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The Due on Sale Clause in a Deed of Trust is Not an Invalid Restraint on the Alienation of Property.

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MORTGAGES—Due On Sale Clause—The Due On Sale Clause In A Deed Of Trust Is Not An Invalid Restraint On The Alienation Of Property

Sonny Arnold, Inc. v. Sentry Savings Association
633 S.W.2d 811 (Tex. 1982).

Sonny Arnold[1] executed a deed of trust on his real estate to Sentry Savings Association[2] to secure payment of a promissory note held by Sentry for the purchase price of the realty. The deed of trust contained a due on sale provision[3] which provided that in the event of a sale or transfer of the property without the lender's consent, the lender could call the entire note immediately due and payable,[4] or in the alternative, allow an assumption of the note by the transferee if he agreed to an increased rate of interest.[5] Arnold conveyed the secured property to Foxmoor[6] without

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1. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 334 (Tex. Civ. App.—Amarillo 1981), *aff'd*, 633 S.W.2d 811 (Tex. 1982). The deed of trust was executed on behalf of Sonny Arnold, Inc., a real estate development firm and presumably a Texas corporation. *See id.* at 334 n.3.

2. *See id.* at 334 n.5 (a Texas corporation).

3. *See id.* at 336 n.11.

4. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 813 (Tex. 1982). The relevant portions of paragraph 19 of the deed of trust read as follows:

> 19. TRANSFERS OF THE PROPERTY OR BENEFICIAL INTERESTS IN BORROWER: ASSUMPTION. On sale or transfer of (i) all or any part of the Property, or any interest therein, or (ii) beneficial interests in Borrower [Arnold] (if Borrower is not a natural person or persons but is a corporation, partnership, trust or other legal entity), Lender [Sentry] may, at Lender's option, declare all of the sums secured by this Instrument to be immediately due and payable, and Lender may invoke any remedies permitted by paragraph 27 of this Instrument. This option shall not apply in case of . . . (b) sales or transfers when the transferee's creditworthiness and management ability are satisfactory to Lender and the transferee has executed, prior to the sale or transfer, a written assumption agreement containing such terms as Lender may require, including, if required by Lender, an increase in the rate of interest payable under the Note.

Id. at 813.

5. *See id.* at 813. It is common for lenders to condition approval of an assumption upon a purchaser's assuming the note at an increased rate of interest. *See, e.g.*, Tierce v. APS Co., 382 So. 2d 485, 486 (Ala. 1979) (Alabama Supreme Court upheld due on sale clause where mortgagee agreed to accept transfer if purchaser paid higher interest rate); Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240, 1245 (Colo. 1973) (lender's agreement to waive acceleration if transferee assumed loan at higher interest held reasonable); Miller v. Pacific First Fed. Sav. & Loan Ass'n, 545 P.2d 546, 549 (Wash. 1976) (increased interest rate provision of promissory note held enforceable). *But see* Patton v. First Fed. Sav. & Loan Ass'n,

Sentry's consent and without the required assumption agreement.[7] Sentry notified Arnold that the entire note was due immediately.[8] He refused to pay the balance of the note and Sentry scheduled a sale of the realty.[9] Arnold and Foxmoor sought an injunction in the trial court on the grounds that Sentry's exercise of the due on sale clause constituted an unreasonable restraint on alienation.[10] The trial court denied Arnold and Foxmoor's application for a temporary injunction and the court of civil appeals affirmed.[11] The appellants' application for writ of error was granted by the Texas Supreme Court to determine whether the clause in question was valid and enforceable.[12] Held—*Affirmed.* The due on sale clause in a deed of trust is a valid restraint on the alienation of property.[13]

A due on sale clause allows the lender, at his option, to declare the outstanding principal and interest owed on a mortgage immediately due and payable upon the sale or transfer of the secured property without the lender's consent.[14] The due on sale clause was used very little in a mortgage instrument prior to the 1960's.[15] During that decade, however, inter-

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578 P.2d 152, 158 (Ariz. 1978) (lender could not condition consent on transferee's agreeing to interest rate increase).

6. *See* Sonny Arnold, Inc. v Sentry Sav. Ass'n, 633 S.W.2d 811, 817 (Tex. 1982). Foxmoor of California is a limited partnership. Foxmoor was requested by Sentry Savings to incorporate before assuming Arnold's note to insure that the increased interest rate would not violate Texas usury laws. *See id.* at 817. The partnership refused to incorporate as required by Sentry. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 335 (Tex. Civ. App.—Amarillo 1981), *aff'd,* 633 S.W.2d 811 (Tex. 1982).

7. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 335 (Tex. Civ. App.—Amarillo 1981) (Arnold remained liable to Sentry on note), *aff'd,* 633 S.W.2d 811 (Tex. 1982).

8. *See id.* at 336 (Arnold continued timely installment payments after notice of acceleration).

9. *See id.* at 335-36 (Paragraph 27 of deed of trust provided for acceleration; remedies included power of sale without prior judicial hearing).

10. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 817 (Tex. 1982).

11. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 334 (Tex. Civ. App.—Amarillo 1981) (held clause is not invalid restraint on alienation), *aff'd,* 633 S.W.2d 811 (Tex. 1982).

12. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 812 (Tex. 1982).

13. *See id.* at 815-16.

14. *See* Wellenkamp v. Bank of Am., 582 P.2d 970, 971 n.1, 148 Cal. Rptr. 379, 380 n.1 (1978) ("due on" clause frequently used in real estate security transactions to provide for acceleration of maturity of note in event of sale, alienation, or further encumbering of secured property); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 335 n.11 (Tex. Civ. App.—Amarillo 1981) (due on sale clause may be self-executing or optional), *aff'd,* 633 S.W.2d 811 (Tex. 1982).

15. *See* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests,* 58 IOWA L. REV. 747, 768 (1973); *see also* G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 296 (1979). One explanation is that direct

est rates began to rise and subsequently, due on sale and due on encumbrance clauses[16] began appearing more frequently in mortgage agreements.[17] The due on sale clause was originally used to protect the lender's security.[18] The threat of acceleration and foreclosure embodied in a due on sale clause effectively accomplished the lender's purpose of preventing a conveyance of the secured property to third persons.[19] At

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restraints on the alienation of property have always been viewed with disfavor by the courts. *See, e.g.*, Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1, 3 (Ill. 1975) (general rule that restraints on alienation are void); Sanders v. Hicks, 317 So. 2d 61, 63 (Miss. 1975) (restraints on alienation not favored and strictly construed); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 338 (Tex. Civ. App.—Amarillo 1981) (Texas law does not favor restraints on alienation), *aff'd*, 633 S.W.2d 811 (Tex. 1982). Another explanation for the clause's non-use is that interest rates did not begin to spiral until the latter half of the 1960's. *See* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 769 (1973) (citing to 1970 FED. HOME LOAN BANK BD. 6, chart 2; 1969 FED. HOME LOAN BANK BD. 3, chart 1).

16. *See* Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 844 (Neb. 1980) (due on encumbrance clause similar to due on sale clause except triggering mechanism is further encumbrance). The following is an example of a due on encumbrance clause: "Should trustor sell, convey, transfer, dispose of or further encumber said property . . . without the written consent of Beneficiary being first obtained, then Beneficiary shall have the right, at its option, to declare all sums secured hereby forthwith due and payable." La Sala v. American Sav. & Loan Ass'n, 489 P.2d 1113, 1115, 97 Cal. Rptr. 849, 851 (1971).

17. *See* Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 481 (Minn. 1981) (clause became vehicle "to ensure lender's position in money market" as interest rates rose during sixties); *see also* Cherry v. Home Sav. & Loan Ass'n, 81 Cal. Rptr. 135, 138 (Ct. App. 1969) (case recognizing due on sale clause appears frequently in deeds of trust); Coast Bank v. Minderhout, 392 P.2d 265, 268, 38 Cal. Rptr. 505, 508 (1964) (landmark case upholding due on sale clause occurred in early sixties). *See generally* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 769 (1973) (use of clause became widespread during sixties).

18. *See, e.g.*, Tierce v. APS Co., 382 So. 2d 485, 489 (Ala. 1979) (due on sale clause traditionally used to protect lender's security from impairment rather than to keep interest rate current); Wellenkamp v. Bank of Am., 582 P.2d 970, 976, 148 Cal. Rptr. 379, 385 (1978) (due on sale clause designed to protect security from impairment by transfer); Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1, 4 (Ill. 1975) (primary purpose of restraint to protect security interest is justifiable since lender may not know character and financial record of subsequent purchaser). "Security" is used in this analysis in the context of collateral security, that is "property which has been pledged or mortgaged to secure a loan or a sale." BLACK'S LAW DICTIONARY 1216 (5th ed. 1979).

19. *See* Wellenkamp v. Bank of Am., 582 P.2d 970, 974-75, 148 Cal. Rptr. 379, 383-84 (1978). If the lender does not consent to assumption of the loan the transfer may not be possible because the mortgagor cannot obtain financing to pay off the accelerated loan or he may not receive enough money from the purchaser to discharge the loan. Even if the lender consents to the transfer on the condition that the assumption be at a higher interest rate, an inhibitory effect still results in that the mortgagor may have to sell the secured property for less to compensate for the higher interest rate, or not sell the property at all. *See id.* at 974-75, 148 Cal. Rptr. at 383-84.

the same time, the lender retained the option of approving the assumption of a mortgage subject to the imposition of certain conditions.[20] Conditioning approval of an assumption on the transferee's agreement to pay a higher rate of interest became of particular importance to the lender when interest rates began to spiral.[21] Thus, the due on sale clause became a device enabling lenders to maximize their interest and maintain a current loan portfolio by requiring an increase in the rate of interest upon the assumption of the loan.[22]

The due on sale clause is most often attacked as being an invalid restraint on alienation of property.[23] Restraints on alienation of property

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20. *See* Patton v. First Fed. Sav. & Loan Ass'n, 578 P.2d 152, 154 (Ariz. 1978) (lender conditioned approval of assumption on payment of transfer fee and increase in interest rate on loan). A deed of trust may also contain a prepayment penalty. The inclusion of both a prepayment penalty and a due on sale clause would work a greater hardship on the mortgagor by accelerating the maturity of the note and then penalizing the mortgagor by requiring him to pay the note off early. *See* Baltimore Life Ins. Co. v. Harn, 486 P.2d 190, 193 (Ariz. Ct. App. 1971) (invoking prepayment penalty clause with acceleration clause might be "unconscionably harsh"); *see also* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 818 (Tex. 1982) (Spears, J., concurring) (restraining effect of clause more pronounced if prepayment penalty imposed also).

21. *See* Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 848 (Neb. 1980) (court found support for mortgagee's position that due on sale clause "main vehicle for increasing interest rates when money is scarce"); *see also* Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240, 1245 (Colo. 1973) (mortgagee's motive of protecting itself from effects of inflation or deflation not improper or unlawful). *See generally* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 769 (1973) (clause operates as "interest-increasing device" when interest rates rise); Comment, *The Due-On-Sale Clause As a Reasonable Restraint on Alienation—A Proposal for Texas*, 8 ST. MARY'S L.J. 514, 516 (1976) (clause's function of maintaining lender's loan portfolio has become more important in recent years with rising interest rate).

22. *See* Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 848 (Neb. 1980) (due on sale clause allows adjustment of portfolio when interest market rises); Gunther v. White, 489 S.W.2d 529, 532 (Tenn. 1973) (court refused to invalidate due on sale clause merely because exercise of option allowed lender and not mortgagor to profit on higher interest rate). *See generally* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 769-70 (1973). The use of the due on sale clause primarily as a means of increasing interest rates and not for the protection of security has been a substantial consideration in how courts in different jurisdictions have viewed the enforceability of such clauses. *See id.* at 770.

23. *See, e.g.*, Coast Bank v. Minderhout, 392 P.2d 265, 267-68, 38 Cal. Rptr. 505, 507-08 (1964) (mortgagors contended that "AGREEMENT NOT TO ENCUMBER OR TRANSFER PROPERTY" contained invalid restraint on alienation); Sanders v. Hicks, 317 So. 2d 61, 63 (Miss. 1975) (complaint averred that clause requiring lender's consent to transfer property an invalid restraint); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 812 (Tex. 1982) (Arnold maintained that optional acceleration clause was unreasonable restraint on alienation); *see also* Comment, *The Due-On-Sale Clause As a Reasonable Restraint on Alienation—A Proposal for Texas*, 8 ST. MARY'S L.J. 514, 516 (1976) (clause most frequently objected to as

are the oldest social restrictions regarding property, appearing as early as the twelfth and thirteenth centuries in England.[24] The Restatement of Property classifies direct restraints on alienation as disabling restraints, promissory restraints, or forfeiture restraints.[25] A few courts have gone so far as to find these classifications to be exclusive, and permit recovery only when one of the above three restraints can be proven.[26] Any attempt, however, to prevent the exercise of the power of the present owners or their successors to convey their property or to lessen the probability of their doing so by the threat of legal consequences is within the contemplation of the rules and may constitute a restraint against alienation.[27]

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restraint on alienation).

24. *See* RESTATEMENT OF PROPERTY, Part II Restraints on Alienation introductory note (1944); *see also* Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1, 3 (Ill. 1975) (power of alienation of real property dates back to English common law).

25. *See* RESTATEMENT OF PROPERTY § 404 (1944). Section 404 is a definition section, and it provides:

> (1) A restraint on alienation, as that phrase is used in this Restatement, is an attempt by an otherwise effective conveyance or contract to cause a later conveyance
> (a) to be void; or
> (b) to impose contractual liability on the one who makes the later conveyance when such liability results from a breach of an agreement not to convey; or
> (c) to terminate or subject to termination all or part of the property interest conveyed.
> (2) If a restraint on alienation is of the type described in Subsection (1), Clause (a), it is a disabling restraint.
> (3) If a restraint on alienation is of the type described in Subsection (1), Clause (b), it is a promissory restraint.
> (4) If a restraint on alienation is of the type described in Subsection (1), Clause (c), it is a forfeiture restraint.

Id.

26. *See, e.g.*, Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 845 (Neb. 1980) (due on sale clause did not cause any effects described in Restatement § 404, therefore not direct restraint on alienation); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 814 (Tex. 1982) (after determining clause neither disabling nor forfeiture restraint, held clause not promissory restraint since no agreement not to convey); Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 826 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (strictly construed Restatement § 404 and upheld enforcement of due on sale clause since no contractual liability resulted in contravention of Restatement).

27. *See* RESTATEMENT OF PROPERTY, Part II Restraints on Alienation introductory note (1944); Volkmer, *The Application of the Restraints Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 773-74 (1973). Professor Volkmer's analysis concludes that the due on sale clause is in effect a direct restraint in that the provision hinders the mortgagor's ability to alienate in almost the same manner as a promissory restraint. *See id.* at 773-74. The concurring opinion in *Sonny Arnold* quotes Restatement § 404 and Volkmer's article in analyzing the due on sale clause as a restraint on alienation. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 817-18 (Tex. 1982) (Spears, J., concurring). Although the *Sonny Arnold* concurring opinion referred to the introductory *comment* to Restatement § 404, the actual reference is to the introductory *note* to Part II Restraints on Alienation of

The courts have struggled with the Restatement of Property's categorization of restraints, the result being a divergence in opinion as to the validity and enforcement of the due on sale clause.[28]

Over the last twenty years two approaches to the restraints doctrine and the due on sale clause have emerged.[29] Some jurisdictions lean toward automatic enforcement of due on sale clauses, finding either no restraint or a reasonable restraint on alienation.[30] These courts have upheld

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the Restatement of Property. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n., 633 S.W.2d 811, 817-18 (Tex. 1982) (Spears, J., concurring) (incorrect reference to Restatement § 404, introductory comment).

28. *Compare* Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 845 (Neb. 1980) (due on sale clause is not direct restraint on alienation within meaning of Restatement) *and* Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 826 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (clause not restraint on alienation prohibited by Restatement) *with* Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 250 N.W.2d 804, 805-06 (Mich. Ct. App. 1977) (clause found to be restraint although did not fit within Restatement's definition of restraint on alienation) *and* Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 483-84 (Minn. 1981) (clause did not come within Restatement's definition of restraint; limited holding found clause not unlawful restraint on transfer of investment residential property). The United States Supreme Court recently held that the Federal Home Loan Bank Board regulation providing federal savings and loan associations with the power to include a due on sale clause in loan instruments preempts state limitations on the use of due on sale clauses by federal savings and loan associations. *See* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, ___ U.S. ___, 102 S. Ct. 3014, 73 L. Ed. 2d 664 (1982). As such, the Board's regulation of due on sale clauses "bars application of the *Wellenkamp* rule to federal savings and loan associations." *Id.* at ___, 102 S. Ct. at 3031, 73 L. Ed. 2d at 686. In response to the United States Supreme Court's decision in *de la Cuesta*, the 97th Congress enacted section 341 of the "Garn-St Germain Depository Institutions Act of 1982." *See* Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 341, 96 Stat. 1469, 1505-07 (1982). Section 341 provides for a moratorium period of three years after its enactment during which states which presently prohibit due on sale clauses either by statute or common law may suspend application of the *de la Cuesta* decision. *See id.* at 1505-06. Section 341 applies only to loans by federal institutions, such that states may enact legislation regulating the use of due on sale clauses by non-federal institutions during this three year period, notwithstanding the *de la Cuesta* decision and the preceding Act. *See id.* at 1506.

29. *See* Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 553 P.2d 1090, 1091-92 (Wash. 1976) (some courts automatically enforce due on sale clause as reasonable restraint on alienation; other courts find clause unreasonable unless transfer increases risk to lender); *see also* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 336-37 n.13 (Tex. Civ. App.—Amarillo 1981) (some jurisdictions hold clause valid and enforceable per se; other jurisdictions hold clause restraint unless lender justifies enforcement), *aff'd*, 633 S.W.2d 811 (Tex. 1982). *See generally* G. OSBORNE, G. NELSON & D. WHITMAN, REAL ESTATE FINANCE LAW 303 (1979) (automatic enforcement versus case-by-case determination of reasonableness of clause); Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 752-53 (1973) ("per se" approach of validity or invalidity of due on sale clause versus "flexible" approach where restraint is valid if reasonable under circumstances).

30. *See, e.g.*, Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1, 5 (Ill. 1975) (valid-

enforcement of the clause despite the acknowledged motive of the lender to obtain an increased interest rate.[31] While parties have the right to contract to whatever terms they might agree upon,[32] these jurisdictions recognize that equity will provide relief in cases of unconscionable or inequitable conduct.[33] Other courts adopt the approach that a due on sale clause is an unreasonable restraint on alienation, valid only if the lender demonstrates that the clause is reasonable under the circumstances by showing that the transfer impairs his security.[34] The due on sale clause may only be invoked on reasonable grounds[35] and must be related to the

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ity of restraint determined by lender's valid purpose in protecting security interest and not by circumstances of each case); First Commercial Title v. Holmes, 550 P.2d 1271, 1272 (Nev. 1976) (court adopts view that clause automatically enforced where outright sale of secured property); Gunther v. White, 489 S.W.2d 529, 530 (Tenn. 1973) (stipulation in mortgage which provided for acceleration if conditions not complied with was "legal, valid and enforceable" and not penalty or forfeiture).

31. *See, e.g.*, Tierce v. APS Co., 382 So. 2d 485, 487-88 (Ala. 1979) (due on sale clause neither unconscionable nor unenforceable when primary purpose is obtaining higher interest rate); Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240, 1245 (Colo. 1973) (lender's motive of protection from inflation by raising interest rate does not render clause invalid); Gunther v. White, 489 S.W.2d 529, 530-31 (Tenn. 1973) (exercise of option to secure current interest rate not unconscionable or inequitable); *see also* Miller v. Pacific First Fed. Sav. & Loan Ass'n, 545 P.2d 546, 549-50 (Wash. 1976) (express increased interest rate provision in deed of trust upheld).

32. *See, e.g.*, Tierce v. APS Co., 382 So. 2d 485, 487 (Ala. 1979) (due on sale clause included in mortgage for purpose; parties bound by its terms for court cannot rewrite contract); Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 848-49 (Neb. 1980) (freedom to contract should not be unnecessarily restricted); Gunther v. White, 489 S.W.2d 529, 531 (Tenn. 1973) (mortgagee's right to accelerate is contractual right entitled to enforcement).

33. *See, e.g.*, Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240, 1245 (Colo. 1973) (equity will intervene where exercise of clause results from lender's unconscionable or inequitable conduct); Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 849 (Neb. 1980) (due on sale clause like other acceleration clauses subject to equitable defenses); Gunther v. White, 489 S.W.2d 529, 531 (Tenn. 1973) (equity may relieve mortgagor from effect of exercise of clause when mortgagee's conduct unconscionable or inequitable).

34. *See, e.g.*, Patton v. First Fed. Sav. & Loan Ass'n, 578 P.2d 152, 158 (Ariz. 1978) (enforcement of clause without lender's showing transfer jeopardizes security is invalid restraint on alienation); Baltimore Life Ins. Co. v. Harn, 486 P.2d 190, 193 (Ariz. Ct. App. 1971) (acceleration clause will not be exercised absent mortgagee's allegation that security is jeopardized); Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 553 P.2d 1090, 1092 (Wash. 1976) (due on sale clause unreasonable restraint unless lender shows enforcement necessary to protect security).

35. *See, e.g.*, Baltimore Life Ins. Co. v. Harn, 486 P.2d 190, 193 (Ariz. Ct. App. 1971) (impairment of security or circumvention of purpose of due on sale clause are reasonable grounds); First Fed. Sav. & Loan Ass'n v. Lockwood, 385 So. 2d 156, 159 (Fla. Dist. Ct. App. 1980) (lender has right to accelerate when violation of provision impairs security; burden on lender to show "legitimate grounds" for disapproving transfer); Silver v. Rochester Sav. Bank, 424 N.Y.S.2d 945, 947-48 (App. Div. 1980) (where mortgage provided lender would

legitimate interests of the mortgagee.[36] Some jurisdictions have expressly rejected the lender's exercise of the due on sale clause for the sole purpose of exacting a higher rate of interest from the transferee.[37]

California is one of the jurisdictions which has rejected the use of the due on sale clause as a means of increasing interest.[38] In the landmark case of *Coast Bank v. Minderhout*,[39] the California Supreme Court held that the plaintiff had validly provided for acceleration of the maturity of

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not unreasonably withhold consent to transfer, unreasonable for lender to withhold consent because buyer refused to agree to higher interest rate).

36. *See, e.g.*, Tucker v. Lassen Sav. & Loan Ass'n, 526 P.2d 1169, 1175, 116 Cal. Rptr. 633, 639 (1974) (protecting security from waste and depreciation and avoiding "moral risk" of resorting to security in event of default viewed as legitimate interests); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 250 N.W.2d 804, 809 (Mich. Ct. App. 1977) (where lender alleged no impingement upon any legitimate interests justifying enforcement of clause, lender's exercise of clause to maintain current loan portfolio was unreasonable); Sanders v. Hicks, 317 So. 2d 61, 64 (Miss. 1975) (court does not mention any legitimate interests other than impairment of security).

37. *See, e.g.*, Patton v. First Fed. Sav. & Loan Ass'n, 578 P.2d 152, 158 (Ariz. 1978) (lender could not arbitrarily withhold consent to transfer or condition assent on increased interest rate); Wellenkamp v. Bank of Am., 582 P.2d 970, 976, 148 Cal. Rptr. 379, 385 (1978) (court rejected lender's desire to maintain loan portfolio at current interest rate as justification for restraint); Silver v. Rochester Sav. Bank, 424 N.Y.S.2d 945, 947 (App. Div. 1980) (in absence of express reservation of right to increase interest rate, lender cannot use clause to protect self from rising interest rate). *See generally* Comment, *Judicial Treatment of the Due-On-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1116-18 (1975) (discussion of "money-market" argument). *But see* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, ___ U.S. ___, ___, 102 S. Ct. 3014, 3031, 73 L. Ed. 2d 664, 685-86 (1982). The United States Supreme Court held that the Federal Home Loan Bank Board's regulation of due on sale clauses preempts conflicting state restrictions. *See id.* at ___, 102 S. Ct. at 3031, 73 L. Ed. 2d at 685-86. The Court reviewed the underlying policy reasons for the federal regulation and the interest income benefits realized by savings and loan institutions in exercising the clause. *See id.* at ___, 102 S. Ct. at 3030, 73 L. Ed. 2d at 685. The Court's determination that the *Wellenkamp* rule is inapplicable to federal savings and loan institutions implies that state courts cannot declare the exercise of a due on sale clause by a federally chartered lending institution invalid when the sole purpose is to obtain an increased interest rate on the assumed loan. *See id.* at ___, 102 S. Ct. at 3030, 73 L. Ed. 2d at 686; *see also* Garn-St Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, § 341, 96 Stat. 1469, 1505-07 (1982) (lender may enter into and enforce contract containing due on sale clause subject to three year moratorium period from date of enactment of Act).

38. *See* Wellenkamp v. Bank of Am., 582 P.2d 970, 976, 148 Cal. Rptr. 379, 385 (1978) (leading case which rejects lender's loan portfolio argument). It is interesting to note that initially the California Supreme Court recognized a due on sale clause as a valid and reasonable restraint on alienation. *See* Coast Bank v. Minderhout, 392 P.2d 265, 268, 38 Cal. Rptr. 505, 508 (1964).

39. 392 P.2d 265, 268, 38 Cal. Rptr. 505, 508 (1964) (leading case recognizing validity of due on sale clause); *see also* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 771 (1973) (*Minderhout* greatly influenced development of law of restraints on alienation).

the note in the event of encumbrance or transfer of the property, and that such a clause was not an unreasonable restraint on alienation.[40] During the next ten years the California courts modified their position.[41] In 1974, the California Supreme Court, in *Tucker v. Lassen Savings and Loan Association*,[42] stated that in determining when a restraint is reasonable the court must examine not only the justification for the restraint but also the quantum of restraint.[43] Finally, in 1978, in *Wellenkamp v.*

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40. *See* Coast Bank v. Minderhout, 392 P.2d 265, 267-68, 38 Cal. Rptr. 505, 507-08 (1964). The court found that an equitable mortgage had been created by an instrument entitled "AGREEMENT NOT TO ENCUMBER OR TRANSFER PROPERTY," and that the plaintiff bank was not unreasonable in conditioning its extension of credit to the borrowers on their retaining ownership in the secured property for the duration of the loan. *See id.* at 266-68, 38 Cal. Rptr. at 506-08.

41. *See* La Sala v. American Sav. & Loan Ass'n, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971); Cherry v. Home Sav. & Loan Ass'n, 81 Cal. Rptr. 135 (Ct. App. 1969). In *Cherry*, the California Court of Appeals upheld a lender's enforcement of a due on sale clause, recognizing that parties have the right to make such contractual agreements. *See* Cherry v. Home Sav. & Loan Ass'n, 81 Cal. Rptr. 135, 138-39 (Ct. App. 1969). The court did not view the lender's refusal to approve the assumption unless a higher interest rate was agreed upon as either bad faith or unfair dealing since the lender was merely asserting rights under the terms of the note. The majority, finding the intent of the provision clear, refused to rewrite the contract and insert an implied covenant that the lender act reasonably in invoking the clause. *See id.* at 139. The court stated that the due on sale clause serves the valid business interests of protecting the lender's security from possible depreciation or destruction upon transfer to a buyer whose character and financial status are unknown to the lender. The clause also allows the lender to avail himself of rising interest rates upon transfer of the property. *See id.* at 138. In La Sala v. American Sav. & Loan Ass'n, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971), the California Supreme Court distinguished the due on sale clause from the due on encumbrance clause, finding that justifications for enforcement of the former were not applicable in enforcement of the latter. *See id.* at 1123-26, 97 Cal. Rptr. at 859-62. Since a junior lien does not terminate the mortgagor's interest in the security or transfer possession as in an outright sale, a further encumbrance does not have the same increased risk effect that a sale might have. *See id.* at 1123, 97 Cal. Rptr. at 859. The court concluded that while due on sale clauses were clearly valid and might be automatically enforced under *Minderhout*, due on encumbrance clauses would only be sustained when enforcement was reasonably necessary to protect the lender's security. *See id.* at 1126, 97 Cal. Rptr. at 862. The lender in *La Sala* had offered to waive acceleration in exchange for the borrowers' agreeing to a higher interest rate. *See id.* at 1116, 97 Cal. Rptr. at 852. The majority stated that when enforcement is not reasonably necessary and the clause is used to obtain "collateral benefits," it must be held as an unlawful restraint. *See id.* at 1125, 97 Cal. Rptr. at 864.

42. 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

43. *See id.* at 1173, 116 Cal. Rptr at 637. Quantum of restraint is the practical effect of the restraint on alienation. The California Supreme Court reasoned that the greater the quantum of restraint, the greater the justification that is required. *See id.* at 1173, 116 Cal. Rptr. at 637. The *Tucker* court concluded that automatic enforcement of a "due on" clause in an installment land contract was not justified, and held that the clause would only be enforced in that context when the lender justified the restraint by showing a threat to "one of his legitimate interests." *See id.* at 1174-75, 116 Cal. Rptr. at 638-39. The majority specifically rejected "a lender's interest in maintaining its portfolio at current interest rates" as a

Bank of America,[44] the California Supreme Court rejected automatic enforcement of a due on sale clause,[45] and held that the clause would only be enforced upon an outright sale if the lender demonstrated that it was reasonably necessary to protect his security interests.[46] The position taken by the California Supreme Court becomes relevant to *Sonny Arnold, Inc. v. Sentry Savings Association,*[47] in that Sonny Arnold urged the Texas courts to adopt the *Wellenkamp* rule, and hold the due on sale clause invalid since Sentry failed to demonstrate impairment of the security.[48]

In *Sonny Arnold, Inc. v. Sentry Savings Association,*[49] a case of first impression, the Texas Supreme Court was to determine whether the due on sale clause in a deed of trust constituted an invalid restraint on the alienation of property.[50] The court examined the definition of a restraint

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legitimate interest justifying the restraint. *See id.* at 1175 n.10, 116 Cal. Rptr. at 639 n.10. *Cherry* was disapproved by the court to the extent that it was inconsistent with the *Tucker* opinion. *See id.* at 1176, 116 Cal. Rptr. at 640. The defendants in *Tucker* had sought automatic enforcement of the due on sale clause without any showing of impairment to their legitimate interests. *See id.* at 1176, 116 Cal. Rptr. at 640.

44. 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

45. *See id.* at 977, 148 Cal. Rptr. at 385-86 (court rejected automatic enforcement of due on clause upon outright sale of secured property, disapproving *Cherry* and overruling *Minderhout* to extent inconsistent with *Wellenkamp*).

46. *See id.* at 977, 148 Cal. Rptr. at 386. The lender in *Wellenkamp* had offered to waive his right to accelerate if the transferee would assume the loan at a higher interest rate. *See id.* at 972, 148 Cal. Rptr. at 381. The court expressly rejected the "lender's interest in maintaining its loan portfolio at current interest rates" as a justification for the restraint, stating that economic risks are inherent in "lending transactions" and should be taken into consideration in determining the initial interest rate on the loan. *See id.* at 976, 148 Cal. Rptr. at 385.

47. 633 S.W.2d 811 (Tex. 1982).

48. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 338 (Tex. Civ. App.—Amarillo 1981), *aff'd,* 633 S.W.2d 811, 813 (Tex. 1982).

49. 633 S.W.2d 811 (Tex. 1982).

50. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 615 S.W.2d 333, 336 (Tex. Civ. App.—Amarillo 1981), *aff'd,* 633 S.W.2d 811, 813 (Tex. 1982). Three courts had dealt with due on sale clauses collaterally without ruling on whether they were a restraint on alienation. *See, e.g.,* A.R. Clark Inv. Co. v. Green, 375 S.W.2d 425, 431-36 (Tex. 1964) (upheld provision in promissory notes which allowed mortgagee to accelerate notes and foreclose liens on personal property in event mortgagor violated terms of chattel mortgage); Ashley v. Leitch, 533 S.W.2d 831, 831-32 (Tex. Civ. App.—Eastland 1975, writ ref'd n.r.e.) (affirmed payee's exercise of contract provision in promissory note which reserved right to approve transfer of property securing note or declare entire note due and payable); Maier v. Thorman, 234 S.W. 239, 239-40 (Tex. Civ. App.—San Antonio 1921, no writ) (court considered deed of trust which provided that secured land would not be sold or transferred without mortgagee's consent where mortgagee consented to assumption of note, making original mortgagor surety thereon). After the Amarillo Court of Civil Appeals held the due on sale clause valid in *Sonny Arnold,* and before the Texas Supreme Court heard the case on ap-

on alientation found in the Restatement of Property,[51] and concluded the Restatement did not prohibit the clause.[52] Although the due on sale clause may operate as an indirect restraint,[53] the Texas Supreme Court maintained that the clause did not come within the usual category of invalid restraints on alienation.[54] Noting that a mortgage is interpreted by the same rules of construction as contracts,[55] Justice McGee emphasized an individual's right to contract so long as the contract is not illegal or contrary to public policy.[56] The *Arnold* court recognized that as an accel-

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peal, the Austin Court of Civil Appeals directly addressed the validity of a due on sale clause on restraint on alienation grounds. *See* Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 826 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (clause not restraint on alienation prohibited by Restatement). The Texas Supeme Court in *Sonny Arnold* makes no mention of the *Crestview* decision, nor the fact that the court had refused Crestview's application for writ of error, holding that there was no reversible error. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811 (Tex. 1982).

51. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 813 (Tex. 1982) (court quoting Restatement of Property § 404 and classification of restraints as disabling, promissory and forfeiture).

52. *See id.* at 813-15. The court concluded that the due on sale clause is neither a disabling nor a forfeiture restraint since it does not operate to make a later conveyance void or terminate the interest upon conveyance. *See id.* at 813-14. The majority reasoned that the clause is not a promissory restraint because the provision does not include an agreement not to convey as proscribed by Restatement § 404(1)(b), nor is "contractual liability" imposed on the mortgagor-transferor of the property. *See id.* at 814-15; RESTATEMENT OF PROPERTY § 404 comment g (1944). The Restatement defines "contractual liability" as that liability which results from the transfer in violation of the restraint so that the mortgagor-transferor is liable for damages or subject to equitable relief in the form of specific performance or injunction or a combination of those remedies. *See* RESTATEMENT OF PROPERTY § 404 comment g (1944).

53. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982). *But see* Baltimore Life Ins. Co. v. Harn, 486 P.2d 190, 193 (Ariz. Ct. App. 1971) (clause clearly restraint on alienation); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 250 N.W.2d 804, 806 (Mich. Ct. App. 1977) (court expands Restatement's definition of restraint to include due on sale clause); *see also* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 773-74 (1973). Professor Volkmer analyzes the due on sale clause and concludes that it "is truely a direct restraint" in that it hinders a "mortgagor's ability to alienate . . . as directly as the classical promissory restraint." *Id.* at 773-74.

54. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982); *see also* Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 845 (Neb. 1980) (due on sale clause does not result in any effects proscribed by Restatement § 404 and cannot be direct restraint).

55. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982); *see also* Gunther v. White, 489 S.W.2d 529, 531 (Tenn. 1973) (mortgagee's right to accelerate based on principle of contract).

56. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982) (citing Curlee v. Walker, 112 Tex. 40, 244 S.W. 497 (1922) and Goodstein v. Huffman, 222 S.W.2d 259, 260 (Tex. Civ. App.—Dallas 1949, writ ref'd)).

eration provision, the due on sale clause is governed by the rules and defenses of equity[57] such as default due to accident or mistake or where the lender has committed fraud or other inequitable conduct.[58] The court noted that Arnold had alleged no fraud or deceit by Sentry in execution of the note and deed of trust.[59] Stressing the harshness of the acceleration remedy,[60] the majority stated that such a contractual provision must be "clear and unequivocal" to be enforced.[61] The Texas Supreme Court found nothing evil or unreasonable in a lender's exacting a higher interest rate from a transferee in exchange for waiving exercise of the option, and stated that such a requirement serves a valid business purpose.[62] The Texas Supreme Court concluded that the due on sale clause was valid and enforceable,[63] and that Sentry had acted within its contractual rights in accelerating the maturity of the note when Arnold transferred the secured property without complying with the unambiguous terms of the deed of trust.[64]

Justice Spears and three other justices concurred in the majority's result, but dissented from the rule established—that a restraint must come within the three classifications in section 404 of the Restatement.[65] The concurring opinion recognized the practical restraining effect of the due on sale clause on a mortgagor who attempts to convey his property.[66] The

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57. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982) (court alternatively referred to clause as optional acceleration provision); *see also* Gunther v. White, 489 S.W.2d 529, 529-30 (Tenn. 1973) (referring to due on sale clause as acceleration provision).

58. Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982) (quoting Parker v. Mazur, 13 S.W.2d 174 (Tex. Civ. App.—San Antonio 1928, writ dism'd)).

59. *See id.* at 815.

60. *See id.* at 815; *see also* A.R. Clark Inv. Co. v. Green, 375 S.W.2d 425, 436 (Tex. 1964) (acceleration remedy harsh).

61. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982); *see also* A.R. Clark Inv. Co. v. Green, 375 S.W.2d 425, 436 (Tex. 1964) (acceleration provision should be "clear and unequivocal").

62. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982); *see also* Tierce v. APS Co., 382 So. 2d 485, 487 (Ala. 1979) (clause serves valid business purpose in allowing lender to terminate loan upon transfer because of rising interest rate); Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 849 (Neb. 1980) (clause enables lending associations to balance "portfolio return with cost of money").

63. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 816 (Tex. 1982).

64. *See id.* at 816.

65. *See id.* at 816-21 (Spears, J., concurring). Justice Spears recognized that the majority's "overly broad" rule precludes review of other contractual provisions which may operate as a practical restraint on alienation and yet do not fall within the three categories of Restatement § 404. *See id.* at 821.

66. *See id.* at 818 (Spears, J., concurring) (inhibitory effect of due on sale clause on mortgagor); *see also* Wellenkamp v. Bank of Am., 582 P.2d 970, 974-75, 148 Cal. Rptr. 379, 384 (1978) (clause results in restraint on alienation); Crestview, Ltd. v. Foremost Ins. Co.,

minority reasoned that if a mortgagor tries to transfer the secured property he faces the "onerous contractual liability" of acceleration of the maturity date and a possible prepayment penalty.[67] Even if the option to accelerate is waived by the lender upon the buyer's assumption of the loan at a higher interest rate, the mortgagor must accede to the buyer's insistence of a lower purchase price or not go through with the sale.[68] Justice Spears discussed the valid business interest served by the clause in allowing the lender to adjust his loan portfolio, which in turn allows the borrower to receive a lower interest rate on the initial loan.[69] The concurrence balanced the benefits derived from the clause with its practical restraining effect, and concluded that the due on sale clause in *Sonny Arnold* was a reasonable restraint on alienation.[70]

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621 S.W.2d 816, 823 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (indirect restraint consists of inhibiting effect). *See generally* Comment, *Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1112-13 (1975) (discussion of impact of acceleration clause).

67. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 818 (Tex. 1982) (Spears, J., concurring). The concurrence finds an "onerous contractual liability" imposed on the mortgagor because he must remit the entire amount due immediately rather than pay his usual installment. *See id.* at 818. When both a prepayment penalty and a due on sale clause are contained in a loan agreement, the restraining effect is even greater. The homeowner is forced to pay off the entire amount of the loan early, and then assessed a penalty for doing so. *See id.* at 818; *see also* Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580, 585 (N.C. 1976) (contractual agreement with due on sale clause and no prepayment penalty appears fair).

68. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 818 (Tex. 1982) (Spears, J., concurring) (provision lessens likelihood of transfer during times when interest rate high); *see also* Wellenkamp v. Bank of Am., 582 P.2d 970, 974-75, 148 Cal. Rptr. 379, 383-84 (1982). *But see* Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 845 (Neb. 1980) ("not every impediment to a sale is a restraint on alienation, let alone contrary to public policy"); Miller v. Pacific First Fed. Sav. & Loan Ass'n, 545 P.2d 546, 548-49 (Wash. 1976) (vendor's ability to obtain "preferred asking price" might be impaired, but provision not restraint on actual transfer nor constraint on freedom to alienate). The *Sonny Arnold* majority relied on both *Occidental* and *Miller* in finding that the due on sale clause is not a direct restraint on alienation. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 814-15 (Tex. 1982). The concurrence noted that the majority's reliance on *Miller* was misplaced since *Miller* dealt with the enforcement of an increased interest rate provision rather than a due on sale clause, a distinction made by the Washington Supreme Court in the later case of Bellingham Fed. Sav. & Loan Ass'n v. Garrison, 553 P.2d 1090, 1091 (Wash. 1976). *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 819 (Tex. 1982) (Spears, J., concurring).

69. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 820 (Tex. 1982) (Spears, J., concurring); *see also* Dunham v. Ware Savings Bank, 423 N.E.2d 998, 1001-02 (Mass. 1981) (acceleration clause reduces "interest rate risk" to mortgagee; results in lower interest rate for mortgagor).

70. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 820-21 (Tex. 1982) (Spears, J., concurring) ("utility of clause outweighs inherent restraint"); RESTATEMENT OF PROPERTY, Part II Restraints on Alienation introductory note (1944). The introductory note

The Texas Supreme Court was justified in upholding the enforceability of the particular due on sale clause in *Sonny Arnold*.[71] The court was short-sighted, however, in choosing to apply mechanically the Restatement's definition of restraint on alienation to the clause in question.[72] The majority could have found that the due on sale clause was a *reasonable* restraint by acknowledging the practical restraining effect of such a clause,[73] and analyzing its reasonableness.[74] Instead, the court found that the clause was not a restraint because it did not fall precisely within the three categories of restraints specified by the Restatement.[75] The Introductory Note to Part II of the Restatement, however, explains that *any agreement* which seeks to eliminate or impede the power to convey one's property and does so in terms of legal consequences for such a conveyance, or attempted conveyance, is the type of interference contemplated

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of Restatement Part II preceding § 404 states that to uphold a restraint on alienation, the objective to be accomplished by imposing the restraint must justify or outweigh the degree of restraint which results so that the policies favored by the freedom of alienation are not impaired. *See* RESTATEMENT OF PROPERTY, Part II Restraints on Alienation introductory note (1944); *see also* Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1, 3 (Ill. 1975) (crucial inquiry directed at comparing "utility of restraint" with "injurious consequences" resulting from enforcement); Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580, 586 (N.C. 1976) (due on sale clause justified under balancing test).

71. Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811 (Tex. 1982).

72. *See id.* at 821 (Spears, J., concurring) (majority's analysis of due on sale clause as restraint prohibited by Restatement § 404 in contravention with court's reasoning in *Mattern*); *cf.* Mattern v. Herzog, 367 S.W.2d 312, 320 (Tex. 1963) (mechanical application of rule prohibiting restraints unnecessarily circumscribes freedom to contract; provision must be related to evil sought to be prevented by rule before invalidation).

73. *See* Wellenkamp v. Bank of Am., 582 P.2d 970, 974-75, 148 Cal. Rptr. 379, 384 (1978) (practical effect of due on sale clause is to inhibit alienation); Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 483 (Minn. 1981) (clause results in restraint on alienation); *see also* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 818 (Tex. 1982) (Spears, J., concurring) (inhibitory effect of clause during times of rising interest rate).

74. *See, e.g.*, Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240, 1243 (Colo. 1973) (court adopts view that validity of restraint depends upon clause's reasonableness with regard to parties' justifiable interests); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 250 N.W.2d 804, 806 (Mich. Ct. App. 1977) (jurisdiction has adopted flexible approach so that restraint not enforced unless reasonable in given case); Sanders v. Hicks, 317 So. 2d 61, 64 (Miss. 1975) (court held due on sale clause not per se invalid, but may be valid if reasonable under circumstances); *see also* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 819 (Tex. 1982) (Spears, J., concurring). Justice Spears noted that this approach has been used by several courts in their determination that the due on sale clause is a *reasonable* restraint on alienation. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 819 (Tex. 1982) (Spears, J., concurring).

75. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 813-14 (Tex. 1982). The Restatement of Property § 404 proscribes three restraints: disabling, promissory and forfeiture. *See id.* at 813-14; RESTATEMENT OF PROPERTY § 404 (1944).

by the Restatement as a restraint.[76]

The court's determination that the due on sale clause in *Sonny Arnold* was not a restraint on alienation instead of recognizing it as a *reasonable* restraint achieves a rule which may be applied not only to various due on sale clauses but also to other similar contractual provisions in general.[77] The court relies on the contractual nature of the clause and the parties' rights to negotiate its terms,[78] but overlooks the fact that since due on sale clauses are purportedly "bargained-for,"[79] the language and the terms of the clause will naturally vary from one instrument to another.[80] Although the due on sale clause in *Sonny Arnold* was found to be clear and unequivocal, not all due on sale clauses contain the same language and clarity.[81]

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76. *See* RESTATEMENT OF PROPERTY, Part II Restraints on Alienation introductory note (1944). The Restatement emphasizes that the underlying rationale operating throughout property law is that the freedom to alienate one's property interest is essential to social welfare. *See id; see also* Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1, 3 (Ill. 1975) (power of alienation considered "socially and economically desirable" since common law and viewed as "attribute of ownership").

77. *Cf.* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 821 (Tex. 1982) (Spears, J., concurring). The concurring opinion warns of the potential problem in applying such an "overly broad" rule. Contractual provisions not yet before the court may be upheld under the majority rule even though the provisions may restrain the alienation of property "as clearly and as effectively" as the restraints prohibited by Restatement § 404. *See id.* at 821.

78. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815-16 (Tex. 1982). The court finds nothing evil or unreasonable in a lender's conditioning approval of a transfer on the purchaser's agreeing to assume the loan at a higher interest rate. As such, when Arnold failed to obtain Sentry's consent before transferring the property, Sentry acted "within its *agreed upon rights*" in accelerating the note. *Id.* at 815-16 (emphasis added); *see, e.g.*, Mills v. Nashua Fed. Sav. & Loan Ass'n, 433 A.2d 1312, 1315 (N.H. 1981) (parties generally bound by terms freely agreed to; court will not rewrite contract because harsh or inequitable); Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580, 587 (N.C. 1976) (law of contracts states that if "a man consents to bind himself, so shall he be bound"); Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 824 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (clause usually arises from agreement).

79. *See, e.g.*, Baltimore Life Ins. Co. v. Harn, 486 P.2d 190, 192-93 (Ariz. Ct. App. 1971) (clause is bargained-for element); Mills v. Nashua Fed. Sav. & Loan Ass'n, 433 A.2d 1312, 1315 (N.H. 1981) (parties in equal bargaining position to protect own interest); Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 821-22 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (likely that due on sale clause and prepayment provision were bargained for).

80. *Compare* Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 553 P.2d 1090, 1090-91 (Wash. 1976) (no mention of increased interest rate upon transfer in deed of trust) *with* Miller v. Pacific First Fed. Sav. & Loan Ass'n, 545 P.2d 546, 547 (Wash. 1976) (express provision that lender may consent to transfer and increase interest rate).

81. *See, e.g.*, Silver v. Rochester Sav. Bank, 424 N.Y.S.2d 945, 946 (App. Div. 1980) (lender conditioned approval of transfer upon increased interest rate; deed of trust recited consent would "not be unreasonably withheld"); Continental Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013, 1019 (Okla. 1977) (held transfer fee was not "bargained-for element" of

It is interesting to note that the Texas Supreme Court declined to pass on an ambiguous due on sale clause in *Crestview Ltd. v. Foremost Ins. Co.*,[82] on the ground that there was "no reversible error."[83] In *Crestview*, the Austin Court of Civil Appeals upheld a due on sale clause which required the lender to act reasonably but contained no express increased interest rate provision.[84] Clearly, the justifications for upholding a due on sale clause containing an express increased interest rate provision, as in *Sonny Arnold*, are not applicable to the clause in *Crestview* which provided no notice to the mortgagor that approval of the transfer would be conditioned upon an increased interest rate or a reduction in principal.[85] The court's holding in *Sonny Arnold* does not resolve the problem of unfair surprise posed by vague due on sale clauses.[86]

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mortgage since mortgage contained no such provision); Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 818 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (lender conditioned consent to transfer upon increased interest rate or reduction in principal; deed of trust provided approval would "not be unreasonably withheld").

82. 621 S.W.2d 816, 816 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.) (writ refused prior to oral argument in *Sonny Arnold*).

83. *See id.* at 816; *see also* TEX. R. CIV. P. 483. The Texas Rules of Civil Procedure state that the notation "writ ref'd n.r.e." denotes that the "Supreme Court is not satisfied that the opinion of the Court of Civil Appeals in all respects has correctly declared the law, but is of the opinion that the application presents no error which requires reversal." *Id.*

84. *See* Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 818 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.). The deed of trust in *Crestview* provided:

> In the event Grantors, or any owner of the Mortgaged Premises, without first obtaining approval of Noteholder (which approval shall not be unreasonably withheld), should sell or otherwise dispose of the Mortgaged Premises, or any part thereof, at any time before this Deed of Trust is fully released and discharged, Noteholder shall have the option to declare the indebtedness hereby secured due and payable . . . .

Id. at 818. The reasoning used by the Austin Court of Civil Appeals in *Crestview* is interesting in that it upholds the validity of the due on sale clause under both the per se approach and the reasonable under the circumstances approach. *See id.* at 826-27. *Compare* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982) (majority upholds validity of clause under per se approach) *with id.* at 816 (Spears, J., concurring) (concurrence finds clause reasonable under circumstances).

85. *See* Crestview, Ltd. v. Foremost Ins. Co., 621 S.W.2d 816, 818 (Tex. Civ. App.—Austin 1981, writ ref'd n.r.e.).

86. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 820-21 (Tex. 1982) (Spears, J., concurring). By failing to explain or distinguish *Crestview* in the *Sonny Arnold* decision, the court did not avail itself of the opportunity to clarify when a due on sale clause is sufficiently "clear and unequivocal" to be valid. *See id.* at 820-21; *see also* Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 250 N.W.2d 804, 808-09 (Mich. Ct. App. 1977) (quoting Justice Lake's dissent in Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580, 589 (N.C. 1976)). Justice Lake stated:

> [T]he accelerating event . . . is a 'sleeper' provision, tucked away in the printed portion of the deed of trust so that its meaning . . . would not readily catch the attention of a mortgagor . . . . To prevent this clause from being a loan shark's trap for the unwary borrower, it should state *explicitly* that it is intended to permit the

The Texas Supreme Court recognized the significant justifications for enforcement of due on sale clauses.[87] Not only does it protect the lender's security from being depreciated or destroyed,[88] it serves the valid business interest of enabling a lender to maintain his loan portfolio at current interest rates, a concern which also benefits the public.[89] Both the majority and concurring opinions in *Sonny Arnold* emphasize the clarity of the terms contained in the particular clause[90] and the fact that the provision was neither wrongfully nor improperly exercised in an oppressive manner.[91]

The Texas Supreme Court's decision in *Sonny Arnold* will provide greater certainty and predictability in the enforcement of due on sale

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money lender to increase the interest rate or to require any other penalty to be paid to the lender.

Id. at 589 (emphasis added). *See generally* Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 799 (1973) (if clause allows variable interest rate, element of disclosure lacking).

87. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 820 (Tex. 1982) (Spears, J., concurring).

88. *See, e.g.*, Cherry v. Home Sav. & Loan Ass'n, 81 Cal. Rptr. 135, 138 (Ct. App. 1969) (court recognized inclusion of clause to prevent impairment of security); Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 480 (Minn. 1981) (clause created to allow lender to evaluate transferee and seek additional interest or security if necessary or terminate loan agreement); Continental Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013, 1017 (Okla. 1977) (underlying rationale of clause to protect mortgagee's security interest); *see also* Dunham v. Ware Sav. Bank, 423 N.E.2d 998, 1001-02 (Mass. 1981) (due on sale clause reduces risk so that bank willing to make loans at lower interest rate); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 820 (Tex. 1982) (Spears, J., concurring) (clause justified as means of protecting security).

89. *See, e.g.*, Dunham v. Ware Sav. Bank, 423 N.E.2d 998, 1001-02 (Mass. 1981) (due on sale clause reduces risk so bank willing to make loans at lower interest rate); Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 849 (Neb. 1980) (due on sale clause critical to lending institutions' survival, therefore public benefits); Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580,585 (N.C. 1976) (due on sale clause enables both lender and borrower to "take advantage of fluctuations in interest rates"). Due on sale clauses are more desirable than variable interest rates in that a variable interest rate fluctuates according to the market, whereas a due on sale clause allows the original borrower to retain the original interest rate. *See* Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240, 1245 (Colo. 1973). If the original mortgator sells the property, the purchaser will probably assume the loan at a rate higher than the original interest rate, but lower than the current interest rate. If lenders did not have a means of adjusting their interest rate returns, they would be forced to make short-term loans. *See id.* at 1245. Original borrowers would have to refinance their loan several times before retiring the indebtness. Monthly payments would also be higher with short-term loans. *See id.* at 1245.

90. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815-16 (Tex. 1982) (terms of mortgage clear). The concurrence emphasizes that the clause discloses its express purpose to obtain a higher interest rate. *See id.* at 820-21 (Spears, J., concurring).

91. *See id.* at 816 (clause not wrongfully or improperly enforced); *id.* at 820-21 (Spears, J. concurring) (clause not "inequitably, arbitrarily, or oppressively exercised").

clauses by avoiding a case by case determination of the validity of the clause.[92] Yet, savings and loan institutions should not lose sight of the reason *why* the particular due on sale clause in *Sonny Arnold* was upheld.[93] Lenders utilizing a due on sale clause in a deed of trust should insure that the terms of the clause are "clear and unequivocal" and that the mortgagor is cognizant of the clause's full import.[94] The burden of proving that a clause was oppressively exercised may be on the mortgagor,[95] but the responsibility for maintaining the legitimacy and enforceability of the due on sale clause lies ultimately with its drafters.[96] If the clause is to continue to serve both as a "sword" and a "shield,"[97] the borrowing public is entitled to a little "armor."

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92. *Compare* Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1, 5 (Ill. 1975) (per se approach promotes "stability of real estate titles" and results in greater certainty and predictability as to clause's enforcement) *with* Comment, *Judicial Treatment of the Due-On-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1120-23 (1975) (reasonable under circumstances approach has disadvantage of producing "a degree of uncertainty upon commercial transactions.")

93. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815-16 (Tex. 1982) (Sentry acting within "clear terms of mortgage" which expressly provided for increased interest rate in return for waiver of acceleration clause).

94. *See* Silver v. Rochester Sav. Bank, 424 N.Y.S.2d 945, 947 (App. Div. 1980). The court stated, "[a]t best, such a clause in the mortgage, standing alone, is ambiguous and misleading to the mortgagor." *Id.* at 947.

95. *See, e.g.*, First Commercial Title, Inc. v. Holmes, 550 P.2d 1271, 1272 (Nev. 1976) (automatic enforcement of clause; burden on mortgagor to establish unenforceability); Occidental Sav. & Loan Ass'n v. Venco Partnership, 293 N.W.2d 843, 850 (Neb. 1980) (clause valid and enforceable in absence of proof by mortgagor that enforcement inequitable); Mutual Fed. Sav. & Loan Ass'n v. American Medical Servs., Inc., 223 N.W.2d 921, 925 (Wis. 1974) (proof of impairment of security not condition precedent to foreclosure under clause).

96. *See* Comment, *The Due-On-Sale Clause As a Reasonable Restraint on Alienation—A Proposal For Texas*, 8 ST. MARY'S L.J. 514, 528 n.107 (1976) (suggested rewording of due on sale clause to provide more adequate notice to borrower). Lenders should keep in mind that "[i]n Texas a writing is generally construed against its author." Republic Nat'l Bank v. Northwest Nat'l Bank, 578 S.W.2d 109, 115 (Tex. 1979).

97. *See* Comment, *Judicial Treatment of the Due-On-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1117-18 (1975) (clause operates as shield from business risks; serves as weapon to combat changing economic conditions).