lenders.

Under Chapter 13 of the Code, individual debtors may obtain adjustment of their indebtedness through a flexible repayment plan approved by a bankruptcy court. Section 1322(b) provides, in relevant part, that the plan "may modify the rights of holders of secured claims, *other than a claim secured only by a security interest in real property that is the debtor's principal residence ... .*"[57] The contract right must be enforceable as a matter of state law to be covered by § 1322(b). Bankruptcy courts have differed as to whether a debtor who is not the original mortgagor may modify the due-on-sale clause in a defaulted home mortgage in a Chapter 13 bankruptcy plan. *Compare In re Tewell* [58] (Illinois bankruptcy court ruled that debtor who obtained residential property from original mortgagor in violation of due-on-sale clause could not modify mortgage to "cure" defaults through Chapter 13 plan over objection of mortgage holder; court lifted automatic stay to permit lender to foreclose) with *In re Flores* [59] (Illinois bankruptcy court denied motion by mortgagee to modify automatic stay, holding that debtor-wife, in her individual Chapter 13 plan, could deal with mortgage debt on residential property that she owned together with her nondebtor-husband and such action would not result in impermissible modification of mortgagee's rights).

As noted above, some bankruptcy courts have held that a debtor may provide for a secured claim in a Chapter 13 bankruptcy plan, even if the debtor acquired the property securing the claim in violation of a due-on-sale clause contained in the mortgage. For example, in *In re Ramos*,[60] the borrower transferred residential property to the debtor pursuant to a quitclaim deed without first obtaining the lender's consent to the transfer as required by the due-on-sale clause in the mortgage. The debtor later filed a Chapter 13 petition under the Code, and the lender filed a motion for relief from the automatic stay. The Florida bankruptcy court denied the motion, holding that "the breach of a due-on-sale clause does not constitute 'cause' to grant a motion for stay relief."[61]

In *In re Espanol*,[62] the debtors transferred the property to their son for the sole purpose of allowing him to obtain a mortgage for which the debtors did not qualify. The debtors' son then transferred the property back to the debtors, in violation of the due-on-sale clause in the mortgage. The Connecticut bankruptcy court stated that "[t]hese actions illustrate why 'due-on-sale clauses' are contained in mortgage documents."[63] The court held that under the facts of this case, the debtors were prohibited by § 1322(b)(2) of the Code from modifying the "rights" of the mortgage lender's secured bankruptcy claim against the property.

The court noted that:

> This Court is fully cognizant that courts are divided as to whether a debtor in default under a "due on sale clause" contained in a mortgage can cure such default without impermissibly modifying a creditor's rights. Nevertheless, and particularly in light of the timing and circumstances attending the Property transfers here, this Court aligns itself with the court in *In re Martin,* 176 B.R. 675, as well as the courts in *In re Mullin,* 433 B.R. 1 (Bankr. S.D. Tex. 2010) and *In re Tewell,* 355 B.R. 674 (Bankr. N.D. Ill. 2006), holding that a debtor seeking to cure such default pursuant to a Chapter 13 plan impermissibly violates Bankruptcy Code § 1322(b)(2).[64]

In *French v. BMO Harris Bank*,[65] the Illinois bankruptcy court held that the Chapter 13 debtor, the nephew of the deceased title holder of the property who was the mortgagor under a mortgage with a due-on-sale clause and received title to the property pursuant to an Independent Executor's Deed, was not in violation of the due-on-sale clause because, as the court stated:

> Under the Garn–St Germain Act and its implementing regulations, a mortgage lender, among other restrictions, "shall not exercise its option pursuant to a due-on-sale clause upon ... [a] transfer to a relative resulting from the death of the borrower." 12 C.F.R. § 591.5(b)(1)(v)(A) (implementing 12 U.S.C. § 1701j–3(d)(5)).[66]

In a recent Chapter 7 bankruptcy case, *In re Krause*,[67] the Illinois bankruptcy court refused to discharge the mortgage because the lender relied on the debtors' misrepresentation that the loan was still secured by the mortgaged property even though the debtors sold the property to a third party three months after obtaining the refinancing loan from the lender. The debtors did not inform the lender of the sale which, the court ruled, violated the due-on-sale clause in the mortgage that would have given the lender an immediate right to the sale proceeds up to the amount of the outstanding debt. The debtors concealed the transfer by continuing to make the scheduled monthly mortgage payments for three years after the sale.

The court noted that "§ 523(a)(2) [of the Code] protects creditors who have been deceived into forbearing from pursuing collection efforts."[68] The court concluded that the lender could have accelerated the mortgage loan had it known the truth. The court therefore ruled the wrongful acts of the debtor constituted an "extension of credit" under § 523(a)(2) because "the sale of the Property triggered legal rights under the existing credit agreement, altering [the lender's] rights thereunder.""[69]

Can an Impermissible Transfer be Rescinded?

A mortgagor that ignores a violation of the due-on-sale clause may do so at its peril. In a case decided by the Federal District Court for the District of Kentucky, *Travelers Ins. Co. v. Corporex Properties, Inc.*,[70] the court expressly upheld a pre-negotiation agreement entered into between the mortgagor and the mortgagee in connection with the workout of a nonrecourse commercial mortgage loan on an office building. Because the mortgagor had conveyed the property during the negotiation discussions to a corporation controlled by it in violation of the due-on-sale clause in the mortgage, to better position the mortgagor for a "new debtor" bankruptcy, to avoid negative publicity, and to put the mortgagor, in its own words, "in a better position to negotiate on an even basis," the court, in an unusual form of relief awarded to the mortgagee, ordered a reconveyance of the property to the mortgagor. The mortgagor appealed the court's decision to the U.S Sixth Circuit Court of Appeals based solely on the court's order of reconveyance, but the mortgagor and the mortgagee subsequently reached a settlement providing for the conveyance of the property to the mortgagee by a deed in lieu of foreclosure, and the appeal was dismissed with prejudice.

But see Weitzel v. Northern Golf, Inc.,[71] where the New York Superior Court for Livingston County stated the issue as follows:

> Claiming, and establishing, that two covenants in the mortgage have been violated—the no alteration or demolition without consent clause and the no sale without consent clause—the plaintiff

> mortgagee sues the mortgagor and the mortgagor's transferee for a preliminary and permanent injunction enjoining any further alterations of the mortgaged premises and rescinding the sale to the transferee.[72]

The court denied the mortgagee's request to rescind the sale of the property by the mortgagor to a third party "subject to" the mortgage, in violation of the due-on-sale clause in the mortgage. The mortgagee attempted to achieve this result by a motion to show cause instead of pursuing a foreclosure action against the property. According to the court, "[The mortgagee] has no standing to rescind the transfer . . . because [the mortgagee] is confined either to a suit on the note to [the mortgagor] or an equitable foreclosure action against the land."[73] The court noted that the mortgagee could not maintain a foreclosure action in the absence of an election to accelerate the mortgage debt, which it had not done.

The court also noted that there was inadequate evidence that the security interest was impaired by the transfer, because the alterations and improvements made by the transferee would actually improve the value of the security. The court also noted that if the mortgagee had properly instituted a foreclosure action against the property "the mortgagor would have the right to pay off the indebtedness and obtain an equitable assignment of the mortgage from the mortgagee so that it might proceed against the land in the hands of its transferee."[74] The court concluded that:

> At bottom, however, as to both mortgagor and transferee, plaintiff has sued in foreclosure against the land itself, a suit which presupposes an acceleration and an ultimate judicial sale of the property. Not having elected to accelerate, and not seeking a judicial sale, plaintiff has not demonstrated a likelihood of success on the merits against either defendant and is not entitled to a preliminary injunction directed to either. In addition, no case has been called to the attention of the court, nor has the court's own research turned up a case, which grants rescission of a mortgagor's transfer of the mortgaged premises to a third party on the ground that the transfer occurred in violation of a mortgage covenant requiring the mortgagee's consent to the transaction in circumstances which did not call into question the adequacy of mortgaged premises to satisfy the monetary obligations incurred under the mortgage.[75]

In *Home Savings Bank of Upstate N.Y. v. Baer Props., Ltd.*,[76] the New York Supreme Court, Appellate Division (3d Department), used equity to deny enforcement of a due-on-sale provision in a mortgage. The court determined that the evidence showed that: the mortgagee knew about the transfer by the mortgagor to a third party in contravention of the due-on-sale clause in the mortgage; the security had not been impaired by the transfer; and that if

of organization, operating agreement or any other agreement, with or without taking any formative action, to cause Borrower to take some action or prevent, restrict, or impede Borrower from taking some action which, in either case, Borrower could take or could refrain from taking were it not for the rights of such individuals; and (2) an "***Immediate Family Member***" shall mean a spouse or a child of any Interest Holder.

(g) The following shall not be considered Transfers subject to the foregoing provisions and requirements:

(i) The sale or other disposition of obsolete or worn out personal property that is contemporaneously replaced by comparable personal property of equal or greater value that is free and clear of liens, encumbrances and security interests other than those created by this [Mortgage] [Deed of Trust] or the other Loan Documents.

(ii) The grant of an easement, if prior to the granting of the easement Borrower causes to be submitted to Lender all information required by Lender to evaluate the easement, and if Lender, in its sole discretion, determines that the easement will not materially affect the operation of the Property or Lender's interest in the Property and Borrower pays to Lender, on demand, all costs and expenses incurred by Lender in connection with considering and reviewing Borrower's request.

ENDNOTES

[1] 12 U.S.C. § 1701j-3 *et seq*. (1982). *See generally* Grant S. Nelson, Dale A. Whitman, Anne Burkhart, and Wilson Freyermuth, 1 REAL ESTATE FINANCE LAW (6th ed. 2014) § 5.24, *Due-on-Clauses – The Garn Act (*discussing history and scope of Act and relevant case law).

[2] The final regulations issued in connection with the Act make this preemption very clear. *See* 12 C.F.R. § 591.1(b), which states that:

> Purpose and scope. The purpose of this permanent preemption of state prohibitions on the exercise of due-on-sale clauses by all lenders, whether federally-or state-chartered, is to reaffirm the authority of Federal savings associations to enforce due-on-sale clauses, and to confer on other lenders generally comparable authority with respect to the exercise of such clauses. This part applies to all real property loans, and all lenders making such loans, as those terms are defined in § 591.2 of this part.

[3] *See* 12 U.S.C. § 1701j-3(d)(1)-(9).

[4] *Id*., § 1701j-3(d)(1).

[5] 12 C.F.R. § 591.2(b). *See County Sav. Bank v. Sain*, 1992 WL 82794 (Ohio App. 10th Dist., April 21, 1992), at *3 ("it is well-established that the sale of property under a land installment contract is a breach of a mortgage covenant prohibiting any change in the ownership of the mortgaged premises.")

[6] *Id.*, § 591.5(b)(1)(i).

[7] 426 Mich. 11 (1986).

[8] M.C.L.A. § 445.1628(2).

[9] 2007 WL 258411 (Mich. App., Jan. 30, 2007).

[10] *Id*. at *3-4.

[11] 796 S.W.2d 369 (Sup. Ct. of Missouri, 1990).

[12] *See generally* Nelson, Whitman, Burkhart, and Freyermuth, note 1, *supra*, § 5:25, *The due-on-sale clauses – Concealment of Transfers* (discussing risks to borrowers and their attorneys of attempts to avoid consequences of violation of due-on-sale clauses, and noting case law and commentary on this topic); Michael T. Madison, Jeffry R. Dwyer, and Steven W. Bender, LAW OF REAL ESTATE FINANCING, § 16.7, *Concealment of transfer in violation of due-on-sale clause* (Database updated December 2014) (describing risks of personal liability and ethical sanctions for attorneys who attempt to conceal property transfers in violation of due-on-sale clause in mortgage); Mark E.

Roszkowski, *Drafting Around Mortgage Due-on-Sale Clauses: The Dangers of Playing Hide and Seek*, 21 REAL PROP. PROB. TR. J. 23, 29 (1986) ("the contract for deed is a popular creative financing device, presenting significant risk to both the buyer and the seller. Additional risks are presented when the arrangement is used to effect a 'silent sale,' a transfer designed to prevent the seller's mortgagee from learning of the sale, thereby preventing it from exercising its due-on-sale clause.").

[13] 12 C.F.R. § 591.5(b)(2)(i) and (ii); 48 F.R. 32160-32162.

[14] 12 C.F.R. § 591.5(b).

[15] 98 Ill. App 3d 646, 648-50, (2nd Dist. 1981).

[16] 110 Wash 2d 716, 721-22 (1988). *See also In re LHD Realty Corp.*, 20 B.R. 722, 730 (Bankr. S.D. Ind. 1982) (refusing to permit lender to collect prepayment premium after borrower's default because prepayment clause did not clearly provide that premium could be collected upon acceleration after default); *Crockett v. First Fed. Sav. & Loan Ass'n,* 289 N.C. 620, 626-27 (1976) (upholding validity and enforceability of due-on-sale clause, but prohibiting prepayment charge); *American Fed. Sav. & Loan Ass'n v. Mid-America Serv. Corp.*, 329 N.W.2d 124, 125-126 (S.D. 1983) (holding, in case of first impression in South Dakota, that mortgagee was not entitled to charge equal to three months' interest upon acceleration of mortgage loan for violation of due-on-sale clause because "the due-on-sale clause is a type of acceleration clause which is triggered at the mortgage holder's option"); *Terry v. Born,* 24 Wash. App. 652, 655 (1979) (in case decided before enactment of Garn-St Germain Act, court held that "the provisions of the [real estate installment contract] which prohibit assignment or conveyance and do not permit prepayment constitute an unreasonable and unenforceable restraint on alienation unless [the real estate installment contract vendee] can show that enforcement of the restraint is necessary to protect his security"); *In re Abramoff*, 92 B.R. 698, 702 (Bankr. W.D. Tex. 1988) (holding that under Texas law "the presence of a due-on-sale provision in tandem with a prepayment penalty raises a sufficient quantum of evidence to support a finding that the lender had created an 'unreasonable restraint upon alienation'"). New York has a statute, N.Y. REAL PROPERTY LAW, § 254-a (McKinney Supp. 1998), which prohibits a prepayment fee upon the lender's exercise of a due-on-sale clause in connection with a residential mortgage, provided, however, that the provisions of the statute shall not apply to the extent they are inconsistent with any federal law or regulation). *See generally* Frank S. Alexander, *Mortgage Prepayment: The Trial of Common Sense*, 72 CORNELL L. REV. 288, 343 n. 187 (January 1987); Gavin L. Phillips, *Validity and Construction of Provision of Mortgage or Other Real-Estate Financing Contract Prohibiting Prepayment for a Fixed Period of Time,* 81 A.L.R. 4th 423 (1991).

[17] *Id.* at 726.

[18] 701 F. Supp. 126 (E.D. Mich. 1988).

[19] *See also Clover Square Associates v. Northwestern Mutual Life Ins. Co.*, 674 F. Supp. 1137, 1138 (D.N.J. 1987) (upholding validity and enforceability of both due-on-sale and prepayment provisions contained in mortgage documents, and rejecting mortgagor's claim that exercise of mortgage's rights under such clauses resulted in an absolute restraint on alienation; court noted that under New Jersey law mortgagee was permitted to "extract a fee from the mortgagor for allowing prepayment of the loan" for

"surrendering the privilege of having its funds invested, and of collecting interest thereon for the term provided in the contract" (citing *Bloomfield Sav. Bank v. Howard S. Stainton & Co.*, 60 N.J. Super. 524, 531-32, 159 A.2d 443 (App. Div. 1960)); *Warrington 611 Associates v. Aetna Life Ins. Co.,* 705 F. Supp. 229, 234 (D.N.J. 1989) (holding that commercial mortgage containing both prepayment penalty and due-on-sale clause was not an unreasonable restraint on alienation where mortgagor was not actually prevented from selling the property; court noted that cases cited by mortgagor to the contrary had been decided before enactment of Garn-St Germain Act); *Westmark Commercial Mortg. Fund IV v. Treeform Assoc., L.P.,* 362 N.J. Super. 336, 347-48 (App. Div. 2003) (mortgagor challenged enforceability of prepayment premium after mortgagee accelerated debt after mortgagor's default; court held that prepayment premium on commercial loan was permissible because debtor freely entered into contract; terms of contract were clear and unambiguous; and parties were experienced and sophisticated). For commentary on this issue *see* Madison, Dwyer, and Bender, note 12, *supra*, § 5:45, *Right to sell mortgaged property – The "double whammy" issue: Can a lender enforce both a prepayment charge and a due-on-sale clause?* (discussing cases where commercial mortgage contains both provisions).

[20] *See, e.g.,* Veterans' Administration loans (24 C.F.R. § 207.253(a)); certain "high cost loans" (12 C.F.R. § 226.32); certain manufactured home loans (12 C.F.R. 590); and loans made by lenders subject to Federal Home Loan Bank Board regulations (38 C.F.R. § 36.4310). *See also Unifirst Fed. Sav. and Loan Ass'n v. Bowen,* 1984 WL 3290 (S.D. Miss. Aug.17, 1984) ("Federal law has restricted the enforcement of the due-on-sale provisions in certain specific situations," citing 12 C.F.R §§ 591.5(b)(1)(i)-(vi)).

[21] 12 U.S.C. 3801 *et seq.*

[22] Pub. L. No. 111-203, 124 Stat 1376 (July 21, 2010).

[23] 12 U.S.C.A. § 3801**,** 3803.

[24] 67 FED. REG. 60542 (September 26, 2002); 67 FED. REG. 76304 (December 12, 2002).

[25] 12 U.S.C.A. § 3802(1), as amended by the Dodd-Frank Act § 1083, effective July 22, 2011.

[26] Dodd-Frank Act, at § 1083(a)(2)(A)(iv).

[27] *See Western Life Insurance. Co. v. McPherson K.M.P.*, 702 F. Supp. 836, 842 (D.Kan.1988) ("The contract involved in the present case does not . . . expressly limit the lender's right to exercise the due-on-sale clause [which stated that consent would not be unreasonably withheld] to cases of impairment of security"). *Cf. Destin Savings Bank v. Summerhouse of FWB, Inc.* 579 So. 2d 232, 237 (Fla. 1st DCA 1991) (stating that "in cases where the agreements contain in the due on sale clause language to the effect that consent to assumption will not be unreasonably withheld, court decisions have frequently construed such a provision as authorizing the trial court to test the withholding of consent against a standard of 'reasonableness'"). *See generally* 59 C.J.S. MORTGAGES § 464, *Consent of mortgagee – Reasonableness and particular conditions* (Database updated December 2014) (collecting and describing cases in this area).

[28] 339 N.W.2d 901 (Minn. Sup. Ct. 1983).

[29] 308 N.W.2d 471 (Minn. Sup. Ct. 1981).

[30] *See also Crestview, Ltd. v. Foremost Insurance Co.*, 621 S.W.2d 816, 823 (Tex. Civ. App. 1981) (holding that mortgagee's conditioning its approval upon an increase in interest rate did not render mortgagee's conduct "unreasonable, unjust, inequitable and oppressive"); *Rubin v. Centerbanc Federal Savings & Loan Association*, 487 So.2d 1193, 1195 (Fla. 2nd DCA 1986) ("the bank did not unreasonably withhold its consent to assumption of the mortgage by requiring an increase in the interest rate to the prevailing market rate").

[31] 664 F.2d 52 (5th Cir. 1981).

[32] *See also Fogel v. S.S.R. Realty Ass'n,* 190 N. J. Super 47, 51-52 (1983); (holding that, based on language in mortgage requiring that mortgagee's consent not be unreasonably withheld, it was unreasonable for mortgagee to require an increase in interest rate as condition to conveyance of secured property); *Silver v. Rochester Sav. Bank*, 424 N.Y.S.2d 997, 998 (Sup. 1980) (holding that where due-on-sale clause in mortgage provided that mortgagee would not unreasonably withhold its consent, mortgagee could not condition sale on increase in interest rate where economic status of transferee was unobjectionable to mortgagee; court noted that if mortgagee had expressly provided in mortgage that it could raise interest rate upon sale by mortgagor, different question would be presented); *Iris v. Marine Midland Bank of Southeastern New York*, 450 N.Y.S. 2d 997, 998-99 (1982) (holding that where due-on-sale clause provided that consent would not be unreasonably withheld, mortgagee could not condition approval of sale on increase in interest rate).

[33] 433 S.W. 3d 658 (Tex. App.-Hous. 1st Dist., March 27, 2014).

[34] *Id*. at 664.

[35] *Id.*

[36] 196 Ga. App. 203, 205-06 (1990).

[37] *Cf. Southern Prestige Homes, Inc. v. Moscoso*, 243 Ga. App. 412, 415 (Ga. App., 2000) (distinguishing *Patel v. Gingrey*, note 36, *supra*, on basis that in this case "[t]he agreement's terms are not vague or indefinite"). *See generally* Annot., *Validity and Enforceability of Due-on-Sale Real-Estate Mortgage Provisions,* 61 A.L.R. 4TH 1070 (1988); Annot., *What Transfers Justify Acceleration Under "Due-on-Sale" Clause of Real Estate Mortgage*, 22 A.L.R. 4th 1266 (Originally published in 1983); Madison, Dwyer, and Bender, note 12, *supra*, § 5:44 (2014), *Right to sell mortgaged property – Planning suggestions* (discussing strategies to establish what is "reasonable" in connection with due-on-sale clauses that provide that consent will not be unreasonably withheld); Baxter Dunaway, 6 L. DISTRESSED REAL ESTATE § 72:15. *Considerations prior to foreclosure – Strict interpretation of acceleration – Due on sale* (Database updated December, 2014) ("Perhaps lesser applicability since passage of Garn-St Germain, there are a minority of cases where the due on sale clause has not been enforced").

[38] *See, e.g., Lyons v. Skunda*, 33 Ohio App.3d 177, 178, (Ohio App., 1986) ("as a contract, the enforcement of a 'due on sale' clause in a mortgage transaction is subject to traditional contract defenses, including equitable defenses. It is not, however, unenforceable *per se*"); *County Sav. Bank v. Sain*, note 5, *supra*, 1992 WL 82794 at *3 ("the right to accelerate the note and foreclose the mortgage upon the violation of such a [due-on-sale] clause is subject to the equitable defenses of estoppel and waiver (citations omitted). The right to foreclose upon the breach of a mortgage agreement is waived where the lender fails to assert its rights within a reasonable period of time after discovering the breach"); *Executive Hills Home Builders, Inc. v. Whitley*, 770 S.W. 2d 507, 509 (Mo. App. 1989) (holding that due-on-sale clause in second deed of trust, which provided for acceleration if property "is sold or transferred by the borrower," was not triggered by foreclosure sale by holder of first deed of trust because such action was involuntary and did not involve sale by borrower; court noted that language in such clauses is strictly construed and preference is given to construction that does not result in forfeiture or acceleration). For an excellent discussion of these issues and a compilation and analysis of cases in this area, *see* Nelson, Whitman, Burkhart, and Freyermuth, note 1, *supra*, § 5.24, *Due-on-Clauses – The Garn Act*; *Mortgagee's duty to respond under the Act,* p. 350 n. 524, which states as follows:

> See *In re Ramos,* 357 B.R. 669 (Bankr. S.D. Fla. 2006) (lender's failure to object to debtor's Chapter 13 bankruptcy plan to cure defaults acted as waiver of lender's right to accelerate under due-on-sale clause); *Besco USA Intern. Corp. v. Home Sav. of America FSB,* 675 So. 2d 687 (Fla. 5th DCA 1996) (lender's response to request for consent to transfer was ambiguous, precluding summary judgment); *Fischer v. First Internat. Bank,* 109 Cal. App. 4th 1433, 1 CAL. RPTR. 3d 162, 173 n.3 (4th Dist. 2003) (lender's failure to accelerate upon sale acted as waiver of its right to do so); *Mata v. Bank of America Nat. Trust and Sav. Ass'n,* 2002 WL 31378387 (Cal. App. 4th Dist. 2002), unpublished/noncitable (not reported in Cal.Rptr.) (lender's acceptance of a payment from grantee, bringing defaulted loan current, did not act as a waiver of lender's right to accelerate under due-on-sale clause)
>
> The cases frequently focus on whether the lender has delayed an unreasonable time after discovering the transfer before accelerating. *See, e.g.*, *Rubin v. Los Angeles Fed. Sav. & Loan Assn.,* 159 Cal. App. 3d 292, 205 Cal. Rptr. 455 (4th Dist. 1984) (one year delay constitutes waiver); *Malouff v. Midland Federal Sav. and Loan Ass'n,* 181 Colo. 294, 304, 509 P.2d 1240, 1245–46 (1973) (one-month delay is reasonable, but one year would not be); *First Nat. Bank of Lincoln v. Brown,* 90 Ill. App. 3d 215, 219, 45 Ill. Dec. 496, 500, 412 N.E.2d 1078, 1082 *(4th Dist. 1980)* (18-month delay gave rise to estoppel where mortgagee had notice and mortgagor detrimentally relied); *Rakestraw v. Dozier Associates, Inc.,* 285 S.C. 358, 329 S.E.2d 437*)* (lender estopped by 17-month delay in accelerating); *Cooper v. Deseret Federal Sav. and Loan Ass'n,*) (five year delay was unreasonable, and deprived lender of power to accelerate). *Cf*. *In re Tewell*) (no waiver or estoppel found despite lender's acceptance of payments for more than seven years after transfer; unclear whether lender had knowledge of transfer);

Empire Sav., Bldg. and Loan Ass'n, 634 P.2d 1021, 1022 (Colo. App. 1981) (no waiver despite lender's acceptance of payments after notice of transfer); *Dunham v. Ware Sav. Bank,* 384 Mass. 63, 67, 423 N.E.2d 998, 1000 (1981) (three-month delay, no waiver or estoppel); *Stenger v. Great Southern Sav. and Loan Ass'n,* 677 S.W.2d 376 (Mo. Ct. App. S.D. 1984) (insufficient evidence to establish waiver or estoppel); *Stipek v. Regional Trustee Services Corp.,* 98 Wash. App. 1037, 1999 WL 1215321 (Div. 1 1999*)* (not reported in P.2d) (no waiver occurred, in light of antiwaiver language in the mortgage).

Waiver or estoppel may also arise from the lender's statements or course of action before the transfer of the real estate. See, e.g., *Great Northern Sav. Co. v. Ingarra,* 66 Ohio St. 2d 503, 20 Ohio Op. 3d 415, 423) (lender encouraged borrowers to sell property and indicated that it had no objection to sale). Cf. *Destin Sav. Bank v. Summerhouse of FWB, Inc.,* 579 So. 2d 232 (Fla. 1st DCA 1991*)* (loan officer's statement that if buyer's financial situation turned out to be as represented, "there will be no problem," was insufficient to estop lender from enforcing due-on-sale clause).

In *Stipek v. Regional Trustee Services Corp.,* 98 Wash. App. 1037, 1999 WL 1215321) (unpublished), a buyer who was a real estate broker accepted a deed of property that was subject to a mortgage containing a due-on-sale clause. The buyer intentionally refrained from notifying the mortgagee of the purchase. Three years later the mortgagee attempted to accelerate and foreclose on the basis of the due-on-sale clause. The buyer sued to enjoin the foreclosure, arguing that the mortgagee, by accepting payments while waiting so long to enforce the clause, had waived its right to do so. There was some evidence that the mortgagee had been aware of the transfer during the three-year period. However, the court, relying on the no-waiver clause in the mortgage, permitted the mortgagee to accelerate the loan.

See also *Brown v. Powell,* 2002 SD 75, 648 N.W.2d 329 (S.D. 2002*)*, a case involving the analogous situation of a purchaser's assignment of a real estate installment contract containing a prohibition on assignment without the vendor's consent. The vendor accepted payments from the assignee from February through September, 1999, but refused to accept the October payment and declared a forfeiture of the contract. The court found that the vendor knew or should have known of the assignment, and hence by accepting seven monthly payments had waived the right to assert that the assignment was a breach. The draconian nature of the forfeiture remedy and the fact that the assignee was apparently more reliable and solvent than the original purchaser may have played a role in the court's decision. A dissenting judge argued that the vendor did not have sufficient notice of the assignment (which was unrecorded and never called to the vendor's attention by the assignee) to permit an inference of waiver to arise.

See generally 2 REAL ESTATE LAW DIGEST 4th § 21:42, *Mortgages and Deeds of Trust, Acceleration of Balance Due* (Database updated October 2014) (containing discussion of decisions of various state and federal cases regarding ability of lender to accelerate loan for alleged violation of due-on-sale clause).

[39] 156 B.R. 167 (Bankr. E.D. Va. 1993).

[40] *See also* P*arks v. CAI Wireless Systems, Inc.*, 85 F. Supp. 2d 549, 555 (D. Md. 2000) (stating that "under appropriate circumstances a corporate merger can result in the violation of an anti-assignment provision contained in a contract"); *The Citizens Bank & Trust Co. of Maryland v. The Barlow Corp.*, 295 Md. 472, 474, 456 A. 2d 1283, 1283 (1983) (holding that merger of corporate tenant under commercial lease into another corporation violated non-assignment clause that expressly excluded assignments by operation of law).

[41] 196 Conn. 270, 281 (1985).

[42] 652 S.W.2d 762, 764-66 (Tenn. App. 1982). *See also Gasparre v. 88-36 Elmhurst Ave. Realty Corp.*, 464 N.Y.S. 2d 106, 106-107 (1983) (holding that sale of stock by sole owners of corporate mortgagor to third party did not violate due-on-sale clause, which stated simply that "This mortgage shall become due upon the sale of the aforesaid property"); *Friedman v. Carey Press Corp*. 498 N.Y.S.2d 839, 840 (N.Y.A.D. 1st Dept., 1986) (holding the transfer or redemption of stock was not a sale of the debtor's business under the terms of acceleration provision in the parties' agreement).

[43] 101 N.C. App. 554 (1991).

[44] *Id*. at 556.

[45] 98 Or. App. 722, 725 (1989).

[46] *See generally* Brent C. Shaffer, *Handling Assignment Clauses in an Age of Chameleon Entities (Part 1)*, 15 THE PRACTICAL REAL ESTATE LAWYER 61 (September 1999); Brent C. Shaffer, *Handling Assignment Clauses in an Age of Chameleon Entities (Part 2)*, 15 THE PRACTICAL REAL ESTATE LAWYER 45 (November 1999); Kathleen Hopkins and Cynthia Thomas, *Alligators in Commercial Leases: Transfers and Rights of First Refusal*, 16 THE PRACTICAL REAL ESTATE LAWYER 43 (March 2000).

[47] 12 U.S.C. § 1701j-3(a)(1) (emphasis added).

[48] 304 U.S. 64 (1938). This case held that federal courts did not have the judicial power to create general federal common law when hearing state-law claims under diversity jurisdiction.

[49] *See, e.g., U.S. v. Med O Farm, Inc.*, 701 F.2d 88, 90 (9th Cir. 1983) (court rejected shareholders' argument that stock transfers do not trigger due-on-sale clause, and stated that "Under Washington law transfer of all of the stock in a corporation implies transfer of an interest in the underlying assets").

[50] 161 Ariz. 325, 328 (1989.

[51] 184 F.3d 143, 157 (2nd Cir. 1999).

[52] *See* 11 U.S.C. §§ 1123(a)(2), (3), (b)(1); § 1126(c).

[53] 15 B.R. 952 (Bankr. D. Utah 1981).

[54] *Id*. at 956. *Accord, In re Otero Mills, Inc*., 31 B.R. 185, 187 (Bankr. D.N.M. 1983) (citing *In re Barrington Oaks General Partnership,* note 53*, supra,* with approval); *In re Real Pro Financial Services, Inc.*, 120 B.R. 216, 217-18 (Bankr. M.D. Fla. 1990); *In re Coastal Equities, Inc.*, 33 B.R. 898, 906-07 (Bankr. S.D. Cal. 1983).

[55] Note 54, s*upra*, 120 B.R. at 219.

[56] *Id. See also In re Coastal Equities, Inc.,* note 54*, supra*, 33 B.R. at 905 ("a due-on-sale clause is not something so sacrosanct that it is immune from modification in a bankruptcy setting")*; In re Western Real Estate Fund, Inc.*, 75 B.R. 580, 586-87 (Bankr. W.D. Okla. 1987); *In re P.J. Keating Co.*, 168 B.R. 464, 473 (Bankr. D. Mass. 1994); Jerald I. Ancel, Marlene Reich, and Gregory J. Seketa, *Are the Secured Creditor's Loan Documents Inviolate?* 13-Aug AM. BANKR. INST. J. 22 (1994).

[57] 11 U.S.C. § 1322(b) (emphasis added).

[58] 355 B.R. 674, 680 (Bankr. N.D. Ill. 2006).

[59] 345 B.R. 615, 617 (Bankr.N.D.Ill.2006).

[60] 357 B.R. 669, 676 (Bankr. S.D. Fla. 2006).

[61] *Id*. at 672. *See also In re Davis,* 2010 WL 5173187 (Bankr. D.S.C., Oct. 12, 2010), at *3 (holding that, in Chapter 13 bankruptcy, "violation of a due on sale clause does not conclusively establish that the moving party is entitled to stay relief"); *In re Garcia,* 276 B.R. 627, 630 (Bankr. D. Ariz. 2002) (concluding that "as a matter of law, the violation of the Bank's due on sale clause does not *per se* entitle the Bank to stay relief");.

[62] 509 B.R. 422 (Bankr. D. Conn. 2014).

[63] *Id*. at 427.

[64] *Id*. at 428.

[65] 2012 WL 1533310 (N.D. Ill., April 30, 2012).

[66] *Id.* at *4.

[67] 510 B.R. 172 (Bankr. N.D. Ill. 2014).

[68] *Id.* at 183.

[69] *Id.* Under § 523(a)(2)(A) of the Code, an individual debtor is not discharged from any debt for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by false pretenses, a false representation, or actual fraud.

[70] 798 F. Supp. 423 (E.D. Ky. 1992).

[71] 2008 WL 465272 (N.Y. Sup., Feb. 20, 2008).

[72] *Id*. at *1.

[73] *Id.*

[74] *Id*. at *2.

[75] *Id*. at *4.

[76] 460 N.Y.S. 2d 833, 834-35 (N.Y.A.D. 1983).