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Federal Housing Loans: Is State Mortgage Law Preempted

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FEDERAL HOUSING LOANS: IS STATE MORTGAGE LAW PREEMPTED?

INTRODUCTION

In the field of real property secured transactions, there exists a pervasive scheme of statutory and judicial protections for debtors.[1] Although the individual rules vary from state to state, most were enacted to prevent creditor overreaching.[2] Under federal law, debtors may lose their state law protections if they have any direct connection with the Federal Housing Administration (FHA), the Small Business Administration (SBA), or the Veterans Administration (VA). This results from the federal agency's involvement in transactions through a direct loan, a full or partial guarantee of a private loan, or a partial guarantee as a substitute for an initial down payment. The agency may later be in federal court litigating the transaction by foreclosing on the mortgage and seeking a judgment for the deficiency.[3] This situation presents a federal-state choice of law question.

In diversity cases, state law applies.[4] Where a federal statute is clearly on point, federal law applies.[5] Generally, real property loan transactions are not covered by a federal statute and are not before the court on diversity. Indeed, SBA, FHA, and VA loans and loan guarantees do not fit the definitions of diversity or federal question jurisdiction. No federal question

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1. *See, e.g.*, CAL. CIV. PROC. CODE § 580a (West 1976); *id.* § 726 (West Supp. 1979) (fair value limitations); *id.* §§ 580b, 580d (West 1976) (anti-deficiency provisions); *id.* § 725a (West 1955) (statutory right of redemption); *id.* § 564 (West 1954) (appointment of receiver pending foreclosure); *id.* §§ 702, 703 (West Supp. 1979) (determination of redemption price).

2. *See, e.g.*, Roseleaf Corp. v. Chierighino, 59 Cal. 2d 35, 378 P.2d 97, 27 Cal. Rptr. 873 (1963), where the purposes behind CAL. CIV. PROC. CODE § 580b are explained. *Cf.* United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970), where the court expressed doubts that statutory redemption really serves the legislative purpose.

3. 28 U.S.C. § 1345 (1976) confers jurisdiction on the federal district courts where a federal agency is a plaintiff. The government, as a plaintiff, will choose a federal court because it is the more responsive forum. For an example of a decision adverse to the government in a state court, see State *ex rel.* Lonctot v. Sparkman & McLean Co., 16 Wash. App. 402, 556 P.2d 946 (1976), where the government as appellant was apparently the victim of local debtor sentiment.

4. Erie R.R. Co. v. Tompkins, 304 U.S. 64 (1938), held that the federal courts must apply the law of the states in which they sit. The holding was limited to cases before the courts solely on the basis of diversity. The federal courts had previously applied "general federal common law" to these cases.

5. U.S. CONST. art. VI, cl. 2 (supremacy clause).

is presented because resolution of questions involving real property does not require interpretation of the Constitution or an act of Congress. Where a federal agency is a party to a real property loan transaction, the federal district courts have jurisdiction because the United States is the plaintiff.[6]

Choice of federal or state law is ill-defined where jurisdiction is not founded on federal question or diversity. Where jurisdiction exists solely because the United States is a party, choice of law is determined on a case-by-case basis.[7]

This comment will examine this gray area and attempt to delineate appropriate standards to govern the choice of law issue where a federal agency is a party to a real property loan transaction. The author concludes that many courts have not applied the traditional preemption balancing test but instead have applied federal law without properly considering the issues in the context of real property loan transactions, thereby depriving a debtor of all state law protections.

EXISTING CHOICE OF LAW RULES

Preemption

Although federal preemption traditionally involves a balancing of federal and state policies,[8] the analysis in real property cases has been obscured. State debtor protections have been preempted in an overwhelming majority of real property loan transaction cases with only conclusory analysis of state and federal policies. Nevertheless, since state law has been the rule of decision on occasion, it is necessary to consider the arguments that have successfully brought about application of state law.

Two theories have been suggested to define the status of state law. The first theory is that state law should apply of its own force where consistent with federal programs.[9] This view

6. 28 U.S.C. § 1345 (1976).

7. Clearfield Trust Co. v. United States, 318 U.S. 363, 366-67 (1943). Speaking directly to this problem, the Supreme Court has said: "In our choice of the applicable federal rule we have occasionally selected state law." *Id.* at 367.

8. *Id.*

9. This view is based upon the argument that a mere jurisdictional grant of power to adjudicate does not necessarily carry with it a federal substantive rule. The argument is based on an extension of the *Erie* doctrine.

> To be sure, *Erie* would not be conclusive on that question, for the functions of the diversity-of-citizenship and United States-a-party jurisdictional grants are distinguishable, and there are situations where power to declare governing law must be implied from a grant of jurisdiction.
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> . . . .

has not been adopted by any court, but several have declined to decide the issue.[10] The second theory is that state law may be incorporated as the federal rule if, in substance, it would promote the objectives of the federal program.[11] It is the second theory that has found acceptance in some courts.[12]

Where state law hinders rather than promotes the objectives of the federal program, a federal common law rule may be formulated—the rationale being that Congress did not intend for state law to defeat the purposes of federal legislation.[13] Obviously, this federal common law rule may replace state debtor protections with protection of the federal investment.

These general preemption principles combined with the federal system of government can cause a variety of rules to be applied. Because federal courts can only incorporate state rules consistent with the federal program, one state's law may be

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> Nevertheless, *Erie* would tend to cast doubt on implication of law-making power simply from the grant of jurisdiction over suits brought by the United States, if only because (1) it establishes that jurisdictional grants do not necessarily entail such a power; and (2) it expresses a strong policy against differences in governing law being based on choice of tribunal . . . .

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, 799 n.10 (1957).

10. *See, e.g.*, United States v. Yazell, 382 U.S. 341, 357 (1966).

11. *See, e.g.*, United States v. Yazell, 382 U.S. 341 (1966); United States v. MacKenzie, 510 F.2d 39 (9th Cir. 1975); Bumb v. United States, 276 F.2d 729 (9th Cir. 1960); State *ex rel.* Lonctot v. Sparkman & McLean Co., 16 Wash. App. 402, 556 P.2d 946 (1976). Congressional intent is important in any consideration of whether state law shall be adopted as the federal rule. For instance, Congress intended the Small Business Administration to "aid, counsel, assist and protect . . . the interests of small business concerns . . . ." 15 U.S.C. § 631(a) (1976). This shows congressional concern for private interests. The policy to protect private interests may be greater than other federal policies, such as collection of the full amount of the debt. If the state rules do not conflict with federal policy, state law should apply. *See* Bumb v. United States, 276 F.2d at 736-37. The applicable federal policy varies with the agency involved in the transaction. *See* United States v. MacKenzie, 510 F.2d at 42 (federal policy concerning SBA loans deemed consistent with and limited by state statutory redemption rights). *MacKenzie* distinguished United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970), where an almost identical state statute was held inapplicable to the Federal Housing Administration on the basis of the difference in congressional purposes of the agencies. The enabling legislation will give the best insight into the general federal policy.

12. Some courts have taken the position that the applicable law is federal by virtue of the fact that a federal agency is a party to the contract and the suit. Most of the courts which rely on this argument virtually assume their conclusions—that state law cannot apply of its own force. The result of this view is that state law will not govern the rights of the parties unless the federal courts adopt state law as the federal rule.

13. United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970); United States v. View Crest Garden Apartments, Inc., 268 F.2d 380, 383 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959).

adopted while a neighboring state's law may not be adopted. Where state law is incorporated as the federal rule, a different rule would be used in each state. In those states where the law is inconsistent with federal policy, the federal courts would fashion a federal rule to be applied only in those states. Thus, "uniformity" is actually nonexistent, and it is important to review the approach used in the Ninth Circuit where California's debtor protection statutes face analysis against the objectives of Congress in enacting federal loan programs.

Ninth Circuit Tests

The courts in the Ninth Circuit consider three initial factors to categorize a transaction and determine whether state law will be incorporated as the federal rule: 1) Is there a federal regulation on point? 2) Is there an individually negotiated contract? 3) Is there a contractual provision that state law shall apply?[14]

Federal Regulation on Point. If a federal regulation is on point, state law covering the same issue and establishing a different rule will be preempted.[15] Regulations adopted pursuant to congressional mandate create the applicable federal law and release the courts from a formulation of a federal common law rule.

In response to unfavorable court decisions, some agencies have issued regulations which vaguely assert that federal law applies. One such regulation purportedly waives any local immunity in favor of federal law.[16] The effect of such regula-

14. United States v. Gish, 559 F.2d 572, 573, 575 (9th Cir. 1977).

15. *Id.*

16. 13 C.F.R. § 101.1(d) (1978). This regulation was adopted in response to United States v. Yazell, 382 U.S. 341 (1966). In *Yazell*, the Small Business Administration had negotiated a contract to which the Court applied state law. The government had contracted with reference to, and had attempted to waive, the state law defense of coverture. When the desired result did not materialize, the SBA decided to remove the problem of compliance with state law. A regulation that covers all contracts is a more efficient means than individually contracting away state-created rights. This regulation implicitly recognizes that state law may apply of its own force. It is very different from the comprehensive scheme adopted by the Veterans Administration in that it is simply an asserted waiver of local rights. Since the regulation states that local immunity is waived, it must mean only that the state protections are waived if they are not incorporated as part of federal law. Presumably, the SBA could not force the debtor to waive federal law, as this would give the SBA an unfair advantage. The only possible application is as a waiver of state law applying of its own force. The implication is that the regulation will have no effect where state law is incorporated as the federal rule. This is because the state protection is federal law, and by the terms of the regulation, federal law applies.

tions has yet to be determined. Assuming the particular agency has congressional authorization, the courts usually defer to the regulations and give them the force and effect of law. Congress typically delegates its law-making authority to federal agencies, with the result that the FHA, the SBA, and the VA are all authorized to create regulations on their own behalf.[17] In all cases where a regulation does not resolve the specific issue of the case, other factors must be considered before the choice of law issue is resolved.

Individually Negotiated Contract. If there is an individually negotiated contract, further consideration of state law will be required. Inquiry will focus on the strength of the state interest, resulting in application of the state rule if a particularly strong local interest is present. The individually negotiated contract may tip the scales in favor of application of state debtor protections.

The first case involving such a contract, *United States v. Yazell,*[18] was decided by the Supreme Court in 1966. In *Yazell,* the Small Business Administration made a disaster loan to a husband and wife. After default, the SBA tried to collect against the wife, who interposed the Texas state law defense of coverture. Because the original contract had been "individually tailored," the Supreme Court concluded that peculiarly local interests, such as the defense of coverture, could not be overridden.[19] The contract was specifically adapted to state law and was not a general form in use throughout the country. These distinctions were important in determining that an individually negotiated contract existed.

Also important in the context of the individually negotiated contract was the strength of the particular state interest

17. 15 U.S.C. § 634(b)(6) (1976) (Small Business Administration); 12 U.S.C. § 1749a(c)(1) (1976) (Federal Housing Administration); 38 U.S.C. § 1819(h) (1976) (Veterans Administration).

18. 382 U.S. 341 (1966).

19. "Again, it must be emphasized that this was a custom-made, hand-tailored, specifically negotiated transaction. It was not a nationwide act of the Federal Government, emanating in a single form from a single source." *Id.* at 347-48.

> Clearly, in the case of these SBA loans there is no 'federal interest' which justifies invading the peculiarly local jurisdiction of these states, in disregard of their laws.
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> The decisions of this Court do not compel or embrace the result sought by the Government. None of the cases in which this Court has devised and applied a federal principle of law superseding state law involved an issue arising from an individually negotiated contract.

Id. at 353.

being asserted. In *Yazell,* the state interest in family law outweighed the federal interest of collection of the federal debt. Family and property arrangements are peculiarly local interests which may not be overridden simply because the government is a party.[20]

Where an individually negotiated contract has been used, congressional intent seems to be less relevant. The courts purport to look only to the contract itself in determining the intent of the parties. This may be contrasted with the case where the individually negotiated contract is not a factor; the courts virtually ignore the contractual intent of the actual parties and look to the overall congressional intent and purposes behind the transactions.[21]

The individually negotiated contract is similar in many respects to contractual choice of law provisions. Specific reference to state law is not a necessary condition of the individually negotiated contract.[22] However, in *Yazell,* it was important that the contract, though apparently not specifically stating that state law was to apply, made reference to one state statute and partially complied with the provisions of the statute at issue. The result of finding an individually negotiated contract is a choice of law term implied from agency conduct where strong state interests are present. Since the courts have implied such provisions, effect should also be given to explicit terms providing for the application of state law.

Contractual Provision that State Law Should Apply. If a contractual choice of law provision is present, it will be followed to the extent that it is reasonable. A contractual provision was held to be determinative in *United States v. Stewart,*[23] involving a VA loan. *Stewart* was an action for a deficiency after a non-judicial sale. California statutes[24] prohibit a deficiency after a non-judicial sale. The deed of trust contained a provision providing: "This Deed shall be construed according to the laws of the State of California."[25] This contractual provision was given effect, and the court applied state law. If the provision had been absent, the VA's comprehensive regulations

20. 382 U.S. at 353.

21. *See id.* at 354.

22. United States v. Gish, 559 F.2d 572 (9th Cir. 1977).

23. 523 F.2d 1070 (9th Cir. 1975).

24. CAL. CIV. PROC. CODE §§ 580b, 580d (West 1976). In this situation, CAL. CIV. PROC. CODE § 580a would not bar a deficiency or even limit it in light of CAL. CIV. PROC. CODE § 580d. Apparently, CAL. CIV. PROC. CODE § 580d was overlooked.

25. 523 F.2d at 1072.

would have been controlling.[26]

Apparently the court felt that the provision in the contract specifically providing for application of state law was a waiver by the VA of its own regulations. By insisting on a provision that state law shall govern the rights of the parties, a debtor can retain his state-created rights. However, since FHA and VA loans are usually guarantees utilizing nationally adopted form contracts rather than individually tailored direct loan contracts, choice of law provisions may be beyond the reach of negotiation by individual debtors.

After initial categorization of the transaction under the factors discussed above, the interrelationship of federal and state interests must be considered. In many cases where an individually negotiated contract or a choice of law provision was not present, the Ninth Circuit has nullified state debtor protections and fashioned a federal common law rule based on the national interests of uniformity and the federal fisc.

The Talismans: Uniformity and the Federal Fisc

In the absence of an individually negotiated contract or a specific choice of law provision in the contract, federal law has almost universally become the rule of decision. Federal law is applied as a consequence of the "need" for uniformity and protection of the federal fisc. Both the uniformity and federal fisc arguments have been taken from other areas of preemption law[27] and have been applied without any real consideration of their meaning in real property loan transactions.

Uniformity. The Ninth Circuit uniformity argument focuses on the burden that a different rule in each state would impose on the federal agencies. Without uniform rules, additional expenses would be incurred in the nature of attorneys'

26. *See* United States v. Shimer, 367 U.S. 374 (1961). *Shimer* was held to be controlling in a similar case, United States v. Rossi, 342 F.2d 505 (9th Cir. 1965). In *Stewart*, the contract had two provisions: one provided that federal law was to govern the rights of the parties, and the other provided that state law was to apply. The provision for federal law was crossed out by the parties at the time of negotiating the contract, thus evidencing a conscious choice on the part of the SBA that state law should apply.

27. The uniformity argument came from Clearfield Trust Co. v. United States, 318 U.S. 363 (1943), a case involving the federal remedy for a government-issued check. The federal fisc argument apparently came from United States v. Standard Oil Co., 332 U.S. 301 (1947), where the U.S. Army sought to recover in tort for interference with the government-soldier relationship arising out of an automobile accident. Although the Court held that federal rather than state law governed, it ruled that the United States was not entitled to recover in the absence of congressional legislation.

fees, separate contract forms for each state, and losses caused by state restrictions on creditor actions and recovery.

Drawing on language from *Clearfield Trust Co. v. United States,*[28] the Ninth Circuit has transplanted the uniformity argument from commercial paper into real property loan transctions.[29] In *Clearfield Trust,* the United States issued a check that was fraudulently endorsed. The United States, as drawee, sought to recover from Clearfield Trust Company in an action based on an express guarantee of prior endorsements. Clearfield Trust Company defended on the grounds that unreasonable delay in giving notice of the forgery barred recovery under Pennsylvania law. The Supreme Court held that a uniform rule was needed in commercial paper transactions where the United States would otherwise be subject to the vagaries of the laws of the several states. The Court went on to say that under the uniform federal rule, recovery would be denied only where the drawee's delay caused damage.

Many Ninth Circuit cases have considered the uniformity argument to be conclusive in real property loan transactions after showing that application of state law would result in a different rule in each state.[30] The ingredient missing in the Ninth Circuit's uniformity analysis is the weighing of federal and state interests—an ingredient crucial to the Supreme Court's analysis in *Clearfield Trust.* If the Ninth Circuit had analyzed the federal and state interests, a federal common law rule might nevertheless be required in many state debtor protection cases because of a large burden placed on a federal agency where state law is imposed. However, there is no focus on such a balancing.

The Federal Fisc. Financial loss is the greatest concern expressed by the Ninth Circuit as a reason for rejecting state law. Potential bankruptcy of the federal programs is possible where state law imposes severe restrictions.

In the landmark case of *United States v. View Crest Apart-*

28. 318 U.S. 363 (1943).

29. *See* United States v. Stadium Apartments, Inc., 425 F.2d 358, 364 (9th Cir.), *cert. denied,* 400 U.S. 926 (1970); United States v. View Crest Garden Apartments, Inc., 268 F.2d 380 (9th Cir.), *cert. denied,* 361 U.S. 884 (1959).

30. *See, e.g.,* United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir.), *cert. denied,* 400 U.S. 926 (1970); Clark Investment Co. v. United States, 364 F.2d 7 (9th Cir. 1966); United States v. View Crest Garden Apartments, Inc., 268 F.2d 380 (9th Cir.), *cert. denied,* 361 U.S. 884 (1959). *Accord,* United States v. Hext, 444 F.2d 804 (5th Cir. 1971) (chattel mortgage).

31. 268 F.2d 380 (9th Cir.), *cert. denied,* 361 U.S. 884 (1959).

ments, Inc.,[31] the Ninth Circuit established a general rule which has been applied almost mechanically by the federal courts for nearly two decades.[32] In that case, the Federal Housing Insurance Authority applied for appointment of a receiver pending foreclosure. Washington state law did not allow appointment of a receiver under the circumstances, but the contract had a provision allowing a receiver. The court held that "the federal policy to protect the treasury and to promote the security of federal investment"[33] required a federal rule allowing the action. The rule promoted the purpose of the federal program which was "to facilitate the building of homes by the use of federal credit."[34] *View Crest* stands for the proposition that where, as in appointment of receivers, state law imposes a large financial burden on the government, a federal common law rule will be adopted.

Although the court in *View Crest* properly chose federal common law as the rule of decision, the case has often been cited too broadly[35] as a justification for rejection of state law in order to protect the federal fisc. Although occasionally indicating that state law may never apply if the result would impinge on the federal fisc,[36] the Ninth Circuit has not really adopted such a simplistic approach.[37]

Protection of federal revenues is an implied congressional policy that can outweigh any state interest. Congress, when it creates a federal agency, does not intend to deplete the treasury and the funding of the program. Therefore, Congress must have intended a rule that would protect the government's fiscal interest. This policy is often inconsistent with state debtor protections.[38]

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32. *See, e.g.*, United States v. Allgeyer, 466 F.2d 1195 (9th Cir. 1972); Branden v. Driver, 441 F.2d 1171 (9th Cir. 1971); United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir.), *cert. denied*, 400 U.S. 926 (1970); Clark Investment Co. v. United States, 364 F.2d 7 (9th Cir. 1966); Herlong-Sierra Homes v. United States, 358 F.2d 300 (9th Cir. 1966); United States v. Rossi, 342 F.2d 505 (9th Cir. 1965); United States v. Queens Court Apartments, Inc., 296 F.2d 534 (9th Cir. 1961).

33. United States v. View Crest Garden Apartments, Inc., 268 F.2d 380, 383 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959).

34. *Id.*

35. *See, e.g.*, United States v. Allgeyer, 466 F.2d 1195, 1196 (9th Cir. 1972).

36. *Id.*

37. *See* United States v. Stewart, 523 F.2d 1070 (9th Cir. 1975); United States v. MacKenzie, 510 F.2d 39 (9th Cir. 1975); Bumb v. United States, 276 F.2d 729 (9th Cir. 1960).

38. Anti-deficiency statutes, such as CAL. CIV. PROC. CODE § 580b (West 1976), are the best examples. Such statutes deny recovery to the creditor without respect to the degree of debtor culpability.

The use of uniformity and protection of the federal fisc as talismanic reasons for rejecting state law usually carry the day. Only one exception has surfaced and successfully overcome these overwhelming federal interests: state law may limit the enforcement of a federal remedy.

An Exception: Balancing In Disguise

A distinction has been drawn between establishment of the validity of the transaction and the government's remedy to enforce the contract.[39] It is almost universally accepted that the initial validity of the transaction must be tested under state law.[40] Problems associated with establishing a different federal rule require this result. The state interest in maintaining one set of records to assure certainty of title to land outweighs the federal interest in having a uniform rule. There is little financial burden on the federal government in complying with state procedures for assuring good title. However, the situation is different when government remedies are involved.[41] The federal interest outweighs the state interest where application of state remedies may have an adverse financial impact on the federal treasury. Thus, while the validity of the transaction is determined by state law, the remedy is determined by federal law.

While the existence of a remedy will usually be federal, the methods of enforcing that remedy may be limited by incorporation of the state rule.[42] Minor state law limitations on federal recovery impose a small burden on the government while advancing important state policies. A balancing of federal and state interests produced this result in two recent Ninth Circuit decisions involving SBA loans.

In *United States v. MacKenzie,*[43] an SBA loan had been foreclosed. The SBA brought suit to recover a deficiency judgment against the debtor. The court held that a Nevada fair

39. United States v. Yazell, 382 U.S. at 356; Bumb v. United States, 276 F.2d at 737; United States v. View Crest Garden Apartments, Inc., 268 F.2d at 383.

40. United States v. Fox, 94 U.S. 315, 320 (1876); United States v. Stadium Apartments, Inc., 425 F.2d at 363-64; Bumb v. United States, 276 F.2d at 736. *But cf.* United States v. Crittenden, 563 F.2d 678, 681 (5th Cir. 1977), *cert. granted*, 99 S. Ct. 77 (1978) (sufficiency of U.C.C. financing statement governed by federal law).

41. Bumb v. United States, 276 F.2d 729 (9th Cir. 1960); United States v. View Crest Garden Apartments, Inc., 268 F.2d 380 (9th Cir.), *cert. denied*, 361 U.S. 884 (1959).

42. United States v. MacKenzie, 510 F.2d at 42; Bumb v. United States, 276 F.2d at 738; State *ex rel.* Lonctot v. Sparkman & McLean Co., 16 Wash. App. 402, 556 P.2d 946 (1976).

43. 510 F.2d 39 (9th Cir. 1975).

value limitation[44] applied. As a result, the SBA was required to comply with a judicial procedure in which the court determined the fair market value of the property foreclosed upon.[45] Application of the statute limited the SBA to the difference between the judicially established fair market value and the amount of the debt. The purpose of the fair value statute was to prevent creditors from bidding less than the fair value at foreclosure sales and later obtaining an excessive deficiency judgment. Clearly the rule did not conflict with the federal purpose of collecting the federal debt because the statute only had an economic effect where the government attempted to effect a "double recovery."[46] Restricting the government to a deficiency not exceeding the difference between the amount of the debt and the value of the security deprived the government of nothing to which it was entitled and was the only equitable result.

In the companion case, *United States v. Engine Service,*[47] the court adopted Arizona statutory redemption as the federal rule. The SBA analogized to a previous Ninth Circuit case involving the FHA[48] where a similar state period of statutory redemption was denied a debtor. In distinguishing this previous case, the court focused on the different purposes of the FHA and SBA. The congressional purpose in establishing the SBA program was to "aid, counsel, assist, and protect, insofar as is possible, the interests of small business concerns in order to preserve free competitive enterprise . . . and to maintain and strengthen the over-all economy of the nation."[49] The thrust of SBA loans is to aid and protect private interests. On the other hand, the underlying purpose of FHA loans is "to assist in relieving the acute shortage of housing . . . and to increase the supply of housing accommodations available to veterans of World War II at prices within their reasonable ability to pay . . . ."[50] FHA loan guarantees exist to provide hous-

44. NEV. REV. STAT. §§ 1-1.457, 1-1.459, 40.455 (1973).

45. *Id.* § 40.457.

46. "Devices to assure that fair market prices are received at foreclosure sales redound to its benefit. Depriving the Government of potential 'double recoveries' created by artificially large deficiencies that it has caused takes away nothing to which it is entitled." United States v. MacKenzie, 510 F.2d at 42.

47. 510 F.2d 39 (9th Cir. 1975).

48. United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir.), *cert. denied,* 400 U.S. 926 (1970).

49. 15 U.S.C. § 631(a) (1976) (cited in United States v. MacKenzie, 510 F.2d at 41).

50. 12 U.S.C. § 1738(a) (1976).

ing, thus showing a greater congressional interest in building homes than in aiding debtors. In *MacKenzie,* this different focus was crucial in the balancing of federal and state interests.

MacKenzie was limited and further explained in a recent case[51] as applying only to state laws limiting the method of enforcing the federal remedy, not to laws prohibiting the remedy itself. Since SBA contracts are generally individually tailored, this exception may, therefore, be limited to the individually negotiated contract.

Thus, although state law will govern the initial validity of the transaction, the existence of a federal remedy cannot be impaired by state law. Federal recovery after foreclosure may be limited by state procedures if no major financial burden will be imposed on the government. Perhaps this represents a return to balancing as proposed by the Supreme Court in *Clearfield Trust.*[52] It is this balancing which should be the basis of a more cogent choice of law analysis in real property loan transactions. In this way, those state laws that do not impinge on federal policy may be adopted and applied to protect debtors.

A Critique

Critical examination has revealed that the courts have not properly weighed the interests of federal and state law. Federal law will generally be applied, and the analysis has on occasion been far too simplistic. Policy arguments have led the courts to application of federal law by reliance on the talismanic slogans of uniformity of result and protection of the federal fisc. These policies have been given disproportionate emphasis in light of their importance in real property transactions, and the weight given to them should be modified accordingly.

In *Clearfield Trust,* uniformity weighed heavily in the analysis and required a federal rule.[53] However, it is important to recognize the balancing of federal and state interests that was present in the analysis. Uniformity was not applied as a litmus test but rather, was applied when considered within the particular circumstances of the case.

Clearfield Trust involved the federal remedy for forged checks. Since commercial paper is commonly involved in multi-state transactions, applicable state law would be diffi-

51. United States v. Gish, 559 F.2d 572 (9th Cir. 1977).
52. 318 U.S. 363, 367 (1943).
53. *Id.*

cult to ascertain. The Court was concerned with the "exceptional uncertainty" resulting from the fortuitous migration from state to state of a particular check, making it impossible to determine which states would be involved and which state's law should prevail.[54] In this situation, the state's interest was relatively minor. Recovery would have been barred under state law because of an unreasonable delay in notifying Clearfield Trust Company of its liability. The state interest in applying its law was outweighed by a strong federal interest in preventing the uncertainty inherent in multi-state transactions. In the absence of multi-state contacts, the state rule might have been adopted as federal law.[55]

Although not involving real property transactions, *Clearfield Trust* is significant because its uniformity analysis has become the basis for the extension of the preemption doctrine to that area.[56] If its balancing analysis were applied instead to the specific facts of real property loans, major distinctions would cause uniformity to have less importance.

One major distinction between the *Clearfield Trust* facts and real property secured transactions is that in the latter, even assuming that state law did apply, there is no uncertainty as to which state's law would be relevant. A multi-state real property secured transaction is not frequently encountered. In addition, real property transactions are less transitory than commercial paper transactions. In real property contracts, there is always an underlying note, mortgage, or other lien and usually a guarantee. The parties to the transaction contract within the same state. Because land is involved, the state law which would be incorporated is nearly always that of the situs of the property. Since multi-state contacts and "exceptional uncertainty" are not present in real property loan transactions,

54. [R]easons which may make state law at times the appropriate federal rule are singularly inappropriate here. The issuance of commercial paper by the United States is on a vast scale and transactions in that paper from issuance to payment will commonly occur in several states. The application of state law, even without the conflict of laws rules of the forum, would subject the rights and duties of the United States to exceptional uncertainty. It would lead to great diversity in results by making identical transactions subject to the vagaries of the laws of the several states. The desirability of a uniform rule is plain.

Id.

55. *Id.*

56. "As the Supreme Court of the United States stated in Clearfield Trust, supra, 'in our choice of the applicable federal rule we have occasionally selected state law.' But not when 'the desirability of a uniform federal rule is plain.'" United States v. View Crest Garden Apartments, Inc., 268 F.2d at 382.

uniformity should not be a major factor in balancing the relative interests of federal and state law.[57]

Application of the different state laws would not be an overwhelming burden. Federal agencies have legal counsel available in each state and are well aware of state law.[58] Where the validity of instruments is concerned, federal agencies must comply with state law in any case. The transaction has such an overwhelming relationship to one state, that the need for uniformity, *on balance*, is not of great significance.

The advantages of consistency within the state easily outweigh the minimal burden to the federal government where minor state limitations are imposed. The fair value limitations,[59] for example, though different in each state, have a common purpose—to insure a fair price for the property at a foreclosure sale. Application of fair value limitations will result in consistency within the state, without any great burden on the agency. The typical statute denies recovery of a deficiency to the extent it has been the result of an artificially low sale price at foreclosure. There is no precarious uncertainty and no element of unfair surprise since conformance with the statute does not deny recovery except to the extent that recovery is inequitable.[60] Proper balancing of federal and state interests should result in incorporation of state fair value limitations.

Several state debtor protections may be strong enough as state interests to outweigh a weak federal interest if a balancing approach is used. State laws governing execution, deficiency after trustee's sale, and multiplicity of actions may be eligible for incorporation as the federal rule.

One federal remedy that has been modified by state law is execution upon a judgment. The federal government is subject to state exemptions, including homestead provisions, when collecting a judgment.[61] This includes execution upon a defi-

57. The Supreme Court in *Clearfield Trust* was concerned with arbitrary results in identical transactions. When the Court complained of "the vagaries of the laws of the several states," it was because the transaction touched several states, and choice of law from among those states would create an arbitrary result. This factor is not present in federal loans and loan guarantees on real property. 318 U.S. at 367.

58. Bumb v. United States, 276 F.2d at 738 (SBA enforcement of chattel mortgage).

59. California has two such statutes. CAL. CIV. PROC. CODE § 726 (West Supp. 1979) (judicial foreclosure); *id.* § 580a (West 1976) (extra-judicial foreclosure).

60. *See* Madison Properties, Inc. v. United States, 375 F.2d 740, 741 (9th Cir. 1967) (district court recognized that it was customary to allow statutory redemption); United States v. West Willow Apartments, Inc., 245 F. Supp. 755, 758 (E.D. Mich. 1965) (statutory redemption) (but federal, not state law applies).

61. FED. R. CIV. P. 69 provides in part:

ciency judgment obtained in a real property foreclosure. Exemption from execution is expressly governed by statute,[62] so that consideration of the competing interests is academic.

Another potential area for modification of the federal remedy is the provision prohibiting a deficiency after a trustee's sale under a deed of trust.[63] There are two methods of foreclosure under a trust deed.[64] Judicial foreclosure requires a hearing where evidence must be presented on the fair market value of the property before a deficiency may be assessed. In order to protect the debtor further, a period of redemption is allowed. Extra-judicial foreclosure through trustee's sale frees the creditor from the burdens of court foreclosure (such as time, expense, and attorneys fees), allows a large amount of freedom in conducting the sale, and gives clear title. However, it prohibits any deficiency. The existence of extra-judicial foreclosure presents a trade-off between the traditional right of statutory redemption and a recovery limited to the value of the original security. If the creditor desires a deficiency, he must judicially foreclose, and the debtor has the protection of redemption. This restriction on the use of trust deeds could be considered a minor limitation of the remedy and may be incorporated as the federal rule.

Similarly, the California one-form-of-action rule[65] may be a valid limitation of the federal remedy. This rule prohibits a multiplicity of actions. An action against one portion of the security without including the entire security is a waiver of the remainder. Compliance by the federal government imposes a small burden because the only requirement of the statute is foreclosure on all security at the same time. If the government

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> Process to enforce a judgment for the payment of money shall be a writ of execution . . . [and] execution shall be in accordance with the practice and procedure of the state in which the district court is held . . . except that any statute of the United States governs to the extent that it is applicable.

62. *Id.*

63. CAL. CIV. PROC. CODE § 580d (West 1976) prohibits such a deficiency in California.

64. For a discussion of the legislative purpose of CAL. CIV. PROC. CODE § 580d, see J. HETLAND, CALIFORNIA REAL ESTATE SECURED TRANSACTIONS 248-50 (1970).

65. CAL. CIV. PROC. CODE § 726 (West Supp. 1979) provides a sanction effect that may be raised by the debtor where not all of the security for a loan has been foreclosed upon at the same time. The purpose is to prevent a multiplicity of actions by requiring the creditor to foreclose on all the security at one time. If a creditor fails to comply, he may lose the rest of his security. In the alternative, the debtor may require the creditor to include all security in the foreclosure action before obtaining a deficiency. For a discussion of CAL. CIV. PROC. CODE § 726, see J. HETLAND, *supra* note 64, at 236-48.

complies with the statute, no additional expenses would ensue. Since the federal fiscal interest is negligible, the state interest should prevail.

The basic suggestion of this comment is that a balancing of federal and state interests is the best solution to the incongruities characteristic to choice of law in real property secured transactions. The courts have found uniformity conclusive of choice of law, even though multi-state contacts were not present. Because the force of the uniformity argument is lost where no multi-state contacts exist, uniformity should constitute no more than one factor to be balanced in the analysis. Protection of the federal fisc, although a predominate federal interest, should not be determinative where only a minor infringement on the federal purse would occur. State law should be adopted as the federal rule where the federal fiscal interest is not significantly impaired.

CONCLUSION

Federal common law has almost universally taken the place of state real property debtor protections. Talismanic use of the goals of uniformity and protection of federal revenues has led the Ninth Circuit analysis away from the traditional balancing of the preemption doctrine to virtual automatic rejection of state law. The Ninth Circuit has developed three additional factors to guide its choice of law decisions. Federal regulations on point will preempt state law. An individually negotiated contract, coupled with a strong state interest or a choice of law provision in the contract, may outweigh the federal interest and result in application of state law. Under this analysis, state law has been applied in a few instances.

The Ninth Circuit has misapplied the uniformity argument and guarded the federal fisc too jealously. Weighing the respective federal and state interests prior to the choice of law decision may advance important state objectives without hindering federal programs. Such a return to traditional analysis would steady a bewildered court system while assuring federal programs continued protection.

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