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**Constitutional Law: Oklahoma Mortgage
Foreclosure Moratoriums...Past, Present
and Future?**

by

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Constitutional Law: Oklahoma Mortgage Foreclosure Moratoriums . . . Past, Present, and Future?

Introduction

In 1986, in response to increased farm foreclosures and a generally distressed farm economy, the Oklahoma State Legislature enacted the Oklahoma Mortgage Foreclosure Moratorium Act (the "Act").¹ The Act was to remain in effect from May 21, 1986 until May 21, 1987. During this period, the Act prevented the Federal Land Bank of Wichita, and the local Federal Land Bank Associations (the "Associations"), from initiating foreclosure actions in Oklahoma's state court system.

While the Act was in effect, the Federal Land Bank filed several foreclosure actions in Oklahoma's state courts. The landowners in these action sought protection under the Act. In several cases, the trial court declared the Act unconstitutional.² Before the Supreme Court of Oklahoma could review the issue, the Act expired by its own terms. Although the Act had expired, the court granted certiorari in *Federal Land Bank v. Story*.³ In *Story*, the Oklahoma Supreme Court affirmed the trial court's decision that the Act was unconstitutional because it violated the contracts clause of both the Oklahoma and United States Constitutions.⁴ Thus, the land owners were unable to gain protection from foreclosure under the Act.

This note analyzes the court's holding in *Story* and discusses several additional constitutional issues relating to the Act. This discussion is necessary because of the cyclical nature of economic distress in the agricultural sector. In the past, the Oklahoma Legislature has dealt with economic distress in the agricultural sector by enacting a mortgage foreclosure moratorium during an economic emergency.⁵ Other states have also used mortgage foreclosure moratoriums during periods of economic emergency.⁶ Economic emergencies will surely recur in the future and one possible response to future economic emergencies is the enactment of a mortgage foreclosure moratorium. This note will explore the feasibility of mortgage foreclosure moratoriums as a response to economic distress. The format for this analysis includes a review of the constitutional shortcomings of the Act and a survey of case law from other jurisdictions addressing the constitutionality of mortgage foreclosure moratoriums.

1. 62 OKLA. STAT. §§ 492-493 (Supp. 1989). The text of the Act is also set forth in *Federal Land Bank v. Story*, 756 P.2d 588, 589 (Okla. 1988).

2. Appeal Numbers 68,077; 63,683; 68,684; 68,872; 68,874; 68,902; 68,903; 68,917; 69,035; and 69,036. *Story*, 756 P.2d at 589.

3. *Id.*

4. *Id.* at 589.

5. 1933 Okla. Sess. Laws §§ 1-4.

6. See IOWA CODE § 654.15 (1950) (continuation of foreclosures in certain situations); 1943 N.Y. Laws 93 (one year suspension on mortgage principal payments); 1933 Minn. Laws 339 (postponment of judicial sales and extension of redemption period).

Confronting Economic Crisis

The use of moratorium legislation as a form of debtor relief during economic crisis is a practice that arose early in our nation's legal history.⁷ Before the 1930's, these attempts at debtor relief were generally overruled by the United States Supreme Court as violations of the contracts clause of the United States Constitution.⁸

The "Great Depression" of the 1930's influenced some states to enact mortgage moratorium legislation.⁹ This economic emergency gave rise to various types of mortgage moratorium legislation.¹⁰ These acts sought to provide short term relief for debtors by postponing judicial sale of property or by extending periods of statutory redemption. This approach presupposed that economic conditions would eventually improve and that mortgagors would be able to resume payments on their debts.

During the 1930's, many mortgagors were unable to fulfill their mortgage obligations and were, therefore, subject to foreclosure proceedings. This economic environment made mortgage foreclosure moratoriums a very popular means for state legislatures to provide immediate relief in response to the public outcry over economic conditions.

In 1933, the Oklahoma Legislature enacted the Oklahoma Mortgage Moratorium Act (the "1933 Act").¹¹ Section 1 of the 1933 Act, which applied to mortgage foreclosure actions already pending, extended the time to answer and postponed trial and judgment for nine months.¹² The

7. Kempter, *Constitutional Law—Due Process Of Law—Moratoria Acts*, 9 NOTRE DAME L. REV. 328, 329 (1934).

8. *Id.*

9. *Id.* at 328.

10. *Id.*

11. 1933 Okla. Sess. Laws §§ 1-8, *cited in State ex rel. Roth v. Waterfield*, 167 Okla. 209, 29 P.2d 24 (1934).

12. Section 1 of the 1933 Act provided as follows:

In all actions now pending in the courts of this State, for the foreclosure of mortgages or other liens upon real estate, where the answer of the defendant or defendants has not been filed, such defendant or defendants shall not be held to answer therein until the expiration of nine (9) months after the date of the service of summons upon the defendant who is the record owner of the real estate, at the time of the filing of suit upon which the mortgage or other lien is sought to be foreclosed, and

In all actions hereafter filed in the courts of this State for the foreclosure of mortgages or other liens upon real estate, the defendant or defendants shall not be held to answer therein until the expiration of nine (9) months after the date of the service of summons upon the defendant who is the record owner of the property at the time of the filing of suit upon which the mortgage or other lien is sought to be foreclosed, and

In all actions now pending in the courts of the State, for the foreclosure of mortgages or other liens upon real estate, in which the answer of defendant or defendants has already been filed, no trial shall be had, and no court of this state shall render judgment therein, until the expiration of nine (9) months after the passage and approval of this Act, upon which the mortgage or other lien is sought to be foreclosed.

1933 Okla. Sess. Laws § 1.

remaining sections of the 1933 Act applied to foreclosure actions initiated after the effective date of the 1933 Act. In these actions, the district courts were given discretion to grant continuances on a case-by-case basis. However, the owner was required to pay interest, taxes and reasonable rental accruing during the continuation.¹³ In *Roth v. Waterfield*,¹⁴ the Supreme Court of Oklahoma declared section one of the 1933 Act unconstitutional because it impaired existing contracts and violated the Oklahoma and United States Constitutions. The Court held the remaining sections of the 1933 Act to be within constitutional limits, and the sections were enforced.¹⁵

Several other agricultural states, including Iowa and Minnesota, also enacted mortgage moratorium legislation in 1933.¹⁶ In *Home Building & Loan Association v. Blaisdell*,¹⁷ the United States Supreme Court upheld the constitutionality of the Minnesota Mortgage Moratorium Law. This departure from past treatment of debtor relief legislation by the Supreme Court rejuvenated mortgage moratorium acts. However, the Oklahoma Supreme Court, on a rehearing of *Roth*, held that the Oklahoma Act was distinguishable from the Minnesota Act considered in *Blaisdell*. Therefore, the court reaffirmed its original decision.¹⁸

Clearly, mortgage foreclosure moratoriums are not a new concept in Oklahoma or other states. Subtle differences in state mortgage moratorium laws have led to different holdings on the constitutionality of these laws. This historical perspective should be helpful when analyzing the recent treatment of Oklahoma mortgage moratorium legislation. It should also be helpful in proposing workable alternatives to the Act which will pass constitutional muster.

Federal Land Bank v. Story

The Federal Land Bank of Wichita filed a mortgage foreclosure action in the District Court of Craig County, Oklahoma, against Jim and Margie Story, on August 7, 1986. The Storys sought protection under the Act and filed a motion to dismiss. The trial court held the Act unconstitutional.¹⁹ The Attorney General intervened on the landowners' behalf²⁰ and the Oklahoma Supreme Court granted certiorari.²¹

13. *Roth*, 29 P.2d at 25-26.

14. *Id.* at 32.

15. *Id.*

16. See 1933 Iowa Acts 211, ch. 182, § 1; 1933 Minn. Laws 339.

17. 290 U.S. 398 (1934).

18. *Roth*, 29 P.2d at 38. The court noted that the Oklahoma Act was distinguishable from the Minnesota Act because the Oklahoma Act granted a fixed extension of time to answer in any foreclosure action pending or to be filed while the Minnesota Act granted extensions based on judicial discretion. *Id.* at 35. In addition, the Minnesota Act granted extensions upon the condition that the mortgagor pay a reasonable rental value during the time of the extension. *Id.* The Oklahoma Act extended the time to answer without compensating the mortgagee. *Id.*

19. *Story*, 756 P.2d at 589.

20. See 12 OKLA. STAT. § 2024(D) (Supp. 1986) for authority of state to intervene.

21. The Attorney General intervened on behalf of the landowners but the trial court

The majority, in an opinion delivered by Chief Justice Doolin, held the Act unconstitutional as a violation of the contracts clause of the Oklahoma and United States Constitutions.²² These provisions of both constitutions prohibit the passing of any laws impairing the obligation of contracts.²³

The court outlined several questions which must be asked to determine if a law violates the contracts clause of either the Oklahoma or United States Constitution. The first question that a court must answer is whether state action caused the alleged impairment.²⁴ The second question is whether state action substantially impaired the existing contracts.²⁵ If the contracts were substantially impaired, the state must identify some legitimate public interest that justifies the impairment.²⁶ Finally, if there was a substantial impairment, the adjustment of the rights of the contracting parties must be based upon reasonable conditions and be appropriate to the public purpose which justifies the action.²⁷

In this case, the court easily decided the first two steps of the analysis. Because the state legislature passed the Act, it was clearly a state action.²⁸ The Act prohibited foreclosures for one year on mortgages that were granted before the Act. Therefore, it clearly impaired existing contracts.²⁹

At this point in its analysis, the court placed substantial weight on its previous decision in *Roth v. Waterfield*.³⁰ The court noted that the Act closely paralleled section 1 of the 1933 Act by prohibiting the Federal Land Bank from initiating any foreclosure action in Oklahoma courts during the life of the Act. Therefore, this review was simplified by the application of stare decisis.³¹

21. The Attorney General intervened on behalf of the landowners but the trial court reaffirmed its earlier decision. The Attorney General filed a petition for Writ of Certiorari to the Oklahoma Supreme Court. Before the parties could fully brief the question, the Act expired by its own terms on May 21, 1987. The Oklahoma Supreme Court granted certiorari for two reasons. First, there were ten pending appeals on the same issue. Second, there was a chance that the act could be revived and would expire again before the court had an opportunity to review the issue. The court stated that "mootness will not act as a bar when the challenged event is capable of repetition yet evading review." *Story*, 756 P.2d at 589.

22. *Id.* at 593. See *supra* text accompanying notes 2-6.

23. The United States Constitution states that "[n]o State shall enter into any Treaty, . . . pass any Bill of Attainder, ex post facto Law, or Law impairing the Obligation of Contracts, or grant any title of Nobility." U.S. CONST. art. I, § 10, cl. 1.

24. *Story*, 756 P.2d at 590-91.

25. *Id.*

26. *Id.* at 591.

27. *Id.*

28. *Id.* at 590.

29. *Id.*

30. 167 Okla. 209, 29 P.2d 24 (1933). See *supra* text accompanying notes 12-14. In *Roth*, the Oklahoma Supreme Court held that section 1 of the 1933 Act amounted to an arbitrary and capricious extension of time. The extension resulted in the taking of private property without compensation or protection of the rights of the mortgagee. *Id.* at 38.

31. *Story*, 756 P.2d at 591.

The Oklahoma Attorney General argued that section 493 of the Act³² allowed the Federal Land Bank to sell mortgages to the Capital Corporation³³ which could then bring foreclosure actions.³⁴ This option provided an alternative remedy to replace the remedy that was eliminated by the Act. Therefore, the Act did not substantially impair contractual obligations.

The court rejected this argument because it found that requiring mortgagees to divest themselves of all contractual rights, by assigning them to a third party, was not an alternative remedy, but a destruction of their contract rights.³⁵ The court held that the existence of emergency conditions did not justify the legislature's action because it was not a reasonable exercise of the state's police power in view of the emergency.³⁶

Justice Hodges, in his dissent, argued that although the Act affected existing contracts, it was appropriate for the existing emergency and was based upon reasonable conditions. He noted that, unlike the 1933 Act, the 1986 Oklahoma Mortgage Foreclosure Moratorium Act provided an alternative to the mortgagee. The Federal Land Bank could sell the mortgage to the Capital Corporation and the mortgage could then be foreclosed. The legislature reasonably limited the Act to apply to the Federal Land Banks because they were the only lenders who could sell to the Capital Corporation. Therefore, the Act did not permanently divest the mortgagee of any remedy because the prohibition on foreclosures was only for the one year life of the Act.³⁷ During this one year period, the mortgagee was

32. The text of section 493 states:

There is hereby declared a period of deferment of not longer than one (1) year from the date of the enactment of this act, during which time the Federal Land Bank of Wichita and any Federal Land Bank Association are prohibited from initiating a foreclosure action in the courts of this state. However, nothing in this act shall prohibit the Capital Corporation from initiating a foreclosure action from and after this date so long as the Capital Corporation has determined that the loan or loans held by the borrower or borrowers are ineligible for restructuring assistance.

62 OKLA. STAT. § 493 (Supp. 1989).

33. In 1985, Congress enacted the Farm Credit Amendments Act of 1985 in order to strengthen the operations of the Farm Credit System. Farm Credit Amendments Act of 1985, Pub. L. No. 99-205, 99 Stat. 1678 (1985). Part D1 of the Act established the Farm Credit System Capital Corporation. 99 Stat. 1678, 1680. The Corporation was to provide assistance to institutions in the Farm Credit System and their borrowers. The Corporation was given the authority to accomplish this purpose through acquiring non-performing loans from other Farm Credit System institutions and providing assistance in restructuring or refinancing loans of member borrowers. *Id.*

34. The Attorney General relied on *Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust Co.*, 300 U.S. 124, 128-29 (1937), where the Supreme Court held that "the particular remedy existing at the date of the contract may be altogether abrogated if another equally effective for the enforcement of the obligation remains or is substituted for the one taken away."

35. *Story*, 756 P.2d at 593.

36. *Id.*

37. *Id.* at 596.

not divested of all remedies because they had the option to sell the mortgage to the Capital Corporation.³⁸

The Contract Clause

Any analysis concerning whether a mortgage moratorium law complies with the contract clause of the United States Constitution must begin with the seminal case of *Home Building & Loan Association v. Blaisdell*.³⁹ *Blaisdell* was the United States Supreme Court's first opportunity to review one of the state mortgage moratorium laws enacted as a result of the Great Depression. The Minnesota Mortgage Moratorium Act extended the periods for judicial sale and redemption by the mortgagor. This extension was available only when the mortgagor made application to the court and paid a reasonable rental value on the property to be applied toward payment of taxes, insurance, interest and mortgage indebtedness.⁴⁰

Blaisdell held that the Constitution's limitation on the impairment of contracts should not be interpreted as an absolute bar.⁴¹ The contract clause must be construed to allow the states to exercise their protective power in the event of an emergency in spite of a temporary restraint on the enforcement of contractual obligations.⁴² The Court noted that the state's right to exercise its police power to protect its citizens applied to economic emergencies as well as natural disasters.⁴³ The Court also advocated a balancing analysis where neither the limitation on the impairment of contracts, nor the states right to exercise its power to protect the public welfare, is completely eliminated.⁴⁴ To survive this balance, the state's action must be addressed to a legitimate purpose which justified the exercise of police power.⁴⁵ After the Court's decision in *Blaisdell*, impairment of contracts was apparently allowed by the Constitution as long as the impairment was a result of a reasonable exercise of police power.

The Supreme Court's reasoning in *East New York Savings Bank v. Hahn*,⁴⁶ is also helpful in reconciling the conflicting powers of the contract clause and the state's authority to impair contracts as a reasonable exercise of the state's police power. The *Hahn* rationale treated the state's authority to exercise its protective power as a condition implied in every contract. Therefore, when the state reasonably exercises that power, it does not impair contractual obligations, but rather enforces the implied condition of the contract.⁴⁷ Although this is a circular theoretical journey, it upholds

38. *Id.* at 597.

39. 290 U.S. 398 (1934).

40. *Id.* at 416-18.

41. *Id.* at 437.

42. *Id.* at 439.

43. *Id.* at 439-40.

44. *Id.* at 439.

45. *Id.*

46. 326 U.S. 230 (1945).

47. *Id.* at 232.

the commonsense notion that the framers of the Constitution did not intend to completely eliminate the state's ability to protect its citizens simply because some private contractual obligations would be impaired.

Substantial deference should be given to a state legislature when determining whether the exercise of the state's protective power is reasonable.⁴⁸ As directly elected officials, legislators are best qualified to determine what steps are necessary to protect the public welfare. In *Hahn*, the Supreme Court validated an extension of the New York Mortgage Moratorium Law which was first enacted in 1933.⁴⁹ Like the Minnesota Act considered in *Blaisdell*, the New York Act required the mortgagor to pay taxes, insurance, and interest during the period the foreclosure was postponed.⁵⁰

The protection of mortgage indebtedness is a key factor in deciding whether a mortgage foreclosure moratorium is considered a reasonable exercise of state police power. In *Blaisdell*, the Court noted that although the means of enforcing contractual obligations were postponed, payment of a reasonable rental value protected the mortgagee.⁵¹ State supreme courts have viewed the impairment of mortgage indebtedness as an important distinguishing factor. Therefore, many states have declared moratorium legislation invalid as a violation of the contract clause.⁵²

As noted earlier, the Oklahoma Supreme Court declared the 1933 Act unconstitutional as a violation of the contract clause.⁵³ After the *Blaisdell* decision, the Oklahoma Supreme Court reaffirmed its prior holding.⁵⁴ In a more recent case, the Kansas Supreme Court declared the Kansas Family Farm Rehabilitation Act unconstitutional because it also violated the contract clause.⁵⁵ The Kansas Supreme Court held that the Act was facially unconstitutional because it impaired the mortgaged indebtedness, altered the rate of interest, permitted partial redemption of mortgaged property and provided inadequate protection for the mortgagee.⁵⁶ The Kansas Family Farm Rehabilitation Act impaired mortgage indebtedness by allowing the mortgagor to redeem the property at the greater of the fair market

48. *Id.* at 232-33.

49. *Id.* at 235. The Court determined that the New York moratorium legislation was the process of legislation at its fairest, for the following reasons: "[F]requent reconsideration, intensive study of the consequences of what has been done, readjustment to changing conditions, and safeguarding the future based on responsible forecasts." *Id.* at 234-35.

50. *Id.* at 231.

51. *Blaisdell*, 290 U.S. at 445-46.

52. See *State ex rel. Roth v. Waterfield*, 167 Okla. 209, 29 P.2d 24 (1934). See also *Federal Land Bank v. Bott*, 240 Kan. 624, 732 P.2d 710 (1987) (Family Farm Rehabilitation Act found to be unconstitutional because it impaired mortgage indebtedness, altered the contract rate of interest, permitted partial redemption of mortgaged property and provided inadequate protection for the mortgagee).

53. See *supra* notes 12-16 and accompanying text.

54. The court noted there was not a conflict between *Roth* and *Blaisdell* because section 1 of the 1933 Act was an arbitrary extension of time that did not provide for compensation or protection of the rights of the mortgagee. 29 P.2d at 38.

55. *Bott*, 732 P.2d at 718.

56. *Id.*

value at the initial hearing or at the time of redemption. Both values were usually much less than the judgment amount. The mortgagee was not given adequate protection because the mortgagor was permitted to remain in possession and was not required to pay rent or taxes.

Courts have interpreted *Blaisdell* and its progeny to allow mortgage foreclosure moratorium legislation to alter the enforcement of contractual obligations, but only when the legislation is deemed a reasonable exercise of the state's police power towards a legitimate end.⁵⁷ The postponement of a remedy available to the mortgagee is not a reasonable exercise of this power when the mortgage indebtedness is impaired or the mortgagee is not adequately protected through the provision of reasonable rental, interest or payment of taxes on the property.⁵⁸

The Oklahoma Supreme Court correctly applied *Blaisdell* and its progeny when it declared the Act unconstitutional as violative of the contract clause.⁵⁹ Section 493 of the Act granted an unconditional prohibition on the filing of foreclosure actions by the Federal Land Bank in Oklahoma state courts.⁶⁰ The Act did not contain any provision that protected the mortgagee's rights during the time the Act was in effect. While the mortgagor was allowed to retain possession of the property under the protection of the Act, the mortgagor was not required to pay rent, taxes or interest. Therefore, according to the principles used in *Blaisdell*, the Act was clearly an unreasonable exercise of the state's police power and a violation of the contracts clause of the Oklahoma and United States Constitutions.

The Attorney General argued that because the Act did not prevent foreclosure actions by the Capital Corporation, the Federal Land Banks could sell delinquent mortgages to the Capital Corporation who could in turn foreclose on the property.⁶¹ This was in effect an alternative remedy available to the Federal Land Bank under the Act. The legislature may modify, limit or alter a remedy for enforcement of a contract, without impairing its obligations, so long as it does not eliminate all remedies.⁶² "The particular remedy existing at the date of the contract may be altogether abrogated if another equally effective for the enforcement of the obligation remains or is substituted for the one taken away."⁶³

The Capital Corporation was established by the Farm Credit Amendments Act of 1985.⁶⁴ The Capital Corporation's purpose was to carry out a program of financial and technical assistance to institutions within the

57. *Id.*

58. *Id.* at 718-19.

59. *Story*, 756 P.2d at 593.

60. 62 OKLA. STAT. § 493 (Supp. 1989). For the text of section 493, see *supra* note 32.

61. *Story*, 756 P.2d at 592.

62. *Richmond Mortgage & Loan Corp. v. Wachovia Bank & Trust*, 300 U.S. 124, 128 (1937).

63. *Id.* at 128-29.

64. Farm Credit Amendments Act of 1985, Pub. L. No. 99-205, 99 Stat. 1678 (1985). See *supra* note 33.

Farm Credit System (and their borrowers) which are experiencing financial difficulties.⁶⁵ One of the means available to accomplish this purpose was to “acquire from other Farm Credit System institutions and participate with such institutions in nonperforming assets of such institutions.”⁶⁶

Both the Federal Land Bank and the Capital Corporation are members of the Farm Credit System. The purpose of the Capital Corporation mandates a program of financial assistance to the mortgagor rather than initiation of foreclosure proceedings. The net result is that no member of the Farm Credit System will be able to foreclose, and the nonperforming loan will remain in the system. Therefore, under the Act, transfer to the Capital Corporation was not an equally effective remedy available to the Federal Land Bank to replace the remedy prohibited by the Act.

As the court held in *Story*, the Act clearly violated the contract clause.⁶⁷ However, ending the constitutional analysis of the Act here would be premature. Several other constitutional issues raised by the Act were not addressed by the court. If mortgage moratorium legislation is to be used in Oklahoma in the future, these issues must be discussed and resolved.

Equal Protection

Although the *Story* court did not discuss equal protection, the Act did not appear to satisfy equal protection requirements. Section 1 of the fourteenth amendment of the United States Constitution provides that no state shall “deny to any person within its jurisdiction the equal protection of the laws.”⁶⁸ The Act, by its express terms, applied only to the Federal Land Bank of Wichita and the Associations. At first glance, this would appear to be an unequal treatment of mortgage lenders by the laws of Oklahoma.

It is well settled that corporations are “persons” within the meaning of the fourteenth amendment.⁶⁹ Therefore, Associations cannot be denied the protection of the fourteenth amendment based solely on their business structure. However, the Constitution does not require that all persons within a jurisdiction receive the same treatment by the laws of that state.⁷⁰ State laws are permitted to use classification to impose restraints on one class which are not imposed on another.⁷¹ However, this classification may not be arbitrary and must be based upon some ground of difference that is reasonably related to a legitimate purpose.⁷² When determining whether

65. *Id.* at 1680.

66. *Id.*

67. *Story*, 756 P.2d at 593.

68. U.S. CONST. amend. XIV, § 1.

69. *Grosjean v. American Press Co.*, 297 U.S. 233, 244 (1936).

70. *Metropolitan Casualty Ins. Co. v. Brownell*, 294 U.S. 580, 583 (1935) (law forbidding foreign insurance corporations from limiting the time within which suit could be brought against them on their contracts to less than three years, while no such restriction was placed on domestic insurers, was not a denial of equal protection).

71. *Id.*

72. *F.S. Royster Guano Co. v. Virginia*, 253 U.S. 412, 415 (1920).

a state law violates the equal protection clause, substantial deference should be given to the decision of the state legislature.⁷³ Courts should declare legislation invalid only if, viewed in light of the facts, it is of such character as to preclude the assumption that classification rests on some rational basis within the legislators' knowledge and experience.⁷⁴

The scope of Federal Land Bank loans is limited to agricultural land loans and certain rural housing loans.⁷⁵ By limiting the application of the moratorium act to the Federal Land Bank, the legislature sought to provide relief for agricultural borrowers placed in financial difficulty because of the slumping agricultural economy. Unless the separate classification of the Federal Land Bank is rationally related to the purpose of the legislation, the Act violated the equal protection clause of the United States Constitution.

In Oklahoma, many commercial banks grant credit to farmers for the purchase of land for agricultural use. Therefore, the fact that the Federal Land Bank lends money primarily for use in the purchase and operation of agricultural land does not sufficiently distinguish it from commercial banks to warrant classification. The Federal Land Bank has been held to be a federal instrumentality.⁷⁶ However, regardless of its federal character, it operates much like a privately owned lending institution. The differences between the operation of the Federal Land Bank and commercial banks are primarily in the administrative operations of the organization rather than in lending practices. Classification based on different administrative practices does not reasonably further the goal of providing relief to distressed agricultural borrowers.

The existence of the Capital Corporation arguably gave the Federal Land Banks an option not available to other lending institutions, and, therefore, the classification was proper because other lending institutions were not similarly situated. However, differences alone do not make classification proper. The differences must have a fair and substantial relation to the object of the legislation.⁷⁷

Congress established the Capital Corporation to engage in a policy to restructure eligible loans. It could be argued that the Federal Land Bank should not be treated differently from commercial banking organizations

73. *Brownell*, 294 U.S. at 584.

74. *Id.*

75. Federal law provides:

The credit and financial services authorized in this subchapter may be made available to persons who are or become stockholders or members of the bank or associations in the district, and who are—

- (1) bona fide farmers, ranchers, or producers or harvesters of aquatic products;
- (2) persons furnishing to farmers and ranchers farm-related services directly related to their on-farm operating needs; or
- (3) owners of rural homes.

12 U.S.C. § 2017 (1988).

76. *Federal Land Bank v. Priddy*, 295 U.S. 229, 231 (1935), *reh'g denied*, 295 U.S. 769 (1934).

77. *F.S. Royster Guano Co.*, 253 U.S. at 415.

who could develop similar restructuring policies of their own. This unequal treatment would, in effect, penalize the Federal Land Bank for trying to help its borrowers. The purposes of the Act would have been better served by prohibiting all foreclosures. The availability of the Capital Corporation to the Federal Land Banks probably did not serve as a difference which would make the classification proper under the equal protection clause.

Any analysis of the classification in this Act would be naive if it ignored the political realities surrounding enactment of the Act. The Act was inspired in an economic environment of a faltering agricultural economy in a state depending heavily on agriculture. A highly visible manifestation of the poor economy was the unusually high number of mortgage foreclosures on farm land. Many of the mortgages on agricultural lands were held by the Federal Land Bank. By applying a foreclosure moratorium exclusively to the Federal Land Bank, the legislature provided immediate relief that was highly visible. However, the burden of the moratorium was born by an organization headquartered outside the state of Oklahoma. This approach satisfied the goal of providing immediate relief to many agricultural borrowers while avoiding the wrath of the many commercial banks in Oklahoma who make agricultural loans.

While the foregoing may have been true, the fact remained that the Act was inconsistent with the limitations of the equal protection clause. The differences between the Federal Land Bank and commercial lending institutions simply did not form a basis for classification that was rationally related to the purpose of providing relief to financially distressed mortgagors. The Act could have been equally effective in promoting this goal if it had been applied to all lending institutions making agricultural land loans.

A recent Iowa case used this approach to broaden the application of a law which provided an extension of the period for redemption to all mortgaged property purchased at forced sales.⁷⁸ This extended redemption period had previously only been applied where the property was not purchased by a member of the FDIC or the FSLIC.⁷⁹ In this case, the Iowa Supreme Court clearly sends the message that equal protection claims will not always remove the burden of a law from a select group, but instead may impose that burden on a larger group.

Federal Preemption

The supremacy clause of the United States Constitution states: "This Constitution, and the laws of the United States which shall be made in pursuance thereof . . . shall be the supreme law of the land . . . anything in the Constitution or laws of any State to the contrary notwithstanding."⁸⁰ The preemption doctrine, which arose out of the supremacy clause, holds

78. *Federal Land Bank v. Arnold*, 426 N.W.2d 153, 157 (Iowa 1988).

79. *Id.* at 155.

80. U.S. CONST. art. VI, § 2.

that certain matters are of such a national character that federal law takes precedence over state laws.⁸¹

The doctrine of preemption is relevant to the Act because the Federal Land Banks were chartered under the authority of the federal government. However, it is not patently clear whether Federal Land Banks should be considered federal entities to be governed exclusively by federal law. Although the Federal Land Banks were organized under United States statutes, the Associations are privately owned by member stockholders.⁸² It can be argued that because the Associations operate as privately owned lending institutions, they should be governed by local law. The resolution of this question is key when determining whether state mortgage foreclosure legislation can be applied to Federal Land Banks. If the Associations are determined to be federal instrumentalities carrying out governmental functions, the preemption doctrine would prohibit the application of moratorium legislation to the Associations if the legislation conflicted with federal law.

In *Federal Land Bank v. Priddy*, the United States Supreme Court held that the "[f]ederal land banks . . . are instrumentalities of the federal government, engaged in the performance of an important governmental function."⁸³ The Court noted that federal status was appropriate though the Federal Land Banks possessed many characteristics of private business corporations.⁸⁴ The Court reaffirmed this position in *Federal Land Bank v. Bismarck Lumber Co.*⁸⁵ In *Bismarck Lumber Co.*, the Court concluded that when Congress constitutionally creates a corporation through which the federal government lawfully acts, the activities of that corporation are governmental.⁸⁶ Further, under its power to make laws, Congress has the power to protect the instrumentalities which it has constitutionally created.⁸⁷ The continuing validity of the Federal Land Bank's federal status is shown by recent circuit court opinions citing *Bismarck Lumber Co.* and *Priddy* as precedent for that very proposition.⁸⁸ Based on *Bismarck Lumber Co.* and *Priddy*, Federal Land Banks can probably use the preemption doctrine as a protection from state laws which conflict with the federal purpose of the organization.

However, several recent district court decisions have held that the Federal Land Banks and similar Farm Credit Institutions are not government

81. *Fidelity Fed. Sav. & Loan v. de la Cuesta*, 458 U.S. 141 (1982).

82. *Kelley & Hoekstra, Litigation Involving The Farm Credit System And The Rights of Member-Borrowers of Federal Land Bank Associations (FLBAs) and Production Credit Associations (PCAs)* (1988).

83. *Priddy*, 295 U.S. at 231.

84. *Id.*

85. 314 U.S. 95 (1941).

86. *Id.* at 102.

87. *Id.*

88. See *Federal Reserve Bank v. Metrocentre Improvement Dist.*, 657 F.2d 183, 186 (8th Cir. 1981), *aff'd*, 455 U.S. 995 (1982). See also *Rust v. Johnson*, 597 F.2d 174, 178 (9th Cir. 1979), *cert. denied*, 444 U.S. 964 (1979).

entities in some circumstances. In *United States v. Haynes*,⁸⁹ the district court held that a Production Credit Association was not an "independent agency" of the United States for the application of a federal criminal conflicts of interest statute. However, the district court noted that Production Credit Associations are federally chartered instrumentalities.⁹⁰ A federal district court, in *Birbeck v. Southern New England PCA*,⁹¹ held that Production Credit Associations and Federal Land Banks were not of sufficient governmental character to grant federal question jurisdiction solely on that basis. The court characterized both organizations as private entities rather than governmental agencies.⁹²

Although it seems inconsistent to allow the Federal Land Bank to claim federal status in some situations and disclaim that status in others, classifying Federal Land Banks as nonfederal entities has been limited to very specific purposes. For example, the *Birbeck* court noted that Congress had specifically limited federal court jurisdiction based solely on the grounds that the action was brought by or against a corporation incorporated under an act of Congress.⁹³ This narrow exception appears to be the result of Congress' desire to reduce the case load of the federal courts. The general rule remains that Federal Land Banks are considered federal instrumentalities.

Where a state law conflicts with a federal law about a federal instrumentality, state law is preempted by federal law.⁹⁴ The preemption doctrine requires the courts to examine Congressional intent which may be either express or implied in the structure and purpose of the Congressional authority.⁹⁵ The issue at hand may be resolved by determining whether Congress explicitly or implicitly manifested an intent to provide the remedy of judicial foreclosure to Federal Land Banks to be used on nonperforming loans.

The Congressional declaration of policy and objectives of the Federal Land Bank states:

It is the objective of this chapter to continue to encourage farmer- and rancher-borrowers participation in the management, control and ownership of a permanent system of credit for agriculture which will be responsive to the credit needs of all types of agricultural producers having a basis for credit . . .⁹⁶

The 1971 Farm Credit Act also mandated that Federal Land Bank loans must not exceed 85% of the appraised value of the real estate security,

89. 620 F. Supp. 474, 477 (M.D. Tenn. 1985).

90. *Id.* at 476.

91. 606 F. Supp. 1030, 1034 (D. Conn. 1985).

92. *Id.*

93. *Id.*

94. *Rust*, 597 F.2d at 179.

95. *Fidelity Fed. Sav. & Loan v. de la Cuesta*, 458 U.S. 141.

96. 12 U.S.C. § 2001(b) (1988).

and shall be secured by first liens on interest in real estate.⁹⁷ The emphasis in the declaration of intent, on extending loans only to those having a basis for credit, along with the strict security requirements set out in the statutes, implies the right of the Federal Land Bank to initiate foreclosure proceedings. The key function of security interests in real estate is to protect the mortgagee when the mortgagor fails to perform. The strict security guidelines enacted by Congress would be of little value if the Federal Land Bank could not start foreclosure proceedings to get possession of the collateral. In addition, Title 12, Section 2202a(j) of the United States Code expressly states that foreclosure is an option that may be exercised by the Federal Land Bank in certain situations.⁹⁸

In summary, judicial foreclosure was clearly intended by Congress to be made available as a remedy to the Federal Land Banks. This intent is implied in the provisions of the United States Code. However, it may be argued that Congress did not intend for the remedy of foreclosure to be available to the Federal Land Banks in all situations. Federal law should control federal programs.⁹⁹ Yet, where Congress has not spoken in an area under federal control, the federal courts must determine the applicable federal law.¹⁰⁰ This determination does not inevitably require a resort to uniform federal rules.¹⁰¹

In *United States v. Kimbell Foods, Inc.*,¹⁰² the United States Supreme Court held that the courts must consider whether a federal program by its nature must be uniform throughout the nation. Where there is not a necessity for a nationally uniform body of law, state law may be used as the federal rule of decision.¹⁰³ When making this choice of law, courts should consider the disruptive effect a uniform federal rule would have on commercial relationships under the state law.¹⁰⁴

The right of Federal Land Banks to foreclose on nonperforming mortgages may readily be inferred from the federal statutes. However, a state law limiting the enforcement of a federal right may sometimes be adopted as the federal rule.¹⁰⁵ Therefore, if a state mortgage foreclosure moratorium was enacted which applied to all agricultural lenders, the state could argue

97. See 12 U.S.C. § 2017 (1988).

98. Section 2202a(j) provides as follows:

This section shall not be construed to prevent any qualified lender from enforcing any contractual provision that allows the lender to foreclose a loan or from taking such other lawful action as the lender deems appropriate, if the lender has reasonable grounds to believe that the loan collateral will be destroyed, dissipated, consumed, concealed, or permanently removed from the State in which the collateral is located.

12 U.S.C. § 2202a(j) (1988).

99. *United States v. Kimbell Foods*, 440 U.S. 715, 727 (1979).

100. *Id.* at 728.

101. *Id.*

102. *Id.* at 729.

103. *Id.*

104. *Id.* at 729-30.

105. *United States v. Ellis*, 714 F.2d 953, 955 (9th Cir. 1983).

that this state law should be adopted as the federal common law. Thus, the mortgage moratorium would be applicable to Federal Land Bank mortgages within that state.¹⁰⁶

The state could rely on *Kimbell* to argue that, although Congress intended the Federal Land Bank to be able to foreclose on its mortgages, Congress did not intend the Federal Land Bank to be on unequal footing with commercial lending institutions. Based on *Kimbell*, this appears to be a situation where the nondiscriminatory application of state law should serve as the federal law. If state law was not applied to the Federal Land Bank, it would have a strong advantage over commercial lenders. Lending relationships entered into under state law could also be disrupted. Therefore, state laws which limit the right of foreclosure should be adopted as the federal law and applied to Federal Land Bank mortgages. This argument is only tenable if the state law is drafted to apply to all lending institutions that make agricultural land loans.

The Future Of Mortgage Foreclosure Moratoriums

The constitutional hurdles encountered by the Act highlight the difficulty in creating constitutional foreclosure moratorium legislation. However, as the Court in *Blaisdell* and *Hahn* indicated, moratorium legislation can exist within the bounds of the constitution. Economic conditions which are conducive to foreclosure moratoriums will surely recur in Oklahoma's future. Therefore, a brief summary of the characteristics of constitutionally sound moratoriums may prove helpful to those who will be faced with choosing a legislative response to conditions of economic distress.

The legislature should require judicial discretion in determining what mortgagees to which a postponement of foreclosure should apply. This judicial discretion would prevent the legislation from being considered arbitrary. Any prohibition of foreclosure should be temporary, to qualify as an alteration to a contractual remedy rather than an elimination of a remedy. A foreclosure moratorium should become effective only when the legislature determines that an emergency exists. If the moratorium legislation impairs contractual rights, the impairment would only be allowed if it is a result of a reasonable exercise of the state's protective power in response to the emergency. Such a law should not impair the mortgage indebtedness and must provide protection to the mortgagee during the

106. This approach is consistent with the rationale of *Kimbell Foods*. The federal statutes do not expressly require that the Federal Land Bank be able to foreclose on its mortgages regardless of state law. Also, this does not appear to be an area that requires a nationally uniform law. There are separate Federal Land Banks in the different regions of the country. These regional Federal Land Banks have numerous Federal Land Bank Associations within their regions. As noted earlier, the Associations operate very much like privately owned lending institutions. These characteristics make the relationship between the Federal Land Bank and its borrowers closer to private sector transactions than transactions between a borrower and the government. These relationships are not distinguishable from the relationship between a privately-owned commercial bank and its borrowers.

period of the moratorium. These limitations can be met if the legislation requires the mortgagor, upon application to the court for protection under a mortgage foreclosure moratorium act, to pay a fair rental value for the period covered by such act. This rent can be apportioned to property taxes, accruing interest, and rent for the actual possession of the property.

The safest way to avoid equal protection claims would be to apply the legislation to all mortgagees of nonperforming mortgages. If the law were to be applied to a particular classification, special care would have to be taken to insure that the classification is based upon differences bearing substantial relation to the object of the legislation.

If the Federal Land Bank or similar "federal instrumentalities" were to seek protection from the legislation under the preemption doctrine, they would probably be unsuccessful. Because Congress did not expressly grant the Federal Land Bank the right to foreclose mortgages without regard to state law, the courts will probably adopt state law to serve as the federal rule. It seems fair to treat the Federal Land Bank and commercial lenders equally because their operations are very similar. However, this reasoning only applies if the law were to be applied to all commercial lenders and not exclusively to the Federal Land Bank.

Conclusion

There are potential negative effects which can result from the use of mortgage foreclosure moratoriums.¹⁰⁷ However, this note focused on the constitutionality of foreclosure moratoriums rather than their effectiveness in remedying economic distress. In spite of potential negative effects, a valid moratorium statute provides immediate and tangible relief to borrowers who otherwise may lose their land, livelihood and cultural identity as a result of an economic emergency they have no way of preventing. The public perception of foreclosure moratoriums as a shield to otherwise helpless borrowers insures that moratoriums will be a source of legislative debate when the next economic emergency occurs.

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107. Availability of funds to the farm sector may be reduced as lenders reallocate their resources to reduce losses. Interest costs may rise as lenders attempt to maintain earnings at acceptable levels. Finally, some high-risk, credit worthy borrowers will be refused additional credit because of the lenders' heightened aversion to the risk of default. Lenders will experience continued lower earnings on capital tied-up by the moratorium and if land values decline during the moratorium the lenders will sustain capital losses. Legislative intervention may harm relations between the borrower and lender, and some lenders will accelerate foreclosure activities in anticipation of moratorium legislation. *Farm Foreclosure Moratoria and the Contract Clause: An Economic Analysis*, 3 CONST. COMMENTARY 331, 340-41 (1986).