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NOTES


I. INTRODUCTION

On October 15, 1982, President Reagan signed into law the Garn-St. Germain Depository Institutions Act of 1982.1 Hailed by President Reagan as “the most important legislation for financial institutions in 50 years,”2 the Garn Act is a wide-ranging attempt to aid the financially troubled banking industry.3

Due to inflation and rising interest rates, banks and savings and loan associations4 are forced to pay rising interest rates to depositors while their earnings on fixed-rate mortgages have remained static.5 The effect of this has been dramatic, causing savings and loan associations net losses of $3.9 billion in the first half of 1982 and threatening to close down one quarter of all savings and loan associations.6

4. While banks and savings and loan associations look quite similar to the average depositor there are important differences. Banks are stock corporations, privately owned, while a savings and loan association is actually owned by its depositors who receive dividends and not interest on their deposits. Further, banks may offer a wider range of services than savings and loan associations which are designed to accept depositors’ funds and loan them out for local home mortgages. T. MARVELL, THE FEDERAL HOME LOAN BANK BOARD 4 (1969). See generally id. at 3-17.
5. Since banks and savings and loan associations work on the simple principle that they pay less interest to depositors than they make on mortgages, keeping the difference as profit, the more they pay out as interest (to keep their depositors from withdrawing assets in favor of better investments) the less they make as profit. See id. at 15-17.
6. 128 CONG. REC. S12,213 (daily ed. Sept. 24, 1982) (statement of Sen. Riegle). Because their profits are more closely linked to mortgages than are those of banks, savings and loan associations are especially vulnerable to this “squeeze” between rising in-
In order to protect themselves from some of the effects of this "profits squeeze," the banking and savings and loan industries have relied upon the fact that mortgages are generally paid off within approximately seven years. Therefore, lenders generally work on the premise that they will be able to reinvest their outstanding mortgages quickly in investments with higher rates of return to counter the effects of increased interest paid to depositors. Lender profits decrease if events occur which contradict this premise and cause mortgage lifetimes to increase. Thus, a slowdown in housing sales can decrease lender profits as lenders are unable to reinvest their funds.

One form of mortgage life extension, sale with an assumption of the outstanding mortgage by buyer, has traditionally been guarded against through the use of what is commonly known as a "due-on-sale" clause. Use of these clauses and the purposes for which they may legally be used have, over the past decade, resulted in a great

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8. Since lenders must cover costs and make profits on the mortgages they issue, the longer they hold a mortgage, the higher the costs incurred and accordingly the higher the interest rate required to make a profit. Thus an estimate of the average life of an outstanding mortgage is necessary to a lender in determining the lowest interest rate it can reasonably charge. See Federal Home Loan Bank Board, Task Force on Due-on-Sale, Final Report and Technical Papers, technical paper no. 3, 3.2-3.3 (March 1982) (available from Federal Home Loan Bank Board) [hereinafter cited as Task Force].

9. An assumption occurs when a sale of the property is made by the original mortgagee and the purchaser promises to pay the debt rather than pay vendor immediately. E. RABIN, FUNDAMENTALS OF MODERN REAL PROPERTY LAW 1086 (1974). In times of rapidly rising interest rates, the buyer who can assume a mortgage at an old, lower interest rate is naturally inclined to do so, thus extending the life of the mortgage for an additional estimated period of seven years.

10. A due-on-sale clause is defined by the Garn Act as "a contract provision which authorizes a lender, at its option, to declare due and payable sums secured by the lender's security instrument if all or any part of the property, or an interest therein, securing the real property loan is sold or transferred without the lender's prior written consent." Garn Act, supra note 1, § 341(a)(1) (codified at 12 U.S.C. § 1701j-3(a)(1) (1982)).

This type of a provision is extremely well suited to the problem of assumptions and for this reason is very widely used, being found in four out of five conventional mortgages outstanding and in nearly all new fixed-rate mortgages. See 15 Fed. Home Loan Bank Bd. J., March 1982, at 16; Task Force, supra note 8, at 2.1.

While due-on-sale clauses were originally designed primarily to "insure that mortgages were not transferred to borrowers with high probabilities of default," it is generally conceded that when interest rates and prices became unstable "the role of the due-on-sale clause was transformed. It became an important tool used by fixed-rate mortgage lenders to limit the expected maturity of their mortgage assets." Task Force, supra note 8,
deal of litigation which has given rise to a confusing array of state restrictions on enforcement of due-on-sale clauses. To remedy this, section 341 of the Garn Act provides that such clauses are governed strictly by federal law and are enforceable by all lenders.

The purpose of this note is to review the decisions which led to the creation of section 341 and the problems solved by it. In addition, the problems created by section 341 will also be discussed.

II. THE DUE-ON-SALE CLAUSE AND UNIFORM MORTGAGES

If every lender were to write its own mortgages, some of the problems resulting from the use of due-on-sale clauses could be avoided because lenders would be freer to negotiate mortgage terms. That, however, is not the case. To provide lenders with some added ability to finance home mortgages, the federal government has set up three "secondary market" organizations. These three organizations, the Federal National Mortgage Association (Fannie Mae), the Federal Home Loan Mortgage Corporation (Freddie Mac), and the Government National Mortgage Association (Ginnie Mae) were each set up to serve a specific part of the national lending industry. Fannie Mae, Freddie Mac and Ginnie Mae each purchase outstanding mortgages from lenders for cash. These organizations require

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12. Garn Act, supra note 1, § 341 (codified at 12 U.S.C. § 1701j-3 (1982)). Section 341 defines "Lender" as "a person or government agency making a real property loan or any assignee or transferee, in whole or in part, of such a person or agency." Id. § 341(a)(2) (codified at 12 U.S.C. § 1701j-3(a)(2) (1982)). Thus all banks and savings and loan associations may enforce due-on-sale clauses as a matter of federal law as corporate "persons." Since the Garn Act was designed to aid banks and savings and loan associations it seems reasonable to assume that the provisions of § 341 would apply to them.
14. Fannie Mae, for example, was originally set up to purchase Federal Housing Administration and Veteran's Administration-backed mortgages so as to promote them among lenders, though it now buys conventional mortgages too. Freddie Mac was designed to create a secondary market for conventional mortgages and Ginnie Mae was created to develop a secondary market for mortgages which are not likely to attract other purchasers such as low income mortgages and mortgages on Indian lands. See A. Axelrod, C. Berger & Q. Johnstone, Land Transfer and Finance 91-96 (2d ed. 1978) [hereinafter cited as LAND TRANSFER].

The secondary market purchases mortgages from lenders at a discount for cash. Thus a bank which has lent out $10,000 at 10% interest for twenty years would sell its
that their own mortgage form, developed in 1975, be used on all mortgages purchased by them. While lenders need not sell to secondary mortgage agencies, and in fact some cannot, the ability to do so is important to lenders who wish to remain competitive in the mortgage market when money is tight. The extent to which the secondary market is patronized is evidenced dramatically by the fact that in 1981, 5.4 percent of the total mortgage market of $1,503 billion dollars in the United States was in the hands of Fannie Mae and Freddie Mac. The pressure, therefore, to use a Fannie Mae or Freddie Mac form mortgage is very strong, with some estimating that 80 percent of all conventional first mortgages issued in 1980 were on the Fannie Mae or Freddie Mac form.

The standard Fannie Mae or Freddie Mac mortgage document mortgage to Freddie Mac or Fannie Mae for a reduced amount which would be calculated on the basis of the present value of that debt less the profits of the secondary lender. Thus the original lender is paid, say $8,000 for his loan which he can now use to reinvest in more mortgages or to cover short-term runs by depositors. See id. See generally Federal National Mortgage Association, A Guide to Fannie Mae (1979).

Once the secondary lender has purchased enough mortgages, it pools them and issues securities to investors backed by the pool. This provides investors with a low-risk investment with a guaranteed rate of return and provides the secondary market with new capital to continue operating. See Federal National Mortgage Association, supra; see also Task Force, supra note 8, at 4.2.

15. Blocher, supra note 7, at 55.
16. Task Force, supra note 8, at 4.4. The theory behind this requirement is that: When each mortgage of a pool of mortgages has the same features, the pool is homogeneous; that is, investors can assess the pool as a single entity, without concern for its component parts. This uniformity is the foundation of the conventional secondary mortgage market because it provides an independent third party, the investor, with the assurance of consistency in the mortgages originated from diverse sources.

17. Fannie Mae and Freddie Mac not only restrict their purchases to mortgages written on their prescribed forms, but their purchases are further regulated. Under Freddie Mac's charter it may only purchase from federally insured or state-insured lenders. 12 U.S.C. § 1454 (1982). While all federally chartered savings and loan associations must be insured and almost any state-chartered savings and loan association may be so insured, 12 U.S.C. § 1726(a) (1982), they can lose their insurance for a number of reasons. Federal Savings and Loan Insurance Corporation Termination of Insurance, 12 C.F.R. §§ 565.2(a), 565.3 (1983).
18. See Land Transfer, supra note 14, at 91.
20. See Randolph, The FNMA/FHLMC Uniform Home Improvement Loan Note: The Secondary Market Meets the Consumer Movement, 60 N.C.L. Rev. 368 n.8 (1982). Of course the fact that these forms underwent a very harsh scrutiny before being accepted makes them very appealing to lenders who can be sure of their validity and comprehensiveness as well. See generally Jensen, Mortgage Standardization: History of
contains a due-on-sale clause as its uniform covenant 17.\textsuperscript{21} Prior to April 1, 1983,\textsuperscript{22} in states in which restrictions existed on enforcement of due-on-sale clauses, it was impossible to use covenant 17. Freddie Mac and Fannie Mae have both provided alternatives to covenant 17. Fannie Mae has, since 1980, offered an alternative provision in its mortgages to lenders in those states where due-on-sale provisions were restricted. The alternative is a "seven year call option."\textsuperscript{23} Such an option "permits the lender to require payment of the mortgage in full when it is seven years old."\textsuperscript{24} On July 2, 1982, Freddie Mac issued a new policy which banned assumption of mortgages it purchased from lenders.\textsuperscript{25} It also stated that where a lender did allow assumption of a mortgage, the lender would be required to repurchase the mortgage.\textsuperscript{26} In addition, Freddie Mac stated it might also require a call option in its mortgages.\textsuperscript{27}

This sudden shift from Freddie Mac's prior policy of allowing assumptions without increasing interest as long as the purchaser passed a credit check\textsuperscript{28} was due to a June 28, 1982 decision of the United States Supreme Court. In \textit{Fidelity Federal Savings and Loan Association v. de la Cuesta},\textsuperscript{29} the Court held that federal law preempted state restrictions on due-on-sale clause enforcement in the mortgages of federally chartered savings and loan associations.\textsuperscript{30} \textit{De la Cuesta}, a case which originated in California, was the culmination of a line of California cases, spanning a decade, which provides a good example of what led to the enactment of section 341.

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Interaction of Economics, Consumerism and Governmental Pressure, 7 \textit{REAL PROP. PROB. \\ \\
& TR. J.} 397 (1972).

d. See Blocher, supra note 7, at 54-55.
23. Blocher, supra note 7, at 96. The seven-year period is due to the fact that this is the average lifetime of a mortgage where due-on-sale clauses are enforceable without restrictions. Thus the same result as having enforceable due-on-sale clauses is effectuated. See id.
24. \textit{Id.}
26. \textit{Id.} When a lender sells a mortgage to Freddie Mac it does not leave the picture entirely. In fact the mortgagor is not likely to even known of the sale because the lender is hired by the secondary market agency to manage the mortgage, collect the payments, forward them and handle delinquent payments and foreclosures for a percentage fee. \textit{FEDERAL NATIONAL MORTGAGE ASSOCIATION, supra} note 14, at 21.
28. \textit{Id.}
29. 102 S. Ct. 3014 (1982).
30. \textit{Id.} at 3031. The reason for the limitation of the \textit{de la Cuesta} holding to federally chartered savings and loan associations is discussed \textit{infra} sections A and B of Part III.
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III. THE CALIFORNIA APPROACH TO DUE-ON-SALE

A. Pre-de la Cuesta

Until 1971, the enforcement of due-on-sale and due-on-encumbrance clauses was not restricted in California. In 1971, however, the California Supreme Court decided *La Sala v. American Savings and Loan Association*. There, the court held that due-on-encumbrance clauses were not enforceable unless the clauses were "reasonably necessary to the protection of the lender's security." Nonetheless, the court stated that due-on-sale clauses remained unrestricted "because such a provision is necessary to the lender's security." Thus, while due-on-sale clauses remained unrestricted by *La Sala*, the framework was set for the creation of future restrictions.

Three years later, the California Supreme Court was presented with a due-on-sale clause in an installment sale contract for purchase of land. In *Tucker v. Lassen Savings and Loan Association*, the court held that due-on-sale clauses are triggered by the equity transfer in an installment sales contract. Having reached that conclusion, the court asserted that before a due-on-sale clause could be enforced, it had to pass a balancing test, that weighed the "justification" for enforcing the clause against the "quantum of restraint" caused by enforcement. Thus, the court held that the restraint im-

31. A due-on-encumbrance clause is similar to a due-on-sale clause except it is triggered by any encumbrance, or a specified type of encumbrance on the subject property.
34. *Id.* at 884, 489 P.2d at 1126, 97 Cal. Rptr. at 637.
35. *Id.* at 883, 489 P.2d at 1126, 97 Cal. Rptr. at 637.
36. In an installment sales contract for land, legal title to the property remains in the vendor until all or a specified portion of the purchase price is paid. Then title is deeded to the purchaser who has, usually, been in possession all along. Nonetheless, as installments are paid the purchaser builds up an equitable interest in the property. See LAND TRANSFER, supra note 14, at 164-65 (quoting Warren, *California Installment Land Sales Contracts: A Time for Reform*, 9 U.C.L.A. L. REV. 608 (1962)); see also R. BOYER, SURVEY OF THE LAW OF PROPERTY 509-10 (3d ed. 1981); A. CASNER & W. LEACH, CASES AND TEXT ON PROPERTY 706 (2d ed. 1969).
38. *Tucker*, 12 Cal. 3d at 635, 526 P.2d at 1173, 116 Cal. Rptr. at 637. The "re-
posed by enforcing a due-on-sale clause, in the case of sale by installment contract, was too great a burden on the landowner in relation to the justification for enforcement absent a "threat to . . . legitimate interests sufficient to justify the restraint on alienation inherent in its enforcement." Nonetheless, the court specifically refused to address the issue of due-on-sale enforcement in cases of outright sale, though it did state, in obiter dicta, that the restraint on alienation in such cases was de minimis.

In 1978, the California Supreme Court was presented with the question of due-on-sale enforcement in the case of an outright conveyance with assumption of mortgage in *Wellenkamp v. Bank of America*. The court applied the test it had created in *Tucker* to conclude that "although circumstances may arise in which the interests of the lender may justify the enforcement of a due-on-sale clause in the event of an outright sale, the mere fact of sale is not in itself sufficient to warrant enforcement of the clause . . . ."

The court noted that an outright sale with assumption was a restraint" referred to here is the restraint on alienation created by the owner's inability to transfer the property using an installment sales contract. See *id.* at 634, 526 P.2d at 1171, 116 Cal. Rptr. at 635.


The California courts have since defined the scope of these legitimate interests. See *infra* note 48.

42. *Id.* at 637, 526 P.2d at 1174, 116 Cal. Rptr. at 638.
43. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978).
44. *Id.* at 952, 582 P.2d at 976, 148 Cal. Rptr. at 385.
situation that required treatment different from that in Tucker, which had specifically involved conventional sales with only new bank financing.\textsuperscript{45} The court went on to state that, in periods of short money supply or high interest rates, an inability to sell with an assumption could seriously hinder or prohibit sale of the property.\textsuperscript{46} In such cases, the court determined, a high quantum of restraint existed.\textsuperscript{47} This restraint was balanced by the court against the justification of lender's legitimate interests:\textsuperscript{48} "preservation of the security from waste or depreciation and protection against the 'moral risks' of having to resort to the security upon default by an uncreditworthy buyer."\textsuperscript{49} Since the buyer of the property must usually produce a large down payment to pay off a seller's equity, however, the court concluded that this incentive to the buyer, to not commit waste, was enough to protect the lender's interests.\textsuperscript{50} Thus, absent additional circumstances, a sale alone was insufficient to provide a justification for due-on-sale clause enforcement.\textsuperscript{51}

The practical effect of the California decisions was that variable rate mortgages\textsuperscript{52} became the almost exclusive form of mortgage

\textsuperscript{45} Id. at 949-50, 582 P.2d at 974, 148 Cal. Rptr. at 383.
\textsuperscript{46} Id. at 950-51, 582 P.2d at 974-75, 148 Cal. Rptr. at 383-84.
\textsuperscript{47} See id. at 951, 582 P.2d at 975, 148 Cal. Rptr. at 384.

\textsuperscript{49} Weltenkamp, 21 Cal. 3d at 951, 582 P.2d at 975, 148 Cal. Rptr. at 384.
\textsuperscript{50} Id. at 951-52, 582 P.2d at 975-76, 148 Cal. Rptr. at 384-85.
\textsuperscript{51} Id. at 952, 582 P.2d at 976, 148 Cal. Rptr. at 385.
\textsuperscript{52} Variable-rate mortgages link the interest paid to the present interest rate throughout the life of the mortgage. Under conditions specifying maximum rate increase per period and minimum period allowable, the mortgagee may increase the interest rate on the mortgage toward the market rate at specified intervals during its life. See LAND TRANSFER, supra note 14, at 122-25.
financing available in the state. When fixed-rate mortgages were available, the interest rate on the mortgages was higher than those prior to *Wellenkamp*.\(^53\) Additionally, the effects of the due-on-sale restrictions in California were estimated to have produced 40 percent of the 1981 losses incurred by state-chartered savings and loan associations in that state, for a total loss of $200 million in the first three-quarters of that year.\(^54\) The other major effect of *Wellenkamp* upon savings and loan associations was to cause a switch to federal charters for many state-chartered savings and loan associations.\(^55\)

The reason for the limitation of these dramatic effects to state-chartered savings and loan associations was that federally chartered savings and loan associations, authorized in 1933,\(^56\) were subject to regulation by the Federal Home Loan Bank Board.\(^57\) The Board has, since 1975, asserted that due-on-sale clauses are enforceable in the mortgages of federally chartered savings and loan associations as a matter of federal law.\(^58\)

This assertion was disputed in 1976 when the Attorney General of California filed for an injunction against Glendale Federal Savings and Loan Association in the California state courts to stop Glendale from exercising due-on-sale clauses in contravention of section 711 of the California Civil Code.\(^59\) At the same time,

\(^53\) *See Task Force, supra* note 8, at 7-8.

\(^54\) *See id.* at 15. These figures have been disputed. The parties all seem to agree, however, that some reduction in earnings will occur if due-on-sale clauses are restricted. *See generally J. Pierce, Economic Consequences of the Due-on-Sale Clause* (June 30, 1979) (available from Professor Pierce at the University of California, Berkeley); *B. Preiss & R. Van Order, An Economic Analysis of Due-on-Sale Clauses* (1981) (available at Office of Policy Development and Research, U.S. Department of Housing and Urban Development).

\(^55\) *Task Force, supra* note 8, at 17.

\(^56\) The creation of federally chartered savings and loan associations was part of the Home Owners Loan Act of 1933, ch. 64, 48 Stat. 128 (codified as amended at 12 U.S.C. §§ 1461-1470, 1464(a) (1976)).


\(^58\) In 1975, the Board issued an advisory opinion which ruled that “federal law exclusively governs” due-on-sale practices of federal savings and loan associations. *Schott v. Mission Fed. Sav. & Loan Ass'n*, Op. Fed. Home Loan Bank Bd. No. 75-647, at 19 (1975) (available from Federal Home Loan Bank Board) (interpreting predecessor of Contract Provisions for Real Estate Loans, 12 C.F.R. § 545.8-3(a) (1983)). This opinion then went on to hold that “[t]he exercise of the ‘due on sale’ clause on the facts of this case, or generally, does not constitute an unreasonable restraint on alienation.” *Id.* at 39.

Glendale filed an action in federal district court which granted Glendale’s motion for summary judgment that asserted federal law preempted state due-on-sale restrictions as to federally chartered savings and loan associations. This was reversed by the Ninth Circuit Court of Appeals in an unpublished opinion. The conclusion that state law still governed, set the stage for a direct confrontation between state and federal savings and loan associations in California.

B. De la Cuesta

The final confrontation was not long in coming. In early 1979, Fidelity Federal Savings and Loan Association found itself defending three suits, which had been consolidated for trial, on precisely the issue which had been reversed by the court of appeals in Glendale. Each of the three plaintiffs were purchasers from owners of Fidelity mortgages who incorporated assumption agreements. In late 1978, Fidelity learned of the transfers and notified plaintiffs of

See CAL. CIV. CODE § 711 (Deering 1971) (repealed 1983), which disallowed unreasonable restraints on alienation.


63. No issue was raised here that Fidelity waited too long to raise its claims though some courts have held that enforcement of due-on-sale clauses is subject to assertion of the right to enforce within a reasonable time. See McJenkin v. Central Bank, N.A., 417
its intent to exercise the due-on-sale clauses in the respective mortgages.\textsuperscript{64} Fidelity had notices of default and options to sell under the mortgages recorded and plaintiffs instituted suit to enjoin defendant from selling their property.\textsuperscript{65}

The trial court granted Fidelity's motion for summary judgment on the preemption issue.\textsuperscript{66} The state court of appeals, however, reversed, taking its opinion almost verbatim from the opinion of another California court of appeals case decided shortly before \textit{de la Cuesta}, though not yet final.\textsuperscript{67}

The court of appeals based its decision on two issues. First, it determined that no preemption existed in situations in which there was no "express congressional design" to preempt.\textsuperscript{68} Secondly, there could be no preemption "by implication" absent conflicts between state and federal regulations "resulting in . . . an inevitable collision between the two schemes of regulation . . . ."\textsuperscript{69} After concluding that California restrictions on due-on-sale enforcement were not preempted by federal law, the court further determined that an additional clause in the trust deeds made California law applicable nonetheless.\textsuperscript{70} Fidelity appealed this decision to the United States Supreme Court which reversed the court of appeals, thus reinstating the trial court decision.\textsuperscript{71}

The two questions presented to the Court were those on which the court of appeals had based its decision: 1) did federal law preempt state law as to the due-on-sale practices of federal savings and loan associations, and if so, 2) did the provision in the trust deeds, regarding applicability of California law, subject the issue to state

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\textsuperscript{64} See \textit{de La Cuesta} v. Fidelity Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 330-33, 175 Cal. Rptr. 467, 467-69 (1981), rev'd, 102 S. Ct. 3014 (1982). While the instruments were not mortgages but rather deeds of trust, the trust deed is really only a three-party mortgage transaction. \textit{See LAND TRANSFER, supra note 14, at 159.}

\textsuperscript{65} \textit{See de la Cuesta}, 121 Cal. App. 3d at 330-33, 175 Cal. Rptr. at 467-69.

\textsuperscript{66} Appellant's Jurisdictional Statement at 29a, Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. 3014 (1982).

\textsuperscript{67} \textit{De la Cuesta}, 121 Cal. App. 3d at 331, 175 Cal. Rptr. at 468 (citing Panko v. Pan Am. Fed. Sav. & Loan Ass'n, 119 Cal. App. 3d 916, 174 Cal. Rptr. 240 (1981)).

\textsuperscript{68} \textit{Id.} at 340, 175 Cal. Rptr. at 474.

\textsuperscript{69} \textit{Id.} (citing Florida Lime & Avocado Growers v. Paul, 373 U.S. 132, 142-43 (1963)).

\textsuperscript{70} \textit{De la Cuesta}, 121 Cal. App. 3d at 341-42, 175 Cal. Rptr. at 476. This provision provided that "[t]his Deed of Trust shall be governed by the law of the jurisdiction in which the property is located." \textit{Id.} at 342, 175 Cal. Rptr. at 475.

\textsuperscript{71} Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta, 102 S. Ct. 3014 (1982).
The Court found for Fidelity as to both issues. The Court first dealt with the preemption issue, holding that federal regulations had the same preemptive effect as federal statutes and that only when arbitrary or beyond authority could the regulations of an administrator be challenged. Thus, the Court concluded, all that was necessary for preemption to exist was the intent to preempt. That the Board intended to preempt state law on due-on-sale clauses was not doubted by the court of appeals. This decision was neither unexpected nor was it unsupported in light of the numerous lower court opinions that had found preemption to exist.

The Court, therefore, held that the Board, while its powers were not boundless, was well within its intended area of regulation as prescribed by Congress and that the assertion of preemption by the Board was valid.

Giving brief treatment to the second issue, the Court concluded that "law of the jurisdiction" includes federal as well as state law.

73. See de la Cuesta, 102 S. Ct. at 3031.
74. Id. at 3022-23 (citing United States v. Shimer, 367 U.S. 374, 381-83 (1961)).
75. De la Cuesta, 102 S. Ct. at 3023. This was directly contrary to the position taken by the court of appeals which had asserted that "we cannot equate the Board's expression of intent with the requisite congressional intent." De la Cuesta, 121 Cal. App. 3d at 339, 175 Cal. Rptr. at 474 (emphasis in original).
76. De la Cuesta, 121 Cal. App. 3d at 339, 175 Cal. Rptr. at 473.
78. De la Cuesta, 102 S. Ct. at 3029. This was also the thrust of the short concurring opinion. Id. at 3031-32 (O'Connor, J., concurring).
79. Id. at 3028. The Court noted in its discussion that the scope of the Board's authority under Home Owner's Loan Act, 12 U.S.C. §§ 1461-70, 1464(a) (1982), was unclear because of the lack of legislative history available thereon. It found, however, that what history did exist supported the proposition that the Board has "great power to administer the act." 102 S. Ct. at 3028 (citing 77 CONG. REC. 2480 (1933) (statement of Rep. Luce)).
80. See de la Cuesta, 102 S. Ct. at 3030-31. The dissent argued that under Section 1428 of the Federal Home Loan Bank Act of 1932, the Board was granted the power only to "withhold or limit" operations where it deemed conditions to be unsatisfactory, but was not granted the power to preempt state law in those areas. Id. at 3032 (Rehnquist and Stevens, J.J., dissenting) (quoting Federal Home Loan Bank Act of 1932, 12 U.S.C. §§ 1421-49, 1428 (1982)) (emphasis in original). This argument, however, would seem inappropriate to this issue as § 1428 deals with federal home loan banks and not federal savings and loan associations. See 12 U.S.C. § 1428 (1982). Further, the Board's power to regulate federal savings and loan associations is granted under the Home Owner's Loan Act and not under the Federal Home Loan Bank Act. See supra note 57.
81. De la Cuesta, 102 S. Ct. at 3024 n.12. This was directly contrary to the court of appeals' reading of the provision. The court of appeals asserted that this reading rendered the provision nonsensical as a whole because the next sentence, referring to "con-
Thus state law was the law of the jurisdiction only insofar as it did not conflict with federal law. As state law in this area was preempted, federal regulation was the "law of the jurisdiction" under the deed of trust.

Thus, as of June 28, 1982, the situation in California was clear. Under the Wellenkamp doctrine, state-chartered savings and loan associations in California were unable to enforce due-on-sale clauses in the mortgages they issued; under de la Cuesta, federally chartered savings and loan associations in California could enforce such clauses.

C. Practicalities in the Post-de la Cuesta World

Since de la Cuesta, federal savings and loan associations have had a competitive advantage over state-chartered savings and loan associations in California and other jurisdictions which restrict due-on-sale clause enforcement. Due-on-sale enforcement restrictions reduce the profitability of the mortgages in the lender's portfolio. State-chartered savings and loan associations must, therefore, accept lower profits to maintain competitive interest rates with those available at their federally chartered counterparts. In the alternative, state savings and loan associations can use variable-rate mortgages or the seven-year call option to maintain their profit levels and keep immediate interest rates level with those of federal savings and loan associations. These alternatives, however, are significantly less palatable terms to the mortgagor than would be the simple fixed-rate mortgage terms available down the street at a federal savings...

82. Other than California, the Board has identified seventeen states which restrict enforcement of due-on-sale clauses: Arizona, Arkansas, Colorado, Florida, Georgia, Illinois, Iowa, Michigan, Minnesota, Mississippi, New Mexico, New York, North Dakota, Ohio, Pennsylvania, Utah, and Washington. TASK FORCE, supra note 8, at 2.2 n.2.

83. See Blocher, supra note 7, at 97.

84. See supra notes 5, 6 & 8 and accompanying text.

85. See Blocher, supra note 7, at 97.

86. See supra note 52 and accompanying text.

87. The seven-year call option remains a business necessity to those savings and loan associations which cannot enforce due-on-sale clauses yet wish to sell on the secondary market. See supra note 23 and accompanying text.
and loan association. One other possible alternative for state-chartered savings and loan associations is to shift to federal charters. That already was occurring on speculation of this situation after Wellenkamp was decided.

The most likely options for state-chartered savings and loan associations, however, are: 1) changes in the law, or 2) assertion that state law is preempted as to them by de la Cuesta also. This latter alternative has been suggested by at least one source and is supported by the following arguments.

The Federal Savings and Loan Insurance Corporation, created in 1934, and presently controlled by the Board, is empowered to insure any state-chartered savings and loan association as well as being required to insure all federally chartered savings and loan associations. It has insured some 2,017 state-chartered savings and loan associations since that time and provides a strong federal interest in maintaining the solvency and competitiveness of state-chartered institutions. Thus, a holding that due-on-sale clauses are “reasonably exercised . . . so as to ensure the financial stability of” savings and loan associations, in conjunction with regulations requiring insured lenders to maintain “safe and sound management” and to pursue “financial policies that are safe and consistent with economical home financing and the purposes of insurance of ac-

88. See Blocher, supra note 7, at 97.
89. This procedure is relatively simple and is specifically authorized by the Board. See Federal Savings and Loan System Eligibility, 12 C.F.R. § 543.8 (1983); Blocher, supra note 7, at 97.
90. Task Force, supra note 8, at 17.
92. See Blocher, supra note 7, at 99.
96. Task Force, supra note 8, at 1.3. This constitutes slightly more than half of all institutions insured. Id.
97. De la Cuesta, 102 S. Ct. at 3031.
counts," commands enforceability of due-on-sale clauses. In addition, a similar argument can be raised on the theory that the creation by the federal government of a secondary mortgage market gives rise to a strong argument for preemption as to those mortgages purchased by Fannie Mae and Freddie Mac. As a result, it is not surprising that the federal government, in enacting section 341, chose to explicitly preempt state due-on-sale restrictions.

IV. THE PROVISIONS OF SECTION 341

As a statement of policy, de la Cuesta is susceptible to the same criticism as the state court decisions it rejects. Absent a statement by the legislature, it is difficult to assert with any justification that public policy is for or against enforcement of due-on-sale clauses. Thus, enactment of section 341 is a valuable statement of policy from Congress on this issue.

Section 341(b) provides that "a lender may, subject to subsection (c), enter into or enforce a contract containing a due-on-sale clause with respect to a real property loan." It is further provided that operation of the clause and all rights and remedies under it shall

99. See Blocher, supra note 7, at 99.
100. In fact, application of preemption to state-chartered lenders was already being tested before § 341 was enacted. In Bleecker Assoc. v. Astoria Fed. Sav. & Loan Ass'n, 544 F. Supp. 794 (S.D.N.Y. 1982), decided just six weeks after de la Cuesta, the court held that a mortgage issued by a state-chartered savings and loan association subject to due-on-sale restrictions and later taken over by a federally chartered savings and loan association remained subject to state law restrictions, as no explicit preemption exists as to state-chartered institutions by the Board. Id. at 798. Further the court suggested that the Home Owners' Loan Act and its regulations might not apply to state-chartered savings and loan associations. Id. at 797 n.13. This, however, was based on a circuit court case decided prior to de la Cuesta and thus the argument is subject to the interpretation of de la Cuesta. How that case would affect the outcome in Bleecker is unclear. See First S. Fed. Sav. & Loan Ass'n v. First S. Sav. & Loan Ass'n, 614 F.2d 71, 73 (5th Cir. 1980).
101. See Blocher, supra note 7, at 97. This has, however, been the assessment of several courts which have ruled that due-on-sale clauses are not contrary to public policy. See Louisiana Sav. Ass'n v. Trahan, 415 So. 2d 592 (La. 1982); Occidental Sav. & Loan Ass'n v. Venco Partnership, 206 Neb. 469, 293 N.W.2d 843 (1980); First Commercial Title, Inc. v. Holmes, 92 Nev. 363, 550 P.2d 1271 (1976); Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works, 71 Wis. 2d 531, 239 N.W.2d 20 (1976).
102. Garn Act, supra note 1, § 341(b) (codified at 12 U.S.C. § 1701j-3(b) (1982)). For a definition of "lender" under section 341 see supra note 12. This applies to state as well as federal lenders because section 341(c)(1) refers to "lenders other than national banks, Federal savings and loan associations, Federal savings banks, and Federal credit unions." Garn Act, supra note 1, § 341(c)(1) (codified at 12 U.S.C. § 1701j-3(c)(1) (1982)). This leaves little else but state-chartered lenders within the class. Further, if Congress had meant to exclude state lenders it easily could have excluded them from its
be governed by the terms of the contract. Nonetheless, the section is quite clear that it encourages lenders to allow assumption agreements and does not, in any way, prohibit them.

The provisions of section 341(b), however, are not to be read as an incontrovertible statement of nationwide policy. Section 341(c) provides that under certain circumstances subsection (b) will not apply. The first of those circumstances is where a state has, by legislation or judicial decision, restricted due-on-sale enforcement in the past. In such cases, all mortgages issued between the date of such restrictive action and October 15, 1982, are not subject to subsection (b) until the close of the so-called “window period” which ends on October 15, 1985. Prior to October 15, 1985, however, a state legislature may adopt or reject application of section 341(b) to state-chartered lenders entirely. Unless specifically adopted, section 341(b) will not apply until after October 15, 1985 without state legislative action to the contrary. This provision allows statements of policy from each state legislature to control the enforceability of due-on-sale clauses therein, yet requires that restrictions on enforcement come directly from the legislature rather than the judiciary in keeping with the criticism of judicial policy-making in this area. Additionally, national banks and federal credit unions are not subject to subsection (b) unless their regulating bodies so choose within the same three year period, or fail to act at all within that time.

It should be noted, however, that the exceptions to section 341(b) are not absolute. They are subject to the rights of the lender to require the borrower’s successor to meet regular credit standards. If a successor fails to meet such standards, the definition of “lender,” however it clearly meant that term to be all-encompassing. See Garn Act, supra note 1, § 341(c)(1)(A) (codified at 12 U.S.C. § 1701j-3(c)(1)(A) (1982)).
due-on-sale clause may be enforced in all mortgages issued after Oc­
tober 15, 1982.\footnote{112} Further, none of the exceptions found in section
341(c) are applicable to federal savings and loan associations or fed­
eral banks.\footnote{113} These provisions simply restrict the provisions of sec­
tion 341(c) to assumptions by state-chartered lenders where there is
no security impairment. Thus, the ability of a state legislature to
decide state policy on due-on-sale restrictions is limited to those
cases where clauses are enforced for purposes other than security im­
pairment, such as portfolio maintenance.\footnote{114}

Under section 341(d), nine specific cases are excluded from the
operation of due-on-sale clauses under section 341(b). These cases
are: 1) subordinate encumbrances, 2) security interests for house­
hold appliances, 3) transfer of any type on the death of a joint tenant
or tenant by the entireties, 4) leases of less than three years provided
there is not an option to purchase, 5) transfer resulting from death of
borrower, 6) transfer to spouses or children of borrower, 7) transfer
to borrower’s spouse subsequent to a divorce, separation or settle­
ment agreement, 8) transfer into inter vivos trust where borrower
remains a beneficiary and no transfer of occupancy exists, and 9) all
other transfers excluded by regulations of the Board.\footnote{115} Finally,
notwithstanding the above exemptions, if a borrower uses a long­
term lease rather than an outright sale, a lender may enforce its due­
on-sale clause if the Board’s rules and regulations so allow.\footnote{116} Fur­
ther, balloon payment restrictions in Board regulations do not apply
to loans covered by section 341.\footnote{117}

\footnote{112. Id.}
\footnote{113. Id. § 341(c)(2)(C) (codified at 12 U.S.C. § 170lj-3(c)(2)(C) (1982)).}
\footnote{114. See supra note 48 and accompanying text. Given the number of states which
have, by judicial decision, held that due-on-sale enforcement is not available only where
lender security is impaired, it is unlikely that many state legislatures will take time within
the next three years, the so-called “window period,” to enact legislation contrary to, or
consistent with § 341(c). It is more likely that they will allow three years to pass by
without acting at all. Thus, it is hard to understand why § 341(c)(1) and § 341(c)(2)(A)
were even added to the section. Aside from being needlessly complex they add little to
the power of the states over regulating due-on-sale clauses and will probably go largely
unused.}
\footnote{115. Garn Act, supra note 1, § 341(d)(1)-(9) (codified at 12 U.S.C. § 170lj-3(d)
(1982)). In the Freddie Mac mortgage, which was later accepted by Fannie Mae, four of
these exclusions were listed: 1) subordinate liens, 2) transfer at death including the death
of a joint tenant, 3) leasehold grant for less than three years without purchase option, and
4) security interest for appliances. With the exception of this last exemption, all of these
were also in the earlier Fannie Mae mortgage as well. Jensen, supra note 20, at 416-17.}
\footnote{116. See Garn Act, supra note 1, § 341(e) (codified at 12 U.S.C. § 170lj-3(e)(1982)).}
\footnote{117. Id. § 341(g) (codified at 12 U.S.C. § 170lj-3(g) (1982)). Such payments occur}
Thus, section 341 provides, with very few limited exceptions, some of which already were included in the Fannie Mae and Freddie Mac form mortgages,\textsuperscript{118} that federal law will prevail over state due-on-sale restrictions.

V. THE EFFECTS OF SECTION 341

Enactment of section 341 has created three classes of mortgages: 1) those mortgages entered into prior to state restrictions on due-on-sale enforcement, 2) those mortgages issued after state restrictions but prior to October 15, 1982,\textsuperscript{119} and 3) those mortgages issued after October 15, 1982. Mortgages in this latter class are not subject to state restrictions on due-on-sale practices unless issued after the enactment of section 341, and issued subject to state legislation mandated within the “window period” after enactment of section 341.\textsuperscript{120}

The status of the first class of mortgages, however, is uncertain. It would appear that until October 15, 1985, these mortgages may be subject to state restrictions on due-on-sale enforcement unless state legislature acts to counter that result.\textsuperscript{121} As a result, in California, any mortgage issued between the Wellenkamp decision and enactment of section 341 may be assumed until October 15, 1985, provided due-on-sale enforcement is not necessary to the lender’s security protection.\textsuperscript{122}

\textsuperscript{118} See supra note 115.

\textsuperscript{119} See supra notes 106-109, 115 and accompanying text.

\textsuperscript{120} See id.

\textsuperscript{121} See supra notes 107-108 and accompanying text.

\textsuperscript{122} It is possible, though not probable, that state restrictions on due-on-sale enforcement would be applicable, even where the lender’s security is threatened. The provision in § 341(c)(2)(A) refers to “any contract to which subsection (b) does not apply pursuant to this subsection” and goes on to require enforcement where the successor or transferee of the borrower cannot meet a credit check. Garn Act, supra note 1, § 341(c)(2)(A) (codified at 12 U.S.C. § 1701j-3(c)(2)(A) (1982)). If this is read narrowly, it can be construed to apply only to § 341(c)(2) which deals with national banks and federal credit unions and not to § 341(c) as a whole. While this is a possible construction, the last line of § 341(c)(2)(C) also states, “[t]his subsection does not apply to a loan which was originated by a Federal savings and loan association or Federal savings bank.” Id. § 341(c)(2)(C) (codified at 12 U.S.C. § 1701j-3(c)(2)(C) (1982)). The only possible ambiguity in § 341(c) which might give rise to thoughts that such institutions were included is in § 341(c)(1). Thus, to give the term “subsection” consistent meaning it would appear that it must apply to § 341(c) as a whole. Additionally, the language of Senator Garn’s statement to Congress in clarification of § 341 would seem to support this. Senator Garn stated that “the committee takes no position on the authority of the National Credit Union Administration or the Comptroller of the Currency to issue regulations covering window period loans originated by national banks and federally chartered credit un-
The issue of what prompted enforcement in any given case—security impairment or portfolio maintenance—will engender no small amount of litigation in the next three years. Raising the requirements for credit probably will also take place at most savings and loan associations so that fewer people will be acceptable as risks. This provides increased ability to enforce mortgages for the savings and loan associations, but is likely to worsen the already tight mortgage market for potential home buyers.

On the other hand, the prospect of section 341 passing already has caused some to advocate making it harder for lenders to foreclose on due-on-sale grounds. Senator Garn referred to this in his clarification of section 341 before Congress when the Garn Act was passed. He referred to several methods being advocated for making due-on-sale based foreclosure more difficult or more costly to lenders including prolonged redemption periods, or prolonged procedures.

The potential battle between the state and federal governments will raise many problems for the judiciary, not the least of which will be the decision of how to treat window period loans that are not completely restricted by state law: Specifically, how far state courts can extend restrictions on due-on-sale enforcement until the window period ends. If the state has failed to legislate on the issue, yet has voiced its opposition to section 341 through other actions or through restrictive legislation enacted prior to section 341, a conflict of federal policy in favor of enforcement and state policy in favor of restriction would suggest that courts could go either way in deciding to extend or retreat from previous positions on enforcement.
ther, in cases in which state legislatures do adopt legislation expanding due-on-sale restrictions, until a uniform policy is agreed upon, those problems inherent in window period enforcement may carry on indefinitely. Questions will be continuously raised as to the reason for enforcement in a specific case and as to which way the courts should lean in deciding whether a given case falls within section 341 or within the state's control under the exceptions.127

VI. CONCLUSION

If the intent of Congress, in passing section 341, was to legislate away the problems of state restrictions on due-on-sale enforcement, its solution is something less than ideal. As has been recognized, courts have been responsible for most state restrictions and it will be those courts that interpret section 341. Thus, court views of the purpose behind raised credit requirements and the purpose behind attempting to enforce due-on-sale provisions—security or portfolio maintenance—are likely to be restrictive of section 341 regardless of the views of state legislatures or Congress.

Further, state legislatures which do act on due-on-sale provisions may attempt to circumvent section 341 rather than to act within the restrictive provisions of section 341(c). This is certain to generate litigation on the validity of such actions and, consequently, it is possible that section 341, rather than being a solution, is merely a postponement of the problem.

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127. It cannot be denied that section 341 will help the banks and savings and loan associations. In the long run it may prove beneficial to consumers as well. Nonetheless, had Congress considered what would be at least tolerable to consumers in the short term, it might have prevented litigation which will undoubtedly result when buyers and sellers alike realize what effects section 341 is having on their ability to afford new housing. Comment, Due-on-Sale Clauses: Is Anyone Winning the Courtroom Battle?, 23 S. Tex. L.J. 351, 371 (1982).