

## Lenders Beware: Default Interest Provisions Within Acceleration Clauses Are Not Automatically Triggered by Maturity

By Steven D. Hamilton and Angela M. Yates

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*The Court of Appeals of the State of California, Second Appellate District has ruled that because the default interest provisions of a promissory note were included within the acceleration clause of a promissory note, the default rate was not triggered when the promissory note matured by its terms. Based on this ruling, default interest provisions in promissory notes should provide that the default interest rate applies not only following a default or acceleration of the maturity date, but also after the scheduled maturity date.*

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The facts of the case of *JCC Development Corp v. Levy* are fairly simple. JCC Development Corp. ("JCCDC") owed money to Hyman Levy ("Levy") under a promissory note. After the promissory note matured, JCCDC paid, under protest, the amounts Levy demanded under the note (which included interest calculated at the default rate). Following its payment of the note under protest, JCCDC sued Levy, claiming that Levy had overcharged JCCDC in interest and other charges. The case proceeded to a judgment and Levy was deemed the prevailing party. During the trial, JCCDC claimed that Levy was not entitled to collect interest under the note at the default rate after the maturity date because Levy had not exercised his option to implement the default interest rate. The trial court rejected JCCDC's argument, ruling that the default interest rate was automatically triggered upon the maturity date, without a requirement that Levy notify JCCDC of his desire to implement the default rate.

On appeal, JCCDC challenged the trial court's ruling that the default rate provisions in the promissory note were automatically triggered by JCCDC's failure to repay the loan on or before the stated maturity date.

The acceleration and default interest provisions of the promissory note read as follows:

"If: (i) Maker shall default in the payment of any interest, principal, or any other sums due hereunder, or (ii) Maker shall default on performance of any of the covenants, agreements, terms or provisions of the deed of trust securing this Note, or (iii) Maker shall sell, lease, convey, hypothecate, transfer,

encumber or alienate the Property (defined below), or any part thereof, or any interest therein, or shall be divested of title or any interest therein in any manner or way, whether voluntarily or involuntarily, without the written consent of the Holder being first had and obtained; then, at Lender's option, all sums owing hereunder shall, at once, become immediately due and payable. **Thereafter**, interest shall accrue at the maximum legal rate permitted to be charged by non-exempt lenders under the usury laws of the State of California." [Emphasis added]

The Court of Appeals concluded that the trial court erred in ruling that Levy was entitled to collect interest at the default rate following the maturity date. The court determined that the plain language of the acceleration and default interest provisions quoted above (namely, use of the term "thereafter" in the last sentence of the above-quoted provision) clearly showed that the default interest was to be implemented only following Levy's acceleration of the loan and not following the maturity date.

In finding that the default interest provision was part of the acceleration clause which was not triggered because the note matured by its terms without an accelerating event, the appellate court concluded that JCCDC's failure to make payment upon maturity did not trigger the default interest rate provision, as such provision only applies to circumstances of acceleration.

### Practical Tip:

Lenders should review their promissory note forms to ensure that the default interest provisions are not contained within or conditioned by the application of the acceleration clause of the note.

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If you have any questions about the content of this alert, please contact the Pillsbury attorney with whom you regularly work, or the authors below.

Steven D. Hamilton **(bio)**  
San Diego  
+1.619.544.3179  
steven.hamilton@pillsburylaw.com

Angela M. Yates **(bio)**  
San Diego  
+1.619.544.3217  
angela.yates@pillsburylaw.com

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