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THE NEW FEDERAL FORECLOSURE LAWS

PATRICK A. RANDOLPH, JR.*

Preemptive federal foreclosure laws are here, and more may be on the way. The development bodes ill for title predictability for properties sold at federal foreclosures and may create a whole separate system of title management and debt collection practices in each state. Practitioners who see value in the concept of states making their own judgment as to the appropriate balance between lenders and borrowers had best be aware of this development. There is a distinct possibility that the federal government's establishment of a separate foreclosure system for itself will grow into a national uniform foreclosure law.

I. The Federal Foreclosure Bill

On October 24, 1995, at the behest of the U.S. Department of Justice, the House of Representatives made a last-minute amendment to House Bill 2491, the House Budget Bill. The amendment added to that bill a proposed federal nonjudicial foreclosure law.¹ Although there were virtually no hearings, the Federal Foreclosure Bill came within a hair's breadth of becoming law as part of the last-minute budget negotiations between President Clinton and Congress.

Ultimately, the Federal Foreclosure provision was removed from the final budget bill. But it is still very much a "live" proposal. The Senate also has passed the provision as part of a funding bill,² and it has been attached to further funding bills as recently as April 1996, when it was added to a health services funding proposal (and later dropped).³

The Federal Foreclosure Bill is a broadly applicable foreclosure statute that preempts all state and federal law (except, arguably, Bankruptcy) and provides for a fast and final private foreclosure of federal agency-owned mortgages⁴ and deeds of trust. The bill applies to all federal loans, including, but not limited to, single family residential properties. Loans held by the Department of Housing and Urban

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1. This article will refer to the proposed law as the "Federal Foreclosure Bill." The bill appears at 141 CONG. REC. H10,726, H10,745-48 (daily ed. Oct. 24, 1995).

2. The first introduction was part of a general funding bill for Environmental Initiatives. See 142 CONG. REC. S2123, S2132-35 (daily ed. Mar. 14, 1996).

3. Health Insurance Reform Act of 1996, S. 1028, 104th Cong. (1995). The Federal Foreclosure Bill appears at 142 CONG. REC. S3634, S3667-70 (daily ed. Apr. 18, 1996). References to provisions of the Federal Foreclosure Bill come from the text included in this Bill, as it is the latest printed version. There is no "pending" bill *per se*, but it may be attached to any funding measure being considered by either the Senate or the House of Representatives.

4. Even where the original debt instrument is styled as a "mortgage" and contains no power of sale, the statute would authorize the appointment of a foreclosure trustee and a power of sale. Federal Foreclosure Bill § 3404, printed in 142 CONG. REC. S3634, S3668 (daily ed. Apr. 18, 1996).

Development (HUD), the Small Business Administration (SBA), the Veterans Administration (VA), the Farmers Home Administration (FmHA), and the Government National Mortgage Association (GNMA) would be covered, whether or not those agencies originated such loans.⁵ Federally related, or partly federal entities, such as the Federal Deposit Insurance Corp. (FDIC), the Federal Savings and Loan Insurance Corp. (FSLIC), the Federal National Mortgage Association (FNMA), and the Federal Home Loan Mortgage Corp. (FHLMC) are not covered,⁶ but future federal agencies holding mortgages originated or acquired by those entities, such as the Resolution Trust Corp. (RTC),⁷ would be covered. The Federal Housing Administration (FHA) is covered, apparently, although there has been some doubt.⁸

The bill gives government mortgagees some of the most brutal foreclosure rights in the country. It creates a twenty-one-day, one-notice foreclosure,⁹ with no redemption rights,¹⁰ no limitations on deficiencies (not even "fair value"),¹¹ no hearing, and conclusive presumptions of validity at every stop.¹²

The bill preempts and eliminates any antideficiency protection¹³ or statutory redemption protection that might otherwise be available to homeowners or others under state law. It makes the foreclosure sale price conclusively "fair" for purposes of deficiency judgments and makes the foreclosure purchaser a bona fide purchaser.¹⁴

5. See Federal Foreclosure Bill § 3401(1) (defining the meaning of "agency" to include executive departments, independent establishments, military departments and wholly owned government corporations). The bill applies to all agencies described in the definition.

6. The apparent purpose of the drafters of the Justice Department drafters of the bill is to deal with mortgages securing the loan of federal funds. Statement of Gerald Stern, Dep't of Justice Special Counsel, Before House Committee on Government Reform and Oversight House Subcommittee on Government Management, Information, and Technology (Sept. 8, 1995), available in Westlaw, 1995 WL 10382670 [hereinafter Statement of Gerald Stern]. FDIC, FSLIC, FNMA, and FHLMC typically deal with mortgages securing loans of nonfederal funds.

7. The RTC was a wholly owned government corporation that dealt with mortgages securing loans of nonfederal funds. FDIC and FSLIC transferred such mortgages to the RTC for management and, where necessary, foreclosure, as part of the workout from the massive failure of government-insured lending institutions in the mid-1980s.

8. Whether FHA is "an executive department" or "a wholly owned government corporation as defined in section 9101(3), title 31, United States Code," as required by Section 3401(1) of the Federal Foreclosure Bill, apparently are uncertain questions. Minutes of Joint Editorial Board Meeting on Uniform Real Property Acts: Visit from Kathleen Haggerty, Ass't U.S. Attorney, Justice Dep't, at 1 (June 8, 1996) [hereinafter Haggerty Meeting] (on file with the *Oklahoma Law Review*). In any event, most FHA loans ultimately could pass into the hands of a covered agency prior to foreclosure, as explained in the text.

9. Federal Foreclosure Bill § 3405.

10. *Id.* § 3410(e).

11. *Id.* § 3409(e). Some agencies may have internal bidding regulations requiring that the agency bid what the agency views as "fair value," see, e.g., 7 C.F.R. § 1955.9(c)(1)(vi)(C), but such procedures are not uniform and are not required by the Federal Foreclosure Bill.

12. Federal Foreclosure Bill §§ 3409(e), 3411(b), 3412.

13. *Id.* §§ 3409(e), 3414.

14. *Id.*

The bill specifically applies retroactively,¹⁵ including its preemption provisions. All loans already in effect that are now held by benefitted agencies (or later acquired by them) would be covered. Thus, for instance, if a borrower is a California homeowner who gave a purchase money deed of trust insured by FHA, believing that he would not ever face a deficiency due to section 580b of the California Civil Code, which prohibits deficiency judgments on purchase money mortgages, the federal bill would preempt California law and render that borrower liable for a deficiency to the federal government¹⁶ if the property value has dropped below the loan balance and foreclosure expenses.

There is a provision for mailed notice to a variety of parties,¹⁷ but the language identifying the notice address leaves considerable doubt as to whether *Mullane*¹⁸ or *Mennonite*¹⁹ standards for "federal action" foreclosures are met.²⁰ There is no provision for hearing prior to the foreclosure required by *Fuentes*,²¹ although arguably this could be substituted by agency action prior to the foreclosure (assuming that an agency hearing is a due process hearing.)²²

An interesting feature of the bill is the foreclosure trustee. Unlike in most state law foreclosures, this trustee has few real responsibilities. All real foreclosure functions, including the conduct of the auction, can be subcontracted, and the cost of such subcontracting comes "off the top" (and thus adds to the deficiency). Nevertheless, the trustee receives a fee of 1.5% of the foreclosure amount.²³

There is one "consumer protective" aspect — a right to cure for owners of one to four family properties.²⁴ The right can only be exercised once a year, paralleling the

15. *Id.* § 3402(d).

16. It is unlikely that such preemption would be viewed as a violation of the "Contracts Clause" of the United States Constitution because the change has to do with remedy, and not with right. Presumably the preemption would not apply if the loan documents specifically denied the government a right to a deficiency, or required foreclosure pursuant to state law.

17. Federal Foreclosure Bill § 3406(b).

18. *Mullane v. Central Hanover Bank & Trust Co.*, 339 U.S. 306, 315 (1950) ("The means [of notice] employed must be such as one desirous of actually informing the absentee might reasonably adopt to accomplish it. . . . [T]he constitutional validity of any chosen method [of notice] may be defended on the ground that it is in itself reasonably certain to inform those affected, or, where conditions do not reasonably permit such notice, that the form chosen is not substantially less likely to bring home notice than other of the feasible and customary substitutes.") (citations omitted).

19. *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 799 (1983) ("Neither notice by publication and posting, nor mailed notice to the property owner, are means 'such as one desirous of actually informing the [mortgagee] might reasonably adopt to accomplish it.'" (citing *Mullane*, 339 U.S. at 315).

20. See discussion *infra* notes 40-65 and accompanying text.

21. *Fuentes v. Shevin*, 407 U.S. 67, 90-92 (1972) ("Only in a few limited situations has this court allowed outright seizure without opportunity for a prior hearing. . . . Thus, the court has allowed summary seizure of property to collect the internal revenue of the United States, to meet the needs of a national war effort, to protect against the economic disaster of a bank failure, and to protect the public from misbranded drugs and contaminated food.").

22. See discussion *infra* notes 58-64 and accompanying text.

23. Federal Foreclosure Bill § 3413(a). The cost of the auctioneer, but not other costs, will be deducted from the commissioner's 1.5% "commission." *Id.* 3409(b).

24. Federal Foreclosure Bill § 3407.

provisions of the Uniform Land Security Interest Act in this regard.²⁵ But note that most conventional first lien mortgages are written on FNMA/FHLMC paper and have an unlimited right to cure²⁶ (which the Bill would not alter), and many states have consumer laws with right to cure provisions that apply to junior mortgages on residences.²⁷ Thus, in context, the federal right to cure has little to benefit most home borrowers, and much to trouble them.

II. Existing HUD Preemptive Foreclosure Statutes

Congress already has passed two foreclosure laws for HUD loans. The first,²⁸ in 1981, applied only to multifamily loans. Regulations implementing this Act were not adopted until a few years ago,²⁹ and HUD has used the procedure only selectively. The second,³⁰ in 1994, applied to single family mortgages held by HUD. The regulations for this Act have just become final.³¹ Again, HUD has not yet implemented this procedure nationwide, but we can anticipate that HUD will use it in many judicial foreclosure states. These statutes are almost certainly preemptive³² retroactively.³³ It is uncertain whether they apply to FHA loans (but many FHA insured loans are sold to HUD before foreclosure anyway).

III. Relationship of Federal Foreclosure Bill to HUD Statutes

The two HUD foreclosure statutes are virtually identical in their process, and quite similar in their general language, to the Federal Foreclosure Bill. They also provide for appointment of a foreclosure trustee, twenty-one-day notice, a "once a year" right to cure for single family mortgage debtors,³⁴ absolute deficiency rights, and certainty of title following foreclosure.

25. UNIF. LAND SECURITY INTEREST ACT § 513, 7A UNIF. LAWS ANN. 220 (Supp. 1995).

26. The FNMA/FHLMC 1-4 Family Uniform Mortgage Instrument language provides that the Borrower may avoid acceleration at any time prior to 5 days before a scheduled private foreclosure if Borrower pays the delinquent amounts (prior to acceleration), certain costs incurred by Lender in preparing to foreclose, and "takes such action as Lender may reasonably require to assure that the lien of this Security Instrument, Lender's rights in the Property and Borrower's obligation to pay the sums secured by this Security Instrument shall continue unchanged."

27. COLO. REV. STAT. ANN. § 38-38-104 (West Supp. 1996); MO. ANN. STAT. § 408.555 (West Supp. 1996); ARK. CODE ANN. § 18-50-114 (Michie 1995).

28. Multifamily Mortgage Foreclosure Act of 1981, Pub. L. No. 97-35, §§ 361-369I, 95 Stat. 357, 422-31 (codified as amended at 12 U.S.C. §§ 3701-3717 (1994)).

29. 24 C.F.R. §§ 27.1-27.65 (1996) (initially adopted June 30, 1993).

30. Single Family Mortgage Foreclosure Act of 1994, Pub. L. No. 103-327, 108 Stat. 2316 (codified at 12 U.S.C. §§ 3751-3758 (1994)).

31. 24 C.F.R. § 29.103 (1996).

32. There is no specific preemption language, but the statute sets up independent federal rights to foreclose, *e.g.*, 12 U.S.C. § 3753 (1994), and to collect a deficiency, *e.g.*, *id.* § 3768, that certainly will be read to be preemptive.

33. Unlike in the Federal Foreclosure Bill, the HUD Single Family statute has no specific retroactive preemption. On the other hand, the definition of mortgage loans covered by the statute appears to include loans already closed. *See id.* § 3752(10).

34. *Id.* § 3759.

The Federal Foreclosure Bill is not only far broader in its coverage than either of the earlier statutes, it is more direct in its retroactive preemption language. Further, it is designed to be "self-activating," so that no regulations will be necessary. Any "softening" or "adjusting" that might be possible through regulatory activities will be impossible. Ultimately, the Justice Department intends that the HUD statutes would be "merged" into a single federal foreclosure device,³⁵ but this will not be accomplished under the terms of the bill now pending.

Interestingly, the stated purpose³⁶ for the Federal Foreclosure law is not to tighten the foreclosure noose, as it does, but simply to eliminate the need for Justice Department lawyers to be involved in lengthy court proceedings, to realize upon real property security for federal debts. The Justice Department,³⁷ backed by some rather thin case law,³⁸ has taken the position that federal agency lenders have the right to preempt local law as to deficiency judgments and statutory redemption even without a congressional enactment, so long as they proceed in a judicial foreclosure. The real purpose of this bill, according to its Justice Department author,³⁹ is to confer the preemption power on nonjudicial proceedings, so as to eliminate the cost of federal court foreclosures using Justice Department lawyers.

IV. Constitutional Issues

Although there is some scant authority to the contrary, most scholars believe that a federal agency foreclosure would be subject to the due process requirements of the United States Constitution, as articulated in a series of cases beginning with *Mullane*

35. The description of the Justice Department position is based upon Haggerty Meeting, *supra* note 8. Haggerty is the principal spokesperson and drafter of the proposed federal foreclosure law.

36. See Statement of Gerald Stern, *supra* note 6; Haggerty Meeting, *supra* note 8.

37. Haggerty Meeting, *supra* note 8.

38. The primary case upon which Justice seems to rely is *Whitehead v. Derwinsky*, 904 F.2d 1362 (9th Cir. 1990), which is at best dicta, since the case rejected a Veteran's Administration attempt to avoid antideficiency provisions applicable to private foreclosures in the state of Washington. The case suggests, indeed, that the VA might have been successful in collecting a deficiency if it had proceeded in a judicial sale, but Washington does not bar deficiencies following judicial sale, so the preemption issue would not be involved. The case summarizes and analyzes earlier authority, including California authority, that arguably would support the VA bypassing antideficiency statutes by seeking judicial foreclosure, but those cases appear to be based upon specific language in the VA statute, and are not general statements of federal preemption law in the area. Further, the cases that permit preemption predate the important decision of *United States v. Kimbell Foods*, 440 U.S. 715 (1979), which significantly delimited preemption arguments for federal lenders, and which *Whitehead* points out has triggered a series of more restrictive preemption decisions in the Ninth Circuit in recent years. Even more significant, the Ninth Circuit has reversed *Whitehead* on its central premise that the VA Statute had not specifically created an independent federal right unaffected by state law. See *Carter v. Derwinsky*, 987 F.2d 611 (9th Cir. 1993). Researching authority citing these cases will produce numerous other recent federal court opinions dealing with the Veterans' Administrations' right to seek a deficiency under its statutory right to seek indemnification from a guaranteed borrower. But the Veterans' Administration cases do not establish that there is an independent federal agency right to recover deficiencies even absent congressional preemption, because they hold that the Veterans' Administration statute confers a specific independent federal right, which of course is preemptive. See, e.g., *Dixon v. United States*, 68 F.3d 1253, 1255 (10th Cir. 1995).

39. Haggerty Meeting, *supra* note 8.

v. *Central Hanover Bank and Trust*⁴⁰ in 1950. A more recent decision confirmed the continuing vitality of *Mullane* in "government action" foreclosures.⁴¹ In the 1970s, the Supreme Court indicated that "government action" foreclosures had to be preceded by adequate due process notice *and hearing* as a condition of their validity.⁴² In the years since the 1970s cases, some uncertainty has arisen as to how much process is "due process" in this context. In cases involving massive government entitlements programs, the Supreme Court has approved hearing processes that were less than a formal judicial proceeding.⁴³ But the Court has never altered the fundamental requirement of adequate notice and has never indicated that a hearing is not a fundamental prerequisite⁴⁴ to a "government action" taking of property.⁴⁵

The various federal foreclosure procedures described above would appear to be quintessential "government action" takings of property subject to the requirements of the Constitution.⁴⁶

The HUD foreclosure statutes appear to have several patent notice defects. Although notice must be sent to the owner and mortgagor at their "last known address," notice to junior lienholders need be sent only to the "address of record."⁴⁷ Although there is some state law authority involving tax foreclosure sales that suggests that reliance upon the "address of record" is adequate in the tax sale context,⁴⁸ the Supreme Court has never so ruled. Particularly, there is no indication

40. 339 U.S. 632 (1950).

41. *Mennonite Bd. of Missions v. Adams*, 462 U.S. 791, 800 (1983) (holding that junior mortgagees have sufficient "property interest" to warrant Due Process Clause notice requirement in tax foreclosure sales).

42. For a thorough discussion of both notice and hearing issues and related cases, see GRANT S. NELSON & DALE A. WHITMAN, *REAL ESTATE FINANCE LAW* 544-71 (1994).

43. See, e.g., *Mathews v. Eldridge*, 424 U.S. 319, 348 (1976) (holding that procedural due process requirements prior to termination of disability benefits were subject to a "cost benefit" sliding scale analysis).

44. *Mathews* upheld a procedure involving a prompt hearing following the termination of the "entitlement" in a disability case, but the *Mathews* test likely would be applied to require preforeclosure hearings in the case of foreclosure, where the injury occasioned by the loss of the property at foreclosure is quite significant and the interference with government interests relatively low.

45. At least one federal circuit court has imposed a high standard on the requisite hearing requirement. "At a minimum, due process, in the context of a government mortgage foreclosure, includes 'notice and a meaningful opportunity to be heard . . . [before a neutral arbiter.]" *Johnson v. U.S.D.A.*, 734 F.2d 774, 782 (11th Cir. 1994) (holding that a preforeclosure hearing before agency official is not adequate).

46. But see *Warren v. GNMA*, 611 F.2d 1229, 1234 (8th Cir. 1980) (holding that a government action to foreclose to collect on a debt owed the government under a federal lending program is not "government action" because the government is not subject to the constitutional Due Process Clause when collecting its contracted for debts). *Warren* has been criticized heavily and has few adherents. See NELSON & WHITMAN, *supra* note 42, at 563-67.

47. The commissioner has discretion to send additional notice to an address "believed to be that of such owner or mortgagor." 12 U.S.C. § 3708 (1994). Although this is discretionary, an argument can be made that the commissioner would be compelled by the Constitution to provide such notice where warranted, and consequently the statute would satisfy on its face constitutional requirements as to notice address.

48. *Keiser v. Young*, 585 N.Y.S.2d 880, 882 (App. Div. 1992) (notice to post office box is sufficient

that notice to the address of record would be adequate if the party giving notice was actually aware of a different address that would be more likely to provide adequate notice.⁴⁹ Note that, although many state deed of trust foreclosure statutes do require that parties other than mortgage debtors maintain a notice address in the record,⁵⁰ these statutes do not necessarily govern "government action" foreclosures and need not meet the more rigorous constitutional notice standards.

A second major defect is the lack of any requirement of notice to parties with nonpossessory interests in the property other than junior mortgagees. Parties who are in possession of the property, such as residential tenants, will receive notice.⁵¹ But parties holding easement or servitude rights, such as homes associations, utility companies, or the like, receive no notice under the statute. However, the statute clearly provides that their interests would be terminated.⁵²

The Federal Foreclosure Bill does provide for notice to all parties with subordinate interests in the property, but fails to provide for notice to addresses other than those contained in the record. The language provides for notice to debtors at the address in the instruments "and if different, to the debtor's last known address *as shown in the mortgage record of the agency*."⁵³ As to other parties, notice is sent to the "address of record or, *if there is no address of record*, to any address at which the agency in good faith believes the notice is likely to come to that person's attention."⁵⁴

Pursuant to the provisions of either of the HUD statutes or the Federal Foreclosure Bill, for example, a foreclosure commissioner could have actual knowledge that the address of a party shown on agency records or official records is inaccurate and have actual knowledge of that party's true address and nevertheless comply with the statute without sending notice to the correct address. Alternatively, the commissioner could have actual knowledge that the address in the agency or official records is inaccurate, such as by a return of a certified letter undelivered, and still have no duty to open the phone book, inquire at the property, or otherwise make an effort to find the

to satisfy due process standard without more even when notice envelope is returned unclaimed).

49. See *St. George Antiochian Orthodox Christian Church v. Aggarwal*, 603 A.2d 484, 490 (Md. 1992) and *Patrick v. Rice*, 814 P.2d 463 (N.M. Ct. App. 1991), which both indicate that due process requires some "due diligence" to insure that the intended notice reaches its destination.

50. N.H. REV. STAT. ANN. § 479:25 (1995); MO. ANN. STAT. § 443.325 (West 1986); 46 OKLA. STAT. § 45 (1991); MD. CODE ANN., REAL PROP. § 7-105 (1996).

51. 24 C.F.R. § 27.15(c).

52. 12 U.S.C. § 3765 (1994). The statute states:

A sale made and conducted as prescribed in this chapter to a bona fide purchaser, shall bar claims upon, or with respect to, the property sold, for each of the following persons:

(4) Any person claiming an interest in the property under a statutory lien or encumbrance created subsequent to the recording or filing of the mortgage being foreclosed, and attaching to the title or interest of any person [with an interest subject to the mortgage].

Id.

53. Federal Foreclosure Bill § 3406(b)(2) (emphasis added), *printed in* 142 CONG. REC. S3634, S3668 (daily ed. Apr. 18, 1996).

54. *Id.* (emphasis added).

correct address. The HUD statutes,⁵⁵ but not the Federal Foreclosure Bill, give the trustee discretion to provide notice to other parties and at different addresses, but it is not clear that such duty is mandatory.⁵⁶ Further, under the HUD Single Family Foreclosure Act and the Federal Foreclosure Bill, a recitation of compliance with the statute is deemed to be conclusive on the subject of validity of the title,⁵⁷ thus potentially terminating property interests of affected parties without full and fair notice.

None of the new federal foreclosure statutes provides for any kind of formal preforeclosure hearing. Apparently the drafters of the statute are relying upon prior agency processing to insure adequate process in this regard. As indicated, there is no certainty that internal agency hearing procedures in this context are satisfactory "hearings" under the Constitution. For instance, such hearings are unlikely to be available to parties other than the debtor. Further, it is likely that the hearing officer will be an agency employee and the process more truncated than might be appropriate under constitutional standards. And, of course, there is no certainty that a given agency at some given future time will not neglect to provide for adequate hearing processes prior to submitting the mortgage to foreclosure.

There is an argument under both the HUD statutes and the Federal Foreclosure Bill that some kind of hearing right is available through the foreclosure commissioner. None of the provisions, however, really provide the kind of hearing that likely would pass constitutional muster. In addition to basic due process concerns, there are significant problems as to whether the designated "hearings" focus appropriately on the key question: Is it lawful, under the applicable contract provisions and laws, for the government to proceed with foreclosure?

In the HUD Multifamily Foreclosure Act, the statute provides that the commissioner shall not proceed with the foreclosure if "the commissioner finds, upon application of the mortgagor, at least three days prior to the date of the sale, that the default or defaults upon which the foreclosure is based did not exist at the time of service of the notice of default and foreclosure sale."⁵⁸ Note that this statute provides rights only to the mortgagor and not to others with interests in the property.⁵⁹ In addition, the only question for the commissioner to determine is whether a default existed at the time of notice. The relevant question, it would seem,

55. 12 U.S.C. § 3708(2) (1994).

56. See discussion *supra* text accompanying note 51.

57. 12 U.S.C. § 3764(b) (1994); Federal Foreclosure Bill § 3411(b). The presumption is conclusive when the foreclosure purchaser is a bona fide purchaser for value. State law cases involving similar statutory language have not always been generous in their interpretation of who constitutes a bona fide purchaser. See, e.g., *Rosenberg v. Smidt*, 727 P.2d 778, 784 (Alaska 1986) (extensive inquiry notice burden on purchaser relating to potential defects in sale process); *Estate of Yates v. West End Fin. Corp.*, 32 Cal. Rptr. 2d 53, 59 (Cal. Ct. App. 1994) (purchaser on notice of possible problems when purchaser becomes aware that there is substantial equity that borrower is not trying to protect). Compare *Glidden v. Municipal Auth. of Tacoma*, 758 P.2d 487, 491 (Wash.) (en banc) (upholding conclusive presumption notwithstanding argued inquiry notice of defects), *amended by* 764 P.2d 647 (Wash. 1988).

58. 12 U.S.C. § 3709(a)(2) (1994).

59. "Mortgagor" is a defined term in the Act and includes, unless the context requires otherwise, the obligor under the loan agreement and the current owner of the property. *Id.* § 3702(4).

is whether a default exists at the time of the hearing so that the commissioner is justified in proceeding to foreclose. If there is no default, then clearly there would be no basis for foreclosure.

The statutory section proceeds to another subpart that authorizes the commissioner to terminate the process at any time prior to the actual sale if a monetary default has been cured,⁶⁰ including costs.⁶¹ This section does not provide for a hearing *per se*, but it obviously does require the commissioner to determine what amounts are due and whether all due amounts have been paid. The commissioner has an absolute duty to make such a determination upon tender of additional payment amounts, apparently, and thus tender may suffice as a requisite trigger of a hearing right. Note that there is no requirement that the tender be made by the mortgagor, so it is possible that junior parties could cure or pay off the accelerated debt under this section and thus prevent the foreclosure. The section does not provide expressly that the commissioner is to make a determination as to whether a default actually existed in the first instance if no additional funds are tendered, but one could certainly make an argument that if a party demanded that the commissioner make such determination, the statutory language supports the imposition of such a duty.

Interestingly, as to nonmonetary defaults, the statute specifically requires that the commissioner, upon application of the mortgagor at any time prior to default, make a determination as to whether any alleged nonmonetary defaults "have been cured."⁶² This probably could be read as a requirement that the commissioner also determine whether an alleged default actually ever existed. But, again, the commissioner makes such determination only at the behest of the mortgagor. Third parties with interests in the property have no right to request the relief.

The new HUD Single Family Foreclosure Act has virtually identical provisions⁶³ relating to notice and hearing as the Multifamily Act.

The Federal Foreclosure Bill language is less capable of supporting an argument that it provides for a hearing right, but there is a weak argument that can be made. The Bill provides that the commissioner shall terminate the sale at anytime prior to the sale if the debtor or the holder of any subordinate interest tenders full performance.⁶⁴ It does not provide expressly for any determination by the commissioner of the fact of default or of the requisite performance. With no discretion set forth in the statute, it is unlikely that the commissioner would terminate a foreclosure if the agency asserted that a default existed, even if the borrower made a credible showing that the agency was wrong.

60. *Id.* § 3709(a)(3)(A). The "cure" right — payment of the amounts due without allowing for acceleration of the debt — is available only once in the life of the mortgage (HUD may permit additional cures, of course). *Id.* § 3709(a)(3)(C).

61. *Id.* § 3709(a)(3)(C).

62. *Id.* § 3709(a)(3)(B).

63. *Id.* § 3759.

64. Federal Foreclosure Bill § 3407(b).

V. Title Problems

Because of the significant notice and hearing deficiencies outlined above, causing doubt as to validity of title passed under these statutes, the American Land Title Association has vigorously lobbied against the passage of the HUD Single Family Foreclosure Act and the Federal Foreclosure Bill.⁶⁵

An unconstitutional title is an "infected" title. Parties who buy property at an unconstitutional foreclosure sale probably will have no rights in the land as against the original foreclosed owner.⁶⁶ Statutory cures typically cannot resolve the problem. Presumptions of validity may assist in close cases, but fundamentally there is nothing that Congress can do that will avoid the consequence of an unconstitutional taking. Bona fide purchasers will not cut off the claim of a party who has been deprived of title through an unconstitutionally defective procedure. The problem already exists with regard to foreclosures following the HUD statutes, but HUD preforeclosure procedures are so elaborate and lengthy that there likely will be few notice or hearing difficulties in fact. The statutes permit discretionary notice by the trustee that likely will prevent the statutes from being declared unconstitutional on their face. Consequently, the infection, if any, resulting from the HUD statutes is likely to be confined.

If the Federal Foreclosure Bill is enacted, however, it will place a foreclosure tool in the hands of present and future federal agencies that will have many and varied procedures. There will be no single set of regulations controlling the actions of these agencies. Further, as the fundamental purpose of the Bill is to remove the U.S. Attorney's office from federal agency foreclosure processes, there will be no central control from a knowledgeable legal advisor. The consequence is likely to be, over time, further and further departure from the constitutional model of notice and hearing. By the time the defective procedures are challenged and identified, many unconstitutional titles will have been created.

VI. Application of Proceeds

The HUD statutes provide for the trustee to pay the costs of foreclosure, prior valid tax liens or assessments, and "any liens recorded before the recording of the mortgage which are required to be paid in conformity with the terms of sale in the notice of default and foreclosure sale."⁶⁷ The Federal Foreclosure Bill contains a similar mandate.⁶⁸ It is unclear just what this statutory language is intended to accomplish. The statutory language providing for notice of default and foreclosure sale⁶⁹ says nothing about payment of prior liens. It does state that the notice can

65. Letter from American Land Title Association to Hon. Steven Crane (n.d.) (on file with author).

66. NELSON & WHITMAN, *supra* note 42, at 567-69.

67. 12 U.S.C. § 3762(a) (1994).

68. Federal Foreclosure Bill § 3413(a)(5), *printed in* 142 CONG. REC. S3634, S3670 (daily ed. Apr. 18, 1996)

69. 12 U.S.C. § 3757 (1994).

provide "any other appropriate terms of sale or information, as the Secretary may determine."⁷⁰ Traditionally, American foreclosure procedure, unlike that in some other countries and unlike Bankruptcy sales, provides for the sale of title as it was conveyed into the mortgage. Title is transferred subject to any prior liens, and the sale proceeds are not used to pay them. The statute is unclear as to whether it envisions some other method of application of payment. Perforce, the statute is also unclear as to whether the term "prior liens" would include judgment liens, statutory liens, equitable liens, or mortgage liens (accelerated or unaccelerated). Although major difficulties could arise from possible implementation of this provision, it is too early to tell whether it ever will have any meaning.

State private foreclosure laws vary in their treatment of foreclosure surplus. Some of them, like the federal provisions, instruct the trustee to distribute proceeds to other lienholders.⁷¹ In other states,⁷² however, lienholders who seek access to the surplus must seek equitable relief to establish a lien upon the proceeds or try to attach the proceeds pursuant to a judgment lien execution, separate in both cases from the foreclosure proceeding itself. But the federal language states that the foreclosure trustee shall pay over any surplus proceeds "[f]irst, to holders of liens recorded after the mortgage in the order of priority under Federal law or the law of the State in which the security property is located."⁷³ The statute provides no guidance as to how the foreclosure trustee is to make this determination, or even as to what types of "liens" are included. The determination of priority, of course, could be quite complex. There is a "disputed claims" procedure, but it is triggered by uncertainty on the part of the foreclosure trustee. In short, it is quite possible that mistakes will be made. It is very possible that fraud could occur.

Even more problematic is the fact that the disposition of proceeds provisions vary from most state law provisions. Consequently, parties with claims subject to federal mortgages will have to maintain special vigilance to insure that their interests are adequately protected. They will have to do so only with the briefest of notice opportunities and, possibly, with no notice at all. None of the statutes provide for any kind of preforeclosure hearing. Apparently the drafters of the statutes are relying upon prior agency processing to provide the constitutionally mandated hearings.⁷⁴ As indicated, there is no certainty that internal agency hearing procedures in this context are satisfactory "hearings" under the Constitution.

70. *Id.* § 3757(11).

71. ARIZ. REV. STAT. ANN. § 33-727 (West Supp. 1996); CAL. CIV. CODE § 2924j(e) (West 1993).

72. MINN. STAT. ANN. § 580.10; IND. CODE ANN. 34-1-53-10; WASH. REV. CODE ANN. 61-12-150.

73. 12 U.S.C. § 3762(b)(1) (1994); Federal Foreclosure Bill § 3413(c)(1)(A). Both the HUD statutes and the federal foreclosure bill do provide for an equitable proceeding in the event of a dispute among claimants to a foreclosure surplus. *See, e.g.*, 12 U.S.C. 3762(b)(2) (1994); Federal Foreclosure Bill § 3413(c)(2). The author's concern is that proceeds will be distributed inappropriately before a dispute becomes apparent.

74. Statement of Gerald Stern, *supra* note 6.

VII. Comment

This commentator, an advocate of the Uniform Land Security Interest Act, which provides for nonjudicial foreclosure, recognizes the argument in favor of simpler and more uniform foreclosure methods.⁷⁵ Further, we all pay for expensive and complex government procedures in collecting debts. The Office of Management and Budget estimates that the adoption of the proposed procedure would save the government \$500 million.⁷⁶

On the other hand, the federal foreclosure proposal dispenses with consumer protections that are the norm in the majority of American jurisdictions.⁷⁷ It also dispenses with hearing protections and possibly with notice protections that are generally regarded as minimal fairness guarantees of the Due Process Clause. Further, it does so without any legislative evaluation in local jurisdictions of whether such debt collection practices are a fair balance of the rights of creditors and debtors, in light of the many unique social, economic, and legal factors in that jurisdiction.

This bill would impose the harshest foreclosure laws on those who were unable to afford to secure credit through conventional sources and thus had to resort to federally supported institutions. Although it would be inaccurate to generalize that all such borrowers represent the "poorest" or "most needy" of the population, it is a safe guess that a substantial number of them would fit that description.

From the standpoint of overall policy in our real estate system, the bill would lead to uncertain title as these "federal action" foreclosures spur foreclosures of questionable constitutionality. Further, state title transfer institutions — closing entities, title companies, and the like — will have to develop a "bifurcated" system of identifying and verifying property acquired through foreclosure. Parties with junior interests, such as homeowner's associations, junior lenders, and tenants, will have to develop a new vigilance concerning whether the land records include any addresses that might not be accurate because they stand to lose important rights without real notice.

It is particularly noteworthy that Congress, in an era marked by increased interest in the ability of individual states to control their destiny, would resume its practice of enacting disruptive federal mandates while it preempts three hundred years of carefully balanced social policies in the states.

Many would agree that existing foreclosure laws are cumbersome and unnecessary and should be supplanted with a more modern commercial approach. But there is a proper means to every end. And the question remains whether this preemption blunderbuss is the right answer. Wouldn't it be better to let the states decide?⁷⁸

75. See Patrick A. Randolph, *The Future of American Real Estate Law: Uniform Foreclosure Bills and the Uniform Land Security Interest Act*, 20 NOVA L. REV. 1109 (1996).

76. Haggerty Meeting, *supra* note 8.

77. For a detailed summary of the many different borrower protective provisions presently effective in American jurisdictions, see SIDNEY A. KEYLES, FORECLOSURE LAW AND RELATED REMEDIES: A STATE-BY-STATE DIGEST (1995).

78. For an extended discussion of these issues, see Randolph, *supra* note 75, at 1127-32.