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Due-on-Sale: Recent Developments Affecting the Future of Due-on-Sale Litigation

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NOTE

DUE-ON-SALE: RECENT DEVELOPMENTS AFFECTING THE FUTURE OF DUE-ON-SALE LITIGATION

I. INTRODUCTION

Preemption of state law by federal law originates in the supremacy clause of the United States Constitution.[1] The preemption issue usually does not involve interpreting the Constitution, but rather involves comparing two statutes.[2] In this Note the conflict arises mainly between federal regulations[3] and

1. U.S. CONST. art. VI, cl. 2. The supremacy clause provides:

> 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.

Id. In this context the word statute is used interchangeably with regulation and case law. *See infra* note 3.

2. The preemption issue arises when state statutory or case law conflicts with federal law. The conflict may be a direct contradiction of federal law by state law or an indirect circumvention of federal intention. *See* Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978).

3. Federal regulations have the same preemptive effect as federal statutes. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. 3014, 3022 (1982). The regulations involved in the due-on-sale clause issue are 12 C.F.R. § 545.8-3(f) and 12 C.F.R. § 545.8-3(g). Section 545.8-3(f) provides in part:

> *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). . . .

12 C.F.R. § 545.8-3(f) (1982) (emphasis in original).

Section 545.8-3(g) provides in part:

state case law.[4]

States, wishing to retain control of areas traditionally subject to their discretion, increasingly confront the federal preemption issue.[5] This contact results in conflicting case law and makes it difficult for the attorney to counsel his client on the status of applicable law in that jurisdiction.

This state-federal conflict recently arose in the United States Supreme Court in the area of mortgage law.[6] Federal law again prevailed. An unsettled issue, however, is whether federal law, under regulations promulgated by the Federal Home Loan Bank Board (Bank Board)[7] affecting federally chartered[8] savings and loan institutions and the recently enacted federal statute affecting state lenders, preempts state mortgage law.[9]

The purpose of this Note is to address the relationship of preemption to due-on-sale clauses, particularly the status of due-on-sale law after *Fidelity Federal Savings & Loan Association v. de la Cuesta*.[10] Principal issues involve the remedies available to the mortgagor and mortgagee and the forum in which they seek those remedies. Specifically, this Note examines the effect of state law on due-on-sale clauses; whether federal law may be applied retroactively to give a federal savings and loan institution authority to enforce a due-on-sale clause that was invalid under state law at

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> *Limitations on the exercise of due-on-sale clauses.* 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 (i) creation of a lien or other encumbrance subordinate to the association's security instrument; (ii) creation of a purchase money security interest for household appliances; (iii) transfer by devise, descent, or operation of law on the death of a joint tenant; or (iv) granting 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-sale 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 . . . agree in writing that the person's credit is satisfactory to the association and that interest on sums secured by the association's security interest will be payable at a rate the association shall request.

12 C.F.R. § 545.8-3(g) (1982) (emphasis in original).

4. State law that conflicts with the federal regulations varies from state to state. Most conflicting state law involves restraint on alienation. For a discussion of restraint on alienation, see *infra* notes 65-99 and accompanying text.

5. *See, e.g.*, Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 475 (Minn. 1981).

6. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. 3014 (1982).

7. The Federal Home Loan Bank Board was created under the Federal Home Loan Bank Act, ch. 577, § 17, 47 Stat. 736 (1933), *amended by* 12 U.S.C. § 1437 (1976). The Bank Board, formed in 1932, is an independent federal regulatory agency with authority to administer the Home Owners' Loan Act of 1933 (HOLA). 12 U.S.C. § 1464 (1976 & Supp. IV 1980).

8. Federal charters are granted pursuant to § 5(a) of HOLA. 12 U.S.C. § 1464(a) (1976 & Supp. IV 1980).

9. For a discussion of this recent legislation, see *infra* notes 167-88 and accompanying text.

10. 102 S. Ct. 3014 (1982). The due-on-sale clause preemption issue involves situations in which federal preemption is asserted in response to the affirmative defense that state law precludes enforcement of the due-on-sale clause.

the time the mortgage was executed; whether federal courts have federal jurisdiction to hear actions involving mortgage accelerations; and whether a state court may refuse to enforce due-on-sale clauses by exercising its equitable jurisdiction.

II. STATE STATUS OF DUE-ON-SALE CLAUSES

A. EVOLUTION OF DUE-ON-SALE CLAUSES

A discussion of the evolution of the due-on-sale clause[11] is essential to understanding the legal problems associated with it. The clause was designed to protect the lender's security from impairment caused by a transfer, without the lender's consent, from the original mortgagor to an unacceptable transferee.[12] The due-on-sale clause, however, developed into a means by which the lender can maximize its interest income.[13]

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11. A due-on-sale clause is an acceleration clause contained in mortgages or deeds of trust that requires the lender's consent prior to any transfer of the borrower's interest. *See* Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 480 (Minn. 1981). Under a due-on-sale clause the lender may deny consent and declare the entire mortgage balance due and payable. *Id.*

The most common due-on-sale clause is often referred to as paragraph 17, which provides:

> 17. Transfer of the Property; Assumption. If all or any part of the Property or an interest therein is sold or transferred by Borrower without Lender's prior written consent, excluding (a) the creation of a lien or encumbrance subordinate to this Mortgage, (b) the creation of a purchase money security interest for household appliances, (c) a transfer by devise, descent or by operation of law upon the death of a joint tenant or (d) the grant of any leasehold interest of three years or less not containing an option to purchase, Lender may, at Lender's option, declare all the sums secured by this Mortgage to be immediately due and payable. Lender shall have waived such option to accelerate if, prior to the sale or transfer, Lender and the person to whom the Property is to be sold or transferred reach agreement in writing that the credit of such person is satisfactory to Lender and that the interest payable on the sums secured by this Mortgage shall be at such rate as Lender shall request. If Lender has waived the option to accelerate provided in this paragraph 17, and if Borrower's successor in interest has executed a written assumption agreement accepted in writing by Lender, Lender shall release Borrower from all obligations under this Mortgage and the Note.

Weiner, *Due-on-Sale: Enforceable*, 61 MICH. B.J. 214, 226 n.11 (1982). *See also* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. at 3018 n.2 (paragraph 17 used by the parties).

Other clauses provide:

> 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.

Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d at 474. *See also* First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528, 530 n.1 (8th Cir. 1982) (transfer occurs if the mortgagor sells or conveys all or any part of his interest).

12. *See* 55 AM. JUR. 2D *Mortgages* § 371 (1971). *See generally* 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).

13. *See Holiday Acres No. 3*, 308 N.W.2d at 480-81. *See generally* Note, *The Due-on-Sale Clause: Enforcement Standards*, 60 NEB. L. REV. 594, 607-11 (1981).

Most mortgages[14] subjected to litigation in the past few years were executed in the 1970s and early 1980s. Interest rates on the earlier mortgages are considerably lower than those available in the present market.[15] Furthermore, statistics indicate that a mortgage, though written for a fixed number of years, usually turns over in about twelve years.[16] This turnover is due to such factors as geographic relocations and life style changes of the mortgagors.

Recently, the American economy has experienced an economic inflationary spiral.[17] Because a lending institution's existence is based upon the funds that it has available to lend out, this economic spiral has forced lenders to accelerate mortgages to keep their loan portfolios current.[18] To insure solvency institutions devised methods to accelerate their mortgages.[19] One mechanism is the due-on-sale clause.

Use of the due-on-sale clause to exact higher interest rates has been the proverbial "thorn in the side" for both the mortgagor and mortgagee. When a mortgage is assumed the mortgagee prefers to raise the interest rate to increase its rate of return.[20] The mortgagor, on the other hand, wants the interest rate to remain the same for two reasons. First, his property is more marketable at a rate lower than the prevailing market rate.[21] Second, the purchaser may insist on a lower purchase price if forced to pay the higher prevailing market rate of interest.[22]

When considering these competing positions, courts find

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14. The term mortgage and deed of trust are used interchangeably in this Note. For a detailed discussion of the two instruments, see Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910, 913 nn.3-4 (4th Cir. 1981). In *Williams* the court held that "while the formalities differ, for many essential intents and purposes . . . a deed of trust is equivalent to a mortgage." *Id.* at 913.

Oklahoma has statutorily subjected deeds of trust to mortgage law: "Every deed of trust on real property, intended as security, shall be subject to all statutory provisions and laws relating to mortgages." OKLA. STAT. ANN. tit. 46, § 1.1 (West 1981 & Supp. 1982).

15. *See* Breaux, *Due-on-Sale Litigation,* 30 LA. B.J. 18 (1982) (7.5% in June of 1972 and 17.5% in July 1981).

16. Dunham v. Ware Sav. Bank, 1981 Mass. Adv. Sh. 1607, ____, 423 N.E.2d 998, 1001 (1981). Figures indicate that mortgages originating in the 1910s remained outstanding on the average from 6.5 to 9.8 years. Recently that figure has changed to 12 years because economic conditions have made people less transient. *Id.* Mortgage turnover means that although the mortgage is executed for a fixed term, 25 or 30 years for example, the borrower usually pays off or transfers the mortgage to another party in a shorter period of time. *See* Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d 220, 226 (Iowa 1982).

17. *See generally* Berryhill, *The Due-on-Sale Clause: A Marriage Gone Sour — A Checklist for the Practitioner,* 16 U. RICH. L. REV. 35, 38 (1981); Crocker, *The "Due-on-Sale" Mortgage Clause as a Method of Reconciling the Competing Interests of Lender and Borrower,* 84 W. VA. L. REV. 301, 307 (1982).

18. *See generally* Case Review, 39 WASH. & LEE L. REV. 524 (1982).

19. Berryhill, *supra* note 17, at 39.

20. *See* Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. 722, ____, 433 A.2d 1312, 1315 (1981). The mortgagee asserts that it is entitled to the increase in interest based on the average life time of the loan. *See* Dunham v. Ware Sav. Bank, 1981 Mass. Adv. Sh. 1607, 423 N.E.2d 998 (1981).

21. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 818 (Tex. 1982) (Spears, J., concurring).

22. *Id.*

themselves aligned as either proconsumer or prolender.[23] Courts must decide whether the clause is legally enforceable, and if so, whether the factual situation before them allows equitable enforcement.

In analyzing the problem many courts consider not only the legal implications of their decisions, but to a significant degree also consider the economic implications.[24] If courts enforce the due-on-sale clause they burden the seller's ability to sell; if they do not enforce the clause they burden the lender's ability to make more home loans available. The due-on-sale clause, therefore, evolved from a security device that protects the lender's interest in specific property to a device that ensures the general economic security of the institution.

B. DEVELOPMENT OF STATE COMMON LAW

The motivating factor behind due-on-sale clause litigation is not consent to the transfer;[25] rather, it is the post-transfer change in interest rates. The lender refuses to consent to an assumption or transfer of the mortgage from the original borrower, now seller, to the purchaser unless the purchaser accepts a higher interest rate. Consent, therefore, is used to exact a higher rate of interest.[26]

The exact form of the due-on-sale clause, which gives the lender the right to accelerate the payment, varies with the ingenuity of the drafter.[27] Litigation has focused on a due-on-sale clause often referred to as paragraph 17 of the Federal National Mortgage Association (FNMA) and Federal Home Loan Mortgage Corporation (FHLMC) uniform mortgage instrument.[28]

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23. Berryhill, *supra* note 17, at 54 One author recently classified Minnesota as a "hybrid" jurisdiction in which principles of both "lender oriented" and "borrower oriented" jurisdiction are found. Comment, *Real Estate Financing — The Due-on-Sale Clause: Its Validity in Minnesota,* 5 HAMLINE L. REV. 71, 82 (1982).

24. *See* Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d 220, 226-28 (Iowa 1982) (discussion of the effect of rapidly rising interest rates on the profits needed to maintain solvency by Iowa asociations).

25. Sanders v. Hicks, 317 So. 2d 61 (Miss. 1975). Consent to the transfer is only one element in the clause. For a discussion of consent to transfer, see *infra* text accompanying notes 59-64.

26. *See, e.g.,* Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. 722, ____, 433 A.2d 1312, 1315 (1981) (bank's sole purpose in foreclosing is to obtain a higher rate of interest); Wisconsin Ave. Assocs., Inc. v. 2720 Wisconsin Ave. Coop. Ass'n, 441 A.2d 956 (D.C. 1982) (clause permitted both acceleration of the debt and refinancing at the current rate of interest).

27. *See, e.g., Wisconsin Ave. Assocs.,* 441 A.2d at 965 (purchaser must refinance at highest prevailing legal rate of interest); Dunham v. Ware Sav. Bank, 1981 Mass. Adv. Sh. 1607, ____, 423 N.E.2d 998, 1000 n.4 (1981) (transfer is any act that causes ownership to become vested in another); First Commercial Title, Inc. v. Holmes, 92 Nev. 363, 550 P.2d 1271 (1976) (mortgage contained sell or contract to sell language); United Virginia Nat'l Bank v. Best, 223 Va. 112, ____, 286 S.E.2d 221, 222 (mortgage provides that to protect security, borrower covenants not to assign or transfer property), *cert. denied,* 103 S. Ct. 175 (1982).

28. 102 S. Ct. at 3018 n.2. The Federal National Mortgage Association (FNMA), referred to as "Fannie Mae," the Federal Home Loan Mortgage Corporation (FHLMC), and the Government

Paragraph 17 excepts four types of property interest transfers from its operation. The excepted transfers are as follows: (1) The creation of a lien or encumbrance subordinate to the mortgage; (2) the creation of a purchase money security interest for household appliances; (3) a testamentary transfer upon the death of a joint tenant; and (4) the grant of a leasehold interest of three years or less that does not contain an option to purchase.[29]

To understand the reasoning of courts in enforcing or invalidating the due-on-sale clause, a familiarity with the elements of the clause, the application of the elements to particular factual situations, and the approaches used by courts in analyzing the clause is required. The approaches used include examining the contractual enforceability of the clause, examining the clause as a restraint on alienation, and examining the effect of equity on the due-on-sale clause. Each approach is discussed below.

1. Contractual Enforceability of the Clause

Acceleration provisions in mortgages are generally construed and the intention of the parties ascertained by the same rules applied to other contracts.[30] Parties usually are held to contract terms[31] that they enter freely and openly.[32] Furthermore, the contractual instrument is strictly construed against the drafter.[33] This is particularly true in a mortgage situation because the drafter, usually a financial institution, is dealing with a weaker party.[34]

A basic rule of construction is that a court will look to the wording of the mortgage for clarity or ambiguity.[35] Also, the

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National Mortgage Association (GNMA) are the three federally sponsored secondary mortgage market agencies. Comment, *The New Mortgages: A Functional Legal Analysis*, 10 FLA. ST. U.L. REV. 95, 99 n.19 (1982). FNMA and FHLMC usually require due-on-sale clauses in the mortgages they purchase. 102 S. Ct. at 3023 n.10. Therefore, the marketability of the mortgage in the secondary market is directly affected by the legal status of the due-on-sale clause. Savings and loan associations sell their mortgages in the secondary market to obtain funds for additional home loans. *Id. See generally* Randolph, *The FNMA/FHLMC Uniform Home Improvement Loan Note: The Secondary Market Needs the Consumer Movement*, 60 N.C.L. REV. 365 (1982).

29. Weiner, *supra* note 11, at 218 n.11.

30. Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982). *See generally* Annot., 69 A.L.R. 3D 713, 739-40 (1976) (language is considered as a whole and accorded popular usage); 55 AM. JUR. 2D *Mortgages* § 175 (1971) (primary rule is to ascertain intention of parties).

31. Equity, however, will not enforce a contract that is illegal, inequitable, oppressive, or unconscionable. 27 AM. JUR. 2D *Equity* § 138 (1966).

32. Annot., 69 A.L.R. 3D at 740. *See* Note, *supra* note 13, at 611.

33. Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d at 919. The court in *Williams* held that any ambiguity in an instrument shall be resolved against the preparer. *Id.*

34. Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. at ____, 433 A.2d at 1314-15. Realistically, the lender has the money that the borrower needs to purchase the home. Usually, the borrower is in a take it or leave it position.

35. *See* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d at 919.

language of the mortgage is considered as a whole.[36] The language is accorded its popular and usual significance with technical words given the interpretation usually accorded them in the lending business.[37]

When considering the enforceability of a due-on-sale clause, courts take note of its elements. The clause includes the following essential elements: (1) a sale or transfer, (2) by the borrower, (3) of all or any part of the property or any interest therein (4) without the lender's prior written consent.[38] if these elements are met, the lender may declare all sums secured by the mortgage due and payable.[39]

a. Sale, Transfer, or Conveyance by the Borrower

Usually, the issue relating to the first element is whether the mortgaged property has been sold, transferred, or conveyed to one other than the original borrower.[40] If the property is conveyed, the clause operates to accelerate the loan.[41] Generally, most courts consider a conveyance to mean any transfer of legal or equitable title.[42] Furthermore, a sale is not strictly interpreted to mean only a

36. Annot., 69 A.L.R. 3d at 740.

37. *Id.*

38. For an example of a due-on-sale clause, see *supra* note 11.

39. A due-on-sale clause allows the lender to accelerate the full amount due, but it is not self-executing. McJenkin v. Central Bank of Tuscaloosa, N.A., 417 So. 2d 153, 157 (Ala. 1982). *Contra* First Commerical Title, Inc. v. Holmes, 92 Nev. 363, 550 P.2d 1271 (1976). The *Holmes* court held that a due-on-sale clause is entitled to automatic enforcement. *Id.* at 1272.

40. *See* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910, 916-20 (4th Cir. 1981) (creation of a land trust and subsequent transfer of beneficial interest is a transfer for due-on-sale clause purposes); Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 87 Wash. 2d 437, 439, 553 P.2d 1090, 1091 (1976) (real estate contract is an inter vivos transfer within the meaning of the due-on-sale clause); Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works, 58 Wis. 2d 99, 105, 205 N.W.2d 762, 766 (1973) (land contract that gave the purchaser equitable title to the property is a conveyance within the meaning of the due-on-sale clause).

41. *See, e.g.*, Society for Sav. v. Bragg, 38 Conn. Supp. 8, 444 A.2d 919 (Super. Ct. 1981). Most clauses do not directly define a sale, transfer, or conveyance. By negative implication, however, the exceptions in the clause limit the definition of a sale, transfer, or conveyance.

The exceptions to paragraph 17 provide the transfer parameters. If the transaction does not fall within one of these exceptions it is a sale, transfer, or conveyance. *See* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d at 920-21; First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d 860, 864 (S.D. 1982) (Fosheim, J., concurring). *Wick* dealt with an ingeniously drafted contract for deed. The parties included in the contract a statement that it was drawn with paragraph 7, similar to FNMA-FHLMC paragraph 17, in mind and that the parties intended compliance with paragraph 7. *Id.* at 861. The due-on-sale clause in the contract allegedly created a lien or encumbrance subordinate to the mortgage. *Id.* The court, however, did not agree. *Id.* at 862. *But see* Daugharthy v. Monritt Assocs., 293 Md. App. 399, 444 A.2d 1030 (Ct. Spec. App. 1982) (a "wrap around" agreement is subject to the existing mortgage).

In another recent case a borrower's assignee claimed that the transaction gave rise to a lien or encumbrance subordinate to the mortgage. Gate Co. v. Midwest Fed. Sav. & Loan Ass'n, 324 N.W.2d 202, 206 n.3 (Minn. 1982). The court concluded that it "need not decide whether the transfer of a vendor's interest in a contract for deed may create a subordinate lien or encumbrance." *Id.* This opinion indicates that it may be possible to create a vendor's interest that is excepted from coverage by a due-on-sale clause in Minnesota.

42. Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981); Bellingham First Fed. Sav. & Loan Ass'n v. Garrison, 87 Wash. 2d 437, 553 P.2d 1090 (1976); Mutual Fed. Sav. &

present conveyance.[43]

Mortgagors have attemped to circumvent the due-on-sale clause by establishing land trusts, which they contend do not operate to accelerate the loans.[44] Other parties have tried to relabel the transaction to fit one of the exceptions in the clause. In a recent South Dakota Supreme Court case, *First Federal Savings & Loan Association v. Wick*,[45] the mortgagor Wick, sold property on a contract for deed. That contract incorporated the wording from the original mortgage, but excepted the application of the due-on-sale clause.[46] The court held that the contract for deed did not constitute a lien or encumbrance, but rather, the contract was sufficient to trigger the due-on-sale clause.[47] Another court, however, found that the sale of property "subject to" an existing mortgage did not trigger the due-on-sale clause.[48]

Some courts have reserved opinion on certain title events that may be considered conveyances for due-on-sale clause purposes.[49] Such events include inheritances;[50] transfers relating to spouses or

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Loan Ass'n v. Wisconsin Wire Works, 58 Wis. 2d 99, 205 N.W.2d 762 (1973). *See also* Century Fed. Sav. & Loan Ass'n v. Van Glahn, 144 N.J. Super. 48, 364 A.2d 558 (Super. Ct. Ch. Div. 1976) (long term contract for sale caused a "change in ownership").

The term convey or conveyance is not generally considered ambiguous. Annot., 69 A.L.R. 3D at 741. Convey may be interpreted, in the strict legal sense, to mean a transfer of legal title to land. *Id.* at 742.

43. *See* Annot., 69 A.L.R. 3D at 742.

44. For a discussion of ingeniously drafted clauses, see *supra* note 41. In Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981), the homeowner entered into a standard real estate sales contract. *Id.* at 912. The contract, subject to the mortgagee's deed of trust, transferred to the transferee the beneficial interest in a land trust. *Id.* at 916-20. The court held that a formal "conveyance" occurred, but no substantive "transfer." *Id.* at 917. The court found that the "end result," the transferee's occupying the property, was the same as a purchase of the property in the customary manner. *Id.* at 918. The court analogized that "[i]f one travels by by-roads rather than use an interstate highway, but ends up at the same destination, the journey has nonetheless taken place." *Id. See also* Case Review, *supra* note 18, at 526.

45. 322 N.W.2d 860 (S.D. 1982).

46. First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d 860, 861 (S.D. 1982).

47. *Id.* The South Dakota Supreme Court previously declared that a due-on-sale clause is enforceable and that a contract for deed is a sufficient conveyance to trigger the clause. First Fed. Sav. & Loan Ass'n v. Lovett, 318 N.W.2d 133 (S.D. 1982); First Fed. Sav. & Loan Ass'n v. Kelly, 312 N.W.2d 476 (S.D. 1981).

48. Daugharthy v. Monritt Assocs., 293 Md. App. 399, 444 A.2d 1030 (Ct. Spec. App. 1982). In *Daugharthy* the deed of trust contained a due-on-sale clause that specifically called for a change in the interest rate to the prevailing rate if the property was sold to a third party. *Id.* at ____, 444 A.2d at 1031. The borrowers sold the property to a third party under a sales agreement that was "subject to and wrap[ped] around" the existing deed of trust. *Id.* The court held that in Maryland, under a sale "subject to" any existing mortgage, the purchaser becomes personally liable only when the original obligation is assumed by the purchaser. *Id.* at ____, 444 A.2d at 1032. Therefore, under these unique facts, the court held that no assumption triggering the acceleration clause occurred. *Id.* at ____, 444 A.2d at 1034.

49. *E.g.*, Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d 220 (Iowa 1982). The Iowa Supreme Court expressed concern over certain events that might not be construed as sales or transfers under the due-on-sale clause. *Id.* at 231. *See also* Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. 722, ____, 433 A.2d 1312, 1316 (1981) (certain transfers may preclude equitable enforcement). *See generally* Bonanno, *supra* note 12, at 272 n.14 (leases, estate transfers, execution sale, or bankruptcy may trigger the due-on-sale clause). Recent congressional legislation addressed some of these transfers by excepting them from triggering the due-on-sale clause. *See infra* note 169.

50. *See, e.g.*, Egner v. Egner, 183 N.J. Super. 326, 443 A.2d 1104 (Super. Ct. Ch. Div. 1982) (transfer of title to real property by operation of law and property devaluation by devise or descent do

marriage dissolutions, by agreement or court order;[51] transfers to an inter vivos trust when the mortgagor is a beneficiary;[52] liens or encumbrances subordinate to the mortgage;[53] transfers to a trustee in bankruptcy;[54] and transfers by one co-obligor to another.[55] Concerning whose actions trigger the clause, one court held that only a conveyance by the original borrower activates the clause in the mortgage.[56]

b. All or Any Part of the Property or Any Interest Therein

Basically, this element protects the mortgagee's security

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not trigger the "due-on-transfer" clause).

51. *See* McJenkin v. Central Bank of Tuscaloosa, N.A., 417 So. 2d 153 (Ala. 1982) (mortgagor conveyed property subject to a due-on-sale clause to former wife).

52. *Cf.* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910, 913 nn.3-4 (4th Cir. 1981) (borrower created a trust in mortgaged property and sold his beneficial interest).

53. Gate Co. v. Midwest Fed. Sav. & Loan Ass'n, 324 N.W.2d 202 (Minn. 1982); First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d 860 (S.D. 1982).

54. *See* Bonanno, *supra* note 12, at 272 n.14 (execution sale or bankruptcy sale may trigger the due-on-sale clause).

55. *See* Rayford v. Louisiana Sav. Ass'n, 380 So. 2d 1232 (La. Ct. App. 1980) (comortgagor's purchase of his co-owners' two-third interest in mortgaged property and assumption of the loan does not trigger the due-on-sale clause).

56. Gate Co. v. Midwest Fed. Sav. & Loan Ass'n, 324 N.W.2d 202, 206 (Minn. 1982). The court held that because the mortgage clause contained the phrase "by the borrower," only the borrower's action would accelerate the mortgage. *Id.* In this particular case the clause was the standard FHLMC-FNMA paragraph 17. The Snyders, the original borrowers, sold the property on a contract for deed to the Timmonses, and Midwest Federal consented to the transfer. The Snyders also sold their vendor's interest in the contract for deed to Gate Company. Gate Company then sold the vendor's interest to another institution. Midwest Federal refused to consent to the last sale. The court held that paragraph 17 was applicable in this case only to an action by the original borrower, the Snyders. *Id.* at 206-07.

When the Snyders financed their purchase, they obtained a loan from Midwest Federal evidenced by a note. As security for the note they pledged the property by a mortgage. *Id.* at 204-05. Both the note and the mortgage contained due-on-sale clauses. *Id.* The mortgage contained paragraph 17 and the note, in an addendum, contained a similarly worded provision. *Id.* at 204.

The court held that the mortgage clause did not activate under these facts because Gate Company was "clearly not a borrower." *Id.* at 206. The court went on to hold, however, that the clause in the note was not limited to an action by the borrower. Therefore, the mortgagee could accelerate the loan. *Id.* at 207.

The court's analysis of the clause in the note does not consider the intention or purpose of the whole transaction. The clause probably was devised to prevent the borrower from transferring any interest in the mortgaged property without the mortgagee's consent. Obviously no other party could "become vested" without the borrower taking some action. If the Minnesota Supreme Court's analysis is extended to its logical conclusion, a court ordered property settlement upon a divorce dissolution, death, business dissolution, or any other action not by the borrower is encompassed by this decision.

The North Dakota Supreme Court recognized that a promissory note and mortgage are interrelated documents. Northwestern Fed. Sav. & Loan Ass'n v. Ternes, 315 N.W.2d 296, 302 (N.D. 1982). The court in *Ternes* presumed that the conditions of the mortgage relate to the entire transaction. *Id.* The court stated as follows:

> [T]he mortgage is given for security and a promise to pay the promissory note and the conditions set forth therein would prevail as to the security given even though the same conditions are not recited in the promissory note. Any other approach would bring about absurd results which the law does not favor.

Id. Applying this analysis the note in *Gate* would be subordinate to the clause in the mortgage. Furthermore, the note and mortgage generally are deemed parts of one transaction. 55 AM. JUR. 2D

interest from depreciating in value. The mortgagee wants to receive any proceeds from the sale or transfer of any part of the property.[57] Courts usually do not distinguish between the sale-transfer element and the property-interest element. For example, when considering whether the transfer of an equitable interest triggers the clause, courts essentially combine these two elements.[58]

c. Lender's Consent

The mortgagor, wishing to dispose of property subject to the mortgage, usually must obtain prior written consent from the mortgagee.[59] If consent is not obtained, generally the clause will be activated.[60]

The lender originally required consent to protect his security interest in the property. Due to changing economic times, however, the consent element has become a vehicle for obtaining higher interest rates.[61] Several mortgagors have challenged the consent element on the basis that withholding consent is unreasonable.[62] The courts, however, that have considered the issue have held that the contractual provision is not "inherently evil, unreasonable, or

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Mortgages § 176 (1971). If a conflict exists in the contract terms, the rules of contract construction would apply. Annot., 69 A.L.R. 3D at 739. Because the note and mortgage in *Gate* contained conflicting terms, they were ambiguous. Therefore, the note and mortgage should have been strictly construed against the drafter.

When the terms of the note and the mortgage are irreconcilable the note generally controls. 55 AM. JUR. 2D *Mortgages* § 176 (1971). In *Gate*, however, the note and the mortgage were not irreconcilable; the intent of the parties was that the mortgaged property not change hands. No mortgaged property changed hands between the two lending institutions. Rather Gate sought merely to transfer the vendor's lien to another lending institution. *Gate*, 324 N.W.2d at 206. Therefore, the distinction arrived at by the court is illogical.

57. Annot., 69 A.L.R. 3D at 743. For example, the mortgagor may impair the value of the property by giving an easement, entering a lease, or otherwise disposing of part of the secured property. *Id.* at 743 n.48.

58. *See, e.g.*, Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910, 918 (4th Cir. 1981) (mortgagor unsuccessfully argued that a conveyance or transfer concerns only full legal or equitable title); Gate Co. v. Midwest Fed. Sav. & Loan Ass'n, 324 N.W.2d 202, 207 (Minn. 1982) (sale of a vendor's interest into profit-sharing trust transfers fee title).

59. Annot., 69 A.L.R. 3D at 744. *See, e.g.*, Gate Co. v. Midwest Fed. Sav. & Loan Ass'n, 324 N.W.2d 202, 205 (Minn. 1982) (lender consented to transfer of equitable interest, but not to profit sharing trust); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 814 n.4 (Tex. 1982) (no agreement not to convey).

60. Annot., 69 A.L.R.3D at 743.

61. *See* First Fed. Sav. & Loan Ass'n v. Lockwood, 385 So. 2d 156, 159 (Fla. Dist. Ct. App. 1980).

62. Jurisdictions prohibiting the use of the due-on-sale clause solely to raise interest rates include the following: Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978); Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 252 Ark. 849, 481 S.W.2d 725 (1972); Dawn Inv. Co. v. Superior Court, 30 Cal. 3d 695, 639 P.2d 974, 180 Cal. Rptr. 332 (1982); Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978); Wisconsin Ave. Assocs. v. 2720 Wisconsin Ave. Coop. Ass'n, 441 A.2d 956 (D.C. 1982); First Fed. Sav. & Loan Ass'n v. Lockwood, 385 So. 2d 156 (Fla. Dist. Ct. App. 1980); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 250 N.W.2d 804 (1977); Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471 (Minn. 1981) (limited to noncommercial loans); Sanders v. Hicks, 317 So. 2d 61 (Miss. 1975); State *ex rel.* Bingaman v. Valley Sav. & Loan Ass'n, 97 N.M. 8, 636 P.2d 279 (1981). The basic

oppressive."[63] These courts have found that "[a] valid business purpose is served by such a requirement."[64]

2. Restraint on Alienation

Whether a due-on-sale clause is a restraint on the alienation of property is an issue usually raised in due-on-sale litigation.[65] Courts considering this issue analyze whether the clause is a direct or indirect restraint on alienation.[66] If restraint exists, courts next consider whether the restraint is reasonable.[67]

a. Indirect or Direct Restraint

When analyzing whether the due-on-sale clause is a direct restraint on alienation, courts apply the Restatement of Property section 404 definition.[68] Generally, courts find that the due-on-sale

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contention is that it is unreasonable to withhold consent until the lender gets the interest rate or assumption fee that he desires. *See* Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d at 481 (due-on-sale clause provides the lender with leverage to negotiate a higher rate of interest). Because it is a contract provision, the clause is subject to those rules of construction applicable to contracts. 55 AM. JUR. 2D *Mortgages* § 175 (1971). Parties have a right to contract as they see fit as long as the contract is not illegal or does not offend public policy. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 815 (Tex. 1982). In a contractual context, however, the mortgage is subject to equitable rules and defenses. *Id.*

63. Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d at 815.

64. *Id.* The business purpose underlying the enforcement of the contract terms is to assure that lending institutions remain solvent. *Id.* at 820 (Spears, J., concurring) (maintaining business profits).

65. For a list of cases involving restraints on alienation, see Louisiana Sav. Ass'n v. Trahan, 415 So. 2d 592, 595 (La. Ct. App. 1982).

66. *See, e.g.*, Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978) (direct restraint); Occidental Sav. & Loan Ass'n v. Venco Partnership, 206 Neb. 469, 293 N.W.2d 843 (1980) (due-on-sale clause is not a restraint on alienation).

67. *See, e.g.*, Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471 (Minn. 1981) (acceleration clause is a reasonable restraint for commercial property but not for residential property); Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 816-21 (Tex. 1982) (Spears, J., concurring) (indirect restraint but reasonable). *See generally* L. SIMES & A. SMITH, THE LAW OF FUTURE INTERESTS § 1164, at 27-30 (2d ed. 1956 & Supp. 1981) (acceleration clauses are generally enforced but authority exists to the contrary); Volkmer, *The Application of the Restraints on Alienation Doctrine to Real Property Security Interests,* 58 IOWA L. REV. 747 (1973) (acceleration clause is an unreasonable direct restraint).

68. *E.g.*, Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d at 228. Section 404 of the Restatement of Property defines a restraint on alienation as follows:

> (1) A restraint on alienation . . . is an attempt by an otherwise effective conveyance or contract to cause a later conveyance
>
> (a) to be void; or
>
> (b) to impose contractual liability on the one who makes the later conveyance when such liability results from an agreement not to convey; or
>
> (c) to terminate or subject to termination all or a part of the property interest conveyed.

RESTATEMENT OF PROPERTY § 404 (1944).

One judge criticized others for blindly adhering to the Restatement, which was written almost 40 years ago. Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d at 817 (Spears, J., concurring). Justice Spears stated that the restraint question should not be dismissed simply because the clause does not contain an "express covenant not to convey and thus does not fit squarely and neatly within section 404(1)(c) of the Restatement." *Id.*

clause does not directly cause any of the results contemplated by the Restatement.[69]

Although the clause may not directly effect alienation, some courts hold that it does so indirectly.[70] Basically their contention is that due to economic conditions, available real estate loan money may become difficult if not impossible to obtain.[71] The buyer is unable to afford the higher interest rate, and the seller is unable to reduce the purchase price to accommodate the sale.[72] Therefore, the lender, by not allowing an assumption, effectively precludes or severely restricts the transaction between the seller and the prospective buyer.[73]

A contrary argument is that instead of being a restraint, the clause actually removes restrictions on alienability.[74] Because the mortgage must be paid in full before any transfer, the clause reduces the encumbrances on the property and actually makes the property more salable.[75]

Other courts realize that the due-on-sale clause may impede the owner's ability to sell the property without restrictions.[76] These courts, however, note that every impediment is not a restraint on alienation.[77] They argue that zoning restrictions, building restrictions, public improvements, and some covenants may impede marketability.[78] Yet, these restrictions are not invalid

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69. Martin v. People's Mut. Sav. & Loan Ass'n, 319 N.W.2d at 228. *But see* Volkmer, *supra* note 67. Professor Volkmer states:

> Although written as an acceleration clause the due on sale clause directly and fundamentally burdens a mortgagor's ability to alienate as surely and directly as the classical promissory restraint. As such, the due on sale clause is truly a direct restraint insofar as the category of direct restraints can be articulated.

Id. at 774.

70. *E.g.*, Redd v. Western Sav. & Loan Co., 646 P.2d 761, 764 (Utah 1982). *See generally* L. SIMES & A. SMITH, *supra* note 67, at 5 (an indirect restraint arises when, while attempting to accomplish some purpose other than the restraint of alienability, the practical effect does restrain); Note, *supra* note 13, at 600.

71. Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 950, 582 P.2d 970, 974, 148 Cal. Rptr. 379, 383 (1978).

72. *Id.* at 949-50, 582 P.2d at 974-75, 148 Cal. Rptr. at 383-84.

73. *Id.* When interest rates or transactional costs of obtaining a loan rise to the point that few prospective purchasers can qualify and the lender is unwilling to allow the prospective purchaser to assume the outstanding mortgage, the transfer of the property is effectively prohibited. The buyer's down payment may not be adequate to discharge the seller's underlying mortgage. Furthermore, if assumption is allowed at a higher interest rate, the increase may prevent the sale. Redd v. Western Sav. & Loan Co., 646 P.2d at 763. *See also* Note, *supra* note 13, at 601 (given the current tight money situation, refusal to consent is a practical restraint on salability).

74. *Wellenkamp*, 21 Cal. 3d at 957, 582 P.2d at 979, 148 Cal. Rptr. at 388 (Clark, J., dissenting).

75. *Id.*

76. *See, e.g.*, Occidental Sav. & Loan Ass'n v. Venco Partnership, 206 Neb. 469, 293 N.W.2d 843 (1980).

77. *E.g.*, Society for Sav. v. Bragg, 38 Conn. Supp. 8, ____, 444 A.2d 919, 925 (Super. Ct. 1981).

78. *E.g.*, Occidental Sav. & Loan Ass'n v. Venco Partnership, 206 Neb. at ____, 293 N.W.2d at 846.

simply because they impede the owner's ability to maximize his sale terms.[79]

b. Reasonableness of the Restraint

Assuming that direct or indirect restraint exists, the issue is whether the restraint is reasonable.[80] Generally courts confronting this issue uphold the restraint if it is reasonably necessary to protect a justifiable or legitimate interest of the parties.[81]

Parties will not contest the proposition that insecurity is a legitimate or justifiable interest, which makes the restraint reasonable.[82] Also, most courts agree that interest rates are the crux of the issue. At this point, however, the courts diverge in their operational definition of what constitutes "justifiable or legitimate interests."[83]

In holding to the principle that the restraints must be "reasonably designed to attain or encourage accepted social or economic ends,"[84] courts that find the restraints reasonable do so on public policy grounds.[85] In *Dunham v. Ware Savings Bank*[86] the Supreme Judicial Court of Massachusetts held the restraints to be reasonable on three policy grounds. First, the clause strikes an equitable balance between the lender and the borrower.[87] Second,

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79. *Id.* In *Occidental Savings* the Supreme Court of Nebraska noted a second problem with finding a restraint. The court stated:

> [I]f the rationale for declaring a "due-on-sale" clause invalid as a restraint on alienation is based upon some notion that buyers will be less willing to buy at a premium property that does not have a long-term fixed mortgage, then one must conclude that short-term variable rates and rollover mortgages will similarly impede the sale of property and constitute indirect restraints on the free conveyance of property, and should, therefore, be held invalid.

Id. at ____, 293 N.W.2d at 848. The court's reasoning reflects the general unwillingness of courts to even consider the due-on-sale clause as an indirect restraint.

80. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 819 (Tex. 1982) (not all restraints on alienation are invalid per se; only those restraints that are unreasonable will not be enforced).

81. Redd v. Western Sav. & Loan Co., 646 P.2d at 764.

82. Protection of the lender's security interest is the historical reason for including the clause in mortgages. The clause still serves that purpose today. *See* Comment, *supra* note 23, at 73.

83. *Redd,* 646 P.2d at 764. *See* Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d 811, 820 (Tex. 1982) (Spears, J., concurring) (exacting higher interest rates to maintain profits is a legitimate business purpose for invoking the due-on-sale clause). *But see* Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 952, 582 P.2d 970, 976, 148 Cal. Rptr. 379, 385 (1978) (increasing interest rates is not a legitimate purpose of the due-on-sale clause).

84. Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d 119, ____, 333 N.E.2d 1, 4 (1975).

85. *See, e.g.,* Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d 220, 230 (Iowa 1982).

86. 1981 Mass. Adv. Sh. 1607, 423 N.E.2d 998 (1981).

87. Dunham v. Ware Sav. Bank, 1981 Mass. Adv. Sh. 1607, ____, 423 N.E.2d 998, 1002 (1981). The situation is equitable when the borrower has the right to prepay without penalty. In that situation the borrower theoretically could refinance when the interest rates fall. A due-on-sale clause allows the lender to adjust his rate when interest rates rise. Occidental Sav. & Loan Ass'n v. Venco Partnership, 206 Neb. 469, ____, 293 N.W.2d 843, 848 (1980). *See also* Sonny Arnold, Inc. v. Sentry

the clause provides state chartered institutions with the same rights granted to federally chartered institutions.[88] Third, the clause socially benefits future borrowers and depositors.[89]

The test used by courts that find the due-on-sale clause an unreasonable restraint is essentially the balancing test set out in *Wellenkamp v. Bank of America.*[90] In *Wellenkamp* the California Supreme Court held that the restraint is reasonable if the quantum of restraint imposed by the due-on-sale clause does not outweigh the justifications for enforcing it.[91]

Courts have held that portfolio maintenance alone is insufficient justification to outweigh the restraint imposed by the clause.[92] Sufficient justification in this context seems limited to either impairment of security[93] or risk of default.[94]

Whether the due-on-sale clause imposes a restraint on alienation, and if so, whether the restraint is unreasonable does not appear to be open for discussion in those jurisdictions that have considered the issue.[95] Most courts hold that whether a due-on-sale clause is a restraint on alienation is a question of law[96] and, therefore, not subject to an ad hoc consideration.[97] The rationale supporting this position is that the due-on-sale clause affords more certainty and greater predictability in land titles.[98] Courts, however, should not adopt such strict noninterpretative standards. The body best suited for these policy decisions is the legislature

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Sav. Ass'n, 633 S.W.2d at 818 (Spears, J., concurring) (restraining effect of due-on-sale clause may be more pronounced if the contract also contains a prepayment penalty).

88. 1981 Mass. Adv. Sh. at ____, 423 N.E.2d at 1002. Two states recently held that state chartered institutions may not enforce due-on-sale clauses. Gate Co. v. Midwest Fed. Sav. & Loan Ass'n, 324 N.W.2d 202, 207 n.4 (Minn. 1982); Att'y Gen. Op. No. 82-703 (Cal. Aug. 17, 1982) (available Oct. 1, 1982, on LEXIS, States library, Calag file).

89. 1981 Mass. Adv. Sh. at ____, 423 N.E.2d at 1002.

90. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

91. Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 949, 582 P.2d 970, 974, 148 Cal. Rptr. 379, 383. (1978). *See also* Case Review, *supra* note 18, at 535.

92. *E.g.,* Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d at 231.

93. Redd v. Western Sav. & Loan Co., 646 P.2d at 765 (acceleration clause protects "security from waste or depreciation").

94. *Id.* The risk of default can include "moral risks," which are defined as the risks of resorting to foreclosure on the security upon default. *Id.* Essentially, the rationale for not considering portfolio maintenance as sufficient justification is that the lenders take into account projections of future economic conditions at the time of the loan. *Wellenkamp,* 21 Cal. 3d at 952, 582 P.2d at 976, 148 Cal. Rptr. at 385. The lender's failure to correctly project the future should not place an undue burden on the borrower-owner. *Id.* at 953, 582 P.2d at 976, 148 Cal. Rptr. at 385.

95. The question of restraint, therefore, should not be a factual issue. "[W]hether a mortgage imposes a legal restraint on alienation of real estate should not be made to turn on the subjective intent of the mortgagee." Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d at 228-29. Jurisdictions following this reasoning would not allow any judicial interpretation; all due-on-sale clauses are per se either valid or invalid. *Id.*

96. Sonny Arnold, Inc. v. Sentry Sav. Ass'n, 633 S.W.2d at 820 (Spears J., concurring).

97. *Martin,* 319 N.W.2d at 229.

98. Baker v. Loves Park Sav. & Loan Ass'n, 61 Ill. 2d at ____, 333 N.E.2d at 5. Predictability of title contributes to mortgage marketability in the secondary market. Financial institutions do not want to risk their secondary market investments in unstable mortgages. *See* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. at 3023 n.10.

where all issues are fully debated.[99]

3. Equity and the Due-on-Sale Clause

Although a court may find that a contractually enforceable due-on-sale clause is not a restraint on alienation, such a finding does not make the clause per se enforceable.[100] Mortgage foreclosure is an equitable action subject to the equitable defenses of laches, estoppel, and waiver.[101] Moreover, mortgage foreclosure is also subject to unconscionable or inequitable conduct by the lender.[102]

The conduct that a court will not equitably enforce depends on the facts of each case. The burden of pleading and proving these special facts is on the party seeking relief.[103] A majority of courts hold that increasing interest rates does not constitute unconscionable conduct.[104] Courts holding to the contrary contend that upholding the due-on-sale clause is inequitable because the clause does not give specific notice of acceleration to the borrower except in instances of an uncreditworthy assignee.[105] This problem, however, is easily resolved by drafting more specific mortgage instruments.[106]

C. STATE STATUTORY LAW

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99. *See* Redd v. Western Sav. & Loan Co., 646 P.2d at 767; S.D. CODIFIED LAWS ANN. § 21-49-13 (Supp. 1982); S.D. COMP. LAWS ANN. §§ 44-8-27, -28 (Supp. 1982). *See generally,* Note, *supra* note 13, at 618 (statutory correction needed).

100. Annot., 69 A.L.R.3D at 747.

101. *See, e.g.,* First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d at 862. *See also* Berryhill, *supra* note 17, at 91 (enforcement of equitable defenses depends on the facts of each case).

102. Some courts consider raising interest rates or requiring payment of transfer fees inequitable. *See* Rayford v. Louisiana Sav. Ass'n, 380 So. 2d 1232, 1239 (La. Ct. App. 1980); Continental Fed. Sav. & Loan Ass'n v. Fetter, 564 P.2d 1013 (Okla. 1977).

103. Occidental Sav. & Loan Ass'n v. Venco Partnership, 206 Neb. at ____, 293 N.W.2d at 850. Some courts hold that the party seeking equity must show why equity should depart from the law when considering enforcement of the due-on-sale clause. *See* Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. 722, 433 A.2d 1312 (1981).

104. For a list of cases in which courts enforced due-on-sale clauses so the lender could update its loan portfolio, see Martin v. Peoples Mut. Sav. & Loan Ass'n, 319 N.W.2d at 230. The justification is that interest rate increases under the acceleration clause are valid because both parties freely entered into the mortgage. *See* Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. 722, 433 A.2d 1312 (1981). In *Mills* the court held:

> The plaintiffs also fail to address the question why a court should "depart from the law which requires it to enforce valid contracts and strike down the acceleration option simply because its exercise will let [them, rather than the bank], make the profit on the interest rate occasioned by the increased cost of money."

Id. at ____, 433 A.2d at 1315 (quoting Gunther v. White, 489 S.W.2d 529, 532 (Tenn. 1973)).

105. *See, e.g.,* Wellenkamp v. Bank of Am., 21 Cal. 3d 443, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).

106. *See* Berryhill, *supra* note 17, at 91 (adequate notice provided if the lender includes his intent to raise interest rates in the clause). *See also* Wisconsin Ave. Assocs. v. 2720 Wisconsin Ave. Coop.

Several states have adopted statutes, which to varying degrees affect mortgages, due-on-sale clauses, and the rights of the parties under these instruments. Some states statutorily allow the use of a due-on-sale clause,[107] while other states declare it an unreasonable restraint on alienation unless security is impaired.[108] Some statutes give the state lending institutions the same rights granted federally chartered institutions under federal law.[109] Other states set limitations on prepayment penalties[110] and transfer fees.[111] Finally, some states provide for alternative forms of financing.[112]

A few statutes are designed to protect consumers from inequitable practices by lenders. For example, Arizona does not allow the lender to arbitrarily withhold consent to a transfer.[113] South Carolina does not allow the lender to raise the interest rate during the term of the mortgage unless the borrower agrees. Even with the borrower's consent, the lender may only raise the rate to one percent above the original loan rate.[114] New Hampshire places mortgage foreclosures within the equitable jurisdiction of superior courts.[115] Virginia requires that the lender include in any mortgage or deed of trust containing a due-on-sale clause a notice,[116] either in capital letters or underlined, advising the borrower of the effect of

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Ass'n, 441 A.2d 956 (D.C. 1982) (clause permitted refinancing at current rate of interest).

107. LA. REV. STAT. ANN. § 6:837 (West Supp. 1982); S.D. CODIFIED LAWS ANN. § 21-49-13 (Supp. 1982); S.D. COMP. LAWS ANN. §§ 44-8-27, -28 (Supp. 1982).

108. CAL. CIV. CODE § 711 (West 1982); COLO. REV. STAT. § 38-30-165 (1982); GA. CODE ANN. § 67-3002 (Supp. 1982); IOWA CODE ANN. § 535.8(2)(c) (Supp. 1982); MINN. STAT. ANN. § 47.20 subd. 6 (Supp. 1982); N.M. STAT. ANN. § 48-7-12 (Supp. 1981); UTAH CODE ANN. ch. 57-15 (Supp. 1981).

109. MONT. CODE ANN. § 32-2-111 (1981); NEB. REV. STAT. § 8-355 (Supp. 1981); NEV. REV. STAT. § 673.225 (1981); R.I. GEN. LAWS § 19-23-3.1(b) (Supp. 1982); WASH. REV. CODE ANN. §§ 33.12.012, .014 (Supp. 1982).

110. ARIZ. REV. STAT. ANN. § 33-806.01 (1974); DEL. CODE ANN. tit. 5, § 3125 (Supp. 1980); D.C. CODE ANN. § 28-3301 (1981); IDAHO CODE § 28-22-112 (1980); KAN STAT. ANN. § 17-5512 (1981); MASS. GEN. LAWS ANN. ch. 183, § 56 (West 1977); MISS. CODE ANN. § 89-1-317 (Supp. 1981); MO. ANN. STAT. § 408.036 (Supp. 1982); NEB. REV. STAT. § 45-101.02 (1978); NEV. REV. STAT. § 673.330 (1981); N.M. STAT. ANN. § 48-7-14 (Supp. 1981); N.C. GEN. STAT. § 24-1.1A(b) (Supp. 1981); OHIO REV. CODE ANN. § 1343-01.1 (Page 1979); OR. REV. STAT. § 86-150 (Supp. 1981); PA. STAT. ANN. tit. 41, § 405 (Purdon 1982); TENN. CODE ANN. § 47-14-108 (1979); VA. CODE § 6.1-330.33 (1979); WIS. STAT. ANN. § 138.05 (West 1974 & Supp. 1981). *See also* 12 C.F.R. § 545.8(g)(2) (1982) (forbids a prepayment charge for acceleration under a due-on-sale clause).

111. GA. CODE ANN. § 67-1301.1 (Supp. 1982); KAN. STAT. ANN. § 17-5514 (1981); KAN. STAT. ANN. § 58-2335 (1976); NEV. REV. STAT. § 107.055 (1979); N.M. STAT. ANN. § 48-7-14 (Supp. 1981); VT. STAT. ANN. tit. 9, § 42 (Supp. 1982).

112. CONN. GEN. STAT. ANN. § 36-9g (West 1981); IDAHO CODE § 26-1936 (Supp. 1982); IND. CODE ANN. § 28-1-21.5-1 (Burns Supp. 1982); PA. STAT. ANN. tit. 7, § 6020-155 (Purdon 1982). For a discussion of alternative forms of financing, see DiGiovanni, *Alternate Methods of Financing the Sale and Purchase of Single Family Residences: Representing the Buyer and the Seller*, 50 J. KAN. B.A. 179 (1981); Walleser, *Balancing the Interest: The Changing Complexion of Home Mortgage Financing in America*, 31 DRAKE L. REV. 1 (1981-1982); Comment, *supra* note 28.

113. ARIZ. REV. STAT. ANN. § 33-806.01 (1974).

114. S.C. CODE ANN. § 34-31-90(2) (Supp. 1982) (if the interest rate is raised on loans of less than one hundred thousand dollars, borrower may prepay without penalty).

115. N.H. REV. STAT. ANN. § 498:1 (1968). *See* Mills v. Nashua Fed. Sav. & Loan Ass'n, 121 N.H. 722, 433 A.2d 1312 (1981) (equity court may bar foreclosure when acceleration would be unconscionable or inequitable).

116. VA. CODE § 6.1-330.34 (1979).

that clause.[117] Finally, California statutorily excludes certain transactions from the definition of a due-on-sale clause transfer.[118]

III. WHETHER SUBSEQUENTLY PROMULGATED FEDERAL REGULATIONS PREEMPT VESTED STATE RIGHTS

Recently, the United States Supreme Court addressed whether federal law preempted state law relating to due-on-sale clauses. In *Fidelity Federal Savings & Loan Association v. de la Cuesta*[119] the Supreme Court held that federal regulations authorizing due-on-sale clauses in mortgages issued by federal savings and loan associations preempted conflicting state law.[120] The specific federal regulation is codified as title 12, section 545.8-3(f) of the Code of Federal Regulations (C.F.R.), effective July 31, 1976.[121] The regulation states that a federal savings and loan association "continues" to have the power to include a due-on-sale clause in its loan instrument.[122]

The controversy in *de la Cuesta* involved purchases of properties encumbered by deeds of trust that contained due-on-sale clauses.[123] The purchasers sought to enjoin federally chartered savings and loan associations from exercising the clauses. Also, they sought to have their foreclosure rights declared by the state court. The purchasers based their action on California state law that prohibits enforcement of a due-on-sale clause unless the lender's security is impaired.[124] The association, however, contended that federal law

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117. Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981). The mortgage form used in *Williams* complied with Virginia law. The notice stated the following in capital letters and bold print: "Notice: The Debt secured hereby is subject to call in full or the terms thereof being modified in the event of sale or conveyance of the property conveyed." *Id.* at 923 (emphasis omitted).

118. CAL. CIV. CODE § 2924.6 (West 1982).

119. 102 S. Ct. 3014 (1982).

120. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. 3014, 3025 (1982).

121. 12 C.F.R. § 545.8-3(f) (1981). For the text of § 545.8-3(f), see *supra* note 3.

122. *See* 12 C.F.R. § 545.8-3(f) (1981). Section 545.8-3(f) provides in part: "An association continues to have the power to include [due-on-sale clauses]. . . ." *Id. See* First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528 (8th Cir. 1982). In *Anderson* the Eighth Circuit found that the Bank Board amended the regulation to expressly authorize due-on-sale clauses. *Id.* at 531. The court further found that the word "continues" was included in the regulation "in an apparent attempt to suggest that such clauses have always been enforceable." *Id.* Also, the court found that the Bank Board expressly stated in its preamble to the regulation that the regulation was intended to preempt state law. *Id. See also* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. at 3019 n.4 (citing a Bank Board advisory opinion authorizing the use of due-on-sale clauses).

123. 102 S. Ct. at 3020. *De la Cuesta* involved three cases consolidated at trial. *Id.*

124. *Id. See* Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978). The action in *Wellenkamp* was based on California Civil Code § 711, which provides: "Conditions restraining alienation, when repugnant to the interest created, are void." CAL. CIV. CODE § 711 (West 1982). *See also* First Fed. Sav. & Loan Ass'n v. Clark Inv. Co., 322 N.W.2d 258, 260 (S.D. 1982) (citing CAL. CIV. CODE § 711 (West 1982)). The South Dakota Supreme Court in *Clark* explained that this statute was adopted by the Dakota Territory Legislature and subsequently

preempted all conflicting state laws.[125]

The Court found that the dispositive issues were "whether the Board meant to pre-empt California's due-on-sale law, and, if so, whether that action is within the scope of the Board's delegated authority."[126] The Court answered both issues in the affirmative.

The Court concluded that the Bank Board's due-on-sale regulation was meant to preempt conflicting state limitations imposed on federally chartered savings and loan associations.[127] Furthermore, the Court concluded that California's state laws created such a conflict.[128] Finally, the Court concluded that the language and history of the Home Owners' Loan Act (HOLA) of 1933[129] shows Congress' intent to delegate to the Bank Board sufficient authority to regulate the lending practices of federal savings and loan associations.[130] Consequently, the Court determined that the due-on-sale regulation was consistent with both the Bank Board's authority and the purposes of the Act.[131]

A. FEDERAL LAW APPLICABILITY TO MORTGAGES EXECUTED BY STATE LENDERS AND SOLD TO FEDERALLY CHARTERED INSTITUTIONS

Although the Supreme Court in *de la Cuesta* decided that mortgages issued after July 31, 1976, by a federal savings and loan association were not subject to state law, it did not address whether federal regulations apply to mortgages that originate in state institutions and are subsequently sold to federally chartered institutions.[132] After *de la Cuesta,* however, a federal district court

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by South Dakota. *Id.* Section 711 is currently codified in South Dakota as S.D. CODIFIED LAWS ANN. § 43-3-5 (1967). The South Dakota court refused to follow California's interpretation of this statute in reference to due-on-sale clauses. 322 N.W.2d at 260.

North Dakota also codified the same statute. N.D. CENT. CODE § 47-02-26 (1978). The North Dakota Supreme Court recognized the similarity of the statutes. Northwestern Fed. Sav. & Loan Ass'n v. Ternes, 315 N.W.2d 296, 303-04 (N.D. 1982). The court in *Ternes,* however, concluded that California's interpretation was distinguishable on the facts because the *Ternes* plaintiff was a federally chartered savings and loan association. In this instance the court found that federal law preempted state law. *Id.* Furthermore, the *Ternes* court indicated that the due-on-sale clause did not violate the North Dakota statute. *Id.* at 304.

125. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. at 3020. The Supreme Court discussed the preemption doctrine and explained that federal regulations are given the same effect as federal statutes. *Id.* at 3022.

126. *Id.* at 3023.

127. *Id.* at 3025.

128. *Id.*

129. 12 U.S.C. §§ 1461-1470 (1976 & Supp. IV 1980).

130. 102 S. Ct. at 3025.

131. *Id.*

132. *See* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981). The court in *Williams* raised this issue but failed to resolve it because of "many uncertainties, or assumptions necessitated by absence of proof to justify that route." *Id.* at 922. One of the uncertainties was

addressed this issue.[133]

In *Bleecker Associates v. Astoria Federal Savings & Loan Association*[134] the court examined a due-on-sale clause mortgage executed in 1973 by a New York state chartered mutual savings and loan association.[135] On January 31, 1979, the savings and loan association was deemed in unsound condition by the State Superintendent of Banks. On that same day the state association was acquired by Astoria Federal through a merger supervised by the Superintendent.[136] Astoria Federal agreed to acquire all the state association's mortgages, including the one executed in 1973.[137]

Subsequently, the mortgaged property was sold without Astoria Federal's consent.[138] Astoria claimed that federal law exclusively governed the mortgage, while Bleecker contended that New York law governed.[139]

Distinguishing *de la Cuesta* factually,[140] the court applied the two-part test used by the Supreme Court in *de la Cuesta* to determine the preemption issue. The first inquiry was whether the Bank Board had authority to preempt state law when federal savings institutions acquire mortgages from state lending institutions.[141] If authority existed, the second inquiry was whether the Bank Board intended the regulations to apply in this situation.[142]

The *Bleecker Associates* court held that the Bank Board showed no intent to preempt state law.[143] The court based its decison on a letter submitted by the Bank Board to the court.[144] The letter stated that the Bank Board had never confronted this question, nor taken a formal position on it.[145] Therefore, the court concluded that

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whether the original lender enjoyed any federal status that invoked federal preemption. *Id.*

133. Bleecker Assocs. v. Astoria Fed. Sav. & Loan Ass'n, 544 F. Supp. 794 (S.D.N.Y. 1982).

134. 544 F. Supp. 794 (S.D.N.Y. 1982).

135. *Id.* at 795.

136. *Id.*

137. *Id.*

138. *Id.*

139. *Id.* at 796. The court found that if the mortgage had been issued by a federal savings and loan association, *de la Cuesta* would have been controlling and the interpretations of the mortgage would have been a matter of federal law. *Id.*

140. The distinction is that the present mortgage was initially held and executed by a state chartered institution. *Id.* Furthermore, the court found *de la Cuesta* limited to interpreting a federal regulation that " 'was meant to preempt conflicting state limitations on the due-on-sale practices of federal savings and loans. . . .' " *Id.* at 797 (citing First Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. at 3025).

141. 544 F. Supp. at 797.

142. *Id.*

143. *Id.* at 798.

144. *Id.* Because the Bank Board had not indicated any position on the matter, the court suggested that the parties ask the Bank Board to submit its position. *Id.* Mr. John Gunther, the deputy director of the Litigation Division, responded by letter to the court. *Id.* at n.16.

145. In the letter the Bank Board stated that federal law exclusively governs the enforcement of a due-on-sale clause for loans originated by a federally chartered savings and loan. *Id.*

under the facts presented, mortgage interpretation was a matter of state law.[146] The court also noted that to hold otherwise might raise constitutional issues.[147]

B. FOOTNOTE 14 — PREEMPTIVE SCOPE OF THE FEDERAL REGULATION

Before concluding that the federal regulation preempted conflicting state law, the Court in *de la Cuesta* quoted a recently codified federal regulation.[148] The regulation gives the Bank Board exclusive authority to regulate the use of due-on-sale clauses in mortgages executed by federally chartered savings and loan associations.[149] The Court, however, qualified this statement in a footnote.[150] The majority stated that because it found an actual conflict between federal and state law the Court need not decide whether the federal regulations "occupy [merely] the field of due-on-sale law or the entire field of federal savings and loan regulation."[151] Arguably, because the regulation does not expressly forbid the application of equitable principles,[152] a state court could apply those principles to invalidate a due-on-sale clause.[153]

C. FOOTNOTE 24 — DESTRUCTION OF A VESTED STATE RIGHT

The Court in *de la Cuesta* considered whether the federal regulation could destroy a vested state right. The Court held that no vested rights were destroyed in *de la Cuesta* because when the federal regulation was promulgated it did not conflict with California law.[154] The Court explained in footnote 24[155] that it need

146. *Id.* at 799.

147. *Id.* at 798-99. The court was concerned about finding preemption. If preemption applied, constitutional issues would exist concerning the impairment of vested property rights acquired under state law. *Id.*

148. Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. at 3025.

149. 12 C.F.R. § 556.9(f)(2) (1982). Section 556.9(f)(2) provides that the due-on-sale practices of federally chartered associations "shall be governed exclusively by the [Bank] Board's regulations, in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise." *Id.*

150. 102 S. Ct. at 3025 n.14.

151. *Id.*

152. *See* First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d 860, 863 (S.D. 1982) (Morgan, J., concurring). *Cf.* 102 S. Ct. at 3032 n.* (O'Connor, J., concurring). Section 556.9(f)(2) implies that even state equitable principles are preempted. The resolution of this issue is yet to come. It will probably be subjected to the same analysis as applied to the regulation in *de la Cuesta.*

153. *See* Porter v. Warner Holding Co., 328 U.S. 395, 398 (1946) (equity not limited absent clear legislative command).

154. 102 S. Ct. at 3031 n.24. Two of the deeds of trust were executed prior to July 31, 1976, the date the regulation was promulgated. *Id.* The Court noted that the regulation merely codified an existing advisory opinion by the Bank Board. *Id.* (citing 102 S. Ct. at 3019 n.4) (advisory opinion). Further, the Court explained that § 545.8-3(g) codified California state law, which at that time allowed the enforcement of due-on-sale clauses. 102 S. Ct. at 3031 n.24. Not until *Wellenkamp,* 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978), in 1978, did California law deny the acceleration of loans under due-on-sale clauses. 102 S. Ct. at 3031 n.24.

155. 102 S. Ct. at 3031 n.24.

not decide whether the federal regulation applied to mortgages executed prior to July 31, 1976, "so as to give the savings and loan broader authority to enforce a due-on-sale clause than it had when the [mortgage] was executed."[156]

Although left unresolved, this issue probably will not have much effect on future litigation. Few state courts have confronted the enforceability issue of due-on-sale clauses executed prior to July 31, 1976.[157] One Eighth Circuit case would present this issue squarely to the Court.[158]

In 1972 the Arkansas Supreme Court declared due-on-sale clauses unenforceable unless the lender's security was impaired.[159] In *First Federal Savings & Loan Association v. Anderson*[160] First Federal, a federally chartered savings and loan association, sought a declaration by the federal courts that federal law preempted Arkansas state law regarding the enforceability of due-on-sale clauses.[161]

The mortgage containing the due-on-sale clause in *Anderson* was executed in 1974 and involved property located in Arkansas.[162] In November 1980 the Andersons sold the property without prior written consent from First Federal.[163] In February 1981 First Federal filed suit in federal district court.[164] The Arkansas Supreme Court had declared due-on-sale clauses unenforceable in 1972, the mortgage was executed in 1974, and the federal regulation was not promulgated until 1976. Consequently, the parties were certain of the status of the clause when they entered the contract. Therefore, in *Anderson* the borrowers had a vested right not to have the due-on-sale clause enforced unless the lender's security interest was impaired. The Eighth Circuit, however, ruled that no federal question jurisdiction[165] existed for the claims.[166]

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156. *Id.* The Bank Board contended that 12 C.F.R. § 545. 8-3(f) effected no change in the law. *Id.*

157. In jurisdictions that have decided the issue, if the turnover statistics on mortgages are indicative of the situation, most mortgages executed prior to July 31, 1976, will be out of the market by now. *See* Dunham v. Ware Sav. Bank, 1981 Mass. Adv. Sh. 1607, ____, 423 N.E.2d 998, 1001 (1981).

158. First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528 (8th Cir. 1982).

159. Tucker v. Pulaski Fed. Sav. & Loan Ass'n, 252 Ark. 849, 481 S.W.2d 725 (1972).

160. 681 F.2d 528 (8th Cir. 1982) (two cases consolidated on appeal; *Anderson* is the Arkansas case).

161. First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528, 530 (8th Cir. 1982).

162. *Id.*

163. *Id.*

164. *Id.*

165. For a discussion of federal jurisdiction, see section IV of this Note.

166. 681 F.2d at 533-34. Based on this ruling, First Federal has two alternatives. First, because the merits of the case were not addressed, First Federal may seek to enforce its federally granted right in state court. The Eighth Circuit stated that it expressed no opinion concerning the application of *Tucker,* 252 Ark. 849, 481 S.W.2d 725 (1972), to the facts alleged in *Anderson,* 681 F.2d at 530 n.3. First Federal could argue that federal law preempts state law and that the regulation's preemptive

D. RECENT CONGRESSIONAL ACTION AFFECTING STATE REFUSAL TO ENFORCE DUE-ON-SALE CLAUSES

The Bank Board regulations in *de la Cuesta* apply only to federally chartered savings and loan associations.[167] Consequently, some states assumed that they remained free to control the enforceability of due-on-sale clauses executed by state chartered lending institutions and private lenders.[168] The United States Congress, however, recently enacted legislation, the Thrift Institutions Restructuring Act, that extends to state lenders the same right to enforce due-on-sale clauses enjoyed by the federally chartered institutions covered by the Bank Board regulations.[169]

On October 15, 1982, Congress amended the Home Owners' Loan Act of 1933 for the sole purpose of preempting state law that prohibits state lenders from exercising due-on-sale clauses.[170] This

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effect is retroactive to the date of the mortgage. *Cf.* Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. at 3031 n.24. Given *Tucker* as precedence and some recent developments, it is possible that the Arkansas courts may not find *de la Cuesta* controlling. *See* Bleecker Assocs. v. Astoria Fed. Sav. & Loan Ass'n, 544 F. Supp. 794 (S.D.N.Y. 1982); First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d 860 (S.D. 1982) (Morgan, J., concurring). A court, however, might interpret footnote 24 to mean that the federal regulations were not drafted with the intent to preempt vested state property rights. If the state court result was not favorable to First Federal, it might again face unfavorable precedence that it created.

First Federal's second alternative would be to petition the United States Supreme Court for review of the Eighth Circuit's decision in *Anderson*. If the Supreme Court accepts review, it could find, based on footnote 24 of *de la Cuesta*, that federal preemption may not be applied to deprive persons of a vested state right. Such a precedent would jeopardize the present bargaining power of federal savings and loan associations.

Either route may not prove fruitful for First Federal. First Federal must decide whether it needs to establish precedence in its favor in this area or whether it should wait for a more favorable factual setting. If First Federal decides to pursue a legal remedy, state court may be the least risky alternative. The state court would provide First Federal with some indication of the current status of Arkansas law on due-on-sale clauses. Furthermore, if First Federal loses in state court, it ultimately has the United States Supreme Court to look to for review.

If First Federal chooses to petition the Supreme Court for review of the Eighth Circuit opinion in *Anderson*, it is possible that the Supreme Court would review only the jurisdictional issue. This would leave the decision on the merits for the trial court. First Federal may be satisfied with the resolution of only the jurisdictional question because if it prevailed, federal courts would be established as an available forum. Moreover, suing in federal court may prevent the application of state equitable doctrines.

167. For a discussion of *de la Cuesta*, see *supra* notes 119-56 and accompanying text.

168. California and Minnesota do not extend the right to enforce due-on-sale clauses to state chartered or private lenders unless their security is impaired. *See supra* note 290.

169. Thrift Institutions Restructuring Act, Pub. L. No. 97-320, 1982 U.S. CODE CONG. & AD. NEWS (96 Stat.) 1496 [hereinafter referred to as Thrift Institutions Act].

The Thrift Institutions Act provides in pertinent part: "Notwithstanding any provision of the constitution or laws . . . of any State to the contrary, a lender may . . . enter into or enforce a contract containing a due-on-sale clause. . . ." *Id.* § 341(b)(1), at 1505.

This section is subject to the limitation that if binding state law prohibiting the exercise of due-on-sale clauses exists prior to enactment of this Act, such state law will control for three years following enactment. *Id.* at 1505-06. During this interim "window" period the states that already have laws contrary to this Act, may by state law enacted by the legislature, otherwise regulate such contracts. *Id.* § 341(c)(1)(A), at 1506. The states that have no constitutional provision or law to the contrary at the date of enactment are bound by the Act.

A lender is defined to include any "person or government agency making a real property loan." Further, the Act exempts federally chartered savings and loan associations. *Id.* § 341(a)(2), at 1505.

170. Presumably the reason Congress passed this legislation rather than the Bank Board just promulgating a regulation to the same effect is because the Bank Board's authority probably does not

legislation gives state lenders the same rights provided the federally chartered lenders under *de la Cuesta.* Presumably, Congress felt that without this Act state lenders would be at a financial disadvantage.[171] The economic soundness of a lending institution is fundamental to its solvency. By employing the due-on-sale mechanism to update their interest rates, state lenders will be able to compete with federal lenders.[172]

The Act preempts all state law in the due-on-sale area with one exception. If conflicting state law[173] existed at the time of the Act's enactment, the legislature in that state must decide within three years from the date of enactment whether to exempt the state mortgage law from coverage under the Act. The Act becomes binding on the state if it fails to legislate within the "window" period.[174] States with no conflicting law at the date of enactment are bound by the Act.

The primary issue raised by this legislation is whether Congress has the power under the United States Constitution to enact such a regulation. The United States Supreme Court's interpretation of the commerce clause in *Hodel v. Virginia Surface Mining & Reclamation Association*[175] and *National League of Cities v. Usery*[176] would probably be central to the controversy.[177] Complete coverage of this issue, however, is beyond the scope of this Note.

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extend this far under HOLA. Justice Rehnquist, dissenting in *de la Cuesta,* found that there was "no indication in HOLA . . . that Congress has empowered the [Bank] Board to determine whether and when federal law shall govern the enforceability" of due-on-sale clauses. 102 S. Ct. at 3033 (Rehnquist, J., dissenting). Furthermore, Justice O'Connor stated in her concurring opinion that "it is clear that HOLA does not permit the [Bank] Board to preempt the application of all state and local laws." 102 S. Ct. at 3032 (O'Connor, J., concurring). Based on these opinions a court could find that the Bank Board is without power to promulgate a regulation similar to this Act. Therefore, the banking lobby had Congress circumvent this argument by enacting the legislation.

171. The federally chartered lenders could use the due-on-sale clause to guarantee their solvency while the state lenders would be unable to update their interest rates. This concern was expressed in the House debate of the Act. *See* H.R. 6267, 97th Cong., 2d Sess., 128 CONG. REC. H8424, H8426, H8438 (daily ed. Oct. 1, 1982).

172. Lenders want the ability to sell, or discount, the mortgage on a secondary market to generate more money to lend. If the purchaser is given the option of purchasing a mortgage with a due-on-sale clause or one without the clause, economically the one with the clause is a better buy. Therefore, the clause makes the mortgage more salable on the secondary market. When a state lender competes against a federal lender, the state lender's mortgage becomes less marketable because it contains no enforceable due-on-sale clause.

173. State law includes the following: constitutional provisions, statutes, and decisions of the highest court of the state or decisions of the next highest appellate court that has rendered a decision applicable statewide. Thrift Institutions Act § 341(c)(1), *supra* note 169, at 1505. Whether the constitutional provision or statute must specifically state that due-on-sale clauses are not enforceable was never addressed during debate. California, North Dakota, and South Dakota could argue that their statutes against restraints on alienation are statutes barring the enforceability of due-on-sale clauses. See *supra* note 124 for the similarities between these statutes.

174. Thrift Institutions Act § 341(d), *supra* note 169, at 1506.

175. 452 U.S. 264 (1981).

176. 426 U.S. 833 (1976).

177. Congress has the exclusive power to regulate commerce under the commerce clause. *E.g.,* National League of Cities v. Usery, 426 U.S. 833 (1976). The issue would then become whether the Act regulates interstate commerce.

Assuming that Congress has the power to enact this legislation, a second issue is whether Congress can legislate exclusive remedies under the Act. The Act provides that the due-on-sale "clause shall be exclusively governed by the terms of the loan contract, and all rights and remedies . . . shall be fixed and governed by the contract."[178] Congress has the authority to limit statutorily the remedies available under a right it creates.[179] The United States Supreme Court qualified this rule in *Porter v. Warner Holding Co.*[180] In *Porter* the Court held that "equitable jurisdiction is not to be denied or limited in the absence of a clear and valid legislative command."[181]

Recently, in *Weinberger v. Romero-Barcelo*[182] the Court had an opportunity to address whether the Federal Water Pollution Control Act (FWPCA) precludes courts from exercising equitable discretion in its enforcement. The Court held that "Congress may intervene and guide or control the exercise of the courts' discretion, but we do not lightly assume that Congress has intended to depart from established [equitable] principles."[183] The Court found that neither the language and structure of FWPCA nor the legislative history suggested that Congress intended to deny courts their traditional equitable discretion.[184]

From the language of the due-on-sale Act it is not clear whether Congress intended to preclude equitable remedies. Arguably, the Act does not present the clear legislative command required by *Porter*. If Congress intended to preclude equitable remedies, it could have done so with express, concise language.[185]

The Act provides exceptions to the general rule that due-on-

178. Thrift Institutions Act § 341(b), *supra* note 169, at 1505. This language implies that the contract exclusively governs all remedies. Therefore, a strict reading of the Act would preclude equitable remedies unless they are included in the contract.

179. Congress limits the remedies available in various areas. *See, e.g.*, TVA v. Hill, 437 U.S. 153 (1978) (Endangered Species Act, 16 U.S.C. § 1531 (1976), limits the remedy to an injunction); Bob Jones University v. Simon, 416 U.S. 725 (1974) (Anti-Injunction Act, 26 U.S.C. § 7421(a) (1976), generally prohibits injunctive relief against the IRS); 29 U.S.C. § 107 (1976) (labor disputes under the Norris-LaGuardia Act). States also limit remedies available under their Workmen's Compensation statutes. *See, e.g.*, N.D. CENT. CODE § 65-01-08 (1960) (no right of action for damages for personal injuries exists; sole compensation is from the Workmen's Compensation fund). *See generally* K. YORK & J. BAUMAN, REMEDIES, CASES & MATERIALS 90-91 (3d ed. 1979) (Anti-Injunction Act and Norris-LaGuardia Act are congressional limits on federal courts' equitable jurisdiction).

180. 328 U.S. 395 (1946).

181. *Id.* at 398.

182. 102 S. Ct. 1798 (1982).

183. Weinberger v. Romero-Barcelo, 102 S. Ct. 1798, 1803 (1982).

184. *Id.* at 1806.

185. *Cf.* Thrift Institutions Act § 341(d), *supra* note 169, at 1506. When the due-on-sale clause is exercised, the Act merely encourages the lender to permit the assumption of the "loan at the existing contract rate or at a rate which is at or below the average between the contract and market rates." *Id.* § 341(b)(3). In any case the lender can require the transferee of the borrower to meet customary credit standards. *Id.* § 341(c)(2)(A).

sale clauses can be exercised in all cases.[186] These exceptions limit the types of transfers that trigger the due-on-sale clause. The exceptions include the traditional equitable situations in which courts hold that the due-on-sale clause should not be exercised.[187] Finally, a transfer occurring prior to enactment of the Act and falling within the exception that state law did not allow enforcement unless security was impaired is not subject to the Act.[188]

This recent legislation will provide the basis for future litigation. Whether the Act can withstand the threshold constitutional issue and whether it precludes equitable remedies will determine furture congressional action in banking legislation. Nevertheless, state legislatures that have the option have three years to address these issues or they will be resolved by the courts.

IV. FEDERAL JURISDICTION

The issue of federal jurisdiction arises when one party claims that federal law preempts state law. A federal savings and loan association usually claims that the federal regulations give it the right to enforce the due-on-sale clause notwithstanding state law to the contrary.[189] The issue is either initially raised in federal court through a declaratory judgment action[190] or removed to federal court from a state court.[191]

The United States Supreme Court in *de la Cuesta* was not presented with the federal jurisdictional issue because the case was appealed from the California Court of Appeal after the Supreme Court of California refused certiorari.[192] The *de la Cuesta* holding was limited strictly to federal preemption of state law.[193]

Although the Supreme Court has not addressed the jurisdictional issue involving federally chartered savings and loan

186. The exceptions include the same four covered under paragraph 17 of the Bank Board standard mortgage form. *See supra* note 3. In addition the exceptions include the following: inheritance, transfer to a spouse or child of the borrower, divorce dissolution transfer, transfer into an inter vivos trust in which the borrower is the beneficiary and remains in occupancy, and any other transfer covered by the Bank Board regulations. Thrift Institutions Act § 341(c)(2)(B), *supra* note 169, at 1506. For a general discussion of these types of transfers, see *supra* notes 49-55 and accompanying text.

187. *See, e.g.*, Martin v. People's Mut. Sav. & Loan Ass'n, 319 N.W.2d 220 (Iowa 1982) (court reserved opinion on the exempt types of transfers).

188. Thrift Institutions Act § 341(c)(2)(B), *supra* note 169, at 1506.

189. For a discussion of preemption, see *supra* notes 119-31 and accompanying text.

190. For a discussion of declaratory judgment actions, see *infra* notes 264-75 and accompanying text.

191. For a discussion of removal actions, see *infra* notes 253-63 and accompanying text.

192. First Fed. Sav. & Loan Ass'n v. Detroit Bond & Mortgage Inv. Co., 687 F.2d 143, 145 (6th Cir. 1982).

193. 102 S. Ct. at 3021-22.

associations, several lower courts have rendered conflicting decisions on the issue.[194]

A. "ARISING UNDER" JURISDICTION

Before rendering a decision on the merits of a case, a federal court must resolve the jurisdictional issue. If a court lacks jurisdiction to hear a case it also lacks authority to adjudicate the merits.[195]

Courts considering the jurisdictional issue have looked to the statutory authority. Federal jurisdiction is usually claimed under federal question jurisdiction[196] and federal subject matter jurisdiction.[197] The key wording in both statutes is that the matter must "arise under" the laws of the United States or Acts of Congress.[198]

1. Federal Question Jurisdiction

a. Historical Background

The United States Supreme Court, in considering whether a suit arose under the laws[199] or Constitution of the United States, stated in *Gully v. First National Bank*[200] that:

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194. For decisions finding no jurisdiction, see First Fed. Sav. & Loan Ass'n v. Detroit Bond & Mortgage Inv. Co., 687 F.2d 143 (6th Cir. 1982); Michigan Sav. & Loan League v. Francis, 683 F.2d 957 (6th Cir. 1982); First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528 (8th Cir. 1982); Trent Realty Assocs. v. First Fed. Sav. & Loan Ass'n, 657 F.2d 29 (3d Cir. 1981); Guinasso v. Pacific First Fed. Sav. & Loan Ass'n, 656 F.2d 1364 (9th Cir. 1981), *cert. denied,* 102 S. Ct. 1716 (1982); Madsen v. Prudential Fed. Sav. & Loan Ass'n, 635 F.2d 797 (10th cir. 1980), *cert. denied,* 451 U.S. 1018 (1981); Coral Gables Fed. Sav. & Loan Ass'n v. Harbert, 527 F. Supp. 284 (S.D. Fla. 1981).

For decisions finding jurisdiction, see Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981); Glendale Fed. Sav. & Loan Ass'n v. Fox, 481 F. Supp. 616 (C.D. Cal. 1979), *rev'd,* 663 F.2d 1078 (9th Cir. 1981), *cert. denied,* 102 S. Ct. 3508 (1982); Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139 (C.D. Ill. 1979). *Cf.* Conference of Fed. Sav. & Loan Ass'n v. Stein, 604 F.2d 1256, 1259 (9th Cir. 1979) (court applies similar federal regulations, but analyzes the issue as a problem of justiciability), *aff'd mem.,* 445 U.S. 921 (1980).

195. Trent Realty Assocs. v. First Fed. Sav. & Loan Ass'n, 657 F.2d 29, 36 (3d Cir. 1981). The court in *Trent* recognized the frustration that inevitably arises when a court would have held for the complaining party, yet is without discretion to do so because "[a] federal court is bound to consider its own jurisdiction preliminary to consideration of the merits." *Id. See also* First Fed. Sav. & Loan Ass'n v. Detroit Bond & Mortgage Inv. Co., 687 F.2d 143, 145 (6th Cir. 1982) (jurisdiction must be affirmatively resolved before the merits).

196. 28 U.S.C.A. § 1331 (West Supp. 1982). Section 1331 provides that "[t]he district courts shall have original jurisdiction of all civil actions arising under the Constitution, laws, or treaties of the United States." *Id.*

197. 28 U.S.C.A. § 1337(a) (West Supp. 1982). Section 1337(a) provides that "[t]he district courts shall have original jurisdiction of any civil action or proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies." *Id.*

198. Madsen v. Prudential Fed. Sav. & Loan Ass'n, 635 F.2d 797, 800 (10th Cir. 1980), *cert. denied,* 451 U.S. 1018 (1981).

199. The definition of laws is construed in this context to include regulations. Coral Gables Fed. Sav. & Loan Ass'n v. Harbert, 527 F. Supp. 284, 287 n.2 (S.D. Fla. 1981).

200. 299 U.S. 109 (1936).

> [T]he controversy must be disclosed upon the face of the complaint, unaided by the answer or by the petition for removal. . . . Indeed, the complaint itself will not avail as a basis of jurisdiction in so far as it goes beyond a statement of the plaintiff's cause of action and anticipates or replies to a probable defense.[201]

The Court held that although a right is granted by federal statute, a suit to enforce that right is not necessarily, or for that reason alone, one arising under federal law.[202]

The rationale in *Gully* is that Congress or the Constitution should provide federal jurisdiction. If Congress or the Constitution did not limit federal jurisdiction, a litigant could find "countless claims of right" based on a federal statute or the Constitution.[203]

b. Federal Question Application to Due-on-Sale Clause Regulations Promulgated by the Bank Board

Courts that have considered the jurisdictional issue primarily rely upon *Gully*.[204] In *Coral Gables Federal Savings & Loan Association v. Harbert*[205] the court considered a foreclosure action brought by Coral Gables, a federally chartered savings and loan association. Coral Gables sought to have the disputed due-on-sale clause declared enforceable.[206]

The issue before the court was "whether a federal savings and loan's suit for foreclosure of a home mortgage triggered by the mortgagor's default under the due-on-sale clause constituted a claim arising under federal law."[207] The court stated that jurisdiction must be determined by a well pleaded complaint, that an answer raising a federal defense cannot be used to invoke jurisdiction, and that it is "insufficient for the plaintiff to assert that federal law invalidates some anticipated defense of the defendant."[208]

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201. Gully v. First Nat'l Bank, 299 U.S. 109, 113 (1936) (citations omitted). *Gully* involved the power of a state to lay a tax upon a national bank. The state contended that the power to tax a national bank was granted within a federal statute. *Id.* at 111-12.

202. *Id.* at 114. The Court stated that "[n]ot every question of federal law emerging in a suit is proof that a federal law is the basis of the suit." *Id.* at 115.

203. *Id.* at 118.

204. *See, e.g.*, Madsen v. Prudential Fed. Sav. & Loan Ass'n, 635 F.2d 797 (10th Cir. 1980) (federal regulations involving escrow accounts versus state contract law), *cert. denied*, 451 U.S. 1018 (1981); Coral Gables Fed. Sav. & Loan Ass'n v. Harbert, 527 F. Supp. 284 (S.D. Fla. 1981) (mortgage foreclosure triggered by due-on-sale clause).

205. 527 F. Supp. 284 (S.D. Fla. 1981).

206. Coral Gables Fed. Sav. & Loan Ass'n v. Harbert, 527 F. Supp. 284, 285 (S.D. Fla. 1981).

207. *Id.*

208. *Id.* at 286.

The court held that the decisive factor was the federal nature of the action rather than whether any established federal right was alleged.[209] The court found that mortgage foreclosure was the nature of the action. Further, the court found that the due-on-sale clause was an alleged federal right.[210]

In *Coral Gables* the court applied the *Gully* approach. The court stated that although the Bank Board's regulation authorizes due-on-sale clauses, the regulation does not create the claim. The court concluded that the underlying action relied on property law, which traditionally is governed by state law.[211] The court stated the general rule that federal preemption is a defense to a state law claim, and therefore, preemption alone does not establish federal jurisdiction.[212] Other courts have relied on the same principle to deny jurisdiction.[213]

In *Madsen v. Prudential Federal Savings & Loan Association*[214] the Tenth Circuit concluded that the suit was based on state law and that the federal regulation only created a defense to recovery.[215] The court held that such a defense is immaterial to the federal question jurisdiction issue.[216] The court stated that property law is typically a matter of state concern. Further, the court found that in this case state law created the contractual obligations.[217] Consequently, applying *Gully,* the *Madsen* court held that no federal right, unaided by the petition for removal, was disclosed on the face of the complaint.[218]

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209. *Id.* at 287.

210. *Id.* at 290. To some this may be hair splitting. One court concluded that the existence of federal jurisdiction in a preemption situation is a "close question." First Fed. Sav. & Loan Ass'n v. Detroit Bond & Mortgage Inv. Co., 687 F.2d 143, 145 (6th Cir. 1982). A careful reading of *Gully*, however, shows that the Court was setting the bounds for federal court jurisdiction. The Court distinguished those disputes that arose under the laws of the United States from those in which federal law was merely collateral. 299 U.S. at 118. The Court refused to establish a rigid test for federal question jurisdiction and realized that a case by case analysis is the common sense approach. 299 U.S. at 117.

Professor Wright observed that no "clear test has yet been developed to determine which cases 'arise under' the Constitution, laws, or treaties of the United States." C. WRIGHT, HANDBOOK OF THE LAW OF FEDERAL COURTS § 18, at 63-64 (3d ed. 1976). Professor Mishkin suggests that for original federal question jurisdiction to exist, the action must include "a substantial claim founded 'directly' upon federal law." Mishkin, *The Federal "Question" in the District Courts*, 53 COLUM. L. REV. 157, 168 (1953).

211. 527 F. Supp. at 288 n.3.

212. *Id.* at 288.

213. *See* Michigan Sav. & Loan League v. Francis, 683 F.2d 957 (6th Cir. 1982); First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528 (8th Cir. 1982); Madsen v. Prudential Fed. Sav. & Loan Ass'n, 635 F.2d 797 (10th Cir. 1980), *cert. denied,* 451 U.S. 1018 (1981). *But see* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981). The court in *Williams* held that a "federal question arises as to whether, as a matter of contract between the lender and the borrower, . . . a sale or transfer" occurred as defined by the regulation. *Id.* at 912 n.2.

214. 635 F.2d 797 (10th Cir. 1980), *cert. denied,* 451 U.S. 1018 (1981).

215. Madsen v. Prudential Fed. Sav. & Loan Ass'n, 635 F.2d 797, 804 (10th Cir. 1980), *cert. denied,* 451 U.S. 1018 (1981).

216. *Id.* at 801.

217. *Id.* at 802.

218. *Id.* at 803.

Similarly, other courts have rejected federal savings and loan associations' attempts to sue in federal court.[219] In *Trent Realty Associates v. First Federal Savings & Loan Association*[220] the Third Circuit held that a federal preemption issue alone does not create federal question jurisdiction if the issue merely anticipates a federal defense.[221] *Trent* involved a due-on-sale clause that specifically included a prepayment interest penalty provision authorized by federal regulations.[222]

c. Mortgage Cases That Have Addressed Federal Jurisdiction

The principal case relied on by parties seeking federal court jurisdiction is *Conference of Federal Savings & Loan Associations v. Stein.*[223] In *Stein* the appellant, California's Secretary of Business and Transportation, contended that federal courts were without jurisdiction to hear the due-on-sale clause action. The Secretary alleged that the savings and loan associations were using federal preemption as a defense to a potential state claim.[224]

The Ninth Circuit distinguished *Public Service Commission v. Wycoff Co.*[225] The court's basis for this distinction was that in *Wycoff* the plaintiff offered no proof of any threatened act by the state commission that might affect the rights of the party contending federal preemption.[226] The court reasoned that *Stein* differed because the state threatened to impose sanctions against the savings and loan association.[227]

Based on this distinction the *Stein* court concluded that an "actual justiciable controversy" was presented because the conflicting positions of the parties created an actual conflict.[228] The

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219. For a list of cases denying federal jurisdiction involving a federal defense, see *supra* note 213.

220. 657 F.2d 29 (3d Cir. 1981). This decision was based upon *Gully,* Louisville & Nashville R.R. v. Mottley, 211 U.S. 149 (1908), and Skelly Oil Co. v. Phillips Petroleum Co., 339 U.S. 667 (1950).

221. Trent Realty Assocs. v. First Fed. Sav. & Loan Ass'n, 657 F.2d 29, 35 (3d Cir. 1981).

222. *Id.* at 30-31.

223. 604 F.2d 1256 (9th Cir. 1979), *aff'd mem.,* 445 U.S. 921 (1980).

224. Conference of Fed. Sav. & Loan Ass'ns v. Stein, 604 F.2d 1256, 1259 (9th Cir. 1979), *aff'd mem.,* 445 U.S. 921 (1980). *Stein* involved a state regulation subjecting federally chartered associations to state antiredlining practices. *Id.* at 1257.

225. 344 U.S. 237 (1952). In *Wycoff* the Court held that "it is the character of the threatened action, and not of the defense" that determines federal question jurisdiction. Public Serv. Comm'n v. Wycoff Co., 344 U.S. 237, 248 (1952). The Court stated: "Federal courts will not seize litigations from state courts merely because one, normally a defendant, goes to federal court to begin his federal-law defense before the state court begins the case under state law." *Id.*

226. 604 F.2d at 1259.

227. *Id.*

228. *Id. But cf.* Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1159 (E.D. Mich. 1980) (criticizing *Stein's* justiciability analysis). For a discussion of justiciability, see L. TRIBE,

court's "justiciability" conclusion was subsequently applied by other courts to distinguish *Stein*.[229]

The Ninth Circuit, in two subsequent decisions,[230] held that *Stein* presented a different issue. *Guinasso v. Pacific First Federal Savings & Loan Association*[231] involved interest payments on funds held in escrow accounts by savings and loan associations. The *Guinasso* court distinguished *Stein* on the basis that the claim in *Stein* involved more than a possible defense to potential state claims. In *Guinasso*, however, the claim merely raised a possible defense.[232] Therefore, the court found no federal jurisdiction.[233]

The second case involved a due-on-sale clause. In *Nalore v. San Diego Federal Savings & Loan Association*[234] the Ninth Circuit considered whether federal preemption of due-on-sale clauses granted federal court jurisdiction. The court found that *Guinasso* presented virtually the identical jurisdictional issues,[235] and therefore, *Guinasso* was controlling. The court stated that the complaint presented a basis for relief that was governed entirely under state mortgage foreclosure[236] law. Consequently, the court concluded that the federal district court lacked jurisdiction. Presumably, the Ninth Circuit will not find federal jurisdiction.[237]

AMERICAN CONSTITUTIONAL LAW § 3-8, at 53 (1978).

229. *See* Michigan Sav. & Loan League v. Francis, 683 F.2d 957 (6th Cir. 1982). In *Francis* the court held: "[J]usticiability presupposes subject matter jurisdiction. Therefore, the propriety of federal preemption as a basis for subject matter jurisdiction was not before the United States Supreme Court when it affirmed *Stein*. Thus, *Stein* is procedurally inapplicable to the instant case." *Id.* at 962. *See also* First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528, 534 n.9 (8th Cir. 1982) (*Stein* court analyzes the jurisdiction issue as a problem of justiciability); Guinasso v. Pacific First Fed. Sav. & Loan Ass'n, 656 F.2d 1364, 1367 n.10 (9th Cir. 1981) (*Stein* presented a justiciable controversy arising under federal law), *cert. denied,* 102 S. Ct. 1716 (1982).

230. It is arguable that a third case reflects upon the Ninth Circuit's present unwillingness to follow *Stein*. The Ninth Circuit, in an unpublished opinion, reversed and remanded a federal district court ruling that jurisdiction existed in a due-on-sale clause federal preemption case. Glendale Fed. Sav. & Loan Ass'n v. Fox, 663 F.2d 1078 (9th Cir. 1981), *rev'g* 481 F. Supp. 616 (C.D. Cal. 1979), *cert. denied,* 102 S. Ct. 3508 (1982).

231. 656 F.2d 1364 (9th Cir. 1981) *cert. denied,* 102 S. Ct. 1716 (1982).

232. Guinasso v. Pacific First Fed. Sav. & Loan Ass'n, 656 F.2d 1364, 1367 n.10 (9th Cir. 1981), *cert. denied,* 102 S. Ct. 1716 (1982).

233. 656 F.2d at 1367.

234. 663 F.2d 841 (9th Cir. 1981).

235. Nalore v. San Diego Fed. Sav. & Loan Ass'n, 663 F.2d 841, 842 (9th Cir. 1981). The issue in *Guinasso* was whether federal preemption is a basis for federal jurisdiction in a removal action. 656 F.2d 1364. The ground for removal in *Nalore* was that federal law preempts conflicting California state law in the area of due-on-sale clauses. 663 F.2d at 842.

236. 663 F.2d at 842. The proper basis for relief in this case is to bring the mortgage foreclosure in state court. *Id.*

237. In *Guinasso* the court distinguished *Stein*. 656 F.2d at 1367 n.10. Because *Nalore* held *Guinasso* to be controlling, *Stein* may be impliedly overruled. 663 F.2d at 842.

Courts relying on *Stein* for jurisdiction base their reliance on the fact that *Stein* was affirmed summarily by the United States Supreme Court. *See, e.g.,* Town of Springfield v. McCarren, 549 F. Supp. 1134, 1144 (D. Vt. 1982). *See also* Michigan Sav. & Loan League v. Francis, 683 F.2d 957 (6th Cir. 1982) (Edwards, C.J., dissenting). The Supreme Court, however, has stated that in summarily affirming a case, the Court does not necessarily adopt the lower court's reasoning. "Our affirmance indicates only our agreement with the result reached by the [lower court]." Sporhase v. Nebraska *ex rel.* Douglas, 102 S. Ct. 3456, 3461 (1981).

In *Stein* the Ninth Circuit addressed two issues, jurisdiction and preemption. The Ninth Circuit

Another opinion often cited by federal savings and loan associations seeking federal jurisdiction is *Williams v. First Federal Savings & Loan Association.*[238] In *Williams* the Fourth Circuit considered due-on-sale clauses in four cases consolidated on appeal. One case was in federal court based on diversity, but diversity was not alleged in the other three cases.[239] In a footnote, the court stated that a federal question arose under 28 U.S.C. § 1331.[240] The court held that a federal question arises when the issue is whether a change in beneficial ownership constitutes a sale or transfer within the meaning of the regulation.[241] The court, however, did indicate uncertainty about its jurisdiction in two of the cases.[242] Because the Fourth Circuit expressed doubt and failed to articulate its "belief" in federal jurisdiction, other courts have distinguished and criticized *Williams.*[243]

2. *Federal Subject Matter Jurisdiction*

Title 28 U.S.C.A. § 1337(a) provides in part: "The district courts shall have original jurisdiction of any civil action or

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affirmed the district court's judgment finding preemption. The Supreme Court, by summarily affirming *Stein,* was not affirming the lower court's rationale but ony indicating its agreement in the result.

The United States Supreme Court had an opportunity to resolve the correctness of courts' reliance on *Stein* last term, but failed to do so. *See* Glendale Fed. Sav. & Loan Ass'n v. Fox, 663 F.2d 1078 (9th Cir. 1981), *cert. denied,* 102 S. Ct. 3508 (1982). The Ninth Circuit reversed the district court's opinion, which included the jurisdictional issue. After *de la Cuesta* the Supreme Court denied review. 102 S. Ct. at 3508.

238. 651 F.2d 910 (4th Cir. 1981).

239. Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910, 912 n.2 (4th Cir. 1981).

240. *Id.*

241. *Id.*

242. *Id.* The court was uncertain whether federal law applied to a state chartered association's loan or to a deed of trust executed prior to the effective date of the regulation. *Id.* Nevertheless, the court concluded that even if no federal question arose and the case should have been dismissed, its decision on the merits would not, because of the doctrine of stare decisis, cause a significantly different result than would an affirmance of the lower court's dismissal. *Id.*

243. *See* Trent Realty Assocs. v. First Fed. Sav. & Loan Ass'n, 657 F.2d 29, 35 (3d Cir. 1981); Coral Gables Fed. Sav. & Loan Ass'n v. Harbert, 527 F. Supp. 284, 289 (S.D. Fla. 1981).

In First Fed. Sav. & Loan Ass'n v. Peterson, 516 F. Supp. 732 (N.D. Fla. 1981), the district court held that federal question jurisdiction existed to consider the preemption issue of due-on-sale clauses. The court found that cases withholding jurisdiction were distinguishable. *Id.* at 733 n.1. The reasons for distinguishing those cases were as follows: (1) the status of the parties is determinative of jurisdiction; (2) the federal question jurisdictional basis, preemption, appears on the face of the complaint; (3) declaratory relief is sought; (4) a defense is not anticipated; and (5) an actual controversy exists over a federal question. *Id.*

This analysis lacks adequate support. First, although First Federal brought the action, this is not dispositive of jurisdiction. Federal courts will not seize litigation from state courts merely because one party, normally a defendant, seeks to begin a federal law defense in federal court before the state court begins the case under state law. Public Serv. Comm'n v. Wycoff Co., 344 U.S. 237, 248 (1952).

The Supreme Court held in Louisville & Nashville R.R. Co. v. Mottley, 211 U.S. 149 (1908), that "[i]t is not enough that the plaintiff alleges [that] some anticipated defense . . . is invalidated [under federal law]." *Id.* at 152. If a question of federal law surfaces in the course of litigation, this alone does not cause the action to arise under the Constitution. *Id.* Professor Charles Wright explains that if an issue concerning title to land arises because of federal law, federal jurisdiction exists to

proceeding arising under any Act of Congress regulating commerce or protecting trade and commerce against restraints and monopolies."[244] Section 1337(a) essentially parallels section 1331. Both sections are primarily concerned with cases "arising under" laws or Acts of Congress.[245] Section 1337 differs from section 1331 in one respect; section 1337 is concerned with regulation of commerce.[246]

Parties seeking federal jurisdiction under section 1337 claim that the regulations promulgated by the Federal Home Loan Bank Board regulate commerce.[247] The courts that have addressed this issue conclude, with little discussion, that the Home Owners' Loan Act of 1933 is an Act regulating commerce.[248]

Assuming that HOLA regulates commerce, this factor alone does not fulfill the jurisdictional requirements of section 1337. The threshold question under section 1337 is whether the mortgage foreclosure action "arises under" an Act of Congress.[249] In deciding whether an action arises under an Act of Congress, courts apply the same analysis under section 1337 as they do under section

remove the cloud on the title, but not to quiet title. C. WRIGHT, *supra* note 210, at 69-70. Professor Wright believes that the well-pleaded complaint rule unnecessarily and impractically restricts the business of federal courts. *Id.* In *Peterson,* then, jurisdiction would exist to declare that federal law preempts state law on due-on-sale clauses, but not to declare a mortgage foreclosure.

Second, the mere allegation of a federal question is not controlling on jurisdiction. Sometimes it is necessary for courts to realign the parties in a declaratory judgment action when analyzing the jurisdictional question. First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528 (8th Cir. 1982). This realignment is used to determine whether the declaratory plaintiff affirmatively asserts a federal claim or only asserts a defense to a possible state court action. *Id.* at 533. In *Peterson* the mortgagee asserted the defense that federal law preempts conflicting state law. 516 F. Supp. at 733.

Third, declaratory relief does not provide a separate basis for jurisdiction. Michigan Sav. & Loan League v. Francis, 683 F.2d 957, 960 n.7 (6th Cir. 1982) ("[section] 2201 does not ipso facto provide a basis for federal jurisdiction"). If the complaint in the declaratory judgment asserts a defense to a potential state court action, the nature of the threatened action, not the defense, will determine jurisdiction. *Wycoff,* 344 U.S. at 248. To hold otherwise would "distort the limited procedural purpose of the [Act]." C. WRIGHT, *supra* note 210, at 71.

Finally, the court in *Peterson* overemphasizes the argument that an actual controversy existed over a federal question. Although an actual controversy may exist, a justiciable issue alone does not provide jurisdiction. *See* Michigan Sav. & Loan League v. Francis, 683 F.2d at 962 (justiciability presupposes subject matter jurisdiction).

244. 28 U.S.C.A. § 1337(a) (West Supp. 1982).

245. Michigan Sav. & Loan League v. Francis, 683 F.2d 957, 960 n.6 (6th Cir. 1982) ("arising under" accorded same meaning in § 1337 and § 1331); First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528, 532 (8th Cir. 1982) (key language in both statutes is "arising under").

246. Section 1337 could be considered more specific than § 1331. Section 1331 is generally related to all civil actions while § 1337 is directed to those civil actions that affect commerce. 28 U.S.C.A. §§ 1331, 1337 (West Supp. 1982).

247. *E.g.,* Goldman v. First Fed. Sav. & Loan Ass'n, 377 F. Supp. 883, 884 (N.D. Ill. 1974).

248. *Id.* Little rationale is given in *Goldman.* The court merely states that the better reasoned cases grant jurisdiction under § 1337 and cites a Second Circuit opinion, which held that the commerce clause need not be the exclusive source of federal power to find §1337 jurisdiction. *Id.* at 885 (citing Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609 (2d Cir. 1967)). *See also* Gibson v. First Fed. Sav. & Loan Ass'n, 347 F. Supp. 560, 564 (E.D. Mich. 1972) ("it appears clear that [HOLA] is an act regulating commerce").

249. The courts in *Goldman* and *Gibson* found § 1337 jurisdiction, but failed to analyze whether mortgage foreclosure is an action arising under an Act of Congress. *Goldman,* 377 F. Supp. at 884-85; *Gibson,* 347 F. Supp. at 564-65.

1331.[250] This analysis requires that the federal law relied on for jurisdiction must form a direct and essential element of the cause of action. This cause of action may not be based on a defense or an anticipated defense.[251] Ordinarily, federal preemption is considered a defense.[252] Furthermore, mortgage foreclosure actions are governed by state law. Therefore, it can be argued that federal courts lack subject matter jurisdiction in due-on-sale cases because the mortgage foreclosure action does not "arise under" an Act of Congress.

B. ALTERNATIVE STATUTES GRANTING FEDERAL COURT JURISDICTION

1. Removal Jurisdiction

Title 28 U.S.C.A. § 1441 provides for removal of cases from state court to federal court.[253] The language in section 1441(b) is similar to that found in section 1331 and section 1337. Courts analyzing the removal issue have applied the same "arising under" analysis as applied under section 1331 and section 1337. Moreover, many courts do not distinguish section 1331, section 1337, and section 1441 in their decisions.[254]

One court indicated concern over this problem. In *Coral Gables Federal Savings & Loan Association v. Harbert*[255] the court recognized in a footnote that section 1441(b) and section 1331 are similar.[256] The

250. Michigan Sav. & Loan League v. Francis, 683 F.2d at 960 n.6; First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d at 532.

251. *See, e.g.*, First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d at 534.

252. *See* Michigan Sav. & Loan League v. Francis, 683 F.2d at 960 (federal law arises only as a preemption defense). *Cf.* Guinasso v. Pacific First Fed. Sav. & Loan Ass'n, 656 F.2d at 1367 n.9 (federal regulations only present federal defenses in preemption cases). *But see* Glendale Fed. Sav. & Loan Ass'n v. Fox, 481 F. Supp. 616, 626 (C.D. Cal. 1979), *rev'd*, 663 F.2d 1078 (9th Cir. 1981), *cert. denied*, 102 S. Ct. 3508 (1982). In *Glendale* the action was brought "not to guard against the possibility of state action, but to remedy state action already taken." 481 F. Supp. at 626.

253. 28 U.S.C.A. § 1441 (West 1973). Section 1441 provides in part:

> (a) Except as otherwise expressly provided by Act of Congress, any civil action brought in a State court of which the district courts of the United States have original jurisdiction, may be removed by the defendant or the defendants, to the district court of the United States for the district and division embracing the place where such action is pending.

Id. § 1441 (a). Subsection (b), which sets forth the types of cases that may be removed, provides:

> (b) Any civil action of which the district courts have original jurisdiction founded on a claim or right arising under the Constitution, treaties or laws of the United States shall be removable without regard to the citizenship or residence of the parties.

Id. § 1441(b).

254. *E.g.*, Nalore v. San Diego Fed. Sav. & Loan Ass'n, 663 F.2d 841 (9th Cir. 1981); Madsen v. Prudential Fed. Sav. & Loan Ass'n, 635 F.2d 797 (10th Cir. 1980).

255. 527 F. Supp. 284 (S.D. Fla. 1981).

256. Coral Gables Fed. Sav. & Loan Ass'n v. Harbert, 527 F. Supp. 284, 289 n.6 (S.D. Fla.

court noted that if jurisdiction was found under section 1331, any mortgagor in future state court due-on-sale foreclosure actions could remove the action to federal court.[257] The court was concerned that allowing state due-on-sale clause litigation in federal court would open the door to other litigation involving regulations encompassing similar problems.[258] The court stated, "If the compass is reset for due on sale cases, new highways of litigation may come traveling into the federal court."[259]

To avoid overloading already full dockets, federal courts have been reluctant to broaden the scope of jurisdictional statutes. Their rationale is that remanding actions to state courts does not prejudice the parties' rights because any improper consideration of their rights in state court is subject to United States Supreme Court review.[260]

Courts that find removal jurisdiction resolve the issue by applying section 1331.[261] These courts hold that the real nature of the claim must be considered when ascertaining removal jurisdiction.[262] Generally, they find that federal preemption provides "arising under" jurisdiction.[263]

2. *Initiate the Action in Federal District Court Under the Declaratory Judgment Act*

A party seeking federal court jurisdiction may initiate the action in federal district court under the Federal Declaratory Judgment Act.[264] Title 28 U.S.C.A. § 2201 gives federal courts the discretionary power of declaratory relief.[265] The Act establishes two

1981).

257. *Id.*

258. *Id.* The court in *Coral Gables* was concerned that if jurisdiction was established for due-on-sale clauses, other litigation may arise dealing with the loan instruments, notes, and bonds covered by the same regulations. *Id.*

259. *Id.* The same concerns are discussed by the United States Supreme Court in *Gully.* For a discussion of *Gully,* see *supra* notes 200-03 and accompanying text.

260. *E.g.,* First Fed. Sav. & Loan Ass'n v. Siegel, 529 F. Supp. 562 (M.D. Fla. 1982).

261. *E.g.,* Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139 (C.D. Ill. 1979).

262. *E.g.,* Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819, 823 (N.D. Ill. 1975).

263. *E.g.,* Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145 (9th Cir. 1974).

264. 28 U.S.C.A. § 2201 (West 1982). Usually the plaintiff is a federal savings and loan seeking a declaration that due-on-sale clauses are enforceable because federal law preempts state law. *E.g.,* First Fed. Sav. & Loan Ass'n v. Anderson, 681 F.2d 528 (8th Cir. 1982). Occasionally, a mortgagor will bring an action seeking a declaratory judgment that a transfer did not trigger a due-on-sale clause. *E.g.,* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d 910 (4th Cir. 1981).

265. 28 U.S.C.A. § 2201 (West 1982). Section 2201 provides:

> In a case of actual controversy within its jurisdiction, . . . any court of the United States, upon the filing of an appropriate pleading, may declare the rights and other legal relations of any interested party seeking such declaration, whether or not further relief is or could be sought. Any such declaration shall have the force and effect of a final judgment or decree and shall be reviewable as such.

Id.

requirements that must be met before a court may issue a declaratory judgment. First, an "actual controversy" must exist and second, that controversy must be within the federal court's jurisdiction.[266]

Assuming the first requirement is met in due-on-sale litigation, a court must still resolve the jurisdictional issue. Because the Act is only procedural, no federal jurisdiction is conferred by section 2201 alone.[267] Rather, jurisdiction must be founded on either diversity, subject matter, or federal question jurisdiction.

The United States Supreme Court in *Skelly Oil Co. v. Phillips Petroleum Co.*[268] held that the Act was not intended to expand the jurisdiction of federal courts. Rather, the Act merely provided an enlarged range of permissible remedies.[269] Two recent Sixth Circuit opinions applied this principle.

In *Michigan Savings & Loan League v. Francis*[270] a group of federally chartered savings and loan associations sought a declaratory judgment that they were exempt from provisions of Michigan's Mortgage Lending Practices Act.[271] The court held that the plaintiff's failure to establish subject matter jurisdiction precluded a declaratory judgment.[272]

Similarly in *First Federal Savings & Loan Association v. Detroit Bond & Mortgage Investment Co.* the Sixth Circuit held that *Francis* was controlling[273] despite a strong dissent by Judge Weick.[274] In *Detroit Bond* First Federal sought a declaration that federal preemption applied to due-on-sale clause litigation. The court held that federal subject matter jurisdiction did not exist.[275] These decisions indicate that federal courts, after *de la Cuesta,* will not find federal jurisdiction in due-on-sale clause litigation.

C. RESOLUTION OF THE FEDERAL JURISDICTION ISSUE

Litigants seeking to enforce rights granted by federal law can look to state courts for protection of those rights. If state courts

266. *Id.*
267. *See* Michigan Sav. & Loan League v. Francis, 683 F.2d at 960 n.7.
268. 339 U.S. 667 (1950).
269. Skelly Oil Co. v. Phillips Petroleum Co., 339 U.S. 667, 671 (1950). Section 2201 is headnoted as a remedy. 28 U.S.C.A. § 2201 (West 1982).
270. 683 F.2d 957 (6th Cir. 1982).
271. Michigan Sav. & Loan League v. Francis, 683 F.2d 957, 958 (6th Cir. 1982).
272. *Id.* at 960.
273. 687 F.2d 143, 145 (6th Cir. 1982).
274. First Fed. Sav. & Loan Ass'n v. Detroit Bond & Mortgage Inv. Co., 687 F.2d 143, 145-46 (6th Cir. 1982) (Weick, J., dissenting).
275. *Id.* at 145.

prejudice the parties' legal rights, they can "appeal adverse state decisions to the Supreme Court of the United States."[276] This may seem like a harsh approach, but as a matter of judicial economy, federal courts were never meant to be the forum for all actions involving federal rights.[277]

In *Glendale Federal Savings & Loan Association v. Fox*[278] Glendale Federal brought an action in federal district court seeking declaratory and injunctive relief. Glendale Federal alleged that federal law preempted California state law in the area of due-on-sale clauses.[279] The federal district court held that federal regulations exclusively govern the validity of due-on-sale clauses in loan instruments executed by federally chartered savings and loan institutions.[280]

On the jurisdictional issue the district court found that Glendale Federal could not avoid the *Wycoff* principle that no federal jurisdiction exists when a federal claim is a mere defense to a state court action.[281] The court noted that the Ninth Circuit "clarified" *Wycoff* in *Rath Packing Co. v. Becker.*[282] In *Rath* the court found that the principal concern in *Wycoff* was the nature of the controversy.[283] Therefore, the district court in *Fox* found that *Rath* distinguished *Wycoff* because the controversy in *Rath* arose independently of any state court action.[284] Furthermore, *Wycoff* involved only a mere possibility of adverse state action, while *Rath* presented an actual adverse state action.[285] Therefore, the district court reasoned that federal jurisdiction existed in *Rath* but not in *Wycoff.*

The district court concluded that Glendale Federal's action was more in line with *Rath* because the action was brought to remedy past rather than possible future state action.[286] On this

276. First Fed. Sav. & Loan Ass'n v. Siegel, 529 F. Supp. 562, 563 (M.D. Fla. 1982).

277. *Gully,* 299 U.S. at 114.

278. 481 F. Supp. 616 (C.D. Cal. 1979), *rev'd,* 663 F.2d 1078 (9th Cir. 1981), *cert. denied,* 102 S. Ct. 3508 (1982).

279. Glendale Fed. Sav. & Loan Ass'n v. Fox, 481 F. Supp. 616, 618-21 (C.D. Cal. 1979), *rev'd,* 663 F.2d 1078 (9th Cir. 1981), *cert. denied,* 102 S. Ct. 3508 (1982).

280. 481 F. Supp. at 632-33.

281. *Id.* at 625.

282. Rath Packing Co. v. Becker, 530 F.2d 1295 (9th Cir. 1975), *aff'd sub nom.* Jones v. Rath Packing Co., 430 U.S. 519 (1976), *cert. denied,* 430 U.S. 954 (1977) (separate petition for certiorari filed by California's Director of Food and Agriculture).

283. 530 F.2d at 1304-05.

284. Glendale Fed. Sav. & Loan Ass'n v. Fox, 481 F. Supp. at 626.

285. *Id.* In *Rath* the State of California ordered Rath Packing Company to stop selling bacon in California in violation of unfair competition laws. Rath Packing Company filed a declaratory judgment action in federal court seeking a judgment that federal law preempted California state law in this area. 530 F.2d at 1304-05.

286. 481 F. Supp. at 626. Glendale Federal wanted to serve as the lender in a housing project sponsored by the California Department of Real Estate. Glendale Federal was notified that its mortgage forms did not comply with California law because they contained due-on-sale clauses. *Id.*

basis the district court found subject matter jurisdiction.[287]

The United States Court of Appeals for the Ninth Circuit reversed and remanded without opinion the district court's decision.[288] Glendale Federal thereafter petitioned for certiorari to the United States Supreme Court. After deciding *de la Cuesta* the Supreme Court denied certiorari.[289] Presumably the Court was indicating that only the preemption issue was decided in *de la Cuesta.*[290]

V. STATE EQUITABLE REMEDIES IN DUE-ON-SALE CLAUSE ACTIONS

It may be too early to predict the effect of *de la Cuesta* on state law. Some jurisdictions, however, have indicated what they might hold if confronted with the enforcement issue.[291] The general view is that due-on-sale clauses may be authorized by federal regulations, but mortgage foreclosure is an action that must be brought in state court.[292]

Another issue in state courts is whether the court may invoke its equitable powers to deny the enforcement of a due-on-sale clause in a mortgage issued by a federally chartered savings and loan. One federal district court prior to *de la Cuesta* discussed this issue in a declaratory judgment action seeking to foreclose a mortgage.[293] In *First Federal Savings & Loan Association v. Siegal*[294] the court held that "obviously" state courts have the power to deny enforcement.[295] The court pointed out that if the parties seeking to enforce mortgage foreclosures think otherwise, "they may appeal adverse state decisions to the Supreme Court."[296] Clearly, the court in *Siegal* believed that state courts have exclusive jurisdiction to

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at 620.

287. *Id.* at 626. The jurisdictional section of the opinion is not entirely clear. First, the court does not discuss the statutory language of 28 U.S.C. § 1337 or 28 U.S.C. § 1441. Also, the district court failed to discuss the threshold "arising under" issue.

288. Glendale Fed. Sav. & Loan Ass'n v. Fox, 663 F.2d 1078 (9th Cir. 1981), *cert. denied,* 102 S. Ct. 3508 (1982).

289. Glendale Fed. Sav. & Loan Ass'n v. Fox, 102 S. Ct. 3508 (1982).

290. Because the *de la Cuesta* Court made no reference to the jurisdictional issue, the question remains open for consideration.

291. Gate Co. v. Midwest Fed. Sav. & Loan Ass'n, 324 N.W.2d 202, 207 n.4 (Minn. 1982) *(de la Cuesta* applies only to lending institutions regulated by the Bank Board; Minnesota law still governs state lenders); First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d 860, 863 (S.D. 1982) (Morgan, J., concurring) (equity is not precluded by *de la Cuesta*); Att'y Gen. Op. No. 82-703 (Cal. Aug. 17, 1982) (available Oct. 1, 1982, on LEXIS, States library, Calag file) (*Wellenkamp* governs state lenders notwithstanding *de la Cuesta*).

292. *See* First Fed. Sav. & Loan Ass'n v. Siegel, 529 F. Supp. 562, 563 (M.D. Fla. 1982).

293. *Id.*

294. *Id.* The court dismissed the suit for lack of federal jurisdiction. *Id.* at 563.

295. *Id.*

296. *Id.*

entertain mortgage foreclosures and that state courts may use all the powers associated with that equitable action.[297]

A concurring opinion subsequent to *de la Cuesta* supports this basic proposition. In *First Federal Savings & Loan Association v. Wick*[298] the South Dakota Supreme Court confronted a due-on-sale clause in a mortgage executed by a federally chartered savings and loan.[299] Justice Morgan in his concurring opinion stated that notwithstanding *de la Cuesta,* "the enforcement of a due-on-sale clause remains subject to equitable defenses — including unconscionability."[300] He concluded that *de la Cuesta* does not change the established state court precedents that recognize equitable defenses as bars to enforcement of due-on-sale clauses.[301]

Considering this limited authority combined with the right factual situation,[302] the recent Thrift Institutions Restructuring Act,[303] and the recent federal regulation declaring due-on-sale clauses absolutely enforceable,[304] the effect of state equitable defenses on due-on-sale clause enforcement actions may become an important issue in the preemption area. It is quite possible, given one of the situations outlined by the court in *Mills v. Nashua Federal Savings & Loan Association,*[305] such as an interspousal transfer, that a state court may find that enforcement serves no social purpose. The best solution is for state legislatures, the Bank Board, or both to establish guidelines where problem areas exist. Any legislation drafted by these groups, however, must protect all vested rights presently existing under state law.

VI. CONCLUSION

De la Cuesta may have resolved the due-on-sale preemption issue, but it left many issues unresolved. If the Bank Board continues to promulgate regulations legitimizing due-on-sale

297. Another court has taken a similar position. *See* First Fed. Sav. & Loan Ass'n v. Lockwood, 385 So. 2d 156, 160 (Fla. Dist. Ct. App. 1980) (party who initiates a suit in equity must be subject to all the applicable consequences of that action). Similarly, another court identified the equitable issue, but was spared deciding it. *See* Williams v. First Fed. Sav. & Loan Ass'n, 651 F.2d at 922 n.28 ("we are fortunately spared the complications associated with what to do where a due-on-sale clause is valid under federal law, but in a particular case leads to a result which state law would disallow as inequitable").

298. 322 N.W.2d 860 (S.D. 1982).

299. First Fed. Sav. & Loan Ass'n v. Wick, 322 N.W.2d 860, 861 (S.D. 1982).

300. *Id.* at 863 (Morgan, J., concurring).

301. *Id.*

302. For a discussion of a factual situation ripe for litigation, see *supra* notes 154-66 and accompanying text.

303. Thrift Institutions Act § 341(d), *supra* note 169, at 1506. For a discussion of this Act, see *supra* notes 167-88 and accompanying text.

304. 12 C.F.R. § 556.9(f)(2) (1982). For the text of § 556.9(f)(2), see *supra* note 149.

305. 121 N.H. 722, 433 A.2d 1312 (1981).

clauses and if present interest rates remain substantially higher than interest rates in mortgages executed eight to ten years ago, future due-on-sale clause litigation is inevitable.

Courts will continue to confront jurisdictional issues, which must be resolved before the courts may discuss the merits. A court's opinion on the underlying merits of any action is irrelevant unless the court has subject matter jurisdiction. Apparently, a majority of federal courts will not entertain jurisdiction over due-on-sale clause mortgage actions. Their rationale may not be flawless, but without direct guidance from the United States Supreme Court it is persuasive.

The resolution of issues concerning state lenders will depend upon the actions taken by individual states. The states have three years to legislate their future. If they fail to act, the courts will be forced to resolve the due-on-sale clause issues. Consequently, to preserve certainty in mortgage contracts, state legislatures have the obligation to decide the future of the due-on-sale clause. Finally, the resolution of the equitable enforcement issue likely will provide the United States Supreme Court with the most difficult due-on-sale clause question in the future.

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