It's Due Time: Federal Preemption of Due-on-Sale Controversies

Barry Bursey

Due-on-sale[1] clauses are routinely included in mortgages and deeds of trust.[2] These provisions allow a lender to immediately accelerate the entire loan balance if a borrower sells or transfers secured property without the lender's consent.[3] The original intent behind due-on-sale clauses was the protection of the lender's security interest.[4] Acceleration of the loan prevented borrowers from being able to freely transfer their property and accompanying indebtedness to less reliable third parties.[5] The secured interest of the lender was thereby protected.

---

1. The term "due-on-sale," as used in this Note, encompasses several different clauses, variously titled "due-on-encumbrance" and "acceleration." All of these clauses allow the lender to declare the remaining loan balance immediately due and payable upon sale, conveyance, transfer, encumbrance or alienation of the secured property by the borrower without the written consent of the lender. 1 H. MILLER & M. STARR, CURRENT LAW OF CALIFORNIA REAL ESTATE § 3.60, at 424-25 (1975).

2. *See* Bartke & Tagaropulos, *Michigan's Looking Glass World of Due-on-Sale Clauses*, 24 WAYNE L. REV. 971, 979 (1978).

3. The following example of a due-on-sale clause was contained in a 1972 deed of trust used by First Federal Savings and Loan Association of Phoenix, Arizona:

> 4. CONSENT TO TRANSFER: In the event that Trustor, . . . shall sell, convey, transfer, contract to sell, lease for more than five (5) years or lease with option to purchase the secured property, or any part thereof, or any interest therein . . . or if title to said property is further encumbered or subjected to any lien or charge, contractual, statutory, by operation of law or otherwise, or if any of said parties shall change or permit the character or use of said property to be changed, . . . without the written consent of Beneficiary, all indebtedness secured by this Deed of Trust, . . . without regard to the adequacy or inadequacy of the security, or solvency or insolvency of Trustor, shall, at the option of the Beneficiary, become immediately due and payable without demand or notice. Beneficiary shall have the contractual right to withhold its consent to a transfer under the provisions of this paragraph in any instance where the security upon reevaluation, . . . does not warrant that consent, or the existing interest rate of this loan is less than the current interest rate being charged on loans to purchasers of properties similar in value to the secured property.

For a discussion of this particular clause, *see* Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 477, 578 P.2d 152, 156 (1978) (clause which allowed acceleration upon conveyance without trust beneficiary's consent found to result in harsh restraint on alienation).

4. Bartke & Tagaropulos, *supra* note 2, at 979.

5. *See, e.g.*, 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, 270-71 (1972); Bonnett, *Enforceability of a Real Estate Financer's Contractual Right to Increase the Interest Rate When Non-Residential Property is Transferred by the Borrower*, 17 ARIZ. B.J. (Aug. 1981) 8, 8-9; Note, *Judicial Treatment of the Due-on-Sale Clause: The Case for Adopting Standards of Reasonableness and Unconscionability*, 27 STAN. L. REV. 1109, 1109-11 (1975).

In recent years, however, lenders have attempted to use due-on-sale clauses for an additional purpose. Institutional lenders have found themselves saddled with numerous long-term, low-interest mortgages.[6] At the same time, institutional lenders, primarily savings and loan associations, have been paying their depositors increasingly higher interest rates.[7] Thus, these lenders have found themselves losing money by paying more to their depositors than they make from the relatively low-interest mortgages.[8] The due-on-sale clause offers several solutions to the lender in this predicament. For example, the clause may be used to retire an older low-interest mortgage by accelerating the debt.[9] The funds received may then be reloaned at the current rate of interest.[10] Lenders can also condition their willingness to refrain from acceleration on the willingness of the borrower and potential buyer to accept a higher interest rate.[11] Thus, the due-on-sale clause recently has evolved into a tool with which lenders attempt to keep their portfolios at current interest rates.

The desire of savings and loan institutions to maximize the interest rate on loans, however, conflicts with the desire of owner/borrowers and potential purchasers to transfer the secured property with the initial low-interest loan intact.[12] If the buyer cannot assume the borrower's low-interest loan, the sale of the property becomes more difficult. Not surprisingly, the incompatibility of the lender's desires with the borrower's desires has engendered much litigation in recent years.[13] Cases spawned by the friction over due-on-sale clauses have arisen principally in the state courts.[14] These cases generally involve disputes based upon state law.[15] Typically, the borrowers contend that, under state law, the enforcement of due-on-sale clauses amounts to an undue restraint on alienation.[16] The lenders typically counter that, under the common law freedom of contract doctrine, the borrower must abide by an agreement containing a due-on-sale

6. *See* authorities cited in note 5 *supra*.

7. *See id.*

8. *See id.*

9. *See id.*

10. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1149 n.1 (E.D. Mich. 1980).

11. *See* Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 479, 578 P.2d 152, 158 (1978). The due-on-sale clause in the First Federal deed of trust (note 3 *supra*), for example, allows the lender to withhold consent to a transfer if "the existing interest rate of this loan is less than the current interest rate being charged on loans to purchasers of properties similar in value to the secured property." *Id.* at 477, 578 P.2d at 156.

12. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1149 n.1 (E.D. Mich. 1980).

13. *See generally* Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978); Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978); Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974).

14. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1149 n.1 (E.D. Mich. 1980); *see* Bartke & Tagaropulos, *supra* note 2, at 972 n.7 (listing a number of the early state court decisions).

15. *See, e.g.*, cases cited in note 13 *supra*.

16. *See, e.g.*, Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 478-79, 578 P.2d 152, 157-58 (1978) (enforcement of due-on-sale clause without showing jeopardy to security interest would be unlawful restraint on alienation); Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 953, 582 P.2d 970, 976-77, 148 Cal. Rptr. 379, 385-86 (1978) (absent an impairment of the lender's security interest, enforcement of a due-on-sale clause would constitute an undue restraint on alienation). Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 484 (Minn. 1981) (enforcement of due-on-sale clause does not amount to an undue restraint on alienation with regard to *investment* residential property).

clause if the borrower voluntarily signed the agreement.[17] The predominant conclusion of state courts facing these arguments is that due-on-sale clauses are enforceable only in situations where the lender's security interest is in jeopardy.[18] Thus, the mere desire of savings and loan associations to increase interest rates is generally an insufficient ground to justify such enforcement under state law.

Recently, federally chartered savings and loan associations[19] (FSLs) have adopted a new approach to the enforcement of due-on-sale clauses. They maintain that, under the doctrine of federal preemption, the issue of the enforceability of their due-on-sale clauses should be decided by federal rather than state law.[20] If federal law allows enforcement of due-on-sale clauses, a federal decision favorable to FSLs would conflict with many state laws.

This Note first will present the general theories of federal preemption. An analysis will then be made of the regulation of due-on-sale clauses in light of these preemption theories. Next, an examination will be made of the procedures by which due-on-sale cases reach the federal courts. Finally, this Note will discuss federal question jurisdiction and the issue of whether, through federal preemption, a federal question is presented sufficient to warrant federal jurisdiction.

THE DOCTRINE OF FEDERAL PREEMPTION

Generally, state law controls intrastate matters.[21] Under the supremacy clause of the Constitution,[22] however, a federal law can pre-

17. *See* Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 80-81, 486 P.2d 190, 192-93 (1971), *appeal denied*, 108 Ariz. 192, 494 P.2d 1322 (1972). *See also* Comment, *Enforcement of Due-on-Sale Clauses in Secured Real Estate Transactions*, 22 ARIZ. L. REV. 311, 313-14 (1980).

18. *E.g.*, Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 478-79, 578 P.2d 152, 157-58 (1978); Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 953, 582 P.2d 970, 976-77, 148 Cal. Rptr. 379, 385-86 (1978); Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 638-39, 526 P.2d 1169, 1175, 116 Cal. Rptr. 633, 639 (1974).

The most recent Arizona state court decision concerning the enforceability of due-on-sale clauses, Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978), weighed the conflicting arguments and stated: "the 'due-on-sale clause' cannot be enforced unless First Federal can show that its security is jeopardized by the transfer of the subject property without First Federal's consent; enforcement of the clause without such showing is an unlawful restraint on alienation. . . ." *Id.* at 479, 578 P.2d at 158. The court went on to say that "First Federal may refuse to consent to the transfer . . . if First Federal reasonably concludes that this transfer will impair its security, but First Federal may not arbitrarily withhold its consent, nor may First Federal exact an interest rate increase as a condition for giving its consent." *Id.*

19. Both state and federally chartered savings and loan associations exist. The latter owe their existence to the Home Owners' Loan Act of 1933 (HOLA), 12 U.S.C. §§ 1461-1470 (1978). HOLA was enacted by Congress as a result of the troubled home financing market following the Depression. Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 908-09 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981). That Act created a system of federally chartered savings and loan associations. *Id.*

20. *See, e.g.*, 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); Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139, 1140-41 (C.D. Ill. 1979); Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 906 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sep. 23, 1981).

21. *See, e.g.*, Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947); U.S. CONST. amend. X; L. TRIBE, AMERICAN CONSTITUTIONAL LAW § 6-25, at 385 (1978).

22. The supremacy clause states that "[t]his Constitution, and the Laws of the United States which shall be made in Pursuance thereof . . . shall be the supreme Law of the Land . . . any

empt state control even in an intrastate matter[23] if the federal law falls within the scope of federal powers under the United States Constitution.[24] Federal preemption may occur in various ways.[25] If state law presents an actual conflict with a congressional act, the state law must give way.[26] The actual conflict may be clear from the face of the competing acts[27] or may be found when the state law conflicts with the underlying objectives of the federal act.[28] When the acts clash unavoidably and no possibility exists of dual compliance, the federal act preempts the state act.[29]

In addition to situations of actual conflict, federal preemption may occur in areas where Congress has indicated its intention to "occupy the field" and to thus preclude even non-conflicting state laws.[30] Such preemption, however, must be the "clear and manifest purpose of Congress," and will not be lightly inferred.[31] When Congress displays preemptive intent in a certain field, no state law will apply to issues arising in that field.[32]

A preemptive purpose may be explicitly declared by Congress.[33] It may also be implied, even though the federal law contains no express declaration by Congress of its preemptive intent.[34] In determining whether congressional intent to occupy a field may be fairly implied, the Supreme Court has inquired whether a "pervasive scheme" of federal regulation or a "dominant federal interest" exists in the area.[35] Where a "pervasive scheme" or "dominant federal interest" is found, state law is preempted.[36]

Thing in the Constitution or Laws of any State to the Contrary notwithstanding." U.S. CONST. art. VI, cl. 2.

23. *See* Pennsylvania v. Nelson, 350 U.S. 497, 501-02 (1956); Parker v. Brown, 317 U.S. 341, 350 (1943); Gibbons v. Ogden, 22 U.S. (9 Wheat.) 1, 210-11 (1824).

24. See text & note 48 *infra*.

25. A preemption ruling is generally warranted whenever it is found that a state law "stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress." Hines v. Davidowitz, 312 U.S. 52, 67 (1941).

26. *See, e.g.*, Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963); McDermott v. Wisconsin, 228 U.S. 115, 132 (1913); Savage v. Jones, 225 U.S. 501, 533 (1912).

27. McDermott v. Wisconsin, 228 U.S. 115, 137 (1913) (retail merchants' compliance with federal labeling laws constituted a direct violation of a state law, federal law preempted).

28. Nash v. Florida Indus. Comm'n, 389 U.S. 235, 239-40 (1967) (state law disqualifying from benefits persons unemployed due to labor controversies conflicted with objectives of the National Labor Relations Act).

29. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963).

30. L. TRIBE, *supra* note 21, § 6-25, at 384 (1978) (congressional preemptive intent may flow from occupation of a particular field); *see* Pennsylvania v. Nelson, 350 U.S. 497, 501-02 (1956) (federal sedition law preempts state laws by occupying the field); Parker v. Brown, 317 U.S. 341, 350 (1943) (occupation of field through exercise of constitutionally granted power is example of congressional power to preempt state laws).

31. *See* Jones v. Rath Packing Co., 430 U.S. 519, 525 (1977); Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947); Parker v. Brown, 317 U.S. 341, 351 (1943).

32. Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145, 1146 (9th Cir. 1974); Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 907 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981); *see* Pennsylvania v. Nelson, 350 U.S. 497, 501-02 (1955).

33. Ray v. Atlantic Richfield Co., 435 U.S. 151, 157 (1978).

34. Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145, 1146 (9th Cir. 1974).

35. Pennsylvania v. Nelson, 350 U.S. 497, 502-09 (1956); Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

36. *See, e.g.*, Motor Coach Employees v. Lockridge, 403 U.S. 274, 285-89 (1971) (dominant federal interest in and pervasive scheme of national regulation of labor relations); Erie R.R. v. New York, 233 U.S. 671, 683 (1914) (dominant interest in national regulation of railroads for

Complicating the federal preemption issue is the common practice of Congress to enact legislation couched in fairly general terms and then to delegate the administrative responsibility of regulatory control to a specific federal agency.[37] The question then arises whether the regulations promulgated by a federal agency carry the same preemptive force as an act of Congress itself.[38] Further, if the agency has issued regulations in a particular field but has not yet addressed a specific part of that field, the question becomes whether state law is preempted in that untouched part.[39] The United States Supreme Court has held that state regulation concerning an as-yet-unregulated phase of a field comprehensively regulated by a federal agency is invalid unless that phase is a "separable or distinct segment of the matter covered by the federal statute and the federal agency has not acted on that segment."[40] In this situation, the states may act until such federal action occurs.[41]

The preceding discussion has provided the reader with an outline of the basic issues which may arise regarding the doctrine of federal preemption. The next section considers the application of the preemption doctrine in a specific area—the regulation of FSL due-on-sale clauses.

FEDERAL PREEMPTION OF THE REGULATION OF FSL DUE-ON-SALE CLAUSES

In 1932, Congress enacted the Federal Home Loan Bank Act (FHLBA) which created the Federal Home Loan Bank Board (FHLBB).[42] The following year, Congress enacted the Home Owners' Loan Act (HOLA).[43] This Act authorized the establishment of federally chartered savings and loan associations.[44] Congress authorized the FHLBB "to provide for the organization, incorporation, examination, operation, and regulation" of FSLs.[45]

Courts have consistently held that FHLBB regulations concerning the

---

public safety); Northern States Power Co. v. Minnesota, 447 F.2d 1143, 1146-54 (8th Cir. 1971) (pervasive federal scheme of regulation of construction and operation of nuclear power plants), *aff'd mem.*, 405 U.S. 1035 (1972).

37. See Bethlehem Steel Co. v. New York State Labor Relations Bd., 330 U.S. 767, 774-75 (1947), for a discussion of the possible interpretations of preemption in the context of such delegated responsibility.

38. *See* L. TRIBE, *supra* note 21 § 6-26, at 386-87 (1978).

39. *See* Bethlehem Steel Co. v. New York State Labor Relations Bd., 330 U.S. 767, 774 (1947).

40. *Id.* In this case the NLRB's failure to accept foremen's unions as valid collective bargaining units was considered equivalent to a potential ruling by the NLRB rejecting such units even though no specific regulation existed in the area. *Id.* at 774-75.

41. *Id.* at 774.

42. 12 U.S.C. §§ 1421-1449 (1978).

43. *Id.* §§ 1461-1470.

44. *Id.* § 1464(a).

45. *Id.* § 1464(a)(1) (Supp. 1981) provides in relevant part:

> In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized . . . to provide for the organization, incorporation, examination, operation, and regulation of . . . 'Federal Savings and Loan Associations,' . . . and to issue charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.

"internal affairs" of FSLs preempt state action in FSL internal affairs.[46] Three principal questions, however, need to be answered concerning federal preemption of due-on-sale regulation. First, is such preemption constitutional? Second, did Congress intend to authorize the FHLBB to promulgate FSL due-on-sale regulations that preempt state law? And finally, do FHLBB due-on-sale regulations mandate preemption of state law? These questions will be addressed in the following subsections.

Is Federal Preemption of Due-on-Sale Regulation Constitutional?

In order for a congressional act to preempt state law under the supremacy clause,[47] the federal act must be enacted pursuant to some authority granted by the Constitution.[48] The commerce clause, for example, grants such federal authority.[49] At least one federal court has specifically stated that Congress, in passing the HOLA, was engaging in the regulation of commerce.[50] The HOLA was determined to be constitutional at an early date.[51] In cases concerning federal preemption of due-on-sale regulation, however, courts have not specifically discussed the constitutionality issue.[52] Nevertheless, these courts have considered issues which would not have arisen if the court had not first reached a conclusion of constitutionality.[53] For instance, the issue of the preemptive power of FHLBB regulations cannot be reached unless it is assumed that the HOLA is constitutional. It therefore appears that Congress has the constitutional

46. *See, e.g.*, Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609, 611 (2d Cir. 1967) (management failure to provide list of eligible voters for FSL directors); Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819, 823-24 (N.D. Ill. 1975) (federal law regarding corporate opportunities and breach of fiduciary duty by directors and officers of FSL preempts state law); Springfield Inst. for Sav. v. Worcester Fed. Sav. & Loan Ass'n, 329 Mass. 184, 187-89, 107 N.E.2d 315, 317-18 (right of FSL to establish branch offices more than fifteen miles from city of principal office), *cert. denied*, 344 U.S. 884 (1952). Even courts denying preemption in the due-on-sale area have held that FHLBB regulation of FSL "internal affairs" preempts state action. Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 478 (Minn. 1981).

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

48. United States v. Germaine, 99 U.S. 508, 510 (1878) (no congressional act is valid unless based on constitutional authority).

49. U.S. CONST. art. I, § 8, cl. 3; *see, e.g.*, Cloverleaf Butter Co. v. Patterson, 315 U.S. 148, 163 (1942); Escanaba Co. v. Chicago, 107 U.S. 678, 683 (1882); People v. Buck, 101 Cal. App. 2d Supp. 912, 914, 226 P.2d 87, 89 (App. Dep't Super. Ct. 1950), *aff'd*, 343 U.S. 99 (1952).

50. Conference of Fed. Sav. & Loan Ass'ns v. Stein, 495 F. Supp. 12, 16 (E.D. Cal. 1979). *See also* Nalore v. San Diego Fed. Sav. & Loan Ass'n, No. 79-3481, slip op. at 1 (9th Cir. Sept. 23, 1981).

51. United States v. Kay, 89 F.2d 19, 21-22 (2d Cir. 1937). *See also* Meyers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145, 1146 (9th Cir. 1974).

52. *See, e.g.*, First Fed. Sav. & Loan Ass'n v. Peterson, No. 79-0940 (N.D. Fla. June 22, 1981); Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139 (C.D. Ill. 1979); Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981).

53. First Fed. Sav. & Loan Ass'n v. Peterson, No. 79-0940, slip op. at 5 (N.D. Fla. June 22, 1981) (in declaratory judgment action seeking declaration that due-on-sale clauses are enforceable and that federal law preempts state law, court did not specifically decide the constitutionality issue since neither party questioned congressional regulatory authority); Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139, 1141 (C.D. Ill. 1979) (without deciding constitutionality issue, court held inclusion and enforceability of due-on-sale clauses in loan instruments are within scope of FHLBB regulatory power under HOLA); Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 910 (C.D. Cal. 1978) (HOLA preempts state law regarding exercise and validity of due-on-sale clauses), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981).

power to preempt state property, mortgage and contract law under the supremacy clause as a valid exercise of congressional authority under the commerce clause.

Did Congress Intend FHLBB Regulation of Due-on-Sale Clauses to Preempt State Action?

In the FHLBA, no specific reference was made to due-on-sale clauses. Although the HOLA expressed congressional preemptive intent in relation to some activities of FSLs,[54] it also made no specific reference to due-on-sale clauses. Thus, Congress has not expressly mandated federal preemption of due-on-sale regulation. Consequently, the issue of whether state regulation has been federally preempted on the basis of implied intent must be considered.

Several courts have found congressional intent to implement a pervasive scheme of regulation in the FHLBA and the HOLA.[55] The same courts have held that Congress delegated pervasive regulatory authority to the FHLBB, and thus, Board regulations pertaining to due-on-sale clauses carry preemptive power.[56] This finding of a pervasive scheme, however, may be too broad in scope. The findings ultimately appear based on language in the FHLBA authorizing the FHLBB "to provide for the organization, incorporation, examination, operation, and regulation" of FSLs.[57] In actuality, this language appears to preempt only state law concerning the internal affairs of FSLs.[58] Consequently, the language does not readily indicate a congressional intent to preclude state law on other matters.[59]

The finding of a congressional intent to occupy the field based on a pervasive scheme is suspect not only because it is based on vague language. It is also argued that if federal regulation is so pervasive as to oc-

54. FSLs are specifically exempt from state limits on the number of branch offices and from state taxes in excess of those on state lending institutions. 12 U.S.C. § 1464(a)(1) (Supp. 1981) & § 1464(h) (1978).

55. *See* 4-D Properties v. Home Fed. Sav. & Loan Ass'n, No. 81-193, slip op. at 3 (D. Ariz. Aug. 17, 1981) ("[t]he [Home Owner's Loan] Act clearly delegates to the [Federal Home Loan Bank] Board complete authority to regulate comprehensively the operation of federal savings and loan associations"); Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139, 1141 (C.D. Ill. 1979) ("[federally-chartered savings and loan association's] power to include a due-on-sale clause in its loan instruments is within the scope of the Board's mandate to determine the 'best practices' for such associations"); Glendale Fed. Sav. & Loan v. Fox, 459 F. Supp. 903, 912 (C.D. Cal. 1978) (in authorizing due-on-sale clauses and preempting state regulation, "the Bank Board exercised precisely the kind of discretion that Congress intended to delegate to it in HOLA"), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981); First Fed. Sav. & Loan Ass'n v. Development & Management Enterprises, Inc., No. 79-880, slip op. at 2 (D. Ariz. Mar. 10, 1981) ("[t]he broad regulatory authority over federal savings and loan associations conferred upon the Federal Home Loan Bank Board by the Home Owner's Loan Act of 1933 wholly preempts the field of regulatory control over First Federal Savings & Loan Association of Arizona").

56. See cases cited in note 55 *supra*.

57. *See* Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139, 1141 (C.D. Ill. 1979).

58. *See* Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 476-80 (Minn. 1981).

59. *See id.* The issue of whether due-on-sale regulation falls within an "occupied field" constitutes only a part of the larger determination of the parameters of the "field" preempted. The issue of how far the preempted field can ultimately be extended and which additional state laws other than those related to due-on-sale clauses are preempted is beyond the scope of this Note. Those boundaries must await future legislative and court action.

cupy the field, all state law relating to the field would be precluded whether conflicting with federal law or not.[60] Such a result would lead to the absurd invalidation of state mortgage and property law regarding title, conveyancing, recording, lien priority, foreclosure proceedings, and deficiency judgments.[61] Indeed, at least one court has noticed the problem, stating that in gaining possession of property, a FSL must be governed by state law since no federal common law of mortgages and real property exists.[62]

On the other hand, some language in one FHLBB regulation may imply that only those state laws which limit the enforcement of due-on-sale clauses are preempted.[63] Under such an interpretation, state law which aids the exercise of due-on-sale clauses, such as foreclosure statutes, would apply. Only state law which hinders enforcement, such as alienation laws, would be preempted.[64]

Implied congressional preemptive intent may also be found by way of the dominant federal interest theory.[65] A dominant federal interest in the fulfillment of the objectives underlying congressional enactments may warrant federal preemption of state law.[66] The underlying objective of the FHLBA and the HOLA was the creation of a federal system of savings and loan associations to replace the inadequate state systems and aid the country's financially troubled citizenry during the Depression.[67] Particularly under the HOLA, congressional intent focused on the establishment of a uniform, federally regulated system of home mortgage financing to alleviate the plight of Depression-era homeowners.[68] A national uniform

60. de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 336, 175 Cal. Rptr. 467, 472 (1981).

61. *Id.* at 336-37, 175 Cal. Rptr. at 471-72. The preemption of state law limitations on the exercise of due-on-sale clauses might preclude not only state property law on the alienation of property but also state mortgage law governing the procedure for foreclosure since the latter may also impose limitations on the exercise of due-on-sale clauses, such as notice and timing requirements. *Id.* at 337, 175 Cal. Rptr. at 472. If the existence of the FHLBB regulations preempts state foreclosure law, it is unclear under what law lenders will enforce their due-on-sale clauses.

62. *Id.* at 337, 175 Cal. Rptr. at 472.

63. Statement of Policy Regarding Due-on-Sale Clauses, issued by the FHLBB on July 23, 1981, 46 Fed. Reg. 39,124 (1981) (to be codified in 12 C.F.R. § 556.9(f)) (FHLBB regulations preempt any state law *limitations* on inclusion or exercise of due-on-sale clauses). For the text of this amendment, see note 91 *infra*.

64. 46 Fed. Reg. 39,124 (1981) (to be codified in 12 C.F.R. § 556.9(f)). Alternatively, if the "actual conflict" test for preemption were applied, only those state laws in conflict with the specific language or underlying objectives of the 1981 amendment would be precluded.

65. See text & notes 33 & 35 *supra*.

66. *See* Pennsylvania v. Nelson, 350 U.S. 497, 504-05 (1956); Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947).

67. *See, e.g.*, Conference of Fed. Sav. & Loan Ass'ns v. Stein, 604 F.2d 1256, 1257-58 (9th Cir. 1979), *aff'd mem.*, 445 U.S. 921 (1980); United States v. Kay, 89 F.2d 19, 22 (2d Cir. 1937); Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 908-09 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981).

68. See cases cited in note 67 *supra*. The desire of Congress to foster uniform federal regulation was demonstrated by the three basic components of the HOLA: the elimination of direct loans by the Federal Home Loan Banks to homeowners, the creation of the Home Owners' Loan Corporation which would exchange bonds only for mortgages meeting a uniform federal standard, and the creation of FSLs specifically subject to the centralized regulatory control of the FHLBB. Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 908-09 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981).

policy in regard to FSL lending practices would aid in the fulfillment of these underlying objectives.[69] More specifically, regulation allowing for the enforceability of due-on-sale clauses would aid prospective homeowners by ensuring the financial soundness of the federal associations and the continued availability of funds.[70]

Enforceable due-on-sale clauses serve the federal interest and intent of Congress by keeping the lives of mortgage loans short and interest rates low.[71] Absent enforceable due-on-sale clauses, it is contended that lenders would have to dramatically increase their loan interest rates in order to receive a return sufficient to pay the competitive rate needed to raise lending funds.[72] That increase would exceed the increase under a scheme allowing for the exercise of due-on-sale clauses because FSLs would have to get a return sufficient to pay not only the current rate demanded by depositors but also an amount to cover the loss on the low-interest loans with unenforceable due-on-sale clauses.[73] The borrowers most in need of loans—first-home buyers and those unable to afford a substantial down payment—would be hurt.[74] Such a result would be inconsistent with the federal governmental interests underlying the FHLBA.[75]

In addition, if enforcement of due-on-sale clauses is greatly restricted, mortgage loans may become less marketable in the secondary mortgage market since the loans could not be refinanced at current interest levels.[76] The mortgage loans would then be less valuable. Maintaining the saleability of mortgage loans would appear to be an integral part of the federal scheme regulating FSLs.[77] An attempt by a state to limit exercise

69. See text & notes 71-78 *infra*.

70. *See* 12 C.F.R. § 556.9(f)(1) (1981); text & notes 71-78 *infra*. Although enforceable due-on-sale clauses may aid homeowners over the long term, such clauses would, nevertheless, have the immediate effect of precluding home buyers from assuming lower-interest mortgages already existing on a home. Thus, one could argue that the objective underlying the HOLA might be better served by denying, rather than affirming, preemption.

71. *See* de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 341 n.7, 175 Cal. Rptr. 467, 475 n.7 (1981); Note, *The Due-On Clause: A Preemption Controversy*, 10 LOY. L.A.L. REV. 629, 638-41 (1977).

In disagreeing with this proposition, the Minnesota Supreme Court noted that the FHLBB regulations merely permit and do not mandate the inclusion of due-on-sale clauses in loan instruments. Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 479 (Minn. 1981). The Minnesota court questioned why the inclusion of due-on-sale clauses in loan instruments, if so important to the national interest, was not made compulsory. *Id.* The FHLBB responded to this question in its 1981 statement of policy, Statement of Policy Regarding Due-on-Sale Clauses, July 23, 1981, 12 C.F.R. § 556.9(f). The Board first stated that "the due-on-sale clause normally is a valuable and often an indispensable source of protection for the financial soundness of federal associations and for their continued ability to fund new home loan commitments." *Id.* The Board went on to explain, however, that it "desires to afford associations the flexibility to accommodate special situations and circumstances." *Id.* Thus, "§ 545.8-3(f) . . . merely authorizes rather than compels the inclusion and exercise of due-on-sale clauses in mortgage loans." *Id.* The Board found that due-on-sale clauses serve a national interest, in spite of the absence of mandatory inclusion and exercise.

72. Note, *supra* note 71, at 638-41; *see* de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 341 n.7, 175 Cal. Rptr. 467, 475 n.7 (1981).

73. *See* Note, *supra* note 71, at 639-40.

74. *Id.* at 640.

75. *Id.* at 639-40. *See also* text & notes 67-68 *supra*.

76. *See* authorities cited in note 72 *supra*.

77. de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 341 n.7, 175 Cal. Rptr. 467, 475 n.7 (1981); Note, *supra* note 71, at 638-41.

of due-on-sale acceleration clauses would necessarily conflict with that scheme.[78]

Lastly, implicit congressional intent to preempt may be found where the state and federal schemes of regulation collide and dual compliance is impossible.[79] In addition to an actual conflict between state laws concerning due-on-sale clauses and the objectives underlying the relevant congressional acts themselves, state laws may also collide with FHLBB regulations. The HOLA authorizes the FHLBB to promulgate regulations regarding FSLs.[80] The FHLBB may express congressional intent through its regulations.[81] It is congressional intent as expressed through FHLBB regulations that may conflict with state law. That conflict will be discussed in the following section of this Note.

Do FHLBB Due-on-Sale Regulations Mandate the Preemption of State Law?

The FHLBB made its first specific reference to due-on-sale clauses in a 1976 regulation.[82] That regulation specifically allows FSLs to include due-on-sale clauses in loan instruments.[83] The regulation does not mandate preemption.[84] It states, however, that the terms of the contract between the parties shall exclusively govern the exercise of due-on-sale

78. See authorities cited in note 72 *supra*.

79. Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132, 142-43 (1963); McDermott v. Wisconsin, 228 U.S. 115, 132 (1913); Savage v. Jones, 225 U.S. 501, 533 (1912).

80. 12 U.S.C. § 1464(a)(1) (Supp. 1981).

81. See text & notes 37-40, 46 *supra*.

82. 12 C.F.R. § 545.8-3(f) (1981) states:

> (f) *Due-on-sale clauses*. An association continues to have the power to include, as a matter of contract between it and the borrower, a [due-on-sale clause] . . . . [The] exercise by an association of such [an acceleration] option (hereafter called a due-on-sale clause) shall be exclusively governed by the terms of the loan contract, and all rights and remedies of the association and borrower shall be fixed and governed by that contract.

In 1948, the FHLBB promulgated a regulation which contained a provision that loan instruments must protect FSLs. 12 C.F.R. § 545.8-3(a) (1981). The Board later interpreted that regulation to be an authorization of due-on-sale clauses for FSLs since those clauses protect FSLs. FHLBB Resolution No. 75-647, at 15 (July 30, 1975). The FHLBB interpreted the 1948 regulation at the request of the United States District Court for the Central District of California, which was determining the case of Schott v. Mission Fed. Sav. & Loan Ass'n, No. 75-366 (C.D. Cal. July 30, 1975). The Board's interpretation was contained in resolution number 75-647 in the form of an advisory opinion. The *Schott* decision has been cited as authority supporting the premise that state law is precluded from interfering with the "internal affairs" of federally chartered savings and loan associations. Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 478 (Minn. 1981).

Two state courts have rejected due-on-sale preemption arguments based on that 1948 regulation and its later interpretation. de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 337-38, 175 Cal. Rptr. 467, 472-73 (1981); Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 477 (Minn. 1981). Those courts ruled that the "full protection" language in the regulation refers only to insurance, taxes, assessments, repairs, etc., and not to due-on-sale clauses. 121 Cal. App. 3d at 338, 175 Cal. Rptr. at 473; 308 N.W.2d at 477. Although correctly noting that the 1948 regulation specifically tied the "full protection" language to "insurance, taxes, assessments, other governmental levies, maintenance, and repairs," both courts failed to address the fact that the regulation considered those specific protections to be "among other protections." 12 C.F.R. § 545.8-3(a) (1980). In fact, the regulation gives no indication whether due-on-sale clauses were intended to be among the "other protections" constituting "full protection." *Id.*

83. 12 C.F.R. § 545.8-3(f) (1981). See note 82 *supra* for the text of this regulatory provision.

84. 12 C.F.R. § 545.8-3(f) (1981).

clauses.[85] Since the regulation states merely that contract terms between the parties control, several courts have disallowed federal preemption of state law governing due-on-sale clauses.[86] Those courts hold that the governing contractual rights of the parties are to be determined by state contract and property law.[87]

Although the regulation itself is vague as to whether state or federal law will govern, the FHLBB, in a preamble to the regulation, displayed its unconditional intention that Board regulations concerning due-on-sale clauses should preempt conflicting state law.[88] That preamble states that FSLs are controlled solely by the accompanying regulation, and are not bound by state law imposing conflicting due-on-sale requirements.[89] Since the accompanying regulation states only that the contract between the parties governs and does not specify which law, state or federal, to apply, it may be argued that state contract and property laws do not really conflict with the requirements of the federal regulation. Indeed, at least one court has held that there is neither "impossibility of dual compliance" nor "inevitable collision" between state and federal law governing due-on-sale clauses on the basis of this analysis of the 1976 regulation.[90]

In July, 1981, the FHLBB issued an amendment to the 1976 regulation.[91] That amendment states that FSL due-on-sale practices are governed exclusively by FHLBB regulations.[92] State law limitations concerning inclusion and exercise of due-on-sale clauses are expressly preempted.[93] Furthermore, state prohibitions based upon restraints on alienation are specifically included in the preemption.[94]

---

85. *Id.*

86. *E.g.*, Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1155 (E.D. Mich. 1980); de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 341, 175 Cal. Rptr. 467, 475 (1981).

87. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1155 n.4 (E.D. Mich. 1980) (contract and its terms made in Michigan between Michigan citizens); de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 341, 175 Cal. Rptr. 467, 475 (1981); Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 478-80 (Minn. 1981).

88. Preamble, 12 C.F.R. § 545.6-11 (1981); *see* de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 339, 175 Cal. Rptr. 467, 473 (1981).

89. Preamble, 12 C.F.R. § 545.6-11 (1981).

90. Panko v. Pan Am. Fed. Sav. & Loan Ass'n, 119 Cal. App. 3d 916, 924, 174 Cal. Rptr. 240, 245 (1981). Several other courts have also accepted this rationale in holding that state contract and property law principles determine the enforceability of due-on-sale clauses. *See, e.g.*, Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1155 (E.D. Mich. 1980); de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 341, 175 Cal. Rptr. 467, 475 (1981); Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 477 (Minn. 1981).

91. In a Statement of Policy Regarding Due-on-Sale Clauses, issued by the FHLBB on July 23, 1981, 46 Fed. Reg. 39,124 (1981) (to be codified in 12 C.F.R. § 556.9) 12 C.F.R. § 556.9(f), was amended by adding the following new paragraph (f):

> (f)—(2) Paragraph (f) of § 545.8-3 confirms the continuing authority of Federal associations to include due-on-sale clauses in their mortgage loan contracts and to exercise such clauses subject only to the express limitations contained in § 545.8-3(g). Due-on-sale practices of Federal associations shall be governed exclusively by the Board's regulations, in preemption of and without regard to any limitations imposed by state law on either their inclusion or exercise (including, but not confined to, state law prohibitions against restraints on alienation, prohibitions against penalties and forfeitures, equitable restrictions and state law dealing with equitable transfers).

92. *Id.*

93. *Id.*

94. *Id.*

The amendment appears to present an actual conflict between the federal regulation of due-on-sale clauses and countervailing state property, mortgage, and contract law since the amendment specifically disallows the application of state laws limiting the inclusion or exercise of due-on-sale clauses. Alternatively, the amendment may be read as an attempt to occupy the field of due-on-sale regulation by express or at least an implied intention to preempt all state law on the subject, pro and con. How the courts will interpret the 1981 language remains to be seen. Despite the uncertainty surrounding the FHLBB regulations, it is clear that the FHLBB does intend to preempt something. It remains for the courts to decide either the scope of the field preempted under the occupation of the field doctrine,[95] or the specific state laws preempted under the actual conflict theory.[96]

In summary, the foregoing analysis of the doctrine of federal preemption and its application to state and federal regulation of the enforcement of due-on-sale clauses in FSL loan instruments demonstrates that federal preemption of the control of due-on-sale clauses is constitutional. In addition, congressional intent to exert that federal preemption seems apparent from the nature of federal acts and regulations concerning FSLs and due-on-sale clauses. Although the pervasive federal scheme theory of preemption presents a debatable basis for a finding of preemption, a federal preemption argument founded upon the dominant federal interest in nationally uniform FSL lending practices may be inferred from the underlying purposes of the FHLBA and the HOLA. Most important, congressional intent to preempt state due-on-sale law stems from the apparent conflict between state undue restraint on alienation laws and FHLBB regulations. Those regulations, although less than perfectly clear in their language, nevertheless present the thrust of the federal position that state law must not stand in the way of the enforceability of FSL due-on-sale clauses.

FEDERAL JURISDICTION AND THE PREEMPTION ARGUMENT

Apart from issues concerning the validity of federal preemption of due-on-sale regulation, there exists a jurisdictional controversy. For a variety of reasons,[97] FSLs have sought to have their preemptive arguments heard in federal court.[98] In this effort, however, FSLs have run into jurisdictional problems. These problems will be the focus of this section.

Most of the earlier due-on-sale cases were brought in state courts.[99] In those cases, the lenders relied chiefly on state law freedom of contract arguments.[100] The majority of state courts considering due-on-sale litigation, however, barred enforcement of those clauses as an undue restraint

95. See text & notes 30-36 *supra*.
96. See text & notes 26-29 *supra*.
97. See text & notes 104-06 *infra*.
98. *See, e.g.*, Glendale Fed. Sav. & Loan Ass'n v. Fox, No. 79-3573, slip op. at 2 (9th Cir. Sept. 23, 1981); Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1150 (E.D. Mich. 1980); Conference of Fed. Sav. & Loan Ass'ns v. Stein, 495 F. Supp. 12, 16-17 (E.D. Cal. 1979).
99. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1149 n.1 (E.D. Mich. 1980).
100. Baltimore Life v. Harn, 15 Ariz. App. 78, 80, 486 P.2d 190, 192 (1971), *appeal denied*, 108 Ariz. 192, 494 P.2d 1322 (1972). The argument was that, under the doctrine of freedom of con-

on alienation.[101] Generally, enforcement was granted only if the lender could show that the sale or transfer represented a threat to the lender's security interest.[102]

The preemption argument did not arise in the earlier state cases.[103] Recently, however, FSLs have looked upon preemption as their best avenue for success. This appears particularly true in those jurisdictions where due-on-sale clauses in the past have been declared undue restraints on alienation.[104] By using the preemption argument, FSLs have sought to negate the unfavorable restraint on alienation doctrine.

FSLs may, of course, raise the issue of federal preemption in any court having jurisdiction over the case, be it a state or federal court.[105] FSLs, however, have suffered a substantial losing streak in state courts.[106] Sensing a more receptive audience in federal court, FSLs have sought to bring the action to that forum.[107]

Due-on-sale cases involving FSLs tend to arrive in federal court in one of two ways: (1) as a declaratory judgment suit brought in federal court by the lender;[108] or (2) as a removal of a declaratory judgment action from state court by the lender.[109] In each instance, the federal court

---

tract, borrowers should be required to abide by the terms of contracts fully understood and freely signed by them. *Id.*

101. *See, e.g.*, Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 478-79, 578 P.2d 152, 157-58 (1978); Wellenkamp v. Bank of Am., 21 Cal. 3d 943, 953, 582 P.2d 970, 976, 148 Cal. Rptr. 379, 385-86 (1978); Nichols v. Ann Arbor Fed. Sav. & Loan Ass'n, 73 Mich. App. 163, 174, 250 N.W.2d 804, 809 (1977).

102. *See, e.g.*, cases cited in notes 99 & 101 *supra*.

103. *See* cases cited in note 99 *supra*. This may have been because the relevant federal regulations did not clearly suggest the possibility of preemption, because the cases did not involve FSLs, or because the preemption strategy did not occur to the FSLs.

104. *See generally* 4-D Properties v. Home Fed. Sav. & Loan Ass'n, No. 81-193 (D. Ariz. Aug. 17, 1981); First Fed. Sav. & Loan Ass'n v. Development & Management Enterprises, Inc., No. 79-880 (D. Ariz. Mar. 10, 1981); Conference of Fed. Sav. & Loan Ass'ns v. Stein, 495 F. Supp. 12 (S.D. Cal. 1979).

105. *See, e.g.*, Smith v. O'Grady, 312 U.S. 329, 331 (1941); Mooney v. Holohan, 294 U.S. 103, 113 (1935); Robb v. Connolly, 111 U.S. 624, 637 (1884).

106. *See, e.g.*, Patton v. First Fed. Sav. & Loan Ass'n, 118 Ariz. 473, 478-79, 578 P.2d 152, 157-58 (1978) (due-on-sale clause unenforceable unless jeopardy to lender's security interest can be shown); de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 340, 175 Cal. Rptr. 467, 476 (1981) (federal regulations held not to preempt California law barring enforcement of due-on-sale clause absent jeopardized security interest); Holiday Acres No. 3 v. Midwest Fed. Sav. & Loan Ass'n, 308 N.W.2d 471, 484 (Minn. 1981) (due-on-sale enforcement regarding owner-occupied residential property is per se unreasonable restraint on alienation, although not per se unreasonable regarding investment residential property).

107. The desire of FSLs to litigate due-on-sale cases in a federal forum is evidenced by their numerous attempts to seek removal jurisdiction or to anticipate suits by bringing declaratory judgment actions in federal court. *See, e.g.*, Glendale Fed. Sav. & Loan Ass'n v. Fox, No. 79-3573, slip op. at 2 (9th Cir. Sept. 23, 1981); Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1148-50 (E.D. Mich. 1980) (consolidating twenty-two due-on-sale cases); Conference of Fed. Sav. & Loan Ass'ns v. Stein, 495 F. Supp. 12, 15 (E.D. Cal. 1979).

108. First Fed. Sav. & Loan Ass'n v. Peterson, No. 79-0940, slip op. at 1-2 (N.D. Fla. June 22, 1981); Glendale Fed. Sav. & Loan Ass'n v. Fox, 459 F. Supp. 903, 906 (C.D. Cal. 1978), *rev'd on other grounds*, No. 79-3573 (9th Cir. Sept. 23, 1981).

109. In a recent district court case, Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147 (E.D. Mich. 1980), twenty-two cases challenging the enforceability of due-on-sale clauses were consolidated. All twenty-two were declaratory judgment actions; fifteen filed by borrowers in state court and removed to federal court, three filed by borrowers in federal court, and four filed by lenders in federal court. *Id.* at 1150.

has the initial task of determining whether it has jurisdiction.[110] In declaratory judgment actions, federal jurisdiction may result either from diversity of citizenship or from the existence of a federal question inherent in the potential action underlying the declaratory judgment action.[111] In removal actions, federal jurisdiction generally exists if the federal court would have had original jurisdiction of the case.[112] That original jurisdiction may be based on the presence of a federal question.[113] Since, in the due-on-sale context, federal question jurisdiction constitutes the usual jurisdictional basis in both removal and declaratory judgment actions,[114] it normally does not matter whether a due-on-sale case is initiated in federal court or is transferred there from a state court.[115] Thus, in the usual case, federal question jurisdiction forms the threshold issue.

Although federal preemption appears to involve issues of federal law, this may not be enough to merit jurisdiction in federal court. To invoke the federal question jurisdiction of the federal courts, a claim must be seen to arise under federal law.[116] Courts have struggled for the better part of two centuries with the meaning of the "arising under" language of article III, section 2 of the United States Constitution, 28 U.S.C. section 1331, and 28 U.S.C. section 1337.[117] The United States Supreme Court has stated, for section 1331 purposes, that the cause of action as stated by the plaintiff's complaint must show a basis in federal law.[118] The Court has also held that the federal claim must be an essential element of the plaintiff's cause of action, clearly disclosed by the complaint standing alone.[119]

Despite these high-court pronouncements, difficulties in interpretation

110. *See, e.g.*, Sosna v. Iowa, 419 U.S. 393, 398 (1975); City of Kenosha v. Bruno, 412 U.S. 507, 511 (1973); Mansfield Coldwater & Lake Mich. Ry. Co. v. Swan, 111 U.S. 379, 384 (1884).

111. Skelly Oil Co. v. Phillips Petroleum Co., 339 U.S. 667, 671-74 (1950); *see* U.S. CONST. art. III, § 2, cl. 1. Although the Declaratory Judgment Act, 28 U.S.C. § 2201 (1976), authorizes a federal court to declare the rights of parties in any actual controversy falling within its jurisdiction, that Act has been held to be procedural only. Aetna Life Ins. Co. v. Haworth, 300 U.S. 227, 240 (1937). Thus, an independent source of jurisdiction such as federal question jurisdiction or diversity jurisdiction must also exist to warrant federal court action.

112. 28 U.S.C. § 1441 (1977).

113. *Id.* Thus, the federal courts in removal situations normally seek to determine whether original jurisdiction exists under 28 U.S.C. § 1331 (1981) (claims arising under the Constitution, laws, or treaties of the United States) or *Id.* § 1337 (claims arising under federal laws in regulation of commerce).

114. *See* cases cited in note 107 *supra*.

115. Since FSLs usually do business solely within a single state, diversity of citizenship rarely applies to due-on-sale litigation. *See* de la Cuesta v. Fidelity Fed. Sav. & Loan Ass'n, 121 Cal. App. 3d 328, 336 n.3, 175 Cal. Rptr. 467, 471 n.3 (1981).

116. See text & note 117 *infra*.

117. *See, e.g.*, Textile Workers Union v. Lincoln Mills, 353 U.S. 448, 457 (1957) (case arises under federal law if federal power to control labor-management controversies is challenged in the case); Osborn v. Bank of United States, 22 U.S. (9 Wheat.) 738, 823 (1824) (case arises under federal law if a federal question forms an ingredient of the cause of action); Cohens v. Virginia, 19 U.S. (6 Wheat.) 264, 379 (1821) ("arising under" test is met if decision depends on construction of either the Constitution or a federal law). *See also* text & notes 118-20 *infra*.

118. American Well Works Co. v. Layne & Bowler Co., 241 U.S. 257, 260 (1916) ("a suit arises under the law that creates the cause of action"); Louisville & Nashville R.R. Co. v. Mottley, 211 U.S. 149, 152 (1908) (a claim arises under the laws of the United States "only when the plaintiff's statement of his own cause of action shows that it is based upon [federal law]").

119. Phillips Petroleum Co. v. Texaco Inc., 415 U.S. 125, 127 (1974); Gully v. First Nat'l Bank, 299 U.S. 109, 112 (1936).

persist. Federal courts are split on whether federal preemption by FHLBB regulation of FSL due-on-sale situations constitutes a federal question sufficient to justify federal jurisdiction.[120] Decisions upholding federal jurisdiction hold either that a federal question of preemption is inherent in the controversy underlying a declaratory judgment action brought in federal court,[121] or that a federal question is inherent in the underlying controversy and therefore implicit on the face of a plaintiff's complaint in a removal action.[122]

A principal federal case upholding federal jurisdiction is *Bailey v. First Federal Savings & Loan Association*.[123] That case involved removal jurisdiction of a declaratory judgment action brought by a borrower in state court.[124] The borrower sought a declaration that the due-on-sale clauses contained in the mortgage instruments were unconstitutional restraints on alienation.[125] The court first noted that, to justify federal question jurisdiction, the federal question must normally be apparent from the face of the complaint.[126] The court ruled, however, that a plaintiff may not avoid removal by carefully wording the complaint so as to conceal the true federal nature of his or her claim.[127] The court then held that the federal question was implicit in the plaintiff's complaint and could therefore be used to justify federal jurisdiction.[128]

Another federal court based its decision favoring federal jurisdiction on a finding of an actual controversy over the federal question of preemption.[129] The Federal District Court of Florida in *First Federal Savings & Loan Association v. Peterson* found that the plaintiff FSL had "alleged a right which [would] 'be supported if the Constitution or laws of the United States are given one construction or effect, and defeated if they receive another.' "[130]

Courts declining to find federal jurisdiction in due-on-sale cases have reasoned that any federal question presented by federal regulations is either not apparent from the face of a state court complaint,[131] not integral to the underlying controversy in the case of a declaratory judgment ac-

120. See text & notes 121-45 *infra*.

121. First Fed. Sav. & Loan Ass'n v. Peterson, No. 79-0940, slip op. at 17 n.1 (N.D. Fla. June 22, 1981); *see* Williams v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 307, 308 (E.D. Va. 1980), *aff'd*, 651 F.2d 910 (4th Cir. 1981).

122. Bailey v. First Fed. Sav. & Loan Ass'n, 467 F. Supp. 1139, 1141-42 (C.D. Ill. 1979).

123. 467 F. Supp. 1139 (C.D. Ill. 1979).

124. *Id.* at 1140.

125. *Id.*.

126. *Id.* at 1141.

127. *Id.*

128. *Id.* at 1141-42. The court stated: "When the complaint discloses . . . a controversy in an area in which federal law has preempted state law, a federal question is necessarily implicit in the complaint." *Id.* One problem with the *Bailey* decision is that it appears to decide the preemption question before it decides the jurisdictional question. After concluding that preemption exists, the court then uses that conclusion as a basis for federal jurisdiction. *Id. Bailey* may be a case of improperly putting the decision on the merits before the jurisdictional decision.

129. First Fed. Sav. & Loan Ass'n v. Peterson, No. 79-0940, slip op. at 17 n.1 (N.D. Fla. June 22, 1981).

130. *Id.*

131. California v. Glendale Fed. Sav. & Loan Ass'n, 475 F. Supp. 728, 732 (C.D. Cal. 1979).

tion,[132] or merely in the nature of a defense and thus not to be considered when determining federal question jurisdiction.[133] Typical of the cases where federal question jurisdiction has been denied is the Tenth Circuit decision in *Madsen v. Prudential Federal Savings and Loan Association*.[134] There, a declaratory judgment action brought in federal court by a FSL was consolidated with a class action brought in state court by borrowers of the same lender.[135] The lender had removed the state action to federal court.[136] At issue was the need of the lender to account to the borrowers or pay them interest on escrowed funds.[137] Although not specifically a due-on-sale suit, the *Madsen* case did involve an argument that federal jurisdiction was warranted because of federal preemption by FHLBB regulation.[138] The borrowers based their claims on the common law concepts of breach of contract and unjust enrichment.[139] The lender argued that it need not account to the borrowers or pay them interest on escrowed funds under a specific federal regulation.[140] With regard to the removal action, the court of appeals held that the lender's federal preemption claim was a defense to the borrower's state law claim and that therefore it was an unsuitable basis for federal question jurisdiction.[141] With regard to the declaratory judgment action, the court held that the underlying controversy centered on the common law claims and that the federal preemption question amounted to a defensive action by the lender.[142] Thus, no federal question was inherent in the potential cause of action underlying the declaratory judgment action and federal jurisdiction was not warranted.[143]

Smart v. First Federal Savings and Loan Association[144] was another case in which several FSLs sought removal of due-on-sale cases to federal court. There, the federal district court enunciated five reasons why the preemption issue did not support federal question jurisdiction. The court ruled that (1) a federal controversy was not disclosed upon the face of the complaint; (2) the idea that any federal law "necessarily brought into play" by a case may be judicially noticed has been rejected by the Supreme Court; (3) the fact that federal law questions arise in a suit does not mean the basis of the suit is federal law; (4) federal laws and regulations which do not create rights of action, but rather function more in the nature of defenses, do not give rise to federal jurisdiction; and (5) the party bringing suit may fashion the action to rely on state or federal law as he chooses

132. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1156-62 (E.D. Mich. 1980).
133. *Id.* at 1156.
134. 635 F.2d 797 (10th Cir. 1980), *cert. denied*, 451 U.S. 1018 (1981).
135. *Id.* at 800.
136. *Id.*
137. *Id.* at 799-800.
138. *Id.* at 800-01.
139. *Id.* at 799.
140. *Id.* at 799-800; 12 C.F.R. § 545.6-11(c) (1977).
141. 635 F.2d at 802. "[A] defense predicated upon federal law is not enough by itself to confer federal jurisdiction, even though the defense is certain to arise." *Id.* at 800-01, *citing* Pan Am. Petroleum Corp. v. Superior Court, 366 U.S. 656, 663 (1961).
142. *Id.* at 803-04.
143. *Id. See generally* text & note 111 *supra*.
144. 500 F. Supp. 1147 (E.D. Mich. 1980).

for certiorari to the United States Supreme Court.[156]

CONCLUSION

Federal courts are divided on the question of whether federal preemption of due-on-sale regulation constitutes a sufficient federal question to warrant federal jurisdiction. The better reasoned decisions find that the federal preemption argument is a defense to a state law cause of action, and thus, does not justify federal jurisdiction.

Regardless of whether these cases are litigated in state or federal court, the ultimate issue to be decided is whether there is federal preemption of due-on-sale regulation. The implied preemptive intent of Congress coupled with the language of the federal regulations appear to indicate that federal law should preempt state law in due-on-sale cases involving FSL loans. Since both state and federal courts have reached inconsistent results, and since the issue involved is one of national and constitutional significance, either Congress must unequivocally express its preemptive intention, or the United States Supreme Court must resolve the controversy.

RECENT DEVELOPMENT

Shortly before publication of this Note, the United States Supreme Court decided the case of Fidelity Federal Savings and Loan Association v. de la Cuesta.[157] The Court adopted the direct conflict theory of federal preemption by finding a conflict between the 1976 FHLBB regulation allowing FSLs to employ due-on-sale clauses and the California restriction on the exercise of those clauses to situations where the lender can demonstrate an impaired security interest.[158] The Court found that FHLBB had acted reasonably within its statutorily delegated authority in promulgating the 1976 regulation,[159] and that the importance of real property law as an area of special state concern did not render the preemption doctrine inapplicable.[160]

The Court indicated in a footnote that the enforceability of due-on-sale clauses in instruments executed prior to the 1976 FHLBB regulation would be governed by the state law existing at the time those instruments were executed.[161] Prior to 1976, however, California did not restrict the enforceability of due-on-sale clauses upon outright transfer. It did not do so until 1978,[162] two years after the preemptive FHLBB regulation appeared. Presumably, the due-on-sale clauses in lending instruments executed prior to 1978 would be enforceable in California even under state law.

156. *See generally* 16 C. WRIGHT, A. MILLER & E. COOPER, FEDERAL PRACTICE AND PROCEDURE § 4012, at 602-03 (1977); *see also*, R. STERN & E. GRESSMAN, SUPREME COURT PRACTICE § 3.5, at 87 (4th ed. 1969).
157. 1982 42 S. CT. BULL. (CCH) B4143.
158. *Id.* at B4161.
159. *Id.*
160. *Id.* at B4156.
161. *Id.* at B4173-74 n. 24.
162. Wellenkamp v. Bank of America, 21 Cal. 3d 943, 953, 582 P.2d 970, 977 (1978).

even when both are available.[145]

As the preceding discussion illustrates, federal courts are divided on the question of whether federal preemption regarding regulation of FSLs constitutes a federal question sufficient to justify federal jurisdiction.[146] The courts seem to agree, however, that in both removal and declaratory judgment actions, the primary issue is whether the federal regulation provides the basis for, or is sufficiently integral to, the underlying cause of action.[147] The cases denying federal jurisdiction seem more analytically sound, particularly in light of the doctrines of limited federal jurisdiction.[148] Regardless of the specific posture of the case, the preemption argument appears to be merely a defense to a borrower's claim that due-on-sale clauses are unenforceable restraints on alienation. In removal actions, it is a defense to a borrower's declaratory judgment action asking the state court to declare the due-on-sale clause unenforceable as an undue restraint on alienation.[149] The lender's defense that the due-on-sale clauses are indeed enforceable due to federal preemption does not appear to support federal removal jurisdiction.[150]

In declaratory judgment actions initiated in federal court, the federal preemption argument can only be viewed as an attempt to anticipate a state court suit by the borrower challenging the enforceability of due-on-sale clauses under state law.[151] A declaratory judgment claim, which is in effect only a defense to a potential state law action, does not justify federal jurisdiction.[152] In other words, in determining federal question jurisdiction in declaratory judgment actions, the federal court must examine the potential underlying action which might have been brought instead of the declaratory judgment action.[153] If that underlying action would involve a federal question solely as a defense to a state law claim, federal jurisdiction is unwarranted.[154]

Since federal jurisdiction is unwarranted, the proper forum for due-on-sale litigation would be the state courts. The lenders, of course, are free to raise federal preemption as a defense in state court.[155] If a state court appears to wrongly decide the preemption issue, a FSL may still petition

145. *Id.* at 1156.

146. See text & notes 121-45 *supra*.

147. See *id.*

148. See text & notes 131-45 *supra*. In areas traditionally governed by state courts, "the general presumption is in favor of applying state law." Madsen v. Prudential Fed. Sav. & Loan Ass'n, 635 F.2d 797, 802 (10th Cir. 1980).

149. *See, e.g.*, Nalore v. San Diego Fed. Sav. & Loan Ass'n, No. 79-3481, slip op. at 2 (9th Cir. Sept. 23, 1981); Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1153-56 (E.D. Mich. 1980); California v. Glendale Fed. Sav. & Loan Ass'n, 475 F. Supp. 728, 733 (C.D. Cal. 1979).

150. *See* text & notes 131-45 *supra*.

151. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1158 (E.D. Mich. 1980). *See also* Public Serv. Comm'n v. Wycoff Co., 344 U.S. 237, 248 (1952).

152. *See* Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1158-59 (E.D. Mich. 1980).

153. *See id.* at 1157. *See also* C. WRIGHT, HANDBOOK ON THE LAW OF FEDERAL COURTS § 18, at 71 (3d ed. 1976).

154. Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1158-59 (E.D. Mich. 1980).

155. *See, e.g.*, Nalore v. San Diego Fed. Sav. & Loan Ass'n, No. 79-3481, slip op. at 3 (9th Cir. Sept. 23, 1981); Guinasso v. Pacific First Fed. Sav. & Loan Ass'n, No. 80-3099, slip op. at 10 (9th Cir. Sept. 21, 1981); Smart v. First Fed. Sav. & Loan Ass'n, 500 F. Supp. 1147, 1153 (E.D. Mich. 1980).

Likewise, the Arizona Supreme Court first restricted the exercise of due-on-sale clauses in 1978,[163] again two years after the conflict-generating FHLBB regulation. Division I of the Arizona Court of Appeals, however, restricted the enforceability of due-on-sale clauses as early as 1971.[164] The Court of Appeals denied acceleration of a due-on-sale clause in a mortgage absent a showing that the purpose of the clause was being violated or the lender's security interest jeopardized.[165] Arguably therefore, in Arizona, the enforcement of due-on-sale clauses could validly be restricted by state law if contained in instruments subject to the jurisdiction of Division I and executed between 1971 and 1976, the date of federal preemption.

163. Patton v. First Federal Sav. & Loan Ass'n, 118 Ariz. 473, 578 P.2d 152 (1978).
164. Baltimore Life Ins. Co. v. Harn, 15 Ariz. App. 78, 486 P.2d 190 (1971).
165. *Id.* at 81, 486 P.2d at 193.