Default and Acceleration

- The first step in the foreclosure process is default and “acceleration” of the maturity date of the debt
- Note and mortgage usually gives the mortgage lender, at its option, the right to accelerate the maturity date of the debt upon “default” (as defined by the loan documents) [note 1, page 679]
  - Upon acceleration, the entire balance of mortgage debt becomes immediately due and payable

Acceleration

- Acceleration is a practical precondition to foreclosure (and, in most loan documents, a specified precondition)
  - A mortgage lien or other security interest can only be foreclosed one time (foreclosure extinguishes both the mortgagor’s title and the mortgagee’s lien)
  - It would make no sense for the mortgage lender to foreclose its lien just to collect past due installments (as the remaining unpaid balance of the debt would thereafter be unsecured)

Acceleration (in Context)

- Acceleration clauses can have different effects in different agreements/contexts
  - E.g., an acceleration clause in a lease may accelerate the due date of all future rent payments (all future payments become due at once)
  - E.g., acceleration clause in a mortgage does not accelerate all future installments; instead, it accelerates the maturity (due date) of the unpaid principal balance

Lender can accelerate following default as defined in the loan documents [note 1, page 679]

- Common “defaults”: (1) nonpayment of any installment of principal and/or interest when due; (2) nonpayment of taxes; (3) failure to keep property insured or maintained; (4) waste; (5) unauthorized use/occupancy of mortgaged property; (6) transfer of mortgaged land w/out mortgagee consent

- Parties are generally free to define any necessary preconditions that may exist for a “default” justifying acceleration of the debt
• For example, the mortgage loan documents can require, as precondition to accelerate:
  – (1) That the mortgagee provide the mortgagor with a “grace period” for cure, without notice of default to mortgagor, or
  – (2) That the mortgagee provide the mortgagor with written notice of default, plus a grace period for cure, or
  – (3) That the mortgagee may accelerate upon default without the need for prior notice or the opportunity to cure
• E.g., Note provides “Borrower shall pay installments by the 1st of each month, but shall not be in default if payment is received within the following 3 days thereafter” (grace period w/out notice)

“Late Fee” Clauses
• Note: “Late fee” provisions do not create a grace period for late payment
  – If payment is due by 1st of the month, and the note defines any late payment as a “default,” a late fee provision does not create a grace period for nonpayment
  – The late fee provision merely ensures that the note complies with any state law limits on the imposition of late fees

• Acceleration

• To what extent should mortgage law constrain the lender’s ability to accelerate, beyond the terms of the loan documents?
  • E.g., suppose Mortgagor has missed 3 consecutive payments. Can Mortgagee accelerate the debt without warning, or should Mortgagee have to warn the Mortgagor first (i.e., “Cure within 10 days, or we’ll accelerate”)?
  • Common law: after default, Mortgagee need not give Mortgagor notice, or a right to cure, prior to accelerating the debt, unless either a state statute or the loan documents so require
    – Rationale: mortgagor is deemed to be know when he/she is supposed to perform
  • Compare Fannie Uniform DOT [¶ 22, p. 1455]
    – Under ¶ 22, Mortgagee agrees to give Mortgagor notice and a 30-day cure period, as a precondition to Mortgagee’s acceleration of the maturity of the debt
Graf v. Hope Building Corp. [p. 669]

- HBC owned land on which Graf held a mortgage
  - Loan was repayable in interest-only monthly payments, with principal due in a “balloon” payment on January 1, 1935
  - Mortgage: entire balance can be accelerated if default in payment continues uncured for 20 days (20 day grace period)
- July 1927 payment was too low (math error)
  - HBC: “we’ll correct it as soon as our president returns from Europe,” but that didn’t happen
- When 20 days “grace” ran out, Graf accelerated the debt
- HBC tendered the late payments, and asked to reinstate the loan, but Graf refused

Questions

- Is Graf’s conduct here sensible? Why wouldn’t/shouldn’t Graf accept HBC’s late payment and reinstate the mortgage loan?
- Should the court treat Graf’s decision to accelerate the loan, and foreclose on the property, as unconscionable (and impermissible) on these facts?
- Why was this a 4-3 case?
• The real hardship in *Graf* is a function of the economic circumstances of the time
  – By 1930, the crash had begun
  – HBC could have reinstated and made its monthly payments going forward, but it couldn't get refinancing to pay off the full accelerated balance (land value had dropped)
• *Graf* is somewhat analogous to the late 2000s market for commercial real estate projects
  – Today, however, many current lenders are choosing NOT to start foreclosure ("extend and pretend")

• Taylor (a soldier on duty in the Philippines) had made 4 mortgage payments more than 20 days late (lender had accepted these late payments without objection)
• Taylor mailed his Sept. 1973 payment 28 days late
  – By time Lender received it, the Oct. 1973 payment was also past due, so Lender returned the Sept. 1973 payment
• Why did Lender do this? Would you have advised Lender to do this?

§ 1-303(a). A “course of performance” is a sequence of conduct between the parties to a particular transaction that exists if:
(1) the agreement of the parties with respect to the transaction involves *repeated occasions for performance by a party,* and
(2) the other party, *with knowledge of the nature of the performance and opportunity for objection to it, accepts the performance or acquiesces in it without objection....

§ 1-303(d). A course of performance ... is relevant in ascertaining the meaning of the parties' agreement, may give particular meaning to specific terms of the agreement, and may supplement or qualify the terms of the agreement.
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Questions

Would you have advised the Lender in *Taylor* to return the Sept. 1973 payment (and the subsequent less-than-complete payments) to the Borrower?

If not, what would you have advised the Lender to do differently?

There’s almost never a good reason for a lender to return a payment that the borrower makes if that payment is an unconditional payment.

- While Lender may have been concerned about risk of waiver, that can be managed by clear communication w/ Borrower
- E.g., if lender *has already accelerated*: “Our accepting this payment does not reinstate your mortgage, which is still in default.”
- E.g., if lender *has not already accelerated*: “Our acceptance of this late payment does not waive your obligation to make any future payments in a timely manner.”

**“Conditional” Payment**

- Lender *should* reject and return any such payment that the Borrower makes that is “conditional”
- E.g., following acceleration of loan, Borrower tenders three missed payments by check
- On the memo line of the check, Borrower has written “For reinstatement of Loan # 34918”
- If lender’s accepts this check, court may conclude that Borrower tendered the payment on condition of reinstatement and that Lender accepted it on that basis

**Acceleration and “Insecurity”**

- Sometimes, a mortgage note provides that the mortgagor can accelerate the maturity of debt *if mortgagor deems itself insecure* [p. 686]. This is an “insecurity clause”
- The exercise of an insecurity clause in any contract (e.g., a promissory note) is governed by U.C.C. § 1-309
- Under § 1-309, Lender can accelerate based on an insecurity clause only if lender “in good faith believes that the prospect of payment or performance is impaired”
- *Graf*, by contrast, was not an “insecurity” case; lender in *Graf* was accelerating based on an “objective” default (untimely payment)