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The Due-on Clause: A Preemption Controversy

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THE DUE-ON CLAUSE: A PREEMPTION CONTROVERSY

Whether the enforceability of due-on-sale clauses[1] contained in loan instruments executed between federal savings and loan associations and California residents should be governed by federal or state law is an issue raised in some thirty cases currently pending in federal district court for the Central District of California.[2] These cases have arisen

1. The "due-on-sale," "due-on-encumbrance," and "acceleration" clauses, all collectively referred to as the "due-on" clause, are provisions in loan instruments which give the lender the option to declare due and payable all remaining installments if the borrower sells, conveys, transfers, encumbers, or in any other way alienates his title to the mortgaged property without the prior written consent of the lender. 1 H. MILLER & M. STARR, CURRENT LAW OF CALIFORNIA REAL ESTATE § 3:66, at 103 (1975) [hereinafter cited as MILLER & STARR]. A due-on clause may be phrased as follows:

> If trustor shall sell, convey, or alienate the premises, or any part thereof, or any interest therein, or shall be divested of his title or any interest therein in any manner, whether voluntarily or involuntarily, without the prior written consent of beneficiary, or if default is made in the payment of any principal or interest payable under the secured ________ [note *or* bond] or in the performance of the covenants or agreements hereof, or any of them, beneficiary shall have the right at its option to declare any indebtedness or obligations secured hereby, irrespective of the maturity date specified in the ________ [note *or* bond] evidencing the same, immediately due and payable.

13 AM. JUR. LEGAL FORMS 2d, *Mortgages and Trust Deeds* § 179:255 (1971).

2. Ostern v. Glendale Fed. Sav. & Loan Ass'n, Civ. No. 76-2415 (C.D. Cal., filed Aug. 7, 1976); Burgess v. Home Fed. Sav. & Loan Ass'n, Civ. No. 76-1179 (C.D. Cal., filed April 12, 1976); Parham v. Home Fed. Sav. & Loan Ass'n, Civ. No. 76-1069 (C.D. Cal., filed April 1, 1976); California Fed. Sav. & Loan Ass'n v. Lasher, Civ. No. 76-829 (C.D. Cal., filed March 15, 1976); California Fed. Sav. & Loan Ass'n v. Woeltjen, Civ. No. 76-828 (C.D. Cal., filed March 15, 1976); Preston v. Fidelity Fed. Sav. & Loan Ass'n, Civ. No. 76-600 (C.D. Cal., filed Feb. 23, 1976); California Fed. Sav. & Loan Ass'n v. Fewins, Civ. No. 76-555 (C.D. Cal., filed Feb. 19, 1976); California Fed. Sav. & Loan Ass'n v. Beall, Civ. No. 76-554 (C.D. Cal., filed Feb. 19, 1976); California Fed. Sav. & Loan Ass'n v. Harding, Civ. No. 76-533 (C.D. Cal., filed Feb. 19, 1976); Hall v. Pomona First Fed. Sav. & Loan Ass'n, Civ. No. 76-528 (C.D. Cal., filed Feb. 17, 1976); California Fed. Sav. & Loan Ass'n v. Lightfoot, Civ. No. 76-492 (C.D. Cal., filed Feb. 11, 1976); California Fed. Sav. & Loan Ass'n v. Hendrix, Civ. No. 76-491 (C.D. Cal., filed Feb. 11 1976); California Fed. Sav. & Loan Ass'n v. Lockwood, Civ. No. 76-478 (C.D. Cal., filed Feb. 10, 1976); California Fed. Sav. & Loan Ass'n v. Diniz, Civ. No. 76-477 (C.D. Cal., filed Feb. 10, 1976); California Fed. Sav. & Loan Ass'n v. Baty, Civ. No. 76-456 (C.D. Cal., filed Feb. 9, 1976); California Fed. Sav. & Loan Ass'n v. Ryan, Civ. No. 76-455 (C.D. Cal., filed Feb. 9, 1976); California Fed. Sav. & Loan Ass'n v. Griebahn, Civ. No. 76-454 (C.D. Cal., filed Feb. 9, 1976); California Fed. Sav. & Loan Ass'n v. Mastrangelo, Civ. No. 76-453 (C.D. Cal., filed Feb. 9, 1976); Cancray Dev., Inc. v. Pomona First Fed. Sav. & Loan Ass'n, Civ. No. 76-450 (C.D. Cal., filed Feb. 9, 1976); California Fed. Sav. & Loan Ass'n v. Horn, Civ. No. 76-238 (C.D. Cal., filed Jan. 21, 1976); California v. Glendale Fed. Sav. & Loan Ass'n, Civ. No. 76-162 (C.D. Cal., filed Jan. 14, 1976);

against a background of diversely reasoned state and federal court decisions. None of these, however, has focused on the precise issue of whether Congress has preempted the area of the due-on clause.[3]

In recent California decisions, courts considering the enforceability of the due-on clause have held that a state association could not exercise its rights under the clause to accelerate mortgage payments when the borrower had entered into an installment sale contract[4] or had executed a junior encumbrance[5] absent an affirmative showing that the transfer enhanced the likelihood of waste or risk of default.[6] The courts deemed insufficient the commercial justification advanced by the associations that the clause was a necessary economic tool by which to adjust their loan portfolios to current interest levels.[7]

Although no California court has yet decided whether the clause is enforceable in an "outright sale" situation,[8] the federal associations are understandably reluctant to submit to California jurisdiction where recent, unfavorable decisions have been rendered against the associations.[9] Consequently, the federal associations argue that Califor-

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Putman v. Glendale Fed. Sav. & Loan Ass'n, Civ. No. 76-005 (C.D. Cal., filed Jan. 2, 1976); Belt v. Glendale Fed. Sav. & Loan Ass'n, Civ. No. 75-4102 (C.D. Cal., filed Dec. 8, 1975); Pittman v. Glendale Fed. Sav. & Loan Ass'n, Civ. No. 75-4052 (C.D. Cal., filed Dec. 3, 1975); First Fed. Sav. & Loan Ass'n v. Crane, Civ. No. 75-3764 (C.D. Cal., filed Nov. 10, 1975); Schott v. Mission Fed. Sav. & Loan Ass'n, Civ. No. 75-366 (C.D. Cal., filed Feb. 4, 1975).

3. The issue has, however, been raised in dicta in a recent case. Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580 (N.C. 1976).

4. Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974). An installment sale contract is one which provides for periodic retirement of the debt where the seller retains title to the property. MILLER & STARR, *supra* note 1, § 2:33.

5. La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971).

6. Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 639, 526 P.2d 1169, 1175, 116 Cal. Rptr. 633, 639 (1974).

7. For a discussion of this argument, see notes 53-70 *infra* and accompanying text.

8. "By the term 'outright sale' we refer to a transaction wherein the seller receives full payment from and transfers legal title to the buyer." Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 634 n.6, 526 P.2d 1169, 1172 n.6, 116 Cal. Rptr. 633, 636 n.6 (1974). The issue has, however, been resolved in an unpublished trial court opinion. Austin v. Calamars, No. 360231 (Super. Ct. San Diego, Cal., Sept. 16, 1975), *digested in* Freshman, *Tucker v. Lassen and the Future of Acceleration*, 8 U.W.L.A.L. REV. 57, 63 (1976) (showing of impaired security interest required even in an outright sale situation).

9. Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1164, 116 Cal. Rptr. 633 (1974); La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971). For a recent application of *Tucker*, see Demey v. Joujon-Roche, 63 Cal. App. 3d 178, 133 Cal. Rptr. 570 (1976), in which the court refused to enforce a due-on clause when the borrower had entered into an installment

nia law is inapplicable because the field of due-on clauses has been preempted by federal law. Such result obtains from the promulgation of regulations governing enforcement of acceleration clauses by the Federal Home Loan Bank Board (the Board), an agency empowered by Congress to issue regulations governing the incorporation and regulation of federal savings and loan assocations.[10] Moreover, should the pronouncements of the Board prove insufficient to preempt state law, the argument runs, preemption may nonetheless result from application of more general preemption-by-occupation principles enunciated by the United States Supreme Court.

This Comment will assess the implications of a regulation recently promulgated by the Board purporting to resolve issues relating to the exercise of acceleration clauses. It will then explore the possibility of preemption through more general Board-promulgated regulations and through occupation of the field by Congress. The final portion will trace the national development of acceleration clauses with a view toward formulating a statement reflecting present federal common law.

I. FEDERAL PREEMPTION THROUGH REGULATORY LAW

Under the supremacy clause of the United States Constitution,[11] preemption of state law may occur by specific regulation[12] or where Congress has manifested an intent to occupy a particular field.[13]

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sale contract absent a showing of impairment to the lender's security interest. *Cf.* Cherry v. Home Sav. & Loan Ass'n, 276 Cal. App. 2d 574, 81 Cal. Rptr. 135 (1969) (exercise of due-on clause for sole purpose of increasing interest rate upheld as not imposing unreasonable restraint on alienation; *Cherry* was disapproved in *Tucker*); Hellbaum v. Lytton Sav. & Loan Ass'n, 274 Cal. App. 2d 456, 79 Cal. Rptr. 9 (1969) (prepayment penalty provision triggered by exercise of due-on clause upheld as not imposing an unreasonable restraint on alienation).

In addition, CAL. CIV. CODE § 2929.6 (West Supp. 1977), with respect to residential housing, prohibits exercise in the following situations (whether or not the borrower lives or intends to live on the property): death of a spouse when the other is also an obligor (regardless of whether the property was held in joint tenancy or in tenancy in common), transfer by one spouse to another when the other becomes a co-obligor (i.e., upon marriage), transfer to an inter vivos trust, and execution of a junior encumbrance. Any waiver of these provisions is void. *Id. See also* 12 C.F.R. §§ 545.6-11(d) to (g), 556.9(a) to (e) (1977), discussed in notes 17-25 *infra* and accompanying text.

Finally, three bills are pending in the California legislature, two attempting to forbid the acceleration merely for the purpose of increasing interest rates and one permitting acceleration specifically for this purpose. A.B. 3278 (1975-76 Reg. Sess.); A.B. 4416 (1975-76 Reg. Sess.); A.B. 3951 (1975-76 Reg. Sess.).

10. 12 U.S.C. § 1464(a), (d) (Supp. V 1975).

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

12. *See, e.g.,* Myers v. Beverly Hills Fed. Sav. & Loan Ass'n, 499 F.2d 1145 (9th Cir. 1974).

13. Pennsylvania v. Nelson, 350 U.S. 497, 501 (1956); Bethlehem Steel Co. v. New

With respect to the federal associations, preemption by regulation may potentially be derived from the Home Owners Loan Act of 1933 (HOLA),[14] under which the federal associations are organized, chartered, and operated. In addition, HOLA provides for creation of the Board which is empowered with all regulatory and supervisory authority over the associations.[15] The purposes of the Act were to establish a nationally uniform system of savings and loan associations in order to provide a convenient and safe method for the public to save and invest money as well as a ready source of economic, long-term home financing.[16]

A. *The Due-On Regulation*

On May 3, 1976, the Board promulgated the "Due-On Regulation,"[17] effective July 31, 1976,[18] which authorizes use of due-on clauses by federal associations. The regulation provides in part:

> [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 instrument 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 consent [and] exercise by an association of such an acceleration option . . . shall be governed exclusively by the terms of the contract . . . and all rights and remedies . . . thereto shall be fixed and governed by said contract.[19]

Although the regulation clearly reflects the Board's desire to permit use of the clause, ambiguities in the regulation suggesting a retroactive effect raise new problems to replace those it solves.

An initial ambiguity lies in the "continuing authority" language, implying that the clause has always been approved by the Board, and

York State Labor Relations Bd., 330 U.S. 767, 772 (1947); Parker v. Brown, 317 U.S. 341, 350 (1943).

14. 12 U.S.C. §§ 1461-1468 (Supp. V 1975).

15. Although the Constitution does not specifically empower Congress to create and maintain federal savings and loan associations, congressional power to do so is not disputed since, for more than 150 years, the Supreme Court has recognized the implied power of Congress to create and maintain banks and other federal financial institutions. McCulloch v. Maryland, 17 U.S. (4 Wheat.) 316 (1819). *See also* Fahey v. Mallonee, 332 U.S. 245, 250 (1947); Larwood Co. v. San Diego Fed. Sav. & Loan Ass'n, 185 Cal. App. 2d 450, 456, 8 Cal. Rptr. 362, 366 (1960).

16. 12 U.S.C. § 1437 (1970).

17. 12 C.F.R. § 545.6-11(d) to (g) (1977). The term is the author's.

18. *Id.* § 556.9.

19. *Id.* § 545.6-11(f).

that the blessing of the Due-On Regulation extends to all loans, even those executed prior to its effective date. Moreover, the regulation forbids the imposition of a prepayment penalty in conjunction with the exercise of an acceleration clause only as to borrower-occupied home loans made after July 31, 1976; the joint use of both provisions is discretionary with regard to loans made prior to July 31, 1976.[20] Since prepayment penalty provisions used in conjunction with acceleration clauses are expressly permitted in loan instruments executed prior to the effective date of the regulation, acceleration clauses are, by implication, also permitted prior to that date.

A further ambiguity concerns the associations' power to exercise the clause under certain circumstances after the effective date of the regulation on loans executed prior to its effective date. Section 545.6-11(g) prohibits enforcement of the clause where title is transferred by the creation of a junior encumbrance, by the creation of a purchase money security interest in household appliances, by a joint tenant, or by the grant of any lease for a period of less than three years which does not contain a purchase option.[21] The enumerated exceptions affect only those loans made after July 31, 1976;[22] with respect to loans made prior to that date, there are no express circumstances under which the clause cannot be exercised. Consequently, the failure of the Board to provide for loans made prior to the effective date of the regulation may, on the one hand, reflect the Board's desire to free pre-effective date loans from regulation. On the other hand, the silence of the Board may evidence concern over extraneous matters[23] and thus not reflect any intent to free loans made prior to the effective date from the purview of the regulation.

The conclusion that the Due-On Regulation applies to loan instruments executed prior to its effective date is disconcerting, for this renders nugatory the effective date of the regulation.[24] If the Board really intended that the regulation apply to pre-July 31, 1976 contracts, one

20. *Id.* § 556.9(b)(1).

21. *Id.*

22. *Id.*

23. Such extraneous matters may include a concern over potential due process considerations if the regulation has a retroactive effect. Letter from Daniel Goldberg, Acting General Counsel, Federal Home Loan Bank Board, to John Richmond (Feb. 15, 1977).

24. The Supreme Court has long disfavored granting statutes and regulations retroactive effect absent express provision or unequivocal implication in the statute or regulation itself. *See* Miller v. United States, 294 U.S. 435 (1935); Twenty Per Cent. Cases, 87 U.S. (20 Wall.) 179 (1873); United States v. Heth, 7 U.S. (3 Cranch) 399 (1806).

can only speculate as to the reason for obscuring that intent by including an effective date. In any event, the Due-On Regulation has yet to be judicially tested. If it is ultimately held inapplicable to loans executed prior to its effective date,[25] the great nucleus of outstanding home loans will remain unregulated. Despite this, preemption may still result from *other* regulations promulgated by the Board.

B. Other Regulations

The rule-making authority of the Board extends not only to the regulation of "internal" matters, but also to "the organization, incorporation, examination, operation and regulation of associations,"[26] language which may confer on the Board the implied power to regulate all matters affecting the stability and efficiency of the associations. However, the provision directing the Board to give "primary consideration to the best practices of local mutual thrift and home financing institutions"[27] would seem to imply that matters of state law are persuasive in those areas common to both federal and state associations.

In a similar vein, another regulation provides that each loan "shall be secured . . . as is in keeping with sound lending practices. The loan contract shall provide for full protection to the Federal Association . . . ."[28] The regulation then enumerates the specific means by which such protection shall be realized: by insurance, taxes, assessments, repairs, and life insurance.[29] There is, however, no mention of the due-on clause; hence, the "full protection" language may be too general to cover specific issues other than those enumerated. The final sentence of the regulation provides that "all loan instruments shall comply with applicable provisions of law,"[30] but no mention is made as to whether such provisions are federal or state.[31]

For a discussion of the constitutional ramifications of determining that a statute or regulation is retroactive, see Hochman, *The Supreme Court and the Constitutionality of Retroactive Legislation*, 73 HARV. L. REV. 692 (1960); Comment, *Federal Regulation of "Substantial Product Hazards": An Analysis of Section 15 of the Consumer Product Safety Act*, 25 AM. U.L. REV. 717 (1976).

25. *See* note 3 *supra*.

26. 12 U.S.C. § 1464(a) (Supp. V 1975).

27. *Id.*

28. 12 C.F.R. § 545.6(a) (1977).

29. *Id.*

30. *Id.*

31. *Id. Cf.* Kaski v. First Fed. Sav. & Loan Ass'n, 240 N.W.2d 367 (Wis. 1974) (where regulation provides that federal associations are to act according to "statute" or "applicable law," such regulation refers to federal law and statutes, *id.* at 371).

II. Preemption by Occupation

Since the Due-On Regulation relates only by implication to loan instruments executed prior to July 31, 1976, a real possibility exists that the regulation will constitute an ineffective basis for preemption by regulation with respect to such loans. Moreover, other regulations promulgated by the Board are possibly too general to support preemption by regulation. As to pre-July 31, 1976 loan instruments, then, preemption will occur only if Congress has manifested an intent to occupy the field.

Such intent may be manifested by express provision.[32] Absent such provision, the inquiry becomes more difficult and has been the subject of nebulous and confusing litigation.[33] Nevertheless, the Supreme Court has identified three bases from which an intent to occupy may be determined: (1) if the scheme of federal regulation is so pervasive that Congress has left no room for the states to act; (2) if the field is one in which the interests of the federal government are so dominant that state action is precluded; or (3) if the enforcement of state law would present serious conflicts with the administration of the federal program.[34]

A. A Pervasive Scheme

While the highly regulated nature of the federal associations is reflected in the provisions of HOLA, and the regulations promulgated thereunder, courts have differed, depending upon the area of regulation involved, on whether a sufficiently pervasive scheme is present. In disputes involving the internal affairs[35] of the associations, courts have uniformly found a pervasive scheme, even in the absence of an express regulation.[36] Thus, in *Murphy v. Colonial Federal Savings &*

32. *See, e.g.*, 29 U.S.C. § 1144 (Supp. V 1975), which provides that the Employee Retirement Income Security Act of 1974 (ERISA), 29 U.S.C. §§ 1001-1381 (Supp. V 1975), supercedes all state laws regulating pension programs.

33. *See* San Diego Unions v. Garmon, 359 U.S. 236, 241 (1959).

34. Pennsylvania v. Nelson, 350 U.S. 497, 502-05 (1956). For an excellent analysis of the case, see Hunt, *State Control of Sedition: The Smith Act as the Supreme Law of the Land*, 41 MINN. L. REV. 287 (1957).

35. For a discussion of "internal affairs," see notes 44-55 *infra* and accompanying text.

36. *See, e.g.*, Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609 (2d Cir. 1967); Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819 (N.D. Ill. 1975); City First Fed. Sav. & Loan Ass'n v. Crowley, 393 F. Supp. 644 (E.D. Wis. 1975); Kaski v. First Fed. Sav. & Loan Ass'n, 240 N.W.2d 367 (Wis. 1974). *Cf.* Lyons Sav. & Loan Ass'n v. Federal Home Loan Bank Bd., 377 F. Supp. 11 (N.D.

Loan Association,[37] shareholder-depositors sought to overturn an election of opposing directors because of management's denial of the shareholders' request to inspect the association's shareholder list. To defeat federal jurisdiction, the association urged that the shareholders' claim was founded on state law. Although no regulation on point had been promulgated,[38] the court noted that shareholder inspection rights involve the internal affairs of the association, and ruled that when courts "deal with the internal affairs of federal savings and loan associations . . . they are . . . applying federal law."[39]

In areas not involving internal affairs, however, preemption has been determined according to whether a regulation governing the specific activity involved is present. Illustrative is *Meyers v. Beverly Hills Federal Savings & Loan Association*,[40] where a prepayment penalty clause in the loan agreement of a federal association was upheld against a charge that the clause ran afoul of a local statute which prohibited liquidated damages. The court ruled that an existing federal regulation directly on point[41] preempted the state prohibition. In a similar vein, courts have held that, absent a specific regulation governing the challenged activity, state law governed in such areas as the charging of usurious interest rates,[42] and the conversion of state to federally chartered associations.[43]

The clear implication of the *Meyers* line of cases is a rejection of the notion that a pervasive scheme is present. These cases further suggest that the gamut of activities engaged in by an association do not fall within one "field" for preemption purposes but rather comprise two "fields," one composed of internal affairs, and the second of all other activities of the association. While Congress has generated a pervasive scheme of control over the "internal affairs" field, such a scheme is lacking for other activities.

Given this distinction, there is considerable incentive present to label exercise of the due-on clause an internal affair. Since all borrowers

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Ill. 1974) (although there was no specific regulation vesting the Board with the power to approve "branching" of federal associations, implied authority of Board to do so held to preempt state statutes prohibiting "branching").

37. 388 F.2d 609 (2d Cir. 1967).

38. *Id.* at 612 n.2. The court implied a right to inspect from a regulation permitting members to vote by proxy. 12 C.F.R. § 544.1(4) (1977).

39. 388 F.2d at 612.

40. 499 F.2d 1145 (9th Cir. 1974).

41. 12 C.F.R. § 545.6-12(b) (1977).

42. First Fed. Sav. & Loan Ass'n v. Norwood Realty Co., 93 S.E.2d 763 (Ga. 1956).

43. Hopkins Sav. & Loan Ass'n v. Cleary, 296 U.S. 315 (1935).

are members of the lender association[44] and acquire various rights upon their membership,[45] an attempt by a borrower-member to substitute another in his stead is thus a matter affecting relations of the new member vis-a-vis existing members and the association; hence, an internal affair.[46] In like manner, since the associations typically have the right to pass on the acceptability of new members, this, too, constitutes an internal affair.[47] Upon examination, however, the "internal affairs" argument proves specious.[48]

One result of labeling an activity an internal affair is to require that all disputes involving that activity be initially litigated through administrative remedies.[49] The Board, however, is ill-equiped to handle litigative action; it is an administrative body and has as its chief function, not the resolution of disputes, but the oversight of the federal asso-

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44. 12 U.S.C. § 1464(b)(1) (Supp. V 1975) permits the associations to require, by corporate charter, all "obligors" of the association to become members. By regulation, the Board requires all new associations to adopt Charter N, which provides, among other things, that all savers and borrowers are members. 12 C.F.R. § 544.1(a)(4) (1977).

45. *See* 12 U.S.C. § 1464(b)(i) (Supp. V 1975).

46. Advisory Opinion of the Federal Home Loan Bank Board, at 18, Schott v. Mission Fed. Sav. & Loan Ass'n, Civ. No. 75-366 (C.D. Cal., filed Feb. 4, 1975) [hereinafter cited as *Advisory Opinion*]. The *Advisory Opinion* resembles an amicus curiae brief and was submitted at the request of the defendant, Mission Federal, in conjunction with its response to plaintiff's motion for summary judgment.

47. *Id.*

48. The "membership" argument is viable only where the assuming party is not already a member of the federal association. Where the assuming party is already a member, the association will, of course, seek to enforce the due-on clause, but must assert other grounds. *See, e.g.*, Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580, 583 (N.C. 1976).

49. Where a statute provides an administrative remedy, such remedy must be exhausted prior to resort to the courts. First Nat'l Bank v. Board of County Comm'rs, 264 U.S. 450 (1923); Abelleira v. District Ct. of App., 17 Cal. 2d 280, 109 P.2d 942 (1943). HOLA provides such a remedy through its administrative hearing process. 12 U.S.C. § 1464(d)(2)(A) (1970); 12 C.F.R. § 508.13 (1977). Accordingly, a dispute over matters concerned with the internal affairs of the associations must be aired before the Board prior to resort to judicial relief. *See* Home Loan Bank Bd. v. Mallonee, 196 F.2d 336 (9th Cir. 1952) (district court order enjoining administrative hearing adjudicating appropriateness of appointment of receiver because of alleged mismanagement of the association held improper); California v. Coast Fed. Sav. & Loan Ass'n, 98 F. Supp. 311 (S.D. Cal. 1951) (action to enjoin federal association from advertising in contravention of state law; held exhaustion of administrative remedies required); Reich v. Webb, 218 Cal. App. 2d 862, 32 Cal. Rptr. 803 (1963) (action to recover profits of association misappropriated by directors held prematurely brought for lack of exhaustion of administrative remedies); Woodard v. Broadway, 111 Cal. App. 2d 218, 244 P.2d 467 (1952) (action to overturn election of board of directors; held exhaustion of administrative remedies a prerequisite).

ciations.[50] Moreover, inclusion of the due-on clause as an internal affair would extend that term beyond its recognized bounds, since the term "internal affairs" has traditionally been used to connote the relations *inter se* of the directors, officers, members, and association. Thus, disputes involving fiduciary duties owed by directors and officers to the association[51] and inspection rights of the members[52] have been labeled internal affairs. In contrast, in a case involving a prepayment penalty clause, the dispute significantly was not referred to as one involving an internal affair.[53] Just as the prepayment penalty clause affects the relations between association and borrower, so also does exercise of the due-on clause. While one individual is often both a borrower and a member,[54] the roles are justifiably distinct.

B. *Dominant Federal Interests and Conflict*

The presence of dominant federal interests as well as potential conflict with federal programs is reflected in the operation of the secondary mortgage market, the process by which both federal and state associations buy and sell mortgages to increase or release part of their cash flow.[55] California associations tend to be sellers of mortgages because of the rapid turnover of property loans within the state.[56] Concomitantly, associations in states having a high volume of savings and a lower turnover of property tend to be buyers of mortgages.[57] If enforcement of the due-on clause is greatly restricted, California loans may become less marketable in the secondary mortgage market, since the loans cannot be refinanced at current interest levels during the life of the loan.[58]

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50. 12 C.F.R. § 500.2 (1977). The regulation details the Board's functions as including the prescribing of rules regulating loans, deposit accounts, advertising, and chartering of federal associations. No mention is made of resolving disputes between members and associations; instead, the functions of the Board are couched in terms of promulgating rules and regulations.

51. *See, e.g.*, Rettig v. Arlington Heights Fed. Sav. & Loan Ass'n, 405 F. Supp. 819 (N.D. Ill. 1975).

52. *See, e.g.*, Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609 (2d Cir. 1967).

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

54. *See* note 44 *supra.*

55. 12 U.S.C. §§ 1716-1723d (1970).

56. Interview with Donald Klink, Vice President, Coast Federal Savings and Loan Association, in Los Angeles (July 18, 1976).

57. *Id.*

58. 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

Maintaining the saleability of California loans would appear to be an integral part of the federal scheme regulating federal associations; hence, an attempt by a state to proscribe exercise of acceleration clauses would necessarily conflict with that scheme.

Further conflict may flow from the effect of denial of due-on clause enforcement on the ability of the federal associations to maintain loan portfolios at current interest levels. California law permits both federal and state associations to use variable interest rates,[59] but such use on residential loans is denied the federal associations under federal law.[60] If the due-on clause is also denied the federal associations, the associations would be locked into long-term mortgage investments without realistic means to adjust portfolios to current levels.[61] There are three alternative methods generally employed to adjust portfolios (aside from variable interest rates and due-on clauses): (1) short-term balloon payment loans,[62] (2) short-term amortized loans,[63] and (3) long-term fixed interest amortized loans at a higher-than-market rate.[64]

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mortgage market.

Opinion of the Office of Economic Research on the Revocation of the Due-on-Sale Clause in the State of California, at 1, Schott v. Mission Fed. Sav. & Loan Ass'n, Civ. No. 75-366 (C.D. Cal., filed Feb. 4, 1975).

59. CAL. CIV. CODE § 1916.5 (West Supp. 1977). A variable interest rate is an interest rate which may be adjusted by means of an external economic indicator during the life of the loan to meet the current market rate. 60 A.L.R.3d 473, 474 (1974). The federal associations employ an index maintained by the Federal Reserve Bank and calculated separately for each region. Downward adjustment is mandatory when the index falls below a prevailing level and upward adjustment is optional when the prevailing level exceeds the loan rate by a set amount. Affidavit of David L. Smith, Chief Economist and Vice President, Glendale Federal Savings and Loan Association, California v. Glendale Fed. Sav. & Loan Ass'n, Civ. No. 76-162 (C.D. Cal., filed Jan. 14, 1976) [hereinafter cited as *Smith Affidavit*].

60. The prohibition is implied from the ban on the raising of monthly loan payments, 12 C.F.R. § 541.14(a) (1977), and the express grant of authority to use "flexible interest rates," a term defined so as to prohibit upward adjustment of the interest rate. *Id.* § 541.14(c).

61. Although residential loans generally have 25 to 30 year terms, the typical California residential loan is paid off in five to ten years. Plaintiff's Opening Argument, Schott v. Mission Fed. Sav. & Loan Ass'n, Civ. No. 75-366 (C.D. Cal., filed Feb. 4, 1975).

62. "A mortgage providing for specific payments at stated regular intervals and final payment of more than twice any of the periodic payments." BLACK'S LAW DICTIONARY 182 (4th ed. rev. 1968).

63. A short-term amortized loan involves a higher down payment with the lower beginning balance to be paid off in higher installments over a relatively short period of time.

64. Where market interest rates display an upward trend, a long-term fixed interest amortized loan will necessarily carry a higher rate of interest than a contemporaneous loan with a due-on clause, since the interest rate on the amortized loan must approximate the average prevailing market rate over the life of the loan. *Advisory Opinion,*

The first is prohibited under federal law,[65] the second is impractical because most borrowers lack sufficient capital, and the third is competitively unfeasible since borrowers would be offered lower rates at the state associations.[66]

In addition, the federal associations have only four primary sources of revenue, all of which are short-term:[67] savings accounts, advances authorized by the Board,[68] the sale of loans in the secondary mortgage market,[69] and cash payments on loans.[70] Thus, unrestrained exercise of the due-on clause is the only realistic means available to the federal associations to realize income at interest levels sufficient to meet the cost of raising revenue in a rising market. Conversely, if enforceability of the clause is severely restricted, the associations may be unable to pay competitive rates on savings accounts and the ensuing decline in savings would force rates higher on new loans.[71] Consequently, only the most creditworthy borrowers able to afford a sufficient down payment or more expensive secondary financing would be able to procure a residential loan. The greatest impact would be felt by borrowers most in need of loans—those financing their first home or unable to afford a substantial down payment.[72] Realistically, however, the economic ramifications evolving from the limited enforceability of the clause under California law may prove illusory insofar as there is no evidence that the effect of *Tucker* on California associations has been

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supra note 46, at 20-24. A loan containing a due-on clause will, on the other hand, be adjusted to market every five to seven years. *See* note 61 *supra.*

65. *See* note 60 *supra.*

66. *Smith Affidavit, supra* note 59.

67. Revenue is used in the sense of a cash flow for which the associations, as borrowers and buyers of cash, must pay market rates. Depending on the source of the revenue, the market rate is expressed as either an interest or a discount rate. A source of revenue referred to as "short-term," then, means that current market interest and discount rates are applied.

In this sense, revenue is to an association what stock-in-trade is to a merchant. To pursue the analogy further, when the association makes a loan, it is effectively selling a portion of its revenue and the price of the loan is expressed as the interest rate charged. The analogy, however, is somewhat imperfect as the merchant's costs as well as prices are both short-term, while the association's costs and prices reflect industry predictions as to future market levels.

68. 12 U.S.C. § 1464(b)(2) (Supp. V 1975).

69. *See* notes 55-58 *supra* and accompanying text.

70. *Smith Affidavit, supra* note 59.

71. *Id.* One possible solution would be for the associations to merely absorb the differential, but due to the extensive number of home loans made by the associations, such practice might well be unrealistic because of the resultant diminished profit margins.

72. *Advisory Opinion, supra* note 46, at 39.

to reduce the number of savings account investors or to impede the availability of residential loans within the state.

C. *The Board's Position*

The Board is quite adamant in its position that federal law governs enforcement of due-on clauses.[73] The Board is equally insistent in its support of the right of the federal associations to invoke the due-on clause, despite conflicting state law, solely as an interest-raising device. The Board has maintained in a number of advisory opinions that its long-standing implied approval is reflected by its knowledge of and refusal to prohibit such use in annual examinations[74] of the federal associations.

Although courts generally display "great deference" toward opinions rendered by regulatory bodies interpreting regulations promulgated by those bodies,[75] such judicial policy is founded upon the circumstantial guarantees of trustworthiness inherent in the rule- and policy-making procedures employed by the agencies.[76] While the Board possesses procedures sufficient to provide such guarantees,[77] Board opinions do not comply with those procedures, but are instead prepared by staff attorneys[78] at the behest of the associations.[79] Indeed, in at least two instances, courts have found occasion to chide the Board for its "hyper-technical"[80] and one-sided[81] interpretations in favor of the industry.

Moreover, the position taken by the Board conflicts with the standing Board policy against varying the interest rate during the life of the

73. *Id.*

74. *See* 12 C.F.R. § 500.3 (1977).

75. Udall v. Tallman, 380 U.S. 1, 16-17 (1965); Kupiec v. Republic Fed. Sav. & Loan Ass'n, 512 F.2d 147, 151 (7th Cir. 1975).

76. Such guarantees of trustworthiness stem from the expertise of the regulators in the area, particularly where the issues are beyond the common experience of judges. *See, e.g.,* Southwestern Sugar & Molasses Co. v. River Terminals Corp., 360 U.S. 411 (1959) (the Court directed the trial court to avail itself of the assistance of the Interstate Commerce Commission to determine the economic ramifications of permitting common carriers to utilize exculpatory clauses); *see also* Far East Conference v. United States, 342 U.S. 570 (1952). Resolution of the legal issues involved, however, is solely the province of the court. *Compare* Southwestern Sugar & Molasses Co. v. River Terminals Corp., 360 U.S. 411, 420-21 (1959), *with* Zuber v. Allen, 396 U.S. 168, 192 (1969).

77. 5 U.S.C. § 553(b), (c) (1970); 12 U.S.C. § 1464(a) (Supp. V 1975); 12 C.F.R. §§ 508-509 (1977). The procedures provide for notice to be posted in the Federal Register and a hearing afforded interested parties.

78. Interview with Daniel Goldberg, Acting General Counsel, Federal Home Loan Bank Board (Feb. 11, 1977).

79. *See* note 46 *supra.*

80. Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609, 611 (2d Cir. 1967).

81. Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580, 588 (N.C. 1976).

loan.[82] Under traditional contract principles, the original borrower stands guarantor upon the assumption of the loan by the new borrower.[83] Thus, the original borrower remains an obligor, albeit secondary, on the loan and, even though the new borrower pays the installments, the same "loan" is involved. When the association conditions its assent to an assumption agreement on the new borrower's acceptance of an increased interest rate, the interest rate has thus effectively been increased during the life of the loan.[84] The Due-On Regulation, in an apparent attempt to sidestep this inconsistency,[85] provides that where the original borrower is relieved of liability upon an increase in the new borrower's interest rate, the resulting agreement constitutes a separate and independent agreement.[86]

D. Policy Considerations

Resolution of whether exercise of the due-on clause is part of a field occupied by Congress is inexorably tied to the policy arguments as to which law, federal or state, ought to apply. That the subject property lies in the state, that the note and trust deed are executed within the state, that the enforceability of both are governed by state law,[87] that many federal associations operate exclusively within one state, that the associations exercise their foreclosure rights pursuant to state law[88] all suggest that state law ought appropriately to govern exercise of the due-on clause. Moreover, some states, including California, are moving toward outright prohibition of the clause for interest rate adjustment.[89] Thus, should federal law preempt state law, a dual standard of enforceability will result: such use permitted the federal associations, but denied the state associations.

On the other hand, if federal law is applied, divergent state court interpretations will be prevented. Since the Board must regulate the

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82. *See* note 60 *supra* and accompanying text.

83. See cases collected 55 AM. JUR. 2d *Mortgages* § 1036 nn.4 & 5 (1971).

84. Plaintiff's Points & Authorities in Support of Motion for Summary Judgment, Schott v. Mission Fed. Sav. & Loan Ass'n, Civ. No. 75-366 (C.D. Cal., filed Feb. 4, 1975).

85. Interview with Daniel Goldberg, Acting General Counsel, Federal Home Loan Bank Board (Feb. 11, 1977).

86. 12 C.F.R. § 545.6-11(g)(3) (1977).

87. In California, for example, the statutory scheme is detailed at CAL. CIV. CODE §§ 2920-2955 (West 1974).

88. In California, for example, the statutory scheme is detailed at CAL. CIV. PROC. CODE § 725 (West 1972).

89. *See* Austin v. Calamars, No. 360231 (Super. Ct. San Diego, Cal., Sept. 16, 1975), *digested in* Freshman, *Tucker v. Lassen and the Future of Acceleration*, 8 U.W.L.A.L. REV. 57, 63 (1976); cases collected at notes 98-99 *infra*.

federal association in all states, it would be manifestly difficult for the Board to contend with a plethora of local variations on enforcement of due-on clauses.[90] Additionally, courts applying federal law would not be confined to past California decisions, would not be forced to anticipate the future policy of California courts in outright sale situations, and would be free to choose a line of reasoning more conducive to effecting a nationally uniform policy. The advantage of looking to other jurisdictions may, however, prove illusory inasmuch as courts in other jurisdictions are divided both as to the appropriate standards applicable to due-on clauses and as to the correct theoretical basis upon which to determine such standards.[91]

III. FEDERAL COMMON LAW

The conclusion that federal regulation of the due-on clause has supplanted state regulation does not of itself determine under what circumstances the clause may be exercised. Since the Due-On Regulation purports to regulate only those loan agreements made after July 31, 1976,[92] the federal regulatory scheme is silent with respect to loan agreements made prior to the effective date.[93] Under these circumstances, pre-July 31, 1976 contracts will be governed by federal common law; that is, law which utilizes precedent drawn from any jurisdiction having considered the issue. Among such jurisdictions, a fundamental rift has developed over whether property law principles relating to unreasonable restraints on alienation or freedom of contract principles should determine the standards applicable to exercise of the clause.

In "property" jurisdictions, the courts have erected a variety of threshold points demarking the quantum of permissible restraint on alienation. At one extreme lies *Crockett v. First Federal Savings & Loan Association*,[94] wherein the court took the position that an un-

90. *See* Murphy v. Colonial Fed. Sav. & Loan Ass'n, 388 F.2d 609 (2d Cir. 1967).

91. *See* notes 92-106 *infra* and accompanying text. Division in the courts may be attributed in part to the relatively recent appearance of the due-on clause as a widely used interest rate adjustment tool. *See* Goddard, *Non-Assignment Provisions in Land Contracts*, 31 MICH. L. REV. 1, 7-8 (1932). That the clause became commonplace during the 1960's is generally attributed to the rapid rise in interest rates which occurred during that decade. Bonanno, *Due On Sale and Prepayment Clauses in Real Estate Financing in California in Times of Fluctuating Interest Rates—Legal Issues and Alternatives*, 6 U.S.F.L. REV. 267, 276 (1972).

92. 12 C.F.R. § 556.9 (1977).

93. *See* notes 20-25 *supra* and accompanying text.

94. 224 S.E.2d 580 (N.C. 1976). In *Crockett*, plaintiffs had purchased a block of apartment houses from the original borrower under the note (a corporation). Although

reasonable restraint on alienation arose only where the borrower would suffer a forfeiture. Since under the terms of the loan agreement the borrower was afforded the opportunity to avert forfeiture by paying, without prepayment penalties, the balance due on the loan upon transfer, no forfeiture could occur if the agreement were complied with; hence, any attendant restraint on alienation was reasonable.[95]

In most jurisdictions, courts have more realistically balanced the lender's purpose in exercising the clause against the borrower's interest in alienation.[96] These jurisdictions, in turn, have divided over whether the lender's desire to increase the interest rate will preponderate over the borrower's interest in alienation,[97] or whether the lender must

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the association had not exercised the acceleration clause upon the initial conveyance, the clause was invoked when the plaintiffs later attempted to convey the property to prospective borrowers who were already members of First Federal. The association stipulated that there was no risk of impairment of security interest since the prospective purchasers were already approved borrowers under another note from the association, that there was no risk of waste inherent in the transfer of the property, and that the plaintiffs would remain primarily liable on the note. Although the issue thus presented was whether the lender had a right to condition assent to the transfer solely to exact a higher interest rate, the court couched its ruling in terms which would permit far greater restraints on alienation.

Although ignored by the court, the failure of the lender to exercise its rights upon learning of the first conveyance has been viewed by other courts as raising potential defenses for the borrower. Chief among these is laches, inasmuch as foreclosure is a proceeding in equity. At least one court has suggested that laches is available if the borrower can show that the lender had knowledge of and acquiesced in the transfer, exercised unreasonable delay in foreclosing, or if the borrower was unnecessarily prejudiced by the delay. *See* Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works, 205 N.W.2d 762 (Wis. 1973), *aff'd after remand,* 239 N.W.2d 20 (Wis. 1976).

95. 224 S.E.2d at 584. Since the loan involved the purchase of commercial property, the decision may be inapplicable to the purchase of a single-family residence inasmuch as the court stressed the absence of unfairness; the court, however, was silent on the point.

96. Typical of cases employing this approach is Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1 (Ill. 1975), wherein the Illinois Supreme Court upheld the right of the lender to increase interest rates upon the initial borrower's execution of an installment sale contract and the transfer of possession without the written consent of the lender. The court relied almost exclusively on property law in determining that the lender's purpose of avoiding an impairment of security interest in transfer of the property was sufficient in itself to allow invocation of the clause. By balancing "the utility of the restraint as compared with the injurious consequences that will flow from its enforcement," the court held that the restraint was reasonable. *Id.* at 3. *See also* Gale v. York Center Community Coop., Inc., 171 N.E.2d 30 (Ill. 1960).

97. Malouff v. Midland Fed. Sav. & Loan Ass'n, 509 P.2d 1240 (Colo. 1973); First Commercial Title, Inc. v. Holmes, 550 P.2d 1271 (Nev. 1976); Shalit v. Investors Sav. & Loan Ass'n, 244 A.2d 151 (N.J. Super. Ct. 1968); Stith v. Hudson City Sav. Instit., 63 Misc. 2d 863, 313 N.Y.S.2d 804 (1970); Gunther v. White, 489 S.W.2d 529 (Tenn. 1973).

We do not consider the motive of Midland in seeking to protect itself and the

make an affirmative showing that the assuming party is a less desirable credit risk than the original borrower or that the likelihood of waste has been enhanced,[98] even in the case of outright sale.[99]

In "contract" jurisdictions, courts have invalidated the clause by narrowly construing language in the loan agreement.[100] For example, the absence of specific language allowing the lender to accelerate in order to raise interest rates has been held an insufficient ground upon which to invoke the lender's acceleration rights, since the clause "merely permits the lender to approve or disapprove the transfer and contains no authority entitling the mortgagee to vary the interest rate."[101] Similarly, language which authorized acceleration "[i]f a conveyance should be made by the Mortgagor . . . without the written consent of the Mortgagee, *and* without assumption . . . by the grantee of the obli-

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> borrower from the effects of inflationary or deflationary conditions in the money market to be improper or unlawful. Both parties have the benefit of their original bargain during their continued creditor-debtor relationship. However, when the property is sold to a purchaser who desires to assume the existing loan, economic consideration may reasonably justify the lender in raising the interest rate to . . . the current market rate.

Malouff v. Midland Fed. Sav. & Loan Ass'n, *supra* at 1245.

98. Tucker v. Lassen Sav. & Loan Ass'n, 12 Cal. 3d 629, 526 P.2d 1169, 116 Cal. Rptr. 633 (1974); La Sala v. American Sav. & Loan Ass'n, 5 Cal. 3d 864, 489 P.2d 1113, 97 Cal. Rptr. 849 (1971); Demey v. Joujon-Rouche, 63 Cal. App. 3d 178, 133 Cal. Rptr. 618 (1976).

99. Walker Bank & Trust Co. v. Neilson, 490 P.2d 328 (Utah 1971); Mutual Fed. Sav. & Loan Ass'n v. American Medical Servs., Inc., 223 N.W.2d 921 (Wis. 1974); *see also* notes 101-02 *infra* and accompanying text.

100. California courts have generally avoided reference to contract law in refusing to enforce the clause, relying instead on property principles. Nevertheless, the California Court of Appeal held in MCA, Inc. v. Universal Diversified Enterprises Corp., 27 Cal. App. 3d 170, 103 Cal. Rptr. 522 (1972), that a clause in a trust deed providing for the right of sale in case of default was enforceable and that the form documents prepared by the lending institution were not contracts of adhesion, per se. Since issues relating to foreclosure on real property have traditionally been resolved on property principles, the *MCA* decision may portend a trend toward evaluation of other property related issues in terms of contract law. *See generally* 55 AM. JUR. 2d *Mortgages* §§ 679-779 (1971).

101. Lane v. Bisceglia, 488 P.2d 474, 476 (Ariz. Ct. App. 1971). In Baltimore Life Ins. Co. v. Harn, 486 P.2d 190 (Ariz. Ct. App. 1971), the court, although acknowledging the validity of the clause, refused automatic enforcement because the lender's purpose for increasing the interest rate was deemed unreasonable:

> In the opinion of this Court the better view is that the parties to a mortgage and note may enter into such agreements as they deem necessary to the transaction of their business. Acceleration clauses are bargained-for elements of mortgages and notes, protecting the mortgagee from the risks connected with transfers. The underlying reason for an acceleration clause of the type before us is to insure that a responsible party is in possession, thus protecting the mortgagee from unanticipated risks. . . . [T]he invocation of the clause must be based on grounds that are reasonable on their face.

Id. at 192-93.

gation" was held to constitute a condition consisting of dual elements, both of which were required to occur before the lender's rights would take effect.[102]

Other courts have upheld exercise of the clause upon a showing that no fraud, coercion, or overreaching was present.[103] A fortiori, in cases involving sophisticated borrowers acting with the assistance of counsel, courts have consistently permitted exercise of the clause to exact an increased interest rate.[104] Decisions in which the essential fairness of the bargain is stressed suggest that if unfairness were present, exercise of the clause would be denied. Such unfairness may follow from a showing that the due-on clause forms part of a contract of adhesion.[105] An adhesion contract arises where a contract offered to the public bears the following characteristics: the parties are of disparate bargaining power, the contract is embodied in a standardized form, all competitor organizations employ similar clauses, and consumers lack knowledge or understanding of the import of the provision.[106]

The due-on clause would seem to fall within the designated tests as applied to the ordinary consumer insofar as the loan instruments are

102. Home Fed. Sav. & Loan Ass'n v. English, 249 So. 2d 707, 708-09 (Fla. Dist. Ct. App. 1971).

103. *See, e.g.*, Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1 (Ill. 1975); People's Sav. Ass'n v. Standard Indus., Inc., 257 N.E.2d 406 (Ohio Ct. App. 1970); Miller v. Pacific First Fed. Sav. & Loan Ass'n, 545 P.2d 546 (Wash. 1976); Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works, 239 N.W.2d 20 (Wis. 1976).

104. Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580 (N.C. 1976).

105. Although no case has yet decided whether the contract-of-adhesion concept is a component of federal common law, the United States Supreme Court has suggested that exculpatory clauses in contracts may be avoided under federal law on public policy grounds. *See* Southwestern Sugar & Molasses Co. v. River Terminals Corp., 369 U.S. 411 (1959). Since avoidance on grounds of a contract of adhesion is but a particularized application of avoidance on public policy grounds, it would seem that the contract-of-adhesion principle forms part of federal common law.

106. Henningsen v. Bloomfield Motors, Inc., 161 A.2d 69 (N.J. 1960). The majority of due-on clause cases have involved purchasers of commercial property or of apparent sophistication and the courts have therefore discussed only tangentially aspects of adhesion contracts. *See, e.g.*, Baker v. Loves Park Sav. & Loan Ass'n, 333 N.E.2d 1 (Ill. 1976) (absent "unconscionable or inequitable conduct of the lender," borrower could not claim that higher interest rate was unreasonable, *id.* at 5); Crockett v. First Fed. Sav. & Loan Ass'n, 224 S.E.2d 580 (N.C. 1976) ("in the absence of . . . proof that the lender acted fraudulently, inequitably, oppressively, or unconscionably," exercise of the clause was neither invalid nor unreasonable, *id.* at 586); Miller v. Pacific First Fed. Sav. & Loan Ass'n, 545 P.2d 546 (Wash. 1976) (absent a showing that enforceability of the clause would be "inequitable under the circumstances," clause was legitimately invoked, *id.* at 549); Mutual Fed. Sav. & Loan Ass'n v. Wisconsin Wire Works, 205 N.W.2d 762 (Wis. 1973), *aff'd after remand*, 239 N.W.2d 20 (Wis. 1976) (absent a showing that the demand for an increased interest rate was "unconscionable or overreaching," clause was enforceable, *id.* at 24).

standardized forms typically unaltered by the borrower. Since the clause generally appears buried within the other provisions of the loan agreement, the borrower's attention is not focused on the clause. Moreover, since most borrowers purchase the property without the assistance of counsel, they presumably fail to comprehend the full ramifications of assumption, acceleration, and foreclosure concepts. Finally, the clause is present in the instruments of virtually all lending institutions.

IV. Conclusion

With the recent promulgation of the Due-On Regulation, federal preemption of the due-on clause is a virtual certainty, particularly as to loan instruments executed after July 31, 1976. Moreover, if federal common law is applied to loans executed prior to that date, the increasing number of jurisdictions adhering to a per se standard for exercise of the clause may render *Tucker* a minority decision.

These recent developments, however, will probably do little to terminate the controversy surrounding the due-on clause. The muddled language of the Due-On Regulation relating to its exceptions to per se enforceability, the meaning of its effective date, and the precatory disclosure provisions concerning the meaning and effect of the clause[107] may well breed new controversies.

Because the state, but not the federal associations are permitted the use of the variable interest rate, the more liberal due-on clause enforcement rights afforded the federal associations tend to balance the available lending tools between the federal and state associations. If federal associations are, as is likely, also permitted use of the variable interest rate, that balance will be upset. If, however, consumers appreciate the import of the more restricted ability of the state associations to enforce the due-on clause as opposed to their federal counterparts, state associations may experience increased loan activity. Thus, the brouhaha over federal preemption may prove to be so much tilting at windmills, as one effect cancels out another until the situation after preemption is indistinguishable from the situation before.

Kathy Agan Knox

107. 41 Fed. Reg. 18,286 (1976).