A Case for Preemption: Wellenkamp v. Bank of America is Inapplicable to Federal Savings and Loan Associations

Kirk A. Musacchio
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INTRODUCTION

A note secured by a deed of trust on real property, or the deed of trust instrument itself, very often includes a provision labeled a due-on-sale clause. This clause allows the lender, at his option, to accelerate repayment of the debt owed by the borrower should the borrower sell the property that secures the underlying note.

The due-on-sale provision serves an important function. It allows the lender to adjust a lower interest rate on the original note to current market rates, thus allowing the lender to re-loan the funds at a more profitable rate. This adjustment can be accomplished in one of two ways. The first requires the borrower to pay back the whole amount due on the note. This would allow new funds to be available for mortgage lending to new borrowers at the prevailing higher rates. The second approach applies in a situation where the borrower wishes to sell the property, and agrees with the new purchaser that the latter should “assume” the existing note and deed of trust as part

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1. To “accelerate” the debt refers to the lender’s ability to call the entire amount of the loan due before maturity.

2. The following is an example of a due-on-sale clause contained in a promissory note of Bay View Federal Savings and Loan Ass’n:

   In the event the undersigned, or any successor in interest of the undersigned shall sell, convey, transfer, contract to sell, or lease with option to purchase the real property described in the deed of trust securing the note, or any part of said real property or any interest therein, either voluntarily or involuntarily, all indebtedness secured by said deed of trust, including the unpaid balance of principle and interest, irrespective of the maturity dates of said indebtedness and notes evidencing the same, shall at the option of the holder hereof and without demand or notice, become immediately due and payable.

3. When a buyer of real property “assumes” an existing loan secured by that property, he agrees to become the primary debtor, and the seller no longer makes payments. In the event of default on the loan, and a foreclosure on the property by the lender, both the assuming buyer and the seller are liable for a deficiency should the property not satisfy the amount of the loan still due. The lender’s ability to obtain a deficiency, however, is subject to CAL. CIV. CODE § 580b (West 1976) (no deficiency judgment on a purchase-money mortgage), CAL. CIV. CODE § 580d (West 1976) (no deficiency judgment after a non-judicial foreclosure), and CAL. CIV. PROC. CODE § 726 (West 1976) (must foreclose on all the security in order to sue for a deficiency), which limits its practice.
of the purchase price. In this situation, the lender could raise the interest rate as part of the assumption fee; that is, raise the rate in lieu of exercising the due-on-sale clause and allow the new buyer to assume the loan.

The California Supreme Court, in its landmark *Wellenkamp v. Bank of America* decision, has declared that due-on-sale clauses may no longer be exercised for interest adjustment purposes. The *Wellenkamp* court held that the only valid use of the due-on-sale clause exists where sale of the property by the borrower would impair the lender’s security. Use of the due-on clause under any other circumstances would be tantamount to an unreasonable restraint on alienation.

The *Wellenkamp* decision is the final episode in a recent series of California Supreme Court cases that have sought to restrict use of the due-on-sale clause. The policy decisions re-

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“Assuming” a loan differs from taking “subject-to” the loan. If a new buyer takes “subject-to,” he is not the primary debtor and is not liable for any deficiency. But he does have the right to pay off the existing note on the property should the debtor-seller fail to do so.

4. 21 Cal. 3d 943, 582 P.2d 970, 148 Cal. Rptr. 379 (1978). The *Wellenkamp* court was concerned with exercise of the due-on-sale clause as it affects the “outright sale.” The court construed this term very broadly to mean “any sale by the trustor of property wherein legal title (and usually possession) is transferred.” *Id.* at 950, 582 P.2d at 974, 148 Cal. Rptr. at 383.

*Wellenkamp* involved exercise of a due-on-sale clause in a note and deed of trust, where the new buyer agreed to pay the seller-debtor’s equity interest and assume the outstanding loan on the property. Such a transaction is referred to as a “cash to loan” sale. But the court also included in its holding the “all cash to seller” sale, where the seller-debtor receives full payment from the buyer, as is typical in obtaining new financing.

The so-called “*Wellenkamp* assumption” means the lender is not involved. Instead of the buyer entering into a formal assumption with the lender, the buyer need only enter into an agreement with the seller to take over payments and the obligation of the existing loan. The lender treats this as a “subject-to” transaction and charges no fees, points, or other amounts. Seminar by Fred Crane, Real Estate Loan Takeover (Jan. 30, 1979)(Fred Crane was the attorney for plaintiff *Wellenkamp*).

5. The court used the “quantum of restraint versus justification” test as set forth in *Tucker v. Lassen Sav. & Loan Ass’n*, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974). They came to the same result as in *Tucker*—that impairment of security (i.e., waste to the property or risks from an uncreditworthy buyer) is the only valid justification for exercise of the due-on clause. 21 Cal. 3d at 949-52, 582 P.2d at 974-76, 148 Cal. Rptr. at 383-85. Otherwise, the quantum of restraint on alienation is just too great.

6. Professor John Hetland, a notable authority in the Real Property Secured Transaction area, has stated that the “impairment of security” situation, under which the due-on clause may be validly exercised, is virtually eliminated. Hetland, *After Wellenkamp*, CAL. REAL ESTATE, Dec. 1978, at 40. Thus, *Wellenkamp* severely limits the lender’s use of the due-on clause, if, in fact, it has any real utility at all.

7. *Wellenkamp* (and the cases cited below) finds broad substantiation in CAL. CIV. CODE § 711 (West 1954), which states: “Conditions restraining alienation, when
flected in these cases have presented many new problems for the home lending industry. One of these problems is preemption: since Wellenkamp is a state court decision, there is some confusion as to whether its holding applies to federal savings and loan associations, which are primarily governed by the Home Owner's Loan Act (HOLA). This comment presents an overview of the case in favor of preemption, arguing that Wellenkamp should not apply to federal associations because specific federal regulations apply.

Finding a solution to the federal preemption problem in light of the Wellenkamp decision is important for two reasons.

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First, a substantial number of savings and loan associations in California are federals. Whether they will be able to use the due-on-sale device to adjust interest rates, depends upon whether federal law governs or whether Wellenkamp applies. Second, the question of preemption involves important constitutional considerations regarding the supremacy and the commerce clauses of the United States Constitution.

This comment will approach the case for preemption by: 1) discussing the federal system that governs savings and loan associations, illustrating the framework under which federal and state associations operate; 2) examining preemption vis-a-vis the supremacy clause; 3) showing that Congress in the Home Owner's Loan Act (which created federal associations) intended federal law only to apply to federal associations; 4) examining the proposition that Wellenkamp creates an undue burden on interstate commerce and violates supremacy of federal law under the commerce clause by interfering with a congressional mandate in the Home Owner's Loan Act; 5) explaining that the due-on-sale clause is essential to the reduction of savings and loan liquidity problems and therefore should be retained as an interest adjusting device; and 6) presenting the current disposition of People v. Glendale Federal Savings and Loan Association and Glendale Federal Savings and Loan Association v. Fox, where the preemption problem has been recognized by the courts.

THE FEDERAL HOME LOAN BANK SYSTEM

The Federal Home Loan Bank (FHLB) was created as an independent federal agency by the Federal Home Loan Bank Act of 1932. It is a central credit facility and a regulatory body for member savings and loan associations. Local functions are controlled by twelve regional Federal Home Loan Banks divided into twelve districts, whose stock is held by the member

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11. See note 22 infra.


14. See Knox, The Due-on Clause: A Preemption Controversy, 10 Loy. L.A.L. Rev. 628 (1977) for a list of cases filed in California regarding the preemption question and federal associations.

banks of that district. These regional banks provide local adjustments by serving as a means of secondary financing in times of heavy withdrawal of deposits (labeled “advances”), helping adjust for the seasonal outflow of savings, and shifting resources from capital-surplus areas to capital-deficient areas. At the head of the system is a three-member Federal Home Loan Bank Board (FHLBB), whose duty it is to charter and regulate federal associations and govern the Federal Savings and Loan Insurance Corporation (FSLIC) and the Federal Home Loan Mortgage Corporation (FHLMC).

The division of labor between the federal and state government centers on chartering of the associations. Federally-chartered associations are organized as “mutuals” (i.e., owned by their depositors and borrowers), and recently, may be organized under Charter S as a stock association. In California, most state-chartered associations are owned by their stockholders, although a few are mutuals. This difference in chartering is important because different laws are applied in each instance.

All federal associations are members of the Bank System by regulation, and are required to be insured by the FSLIC. They are governed by the Home Owner's Loan Act of 1933 and regulations of the Federal Home Loan Bank Board. State associations do not have to be members of the FSLIC and are not

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16. “Advances” are loans to the associations by a Federal Home Loan Bank (FHLB), which serve as the primary source of funds for everyday cash needs when savings flows decrease. Advances to members of the FHLB of San Francisco at 12/31/77 were almost $5 billion. Federal Home Loan Bank of San Francisco, Annual Report 27 (1977). They are an expensive form of credit. For example, the FHLB of San Francisco was charging 10.75% on Short-Term Credit (70 to 360 days), effective Nov. 16, 1978. Federal Home Loan Bank of San Francisco, Bulletin No. 170 (Nov. 15, 1978).


19. 12 C.F.R. §§ 552.1-.12 (1979). A “Charter S” association is a federal savings and loan which is a stock (shareholder owned) instead of a mutual (depositor owned) organization.

19.1. This statement, regarding FSLIC membership, should be qualified as it applies to state-chartered savings and loan associations in California. The regulation on point is found in 10 CAL. ADMIN. CODE § 145.11 (1978), which states: “No savings and loan association shall commence in this state the business of accepting savings, unless its accounts are insured by the Federal Savings and Loan Insurance Corporation.” (Emphasis added.) The California Department of Savings and Loan has interpreted this section as requiring all state-chartered savings and loans, before being
governed by the Home Owner’s Loan Act. However, ninety-five percent of the state-chartered associations have insurance through the FSLIC.\(^2\) This connection makes them members of the system and, at least to some extent, brings them within the ambit of federal regulations. As of 1974, the FHLBB supervised 2,048 federals and 2,030 state-chartered institutions.\(^2\) It is within this institutional setting of the Federal Home Loan Bank System, that the question of preemption must be viewed.

**Wellenkamp and the Preemption Issue**

An understanding of the Bank System is only the first inquiry necessary in deciding whether Wellenkamp applies to federal associations. Whether a federal law preempts state law requires an analysis of congressional intent and a constitutional inquiry into the supremacy and commerce clauses.

The federal regulation in question is spelled out in Title 12, section 545.6-11(f) and (g) of the *Code of Federal Regulations*\(^2\) licensed to operate, to have FSLIC insurance. It is also the Department’s understanding, however, although not covered expressly by statute or regulation, that such insurance should be kept during the association’s operation.

20. B. Gup, *Financial Intermediaries: An Introduction* 51 (1976). At year-end 1977, there were a total of 188 associations belonging to the FHLB of San Francisco (District 11, serving Cal., Nev., Ariz.), of which 79 were federally-chartered and 109 were state-chartered. U.S. League of Savings and Loans, *Savings and Loan Fact Book* 1978, at 96.


22. The relevant part of 12 C.F.R. § 545.6-11 (1979) follows:

(f) *Due-on-sale clauses.* 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. Except as provided in paragraph (g) of this section with respect to loans made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, exercise by an association of such an acceleration option (hereafter called a due-on-sale clause) shall be governed exclusively by the terms of the contract between the association and the borrower, and all rights and remedies of the association and borrower thereto shall be fixed and governed by said contract.

(g) *Limitations on the exercise of due-on-sale clauses.* (1) With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association may not exercise a due-on-sale clause based on any of the following:

(i) Creation of a lien or other encumbrance subordinate to the association’s security instrument;

(ii) Creation of a purchase money security interest for household appliances;
promulgated by the FHLBB. Section (f) is the authorizing clause, allowing federal associations to use the due-on-sale

(iii) Transfer by devise, descent, or by operation of law upon the death of a joint tenant; or
(iv) Grant of any leasehold interest of three years or less not containing an option to purchase.

(2) With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, no Federal association shall impose a prepayment charge or equivalent fee in connection with the acceleration of the loan pursuant to the exercise of a due-on-sale clause.

(3) With respect to any loan made after July 31, 1976, on the security of a home occupied or to be occupied by the borrower, a Federal association shall have waived its option to exercise a due-on-sale clause as to a specific transfer if, prior to that transfer, the association and the person to whom the property is to be sold or transferred (the existing borrower's successor in interest) reach written agreement that the credit of such person is satisfactory to the association and that the interest payable to the association on sums secured by its security instrument shall be at such rate as the association shall request. Upon such written agreement and resultant waiver, the association shall release such existing borrower from all obligations under the loan instruments, and for purposes of § 541.14(a) the association shall be deemed to have made a new loan to such existing borrower's successor in interest.

Another relevant code section is 12 C.F.R. § 556.9 (1979) which states:

*Imposition of late charges and due-on-sale clauses.*

(a) The Board allows Federal savings and loan associations certain authority to incorporate into loan instruments provisions for imposition of late charges, prepayment charges, and exercise of acceleration clauses, including due-on-sale clauses. The Board expects associations to adopt procedures sufficient to ensure that, no later than the time of loan closing, the rights and obligations of the contracting parties under these provisions are fully and specifically disclosed to borrowers.

(c) Paragraph 545.6-11(g)(1) of this subchapter prohibits with respect to borrower-occupied-home loans made after July 31, 1976, exercise of due-on-sale clauses to accelerate the loan based on creation of junior liens, certain purchase-money security interests, transfers by devise, descent, or by operation of law upon the death of a joint tenant, and certain short-term leasehold interests. However, the Board believes that there may be other situations respecting loans made on the security of borrower-occupied homes in which, depending on the circumstances of the individual case, it will be appropriate for Federal associations to waive their contractual right to accelerate. These situations include transfers of title to members of the borrower's immediate family, including a former spouse in connection with a divorce, who occupy or will occupy the property. . . . In addition, associations should consider waiving any right to require an increase in interest rate pursuant to a due-on-sale clause in cases of extreme hardship to the existing borrower.

(d) Paragraph 545.6-11(g)(3) of the subchapter authorizes Federal associations to increase the interest rate as a condition of loan assumption. However, the Board expects that no association will request an increase in the interest rate to a rate in excess of the then prevailing rate on comparable new loans made by the association applying its normal underwriting standards.
clause as a matter of contract between the association and the borrower. Section (g) presents the limitations under which the due-on-sale clause may be exercised.

Two questions must be answered to determine if section 545.6-11(f) preempts Wellenkamp: First, is there any real conflict between Wellenkamp and the federal rule? And second, although FHLBB regulations have been held preemptive in internal affairs of savings and loans, does this preemptive power also extend to contract rights involving a borrower that may go beyond the scope of internal affairs? The resolution of these questions depends to a large extent upon congressional intent expressed in the Home Owner's Loan Act (HOLA).²³

Wellenkamp and Section 545.6-11(f), (g)—The Supremacy Clause Argument

It is a well-established principle of constitutional law that when a valid federal law²⁴ conflicts with a state law, the federal law prevails.²⁵ Since the FHLBB is an instrumentality and agency of the United States Government charged with administering federal law, its regulations, like congressional legislation, are also preemptive.²⁶

McCulloch v. Maryland²⁷ recognized the importance of having various implied powers vested in Congress in order to implement those powers expressly granted under article I, section 8 of the U.S. Constitution. In McCulloch, the Supreme Court held that Congress could create the Second Bank of the United States, as it was a necessary and proper means in carry-

²³. See note 9 supra.
²⁴. The meaning of "valid," is that Congress has been empowered to enact laws necessary and proper to carrying out those enumerated powers under art. I, § 8 of the U.S. Constitution.
²⁵. U.S. Const. art. VI, § 2 states:
This Constitution, and the laws of the United States which shall be made in pursuance thereof... shall be the supreme law of the land; and the Judges in every State shall be bound thereby, anything in the Constitution or laws of any State to the contrary notwithstanding.
ing out the federal government's fiscal operations. Based on the McCulloch rationale, the Home Owner's Loan Act of 1933, establishing federal savings and loans governed by the FHLBB, has been upheld as a constitutional exercise of congressional power.²⁸

The Supreme Court has addressed the subject of preemptive federal power many times, and has come up with the following general rule: A state law may be preempted if it is directly contrary to a federal law on point and Congress expresses an intent to preempt through uniform national policy, or if the state law somehow frustrates the purpose of the federal law,²⁹ or has a basic incompatibility with it, even though not inconsistent.³⁰ The Court has shown that Congress may even preempt state "police" powers,³¹ should they conflict with, or frustrate a federal law.³² For our purposes then, although federal associations are subject to some state regulation,³³ the FHLBB has plenary powers in many areas. This power is explicit in HOLA³⁴ and, with the force of the supremacy clause, preempts Wellenkamp.


²⁹ Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978); Burbank v. Lockheed Air Terminal, 411 U.S. 624 (1973). As to what constitutes a "conflict" with state law, see Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963)(a conflict exists "where compliance with both federal and state regulation is a physical impossibility . . . ." Id. at 142-43); Hines v. Davidowitz, 312 U.S. 52 (1941)(where the state law "stands as an obstacle to the accomplishment and execution of the full purpose and objectives of Congress." Id. at 67).


³¹ These police powers (e.g., those protecting health, safety and welfare), have traditionally been held to be within those powers expressly reserved to the states under the 10th amendment. The 10th amendment of the United States Constitution states: "The powers not delegated to the United States by the Constitution, nor prohibited by it to the States, are reserved to the States respectively, or to the people."

³² Ray v. Atlantic Richfield Co., 435 U.S. 151 (1978), held that federal law preempted a Washington State law regulating tankers navigating on Puget Sound. Such safety regulations were vested, by Congress, in the Secretary of Transportation exclusively, precluding even stricter state provisions. See also National League of Cities v. Usery, 429 U.S. 833 (1976).


³⁴ 12 U.S.C. § 1464(a) states:
(a) In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examina-
The Congressional Intent Argument

Theory and law. The United States Supremacy Court has indicated, however, that when a state's exercise of its power is challenged under the supremacy clause, "we start with the assumption that the historic . . . powers of the States were not to be superceded by the Federal Act unless that was the clear and manifest purpose of Congress." As the Federal District Court in Glendale Federal Savings and Loan Association v. Fox aptly put it:

The relevant inquiry is whether Congress has either explicitly or implicitly declared that the States are prohibited from regulating the loan instruments of federal savings and loan associations chartered by the Federal Home Loan Bank Board.

The congressional intent in HOLA is found in its statement of purpose:

In order to provide local mutual thrift institutions in which people may invest their funds and in order to provide for the financing of homes, the Board (FHLBB) is authorized, under such rules and regulations as it may prescribe, to provide for the organization, incorporation, examination, operation, and regulation of associations to be known as 'Federal Savings and Loan Associations,' and to be issued charters therefor, giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States. (Emphasis added.)

McKenna, Control and Management of Federal Savings and Loans, 27 So. Cal. L. Rev. 47, 53 (1953) states:

A reasonable conclusion from Section 5, particularly paragraphs (a) and (d) of the HOLA (now 12 U.S.C. §§ 1464(a) and (d)) and the references to regulations is a Congressional mandate that uniform rules be prescribed for the conduct of all units in the federal savings & loan system.

35. Rice v. Santa Fe Elevator Corp., 331 U.S. 218, 230 (1947)(emphasis added). Ray v. Atlantic Richfield Co. makes it clear that this "clear and manifest purpose of Congress" can be either express (declared by statute itself) or implied (state policy frustrates or the scheme is so pervasive as to reasonably infer Congress meant only federal action, or where the federal interest precludes the state from acting because it is so dominant). 435 U.S. at 157-58.

practices of local mutual thrift and home-financing institutions in the United States. (Emphasis added.)

When this statute is analyzed with the historical perspective under which HOLA was enacted—a time when many home-owners were defaulting on their loans—it is evident that a uniform system was needed to rebuild the home-financing industry and to stop ruinous state practices.

The need for a uniform federal scheme was apparent when the Ninth Circuit stated that the FHLBB governs the entire range of federal savings and loan practices “from . . . cradle to . . . corporate grave.” The court stressed that “no provision is made for sharing the Board’s delegated authority with state regulatory or supervisory agencies.”

In addition, Congress has mandated a procedure for home loan lending which implicitly must include the due-on-sale clause. The reason is that the due-on provision is an essential term in all loan contracts in which it is included. And finally, the mandate for uniformity seems to be the Bank Board’s interpretation of HOLA, since it has enacted an entire regulatory scheme for home loans, including due-on-sale clauses.

38. The statute creating federal associations is valid under the “general welfare” clause, in view of the national scope of the problem of preserving home ownership and promoting sound systems for home mortgages. First Fed. Sav. & Loan Ass’n v. Loomis, 97 F.2d 831 (7th Cir. 1938), cert. dismissed sub. nom. Martin v. First Fed. Sav. & Loan Ass’n, 305 U.S. 666 (1939).

The HOLA preamble (12 U.S.C. § 1464(a)) suggests it was passed because of state “sharp lending practices.” Seminar by Fred Crane, supra note 4.

39. People v. Coast Fed. Sav. & Loan Ass’n, 98 F. Supp. 311, 316 (S.D. Cal. 1951); Meyers v. Beverly Hills Fed. Sav. & Loan Ass’n, 499 F.2d 1145, 1147 (9th Cir. 1974); see also McKenna, supra note 34, and Plaintiff’s Points & Authorities, supra note 36, at 11 n.10, quoting MARVELL, THE FEDERAL HOME LOAN BANK BOARD 26 (1969): “[T]he states had developed a hodge podge of savings and loan laws and regulations, and Congress hoped that FHLBB rules would set an example for uniform and sound savings and loan regulations.”


Every Federal Court which has addressed preemption questions involving HOLA has held that Congress impliedly intended that federal law should govern the regulation of federal savings and loan associations.... Such holdings establish the impropriety of any state regulation in the area.

(Emphasis added.)

43. See 12 C.F.R. § 545.6 (1979); FHLBB Resolution 76-296, at 1-2, 5 (Apr. 28, 1976). The argument that the FHLBB regulation preempts state law only on internal
Case interpretation. In addition to the Bank Board and Congress, the courts have interpreted the intent behind HOLA as one demanding uniformity. In People v. Coast Federal Savings and Loan Association, the issue presented was whether state or federal law would apply where a federal savings and loan was charged with transacting business in such a way that the public was led to believe it was a bank. The misrepresentation was a violation of state law. Addressing the preemption problem, the court stated:

Not only does the act of Congress (HOLA) which authorized the creation, operation and supervision of federal savings and loan associations by the Home Loan Board, embrace the entire field, but the comprehensive rules and regulations adopted by the Board clearly meet the test of covering the subject matter of the Statute. To federal savings and loan associations, Congress made plenary, preemptive delegation to the Board to organize, incorporate, supervise and regulate, leaving no field for state supervision. (Emphasis added.)

In another case, Meyers v. Beverly Hills Federal Savings and Loan Association, the Ninth Circuit agreed with the Coast Federal approach on facts very similar to Wellenkamp. In Meyers, plaintiff borrowers alleged that prepayment penalty provisions in the loan agreements of federal associations were void under California law. The court, taking notice of the Coast Federal principle—that the Board promulgated comprehensive regulations covering the association from its cradle to its corporate grave—found that "somewhere between the 


The Silberman and Chapman cases go beyond mere internal affairs since the practice of redlining—failure to lend in low-income areas—affects potential borrowers. This same effect is analogous to the effect on borrowers that a due-on-sale clause would have. Silberman also involved a due-on-sale issue, but only the red-lining issue has been appealed.

44. 98 F. Supp. 311 (S.D. Cal. 1951).
45. Id. at 318. See also 13 AM. JUR. 2d, Building and Loan Assoc's § 10 n.5 (1964).
47. 499 F.2d 1145 (9th Cir. 1974).
48. The alleged violation concerned CAL. CIV. CODE § 1670 (West 1979), which provides that every contract by which an amount of damages is to be paid for breach of that contract, is void if determined in anticipation thereof.
dle and the grave is 12 C.F.R. § 545.6-12(b), which specifically covers the area of prepayment penalties . . . ." The due-on-sale clause, like the prepayment penalty of Meyers, and association advertising practices of Coast Federal, similarly affects the public. It is therefore difficult to distinguish the due-on-sale clause from Meyers or Coast Federal on the grounds that the latter cases are regulations of internal affairs that do not affect the public.

In the Glendale Federal Savings and Loan Association v. Fox case, the FHLBB recognized that, even though section 545.6-11(f), (g) is said to apply on or after June 8, 1976, the wide use of due-on-sale clauses by federals was evident during annual examinations and audits before that date and that such practices had thereby received the Board’s tacit approval. Also, Board regulations provided that all loan contracts were to give full protection to associations. The Bank Board interpreted the 1948 regulation as authorizing use of the due-on-sale clause as necessary to achieve such full protection.

Furthermore, HOLA provides that the FHLBB is to regulate “giving primary consideration to the best practices of local mutual thrift and home-financing institutions in the United States.” One of the goals Congress sought in that section of

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49. 499 F.2d 1145, 1147 (9th Cir. 1974). See also Kaski v. First Fed. Sav. & Loan of Madison, 240 N.W.2d 367 (1976), where the Wisconsin Supreme Court, drawing from Meyers v. Beverly Hills Fed. Sav. & Loan Ass’n, upheld an interest rate escalation clause contained in a note of a federal association. The court held that “it is apparent that Congress has substantially occupied the field in regard to the regulation of federal savings and loan associations, particularly in the area of the regulation of lending practices.” Id. at 371.

50. FHLBB Resolution No. 76-296, at 6 (Apr. 28, 1976).
51. Examinations are held pursuant to 12 U.S.C. §§ 1726(b), 1730(m)(1)-(2) (1977).
52. 12 C.F.R. § 545.6-11 (1979).
53. See, e.g., Letter from FHLBB to the individual addressed (June 6, 1974)(unpublished, government agency ruling), reprinted in U.S. LEAGUE OF SAV. & LOAN, FED. GUIDE § 12, Para. U 12-49.70, which provides:
   [1]It is our view that the association could require the purchaser, as a condition of permitting the substitution, to assume the mortgage at the increased rate with increased monthly payments . . . . This clause was in use for all lending by the association prior to January 1, 1974, and is currently used for all of its lending . . . . We agree with the association that the opportunity to deal with new customers on a current rate basis is desirable.

See also 7 FEDERAL HOME LOAN BANK BOARD JOURNAL 25 (Sept. 1974) reprinted in U.S. LEAGUE OF SAV. & LOAN, FED. GUIDE § 14 (ruling issued by the Office of the General Counsel of the FHLBB).
HOLA, was to improve upon the failures of the Federal Home Loan Bank Act.\textsuperscript{55} A major shortcoming of that legislation was that a variety of conflicting state policies governed the home-financing system.\textsuperscript{56} Realizing that Congress sought to remedy this shortcoming, an Illinois federal court in \textit{Lyons Savings and Loan Association v. FHLBB}\textsuperscript{57} held that HOLA requires the Board to give “primary consideration to the best practices of local . . . home-financing institutions in the United States.”\textsuperscript{58} The decision went on to say that “the courts have construed this language as vesting discretion in the Board to determine, first, what the ‘best practices’ are, and second, to implement them on a nationally uniform basis.”\textsuperscript{59} Finally, the court noted that state law cannot limit what the Board thinks is the “best practice, . . . without undermining this fundamental purpose of the statute.”\textsuperscript{60}

Assuming that preemption only applied to the governing of an association’s internal affairs, the court in \textit{Kaski v. First Federal Savings and Loan of Madison} recognized that “regulation of loan practices directly affects the internal management and operations of federal associations and therefore requires uniform federal control.”\textsuperscript{61} The FHLBB, in its Resolution No. 75-647, argued that applying state law to due-on-sale provisions did involve internal affairs of the association since it regulated when and under what terms new members could be accepted.\textsuperscript{62} The Board further argued that the efficiency of

\textsuperscript{55} For example, by 1933—one year after passage of the Act and the year HOLA was passed—40% of all home loans in the U.S. were in default. Plaintiff’s Points & Authorities, supra note 36, at 7. See generally FHLBB, \textit{The Federal Home Loan Bank System}, 17-28 (1961).

\textsuperscript{56} See Marvell, supra note 35. For example, the Home Owner’s Loan Corporation (HOLC) was created under HOLA to exchange its obligations for mortgages held by all savings and loan associations. But in striving for a uniform standard, HOLC would only take loans providing for direct repayment in equal monthly installments. It would not accept those loans with provisions in widespread use under state laws, which practices were injurious to associations. These practices included balloon payments and repayment by requiring “sinking fund” savings accounts. The clear intent was to suppress these dangerous state practices which varied so much from state to state. For more on the mandate of uniformity see People v. Coast Fed. Sav. & Loan Ass’n, 98 F. Supp. 311, 319 (S.D. Cal. 1951); Rettig v. Arlington Heights Fed. Sav. & Loan Ass’n, 405 F. Supp. 821, 826 (N.D. Ill. 1975).


\textsuperscript{58} 377 F. Supp. at 17.

\textsuperscript{59} Id. at 18.

\textsuperscript{60} Id. at 17-18.

\textsuperscript{61} 240 N.W.2d 367, 373 (1976).

federal associations would be impaired and state law would further interfere with the purpose of HOLA.\textsuperscript{63}

In summary, it is established that federal law preempts state law where Congress has, expressly or impliedly, intended that federal law should apply. An examination of HOLA and its historical setting clearly shows congressional intent for a uniform national policy regarding federal savings and loan associations. Also, HOLA authorized the FHLBB to exercise its regulatory authority in order to accomplish this uniform policy after looking at all the best practices of the states. Furthermore, it is firmly established that federal law is preemptive in areas of internal affairs of federal associations and it has been recognized that regulation of loan practices (including due-on clauses) is internal.

The Interstate Commerce Argument

In addition to the supremacy clause and clear congressional intent, Wellenkamp's applicability to federal associations may be attacked on grounds that it unduly burdens interstate commerce.\textsuperscript{64}

Whether savings and loan activity is within this definition of interstate commerce, is without question.\textsuperscript{65} Gibbons \textit{v. Ogden},\textsuperscript{66} the seminal case validating federal power to regulate interstate commerce, interpreted the commerce clause very broadly. This commerce includes not only "traffic among and between the states, but intercourse" as well.\textsuperscript{67} Savings and loan associations are involved in a nationwide network of lending practices.\textsuperscript{68} In addition, the Federal Home Loan Bank System, associations may, by charter, make obligors members of the association. Also, 12 C.F.R. § 544.1(a)(4) (1979) requires all new federal associations to make savers and borrowers members of the association.

63. For an explanation on how efficiency would be impaired, see text accompanying notes 78-97 infra.
64. Art. I, § 8 of the U.S. Constitution holds that Congress shall have the power "[t]o regulate commerce with foreign nations, and among the several States . . . ."
65. See Russell, Savings and Loan Associations 561 (1960), citing First Fed. Sav. & Loan Ass'n \textit{v. Loomis}, 97 F.2d 831 (1938), which states, "Many authorities . . . have taken the position that the powers to provide for the 'general welfare' and to regulate commerce . . . ," could be invoked to justify congressional action involving savings and loans. (Emphasis added.)
67. This includes all commercial intercourse between different states, and all component parts of that intercourse. Carter \textit{v. Carter Coal Co.}, 298 U.S. 238 (1936).
68. Nationwide lending is described in 12 C.F.R. § 563.9 (1979). Section (a) describes this practice as involving the making or purchasing of loans "on the security
operating through quasi-governmental entities," promotes the flow of funds into the national housing market by establishing an active secondary market in mortgages. Both these practices involve the transfer of funds over state lines, well within the scope of interstate commerce set out in *Gibbons*.

When a state attempts to regulate a business in interstate commerce, the United States Supreme Court may determine whether or not federal law exists that preempts state law. The Court has used various methods, including the traditional test found in *Cooley v. Board of Wardens of the Port of Philadelphia*, and, the *Ray v. Atlantic Richfield Co.* analysis, which is the general test the Court focuses on today.

In *Cooley*, the Court held that where Congress enacts legislation dealing with a problem of national concern, it may require a *uniform system*; that is, Congress may justly call for exclusive federal legislation. Congress has made a demand for a uniform system in the Home Owner's Loan Act, creating federal associations and making the FHLBB their exclusive governing agent. *Ray* looked to *congressional intent* behind the federal law in order to judge whether it preempts state law. A review of HOLA shows that Congress did intend to give exclusive governing power over federal associations to the FHLBB.

The state law, declared in *Wellenkamp*, is a burden on

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of real estate located *outside* its normal lending territory . . . ." *Id.* § 563.9(2) (emphasis added). Lenders may also participate with other lenders in making these loans. Federal savings and loan associations are permitted to make such loans. *U.S. League of Savings and Loans, Federal Guide* 6116 (opinion of the General Counsel of the FHLBB, Oct. 24, 1967).

69. These entities include the Federal Home Loan Mortgage Corporation, the Federal National Mortgage Association, and the Government National Mortgage Corporation.


71. 53 U.S. (12 How.) 299 (1851).


73. *See text accompanying notes 38-63 supra*, for the argument that HOLA was a congressional mandate for a uniform system.

74. The *Ray* court stated that:

The Court's prior cases indicate that when a State's exercise of its police power is challenged under the Supremacy Clause, "we start with the assumption that the historic police powers of the States were not to be superseded by the Federal Act unless that was the clear and manifest purpose of Congress." *Id.* at 157 (quoting *Rice v. Santa Fe Elevator Co.*, 331 U.S. 218, 230 (1947)).

75. *See text accompanying notes 35-63 supra*, for the congressional intent argument in support of preemption.
interstate commerce and is therefore preempted, because it frustrates the purpose of national uniformity since it is contradictory to an express regulation of the Bank Board allowing the due-on-sale clause.

The case of *San Diego Building Trades Council v. Garmon* confirms the notion that an important factor in a question of preemption is "the fact that Congress has entrusted administration of the . . . policy for the Nation to a centralized administrative agency . . . ." In our case, such an agency is the FHLBB, authorized to set a uniform policy for the nation's savings and loans. Frustration of this purpose by state law is an impermissible burden on Congress' commerce power.

**Preemption and the Economics of Interest Rate Adjustment**

In judging whether *Wellenkamp* applies to federals, this comment suggests that the congressional intent in HOLA should not be the only convincing factor in favor of preemption. Since the passage of HOLA, a broad statutory scheme has evolved that protects borrowers from the kinds of default problems encountered during The Depression. But it is only a healthy home-loan industry that can continue to successfully carry out the full intent of HOLA. Therefore, it is important to examine the potentially adverse effects of *Wellenkamp* on the future operations of savings and loan associations.

Savings and loan associations have at least two recurring economic problems: outward flow of funds, or disinterme-

77. Id. at 242. The Garmon case has been explained as illustrative of the "one master" theory:

When Congress delegates broad regulatory power to a federal agency without addressing itself to the question of preemption in any detail (as is true in HOLA), the court (referring to the U.S. Supreme Court) infers that the agency will make all of the regulations which it deems to be required in the field. As a corollary of this principle, the court generally infers that supplementary state regulations are to be pre-empted either because of an inference that the federal agency's failure to establish similar regulations represents an agency judgment that they are not needed or because of the operation of other presumptive considerations such as the need for national uniformity.


78. See text accompanying notes 38-39 supra.
79. Residential financing has been revitalized since The Depression, to become one of the most substantial uses of credit in the nation. See note 89 infra.
disintermediation, and profit "squeezes" caused by a peculiar asset-liability structure. In part, disintermediation results from low interest rate ceilings on deposits relative to other interest attractive investments. The outflow of money, of course, directly reduces the amount of loanable funds available for mortgages, "and in some cases threaten[s] the very existence of some savings and loan associations." An equally perplexing problem is that the asset structure of savings and loan associations (mostly loan repayments) is much more long-term than the liability structure (mostly interest on savings). The inability to turn over assets faster, resulting in existing loan rates lagging behind market rates, coupled with high interest rates being paid on shorter-term savings accounts, causes a profit squeeze on savings and loan associations. To help prevent the adverse effects of disintermediation and profit squeezes, the due-on-sale provision assures an inflow of funds and quickly adjusts low-yield loans to current market rates.

The rationale behind the due-on-sale clause is fairness to the lender. When interest rates are high, the lender runs a risk that the rates may drop, at which point the borrower will often refinance his debt elsewhere at a lower rate and pay off the original, higher interest rate loan. But, when funds are loaned at lower interest rates, the lender runs the risk of losing the benefit of later market increases in the rate. Thus, the due-on-sale clause helps prevent the latter problem where there is an assumption of an existing loan, thus offsetting the lender's risks of refinancing should the rates drop.

There have been alternative suggestions for eliminating the harmful effects of disintermediation and profit squeezes, none of which are completely satisfactory. For example, the secondary mortgage market is available for unloading low yield loans. There are two reasons, however, why this is not very profitable: First, a loan with lower yield will have to be discounted by the difference between the lower face rate and the higher market rate, in order to be saleable; and second, a loan

80. Federal Reserve Bank Regulation Q, 12 C.F.R. §§ 217.0-.7 (1979) governs the interest ceiling that is kept on savings deposits of financial institutions.
81. Short-term rates in the nation's money markets, rose more than 150 basis points from April to October, 1977. This played a key role in inhibiting the inflow of new savings during the latter half of 1977. Federal Home Loan Bank of San Francisco, Annual Report 10 (1977).
83. Id. at 53.
without a due-on-sale provision is less attractive than a loan with such a provision. Thus, associations in states that allow due-on provisions would have a distinct advantage over those states that do not allow such provisions in terms of saleability.84

Another alternative to the due-on-sale clause for interest rate adjustment is the Variable Rate Mortgage (VRM, or Variable Interest Rate—VIR). Pursuant to California Civil Code section 1916.5,85 the VRM can increase a maximum of 2.5 percent based upon a Cost of Deposits and Borrowings Index of the FHLB. The problem is that there is currently no active secondary market for VRM's since VRM's are still in their unproven, experimental stage. As of June 30, 1979, only twenty-three of one hundred eight associations in California were using the variable rate device.86 Moreover, an association would be placed in the precarious position of being forced to rely on set maximum increases provided by the VRM, while decreases in rate are unlimited.87 Finally, use of VRM's by federal associa-


The Office of Economic Research views the revocation of the "due-on-sale clause" as a factor that will lead to higher mortgage interest rates and will reduce the marketability of such mortgages in the secondary market.

.... [T]he due-on-sale clause is an important part of the mortgage contract throughout the country, and its revocation sets a dangerous precedent in terms of the consequences in the mortgage market.

It is noteworthy that Covenant 17 of the Uniform Deed of Trust, issued by the Federal National Mortgage Corporation and the Federal Home Loan Mortgage Corporation, is a due-on-sale clause.


86. Telephone conversation with Joseph Vella, California Department of Savings and Loan, quoting from an internal report entitled "Mortgage Loans Outstanding" (Nov. 7, 1979). The FHLBB has also noted the experimental nature of VRM's, regarding the recent approval of the instrument for federal associations. See note 85 supra. They have classified the instrument as "controversial" and plan on monitoring association's offering VRM's "to ascertain whether borrowers are being offered an effective choice." 43 Fed. Reg. 59337 (1978).

In addition, 12 C.F.R. § 545.6-2(c)(2)(b)(iii)(1979) provides an expiration date (4 years after implementation) for the regulations approving VRM usage by federal associations. The FHLBB claims the reason for this expiration date is "to give the Bank Board sufficient time to assess the value and effect of VRM's in the mortgage market." 43 Fed. Reg. 59337 (1978).

87. The unlimited decrease in rate can be a heavy burden, because downward adjustments must be made, while increases are at the lender's option. 12 C.F.R. § 545.6-2(c)(4)(iv) (1979).
tions is very restricted.88

In addition to eliminating the dangers of profit squeezes and disintermediation, the due-on-sale clause serves another purpose. Rising interest rates are often part of a design by federal monetary authorities to make credit less available, and tighten the money supply. This is true especially during an inflationary period. Allowing assumptions of loans at lower interest rates by abandoning the due-on-sale clause circumvents this purpose. While the assumptions of home loans at lower rates in California may only have a small effect compared to all other credit activity in the country, new laws prohibiting the due-on-sale clause may spread to other states thereby multiplying the aggregate effect.88 Already, Arizona90 and Arkansas91 have joined California in what is currently the minority rule, striking down the due-on clause for interest adjustment purposes.92

Another problem of limiting the lender's use of the due-on-sale provision was pointed out by Justice Clark in his Wellenkamp dissent. Future borrowers would have to pay much higher interest rates to offset the losses the association will sustain as a result of Wellenkamp. The Justice states that, "in attempting to assist the Wellenkamps, the majority opinion must necessarily restrict if not dry up mortgage funds otherwise available to the next generation of borrowers."93

Finally, the FHLBB has expressed its expectation that interest rates, negotiated upon assumption of a loan after a due-on-sale has been exercised, will not be unconscionable. Lenders permitting written assumption with interest adjust-

88. 12 C.F.R. § 545.6-2(c)(2)(a), (b) (1979) requires that the FHLBB determine that a federal association needs the VRM "to maintain competitive balances with other financial institutions..." before the association is authorized to use the instrument.

In addition, the disclosure documents (used to allow the borrower to make an informed choice between VRM's and other types of loans) required by 12 C.F.R. § 545.6-2(c)(5) (1979), would be "costly and burdensome." 43 Fed. Reg. 59337 (1978).

89. There is evidence that home lending is not such a small proportion of total credit activity in the United States. At year-end 1977, residential mortgage loans outstanding totaled $760.6 billion (savings and loans held about $400 billion of this amount), representing 23.1% of all credit outstanding in the United States. Only the federal debt was of comparable size, at $730.9 billion. U.S. LEAGUE OF SAVINGS AND LOANS, SAVINGS AND LOAN FACT BOOK 1978, at 26.

93. 21 Cal. 3d at 954, 582 P.2d at 977, 148 Cal. Rptr. at 386.
ment are strictly limited by federal regulation\(^4\) in that they may not charge rates in excess of the prevailing market.\(^5\) This idea is premised upon the notion that the marketplace should be the guide to interest rates and it is not the place of the courts to set up low cost real estate as a "property right". Rates, instead, are a contract right granted to a borrower at arm's length and not intended to be passed onto the subsequent purchasers of the property.\(^6\) A lender may be willing to lend money to some person at one rate of interest, but insist upon a higher rate for other less desirable risks. This is not a lack of good faith or fair dealing between borrowers and lenders, but is a justified exercise of the lender's prerogatives. Applying *Wellenkamp* to federal associations allows the courts to make a better contract for the property seller and assuming purchaser than the marketplace would allow.\(^7\)

**The Glendale Cases and A.B. 748**

In *People v. Glendale Federal Savings and Loan*

\(^4\) See Fed. Home Loan Bank Board J., Apr. 1976. Lenders are limited under the terms of 12 C.F.R. § 545.6-11(g)(3) (1979) (provision for written assumptions by borrowers and waiver of due-on-sale clause by lender).

\(^5\) 12 C.F.R. § 556.9(d) (1979).

\(^6\) 44 Legal Bull. 370, 376 (Nov. 1978).

\(^7\) It is noteworthy that in the case of *People v. Glendale Fed. Sav. & Loan Ass'n*, No. C 147921 (Super. Ct. L. A. County 1979), plaintiffs contended, and the court agreed, that *Wellenkamp* would not provide an economic detriment to federal associations. Accordingly, the court granted plaintiff's motion for judgment pursuant to Cal. Civ. Proc. Code § 631.8 (West 1979) on this issue. The text of the court's discussion was as follows:

The Court finds that the impact of the imposition of Wellenkamp restrictions on the exercise of due-on-sale provisions in pre June 8, 1976 loan contracts is insignificant, and that there is no discrimination. Counsel have agreed that the test is whether or not the state restrictions would "handicap or obstruct the operation of the Federal institution to such extent that it could not carry out the intent of Congress." The opinion of the expert as to the economic loss which would be suffered is largely based on assumption and supposition. Even if accepted, the loss of income to the Association would not be such that it would be prohibited from carrying out the purpose of Congress. The burden must be actual and not merely hypothetical. It is nothing more than a guess to project that just because of the restrictions imposed by Wellenkamp the funds represented by pre June 8, 1976 loans will be locked in and funds will not be available to the association, but even accepting the figures presented by defendant the impact would be insignificant. The purpose for which Federal Savings and Loans were established is to provide assistance and relief to homeowners, and neither that purpose nor any of the subsequent purposes will be frustrated by the imposition of the Wellenkamp restriction on that portion of the loan portfolio consisting of pre
Association,\textsuperscript{88} filed in 1975 before the enactment of FHLBB's section 545.6-11(f), (g) regulation governing due-on-sale, the State of California sought declaratory and injunctive relief against the defendants, alleging that the defendant violated \textit{Tucker v. Lassen Savings and Loan Association}\textsuperscript{89} by accelerating repayment of a loan solely on the grounds that the debtor-seller entered into an installment land-sale contract. This, the State claimed, was done to unlawfully readjust the interest rate. The defendant maintained that its exercise of the due-on-clause was valid, regardless of the \textit{Tucker} violation, since federal law authorizes use of the clause by federal associations. According to a minute order dated July 30, 1979, the Superior Court, County of Los Angeles determined that plaintiff was bound by judgment in \textit{Glendale v. Fox}\textsuperscript{100} under principles of collateral estoppel.\textsuperscript{101} The court, however, expressed the opinion that having found no mandate for national uniformity, state law must be upheld, unless there is an actual conflict between federal and state law so the two cannot stand in the same area, or evidence is presented showing some congressional design to preempt the field.\textsuperscript{102}
Glendale Federal Savings and Loan Association v. Fox involved a California law\(^{103}\) that required the Real Estate Commissioner's approval before a developer could sell or lease parcels of a subdivision. Glendale was dropped as the "take-out" lender because, in the Commissioner's opinion, Glendale's standardized note and deed of trust were illegal under Civil Code section 2924.6.\(^{104}\) Glendale filed suit August 30, 1977 seeking, *inter alia*, a declaration that 12 C.F.R. section 545.6-11(f) and (g) preempted state law.

On June 21, 1979, the U.S. District Court entered a final summary judgment in favor of Glendale and cross-claimant, the Federal Home Loan Bank, pursuant to Rule 56(b) of the Federal Rules of Civil Procedure. The judgment held:

Federal law, including specifically 12 C.F.R. § 545.6-11(f) and (g), exclusively governs the validity and exercisability of due-on-sale clauses in the loan instruments of federally-

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\(^{103}\) CAL. BUS. & PROF. CODE § 11018 (West Supp. 1979).

\(^{104}\) Glendale was informed by the developer, in a letter authorized by the Commissioner of Real Estate, that its note and deed of trust did not conform with section 2924.6, which limits the exercisability of due-on-clauses. CAL. CIV. CODE § 2924.6 (West Supp. 1979) states:

(a) An obligee may not accelerate the maturity date of the principal and accrued interest on any loan secured by a mortgage or deed of trust on residential real property solely by reason of any one or more of the following transfers in the title to the real property:

(1) A transfer resulting from the death of an obligor where the transfer is to the spouse who is also an obligor.

(2) A transfer by an obligor where the spouse becomes a co-owner of the property.

(3) A transfer resulting from a decree of dissolution of the marriage or legal separation or from a property settlement agreement incidental to such a decree which requires the obligor to continue to make the loan payments by which a spouse who is an obligor becomes the sole owner of the property.

(4) A transfer by an obligor or obligors into an inter vivos trust in which the obligor or obligors are beneficiaries.

(5) Such real property or any portion thereof is made subject to a junior encumbrance or lien.

(b) Any waiver of the provisions of this section by an obligor is void and unenforceable and is contrary to public policy.

(c) For the purposes of this section, "residential real property" means any real property which contains at least one but not more than four units.

(d) This act applies only to loans executed or refinanced on or after January 1, 1976.
chartered savings and loan associations executed after June 8, 1976. California law on the validity and exercisability of due-on-sale clauses does not apply to such loan instruments.\(^{105}\)

The court found that no genuine issues of material fact remained, and that the state's affirmative defenses were without merit.

In its judgment, the court noted, as did the superior court in the state case, that although both cases had a different factual genesis, they involved the same controversy—federal preemption. Noting that mere pendency of a concurrent proceeding in state court does not automatically dismiss a federal action, the court, realizing the possibility of duplicative and conflicting decisions, nevertheless held that:

Both parties, however, have a substantial interest in having the issues presented by this action resolved [citation omitted], and the federal court appears to have reached such a resolution with more deliberate speed than the state court.\(^ {106}\)

**Assembly Bill 748**

There has been one final development in the *Wellenkamp* controversy: the introduction of Assembly Bill 748 on March 5, 1979.\(^ {107}\) AB 748 offered residential borrowers on one to four unit

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\(^{105}\) No. CV 77-3274-WMB, at 2.

\(^{106}\) Id. at 26.

\(^{107}\) A.B. 748, CAL. LEGIS. 1979-1980 Reg. Sess. states in pertinent part:

(a) A provision in a mortgage or deed of trust on residential or nonresidential real property permitting the mortgagee or beneficiary to accelerate the maturity date of the principal and accrued interest on a loan or other obligation secured by such mortgage or deed of trust upon a transfer of legal or equitable title to such real property, whether by deed, contract of sale, or otherwise, is not a condition restraining alienation or a restraint against alienation under Section 711, and is valid and enforceable, provided that, if the mortgage or deed of trust is on residential real property and secures a loan made by an institutional lender, the loan obligor was offered before consummation of the loan the choice between such loan and a comparable loan secured by a mortgage or deed of trust that excludes such acceleration provision. For purposes of this section, such choice may be offered subject to reasonable distinctions in terms (including, without limitation, the rate of interest and period of repayment) between loans made with an acceleration provision and loans made without such a provision.

(b) For purposes of this section, a difference in interest rate not exceeding 1 percent per annum and a variation in period of repayment of not more than five years shall be deemed to be reasonable distinctions in terms.
dwellings, a choice between two mortgage instruments—one that contains a due-on-sale clause (non-assumable), and one that does not contain such a clause (assumable). The exercise of the option would be subject to "reasonable distinctions in terms (including, without limitation, the rate of interest and period of payment)."\textsuperscript{108} The bill, however, specifies that the difference in interest may not exceed "1 percent per annum and a variation in period of repayment of not more than five years . . . ."\textsuperscript{109}

The California Savings and Loan League analyzed the bill as follows:

Under AB 748, the lender could charge a higher interest rate to those borrowers wishing the assumable loan, and require a shorter length of the life of the mortgage. Thus, a consumer who believes that mortgage rates will permanently rise and wants to take advantage of that fact when he sells his home would pay a premium for the ability to offer his fixed rate to a new buyer. The consumer who is only interested in the guaranteed mortgage rate for the period of time he owns his home, and does not want to speculate on the future mortgage rates and their potential advantage in selling his house, would pay a lower interest rate for his non-assumable mortgage (i.e., allowing financial institutions to adjust the interest rate to the new buyer according to existing market rates).\textsuperscript{110}

AB 748, however, failed to muster enough votes to pass the California Assembly. Thus, the \textit{Glendale v. Fox} case remains dispositive of the issue of \textit{Wellenkamp}'s applicability to federal associations.

\textbf{CONCLUSION}

Pending an appeal of \textit{Glendale v. Fox}, it appears that federal associations are free to exercise due-on-sale clauses in their deeds of trust (at least with respect to those instruments executed after June 8, 1976).\textsuperscript{111} The full effect of this bifurcated

\begin{itemize}
  \item \textsuperscript{108} \textit{Id.}
  \item \textsuperscript{109} \textit{Id.}
  \item \textsuperscript{110} Memo. to Editor from California Savings and Loan League (June 1, 1979) (emphasis in original)(on file at Santa Clara Law Review).
  \item \textsuperscript{111} For instance, some federal associations will start foreclosure proceedings if a buyer refuses to assume at a higher rate. Others attempt to exact various charges, points, or fees for assumption. And still others are accepting "Reservation of Rights Agreements." This latter arrangement between the new buyer and the lender, allows the buyer to take ownership and make payments on the assumed loan without threat
\end{itemize}
system created by Wellenkamp remains to be seen. Another open question is whether or not legislation addressing the Wellenkamp issue will arise again, given the two powerful interest groups involved—the real estate and savings and loan industries.

This comment advocates the need for uniformity in compliance with the intent of Congress expressed in the Home Owner's Loan Act. The Glendale summary judgment reflects this view. Without such national uniformity, we would take a step backward, allowing diverse state policies to govern as they did prior to the passage of HOLA.

The need for a healthy home-loan industry in the United States was a lesson well-learned in the Great Depression. The Federal Home Loan Bank Board's promulgation of 12 C.F.R. section 545.6-11(f) and (g), and its insistence on federal preemption, seeks to further this goal by retaining the due-on-sale clause as a valid interest rate adjuster.

The Glendale cases serve as excellent fora for clear resolution of the potential issues that Wellenkamp and the preemption doctrine present. The State of California and the federal government will most likely bring all their resources to bear on a denouement to these issues, especially in light of Wellenkamp's tremendous impact on the important real estate and home mortgage markets.

Kirk A. Musacchio

of foreclosure or litigation, pending the final disposition of the Glendale cases. The rights of neither party are waived, until this disposition. Seminar by Fred Crane, supra note 4.