Comments

AN UPDATE OF THE LAW GOVERNING PREPAYMENT CLAUSES

This Comment examines the validity of the prepayment clause in light of the Wellenkamp v. Bank of America *decision. The author reviews the common judicial development of the prepayment and due-on-sale provisions. The Comment highlights the inconsistencies in the law governing the two loan terms and concludes by suggesting the need for uniformity.*

"Creditors have better memories than debtors; they are a superstitious sect, great observers of set days and time."—Benjamin Franklin

The economic ills which have troubled this country in recent years are likely to continue in the 1980's. Double-digit inflation, skyrocketing prices and wages, dollar devaluation, long term unfavorable balances of trade, periodic unemployment, and the large budget deficits of the federal government characterize the uncertain economy.[1] The increased use of credit by all segments of our society typifies the inflationary trend.[2] The real estate industry is particularly sensitive to fluctuations in the credit indices.[3] When a buyer of real property is able to assume an existing loan with an interest rate lower than the current prime rate, transferability is facilitated. The lender, however, is precluded from obtaining the greater profits which refinancing at higher interest rates would yield when assumption is permitted.

1. M. GORDON, INFORMATION PLEASE ALMANAC, BUSINESS AND THE ECONOMY 40-74 (33d ed. 1979).

2. B. SPRINKEL, MONEY AND MARKETS—A MONETARIST VIEW 33-34 (1971).

3. Dasso, *Lender Participation Financing: Its Nature and Significance to Appraisers*, REAL EST. APPRAISER, Mar.-Apr. 1972, at 13-14.

Motivated by the desire to maximize profits and limit losses during periods of unstable interest rates, lenders have attempted to regulate the assumption of existing loans.[4] In order to achieve this goal, clauses originally designed to protect security interests have been employed to insure economic advantages during times of volatile interest rates.[5] The lender frequently uses the prepayment and the due-on-sale clauses to enhance profits during times of erratic interest rates.

In California the trustor of a real estate loan is generally not permitted to prepay his debt without the consent of the lender.[6] Real estate financing agreements often include a prepayment clause which governs the right of the debtor to repay the loan before maturity.[7] Such clauses typically provide for the assessment of a "penalty," "fee," or "bonus" for early payment.[8]

An acceleration provision in a trust deed or mortgage gives the lender the right to demand immediate payment of the outstanding secured debt under certain circumstances.[9] The acceleration provision usually takes the form of a due-on-sale clause. A sale or transfer of the security interest will trigger the due-on-sale clause and the loan becomes immediately due and payable.[10]

The due-on-sale provision and the prepayment clause may interact to shift the economic burden of unstable interest rates to the borrower.[11] In the event of a sale, the due-on-sale provision permits acceleration of the loan which in turn creates an early payment. This early payment results in the assessment of a penalty under the prepayment clause. As a consequence of the combined exercise of these clauses, not only is assumption prevented, but the entire transfer is inhibited. Alienation is restrained.

In 1978, the California Supreme Court ruled, in *Wellenkamp v. Bank of America*, that the automatic acceleration of a loan is an unreasonable restraint on alienation absent some showing of an

4. Almost without exception, the due-on-sale provisions of institutional lending agreements are specifically designed to prevent assumption in the event of a transfer. Toone, *"Due on Sale" Revisited*, 55 SAN DIEGO REALTOR 12 (1980).

5. 1 H. MILLER & M. STARR, CURRENT LAW OF CALIFORNIA REAL ESTATE § 3:64 (rev. ed. 1975).

6. R. BERNHARDT, CALIFORNIA MORTGAGE AND DEED OF TRUST PRACTICE §§ 2.46-.47 (1979).

7. *Id.*

8. *See* 1 H. MILLER & M. STARR, *supra* note 5, § 3:70; 13 AM. JUR. LEGAL FORMS 2D *Mortgages and Trust Deeds* § 179 (1971).

9. J. CARTWRIGHT, GLOSSARY OF REAL ESTATE LAW 11-12 (1972).

10. *Id.*

11. Bonano, *Due on Sale and Prepayment Clauses in Real Estate Financing in California in Times of Fluctuating Interest Rates—Legal Issues and Alternatives*, 6 U.S.F. L. REV. 267, 271 (1972).

impairment to the security.[12] Prior to *Wellenkamp* the validity of the prepayment penalty had been established in decisions that relied on the rationale employed in upholding the legitimacy of acceleration clauses.[13]

It is the purpose of this Comment to analyze the prepayment clause in light of the *Wellenkamp* decision. A brief survey of the doctrine of restraints on alienation and the law governing the prepayment and due-on-sale provisions will be presented. Emphasis will be placed on the current inconsistency in the law governing these clauses after *Wellenkamp*. This Comment concludes by suggesting that the prepayment penalty is an unreasonable restraint on alienation and should be conformed to the rationale set forth in *Wellenkamp*.

THE PREPAYMENT CLAUSE

The prepayment clause governs the "right" of the borrower to pay off his loan before maturity. The lender has the right to insist on receiving payment neither early nor late.[14] Except in certain limited situations, the mortgagor does not possess the prerogative of prepaying the debt unless the right is expressly granted by contract.[15] The two most common types of prepayment terms are the "option" and "non-option" fees. The non-option situation occurs when the loan agreement is silent with respect to prepayment. Under such circumstances, when the borrower desires to prepay, he must negotiate with the lender regarding the charge assessed for the privilege of premature remittance.[16] On the other hand, the option type expressly provides for the right to prepay at a predetermined fee.[17]

A typical option prepayment clause appears as follows:

> Privilege is reserved to make additional payments on the principal of this indebtedness at any time without penalty, except that as to any such payments that exceed 20% of the original principal amount of this loan during any successive 21-month period beginning with the date of this promissory note, the maker agrees to pay, as consideration for acceptance of such payment, six months advance interest on that part of the aggregate amount of all prepayments in excess of said 20%.[18]

12. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).
13. R. BERNHARDT, *supra* note 6, § 2.46.
14. *Id.*
15. *See* Smiddy v. Grafton, 163 Cal. 16, 124 P. 433 (1912).
16. 1 H. MILLER & M. STARR, *supra* note 5, § 3:70.
17. *Id.*
18. R. BERNHARDT, *supra* note 6, § 2.47.

A borrower who is subject to the above clause and who owes $100,000 at fifteen percent interest could be penalized as much as $6,000 for prepayment. Unfortunately, when applying for a loan few borrowers contemplate the effects of a prepayment, even when the contract contains an option term.[19] Obviously, in a climate of economic duress, the prepaying borrower is at the lender's mercy.[20]

The most common situation giving rise to a prepayment occurs when property is sold. In the event of a sale, the due-on-sale clause and prepayment provisions operate to the borrower's detriment. The due-on-sale term forces acceleration of the loan which precludes assumption by a prospective buyer. The acceleration generates a prepayment and a penalty is charged under the prepayment clause. The ultimate result is a restraint on alienation.

RESTRAINTS ON ALIENATION

The right to freely transfer land is characterized by a long history of judicial battles.[21] In the real estate context, the doctrine of restraints on alienation is aimed at restrictions in conveyancing instruments which either expressly or impliedly prohibit or penalize the right to transfer real property. The basis of the doctrine lies in the social policy disfavoring restrictions that might remove property from commerce, concentrate wealth, suppress creditors, or deter property development.[22] Restraints may be total or partial depending on whether a restriction precludes transfer or merely limits the time and manner of conveyance. Such constraints may be imposed either directly or indirectly,[23] depending on whether they prohibit or condition the transfer, or merely penalize alienation.[24]

California Civil Code section 711 was enacted to prohibit re-

19. *See generally* 1 H. MILLER & M. STARR, *supra* note 5.

20. The economic duress situation ordinarily involves a lack of free choice and unequal bargaining positions. Yet, Professor Williston indicates that "[t]he threatened person need only be compelled to choose between regrettable alternatives." 13 WILLISTON ON CONTRACTS § 1602 (3d ed. 1970).

Certainly the seller of real property, subject to a prepayment clause, is forced to make the regrettable decision between bearing the expense of a prepayment penalty upon acceleration of the debt and not selling at all. In a New York case, abuse was evident when a $2,000 penalty was exacted for a prepayment of less than $15,000. Feldman v. Kings Highway Sav. Bank, 278 A.D. 589, 102 N.Y.S.2d 306, *aff'd* 303 N.Y. 675, 102 N.E.2d 835 (1951).

21. Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747, 757-67 (1973).

22. A. CASNER & W. LEACH, CASES AND TEXT ON PROPERTY 1008 (2d ed. 1969).

23. *Id.*

24. L. SIMES & A. SMITH, THE LAW OF FUTURE INTERESTS § 1112 (2d ed. 1956).

straints on alienation.[25] The California Supreme Court, however, has ruled that section 711 bars only unreasonable restraints on alienation.[26] This prohibition against unreasonable restraints necessarily involves a balancing test. The interests served by a restraint must outweigh the social policy disfavoring limitations on alienation.[27]

Prepayment and due-on-sale clauses are examples of indirect restrictions.[28] Neither clause is a restraint on alienation per se, because neither directly prohibits the transfer of property. Nevertheless, when the lender invokes the prepayment and due-on-sale provisions, alienation is effectively restrained because of the increased cost of a conveyance.[29]

Due-On-Sale

Real estate lending agreements commonly contain provisions that restrain the borrower from transferring the security interest without the consent of the lender.[30] These provisions grant to the lender the authority or option to accelerate the balance due on the loan in the event of a conveyance.[31] The "due-on-sale clause" is the generic name given such provisions.

The chronological development of the validity of the due-on-sale clause in California parallels the judicial attitude toward consumerism. Prior to 1930 such clauses were almost nonexistent.[32] The courts that initially upheld the validity of due-on-sale clauses based their decisions on the rationale of protecting the lender's security interest.[33]

The California Supreme Court first considered the validity of an

25. CAL. CIV. CODE § 711 (West 1954) ("Conditions restraining alienation, when repugnant to the interest created, are void.").

26. Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

27. [The restraint is valid] if the objectives behind the imposition of the restraint are sufficiently important to outweigh the social evils which flow from the enforcement of the restraint or if the interference with the power of alienation is so insignificant that no appreciable harm results from the enforcement of the restraint.

RESTATEMENT OF THE LAW OF REAL PROPERTY § 410, Comment a (1944).

28. These provisions penalize transfers rather than prohibit them.

29. *See* Comment, *Debtor-Selection Provisions Found in Trust Deeds and the Extent of Their Enforceability in the Courts*, 35 S. CAL. L. REV. 475, 477-80 (1962).

30. 1 H. MILLER & M. STARR, *supra* note 5, §§ 3:64-:65.

31. *Id.*

32. *See* Bonano, *supra* note 11, at 271.

33. *Id.*

acceleration clause in *Coast Bank v. Minderhout*.[34] Writing for the majority, Justice Traynor recognized that acceleration provisions impose restraints on alienation.[35] He concluded, however, that public policy justifies reasonable restraints on alienation in order to protect the security interest of the lender. Justice Traynor analyzed the validity of the clause on its face rather than considering its impact on transferability.[36] He employed a theoretical approach in dealing with the doctrine of restraints on alienation.[37] Justice Traynor also failed to make any distinction between the due-on-sale and due-on-encumbrance provisions. As a result, subsequent decisions assumed that automatic enforcement of both provisions was proper.[38]

Seven years after *Minderhout*, the court considered the reasonableness of a due-on-encumbrance clause in *La Sala v. American Savings and Loan Association*[39] and distinguished it from due-on-sale provisions. The restraint in *La Sala* permitted acceleration of the debt upon encumbrance of the security. When the borrower obtained a second mortgage on his property, the lender sought to accelerate the debt automatically. The court, noting that the "reasonable necessity" for enforcement of the due-on-sale provision does not apply with equal force to restraints against future encumbrances,[40] indicated that two factors should be balanced in applying the reasonable necessity standard. The degree of restraint on alienation must be weighed against the potential impairment of the lender's security.[41] Therefore, the court held that the due-on-encumbrance clause could not be exercised automatically unless the lender could demonstrate that enforcement was reasonably necessary to protect his interest in the security.

The cases that followed *La Sala* expanded the rights of the borrower by extending the balancing approach. In *Tucker v. Lassen*

34. 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).

35. *Id.* at 315, 392 P.2d at 268, 38 Cal. Rptr. at 508.

36. Note, *Judicial Treatment of the Due-On-Sale Clause: The Case for Adopting Standards of Unreasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1113 (1975).

37. *Id.* Justice Traynor discussed the restraints on alienation that are permitted in estates less than fee interests but did not consider the economic effects on modern transfers.

38. The first decision which failed to go beyond the inflexible rule of *Minderhout* was Jones v. Sacramento Sav. & Loan Ass'n, 248 Cal. App. 2d 522, 56 Cal. Rptr. 741 (1967). *See also* Mountain Brow Lodge, I.O.O.F. v. Tuscano, 257 Cal. App. 2d 22, 64 Cal. Rptr. 816 (1967).

39. 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

40. *Id.* at 879-80, 489 P.2d at 1123, 97 Cal. Rptr. at 859.

41. *Id.* at 877-78, 489 P.2d at 1121, 97 Cal. Rptr. at 857.

Savings & Loan Association,[42] the supreme court held that automatic acceleration of a due-on-sale clause would not be permitted with respect to installment land sales. The court enlarged the reasonableness doctrine by balancing the interests of the borrower directly against those of the lender.[43] As the quantum of restraint arising from an acceleration clause increases, the lender's burden of justifying enforcement also increases. The court found that the quantum of restraint arising from a due-on-sale clause is significant and that the risks of waste and default in an installment land sale are slight.[44] Therefore, the minimal impairment of security resulting from an installment land sale places a significant burden on the lender to show enforcement is necessary. The court also rejected the lender's use of the acceleration clause as a device to hedge against rising interest rates.[45]

Against this background, the California Supreme Court in 1978 made a decisive move to protect the borrower against the unreasonable enforcement of acceleration provisions. In the landmark case of *Wellenkamp v. Bank of America*, the court held that automatic exercise of a due-on-sale clause would not be permitted absent a showing of impairment to the lender's security interest.[46] This rule was held to apply even in the situation where there is an outright sale of the security interest.

In order to reach their conclusion, the court applied the balancing principles established in *La Sala* and *Tucker*.[47] Justice Manual found that a transaction may be "inhibited entirely" if the lender refuses to permit the buyer to assume an existing loan.[48] Moreover, the alternative of allowing assumption at an increased interest rate would still have an "inhibitory effect."[49] Thus, the seller would be forced to either reduce the purchase price and absorb the loss, or not sell at all. Justice Manual concluded that, in either event, the restraint on alienation is apparent.[50]

The court rejected the argument that the risks of waste and default in an outright sale are enhanced when the borrow/seller no

42. 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).
43. *Id.* at 639, 526 P.2d at 1176, 116 Cal. Rptr. at 639.
44. *Id.*
45. *Id.* at 640, 526 P.2d at 1176, 116 Cal. Rptr. at 640.
46. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978) (Clark, J., dissenting).
47. *Id.* at 949, 582 P.2d at 974, 148 Cal. Rptr. at 383.
48. *Id.* at 950, 582 P.2d at 974, 148 Cal. Rptr. at 383.
49. *Id.* at 950, 582 P.2d at 975, 148 Cal. Rptr. at 384.
50. *Id.*

longer retains an interest in the transferred security.[51] Assumption does not invariably increase the lender's risks.[52] When the buyer makes a down payment equal to the seller's equity interest, an incentive exists not to commit waste. In any case, the lender is not justified in automatically assuming that the buyer presents a greater risk than the seller.[53]

The court also rejected the argument that automatic enforcement of the due-on-sale provision is necessary in order to maintain a loan portfolio which reflects current interest rates.[54] The court approached this argument by examining the relative economic burdens of the lender and borrower. Justice Manual indicated that the hardships of an inflationary economy are inherent risks which the lender must bear. The lender is typically more sophisticated than the borrower and better equipped to project changes in economic conditions.[55] The due-on-sale provision's purpose of protecting the lender's security interest is inconsistent with the bank's economic justifications.[56] Therefore, "it would be unjust to place the burden of the lender's mistaken economic projections on property owners exercising their right to freely alienate their property."[57] The court did not, however, consider the validity of the prepayment clause nor its consequent economic burdens.

Prepayment Clauses

Early attacks on prepayment charges were manifested in a variety of claims. Borrowers asserted that the fees were excessive and usurious.[58] However, although California has long recognized the unenforceability of excessive penalty provisions,[59] the courts have uniformly rejected the usury argument on the rationale that the prepayment fee is not an actual charge for the use of the money.[60] Instead, the courts have interpreted the fee as an optional expense incurred by the borrower for discontinuing the use of the money.[61]

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51. *Id.* at 951, 582 P.2d at 975, 148 Cal. Rptr. at 384.
52. *Id.*
53. *Id.* at 952, 582 P.2d at 976, 148 Cal. Rptr. at 385.
54. *Id.*
55. *Id.*
56. *Id.*
57. *Id.* at 953, 582 P.2d at 976, 148 Cal. Rptr. at 385.
58. 1 H. MILLER & M. STARR, *supra* note 5, § 3:71.
59. Lazzareschi v. San Francisco Sav. & Loan Ass'n, 22 Cal. App. 3d 303, 99 Cal. Rptr. 417 (1971); Hellbaum v. Lytton Sav. & Loan Ass'n, 274 Cal. App. 2d 456, 79 Cal. Rptr. 9 (1969).
60. Lazzareschi v. San Francisco Sav. & Loan Ass'n, 22 Cal. App. 3d 303, 308, 99 Cal. Rptr. 417, 420 (1971).
61. *Id.*

Borrowers have also asserted that the prepayment charge is an unlawful attempt to acquire liquidated damages. Accordingly, such borrowers claimed that the usual prepayment situation should be governed by liquidated-damages statutes.[62] Such statutes permit the lender to predetermine the amount of damages only when it would be extremely difficult to assess actual damages. Since the lender can accurately fix damages at the time of prepayment, assessment of a predetermined or fixed rate prepayment charge would be an invalid penalty.[63] The courts have held, however, that prepayment penalties are not liquidated damages since most prepayments are voluntary.[64]

The most common attack on prepayment charges has been that they are unreasonable restraints on alienation. In *Hellbaum v. Lytton Savings & Loan Association of Northern California*, the California District Court of Appeal considered the validity of a prepayment clause which was coupled with an acceleration provision.[65] Relying on the decision in *Minderhout*, the court began by examining the law governing due-on-sale provisions and suggested that the "justifiable interest" which permits automatic exercise of the acceleration clause also permits prepayment penalties.[66] The court apparently accepted the argument, that administrative costs and the threat of idle money are justifiable interests which support the assessment of a prepayment penalty. Prepayment penalties, therefore, even when coupled with the exercise of an acceleration clause, do not constitute unreasonable restraints on alienation.[67] The decision, however, did not clarify whether the exercise of the prepayment clause standing alone would be an unreasonable restraint. No clear distinction was made between the justifiable interests that support the exercise of prepayment clauses and those that support the exercise of acceleration clauses.

The prepayment charge that results from acceleration of the loan may be said to be a consequence of the borrower's actions.

62. Meyers v. Home Sav. & Loan Ass'n, 38 Cal. App. 3d 544, 113 Cal. Rptr. 358 (1974).
63. Mink, *Prepayment Penalties in California*, 4 J. BEVERLY HILLS B.A. 26 (1970).
64. *See generally* Comment, *Secured Real Estate Loan Prepayment and the Prepayment Penalty*, 51 CAL. L. REV. 923 (1963).
65. 274 Cal. App. 2d 456, 79 Cal. Rptr. 9 (1969).
66. *Id.* at 459, 79 Cal. Rptr. at 11.
67. *Id.*

The borrower is the one who initiates a transfer of the security. However, penalties for involuntary prepayments which are neither the fault of the lender nor the borrower present a different problem.

Although it would appear inequitable to penalize a borrower for an involuntary sale, such was the case in *Lazzareschi Investment Co. v. San Francisco Federal Savings & Loan Association*.[68] An involuntary prepayment resulted when the court ordered that the property securing a debt be sold in a divorce action. The existing loan contained a prepayment clause which expressly provided for the assessment of a penalty regardless of whether the prepayment was voluntary or involuntary. The court held that the lender could exact the prepayment charge and that such a requirement was not an unreasonable restraint on alienation.[69] Under such reasoning, it would appear appropriate for a lender to accelerate a loan and then assess a penalty for the resulting early payment.

The *Hellbaum* case, which established the validity of prepayment clauses, was derived from the rationale in *Minderhout* regarding due-on-sale provisions. The court in *Minderhout* specifically noted that the two clauses bear "the same relation" to the doctrine of restraints on alienation.[70] This line of cases needs to be reassessed in light of the recent *Wellenkamp* decision. Although *Wellenkamp* did not expressly refer to the validity of prepayment penalties, the decision does represent the most recent ruling of the California Supreme Court on the validity of acceleration provisions as restraints on alienation. Therefore, the continued cogency of the prepayment clause is questionable.

The Validity of the Prepayment Penalty After *Wellenkamp*

The restraining effect of prepayment penalties must be reconsidered in light of the *Wellenkamp* decision. California Civil Code section 711 precludes unreasonable restraints on alienation. The *Wellenkamp* case holds that automatic exercise of the due-on-sale clause is an unreasonable restraint on alienation absent some showing of impairment to the lender's security.[71] There is no doubt that a prepayment penalty can be unreasonable. When a prepayment charge is levied on a percentage basis without regard to the lender's actual costs or impairment to security, the fee

68. 22 Cal. App. 3d 303, 99 Cal. Rptr. 417 (1971).
69. *Id.* at 311, 99 Cal. Rptr. at 422.
70. Coast Bank v. Minderhout, 61 Cal. 2d 311, 392 P.2d 265, 38 Cal. Rptr. 505 (1964).
71. *See* text accompanying notes 46-57 *supra*.

becomes a penalty. This method of exacting the prepayment fine is clearly an unreasonable restraint on alienation. There is no justification in law or public policy for the imposition of a penalty-type restraint upon alienation of the security.[72] Nevertheless, this is exactly the result of a prepayment penalty incident to the exercise of the due-on-sale clause according to the rule announced in *Hellbaum*. Although the lender has an interest in guarding against transfers of its security interest to insolvent persons, there is no "justifiable interest" in penalizing the parties to a conveyance when a transfer is made to a qualified purchaser.

The court in *Wellenkamp* rejected the argument that transfers invariably enhance the risks of default and waste and that automatic acceleration is necessary in order to maintain a current loan portfolio.[73] The decision focused primarily on the lender's right in protecting his security interest. Therefore, a lender's right to exercise a prepayment clause should also be based on justifiable interests which outweigh any restraints on alienation.

The interests mentioned in the *Hellbaum* case were the administrative expenses incurred by the lender in the event of a prepayment and the lender's desire to avoid idle money. The administrative expenses incident to an early payment are not sufficient to warrant the automatic exercise of a prepayment clause that exacts a percentage-type penalty. Certainly the lender is capable of appraising reconveyance costs accurately. Further, the lender is undoubtedly better equipped to forecast economic conditions than the typical borrower. The assessment of a fee to cover administrative expenses is not unreasonable per se. Yet, the lender should not be permitted to predetermine prepayment charges on a percentage basis without regard to actual costs. Likewise, the lender should not be allowed to negotiate a prepayment charge in the "non-option" situation in an atmosphere of economic duress.

The lender's interest in avoiding idle money is also a justification without merit. When interest rates are rising the lender benefits by prepayments. More funds are available to lend out at higher rates. When interest rates decrease the flow of money is greater. Lower rates typically stimulate more lending, which thereby permits the lender to recirculate more money—usually at

72. Bonano, *supra* note 11, at 283.
73. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

a faster turnover. In any case, regardless of the economic conditions, the lender can immediately place funds into government bonds in order to avoid idle money. The logical application of the rationale employed in *Wellenkamp* indicates that the prepayment clause should not be used as a weapon for the purpose of generating profits or in maintaining a loan portfolio that reflects current interest rates.

Finally, the need to conform the law governing prepayment clauses to that of acceleration provisions is of particular importance when the possibility of abuse is considered. Lenders will undoubtedly try to escape the requirements of *Wellenkamp*. This may be possible because of the inconsistency in the law governing prepayment and due-on-sale provisions. Since the *Hellbaum* court referred to the prepayment penalty as an "assumption fee," this terminology could be employed by the lender to evade the mandate of *Wellenkamp*. Rather than accelerate the debt upon a sale, the lender could simply impose an assumption fee on the assuming borrower. In effect, the lender complies with *Wellenkamp* by not accelerating the loan while assessing an assumption penalty. Such casuistry shifts the burden of higher interest rates to the borrower and permits the lender to approximate a current loan portfolio.

Conclusion

The inflationary turmoil and unstable economy of recent years has dramatically increased the use of credit. The increased use of credit has focused judicial attention on clauses in lending agreements that unreasonably restrain alienation. The due-on-sale clause is a prime example. The *Wellenkamp* decision represents the culmination of this concern. In *Wellenkamp*, the California Supreme Court decisively shifted the burden of fluctuating interest rates to the lender. The implications of *Wellenkamp* are broad and far-reaching. Application of the consumer-oriented attitude manifested in *Wellenkamp* will have a significant effect on other clauses in lending agreements.

The prepayment penalty represents a clause particularly susceptible to the reasoning established in *Wellenkamp*. A re-examination of the validity of the prepayment clause is necessitated. The case law defining when the prepayment clause may be exercised is antiquated. Decisions that supported the use of prepayment penalties were based on the rationale of acceleration cases that were rejected by *Wellenkamp*.

Therefore, since the courts have always disfavored unreasonable restraints on alienation, the law governing prepayment penal-

ties should be updated. The analysis and cases presented in this Comment demonstrate that the automatic exercise of the prepayment clause effectively restrains free alienation. Should the validity of the prepayment clause come before the California Supreme Court, the court should conform the law of prepayment clauses to the *Wellenkamp* rationale. Reasonable assessment of a prepayment charge entails an accurate evaluation of the lender's costs. It does not involve a predetermined amount, a percentage-based penalty, or automatic enforcement.

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