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# Federal Intervention in Real Estate Finance: Preemption and Federal Common Law

Frank S. Alexander

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# FEDERAL INTERVENTION IN REAL ESTATE FINANCE: PREEMPTION AND FEDERAL COMMON LAW

FRANK S. ALEXANDER\*

*Historically, real property law has been the exclusive domain of the states. This autonomy inevitably bred tremendous diversity in the laws that affect real estate finance. Over the last sixty years, however, the federal government has become increasingly involved in real estate finance, both as a regulator and a market participant. The courts have been forced to rely on the doctrines of implied preemption and federal common law to determine when and to what extent federal law should displace diverse state real estate finance laws and impose uniformity. The result has been chaos.*

*In this Article Professor Alexander describes the history of diversity in state real estate finance laws, surveys the growth of federal involvement in real estate finance, and exposes the inconsistent and unpredictable results courts have reached in applying preemption analysis in many critical areas. He blames the multifactored analysis under the doctrines of implied preemption and federal common law for this confusion. He asserts that the present analysis affords traditional state concerns too little weight. Professor Alexander proposes a new approach to preemption analysis premised on the functional difference between federal regulation of real estate finance and federal participation in the real estate market.*

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## I. INTRODUCTION

The law of real estate finance is in the midst of its most significant transformation in centuries. An area of law historically within the province of state autonomy and control, real estate finance laws have become subject to increasing economic pressures for national uniformity. In recent decades federal law has become an element of virtually every mortgage transaction. The pressure for uniformity and this increased federal intervention raise the issue of what law governs real estate finance.

There is no doubt that Congress can, by express declaration, displace state laws governing real estate transactions. It has expressly mandated minimum disclosure requirements; it has expressly limited states' authority to regulate substantive issues such as usury and adjustable rate mortgages. There is also little doubt that Congress can make the federal government a direct participant in the real estate finance market. Federal agencies serve as primary real estate lenders; they insure and guarantee loans; they purchase and "securitize" loans on the secondary mortgage market; they act as receivers for loan portfolios of insolvent financial institutions.

When Congress expressly displaces state laws by market regulation of real estate finance, there may be questions about the wisdom or efficacy of such legislation, but the requirements and effect of such laws are generally clear. When, however, Congress has not spoken directly and clearly on the question of the applicable law, the judiciary must determine whether a federal rule should supplant state law, and, if so, the content of such a rule. Faced with a multitude of criteria upon which to draw and two distinct constitutional doctrines—implied preemption and federal common law—upon which to base its reasoning, the judiciary has reached entirely inconsistent and unpredictable conclusions.

The dilemma is threefold. First, federal laws in real estate finance are not being written on a clean slate. Over the past two centuries each state has developed its own complex and interdependent system of allocating the rights and duties of creditors and debtors in secured real estate finance transactions. No two states have identical mortgage laws. Second, although national uniformity may be desirable for the efficient operation of the real estate finance market, imposition of a uniform rule affecting one particular issue (for example, the availability of nonjudicial foreclosure or the existence of a statutory right of redemption) may significantly alter the delicate balance of creditors' and debtors' rights in one jurisdiction while having little or no effect in other jurisdictions. Perhaps for this reason all attempts thus far to adopt uniform or model mortgage laws have been resoundingly unsuccessful. Third, the very na-

ture of federal involvement in real estate finance has been ambivalent and ambiguous. Although enacted in part to achieve nationally uniform laws, much of the recent congressional action expressly permits individual states to reject the federal rule and retain their own laws or to impose their own requirements in addition to federal law. When federal agencies participate in real estate finance, usually as creditors, they rely upon state laws for protection of the security yet seek to avoid state laws which impose constraints on creditor's rights.

Part II of this Article analyzes the wide diversity among the states in key areas of real estate finance law. One of the few characteristics of mortgage law common to all jurisdictions in the United States is the continuing tension between protection of a debtor's right to possess and control the property and recognition of a creditor's right to foreclose and maximize recovery of the debt. The history of mortgage law is the story of swings between creditors' and debtors' rights. Creditors' preference for the defeasible fee was tempered by the rise of the equity of redemption. The uncertainty of the exercise of redemption led to the creditor's right to foreclose. The harshness of strict foreclosure was partially ameliorated by foreclosure sales, but creditors were able to achieve expedited nonjudicial sales. The price inadequacy of nonjudicial foreclosure sales was countered with statutory rights of redemption and antideficiency legislation. Each state has reached a different compromise between these competing goals, and efforts to achieve a nationally uniform real estate finance law have been completely unsuccessful.

Part III examines the growth of federal involvement in real estate finance. Largely a phenomenon of the last few decades, congressional action has taken the form of both market regulation and market participation. The breadth and depth of such action are reflected in two facts. First, for certain purposes virtually every residential mortgage loan in the United States is a "federally related mortgage" subject to federal requirements. Second, federal agencies and federally related entities are the largest holders of mortgage loans in the country.

In light of this expansive scope of federal participation, Part IV of this Article surveys judicial determinations of whether state law or federal law governs in specific substantive areas. When Congress has not expressly declared the law applicable to federal loan programs, courts have reached inconsistent and unpredictable conclusions.

A primary reason for this chaos is that courts use two separate, yet overlapping, constitutional doctrines to decide the question of what law governs in cases involving federal loan programs. The most commonly used approach is that of implied preemption: Did Congress intend to displace state law and create a separate federal rule to govern the trans-

action? As a form of statutory construction, an implied preemption analysis normally draws upon multiple factors to determine whether preemption of state law is necessary or desirable. Two decisions of the United States Supreme Court in the 1960s, which have been the basis for much of the subsequent litigation, reflect the problems inherent in a discretionary multifactored analysis. In *United States v. Shimer*,<sup>1</sup> the Court held that a federal agency regulation "was intended to provide the whole and exclusive source of protection of the interests of the Veterans Administration as guarantor and was, to this extent, meant to displace inconsistent state law."<sup>2</sup> A few years later, in response to the question whether Texas law of coverture was binding on the Small Business Administration, the Court concluded, in *United States v. Yazell*,<sup>3</sup> that state law remained controlling. This opinion emphasized that the particular loan in question was individually negotiated (hence not part of any nationally uniform program), and that there was no statutory, regulatory, or contractual indication that state law would not apply.<sup>4</sup> The Court expressly rejected the argument that the federal government's financial interests should be exempt from the disparities in state laws.<sup>5</sup>

The second constitutional doctrine used as a basis for decisions involving federal real estate finance programs is federal common law. Broad in its scope and diverse in its application, the doctrine of federal common law provides that, in certain circumstances, rights and remedies created by the federal judiciary constitute the governing law and displace inconsistent state law. One particular branch of federal common law doctrine holds that when the federal government is itself a party to a proceeding, courts have the authority to decide (in the absence of express congressional declaration) what law governs the transaction. Derived from the Supreme Court decision in *Clearfield Trust Co. v. United States*,<sup>6</sup> and subsequently developed in *United States v. Kimbell Foods, Inc.*,<sup>7</sup> this expression of federal common law encompasses two distinct propositions. First, when the federal government is a party to a transaction, federal courts have the authority to establish the governing law. Second, courts have discretion either to establish an applicable rule independent of what state law provides, or to adopt a particular state law as the governing law. Selection of the governing law depends upon

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1. 367 U.S. 374 (1961).

2. *Id.* at 381.

3. 382 U.S. 341 (1966).

4. *Id.* at 344-48, 350-51.

5. *Id.* at 354.

6. 318 U.S. 363 (1943).

7. 440 U.S. 715 (1979).

whether there is a need for a nationally uniform body of law, whether application of state law would frustrate objectives of the federal program, and whether application of federal rules would disrupt commercial relationships based on state law.<sup>8</sup>

Early in the growth of federal participation in real estate finance the majority of judicial decisions concluded, either on the basis of *Shimer* and implied preemption,<sup>9</sup> or by superficial application of federal common law,<sup>10</sup> that federal law displaced state law. As federal participation has become more extensive and the impact of possible displacement of state law more carefully considered, judicial decisions have split widely on the question.<sup>11</sup> The availability of these dual constitutional doctrines, each

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8. *Id.* at 728-29.

9. Of fifteen opinions rendered between 1953 and 1968, *United States v. Yazell*, 382 U.S. 341 (1966), was the only one that held in favor of state law. *See id.* at 352. In the remaining fourteen, the courts decided that state law was not applicable to the federal program. *See United States v. Shimer*, 367 U.S. 374, 381 (1961) (VA regulations preempt state law); *United States v. Wells*, 403 F.2d 596, 598 (5th Cir. 1968) (VA deficiency action permitted notwithstanding state law); *Clark Inv. Co. v. United States*, 364 F.2d 7, 9 (9th Cir. 1966) (federal law governs application of rents during redemption period); *Herlong-Sierra Homes, Inc. v. United States*, 358 F.2d 300, 300 (9th Cir.) (FHA loan not subject to state antideficiency law), *cert. denied*, 385 U.S. 919 (1966); *United States v. Rossi*, 342 F.2d 505, 506 (9th Cir. 1965) (VA deficiency action permitted on basis of indemnity and need for uniformity); *United States v. Chester Park Apts., Inc.*, 332 F.2d 1, 4-5 (8th Cir.) (federal law governs appointment of receiver pending FHA foreclosure), *cert. denied*, 379 U.S. 901 (1964); *United States v. Somerville*, 324 F.2d 712, 716 (3d Cir. 1963) (FmHA policies govern sale of collateral), *cert. denied*, 376 U.S. 909 (1964); *United States v. Helz*, 314 F.2d 301, 303 (6th Cir. 1963) (FHA not bound by state coverture law); *United States v. Queen's Court Apts., Inc.*, 296 F.2d 534, 538 (9th Cir. 1961) (FHA entitled to hold reserve and replacement funds); *United States v. View Crest Garden Apts., Inc.*, 268 F.2d 380, 381-82 (9th Cir.) (federal law applies to FHA receivership petition), *cert. denied*, 361 U.S. 884 (1959); *McKnight v. United States*, 259 F.2d 540, 544 (9th Cir. 1958) (VA deficiency action permitted on basis of indemnity); *United States v. Montgomery*, 268 F. Supp. 787, 789 (D. Kan. 1967) (state statutory redemption period preempted by SBA program); *United States v. Jones*, 155 F. Supp. 52, 54-55 (M.D. Ga. 1957) (VA deficiency action permitted on basis of indemnity); *United States v. Henderson*, 121 F. Supp. 343, 344 (S.D. Iowa 1953) (VA deficiency action permitted on basis of indemnity and need for uniformity).

10. Courts frequently relied upon the rationale of *Clearfield Trust* in holding that federally insured or guaranteed mortgage programs are not subject to state law requirements once the mortgage is owned by the government. *See, e.g., Wells*, 403 F.2d at 598; *Chester Park Apts.*, 332 F.2d at 3; *Sommerville*, 324 F.2d at 714; *Helz*, 314 F.2d at 303; *View Crest Garden Apts.*, 268 F.2d at 382. Several of the initial cases which addressed the question whether state laws applied to actions arising out of federally insured loan programs concluded, with little analysis of possible preemption, that state laws protecting debtors were not binding on the federal government. *See, e.g., McKnight*, 259 F.2d at 544; *Jones*, 155 F. Supp. at 54-55; *Henderson*, 121 F. Supp. at 344.

11. Four recent appellate court decisions reflect the inconsistent analyses and results, based upon implied preemption and federal common law, of the past twenty years. *Compare United States v. Davis*, 961 F.2d 603, 608 (7th Cir. 1992) (holding that VA loan regulations displace state law) and *Jones v. Turnage*, 699 F. Supp. 795, 800-02 (N.D. Cal. 1988) (same), *aff'd sub. nom. Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1496

having a fluid, multifactored analysis, has compounded the confusion.

Part V of this Article analyzes implied preemption and federal common law in the context of real estate finance. Such an analysis, in comprehensive form, has not been undertaken previously and is long overdue. It evaluates each of the criteria underlying the doctrines in terms of the diversity in real estate finance laws throughout the states, and the significance of national uniformity by and for the federal government in this field. The present formulations of implied preemption and federal common law cannot bear the normative and analytical weight expected of them. Too often courts equate the omnipresence of the federal role with omniscience about the purpose and effect of state real estate finance laws, and consequently reject historic state concerns.

Part VI proposes a significantly revised analysis to provide clarity and predictability in real estate finance. The recommended approach draws upon the distinctive functions of market regulation and market participation, and significantly narrows the discretionary displacement of state law by federal law solely on the grounds that the federal government is a party. The suggested approach similarly modifies criteria for application of implied preemption by requiring the courts to focus on the impact of preemption on related state laws, a criterion traditionally absent from implied preemption analysis.

## II. REAL ESTATE FINANCE LAWS: A HISTORY OF DIVERSITY

For two hundred years the laws pertaining to real estate finance have reflected tremendous diversity among the states. Whether viewed as a leading example of states' autonomy in the face of federalism, as a striking example of the effect cultural influences have in the formation of state laws, or even simply as a consequence of radically different economic and social contexts, each state has followed a different path in the development of laws governing the relationship of debtors and creditors in secured real estate transactions.

Real estate finance is most easily understood in three different stages that parallel the life of a mortgage.<sup>12</sup> The first stage concerns the nature of the instrument itself, the interest which is conveyed, and the corre-

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(1991) *with* *Regan v. United States Small Business Admin.*, 926 F.2d 1078, 1081 (11th Cir. 1991) (holding that state laws should apply to Small Business Administration guaranties) *and* *Whitehead v. Derwinski*, 904 F.2d 1362, 1369 (9th Cir. 1990) (holding that state antideficiency laws apply to VA loans).

12. Unless the context indicates otherwise, the term "mortgage" is used throughout this Article in the generic sense of an instrument transferring an interest in real property for the purpose of securing an obligation. In such usage it is intended to include mortgages, deeds of trust, and security deeds in their more technical contexts.



sponding rights and duties of the parties in the event of default. The second stage focuses on foreclosure—the method by which the creditor may take, or force a sale of, the security following default. The third stage, most recent in its historical development, addresses the relative rights and duties of the debtor and creditor after foreclosure. In each of these three stages no two states are completely alike in the allocation of rights and duties.

### A. *Variations in the Nature of the Mortgage*

The first stage in the life of a mortgage concerns the structure of the transaction. Originating as the real property equivalent of a pledge of personal property, the mortgage derived from the twelfth century gage in which property was transferred to the possession of a creditor and the creditor was permitted to receive the rents and profits of the land in payment of the debt.<sup>13</sup> As disputes emerged over the rights of a debtor to redeem its property from the obligation and the rights of a creditor to terminate the debtor's interests in the property, two distinct approaches developed. The first approach held that the security instrument constituted transfer of legal title to the property to the creditor (the "title" theory), while the second held that the security instrument only constituted a lien on the property, and not a transfer of title (the "lien" theory).

The title theory of mortgages follows directly from the early development of the defeasible fee as a substitute for the gage.<sup>14</sup> The security instrument was a fee simple conveyance with the condition that if the debtor repaid the indebtedness by a specified date the creditor would reconvey the property to the debtor. If the debtor failed to make such repayment by the specified date, the creditor would hold the property in fee simple absolute.<sup>15</sup>

The lien theory of mortgages emerged when courts of equity began to protect debtors by permitting redemption of the property from the debt despite the passage of the due date in the security instrument. Such protection became known as the "equity of redemption" and is perhaps the sole feature common to the law of mortgages in every jurisdiction

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13. THE TREATISE ON THE LAWS AND CUSTOMS OF THE REALM OF ENGLAND COMMONLY CALLED GLANVILL 120-26 (G.D.G. Hall ed. & trans., 1965) [hereinafter GLANVILL]. The late medieval development of the mortgage is explored at length in Harold D. Hazeltine, *The Gage of Land in Medieval England*, 17 HARV. L. REV. 549, 549-57 (1904), and John H. Wigmore, *The Pledge-Idea: A Study in Comparative Legal Ideas*, 10 HARV. L. REV. 321, 326-40 (1897). See Frank S. Alexander, *Mortgage Prepayment: The Trial of Common Sense*, 72 CORNELL L. REV. 288, 290-98 (1987).

14. William F. Walsh, *Development of the Title and Lien Theories of Mortgages*, 9 N.Y.U. L. REV. 280, 291-96 (1932).

15. 3 WILLIAM HOLDSWORTH, A HISTORY OF ENGLISH LAW 129-30 (3d ed. 1923).

today.<sup>16</sup> In every jurisdiction the only method by which a creditor can force a termination of the debtor's equity of redemption is foreclosure, and in equity the debtor remains the owner of the property until foreclosure. Thus, "[t]he legal ownership is vested in the creditor; but, in equity, the mortgagor remains the actual owner, until he is debarred by his own default, or by judicial decree."<sup>17</sup> Although the intervention of equity itself did not recharacterize mortgages from titles to liens,<sup>18</sup> by 1781 the functional limitations on the title theory prompted Lord Mansfield's observation, "It is an affront to common sense to say the mortgagor is not the real owner."<sup>19</sup>

Characterization of a mortgage as either a conveyance of a lien or conveyance of legal title has been a source of confusion going far beyond the method of terminating the equity of redemption. From the sixteenth to the nineteenth centuries, unresolved questions included: (1) whether the respective interests of the mortgagor and mortgagee constituted real property or personal property for purposes of inheritance;<sup>20</sup> (2) whether the mortgagor's interest (the equity of redemption) could be subject to levy and sale, and, correspondingly, whether the mortgagee's security interest itself could be subject to liens;<sup>21</sup> (3) whether homestead rights or marital rights such as dower and curtesy applied to a mortgage;<sup>22</sup> (4) whether mortgaged property must be exonerated by a decedent's estate;<sup>23</sup> (5) whether, and when, a mortgagee could take possession of the

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16. Because the equity of redemption evolved from a long series of Chancery Court decisions, it is not possible to point to a specific date for its initial recognition. The substantive development of this doctrine is found most clearly in a series of cases decided by Lord Chancellor Nottingham in the late seventeenth century. *Howard v. Harris*, 23 Eng. Rep. 406, 408 (Ch. 1683); *Talbot v. Braddill*, 23 Eng. Rep. 402, 402-03 (Ch. 1683), *aff'd on reh'g*, 23 Eng. Rep. 539 (Ch. 1686). The most comprehensive single study of redemption is R. W. TURNER, *THE EQUITY OF REDEMPTION* (1931).

17. 4 JAMES KENT, *COMMENTARIES ON AMERICAN LAW* \*136 (12th ed. 1873).

It is true, that in discussions in Courts of Equity, a mortgage is sometimes called a lien for a debt. And so it certainly is, and something more; it is a transfer of the property itself, as security for the debt. This must be admitted to be true at law; and it is equally true in equity; for in this respect equity follows the law.

*Conard v. Atlantic Ins. Co.*, 26 U.S. (1 Pet.) 386, 441 (1828).

18. William H. Lloyd, *Mortgages—The Genesis of the Lien Theory*, 32 YALE L.J. 233, 235 (1923).

19. *King v. St. Michaels*, 99 Eng. Rep. 399, 400 (K.B. 1781); see Lloyd, *supra* note 18, at 237.

20. RICHARD HOLMES COOTE, *A TREATISE ON THE LAW OF MORTGAGE* \*566-91 (1837); 1 JOHN JOSEPH POWELL, *A TREATISE ON THE LAW OF MORTGAGES* 438-58 (1799).

21. 1 FRANCIS HILLIARD, *THE LAW OF MORTGAGES* 277-80, 406-17 (1864); 4 KENT, *supra* note 17, at \*161.

22. 1 HILLIARD, *supra* note 21, at 420-21; 2 POWELL, *supra* note 20, at 701-35.

23. COOTE, *supra* note 20, at \*457-509; 2 POWELL, *supra* note 20, at 803-956.

property before foreclosure;<sup>24</sup> and (6) whether the creditor must reconvey the mortgaged property upon full payment by the debtor, or whether the mortgage became a nullity upon such payment.<sup>25</sup> In light of this range of issues and divergent pressures, it is not surprising that the various states reached different conclusions.<sup>26</sup>

This differential treatment of mortgages at law and in equity lies at the foundation of the distinctions between title theory states and lien theory states. States that desired to protect the debtor's control over the property, or at least to render the debtor's estate complete for purposes of alienation, inheritance, and attachment by third party creditors, favored the lien theory approach because it maximized the debtor's control and minimized the creditor's exposure.<sup>27</sup> States that desired to protect the creditor's ability to control the property upon default and obtain a quick foreclosure favored the title theory approach, which maximized the creditor's options and minimized the debtor's rights. By the latter part of the nineteenth century, eighteen states followed a title theory ap-

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24. 4 KENT, *supra* note 17, at \*164; 1 POWELL, *supra* note 20, at 23-76.

25. *Compare Farmers' Fire Ins. & Loan Co. v. Edwards*, 26 Wend. 541, 543-44 (N.Y. 1841) (payment extinguishes mortgage without need for deed of reconveyance) with *Parsons v. Welles*, 17 Mass. 419, 427 (1821) (deed of reconveyance required). See COOTE, *supra* note 20, at \*8.

26. Because the characterization of a jurisdiction as a lien theory or title theory state depends upon the conclusion reached with respect to anywhere from eight to thirty separate legal questions, it is not surprising that commentators could reach different conclusions. "[T]he only guiding generalization through the morass which can be ventured safely is that the necessity and desirability of according to the mortgagee various legal incidents of title for security purposes will consciously or unconsciously influence the court in deciding whether the mortgagee has them or not." 4 AMERICAN LAW OF PROPERTY 33 (1952). One of the most recent conclusions has been that "[t]he substantial majority of states follow the lien theory of mortgages." GRANT S. NELSON & DALE A. WHITMAN, REAL ESTATE FINANCE LAW § 4.2, at 145 (2d ed. 1985). The fact that some states may change their own identification from lien theory to title theory, or the reverse, or recognize multiple approaches simultaneously, does not make the task any easier. For example, one commentator, in 1878, and the National Conference of Commissioners, in 1922, classified Georgia as a lien theory state. See 1 LEONARD A. JONES, A TREATISE ON THE LAW OF MORTGAGES OF REAL PROPERTY 23 (1878); 1922 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 280 [hereinafter 1922 HANDBOOK]. For most legal issues Georgia did, in fact, follow the lien theory approach until the Civil War Reconstruction Period, when statutes were enacted increasing significantly the rights of the mortgagees and adopting the "Deed to Secure Debt" as the instrument of conveyance. By the early twentieth century it was clear that the title theory approach was not only permissible in Georgia but predominant as a matter of practice, even though separate statutory authorization for mortgages (as liens only) continued to exist. See FRANK S. ALEXANDER, GEORGIA REAL ESTATE FORECLOSURE LAW 12-32 (1990).

27. One commentator concluded that mortgages, under the lien theory perspective, were in function nothing more than a contractually enforceable power of sale upon default. Bernard C. Gavit, *Under the Lien Theory of Mortgages is the Mortgage Only a Power of Sale?*, 15 MINN. L. REV. 147, 148 (1931).

proach, another eighteen states followed a lien theory approach, and six other states adopted a blend of the two approaches.<sup>28</sup> The title theory approach predominated east of the Mississippi, while New York and most of the mid-western and western states and territories followed the lien theory approach. Fifty years later there were twenty-seven lien theory states, seventeen "estate" theory states, and nine states utilizing the intermediate "Deed of Trust"; at least four states permitted multiple approaches.<sup>29</sup>

The most significant issue dividing title and lien theory states was the creditor's right to possession of the land before foreclosure. Although the late medieval gage contemplated possession by the creditor from the outset of the mortgage,<sup>30</sup> by the middle of the seventeenth century the custom, if not the underlying contract, permitted the debtor to remain in possession of the property until default.<sup>31</sup> The dividing line between the title and lien theories occurred with the debtor's default. Could the creditor demand immediate possession of the property upon default, or did he have to await foreclosure?

Historically, the title theory, with its premise of a transfer of title to the mortgagee, affirmed the rights of the mortgagee to possession, as well as to rents and profits, immediately upon default.<sup>32</sup> In contrast, lien theory jurisdictions denied a mortgagee an action in ejectment against the mortgagor; the mortgagee could obtain protection of the rents and profits only through foreclosure or the appointment of a receiver.<sup>33</sup> Throughout the nineteenth century, most states enacted statutes which addressed this issue; several jurisdictions (frequently labelled the "intermediate theory" states) expressly granted the mortgagor the right of possession until default and gave the mortgagee the right thereafter.<sup>34</sup>

### B. Variations in Foreclosure Procedures

From the perspective of both the debtor and the creditor, the second stage in the life of a mortgage, the timing and method of foreclosure of

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28. 1 JONES, *supra* note 26, at 36-38.

29. 1922 HANDBOOK, *supra* note 26, at 280.

30. Hazeltine, *supra* note 13, at 549. In the *vivum vadium*, the "living gage," rents and profits during the creditor's possession were applied against the indebtedness, while in the *mortuum vadium*, the "dead gage," such income to the creditor did not reduce the indebtedness. See GLANVILL, *supra* note 13, at 124.

31. Walsh, *supra* note 14, at 292.

32. 1 POWELL, *supra* note 20, at 225-27.

33. Edgar N. Durfee, *The Lien or Equitable Theory of the Mortgage—Some Generalizations*, 10 MICH. L. REV. 587, 603-04 (1912); Walsh, *supra* note 14, at 292.

34. See Robert Kratovil, *Mortgages—Problems in Possession, Rents, and Mortgagee Liability*, 11 DEPAUL L. REV. 1, 6 (1961).

the equity of redemption, is frequently the most significant aspect of the secured transaction. By the American Revolution the debtor's right of redemption had become so established in equity by the English Chancery Courts that foreclosure, in one form or another, became the sole method of terminating a debtor's interest.<sup>35</sup>

An early response to the use of the defeasible fee as the mortgage instrument was "strict foreclosure," a process by which a date was established for payment of the debt and upon passage of the date the title to the property vested absolutely in the creditor.<sup>36</sup> While strict foreclosure is still available in limited circumstances in a few jurisdictions today,<sup>37</sup> the possibility of a large disparity between the amount of the debt and the value of the property led every state to adopt, by the close of the nineteenth century, foreclosure by sale.<sup>38</sup>

What has divided the various states since the late nineteenth century is whether foreclosure of the equity of redemption requires a judicially authorized sale, or whether a contractually authorized power of sale is sufficient. It has long been within the inherent powers of a court of equity to order a sale of the mortgaged premises,<sup>39</sup> and many jurisdictions, following the merger of law and equity, enacted statutes specifically authorizing foreclosure by sale procedures.<sup>40</sup> England recognized the validity of the contractually authorized power of sale in 1860.<sup>41</sup> Jurisdictions in the United States quickly followed suit either by statutory affirmation of such a power<sup>42</sup> or by judicial enforcement of the power of sale under

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35. See TURNER, *supra* note 16, at 83.

36. See 2 HILLIARD, *supra* note 21, at 31-32.

37. See CONN. GEN. STAT. ANN. § 49-15 (West 1978 & Supp. 1992); VT. STAT. ANN. tit. 12, § 4528 (1973).

38. 2 JONES, *supra* note 26, at 290-342; see 1 HILLIARD, *supra* note 21, at 128. In some American jurisdictions the foreclosure procedures were considered so vital that they were set forth in detail in the original state judiciary acts following the Revolution. See, e.g., Act of Dec. 9, 1790, No. 438, § VII (Judiciary Act of Georgia of 1790), in ROBERT WATKINS & GEORGE WATKINS, A DIGEST OF THE LAWS OF THE STATE OF GEORGIA 422, 424 (1800).

39. See 2 JOSEPH STORY, COMMENTARIES ON EQUITY JURISPRUDENCE § 1026 (2d ed. 1839). By statute enacted in 1852, England clarified the procedures to be followed in equity by specifying the availability of a judicially ordered sale of the premises upon such terms as the court deemed appropriate. 15 & 16 Vict., ch. 86, § 48 (1852) (Eng.). Prior to this time foreclosures by powers of sale were "of too doubtful a complexion to be relied on as the source of an irredeemable title." 1 POWELL, *supra* note 20, at 19.

40. Notwithstanding the trend toward codification of the foreclosure sale requirements, the wide differences among the jurisdictions prompted one commentator to urge the adoption of a uniform system among the states in 1878. 2 JONES, *supra* note 26, at 290 n.1.

41. 23 & 24 Vict., ch. 145 (1860) (Eng.).

42. 2 JONES, *supra* note 26, at 557; see CAL. CIV. CODE § 2932 (West 1974) (enacted 1872); GA. CODE ANN. § 23-2-114 (1982) (enacted as GA. CIV. CODE § 4023 (1895)).

basic agency principles.<sup>43</sup>

By the early twentieth century there were thus wide variations among the states in the methods of foreclosing a mortgage: judicial foreclosure (at law or in equity) without statutory requirements (sixteen states), judicial foreclosure (at law or in equity) with statutory requirements (twelve states), nonjudicial foreclosure by power of sale, with minimal statutory requirements (eleven states), and nonjudicial foreclosure with significant statutory requirements (six states).<sup>44</sup> In 1984, approximately thirty-two jurisdictions permitted some form of nonjudicial power of sale foreclosure.<sup>45</sup>

Statutory requirements applicable to power of sale foreclosures have usually included notice to the mortgagor, publication of notice of the sale for a specified period of time, specification of the contents of the notice of sale, restrictions on the time and place of sales, and, in some jurisdictions, a requirement that sale prices equal fair market value. Even where these requirements have existed, however, no two states have followed identical patterns. The length of time required to complete a nonjudicial foreclosure varied, in 1922, from as little as a few days to over several months, exclusive of any post-foreclosure right of redemption.<sup>46</sup>

### C. *Post-Foreclosure Requirements*

The completion of a foreclosure sale begins the third stage in the allocation of rights among secured creditors and debtors. Many jurisdictions have extended to debtors an additional period of time, post-foreclosure, in which to redeem the property from the debt or have restricted a creditor's right to sue for a deficiency.

Although a nonjudicial power of sale foreclosure permits a creditor to avoid the costly and time-consuming effects of a judicial foreclosure by selling the debtor's property shortly after default, the "forced sale" characteristic of this nonjudicial foreclosure has caused significant concern. Largely because such a sale rarely, if ever, achieves the fair market price for the property, and therefore results in a significant loss of equity to a

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43. See, e.g., *Robenson v. Vason*, 37 Ga. 66, 79-80 (1867).

44. 1922 HANDBOOK, *supra* note 26, at 280.

45. Jack Jones & J. Michael Ivens, *Power of Sale Foreclosure in Tennessee: A Section 1983 Trap*, 51 TENN. L. REV. 279, 293 n.118 (1984). A different study concluded that 19 states explicitly or implicitly recognized only judicial foreclosure, while 31 states permitted nonjudicial foreclosure. Patrick B. Bauer, *Judicial Foreclosure and Statutory Redemption: The Soundness of Iowa's Traditional Preference for Protection over Credit*, 71 IOWA L. REV. 1, 4-5 & n.8 (1985).

46. 1922 HANDBOOK, *supra* note 26, at 258.

debtor, a number of jurisdictions have created by statute an additional post-foreclosure period for redemption by the debtor.

The different approaches to post-foreclosure rights of redemption mirror the diversity among the jurisdictions in foreclosure procedures. By 1922, approximately thirty-two states provided for some statutory redemption period, varying from six to eighteen months.<sup>47</sup> Some states shifted the right of redemption to a specified period before the foreclosure sale, while others required both a substantial period of time for redemption before the sale as well as after the sale.<sup>48</sup> In 1985 approximately twenty-nine states continued to have some form of statutory redemption rights, but the scope of such redemption rights was not consistent.<sup>49</sup> In some jurisdictions the post-foreclosure rights of redemption apply to all mortgage foreclosures; in others they apply only to judicial foreclosures; in yet others they apply only to nonjudicial power of sale foreclosures.<sup>50</sup>

A separate but related issue concerns whether a debtor is liable for any amounts due a creditor in excess of the amount realized at foreclosure. Here again states have adopted widely divergent approaches. Some jurisdictions prohibit deficiency actions entirely in certain circumstances, when the transaction involves a purchase money mortgage,<sup>51</sup> or in all situations involving exercise of a power of sale foreclosure,<sup>52</sup> effectively rendering the underlying promissory notes in these situations non-recourse debt. Other jurisdictions tie the right to bring a deficiency action to a finding that the foreclosure sale resulted in fair market value;<sup>53</sup> still others require that the creditor file an action for liability on the note simultaneously with an action for foreclosure.<sup>54</sup>

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47. *Id.* at 280.

48. *Id.*

49. Patrick B. Bauer, *Statutory Redemption Reconsidered: The Operation of Iowa's Redemption Statute in Two Counties Between 1881 and 1980*, 70 IOWA L. REV. 343, 345-46 (1985).

50. *Id.* at 345 n.11. The effectiveness of statutory rights of redemption in protecting against foreclosure sales prices far below fair market value has been the subject of continuing debate, with studies suggesting that redemption occurs in less than 10% of foreclosure sales. *Id.* at 350; Robert M. Washburn, *The Judicial and Legislative Response to Price Inadequacy in Mortgage Foreclosure Sales*, 53 S. CAL. L. REV. 843, 854 n.57 (1980) (citing William C. Prather, *Foreclosure of the Security Interest*, 1957 U. ILL. L. REV. 420, 452 (suggesting mortgages rarely redeem from sale)); Terry Schaplaw, Comment, *Oregon's Statutory Right of Redemption—Any Redeeming Qualities?*, 16 WILLIAMETTE L. REV. 891, 915 (1980).

51. See, e.g., CAL. CIV. PROC. CODE § 580b (West 1976 & Supp. 1992); N.C. GEN. STAT. § 45-21.38 (1991).

52. See, e.g., MONT. CODE ANN. § 71-1-317 (1991); WASH. REV. CODE ANN. § 61.24.100 (West 1989).

53. See, e.g., GA. CODE ANN. § 44-14-161 (1982).

54. NELSON & WHITMAN, *supra* note 26, § 8.2, at 598-600.

#### D. Attempts at Uniformity

By the early part of the twentieth century it was clear that no two states had chosen identical paths for allocating rights among debtors and creditors in real estate finance.<sup>55</sup> As real estate finance became increasingly national in scope, pressures began to mount for uniformity among jurisdictions. The most extensive, and least successful, effort to achieve uniformity has been through attempts to draft uniform or model laws for voluntary enactment by each state. Congressional actions to impose uniformity expressly and directly have been more limited in scope.

In the face of the differences among the states, the National Conference of Commissioners on Uniform State Laws began work in 1911 on a uniform mortgage law.<sup>56</sup> It considered initial drafts in 1921<sup>57</sup> and 1922,<sup>58</sup> and debated the proposed uniform law in detail in 1925.<sup>59</sup> When considered on a section-by-section basis, each section received an affirmative vote, but when considered in its entirety, the proposed uniform law was defeated by a vote of nineteen to fourteen.<sup>60</sup> The following year the uniform mortgage law again came under review.<sup>61</sup> In 1927, the Uniform Real Estate Mortgage Act was overwhelmingly approved.<sup>62</sup> It had as its

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55. An example cited in 1927 was that in Kansas City, Missouri, a mortgage could be foreclosed in three weeks, without any subsequent redemption period, while across the river in Kansas City, Kansas, judicial foreclosure was required, with an 18 month right of redemption following foreclosure. 1927 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 656-57 [hereinafter 1927 HANDBOOK].

56. 1911 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 185; see Jon W. Bruce, *The Role Uniform Real Property Acts Have Played in the Development of American Land Law: Some General Observations*, 27 WAKE FOREST L. REV. 331, 331-32, 336-41 (1992).

57. 1921 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 245-65.

58. 1922 HANDBOOK, *supra* note 26, at 253.

59. 1925 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 169-75, 176-78, 217-18 [hereinafter 1925 HANDBOOK].

60. *Id.* at 301-03. The 1925 defeat of the proposed Uniform Mortgage Law was, no doubt, a serious blow to its chief advocate, Nathan MacChesney, who at the time was serving his final year as the tenth president of the National Conference of Commissioners on Uniform State Laws. *Id.* at 6. MacChesney was also general counsel of the National Association of Real Estate Boards. 1927 HANDBOOK, *supra* note 55, at 664.

61. 1926 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 125.

62. 1927 HANDBOOK, *supra* note 55, at 195-96. During the brief period of time between the initial defeat of the uniform law and its subsequent adoption, considerable institutional support was given to its passage. Real estate licensing boards, title insurance companies, mortgage companies, and local bar associations all endorsed the proposed act. See 1924 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 450-53; 1927 HANDBOOK, *supra* note 55, at 658-62. Similarly, academic evaluations generally supported the passage of the act. See Edgar N. Durfee & Delmar W. Doddridge, *Redemption*



principal features the declaration of a mortgage as a lien (with possession remaining in the mortgagor until foreclosure), a regulated foreclosure by power of sale (in addition to the possibility of judicial foreclosure), and a post-foreclosure redemption period (with the length of time to be determined by each state).<sup>63</sup> Notwithstanding its adoption in 1927, the initial defeat of the uniform act presaged its ultimate failure.

Because the states differed so significantly in their approaches to the numerous areas of conflict between debtors' and creditors' mortgage rights, the compromise reflected by the uniform law necessarily contained "a form of foreclosure unfamiliar to practitioners in many jurisdictions."<sup>64</sup> Whether because of a general political resistance to the adoption of uniform laws<sup>65</sup> or because the uniform act would require significant changes in the laws of virtually every state,<sup>66</sup> it achieved less success than virtually any other uniform law recommended for adoption. Over the ensuing seventeen years only one state adopted the uniform act, and in 1943 the Commissioners declared the uniform act "obsolete."<sup>67</sup>

In 1940 the National Conference of Commissioners on Uniform State Laws took a different approach, recommending a Model Act instead of a uniform law for consideration by the states.<sup>68</sup> More modest in approach, the Model Power of Sale Mortgage Foreclosure Act provided for a power of sale foreclosure after three months notice to the mortgagor and specified a nine-month statutory right of redemption; it also prohibited deficiency actions.<sup>69</sup> Suffering the same fate as its predecessor, the

from *Foreclosure Sale—The Uniform Mortgage Act*, 23 MICH. L. REV. 825, 838-41, 860-66 (1925); F.D.G. Ribble, *The Uniform Mortgage Act*, 12 VA. L. REV. 674, 674 (1926).

63. The chief changes from the 1925 proposal, which failed, to the 1927 proposal, which passed, included leaving the statutory period of redemption to be determined by each individual state, clarifying that judicial foreclosures need not be affected by passage of the uniform act, and allowing each state to determine the appropriate amount of attorneys' fees to be awarded. The complete text of the Act, as approved and recommended to the states, is set forth in 1927 HANDBOOK, *supra* note 55, at 672-718.

64. Note, *Another Step Toward Progressive Legislation: The Uniform Mortgage Act*, 38 HARV. L. REV. 651, 658 (1926).

65. In his last annual address as President of the National Conference of Commissioners on Uniform State Law, Nathan MacChesney spoke at great length on the political debates concerning states' autonomy and federalism. See 1925 HANDBOOK, *supra* note 59, at 349-76.

66. The basic structure of the uniform act was evidently taken from the then-existing Minnesota statute, which itself derived from the 1828 statutes of New York. Durfee & Doddridge, *supra* note 62, at 835 n.35.

67. 1943 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 66. The one state reported to have adopted the uniform act was Minnesota, whose statute had been the model for the uniform act in the first place. See *supra* note 66.

68. 1940 HANDBOOK OF THE NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 175 [hereinafter 1940 HANDBOOK].

69. *Id.* at 254, 257.

Model Act was not enacted by any jurisdiction.

Beginning in 1975 the National Conference started producing a large number of uniform laws addressing real estate issues in general and real estate finance questions in particular. The Uniform Land Transactions Act ("ULTA"),<sup>70</sup> approved in 1975, and the Uniform Simplification of Land Transfers Act ("USLTA"),<sup>71</sup> approved in 1976, address issues central to real estate transfers and real estate finance. The Uniform Land Security Interest Act ("ULSIA"),<sup>72</sup> approved in 1985, deals solely with real estate finance transactions and follows closely the corresponding provisions of the ULTA. ULSIA permits a secured creditor to take possession upon default if the security agreement so provides,<sup>73</sup> permits power of sale foreclosure if authorized by the security agreement,<sup>74</sup> requires five weeks notice of a sale to the debtor and all other interested parties,<sup>75</sup> prohibits deficiency actions following power of sale foreclosure of residential owner occupied property,<sup>76</sup> and contains no post-foreclosure sale right of redemption.<sup>77</sup> ULSIA, for the first time, recognizes a separate category of "protected persons" such as residential debtors who are entitled to additional protections.<sup>78</sup> As of 1991, no state had enacted ULTA, USLTA, or ULSIA.<sup>79</sup>

In yet another attempt to provide a degree of coherence to the diversity of real estate finance laws across the country, the American Law Institute began preparing, in 1990, a Restatement of the Law dealing

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70. UNIF. LAND TRANSACTIONS ACT, 13 U.L.A. 469 (1975) (amended 1977 and 1983).

71. UNIF. SIMPLIFICATION OF LAND TRANSFERS ACT, 14 U.L.A. 249 (1976) (amended 1990).

72. UNIF. LAND SECURITY INTEREST ACT, 7A U.L.A. 184 (Supp. 1992).

73. UNIF. LAND SECURITY INTEREST ACT § 503(a), 7A U.L.A. 217 (1986 & Supp. 1992).

74. *Id.* § 507(c), 7A U.L.A. 223; see James M. Pedowitz, *Mortgage Foreclosure under ULSIA*, 27 WAKE FOREST L. REV. 495, 499-501, 504-05 (1992).

75. UNIF. LAND SECURITY INTEREST ACT § 508, 7A U.L.A. 224 (1986 & Supp. 1992). Significant to many jurisdictions, this provision rejects the adequacy of notice by publication.

76. *Id.* § 511(b), 7A U.L.A. 228. See John Mixon & Ira B. Shepard, *Antideficiency Relief for Foreclosed Homeowners: ULSIA Section 511(b)*, 27 WAKE FOREST L. REV. 455, 457 (1992).

77. UNIF. LAND SECURITY INTEREST ACT § 513 cmt. 1, 7A U.L.A. 230 (1986 & Supp. 1992).

78. *Id.* § 113, 7A U.L.A. 199-200. When a protected party is the debtor, the notice of default and intent to foreclose cannot be given until a default has existed for five weeks, *id.* § 507(b), and the foreclosure sale cannot be conducted until five weeks after the notice is sent. *Id.* § 509(a). Thus, the Act functionally grants the debtor a minimum period of 10 weeks following initial default.

79. 1991-1992 REFERENCE BOOK, NATIONAL CONFERENCE OF COMMISSIONERS ON UNIFORM STATE LAWS 115, 120 (1991).

with mortgages.<sup>80</sup> Based on the proposition that while the "lack of uniformity may have been only a minor inconvenience in an earlier era[,] today it is a serious obstacle to the nation's economic welfare,"<sup>81</sup> the Institute seeks to provide a basis for uniform legal rules.<sup>82</sup>

While much of the impetus for uniform laws during the twentieth century has come from conventional institutional lenders, title insurance companies, and bar associations, the emergence during the late 1970s of the secondary mortgage market also created a significant demand for standardization in real estate finance. For a number of years the governmental purchasers of home mortgages, particularly the Federal National Mortgage Association (FNMA) and the Federal Home Loan Mortgage Corporation (FHLMC), developed and required standard form promissory notes and security instruments.<sup>83</sup> Such instruments contain a large number of uniform covenants, but, because of the differences in state laws, they are also tailored to each jurisdiction by nonuniform covenants. Notwithstanding this lack of uniformity, the secondary mortgage market and mortgage securitization grew rapidly during the 1980s. By the end of 1978, approximately ten percent of all mortgages on one to four family non-farm properties were held in mortgage pools or trusts; by the end of 1989, the percentage had nearly quadrupled.<sup>84</sup>

The diversity among the states in the allocation of rights and duties between debtors and creditors in real estate finance thus reflects several basic propositions. First, state laws are a complex balance between recognition of creditors' rights and protection of debtors' interests. Second, each state differs in its current approach, with questions of foreclosure procedures, rights of redemption, and deficiency restrictions being set in a web of contractual and statutory relationships. Third, attempts to achieve voluntarily interstate uniformity have been unsuccessful.

### III. GROWTH OF FEDERAL INVOLVEMENT

The role of the United States government in real estate finance arose

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80. RESTATEMENT OF THE LAW PROPERTY-SECURITY (MORTGAGES) (Tentative Draft No. 1, 1991; Tentative Draft No. 2, 1992).

81. RESTATEMENT OF THE LAW PROPERTY-SECURITY (MORTGAGES) at 1 (Tentative Draft No. 1, 1991).

82. "A major goal of this Restatement, then, is to assist in unifying the law of real property security by identifying and articulating legal rules that will meet the legitimate needs of the lending industry while at the same time providing reasonable protections for borrowers." *Id.* at 2.

83. CHARLES L. EDSON & BARRY G. JACOBS, SECONDARY MORTGAGE MARKET GUIDE app. C (1991).

84. SAVINGS & HOME FINANCING SOURCE BOOK tbl. C-1 (1989) (Mortgage Debt Outstanding on 1-4 Family Nonfarm Homes by Type of Holder).

only in the twentieth century. That role, however, has been immense. There is virtually no area of real estate finance law today that is immune from federal law. The participation of and intervention by the federal government has occurred in two forms, or phases. The first phase, from 1933 to 1968, involved primarily the creation of national housing policies and targeted federal housing programs. The second phase, from roughly 1968 to the present, reflects direct transaction regulation and specific substantive intervention. This phase included the wave of deregulation and the banking collapse, which have left the federal government as the owner of mortgages of every type in every jurisdiction. During both phases, but particularly during the last two decades, there has been a dramatic increase in indirect regulation of real estate finance by other federal laws, notably bankruptcy and environmental laws.

Over the course of the twentieth century the federal government has functioned in a large variety of markedly different roles. It has served as a market regulator in establishing disclosure requirements and by limiting substantive terms of real estate transactions in areas such as the enforceability of due-on-sale clauses and usury. It has functionally served as a direct market participant by originating and holding mortgages, and as an indirect market participant by insuring and guaranteeing loans. It has served as a market catalyst and stimulator in purchasing loans in the secondary mortgage market. As banking regulator and insurer, the federal government has become the largest single holder of mortgages in the country.

The fact that the federal government plays so many roles increases substantially the difficulties posed by the lack of uniformity in real estate finance among jurisdictions. While Congress has, in many statutes, expressly established uniform requirements, or at least a minimum set of requirements, the overlay of federal and state laws has created substantial confusion over what law governs a particular transaction.

### *A. Early Involvement*

Although there were a few scattered earlier efforts,<sup>85</sup> active federal involvement in real estate finance began with the New Deal. The Federal Home Loan Bank Act of 1932<sup>86</sup> established a source of credit reserves to enable lending institutions to make long-term home mortgages; the

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85. See, e.g., Pub. L. No. 65-149, ch. 74, 40 Stat. 550 (1918) (authorizing the development of housing programs to meet the housing needs in the District of Columbia prompted by World War I).

86. Pub. L. No. 72-304, ch. 522, 47 Stat. 725 (1932) (codified as amended at 12 U.S.C. § 1421 (1988 & Supp. II 1990)).

Home Owners' Loan Act of 1933<sup>87</sup> created the initial Home Owners' Loan Corporation and federal savings and loan associations to finance and refinance single family residences; and the National Housing Act of 1934<sup>88</sup> created the Federal Housing Administration (FHA) and the Federal Savings and Loan Insurance Corporation, and initiated the first federal mortgage insurance program. The primary thrust of these early congressional efforts was to provide a stable and long-term source of funds for residential mortgages, primarily through increasing liquidity for lending institutions and providing mortgage insurance. The Reconstruction Finance Corporation, created in 1935,<sup>89</sup> served as an initial liquidity provider by purchasing FHA-insured mortgages, and in so doing set the precedent for the secondary mortgage market phenomenon. From this precedent emerged the Federal National Mortgage Association (FNMA).<sup>90</sup> Following World War II Congress granted FNMA a separate congressional charter,<sup>91</sup> authorizing it to serve as the sole secondary mortgage market entity, and vested it with authority to purchase not only FHA-insured mortgages but also the rapidly expanding supply of guaranteed loans to veterans.<sup>92</sup> The expansion of these programs coincided with the congressional declaration that:

[T]he general welfare and security of the Nation and the health and living standards of its people require housing production and related community development sufficient to remedy the serious housing shortage. . . . and the realization as soon as feasible of the goal of a decent home and a suitable living environment for every American family.<sup>93</sup>

With the exception of a relatively small number of direct loan programs,<sup>94</sup> the role of the federal government throughout this period was

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87. Pub. L. No. 73-43, ch. 64, 48 Stat. 128 (1933) (codified as amended at 12 U.S.C. § 1461 (1988 & Supp. II 1990)). The Home Owners' Loan Corporation was dissolved by Act of June 30, 1953, ch. 170, 67 Stat. 121, 126-27 (1953).

88. Pub. L. No. 73-479, 48 Stat. 1246 (1934) (codified as amended in scattered sections of 12 U.S.C., primarily 12 U.S.C. §§ 1701-1742 (1988 & Supp. II 1990)).

89. Pub. L. No. 74-1, ch. 2, 49 Stat. 1 (1935).

90. A brief historical summary of the Federal National Mortgage Association and the Reconstruction Finance Corporation is set forth in 43 Fed. Reg. 36,200, 36,200-02 (1978).

91. Pub. L. No. 80-864, 62 Stat. 1206 (1948).

92. The residential mortgage loan guarantee program for veterans commenced in 1944. Servicemen's Readjustment Act of 1944, Pub. L. No. 78-346, ch. 268, 58 Stat. 284 (1944). The veterans' guaranteed loan program is presently codified at 38 U.S.C. ch. 37, §§ 1802-1851 (1988 & Supp. I 1989).

93. Housing Act of 1949, Pub. L. No. 81-171, ch. 338, 63 Stat. 413 (1949) (codified as amended at 42 U.S.C. § 1441 (1988)). Congress reaffirmed this national goal in 1968. Pub. L. No. 90-448, 82 Stat. 476 (1968) (codified at 12 U.S.C. § 1701t (1988)).

94. *See, e.g.*, 38 U.S.C. § 1811 (1988) (direct loans to veterans when credit is not otherwise available).

to serve as a facilitator of the real estate finance market, particularly with respect to residential mortgages. The only major controversy arising from the federal government's involvement was that the success of FNMA prompted protests by private secondary mortgage market entities. As a result, in 1954 Congress amended the charter of FNMA to impose certain restrictions on its mortgage purchases.<sup>95</sup>

Because this federal involvement was indirect, there was little question whether the existence of the federal programs constituted a basis for overriding state real estate finance laws in favor of a federal common law of real estate finance. The federal insurance and guarantee programs seemed by their silence to assume the application of state laws. A leading commentator on federal housing programs during this period pointed out, "It is a fact of vital importance in the shaping of a national housing policy that in the control of credit institutions dealing with housing, as in land control, the role of the states is constitutionally dominant."<sup>96</sup>

### *B. Direct Regulation*

After 1968, the role of the federal government in real estate finance changed dramatically. Congress increased its role as a market regulator of real estate finance transactions, initially by mandating disclosure requirements for virtually all residential mortgage loan transactions. Later Congress began to set substantive limitations on the authority of states to legislate on specific issues. Additionally, Congress expanded considerably its role as a market participant by increasing the number of federally related secondary mortgage market entities. These heightened roles raised more acutely the question whether federal or state law governed the transaction.

Congressionally enacted mandatory disclosure laws took the form of the Truth in Lending Act of 1968 (TILA),<sup>97</sup> the Real Estate Settlement Procedures Act of 1974 (RESPA),<sup>98</sup> and the Home Mortgage Disclosure Act of 1975 (HMDA).<sup>99</sup> In all three instances Congress concluded that existing market mechanisms did not provide comprehensible information

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95. Housing Act of 1954, § 304(d), Pub. L. No. 83-560, 68 Stat. 590, 616 (1954).

96. CHARLES M. HAAR, *FEDERAL CREDIT AND PRIVATE HOUSING* 7 (1960). Professor Haar recognized that "[w]ithout regard to the wisdom of any particular provision, diversity of state law is in and of itself an impediment to mortgage investment," and that "the enactment of uniform mortgage laws, uniform mechanics lien laws, standard real estate mortgage tax laws, and uniform standards of title requirements by all of the states could do much to assure the successful operation of Federal legislation in aid of private housing finance." *Id.* at 342-43.

97. Pub. L. No. 90-321, 82 Stat. 146 (1968) (codified as amended at 15 U.S.C. § 1601 (1988)).

98. Pub. L. No. 93-533, 88 Stat. 1724 (codified as amended at 12 U.S.C. § 2601 (1988)).

99. Pub. L. No. 94-200, 89 Stat. 1125 (codified as amended at 12 U.S.C. § 2801 (1988)).

to the consumer and that clearer, less complex information could result in greater competition and prevent unfair practices.<sup>100</sup> TILA required uniform disclosure of financing charges and annual percentage rates to borrowers;<sup>101</sup> RESPA required advance disclosure of the charges, terms, and condition of a loan, and a uniform settlement statement for closing costs;<sup>102</sup> HMDA required that lending institutions compile and disclose detailed statistical information on their mortgage loans by location of the secured property.<sup>103</sup> While these Acts have achieved a certain degree of uniformity and disclosure, some commentators have seriously questioned whether the required disclosures have achieved the original congressional purposes.<sup>104</sup>

The congressional introduction of the concept of a "federally related mortgage loan"<sup>105</sup> reveals the intended reach of these federal disclosure laws, as well as the increased role of the federal government in mortgage lending. Because such loans include any residential first mortgage loan made by a federally insured lender, any loan insured by a federal agency, and any loan which is intended to be sold to a federally related secondary mortgage market entity, the disclosure laws are applicable to the overwhelming majority of all residential first mortgage loans in the country. Such a sweeping definition has, in turn, become the basis for other congressional declarations on real estate finance.<sup>106</sup>

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100. See 12 U.S.C. § 2601(b)(1) (1988); *id.* § 2801(b); 15 U.S.C. § 1601(a) (1988).

101. The comprehensive regulations of the Truth in Lending Act are set forth in what is known as "Regulation Z." 12 C.F.R. pt. 226 (1992).

102. The regulations pertaining to real estate loans are set forth in what is known as "Regulation X." 24 C.F.R. pt. 3500 (1989). For a discussion of the background and interpretation of RESPA, see Dale A. Whitman, *The Real Estate Settlement Procedures Act: How to Comply—Problems and Prospects*, 4 REAL EST. L.J. 223, 223-43 (1976).

103. 12 U.S.C. § 2803(a) (1988 & Supp. II 1990). In 1977, Congress imposed limited affirmative duties on financial institutions by requiring residential mortgage lenders to develop plans to meet the credit needs of the entire community in which the institution is located. Community Reinvestment Act of 1977, Pub. L. No. 95-128, 91 Stat. 1147 (codified at 12 U.S.C. §§ 2901-2902 (1988 & Supp. II 1990)).

104. See William N. Eskridge, Jr., *One Hundred Years of Ineptitude: The Need for Mortgage Rules Consonant with the Economic and Psychological Dynamics of the Home Sale and Loan Transaction*, 70 VA. L. REV. 1083, 1128-35 (1984); Diana Stoppello, *Federal Regulation of Home Mortgage Settlement Costs: RESPA and its Alternatives*, 63 MINN. L. REV. 367, 445-56 (1979).

105. See, e.g., 12 U.S.C. § 2602(1) (1988). This sweeping definition of a federally related mortgage loan appears to have been first used in the antidiscrimination provisions of the Housing and Community Development Act of 1974, Title VIII, § 808(a), Pub. L. No. 93-383, 88 Stat. 633, 728-29 (codified as amended at 12 U.S.C. § 1735f-5(b) (1988)).

106. See, e.g., Depositor Institutions Deregulation and Monetary Control Act of 1980, Title V, § 501, Pub. L. No. 96-221, 94 Stat. 132, 161-62 (codified at 12 U.S.C. § 1735f-7a (1988 & Supp. II 1990)) (congressional preemption of state usury limits with respect to residential mortgage loans). The broad sweep of the "federally related mortgage loan" has been noted with some dismay. See *McInnis v. Cooper Communities, Inc.*, 271 Ark. 503, 507, 611 S.W.2d

In enacting these disclosure laws Congress made it abundantly clear that the requirements of federal law preempt corresponding state laws only to the extent of an inconsistency between federal law and state law.<sup>107</sup> States expressly retain the authority to enact requirements which provide greater protections to the consumer or require more extensive disclosures.<sup>108</sup>

The second form of market regulation which developed during this period was the determination by Congress that certain state laws interfered with the optimum functioning of the real estate finance market. The two most visible examples of this were the express preemption, in 1980, of state usury laws relating to real estate finance,<sup>109</sup> and, in 1982, of state laws regulating due-on-sale clauses in mortgages.<sup>110</sup> The usury preemption expressly permitted an affirmative state override if undertaken within three years, and sixteen jurisdictions chose to reinstate their own usury statutes.<sup>111</sup> Express congressional preemption of the laws concerning due-on-sale clauses followed by only a few months the Supreme Court's decision in *Fidelity Federal Savings & Loan Ass'n v. de la Cuesta*,<sup>112</sup> in which the Court held that regulations issued by the Federal Home Loan Bank Board (FHLBB) preempted conflicting state laws restricting the use of due-on-sale clauses. The FHLBB regulations permitted savings and loan associations to enforce due-on-sale clauses in accordance with their terms even though several states had limited the exercise of such clauses. Because there was no express statutory preemption, the Supreme Court held that regulations within the scope of statutory authority could preempt conflicting state laws where the agency intended such preemption.<sup>113</sup> The subsequent congressional legislation made express what had been implied and extended the preemption to

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767, 773 (1981) (Hickmon, J., dissenting) ("[The lender] claims it has 'federally-related' business under the federal law simply because it keeps a lien on the land it sells. Most lenders keep a lien on land that is sold. If such an act is 'federally-related' then brushing your teeth is federally related.").

107. 12 U.S.C. § 2616 (1988); *id.* § 2805(a); 15 U.S.C. § 1610 (1988).

108. 12 U.S.C. § 2616 (1988); *id.* § 2805(a); 15 U.S.C. § 1610 (1988).

109. Depository Institutions Deregulation and Monetary Control Act of 1980, Title V, § 501, Pub. L. No. 96-221, 94 Stat. 161 (codified at 12 U.S.C. § 1735f-7a (1988)); 12 C.F.R. pt. 590 (1992).

110. Garn-St. Germain Depository Institutions Act of 1982, Title III, § 341, Pub. L. No. 97-320, 96 Stat. 1469, 1505-07 (1982) (codified at 12 U.S.C. § 1701j-3 (1988 & Supp. II 1990)).

111. Twelve of these jurisdictions, however, expressly permit any rate of interest to be adopted so long as it is disclosed in the underlying documentation. EDSON & JACOBS, *supra* note 83, at 10-15 & n.70; Eskridge, *supra* note 104, at 1109 n.92. In the opinion of the Office of Thrift Supervision, such preemption extends not only to civil usury statutes but to criminal usury statutes as well. 12 C.F.R. § 590.101(b) (1992).

112. 458 U.S. 141 (1982).

113. *Id.* at 153, 159, 167.



virtually all residential mortgage loans.<sup>114</sup>

Two additional examples of express substantive intervention by Congress involve adjustable rate mortgages and the transfer of mortgage servicing rights. In the Alternative Mortgage Transaction Parity Act of 1982,<sup>115</sup> Congress expressly preempted all state laws pertaining to alternative mortgage instruments<sup>116</sup> insofar as such laws were more restrictive than parallel regulations issued by the Comptroller of the Currency for federally regulated financial institutions.<sup>117</sup> As in the case of usury preemption, states were permitted to "override" this preemption by additional state legislation before October 15, 1985.<sup>118</sup> Although less dramatic substantively, Congress in 1990 enacted uniform disclosure and notice requirements for the transfer or sale of mortgage loan servicing.<sup>119</sup> Designed to provide protection to mortgage debtors and to facilitate the sale of servicing rights, this legislation expressly preempts inconsistent state law requirements.<sup>120</sup>

One of the first congressional attempts to establish a uniform mortgage foreclosure law was the proposed Federal Mortgage Foreclosure Act, first introduced in Congress in 1973.<sup>121</sup> The proposed bill, which was never enacted, provided for a nonjudicial power of sale foreclosure by a "foreclosure commissioner" as early as sixty days after the initial default.<sup>122</sup> The bill contained no requirement that sales be made for fair market value, no limitations on deficiency actions, and no statutory right

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114. See Grant S. Nelson & Dale A. Whitman, *Congressional Preemption of Mortgage Due-on-Sale Law: An Analysis of the Garn-St. Germain Act*, 35 HASTINGS L.J. 241, 273-98 (1983). The congressional preemption expressly preserved state law restrictions on the exercise of due-on-sale clauses with respect to a narrow "window period" and permitted states to extend the window period in certain circumstances. 12 U.S.C. § 1701-j(3)(c) (1988); 12 C.F.R. § 591 (1992); see EDSON & JACOBS, *supra* note 83, at 10-20 & n.87.

115. Pub. L. No. 97-320, tit. VIII, 96 Stat. 1545, 1545 (codified at 12 U.S.C. § 3801 (1988 & Supp. II 1990)).

116. Alternative mortgage instruments include primarily adjustable rate mortgages, graduated payment mortgages, and reverse annuity mortgages. 12 U.S.C. § 3802(1) (1988); see NELSON & WHITMAN, *supra* note 26, § 11.4, at 776-800.

117. 12 C.F.R. pt. 34.1 (1992).

118. 12 U.S.C. § 3804(a) (1988). Several jurisdictions chose to exercise this override authority. See, e.g., ME. REV. STAT. ANN. tit. 9-A, § 1-110 (West Supp. 1991); N.Y. BANKING LAW § 6-g (McKinney 1990).

119. The Real Estate Settlement Procedures Act of 1974, § 941, Pub. L. No. 101-625, 104 Stat. 4405, 4405 (codified at 12 U.S.C. § 2605 (Supp. II 1990)).

120. 12 U.S.C. § 2605(h) (Supp. II 1990).

121. Title IV of the National Housing Act of 1973, S. 2507, 93d Cong., 1st Sess., reprinted in *Hearings on S. 2490, S. 2507, & S. 2508 Before Senate Comm. on Banking, Housing and Urban Affairs*, 93d Cong., 1st Sess. 394, 483 (1973).

122. Sections 405, 412, Title IV of the National Housing Act of 1973, S. 2507, 93d Cong., 1st Sess., reprinted in *Hearings on S. 2490, S. 2507, & S. 2508 Before Senate Comm. on Banking, Housing and Urban Affairs*, 93d Cong., 1st Sess. 394, 487, 498 (1973). The foreclosure

of redemption. Applicable to any mortgage made, owned, insured, or guaranteed by the federal government, the primary objective of this proposal was to reduce costs to the government as a secured creditor rather than to achieve any uniform protections for debtors.<sup>123</sup>

Congress passed virtually identical provisions eight years later in the Multifamily Mortgage Foreclosure Act of 1981.<sup>124</sup> Applicable only to multifamily mortgages held by the Secretary of Housing and Urban Development, this Act authorizes a nonjudicial power of sale foreclosure as early as thirty days following default, provided twenty-one days advance notice of the sale is given to all interested parties. This Act does not require that sales be for the fair market value of the property; sealed bids rather than competitive open bids are submitted at the sale.<sup>125</sup> There is no statutory right of redemption, and deficiency actions are permitted to the extent authorized by the security documents and state law.<sup>126</sup>

Although it applies only to a minority of all multifamily mortgages outstanding in the United States, and an extremely small percentage of the total outstanding mortgage debt in the United States,<sup>127</sup> this Act stands as the first, and clearest, example of congressionally mandated uniformity in real estate foreclosure laws. In expressly preempting state laws in a majority of jurisdictions, this Act is striking in two respects.<sup>128</sup> First, its objectives of achieving foreclosures more expeditiously and lowering overall costs to the creditor are simple and clear. Second, its silence with respect to the diversity among the states in this area of law,

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commissioner, although disinterested in form, would in substance be designated by the security agreement—presumably prepared by the secured creditor.

123. As proposed the bill included congressional findings "(1) that disparate State laws relating to the foreclosure of real estate mortgages and deeds of trust . . . have burdened Federal programs involving real estate mortgages made, owned, insured or guaranteed by the United States, . . . (5) that the availability of a uniform, less expensive, and more expeditious foreclosure procedure is required to . . . facilitate the sale and resale in nationwide secondary mortgages markets of secured real estate loans . . . , (6) that enactment of legislation providing for a less expensive and more expeditious nonjudicial foreclosure procedure will reduce unnecessary litigation . . . ." Section 402, Title IV of the National Housing Act of 1973, S. 2507, 93d Cong., 1st Sess., reprinted in *Hearings on S. 2490, S. 2507, & S. 2508 Before Senate Comm. on Banking, Housing and Urban Affairs*, 93d Cong., 1st Sess. 394, 484-85 (1973). The weaknesses of the bill were noted in Washburn, *supra* note 50, at 935-36.

124. Pub. L. No. 97-35, tit. III, 95 Stat. 422, 422 (codified at 12 U.S.C. § 3701 (1985)).

125. 12 U.S.C. § 3710(b) (1988).

126. *Id.* § 3713(d).

127. As of the end of 1990, FmHA, FHA, VA, FNMA, and FHLMC directly held approximately \$28 billion in multifamily mortgages, with an additional \$28 billion held in mortgage pools by GNMA, FHLMC, and FNMA. This amount represents approximately 18% of all multifamily mortgages, but only 1% of the aggregate mortgage debt outstanding in the United States. 78 FED. RESERVE BULL., Jan. 1992, at A36, Tbl. 1.54.

128. S. REP. NO. 97-139, 97th Cong., 1st Sess. 263 (1981), reprinted in 1981 U.S.C.C.A.N. 559, 559-64.

and their constant struggle with the fair allocation of rights among debtors and creditors, is deafening.

### C. Indirect Regulation

Three separate areas of law, in recent years, have profoundly affected state real estate finance laws: bankruptcy, environmental liability, and drug forfeiture. In each of these areas Congress has altered the traditional allocations within each state of the rights and duties of the secured creditor and debtor.

Federal bankruptcy laws have had the most significant impact on real estate finance. While federal law makes the filing of a bankruptcy petition an automatic stay of all other proceedings, including foreclosures,<sup>129</sup> and grants a bankruptcy trustee the power to avoid the secured transaction entirely,<sup>130</sup> to cure a default and "deaccelerate" the indebtedness,<sup>131</sup> and to avoid preferential transfers,<sup>132</sup> the most controversial provisions have pertained to the authority to set aside fraudulent conveyances and to modify terms of outstanding loans. Applying the fraudulent transfer provision<sup>133</sup> to foreclosure sales, courts have concluded that sales for substantially less than fair market value can constitute a fraudulent transfer. In a threshold case the Fifth Circuit suggested, in dicta, that a sale for less than seventy percent of fair market value would constitute "less than reasonably equivalent value."<sup>134</sup> The Eleventh Circuit later modified this bright line rule to reject any percentage test as the basis for a presumption.<sup>135</sup> Other jurisdictions have suggested that the substantive issue is whether setting aside the transfer

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129. 11 U.S.C. § 362(a) (1988). An exception is granted, however, for multifamily HUD-insured mortgages. *Id.* § 362(b)(8).

130. *Id.* § 558.

131. *Id.* § 1322(b)(3).

132. *Id.* § 547(c). Whether a nonjudicial power of sale foreclosure can be set aside as a voidable preference (as opposed to a fraudulent transfer) is unclear. Several courts have held that such sales can be set aside on this basis. *See Park N. Partners v. Park N. Assocs. (In re Park North Partners)*, 80 B.R. 551, 555 (Bankr. N.D. Ga. 1987); *FNMA v. Wheeler (In re Wheeler)*, 34 B.R. 818, 820-21 (Bankr. N.D. Ala. 1983); *Morris Plan Co. v. Fountain (In re Fountain)*, 32 B.R. 965, 957-68 (Bankr. W.D. Mo. 1983). Other courts have concluded that preferential avoidance is not applicable to foreclosure sales. *See Ehrling v. Western Community Moneycenter (In re Ehrling)*, 900 F.2d 184, 189 (9th Cir. 1990); *First Fed. Sav. & Loan Ass'n of Warner Robbins v. Standard Bldg. Assocs.*, 87 B.R. 221, 224 (Bankr. N.D. Ga. 1988); *Park N. Partners, Ltd. v. Park N. Assocs.*, 85 B.R. 916, 919 (Bankr. N.D. Ga. 1988).

133. 11 U.S.C. § 548(a) (1988).

134. *Durrett v. Washington Nat'l Ins. Co.*, 621 F.2d 201, 203 (5th Cir. 1980). Thus, sales at 64% and 68% of fair market value have been avoided. *Lindsay v. Beneficial Reinsurance Co. (In re Lindsay)*, 98 B.R. 983, 988-89 (Bankr. S.D. Cal. 1989); *Warner Robbins*, 87 B.R. at 222-23.

135. *Grissom v. Johnson*, 955 F.2d 1440, 1443 (11th Cir. 1992).

would result in any benefit to the debtor's estate,<sup>136</sup> or would solely benefit other creditors.<sup>137</sup> Several circuits have rejected a mathematical approach, preferring to evaluate the issue on the particular facts of each case.<sup>138</sup>

Of equal concern to secured creditors is the possibility that a bankruptcy court could determine that the creditor has a secured claim in bankruptcy only to the extent of the fair market value of the security, with the remainder of the claim not being an "allowed secured claim."<sup>139</sup> The United States Supreme Court has recently ruled that such "lien-stripping" is not permitted in the context of a Chapter 7 bankruptcy petition,<sup>140</sup> but arguably left open the question whether this interpretation would also be applied in the context of a Chapter 11 or Chapter 13 proceeding.<sup>141</sup>

Environmental laws adopted by Congress over the last fifteen years have also had a dramatic impact on real estate finance. Federal laws have imposed liability upon owners and operators, and possibly secured creditors.<sup>142</sup> Although there is an exception from strict liability for a party "who, without participation in management, holds indicia of ownership primarily to protect his security interest,"<sup>143</sup> secured creditors can become liable for hazardous waste clean-up costs either through extensive participation in management<sup>144</sup> or through purchasing the property

136. *Walker v. Littleton (In re Littleton)*, 888 F.2d 90, 94 (11th Cir. 1989).

137. *Brown v. Vanguard Holding Corp. (In re Brown)*, 104 B.R. 609, 614-15 (Bankr. S.D.N.Y. 1989).

138. *E.g.*, *Barret v. Commonwealth Fed. Sav. & Loan Ass'n*, 939 F.2d 20, 23 (3d Cir. 1991); *Bundles v. Baker*, 856 F.2d 815, 824 (7th Cir. 1988).

139. 11 U.S.C. §§ 506(a), 506(d) (1988).

140. *Dewsnup v. Timm*, 112 S. Ct. 773, 778 (1992).

141. *Id.* at 778 n.3. Several lower courts have held that such modification is permitted. *Eastland Mortgage Co. v. Hart (In re Hart)*, 923 F.2d 1410, 1413 (10th Cir. 1991); *Wilson v. Commonwealth Mortgage Corp.*, 895 F.2d 123, 126 (3d Cir. 1990); *Hougland v. Lomas & Nettleton Co. (In re Hougland)*, 886 F.2d 1182, 1183 (9th Cir. 1989); *Franklin v. Union Mortgage Co. (In re Franklin)*, 126 B.R. 702, 707 (Bankr. N.D. Miss. 1991).

142. *E.g.*, Comprehensive Environmental Response, Compensation and Liability Act of 1980 (CERCLA), Pub. L. No. 96-510, 94 Stat. 2767, 2767 (codified at 42 U.S.C. §§ 9601-9657 (1988)), amended by The Superfund Amendments and Reauthorization Act of 1986 (SARA), Pub. L. No. 99-499, § 101(35), 100 Stat. 1613 (codified at 42 U.S.C. §§ 9601-9675 (1988)).

143. 42 U.S.C. § 9601(20)(A) (1988).

144. *Compare United States v. Fleet Factors Corp.*, 901 F.2d 1550, 1557-58 (11th Cir. 1990) (holding that capacity to influence hazardous waste decisions may be sufficient basis for liability), *cert. denied*, 111 S. Ct. 752 (1991) with *Bergsoe Metal Corp. v. The East Asiatic Co. (In re Bergsoe Metal Corp.)*, 910 F.2d 668, 672 (9th Cir. 1990) (holding that mere capacity to influence management decisions is insufficient basis for liability). *See also United States v. Kayser-Roth Corp.*, 724 F. Supp. 15, 22 (D.R.I. 1989) (holding that active involvement of a creditor parent corporation is sufficient basis for liability), *aff'd*, 910 F.2d 24 (1st Cir. 1990), *cert. denied*, 111 S. Ct. 957 (1991). *See generally* Note, *Cleaning Up the Debris After Fleet*

at a foreclosure sale.<sup>145</sup> The Environmental Protection Agency has issued regulations designed to clarify safe harbor boundaries of a lender's permissible involvement.<sup>146</sup> In addition to identifying the parties potentially liable for environmental contamination, the statute permits the federal government to obtain a lien on the property for all costs and damages of actual and potential clean-up.<sup>147</sup>

The third area of recent federal legislation cutting across the diversity in state real estate finance laws permits forfeiture of any real and personal property used in illegal drug activities.<sup>148</sup> Because the effective date of the forfeiture derives from the date of the illegal conduct rather than the date of seizure, owners and creditors are placed in a precarious position.<sup>149</sup> While the statute contains an "innocent owner defense" against forfeiture,<sup>150</sup> there is a split of authority on whether lack of knowledge and lack of consent are both necessary conditions of the defense.<sup>151</sup> A lienholder is protected only to the extent of its interest in the real property,<sup>152</sup> and it is not clear whether a lienholder is entitled to interest which accrues during the post-seizure period.<sup>153</sup>

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*Factors: Lender Liability and CERCLA's Security Interest Exemption*, 104 HARV. L. REV. 1249, 1250 (1991) (arguing that federal courts have misunderstood the purpose of the security interest exemption and the scope of its application to lenders).

145. *Guidice v. BFG Electroplating & Mfg. Co.*, 732 F. Supp. 556, 561 (W.D. Pa. 1989); *United States v. Maryland Bank & Trust Co.*, 632 F. Supp. 573, 579 (D. Md. 1986).

146. 57 Fed. Reg. 18,344, 18,383-85 (1992) (to be codified at 40 C.F.R. § 300.1100 to .1105).

147. 42 U.S.C. § 9607(i) (1988).

148. 21 U.S.C. § 881 (1988 & Supp. II 1990).

149. *Id.* § 881(h) (1988).

150. *Id.* § 881(a)(7).

151. Some courts have held that a claimant must prove that it was without knowledge *and* consent. *United States v. Lot 111-B*, 902 F.2d 1443, 1445 (9th Cir. 1990). Other courts have held that either lack of knowledge or lack of consent is a sufficient condition. *United States v. 890 Noyac Rd.*, 945 F.2d 1252, 1260 (2d Cir. 1991); *United States v. 6109 Grubb Rd.*, 886 F.2d 618, 620 (3d Cir. 1989); *see also Calero-Toledo v. Pearson Yacht Leasing Co.*, 416 U.S. 663, 686 (1974) (finding no Fifth Amendment violation in declaring forfeiture of property of innocent owner).

152. 21 U.S.C. § 881(a)(7) (1988).

153. Some courts have held that a creditor is not entitled to post-seizure interest. *United States v. 8.4 Acres of Land*, 648 F. Supp. 79, 81-82 (D.S.C. 1986), *aff'd*, 823 F.2d 549 (4th Cir.), *aff'd sub nom. Coastal Seafood Enters. v. United States*, 823 F.2d 546 (4th Cir. 1987); *United States v. One Condominium Apt.*, 636 F. Supp. 457, 458 (S.D. Fla. 1986); *United States v. One Piece of Real Estate*, 571 F. Supp. 723, 724 (W.D. Tex. 1983). Others have held that the real property is security for the accrued interest as well. *In re Metmor Fin., Inc.*, 819 F.2d 446, 448 (4th Cir. 1987); *Monroe Sav. Bank, FSB v. Catalano*, 733 F. Supp. 595, 598-99 (W.D.N.Y. 1990); *United States v. Real Property Titled in Name of Shashin, Ltd.*, 680 F. Supp. 332, 336-37 (D. Haw. 1987).

*D. Market Participation*

One of the most dramatic changes in real estate finance during the twentieth century has been the emergence of the secondary mortgage market and its explosive growth in recent years. With the precedent firmly established by the Federal National Mortgage Association (FNMA), both governmental and private participation in the secondary mortgage market has expanded substantially since 1968. In 1968, Congress restructured FNMA as a private corporation and created a separate governmental agency, the Government National Mortgage Association (GNMA), to assume purchasing loans of the targeted special assistance programs of the federal government.<sup>154</sup> Two years later it created the Federal Home Loan Mortgage Corporation (FHLMC) primarily to assist savings and loan associations through the purchase of VA, FHA, and conventional loans.<sup>155</sup> FNMA, FHLMC, and GNMA all serve as secondary mortgage market purchasers of real estate loans. They also serve as secondary market conduits by creating large pools of mortgages and selling to investors certificates giving them rights to the principal and interest payments received by the pool.<sup>156</sup> By the end of 1990 approximately thirty percent of the aggregate mortgage debt in the United States was held in some form of mortgage-backed security.<sup>157</sup>

As skyrocketing interest rates coupled with a recessionary economy during the late 1970s led to federal preemption of due-on-sale clauses, usury limitations, and restrictions on alternative mortgage instruments, the collapse of large segments of the savings and loan industry in the late 1980s placed the federal government in the center of the mortgage lending market. The enactment of the Financial Institutions Reform, Recovery, and Enforcement Act of 1989 (FIRREA)<sup>158</sup> constituted the most significant restructuring of federal banking regulatory agencies since the 1930s.<sup>159</sup> Among other changes, it dissolved the existing insurance corporation for savings and loan associations; placed insurance responsibil-

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154. Title. VIII, Housing and Urban Development Act of 1968, Pub. L. No. 90-448, 82 Stat. 536 (codified as amended at 12 U.S.C. § 1716 (1988 & Supp. II 1990)).

155. Federal Home Loan Mortgage Corporation Act of 1970 §§ 301-310, Pub. L. No. 91-351, 84 Stat. 451, 454-55 (codified as amended at 12 U.S.C. § 1451 (1988 & Supp. II 1990)).

156. KENNETH G. LORE, MORTGAGE-BACKED SECURITIES: DEVELOPMENTS AND TRENDS IN THE SECONDARY MORTGAGE MARKET § 2.01 (1991); see NELSON & WHITMAN, *supra* note 26, § 11.3, at 764-73.

157. 78 FED. RESERVE BULL., Jan. 1992, at A36, Tbl. 1.54. Almost half of all mortgages originated during 1989 were subsequently moved onto the secondary mortgage market; see LORE, *supra* note 156, § 1.01, at 1-5.

158. Pub. L. No. 101-73, 103 Stat. 183 (1989) (codified at scattered sections of 12 U.S.C. and 15 U.S.C.).

159. Carl Felsenfeld, *The Savings and Loan Crisis*, 59 FORDHAM L. REV. S7, S49 (1991).

ity solely with the Federal Deposit Insurance Corporation; shifted regulatory responsibility to the Department of Treasury, Office of Thrift Supervision (OTS); and created a new agency, the Resolution Trust Corporation (RTC), to manage and resolve insolvent thrift institutions.<sup>160</sup>

While the total cost of the thrift industry bailout encompassed by FIRREA is unknown,<sup>161</sup> it is clear that virtually overnight the RTC became one of the largest holders of mortgages in the United States. In the first two years of its existence, from August 1989 through August 1991, the RTC took control of 646 thrift institutions (closing 511 of them), having assets of \$340.7 billion, of which \$161.3 billion were represented by mortgage loans.<sup>162</sup> At the end of this period the RTC still retained over \$83 billion in mortgage loans.<sup>163</sup>

This indirect participation in real estate finance, whether through the federally related secondary mortgage market entities or through the RTC as the successor of failed savings and loan associations, provides yet additional bases for uncertainty about whether state or federal laws govern the real estate transactions. Efficiency in the operations of the secondary mortgage market requires a high degree of national uniformity.<sup>164</sup> Efficiency concerns could easily justify express congressional preemption, but thus far secondary mortgage market legislation has not preempted state real estate finance laws expressly; judicial decisions have tended to treat the federal entities as private actors for most purposes.<sup>165</sup> Nonetheless, Congress has bestowed upon the RTC the protection of federal common law and express statutory exemptions from the application of state laws.<sup>166</sup> Although the size of the RTC mortgage holdings comprises only a small percentage of the total mortgages held by the federal government,<sup>167</sup> the impact of such holdings on the state real estate finance laws

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160. JAMES R. BARTH & PHILIP R. WIEST, CONSOLIDATION AND RESTRUCTURING OF THE U.S. THRIFT INDUSTRY UNDER THE FINANCIAL INSTITUTIONS REFORM, RECOVERY AND ENFORCEMENT ACT 2-3 (Office of Thrift Supervision Research Paper #89-01, 1989).

161. It has been estimated to be as high as \$180 billion. WILLIAM JACKSON & BARBARA L. MILES, HOUSING FINANCE RESTRUCTURING: CHANGES AND NEW ISSUES CREATED BY FIRREA (P.L. 101-73), CRS-8, Major Studies and Issues Briefs of the Congressional Research Service: 1991 Supp., No. 91-296E (University Publications of America, Feb. 22, 1991).

162. RTC REV., Aug. 1991, at 1, 15-16.

163. *Id.* at 16. As of August 31, 1991 the RTC retained \$33.1 billion in performing 1-4 family mortgage loans, and \$3.6 billion in delinquent 1-4 family mortgage loans. *Id.* at 2.

164. The drafters of the ULTA had argued that "[o]ne of the major purposes of this Act is to provide uniformity in state law which will facilitate the creation of a legal atmosphere which encourages development of a widespread secondary mortgage market." UNIF. LAND TRANS-ACTIONS ACT, 13 U.L.A. 470 (1977).

165. See *infra* notes 456-58 and accompanying text.

166. See *infra* notes 443-46 and accompanying text.

167. As of the end of 1990 the federal government and related agencies (GNMA, FmHA,

is disproportionate to its size. The RTC's entitlement to the protection of judicially created federal common-law rules and express statutory protections compounds uncertainty, because the laws governing a real estate transaction change when the creditor changes from a private commercial institution to a federal agency.

In the dramatic growth in the form and substance of federal intervention in real estate finance during the twentieth century, several distinct forces have emerged. First, Congress's role as a market regulator has expanded considerably, both in terms of mandatory disclosure laws and in express displacement of state regulations of particular substantive issues. Second, the federal government's involvement as a market participant, primarily in insuring or guaranteeing loans, has increased the frequency of conflicts between such loan programs and state real estate laws.

#### IV. THE CHAOS OF PREEMPTION AND FEDERAL COMMON LAW

The phenomenal growth of involvement of the federal government in real estate finance over the past sixty years has taken many forms. This multitude of forms evidences the increasingly national scope of real estate finance and the need for constant attention to the pivotal role of federal law in an area historically dominated by state law. When Congress, through express preemption, has displaced state laws directly by establishing minimum finance disclosure requirements, or indirectly by imposing additional requirements through bankruptcy or environmental laws, it has made more complex the practice of real estate finance. Express preemption, however, has not necessarily made the practice less predictable.

The greatest blow to predictability occurs when there is significant federal government involvement without an accompanying express determination by Congress of the applicable law. Implied preemption and federal common law have been inadequate foundations for the judicial resolution of conflicts between state real estate finance laws and the operation of federal mortgage programs. In key areas of real estate finance, where the states have developed complex allocations of rights and duties among debtors and creditors, judicial determinations of controlling law have proven neither consistent nor predictable.<sup>168</sup>

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FHA, VA, FNMA, FHLMC, and Federal Land Banks) held over \$250 billion in mortgages, with an additional \$1,106 billion held primarily in federally related mortgage pools and trusts. 78 FED. RESERVE BULL., Jan. 1992, at A36, Tbl. 1.54.

168. To the extent that one moves from the more central issues of real estate finance to peripheral matters, there is a greater likelihood that state laws will govern the dispute, but there is still a lack of consensus in the preemption analysis. For example, the courts are split



### A. State Antideficiency Laws

In *United States v. Shimer*,<sup>169</sup> the United States Supreme Court, in 1961, confronted the issue of whether the Veterans Administration (VA), having failed to obtain a confirmation of the foreclosure sale as required by state law, could nonetheless proceed in an action for a deficiency against the original debtor.<sup>170</sup> The Court held that regulations issued by the Veterans Administration governing its guaranteed loan program were "meant to displace state law."<sup>171</sup> One might innocently have thought that this decision would have clarified this issue, and that as a general proposition federal mortgage loan program regulations would preempt state antideficiency laws. In the thirty-odd years since *Shimer*, however, this simply has not been the case.<sup>172</sup>

Of the twenty cases decided since *Shimer* which most clearly have addressed possible preemption of state antideficiency laws by federal

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on whether local landlord-tenant laws are preempted. Compare *Ayers v. Philadelphia Hous. Auth.*, 908 F.2d 1184, 1189-93 (3d Cir. 1990) (holding that HUD regulations preempt state eviction laws), *cert. denied*, 111 S. Ct. 1003 (1991) with *Rowe v. Pierce*, 622 F. Supp. 1030, 1031-33 (D.D.C. 1985) (holding that HUD regulations do not preempt local law concerning evictions). The same lack of consensus exists with respect to housing code requirements. Compare *Burroughs v. Hills*, 564 F. Supp. 1007, 1018-19 (N.D. Ill. 1983) (holding that HUD-owned properties are subject to local housing codes), *aff'd*, 741 F.2d 1525 (7th Cir. 1984), *cert. denied*, 471 U.S. 1099 (1985) and *City of Phila. v. Page*, 363 F. Supp. 148, 152-55 (E.D. Pa. 1973) (holding that HUD is subject to local codes on lead-based paint) with *Conille v. Secretary of Hous. & Urban Dev.*, 840 F.2d 105, 109-14 (1st Cir. 1988) (holding that federal common law, not state law, applies to HUD leasehold obligations). Requirements pertaining to tax and insurance escrows are more complex. Compare *Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass'n*, 281 Or. 533, 548-49, 577 P.2d 477, 487-88 (holding that S&L can be subject to state laws on income from escrows when FHLBB has not issued regulations), *cert. denied*, 439 U.S. 1051 (1978) with *First Fed. Sav. & Loan Ass'n v. Greenwald*, 591 F.2d 417, 425-26 (1st Cir. 1979) (holding state law on interest governing escrow accounts preempted by FHLBB regulations) and *Goudreau v. Standard Fed. Sav. & Loan Ass'n*, 511 A.2d 386, 390-92 (D.C. 1986) (holding that local law prohibiting mandatory escrow accounts in certain circumstances was preempted by FHLBB regulation) and *Olsen v. Financial Fed. Sav. & Loan Ass'n*, 115 Ill. App. 3d 364, 367-70, 434 N.E.2d 406, 409-11 (1982) (holding that state law governing interest on escrow accounts was preempted by FHLBB regulations). Preemption is found when rent control limits conflict with the federal program. *City of Boston v. Harris*, 619 F.2d 87, 89 (1st Cir. 1980) (holding that HUD regulations on permissible rent levels preempt local rent control laws).

169. 367 U.S. 374 (1961).

170. *Id.* at 375-77.

171. *Id.* at 381.

172. The result in *Shimer* is consistent with three earlier lower court opinions, although the holdings of each of the earlier opinions appear to have been based on the existence of a separate indemnity agreement between the VA and the debtor. *McKnight v. United States*, 259 F.2d 540, 543-44 (9th Cir. 1958); *United States v. Jones*, 155 F. Supp. 52, 56 (M.D. Ga. 1957); *United States v. Henderson*, 121 F. Supp. 343, 344 (S.D. Iowa 1953). The result in *Shimer* is expressly based upon the alternative rationales of implied preemption and the separate indemnity agreement. See *Shimer*, 367 U.S. at 381-85, 387.

mortgage programs, twelve have held in favor of preemption and permitted the deficiency action.<sup>173</sup> In eight, the courts have concluded that state law controls and have denied the deficiency actions.<sup>174</sup> These disparate results can be explained (although not necessarily justified) by several discrete factors. Some of the courts rejecting preemption did so in cases involving loans made by the Small Business Administration (SBA), not the Veterans Administration; these courts found that because SBA loans lacked national uniformity in character, preemption was unnecessary.<sup>175</sup> One decision, however, found that once the SBA has issued comprehensive regulations, preemption is appropriate.<sup>176</sup> Cases involving only the Veterans Administration have produced similarly mixed results. Seven cases permitted the deficiency action<sup>177</sup> and four cases rejected it.<sup>178</sup> Two additional cases rejected a VA deficiency action on separate grounds.<sup>179</sup>

The availability of alternative remedies under state law for secured creditors, such as the option of a judicial foreclosure and a possible deficiency action or a nonjudicial foreclosure without a deficiency action, is

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173. *United States v. Davis*, 961 F.2d 603, 610-11 (7th Cir. 1992); *Connelly v. Derwinski*, 961 F.2d 129, 130 (9th Cir. 1992); *Vail v. Derwinski*, 946 F.2d 589, 592 (8th Cir. 1991); *United States v. Gish*, 559 F.2d 572, 575 (9th Cir. 1977), *cert. denied*, 435 U.S. 996 (1978); *United States v. Haddon Haciendas Co.*, 541 F.2d 777, 783-84 (9th Cir. 1976); *United States v. Allgeyer*, 466 F.2d 1195, 1195-96 (9th Cir. 1972); *United States v. Merrick Sponsor Corp.*, 421 F.2d 1076, 1078-79 (2d Cir. 1970); *United States v. Wells*, 403 F.2d 596, 597-98 (5th Cir. 1968); *Herlong-Sierra Homes, Inc. v. United States*, 358 F.2d 300, 300 (9th Cir.), *cert. denied*, 385 U.S. 919 (1966); *United States v. Rossi*, 342 F.2d 505, 506 (9th Cir. 1965); *Jones v. Turnage*, 699 F. Supp. 795, 800 (N.D. Cal. 1988), *aff'd sub nom. Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1309 (1991); *Branden v. Driver*, 293 F. Supp. 871, 873 (N.D. Cal. 1968), *aff'd*, 441 F.2d 1171 (9th Cir. 1971).

174. *Whitehead v. Derwinski*, 904 F.2d 1362, 1369 (9th Cir. 1990); *Great Southwest Life Ins. Co. v. Frazier*, 860 F.2d 896, 899-900 (9th Cir. 1988); *United States v. Irby*, 618 F.2d 352, 355 (5th Cir. 1980); *United States v. Dismuke*, 616 F.2d 755, 758-59 (5th Cir. 1980); *United States v. Stewart*, 523 F.2d 1070, 1070-71 (9th Cir. 1975); *United States v. MacKenzie*, 510 F.2d 39, 40 (9th Cir. 1975) (en banc); *Carter v. Derwinski*, 758 F. Supp. 603, 605-06 (D. Idaho 1991), *reh'g granted*, 970 F.2d 662 (9th Cir. 1992); *United States v. Vallejo*, 660 F. Supp. 535, 537-39 (W.D. Wash. 1987).

175. *Great Southwest Life Ins.*, 860 F.2d at 900; *MacKenzie*, 510 F.2d at 42.

176. *Gish*, 559 F.2d at 574-75.

177. *Davis*, 961 F.2d at 610-11; *Connelly*, 961 F.2d at 130; *Vail*, 946 F.2d at 592; *Wells*, 403 F.2d at 597-98; *Rossi*, 342 F.2d at 506; *Jones*, 699 F. Supp. at 800; *Branden*, 293 F. Supp. at 873.

178. *Whitehead*, 904 F.2d at 1369; *Stewart*, 523 F.2d at 1071-72; *Carter*, 758 F. Supp. at 605-06; *Vallejo*, 660 F. Supp. at 537-39.

179. *United States v. Church*, 736 F. Supp. 1494, 1498 (N.D. Ind. 1990) (holding that since lender released debtor without VA's permission, payment on guaranty by VA was gratuitous); *United States v. Murdock*, 627 F. Supp. 272, 277-79 (N.D. Ind. 1985) (denying government's summary judgment motion because issue of fact remained as to sufficiency of notice to defendant).

also a critical factor in explaining the inconsistent results reached by courts. Several decisions have held that in electing to proceed with a nonjudicial foreclosure, the federal agency waived its right to a deficiency.<sup>180</sup> Where state law does not provide the possibility of a deficiency action under any circumstance, state law has been preempted.<sup>181</sup> Although this rationale at least draws on state law, it begs the question whether there is a need for a nationally uniform policy permitting both nonjudicial foreclosure and a deficiency action—the result sought by the VA regulations.<sup>182</sup>

One potentially significant differentiating factor among these cases is that ten of the twenty post-*Shimer* cases dealing with antideficiency laws were also decided after the United States Supreme Court's 1979 decision in *United States v. Kimbell Foods, Inc.*<sup>183</sup> While *Kimbell Foods* did not involve a deficiency action, it did address squarely the question whether state law or federal law applied to federal mortgage loan programs.<sup>184</sup> The result in *Kimbell Foods*, which incorporated state law as the applicable federal law, was based upon federal common-law doctrine (because the federal government was a direct party in interest) rather than implied preemption.<sup>185</sup> In its analysis the Court set forth specific criteria for determining whether a separate federal rule should be developed, or state law incorporated as the applicable federal rule.<sup>186</sup> Unfortunately, using

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180. *Whitehead*, 904 F.2d at 1363; *Vallejo*, 660 F. Supp. at 538; *Dalton Motors, Inc. v. Weaver*, 446 F. Supp. 711, 714 (D. Minn. 1978) ("[I]f the SBA chooses to seek the procedural benefits of a summary foreclosure procedure offered by a state, it should be ready to accept as well the protections the state affords its mortgagors under that procedure.").

181. *Davis*, 961 F.2d at 608; *Shepherd v. Derwinski*, 961 F.2d 132, 133 (9th Cir. 1992); *Connolly*, 961 F.2d at 130; *Jones*, 699 F. Supp. at 800.

182. Recognizing that deficiency actions provide relatively small recoveries and constitute a "threat of . . . liability [which] can linger for months or years and can delay and complicate a veteran's recovery from the financial catastrophe that already claimed his or her home," Congress in 1989 amended the VA loan statute to abandon deficiency actions, requiring instead payment of a fee, at loan origination, to help cover losses from defaults. S. REP. NO. 101-126, 101st Cong., 1st Sess. 265, reprinted in 1989 U.S.C.C.A.N. 1470, 1671; Veterans' Benefits Amendments of 1989, Pub. L. No. 101-237, § 304(a), 103 Stat. 2062 (codified at 38 U.S.C. § 3703(e) (1991)).

183. 440 U.S. 715 (1979). Of the ten decisions dealing with state antideficiency laws rendered after the 1979 *Kimbell Foods* decision, see *supra* notes 173 & 174, six declined to find preemption and applied state antideficiency laws. See *supra* note 174.

184. *Kimbell Foods* involved the specific question of whether state laws governing lien priority applied to federal programs. See *infra* notes 229-31, 287-94 and accompanying text.

185. *Kimbell Foods*, 440 U.S. at 726.

186. Determining that federal law rather than state law applies is, however, only the threshold question and, as it turns out, the easy one. The court must then consider whether (1) there is a need for a nationally uniform body of law, (2) application of state law would frustrate objectives of the federal program, and (3) application of federal rules would disrupt commercial relationships based on state law. *Id.* at 728-29.

these enhanced criteria, which are at once more specific and more flexible, lower courts have reached diametrically opposed conclusions with respect to the same federal program.<sup>187</sup>

### B. State Statutory Rights of Redemption

Slightly over half of the states recognize some form of post-foreclosure right of redemption, extending either to the original mortgagor alone or to subordinate lien holders as well.<sup>188</sup> In affirming the significance of such a right, at least as to junior creditors, Congress has decided that whenever the federal government has a lien on property it is entitled to a one-year right of redemption following judicial foreclosure,<sup>189</sup> and that such right takes precedence over state laws to the contrary.<sup>190</sup> Congress acts, at least in this context, primarily to protect the federal government's rights as a creditor rather than as an arbiter of a fair allocation of rights and duties among debtors and creditors. Indicative of this fact is the requirement that when the federal government is foreclosing HUD-insured multifamily mortgages, no post-foreclosure rights of redemption exist.<sup>191</sup>

Whether a state statutory right of redemption is applicable to fed-

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187. Compare *United States v. Vallejo*, 660 F. Supp. 535, 539 (W.D. Wash. 1987) (federal law governs VA deficiency action, but state law may be applied because there is no real conflict with federal program objectives) with *Jones v. Turnage*, 699 F. Supp. 795, 801-02 (N.D. Cal. 1988) (federal law governs VA deficiency actions, and uniform rule should be applied in order to protect federal program objectives), *aff'd sub. nom. Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1309 (1991).

188. See *supra* notes 47-50 and accompanying text.

189. 28 U.S.C. § 2410(c) (1988). The statutory right of redemption expressly does not apply when the subordinate lien of the United States is an FHA-insured or VA-guaranteed loan. *Id.*; 12 U.S.C. § 1701k (1988) (FHA loans); 38 U.S.C. § 1820(d) (1988) (VA loans). A federal tax lien carries with it a 120-day right of redemption following a nonjudicial foreclosure of a senior lien if the senior lienor provided appropriate notice. 26 U.S.C. § 7425(c), (d) (1988). If notice is not given, the tax lien continues to encumber the property. *Id.*

190. *United States v. John Hancock Mut. Life Ins. Co.*, 364 U.S. 301, 305, 307-08 (1960). But see *Dupnik v. United States*, 848 F.2d 1476, 1480 (9th Cir. 1988) (holding that the federal redemption statute was not intended to preempt state requirements concerning advance notice of intent to redeem).

191. 12 U.S.C. § 3713(d) (1988). The inconsistent policies of Congress concerning post-foreclosure rights of redemption have been made clear:

How Congress could have concluded that the federal government should have the benefit of statutory redemption, but not be subject to its burdens, at first glance seems puzzling. In fact, however, while the 1981 legislation was strongly motivated by a Congressional desire to create a uniform and expeditious federal foreclosure remedy, there is no evidence to suggest that Congress was aware of the double standard it was creating. Otherwise, one would be tempted to conclude that Congress was unwilling to subscribe to the old adage that "what is sauce for the goose should be sauce for the gander."

NELSON & WHITMAN, *supra* note 26, § 8.4, at 617.

eral mortgage programs is an issue which, similar to state antideficiency laws, has received widely divergent treatment.<sup>192</sup> Of eleven federal district and appellate court opinions between 1967 and 1986 that addressed this issue, six rejected the application of state redemption rights<sup>193</sup> and five held such rights to be binding on the federal programs.<sup>194</sup> In virtually all of these decisions, the courts rather easily concluded that federal law, rather than state law, governed the issue.<sup>195</sup> The initial decisions concluded that unless Congress or the federal agencies expressed an intent to incorporate a state statutory right of redemption, the state right did not apply because "[i]t would be contrary to the teaching of every case that we have cited to hold that there is a different federal policy in each state, thus making FHA 'subject to the vagaries of the laws of the several states.'"<sup>196</sup> The decisions began to divide when several courts concluded, following *Kimbell Foods*,<sup>197</sup> that recognition of the applicability of federal law is but the initial issue, with the possible selection of state law as the appropriate federal rule for decision constituting the major issue. Each of the courts that held state statutory rights of redemption to be applicable found that state law concerns were paramount and adopted the state law as the federal law.<sup>198</sup> *Kimbell Foods*, however, does not explain sufficiently these differences. Three decisions which upheld preemption, although rendered after *Kimbell Foods*, did not rely upon *Kimbell Foods* in their analysis;<sup>199</sup> in two of those decisions, moreover,

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192. See Kenneth C. Day, Note, *Federal Courts—Choice of Controlling Law in Cases Involving Federally Insured Mortgages*, 49 N.C. L. Rev. 358, 360 (1971) (pointing out that courts apply various analyses to determine whether state or federal law controls in these cases).

193. *United States v. Victory Highway Village, Inc.*, 662 F.2d 488, 497 (8th Cir. 1981); *United States v. Scholnick*, 606 F.2d 160, 164 (6th Cir. 1979); *United States v. Stadium Apts., Inc.*, 425 F.2d 358, 360 (9th Cir.), *cert. denied sub nom. Lynch v. United States*, 400 U.S. 926 (1970); *United States v. Curry*, 561 F. Supp. 429, 430 (D. Kan. 1983); *John Hancock Mut. Life Ins. Co. v. Bruening Farms Corp.*, 537 F. Supp. 936, 938 (N.D. Iowa 1982); *United States v. Montgomery*, 268 F. Supp. 787, 788 (D. Kan. 1967).

194. *United States v. Pastos*, 781 F.2d 747, 752 (9th Cir. 1986); *United States v. Ellis*, 714 F.2d 953, 957 (9th Cir. 1983); *United States v. MacKenzie*, 510 F.2d 39, 41-42 (9th Cir. 1975) (en banc); *United States v. Hargrove*, 494 F. Supp. 22, 24 (D.N.M. 1979); *United States v. Marshall*, 431 F. Supp. 888, 892 (N.D. Ill. 1977).

195. This holding is based on the line of reasoning derived from *Clearfield Trust Co. v. United States*, 318 U.S. 363 (1943), and developed in detail in a 1959 Ninth Circuit decision that held that federal law applies to the appointment of a receiver. *United States v. View Crest Garden Apts., Inc.*, 268 F.2d 380, 382-83 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959); see, e.g., *Stadium Apts.*, 425 F.2d at 360 ("It is settled that the applicable law is federal.").

196. *Stadium Apts.*, 425 F.2d at 364 (quoting *Clearfield Trust*, 318 U.S. at 367).

197. 440 U.S. 715 (1979).

198. *Pastos*, 781 F.2d at 752; *Ellis*, 714 F.2d at 957; *MacKenzie*, 510 F.2d at 41-42; *Hargrove*, 494 F. Supp. at 24; *Marshall*, 431 F. Supp. at 892.

199. *United States v. Victory Highway Village, Inc.*, 662 F.2d 488, 497-98 (8th Cir. 1981); *United States v. Curry*, 561 F. Supp. 429, 430 (D. Kan. 1983); *John Hancock Mut. Life Ins.*

the courts, as part of their inherent equity powers, granted some form of additional redemption rights.<sup>200</sup>

### C. State Laws Concerning Contractual Waivers

An additional question in preemption analysis involves the enforceability of an agency regulation or contractual provision that expressly designates the applicable law. In the Supreme Court's threshold decision *United States v. Yazell*,<sup>201</sup> the absence of a federal regulation stating the applicable law was critical to the Court's refusal to find preemption.<sup>202</sup> Correspondingly, where the underlying contractual documents contain an express provision that state law protections shall apply, courts have denied preemption.<sup>203</sup>

Predictably, after *Yazell* federal agencies began to issue regulations stating that federal law governed the transactions and required debtors to waive state law protections.<sup>204</sup> Judicial treatment of contractual waivers required by federal regulations has once again been inconsistent. Two cases have held such waivers to be enforceable against the debtor even though the right in question was not waivable under state law.<sup>205</sup> In five other decisions, the courts have refused to enforce such waivers, deferring instead to state policies prohibiting such waivers.<sup>206</sup> These decisions clearly imply that the contract does not necessarily control the determination of whether to apply state law or a distinct federal rule.<sup>207</sup>

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Co. v. Bruening Farms Corp., 537 F. Supp. 936, 938 (N.D. Iowa 1982). None of these three decisions even discussed or cited *Kimbell Foods*.

200. *Curry*, 561 F. Supp. at 431 (granting debtor redemption rights for 180 days after foreclosure sale); *United States v. Montgomery*, 268 F. Supp. 787, 790 (D. Kan. 1967) (granting debtor redemption rights for 60 days after foreclosure sale); see also *United States v. West Willow Apts., Inc.*, 245 F. Supp. 755, 758 (E.D. Mich. 1965) (holding that FHA may grant a right of redemption even if not required to do so).

201. 382 U.S. 341 (1966).

202. *Id.* at 349-51.

203. *United States v. Stewart*, 523 F.2d 1070, 1072 (9th Cir. 1975); *United States v. Johansson*, 467 F. Supp. 84, 85 (D. Me. 1979).

204. See 31 Fed. Reg. 10,466 (1966) (regulations issued by SBA shortly after the decision in *Yazell*).

205. *United States v. Gish*, 559 F.2d 572, 574 (9th Cir. 1977), cert. denied, 435 U.S. 996 (1978); *United States v. Curry*, 561 F. Supp. 429, 430 (D. Kan. 1983). A third decision enforced a contractual waiver, but the rights in question could be waived under state law. *John Hancock Mut. Life Ins. Co. v. Bruening Farms Corp.*, 537 F. Supp. 936, 938 (N.D. Iowa 1982).

206. *Great Southwest Life Ins. Co. v. Frazier*, 860 F.2d 896, 902-03 (9th Cir. 1988); *United States v. Pastos*, 781 F.2d 747, 751-52 (9th Cir. 1986); *United States v. Ellis*, 714 F.2d 953, 955-57 (9th Cir. 1983); *United States v. Crain*, 589 F.2d 996, 999 n.2, 999-1000 (9th Cir. 1979); *United States v. Hargrove*, 494 F. Supp. 22, 24 (D.N.M. 1979).

207. "[C]ontractual provisions do not have the force of federal law and do not foreclose the question of what the federal rule is." *Pastos*, 781 F.2d at 750.

#### D. State Notice Requirements

Cases involving state notice requirements do not show a clear pattern of federal preemption. Under the rationale of *Shimer*,<sup>208</sup> as clarified in *Fidelity Federal*,<sup>209</sup> regulations and procedures promulgated by a federal mortgage program can preempt state laws if they are intended to provide the exclusive source of rules and if there is a direct conflict with state laws.<sup>210</sup> Six judicial decisions, rendered within a short period of time, reveal the difficulty of applying such standards to state foreclosure notice requirements.

Four of these decisions, *United States v. Black*,<sup>211</sup> *United States v. Royer*,<sup>212</sup> *United States v. Mikolaitis*,<sup>213</sup> and *United States v. Spears*,<sup>214</sup> considered whether Pennsylvania statutes governing notice to a mortgagor in default were applicable to the Farmer's Home Administration (FmHA) loan program. *Black*, *Royer*, and *Spears* each concluded that since federal law governed the program, state notice requirements were not applicable.<sup>215</sup> *Mikolaitis*, however, reached the opposite conclusion—that the FmHA program was subject to state notice requirements.<sup>216</sup> A fifth decision, *United States v. Whitney*,<sup>217</sup> applied a New York statutory notice requirement to a VA deficiency action after concluding there was no preemption. *Whitney* offered a second rationale in rejecting the VA deficiency action—that the VA failed to provide the notice to the debtor required by due process.<sup>218</sup> This rationale became the basis for the sixth decision, *United States v. Murdock*,<sup>219</sup> which denied summary judgment to the VA in light of questions concerning whether the VA provided constitutionally sufficient notice to the debtor.<sup>220</sup>

The reasoning of these six decisions, both implicitly and explicitly, reflects the chaos prompted by the effects of federal participation in real

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208. 367 U.S. 374 (1961).

209. 458 U.S. 141 (1982).

210. *Id.* at 152-54.

211. 622 F. Supp. 669 (W.D. Pa. 1985).

212. 683 F. Supp. 484 (M.D. Pa. 1986), *aff'd without opinion*, 815 F.2d 696 (3d Cir. 1987).

213. 682 F. Supp. 798 (M.D. Pa. 1988).

214. 859 F.2d 284 (3d Cir. 1988).

215. *See Spears*, 859 F.2d at 291; *Royer*, 683 F. Supp. at 486; *Black*, 622 F. Supp. at 672-73.

216. *Mikolaitis*, 682 F. Supp. at 802. Curiously, the same federal district judge, Judge Caldwell, issued the opinions in both *Royer* and *Mikolaitis*.

217. 602 F. Supp. 722 (W.D.N.Y. 1985).

218. *Id.* at 731-33.

219. 627 F. Supp. 272 (N.D. Ind. 1986).

220. *Id.* at 277-78. Whether state action is present in a nonjudicial foreclosure, even when the debt is insured or guaranteed by a federally related entity, remains very much an open question. *See infra* notes 452-65 and accompanying text.

estate finance. *Black* and *Royer* affirmed preemption by relying primarily on the proposition that federal law governs the rights and duties of the parties to the federal loan program because of the Supremacy Clause and the need to protect the funds of the United States.<sup>221</sup> *Whitney*, on the other hand, reasoned that preemption by implication (through federal regulations) is required only when there is an inconsistency between state and federal requirements which cannot be reconciled and a federal agency could easily meet state notice requirements.<sup>222</sup> The *Whitney* court also concluded that the state notice requirement is not an obstacle to the purposes of the federal program.<sup>223</sup> In both *Mikolaitis*, which declined to find preemption, and *Spears*, which found preemption, the courts relied upon the criteria set forth in *Kimbell Foods*.<sup>224</sup> Both courts concluded that there was no compelling need for national uniformity in the FmHA foreclosure notice requirements.<sup>225</sup> Similarly, both courts concluded that application of state law would not frustrate the objectives of the federal program.<sup>226</sup> *Mikolaitis* found that application of federal law would frustrate commercial relationships based on state law and denied preemption.<sup>227</sup> In contrast *Spears* held that when the dispute is solely between the government and its debtor, and no third parties are affected, there is no frustration of commercial relationships and state law should not apply.<sup>228</sup>

#### E. State Laws Concerning Lien Priority

Before 1979, when questions arose as to the applicable law for disputes concerning lien priorities involving a federal program, courts tended to conclude, on the basis of *Clearfield Trust Co. v. United States*<sup>229</sup> and the need to protect the federal treasury, that federal law governed the dispute, with the result that federal programs were not subject to state lien priority laws.<sup>230</sup> The Supreme Court in *Kimbell Foods*

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221. *United States v. Royer*, 683 F. Supp. 484, 486 (M.D. Pa. 1986) ("Federal law controls the rights and obligations of the parties to the agreement . . ."), *aff'd without opinion*, 815 F.2d 696 (3d Cir. 1987); *United States v. Black*, 622 F. Supp. 669, 672-73 (W.D. Pa. 1985).

222. *Whitney*, 602 F. Supp. at 728; *see also* *United States v. Kennedy (In re Kennedy)*, 785 F.2d 1553, 1556 (11th Cir. 1986) (holding that state notice requirements are applicable to FmHA program because there is no inherent conflict).

223. *Whitney*, 602 F. Supp. at 729.

224. 440 U.S. 715 (1979); *see supra* note 186; *infra* text accompanying notes 287-97.

225. *United States v. Spears*, 859 F.2d 284, 290 (3d Cir. 1988); *United States v. Mikolaitis*, 682 F. Supp. 798, 802 (M.D. Pa. 1988).

226. *Spears*, 859 F.2d at 290; *Mikolaitis*, 682 F. Supp. at 802.

227. *Mikolaitis*, 682 F. Supp. at 802.

228. *Spears*, 859 F.2d at 290-91.

229. *See supra* note 6 and accompanying text; *infra* notes 278-86 and accompanying text.

230. *See, e.g., Clark Inv. Co. v. United States*, 364 F.2d 7, 9 (9th Cir. 1966) (explaining that



directly addressed this issue and concluded that while federal law governed the dispute, state laws could nonetheless be incorporated as the applicable federal law.<sup>231</sup> At least in this context *Kimbell Foods* has resulted in relative consistency. Most courts have concluded that because selection of a federal rule would seriously disrupt commercial relationships predicated on state laws, state laws of lien priority should be adopted as the rule of decision.<sup>232</sup> This result has been reached when the conflict is between federal liens and local government liens,<sup>233</sup> as well as when the conflicting liens may derive from application of the state commercial code<sup>234</sup> or state landlord-tenant laws.<sup>235</sup>

Despite this relative consistency, the apparent flexibility of the *Kimbell Foods* criteria has led some courts to the opposite conclusion. In one case which provoked a rare dissent from denial of certiorari to the Supreme Court,<sup>236</sup> the Eighth Circuit held that in an action involving a claim by FmHA to a lien on crops, "adoption of state law . . . would

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federal law governs the application of rents collected during the redemption period following foreclosure of FHA loan); *United States v. Sommerville*, 324 F.2d 712, 715-16 (3d Cir. 1963) (concluding that FmHA cattle loan program regulations preempt state laws), *cert. denied*, 376 U.S. 909 (1964).

231. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 727, 740 (1979).

232. *Federal Land Bank v. Ferguson*, 896 F.2d 1244, 1247-48 (10th Cir. 1990) (per curiam) (adopting state law to resolve conflict between relative priorities of FLB liens, FmHA liens, and third party liens); *United States v. Walter Dunlap & Sons, Inc.*, 800 F.2d 1232, 1233-37 (3d Cir. 1986) (holding that FmHA lien claim to cattle governed by state law); *United States v. Progressive Farmers Mktg. Agency*, 788 F.2d 1327, 1329 (8th Cir. 1986) (incorporating state law in order to determine FmHA claim); *United States v. Tugwell*, 779 F.2d 5, 7 (4th Cir. 1985) (holding state law controls FmHA suit for conversion of combine); *Chicago Title Ins. Co. v. Sherred Village Assocs.*, 708 F.2d 804, 807-11 (1st Cir. 1983) (holding that state law determines priority of mechanic's lien over HUD lien); *United States v. S.K.A. Assocs.*, 600 F.2d 513, 514-15 (5th Cir. 1979) (holding that state law is to be applied in dispute between SBA claim to personalty of debtor and landlord's lien).

233. *United States v. Tipton*, 898 F.2d 770, 771-72 (10th Cir. 1990) (holding that SBA lien is subject to governmental tax liens); *Pearlstein v. United States Small Business Admin.*, 719 F.2d 1169, 1177-78 (D.C. Cir. 1983) (holding that District of Columbia law applies to question of relative priority of SBA lien and lien for unpaid sales taxes); *United States v. Ravaali County Creamery, Inc.*, 657 F. Supp. 481, 482-84 (D. Mont. 1987) (holding that state law controls conflict between SBA lien being foreclosed and county claim for penalties and interests on taxes); *United States v. Dansby*, 509 F. Supp. 188, 191 (N.D. Ohio 1981) (holding that state law governs priority of real estate tax liens). *But cf. More v. United States*, 505 F. Supp. 612, 614 (N.D. Fla. 1980) (holding that FmHA has superior interest as against purchaser under tax deed); *Sims v. Smith*, 502 F. Supp. 609, 610 (N.D. Fla. 1980) (same).

234. *See, e.g., United States v. Lattaudio*, 748 F.2d 559, 562 (10th Cir. 1984) ("Since there is no Act of Congress to the contrary, we shall assume, in our disposition of the present case, that in fashioning the governing rule the [UCC] of [New Mexico] is incorporated . . .").

235. *See, e.g., S.K.A. Assocs.*, 600 F.2d at 514-15 (holding that state law is to be applied in dispute between SBA claim to personalty of debtor and landlord's lien).

236. *United States v. Missouri Farmers Ass'n*, 475 U.S. 1053, 1054 (1986) (White, J., dissenting from denial of certiorari).

conflict with the federal interests present in the FmHA loan program.”<sup>237</sup> Other circuit courts have reasoned that state law applies only when a federal rule has not been announced,<sup>238</sup> or when there is no need to protect the federal lender “from the vagaries of state law.”<sup>239</sup>

#### F. *Appointment of Receivers*

Insofar as the power to appoint a receiver to receive rents and profits or to take possession of property is within the equitable discretion of the court,<sup>240</sup> decisions addressing the authority of a federal agency to obtain the appointment of a receiver pending foreclosure have uniformly approved such an appointment. In many of these decisions, courts have relied primarily upon contractual authorization for such receiverships.<sup>241</sup> When the underlying contractual documents are silent on this point, courts have relied upon the need for national uniformity and “the federal policy to protect the treasury and to promote the security of federal investment which in turn promotes the prime purpose of the [National Housing] Act,” concluding that federal law, not state law, governs the appointment of a receiver.<sup>242</sup> Thus, state law criteria for appointment of receivers have been simply irrelevant.<sup>243</sup>

#### G. *State Statutes of Limitations*

Congress has spoken directly and clearly regarding the applicable statute of limitations governing actions on a contract to which the United States is a party,<sup>244</sup> and express preemption of state statutes of limitations

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237. *United States v. Missouri Farmers Ass'n, Inc.*, 764 F.2d 488, 489 (8th Cir. 1985), *cert. denied*, 475 U.S. 1053 (1986).

238. *See, e.g., United States v. Kennedy*, 738 F.2d 584, 586 (3d Cir. 1984) (holding that federal law applies to FmHA suit for conversion because *Kimbell Foods* applies only in the absence of a federal rule, and here the federal rule was established by an earlier case).

239. *United States v. Landmark Park & Assocs.*, 795 F.2d 683, 687 (8th Cir. 1986).

240. 1 STORY, *supra* note 39, at 132-35.

241. *United States v. Queen's Court Apts., Inc.*, 296 F.2d 534, 539-40 (9th Cir. 1961); *United States v. American Nat'l Bank & Trust Co.*, 573 F. Supp. 1317, 1318-19 (N.D. Ill. 1983); *United States v. Mountain Village Co.*, 424 F. Supp. 822, 828 (D. Mass. 1976).

242. *United States v. View Crest Garden Apts., Inc.*, 268 F.2d 380, 383 (9th Cir. 1959), *cert. denied*, 361 U.S. 884 (1960); *see United States v. Chester Park Apts., Inc.*, 332 F.2d 1, 4-5 (8th Cir.), *cert. denied*, 379 U.S. 901 (1964).

243. *United States v. Sylacauga Properties, Inc.*, 323 F.2d 487, 491 (5th Cir. 1963); *United States v. Drexel View II, Ltd.*, 661 F. Supp. 1120, 1122 (N.D. Ill. 1987).

244. The applicable statute of limitations is six years for actions brought by the United States on a contract to which it is a party. 28 U.S.C. § 2415(a) (1988). As a junior lienor the United States has one year following the foreclosure sale pursuant to a senior lien in which to redeem the property from the foreclosure. *Id.* § 2410(c) (1988).

has been found.<sup>245</sup> Because of this express preemption, courts generally have not undertaken the multifactor analysis of *Kimbell Foods*.<sup>246</sup> The six-year federal statute of limitations applies only to actions arising out of a contract and does not bar an action, beyond that time period, to foreclose a mortgage held by the federal government.<sup>247</sup>

In each of these critical areas of real estate finance law, the very presence of federal participation has resulted in chaos in the determination of applicable law. There is little consistency either in reasoning or in result, within a circuit or among the circuits, in the determination of the governing law when a federal agency is directly or indirectly involved in a real estate finance transaction. Courts invoke the talisman of implied preemption or federal common law in entirely unpredictable manners, relying upon different criteria, each interpreted in significantly different ways.

## V. PREEMPTION AND FEDERAL COMMON LAW

The critical constitutional doctrines for determination of applicable law in this context are the preemption doctrine and federal common law. Both doctrines are far easier to accept in theory than to apply in fact. Both doctrines invoke the criteria of "the need for national uniformity" and "protection of federal interests" yet afford broad judicial discretion in reaching conclusions. As developed, both doctrines fail to reflect the inherent differences between federal market regulation and federal market participation. As applied, both doctrines have permitted, in inconsistent fashion, the federal government's involvement as a creditor to override the states' allocation of rights among creditors and debtors.

### A. The Constitutional Doctrines

#### 1. Preemption Doctrine

The constitutional bases for federal preemption of state real estate

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245. *United States v. John Hancock Mut. Life Ins. Co.*, 364 U.S. 301, 308 (1960).

246. *United States v. Hanson*, 649 F. Supp. 100, 105 (D. Me. 1985); *United States v. Kurtz*, 525 F. Supp. 734, 740 (E.D. Pa. 1981), *aff'd without opinion*, 688 F.2d 827 (3d Cir.), *cert. denied*, 459 U.S. 991 (1982). A state statute imposing a time limitation for confirmation of a foreclosure as a precondition to a deficiency action has been held to be preempted by federal regulations, although this conclusion was reached before the decision in *Kimbell Foods*. *United States v. Merrick Sponsor Corp.*, 421 F.2d 1076, 1078-79 (2d Cir. 1970). A different result is not only possible but probable under *Kimbell Foods* and more recent decisions of the United States Supreme Court.

247. *Westnau Land Corp. v. United States Small Business Admin.*, 785 F. Supp. 41, 43 (E.D.N.Y. 1992); *Curry v. United States Small Business Admin.*, 679 F. Supp. 966, 970 (N.D. Cal. 1987); *Cracco v. Cox*, 66 A.D.2d 447, 448, 414 N.Y.S.2d 404, 405 (1979).

finance laws are first, the Supremacy Clause of the Constitution<sup>248</sup> and second, the Commerce Clause.<sup>249</sup> Although at times in our constitutional history it has been believed that the Commerce Clause was inherently limited in its reach,<sup>250</sup> "[c]ontemporary commerce clause doctrine grants Congress such broad power that judicial review of the affirmative authorization for congressional action is largely a formality."<sup>251</sup> While certain internal constitutional constraints,<sup>252</sup> and arguably Tenth Amendment principles of federalism,<sup>253</sup> necessarily limit the reach of the Commerce Clause, explicit congressional action in the area of real estate finance in general, and housing in particular, is well within the scope of the Commerce Clause.

When Congress expressly and unequivocally declares its intention to preempt state laws, courts will sustain such preemption as long as it is otherwise within constitutional limits.<sup>254</sup> Congress can expressly address the question of the preemptive effect of federal law in a number of different ways. For instance, Congress can enact statutes in particular areas and yet expressly disclaim any intent to preempt similar state laws.<sup>255</sup> It

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248. "This Constitution, and the laws of the United States . . . shall be the supreme Law of the Land . . . ." U.S. CONST. art. VI, cl. 2.

249. "The Congress shall have Power . . . To regulate Commerce . . . among the several States . . . ." U.S. CONST. art. I, § 8, cl. 3.

250. JOHN E. NOWAK & RONALD D. ROTUNDA, *TREATISE ON CONSTITUTIONAL LAW* §§ 4.4-4.9, at 138-63 (4th ed. 1991); LAURENCE H. TRIBE, *AMERICAN CONSTITUTIONAL LAW* § 5.4, at 305-10, § 6-2 to 6-4, at 403-08 (2d ed. 1988).

251. *Federal Energy Regulatory Comm'n v. Mississippi*, 456 U.S. 742, 758 (1982) ("It is not for us to say whether the means chosen by Congress represent the wisest choice. It is sufficient that Congress was not irrational in concluding that limited federal regulation . . . was essential to protect interstate commerce."); NOWAK & ROTUNDA, *supra* note 250, § 5-8, at 129-30 ("Today, the [Supreme] Court will uphold the decisions of Congress so long as there is some rational argument for finding that the items that the Congress regulates fall within the commerce power."); TRIBE, *supra* note 250, at § 5.8, at 316.

252. Such constraints take the form primarily of restrictions flowing from (1) the separation of powers, such as the grant of executive power, U.S. CONST. art. II, § 1, or judicial authority, U.S. CONST. art. III, § 1; (2) the specification of individual rights in the Bill of Rights, U.S. CONST. amend. I-VIII; or (3) specific prohibitions to Congress such as the denial of power to tax exports from any state. U.S. CONST. art. I, § 9, cl. 5.

253. Although the Supreme Court in *Garcia v. San Antonio Metropolitan Transit Authority*, 469 U.S. 528, 530-31 (1985), overruled *National League of Cities v. Usery*, 426 U.S. 833 (1976), and held that commercial regulation by Congress of a governmental activity would be sustained, most agree that Tenth Amendment limitations could, at some point, stand as a barrier to congressional action ostensibly justified on the basis of the Commerce Clause. See NOWAK & ROTUNDA, *supra* note 250, § 4.10, at 183-87; TRIBE, *supra* note 250, § 5-20, at 378 n.4, 397-98.

254. *Hillsborough County, Fla. v. Automated Medical Lab., Inc.*, 471 U.S. 707, 713 (1985).

255. See, e.g., 18 U.S.C. § 3231 (1988) (recognizing expressly the jurisdiction of state courts over state criminal law matters).

can establish federal standards and yet expressly permit state regulations containing additional requirements, the approach taken in the case of most real estate finance disclosure laws.<sup>256</sup> It can expressly preempt all state laws concerning a particular substantive issue, but nonetheless permit states to "override" that preemption by subsequent legislative act—the path chosen in congressional preemption of usury laws and adjustable rate mortgages.<sup>257</sup>

The difficult preemption questions arise not when Congress has expressly displaced state law, but when Congress has enacted a statute on a particular subject matter, or has created a federal program, and has failed to state clearly whether it intended to displace state law. In these cases of implied preemption, courts must "examine congressional intent."<sup>258</sup> Ascertaining the preemptive intent of Congress, not surprisingly, has yielded a considerable range of factors, or relevant criteria, including: (1) whether congressional legislation completely "occupies the field," (2) whether there is a conflict between the requirements of state law and federal law, (3) whether the federal interests and the need to protect direct federal interests dominate, (4) whether there is a need for national uniformity, (5) whether state law would frustrate the specific objectives of the federal programs, and (6) whether application of federal law would disrupt commercial relationships predicated on state law.<sup>259</sup> Given this range of factors and the diverse conclusions reached from them, it is an understatement to suggest that "none of these expressions provides an infallible constitutional test or an exclusive constitutional yardstick."<sup>260</sup>

Any implied preemption analysis must begin with the question whether there is a presumption *against* implied preemption. Although the Supreme Court has not enunciated such a presumption applicable in all preemption contexts, it has on several occasions strongly suggested that "[w]here . . . the field which Congress is said to have pre-empted has been traditionally occupied by the States 'we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act.'"<sup>261</sup> Property law has been identified as one area de-

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256. See *supra* note 108 and accompanying text.

257. See *supra* notes 111 & 118 and accompanying text.

258. *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 152 (1982).

259. See *infra* Part V. B, notes 303-91 and accompanying text.

260. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941).

261. *Jones v. Rath Packing Co.*, 430 U.S. 519, 525 (1977) (citations omitted) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)); see also *Schwartz v. Texas*, 344 U.S. 199, 202-03 (1952) ("The exercise of federal supremacy is not lightly to be presumed."). But see *Conference of State Bank Supervisors v. Conover*, 710 F.2d 878, 882 (D.C. Cir. 1983) ("[A] presumption against preemption cannot be supported.").

serving such a negative presumption.<sup>262</sup> This presumption against preemption, however, tends to be weak at best,<sup>263</sup> for even when the Supreme Court seems to have both stated and applied the presumption, it acknowledges that certain factors can override it.<sup>264</sup> An alternative formulation of this presumption is "that federal regulation of a field of commerce should not be deemed preemptive of state regulatory power in the absence of persuasive reasons—either that the nature of the regulated subject matter permits no other conclusion, or that the Congress has unmistakably so ordained."<sup>265</sup> Read literally, this presumption would seem to indicate that only a direct conflict could be the basis for implied preemption. Unfortunately, however, the Court obscured the possible clarity of such a rule by its analysis, immediately following the stated presumption, of legislative history and the significance of national uniformity as a possible basis for preemption.<sup>266</sup>

Of the numerous factors which may provide the basis for implied preemption, no single factor seems to be a necessary condition, and any factor alone may be a sufficient condition. The existence of detailed federal regulations is the clearest example of this principle. When Congress has delegated rule-making authority to an agency, the agency's regulations may be the basis for preemption of state law. "Federal regulations have no less pre-emptive effect than federal statutes."<sup>267</sup> The existence of such regulations, however, even in a relatively comprehensive form, may alone be insufficient, as the Supreme Court is "even more reluctant to infer pre-emption from the comprehensiveness of regulations than from the comprehensiveness of statutes."<sup>268</sup>

## 2. Government as a Party—Federal Common Law

Because federal intervention in real estate finance involves not merely market regulation but direct market participation as well, the second constitutional doctrine, federal common law, comes into play.

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262. *Kamen v. Kemper Fin. Serv., Inc.*, 111 S. Ct. 1711, 1717 (1991) (citing *Reconstruction Fin. Corp. v. Beaver County*, 328 U.S. 204, 210 (1946)).

263. *Maryland v. Louisiana*, 451 U.S. 725, 746-47 (1981).

264. *See, e.g., Hillsborough County, Fla. v. Automated Medical Lab., Inc.*, 471 U.S. 707, 715-16 (1985) (stating that presumption in favor of state regulation of health and safety matters can only be overcome by showing that federal law occupies the whole field or that there is a direct conflict); *Commonwealth Edison Co. v. Montana*, 453 U.S. 609, 634 (1981) (declaring that specific statutes, not general statements of national policy, must be the basis for a conflict that overcomes presumption against preemption).

265. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142 (1962).

266. *Id.* at 146-52.

267. *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982).

268. *Hillsborough County, Fla.*, 471 U.S. at 717.

Notwithstanding the pronouncement in *Erie Railroad v. Tompkins*<sup>269</sup> that "[t]here is no federal general common law,"<sup>270</sup> both the Supreme Court<sup>271</sup> and commentators<sup>272</sup> recognize the necessity of federal common law in particular contexts. The more obvious contexts include interstate competition for water resources,<sup>273</sup> Native American land claims,<sup>274</sup> constitutional rights,<sup>275</sup> and international relations.<sup>276</sup> Federal common law, however, is far broader in its reach than these relatively discrete categories, and encompasses "any rule of federal law created by a court (usually but not invariably a federal court) *when the substance of that rule is not clearly suggested by federal enactments*—constitutional or congressional."<sup>277</sup>

In 1943, in *Clearfield Trust*,<sup>278</sup> the Supreme Court applied federal common law to the rights and duties of commercial paper issued by the federal government. Interpreted in its strongest sense, *Clearfield Trust* stands for the proposition that "federal law governs questions involving the rights of the United States arising under nationwide federal programs."<sup>279</sup> Thus, with respect to virtually every federal loan program, whether federally insured, guaranteed, or involving a direct federal loan, including the loan programs of FHA,<sup>280</sup> VA,<sup>281</sup> SBA,<sup>282</sup> FmHA,<sup>283</sup> and

269. 304 U.S. 64 (1938).

270. *Id.* at 78.

271. The Supreme Court, on the same day it decided *Erie*, ruled that federal common law applied to interstate disputes on water resource allocation. *Hinderlider v. La Plata River & Cherry Creek Ditch Co.*, 304 U.S. 92, 110 (1938).

272. Martha A. Field, *Sources of Law: The Scope of Federal Common Law*, 99 HARV. L. REV. 883, 953-62 (1986); Henry J. Friendly, *In Praise of Erie—and of the New Federal Common Law*, 39 N.Y.U. L. REV. 383, 405-22 (1964); Paul J. Mishkin, *The Variousness of "Federal Law": Competence and Discretion in the Choice of National and State Rules for Decision*, 105 U. PA. L. REV. 797, 810-32 (1957).

273. *Colorado v. New Mexico*, 459 U.S. 176, 183 (1982).

274. *County of Oneida v. Oneida Indian Nation*, 470 U.S. 226, 236 (1985).

275. *Bivens v. Six Unknown Named Agents*, 403 U.S. 388, 392-97 (1971).

276. *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 408-12 (1964); see ERWIN CHERMERINSKY, *FEDERAL JURISDICTION* § 6.2.4 (1989).

277. Field, *supra* note 272, at 890. Alternatively, federal common law has been defined as "any federal rule of decision that is not mandated on the face of some authoritative federal text—whether or not that rule can be described as the product of 'interpretation' in either a conventional or an unconventional sense." Thomas W. Merrill, *The Common Law Powers of Federal Courts*, 52 U. CHI. L. REV. 1, 5 (1985).

278. 318 U.S. 363 (1943).

279. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 726 (1979) (citing *Clearfield Trust Co. v. United States*, 318 U.S. 363, 366-67 (1943)).

280. *E.g.*, *United States v. Stadium Apts., Inc.*, 425 F.2d 358, 360 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970); *United States v. Chester Park Apts., Inc.*, 332 F.2d 1, 3 (8th Cir.), *cert. denied*, 379 U.S. 901 (1964); *United States v. View Crest Garden Apts., Inc.*, 268 F.2d 380, 382 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959).

281. *E.g.*, *Whitehead v. Derwinski*, 904 F.2d 1362, 1365 (9th Cir. 1990).

HUD,<sup>284</sup> appellate courts have concluded, on the basis of *Clearfield Trust*, that federal common law governs the dispute. This assertion of authority of federal law is the "first prong" of the *Clearfield Trust* analysis.<sup>285</sup>

The judicial determination that federal law applies, however, is and should be only the first question. The "second prong" of the *Clearfield Trust* analysis involves what the content of the federal rule should be.<sup>286</sup> In *Kimbell Foods*,<sup>287</sup> the Supreme Court considered the question of the relative priority of federal loan program liens and private liens. In brief fashion the Court concluded, on the basis of *Clearfield Trust*, that "the priority of liens stemming from federal lending programs must be determined with reference to federal law."<sup>288</sup> The more difficult task, the Court suggested, is to determine whether the content of the federal law should be a judicially fashioned uniform rule or whether applicable state law should be incorporated as the rule of decision.<sup>289</sup> The Court identified three criteria for making such a determination: (1) whether the federal programs by their nature necessitated a uniform federal rule; (2) whether application of state law would frustrate specific objectives of the federal programs; and (3) whether application of a federal rule would disrupt commercial relationships predicated on state law.<sup>290</sup> In the context presented, the Court unanimously concluded that state law should be incorporated as federal law.<sup>291</sup> The Court held, first, that SBA and FHA loan programs did not necessitate national uniformity insofar as such loan programs are frequently tailored to state laws and are individually negotiated.<sup>292</sup> Second, incorporation of state laws would not frustrate the purposes of the federal programs except in the narrow sense of possibly making it more difficult for the government, as creditor, to recoup the loan.<sup>293</sup> Third, adoption of a different federal rule would seri-

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282. *E.g.*, *Great Southwest Life Ins. Co. v. Frazier*, 860 F.2d 896, 899 (9th Cir. 1988); *United States v. Crain*, 589 F.2d 996, 998 (9th Cir. 1979).

283. *E.g.*, *Kimbell Foods*, 440 U.S. at 726; *United States v. Walter Dunlap & Sons, Inc.*, 800 F.2d 1232, 1236 (3d Cir. 1986); *United States v. Ellis*, 714 F.2d 953, 954-55 (9th Cir. 1983).

284. *E.g.*, *United States v. Scholnick*, 606 F.2d 160, 164 (6th Cir. 1979).

285. *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 593 (1972); Mishkin, *supra* note 272, at 802.

286. Friendly, *supra* note 272, at 410; Mishkin, *supra* note 272, at 802.

287. 440 U.S. 715 (1979).

288. *Id.* at 726.

289. *Id.* at 727-29.

290. *Id.* at 728-29.

291. *Id.* at 740.

292. *Id.* at 729-33.

293. *Id.* at 733-38.



ously undermine commercial expectations based upon state law.<sup>294</sup> *Kimbell Foods* thus affirms the importance of evaluating state law concerns while acknowledging the authority of federal common law.

Whether a presumption exists favoring the displacement of state law in the second prong of the federal common law analysis is not clear.<sup>295</sup> When the United States is a contracting party and the applicable state law is hostile to the interests of the United States, state law will not be applied.<sup>296</sup> Conversely, even though the United States may be a contracting party, at times the federal interest may be "too speculative, far too remote a possibility to justify the application of federal law to transactions essentially of local concern."<sup>297</sup>

### 3. Doctrinal Chaos

The overlapping and ambiguous nature of the constitutional doctrines of preemption and federal common law has been a primary cause of the chaos in judicial reasoning and judicial results in real estate finance cases. One might plausibly assume, for example, that the preemption doctrine will be applied when Congress acts as a market regulator, not a market participant, and that federal common law will be applied when the federal government is a direct market participant. Such has not been the case, however. In one of the two leading Supreme Court opinions involving direct market participation, *Shimer*,<sup>298</sup> the Court undertook its analysis solely on the basis of federal preemption doctrine, while in *Kimbell Foods*, the second leading opinion in the area, the Court based its reasoning entirely upon federal common law and *Clearfield Trust*.<sup>299</sup>

Both lines of constitutional reasoning cite as relevant factors the need for national uniformity and the need to protect the objectives of federal programs. The preemption doctrine begins with a weak presumption in favor of state law, yet incorporates numerous other relevant fac-

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294. *Id.* at 739-40.

295. In a weak sense, of course, the Rules of Decision Act, enacted in 1789, creates some presumption that "[t]he laws of the several states, except where the Constitution or treaties of the United States or Acts of Congress otherwise require or provide, shall be regarded as rules of decision in civil actions in the courts of the United States, in cases where they apply." 28 U.S.C. § 1652 (1988). Some commentators feel comfortable with the proposition that there is "a strong presumption against the federal courts fashioning common law to decide cases." CHEMERINSKY, *supra* note 276, § 6.1, at 293.

296. *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 597 (1972).

297. *Miree v. DeKalb County, Ga.*, 433 U.S. 25, 32-33 (1977) (quoting *Bank of America Nat'l Trust & Sav. Ass'n v. Parnell*, 352 U.S. 29, 33-34 (1956)).

298. 367 U.S. 374 (1961).

299. A second United States Supreme Court opinion acknowledged the *Clearfield Trust* doctrine, yet held that the SBA loan program was subject to state laws. *United States v. Yazell*, 382 U.S. 341, 354-58 (1965).

tors—none of which expressly include the potential impact on state law. When the government is a party the assumption appears to be that federal law governs without any presumption as to the content of the law. Federal common law, however, does include as a relevant factor the potential negative impact on state commercial relationships, a factor largely absent from preemption analysis.

The problem is not solely the presence of judicial discretion in determining congressional intent to preempt state laws, nor solely the applicability of the federal common law to disputes to which the government is a party. The problem, for federal intervention in real estate finance, is that the fluid multifactored tests, which include the need for national uniformity and the protection of federal interests, are simply insufficient to bear the normative or predictive significance expected of them.<sup>300</sup> Every federal loan program exposes the federal treasury to a risk of loss. Every secured real estate transaction exposes the federal government, as a secured creditor, to state laws designed to strike a balance between debtors and creditors. Congress has, with increasing frequency, determined that it is necessary and appropriate to legislate substantive issues concerning all “federally related mortgage loans.”<sup>301</sup> Congress has also demonstrated that it can act expressly to preempt state laws which offer debtor or third party protections when it desires solely to protect the federal treasury or the federal program.<sup>302</sup> The authority to find implied preemption, whether in congressional market regulation or by application of federal common law when the government is a party, becomes an unbridled power yielding unpredictable results when the relevant factors are so fluid.

## B. *An Analysis of Criteria*

### 1. Occupation of the Field

One of the most traditional, and least useful, tests for determining if state law has been displaced by federal law is whether Congress “has taken the particular subject-matter in hand,”<sup>303</sup> or authorized a “‘scheme of federal regulation . . . so pervasive as to make reasonable the

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300. See Field, *supra* note 272, at 928 (“The absence of an articulated standard, or even an accepted way of looking at federal common-law questions, has exacerbated the inconsistency and unpredictability that in any event accompanies a system vesting so much discretion in the judiciary.”).

301. See *supra* notes 105-06 and accompanying text.

302. See *supra* notes 124, 189-90 and accompanying text.

303. *Charleston W.C. Ry. v. Varnville Furniture Co.*, 237 U.S. 597, 604 (1915); *TRIBE, supra* note 250, § 6-26, at 491.

inference that Congress left no room for the states to supplement it.'"<sup>304</sup> Preemption by occupation of the field is most evident in areas where Congress has inherent concerns such as alien registration,<sup>305</sup> or where Congress has created and empowered a national regulatory agency.<sup>306</sup>

In *Shimer*<sup>307</sup> the Supreme Court seemed to adopt the tenor of this test in holding that the regulations of the Veterans Administration preempted state laws limiting deficiency actions against debtors. "We have no doubt that this regulatory scheme, complete as it is in every detail, was intended to provide the whole and exclusive source of protection of the interests of the Veterans Administration as guarantor and was, to this extent, meant to displace inconsistent state law."<sup>308</sup> It would be a mistake, however, to view *Shimer* as standing for the proposition that because the agency has issued extensive regulations, state laws are inapplicable. As later decisions made clear, the existence of comprehensive regulations is clearly less significant for implied preemption purposes than the existence of a comprehensive statute.<sup>309</sup> Many federal programs require extensive regulations, but it does not follow that such regulations indicate the intent of Congress to displace state laws.<sup>310</sup> Occupation of the field, as evidenced by extensive regulations, is a sufficient basis for implied preemption only if other criteria are also present, such as a direct conflict with state laws or the need for national uniformity.

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304. *Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190, 204 (1983) (quoting *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141, 153 (1982) (quoting *Rice v. Sante Fe Elevator Corp.*, 331 U.S. 218, 230 (1947))).

305. *See Hines v. Davidowitz*, 312 U.S. 52, 67-68 (1941) (holding that state alien registration act was preempted by federal act).

306. *See San Diego Bldg. Trades Council v. Garmon*, 359 U.S. 236, 244-45 (1959) (holding that state tort action for picketing was preempted by National Labor Relations Act); *Farmers Educ. Union & Coop. v. WDAY, Inc.*, 360 U.S. 525, 535 (1959) (holding that state libel actions were preempted by FCC regulations).

307. 367 U.S. 374 (1961).

308. *Id.* at 381.

309. *See Hillsborough County, Fla. v. Automated Medical Lab., Inc.*, 471 U.S. 707, 717 (1985) ("We are even more reluctant to infer pre-emption from the comprehensiveness of regulations than from the comprehensiveness of statutes.").

310. As the Court put it:

To infer pre-emption whenever an agency deals with a problem comprehensively is virtually tantamount to saying that whenever a federal agency decides to step into a field, its regulations will be exclusive. Such a rule, of course, would be inconsistent with the federal-state balance in our Supremacy Clause jurisprudence.

*Id.* *See New York Dep't of Social Serv. v. Dublino*, 413 U.S. 405, 415 (1972) ("We reject . . . the contention that pre-emption is to be inferred merely from the comprehensive character of the federal work incentive provisions.").

## 2. Conflict Preemption

In the event of a conflict between the requirements of federal law (including federal regulations) and the requirements of state law, the Supremacy Clause requires the displacement of state law.<sup>311</sup> Although the Supreme Court<sup>312</sup> and commentators<sup>313</sup> have suggested that preemption takes three forms—express, implied, and conflict preemption—in fact, conflict preemption is a form of implied preemption.<sup>314</sup>

Courts have construed the existence of a conflict as a basis for preemption in three different ways. First, it refers to a situation in which required or prohibited behavior under federal law is directly and completely contrary to that required or prohibited under state law. In this context “compliance with both federal and state regulations is a physical impossibility.”<sup>315</sup> Second, it refers to a situation where application of state laws may be “an obstacle to the accomplishment and execution of the full purposes” of the federal statute or program.<sup>316</sup> Third, it has been used to evaluate situations in which federal law prescribes a minimum standard of behavior, but the question is uncertain as to whether additional state standards or requirements may also apply.<sup>317</sup> The first context, of a conflict yielding a physical impossibility, is a pure conflict, the second, an instrumental or policy conflict, and the third, no conflict at all.

An attempt to reconcile or predict the conflict preemption cases, on anything other than a result-oriented basis, proves no easy task because the categories overlap and the lines blur.<sup>318</sup> A highly skilled advocate

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311. *Gibbons v. Ogden*, 22 U.S. (9 Wheat.) 1, 211 (1824).

312. *See Pacific Gas & Elec. Co. v. State Energy Resources Conservation & Dev. Comm'n*, 461 U.S. 190, 203-04 (1983); *Pennsylvania v. Nelson*, 350 U.S. 497, 502-05 (1956).

313. NOWAK & ROTUNDA, *supra* note 250, § 9.1, at 312; TRIBE, *supra* note 250, § 6-35, at 479.

314. This assumes, of course, that it is not a conflict addressed by express preemption.

315. *Florida Lime & Avocado Growers, Inc. v. Paul*, 373 U.S. 132, 142-43 (1963); *see United States v. John Hancock Mut. Life Ins. Co.*, 364 U.S. 301, 301 (1960) (holding that twelve-month federal statutory right of redemption controls over conflicting state law which permitted a junior creditor to redeem only after the twelfth month and before the sixteenth month). It is entirely plausible, however, that in *John Hancock* there was no direct conflict because the interests of the United States, as reflected in the federal statutory history, could have been adequately served by redemption during the three-month window.

316. *Perez v. Campbell*, 402 U.S. 637, 649 (1971) (quoting *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941)).

317. *See Silkwood v. Kerr-McGee Corp.*, 464 U.S. 238, 258 (1984) (holding that state tort law for radiation injuries was not preempted by federal nuclear safety regulations); *Florida Lime & Avocado Growers*, 373 U.S. at 152 (upholding California marketing statute imposing strict requirements).

318. *See TRIBE, supra* note 250, § 6-26, at 481-97.

can always find a conflict when two sovereigns have spoken on similar subjects, just as such an advocate can almost invariably (save for instances of physical impossibility) find ways to reconcile the words of separate sovereigns. In evaluating a possible conflict between federal law and state law, the more important issue is the phrasing of the question itself—the identification of matters potentially in conflict.

Cases involving potential conflicts between state and federal laws in real estate finance reveal that when a specific state requirement, or prohibition, is compared to a more general federal program, courts are likely to find a conflict and displace state law. For example, when a state prohibits a deficiency action after nonjudicial power of sale foreclosures, but a federal agency nonetheless seeks a deficiency, the result depends in large measure upon what the court compares for purposes of evaluating the conflict. If the court weighs the regulations, policies, and goals of the federal agency seeking the deficiency action against the state prohibition of deficiency actions in nonjudicial foreclosures, a conflict seems evident, and courts have used such reasoning to preempt state law.<sup>319</sup> When, however, courts have compared the federal goal of obtaining a deficiency not simply with the particular state antideficiency legislation but with the broader state system of secured creditors' rights, courts have reached a different result. For example, when state laws contain alternative methods by which a secured real estate creditor could preserve rights to a deficiency action, some courts have refused to find a conflict, holding instead that the federal agency simply waived its right to a deficiency by the course of action it selected.<sup>320</sup>

This inappropriate comparison of apples with oranges, or apples with all fruits, as a way of determining which is sweeter, also occurs when federal regulations either have not addressed the existence of a debtor's post-foreclosure right of redemption or have provided for a waiver of such right. Thus, federal loan programs have been held not subject to statutory rights of redemption, in order "to assure the protec-

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319. See *United States v. Shimer*, 367 U.S. 374, 380-81 (1961); *United States v. Gish*, 559 F.2d 572, 575 (9th Cir. 1977) (holding that the SBA must be allowed to recover deficiencies whenever state law applies), *cert. denied*, 435 U.S. 996 (1978); *Branden v. Driver*, 293 F. Supp. 871, 873 (N.D. Cal. 1968) (holding that the federal policy of collection on its loans must be considered paramount to any state policy), *aff'd per curiam*, 441 F.2d 1171 (9th Cir. 1971).

320. *Whitehead v. Derwinski*, 904 F.2d 1362, 1369 (9th Cir. 1990); *Carter v. Derwinski*, 758 F. Supp. 603, 608 (D. Idaho 1991), *reh'g granted*, 970 F.2d 662 (9th Cir. 1992). But see *United States v. Davis*, 961 F.2d 603, 611 (7th Cir. 1992) (holding that the VA was not estopped by asserting rights under indemnity agreement); *Vail v. Derwinski*, 946 F.2d 589, 592 (8th Cir. 1991) (holding that the VA guaranty contract was not affected by non-judicial foreclosure); *Jones v. Turnage*, 699 F. Supp. 795, 802 (N.D. Cal. 1988) (rejecting the argument of waiver by the VA and holding in favor of preemption), *aff'd sub. nom. Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1309 (1991).

tion of the federal program against loss.”<sup>321</sup> Again, however, when courts have examined the statutory right of redemption in the broader context, the potential adverse impact on the federal treasury has faded.<sup>322</sup> When they have examined a contractual waiver, in the federal loan documents, of state debtor protection laws in the full context of the state policies prohibiting such waivers in real estate finance, courts have been far more reluctant to displace state laws.<sup>323</sup> State laws setting forth notice requirements, when examined not merely in the narrow sense of possible differences with federal notice requirements but in the broader context of state policies, have been sustained.<sup>324</sup>

What a court chooses to compare, therefore, will in large measure determine the existence of a conflict as a basis for implied preemption in real estate finance. If the court contrasts a narrow and specific state regulation with an entire federal program and its purposes, policies, and regulations, the state law will conflict with federal law and yield to it. If, on the other hand, the court views state law in the broader context of the state’s allocation of rights and duties among secured real estate creditors and debtors and the interplay of such allocation, the federal program will more likely yield to state law.

### 3. Federal Interests

The “dominance of the federal interests” and the “need to protect direct federal interests” are frequently mentioned factors in an implied preemption analysis. The strongest such statements by the United States Supreme Court arise in contexts other than real estate finance, such as

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321. *United States v. Stadium Apts., Inc.*, 425 F.2d 358, 362 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970); *see United States v. Victory Highway Village*, 662 F.2d 488, 495 (8th Cir. 1981) (holding that HUD has broad discretion to choose its possible remedies when performing its duties); *United States v. Scholnick*, 606 F.2d 160, 164-65 (6th Cir. 1979) (recognizing an overriding federal interest in protecting the funds of the United States).

322. *See United States v. Pastos*, 781 F.2d 747, 750 (9th Cir. 1986) (holding that state redemption laws do not provide complete immunity from the debt as antideficiency laws might).

323. *Compare Great Southwest Life Ins. Co. v. Frazier*, 860 F.2d 896, 903 (9th Cir. 1988) (holding that contractual waiver of state law defense was ineffective), *Pastos*, 781 F.2d at 752 (holding that contractual waiver was unenforceable because not required by federal law), *United States v. Ellis*, 714 F.2d 953, 956 (9th Cir. 1983) (finding that overriding federal purpose is not adversely affected, and may even be advanced, by adopting state law), *United States v. Crain*, 589 F.2d 996, 1000 (9th Cir. 1979) (stating that the adoption of state law would not adversely affect federal policies), *and United States v. Hargrove*, 494 F. Supp. 22, 24 (D.N.M. 1979) (holding a contractual waiver unenforceable) *with United States v. Gish*, 559 F.2d 572, 574 (9th Cir. 1977) (holding debtor bound by contractual waiver of immunity), *cert. denied*, 435 U.S. 996 (1978) *and United States v. Curry*, 561 F. Supp. 429, 431 (D. Kan. 1983) (holding a contractual waiver enforceable under federal law even if not enforceable under state law).

324. *See supra* notes 216-27 and accompanying text.

sedition laws<sup>325</sup> and alien registration statutes.<sup>326</sup> In real estate finance, "federal interests" has been used to refer either to the fiscal concerns of the federal government in debt collection, or to the more specific objectives of the federal programs.

The logical relevance of federal financial interests is that in order to achieve the broad objectives of the federal program, the financial integrity of the program is important; in order to protect the financial integrity of the program it is necessary that the federal government, as the secured creditor, recover on the debt owed to it.<sup>327</sup> Alternatively, this factor has been offered simply as a conclusive proposition: "[T]he Federal policy of collection on its loan must be considered paramount to any State policy with which we are concerned."<sup>328</sup> In one of the most extensively briefed cases on whether federal loan programs are subject to state statutory rights of redemption, the Ninth Circuit considered, but rejected, the argument that state redemption rights constituted a significant policy judgment of the state concerning the allocation of rights and duties among creditors and debtors.<sup>329</sup> Precisely because a state redemption right could cost the government money, the court held it inapplicable to the federal program.<sup>330</sup>

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325. See *Pennsylvania v. Nelson*, 350 U.S. 497, 504 (1956) ("Congress has devised an all-embracing program for resistance to the various forms of totalitarian aggression.").

326. See *Hines v. Davidowitz*, 312 U.S. 52, 68 (1941) (stating that such legislation is in a field which demands broad national authority).

327. See *United States v. Scholnick*, 606 F.2d 160, 164 (6th Cir. 1979) (holding there is a federal interest in protecting the funds of the United States and in securing federal investments, thereby promoting the purposes of the National Housing Act); *United States v. View Crest Garden Apts., Inc.*, 268 F.2d 380, 383 (9th Cir.) ("[T]he federal policy to protect the treasury and to promote the security of federal investment which in turn promotes the prime purpose of the Act . . . becomes predominant."), *cert. denied*, 361 U.S. 884 (1959).

328. *Branden v. Driver*, 293 F. Supp. 871, 873 (N.D. Cal. 1968), *aff'd per curiam*, 441 F.2d 1171 (9th Cir. 1971). While the appellate court affirmed the holding of preemption, it evidently disagreed with its wisdom, saying: "Here the government gets, under tragic circumstances of the debtor, a deficiency it could not get under California state law. Much can be said for requiring federal loans to be made under the local law, but we are not now free to order the California law applicable." *Brandon v. Driver*, 441 F.2d 1171, 1171 (9th Cir. 1971). Judge Ely, in dissent, emphasized the presence of the California antideficiency statute as part of the "ideal of basic fairness" and stressed the importance of such law to the policies of California. *Id.* (Ely, J., dissenting).

329. *United States v. Stadium Apts., Inc.*, 425 F.2d 358, 365 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970). Judge Ely's intense dissent in this case stressed the need for a contextual analysis of a state redemption right:

I could not hold that silence on the part of Congress can be taken to effect an abrogation of time-honored state rights, derived from the most exalted principles of equity and so carefully designed, not only for the protection of debtors and creditors alike, but also for the promotion of the general economic welfare of the public at large.

*Id.* at 373 (Ely, J., dissenting).

330. *Id.* at 366-67 ("[The federal government] should not have to hold and manage proper-

The problem with this argument is that it simply proves too much. If federal interests are synonymous with federal financial interests, then all federal mortgage programs will preempt state laws to the extent that they may impose a cost on the federal government. Because the role of the federal government as a market participant in real estate finance is largely the role of a secured creditor, preemption of one half of the creditor-debtor allocation of rights and duties will invariably occur in all federal mortgage programs. The same problem arises whether one is following traditional implied preemption doctrine or federal common law doctrine because the government is a party. To hold that simply because the federal government is a party to a dispute the rule that favors the financial interests of the government should prevail, is, in this context, to destroy the historical allocation at law and in equity of real estate finance obligations.<sup>331</sup> It also likely will create havoc precisely because many state statutes, including the statutory right of redemption, can serve to benefit not only a debtor but also a creditor.<sup>332</sup>

The Supreme Court, as well as appellate courts, have recognized the inadequacy of federal financial interests as a basis for preemption. In *United States v. Yazell*,<sup>333</sup> the Court reasoned that "[t]he desire of the Federal Government to collect on its loans is understandable. . . . But this serves merely to present the question—not to answer it. Every creditor has the same interest in this respect; every creditor wants to collect."<sup>334</sup> In upholding the application of state law to the federal loan program, the Court disavowed the proposition that the government's claim, as a creditor, is absolute.<sup>335</sup> Other courts have recognized that "[i]ncreased costs alone, however, are not a strong enough federal interest to override states' concerns in protecting debtors."<sup>336</sup>

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ties for any period longer than is absolutely necessary for it to get back its money. . . . Nor is it accurate to say that the application of state redemption rights does not tie up government funds.").

331. As Professor Field has observed, "Such a suggestion is problematic. It smacks of one party to the controversy deciding the rules in its own favor." Field, *supra* note 272, at 955.

332. See *supra* notes 47-49 & 188-91 and accompanying text; see also *United States v. Crain*, 589 F.2d 996, 1000 (9th Cir. 1979) (stating that state laws protecting guarantors make it easier for federal programs to find sureties).

333. 382 U.S. 341 (1966).

334. *Id.* at 348.

335. *Id.* at 348-49. The Court acknowledged that the magnitude of the federal financial interest at stake in *Yazell* was "of little consequence," *id.* at 343, but nonetheless rejected the conclusions which could flow from a *Clearfield Trust*-based argument.

336. *United States v. Vallejo*, 660 F. Supp. 535, 539 (W.D. Wash. 1987); see *United States v. MacKenzie*, 510 F.2d 39, 41-42 (9th Cir. 1975) (en banc) (holding that federal interests of protecting federal fisc and purposes of SBA program are insufficient basis to preempt state antideficiency law); see also *United States v. Haddon Haciendas Co.*, 541 F.2d 777, 784 n.8



The absence in the *Kimbell Foods* three-factored analysis for application of federal common law of a factor identified solely as "protection of federal interests" is revealing. In *Kimbell Foods* the Supreme Court carefully considered, and rejected, the argument that federal loan programs deserve special protection unavailable to ordinary commercial creditors:<sup>337</sup> "The Government therefore is in substantially the same position as private lenders, and the special status it seeks is unnecessary to safeguard the public fisc."<sup>338</sup> Recognizing the significance of this more limited delineation of factors has produced an increased number of decisions sustaining the application of state law to federal programs.<sup>339</sup>

#### 4. Need for National Uniformity

The need for or desirability of national uniformity is one of two factors common to both the traditional implied preemption analysis<sup>340</sup> and federal common law analysis;<sup>341</sup> the second common factor being the frustration of federal program objectives. Congress, however, has largely avoided complete preemption even in enacting comprehensive legislation in real estate finance. In the mandatory disclosure laws Congress established only minimum disclosure requirements, leaving states free to require additional disclosures.<sup>342</sup> Similarly, when Congress expressly preempted specific substantive areas such as usury laws or adjustable rate mortgage laws, states retained authority to override the provisions of federal law.<sup>343</sup> Although Congress has expressly avoided the imposition of national uniformity in critical areas of real estate finance, the need for national uniformity resounds in judicial reasoning about real estate finance.

The "need for national uniformity" factor has appeared in radically different contexts. In *Clearfield Trust*,<sup>344</sup> the Supreme Court considered whether the commercial paper of the federal government could be subject to the laws of the different states and concluded that the obligations

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(9th Cir. 1976) (suggesting that protection of the public fisc is an insufficient basis for preemption).

337. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728-29 (1979).

338. *Id.* at 737.

339. *See Whitehead v. Derwinski*, 904 F.2d 1362, 1370 (9th Cir. 1990) (attributing court's shift in analysis to the decision in *Kimbell Foods*); *Great Southwest Life Ins. Co. v. Frazier*, 860 F.2d 896, 899-901 (9th Cir. 1988) (applying *Kimbell Foods* factors to deficiency action defenses).

340. *See, e.g., United States v. Shimer*, 367 U.S. 374, 377 (1961).

341. *See, e.g. Kimbell Foods*, 440 U.S. at 728.

342. *See supra* notes 107-08 and accompanying text.

343. *See supra* notes 111 & 118 and accompanying text.

344. 318 U.S. 363 (1943).

of the United States under identical instruments should not be "subject to the vagaries of the laws of the several states," creating a uniform rule of federal common law.<sup>345</sup> Uniformity has also been found desirable in federal mortgage programs which operate on a nationwide basis and adopt regulations and policies governing its operations. In *Shimer*,<sup>346</sup> the Supreme Court concluded that such regulations "were intended to create a uniform system"<sup>347</sup> and held that they displaced inconsistent state law.<sup>348</sup> In *United States v. Yazell*,<sup>349</sup> however, the Court distinguished both *Clearfield Trust* and *Shimer*, stating that the loan program "was not a nationwide act of the Federal Government, emanating in a single form from a single source," but a specifically negotiated transaction.<sup>350</sup>

The problem with the "need for national uniformity" as a basis for displacing state law is twofold. First, there is a great tendency to think that what may be desirable for the ease of operation of a program is the same as that which may be necessary for the success of the operation. Second, one's initial, often unspoken, premise tends to dictate the result. If one regards a federal national mortgage program as federal, in the sense of sovereignty and supremacy, and national, in its essential character, state law is likely to be displaced. If, however, one regards a federal national mortgage program as federal, in the weak sense of the identity of the sponsor, and national, in its geographical scope, state laws are likely to prevail.

Except for the specific instances of express congressional action,<sup>351</sup> all attempts at establishing uniformity among the states in real estate finance and foreclosure have failed.<sup>352</sup> Although there are significant differences among the federal mortgage loan programs in the extent of uniformity in transactions,<sup>353</sup> every federal loan program is jurisdiction-specific in numerous respects. Most obviously, each program uses the security instrument recognized in that particular jurisdiction, whether it is a mortgage, deed of trust, or security deed. With only one recent ex-

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345. *Id.* at 367.

346. 367 U.S. 374 (1961).

347. *Id.* at 377 (interpreting VA regulations).

348. *Id.* at 381.

349. 382 U.S. 341 (1966).

350. *Id.* at 348 (describing the SBA loan program in contrast to the issuance of United States commercial paper at stake in *Clearfield Trust*).

351. See *supra* notes 97-99, 124 and accompanying text.

352. See *supra* notes 67-79 and accompanying text.

353. In general, the loan programs of the SBA and FmHA tend to be more individually negotiated and tailored to specific transactions. FHA, VA, and HUD loans tend to be more uniform in character.

ception,<sup>354</sup> Congress has not established a federal mortgage foreclosure procedure. Each federal loan program presupposes reliance, in the event of default, on state foreclosure procedures. As the Ninth Circuit recently noted, "Because federal law does not provide a federal foreclosure procedure, but rather relies upon foreclosure procedures under various state statutes, it appears that Congress saw no need for 'a nationally uniform body of law.'" <sup>355</sup> Several different foreclosure methods are available in some states, while others permit only one approach.<sup>356</sup> When a federal agency elects a foreclosure procedure (such as a nonjudicial power of sale foreclosure) not available in other jurisdictions, a lack of national uniformity inevitably results.<sup>357</sup>

*Kimbell Foods* recognized that federal mortgage programs, such as the SBA and FmHA loan programs, may be national in scope yet not "need" (in the strong sense) to displace state law.<sup>358</sup> The Supreme Court held that state laws of lien priority should be incorporated as the applicable federal law. Federal mortgage programs which permit individual negotiation of the terms and conditions of the loan<sup>359</sup> reveal that national uniformity is merely a desirable, rather than an essential, characteristic of the program. Also suggesting the lack of an essential requirement for uniformity are judicial decisions which hold that state law is displaced but nonetheless grants a remedy to the debtor, under the equitable power of the court, substantially identical to what state law would have provided.<sup>360</sup>

This confusion between what is a necessary basis for uniformity and what is convenient or efficient is reflected in the widely disparate conclusions of the appellate courts in virtually every area of substantive law in real estate finance. There is no agreement whatsoever on whether the availability of a deficiency judgment,<sup>361</sup> a binding foreclosure without

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354. The Multifamily Housing Foreclosure Act, Pub. L. No. 97-35, tit. III, 95 Stat. 422 (codified at 12 U.S.C. § 3701 (1985)); see *supra* note 124 and accompanying text.

355. *Whitehead v. Derwinski*, 904 F.2d 1362, 1371 (9th Cir. 1990) (quoting *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728 (1979)).

356. See *supra* notes 44-45 and accompanying text.

357. Compare *Whitehead*, 904 F.2d at 1372 (holding that VA waived right to a deficiency by choosing power of sale foreclosure) with *Jones v. Turnage*, 699 F. Supp. 795, 799-800 (N.D. Cal. 1988) (holding that state law is preempted and deficiency is permitted because state anti-deficiency laws did not give VA an option), *aff'd sub nom. Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1309 (1991).

358. *Kimbell Foods*, 440 U.S. at 728.

359. See, e.g., *United States v. Yazell*, 382 U.S. 341, 345-46 (1966); *United States v. Stewart*, 523 F.2d 1070, 1072 (9th Cir. 1975).

360. See *supra* note 200 and accompanying text.

361. See *supra* notes 173-74 and accompanying text.

right of redemption,<sup>362</sup> or consistent notice requirements<sup>363</sup> constitute a sufficient justification for imposed national uniformity. The split in the appellate courts on the enforceability of a contractual waiver of state laws indicates that it may be one thing to displace a state debtor protection law, but yet another to override state policies underlying nonwaivable rights.<sup>364</sup>

If implied preemption of state real estate finance laws is to be based upon a need for national uniformity, the doctrine will result only in inconsistent and unpredictable results. The loose texture of such a standard and the considerable inconsistency in results among the jurisdictions undermine the very attempt to achieve uniformity.

### 5. Frustration of Federal Program Objectives

The possibility that enforcement of a state law could frustrate the specific objectives of a federal program is the second criterion common to both the implied preemption test<sup>365</sup> and federal common law doctrine.<sup>366</sup> It also appears as a functional restatement of the conflict preemption analysis,<sup>367</sup> or as a different expression of the goal of protecting federal financial interests.<sup>368</sup>

When congressional action involves market regulation of real estate finance, as opposed to direct market participation, the possibility that state laws could frustrate the objectives of the federal laws certainly exists, but potential frustration has not been problematic for two reasons. First, the federal laws frequently address the scope of the preemptive effect in express terms or delegate a determination of the issue.<sup>369</sup> Sec-

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362. See *supra* notes 192-98 and accompanying text.

363. See *supra* notes 211-20 and accompanying text.

364. See *supra* notes 204-07 and accompanying text. "[C]ontractual provisions do not have the force of federal law and do not foreclose the question of what the federal rule is." *United States v. Pastos*, 781 F.2d 747, 750 (9th Cir. 1986) (citing *United States v. Crain*, 589 F.2d 996, 999 n.2 (9th Cir. 1979)).

365. *Hines v. Davidowitz*, 312 U.S. 52, 67 (1941) (determining whether state law "stand[s] as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress" in preemption analysis).

366. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 728 (1979) (establishing as a criterion whether "state laws frustrate specific objectives of the federal programs").

367. *Chicago & N.W. Trans. Co. v. Kalo Brick & Tile Co.*, 450 U.S. 311, 317 (1981); *Perez v. Campbell*, 402 U.S. 637, 649-52 (1971); see *supra* notes 311-17 and accompanying text.

368. *Jones v. Turnage*, 699 F. Supp. 795, 802 (N.D. Cal. 1988) ("While the cost of the federal program is not a controlling factor in determining whether a uniform federal rule should apply it may be considered in determining whether federal objectives are frustrated by adoption of state law."), *aff'd sub nom. Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1309 (1991); see *supra* notes 327-30 and accompanying text.

369. See 12 U.S.C. § 2616 (1988) (setting forth scope of preemption of Real Estate Settlement Procedures Act, and delegating authority to Secretary to determine inconsistencies with

ond, it is much easier to recognize a conflict between the state and federal requirements when specific conduct is required or prohibited under the laws.<sup>370</sup>

When, however, the congressional action takes the form of direct market participation, as in the federal mortgage programs, the government's role as a secured creditor carries with it the additional objective of recovering the indebtedness. As previously noted,<sup>371</sup> the protection of federal financial interests alone is insufficient to justify implied preemption in this context.<sup>372</sup> In specific contexts, such as the applicability of local rent control laws to HUD programs<sup>373</sup> or the management of federally insured projects,<sup>374</sup> state or local laws may frustrate the program's objectives in ways other than simply impeding recovery of the debt.

A conceptual difficulty with heavy reliance on "federal program objectives" is that it effectively destroys any balance which a state may have achieved in the allocation of rights and duties among debtors and creditors. Federal agencies seek displacement of state mortgage laws when it is to the financial benefit of the federal agency as a creditor. The same agencies argue that debtors are left to "state law remedies available to protect mortgagors from unconscionable mortgages."<sup>375</sup> Yet if state

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state law); 15 U.S.C. § 1610(a) (1988) (setting forth scope of preemption of Truth in Lending Act, and delegating authority to the Board of Governors of the Federal Reserve System to determine inconsistencies).

370. See *Federal Home Loan Bank Bd. v. Empie*, 778 F.2d 1447, 1454 (10th Cir. 1985) (holding that state law prohibiting use of term "bank" by institutions not state-chartered directly conflicts with Home Owners' Loan Act); *Derenco, Inc. v. Benjamin Franklin Fed. Sav. & Loan Ass'n*, 281 Or. 533, 540, 577 P.2d 477, 483 (1978) (finding no actual conflict between FHLBB regulations and state laws concerning tax and insurance escrows), *cert. denied*, 439 U.S. 1051 (1978).

371. See *supra* notes 327-36 and accompanying text.

372. *United States v. Yazell*, 382 U.S. 341, 348-49 (1966) ("The United States, as sovereign, has certain preferences and priorities, but neither Congress nor this Court has ever asserted that they are absolute."). The Supreme Court distinguished the revenue production purpose of federal tax lien laws from federally insured mortgage programs, stating: "We believe that had Congress intended the private commercial sector, rather than taxpayers in general, to bear the risks of default entailed by these public welfare programs, it would have established a priority scheme displacing state law." *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 735 (1979).

373. See *City of Boston v. Harris*, 619 F.2d 87, 94 (1st Cir. 1980) ("Federal regulation of rents accord [sic] the government a voice in securing the economic viability of federally subsidized insured housing.").

374. See *United States v. Haddon Haciendas Co.*, 541 F.2d 777, 784 (9th Cir. 1976) ("[H]ere the federal interest cannot be characterized simply as the protection of the federal fisc. . . . The purpose is to deter the exploitive management of federally-insured projects and the resulting substandard and slum-like housing conditions that the NHA was designed to eliminate.").

375. *Rank v. Nimmo*, 677 F.2d 692, 697 (9th Cir.), *cert. denied*, 459 U.S. 907 (1982) (quoting *Roberts v. Cameron-Brown Co.*, 556 F.2d 356, 361 (5th Cir. 1977)). In a manner directly

law remedies are preempted as conflicting with federal program objectives, the government, as secured creditor, is indeed left with ample federal rights while the debtor is left with no protections. Consistent with this doctrinal bias, the same federal agencies strenuously argue that federal statutes, regulations, and policies do not create a private cause of action against the federal agency.<sup>376</sup>

## 6. Disruption of Commercial Relationships

Evaluating the potential impact on commercial relationships predicated on state law is the most significant distinction between the criteria used under implied preemption doctrine and federal common law. This analysis is the distinctive feature and major contribution of *Kimbell Foods*.<sup>377</sup> It recognizes that state laws may be a web of intimately and intricately related provisions. To preempt but one state law may tear the web, undermine stability, and thwart expectations of ongoing commercial relationships.<sup>378</sup>

*Kimbell Foods* held that federal law applied to contractual liens arising from federal loan programs, but state law should be incorporated as the governing law to determine the relative priority of such liens.<sup>379</sup> "Developing priority rules on a case-by-case basis, depending on the types of competing private liens involved, leaves creditors without the definite body of law they require in structuring sound business transactions."<sup>380</sup> This requirement that a court consider the impact on commercial relationships by displacement of state law has led the majority of courts since *Kimbell Foods* to conclude that state laws should be adopted as the applicable federal law in the area of lien priority.<sup>381</sup> Even in this particular context, however, the results have not been uniform.

In the context of state antideficiency laws,<sup>382</sup> state statutory rights of redemption,<sup>383</sup> state laws concerning contractual waivers,<sup>384</sup> and state

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contrary to *Shimer*, the Ninth Circuit concluded, "[I]t [is] most improbable that the VA Act was intended to authorize the federal courts to create, with respect to the area of VA-guaranteed home loans, a federal common law of mortgages to supplement or supplant the law provided by the states." *Id.* The only possible reconciliation of *Rank* with *Shimer* is a rationale that Congress intended to confer upon the VA all rights and to strip the debtors of all remedies.

376. *Id.*

377. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 729 (1979).

378. *Id.* at 739.

379. *Id.* at 718.

380. *Id.* at 739 n.42.

381. *See supra* note 232 and accompanying text.

382. *See supra* notes 171-74, 186-87 and accompanying text.

383. *See supra* notes 193-98 and accompanying text.

notice requirements,<sup>385</sup> courts have displayed, since the decision in *Kimbell Foods*, an increasing reluctance to displace state law. Nonetheless, in each substantive area courts have still reached opposite conclusions on identical issues.

There are several possible explanations for this lack of consistency. One is that a number of jurisdictions have chosen not to apply the *Clearfield Trust* and *Kimbell Foods* line of reasoning concerning federal common law, and instead have followed implied preemption analysis derived from *Shimer*.<sup>386</sup> The reasoning in *Shimer* not only failed to consider the impact of preemption on state commercial relationships, but ignored entirely the equally applicable *Clearfield Trust* line of decisions.<sup>387</sup> A second explanation is that courts have reached different conclusions about separate factors, such as the existence of a conflict,<sup>388</sup> or the significance of a separate state policy prohibiting contractual waivers.<sup>389</sup>

An additional explanation for the lack of consistency following *Kimbell Foods* is the illusive nature of the requirement to consider the impact of preemption on commercial relationships. For example, one court has limited the application of *Kimbell Foods* only to commercial relationships involving third parties and excluded its application to parties in a direct contractual relationship with the federal government.<sup>390</sup> Although plausible in concept, such a limitation finds little support in the reasoning of *Kimbell Foods*, which addressed "settled commercial practices" in general and the impact of the government's relationships directly with its debtors in particular.<sup>391</sup>

While the addition of this critical factor of the potential impact on existing state laws and commercial relationships has required courts to evaluate the adverse consequences of preemption on state policies, it has

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384. See *supra* notes 204-07 and accompanying text.

385. See *supra* notes 211-28 and accompanying text.

386. 367 U.S. 374, 379-81 (1961).

387. In three decisions, rendered after *Kimbell Foods*, it was held that state statutory rights of redemption were preempted, but no reference was made to *Kimbell Foods*. *United States v. Victory Highway Village, Inc.*, 662 F.2d 488, 498 (8th Cir. 1981); *United States v. Curry*, 561 F. Supp. 429, 430 (D. Kan. 1983); *John Hancock Mut. Life Ins. Co. v. Bruening Farms Corp.*, 537 F. Supp. 936, 938 (N.D. Iowa 1982).

388. Compare *United States v. Vallejo*, 660 F. Supp. 535, 538-39 (W.D. Wash. 1987) (applying state antideficiency law after finding no conflict with federal law) with *Jones v. Turnage*, 699 F. Supp. 795, 800 (N.D. Cal. 1988) (preempting state antideficiency law), *aff'd sub. nom. Jones v. Derwinski*, 914 F.2d 1496 (9th Cir. 1990), *cert. denied*, 111 S. Ct. 1309 (1991).

389. Compare *Curry*, 561 F. Supp. at 430 (enforcing a contractual waiver) with *United States v. Pastos*, 781 F.2d 747, 752 (9th Cir. 1986) (finding that a contractual waiver of state laws is not binding on federal court).

390. *United States v. Spears*, 859 F.2d 284, 290-91 (3d Cir. 1988).

391. *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 739, 739-40 & n.43 (1979).

not achieved uniformity in interpretation or application. As is true with all other relevant criteria for both forms of implied preemption analysis, there is no predicative significance to these factors, resulting in chaos among jurisdictions and within jurisdictions.

C. *Recent Approaches to Federal Common Law and Implied Preemption*

Recent scholarship on implied preemption and federal common law has largely ignored real estate finance. Whether this is due to the historic view that property law and real estate finance are matters peculiar to state law, or is simply a reflection of an academic preoccupation with constitutional allocations of power, there has been very little attention to this area since the economic collapse of the 1930s.<sup>392</sup> Leading constitutional treatises provide little, if any, analysis of *Shimer*, *Yazell*, *Kimbell Foods*, or *Clearfield Trust*, the dominant Supreme Court opinions which bear on the relationship between federal and state real estate finance laws.<sup>393</sup> Basic works on federal courts and federal jurisdiction provide slightly more analysis,<sup>394</sup> but even in these texts the discussion tends to focus on the issue of the authority of federal common law rather than its content. Conversely, with one exception,<sup>395</sup> scholarship in real estate finance has tended to be issue-specific in nature.<sup>396</sup> The task, therefore, is to develop a coherent doctrine of preemption and federal common law which acknowledges both historic diversity among states and the complexity of interwoven rights and duties of debtors and creditors. Three possible approaches to preemption and federal common law which have been discussed in recent years in analogous contexts—the “enclave” analysis, the “substantial effect” test, and the “congressional directive” approach—all fall short of providing the needed conceptual clarity.

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392. An otherwise comprehensive and insightful work which traces the growth of federal preemption over the past 60 years, JOSEPH F. ZIMMERMAN, *FEDERAL PREEMPTION: THE SILENT REVOLUTION* (1991), omits entirely any discussion of preemption in real estate finance.

393. For example, NOWAK & ROTUNDA, *supra* note 250, §§ 4.4-4.9, at 138-63, do not discuss any of these cases, while TRIIBE, *supra* note 250, does not discuss *Shimer*, *Yazell*, or *Kimbell Foods*, and cites *Clearfield Trust* only in passing. *Id.* § 3.23, at 159 n.24.

394. PAUL M. BATOR ET AL., *HART AND WECHSLER'S THE FEDERAL COURTS AND THE FEDERAL SYSTEM* 854-69 (3d ed. 1988); see, e.g., CHERMERINSKY, *supra* note 276, §§ 6.1-6.2.3, at 293-309.

395. NELSON & WHITMAN, *supra* note 26, § 11.6, at 811-25.

396. For example, controversy surrounding federal regulatory preemption of due-on-sale clauses prompted an extensive range of scholarship within a short period of time. See *id.* § 5.20, at 316 n.9.



## 1. Real Estate Finance as an "Enclave"

One recurring approach to the analysis of displacement of state law by federal common law or implied preemption is that there are certain "enclaves" which are particularly appropriate for uniform federal law. These have been identified as interstate and international disputes, admiralty, and the rights and obligations of the United States.<sup>397</sup> Conversely, there are areas in which states have been left largely autonomous, such as family law.<sup>398</sup> For present purposes, in real estate finance the question is not whether federal courts have the power to displace state law but whether, and when, the choice to exercise such power should be made.<sup>399</sup>

Real property laws have traditionally received strong deference as a subject matter peculiar to the domain of state sovereignty. Even the threshold opinion seeking to establish the broad sweep of federal common law, *Swift v. Tyson*,<sup>400</sup> recognized the application of state law "to rights and titles to things having a permanent locality, such as the rights and titles to real estate."<sup>401</sup> Over one hundred years later, in *Reconstruction Finance Corp. v. Beaver County*,<sup>402</sup> the Supreme Court again recognized that "[c]oncepts of real property are deeply rooted in state traditions, customs, habits and laws."<sup>403</sup> *Beaver County* involved the question whether state definitions of real property, for ad valorem taxation purposes, should be applicable to fixtures owned by a governmental agency. As long as such state laws were not discriminatory against the federal government, the Court held, "settled state rules as to what constitutes 'real property' " would control.<sup>404</sup>

The emergence over the past sixty years, however, of the secondary mortgage market, of uniform residential mortgage instruments, and of increased federal intervention in the substantive terms of mortgage lending renders the "enclave" approach no longer viable today; some aspect

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397. *Texas Indus., Inc. v. Radcliff Materials, Inc.*, 451 U.S. 630, 641 (1980); *Banco Nacional de Cuba v. Sabbatino*, 376 U.S. 398, 426-27 (1964).

398. See *United States v. Yazell*, 382 U.S. 341, 353 (1966) (noting the "peculiarly state province of family [and] family-property arrangements"); *De Sylva v. Ballentine*, 351 U.S. 570, 580 (1956) ("[T]here is no federal law of domestic relations . . .").

399. As Professor Field has observed, the issue is not so much whether there is a constitutional reservation to the states of authority in certain areas, but "whether there has been a federal decision—constitutional, congressional, or judicial—to assume responsibility for law-making in an area." Field, *supra* note 272, at 979-80.

400. 41 U.S. (16 Pet.) 1 (1842).

401. *Id.* at 18.

402. 328 U.S. 204 (1946).

403. *Id.* at 210.

404. *Id.* Significantly, the Court expressly rejected the argument for national uniformity by pointing out that Congress, in permitting local taxation of real property, "made it impossible to apply the law with uniform tax consequences in each state and locality." *Id.* at 209.

of federal law is inexorably involved in virtually every real estate financing transaction. Despite these developments, however, one must recognize that real estate finance is a highly complex system of rules which evolved differently in each jurisdiction and which underlie the expectations of all parties in each jurisdiction.<sup>405</sup> In the analogous context of determining the legal definition of "children," the Supreme Court concluded that when state law defines the relationships of parties, it is appropriate to incorporate state law definitions of the parties themselves.<sup>406</sup>

## 2. Substantial Effect on Program Operations

An approach which has emerged over the last twenty years suggests that, when "the issue's outcome bears some relationship to a federal program, no rule may be applied which would not be wholly in accord with that program."<sup>407</sup> Unfortunately, this suggestion is misleading in several respects and offers little clarity if taken at face value. If followed literally, no state law would apply to federal mortgage loan programs except those laws which furthered the ability of the federal government to collect on such loans. This suggestion, found in *United States v. Little Lake Misere Land Co.*,<sup>408</sup> must be read in the context of the underlying facts in which a state statute expressly attempted to abrogate, or unilaterally revise, the property rights of only the federal government and not private parties. In rejecting the application of state law, the Supreme Court simply applied the exception, recognized in *Beaver County*,<sup>409</sup> that deference to state real property laws is appropriate only so long as there is no affirmative discrimination against the federal government.<sup>410</sup>

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405. "The presumption that state law should be incorporated into federal common law is particularly strong in areas in which private parties have entered legal relationships with the expectation that their rights and obligations would be governed by state-law standards." *Kamen v. Kemper Fin. Serv., Inc.*, 111 S. Ct. 1711, 1717 (1991) (citing *Reconstruction Fin. Corp. v. Beaver County*, 328 U.S. 204, 210 (1946)).

406. *De Sylva v. Ballentine*, 351 U.S. 570, 580-81 (1956).

407. *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 604 (1972) (quoting with approval *Mishkin*, *supra* note 272, at 805-06); see *CHEMERINSKY*, *supra* note 276, § 6.2, at 303-04.

408. *Little Lake Misere Land Co.*, 412 U.S. at 604.

409. 328 U.S. at 210.

410. *Little Lake Misere Land Co.*, 412 U.S. at 596. Both Justices Stewart and Rehnquist rejected the appropriateness of an invocation of federal common law, preferring instead to reject the state statute as an unconstitutional retroactive impairment of contractual obligations, or as discriminatory against the federal government. Both Justices argued that federal common law should not apply.

It seems clear to me, as a matter of law, not a matter of "choice" or "borrowing," that when anyone, including the Federal Government, goes into a State and acquires real property, the nature and extent of the rights created are to be determined, in the absence of a specifically applicable statute, by the law of the State.

The original statement appears first in Professor Mishkin's leading essay on federal common law.<sup>411</sup> However, to read the suggestion as a result-oriented preference for whatever rule benefits the federal government's interest is to take the proposition out of context.<sup>412</sup> The basic thrust of Professor Mishkin's analysis calls into question a simplistic interpretation of the *Clearfield Trust* analysis which suggests that whenever the federal government is a party, federal uniform rules should be applied. Mishkin argues, quite forcefully, that such analysis "can have one of two possible results: either it provides only the illusion of uniformity, or it achieves its substance—for the Government—by the process of passing the burdens onto private shoulders."<sup>413</sup>

Indeed, the chaos which has resulted from the selective application of federal common law rules to federal mortgage programs has proved Mishkin's thesis rather than undermined it. As he correctly anticipated, incorporation of well-developed state laws provides greater predictability in real estate finance than do isolated federal rules which may result in loss of predictability and uniformity.<sup>414</sup>

### 3. Congressional Directive

A superficially attractive approach to the determination of applicable rules in real estate finance is to require a congressional directive.<sup>415</sup> Such an approach could take several forms. If "congressional directive" is taken in the strong sense to mean an express declaration of the rights and duties of the parties, either in the form of express preemption or express incorporation of state law, clarity and uniformity are indeed

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*Id.* at 605 (Stewart, J., concurring).

[T]he interest of the Federal Government in having real property acquisitions that it makes in the States pursuant to a particular federal program governed by a similarly uniform rule is too tenuous to invoke the *Clearfield Trust* principle, especially in light of the consistent statements by this Court that state law governs real property transactions.

*Id.* at 607 (Rehnquist, J., concurring).

411. Mishkin, *supra* note 272, at 805-06; *see supra* note 407.

412. Professor Mishkin's citation, at the conclusion of the suggestion, is to *Beaver County's* discrimination exception to deference to state law. Mishkin, *supra* note 272, at 806 n.23.

413. *Id.* at 832.

414. *Id.*

415. Congressional directive, in this context, refers not so much to the underlying question of the power or authority to create and apply federal common law, but rather to the content of the rule itself. I concur with Professor Field's analysis that the traditional two-prong analysis (of power and of content) is not helpful, and that an expansive or "permissive" reading of federal common law authority is more accurate. *See* Field, *supra* note 272, at 885-88. Her analysis of the "directive" approach pertained to the question of authority to create federal common law. *Id.* at 934-42. In contrast, this section evaluates the "directive" approach solely with respect to the question of the content of the federal rule.

achieved.<sup>416</sup> Unfortunately, however, in real estate finance an affirmative decision to preempt all state laws would require enactment of a comprehensive code far exceeding in scope and complexity any recent federal enactments in this area. Conversely, an express decision not to preempt any state real estate finance laws ignores the intricacies of the secondary mortgage market and existing federal legislation.

Alternatively, one could argue that displacement of state law through implied preemption and federal common law should occur only when Congress expressly directs the federal judiciary to develop the appropriate federal rules. An express congressional directive for the courts to determine the rules would not necessarily identify the relevant criteria for formulating the rules, and the absence of such criteria would result in inconsistency and unpredictability, unless the Supreme Court resolved all questions.<sup>417</sup> If "congressional directive" is construed in the weak sense of including implicit directives, whether derived from legislative history, the scope of legislation, or the existence of regulations, the present lack of clarity and predictability will continue. Although their focus has been primarily on the question of the authority of federal courts to decide issues as a matter of federal common law, leading commentators have accepted this weak sense of directive as sufficient guidance for determining the content of federal law.<sup>418</sup> Judge Friendly has argued that "federal courts must follow state decisions on matters of substantive law appropriately cognizable by the states whereas state courts must follow federal decisions on subjects within national legislative power where Congress has so directed."<sup>419</sup> At the same time, however, he acknowledged that

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416. Unless, of course, the congressional act itself permits states to override or otherwise reject application of the congressional standard, which undercuts the very attempt at uniformity. Such has been the case, to varying degrees, with many instances of express congressional preemption in the area of real estate finance. *See supra* notes 108, 111, 118 and accompanying text.

417. As noted by Judge Friendly almost 30 years ago, decisions on such an extensive range of real estate issues by the United States Supreme Court are hardly likely under our current judicial system. Friendly, *supra* note 272, at 406.

418. Professor Thomas Merrill offers an analytic framework by which to identify the critical questions. He suggests determining first, whether the issue involves a substantive rule of decision; second, whether the applicable federal rule can be determined from conventional textual interpretation; third, whether a federal rule is necessary to protect a federal policy; and fourth, whether there is evidence of delegation to the federal courts of rule-making authority. Merrill, *supra* note 277, at 46-47. Insofar as his thesis concerns the legitimacy of federal common law power, the framework is useful. Insofar, however, as the issue involves the content of the federal common law rule, the analysis suffers the same difficulties as others, acknowledging neither the significance of established and complex state law systems, nor the uncertainty which results from a highly discretionary determination of the content of the federal rule.

419. Friendly, *supra* note 272, at 422.

determining when Congress has directed a federal uniform rule is no easy task:

The issue that must be determined in each instance is what heed Congress intended to have paid to state law in an area where no heed need constitutionally be paid—more realistically, in Gray's famous phrase, "to guess what it would have intended on a point not present to its mind, if the point had been present."<sup>420</sup>

This weak sense of congressional directive thus offers little, if any, foundation or guidelines for determining when displacement of state laws should occur.

In a similar manner Professor Field has argued in favor of a broad conception of federal common law authority, but has given little attention to the appropriate content of federal law.<sup>421</sup> Although she states that there is "a presumption in favor of using state law,"<sup>422</sup> her analysis mirrors the ambiguity of a flexible multifactored analysis:<sup>423</sup> "[F]ederal rules will be made when there is a need for national uniformity that outweighs the need for uniformity within a state; or when national interests require. But state law should apply whenever that result is not inconsistent with federal purposes."<sup>424</sup> If federal common law power is as extensive as Professor Field argues and displacement of state law occurs whenever there is a need for it, the only thing certain and predictable is the complete lack of certainty and predictability in judicial determination of need, the precise result evident today in real estate finance.

## VI. A REVISED ANALYSIS

The addition of new, even more specific, criteria for determining whether federal law does or should displace state laws in real estate finance will not clarify the chaos. Such criteria would likely only restate the factors suggested thus far, would further increase judicial flexibility, and would further decrease consistency and predictability. A balancing test is simply not viable. Conversely, the interstitial law-making functions of federal common law, and statutory interpretation functions of implied preemption generally, are too vital to be rejected in their entirety.

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420. *Id.* at 410 (quoting JOHN CHIPMAN GRAY, *THE NATURE AND SOURCES OF THE LAW* 173 (1963)).

421. *See* Field, *supra* note 272.

422. *Id.* at 950.

423. Professor Field identifies what she terms a "well-developed list of factors" including: (1) the need for national uniformity, (2) the United States as a party, (3) developed state law and intrastate uniformity, and (4) feasibility. *Id.* at 953-60.

424. *Id.* at 962.

The clearest solution would entail an express congressional directive either to incorporate state laws in all federal mortgage programs, or the enactment of a comprehensive body of federal law governing all aspects of debtor and creditor relationships in secured real estate transactions. The problem with the former approach is that it fails to account for the distinctive roles of the federal government as market regulator and as market participant. The problem with the latter approach is that the scope and depth of such legislation would require action well beyond what Congress traditionally has enacted, and such action is not likely to occur in the foreseeable future.

A coherent approach must recognize both the complex nature of state real estate finance laws and the dual role of increased federal intervention in real estate finance. The history of real estate finance is one of continuing adjustments to the rights of debtors and creditors, with each state developing a unique, complex allocation of such rights, resistant to all attempts at interjurisdictional uniformity. Congressional action over the past sixty years has taken two significantly different forms, market regulation and market participation, each of which requires distinct explanations and justifications for possible displacement of state laws. Because virtually every mortgage loan today is "federally related" in some sense,<sup>425</sup> the traditional criteria which point toward federal interests are unworkable.

What is necessary to provide clarity and coherence in this area is an acknowledgment that fundamental differences exist between congressional action regulating the real estate finance market and federal participation in the market. In *Hughes v. Alexandria Scrap Corp.*,<sup>426</sup> the Supreme Court recognized such a difference in deciding whether a state plan to purchase scrap automobile products violated the Commerce Clause. In the absence of congressional action, the Court held, the Commerce Clause does not prohibit a state "from participating in the market and exercising the right to favor its own citizens over others."<sup>427</sup> Subsequently the Supreme Court reaffirmed the proposition that the distinction "between States as market participants and States as market regulators makes good sense and sound law."<sup>428</sup> While this distinction developed in the context of Commerce Clause limitations on state programs and may well be "problematic" in that context,<sup>429</sup> it offers a viable method of constraining the application of federal common law to federal

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425. See *supra* notes 105-06 and accompanying text.

426. 426 U.S. 794 (1976).

427. *Id.* at 810.

428. *Reeves, Inc. v. Stake*, 447 U.S. 429, 436 (1979).

429. See *TRIBE*, *supra* note 250, § 6-11, at 432.

mortgage programs while preserving the necessity for implied preemption in federal mortgage regulation.

When the federal government is acting as a market participant, either as a direct mortgagee or as an insurer or guarantor of mortgage loans, there should be no displacement of state laws except in the case of a direct conflict with express congressional requirements. When the government is acting as a market regulator in real estate finance, state laws may be displaced through an implied preemption analysis, but the relevant criteria should be limited to the factors identified in *Kimbell Foods*. This new approach does not alter the constitutional authority for federal displacement of state law; it does significantly change, however, the discretionary exercise of this authority.

#### A. *Federal Common Law and Market Participation*

All federal mortgage programs share certain basic characteristics, whether the federal agency is a direct mortgagee or an insurer or guarantor of loans. First, the federal government is acting in the capacity of a secured creditor, functionally identical to a private creditor. The only differences may be the purposes of the loan (FmHA loans), the restricted class of debtors (VA loans), or restrictions pertaining to use of the security (HUD low-income housing loans). Second, the underlying transaction relies largely on existing state law to identify, secure, and protect the security. This includes reliance on state recording statutes, title examination procedures, and foreclosure requirements. Third, as a secured creditor the federal government's interest is, at least in part, to maximize the protection of its security and its ability to recover the indebtedness.

*When the federal government is acting simply as a market participant in real estate finance, and Congress has not expressly declared otherwise, state law should apply to the transaction.* The federal interest in protecting the security and recovering the indebtedness is federal only because it identifies the holder of the interest; it is not federal because of any attribute of sovereignty.<sup>430</sup> There is no inherent or obvious reason to displace state law and create judicially a federal rule which prefers the position of the government as creditor. To the contrary, when acting in the same capacity as a private creditor, the federal government "should fare no better, and no worse, than a private lender."<sup>431</sup>

Only two exceptions should exist to this rule that state law applies in

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430. See *United States v. Kimbell Foods, Inc.*, 440 U.S. 715, 734 (1979) ("[W]hen the United States operates as a moneylending institution under carefully circumscribed programs, its interest in recouping the limited sums advanced is of a different order.").

431. *United States v. S.K.A. Assocs., Inc.*, 600 F.2d 513, 516 (5th Cir. 1979).

instances of federal market participation. The first arises when a direct conflict between state law and the requirements of federal law exists. Conflict here, however, refers only to the rare situation where it is functionally impossible to comply with both the federal act and the state law. A purported conflict with federal policy manuals or the purposes of the federal program, for example, will not suffice to displace state law. A conflict of state law requirements with federal regulations will suffice if and only if the regulations flow from the congressional act as a matter of necessity<sup>432</sup> and not as a matter of administrative discretion.<sup>433</sup> The second exception occurs when applicable state law discriminates against the federal government as a market participant. This exception simply affirms the proposition that state laws, as applied to the federal government, must be nondiscriminatory in nature.<sup>434</sup>

This rule for the selection of applicable law, requiring selection of state law in instances of federal participation, is certainly subject to the authority of Congress to speak clearly and unequivocally on a precise issue.<sup>435</sup> Because the federal government's interest, in instances of market participation, is synonymous with a creditor's interest, judicial decisions based upon federal common law tend to select a rule which favors the creditor. This ignores the complex state allocations of rights and duties between creditors and debtors. Such a reallocation of rights, as a matter of constitutional theory, is far more appropriately the responsibility of the legislative rather than the judicial branch of government.<sup>436</sup> In

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432. This "necessity" approach differs from the one considered, and rejected, by Professor Field, for she evaluated it for purposes of ascertaining judicial power, not determining judicial discretion in the content of the applicable law. Field, *supra* note 272, at 945-46.

433. This position is not inconsistent with the decision of the Supreme Court in *Fidelity Fed. Sav. & Loan Ass'n v. de la Cuesta*, 458 U.S. 141 (1982). See *supra* notes 112-13 and accompanying text. In *de la Cuesta* the Supreme Court applied an implied preemption analysis to a context involving market regulation rather than market participation—federal regulation of financial institutions. 458 U.S. at 153, 159, 167. While federal banking insurance regulations may lie on a gradual plane which evolves from market regulation into market participation, see *infra* notes 448-51 and accompanying text, there is no requirement that the preemptive authority of federal regulations apply in instances of direct federal market participation.

434. *United States v. Little Lake Misere Land Co.*, 412 U.S. 580, 608 (1972) (Rehnquist, J., concurring).

435. An example of such an affirmative statement by Congress, in the area of market participation, is the establishment of uniform foreclosure procedures applicable to HUD multi-family loan foreclosures. See *supra* notes 124-26 and accompanying text.

436. The Court has said:

It must be recognized that the factors supporting a federal rule of uniformity in this field, and those militating against the dislocation of long-standing state procedures, are full of competing considerations. They involve many imponderables which this Court is ill-equipped to assess, on which Congress has not yet spoken, and which we think are best left to that body to deal with in light of their full illumination.



the analogous context of cases addressing the breadth of the Commerce Clause, the Supreme Court has imposed a requirement of a "clear statement" on Congress in order to achieve a stronger sense of such legislative accountability.<sup>437</sup> *Clearfield Trust*, which has been the basis for federal common-law displacement of state laws when the government is a party, largely ignored this proposition of legislative accountability.<sup>438</sup>

### B. *Implied Preemption and Market Regulation*

When congressional action takes the form not of direct market participation but of market regulation, the issues change significantly. The tendency toward decisions favoring the self-interest of the government as a creditor is absent, and the action can be content-neutral, at least insofar as no government agency is serving in a role equally played by private parties. In this context the goal is not so much to constrain judicial discretion to preempt state laws by implication as it is to clarify the relevant criteria for such preemption.

*Implied preemption by governmental market regulation should occur only when national uniformity is an essential characteristic of the congressional action and when creation of a separate federal rule will not have a significantly adverse impact on existing state laws and the relationships predicated on such laws.*

The first step in this two-part analysis consolidates the existing tests employed to determine the question of implied preemption. It assumes the existence of a conflict, narrowly construed, and follows the pattern of the federal real estate finance disclosure laws in recognizing that states are free to impose additional requirements, with federal action establishing only minimum requirements. It rejects the "occupation of the field" test because it is clear, at least in the context of real estate finance, that Congress has not yet begun to exhaust the necessary regulation of this field. Because the context is market regulation rather than market participation, the two tests of "dominance of federal interest" and "frustration of federal program objectives" do not stand as separate tests, but instead are subsumed into the test of the "need for national uniformity."

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United States v. Brosnan, 363 U.S. 237, 251-52 (1960).

437. United States v. Bass, 404 U.S. 336, 349 (1971). "Congress must be prevented from resorting to ambiguity as a cloak for its failure to accommodate the competing interests bearing on the federal-state balance." *TRIBE*, *supra* note 250, § 5-8, at 317.

438. The Court thus ignored the need to ground federal policy in the specific intentions of Congress. If the policy is not so grounded, then the states cannot be deemed to have "acquiesced" in it, the elected representatives in Congress and the President will not have passed upon it, and it cannot be said to be "required" by the Constitution or laws of the United States.

Merrill, *supra* note 277, at 38.

In recent years the rationale of the need for national uniformity has arisen primarily in market participation cases involving federal loan programs, leading to inconsistent results. Under this revised analysis, it would not apply to market participation, but only to market regulation. Whether there is in fact a need for national uniformity, in the strong sense of an essential requirement, is more often than not evident from the terms of the underlying federal legislation. When Congress, for example, expressly permits states to override, or disclaim, substantive market regulation, there is clear indication that while national uniformity may be desirable, it is not essential.

The second step in this revised implied preemption analysis requires an examination of the impact of creating a separate federal rule on existing state laws. Derived from *Kimbell Foods*,<sup>439</sup> this inquiry injects into implied preemption analysis a factor which has largely been missing. Every issue in real estate finance, including deficiencies, rights of redemption, contractual waivers, notice requirements, receiverships, foreclosure procedures, and lien priorities, is part of an intricate and complex system of rights and remedies among creditors and debtors. A federal rule should not displace or revise a single issue without consideration of the consequent impact on this delicate balance. When the authority for displacement of state law is by implication only, the reluctance to intervene should be strong. This cautionary approach affirms not only the authority of Congress to declare subsequently a national rule by express action, but also the responsibility of the legislative branch to decide the scope of federal and state decision-making in real estate finance.

### C. *When Regulation Becomes Participation*

The conceptual division of market regulation and market participation inevitably breaks down in certain contexts, especially when the federal role combines the two functions. A primary example is when federal banking regulations are transformed into direct federal participation by virtue of conservatorship or receivership actions for failed financial institutions. In this context the Supreme Court has determined, in *D'Oench, Duhme & Co. v. FDIC*,<sup>440</sup> that federal common law displaces state laws. Decided shortly before *Clearfield Trust*, *D'Oench Duhme* involved a promissory note taken by a federally insured bank in which the bank and the maker of the note agreed that the note would never be called and was solely for the purpose of permitting the bank to carry it as an asset in lieu of other defaulted loans. At issue was whether state or federal law ap-

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439. 440 U.S. 715 (1979); see *supra* notes 377-81 and accompanying text.

440. 315 U.S. 447 (1942).

plied to the cause of action, and if federal law applied, whether the maker was barred from raising certain state law defenses. The Court held that federal law, as derived from the federal banking laws, was applicable, and that in light of the "federal policy to protect [the FDIC], and the public funds which it administers,"<sup>441</sup> the maker of the note is estopped to raise its defenses against the government.<sup>442</sup> This application of federal common law<sup>443</sup> was codified, in part, by the enactment in 1950 of the Federal Deposit Insurance Act.<sup>444</sup> Although there may be a question whether the codification supersedes the common-law decision,<sup>445</sup> there is no question that all of the defenses available to the FDIC are now available to the RTC.<sup>446</sup> The RTC is thus in a position, in resolving failed institutions, to override state laws and proceed against the makers of notes notwithstanding defenses of failure of consideration, fraud, and oral agreements to the contrary.<sup>447</sup>

Insofar as questions remain about applying state law to the activities of the Office of Thrift Supervision, the RTC, or parallel entities, the differential tests for market regulation and market participation do not fit neatly. The reason is that in acting as a regulator, insurer, and receiver of financial institutions the federal government's function is radically different from roles played by private market participants. While it is one of the largest single holders of residential mortgages in the country,<sup>448</sup> the RTC holds this status not primarily as an ordinary market participant, but as a consequence of the now sovereign functions of resolving failed thrift institutions.<sup>449</sup> It is appropriate, therefore, in such a blended

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441. *Id.* at 457.

442. *Id.* at 459.

443. *See id.* at 465-75 (Jackson, J., concurring).

444. Pub. L. No. 81-797, 64 Stat. 873 (1950) (codified as amended at 12 U.S.C. §§ 1811-32 (1988 & Supp. II 1990)). The present statutory parallel is 12 U.S.C. § 1823(e) (1988 & Supp. II 1990).

445. *See* FSLIC v. Two Rivers Assocs., 880 F.2d 1267, 1276 (11th Cir. 1989) (*D'Oench Duhme* is applicable to FSLIC in both corporate and receivership capacities); FDIC v. McClanahan, 795 F.2d 512, 514 n.1 (5th Cir. 1986) (12 U.S.C. § 1823(e) does not preclude application of the *D'Oench Duhme* doctrine); Marsha Hymanson, *Borrower Beware: D'Oench, Duhme and Section 1823 Overprotect the Insurer When Banks Fail*, 62 S. CAL. L. REV. 253, 269-74 (1988). As Professor Tribe has observed, "[E]ven when Congress declares its preemptive intent in express language, deciding exactly what it meant to preempt often resembles an exercise in implied preemption analysis." TRIBE, *supra* note 250, § 6-26, at 481 n.14.

446. 12 U.S.C. § 1441a(b)(4) (Supp. II 1990); see *Resolution Trust Corp. v. Dismuke*, 746 F. Supp. 104, 105 (N.D. Ga. 1990) (applying *D'Oench Duhme* and § 1823(e) to the RTC).

447. *Bauman v. Savers Fed. Sav. & Loan Ass'n*, 934 F.2d 1506, 1514-17 (11th Cir. 1991); Wayne M. Josel, *The Resolution Trust Corporation: Waste Management and the S&L Crisis*, 59 FORDHAM L. REV. S339, S355-56 (1991).

448. *See supra* notes 158-63 and accompanying text.

449. Congressional action created the "new corporation, to be known as the Resolution

role of regulation and participation, to permit displacement of state law based upon the need to protect federal interests.<sup>450</sup> Any displacement still must be clearly grounded doctrinally either upon implied preemption as a form of statutory construction or upon federal displacement as a matter of federal common law.<sup>451</sup>

#### *D. Parallels with State Action Analysis*

When the federal government is a direct market participant in mortgage programs, there is the possibility of doctrinal inconsistency among implied preemption, federal common law, and constitutional due process requirements. An expansive interpretation of federal common law in the context of federal mortgage programs arguably requires an expansive application of the governmental action doctrine (and consequent due process requirements) in two ways. First, while the extensive nature of federal regulations and policies may support an argument in favor of preemption, it also supports the proposition that the governmental functions are subject to due process requirements. Second, the judicial displacement of state law with a federal common law rule may itself constitute governmental action rendering the transaction subject to due process requirements.

For example, the majority of jurisdictions recognize the validity of nonjudicial power of sale foreclosures. In such proceedings subordinate mortgagees and creditors are frequently entitled only to notice by publication. Where there is no other form of government involvement, the Supreme Court has held that contractually authorized power of sale foreclosures are not subject to constitutional due process notice requirements.<sup>452</sup> When there is direct governmental involvement as the party conducting the foreclosure, constitutional due process requirements are applicable and any interested party whose identity is reasonably ascertainable is entitled to "[n]otice by mail or other means as certain to ensure actual notice."<sup>453</sup>

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Trust Corporation, to deal with failed thrift institutions." H. Conf. Rep. No. 222, 101th Cong., 1st Sess., reprinted in 1989 U.S.C.C.A.N. 432.

450. See, e.g., *Resolution Trust Corp. v. Elman*, 949 F.2d 624, 629-30 (2d Cir. 1991) (interpreting FIRREA and the public's "very strong interest in efficient resolution" of issues to support a trial court issuance of an affirmative injunction).

451. See *Coit Independence Joint Venture v. FSLIC*, 489 U.S. 561, 589 (1989) (Scalia, J., concurring) (quoting *Rice v. Santa Fe Elevator Corp.*, 331 U.S. 218, 230 (1947)) (requiring evidence of the clear and manifest purpose of Congress to preempt state law); *Gaff v. FDIC*, 919 F.2d 384, 387 (6th Cir. 1990) (holding that federal common law governs FDIC in liquidation of a bank).

452. *Scott v. Paisley*, 271 U.S. 632, 636 (1926).

453. *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 800 (1983).

If all federal mortgage programs were identical in nature and were held to constitute governmental action for purposes of due process requirements, this doctrinal inconsistency would not occur. Instead, however, the nature of federal mortgage programs includes direct mortgage lending with little or no private lending involvement, indirect mortgage lending by virtue of loan insurance and guaranties, and federally related secondary mortgage market entities such as FNMA, GNMA, and FHLMC.<sup>454</sup> Generally, the presence of a governmental entity as a direct mortgage lender, such as FmHA,<sup>455</sup> has been a sufficient basis for application of constitutional due process requirements. When the governmental role has been indirect, however, as in the case of VA-guaranteed mortgages,<sup>456</sup> HUD-subsidized mortgages,<sup>457</sup> and mortgage foreclosures by secondary mortgage market entities,<sup>458</sup> due process requirements have been found to be inapplicable on the basis of insufficient governmental involvement.

In determining whether there is sufficient governmental action to require due process, the "nexus" between the governmental entity and the lender actually conducting the foreclosure,<sup>459</sup> and the nature of the activities undertaken by the governmental entity are considered.<sup>460</sup> Precisely because the application of federal common law, in the context of federal mortgage programs, is premised upon the significance of the government's role as a direct participant, it is difficult to see how there could be an insufficient nexus for state action, and yet a sufficient basis for federal common law preemption of state law. This is precisely what has occurred, however. Even though courts have concluded that the VA guaranty program displaces state laws because the "regulatory scheme [for VA related foreclosures], complete as it is in every detail, was in-

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454. See NELSON & WHITMAN, *supra* note 26, § 7.28, at 580-84.

455. *Johnson v. United States Dep't of Agric.*, 734 F.2d 774, 782 (11th Cir. 1984); *Ricker v. United States*, 417 F. Supp. 133, 138 (D. Me.), *order supplemented*, 434 F. Supp. 1251 (D. Me. 1976).

456. *Rank v. Nimmo*, 677 F.2d 692, 702 (9th Cir. 1982), *cert. denied*, 459 U.S. 907 (1982).

457. *Roberts v. Cameron-Brown Co.*, 556 F.2d 356, 358 (5th Cir. 1977).

458. *Warren v. GNMA*, 611 F.2d 1229, 1234 (8th Cir. 1980), *cert. denied*, 449 U.S. 847 (1980); *Northrip v. FNMA*, 527 F.2d 23, 30 (6th Cir. 1975); *FNMA v. Scott*, 548 S.W.2d 545, 549 (Mo. 1977).

459. *Northrip*, 527 F.2d at 30. Compare *Miller v. Hartwood Apts., Ltd.*, 689 F.2d 1239, 1243 (5th Cir. 1982) (holding that HUD § 8 tenants have no cause of action under 42 U.S.C. § 1983 because there was no governmental action, since apartments were privately operated) with *Jeffries v. Georgia Residential Fin. Auth.*, 678 F.2d 919, 923 (11th Cir.) (holding that participation of state finance authority was sufficient basis for state action; thus, due process requirements applied to eviction procedures), *cert. denied*, 459 U.S. 971 (1982).

460. *Warren v. Government Nat'l Mortgage Ass'n*, 611 F.2d 1229, 1232 (8th Cir.), *cert. denied*, 449 U.S. 847 (1980).

tended to provide the whole and exclusive source of protection of the interests of the Veterans Administration,"<sup>461</sup> and "federal common law requires that [the VA indemnity right] exist,"<sup>462</sup> one court has concluded "that foreclosure by a private lender of a mortgage in a federal [VA] mortgage guaranty program does not involve federal action sufficient to invoke the due process clause of the Fifth Amendment."<sup>463</sup> Perhaps recognizing implicitly this doctrinal inconsistency, a recent decision acknowledged that "government participation in this type of [non-judicial] foreclosure procedure raises serious due process questions."<sup>464</sup>

The more constrained application of implied preemption and federal common law in real estate finance proposed in this Article would reduce this potential for doctrinal inconsistency. A broad and permissive approach to displacement of state law on the basis of federal participation and federal interests is inconsistent with a narrow interpretation of the requisite federal involvement for governmental action. So long as there remains a judicial tendency to find insufficient governmental action in indirect federal mortgage programs to invoke due process, it is difficult to justify displacing state laws on the basis of the same governmental interests.<sup>465</sup> How a governmental agency can receive implicitly the mantle of authority to displace state laws in the name of the Commerce Clause and the Supremacy Clause, while simultaneously claiming the prerogative of

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461. *United States v. Shimer*, 367 U.S. 374, 381 (1961).

462. *Jones v. Turnage*, 699 F. Supp. 795, 802 (N.D. Cal. 1988), *aff'd sub nom. Jones v. Derwinski*, 914 F.2d 1496 (1990), *cert. denied*, 111 S. Ct. 1309 (1991).

463. *Rank v. Nimmo*, 677 F.2d 692, 702 (9th Cir.), *cert. denied*, 459 U.S. 907 (1982).

464. *Vail v. Derwinski*, 946 F.2d 589, 593 (8th Cir. 1991); *see also* *Mortgage Assocs. v. Cleland*, 651 F.2d 476, 479 (7th Cir. 1981) ("Failure to give the [debtors] notice raises serious due process questions in any attempt to saddle them with an increased deficiency."); *United States v. Murdock*, 627 F. Supp. 272, 278 (N.D. Ind. 1985) (holding due process does apply to VA authorized power of sale foreclosure); *United States v. Whitney*, 602 F. Supp. 722, 734 (W.D.N.Y. 1985) ("[T]he V.A.'s right to indemnity is defeated in this situation, because of the Government's intimate complicity in the violation of defendant's statutory and constitutional rights.").

465. This proposition is not intended to suggest agreement in any form with the existing judicial analysis concerning the presence or absence of sufficient governmental action to bring due process requirements to bear on federally related mortgage programs. More simply it is designed to point out the doctrinal inconsistencies. It is entirely possible, and doctrinally consistent, for a court to conclude the absence of both governmental action (for due process requirements) and the lack of need to displace state law. Conversely, a court could find, in a doctrinally consistent manner, the presence of both sufficient governmental action (for due process requirements) and a sufficient justification for displacement of state law. It would also be conceptually consistent for a court to find that sufficient governmental action (for due process requirements) exists, but that there is an insufficient basis for displacement of state law, so long as the state law in question is not itself constitutionally defective. What is inconsistent is a finding of no sufficient governmental action (for due process requirements) yet a finding that state law is displaced by federal common law.

relying upon constitutionally defective foreclosure procedures, is curious at best.

## VII. CONCLUSION

The rapidly expanding federal governmental involvement in real estate finance requires doctrinal clarity to address the possible displacement of state laws by federal laws. Each state has developed, over a period of two centuries, a complex matrix of the rights and duties of debtors and creditors in real estate finance transactions. No two states are identical in their current real estate laws, and the lack of uniformity poses obstacles for real estate finance. The fact of federal intervention in real estate finance, however, cannot in and of itself be an adequate basis for displacing state laws.

Express congressional preemption of state real estate finance laws reflects the ability of Congress to override state law when it deems it necessary and appropriate. It also reflects the tendency of Congress to allow states the authority to override or supplement congressional requirements. This congressional acknowledgment of state autonomy in real estate finance itself demonstrates that uniformity among jurisdictions may be desirable, but is not mandatory.

In their present forms, the implied preemption and federal common law doctrines do not provide a solid and coherent basis to justify displacing state real estate finance laws. When using multifactored tests which rely heavily on questions of intent and policy, courts reach inconsistent, if not contradictory, conclusions. The omnipresence of federal governmental intervention does not embody an omniscient federal common law.

The need for clarity and predictability in real estate finance and the complexity of state real estate finance laws require a significant revision in the application of implied preemption and federal common law. This Article proposes that when the federal government is acting simply as a market participant in real estate finance, and Congress has not expressly declared otherwise, state law should apply to the transaction. Implied preemption by governmental market regulation should occur only when national uniformity is an essential characteristic of the congressional action and when creation of a separate federal rule will not have a significant adverse impact on existing state laws and relationships predicated on such laws. This new approach will recognize the complex and delicate balances in each state of creditor and debtor rights in real estate finance, will affirm the authority of each state to regulate such balance in the absence of express congressional declaration to the contrary, and will provide a clearer and more predictable application of the laws governing real estate finance.