



10-1981

Fidelity Federal Sav. & Loan Assn. v. de la Cuesta

Lewis F. Powell Jr.

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I am checking to see whether I am out of this case

Out - letter to M. Sleas 11/21/82

Note

Case is dead wrong & is of enormous importance to all lending institutions

Most notes, whether taken by bank, S & Ls or other lenders, provide that a sale of real property accelerates the due date of principal & interest - unless lender consents (this is the "due on sale" clause).

and to public interest rates will go up if this case is appealed.

Wow!

Calif S/Ct held this an invalid restraint on alienation of property.

Preliminary Memo

As the Fed Home Loan Bk Board authorizes S & L to include the clause in notes, the

January 22, 1982 Conference List 1, Sheet 1

No. 81-750

SG your appellant in argument

Fed. preemption

Timely

FIDELITY
FEDERAL
SAVINGS
& LOAN
ASS'N,
et al.

v.

de la CUESTA,
et al.

Appeal from
Cal. Ct. App.
4th App. Dist.
(Kaufman,
McDaniel
& Morris)
State/Civil

1. SUMMARY: Whether regulations issued by the Federal Home Loan Bank Board (the "Board"), pursuant to the Homeowner's Loan Act of 1933, 12 U.S.C. §1461, et seq. (the "Act"), preempt state restrictions on enforcement of "due on sale" clauses in mortgages written by federal savings and loan associations.¹

Note. This is an important Calif. real estate issue. No adequate & independent state ground.

Footnote(s) 1 will appear on following pages.

2. FACTS: In 1976, the Board adopted the following regulation:

"A federal association continues to have the power to include, as a matter of contract between it and the borrower, a provision in its loan instruments whereby the association may, at its option, declare immediately due and payable all of the sums secured by the association's security instrument if all or any part of the real property securing the loan is sold or transferred by the borrower without the association's prior written consent." 41 Fed. Reg. 18288 (1976), codified at 12 C.F.R. 545.8-3(f).

This is a customary provision in bank & well as S&L loans

Appts are a Federal Savings & Loan Association chartered by the Board, pursuant to § 5(a) of the Act, and its wholly-owned subsidiary. Appees are each purchasers of real property which by Deed of Trust secures a loan made earlier by appt to the transferors of that property. Each of the transferors sold their property without appts' prior written consent, even though each Deed of Trust includes a clause which provides that if the real property is transferred without that consent, Fidelity Federal may call the loan due (a "due on sale" clause). Appts exercised their option to declare the balance due and, when the balance was not paid, instituted foreclosure proceedings.

Appees sought to enjoin the foreclosure proceedings in state court.² They argued that enforcement of the due on sale clauses

¹This case should be considered along with Nos. 81-922, 81-992 and 81-993. All of these cases raise the same issue. Please read this memo first.

²Three separate actions were filed; the cases were consolidated before entry of judgment in the trial court, and treated as one case in the appellate court.

violated California Civil Code §711, which forbids unreasonable restraints on the alienation of real property. The trial court granted appts' motion for summary judgment, concluding that the state statute was preempted by the federal act and regulations.

3. DECISION BELOW: The California Appellate Court reversed.³ California law does not permit enforcement of a due on sale clause "unless the lender can demonstrate that enforcement is reasonably necessary to protect against impairment to its security or the risk of default." Wellenkamp v. Bank of America, 21 Cal. 3d 943, 953 (1978). Fidelity Federal did not claim such an impairment or a risk of default as a result of the sales in question. Therefore, the due on sale clauses could not be enforced -- unless, of course, California law is preempted.

There are at least three parts to the court's preemption analysis. First, nothing in the Act demonstrates a clear congressional mandate that federal rather than state law shall control here. The Act itself makes no reference to the subject of due on sale clauses. Second, the "occupation of the field" doctrine is not applicable here. Although the Board has plenary authority to regulate and control federal savings and loan associations, no one suggests that it was the intent of Congress to supplant all state laws pertaining to real property and mortgages. Federal Savings & Loan Associations have always used

³The Appellate Court adopted in large measure an opinion by the Court of Appeal for the First App. Dist. in Panko v. Pan American Federal Savings & Loan Ass'n. Panko is No. 81-922 and is straight-lined with this case.

and been governed by state real property and mortgage laws in respect to numerous matters (e.g., title, conveyancing, recording, priority of liens, and proceedings for foreclosure). When the federal government "occupies a field," however, no state law pertaining to the "field" is applicable. Third, although the Board has manifested its intention that state regulation of due on sale clauses be preempted, federal and state regulations in this case are not wholly conflicting and the mere expression of intent by the Board is not sufficient to preempt state law.⁴ The federal regulation merely authorizes federal savings and loan associations to include a due on sale clause in their loan contracts; it does not compel their use or enforcement. California law permits enforcement of such a clause only upon a showing that the lender's security may be at risk as a consequence of the transfer. Thus, it is not physically impossible for a federal association to comply with the two regulatory schemes.

The court also noted that the following provision was included in two of the three Deeds of Trust: "This Deed of Trust shall be governed by the law of the jurisdiction in which the property is located."⁵ In its view this clause meant that state

⁴In the preamble to the regulation, 12 C.F.R. " 11(f), the Board stated that "it was and is the Board's intention to have . . . due on sale practices of federal associations governed exclusively by federal law. . . . Federal associations shall not be bound by or subject to any conflicting state law which imposes different . . . due on sale requirements."

Footnote(s) 5 will appear on following pages.

law was to govern the interpretation, validity and enforcement of the loan security instrument. This includes the limitation on enforcement of due on sale provisions. It rejected the argument of FHLMC, which had appeared as an amicus, that state law includes all federal law the state is required to enforce by preemption or otherwise.

The California Supreme Court denied review.

4. CONTENTIONS: Appts note that there are hundreds of similar cases pending in the California courts against other federal associations. The California court's holding will have a substantial effect on the ability of the Board to assure the stability of the federal savings and loan system, as well as on the secondary mortgage market. On the substantive question, appts begin with the proposition that federal regulations preempt state law when their preemptive intent is clear and the regulations are not inconsistent with federal law under which they are promulgated. Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978). The federal regulation at issue here was fashioned by the Board with the express intent of preempting state laws. The Board's regulation is entirely consistent with the Act's purpose of creating and maintaining an economically viable federal savings and loan system: The Board has concluded that the ability of a federal association to exercise a due on sale

⁵This is a uniform provision used in the form instruments promulgated by the Federal Home Loan Mortgage Corporation ("FHLMC"), use of which is a precondition to the purchase of a mortgage by FHLMC.

clause at the lender's option is necessary to the stability of the federal savings and loan system. The state court avoided finding a direct conflict by distinguishing between permissive and mandatory provisions. This distinction is not persuasive because the state law flatly precludes that which the federal law embraces. Other courts have found preemption in situations involving "permissive" federal regulations. See Meyers v. Beverly Hills Federal Saving & Loan Ass'n, 499 F.2d 1145 (CA 9 1974) (involving prepayment penalties for early repayment of mortgage loans). Moreover, in Conference of Federal Savings & Loan Associations v. Stein, 604 F.2d 1256 (CA 9 1979), aff'd, 445 U.S. 921 (1980), the CA 9 held that the Act was a comprehensive regulatory scheme intended by Congress to preempt all state laws which sought in any way to regulate or control the operation of federal savings and loan associations: "The broad regulatory authority over the federal associations conferred upon the Bank Board by HOLA does wholly preempt the field of regulatory control over these associations." Id. at 1260. This Court summarily affirmed that decision. In contrast, the California court distinguished the "internal" and "external" activities of federal associations and held that while the Board has complete authority to regulate the internal affairs of federal associations, it does not have such authority over its external affairs. Appts point out that numerous courts have upheld the preemptive power of federal regulations dealing with aspects of the lender/borrower relationship. Finally, appts contend that the "law of the jurisdiction clause in the Deed of Trust did not preclude a

finding of preemption because the law of the state necessarily includes preemptive federal law." See Hauenstein v. Lynhan, 100 U.S. 483 (1880).⁶

Appes primarily adopt the argument of the California court. The state has not attempted to regulate federal associations; rather, Cal. Civil Code §711 is a substantive rule of real property, which incidently infringes upon the federal associations' transactions. There is ample room, whatever the Board's authority, for continued state regulation of real property. Moreover, under the federal regulation it would be permissible for any and all federal associations to contract to enforce the due on sale clause only when a transfer impairs their security: a state law which achieves the same result does not conflict with the Act. Finally, this Court need not reach the issue of whether Civil Code § 711 conflicts with the federal regulation, because two of the deeds of trust were executed prior to the effective date of the regulation (July 31, 1976), and the judgment with respect to the third transaction rests on an adequate nonfederal basis -- the contractual "law of the jurisdiction" clause.⁷

Appts reply to this final argument, as follows. Whether a federal lender by contract has waived a federal right is a

⁶Appts contend that the California court incorrectly believed this clause to be in two of the deeds, when it was only in one.

⁷Appes also suggest that this last argument justifies this Court's dismissal of the case.

question of federal, not state law. Moreover, the California courts' discussion of this issue is only dicta: It was unnecessary to reach the issue after holding that the federal regulations were not preemptive. With respect to the deeds executed before the 1976 effective date of the regulation, appts reply that the regulation "merely codified what had been consistently the policy and position of the Bank Board." The regulation itself starts with the phrase "An association continues to have the power to include . . . "

The SG has filed an amicus brief for the Board. The Board contends that the decision below will seriously impair the federal government's efforts to control federal savings and loan associations' mortgage rates. Insofar as the California court's decision rests on the view that the Board's authority is limited to regulating the internal affairs of savings and loan associations, it conflicts with numerous decisions which have upheld the Board's pervasive regulatory control. See, e.g., Stein, supra (reporting and notice requirements regarding possible discriminatory lending practices); First Federal Savings & Loan Ass'n of Boston v. Greenwald, 591 F.2d 417 (CA 1 1979) (payment of interest on escrow accounts); Kupiec v. Republic Federal Savings & Loan Ass'n, 512 F.2d 147, 150 (CA 7 1975) (methods of supplying notice to Association members); Kaski v. First Federal Savings & Loan Ass'n of Madison, 240 N.W.2d 367 (Wis. 1976) (prepayment penalties). The CA 5, however, has also concluded that the Board's power is limited to controlling internal affairs of federal associations. Gulf Federal Savings &

Loan Ass'n of Jefferson Parish v. Federal Home Loan Bank Board, 651 F.2d 259, 266 (1981). He also challenges the California courts' suggestion that a different standard of preemption applies when a federal administrative agency is the source of a federal rule, as opposed to an Act of Congress directly. This Court has long-recognized that an administrative regulation which properly implements a statute has the identical preemptive effect. See Free v. Bland, 369 U.S. 663, 668 (1962).

Appes have filed a reply to the Board's brief which notes that legislation is pending which addresses the issue involved in this case. These bills, S.1720 and S.1703, would provide for federal preemption of any state law prohibiting enforcement of the due on sale clause. Since passage of this legislation would moot this case, appees contend that the Court should dismiss or affirm without a hearing.

5. DISCUSSION: This appears to be a proper appeal under 28 U.S.C. §1257(2); appts expressly raised the constitutional validity of Civil Code §711 and the California court upheld the state provision in the fact of this preemption claim. There is little reason to question appts' and the Board's contention that the California decision will have a drastic effect on the availability of mortgages from federal savings and loan associations and on the secondary market in mortgages. Due on sale clauses shorten the average life of a conventional mortgage and thus permit lenders to increase the interest they can charge on long-term loan commitments during periods of rising interest rates. On the merits, both of the distinctions that stand behind

the California court's opinion -- that between the internal and external affairs of the association and that between preemption by statute and by federal regulation -- are not very persuasive. As appts and the SG point out, numerous courts have upheld the authority of the Board to regulate the relationship between federal savings and loan associations and their borrowers. Federal regulations, consistent with their authorizing statutes, are just as capable of preempting state laws as are the statutes themselves. Nor do I think the state court is very convincing in its claim that the state effort to prohibit what the federal law permits does not directly conflict with the federal regulation.

I recommend that the Court note probable jurisdiction.

There is a motion to affirm or dismiss, a reply brief, two amicus briefs (one filed by the SG and one by the California Secretary of Business Transportation and Housing), and a reply to the SG's brief.

January 13, 1982

Kahn

Opinion in Appendix

ME

Court

Voted on....., 19...

Argued, 19...

Assigned, 19...

No. 81-750

Submitted, 19...

Announced, 19...

FIDELITY FED. SAVINGS AND LOAN ASSN.

VS.

de la CUESTA

Out

Noted

[illegible]

THE C. J.	W. J. B.	B. R. W.	T. M.	H. A. B.	L. F. P.	W. H. R.	J. P. S.	S. D. O'C.
				5/3/82				
Join HAB 6/9/82	Join HAB 6/8/82	Join HAB 6/8/82	Join HAB 6/8/82	1st Draft 6/7/82	out	will disent 6/9/82	await disent 6/9/82	Join HAB 6/8/82
						1st Draft 6/18/82	Join with 6/18/82	1st Draft 1st Draft congrat 6/21/82
				81-750 Fidelity Fed.			v. de la Cuesta	