

HOLIDAY ACRES v. MIDWEST FEDERAL SAVINGS AND LOAN ASSOCIATION: PREEMPTION OF THE DUE-ON-SALE CLAUSE

Due-on-sale clauses,¹ in mortgages and other security agreements,² grant lenders the option to declare an entire loan balance due and payable immediately upon transfer of the collateral property.³ Traditionally, lenders utilized these clauses to protect their security from impairment⁴ when title to the property passed to persons other than

1. Due-on-sale clauses began to appear routinely in mortgages and deeds of trust in the 1960's. 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, 271 (1972). See Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests*, 58 IOWA L. REV. 747 (1973). Due-on-sale clauses appear in myriad forms. See note 15 *infra* for a fairly typical example. See Bonanno, *supra*, at 272, nn.14-16 for other examples.

2. Acceleration clauses, which are substantially similar to due-on-sale clauses, have appeared for many years in land sale contracts. See Volkmer, *supra* note 1 at 753-67. For chattel loans, the Uniform Commercial Code automatically grants lenders rights similar to those granted lenders by due-on-sale clauses in mortgages. See, e.g., U.C.C. §§ 9-306, 9-505.

3. See generally Bonanno, *supra* note 1; Volkmer, *supra* note 1. A typical property transfer that triggers exercise of the clause is the sale of real property wherein the buyer assumes the seller's mortgage. See, e.g., cases cited note 8, *infra*. This type of sale is becoming increasingly prevalent, though damaging to savings and loan associations, because it permits the buyer to assume the seller's mortgage, usually having an interest rate much lower than current market mortgage interest rates. See *Ban on Due-on-Sale Clauses Would Push Up Mortgage Rates, Says HUD Study*, 8 Hous. & Dev. Rep. (BNA) 1055 (1981). See also note 9, *infra*. Another type of transfer that triggers the clause is the sale of property with a wraparound mortgage. See *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) (land contract "wraparound" mortgage will trigger the due-on-sale clause); Bartke & Tagaropulos, *Michigan's Looking Glass World of Due-on-Sale Clauses*, 24 WAYNE L. REV. 971, 982-84 (1978).

Other types of mortgage and deeds of trust transfers that may trigger exercise of the clause are junior encumbrances on the security (such as a "second mortgage" clause), execution of leases with option to buy, installment land contract sales, and possibly devises, as well as outright sales. Bonanno, *supra* note 1 at 727 n.14. See Annot., 69 A.L.R. 3d 713 (1976).

4. A lender may perceive a risk that the transferee will waste the property and thus cause diminution of the collateral's value. Alternatively, the transferee may

the original borrower.⁵ With the onset of long-range inflation and rising interest rates,⁶ however, mortgage lenders have sought to use due-on-sale clauses as leverage to negotiate a higher interest rate.⁷ State courts are split on the issue of whether use of the clause for this purpose is permissible.⁸ Recently, federally chartered savings and loan associations have attempted to circumvent state restrictions on

present a greater credit risk than the transferor. In both of these circumstances courts have held that exercise of the clause is justified. *Cherry v. Home Sav. & Loan Ass'n*, 276 Cal. App. 2d 574, 578-79, 81 Cal. Rptr. 135, 138 (1969). *See, e.g.*, cases cited in note 8, *infra*.

5. Bonanno, *supra* note 1, at 271; Comment, *Due-on Clauses: Restraints on Alienation and the Legitimacy of Portfolio Maintenance*, 14 WILLAMETTE L.J. 295, 296 (1978). *See* Volkmer, *supra* note 1, at 257-65 for a comprehensive discussion of the traditional purpose of due-on-sale clauses.

6. *See* Bartke, *supra* note 3, at 973-84 for an excellent discussion of recent economic developments that have influenced the use of due-on-sale clauses.

7. *See generally* Bartke, *supra* note 3. A lender may use a due-on-sale clause to negotiate a higher interest rate by threatening to exercise the clause unless the buyer agrees to pay a higher interest rate on the mortgage. Volkmer, *supra*, note 1 at 769. *See, e.g.*, cases cited in note 8, *infra*.

8. Jurisdictions that allow exercise of the clause only if there is a risk that security will be impaired are as follows: Arizona: *Patton v. First Fed. Sav. & Loan Ass'n*, 118 Ariz. 473, 578 P.2d 152 (1978). Arkansas: *Tucker v. Pulaski Fed. Sav. & Loan Ass'n*, 252 Ark. 849, 481 S.W.2d 725 (1972); California: *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978); Florida: *First Fed. Sav. & Loan Ass'n of Englewood v. Lockwood*, 385 So. 2d 156 (Fla. Dist. Ct. App. 1980); Illinois: *Baker v. Loves Park Sav. & Loan Ass'n*, 61 Ill. 2d 119, 333 N.E.2d 1 (1975); Michigan: *Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n*, 73 Mich. App. 163, 250 N.W.2d 804 (1977); Mississippi: *Sanders v. Hicks*, 317 So. 2d 61 (Miss. 1975); Oklahoma: *Continental Fed. Sav. & Loan Ass'n v. Fetter*, 564 P.2d 1013 (Okla. 1977); Ohio: *People's Sav. Ass'n v. Standard Indus. Inc.*, 22 Ohio App. 2d 35, 257 N.E.2d 406 (1970).

Jurisdictions that uphold use of the clauses to maintain lenders' loan portfolios at current interest rates as well as to protect lender's security are: Alabama: *Tierce v. APS Co.*, 382 So. 2d 485 (Ala. 1979); Colorado: *Malouff v. Midland Fed. Sav. & Loan Ass'n*, 181 Colo. 294, 509 P.2d 1240 (1973); Nebraska: *Occidental Sav. & Loan Ass'n v. Venco*, 206 Neb. 469, 293 N.W.2d 843 (1980); Nevada: *First Commercial Title Inc. v. Holms*, 92 Nev. 363, 550 P.2d 1271 (1976); New Jersey: *Fidelity Land Dev. Corp. v. Rieder & Sons*, 151 N.J. Super. 502, 377 A.2d 691 (1977); *Shalit v. Investors Sav. & Loan Ass'n*, 101 N.J. Super. 283, 244 A.2d 151 (1968); New York: *Nichols v. Evans*, 92 Misc. 2d 938, 401 N.Y.S.2d 426 (1978); North Carolina: *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, 224 S.E.2d 580 (1976); Tennessee: *Gunther v. White*, 489 S.W.2d 529 (Tenn. 1973); Utah: *Walker Bank & Trust Co. v. Neilson*, 26 Utah 2d 383, 490 P.2d 328 (1971); Washington: *Terry v. Born*, 24 Wash. App. 652, 504 P.2d 504 (1979); Wisconsin: *Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works*, 58 Wis. 2d 99, 205 N.W.2d 762 (1973).

For a more comprehensive list, see *Occidental Sav. & Loan Ass'n v. Venco*, 206 Neb. 469, 482, 293 N.W.2d 843, 850 (1980) (Appendix to Majority Opinion).

their use of the clauses⁹ by claiming federal preemption.¹⁰ Federal

9. See note 8 *supra*. Restrictions on the clause are attributable to diverging views on a policy issue. This issue is whether sellers or lenders will bear the burden of inflationary interest increases in the money market. In times of high interest rates, mortgage assumptions are the preferred method of structuring home sales. See Note, *Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1113 (1975) [hereinafter cited as *Judicial Treatment*]; Bartke, *supra* note 3 at 981. A homeowner with a low interest mortgage can exact a premium sales price for his property. Property with an assumable low interest loan will ultimately cost the buyer less than property mortgaged at prevailing rates. Therefore the buyer is willing and able to pay a premium for the low interest property. See Bartke, *supra* note 3, at 981. But the premium price is not necessarily a windfall to the seller (at least to the extent it represents inflationary interest increases). In order to buy another home he must either obtain a mortgage at prevailing rates, using up the "windfall" he received, or he must pay a similar premium to assume another mortgage.

The due-on-sale clause can work to shift the transaction's premium from the seller to the lender. The lender may use the clause as leverage to negotiate a higher interest rate. This will force the seller to lower his price to induce the buyer to assume the mortgage at a higher interest rate. *Judicial Treatment, supra*, at 1113. Alternatively, the lender may refuse to allow the assumption and call in the low-interest loan, thus freeing his funds for re-lending at prevailing interest rates. *Occidental Sav. & Loan Ass'n. v. Venco*, 206 Neb. 469, 479, 293 N.W.2d 843, 848 (1980).

In times of rising interest rates, if the seller or the lender realizes a premium from the transaction, the other bears the cost of the rising rates. For a homeowner seeking to sell his property, the effect of a due-on-sale clause exercised to raise interest rates may amount to a restraint on alienation. *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 950-51, 582 P.2d 970, 974-75 (1978), 148 Cal. Rptr. 379, 383-84. In times of tight mortgage money or high interest rates, a homeowner can often sell only if the buyer can assume the seller's mortgage. *Id.* One reason is that as interest rates climb faster than incomes, fewer buyers can qualify for high interest loans. See McDonough, *Advantages of Innovations in Variable-Rate Mortgages*, in FINANCIAL INSTITUTIONS AND MARKETS IN A CHANGING WORLD 524 (Fraser & Rose eds. 1980). If the lender chooses to call in the loan rather than allow the buyer to assume it, the effect is to prohibit the sale. The buyer cannot borrow the funds to pay the loan and the seller will not have the funds to pay it until the sale goes through. 21 Cal. 3d at 950-51, 582 P.2d at 974-75, 148 Cal. Rptr. at 383-84. On the other hand, if the lender waives his right to exercise the clause in exchange for the buyer's assumption at a higher interest rate, the seller usually has only two alternatives. He must either lower his price, thus reducing his equity interest in the property and his ability to purchase a comparable home, or he must terminate the sale. *Id.* See also, Bonanno, *supra* note 1, at 284; *Judicial Treatment, supra* at 1113. The consequences of such a situation can be particularly onerous for homeowners who must sell as a matter of necessity (because of job transfers, etc.). See *Crockett v. First Fed. Sav. & Loan Ass'n*, 289 N.C. 620, 642-43, 224 S.E.2d 580, 594-95 (1976) (dissenting opinion). Thus, if a lender uses the clause to raise the interest rate, the seller's interests are damaged.

Alternatively, if the lender is prohibited from using the clause to negotiate a higher rate, the lender rather than the seller is damaged. Mortgage lenders are predominantly savings and loan associations. C. HENNING, W. PIGOTT & R. SCOTT, FINANCIAL MARKETS AND THE ECONOMY 143 (3d ed. 1981) [hereinafter cited as HENNING].

The associations are hit especially hard by the effects of inflationary interest increases because of the nature of their assets. *Id.* at 182. The associations "borrow short and lend long." Over four-fifths of their assets are fixed-rate, long-term mortgages. *Id.* at 148. Their liabilities, on the other hand, are primarily short-term deposits, removable at will by the depositors. McDonough, *supra* at 524. In times of rising interest rates, the associations must pay out higher rates to their depositors to attract funds for mortgage lending. Their mortgage portfolios, however, bring in income in the form of interest, at less than the market rate. *Id.* Thus the associations' cost of funds rises faster than their mortgage portfolio yields, causing reduced or negative earnings. See Advisory Opinion of the Federal Home Loan Bank Board, Resolution No. 75-647, *Schott v. Mission Fed. Sav. & Loan Ass'n*, Case No. Civ-75-366 (C.D. Cal. 1975) [hereinafter cited as *Schott Opinion*]; *Opinion of the Office of Economic Research On the Revocation of the "Due-on-Sale Clause" in the State of California* 3-5 [hereinafter cited as OER]; *S & L Cost of Funds Exceeds Mortgage Yield; Industry Suffers Heavy Losses*, 9 Hous. Dev. Rep. (BNA) 397-98 (1981).

The effect of rapidly rising interest rates on the associations' earnings, combined with federal regulation placing ceilings on the amount of interest the associations may pay on deposits, have threatened the health of the savings and loan industry. See HENNING, *supra* at 182; *The Savings Revolution*, TIME, June 8, 1981, at 58, 58-60 [hereinafter cited as TIME]. When interest rates began to rise above the ceilings, depositors began shifting their funds to higher yield investments on a massive scale. See HENNING, *supra* at 182. From 1970 to 1980, deposits in the associations dropped more than 26%. TIME, *supra* at 62. As a result, the associations had even less money to lend at prevailing rates to generate income and their earnings were reduced even further. As of June, 1981 it was estimated that 90% of the nation's savings and loan associations were losing money. *Id.* at 58. Even though the government is currently lifting the regulatory ceilings, one industry analyst estimated that if interest rates do not abate, as many as one-third of the associations might fail in the next five years. *Id.*

Thus savings and loan associations have a compelling reason for utilizing the clause to raise their loan portfolio yield. Due-on-sale clauses are the associations' main vehicle for raising mortgage yields as interest rates rise. *Schott Opinion*, *supra* at 22; Volkmer, *supra* note 1, at 769-70. As interest rates rise, more assumptions occur. See *FNMA Delaying Enforcement of Due-on-Sale Clause*, 8 Hous. & Dev. Rep. (BNA) 359 (1980). A recent HUD study estimates that mortgage earnings losses would equal a seven per cent capital loss if prohibitions on the enforcement of due-on-sale clauses extended the existing loans' remaining life from 5 years to 15 years. *Ban on Due-On-Sale Clauses Would Push Up Mortgage Rates, Says HUD Study*, 8 Hous. & Dev. Rep. (BNA) 1055 (1981) [hereinafter cited as *HUD Study*]. Such a loss could severely damage the already unsteady savings and loan industry. Thus the associations are in no better position than sellers to bear the inflationary increase effects in the money market.

Homebuyers may also suffer if exercise of the clause is prohibited. *HUD Study*, *supra* at 1055; OER, *supra* at 3-5. Savings and loan associations, faced with shrinking or negative spreads between interest they receive from their mortgage portfolios and their cost of funds, will raise the mortgage rates on new loans to create more income. OER, *supra* at 3-5. See Comment, *Due-On Clauses: Restraints on Alienation and the Legitimacy of Portfolio Maintenance*, 14 WILLAMETTE L.J. 295, 309 (1978), for a discussion of this effect. As a result, prospective homeowners may be forced to downgrade their purchases or forego home ownership altogether. McDonough, *supra* at

courts have upheld the federal associations' arguments.¹¹ A recent Minnesota Supreme Court decision brings the controversy into sharp focus. *Holiday Acres v. Midwest Federal Savings and Loan Association*¹² held that federal law does not preempt state law with respect to exercise of due-on-sale clauses by a federal savings and loan association.¹³

In *Holiday Acres*, Midwest Federal Savings and Loan (Midwest) financed the purchase of an apartment complex by Holiday Acres (Holiday).¹⁴ The mortgage contained a standard due-on-sale clause.¹⁵ Holiday attempted to sell the property by transferring the mortgage to a third party buyer.¹⁶ Midwest threatened to exercise the clause unless the buyer agreed to refinance the property at a higher

524. Since the due-on-sale clause is a major vehicle for raising portfolio yields, prohibition of the clause exacerbates high mortgage rates to the home buyer's detriment. *HUD Study, supra* at 1055; OER, *supra* at 6.

Thus the decision of whether or not to permit the savings and loan associations' use of the clause to raise mortgage interest rates is a complex one. Either alternative could have a substantial adverse impact on sellers and on lenders.

10. See, e.g., *First Fed. Sav. & Loan Ass'n v. Peterson*, 516 F. Supp. 732 (N.D. Fla. 1981); *Bailey v. First Fed. Sav. & Loan Ass'n* 467 F. Supp. 1139 (C.D. Ill. 1979); *De la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n*, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981), *rev'd*, 50 U.S.L.W. 4916 (June 28, 1982) (No. 81-750).

Specifically, the federal associations allege that Federal Home Loan Bank Board (FHLBB) regulations, which permit federal association use of the clause to raise interest rates, (see note 70 *infra*) preempt state laws governing the federal associations' activities in this area.

11. Cases in which federal courts have ruled that FHLBB regulations preempt state law with respect to the federal associations' exercise of the clause include: *First Fed. Sav. & Loan Ass'n v. Peterson*, 516 F. Supp. 732, 737 (N.D. Fla. 1981); *Williams v. First Fed. Sav. & Loan Ass'n*, 500 F. Supp. 307, 308 (E.D. Va. 1980); *Conference of Fed. Sav. & Loan Ass'ns v. Stein*, 495 F. Supp. 12, 16-17 (E.D. Cal. 1979).

12. 308 N.W.2d 471 (Minn. 1981).

13. *Id.* at 480.

14. *Id.* at 473. Holiday is a partnership formed for investment purposes. Midwest is a federally chartered savings and loan association. *Id.*

15. *Id.* at 474. Midwest's due-on-sale clause provided as follows:

In the event that the mortgagors convey the title, (legal, equitable or both) to all or any portion of said premises or in the event that such title becomes vested in a person other than the mortgagors in any manner whatsoever except under the power of eminent domain, that in any such case the entire unpaid principal of the note secured hereby with all accrued interest thereon shall, at the option of the mortgagee at any time thereafter, become immediately due and payable without notice.

Id.

16. *Id.*

interest rate.¹⁷ The buyer terminated the purchase agreement and Holiday sought a declaratory judgment that Midwest's use of the clause was an illegal restraint on alienation.¹⁸ Midwest alleged that, as a federally chartered savings and loan association, federal law exclusively governed its exercise of the clause.¹⁹ The Minnesota Supreme Court rejected this argument, finding no congressional intent in the relevant federal statutes²⁰ and regulations²¹ to preempt state law.²²

The doctrine of preemption, deriving from the supremacy clause,²³ allows Congress to preempt state law that conflicts with a valid exercise of federal power.²⁴ Federal preemption may be explicit in the

17. *Id.* In addition, Midwest would require that the loan be callable after ten years. *Id.*

18. *Id.* at 473. On remand from a previous Minnesota Supreme Court ruling (see *Holiday Acres v. Midwest*, 271 N.W.2d 445 (Minn. 1978)), the Dakota County District Court agreed with Holiday and permanently restrained Midwest from exercising any rights under the clause. *Id.* For a discussion of due-on-sale clauses as restraints on alienation, see Bonanno, *supra* note 1, at 273-91; Volkmer, *supra* note 1, at 769-804; Bartke, *supra* note 3, at 984-1009; Note, *Due-on-Sale Clauses and Restraints on Alienation: Does Wellenkamp Apply to Federal Institutions?*, 11 PAC. L.J. 1085, 1085-96 (1980); Comment, *Due-On-Sale Clause Not a Restraint On Alienation of Property*, 59 WASH. U.L.Q. 1047 (1981).

19. 308 N.W.2d at 474.

20. The relevant federal statutes include Federal Home Loan Bank Act, Ch. 522, 47 Stat. 725 (1932), *codified at* 12 U.S.C. §§ 1421-1449 (1976 & Supp. III 1979); Home Owners' Loan Act of 1933, 48 Stat. 128 (1933), *codified at* 12 U.S.C. §§ 1461-1470 (1976 & Supp. III 1979).

21. The relevant federal regulations include 12 C.F.R. § 545.6-11(f) and (g), *recodified at* 12 C.F.R. § 545.8-3(f) and (g) (1980).

22. 308 N.W.2d at 479-80. The court found that federal law did not preempt state regulation of due-on-sale clauses used by federal savings and loan associations. Nevertheless, it overturned the lower court's decision in favor of Holiday. The Minnesota Supreme Court found that, since Holiday was an investor in residential property rather than a homeowner, the economic exigencies of the transaction did not amount to an unreasonable restraint on alienation. *Id.* at 484. For further information on due-on-sale clauses as restraints on alienation, see note 18 *supra*.

23. U.S. CONST. art. VI, § 1, cl. 2.

24. See *Ray v. Atlantic Richfield Co.*, 435 U.S. 151 (1978) (Federal Waterways Safety Act preempts Washington statute regulating oil tankers); *Jones v. Rath Packing Co.*, 430 U.S. 519 (1977) (federal statute preempts California law regarding package labeling for meat and flour); *City of Burbank v. Lockheed Air Terminal, Inc.*, 411 U.S. 624 (1973) (FAA has full control over aircraft noise under Noise Control Act and therefore preempts state control); *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132 (1963) (state statutes regarding permissible percentage of oil in avocados do not conflict with Federal laws certifying avocados as mature); *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218 (1947) (Federal Warehouse Act preempts state licensing

statute's language or implicit in a statutory purpose or design.²⁵ In finding an implicit intent to preempt, courts look for a federal interest so strong as to require national uniformity,²⁶ or a statutory scheme so pervasive that it wholly occupies a field of legislation.²⁷ If, as part of a statutory scheme, Congress delegates authority to an agency to act alone in a field, administrative regulations as well as statutes may preempt state law.²⁸ Even if Congress has not entirely foreclosed legislation in a particular area, state law that conflicts with federal law is void.²⁹ Conflict may mean that compliance with both federal and state law is physically impossible or that state law prevents realization of a federal law's purpose.³⁰

Congress, in the Home Owner's Loan Act of 1933 (HOLA),³¹ delegated the authority to create and regulate federal savings and loan associations to the Federal Home Loan Bank Board (the Board).³² HOLA, which amended the Federal Home Loan Bank Act of 1932³³ (the FHLBA), was part of a congressional plan to maintain the availability of funds for home mortgages and to control the national economy.³⁴ Responding to the depression crisis in home financing,

of those warehouses licensed under the Act and of other matters regulated by the Act).

25. *Ray v. Atlantic Richfield Co.*, 435 U.S. at 157; *Jones v. Rath Packing*, 430 U.S. at 525; *City of Burbank v. Lockheed Air Terminal*, 411 U.S. at 633.

26. *Florida Lime and Avocado Growers, Inc. v. Paul*, 373 U.S. at 143-44.

27. *Ray v. Atlantic Richfield*, 435 U.S. at 157; *Rice v. Santa Fe Elevator Corp.*, 331 U.S. at 230.

28. *United States v. Shimer*, 367 U.S. 374, 381-82 (1961). *See also*, *Fidelity Fed. Sav. & Loans Ass'n v. De la Cuesta*, 50 U.S.L.W. 4916, 4919 (June 28, 1982) (No. 81-750).

29. *Glendale Fed. Sav. & Loan Ass'n v. Fox*, 459 F. Supp. 903, 907 (C.D. Cal. 1978).

30. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. at 142-43.

31. Ch. 64, 48 Stat. 128 (1933) (current version at 12 U.S.C. §§ 1461-1470) (1976 & Supp. IV 1980).

32. 12 U.S.C. § 1464(a) (1976 & Supp. IV 1980).

33. 12 U.S.C. §§ 1421-1449 (1976 & Supp. IV 1980) *as amended* by HOLA of 1933, ch. 64, 48 Stat. 128 (1933), *codified* at 12 U.S.C. §§ 1461-1470 (1976 & Supp. IV 1980).

34. *See* Brief for Amicus Federal Home Loan Bank Board at 12, note 9, *Holiday Acres v. Midwest Fed. Sav. & Loan Ass'n*, 308 N.W.2d 471 (Minn. 1981) [hereinafter cited as Brief for Amicus].

On April 13, 1933 President Franklin D. Roosevelt sent a letter to Congress on the objectives of S. 1317 and H.R. 4980, the legislation that subsequently became known as HOLA. The letter stated in part: "Implicit in the legislation . . . is a declaration of

Congress purported to create a national system of financial intermediaries and to promote sound, uniform lending practices through HOLA.³⁵ Congress did not expressly articulate the extent to

national policy. This policy is that the broad interest of the Nation requires that special safeguards should be thrown around home ownership as a guaranty of social and economic stability." H.R. Doc. No. 19, 73rd Cong., 1st Sess. 1618, 1702 (1933). *Id.*

35. See *Glendale Fed. Sav. & Loan Ass'n v. Fox*, 459 F. Supp. 903, 908 n.9 (C.D. Cal. 1978), citing FEDERAL HOME LOAN BANK BOARD, THE FEDERAL HOME LOAN BANK SYSTEM 17 (1971) and MARVELL, THE FEDERAL HOME LOAN BANK BOARD 18-19 (1969).

The schemes of HOLA and the FHLBA reflect this congressional purpose. The FHLBA created an independent federal agency, the Federal Home Loan Bank Board (the Board) and directed it to set up twelve Home Loan Banks. 12 U.S.C. § 1423 (1976). These banks were to facilitate the flow of funds to the mortgage market by providing a secondary line of financial intermediation for member lending institutions such as state mortgage lenders. Brief for Amicus, *supra*; 459 F. Supp. at 908.

But the FHLBA proved an ineffective remedy to the crisis in home financing. Although general economic conditions were partially responsible for the crisis, the lending practices of state financial institutions contributed significantly to the problem.

These practices included the broad scale use of "sinking fund" loans. Under the terms of these loans, principal payments first were accumulated in a compulsory savings account until the balance, together with any dividends that had been credited to the account, equalled the amount of the loan, at which time the loan was paid off. Among the disadvantages of this plan were that the loan took longer to mature than expected if dividend rates were reduced, share values could be written down in case of reorganization, and entire share accounts could be sacrificed in case of liquidation, including those required of borrowers. The borrower, however, still owed the full amount of the mortgage.

STANFORD RESEARCH INSTITUTE, THE SAVINGS AND LOAN INDUSTRY IN CALIFORNIA, Section III-37 (1960), *quoted in* Brief for Amicus, *supra* note 34, at 13; 459 F. Supp. at 908. Financial institutions also frequently used loans that called for balloon payments. This provided for the rollover of principal at specified intervals. Brief for Amicus *supra* note 34, at 14.

One reason that the Bank Act failed to deal adequately with the emergency was that it made no attempt to reform the existing state-run home-financing system. *Id.* Therefore, a year after passage of the FHLBA, Congress refined the scheme by enacting HOLA. As part of its plan to suppress the unsound practices of the local institutions, and to replace them with uniform federal standards, HOLA provided for the creation of federally chartered savings & loan associations which would be subject to uniform regulation by the Board.

In creating that system, Congress could have elected to subject the operations of federal associations to state law. Had Congress done so, however, it would have perpetuated in the federal system precisely the pernicious state practices that the HOLA was designed to eliminate. This would have been anathema to a Congress so acutely cognizant of the failings of the existing state operated home-financing system.

Id. at 15.

A second part of HOLA's scheme to suppress unsound local practices and replace

which HOLA and the Board's regulations were to preclude concomitant state control over the federal associations.³⁶ The Act contemplates some state regulation; for instance, it provides that state laws regarding discrimination, consumer protection and taxation apply to the federal associations.³⁷ Beyond HOLA's express delegation of certain matters to state control, the Act's language grants the Board plenary power to regulate the federal associations.³⁸

Although courts acknowledge the plenary nature of the Board's regulation of federal associations,³⁹ they disagree on whether HOLA's scheme occupies the entire field.⁴⁰ Courts uniformly find

them with uniform federal standards was the creation of the Home Owners Loan Corporation. This agency was authorized to exchange its bonds for mortgages held by various financial institutions, including savings and loan associations. *Id.* The only mortgages eligible for exchange were those that required direct monthly payments in equal installments. Loans that called for balloon payments and for repayment by sinking fund were ineligible. *Id.*

36. See 12 U.S.C. §§ 1464-1470 (1976 & Supp. IV 1980).

37. 12 U.S.C. § 1464(a)(1)(h)(1) (1976 & Supp. IV 1980).

38. 12 U.S.C. § 1464(a)(1) (Supp. IV 1980). The statute states:

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", and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.

Id.

39. See, e.g., *Community Fed. Sav. & Loan Ass'n. v. Fields*, 128 F.2d 705, 707 (8th Cir. 1942) (Board's regulations regarding branch offices are binding on a federal association and have the force of law so therefore preempt state law); *Federal Home Loan Bank Board v. Superior Court of State of Arizona*, 494 F. Supp. 924, 925 (D. Ariz. 1980) (Board's regulation prohibiting disclosure of reports of examinations of the federal associations had the force and effect of law); *California v. Coast Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311, 316 (S.D. Cal. 1951) (Board's regulations regarding advertising by federal associations have the force and effect of law and thereby preempt state control); *Woodward v. Broadway Fed. Sav. & Loan Ass'n*, 111 Cal. App. 2d 218, 244 P.2d 467 (1952) (Nominees for director of federal associations challenging manner in which election was conducted must exhaust administrative remedies provided in the Board's regulations which have force and effect of law).

40. Compare *Lyons v. Federal Home Loan Bank Board*, 377 F. Supp. 11, 17 (N.D. Ill. 1974), *California v. Coast Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311, 318-19 (S.D. Cal. 1951) holding HOLA's scheme occupies the entire field, with *Murphy v. Colonial Fed. Sav. & Loan Ass'n*, 388 F.2d 609, 612 (2d Cir. 1967); *Federal Sav. & Loan Insurance Corp. v. Kearney Trust*, 151 F.2d 720, 725 (8th Cir. 1945); *Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n*, 405 F. Supp. 819, 823; (W.D. Pa. 1975); *City Fed. Sav. & Loan Ass'n v. Crowley*, 393 F. Supp. 644, 656 (E.D. Wis. 1975)

express preemption of those federal association activities governed by HOLA provisions⁴¹ and by Board regulations.⁴² In addition, courts agree that, even in the absence of express provisions or regulations, HOLA's scheme occupies the entire field of the federal associations internal affairs and thus preempts state control of these affairs.⁴³

holding HOLA's scheme occupies the field of the federal association's internal matters.

41. *See, e.g., United States v. State Tax Comm'n*, 481 F.2d 963 (1st Cir. 1973) (state statutes which allowed no tax deduction for loans made on real estate outside a 50 mile radius amount to a "greater tax on federal associations," prohibited by HOLA; thus state statute preempted); *First Fed. Sav. & Loan Ass'n. of Altadena v. Johnson*, 49 Cal. App. 2d 465, 122 P.2d 84 (1942) (Federal saving and loan association subject to state tax as long as the tax is not greater than that levied on similar state institutions).

42. *See First Fed. Sav. & Loan Ass'n, Boston v. Greenwald*, 591 F.2d 417 (1st Cir., 1979) (Board's regulations concerning escrow accounts preempt state law); *Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n*, 499 F.2d 1145 (9th Cir. 1974) (Board's regulations concerning prepayment clauses preempt state law); *North Arlington National Bank v. Kearney*, 187 F.2d 564, 565 (3rd Cir. 1951) (Board's regulations concerning branch offices preempt state law); *Washington Fed. Sav. & Loan Ass'n v. Balaban*, 281 So. 2d 15 (Fla. 1973) (Board's regulations concerning branch offices preempt state law).

43. *Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n*, 405 F. Supp. 819, 823 (W.D. Pa. 1975).

By virtue of the plenary powers vested in the Board by the HOLA, the courts have consistently recognized the congressional intent to have federal law govern the regulation and supervision of federal associations. [Citations omitted.] The cases are legion which hold that this preemptive delegation of authority to the Board extends to the internal operation of these institutions, precluding any regulation or interference by the state [Citations omitted] . . . [T]o the extent that there may be gaps in the Board's consideration of these matters it is necessary for the courts to fashion and apply federal common law.

Id. at 823, 824; *see also* Comment, *The Due-on Clause: A Preemption Controversy*, 10 LOYOLA L.A. L. REV., 629, 635-36 (1977).

For example, courts hold that fiduciary duties, *see, e.g., Fed. Sav. & Loan Insurance Corp. v. Third National Bank of Nashville*, 153 F.2d 678 (6th Cir. 1945); *Rettig v. Arlington Heights Sav. & Loan Ass'n*, 405 F. Supp. 819 (W.D. Pa. 1975); *City Fed. Sav. & Loan Ass'n v. Crowley*, 393 F. Supp. 644 (E.D. Wis. 1975); rights of shareholders, *see, e.g., Murphy v. Colonial Fed. Sav. & Loan Ass'n*, 388 F.2d 609 (2d Cir. 1967); *Beverly Hills Fed. Sav. & Loan Ass'n. v. Federal Home Loan Bank Board*, 371 F. Supp. 306 (C.D. Cal. 1973); and advertising practices, *see, e.g., People of State of California v. Coast Fed. Sav. & Loan Ass'n*, 98 F. Supp. 311 (S.D. Cal. 1951) are internal affairs and are thereby preempted, despite the absence of federal regulation. By comparison, courts look to express regulations to decide issues of interest paid on escrow accounts, *see, e.g., First Fed. Sav. & Loan Ass'n of Boston v. Greenwald*, 591 F.2d 417 (1st Cir. 1979), and branch offices, *see, e.g., North Arlington National Bank v. Kearney*, 187 F.2d 564 (3rd Cir. 1951); *Washington Fed. Sav. & Loan Ass'n v. Balaban*, 281 So. 2d 15 (Fla. 1973). These decisions imply that the scope of federal

Does federal preemption extend to due-on-sale clauses included in the associations' mortgage contracts? Neither HOLA nor the FHLBA expressly mention due-on-sale clauses. The Board, on the other hand, has consistently maintained that federal law exclusively governs the federal associations' use of the clause.⁴⁴ In *Schott v. Mission Federal Savings and Loan Association*,⁴⁵ plaintiffs attacked the due-on-sale clause in the federal association's mortgage. At the request of the *Schott* court, the Board filed a formal advisory opinion⁴⁶

preemption extends to matters expressly preempted by statutes and regulations, and to the associations' internal matters implicitly preempted by HOLA's scheme. Under this view, state control extends to the federal associations' "external" affairs not governed by regulations, as well as matters expressly delegated to state control by HOLA. See Comment, *The Due-On Clause: A Preemption Controversy*, *supra* at 636.

Two courts have used this framework to determine if state law controls clauses in the federal associations' mortgage contracts. These courts have held that federal law preempts clauses closely analogous to due-on-sale clauses. In *Kaski v. First Fed. Sav. & Loan Ass'n of Madison*, 72 Wis.2d 132, 240 N.W.2d 367 (1976), the Wisconsin Supreme Court ruled that an interest rate escalation clause in a federal association's mortgage contract was an internal matter. The clause read as follows:

The rate of interest stipulated herein may be increased at the option of the Association; provided, however, that the Association may not exercise such right in less than three years from the date of the loan, and then only upon at least four months' written notice to the borrower. . . .

Id. at 133 n.1, 240 N.W.2d at 369 n.1. The court also noted:

The general tenor of these cases is that any regulatory power which a state attempts to exercise that potentially conflicts with federal legislation or its purpose, or that results in lack of uniformity in the internal management or lending practices of federal savings and loan associations, is subordinate to federal law. The regulation of loan practices directly affects the internal management and operations of federal associations and therefore requires uniform federal control.

Id. at 141-42, 240 N.W.2d at 373.

Despite the absence of a regulation on point, the court held that the Board's regulation of federal associations' lending practices demonstrated a congressional intent to occupy the field. *Id.* at 140; 240 N.W.2d at 372.

In the second case, *Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n*, 499 F.2d 1145 (9th Cir. 1974), the Ninth Circuit considered a federal regulation directly on point as evidence of federal preemption in the area of prepayment clauses in the association's mortgage contracts.

44. *Schott* Opinion, *supra* note 9, at 14-15 & n.4.

45. Case No. Civ 75-366 (C.D. Cal. 1975).

46. *Id.* at 38.

The Board described the legal weight courts should accord its advisory opinions as follows:

Where a Board regulation, such as 12 C.F.R. 545.6-11, grants a right or imposes a duty in "general" terms respecting Federal associations or their members, any issue concerning such rights or duties must be resolved exclusively under Federal law. . . . Therefore, to the extent that there may be gaps in the general

on the preemption question.⁴⁷ The opinion asserted that even in the absence of express regulations, HOLA's delegation of plenary authority to the Board implied congressional intent to preempt state control of the federal associations' internal affairs.⁴⁸ Furthermore,

subject matter encompassed by the Board's regulations, they must be "fleshed out" by Federal law in one of two ways. The Board may close the "gap" by the promulgation of additional regulations, the adoption of Board Rulings or Policy Statements, or by the issuance of interpretive opinions, such as this Advisory Opinion. Alternatively, to the extent that the Board does not take such specific formal action, it will be necessary for the courts to resolve the matter by applying or fashioning Federal common law.

When "fashioning" Federal common law, the Court should give considerable weight to the Board's interpretation of its own regulations. *See, e.g.*, *Bowles v. Seminole Rock & Sand Co.*, 325 U.S. 410, 413-414; *Udall v. Tallman*, 380 U.S. 1, 16-17 (1965).

Id. at 15.

Udall v. Tallman holds that courts should give great weight to an administrative agency's interpretation of its regulation unless the interpretation is inconsistent with the statute's plain language or contrary to public policy. *Id.* 16-17.

47. *Id.* at 1. In the *Schott* Opinion, *supra* note 9, the Board concluded:

1. Federal law exclusively governs the validity of "due-on sale" clauses in the loan instruments of the Federal savings and loan associations.
2. "Due-on-sale" clauses are fully permissible under 12 CFR 545.6-11 (1975), the Board regulation governing the terms of the loan documents used by Federal associations.
3. There are valid and compelling economic and marketing considerations underlying the use and exercise of "due-on-sale" clauses.
4. The "due-on-sale" clause is vital and necessary to enable savings and loan associations to adjust their loan portfolios toward current market rates, thereby protecting the associations' financial stability and enabling them to make new home loans at lower interest rates than otherwise would be necessary to maintain an adequate yield on their mortgage portfolios.
5. The "due-on-sale" clause enables savings and loan associations to sell their existing home loans to the secondary market in an orderly manner, thereby generating new funds for additional residential loans, which otherwise would be unavailable.
6. Elimination of the "due-on-sale" clause is likely to cause higher interest rates on home loans generally, and a reduction of home loan funds.
7. Elimination of the "due-on-sale" clause will benefit only a limited number of home sellers, but will cause economic hardship to the majority of home buyers and potential home buyers. . . .

Schott Opinion, *supra* note 9, at 38-39.

48. *Id.* at 7-18. The Board defines the scope of its power to regulate and control the federal associations as extending to:

. . . the affairs, business, business powers and authority, internal and external expansion, supervisory matters, internal operations and affairs, relationships between the association, its management and its members, and all similar and related matters respecting Federal associations. The Board does not seek to regulate wholly unrelated matters of purely local concern, such as zoning for

the Board construed a regulation⁴⁹ as authorizing the federal associations to use the clause to raise interest rates.⁵⁰ Based on studies by its economists,⁵¹ the Board concluded that exercise of the clause for this purpose was necessary for the federal associations' economic protection.⁵² The Board reasoned that invalidation of the clause could threaten the economic well-being of the associations. Thus, the clause would subvert HOLA's purpose to promote the availability of home mortgage money through uniform regulation.⁵³

Some states refused to follow the advisory opinion to uphold the federal associations' use of due-on-sale clauses to increase interest rates, however.⁵⁴ The Board, in light of this refusal, promulgated a due-on-sale regulation expressly allowing use of the clause for this purpose.⁵⁵ The regulation applied only to loans executed after July

Federal association property, methods for recording title, etc., which are left by the Board to State and local authorities, since they do not impinge upon the regulatory areas under Board control, or interfere with the Board's overall regulatory scheme.

Id. at 17.

49. 12 C.F.R. § 545.6-11(a) (1975). The provision reads as follows:

Required and authorized provisions. Each loan shall be evidenced by note, bond, or other instrument . . . as in keeping with sound lending practices. The loan contract shall provide for full protection to the Federal association in accordance with applicable provisions of law, applicable governmental rules and regulations.

Id.

50. *Schott* Opinion, *supra* note 9, at 15. In the *Schott* Advisory Opinion, the Board interpreted this regulation's "full protection" language as authorizing the use of the clause to raise interest rates for the federal associations' economic protection.

Id.

51. *Id.* at 2. *See id.* at 19-34. The economists' opinion was stated in *Opinion of the Office of Economic Research on the Revocation of the "Due on Sale Clause" in the State of California*, Exhibit 1, *Schott* Opinion, *supra* note 9. After examining its economists' opinion, the Board concluded that due-on-sale clauses were necessary to protect the federal associations' financial stability and to keep mortgage rates low. *Id.* at 21-28. It also concluded that the due-on-sale clauses necessarily enabled the federal associations to remain competitive in the secondary mortgage market. *Id.* *See* HENNING, *supra* note 9, at 356-61 for a description of the secondary mortgage market.

52. *Schott* Opinion, *supra* note 9, at 38. *See id.* at 21-34. For more information on the economic protection rationales, *see* notes 9 and 50 *supra*.

53. *Schott* Opinion, *supra* note 9, at 17-19.

54. *See, e.g., Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

55. 12 C.F.R. § 545.6-11(f) and (g), *recodified* at 12 C.F.R. § 545.8-3(f) and (g), (1981).

31, 1976.⁵⁶ In the preamble to the regulation, the Board issued a policy statement⁵⁷ declaring that federal law preempted the associations' exercise of the clause.⁵⁸

The regulation provides as follows:

(f) *Due-on-sale clauses.*

An 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 provided in paragraph (g) of this section with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by an 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 that contract.

(g) *Limitations on the exercise of due-on-sale clauses.*

(1) With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association: (1) shall not exercise a due-on-sale clause because of:

- (a) Creation of a lien or other encumbrance subordinate to the association's security instrument;
- (b) Creation of a purchase money security interest for household appliances;
- (c) Transfer by devise, descent, or by operation of law upon the death of a joint tenant;
- (d) Granting of a leasehold interest of three years or less not containing an option to purchase;

(2) Shall not impose a prepayment charge or equivalent fee for acceleration of the loan by exercise of a due-on-sales clause; and (3) waives its option to exercise a due-on-sale clause as to a specific transfer if, before the transfer, the association and the person to whom the property is to be sold or transferred (the existing borrower's successor in interest) agree in writing that the person's credit is satisfactory to the association *and that the interest on sums secured by the association's security interest will be payable at a rate the association shall request.* Upon such agreement and resultant waiver the association shall release the existing borrower from all obligations under the instruments, and the association is deemed to have made a new loan to the existing borrower's successor in interest.

Id. [Emphasis supplied.]

56. *Id.* at § 545.6-11(f) *recodified at* § 545.8-3(f) (1981).

57. Board Resolution No. 76-296, 41 Fed. Reg. 18,286-87 (1976).

58. *Id.* The preamble reads in part:

Finally, it was and is the Board's intent to have late charges and due-on-sale practices of Federal associations governed exclusively by Federal law. Therefore, charging of late charges and exercise of due-on-sale clauses by Federal associations shall be governed and controlled solely by section 545.6-11 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 late charges or due-on-sale requirement. . . .

Id.

A California district court upheld the Board's policy statement in *Glendale Federal Savings and Loan Association v. Fox*.⁵⁹ In *Glendale*, a state statute required that prospective mortgagees for homes in subdivisions submit blank copies of their loan instruments for the Commissioner of Real Estate's approval.⁶⁰ Upon notification that the due-on-sale clauses in its mortgage forms did not conform to California law, Glendale Federal sought a declaratory judgment that federal law exclusively governed the validity of the clause.⁶¹ The court construed HOLA's purpose and language⁶² as a congressional grant of authority to the Board, not to the states, to select and prescribe the best practices for supervising and regulating the federal associations.⁶³ The court concluded that by rejecting state limitations on the operation of due-on-sale clauses, the Board exercised precisely the discretion delegated to it by HOLA.⁶⁴ Moreover, in examining the language, history, purpose and structure of the Act, the court found that, beyond express preemption of due-on-sale clauses, HOLA's scheme preempted virtually the entire field of control over the federal associations.⁶⁵

The *Glendale* court expressly declined to discuss the validity of the federal associations' due-on-sale clauses in loan contracts executed

59. 459 F. Supp. 903 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir, Sept. 23, 1981) (subsequent to the district court's ruling, California's Commissioner of Real Estate and Secretary of Transportation changed their policy and decided to issue public reports (*see note 60 infra*) even when lending documents contain due-on-sale clauses. On appeal the 9th Circuit reversed the district court's ruling on jurisdictional grounds, *petition for cert. filed*, 50 U.S.L.W. 3518 (U.S. Dec. 21, 1981) (No. 81-1192)).

60. *Id.* at 906. A California statute required that the Commissioner of Real Estate examine any proposed subdivision and (unless grounds for denial existed), issue to the subdivider a public report authorizing sale or lease of the lots within the subdivision. The Real Estate Department was also required to examine sample notes and mortgages of lenders providing the loans to the ultimate homeowners in the subdivision. Glendale Federal was such a lender for a proposed development and submitted its forms in compliance with the law. Subsequent to the required examination, Glendale was told that its due-on-sale clauses did not conform to California law and that Glendale could not serve as lender. *Id.* at 905-06.

61. *Id.* at 906.

62. 459 F. Supp. at 908-10.

63. *Id.* at 910.

64. *Id.* at 912.

65. *Id.* at 910.

prior to the Board's 1976 regulation.⁶⁶ Another federal court, however, subsequently ruled on the issue. In *Conference of Federal Savings and Loan Associations v. Stein*,⁶⁷ twenty federal associations in California sought a declaratory judgment that federal law preempted state control over the validity of their due-on-sale clauses.⁶⁸ The court upheld the Board's advisory opinion in the *Schott* case⁶⁹ authorizing the federal associations to use due-on-sale clauses for their economic protection.⁷⁰ The court reasoned that under the *Schott* advisory opinion, the regulation preempted state control over the federal associations' use of due-on-sale clauses in mortgages executed prior to, as well as after, the Board's 1976 regulation.⁷¹

Notwithstanding these federal court pronouncements, some state courts have ruled that state law controls the federal associations' exercise of the clause.⁷² The first state challenge to these district court rulings was *First Federal Savings and Loan Association of Englewood v. Lockwood*.⁷³ In a foreclosure action, First Federal appealed a lower court summary judgment that held the clause unenforceable under state law. First Federal contended that the Board's due-on-sale regulation preempted state law.⁷⁴ The Florida appellate court did not discuss the substantive issues of preemption. Ruling instead on a procedural issue,⁷⁵ the court implicitly assumed that federal law did not occupy the field of due-on-sale clauses, despite the existence of an express regulation on point.⁷⁶

66. *Id.* at 912, construing 12 C.F.R. § 545.6-11(f) and (g), recodified at 12 C.F.R. § 545.8-3(f) and (g) (1981).

67. 495 F. Supp. 12 (E.D. Cal. 1979).

68. *Id.* at 15.

69. *Schott v. Mission Fed. Sav. & Loans Ass'n*, Case No. Civ-75-366 (C.D. Cal. 1975).

70. 495 F. Supp. at 17.

71. *Id.*

72. See *Panko v. Pan Am. Fed. Sav. & Loan Ass'n*, 119 Cal. App. 3d, 174 Cal. Rptr. 240 (1981); *De la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n*, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981); *First Fed. Sav. & Loan Ass'n v. Lockwood*, 385 So. 2d 156 (Fla. 2d Dist. Ct. App. 1980).

73. 385 So. 2d 156 (Fla. Dist. Ct. App. 1980).

74. *Id.* at 157.

75. *Id.* at 160. It held that in the absence of enforcement procedures in the regulation, a state resident would have the option of seeking relief in state court, where the court must apply traditional equitable remedies. *Id.*

76. *Id.* at 160. Rather the court concluded that:

The true issue before us is not whether a due-on-sale clause may be authorized or

*Holiday Acres*⁷⁷ was the first state court to directly address the preemption question after *Glendale*. The Minnesota Supreme Court's approach to the preemption issue, however, was evasive. Rather than confronting and refuting evidence favoring preemption, the court ignored it or considered it superficially. Notwithstanding prior judicial determination of congressional intent to preempt⁷⁸ and the Board's statements of policy,⁷⁹ the court viewed HOLA's scheme as permitting concomitant state control over the federal association's use of due-on-sale clauses.⁸⁰ The primary theme pervading the court's argument was that mortgages and contract law are traditional areas of state concern.⁸¹ Purporting to use traditional preemption analysis,⁸² the court found that neither the statute nor the Board's regulations expressly preempted state law regarding due-on-sale clauses.⁸³ The court made no reference to the preamble of the Board's 1976 due-on-sale regulation mandating preemption.⁸⁴ Rather, the court viewed

even required in a federal association mortgage instrument, but whether the due-on-sale clause must be automatically enforced by a state court without regard to traditional principles of equity. . . . We answer the question by stating that a plaintiff who initiates a suit in equity must be subject to *all* the applicable consequences of that action and not merely those to which he chooses to submit. This is especially true in the instant case where applicable federal regulations exhibit a noticeable gap in the area of enforcement.

Id.

77. 308 N.W.2d 471 (Minn. 1981).

78. See notes 59-71 and accompanying text *supra*.

79. See notes 46-53 and accompanying text *supra*.

80. 308 N.W.2d at 477-79.

81. See, e.g., *id.* at 477 and 479.

82. The court used the test for preemption established in *Northern States Power Co. v. Minnesota*, 447 F.2d 1143, 1146-47 (8th Cir. 1971), *aff'd*, 405 U.S. 1035 (1972):

(1) Does the Federal government possess the power to regulate in a given area?

(2) If so, is compliance with federal law and state law a physical impossibility?

(3) If not, did Congress unequivocally and expressly declare that the authority conferred by it should be exclusive? (4) Even if not, has Congress impliedly preempted state control? Key factors to be considered here include the intent of Congress, the persuasiveness of the regulatory scheme, whether the nature of the subject matter "demands exclusive federal regulation in order to achieve uniformity vital to national interests," whether state law would "stand as an obstacle" to the realization of such national policy.

308 N.W.2d at 475. See notes 23-30 and accompanying text *supra*.

83. *Id.* at 476-77.

84. Board Resolution No. 76-296, 41 Fed. Reg. 18286. See note 58 *supra* for the language of the preamble.

Subsequent to *Holiday Acres*, the Board issued a new, stronger policy statement, codified at 12 C.F.R. § 556.9(f) (1981) "in order to allay the uncertainty expressed by

the regulation's language that "all rights and remedies of the association and the borrower shall be fixed and governed by that contract"⁸⁵ as requiring state property and contract law to govern the rights of parties to mortgages.⁸⁶ With respect to preemption prior to 1976, the court narrowly construed the regulation providing "full protection to the association,"⁸⁷ limiting it only to the factors listed in the regulation.⁸⁸ The court neither considered the Board's advisory opinion in *Schott*⁸⁹ nor discussed the *Conference* ruling⁹⁰ on due-on-sale clauses.⁹¹

The court's analysis of implied preemption was also less than enlightening. The court distinguished *Glendale*⁹² by noting that, in the instant case, Minnesota law required no approval of forms nor did it regulate other internal matters of the federal associations.⁹³ The *Holiday Acres* court failed to confront the contention that mortgage contracts were internal matters and thereby federally preempted.⁹⁴ Instead, the court held *per se* that mortgage contracts were not inter-

a few state courts regarding this matter." Federal Home Loan Bank Bd. Resolution No. 81-409, July 23, 1981. The new statement reads in part:

(1) Paragraph (f) of § 545.8-3 confirms the continuing authority of Federal associations to include due-on-sale clauses in their mortgage loan contracts and to exercise such clauses, subject only to the express limitations contained in § 545.8-3(g). Due-on-sale practices of Federal associations shall be governed exclusively by the Board's regulations, in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise (including, but not confined to, state law prohibitions against restraints on alienation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers).

12 C.F.R. § 556.9(f)(2) (1981).

85. 12 C.F.R. § 545.6-11(f) (1975) *recodified* at 12 C.F.R. § 454.8-3(f) (1981).

86. 308 N.W.2d at 477.

87. 12 C.F.R. § 545.6-11 (1975). *See* notes 49-50 *supra*.

88. 308 N.W.2d at 477.

89. *Schott* Opinion, *supra* note 9.

90. 495 F. Supp. 12 (E.D. Cal. 1979). *See* notes 67-71 and accompanying text *supra*.

91. The court instead considered the wrong *Conference* case: it distinguished a companion case, *Conference of Fed. Sav. & Loan Ass'ns. v. Stein*, 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980), which involved a California anti-redlining statute. *See* 308 N.W.2d at 478.

92. 459 F. Supp. 903 (C.D. Cal. 1978). *See* notes 59-65 and accompanying text *supra*.

93. 308 N.W.2d at 479.

94. The *Holiday Acres* court distinguished *Kaski v. First Fed. Sav. & Loan Ass'n of Madison*, 72 Wis. 2d 132, 270 N.W.2d 367 (1974) on an inapposite technicality.

nal matters.⁹⁵

Ignoring the preventative aspects of the statutory scheme, the court construed HOLA's purpose narrowly, suggesting that Congress passed HOLA only to remedy the Depression conditions.⁹⁶ The court, addressing the need for national uniformity, noted that the Board's 1976 regulation merely granted *permission* to include the clause.⁹⁷ The court reasoned that if national uniformity were an important policy, the regulation would *require* a federal association to include a clause declaring such in the loan contract.⁹⁸ In addition, the court saw no inconsistency between the 1976 regulation⁹⁹ and state control: federal permission to include the clause "does not nec-

308 N.W.2d at 480 n.9. 72 Wis. 2d 132, 136, 240 N.W.2d 367, 370 (1976). (For more detailed discussion on *Kaski*, see note 43 *supra*).

The *Holiday Acres* court noted that, in the context of exemption from state sales tax and use taxes, the Minnesota Supreme Court had previously held that federal savings and loan associations were not instrumentalities of the United States. 308 N.W.2d at 480 n.9. The court did not mention the fact that HOLA expressly grants to the states the right to levy state taxes on federal savings and loan associations. See 12 U.S.C. § 1464(h) (1976).

The *Holiday Acres* court suggested that *Kaski's* holding of federal preemption was based on the *Kaski* court's assumption that federal savings and loan associations are "instrumentalities of the United States." The *Kaski* court actually stated:

The fact that a federal savings and loan association, such as defendant in the instant case, is chartered under a comprehensive federal law and is, by law, an instrumentality of the United States raises the question of whether the law applicable to it in respects not specifically acknowledged to be within the authority of the states is preempted by the comprehensive statutory scheme enacted by Congress and by the rules of the Home Loan Bank Board pursuant to the United States Code.

95. 308 N.W.2d at 478.

96. *Id.* at 479. See note 35 and accompanying text *supra* for a discussion of HOLA's history and purpose.

97. *Id.*

98. *Id.* The Board's new policy statement speaks specifically to this issue of granting permission to include the clause.

. . . [T]he Board has determined that the due-on-sale clause normally is a valuable and often an indispensable source of protection for the financial soundness of Federal associations and for their continued ability to fund new home loan commitments. Consequently, the Board for many years has authorized due-on-sale clauses for use by Federal associations. However, because the Board desires to afford associations the flexibility to accommodate special situations and circumstances, § 545.8-3(f) of this Subchapter by its terms merely authorizes rather than compels the inclusion and exercise of due-on-sale clauses in mortgage loans.

12 C.F.R. § 556.9(f)(1) (1981).

99. See 12 C.F.R. § 454.68-3(f), (g) (1980).

essarily preclude state prohibition."¹⁰⁰

The *Holiday Acres* court's failure to present cogent arguments against the evidence favoring preemption¹⁰¹ may have hastened the result it sought to avoid. As this comment went to press, the Supreme Court decided *Fidelity Federal Savings and Loan Association v. De le Cuesta*,¹⁰² holding that the Board's due-on-sale regulation¹⁰³ preempts conflicting state restrictions on the due-on-sale practices of federal savings and loans associations.¹⁰⁴

In *Fidelity Federal*, the Court considered the validity of a California rule limiting the exercise of due-on-sale provisions to situations where the lender demonstrated that the transfer of the property impaired its security.¹⁰⁵ The Court first found that the Board, in promulgating the regulation, clearly intended to preempt conflicting state laws.¹⁰⁶ Appellees argued that the regulation did not totally displace state law,¹⁰⁷ asserting that the language of the regulation¹⁰⁸ permitted incorporating state contract law. The Court rejected the

100. 308 N.W.2d at 479.

101. The *Holiday Acres* court's analysis is not indefensible. For example, the court's analysis implied a federalism argument but did not explore it. It is certainly arguable that state citizens have the right under the Constitution to decide (through their elected representatives in the state legislature) whether lenders or homeowners should bear the cost of inflationary interest rates. See note 9 *supra*. As a complex economic question requiring the balancing of the interests of each group, a legislative body rather than an administrative one (such as the Board) might better decide the issue. One court has in fact touched upon this argument. See *De le Cuesta v. Fidelity Federal Sav. & Loans Ass'n*, 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981), *rev'd*, 50 U.S.L.W. 4916 (June 28, 1982) (No. 81-750).

102. 50 U.S.L.W. 4916 (June 28, 1982) (No. 81-750).

103. See 12 CFR § 545.8-3(f) (1982).

104. 50 U.S.L.W. at 4923-24.

105. *Id.* at 4918. The rule in question was announced by the California Supreme Court in *Wellenkamp v. Bank of America*, 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978). The California Court of Appeals relied upon *Wellenkamp* to hold that the lender could not enforce a due-on-sale provision in a loan contract specifying appellees' property which they had purchased from the original borrower, as security. *Id.* at 4918. See 121 Cal. App. 3d 328, 175 Cal. Rptr. 467 (1981).

106. 50 U.S.L.W. at 4919-20.

107. *Id.* at 4920.

108. The language relied upon by the appellees provided:

[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 that contract.

Id. at 4920, quoting CFR § 545.8-3(f) (1982).

argument, ruling that the language in question merely limited the scope of the regulation to the terms of the loan contract.¹⁰⁹

In the second part of its analysis, the Court found that the Board had acted within the authority delegated to it by Congress.¹¹⁰ Justice Blackmun ruled that Congress, in enacting HOLA, granted the Board plenary power to regulate the operations of federal savings and loans.¹¹¹ The Court read these powers broadly,¹¹² noting that "Congress plainly envisioned that federal savings and loans would be governed by what the Board—not any particular State—deemed to be the 'best practices.'" ¹¹³ In light of the Board's broad regulatory authority under HOLA, the Court deferred to its justification for the due-on-sale¹¹⁴ provision despite countervailing arguments.¹¹⁵

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109. The Court ruled that

[T]he second sentence of 545.8-3(f) simply makes clear that the regulation does not empower federal savings and loans to accelerate a loan upon transfer of the security property unless the parties to the particular loan instrument, as a matter of contract, have given the lender that right. Similarly, if the parties to a given contract agree somehow to limit the association's right to exercise a due-on-sale provision, the second sentence . . . precludes the lender from relying on the first sentence as authorizing more expansive use of the clause.

Id. at 4920.

110. *Id.* at 4921.

111. *Id.*

112. *Id.* The Court found that

The broad language of § 5(a) [of HOLA] expresses no limits on the Board's authority to regulate the lending practices of federal savings and loans. As one court put it, '[i]t would have been difficult for Congress to give the Bank Board a broader mandate.' [Citing *Glendale Federal Sav. & Loans Ass'n v. Fox*, 459 F. Supp. 903, 910 (C.D. Cal. 1978), *supplemented*, 481 F. Supp. 616 (1979), *rev'd and remanded on other grounds*, 636 F.2d 1078 (9th Cir. 1981), cert. pending, No. 81-1192.] And Congress' explicit delegation of jurisdiction over the 'operation' of these institutions must empower the Board to issue regulations governing mortgage loan instruments, for mortgages are a central part of any savings and loan's 'operation.'

Id.

113. 50 U.S.L.W. at 4921.

114. *Id.* at 4923.

115. *Id.* at 4923 n.22.

