Beyond Tucker v. Lassen: The Future of the Due-on-Sale Clause in California

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BEYOND TUCKER v. LASSEN: THE FUTURE OF THE DUE-ON-SALE CLAUSE IN CALIFORNIA

_Tucker v. Lassen Savings and Loan Association_ might be termed the case of the seven thousand dollar loan which shook the lending industry. The decision has received considerable attention within the real estate and lending community and promises to cause significant changes in the use of the due-on-sale clause in California. In brief, the California Supreme Court in _Tucker_ ruled that a lender may not automatically enforce a due-on-sale clause in instances in which the trustor-obligor has entered into an installment land contract to sell the real property secured by a deed of trust (or mortgage) to a third party. The purpose of this note is to consider the _Tucker_ decision in light of previous California cases and to explore the impact which it may have on future use of the due-on-sale clause. The note begins with a dis-

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2. The term “trustor-obligor” describes anyone who secures a loan under a deed of trust for the purchase of real property.
   The use of deed of trust in a real estate transaction may be best understood by illustration. Suppose _A_ wishes to buy some land. He goes to an institutional lender (_L_) and applies for a loan. _L_ agrees to make the loan, on condition that _A_ executes a trust deed. _A_, _L_, and a trust company (_T_) draw up the necessary document. Technically, _A_ puts the land in trust, and he names _T_ as trustee and _L_ as beneficiary. _A_ becomes a trustor.
   In theory, when _A_ signs the trust deed, title to the land passes from _A_ to _T_. See R. Hetland, _Syllabus on California Real Property Secured Transactions_ (1962). On the other hand, _T_ receives no right of possession. Comment, _Debtor-Selection Provisions Found in Trust Deeds and the Extent of their Enforceability in the Courts_, 35 S. Cal. L. Rev. 475 (1962). Moreover, although title technically passes to _T_, he must reconvey the property to _A_ upon payment of the loan: “In other words, legal title passes to the trustee solely for the purpose of securing the performance of the obligation and he receives only such title as necessary for the execution of his trust; until a default occurs or the obligation is satisfied by the trustor, the trustee’s title remains inactive.” 1 H. Miller & M. Starr, _Current Law of California Real Estate_ 372 (1965) [hereinafter cited as Miller & Starr].
3. See text accompanying notes 62-77 infra.
4. 12 Cal. 3d at 637, 526 P.2d at 1175, 116 Cal. Rptr. at 639.
5. The potential impact which the _Tucker_ decision could have on the lending industry, and on society as a whole, is significant. In California, as of December 31, 1973, savings and loan associations held mortgage loans totalling $41,116,457,000. _Calif. Dep’t of Finance, California Statistical Abstract_, 123 (1974). In the entire United States, in 1972, $51,400,000,000 worth of mortgage loans was made in one year, of which $8,500,000,000 went for home construction and $26,600,000,000 went for home

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cussion of the California cases prior to Tucker which have dealt with "due-on" provisions. Following this introduction, the focus shifts to the new test announced in the Tucker decision and the applications which this test might have to real property transactions such as "wrap-around" mortgages, sale-leasebacks, sale-buybacks, "front money" arrangements, and outright sales in which a legal title is conveyed to the buyer at closing. The note considers as well the effect of the Tucker decision on foreclosures by national banks. Finally, it discusses three grounds upon which the due-on-sale clause may be challenged in the future: as a prejudgment seizure of property in violation of the fourteenth amendment, a contractual penalty, and an adhesion provision.

The "Due-on" Clause: California Cases Prior to Tucker

Most simply stated, a "due-on" clause is a provision in a loan agreement wherein the borrower agrees that if he alienates or encumbers his secured property, the lender can demand immediate repayment of the full amount of the loan. The "due-on" clause has been in existence for many years as a security device, but its current widespread use is largely the result of recent tight money conditions, since it is a means by which lenders can improve their loan portfolios. The first California case to address the subject of the due-on-sale clause, Coast Bank v. Minderhout, was decided in 1964. In Coast Bank, the borrowers bought property and financed it with a bank loan, covenanted not to transfer the property, absent the bank's consent,
until the loan had been paid. Buyers later breached the covenant, and the bank demanded immediate payment of all of the outstanding debt.

In holding that the loan agreement did not constitute an unlawful restraint on alienation, the court adopted the minority doctrine concerning restraints. According to this doctrine, a restraint is valid, provided that it is reasonable under the circumstances. The majority common law view had been that most restraints on alienation were presumptively void.

Following Coast Bank, several appellate courts upheld the due-on-sale provisions before them without much discussion of whether or not the provision constituted a reasonable restraint on alienation. In Jones v. Sacramento Savings and Loan Association, decided in 1967, the court simply disposed of the issue by declaring in a footnote that as the result of Coast Bank, the due-on-sale clause was valid in California. The court did not discuss whether or not the lender had to act reasonably in exercising the clause.

9. The court in Coast Bank construed the loan agreement to be an "equitable mortgage." Thus, the case did not deal with a due-on-sale clause in a deed of trust and promissory note. Miller and Starr define an equitable mortgage as "one which is created by a court of equity rather than by the formal act of the parties. Under certain circumstances the court will determine that equity, fairness and justice demand that a security device be enforced between two parties despite the fact that no formal mortgage has been created or that its attempted creation was defective." Miller & Starr, supra note 4, at 395. In Coast Bank, the doctrine of equitable mortgages was applied even though the instrument in question did not show on its face that the parties intended to make the property security for the indebtedness. See, e.g., Fred, Analysis of Coast Bank vs. Minderhout and Cases Following It, 4 J. BEVERLY HILLS B. ASS'N 21 (1970).


12. "A restraint is reasonable under the circumstances if the particular purpose behind its imposition outweighs its effect in terms of the actual hindering of alienability of the particular property involved." Id. at 1177. In holding that California should adopt the "minority doctrine," Justice Traynor noted that the California courts had already recognized several property interests as justifying reasonable restraints on alienation. Among such interests were spendthrift trusts, leases for a term of years, life estates, corporate stock ownership, and executory land contracts. Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).


15. Id. at 527 n.3, 56 Cal. Rptr. at 745.

16. The court did state that the due-on-sale clause gave the lender several options: (1) the lender could elect to continue the borrower (a subdivider) as its primary obligor; (2) the lender could permit a borrower of satisfactory credit to assume the construction
Mortgage Company\textsuperscript{17} sustained the right of a lender to require modification of the loan as consideration for its waiver of acceleration.\textsuperscript{18} In \textit{Hellbaum v. Lytton Savings and Loan Association},\textsuperscript{19} the court held that a lender's right to accelerate upon transfer by the trustor-obligor, and its right to impose a fee for prepayment, did not constitute an unlawful restraint on alienation.\textsuperscript{20}

The 1969 decision in \textit{Cherry v. Home Savings and Loan Association}\textsuperscript{21} helped explain why the courts were willing to support due-on-sale clauses. In \textit{Cherry}, the Wickershims executed a promissory note secured by a deed of trust on certain real property. Both instruments contained due-on-sale clauses. Subsequently, plaintiff Cherry expressed a desire to buy the property. A contract was proposed under which Cherry would purchase the property subject to the lender's security interest and the Wickershims would remain primarily liable. The lender, however, refused to consent to the sale unless Cherry agreed to pay an assumption fee and assume all of Wickershims's indebtedness at a higher rate of interest. Cherry agreed under protest and filed suit against the lender.

In upholding the actions of the savings and loan association, the court proposed two justifications for the due-on-sale clause. First, the court stated that automatic acceleration is justified to reduce the lender's risk of loss caused by the transfer of the property to an irresponsible third party.\textsuperscript{22} In the case at hand, however, the lender never argued that Cherry was a poor security risk.\textsuperscript{23}

\begin{thebibliography}{9}
\bibitem{17} Civil No. 8636 (Cal. Ct. App., 4th Dist., Jan. 18, 1968).
\bibitem{18} Note, however, that unpublished opinions of the court of appeal have no value as precedent. \textit{Cal. R. Ct. (Miscellaneous)} 977 (West 1975).
\bibitem{19} 274 Cal. App. 2d 456, 79 Cal. Rptr. 9 (1969).
\bibitem{20} The holding of the case is criticized in Comment, \textit{The Case for Relief from Due-on-Sale Provisions: A Note to Hellbaum v. Lytton Savings and Loan Association}, 22 \textit{Hastings L.J.} 431 (1971). Cases dealing with whether a prepayment fee alone constitutes an unlawful penalty or unlawful usury are cited in notes 182-83 infra. \textit{See also} Hassen v. Lytton Sav. & Loan Ass'n, Civil No. 30374 (Cal. Ct. App., 2d Dist., filed Jan. 8, 1968) \textit{discussed in Comment, Due on Sale and Due on Encumbrance Clauses in California}, 7 \textit{Loyola L. Rev. (Los Angeles)} 306, 308-09 (1974).
\bibitem{22} \textit{Id.} at 579, 81 Cal. Rptr. at 138.
\bibitem{23} In fact, even if Cherry had been a poor security risk, the lender's security would not have been impaired. As the Wickershims argued (correctly, if not persuasively), they would remain personally liable on the obligation, even after a sale to Cherry. \textit{Id.} at 577, 81 Cal. Rptr. at 137.
\end{thebibliography}
The second justification given for the due-on-sale clause was that it is necessary to enable the lender to maintain its loan portfolio at the current market rate of interest. The court noted that when interest rates are high, the lender runs the risk that they will drop. If they do, the borrower can refinance his debt at a lower rate, pay off the loan, and leave the lender with money to loan at a less favorable interest rate. On the other hand, when interest rates are low, the lender risks losing the benefit of a later increase in rates. The due-on-sale clause helps remedy this problem by permitting the lender to call a loan due in the event the borrower transfers the security.

The decision in *Cherry* reflected the California courts' concern about the harsh effects that tight money conditions were having on institutional lenders. Nevertheless, it is questionable whether the *Cherry* court acted appropriately in sanctioning the lenders' use of a due-on-sale clause solely for the purpose of procuring higher interest rates.

**La Sala: First Distinction Between Due-on-Sale and Due-on-Encumbrance Clause**

The reasoning employed in *Cherry* and the other cases upholding the due-on-sale clause was reexamined in *La Sala v. American Savings and Loan Association*. In *La Sala*, the lender threatened to accelerate when the trustor-obligors encumbered their property with a second deed of trust. The California Supreme Court ruled that automatic acceleration could not be justified under the circumstances.

In its decision, the court distinguished due-on-encumbrance from due-on-sale clauses. It noted that a trustor-obligor who makes a junior encumbrance retains his title to the property and usually retains

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24. These propositions may be illustrated in the following manner. Suppose A borrows $10,000 from B, repayable in 25 years at 10% interest per annum. After one year, the market rate of interest drops to 9%. A can borrow $10,000 at 9% from C and use the money to pay off his loan from B (A may also have to pay a prepayment fee). B gets his $10,000 back, but now he can obtain only a 9% return (the current rate) when he loans it to a third party.

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

26. See text accompanying notes 126-34 infra.

27. 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

28. Acceleration is the term used to describe the process of calling a loan immediately due.

29. 5 Cal. 3d at 879, 489 P.2d at 1123, 97 Cal. Rptr. at 858. The Tucker court explained the distinction: "The cases and the literature in this area of the law generally refer to acceleration clauses triggered by sale or encumbrance according to the particular triggering event involved in the case in question. Thus, even though a clause may permit acceleration *either* upon sale or upon encumbrance, it is normally referred to as a ‘due-on-sale’ clause when the particular case involves sale and a ‘due-on-encumbrance’ clause when the case involves encumbrance." Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d at 631 n.1, 526 P.2d at 1170, 116 Cal. Rptr. at 634.
possession, as well. Thus, although the creation of a junior lien by
a borrower might increase the risk of future foreclosure, this risk is not
sufficient to permit a lender to have uncontrolled discretion to accelerate. Rather, a lender may enforce a due-on-encumbrance clause only
when reasonably necessary to protect his security.30

The court rejected the argument that automatic acceleration under
a due-on-encumbrance clause could be justified to minimize the risks
imposed on the lender by rising interest rates. The court noted that
this argument, which had been voiced in the Cherry case, was appealing as applied to a sale of the property because the sale terms usually
provide for payment of the prior trust deed. A junior encumbrance,
on the other hand, represents only a small fraction of a borrower's equity in the property, and it rarely provides the borrower with the
means to discharge the balance secured by the trust deed. Consequently, if a lender could automatically enforce a due-on-encumbrance
clause, the borrower would be restrained from executing any junior encumbrance unless he were able to accede to the lender's demand that he immediately pay off his entire debt on the first trust deed at current
high interest rates.31

In direct contrast to its holding with respect to the due-on-encumbrance clause, the La Sala court suggested that lenders might be able
to exercise due-on-sale clauses automatically.32 The court based this
different treatment on the reasoning that a trustor-obligor who sells his property to a third party usually passes title and possession. As a
result, he arguably has little interest in assuring that the property is
maintained.33

30. 5 Cal. 3d at 882, 489 P.2d at 1124-25, 97 Cal. Rptr. at 860-61. In discussing
the meaning of "security," the court used the criteria set forth in the Cherry case: "If a
borrower were able to sell the security without concern for the debt, he may take the
proceeds of the sale, leaving for parts unknown, and the new owner of the property
might permit it to run down and depreciate." Id. at 879-80, 489 P.2d at 1123, 97 Cal.
Rptr. at 859. The court, however, did not limit its definition of "security risk" to the
mere danger of physical deterioration of the property due to default. It proceeded to
cite in a footnote Professor Hetland's argument that the protection of security includes
the protection against "moral risks"—i.e., the increased danger, upon the making of a
third party sale, that the lender will have to resort to the property due to default. Id. at
880 n.16, 489 P.2d at 1123, 97 Cal. Rptr. at 859. In the Tucker case, the court clearly
included both of the above-mentioned elements in its definition of security. See text
accompanying notes 46-47 infra.

31. 5 Cal. 3d at 880-81 n.17, 489 P.2d at 1123-24, 97 Cal. Rptr. at 859-60.
32. "Following our ruling upholding reasonable restraints on alienation, we have
distinguished the due-on-sale from the due-on-encumbrance clauses; we have concluded
that the lender may insist upon the automatic performance of the due-on-sale clause
because such a provision is necessary to the lender's security. We have decided, however,
that the power lodged in the lender by the due-on-encumbrance clause can claim no such
mechanical justification." Id. at 883-84, 489 P.2d at 1126, 97 Cal. Rptr. at 862.
33. Id. at 879-80, 489 P.2d at 1122-23, 97 Cal. Rptr. at 858-59.
This position has been severely criticized. It has been observed that the third party buyer may, in fact, be a better security risk than the trustor-obligor. Moreover, the trustor-obligor who sells to a third party often remains liable on his obligation under his first trust deed, therefore, he has an incentive to make certain that the property is maintained and that all payments are made. Finally, there is no more reason why lenders should be able to accelerate on sale than on encumbrance, if the sole purpose of the acceleration is to keep the lending portfolio at the current rate of interest.

**Tucker and the Installment Contract of Sale**

The *La Sala* case left many questions unanswered. The court clearly determined that the trustor-obligor could encumber his property with a junior lien without fearing that the lender would automatically accelerate; instead, the lender would have to be prepared to prove that the security was impaired by the second lien. The decision also directed that if the trustor-obligor made an outright sale to a third party, the lender could demand immediate payment without showing any impairment.

Nevertheless, a trustor-obligor might engage in many transactions with respect to the property which would constitute neither junior liens nor outright sale. *Tucker v. Lassen Savings and Loan Association* was the first case to address itself to this gray area. The facts of the case were as follows. The Tuckers purchased some property for $11,400. They made a down payment of $4,000 and financed the balance of $7,400 by a loan from defendant Lassen Savings and Loan Association. To obtain the loan, the Tuckers had to sign a promissory

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35. Bonanno, *supra* note 7, at 280-91. It should be noted that one of the traditional objections to restraints on alienation is that they discourage improvements on land. "A landowner will be reluctant to make improvements on land that he cannot sell during the period of restraint." 6 AMERICAN LAW OF PROPERTY § 26.3 (A.J. Casser ed. 1952).

36. See Bonanno, *supra* note 7, at 287. For cases in which the trustor-obligor does not remain liable under his trust deed see notes 135-144 *infra*.

37. See Bonanno, *supra* note 7, at 284.

38. See text accompanying notes 96-124 *infra*.
note secured by a deed of trust. Both instruments contained "due-on" clauses covering sale and encumbrance.\textsuperscript{39}

Soon after purchasing the property, the Tuckers rented it to the Nolls on a month-to-month tenancy. The lenders were informed of the situation, but made no effort to enforce the "due-on" clause. Several months later, plaintiffs entered into an installment land contract with the Nolls. The contract provided that the Tuckers would retain legal title to the property until the full purchase price had been paid.

Upon learning of the installment land contract, the lenders decided to enforce the "due-on" provision. They demanded that the Tuckers pay the unpaid principal as well as $230 in prepayment fees, but the Tuckers were unable to pay this amount or obtain substitute financing. The savings and loan association then offered to permit the Nolls to assume the Tuckers's loan at a higher rate of interest, provided that the Tuckers executed a quitclaim deed.\textsuperscript{40} The Tuckers executed the deed, but brought suit against Lassen for the difference between what the Nolls owed them under the installment land contract and what they in turn owed Lassen on the original loan.\textsuperscript{41}

In its decision, the supreme court first discussed its previous holdings in \textit{Coast Bank} and \textit{La Sala} and then announced a new test which would govern its enforcement of a "due-on" clause in particular circumstances. The test requires the balancing of two factors: the extent to which the exercise of the clause is justified under the circumstances, and the actual quantum of restraint which the exercise of the clause imposes on the trustor-obligor. Applying this test, the court concluded that Lassen's exercise of the "due-on" clause constituted an invalid restraint on alienation.\textsuperscript{42}

The First Factor

The first factor which the court considered essentially concerns the lender's interest in protecting the secured property. In \textit{Coast

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\item \textsuperscript{39} The "due-on" clause incorporated by reference into the deed of trust read: "TO PROTECT THE SECURITY OF THIS DEED OF TRUST, TRUSTOR AGREES... (12) That if the Trustor shall sell, convey, or alienate, or further encumber said property, or any part thereof, or any interest therein, or shall be divested of his title or any interest therein in any manner or way, whether voluntary or involuntary, all obligations secured hereby, irrespective of the maturity date expressed in any note evidencing the same, at the option of the Beneficiary and without demand or notice, shall immediately become due and payable." 12 Cal. 3d at 632-33 n.3, 526 P.2d at 1171, 116 Cal. Rptr. at 635.
\item \textsuperscript{40} "A quitclaim deed transfers to the grantee all of the right, title and interest which the grantor had at the time he executed and delivered the deed and which is capable of being conveyed by a deed." 2 MILLER & STARR, supra note 2, at 501.
\item \textsuperscript{41} 12 Cal. 3d at 632-33, 526 P.2d at 1171, 116 Cal. Rptr. at 635.
\item \textsuperscript{42} \textit{Id.} at 640, 526 P.2d at 1176, 116 Cal. Rptr. at 640.
\end{itemize}
Bank, the court declared that it would permit only reasonable restraints on alienation. In La Sala, the court held that the exercise of a due-on-encumbrance clause would be reasonable only if the lender could show that the trustor-obligor had endangered the security of the first lien. 43

In Tucker, the court decided that the same standard should apply when the trustor-obligor made an installment contract of sale with a third party. Certainly, there are differences between a junior encumbrance and an installment sale. In the former transaction, possession of the property generally remains in the hands of the trustor-obligor, whereas in the latter, possession often passes to the third party buyer. 44 Nevertheless, the court held that the mere fact that the trustor-obligor relinquishes possession after making an installment contract would not, in itself, justify acceleration by the lender. 45

Instead, acceleration is appropriate only if the lender demonstrates a substantial threat to one of his "legitimate interests" in the security. Those interests include the preservation of the security from waste or depreciation and the protection against the "moral risks" of having to resort to the security upon default. 46 The court illustrated these legitimate interests in the following manner:

Thus, for example, if the beneficiary can show that the party in possession under the installment land contract is, or is likely to be, conducting himself with respect to the property in a manner which will probably result in a significant wasting or other impairment of the security, he may properly insist upon enforcement of the "due-on" clause. Similarly, if the beneficiary can show that the prospects of default on the part of the vendor (requiring the inconvenience of resort to the security) are significantly enhanced in the particular situation, such circumstances might constitute a sufficient

43. Miller and Starr state: "Many institutional deeds of trust provide that the trustor cannot impose junior liens on the secured property. The lenders justify this prohibition with the argument that additional encumbrances will reduce the trustor's ability to comply with the provisions of the senior lien. The argument is somewhat circuitous in that the lender can thereby declare the trustor in default because the additional obligation increases the probability that he will default." 1 MILLER & STARR, supra note 2, at 126 (Supp. 1974).
44. See text accompanying notes 62-77 infra.
45. In a footnote, the court noted that the lender's concern that the Tuckers remain in possession in order to prevent waste and depreciation seemed "somewhat exaggerated" in view of the fact that the due-on-clause is not normally exercised when the secured property is leased to another by the trustor. 12 Cal. 3d at 638 n.8, 526 P.2d at 1175, 116 Cal. Rptr. at 639.
The justification for enforcement of the clause despite its restraining effect.

The Second Factor

The second factor in the new test announced in *Tucker* is the quantum of restraint which an exercise of the "due-on" clause imposes on the trustor-obligor. In *La Sala*, the court rejected the argument that automatic exercise of a due-on-encumbrance clause was necessary to enable the lender to maintain its portfolio at the current rate of interest. The court observed that when the trustor-obligor makes a junior encumbrance, he rarely receives enough money to be able to pay off his obligation under the first lien. Thus, the exercise of the due-on-encumbrance clause creates a substantial risk that the trustor-obligor will lose his property.

In *Tucker*, the court extended this reasoning to the situation in which the trustor-obligor makes an installment land contract. In such a case, the trustor-obligor normally receives a relatively small down payment upon execution of the contract with the remainder of the purchase price to be paid through monthly installments. This down payment, like the proceeds of the junior encumbrance involved in *La Sala*, is often insufficient to enable him to complete his obligation under the first lien. Consequently, the exercise of a due-on-sale clause can substantially restrain his ability to alienate.

Balancing of the Two Factors in the Test

The court never directly discussed how these two factors should be balanced in determining whether the exercise of a "due-on" clause, in a particular situation, constitutes an unlawful restraint on alienation. One of the footnotes of the opinion did, however, provide some indication of the proper methods.

A few hypothetical examples may be helpful in understanding how the court appears to have intended the *Tucker* test to be applied. Suppose a trustor-obligor has entered into an installment contract, and the lender wishes to accelerate. To satisfy the first factor in the *Tucker* test, the lender must establish that the trustor-obligor's installment sale to the third party poses a threat to the lender's legitimate interests in the security. It should be recalled that these "legitimate interests" include both the risk that waste will be committed on the

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47. 12 Cal. 3d at 639, 526 P.2d at 1175, 116 Cal. Rptr. at 639.
48. See text accompanying notes 32-37 supra.
49. *But see* text accompanying notes 62-77 infra.
50. *See* 12 Cal. 3d at 637, 526 P.2d at 1174, 116 Cal. Rptr. at 638.
51. Id. at 639 n.9, 526 P.2d at 1175, 116 Cal. Rptr. at 639.
property and the risk that the trustor-vendor will default. The court will then weigh these risks against the actual restraint which the lender's exercise the "due-on" clause, even if the lender could show that the third ability to alienate.

Suppose, for example, that the third party buyer has paid the trustor-obligor only a small down payment, promising to pay the balance at a later time. The court would probably not permit the lender to exercise the "due-on" clause, even if the lender could show that the third party buyer was not so good a credit risk as the trustor-obligor. After all, the trustor-obligor in this situation retains a substantial incentive to prevent default; if a default occurs, he could lose the property through a forced sale, and he would retain only the buyer's small down payment as compensation. Similarly, should the new buyer commit waste, the trustor-obligor could be held liable, and he would have only the buyer's small down payment from which to satisfy an adverse judgment. Hence, it is likely that the trustor-obligor would use his best efforts to prevent both default and the commission of waste.

On the other hand, if the trustor-obligor has received a large down payment from the new buyer (or if he has received a small down payment and a large percentage of the balance due), the court would probably be more willing to permit the enforcement of the "due-on" clause. In this instance, the trustor-obligor has less incentive to prevent default: should a default occur, he might lose the property through a forced sale, but he would be able to retain the buyer's larger down payment as compensation. In addition, since the trustor-obligor has received a large down payment from the new buyer, it is more likely that he would be able to discharge the balance which he owes the lender on the original loan, should the lender demand immediate

52. See text accompanying notes 66-77 infra.
53. See 12 Cal. 3d at 639 n.9, 526 P.2d at 1175, 116 Cal. Rptr. at 639.
54. Section 725a of the California Code of Civil Procedure gives the beneficiary or trustee of a trust deed the right to seek judicial foreclosure, should he choose not to exercise his power of sale. CAL. CODE CIV. PROC. § 725a (West 1955). See Comment, Recent Legislation on Trust Deeds and Power of Sale Mortgages, 21 CALIF. L. REV. 471 (1933). Civil Procedure Code section 580d, however, generally precludes a deficiency judgment in such cases. CAL. CODE CIV. PROC. § 580d (West 1955).
55. See note 114 infra.
56. Since the Tucker case, some have tried to evade the impact of a due-on-sale clause by having the seller receive down payment equal to his equity in the property and then enter into an installment sale contract with the buyer for the balance due in an amount equal to that owed to the original lender on the deed of trust. Such a transaction may resemble the transaction involved in the Tucker case, but it would probably be subject to automatic exercise of the due-on-sale clause unless the seller were still personally liable on the original note and deed of trust in the event of a deficiency judgment. Interview with Jack F. Bonnano at Hastings College of the Law, July 11, 1975.
payment. Hence, the quantum of restraint on alienation imposed by the "due-on" clause would be less substantial than that in the situation described in the previous paragraph.

Finally, the court indicated that if the trustor-obligor has received full payment from the buyer through complete payment of the balance due, the lender should have an automatic right to accelerate. At this point, in the court's view, the trustor-obligor would have no incentive to prevent default or to make certain that the property is kept free from waste:

As long as the trustor-vendor's equitable interest in the security remains significant, he retains a real incentive to prevent default, and the credit standing of his vendee would not offer sufficient justification for enforcement of the "due-on" clause. However, as the trustor-vendor's equitable interest diminishes through payment by the vendee, his incentive to prevent default—as well as his incentive to prevent damage to or waste of the security—also diminishes, until the moment when his entire equitable interest has passed to the vendee. At this point, the propriety of enforcing the clause is clear. The trustor-vendor will now have been provided with the means to discharge the balance secured by the trust deed, so that the quantum of actual restraint on alienation caused by enforcement at this point will be minimal. Moreover, the beneficiary will no longer have the benefit of the built-in incentive to prompt payment and preservation of the property which the trustor-vendor's equitable interest provides. Accordingly, in a normal case the lender will be permitted to insist on enforcement of the "due-on" clause when the trustor-vendor's entire equitable interest in the security has passed to the vendee.

Application of the Test

This balancing test applied very well to the facts of the Tucker case. First, the lenders failed to establish that the Nolls (third party buyers) were a greater security risk than the Tuckers. In fact, the lenders made no investigation of the Nolls's credit standing or the manner in which they were maintaining the property. Second, a large

57. 12 Cal. 3d at 639 n.9, 526 P.2d at 1175, 116 Cal. Rptr. at 639. It should be noted, however, that in footnote 7 of the opinion, the court specifically declined to rule on the validity of the exercise of a due-on-sale clause when the trustor-obligor makes an outright sale to a third party. The distinction between an outright sale and an installment sale in which the buyer has completed all of his installments seems illusive to the author.

58. It is doubtful that the court's observation could properly be applied to a case in which the original deed of trust is not subject to anti-deficiency legislation. In such a case, the trustor-obligor would remain liable for any waste committed by the third party buyer and could be sued following a default. See text accompanying note 114 infra.

59. 12 Cal. 3d at 639 n.9, 526 P.2d at 1175, 116 Cal. Rptr. at 639.

60. Id. at 640 n.11, 526 P.2d at 1176, 116 Cal. Rptr. at 640. In an amicus brief on plaintiff's behalf, it was contended that the Tuckers told Lassen of their intent to lease
quantum of restraint would have resulted if the lenders had been permitted to exercise the due-on-sale clause. The Tuckers had received only a small down payment from the Nolls, and owed almost the entire obligation on the first lien.\footnote{1}

Although the balancing test applied well in \textit{Tucker}, it is not certain how well it would apply to other real property security transactions. The potential applicability of the test is the subject of a large portion of this note.

**Questions Raised by the Tucker Test**

In several respects, the meaning of the \textit{Tucker} decision is unclear. The court did not indicate whether the \textit{Tucker} test is to govern all types of installment sales or merely those of the conventional type. Moreover, in its use of the term “equitable interest” and “equitable contract,” the court somewhat obfuscated the meaning of the opinion.

**Installment Sale**

Although the court indicated that the newly announced test would apply whenever the trustor-obligor enters into an installment sale contract with a third party,\footnote{2} it did not define what it meant by an installment sale.

In the usual installment sale situation, the buyer tenders an initial sum and completes his obligation by making periodic payments which include part of the principal as well as interest on the unpaid balance.\footnote{3} As a result, the buyer’s equity\footnote{4} in the property increases as time

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\footnote{1}{Plaintiff’s lawyer noted that the Tuckers borrowed $7,400 to finance the purchase. Because of the loan fees, they signed a trust deed for $7,800. When Lassen called the loan fifteen months later, it demanded payment of the remaining principal on the note plus a prepayment charge of $229.32, bringing Lassen’s total demand to $7,904.47—some $104.47 more than the original note signed by the Tuckers and $504.47 more than the Tuckers had borrowed. Brief of Respondents in Answer to Brief for California Savings & Loan League as Amicus Curiae at 5, \textit{Tucker v. Lassen Sav. & Loan Ass’n}, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974). It should also be noted that the lender subsequently accepted a note and deed of trust from the Nolls for an amount greater than that provided in the Tuckers’ note.}

\footnote{2}{12 Cal. 3d at 632, 526 P.2d at 1170, 116 Cal. Rptr. at 634.}

\footnote{3}{See J. PUGH & W. HIPPAKA, \textit{CALIFORNIA REAL ESTATE FINANCE} 190 (2d ed. 1973) [hereinafter cited as PUGH & HIPPAKA].}

\footnote{4}{Here, the term “equity” is being used to denote the amount of principal which the buyer has paid. \textit{But see} text accompanying notes 78-85 infra.}
passes. Nevertheless, the seller retains title to the property as security for performance by the buyer, and he does not usually relinquish title until the full purchase price has been paid.\textsuperscript{65}

It is possible, however, that a trustor-obligor will enter into a less conventional form of installment sale. Consider, for example, the term loan. Although this type of transaction was more common fifty years ago, it is occasionally used today.\textsuperscript{66} Under the term loan, the buyer is not required to pay the principal on the debt until the due date; during the term of the note, he pays only the interest on the debt. Title may pass to the buyer at the beginning of the term, rather than on the date that the principal is due.\textsuperscript{67}

The term loan is an installment sale,\textsuperscript{68} but only the interest is paid in installments. Certain problems occur when one attempts to apply the rationale of the \textit{Tucker} case to this type of arrangement. On one hand, since title\textsuperscript{69} passes from the trustor-obligor to the buyer at the beginning of the transaction, one might conclude that the lender should be able to accelerate automatically, especially if the trust deed is subject to anti-deficiency limitations.\textsuperscript{70} After all, if the trustor-obligor should default, the lender might not be able to recover anything against him; hence, it might be argued that the trustor-obligor has no real in-

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\textsuperscript{65} It should be observed that "equity" also refers to the difference between the fair market value of the property and the balance due on any deeds of trust or other encumbrances on the property. This meaning of "equity" would be significant when the property has appreciated in value since the date the sales contract was signed, because the buyer would be entitled to all the appreciation in value.

\textsuperscript{66} \textit{MILLER} \& \textit{STARR}, supra note 2, at 262.

\textsuperscript{67} \textit{PUGH} \& \textit{HIPPAKA}, supra note 63, at 189.

\textsuperscript{68} \textit{Id.}

\textsuperscript{69} Compare the term loan with a lease-option, in which the third party rents the property and has the option to buy it at the end of a number of years. If the trustor-obligor entered into a lease-option, the lender could not accelerate. Note, for example, the following language from the respondent's brief in the \textit{Tucker} case: "Had the plaintiffs [Tuckers] and the Nolls entered into an agreement whereby the Nolls leased the property in question for a sufficient number of years to pay to the appellants the sum of $11,500 at the rate of $110.00 a month, plus 8\% interest on the declining balance . . . with the further provision that at the end of the lease the Nolls would have the option to buy the property for $1.00, they would have had essentially the same agreement as the one entered into here. Apparently, if they had called their agreement a lease-option rather than a contract of sale, there would have been no problem." Brief for Respondent at 10, Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

\textsuperscript{70} Note here that the title being passed is technically not legal title. See note 2, supra.

\textsuperscript{70} See text accompanying notes 135-39 \textit{infra}. Basically, this legislation provides that in certain circumstances a seller is prevented from seeking a personal judgment against a buyer, following a foreclosure. Rather, he must look to the security for recovery of the obligation.
centive to pay off the loan. On the other hand, the trustor-obligor maintains his equity in the property until the due date, since the buyer does not pay the full principal until then. Therefore one might conclude that the lender should not be able to accelerate automatically when a term loan is made, since the trustor-obligor retains a substantial interest in the property until the due date, even though he has relinquished title. In short, the court in Tucker failed to specify which interest, full title or the mere right to obtain full title, must be passed from the trustor-obligor to the buyer before the lender will be able to accelerate automatically.

Similar problems arise when the installment sale is made by means of a blanket trust deed. A blanket trust deed is often used by developers who have purchased a single tract of land with the intention of subdividing it. The lien on the property provides that upon the buyer's payment of designated amounts the creditor will release title to certain portions of the property. For example, suppose that a

71. It is possible that the buyer may pay some principal, in the form of a down payment.

72. Note that the term loan could be considered a variation of a "balloon payment" loan. The balloon payment loan is frequently used in real estate transactions when the lender wants to make a relatively short term real estate loan (ten years, for instance) but the buyer-borrower is not strong enough financially to pay the entire principal in ten years. With a balloon payment loan, the unpaid principal at the end of the term is renewed (or rolled-over) by the lender at whatever is the current interest rate at the time of renewal. Many non-institutional lenders use this device to secure an opportunity to raise interest rates at the end of the short term of the loan without the use of a due-on-sale clause. The borrower typically cannot refinance with another lender and is quite willing to renew the loan at the current higher rate of interest as to the part of the principal amount of the note that is still unpaid. It would appear that the same problems raised by an attempt to apply the Tucker test to a term loan would be raised in the balloon payment loan situation.

73. Note that the second factor in the Tucker test (quantum of restraint on the trustor-obligor's ability to alienate) would work basically the same way in the term loan as it would in the conventional installment sale: as time passed, the amount of restraint on the trustor-obligor's ability to alienate would decrease.

Suppose that the trustor-obligor (T-O) borrows $10,000 from a lender (L) for the purchase of Blackacre. The trust deed which T-O signs contains a due-on-sale clause. T-O then sells the property to a third party buyer (B) for $11,000, financed by a term loan. In the loan agreement, B agrees to pay $1,000 down and to pay $10,000 at the end of twenty-five years. During the interim period, B agrees to pay T-O the accruing interest on the loan (suppose this amount totals $1,000 per annum).

Each year, T-O will receive interest payments from B. Therefore, as time passes, and T-O accumulates B's payments, it would be increasingly likely that T-O could pay L, should he exercise the due-on-sale provision and call the loan immediately due. Thus, one could say that the quantum of restraint on T-O's ability to alienate would decrease as time passed, even though T-O would not be receiving payments on the principal of his loan to B.

74. PUGH & HIPPAKA, supra note 63, at 186.

75. Id.
trustor-obligor (developer) sells ten acres of land to buyer for $10,000 (with $2,000 down payment), and takes back a second trust deed. The trust deed states that the buyer must pay $1,500 before he receives title to one acre, and $2,500 before he receives title to two acres. The buyer will receive title to all ten acres only when he pays the entire debt. Once again, it is uncertain whether or not the opinion in Tucker was intended to apply to this type of installment sale.

"Equitable Interest"

A second difficulty with the Tucker opinion is the court's frequent use of the term "equitable interest." For example, in one previously cited passage, the opinion reads: "As long as trustor-vendor's equitable interest in the security remains significant, he retains a real incentive to prevent default, and the credit standing of his vendee would not afford sufficient justification for enforcement of the 'due-on' clause."78

Unfortunately, the court appears to have confused the term "equitable interest" with "equity." The Restatement of Property defines an equitable interest in land as one which has origins in the principles, standards and rules developed by the courts of chancery.79 Professor Powell has pointed out that legal and equitable interests in land differ in their methods of creation, methods of enforcement, constituent content, and methods of termination.80

In a land sale contract, the term "equitable interest" has been given a special meaning. As soon as such a contract is created by the owner's acceptance of the buyer's offer to purchase, the buyer is said to have an "equitable interest" in the property.81 In other words, the buyer has a right to the land and, as far as equity is concerned, owns it.82 Thus, in a conventional installment land contract, even though the seller does not relinquish title until a future date, the buyer still

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76. This type of arrangement gives the developer added security. For example, after one year, buyer will owe $6,500, but the land still subject to the lien will be worth $9,000. Id.
77. Note also that the blanket trust deed may raise additional questions, in view of new statutory subdivision requirements. For example, when a blanket trust deed is involved, would the seller be required to conform to the statutes at the time of sale, or at the time of the partial release or reconveyance of the property to the trustor or mortgagor? The statutes make no express provision. Compare Cal. Gov't Code §§ 66478.1-14 (West Supp. 1975) with Cal. Bus. & Prof. Code §§ 11000.1-11030 (West 1964 & Supp. 1975).
78. Id. at 639 n.9, 526 P.2d at 1175, 116 Cal. Rptr. at 639.
79. Restatement of Property § 6(3) (1936).
81. Pugh & Hippaka, supra note 63, at 163.
82. Id. at 164.
has "equitable ownership" of the property for the duration of the contract.\textsuperscript{83}

In \textit{Tucker}, Justice Sullivan wrote that as a trustor-obligor's "equitable interest" in the secured property diminishes through payments by the buyer, the court should be more willing to allow the lender to accelerate automatically under the "due-on" clause.\textsuperscript{84} What does the court mean by "equitable interest"? Certainly, the court is using the expression in a different sense than that discussed in the paragraph above. After all, the buyer has just as much right to the property ("equitable interest") when he makes his down payment as he does after he has made several installment payments. Thus, if one takes the term "equitable interest" to mean a party's right to the property, the "equitable interest" of the buyer does not increase as he completes more installments, nor does the seller's equitable interest decrease.

The court in \textit{Tucker} seems, however, to be using the expression "equitable interest" to mean the difference between the fair market value of the property and the principal balance still due on the contract or deed of trust. In real estate terminology, this amount is usually called "equity."\textsuperscript{85} In other words, as a buyer completes an increasing number of his installment payments, normally his "equity" in the property increases.\textsuperscript{86} At the same time, the trustor-obligor's "equity" in the property decreases commensurately. In this note, it has been assumed that the court in \textit{Tucker} used "equitable interest" to mean "equity." It is unfortunate, however, that the court did not articulate more precisely the meaning of its terminology.

"Executory Contract"

A further difficulty with the \textit{Tucker} opinion is the court's use of the expression "executory contract" when stating the holding of the case. The paragraph in question reads as follows:

In the instant case we confront the question whether the lender may automatically enforce a "due-on" clause when the trustor-obligor has entered into an installment land contract covering all or some of the property securing the loan. As will appear, we have concluded that such an executory contract does not necessarily, and in the circumstances of the case at bench in fact did not, justify the enforcement of the clause.\textsuperscript{87}

\textsuperscript{83} 1 \textsc{Miller \\& Starr}, \textit{supra} note 2, at 262.
\textsuperscript{84} 12 \textsc{Cal. 3d} at 639 n.9, 526 \textsc{P.2d} at 1175, 116 \textsc{Cal. Rptr.} at 639.
\textsuperscript{85} See note 64 \textit{supra}.
\textsuperscript{86} It is assumed that the installment contract is of the conventional type. As discussed previously, if the installment contract were made as a term loan, the installment payments would not include principal. Hence, the buyer's equity in the property would not increase as time passes. See text accompanying notes 66-73, \textit{supra}.
\textsuperscript{87} 12 \textsc{Cal. 3d} at 632, 526 \textsc{P.2d} at 1170, 116 \textsc{Cal. Rptr.} at 634.
It is not clear why the court chose to use the expression "executory contract" or whether it would rule differently in the case of an executed contract.

The California Civil Code states that an executed contract is one whose object is fully performed. All other contracts are deemed executory. An executed contract gives rise to many rights and obligations which are not present when the contract is merely executory. For example, one case has held that the California anti-deficiency statute applies only when a contract of sale is fully executed. The importance of the anti-deficiency legislation in determining whether a lender should be able to accelerate under a due-on-sale clause will be discussed later in this note.

The determination of whether a land sale contract is executed or executory may hinge on whether title has passed from buyer to seller. For example, in Smith v. Allen, the court held that when a vendor conveys property to the vendee and takes back a deed of trust, the contract of sale has been fully executed, since title has passed. Based on similar reasoning, another case held that when a party makes a down payment on some property, goes into possession, and agrees to complete his obligation through installment payments, the contract is still executory, since title has not passed. It is thus possible that the opinion in Tucker limits its restrictions on due-on-sale clauses to conveyances in which the trustor-obligor does not pass title to the third party buyer. Nonetheless, subsequent discussion will indicate that there is no substantial reason why the Tucker case should be so narrowly construed.

Application of the Test in Tucker to Other Transactions by the Trustor-Obligor

The court in Tucker considered only installment land sale contracts. These types of contracts, however, are not commonly used,

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92. Once again, it should be noted that legal title does not really pass, since actual title to the property remains in the hands of the title insurance company. See note 2 supra.
94. Moreover, the court concerned itself only with a trust deed and promissory note, and not with a mortgage. Presumably, the holding of the Tucker case would apply when a mortgage is used.
since they have inherent limitations. One of the clearest disadvantages for the buyer is that he has no guarantee that the trustor-obligor will use the installment money to pay off the original loan; thus, the buyer could be subject to foreclosure at any time. The real importance of Tucker, then, depends upon the extent to which the holding may be applied to other types of transactions. It will be seen that the balancing test announced in Tucker has potentially broad applicability.95

“Wrap-Around” Mortgage

One transaction to which the Tucker test should apply is the all-inclusive or “wrap-around” mortgage.96 This type of mortgage has recently become popular as a tax tool in connection with real estate syndications.97 It also offers the buyer and seller certain non-tax advantages, which are particularly desirable in the face of a tightening money market.98

The wrap-around mortgage has been defined as a purchase money deed of trust99 which is subordinate to, yet includes the encumbrance to which it is subordinated.100 The following illustration suggests how the mortgage might work in connection with a due-on-sale clause:

Suppose the trustor-obligor (T-O) purchases property worth $11,000. T-O makes a $4,000 down payment and takes a $7,000 loan from the lender (L), payable at 7.5 percent interest. The promissory note and deed of trust which T-O signs contain due-on-sale provisions. Note that, thus far, the illustration roughly approximates the situation in Tucker.

95. Much of the thinking behind the following sections is based on an excellent set of hypothetical situations developed by Professor Jack F. Bonanno, of the University of California, Hastings College of the Law. The author wishes to thank Professor Bonanno for his generosity in sharing these materials, as well as his kindness in discussing his views on the Tucker case. However, the author assumes full responsibility for any errors contained in the ensuing presentation.


98. Grebow, supra note 96, at 18-19. In Grossman v. Sirianni, Civil No. 38138 (Cal. Ct. App., 2d Dist., filed Jan. 27, 1972), the court held that the transactions involving a “wrap-around” mortgage were not usurious.

99. A purchase money trust deed is a generic term for a trust deed issued by the borrower who is obtaining credit for the purpose of purchasing real estate. PUGH & HIPPARKA, supra note 63, at 184.

100. Grebow, supra note 96, at 17.
T-O finds a third party (B) who would like to purchase the property for $12,000. T-O and B decide to execute a “wrap-around” mortgage. B makes a $1,000 down payment to T-O. Then B gives T-O a second deed of trust, in which B promises to pay the remaining $11,000 in monthly installments, with 8.5 percent interest on the unpaid balance. B takes possession of the property, but T-O retains title and continues to make payments on his $7,000 loan from L.

This arrangement pleases both T-O and B. T-O still has title to the property and retains the original financing from L. Moreover, T-O can obtain a higher effective interest rate than if he had taken back a conventional second trust deed.

If T-O had used a conventional second trust deed, B would have assumed T-O’s $7,000 loan from L, and he would have borrowed the remaining $4,000 from T-O at 8.5 percent interest, the same interest rate as in the previous illustration involving the “wrap-around” mortgage. During the first year, then, T-O would receive interest amounting to $34 (8.5 percent of $4,000).

Under the “wrap-around” mortgage, however, T-O receives $41 during his first year. This figure is obtained by taking the amount of interest T-O receives from B (8.5 percent of $11,000, or $93.50), and subtracting the amount of interest T-O owes L on the original loan (7.5 percent of $7,000, or $52.50). In effect, under the “wrap-around” plan, T-O receives 10.25 percent on the $4,000 loan during the first year. As the years pass, T-O’s effective interest rate will drop, but until his $7,000 loan is completely paid, he will be earning more interest than if he had used the conventional second trust deed. On the other hand, B is happy because he is paying only 8.5 percent interest on the outstanding debt, rather than the current market interest rate (which may be considerably higher).

Everything seems fine until L discovers what has occurred. Claiming that T-O has sold the property, L exercises the due-on-sale clause in the original deed of trust and demands that T-O immediately

101. Id. at 18.

102. Considerations of usury are beyond the scope of this article. However, it should be noted that if the California usury law applied, T-O would possibly be able to exceed the 10% legal limit, (because he is technically charging only 8.5% interest). But see, e.g., Martin v. Ajax Constr. Co., 124 Cal. App. 2d 425, 269 P.2d 132 (1954) (as a general rule courts will not permit an evasion of the usury law by subterfuge).

103. For example, suppose after the first year, B has paid off $1,000 of T-O’s loan from L. All other things being equal, T-O will receive an effective interest payment of $40 [the amount of interest paid to T-O by B (8.5% of $10,000, or $85) minus the amount of interest T-O owes L on the original loan (7.5% of $6,000, or $45)]. In effect, T-O is now receiving only 10% on the $4,000 loan. If, after a second year, B has paid off an additional $1,000 of T-O’s loan from L (making a total of $2,000), T-O will receive an effective interest payment of $39, or 9.75% interest rate.
pay the rest of his obligation on the $7,000 loan. L sues, and the judge
decides to adjudicate the matter on the basis of the test proposed in
Tucker. How should he proceed?

To satisfy the first element of the test, L must demonstrate that
B has been committing waste on the property or is likely to default
on his payments to T-O. If this part of the test is satisfied, the court
will then look at T-O's interest in the property. If T-O has received
only a small down payment from B and a large balance remains due,
exercise of the due-on-sale clause should not be permitted, since T-
O still has sufficient incentive to complete his obligation to L. If, how-
ever, B has made a large down payment, or only a small balance re-
mains due, the court should be more willing to allow the clause to be
enforced.

L may argue that acceleration should be automatic in both cases,
since the “wrap-around” mortgage technique is a ruse to disguise the
transfer of property, and the courts should discourage such transfers.

Although this argument has a certain appeal, it should be rejected.
There is only one basis upon which the court should decide if accelera-
tion is proper: whether or not the risks to the lender's security interest
caused by the transfer outweight the harmful effects of the consequent
restraint on alienation. It is true that the lender may be harmed by
a disguised transfer to a third party who is a bad security risk, espe-
cially since it would be more difficult for the lender to make a proper
investigation of the new buyer. Nevertheless, this fact alone should
not justify the blanket enforcement of the due-on-sale clause, especially
when the lender is exercising the clause to increase its interest rates
rather than to protect its security.104

The Sale-Leaseback

Another type of security arrangement which is becoming increas-
ingly popular, especially among builders and developers, is the sale-
leaseback.105 Most simply stated, a sale-leaseback is a transaction in
which a prospective developer sells property to an investor and then
leases it back.106 This arrangement is advantageous to the developer

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104. It should also be observed that if T-O still has a sizeable balance tied up in the
“wrap-around” mortgage, over and above the lender's mortgage or deed of trust, then T-
O (as seller) has a substantial interest in seeing that the buyer paid off the lender and
protected the security.

105. This device is not used extensively by savings and loan associations, owing to
statutory limitations on their ability to own land. See CAL. FIN. CODE § 6705 (West
1968 & Supp. 1975); Moewe, Sale and Leaseback Financing of Real Estate as Mort-

106. See generally Thomas, Leasebacks in Commercial and Family Transactions, 28
because it provides him with liquidity, as well as a high rate of financing in relation to the value of the property.\textsuperscript{107} For the investor, the sale-leaseback offers the flexibility of a leasing arrangement as well as a rate of return that is slightly higher than that which is available on mortgages.\textsuperscript{108}

These various advantages may best be understood through an illustration. Suppose \textit{T-O} buys an unimproved lot for $11,000, pays $4,000 down and takes a $7,000 loan from \textit{L}, repayable at 7.5 percent interest. Again, these terms very roughly approximate those of the \textit{Tucker} case. Now, assume that \textit{T-O} is a developer who wishes to build a house on the lot but does not want to take out a conventional second trust deed on the land in order to finance his project. Instead, he sells the lot to investor (\textit{B}) for $11,000, and \textit{B} in turn leases it back to \textit{T-O} at $100 a month for a fixed term.\textsuperscript{109}

This arrangement, which strongly resembles a secured loan, has advantages for both \textit{B} and \textit{T-O}. \textit{B} obtains land worth $11,000. In all probability, the land will appreciate in value as the years pass. Moreover, \textit{B} is receiving $1,200 a year in rent, or an effective return of 10.9 percent on his $11,000 investment. If \textit{B} in fact intended the transaction to be a secured loan, he may have succeeded in skirting the 10 percent interest ceiling imposed by the California usury law.\textsuperscript{110}

\textsuperscript{107} Note, The Expanding Definition of "Security": Sale-Leasebacks and Other Commercial Leasing Arrangements, 1972 DUKE L.J. 1221. It should be observed that the threat of usury is present here.

\textsuperscript{108} Id.

\textsuperscript{109} Admittedly, the hypothetical example concerning the sale-leaseback is oversimplified. In actual fact, the investor would probably pay the seller-lessee only an amount equal to the fair market value of the property minus the principal amount still due to the lender on the deed of trust. The investor would be very unlikely to pay the full market value of the property to the seller-lessee in cash (in the example, $11,000) without receiving some additional security from the seller. Otherwise, the seller could be tempted to leave for parts unknown with the cash, thereby leaving the investor with a worthless lease and property having a net worth less than the amount paid by the investor. Nevertheless, it is suggested that this hypothetical sets forth, in most simplified form, the basic problems raised when the \textit{Tucker} test is applied to the sale-leaseback.

\textsuperscript{110} The courts may determine, however, that the sale-leaseback is merely a subterfuge for a secured loan. In other words, the court may decide that the relationship is really that between a mortgagor and mortgagee, with title to the property being conveyed merely for security. In such event, the rent payments will be considered interest payments for the use of the purchase price (here, $12,000) and consequently will be subject to the California usury law. See Moewe, Sale and Leaseback Financing of Real Estate and Mortgages under California Law, 48 CAL. ST. B.J. 555, 560 (1973).

The California usury provision, found in the constitution, reads, in part: "No person, association, copartnership or corporation shall by charging any fee, bonus, commission, discount or other compensation receive from a borrower more than 10 percent per annum upon any loan or forbearance of any money, goods or things in action." CAL. CONST. art. XX, § 22. See generally Glushon & Oaks, The California
On the other hand, T-O is also happy. Although he has passed title to B,\footnote{111} he still retains possession of the land, and he can therefore continue with his development project.\footnote{112} Moreover, he has $11,000 (minus the monthly rental payments, and the continued payments on the loan from L) which he can use to promote his enterprise. If he so desires, he can invest part of this sum and thereby help to offset the cost of his rent.

Consider, now, whether the Tucker test should apply if a due-on-sale clause is involved in a sale-leaseback situation. Suppose, in the above illustration, that T-O has given L a trust deed, containing a due-on-sale clause, as security for the $7,000 loan. T-O then enters into the above-described sale-leaseback arrangement with B. Should L be permitted to accelerate?

Some preliminary problems must be considered before determining whether the Tucker test should apply by analogy. Above all, there are important differences between an installment sale (to which the Tucker test was applied) and a sale-leaseback. First, in the installment sale contract, title remains in the trustor-obligor and possession generally passes to the third party buyer. In the sale-leaseback, on the other hand, title passes to the third party buyer and possession remains with the trustor-obligor. Moreover, in a sale-leaseback, laws concerning the landlord-tenant relationship come into play.

In spite of these differences, it is submitted that the Tucker test should be applicable in the sale-leaseback situation. In the sale-leaseback, as in the installment sale, the interests of the lender in protecting his security may conflict with the interest of the trustor-obligor in being able to alienate his property. Thus, a standard is needed by which these conflicting interests may be balanced. The Tucker test would appear to be appropriate for the purpose.

Assume, once again, that L attempts to accelerate after T-O has entered into a sale-leaseback with B, and the court seeks to apply the test used in Tucker.

To satisfy the first element of the test, L will have to demonstrate that B is committing waste, or that the sale-leaseback has enhanced the risk of default. It will be difficult for L to show that B is engaging in waste, since B is not in possession of the lot. Furthermore, if T-

\footnote{111. Actually, T-O has passed only equitable title to B, since the legal title remains in the holder of the original trust deed. See note 2, supra.}
\footnote{112. B is now, of course, subject to applicable landlord-tenant law regarding "good husbandry" and waste. See note 114, infra.}
commits omissive or permissive waste, he is liable not only to $L$, but also to $B$. Therefore, $T-O$ has a strong incentive to practice good husbandry in his treatment of the property.

Moreover, it is unlikely that the transfer will significantly enhance a risk of default. If $T-O$ has received only partial payment from $B$, there may be a risk that $B$ will default. Nevertheless, it may well be that $B$ is a better security risk than $T-O$. Furthermore, absent a novation or the applicability of anti-deficiency legislation, both $T-O$ and $B$ will now be liable to $L$. Thus, $L$ will have even greater security than before.

On the other hand, the second element in the Tucker test could weigh heavily in $L$’s favor. If $T-O$ has made an outright sale to $B$, automatic acceleration by $L$ would result in a minimal quantum of restraint, since $T-O$ would probably have sufficient funds to pay off the first lien. If, however, $T-O$ has made an installment contract with $B$, the reasoning developed earlier with respect to installment contracts would apply: the quantum of restraint would vary according to the amount of the down payment which $T-O$ has received and the sum which remains outstanding.

The Sale-Buyback

The sale-buyback involves the purchase of property by the investor at a mutually determined price, and immediate resale by the investor at the same price to the developer on a long-term installment contract. If a due-on-sale clause is involved, the transaction should be treated similarly to a sale-leaseback.

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113. Presumably, the developer would not be liable for meliorating waste. If the property in question were a residential building, rather than an unimproved lot, $T-O$ (tenant) would have statutory remedies in California. Cal. Civ. Code §§ 1941, 1942 (West 1954 & Supp. 1975).

114. “If a guardian, tenant for life or years, joint tenant, or tenant in common of real property, commit waste thereon, any person aggrieved by the waste may bring an action against him therefor, in which action there may be judgment for treble damages.” Cal. Code Civ. Proc. § 732 (West 1955). Note that waste is not defined by the statute, but must be determined by common law standards. McCord v. Oakland Quicksilver Mining Co., 64 Cal. 134, 27 P. 863 (1883).

115. See text accompanying notes 135-37 infra.

116. See text accompanying notes 40-59 supra.


118. Granted, distinctions exist between sale-leasebacks and sale-buybacks. landlord-tenant laws apply only to the former type of transaction. Moreover, in a sale-buyback, the trustor-obligor regains his equity in the property with each payment that he makes to the third party buyer. Nevertheless, it is submitted that these distinctions do not alter the basic thrust of the argument developed in the section dealing with sale-leasebacks.
“Front Money” Arrangements

In “front money” deals, the investor purchases land and then joins with a developer to undertake a development project. The investor and developer enter into a joint venture or partnership, or they form a corporation in which the two share the stock.119 Usually the investor is assured priority in using the profits from the enterprise to return the original investment. After the return of capital has been achieved, he shares in the profits according to a formula established in the agreement.120

The advantage of the “front money” arrangement is that the investor and builder can pool their skills in a common endeavor. Moreover, if the enterprise is successful, the investor will receive a large return.121 On the other hand, it should be noted that certain risks are involved as well. The investor may incur liabilities by becoming a member of the enterprise. It is also possible that the enterprise will not be sufficiently profitable to return his capital and generate an adequate yield on the investment.122

Now, suppose the investor purchases the land with a loan containing a due-on-sale clause. He then joins with a developer in a “front money” arrangement. It is submitted that the lender should not be able to accelerate automatically. In the first place, the investor is merely sharing his title and possession of the property with a third party; he is not making an outright transfer. In this respect, “front money” deals differ from the other security transactions thus far considered. In the second place, when the investor enters into the “front money” arrangement, he remains primarily liable to the original lender, absent a novation.123 Thus, the lender should be required to show a

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119. For discussion of the relative advantages of the joint venture (general partnership) and the limited partnership, as far as developer and investor are concerned, see Fink, Joint Ventures, Limited Partnerships, Sale-Leaseback and Other Devices: The Developer's Approach—Part I, 52 Cal. B. Rec. 323 (1971).

120. Pugh & Hippaka, supra note 63, at 219.

121. That is, larger than if the lender had kept his money within the conventional lending market.

122. Pugh & Hippaka, supra note 63, at 219.

123. If the investor forms a corporation with the developer, the investor will remain personally liable on the note, since it would constitute a pre-incorporation contract. Even if the corporation subsequently “adopted” the investor's obligation, he would still remain individually liable. See N. Lattin, Lattin on Corporations 111 (2d ed. 1971). For discussion of California law relating to the liability of promoters, see MacDonald v. Arrowhead Hot Springs Co., 114 Cal. App. 496, 300 P. 105 (1931).

If the investor forms a joint venture or partnership with the developer, the investor also remains personally liable on the note. In the case of Bank of America Nat. Trust & Sav. Assn. v. Kumle, 70 Cal. App. 2d 362, 160 P.2d 875 (1945) the court held that when a person borrows money from a bank and later joins a partnership, the partnership is not liable on the loan.
security risk before exercising its powers under the due-on-sale clause.  

Outright Sale by Trustor-Obligor

In *La Sala*, the court held that a lender should have an automatic right to accelerate if the trustor-obligor makes an outright sale of the encumbered property to a third party. This part of the decision was dictum, and future courts may wish to reconsider this view in light of the reasoning developed in *Tucker*. There are three types of outright sales to which a court might apply the *Tucker* test.

Trustor-Obligor Receives Back a Note and Second Deed of Trust from Purchaser

In the first type of sale, the trustor-obligor conveys legal title and possession to the buyer and receives back a promissory note and second deed of trust as part of the consideration. Here, the court should use the same criteria in judging the transaction as it would in the case of an installment contract. If the trustor-obligor has received a small cash payment, and a large balance remains due on the second deed of trust, the lender should have a strong burden of showing that the transfer enhances the risk of waste or default. If, on the other hand, the trustor-obligor has received a large cash payment, or only a small balance is left outstanding, the court should be more willing to permit acceleration.

Trustor-Obligor Receives Full Payment, and his Original Deed of Trust is not Subject to Anti-Deficiency Legislation

In the second type of sale, the trustor-obligor conveys legal title and possession to the buyer and receives full payment for his equity in cash or other property. Moreover, the trustor-obligor's original deed of trust is not subject to anti-deficiency legislation; consequently, when title passes to the third party buyer, the trustor-obligor remains fully liable on the first obligation.

Whether or not a lender should automatically be able to accelerate in this situation depends on the extent to which the court still accepts the reasoning advanced in the *Cherry* case. In *Cherry* it was held that

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124. Professor Hetland suggests that a due-on-sale clause should not be automatically exercisable when there is an assignment from one co-owner to another, transfer from the trustor-obligor to his wholly-owned corporation, or sale of corporate stock by the corporate trustor-obligor. J. HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS 191 (1970).

125. See text accompanying notes 27-37 supra.

126. In other words, the trustor-vendor receives no promissory note or deed of trust from the third party buyer.

127. See text accompanying notes 135-39 infra.
a lender's desire to maintain its portfolio at current interest rates justified the exercise of a due-on-sale clause.\textsuperscript{128} This argument was subsequently rejected in \textit{La Sala} as being inapplicable when the trustor-obligor merely encumbered his property with a junior lien.\textsuperscript{129} The argument was also rejected in \textit{Tucker}, in so far as it might apply to installment sale contracts.\textsuperscript{130} Nonetheless, the court in \textit{Tucker} specifically refrained from considering the validity of the \textit{Cherry} argument in a situation in which the trustor-obligor makes an outright sale to a third party.\textsuperscript{131}

If the court applies the reasoning in \textit{Cherry} to outright sales, then the lender should have little difficulty justifying automatic acceleration. The quantum of restraint imposed on the trustor-obligor would be minimal, since he could pay off his original obligation with the money he receives from the third party buyer.

It is submitted, however, that the \textit{Cherry} argument should be rejected entirely. The clear thrust of the \textit{Tucker} decision is that a "due-on" clause is valid only to protect the lender's security. A lender may resort to other devices to keep interest rates at current market levels which do not so severely impair a trustor-obligor's freedom of alienation.\textsuperscript{132} Thus, in order to exercise a due-on-sale clause, the lender

\textsuperscript{128} See text accompanying notes 21-25 supra.
\textsuperscript{129} See text accompanying notes 27-37 supra.
\textsuperscript{130} 12 Cal. 3d at 639 n.10, 526 P.2d at 1175-76, 116 Cal. Rptr. at 639-40.
\textsuperscript{131} \textit{Id.} at 634-35 n.7, 526 P.2d at 1172, 116 Cal. Rptr. at 636.
\textsuperscript{132} Professor Bonnano has proposed three possible devices: variable interest rates, short term loans with an option to renew, and a true long-term loan. Note that the true long term loan contemplates a lock-in clause to prevent prepayment. See Bonanno, supra note 11, at 303-07. See also Comment, \textit{The Variable Interest Note: An Answer to Uncertainty in a Fluctuating Money Market}, 1971 L. & SOC. ORDER 600; Comment, \textit{The Variable Interest Rate Clause and Its Use in California Real Estate Transactions}, 19 U.C.L.A. REV. 468 (1972). In an amicus brief for defendant Lassen Savings and Loan, arguments were presented in opposition to Professor Bonanno's suggested alternatives to the "due-on" clause. The arguments were (1) the "due-on" clause leaves a portion of the risk of upward fluctuation on the lender, whereas the three proposals would shift the risk to the borrower; (2) the cost of administering the three proposed alternatives would be substantial, owing to the additional clerical work involved; and (3) Professor Bonanno's proposals would introduce a high level of uncertainty into real estate financing. Brief for California Savings & Loan League as Amicus Curiae at 35-37, Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

These arguments are specious. First, the risk of upward fluctuation rests solidly on the trustor-obligor who is subject to automatic acceleration under a "due-on" clause. If interest rates go up, the lender can threaten to enforce the clause should the trustor-obligor transfer the property, even if the transferee is an excellent security risk. Consequently, there is a serious restraint on the trustor-obligor's ability to alienate, and the lender often is able to exact higher rates of interest from the trustor-obligor or the new buyer. On the other hand, if interest rates go down, the trustor-obligor receives no benefit at all. He must continue to pay the lender the previously high rate. It is difficult to imagine that Professor Bonanno's proposed alternatives could involve any greater risk to the borrower.
should have the burden of showing that a sale by the trustor-obligor

Secondly, there is no reason to suppose that the administration of variable interest rates would be costly. Other countries have had successful experiences with them. Moreover, as Professor Bonanno notes, many savings and loan associations in California have successfully dealt with the annual variations that are introduced into monthly mortgage payments, which include an amount to be held as an impound for the payment of property taxes. Nevertheless, the institutional lenders have not complained about the administrative costs of making these changes. Brief for Jack F. Bonanno as Amicus Curiae at 17, Tucker v. Lassen Sav. & Loan Assn', 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

Finally, it is unlikely that the alternatives proposed by Professor Bonanno would introduce a high level of uncertainty into real estate financing. Under a due-on-sale clause the trustor-obligor who wishes to transfer his property is already subject to great uncertainty in that the lender may exercise the clause and demand full immediate payment as well as a prepayment fee. This uncertainty would not arise under the suggested alternatives. From the lender's point of view, variable interest rates would permit savings and loan associations to make long term loans without risking a poor investment return, since they would be assured of not being locked into lower interest rates in times of inflation. Comment, The Variable Interest Rate Clause and Its Use in California Real Estate Transactions, 19 U.C.L.A. L. Rev. 468, 482 (1972). Thus, the variable interest rate would reduce rather than increase the uncertainty for the lender.

The variable interest rate has been used successfully in other countries. In 1966, Canada's Central Mortgage and Housing Corporation was authorized to reset the maximum interest rate quarterly, at 1½% above the yield on the long term Government of Canada bonds, adjusted to the nearest ¼%. 13 Construction Review, August, 1967 at 10. The variable interest rate was used in Chile, prior to the 1973 coup. Martin, The Chile Savings and Loan System, Organization for Economic Co-operation and Development, Development Assistance (1968). Index bonds (government bonds linked to a predetermined index) have been tried or considered in France, Switzerland, Denmark, Iceland, Finland, Japan, Israel, Sweden and Luxemburg. Robinson, Readjustable Mortgages in an Inflationary Economy—A Study of the Israeli Experience, 5 J. Int'l L. & Econ. 169, 170 (1971). See generally, Lefcoe, Monetary Correction and Mortgage Lending in Brazil: Observations for the United States, 21 Stan. L. Rev. 106 (1968).

In 1971, legislation was enacted in California to permit the use of variable interest rates. Cal. CIV. Code §1916.5 (West Supp. 1975). The index to be used is the average cost of savings, borrowings, and Federal Home Loan Bank advances to members of the FHLB of San Francisco. Increases or decreases in the interest rate may not exceed ¼ of 1% in any semi-annual period. Adequate notice must be given to borrowers before the rates can be changed. Moreover, if the savings and loan association intends to increase the rate, the borrower has a right to prepay the loan, without a prepayment charge.

The Federal Home Loan Bank has also established rules to facilitate the variable interest rate. These rules are not yet in effect. They provide that (1) changes in the interest rate would follow an index beyond the control of the lender; (2) increases could come no more often than once every six months, and could not exceed ½ of 1% at any time, with a 2½% absolute ceiling on upward movement; (3) increases in the index could permit increases in the mortgage rate at the lender's option, but decreases in the index would have to be passed on to the homeowner; (4) 45 days notice would have to be given before any change in the rates; (5) the borrower could prepay the loan at any time without penalty; and (6) complete disclosure, including the potential maximum cost of the loan, would have to be made at the outset. The Evening Star, Aug. 11, 1974
enhances the risk of waste or default.  

This burden should be difficult to establish when the original deed of trust is not subject to anti-deficiency legislation and the trustor-obligor still owes a substantial sum on the obligation. Since the trustor-obligor in this situation remains liable to the lender, he has an important incentive not to default. For the same reason, he has an interest in making certain that the third party buyer keeps the property free from waste. Conversely, the burden should be less difficult to establish when the trustor-obligor owes only a small amount on the first lien, since he would have less incentive to prevent a default.

The Original Deed of Trust is Subject to Anti-Deficiency Legislation

The due-on-sale clause should be treated differently if the original deed of trust is subject to anti-deficiency legislation under section 580b of the California Code of Civil Procedure. This section provides


Other solutions have been proposed to help savings and loan associations deal with the present tight money conditions. For example, contingent interest features could provide a lender with the possibility of additional income beyond the contract mortgage rate, subject to the earnings performance of the property calculated as a percentage of gross income, net income (after expenses, debt services and taxes), or some other measure defined in the loan agreement. Wright, Innovations in Mortgage Finance, 25 J. AM. SOC'Y OF CHARTERED LiFE UNDERwRrrERS Jan., 1971, at 29, 33.

For further discussion of the variable interest rate, see generally Poole, Opper & Tayloy, The Variable-Rate Mortgage on Single-Family Homes, FEDERAL RESERVE STAFF STUDY: WAYS TO MODERATE FLUCTUATIONS IN HOUSING CONSTRUCTION 377, (1972); McManus, Variable Mortgage Note: Route to Increased Housing, 55 A.B.A.J. 557 (1969); Plant, Variable Rate Mortgages: Their Advantages for Lenders, Borrowers, and the Shelter Industry, FED. HOME LOAN BANK BOARD J., Sept., 1974, at 11. The new "anti-recession" tax law, signed by President Ford, includes a tax credit of 5% of the cost of a new home purchase, up to a maximum of $2,000. Credit is limited to purchases between March 13 and December 31, 1975, and to homes never before occupied that were built or under construction as of March 25, 1975. N.Y. Times, March 30, 1975, at 30, col. 5.

133. Nevertheless, some would argue that the trustor-obligor who received full payment for his equity could evade the obligation by leaving the country or going into bankruptcy, whereas the trustor-obligor who was to receive piecemeal payment for his equity and retain an interest in the property to assure such payment would not leave the country or go into bankruptcy, since the piecemeal payments would then be lost.

134. See note 114 supra.

135. "No deficiency judgment shall lie in any event after any sale of real property for failure of the purchaser to complete his contract of sale, or under a deed of trust, or mortgage, given to the vendor to secure payment of the balance of the purchase price of real property, or under a deed of trust, or mortgage, on a dwelling for not more than
that if a creditor receives a purchase money security, under no circum-
stances may he recover a personal judgment against the buyer after a foreclosures. Rather, he must look to the security for recovery of the obligation.136

In 1963, limitations were placed on the definition of a “purchase money” security. The law now provides that a third party loan is subject to section 580b only if (1) it is used to pay all or part of the pur-
chase price of the property; (2) it is secured by the property pur-
chased; (3) the property purchased is to be used as a dwelling by not more than four families; and (4) the dwelling, or some part of it, is occupied by the purchaser.137 Any third party loan which is secured by commercial or unimproved property is not a “purchase money” loan under section 580b.138

Consider the effect of this anti-deficiency legislation on the exercise of a due-on-sale clause. Trustor-obligor (T-O) has executed a “purchase money” deed of trust in favor of lender (L). The deed of trust contains a due-on-sale clause. T-O sells the encumbered prop-
erty to a third party buyer (B), and L decides to accelerate.139 How should a court apply the Tucker test in this situation?

Even assuming that a due-on-sale clause is valid only to protect the lender’s security, L should be able to accelerate automatically, since T-O has no incentive to prevent waste or default. According to section 580b, L’s only remedy against T-O in case of default is to retake the encumbered property; since T-O no longer owns the property, L can get nothing from him. As a result, it would be fair to permit L to exercise the due-on-sale clause and call the loan immediately due.

four families given to a lender to secure repayment of a loan which was in fact used to pay all or part of the purchase price of such dwelling occupied, entirely or in part, by the purchaser.” CAL. CODE CIV. PROC. § 580b (West Supp. 1975). See also Hetland, Deficiency Judgment Limitations in California—A New Judicial Approach, 51 CALIF. L. REV. 1 (1963); Riesenfeld, California Legislation Curbing Deficiency Judgments, 48 CALIF. L. REV. 705 (1960); Rintala, California’s Anti-Deficiency Legislation and Suretyship Law: The Transversion of Protective Statutory Schemes, 17 U.C.L.A.L. REV. 245 (1969).


137. See also id. at 542.

138. Thus, the loan in the Tucker case did not fall within the ambit of section 580b, since the Tuckers did not intend to use the property as their dwelling. See Brief for Jack F. Bonnano as Amicus Curiae at 9, Tucker v. Lassen Sav. & Loan Ass’n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

139. In this hypothetical example, it is assumed that T-O is given full payment in cash or property for his equity in the property.
Separately Secured Notes

The situation would become more complex should the trustor-obligor decide to execute separately-secured promissory notes.\textsuperscript{140} Suppose T-O buys Blackacre for $100,000. He pays $20,000 in cash and assumes a $50,000 trust deed on the property. To complete the balance of the purchase price, T-O gives L two promissory notes, one for $20,000 and the other for $10,000. The $20,000 note is secured by Blackacre, and the $1,000 note is secured by Whiteacre, another parcel of property which T-O owns.

The above facts roughly approximate the situation in \textit{Roseleaf Corp. v. Chierighino},\textsuperscript{141} a leading case concerning California anti-deficiency legislation. It should be observed that the $10,000 note does not fall within section 580b, since it is secured by property other than that which is being purchased.\textsuperscript{142} In \textit{Roseleaf}, the court held that the beneficiary (L, in our hypothetical) could foreclose the two promissory notes independently.\textsuperscript{143} In other words, after calling the $20,000 purchase money note due, L could recover a deficiency judgment on the $10,000 non-purchase-money note to the extent that L's security (Blackacre) was inadequate to satisfy the original judgment.

\textsuperscript{140} See 1 Miller & Starr, supra note 2, at 548-49.
\textsuperscript{141} 59 Cal. 2d 35, 378 P.2d 97, 21 Cal. Rptr. 873 (1963). The fact situation is based on that found in 1 Miller & Starr, supra note 2, at 548. Note that other situations may complicate the "anti-deficiency" considerations. For example, section 580b may be waived under some circumstances. In Spangler v. Memel, 7 Cal. 3d 603, 498 P.2d 1055, 102 Cal. Rptr. 807 (1972), defendants bought some property for $90,000. They paid $26,100 in cash and gave a promissory note for $63,900 secured by a purchase money deed of trust, which was to be subordinated to constructions notes for up to $2 million. Defendants waived their protection from anti-deficiency judgments and gave a written personal guarantee of joint and several liability for the payment of the $63,900 note. Upon default, the court held that defendants' waiver of section 580b was valid; therefore, plaintiff was permitted to seek a deficiency judgment. The court ruled that section 580b applies to sold out junior lienors holding a purchase money trust deed. This ruling, however, applies automatically only to the standard purchase money situation. If the transaction in question is a variation on the standard purchase money mortgage or trust deed, it should be examined so as to determine whether it subserves the purposes of section 580b. \textit{Id.} at 611, 498 P.2d at 1059, 102 Cal. Rptr. at 811.

In addition, only a part of a piece of property may be secured by a "purchase money" loan. In Prunty v. Bank of America, 37 Cal. App. 3d 430, 112 Cal. Rptr. 370 (1974), plaintiffs obtained a construction loan to erect a residence on the property. The residence was built with the proceeds of the loan, but was later destroyed by a natural disaster. The court held that section 580b banned the bank from recovering a deficiency judgment in the event of plaintiff's default and judicial foreclosure and sale under the deed of trust. The court noted that although the construction loan was not made to effect the \textit{purchase} of land, the protections of section 580b still applied.

\textsuperscript{142} See note 135 supra.
Now suppose that the $20,000 purchase money note contains a due-on-sale clause, and T-O sells Blackacre to B. Should L be permitted to accelerate automatically on the $20,000 note? If one applies the Tucker test, there should be no acceleration unless L can show a risk of waste or default. T-O still has an incentive to prevent default, even after he transfers Blackacre to B, because he is liable on the $10,000 note. If the non-purchase-money note has been for more than $10,000 (for example, $20,000), T-O would have even greater incentive to prevent default, and the court should be even more reluctant to allow automatic acceleration.

Additional Security

The situation would also become more complicated if the lender took both a chattel mortgage and a trust deed to secure the same obligation from the trustor-obligor. The law provides that if the trustor-obligor defaults, the lender can foreclose the lien on the chattel either before or after he has foreclosed the trust deed. This rule is valid whether or not anti-deficiency legislation would otherwise be applicable.

Assume that T-O has given L a purchase money deed of trust, as well as a chattel mortgage, to secure the loan that he has received to pay for Blackacre. T-O then sells Blackacre to B. Although T-O is no longer liable on this deed of trust, he remains liable on the chattel mortgage. Hence, he still has some incentive to prevent default by B. As a result, L should not be able to accelerate automatically when T-O transfers the property.

Effect of the Tucker Decision on National Banking Associations Located in California

National banking associations are empowered by federal law to make real estate loans secured by first liens upon improved real estate. Federal Savings and Loan Associations, chartered by the Federal Home Loan Bank Board, may also make such loans, provided the secured real estate lies within one hundred miles of the home office.

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144. 1 MILLER & STARR, supra note 2, at 546.
145. "A first lien on real estate within the meaning of 12 U.S.C. § 371 is any lien which grants to the holder thereof a claim against the property so secured which is prior to the rights of all others with respect thereto. Such a lien will normally be created by an instrument in the form of a mortgage or deed of trust but may also consist of a judgment which by operation of law creates a lien against certain property of the judgment debtor or a land contract . . . ." 12 C.F.R. § 7.2040(b) (1975).
Since national banking associations often foreclose in federal courts, the question may arise as to the effect of the *Tucker* decision on such proceedings.

A federal court which conducts such a foreclosure proceeding would not necessarily be bound by state substantive law, since the *Erie* doctrine\(^{148}\) applies only to cases in federal court because of diversity of citizenship.\(^{149}\) Nonetheless, there is still some basis for arguing that *Tucker* may have some impact. Consider, for example, the following excerpt from a regulation issued by the Comptroller of Currency, regarding real estate loans secured by leaseholds:\(^{150}\)

(2) In order to qualify as an acceptable leasehold for security for a real estate loan made by a national bank, the covenants and restrictions contained in the lease which provide for forfeiture or reversion in the event of a breach must not be more onerous or burdensome than those contained in leases in general use in the area in which such bank is located . . . \(^{151}\)

Could one extend this statute, by analogy, to the situation in which a piece of real estate is secured by a trust deed containing a due-on-sale clause? If so, it would seem that exercise of the due-on-sale clause by a federal banking association should be governed by the same standards as those applicable to California chartered lenders.

**Further Challenges to the “Due-on” Clause**

**After Tucker v. Lassen**

As has been demonstrated, the test proposed in *Tucker* may be applied to a wide variety of situations in which the trustor-obligor conveys title or possession to a third party. Moreover, the test is a fair one: it balances the legitimate interests that the lender has in avoiding waste and default on the encumbered property against the legitimate right of the trustor-obligor to transfer his property.

Nevertheless, it is likely that the “due-on” clause will be challenged further. Three likely grounds for objection to the “due-on” clause are that (1) its exercise constitutes an unlawful taking of property, absent a preliminary hearing; (2) it constitutes a penalty and

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149. Nevertheless, since restraints on alienation affect transferability, the substantive law on transferability of the situs should apply. Therefore, *Tucker* would be important in *all* federal cases, not merely those in which there is diversity of citizenship.

150. National banking associations are permitted to make real estate loans secured by first liens upon improved real estate, on a leasehold under a lease which does not expire for at least 10 years beyond the maturity date of the loan. 12 U.S.C. § 374 (1970).

is therefore in violation of the California Civil Code; and (3) it is void as an adhesion contract. Given the present state of California law, it is unlikely that any of these three arguments will be successful in the near future. Nevertheless, each of them merits discussion.

Requirement of a Hearing

In the landmark decision of *Sniadach v. Family Finance Corp.*, the United States Supreme Court declared that prejudgment garnishment of wages is unconstitutional unless the debtor is first afforded the opportunity of a preliminary hearing to determine the validity of the creditor’s action. The *Sniadach* principle has subsequently been extended to govern a wide variety of prejudgment remedies. The argument has therefore been made that the “due-on” clause is a prejudgment remedy which should also be governed by this principle.

The *Sniadach* holding was based on the fourteenth amendment provision that a state may not deprive a person of life, liberty, or property without due process of law. Exercise of a “due-on” clause does not necessarily involve the loss of property. If the trustor-obligor can pay the loan when it is called due, he retains ownership and posses-

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152. One other argument that the author has chosen not to discuss in the main text is that the “due-on” clause is potentially a tool which a lender can use to practice racial discrimination. This possibility is suggested by the facts in *Tucker v. Pulaski Fed. Sav. & Loan Ass'n*, 252 Ark. 849, 481 S.W.2d 725 (1972). In *Pulaski*, plaintiff (a White resident) purchased some property in Little Rock. More Blacks gradually moved into the neighborhood. Because of increasingly difficult trouble in finding renters, plaintiff endeavored to sell his property to a Black couple. Pulaski (from whom the plaintiff had obtained a mortgage on the property) refused to approve the transfer and attempted to accelerate the outstanding debt. The court in this case decided that acceleration was improper, and held that a due-on-sale clause can be enforced only where the lender shows a security risk. It is conceivable, however, that a lender could use the threat of acceleration under a “due-on” clause as a means of pressuring White trustor-obligors not to transfer to Blacks.


On the other hand, he loses certain property rights, among them the benefit of a long-term loan, which would permit him to spread the purchase price of the property over as long as twenty or thirty years. Even more seriously, if he cannot meet the lender's demand for acceleration, he risks foreclosure.

These property rights are of the type afforded protection by the Constitution. In *Fuentes v. Shevin*, the Supreme Court held that a temporary, nonfinal deprivation of property is nonetheless a "deprivation" in terms of the fourteenth amendment. The court added that the amendment's protection of property has never been interpreted as applying merely to the right of undisputed ownership; rather, it has been read broadly to extend protection to "any significant property interests." Although *Fuentes* involved the constitutionality of a state law authorizing the summary seizure of goods under a writ of replevin, the broad interpretation which the court gave to the applicability of the fourteenth amendment should apply to a trustor-obligor's property rights, as well.

Moreover, the lender could not contend that when the trustor-obligor signed the trust deed containing the "due-on" clause, he waived his due process protection. In *D.H. Overmyer Co. v. Frick Co.*, the Supreme Court ruled that one can contractually waive his due process protections, provided the waiver is made "voluntarily, intelligently, and knowingly." In *Overmyer*, a contract was negotiated between two corporations, and the waiver provision in question was specifically bargained for and drafted by the lawyers in the process of the negotiations. Therefore, the waiver was upheld.

The Court in *Fuentes* distinguished the situation in *Overmyer*. In *Fuentes*, the contract which appellant signed provided that if she defaulted on any payment, the seller could retake the merchandise.  

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156. Technically, the trustee retains ownership for the duration of the trust deed. Thus, when the trustor-obligor pays off the debt after the lender has accelerated, he obtains clear title to the property. See note 2 supra.


159. 405 U.S. 174 (1972).

160. *Id.* at 187.

161. *Id.*

162. In *Fuentes*, plaintiff purchased a gas stove and a stereo from Firestone Tire and Rubber Company. The total cost of the stove and stereo was about $500, plus an additional financing charge of over $100. Under the contracts, Firestone retained title to the merchandise, but plaintiff was entitled to possession until she defaulted on her installment payments.
The Court ruled that the appellant had not waived her fourteenth amendment rights, since the waiver provision, which was a necessary condition of the sale, was a printed part of a form sales contract. Furthermore, the parties, unlike those in Overmyer, had unequal bargaining power. A "due-on" provision is part of a standard form deed of trust. The trustor-obligor can never bargain for its exclusion. Consequently, a trustor-obligor should not be deemed to have waived his constitutional protections merely because he signs the document.

Nevertheless, it is unlikely that a trustor-obligor would be afforded a mandatory preliminary hearing prior to a lender's exercise of a "due-on" clause, since the fourteenth amendment applies only to state action. Consequently, the California courts have invoked Sniadach only in cases in which state action could be proved.

The involvement of state personnel is normally a prerequisite to a finding of state action. In Kipp v. Cozens, the court recognized that there are certain exceptions to this rule, but noted that the exceptions have generally been recognized only when a state official was acting in concert with a private individual, when state law compelled the action, when the power exercised was purely of statutory as distinguished from common law or contractual origin, or when private conduct has become entwined with governmental action.

The only exception which could conceivably apply to the "due-on" clause is the last one. The trustor-obligor might argue that the lending industry is so highly regulated and performs so important a function that the act of the lender should be treated as the act of the state itself. This argument, however, was specifically rejected by the state supreme court in Kruger v. Wells Fargo Bank. In Kruger, a depositor sued to stop the bank from applying the balance of her checking account to a delinquency in her charge account. Although the court noted that banking corporations owe their existence to state law, derive their right to practice banking from a government license, are

For more than a year, plaintiff made her installment payments; however, with about only $200 remaining to be paid, a dispute developed between her and Firestone over the servicing of the stove. Firestone sued in small claims court for repossession of both the stove and the stereo. At the same time, Firestone obtained a writ of replevin ordering a sheriff to seize the disputed goods.

163. Id. at 95.
164. See text accompanying notes 186-203 infra.
165. Ex parte Virginia, 100 U.S. 339 (1879). In Kruger v. Wells Fargo Bank, 11 Cal. 3d 352, 521 P.2d 441, 113 Cal. Rptr. 449 (1974) the court held that article 1, section 13 of the California Constitution also imposes a requirement of state action.
167. Id. at 714-15, 115 Cal. Rptr. at 426.
subject to extensive state and national regulations, fulfill important functions often performed by government agencies, and exert great influence upon the economic health of the nation,\textsuperscript{169} the justices nonetheless ruled that the bank's set-off of the depositor's charge account debt constituted private rather than state action. The court added:

As concepts of state action evolve to correspond more closely to economic reality, we may arrive at judicial recognition that such institutions and enterprises should be considered agents of the state, so that those who deal with them will receive the protection not only of decisional law but of constitutional due process . . . . A decision at this time subjecting banks and other public service enterprises to the requirements of constitutional due process would be unwarranted in light of present authority.\textsuperscript{170}

The "Due-on" Clause as a Liquidated Damages Provision

In several states, courts have treated the due-on-sale clause as liquidated damages.\textsuperscript{171} Lenders attempting to exercise such a clause must generally prove impairment of security before being granted a right of acceleration.\textsuperscript{172} In effect, the lenders in these states are subject to the same standard as the one proposed by the \textit{Tucker} test, since the due-on-sale clause is considered valid only in so far as it protects the lender's security interest. In California, this result has been achieved through the restraints on alienation doctrine rather than through the application of principles relating to liquidated damages. Thus, California courts have apparently had no need to consider whether or not "due-on" clauses constitute liquidated damages.

Classically, the judiciary in California has been among the quickest to invalidate liquidated damages provisions. In light of this severe attitude, it is arguable that the state courts could be convinced to use liquidated damages principles to invalidate the due-on-sale clause completely, even in situations in which the lender can prove impairment of security. It is submitted, however, that these courts would not do so, at least at the present time.

Generally, California law provides that clauses providing for liquidated damages upon breach of a contract are void, unless it would be impracticable or extremely difficult to fix the actual damage.\textsuperscript{173} With

\textsuperscript{169} \textit{Id.} at 364-65, 521 P.2d at 448, 113 Cal. Rptr. at 456.

\textsuperscript{170} \textit{Id.} at 365, 521 P.2d at 449, 113 Cal. Rptr. at 457.


\textsuperscript{173} California Civil Code section 1670 provides: "Every contract by which the amount of damage to be paid, or other compensation to be made, for a breach of an obligation, is determined in anticipation thereof, is to that extent void, except as expressly provided in the next section."
respect to land contracts in particular, the court in *Drew v. Pedlar* suggested that a liquidated damages clause may never be proper, since section 3307 of the California Civil Code specifies the damages recoverable in such contracts.

In this light, acceleration provisions in land contracts would appear especially vulnerable to invalidation. Nonetheless, the California courts have not always reached this conclusion; they have refused to enforce acceleration provisions in leases, but have sustained those found in promissory notes. In *Ricker v. Rombaugh,* for example, the court voided a lease provision which permitted the landlord to accelerate all of the rent payments should the tenant default at anytime or violate any term in the lease. In *Ricker,* Judge Hoyt explained why he would treat an acceleration clause in a promissory note differently:

> In leases the tenant pays rent for the possession and use of the property leased. In promissory notes the borrower pays interest for the possession and use of the money loaned. For an acceleration clause in a note to be similar to a rent acceleration clause in a lease it would have to provide that upon default all of the interest agreed to be paid should become immediately due and payable. Note acceleration clauses provide for acceleration of the payment of the principal sum loaned not for acceleration of interest.

If the court's distinction between a valid charge for the use of money and a penalty for the failure to pay is sound, one must conclude that a due-on-sale clause in a promissory note or deed of trust does not constitute liquidated damages. By the same reasoning, it

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California Civil Code section 1671 provides: "The parties to a contract may agree therein upon an amount which shall be presumed to be the amount of damage sustained by a breach thereof, when, from the nature of the case, it would be impracticable or extremely difficult to fix the actual damage." See generally, Sweet, *Liquidated Damages in California*, 60 Calif. L. Rev. 84 (1972); Comment, *The Liquidated Damages Clause in a California Contract for the Sale of Real Property*, 35 S. Cal. L. Rev. 301 (1962).


174. 87 Cal. 443, 25 P. 749 (1891).

175. *See J. Hetland, Syllabus on California Real Property Security Transactions* (1963). Section 3307 provides: "The detriment caused by the breach of an agreement to purchase an estate in real property, is deemed to be the excess, if any, of the amount which would have been due to the seller, under the contract, over the value of the property to him."


178. *Id.* at 919, 261 P.2d at 331.

179. Note that *Ricker* was followed in Vincent v. Grayson, 30 Cal. App. 3d 899,
would seem that a due-on-sale clause must be invalid if joined with a prepayment provision.

Thus far, however, the California courts have consistently upheld all types of prepayment penalties imposed by a lender upon acceleration. It may be recalled that in *Hellbaum v. Lytton Savings and Loan Association*, the court ruled that a lender's right to accelerate upon transfer by the trustor-obligor, and his right to impose a fee for prepayment, did not constitute an unlawful restraint on alienation. In the case of *Meyers v. Home Savings and Loan Association*, the court held that prepayment provisions are generally valid, as an alternative method given to the debtor of paying his debt and do not constitute liquidated damages.

No due-on-sale clause was involved in *Meyers*. Nevertheless, when *Meyers* is considered together with *Hellbaum* and a number of other cases, there is reason to believe that a court would reach the same result in a case involving a prepayment fee used in conjunction with a due-on-sale clause. This result seems inherently unfair, particularly when the disparity of bargaining power between the lender and the trustor-obligor is considerable. Under present case law, however, it is improbable that a court could be convinced to decide otherwise.

The "Due-on" Clause as Adhesion Contract

A final argument often made is that the "due-on" clause should be deemed unenforceable as an adhesion contract. Unfortunately,

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106 Cal. Rptr. 733 (1973).
182. Id. at 546, 113 Cal. Rptr. at 359-60. The court distinguished its holding from that in *Garrett v. Coast & Southern Fed. Sav. & Loan Ass'n*, 9 Cal. 3d 731, 511 P.2d 1197, 108 Cal. Rptr. 845 (1973). In *Garrett*, plaintiffs were obligors under promissory notes secured by deeds of trust in favor of defendant savings and loan association. Each plaintiff was assessed a late charge owing to an alleged tardiness in the tendering of an installment payment. Plaintiffs sought recovery of the sums assessed on the grounds that they constituted unlawful liquidated damages under California Civil Code section 1670. The supreme court held that the plaintiffs had stated a cause of action and reversed the lower court's order of dismissal.

The court in *Meyers* stated that *Garrett* clearly involved the "breach of an obligation" contemplated by section 1670, but that no such breach was involved in the instant case.

184. See text accompanying notes 185-203 infra.
185. See, e.g., Valensi, *The Due on Sale Clause—A Dissenting Opinion*, 45 L.A.B. BULL. 121, 122 (1970); Comment, *Applying the Brakes to Acceleration Clauses:*
the status of the California law with respect to adhesion contracts is in many respects unclear. Although the California legislature has rejected the unconscionability section of the Uniform Commercial Code, the state courts have long professed that they will not enforce unconscionable agreements.

The doctrine of unconscionability was employed by the early American equity courts, especially to invalidate land contracts containing harsh forfeiture agreements or attempts to bar mortgage redemptions. Although unconscionability has recently been the subject of much discussion within the commercial setting, some scholars have argued that the doctrine is still best applied to real estate transactions. After all, most people make very few purchases of real property during their lifetimes, and they are likely to hold inferior bargaining positions when dealing with more experienced sellers. In addition, the purchase price of a parcel of land is usually more economically significant for both the buyer and the seller than the purchase price of a particular piece of merchandise.

The adhesion contract is a potential source of unconscionability. It has been defined as a “standardized contract, which, imposed and


186. Hurd & Bush, Unconscionability: A Matter of Conscience for California Consumers, 25 HASTINGS L.J. 1, 5 (1973) [hereinafter cited as Hurd & Bush]. Section 2-302 of the Uniform Commercial Code reads: “(1) If the court as a matter of law finds the contract or any clause of the contract to have been unconscionable at the time it was made the court may refuse to enforce the contract, or it may enforce the remainder of the contract without the unconscionable clause, or it may so limit the application of any unconscionable clause as to avoid any unconscionable result.” The Uniform Commercial Code applies only to transactions involving the sale of goods. Nevertheless, the reasoning employed in the code has been extended by analogy to other types of transactions.

187. An unconscionable contract has been defined as one “such as no man in his senses and not under a delusion would make on the one hand, and as no honest and fair man would accept on the other.” Swanson v. Hempstead, 64 Cal. App. 2d 681, 688, 149 P.2d 404, 407 (1944). One article, in criticizing this definition, states: “Little, if any, use has ever been made of this rather untenable definition, however, and no later California cases have used unconscionability as the sole basis for relief. Because the California courts have not utilized the doctrine of unconscionability, they have been forced to seek other grounds such as fraud, misrepresentation, lack of mutuality, and finding contract clauses to be ambiguous in an attempt to reach the same result.” Brittenham, Coombs, Henderson, Mann & Reitner, The Direct Selling Industry: An Empirical Study, 16 U.C.L.A. L. REV. 890, 1000 (1969).


190. Id.

191. Id.
drafted by the party of superior bargaining strength, relegates to the subscribing party only the opportunity to adhere to the contract or reject it.\textsuperscript{192} The weaker party, frequently in need of the goods or services, is not in a position to shop around for better terms, either because the stronger party has a monopoly or because all competitors use the same clause.\textsuperscript{193}

The "due-on" clause seems to fit this description. It is a standard form provision. Most, if not all lenders use it. Indeed, in \textit{Tucker}, the president and general manager of Lassen Savings and Loan testified that the due-on-sale clause was never deleted from any deed of trust which their institution issued.\textsuperscript{194}

Nevertheless, the California courts have narrowly defined the types of adhesion contracts which they refuse to enforce. The California adhesion contracts doctrine has thus far been limited in application to form contracts between parties of unequal bargaining power; the superior party is frequently some type of public service enterprise.\textsuperscript{195} Moreover, the California courts have employed the doctrine primarily when dealing with exculpatory provisions in insurance policies, and they have not often ventured into other areas.\textsuperscript{196} Nevertheless, since the elements of unconscionability found in insurance cases may also be present in various other situations in which standard form provisions are involved, there is no inherent reason why the courts cannot extend their application of the adhesion doctrine.\textsuperscript{197}

\textsuperscript{192} Neal v. State Farm Ins. Cos., 188 Cal. App. 2d 690, 694, 10 Cal. Rptr. 781, 784 (1961).

\textsuperscript{193} Kessler, \textit{Contracts of Adhesion—Some Thoughts About Freedom of Contract}, 43 \textit{COLUM. L. REV.} 629, 632 (1943). Slawson writes that adhesion contracts gain no legitimacy from the supposed consent of the adhering party, since manifestations which are known to be the product of adhesion do not constitute true consent. As a result, the legitimacy of adhesion contracts depends on their compliance with standards in the public interest. Slawson, \textit{Standard Form Contracts and Democratic Control of Lawmaking Power}, 84 \textit{Harv. L. Rev.} 529, 566 (1971).


\textsuperscript{195} Hurd & Bush, \textit{supra} note 186, at 36. In \textit{Tunkl v. Regents of the University of California}, the court noted that in placing particular contracts within or without the category of those affected with a public interest, the California courts have roughly indicated the type of transaction in which exculpatory provisions will be held invalid: (1) the transaction concerns a matter generally thought suitable for public regulation; (2) the party seeking exculpation is engaged in performing a service of great importance to the public; (3) the party holds himself out as being willing to perform the service for any member of the public coming within certain established standards; and (4) the party invoking exculpation has decisively superior strength. Tunkl v. Regents of the Univ. of California, 60 Cal. 2d 92, 98-100, 383 P.2d 441, 444-46, 32 Cal. Rptr. 33, 36-38 (1963). \textit{See generally Comment, Contracts of Adhesion Under California Law}, 1 \textit{U.S.F.L. REV.} 306 (1963).

\textsuperscript{196} Hurd & Bush, \textit{supra} note 186, at 35.

\textsuperscript{197} \textit{Id.}
The doctrine might well be extended to include a "due-on" clause in a deed of trust issued by an institutional lender. The courts have several times categorized banks and other lending institutions as public service enterprises.\textsuperscript{198} Furthermore, the lender who is benefited by a "due-on" clause is often in a superior bargaining position, especially when the trustor-obligor is a small developer or simply the purchaser of a single family dwelling. Thus, it is not surprising that in \textit{La Sala} the court suggested that an adhesion situation might conceivably arise in a case involving a due-on-sale clause.\textsuperscript{199}

A further limitation, however, has been placed on the California doctrine of adhesion contracts. The state courts have thus far limited their application of the doctrine to instances in which the adhering party did not understand the term in question. For example, the doctrine has been applied to cases in which a party signed a detailed agreement in order to obtain particular goods or services, without truly comprehending each of the provisions in the document.\textsuperscript{200} The courts have held that in such instances a clause must be "conspicuous, plain and clear" in order to be enforceable.\textsuperscript{201} California courts have not yet extended the adhesion doctrine to the situation in which the adhering party knows of an unfair term, but is precluded from bargaining for its removal.\textsuperscript{202} This hesitancy of the courts is unfortunate, since a buyer may knowingly accept such a term because he needs what the stronger party offers or can receive no better treatment anywhere else.\textsuperscript{203}


\textsuperscript{199} 5 Cal. 3d 864, 876-77, 489 P.2d 1113, 1120-21, 97 Cal. Rptr. 849, 856-57 (1971).


\textsuperscript{202} Various efforts have been made to categorize the forms of unconscionability. Professor Leff distinguishes "substantive" from "procedural" unconscionability. He writes "there are two separate social policies which are embodied in the equity unconscionability doctrine. The first is that bargaining naughtiness, once it reaches a certain level, ought to avail the practitioner naught. The second is directed not against bargaining conduct (except insofar as certain results often are strong evidence of certain conduct otherwise unproved) but against results and embodies the doctrine . . . that the infliction of serious hardship demands special justification." Leff, \textit{Unconscionability and the Code—The Emperor's New Clause}, 115 U. PA. L. REV. 485, 539 (1967).

In any event, the extent to which the doctrine of adhesion contracts might apply to the "due-on" clause is unclear. The doctrine should apply if the trustor-obligor is unaware of the clause and has no reason to be aware of its existence. It might also apply if the trustor-obligor is aware of the clause but does not comprehend the serious ramifications of the lender's ability to accelerate at will. On the other hand, the courts would probably not invoke the doctrine of adhesion contracts to invalidate a "due-on" clause if the trustor-obligor is aware of the existence of the clause and fully comprehends how it might be used against him.

Finally, it should be observed that if the *Tucker* test is applied as suggested earlier in this note, the adhesion contracts problem would become moot. It would be difficult to argue that a "due-on" clause which permits a lender to accelerate only when he can prove severe damage to his security is an unconscionable provision. The suggested extension of the *Tucker* test would thus serve to resolve troublesome problems of unconscionability.

**Conclusion**

Viewed in the most limited way, *Tucker* holds merely that a lender may not automatically enforce a due-on-sale clause in instances in which the trustor-obligor has entered into an installment land contract with a third party. Nonetheless, the case suggests potentially vast ramifications. The rule announced in *Tucker* relative to the lender's ability to exercise a "due-on" clause is a fair one, and it should be extended as indicated in this discussion.

Moreover, in a larger sense, *Tucker* must be considered an important victory against the overreaching which is sometimes practiced by lending institutions. As the California Supreme Court becomes increasingly sensitive to the position of borrowers, it will hopefully grant them even greater protection.

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