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Stanley Martin Redd, Sheila M. Redd, His Wife;
Sterling Hardson Redd, Jill D. Redd, His Wife; Paul
Dutson And Donna Dutson, His Wife v. Western
Savings & Loan Company : Reply Brief of
Appellants

Utah Supreme Court

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IN THE SUPREME COURT OF THE STATE OF UTAH

STANLEY MARTIN REDD, SHEILA M.)
REDD, his wife; STERLING HARDSON)
REDD, JILL D. REDD, his wife;)
PAUL DUTSON and DONNA DUTSON,)

Plaintiffs-Appellants,)

vs.)

Case No. 17231

WESTERN SAVINGS & LOAN COMPANY)

Defendant-Respondent.)

REPLY BRIEF OF APPELLANTS

Appeal from Summary Judgment in favor of the Respondent by the Third Judicial District Court of Salt Lake City, Utah, the Honorable Kenneth Rigtrup, Judge, presiding.

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REPLY BRIEF OF APPELLANTS

POINT I
EXERCISE OF THE "DUE ON SALE" CLAUSE
IN THIS CASE CONSTITUTES AN UNREASONABLE
RESTRAINT ON ALIENATION

The Respondent, in arguing the lack of restraints on alienation in this case, ignores or misconstrues the affect which varying interest rates and refinancing costs have upon alienability of real property. According to an advertisement sponsored by the Federal National Mortgage Association ("Fannie Mae") in December 1980, whenever mortgage rates increase by one percent, approximately 1.4 million potential home buyers are priced out of the housing market. One Answer to the Mortgage Affordability Crisis, The Realtor News, December 8, 1980, at 5. According to the president of the U.S. League of Savings Associations, a five percent jump in the interest rate means an increase of \$200 per month in the average mortgage payment, making it virtually impossible for the average prospective home buyer to qualify. Savings League Survey Shows Gloomy Mortgage Rate Views, The Denver Post,

September 17, 1980, at 42. According to a savings and loan analyst, several million people could be thrown out of their homes if the rise of industry costs does not reflect inflation but merely reflects increases caused by regulators in their efforts to decontrol interest rates. Controversial California Mortgage Bill, Sought by Lenders, is Vetoed by Governor, The Wall Street Journal, July 22, 1980, at 12.

This type of data has been a significant factor convincing courts, including the California Supreme Court in its series of recent decisions, that the automatic enforcement of "due on sale" clauses is an unlawful restraint on alienation.

The California cases, as well as other cases cited in this brief and in the Appellants' initial brief, which require a showing of reasonableness in the enforceability of a "due on sale" clause, contain the common thread of the degree to which such enforcement constitutes a restraint on alienation and the justification for the restraint.

The issues before the courts are not simply theoretical black and white issues of law to be considered in a vacuum. Rather, the determination of these legal issues involves an examination in each case to determine whether, in fact, such a restraint exists and whether it is unreasonable.

The degree of restraint resulting from an increase in interest rates depends upon the amount of the increase and the circumstances under which they are increased. As the interest rate climbs, the restrictive nature of the "due on sale" clause becomes more burdensome, because more potential buyers

are forced out of the market. Thus, the affect of the acceleration clause as a restraint on alienation increases as the interest rate rises. The issue for the court to decide is whether, under the circumstances of a case, a lender's attempt to accelerate a loan is a reasonable protection of a justifiable interest so that the operative affect of the clause does not constitute an unreasonable restraint on alienation.

In Tucker v. Lassen Sav. & Loan Assn., 116 Cal. Rptr. 633, 526 P.2d 1169 (1974), the California Supreme Court held that a lender's automatic enforcement of the acceleration clause, as a result of borrowers entering into an installment land contract involving investment property, was an unreasonable restraint on the alienation of property when enforcement of the clause was not reasonably necessary to protect certain interests of the lender. That court recognized two aspects of the problem, i.e., the justification for a particular restraint on property and whether that restraint serves a justifiable interest of the restraining party and, secondly, the quantum of restraint which is appropriate in that particular circumstance. The Court in Tucker noted that, to the degree the enforcement of the "due on sale" clause would result in an increased quantum of actual restraint on alienation in a particular case, greater justification for the enforcement in terms of the lender's legitimate interest will be required. The Colorado Supreme Court in Malouff v. Midland Federal Savings & Loan Ass'n., 509 P.2d 1240 (Colo. 1973), cited by the Respondent, also recognized this consideration when it spoke of "the operative effect" of the clause. 509 P.2d at 1245.

In its analysis, the California Court in Tucker examined the quantum of restraint by determining that, when a sale takes place in which the seller is paid out his entire equity, the acceleration may only have a slight affect upon alienation and, hence, the exercise of the due on sale clause may be justifiable in those circumstances. In the subsequent case of Wellenkamp v. Bank of America, 148 Cal. Rptr. 379, 582 P.2d 970 (1978), the California Supreme Court, in a considerably wider-reaching decision, held that automatic exercise of the "due on sale" clause constitutes an unlawful restraint on alienation even in the case in which the borrower's entire equity is paid out.

In the context of the rationale of Wellenkamp and Tucker, the instant case constitutes a particularly difficult problem for a lender to justify acceleration when the borrower elects to sell his property and is unable or unwilling to obtain cash for the full amount of his interest. When this property is sold through an arrangement whereby the original borrower will not receive cash at the outset for all of his interest in the property (as is the situation in the instant case), the exercise of the "due on sale" clause has a major and profound effect because it often eliminates the potential transaction from the marketplace. Certainly, persons who are unwilling or unable to pay the rate of interest charged by institutional lenders are not available to sellers as prospective buyers in private transactions. Likewise, persons who

are either unable or unwilling to qualify for a loan at institutional rates from institutional lenders will also be unavailable to sellers. Indeed, clear indications exist that the Respondent's policy to accelerate loans on a resale of property has had a direct affect in Utah on preventing resales on property entirely. Pickets Demand End to 'Due on Sale' Clause, The Deseret News, March 9, 1981, at 6D.

The Respondent, on page 7 of its Brief, argues that the Appellant's recognition of the restraints on alienation "tortures this concept," the implication being that no reasonable thinking person could arrive at such a conclusion. The Respondent, of course, ignores the cases supporting the Appellant's argument. It also is instructive that the Utah Attorney General filed a complaint entitled The State of Utah v. Western Savings and Loan Company in the Third Judicial District Court of Salt Lake County, Utah, as Civil No. C-80-10054 in which it is alleged that the Defendant (the Respondent in the instant case) has no lawful authority to utilize a "due on sale" clause because it violates Article I, Section 7 of the Utan Constitution and the statutory authority adopted therefor. That case also includes allegations that enforcement of the "due on sale" clause constitutes an unlawful restraint on alienation. While the mere filing of that action is not determinative of any issues in this case, it is illustrative of the fact that, not merely the Appellants, but also representatives of the State of Utah have taken the position that

the "due on sale" clause, as applied in this case, is an unlawful restraint on alienation. Parenthetically, the new Attorney General placed an indefinite halt to those proceedings pending legislative action, with the proviso that if the legislature were not to treat the matter, the Attorney General would look at pursuing this suit and possibly others. AG Halts Due-On-Sale Suit; Awaits Legislative Action, The Enterprise, January 19, 1981, at 1.

A final note is relevant. The Respondent, on page 21 of its Brief, alleges that the California Courts have somehow backed off the broad holding of the Wellenkamp case and held that a "due on sale" clause is automatically enforceable for commercial or investment properties. For this proposition, the Respondent cites Medovi v. American Savings and Loan Ass'n., 89 Cal. App. 3d 875, 152 Cal. Rptr. 572 (1979), a case in which the borrower defaulted and abandoned the property. Significantly, Medovi was a lower appellate court decision; and the California Supreme Court, in denying hearing, clarified its order in its introductory and clarifying note that the opinion of that case should not be published. Further, the California Supreme Court itself has ruled on that specific issue in Tucker, supra, which specifically involved a sale of properties previously purchased solely for investment. 116 Cal. Rptr. at 635, 526 P.2d at 1171.

POINT II
ENFORCEMENT OF A "DUE ON SALE" CLAUSE
WILL NOT ADVERSELY AFFECT THE SECONDARY
MORTGAGE MARKET FUNDING

The Respondent, relying primarily upon a self-serving affidavit of an officer of the Respondent, R. 29, argues that Utah lenders would be precluded from, or severely limited in, the sale of financing instruments into the secondary mortgage market in the event lenders cannot automatically enforce the "due on sale" clause. It is important to note that the Appellants do not urge the necessary elimination of appropriate "due on sale" language from such security instruments but, rather, seek at the minimum continued recognition that the application of this language should continue to be governed by real property law. It simply is not correct to assume that any successor-in-interest to a Utah lender will be adversely or unequitably treated by the application of such language for the purpose for which it was intended, i.e., the protection of that lender's security; and enforcement of such language is justifiable only upon a showing of jeopardy to the security or risk to the lender's ability to receive repayment of the loan. The entry by the lower court of summary judgment, of course, precluded the Appellant from presenting evidence pertaining to these issues, as well as from the necessary discovery procedures required to bring all relevant and material facts before the court for its determination. Moreover, summary judgment precluded the Appellant's efforts to counter or to qualify the allegations made by the Respondent who is peculiarly in possession of the information upon which it relies for its own business determinations.

The major reason, however, that the Respondent's arguments are not valid with respect to the secondary market is that the Respondent's scenario is contradicted by present available information. The Respondent, in its brief, stated that "Fannie Mae," beginning with loans written after October 1, 1980, would refuse assumption of existing loans unless, among other things, a buyer agrees to accept the prevailing market interest rate. Respondent's Brief at 17. The Respondent, however, ignores the critical fact that Fannie Mae has notified the nation's mortgage lenders that it will delay indefinitely any enforcement of "due on sale" clauses on conventional mortgages. Plan to Ban Assumable Home Mortgages is Postponed Indefinitely by Fannie Mae, The Wall Street Journal, September 24, 1980, at 9. While Fannie Mae has expressed concern about 11 states designated by Fannie Mae which, by Court decision or legislation, have put limitations upon the exercise of the "due on sale" clause, Fannie Mae (contrary to the Respondent's allegations) has decided it will also continue purchasing mortgages from those 11 states for the indefinite future. Fannie Mae clearly is faced with the problem that its proposed policy runs counter, not only to laws and decisions in those 11 states, but the spirit of federal policy as well, since mortgages insured by the Federal Housing Administration or guaranteed by the Veteran's Administration are assumable and are not subject to "due on sale" clause applications.

"The Fannie Mae policy change wouldn't apply to federally guaranteed mortgages. And it couldn't be enforced in the 11 problem states without an act of Congress, which is not likely any time soon." The Wall Street Journal, September 24, 1980, supra.

It is significant to place the secondary mortgage market in additional perspective beyond the simplicity indicated in the Respondent's Brief. According to a vice-president of the Respondent, not only has the Respondent not sold most of its mortgage money in the secondary market, the Respondent has eighty percent (80%) of its assets tied up in first mortgage loans which it owns. Clause S & L's Meat and Seller's Poison, The Deseret News, March 11, 1981, at G7. Fannie Mae, which furnishes or supplies somewhat over 5% of mortgage funds, also provide funds for FHA and VA mortgages which are not subject to nonassumption provisions. Higher Mortgages, 'Call-In Option' Threaten Home-buyers, Industry, The Salt Lake Tribune, November 8, 1980, at 6. Given the fact, therefore, that a small percentage of mortgage funds are handled through Fannie Mae, and given the fact that at least 11 major states are not faced with any present limitations on the purchase of mortgages by Fannie Mae, it is not correct to state that the secondary market is adversely affected by limitations on "due on sale" clauses or the manner of their enforcement, particularly since the vast majority of the Respondent's loans are not sold into the secondary market.

The Respondent, particularly in arguments before the lower court, also alleged that similar problems will arise with loans sold to the Federal Home Loan Mortgage Corporation ("FHLMC") as a result of the inability automatically to enforce "due on sale" clauses. It is significant to note, however, that the FHLMC Servicers' Guide does not require a "due

on sale" clause in mortgages purchased by it. That Guide says in pertinent part:

FHLMC will allow the transfer of mortgaged premises subject to the terms of an existing mortgage on all FHA mortgages and conventional mortgages that do not contain a right of acceleration upon transfer of ownership of the mortgaged premises. Federal Home Loan Mortgage Corporation Servicers Guide, April 1, 1976, at 528.

Experience has clearly demonstrated that the secondary market has not been foreclosed to the states placing limitations on "due on sale" enforcement. Two of the eleven states specified by Fannie Mae as restricting "due on sale" enforcement are California and New Mexico. California, by virtue of Wellenkamp, supra, and New Mexico, by virtue of legislation, both place restrictions upon the automatic enforcement of "due on sale" clauses. Information indicates, however, that this has had no significant affect because FHLMC still purchased 3.1 billion dollars of California mortgages in 1979, the year following the Wellenkamp decision. Freddie Mac Aides Rap State Mortgage Proposal, The Rocky Mountain News, September 12, 1980, at 8. In addition, according to a state senator who helped draft the New Mexico legislation, housing in New Mexico is not more expensive than it would have been had that state not passed its legislation. N.M. Fair Plan Results Praised, Colorado Springs Sun, October 29, 1980, at 3-D.

Finally, a Utah Assistant Attorney General stated his opinion that the threats that the secondary mortgage money market will dry up were intended to constitute scare tactics

and that Fannie Mae would not stop buying mortgages from any states that have modified or done away with "due on sale." Fannie Mae is Blackmailing Utah, says Assistant Attorney General, The Enterprise, October 27, 1980, at 12.

The argument that, somehow, public policy demands automatic enforcement of the "due on sale" clause to preserve the secondary market simply does not have substance, and that argument merely distracts from the real reason that the Respondent wants to be entitled to automatic enforcement, i.e. increased profits and returns from the mortgages.

In short, it is not reasonable nor believable to take at face value the Respondent's assertion of the degree of supposed damage that an equitable application of a "due on sale" clause would have on the mortgage industry in the State of Utah. If, as the Respondent alleges, the lower court accepted on its face the Respondent's allegations concerning the secondary mortgage market, without giving the Appellants the opportunity of presenting a more complete and accurate picture of the complex market forces involved, that Judgment was clearly an error.

POINT III
ENFORCEMENT OF THE "DUE ON SALE" CLAUSE IS NOT
AN APPROPRIATE VEHICLE TO ALLEVIATE FINANCIAL
PROBLEMS OF SAVINGS AND LOAN ASSOCIATIONS

The Respondent, as further justification for automatic enforcement of a "due on sale" clause, argues that such a clause is a desirable mechanism to assist savings and loans in maintaining profitability in the face of current inflated interest rates. Brief of Respondent at 10-16.

This argument incorrectly assumes that a "due on sale" clause was intended initially as an economic device when, instead, that clause was originally conceived and historically treated as a device to protect a lender's security. Enforceability of Due-On-Sale, Due-On-Encumbrance Clauses, 13 Real Property, Probate & Trust Journal, 826 (Fall, 1978). Moreover, efforts by financial institutions to utilize "due on sale" clauses to increase profits is merely symptomatic (not a cause) of a larger economic picture creating pressures on savings and loans.

The Respondent's summary of the issues presented to this Court oversimplifies the actual complexity of the issues which include, among other issues, the complex issue of mortgage financing, the relationships with the secondary market, and the affect of interest rates and inflation. Obviously, the economic issues involving "due on sale" enforcement are only part of the entire picture involving enforcement of real property laws, the lending practices and powers of savings and loan associations and the nature of the mortgage industry in the United States. The present status of the mortgage industry and the financial affects upon the savings and loans are a result of numerous complex and controlling forces such as the unprecedented volatility in interest rates, An Even More Flexible Mortgage, Business Week, February 9, 1981, at 68; Deregulation of Commercial Banks and Savings and Loan Associations, S & L's See Tough Times in Vying with Banks as Regulations Wane, The Wall Street Journal, December 11, 1980, at 1 and 18;

differences between federal regulation of banks vs. savings and loans, Small Banks Stand Up to Goliaths, Fortune, January 26, 1981, at 28, Earthquake Dangers for S and Ls, Time, March 21, 1981, at 70; outmoded regulation and weak management, Competition that Hurts, Business Week, April 20, 1981, at 132; and the Depository Institutions Deregulation and Monetary Control Act of 1980, Pub. L. 96-221, Section 1, Mar. 31, 1980, 94 Stat. 132, which changed the effect of regulations previously placing ceilings on interest rates and previously limiting savings and loans to the amount of the mortgage portfolio required.

It is apparent, therefore, that in order to treat these problems, the appropriate approach should be to treat the causes and not merely a symptom, as is attempted in this case. The acceleration of "due on sale" clauses is just one minor way in which savings and loans are attempting to increase their profitability without any requisite benefit to the public.

It is further significant to note that many of the pressures facing savings and loans, such as the Respondent, are not necessarily the same nor of equal seriousness as pressures facing banks and other financial institutions, insurance companies and other lender's who also often use "due on sale" clauses in their documentation. Fortune, January 26, 1981, supra. For this reason, it simply is not correct to oversimplify the economic and comparative examinations of the mortgage market and the secondary money markets by establishing a

broad rule governing all application of "due on sale" clauses by all lenders. Indeed, the impact, if any, on different types and classes of lenders will vary, thus requiring a careful examination of facts in order even to consider justifiable the utilization of a security device to increase interest rates.

Significantly, the savings and loans, including the Respondent, are faced with additional opportunities which are intended to alleviate many of these problems. The Depository Institutions, Deregulation and Monetary Control Act of 1980, supra, signed into law on March 31, 1979, provides for a six (6) year phase out of Regulation Q which put a ceiling on the interest rates financial institutions can pay on deposits. Also, changes in the manner and use of mortgages are being effecuated nationwide, such as variable rate mortgages, graduated payment mortgages, shared-appreciation mortgages and increased use of higher interest, shorter term second mortgages. Two New Types of Mortgages Proposed by Bank Board to Boost Home Purchases, The Wall Street Journal, October 1, 1980, at 5; Home Buyers to Face Higher Costs and Risk as Banks Offer New Types of Mortgage Plans, The Wall Street Journal, August 18, 1980, at 28; Lenders Pushing Second Mortgages to Ease Pinch of Long-term Loans, The Wall Street Journal, November 4, 1980 at 31. Accordingly, savings and loans are no longer limited by federal regulation to making home mortgages and can fill up to twenty percent (20%) of their loan portfolios with consumer loans and corporate bonds. In addition, contrary to

previous restricted activities, savings and loans are permitted to offer credit cards, trust services, interest bearing checking accounts known as "negotiable orders of withdrawal" accounts, credit lines and consumer loans. Fortune, January 26, 1981, supra.

Some commentators, in fact, have speculated that such changes in the regulatory framework actually will provide some competitive advantage to savings and loans over banks as a result of the ease and availability of electronic banking systems, thorough knowledge of local markets, automatic teller machines and one-man "kiosk" branchlets, and other similar devices. Fortune, January 26, 1981, supra. These circumstances are in addition to activities being pursued by the federal government in its anti-inflationary attempts. Given the substantial regulatory changes and the increasing flexibility available to savings and loans, the misconstruing of a property security device as an economic planning device is not the appropriate corrective action. The real battle grounds lie in government efforts to combat inflation and the other developments in the complex economic, banking, mortgage and regulatory field to preserve competitiveness, profitability and regulation of savings and loans.

POINT IV
SUMMARY JUDGMENT WAS NOT APPROPRIATE BECAUSE
OF THE NUMBER OF DISPUTED ISSUES OF FACT AND LAW

The Respondent's Brief, in addition to the items specified in the Appellant's Brief, set out a number of items which clearly indicate that significant issues of fact and law

exist which should have precluded entry of summary judgment. Among those items raised or acknowledged in the Respondent's Brief are the following:

1. The Respondent has alleged that the Appellants "secretively breached the agreement, having unclean hands and deliberately concealed the subsequent sale of their property." Respondent's Brief at 4. No such showing or evidence was presented to the lower court, and these facts are certainly relevant to the determination as to the Appellant's understanding as to the effect of the "due on sale" language. It is just as reasonable to conclude that any failure of the Appellants to notify the Respondent of that sale was the result of their lack of knowledge or understanding that such notification was necessary, i.e., no such contract requirement existed. Indeed, had the Appellants intended to conceal the sale from the Respondent, the Appellants would not have established an escrow by which payments were being made but, rather, would have continued to make the payments to the Respondent by their own personal checks.

2. The Appellants have raised a significant issue in their Brief as to whether the inconsistencies between the promissory note and the trust deed (i.e., regarding the prepayment penalty) require subsequent and additional evidence to be presented to the Court. Appellant's Brief at 4, 5, 11. The only response the Respondent has made is to allege that it was the Respondent's "policy" not to charge a prepayment fee in

such an event. Respondent's Brief at 19. This statement is not even backed up by statements in an affidavit and certainly is relevant to Court consideration.

3. The Respondent raises substantial allegations as to the affect of enforceability or nonenforceability of the "due on sale" clause on the secondary mortgage market. These issues have been raised in greater detail on pages 7-11, supra. Suffice it to say that those matters raise substantial areas of dispute mandating determinations of fact.

4. The Respondent argues, with considerable vigor, that the equities would justify the lower court's summary judgment. Respondent's Brief at 18-21. Obviously, determination of equities assumes a prior factual determination. Equity certainly cannot be carried out in a vacuum, and summary judgment precluded the Appellants from presenting these necessary facts.

5. For the reasons set forth in this Brief involving unreasonable restraints on alienation, pages 1-6 supra, the issues as to whether something is an unreasonable restraint require evidence and resultant findings, none of which were permitted by the lower court.

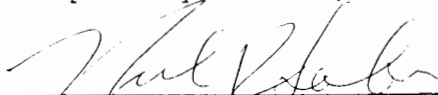
Regardless of the exact wording of the lower court's Findings of Fact, which were prepared without evidentiary hearing, and this being an equity case, the Supreme Court is not bound exactly to follow the findings or facts of the trial court, but may make its own findings when justice requires. Constitution of Utah, Article VIII, Section 9, First Security Bank v. Demiris, 10 U.2d, 405, 354 P.2d 97 (1960).

For the reasons stated herein, it is imperative, not only in this case but also for guidance for the real estate and mortgage markets generally, that the Court have reasonable opportunity to examine the issues, evidence and facts before making the major determinations and creating the precedent which were arbitrarily imposed by summary judgment.

CONCLUSION

The entry of summary judgment by the lower court was not appropriate and the judgment of the lower court should be reversed and this matter remanded for evidentiary hearing.

Respectfully submitted,



NEIL R. SABIN

Attorney for Appellants

CERTIFICATE OF SERVICE

I hereby certify that on the 20th day of April, 1981, I served two (2) copies of the attached Reply Brief of Appellants on Richard W. Giaugue, James R. Holbrook and Stephen T. Hard, of Giaugue, Holbrook, Bendinger & Gurmankin, attorneys for Respondent, by hand delivering two (2) copies thereof.

