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Constitutional Law - Federal Law Enters the Field of Real Property Law - Fidelity Federal Savings and Loan Association v. de la Cuesta

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CONSTITUTIONAL LAW—Federal Law Enters the Field of Real Property Law—*Fidelity Federal Savings and Loan Association v. de la Cuesta*, 458 U. S. 141 (1982).

INTRODUCTION

A controversy has raged in the state and federal courts over the enforcement of due-on-sale clauses in mortgage loans. The controversy has been waged between major competing interests: institutional mortgage lenders on one side and individual property owners supported by real estate brokers on the other side. The final outcome of the controversy would determine the extent to which the Federal Home Loan Bank Board may regulate local property transfers.[1]

It was inevitable that the United States Supreme Court would be called upon to settle the controversy. State courts generally upheld the individual property owner's position and refused to enforce due-on-sale clauses. Federal courts upheld the federal mortgage lender's position and enforced due-on-sale clauses. When the California state courts refused to enforce federal regulations permitting due-on-sale clauses on the theory of predominant state domain in property law, the United States Supreme Court granted certiorari in *de la Cuesta v. Fidelity Federal Savings and Loan Association.*

FACTUAL CONTEXT OF THE DECISION

Three California residents entered into mortgage loan agreements with the appellant, Fidelity Federal Savings and Loan Association, a privately-owned, federally-chartered savings and loan association (hereinafter referred to as Fidelity).[2] A deed of trust containing a due-on-sale clause [3] was executed to secure each loan.[4] Two of the deeds of trust also provided that the deed "shall be governed by the law of the jurisdiction in which the Property is located."[5] Both of these provisions are used in many deeds of

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1. Bonanno, *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 (1972).
2. Fidelity Federal Savings and Loan Association has its principal place of business in Glendale, California.
3. A due-on-sale clause is a contractual term used in many promissory and mortgage notes. It allows the lender to exercise an option to demand the entire unpaid balance of the loan when the borrower sells the property which secures the mortgage. If the borrower is unable or refuses to meet the demand and tender payment, the lender's remedy is foreclosure of the property.
4. *See,* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 145 n.2 (1982).
5. *Id.* at 148 n.5.

trust nationwide and are taken from the uniform mortgage instrument used by the Federal Home Loan Mortgage Corporation and the Federal National Mortgage Association.[6]

The mortgagors sold their property to the appellees, de la Cuesta, Moore, and Whitcombe, who did not notify Fidelity of their purchases as required by the due-on-sale clause. When Fidelity learned of the transfers, it notified appellees of its intent to exercise its rights under the due-on-sale clause. Fidelity would have consented to the transfer had the appellees agreed to an increase in the interest rate of the loan to the prevailing market rate. When appellees refused, Fidelity accelerated the loan and demanded payment of the balance due. Appellees refused, and Fidelity began a nonjudicial foreclosure of the properties.

Appellees filed separate actions to enjoin the foreclosure in state court. Asserting that California law known as the *Wellenkamp* doctrine was controlling, the appellees claimed that exercise of the due-on-sale clause was an unreasonable restraint on alienation under Cal. Civ. Code Ann. § 711, "unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default."[7] The Superior Court granted Fidelity's motion for summary judgment, holding that federal regulations of federal savings and loan associations specifically allowed due-on-sale clauses in mortgage loan agreements and that the regulations preempted the application of the *Wellenkamp* doctrine to mortgages of federal savings and loans.[8]

The California Court of Appeal for the Fourth Appellate District reversed the Superior Court.[9] The Court of Appeal held

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6. *Id.* at 145-46 n.2.

7. Wellenkamp v. Bank of America, 21 Cal. 3d 943, 953, 582 P.2d 970, 977 (1978).

8. The Federal Home Loan Bank Board is the chartering and supervising federal agency for federal savings and loan associations. Comment, *A Case for Preemption: Wellenkamp v. Bank of America is Inapplicable to Federal Savings and Loan Associations*, 20 SANTA CLARA L. REV. 219, 222-24 (1980). The Board issued a regulation effective July 31, 1976, now 12 C.F.R. § 545.8-3(f) (1982), which provides as follows:

> [A federal savings and loan] association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instrument whereby the association may, at its option, declare immediately due and payable sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent. Except as [otherwise] provided in . . . this section . . . , exercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by the contract.

9. De la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (Cal. Ct. App. 1981). The opinion quoted verbatim the First Appellant District's opinion in Panko v. Pan Amer. Fed. Sav. & Loans Ass'n., 119 Cal. App. 3d 916, 174 Cal. Rptr. 240 (Cal. Ct. App. 1981), for its reasoning.

that *Wellenkamp* was a doctrine of substantive law in California from which federal savings and loan associations derive their rights and limitations in mortgage and real property transactions.[10] The court could find no express Congressional intent to preempt substantive state property law. As a matter of construction, the federal due-on-sale regulation is permissive, allowing but not requiring use of the due-on-sale clause by the federal savings and loan association; therefore it could not be read to preempt California law. The court held that *Wellenkamp* was not incompatible with federal regulations, but even if it were, paragraph 15 (the law of the jurisdiction section) bound Fidelity to have its contract interpreted by California law, i.e., the *Wellenkamp* doctrine. The California Supreme Court refused to review Fidelity's appeal.

THE ISSUES AND THE COURT'S ANALYSIS

In its opinion the California Court of Appeal held that the Federal Home Loan Bank Board (hereinafter referred to as FHLBB or the Board) intended to preempt the *Wellenkamp* doctrine with 12 C.F.R. § 545.6-11(f)(1976).[11] The Court of Appeal reasoned that compliance with both the federal and state regulatory schemes was not impossible. FHLBB's regulation authorizes but does not require federal savings and loan associations to include due-on-sale clauses and exercise rights under the clause. The Court of Appeal apparently reasoned that if it could choose this permissive option to include and exercise due-on-sale clauses, a federal savings and loan association might choose not to include the clause, thereby destroying the preemptive effect of the regulation. Therefore, the federal regulation did not affect the rights and remedies of the parties and enforcement of a due-on-sale clause would be subject to state law.[12]

Justice Blackmun, writing for the Supreme Court, rejected this mandatory/permissive distinction as specious. A reading of permissiveness into the regulation would destroy the flexibility given by the Board. The California courts would not give the federal savings and loan association the due-on-sale option authorized by the Board because the federal savings and loan association would be limited to exercise of the due-on-sale clause upon a showing

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10. Examples of these laws evincing rights and limitations include title, conveyancing, recording, priority of liens and foreclosure proceedings. Fidelity Fed. Sav. & Loan Ass'n. v. de la Cuesta, 458 U.S. 141, 150 (1982).

11. De la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n., 121 Cal. App. 3d 328, 339, 175 Cal. Rptr. 467, 473-74 (Cal. Ct. App. 1981).

12. *Id.* at 341, 175 Cal. Rptr. at 475.

of impairment of the security. A federal savings and loan association could not exercise the clause to protect its contractual expectation in a higher interest rate upon conveyance of the property.[13] California had created an obstacle to the accomplishment and execution of the full purposes and objectives of the federal regulatory scheme to promote the financial stability of the thrift industry.[14]

Appellees also contended that the federal regulation mandated the applicability of state contract law to determine rights at the time of exercise of the due-on-sale clause.[15] Construing the language of the regulation by its literal meaning, the Court held that the exercise of due-on-sale required the clause to be a term of the contract.

Appellees argued that paragraph 15 of the deeds of trust required that the deeds be interpreted according to the law of the jurisdiction. The Court held that the law of the jurisdiction included federal law and federal regulations so that the due-on-sale regulation was part of the law of the jurisdiction.[16] The Court cited *Testa v. Katt*,[17] a 1947 opinion requiring enforcement by state courts of federal regulations on the theory that federal regulations are incorporated into state law. The federal regulation in question, 12 C.F.R. § 545.8-3(f), specified creation of due-on-sale rights by contract and did not grant a due-on-sale power in the lender by operation of law.

The intent of FHLBB to preempt state law limiting due-on-sale seems obvious in the preamble to the regulations.

> "[D]ue-on-sale practices of Federal associations [are] governed *exclusively* by Federal law. Therefore, . . . exercise of due-on-sale clauses by Federal associations shall be governed and controlled *solely* by [§ 545.8-3] and the Board's new Statement of Policy. Federal associations shall not be bound by or subject to any conflicting State law which imposes different due-on-sale requirements."[18]

Appellees saw the preamble as an interpretive regulation which lacked the force of law and relied upon *Chrysler Corp. v. Brown*.[19] *Chrysler* held that a policy statement which does not comply with notice and hearing requirements of the Administrative Procedures

13. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 148-58 (1982).
14. *Id.* at 154.
15. 12 C.F.R. § 545.8-3(f) (1982): "[E]xercise by the association of such option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by the contract."
16. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 157 (1982) (quoting Havenstein v. Lynham, 100 U.S. 483, 490 (1880)).
17. 330 U.S. 386, 390-92 (1947).
18. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 158 (1982) (quoting 41 Fed. Reg. 18,286, 18,287 (1976)) (emphasis added by the Court).
19. 441 U.S. 281, 315-16 (1979).

Act [20] is interpretive and not binding unless authorized by the nexus between the regulation and a delegation of legislative authority. The Court concluded that it was unnecessary to deal with the legal compliance of the preamble and cited *Udall v. Tallman.*[21] The *Udall* court held that: "When faced with a problem of statutory construction this Court shows great deference to the interpretation given the statute by the officers or agency charged with its administration. . . . When the construction of an administrative regulation rather than a statute is in issue, deference is even more clearly in order."[22]

The final and crucial question in the case was whether the Board acted within its statutory authority in issuing the due-on-sale regulation. The pivotal language in § 5 of the Home Owners Loan Act of 1933 (hereinafter referred to as HOLA) authorized the Board

> under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Association,' or 'Federal mutual savings banks'..., and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home financing institutions in the United States.[23]

This sweeping language must be interpreted in context in order to ascertain its meaning.[24] Reasoning that the legislative purpose[25] of federal savings and loan associations is to provide for the financing of homes by mortgage lending, the Court read the language expansively and construed "operation" to give the Board jurisdiction to issue regulations for mortgage loan instruments because mortgages are a central function of the operation of a savings and loan association. The Court construed the phrase "the best practices of local mutual thrift and home-financing institutions in the

20. *Id.*
21. 380 U.S. 1, 16 (1965).
22. *Id.* at 16.
23. 12 U.S.C. § 1464(a) (Supp. V 1976) (hereinafter referred to as HOLA).
24. The court will resort to interpretation when it endeavors to ascertain the meaning of a word found in a statute, which when considered with the other words in the statute may reveal a meaning different from the apparent when the word is considered abstractly or when given its usual meaning.

R. DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 19 (1975).

25. "Legislative purpose" in general legal usage refers to "the ulterior purpose that the legislature intends the statute to accomplish or help to accomplish." R. DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 88 (1975).

United States" as authority for federal regulation to supersede the state law. The Court cited *United States v. Southwestern Cable Company*[26] and *Phelps Dodge Corporation v. NLRB*[27] as authority for its broad interpretation of the context within the statute. *Southwestern Cable* read the authority of the Federal Communications Commission broadly to include the regulation of telecommunications, a field not addressed by the statute. *Phelps Dodge* held that limitation of a word denoting a general class must be authorized in the policy of the statute or specifically by a provision of the statute.

HOLA was enacted in 1933. The enactment process, from President Roosevelt's request for the bill to his actual signing of the bill, took less than two months.[28] The Court attempted to glean legislative intent[29] and support for its reading of the statutory language from the legislative history.[30] The legislative history of HOLA shows that the primary concern of the legislators who enacted HOLA was the terms and operation of a fund to buy defaulted home mortgages, the fund to be administered by the Home Owners Loan Corporation.[31] The Congress gave only cursory examination to the breadth of the Board's powers during the debates. Subsequent post-enactment history of amendments to HOLA provides a better foundation for the Court's use of legislative history to support its interpretation of the statute.[32]

Delegation of congressional power to the FHLBB has the purpose of creating and regulating federal savings and loan associa-

26. 392 U.S. 157, 172 (1968).

27. 313 U.S. 177, 193-94 (1941).

28. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 163-64 n.18 (1982).

29. Legislative intent concurs with the legislative purpose which the statute intends to express and accomplish and is a guide to the judiciary for interpretation of the statute and an aid in evaluating the language and context of the statute. R. DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 85-88 (1975). Different tests are used by courts to determine legislative intent. The plain-meaning test is a literalist approach looking to the words of the statute and not delving into the legislative purpose or history. A second approach is the search for application of the original legislative purpose. A third approach is judicial creation of the best rule of law under the circumstances when the original legislative intent is unclear. E. CALABRESI, A COMMON LAW FOR THE AGE OF STATUTES 214-15 (1982).

30. Legislative history is a part of the context of a statute and may be used to determine the legislative purpose. It is the history of the enactment process and includes changes in wording when expressive of intent, committee reports, and statements of leading proponents of the bill. R. DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 137-38 (1975).

31. *See* 77 CONG. REC. 2473, 2476 (1933).

32. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 166-67 n.19 and n.20 (1982). There is a split of authority over whether subsequent legislative history in amendments to the original act is dispositive in issues arising out of the statutory language as originally enacted. In United States v. Southwestern Cable Co., 392 U.S. 157 (1968), little significance was given by the Court to subsequent legislative history. However, in Red Lion Broadcasting Co. v. F.C.C., 395 U.S. 367 (1969), subsequent legislative history was dispositive in the construction of the statute and administrative regulations.

tions. Protecting the financial soundness of these institutions and enabling them to supply financing for home construction and purchase are legitimate ends for Board regulation. The Board established a nexus between the statutory purpose and the due-on-sale regulation. The Court deferred to the Board's judgment that the due-on-sale clause contributed to the financial soundness of Federal Savings and Loans. The Court concluded that the Board acted within its authority in promulgating the due-on-sale regulation and acted pursuant to the purpose of HOLA. The Court *held* that due-on-sale clauses in mortgages of federal savings and loan associations are enforceable and reversed the California court.

In a concurring opinion, Justice O'Connor expressed concern about the unrestricted deference to the Board's interpretation of its powers. O'Connor cautioned that even though Congress delegated broad power to the Board to insure the financial soundness of federal savings and loan associations, the legislative history would not support authority for regulations that displaced purely local matters such as tax statutes and zoning ordinances.

Justice Rehnquist, joined by Justice Stevens, dissented and would hold that the Board does not have authority to promulgate a regulation which preempts state property law. The dissent agreed that § 5(a) of HOLA grants broad authority to the Board to regulate mortgage lending practices of federal savings and loan associations. But this act must be read in light of § 8 of the Federal Home Loan Bank Act of 1932,[33] which was found by those dissenting to require the Board to examine state law and withhold or limit the operation of a Federal Home Loan Bank if the enforcement of the rights of holders of mortgages on lands securing loans was found to be inadequate protection to the bank. Upon a finding of inadequate protection because of a state law such as the *Wellenkamp* doctrine, the Board would withhold or limit the operation of the federal savings and loans in California.

The dissent agreed that § 8 of the Federal Home Loan Bank Act of 1932 implied that contract and property law are matters of state regulation. *Aronson v. Quick Point Pencil Co.*[34] (commercial law) and *Butner v. United States*[35] (property interests) were cited as support. Also cited was *Texas Industries, Inc. v. Radcliff Materials, Inc.*,[36] where the Court refused to create a federal com-

33. Federal Home Loan Bank Act of 1932, §8, 12 U.S.C. § 1428 (1976).
34. 440 U.S. 257, 262 (1979).
35. 440 U.S. 48, 55 (1979).
36. 451 U.S. 630 (1981).

mon law in the absence of congressional authority. To the dissenters, one implication of the due-on-sale regulation is the creation of a federal common law of mortgages.

Justice Rehnquist did not read the statute to allow the due-on-sale clause. In his eyes, the Board had decided whether it could preempt state law and had "gone beyond regulating how, when, and in what manner"[37] lending may occur. The operation of a federal savings and loan association included provision for what terms might be necessary in the mortgage agreement, but did not include the substantive rights of the parties.[38] The dissent saw the majority's approach not as an attempt to determine the legislative purpose but rather as a judicial creation of a power in the FHLBB to determine whether and when state property and contract law must give way to federal regulation.

PREEMPTION

The supremacy clause[39] is the substantive constitutional antecedent for the doctrine of federal preemption. The supremacy clause is said to have become a part of the Constitution to act as a restraint upon the federal government and thereby foster equality in national treatment of state interests.[40] Application of the clause in judicial opinion has yielded another result: the federal government has supremacy in the constitutional framework of federalism when it acts within the substantive source of its powers.[41]

The substantive source of congressional power has been granted by the Constitution and limited to "the legislative powers herein granted."[42] The exercise of congressional power may be

37. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 173-75 (1982)(Rehnquist, J. dissenting).

38. The traditional view of statutory interpretation holds that a statute contains the answer to every question and therefore the judiciary's responsibility is to discover the intent of the legislature through the ascertainment of meaning. The traditional school would limit the creative function of statutory interpretation. The ascertainment of meaning is a search for the relevant and competing elements to determine an inference of intended meaning. R. DICKERSON, THE INTERPRETATION AND APPLICATION OF STATUTES 15, 22-23 (1975). Therefore, Justice Rehnquist sees the Court's interpretation of "operation" as unsupported by the context of the statute and as an attempt to exercise a judicial creativity or lawmaking function.

39. This Constitution, and the Laws of the United States which shall be made in Pursuance thereof; and all Treaties made, or which shall be made, under the Authority of the United States, shall be the supreme Law of the Land; and the Judges in every State shall be bound thereby, any Thing in the Constitution or Laws of any State to the Contrary notwithstanding.

U. S. CONST. art. VI, cl. 2.

40. J. MADISON, THE FEDERALIST, No. XLIV 311-12 (1788); J. MADISON, THE FEDERALIST, No. XLV 316-17 (1788).

41. L. TRIBE, AMERICAN CONSTITUTIONAL LAW 376 (1978).

42. U. S. CONST. art. I, § 1.

viewed as limited internally or externally.[43] Internal limitation is limitation from the powers themselves. External limitation is limitation from the constitutional structure, such as the Bill of Rights, and is therefore a broader and less constraining analytical framework. Supreme Court decisions have not attempted to place internal restraints upon congressional powers but have defined external or constitutionally mandated constraints upon these powers.[44]

Congressional powers are derived from those enumerated powers in article I, section 8 of the Constitution and in other articles and amendments. The grant of congressional powers is limited by the Constitution to those affirmatively authorized. State powers are unlimited by the Constitution unless explicitly or implicitly prohibited. Those powers not granted to the federal government are reserved to the States or the people.[45]

When not expressly provided for in the Constitution, the power may be justified by the doctrine of implied powers. This doctrine is a product of the necessary and proper clause.[46] It expresses what might otherwise arise by implication—that congressional power also includes the power to effectuate its enumerated powers by exercising unexpressed but inferential powers.

McCulloch v. Maryland[47] recognized that the implied power of Congress to charter a bank was necessary and proper to effectuate the enumerated constitutional power to coin money.[48] By applying the requirement that the implied power must have a legitimate relationship to an enumerated power, the *McCulloch* Court created the traditional analytical framework for review of implied congressional power. Equally pertinent to this analysis is the holding that the power to create and regulate financial institutions is not reserved to the states. Congress may exempt its instrumentalities from state restrictions upon those grants of federal power.

Gibbons v. Ogden[49] further tipped the scales of supremacy toward the federal government. In *Gibbons v. Ogden*, Chief Justice Marshall held that the supremacy clause supported the legitimate exercise of implied congressional power to license steamboats in

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43. L. TRIBE, AMERICAN CONSTITUTIONAL LAW 224 (1978).
44. *Id.*
45. U. S. CONST. amend. X; L. TRIBE, AMERICAN CONSTITUTIONAL LAW 225 (1978).
46. U. S. CONST. art. I, § 8, cl. 18. "To make all Laws which shall be necessary and proper for carrying into Execution the foregoing Powers, and all other Powers vested by this Constitution in the Government of the United States, or in any Department or Officer thereof."
47. 17 U.S. (4 Wheat.) 316 (1819).
48. *Id.* at 423.
49. 22 U.S. (9 Wheat.) 1 (1824).

furtherance of its enumerated power to regulate interstate commerce. When this implied power conflicted with the attempt by New York to create monopoly in shipping between itself and New Jersey, the implied congressional power prevailed. The Court framed a classic statement of federal preemption when it wrote:

> In argument, however, it has been contended, that if a law passed by a state, in the exercise of its acknowledged sovereignty, comes into conflict with a law passed by Congress in pursuance of the constitution, they affect the subject, and each other, like equal opposing powers.
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> But the framers of our constitution foresaw this state of things and provided for it, by declaring the supremacy not only of itself, but of the laws made in pursuance of it. The nullity of any act, inconsistent with the constitution, is produced by the declaration, that the constitution is the supreme law. The appropriate application of that part of the clause which confers the same supremacy on laws and treaties, is to such acts of the State Legislatures as do not transcend their powers, but, though enacted in the execution of acknowledged State powers, interfere with, or are contrary to the laws of Congress, made in pursuance of the constitution, or some treaty made under the authority of the United States. In every such case, the act of Congress, or the treaty, is supreme; and the law of the State, though enacted in the exercise of powers not controverted, must yield to it.[50]

When the implied congressional power is confronted directly by a state attempt to regulate the activity, the supremacy clause swings the balance to the congressional power. This rule has profound significance for our federal system. Where congressional power is not limited by an external constraint such as the Bill of Rights or a specific internal restraint within the Constitution itself, Congress may define the scope and limit of the federal-state relationship. Congress may allow a greater or lesser state role in an area of potential congressional regulation. Congress may also preclude the exercise of any state authority in these implied power areas when the state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[51]

Congressional power may preempt the state regulatory power even over local matters.[52] When Congress exercises power, it does not create legislation in a regulatory void. Rather, Congress acts within the context of "the total corpus juris of the state in much the same way that a state legislature acts against the backdrop of the common law, assumed to govern unless changed by

50. *Id.* at 210-11.
51. Hines v. Davidowitz, 312 U.S. 52, 67 (1941).
52. United States v. Darby, 312 U.S. 100, 114, 123-124 (1941).

legislation."[53] When Congress acts against this backdrop of state law, courts must determine whether the exercise of congressional power was calculated to complement state law or to supersede it. A court's review of an activity regulated by both federal and state law must determine whether and under what circumstances Congress sought to regulate the activity.[54]

The doctrine of preemption has developed to facilitate judicial inquiry into federal-state spheres of regulation. "Preemption occurs when a state statute obstructs the accomplishment and execution of the full purposes and objectives of an Act of Congress." [55] The focus of the inquiry is the congressional regulatory design and the activity which Congress sought to encourage or prevent.[56] Two models of judicial analysis prevail in decisions on preemption claims.

Occupation of the field of regulation is one model for application of the doctrine of preemption. The federal regulatory design supersedes the state regulatory design when the subject matter occupies an exclusive federal domain.[57] This may occur when the federal scheme is so pervasive that it does not allow supplementation by the states; or the field of regulation is dominated by federal interest; or "the object sought" and "the character of obligations imposed" is predominantly federal.[58] However, the Court has treated the federal domain as susceptible to state regulation where the subject matter has been traditionally regarded as within the scope of state supervision.[59]

The second model for application of preemption is the conflict ground. The best example of the conflict ground occurs where federal and state statutes further diametrically opposing interests. The federal interest will be obstructed if the state power functions. The statutes are construed to determine whether a conflict exists, and where a conflict is found the state statute will be preempted.[60] Analysis of conflicting federal and state regulation requires close scrutiny when the regulatory schemes are acting upon different interests or parties within the field.

53. H. HART, H. WECHSLER, THE FEDERAL COURTS AND THE FEDERAL SYSTEM 470-71 (1973).

54. Note, *Preemption as a Preferential Ground: A New Canon of Construction*, 12 STAN. L. REV. 208, 209-10 (1959).

55. Note, *Preemption Doctrine: Shifting Perspectives on Federalism and the Burger Court*, 75 COLUM. L. REV. 623, 625 (1975).

56. Note, *Preemption as a Preferential Ground: A New Canon of Construction* 12 STAN. L. REV. 208, 210 (1959).

57. Note, *supra* note 55, at 625.

58. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

59. Florida Lime and Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963).

60. Note, *supra* note 55, at 626.

These two models provide satisfactory theoretical categories for the doctrine of preemption. However, the Supreme Court's decisions on preemption take on an *ad hoc,* unprincipled appearance. The decisions, whether of conflict or of occupation of the field categories, must analyze the purposes and objectives of the federal regulatory design. This analysis usually considers the text of the statute, the history of the statute, administrative interpretation and judicial policy of deference in the subject matter.[61] The inferences drawn from each area may be conflicting.[62] Judicial presumptions about the legitimacy of state interests or the exclusivity of federal regulatory expertise lead to inconsistent results in the Court's decisions.[63]

The *de la Cuesta* Court categorized the Federal Home Loan Bank Board's exercise of federal regulatory power as a model of conflict created by the promulgation of the due-on-sale regulations. *Hines v. Davidowitz* struck down a Pennsylvania state statute imposing burdens on aliens because the state statute stood as "an obstacle to the accomplishment and execution of the full purposes and objectives of Congress."[63.1] *Jones v. Rath Packing Co.*[64] decided that California's attempt to regulate the weight packaging of flour sold in retail stores was preempted by the federal Fair Packaging and Labeling Act. In *Jones*, the Court held that preemption "is compelled whether Congress' command is explicitly stated in the statute's language or implicitly contained in its structure and purpose." [65]

An inference from the federal regulatory scheme may disclose congressional intent to supersede the state law. The federal regulatory scheme in *Rice v. Santa Fe Elevator Corp.*[66] was held to preempt Illinois state law because the scheme of federal regulation demonstrated a congressional intent to preclude supplementation by the states. Congress had amended the U. S. Warehouse Act and had given the Secretary of Agriculture authority to regulate warehouse rates and operations so as to make it possible to properly finance agricultural products while in storage. Illinois regulations were directly opposed in several specifics. The Court reasoned that the inference of the legislative history was that Congress sought to eliminate state regulation and thereby achieve fair

61. Note, *supra* note 56, at 210.
62. *Id.*
63. Note, *supra* note 55, at 626.
63.1. *See supra* note 51.
64. 430 U.S. 519 (1977).
65. *Id.* at 525.
66. 331 U.S. 218 (1947).

and uniform interstate business practices. Regulation of the marketing of agricultural products is a field traditionally occupied by the states, and a clear intent of Congress must be shown to supersede this traditional activity. Congress had amended the original act to repeal a section giving the states power to nullify the act by state legislation. The Court held that matters not within the scheme of the federal regulations could be regulated by the state.

Justice Frankfurter dissented in *Rice v. Santa Fe Elevator Corp.* He argued that the presumption of state authority over traditional state matters should be adopted to preserve the constitutional balance of federalism. Frankfurter would limit federal regulatory preemption to fields in which Congress clearly expresses intent and to those in which the state's regulation is "in unmistakeable conflict with what Congress has ordered."[67]

Traditional areas of state regulation have not been preempted by federal regulations in other cases. In *Florida Lime & Avocado Growers, Inc. v. Paul*[68] the California regulations setting tests and minimum standards for retail sales of avocados were not preempted by federal regulations establishing different tests and lower standards for the marketing of avocados. California had an interest in regulation of the distribution and sale of retail food products and in preventing fraud and deception in retailing of foodstuffs. These traditional areas were not preempted by federal marketing orders which the Court distinguished as regulation of the production and transportation segments of the commerce stream.

When focused upon as a group, the cases cited do not present a consistent pattern. The Court begins by reviewing the congressional statute and its legislative history. A conclusive finding of express intent to preempt is controlling. An inconclusive review for express congressional intent is followed by an analysis of the interests furthered by federal and state regulation. Cases such as *Florida Lime & Avocado Growers, Inc. v. Paul* have favored the interests of state regulation; other cases such as *Jones v. Rath Packing Co.* and *Rice v. Santa Fe Elevator Corp.* have held that the interests of state regulation are inconsequential. When the Court weighs these interests, it may properly adopt state regulatory power as the dominant authority for analyzing the exercise of federal regulatory power in fields of traditional state regulation. Federal regulation must define its scope clearly, though not explicitly, in fields of traditional state regulation. In fields of only minimal state

67. *Id.* at 241 (Frankfurter, J., dissenting).
68. 373 U.S. 132 (1963).

regulatory interest or fields of predominant federal regulatory interest, the Court should adopt a presumption of federal power. Overcoming the presumption of state authority in a field of traditional state regulation should require a clear expression of preemptive intent over the subject matter of the state regulation.

State regulatory power is historically prevalent in the field of regulation of real property, but the *de la Cuesta* Court reasoned that federal regulatory power may preempt state law in this area. The Court cited *Free v. Brand*[69] and *Ridgway v. Ridgway*[70] for the proposition that the importance of state regulation in its own regulatory scheme is immaterial to the judicial inquiry when the conflict between federal and state regulatory power is direct. In *Free v. Brand* federal law for payment of federal savings bonds to a beneficiary preempted Texas community property law. In *Ridgway v. Ridgway*, Veterans' Administration regulations allowing choice of beneficiaries controlled the payment of proceeds over a state court decision directing payment to another.

The *de la Cuesta* Court cited *United States v. Shimer*[71] as authority for the equality of federal regulations with federal statutes as grounds for preemption.

Shimer presented the issue of the authority of the Veterans' Administration to prescribe regulations which preempted a Pennsylvania statute. The statute precluded recovery by a guarantor of a mortgage loan when the property subject to the mortgage was not valued by a state court before foreclosure. Shimer obtained a loan of $13,000 to purchase residential property and gave a mortgage on the property as security for the loan. Shimer obtained a guarantee of $4,000 from the Veterans' Administration as authorized by Title III of the Servicemen's Readjustment Act of 1944, 58 Stat. 291, 38 U.S.C.A. § 1801 *et seq.* The loan and guaranty agreements specified that Veterans' Administration regulations controlled the rights of the parties. Shimer defaulted and the mortgagee savings and loan association notified the Veterans' Administration of the default. The mortgagee foreclosed the property, bought it back at the sheriff's sale, and the Veterans' Administration paid $4,000 pursuant to the terms of the guaranty and sued Shimer for indemnity.

Pennsylvania's Deficiency Judgment Act provided that a mortgagee who purchases the property in a foreclosure sale must ob-

69. 369 U.S. 663 (1962).
70. 454 U.S. 46 (1981).
71. 367 U.S. 374 (1961).

tain a court determination of the property's fair value and credit that amount to the unsatisfied liability as a condition precedent to recovery of a deficiency judgment. Regulations of the Veterans' Administration established a procedure for computing the amount of the guaranty which could be claimed by the mortgagee. The regulations also provided for the manner in which credits from proceeds of the judicial sale were to be applied to reduce the outstanding indebtedness. The act further authorized the Administrator to specify the minimum amount to be credited from the sale of the property by the mortgagee. The mortgagee had the option to sell the property to the Veterans' Administration for this minimum amount.

While recognizing that the federal scheme was the functional equivalent of the Pennsylvania statute, the *Shimer* Court held that the state statute was inconsistent with and preempted by the federal regulation. The determination of fair value by the state court could not be imposed upon the Veterans' Administration. The federal regulations were "intended to provide the whole and exclusive source of protection of the interests of the Veterans' Administration."[72] When Congress grants authority and discretion to an agency, agency decisions are reviewable only when they exceed statutory authority or are clearly wrong. Minimizing risks to the Agency upon foreclosure was held to be a purpose of the federal act. The legislative history demonstrated congressional intent that the Agency's guarantee could act as a substitute for a down payment and induce lenders to provide 100% financing of homes. The regulation assured lenders that their economic interest in financing mortgage loans to veterans would be protected to the extent of the guaranteed amount.

Under *Shimer,* the Court's inquiry into when a regulatory agency intends to preempt state law amounts to a determination of whether the action is within the scope of the congressional mandate to the agency. The "regulations must not be 'unreasonable, unauthorized or inconsistent with' the underlying statute."[73] Express authorization from Congress is not required. It is the agency's intent to preempt state law and the scope of its authority which control the case.

72. *Id.* at 381.
73. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 154 (1982) (citing Free v. Bland, 369 U.S. 663, 668 (1962)).

EVALUATING THE COURT'S PREEMPTION ANALYSIS

Creation of the Federal Home Loan Bank Board for the purpose of protecting the financial soundness of federal savings and loan associations is exercise of an implied power emanating from the express power to coin money. The powers given to the Board by congressional delegation must have a nexus to the implied power and further the express power. The federal regulatory design in HOLA was the creation of a federal agency which would charter and regulate a national system of federal savings and loan associations. HOLA was forged in times of economic emergency when congressional grants of power to federal agencies were new and contained few guidelines. Subsequent legislative history implies that Congress delegated broadly to the Board. The Board promulgated a clearly preemptive regulation. The broad reading of the power to regulate the operation of federal savings and loans gives the due-on-sale regulation the required nexus to the implied power and the express power.

There is an historical presumption that property and contract law are the domain of state regulation. It is this presumption which posed a doctrinal problem for the *de la Cuesta* Court. While congressional power may subsume state regulation over local matters, its exercise raises serious implications for federalism. When federal regulatory agencies act in these state presumption areas, there should be a clear statement of intent to preempt state law. FHLBB clearly stated its intention to preempt state law in regulation of due-on-sale clauses used by federal savings and loan associations. However, Congress had not spoken and it would appear that the silence could not be taken as acquiescence. Justice Frankfurter's dissent in *Rice v. Santa Fe Elevator Corp.* called for a clear statement from Congress in preemption of the state domain, by federal agencies. The dissenting Justices in *de la Cuesta*, Rehnquist and Stevens, would require congressional intent to preempt property and contract law in the state domain. Justice O'Connor also seemed to recognize areas of state domain which federal regulatory agencies cannot preempt without express congressional authority.

The majority of the Court chose a substitute for a clear congressional statement in preemption of the state domain. The Court substituted its traditional deference on economic matters to federal agencies for the clear congressional intent to preempt the state domain. The interests of state regulation to prevent restraint on alienation of real property and the federal interests to protect the financial integrity of federal savings and loan associations are diametrically opposed in mortgage assumptions. The state policy cannot be furthered without impinging on the federal objectives. A conflict clearly exists within an area of traditional state interests. The majority admitted that the Board's exercise of power might be disputed on economic grounds, but deference to the Board was appropriate because "as judges, it is neither our function, nor within our expertise, to evaluate the economic soundness of the Board's approach."[73.1] Only a clear congressional limitation on an agency's economic policymaking power would alter economic deference.

Economic deference to FHLBB's economic policymaking power comports with precedent in cases decided in banking regulation. Traditional deference to economic regulatory expertise is exemplified in two cases. In *Franklin National Bank v. New York*,[74] a state statute prohibited the use of the word "savings" in bank advertising. Federal regulations promulgated by the Federal Reserve Board authorized banks to accept savings deposits and advertise for them. The Court held that where a conflict of authority exists between the state and federal regulatory schemes, the Court could not resolve the conflict by choosing the most efficacious policy but must defer to the federal regulatory scheme.[75] In *Ford Motor Credit Co. v. Milhollin*[76] a Federal Reserve Board regulation was interpreted by the Board as not requiring that a creditor disclose its right to accelerate payment of the entire debt upon default by the borrower. Consumers attacked this regulation as unauthorized by the statutory language of the Truth-In-Lending Act. The Court held that deference to agency expertise and interpretations of its statutory authority are traditional and "to the extent that deference to administrative views is bottomed on respect for agency expertise,"[77] deference is appropriate for the agency interpretation of its statutory authority.

Deference to federal agencies in economic policy matters was an insurmountable burden for the appellees in *de la Cuesta*. Their argument was that a conflict between this economic deference and the state regulatory scheme was not inevitable when the due-on-sale regulation was found to be permissive or when the contract was found to rely on state law as the law of contractual expectation. The Board made its preemptive intent in the regulation clear and met the test of *United States v. Shimer* in that the regulation was not unreasonable, unauthorized or inconsistent with HOLA. Therefore, the determinative issue in the decision was whether federal regulations for economic policy matters are incorporated into state law.

73.1 *Id.* at 169-70.
74. 347 U.S. 373 (1954).
75. *Id.* at 378.
76. 444 U.S. 555 (1980).
77. *Id.* at 566 n.9.

De la Cuesta's affirmative answer to this issue creates a precedent for the use of federal regulation of the economy as a rationale for future incursions into the state regulatory domain by the Federal Home Loan Bank Board and other agencies exercising economic policymaking functions. This conclusion opens the field of state taxing policy to regulation by the Board acting to protect federal savings and loan associations.

PROPERTY INTERESTS AND FEDERAL REGULATORY POWER

As a general rule, a mortgagor may convey mortgaged premises subject to the mortgage, or he may convey so that the grantee assumes the payment of the debt.[78] By assuming the loan, the grantee agrees to make payments under the terms of the existing mortgage. Absent an agreement with the mortgagee to substitute a grantee as the mortgagor, the mortgagor continues to be liable to the mortgagee for the debt and both the grantee and the mortgagor are liable for any deficiency after the foreclosure of the property.[79] During periods of rising interest rates and restricted availability of funds, mortgagors and grantees view assumption of mortgages with less than prevailing rates as a common and desirable method of financing.[80] The due-on-sale clause limits the alternatives of the parties: the mortgagor may pay the balance of the loan or the grantee may assume the loan with the consent of the mortgagee. Mortgagees use due-on-sale clauses to increase interest rates when the contract rate of the original note is lower than the current market rate. Due-on-sale clauses allow the lender to receive the amount of the outstanding balance and make these funds available to other borrowers at current market rates or to increase the return on the existing loan up to the current market rate.

The Mississippi Supreme Court decided *Sanders v. Hicks,*[81] a case where a due-on-sale clause of a mortgage was at issue. The court held that restraints on alienation imposed by clauses in deeds of trust are not invalid *per se*, but where their exercise is not related to remedying a threat to the mortgagee's legitimate interests, they are invalid. The restraining clause in the mortgage in *Sanders v. Hicks* required the express written consent of the mortgagees to any sale of the property. The mortgagees, individuals and not institutional lenders, contended that the note charged no interest until

78. Hodges v. Building & Loan Ass'n, 166 Miss. 677, 148 So. 223 (1933).

79. Smith v. General Investments, 246 Miss. 765, 150 So. 2d 862 (1963).

80. Comment, *Due-on-Sale Clauses: The Economic and Legal Issues,* 43 U. PITT. L. REV. 441 (1982).

81. 317 So. 2d 61 (Miss. 1975).

default as an exclusive concession to the mortgagors, who were unable to pay interest. Chief Justice Gillespie, writing for the court, held that the protection of the mortgagee from the transfer of this interest concession to a grantee was not a legitimate interest to be recognized in equity. A restraint on alienation was invalid when not protecting against a threat to the mortgagee's legitimate interest. Citation was made to cases where the restraint on alienation was a due-on-sale clause.[82] The court's analytical approach involved a balancing of the interests of the lender against the policy prohibiting restraints on alienation,[83] but the court left open the question of what interests would be considered legitimate.

The California Supreme Court's 1978 decision in *Wellenkamp v. Bank of America*[84] raised the doctrine preempted by the *de la Cuesta* decision. Wellenkamp purchased residential property from mortgagors of a mortgage containing a due-on-sale clause with the Bank of America. Wellenkamp attempted to assume the loan by giving notice and tendering her check for the monthly payment of the mortgage. The bank returned the check to Wellenkamp with a letter notifying her of its right to accelerate upon transfer of the property by the mortgagors. The bank offered to allow assumption at a higher rate. Wellenkamp refused, and the bank filed a notice of default and election to sell the property. Wellenkamp sought an injunction against the bank, contending that enforcement of the due-on-sale clause without a showing of impairment of the security interest is an unreasonable restraint on alienation and violates California law. The trial court refused to enjoin the bank. The California Supreme Court reversed the trial court and held for plantiff Wellenkamp.

The *Wellenkamp* court analyzed the "quantum of restraint" on alienation caused by the exercise of a due-on-sale clause when there was insufficient showing of impairment of the mortgagee's security interest. Outright sales of real property[85] require financing dependent "upon the circumstances existing at the time of sale.... [W]hen, however, new financing is unavailable or is economically unfeasible, the buyer may arrange, as did plaintiff herein, to pay the seller only the amount of the seller's equity in the property, agreeing to assume or take 'subject to' the existing deed of

82. *Id.* at 64.

83. Note, *Due-on-Sale Clause is an Unreasonable Restraint on Alienation Absent a Showing of Protection of Mortgagee's Legitimate Interests*, 47 MISS. L. J. 331, 345 (1976).

84. 21 Cal. 3d 943, 582 P. 2d 970, 148 Cal. Rptr. 379 (1978).

85. The court defined outright sale as "any sale by the trustor of property wherein legal title (and usually possession) is transferred." *Id.* at 950, 582 P.2d at 974, 148 Cal. Rptr. at 383.

trust, in a 'cash-to-loan' arrangement."[86] Availability of financing is dependent upon economic conditions. When interest rates are high, and funds available for mortgage loans are difficult to obtain, assumptions of existing loans are the normal method of financing real estate sales. If lenders are unwilling to permit assumptions of existing loans and exercise their due-on-sale clauses, property conveyances may be impossible. Consent to the assumption predicated on a higher rate of interest does not mitigate the adverse impact, because the purchase usually requires a lower selling price to achieve a comparable monthly payment at the higher interest rate.

The bank argued that due-on-sale clauses could be exercised to increase interest rates in loan portfolios. The court rejected this financial expectation argument. Recognizing the demands on lenders to pay higher interest rates to depositors during tight money periods, the court reasoned that economic risks are foreseeable and inherent in lending. The court concluded that the risk of economic reversals should be borne by the lender and not the subsequent purchasers.[87]

Other courts have recognized the legitimate financial interests of institutional lenders to increase interest rates at the conveyance of the subject property.[88] The traditional mortgage loan portfolio of a savings and loan association is a composite of loans made at fixed interest rates and with maturities of between twenty and thirty years. The association acquires funds for its lending from deposits of shorter maturities than their loans, from capital, and from the conversion of assets (e.g., repayment of loans). During periods of rising interest rates, the cost of funds supplied by deposits and capital increases as general market rates increase. As the increase in cost of funds supplied approaches the yield of the mortgage loan portfolio, the profitability of the lender is adversely affected. When the cost of funds supplied exceeds the yield of the loan portfolio, the lender will be realizing a negative profitability. The alternative offered in conversion of assets with low rates of interest is extremely useful because it mitigates the need for expensive deposits and capital. Lenders place great value on con-

86. *Id.*

87. *Id.* at 952, 582 P.2d at 976, 148 Cal. Rptr. at 385.

88. Williams v. First Fed. Sav. & Loan Ass'n of Arlington, 500 F. Supp. 307 (E.D.Va. 1980), *aff'd*, 651 F.2d 910 (4th Cir. 1981); Tierce v. APS Co., 382 So. 2d 485 (Ala. 1980); Dunham v. Ware Sav. Bank, 384 Mass. 63, 423 N.E.2d 998 (1981); Occidental Sav. & Loan Ass'n v. Venco, 206 Neb. 469, 293 N.W. 2d 843 (1980). *See* Comment, *Due-on-Sale Clauses: The Economic and Legal Issues*, 43 U. PITT. L. REV. 441 (1982).

89. *See* Note, *Due-on-Sale Clause is an Unreasonable Restraint on Alienation Absent a Showing of Protection of Mortgagee's Legitimate Interests*, 47 MISS. L. J. 331, 338-39 (1976).

tractual terms such as due-on-sale clauses which allow a conversion of low-yielding assets. The due-on-sale clause allows the lender to protect the financial return anticipated when making the mortgage loan. It also prevents an unexpected windfall to the mortgagor who otherwise would be able to sell the property at a premium because of the low interest rate.[89]

The Federal Home Loan Bank Board views due-on-sale clauses as serving two functions in regulation of federal savings and loan associations: protection of the underlying security from waste or deterioration in creditworthiness, and control of the financial soundness of the mortgage loan portfolio.

Since 1948, the Board has interpreted 12 C.F.R. § 545.8-3(a) as allowing due-on-sale clauses. This regulation was promulgated by the Federal Home Loan Bank Board in 1948 and required that all loan agreements "provide for full protection to the Federal association." FHLBB interpreted this phrase as authorizing exercise of due-on-sale clauses because they afford protection to the association.[90] The *Wellenkamp* doctrine limited "protection" by allowing exercise of the due-on-sale clause only in those cases where there is a showing of impairment of the security interest.

In response to the need for a financial expectation rationale for the authority of federal savings and loan associations to exercise due-on-sale clauses, the FHLBB promulgated the due-on-sale regulation in 1976.[91] The Board's reasoning incorporated both the security interest and the financial expectation of the savings and loan associations. It found that restrictions on exercise of due-on-sale clauses 1) endanger the financial security of a savings and loan association when the subsequent mortgagor lacks the ability to repay the loan; 2) reduce the cash flow and income of the associations and force them to charge higher rates and fees on home loans generally; and 3) make the loans unsaleable and less valuable in the secondary mortgage markets. Balancing these factors with the property interests of potential subsequent mortgagors and grantees, the Board concluded that financial expectations are directly related to preservation of the viability of the secondary mortgage market.[92] The Board expressed its intent that due-on-sale clauses of federal savings and loans be governed "exclusively by federal law" in the preamble to the final publication of the

90. *See* Advisory Opinion, Resolution No. 75-647, in Schott v. Mission Fed. Sav. & Loan Ass'n, No. Civ. 75-366, at 13-15 (C.D. Cal. July 30, 1975).
91. 12 C.F.R. § 545.6-11(f) (1976), *Now* 12 C.F.R. § 545.8-3(f) (1983).
92. 41 Fed. Reg. 6283, 6285 (1976) (to be codified at 12 C.F.R. § 545.6-11(f)).

regulation.[93] Federal courts have upheld the Board's authority to preempt state law with this regulation.[94]

The Federal Home Loan Bank Board was created by the Federal Home Loan Bank Act of 1932.[95] Enactment of this statute was a first response to the mortgage loan crisis of the early 1930s. A system of Federal Home Loan Banks, chartered and supervised by the Board, were to serve as purchasers of defaulted loans from the state-chartered savings and loan associations. One year later, in the depth of the Great Depression, Congress had become impatient with the lack of progress afforded by the regional bank concept. A more radical approach to solving the problem of mortgage defaults was contemplated (approximately half of the nation's residential mortgage loans were in default) and in 1933 Congress passed the Home Owners Loan Act. HOLA gave the Board a mandate to create and regulate a system of federal savings and loan associations:

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations,' or 'Federal mutual savings banks'... and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.[96]

In this broad language, lower federal courts have found the Board's plenary authority to issue regulations. Congressional delegation of duty and authority to the Federal Home Loan Bank Board includes the power to make rules and regulations and the constitutionality of this delegation has been upheld.[97] The chartering of the associations renders them instrumentalities and agencies of the United States.[98] The rules and regulations of FHLBB rule an association from "its cradle to its corporate grave" and have the force and effect of law.[99] The *de la Cuesta* decision was strong affirmation of those lower federal court decisions.

Evaluating the Court's Interpretation of HOLA

The holding in *de la Cuesta* clearly establishes that the ex-

93. 41 Fed. Reg. 18,286, 18,287 (1976) (to be codified at 12 C.F.R. § 545.6-11(f)).
94. *See, e.g.*, Williams v. First Fed. Sav. & Loan Ass'n of Arlington, 500 F. Supp. 307 (E. D. Va. 1980), *aff'd*, 651 F.2d 910 (4th Cir. 1981).
95. Federal Home Loan Bank Act of 1932, § 1427, 12 U.S.C. § 1421 (1976).
96. 12 U.S.C. § 1464(a) (Supp. V1981).
97. People v. Coast Fed. Sav. & Loan Ass'n., 98 F. Supp. 311 (S.D. Cal. 1951).
98. *Id.* at 316.
99. *Id.*

plicit power to promulgate regulations for the operation of a federal savings and loan association under HOLA also includes the implicit power to regulate the terms of mortgage agreements used by federal savings and loan associations.[100] The holding also suggests that these regulations may embody the most beneficial national standards for the control of the mortgage loan portfolio within a federal savings and loan association.[101] *De la Cuesta* has far-reaching implications for the law of property and contract in the states. The FHLBB seems to have the power to develop a body of federal real property law which will preempt state law. Such a federal regulatory power could conceivably include all aspects of property law from filing to foreclosure. The dissent would have limited the FHLBB remedy for state regulatory schemes which adversely impact the financial soundness of a federal savings and loan association. The dissent's approach would require the FHLBB to identify the potential harm inherent in the state regulatory scheme and place the state on notice that the continued existence of the offending statute would call for the discontinuation of federal savings and loan associations' lending activities.[102]

While the majority's approach may lead to more extensive preemption of state property law, the dissent's regulatory scheme might cause confrontation between federal and state agencies. The FHLBB would evaluate state regulatory schemes and face questions of whether the state regulation was sufficiently harmful to justify exercise of its power to discontinue lending. Moreover, if the FHLBB determined that a state regulatory scheme must be changed, its decision might be greeted by state opposition or inertia. The discontinuance of the lending operation of federal savings and loan associations would cause disruption in the real estate markets, perhaps at times when these markets are most vulnerable. Acquiescence in the FHLBB decision would be applicable to all borrowers and lenders, whether federally or state-chartered, to avoid disparate treatment. Therefore, the federal regulatory scheme proposed by the dissent would give the FHLBB a more far-reaching impact on state property law than that of the majority.

The *de la Cuesta* decision raised questions for the enforceability of due-on-sale clauses. When a state-chartered savings and loan association converts to a federally chartered association, does the federal regulation become retroactive to those mortgages made by

100. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 458 U.S. 141, 141-42, (1982).
101. *Id.* at 142.
102. *Id.* at 172-75, (Rehnquist, J., dissenting).

the association operating under a state charter? How does federal preemption affect the position of lenders other than federal savings and loan associations in states which impose restrictions of exercise of due-on-sale clauses and in states which allow the most favored lender rule to apply to all lenders? Moreover, how would the marketability of property encumbered by due-on-sale clauses be affected by uncertainty over how mortgages of other lenders would be treated?

POST-DECISION CONGRESSIONAL ACTION

After the *de la Cuesta* decision, an omnibus bill, the Garn-St. Germain Depository Institutions Act of 1982,[103] answered these questions by preempting state laws restricting exercise of due-on-sale clauses. The Senate Banking Committee report on the bill recognized the disadvantage for other lenders and the uncertainty for mortgagors and grantees created by the *de la Cuesta* decision.[104] It also recognized the potential problems of the charter conversion problem.[105] Title III, Part C of the Act preempted "state laws and judicial decisions which restrict the enforcement of due-on-sale clauses in real property loans, except for loans originated or assumed during a 'window period.' "[106] The "window period" is the period between the date the state law, constitutional provision, or judicial decision restricted the exercise of the due-on-sale clause and the date of enactment of this Act.[107]

Window period loans of state chartered lenders are subject to state law for three years unless the state legislature changes the law applicable to these loans. The state legislature may lengthen the period for which state restrictions would apply to window period loans or may repeal state restrictions on these loans, but may not expand the type of loans to which the restrictions apply.[108] Loans outside the dates of the window period are subject to federal law allowing exercise of due-on-sale clauses. Where a state does not have a window period it may not enact restrictions. If a state has a window period and does not act during the three years, its window period loans will be subject to federal preemption in

103. Garn-St. Germain Depository Institutions Act of 1982, Pub. L. No. 97-320, 96 Stat. 1469 (codified in scattered sections of 12 U.S.C.S.) [hereinafter cited as Garn-St. Germain Act].

104. S. REP. NO. 536, 97th Cong., 2d Sess. 20-21 (1982).

105. *Id.* at 24.

106. *Id.* at 21. *See* Garn-St. Germain Act, *supra* note 103, § 341(c)(1), 12 U.S.C.S. § 1701j-3(c)(1). The due-on-sale clause is defined by the statute at 12 U.S.C.S. § 1701j-3(a)(1).

107. *Id.* at 21. *See* Garn-St. Germain Act, *supra* note 103, § 341(c)(1), 12 U.S.C.S. § 1701j-3(c)(1). Judicial decisions include those of the highest court of the state of an appellate court if the decision applies throughout the state.

108. *Id.* at 23.

October, 1985.[109]

Federally chartered institutions are treated under separate classifications. Window period loans originated by national banks and federal credit unions are subject to state law for three years.[110] After the three year period, any state restrictions are not applicable unless the Comptroller of the Currency or the National Credit Union Administration Board acts to regulate these loans. Federal savings and loan associations are governed by the *de la Cuesta* decision. How the association was chartered at the time of the loan origination determines whether state restrictions apply during the window period.[111]

All loans, whether window period or not, of all lenders are subject to nine consumer-protection exceptions to exercise of due-on-sale clauses.[112] The Senate report suggests that these exceptions encompass those cases where exercise of a due-on-sale clause would not be equitable.[113]

The Senate banking committee report on the bill attempted to analyze the effect of the bill on state law. In a footnote,[114] the committee recognized that Mississippi law is determined by judicial decision, presumably *Sanders v. Hicks*, and concluded that "[t]he Supreme Courts of Illinois and Mississippi appear to leave the door open not to enforce due-on-sale clauses under some circumstances."

Whatever weight may attach to the evaluation of Mississippi law by the Senate Committee, the Garn-St. Germain Depository Institutions Act will have a confusing impact on Mississippi law. *Sanders v. Hicks* left open the question of what legitimate interests are recognizable in equity to allow the exercise of a due-on-sale clause. The mortgagee in *Sanders v. Hicks* was an individual and not a financial institution whose financial soundness could be impaired by unenforceability. Moreover, the Mississippi Savings Association Board promulgated a regulation allowing due-on-sale clauses in mortgages of state-chartered savings and loan associations in 1980.[115] Taken together with the persuasive authority of the *de la Cuesta* decision upholding the exercise of a due-on-sale clause to protect an institutional lender's financial expectation in a mortgage, the *Sanders v. Hicks* holding could be construed as limited to the facts of that case and leaving open the question of

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109. *Id.*
110. *Id.*
111. *Id.* at 24.
112. Garn-St. Germain Act, Pub. L. No. 97-320, § 341(d), 96 Stat. 1469, 1506, 1507 (1982).
113. S. REP. No. 536, 97th Cong., 2d Sess. 24-25 (1982).
114. *Id.* at 22.
115. Mississippi Savings Association Board Order No. 92 (September 1982).

whether a financial institution may exercise a due-on-sale clause.

Because the legitimate interests of a financial institution in Mississippi have not been considered by the state's highest court and no legislative restriction of due-on-sale clauses has been enacted, Mississippi's window period loans would be those loans where no legitimate interest of an individual mortgagee may be found. *De la Cuesta* implicitly recognizes the legitimacy of the institutional lender's financial expectation. Moreover, the Garn-St. Germain Depository Institutions Act places authority for future regulation of window loans in the state legislatures,[116] thereby foreclosing any further judicial definition of legitimate interests. Prior to passage of the Garn-St. Germain Act, a Chancery Court decision in Warren County held a due-on-sale clause in a mortgage of a national bank to be unenforceable.[117] This decision does not establish the window period because the Chancery Court's decision does not apply statewide, a condition required in the Garn-St. Germain Act.[118]

To the extent they may exist, the future exercise of due-on-sale clauses in window period loans is for the Mississippi legislature to decide for mortgages of state-chartered banks, state-chartered credit unions, and individuals. It may also decide the treatment of window period loans for national banks and federally chartered credit unions unless the federal regulatory authorities act to regulate these loans. Window period loans of federal savings and loan associations issuing mortgages with due-on-sale clauses will continue to be allowed by FHLBB regulation and the *de la Cuesta* decision. Mortgages of state savings and loan associations will continue to be subject to regulations of the Mississippi Savings Association Board.

This confused situation can be remedied only by clear statutory pronouncement of the Mississippi legislature. It may repeal all restrictions on due-on-sale clauses but may not expand the type of loans to which the window period applies. In light of the uncertain applicability of the *Sanders v. Hicks* decision, removal of all restrictions on the exercise of due-on-sale clauses would eliminate confusion existing in Mississippi in the wake of the sweeping

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116. Garn-St. Germain Act, Pub. L. No. 97-320, § 341(c)(1), 96 Stat. 1469, 1505, 1506(1982).

117. Caruthers v. First Nat'l Bank of Vicksburg, No. 28, 850 (Ch. Warren July 10, 1981), *appeal docketed*, No. 53, 801 (Miss. Mar. 9, 1982).

118. S. REP. No. 536, 97th Cong., 2d Sess. 22 (1982).

preemption of this aspect of mortgage law by the Garn-St. Germain Depository Institutions Act of 1982.

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