

Winter 1978

Constitutional Problems with Power of Sale Real Estate Foreclosure: A Judicial Dilemma

Grant S. Nelson

Follow this and additional works at: <https://scholarship.law.missouri.edu/mlr>



Part of the [Law Commons](#)

Recommended Citation

Grant S. Nelson, *Constitutional Problems with Power of Sale Real Estate Foreclosure: A Judicial Dilemma*, 43 MO. L. REV. (1978)

Available at: <https://scholarship.law.missouri.edu/mlr/vol43/iss1/8>

This Article is brought to you for free and open access by the Law Journals at University of Missouri School of Law Scholarship Repository. It has been accepted for inclusion in Missouri Law Review by an authorized editor of University of Missouri School of Law Scholarship Repository. For more information, please contact bassettcw@missouri.edu.

CONSTITUTIONAL PROBLEMS WITH POWER OF SALE REAL ESTATE FORECLOSURE: A JUDICIAL DILEMMA*

GRANT S. NELSON**

INTRODUCTION

Two main types of mortgage foreclosure are currently utilized in this country. The more common type is judicial foreclosure. It may be used in all jurisdictions, and is the sole method of foreclosure permitted in at least half of the states. This method utilizes a full judicial proceeding in which all persons having an interest in the real estate junior to the mortgage being foreclosed must be made parties. After a decree of foreclosure, the property is sold at a public sale. This method is costly and often time-consuming.¹ The other foreclosure method, permitted in about twenty-five states, is power of sale foreclosure. Under this method, no judicial proceeding is required. After varying types and degrees of notice, the property is sold at a public sale, either by a public official, such as a sheriff, by some other third party, or by the mortgagee.²

In some states utilizing the power of sale method, the deed of trust is the most commonly used mortgage instrument. The mortgagor-trustor conveys the real estate to a trustee who holds the property in trust for the mortgagee-beneficiary until full payment of the mortgage debt. In the event of foreclosure, the power of sale is exercised by the trustee, who holds a public sale of the mortgaged property; the sale is usually not judicially supervised.

Recent constitutional litigation has focused on two common characteristics of power of sale foreclosure: limited notice requirements and the absence of an opportunity for hearing prior to the foreclosure

* © 1978, Grant S. Nelson.

** Enoch H. Crowder Professor of Law, University of Missouri-Columbia. B.A., 1960, J.D., 1963, University of Minnesota.

1. See G. NELSON & D. WHITMAN, *CASES AND MATERIALS ON REAL ESTATE FINANCE & DEVELOPMENT* 5 (1976); McElhone & Cramer, *Loan Foreclosure Costs Affected By Varied State Regulations*, 36 *MORTGAGE BANKER* 41 (1975).

2. As of 1968 power of sale foreclosure was used in Alaska, Alabama, California, Colorado, District of Columbia, Georgia, Hawaii, Idaho, Maryland, Massachusetts, Michigan, Minnesota, Mississippi, Missouri, Nevada, New Hampshire, North Carolina, Oregon, Rhode Island, South Dakota, Tennessee, Texas, Virginia, Washington, West Virginia and Wyoming. *Cost and Time Factors in Foreclosure of Mortgages*, 3 *REAL PROF., PROB. & TR. J.* 413, 414 (1968).

sale.³ As previously indicated, the notice requirements under power of sale foreclosure vary, but are usually less rigorous than those associated with judicial foreclosure. Notice, as used here, may be simply notice of foreclosure or notice of default or a combination of the two. While some states require that notice by mail or personal service be provided for any person having a record interest in the real estate junior to the mortgage being foreclosed,⁴ many do not. A few states require only notice by publication.⁵ This publication sometimes takes the form of newspaper advertisement and sometimes consists only of public posting. Other states, in addition to published notice, require notice either by mail or personal service to the mortgagor and the owner of the mortgaged real estate, but not to junior lienors and others holding an interest subordinate to the mortgage being foreclosed.⁶ A few states attempt to protect those interested parties who are neither mortgagors nor owners by requiring that the notice of foreclosure be mailed to any person who has previously recorded a request for such notice.⁷ Finally, almost no power of sale foreclosure statutes provide for an opportunity for a hearing prior to the foreclosure sale.

SUFFICIENCY OF NOTICE REQUIREMENTS

Until recently, it had been assumed that where a mortgagor gave a power of sale in a mortgage or deed of trust, the specific level of notice required was merely a contractual or statutory consideration, not a constitutional problem. Indeed, in *Scott v. Paisley*⁸ the United States Supreme Court stated in dictum in 1927:

Plainly the right of one who purchases property subject to a security deed, with a statutory power of sale which must be read into the deed, is no greater than that of one who pur-

3. See Leen, Galbraith & Gant, *Due Process and Deeds of Trust—Strange Bedfellows*, 48 WASH. L. REV. 763 (1973); Nelson, *Deed of Trust Foreclosure Under Power of Sale—Constitutional Problems—Legislative Alternatives*, 28 J. MO. B. 428 (1972); Pedowitz, *Current Developments in Summary Foreclosure*, 9 REAL PROP., PROB. & TR. J. 421 (1974); Comment, *The Constitutionality of California Trustees Sale*, 61 CALIF. L. REV. 1282 (1973); Comment, *Power of Sale Foreclosure After Fuentes*, 40 U. CHI. L. REV. 206, 217-20 (1972); Comment, *Due Process Problems of Mississippi Power of Sale Foreclosure*, 47 MISS. L.J. 67 (1976); Comment, *Notice Requirements of the Nonjudicial Foreclosure Sale*, 51 N.C.L. REV. 1110 (1973).

4. See, e.g., COLO. REV. STAT. § 38-37-113 (2), (3) (1973); IDAHO CODE § 45-1506 (1967); WASH. REV. CODE § 61.24.040 (1975); MONT. REV. CODES ANN. § 93-6005 (1963).

5. See, e.g., MISS. CODE ANN. § 89-1-55 (1972).

6. See, e.g., D.C. Code § 45-615 (1973). Compare MINN. STAT. ANN. § 580.03 (1947) (personal service on person in possession only).

7. See, e.g., § 443.325, RSMo (Supp. 1975). Some states combine required mailed notice to all parties having record interest in the real estate together with mailed notice to any other person who has previously recorded a request for it. See, e.g., ARIZ. REV. STAT. § 33-809 (1974); CAL. CIV. CODE § 2924(b) (West 1976).

8. 271 U.S. 632 (1927).

chases property subject to a mortgage or trust deed, with a contractual power of sale. The validity of such a contractual power of sale is unquestionable. In *Bell Mining Co. v. Butte Bank*, 156 U.S. 470, 477, this court said: 'There is nothing in the law of mortgages, nor in the law that covers what are sometimes designated as trust deeds in the nature of mortgages, which prevents the conferring by the grantor or mortgagor in such instrument of the power to sell the premises described therein upon default in payment of the debt secured by it, and if the sale is conducted in accordance with the terms of the power, the title to the premises granted by way of security passes to the purchaser upon its consummation by a conveyance.' In the absence of a specific provision to that effect, the holder of a mortgage or trust deed with power of sale, is not required to give notice of the exercise of the power to a subsequent purchaser or incumbrancer; and the validity of the sale is not affected by the fact that such notice is not given . . .⁹

Such reasoning, of course, did not take into account the possible impact of *Mullane v. Central Hanover Bank & Trust Co.*¹⁰ on power of sale foreclosure. That case involved the sufficiency of notice to beneficiaries of a judicial settlement of accounts by a trustee of a common trust fund established under New York banking law. The only notice given the beneficiaries of the proceeding was publication in a local newspaper in strict compliance with the statutory requirements. The Supreme Court held that the type of notice used must be "reasonably calculated . . . to apprise interested parties . . ." ¹¹ The Court also noted that "[w]here the names and post office addresses of those affected by a proceeding are at hand, the reasons disappear for resort to means less likely than the mails to apprise them of its pendency."¹²

Assuming that the notice requirements of *Mullane* are applicable to power of sale foreclosure statutes, and absent a valid waiver by the affected parties of such fourteenth amendment notice rights, it is difficult to escape the conclusion that the notice provisions of many state power of sale statutes are unconstitutional. Certainly those statutes that provide only for notice by publication must fail the constitutional test, because *Mullane* requires that when the names and addresses of interested parties are available (as at least the property owner's nearly always is), at least notice by mail is required. Under such state statutes *no* interested party is guaranteed constitutionally acceptable notice.

While one earlier case suggests that a notice by publication provision in a power of sale statute violates the *Mullane* principle,¹³ only three

9. *Id.* at 635.

10. 339 U.S. 306 (1950).

11. *Id.* at 314.

12. *Id.* at 318. See also *Schroeder v. City of New York*, 371 U.S. 208 (1962) (advertisement insufficient in condemnation); *Walker v. City of Hutchinson*, 352 U.S. 112 (1956) (advertisement insufficient in condemnation).

13 See *Law v. United States*, 366 F. Supp. 1233 (N.D. Ga. 1973).

cases have met that issue squarely.¹⁴ In *Ricker v. United States*¹⁵ the Farmers Home Administration (FmHA), under a Maine nonjudicial foreclosure statute,¹⁶ foreclosed a mortgage securing a direct loan that it had made to the mortgagors. After the proceedings were completed and the FmHA conveyed the land to a subsequent purchaser, the mortgagors sued in federal court to nullify the sale, in part on the theory that the Maine statute's notice requirements did not satisfy the requirements of the due process clause of the fifth amendment. The notice required by statute, and that actually provided, was published notice for three successive weeks. The mortgagors did not see the notices but heard about the proceedings through rumors and other second-hand sources. The court held that the published notice "plainly failed to meet" the *Mullane* standards and emphasized that published notice will not suffice constitutionally where a party's name and address are known or are very easily ascertained.¹⁷ Similarly, in *Turner v. Blackburn*¹⁸ a three-judge federal court invalidated a North Carolina power of sale statute that provided for notice only by newspaper publication and posting. The court stated: "To propose to a homeowner that he trek to the courthouse or spend 20 cents to examine fine-print legal notices, *daily* for the duration of a twenty-year mortgage, as his sole protection against summary eviction, seems to us to offer him nothing of value."¹⁹

The statutes that provide for publication plus notice by mail or personal service only for the mortgagor and the owner of the real estate are probably also defective because no provision is made for notice to other interested parties such as junior mortgagees and judgment creditors. It could, of course, be argued that such parties tend to be sophisticated commercial lenders able to keep themselves informed of the status of the senior mortgage. However, it is not clear that even a majority of junior lienors fall into such a class. Moreover, junior lienors often stand to lose more than the mortgagor or the owner. Where junior liens exist it is not uncommon for the mortgagor or the owner to have a smaller economic stake in the mortgaged real estate than that of an individual junior lienor.

Those statutes that provide for notice by mail or personal service both for the mortgagor and the owner and for anyone else who has

14. See *Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Roberts v. Cameron-Brown Co.*, 410 F. Supp. 988 (S.D. Ga. 1975); *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975).

15. 417 F. Supp. 133 (D. Me. 1976).

16. 14 ME. REV. STAT. tit. 14, §§ 6203-6204 (1965).

17. 417 F. Supp. at 138.

18. 389 F. Supp. 1250 (W.D.N.C. 1975).

19. *Id.* at 1258 (emphasis in original). See *Roberts v. Cameron-Brown Co.*, 410 F. Supp. 988 (S.D. Ga. 1975). Cf. *Brown v. Federal Nat'l Mtg. Ass'n*, 359 A.2d 661 (Del. 1976).

previously recorded a request for such notice represent a closer case constitutionally. It is true that under such legislation an interested party could be wiped out without being provided any notice "reasonably calculated to provide actual notice." On the other hand, perhaps the relative sophistication of junior lienors *as a class* can be recognized in this context; after all, such parties can assure themselves of a constitutional form of notice by simply requesting it. Probably the only notice provisions that are clearly constitutional are those that closely approximate the notice provided to interested parties under judicial foreclosure: at least notice by mail to all parties who have a record interest in the foreclosed property junior to the mortgage being foreclosed. In the last analysis, perhaps a finding of constitutionality is justified only as to this latter type of notice provision; whatever the arguments in favor of more limited notice, the cost and time involved in searching the title for those who have a record interest subsequent to the mortgage being foreclosed are minor.

The question remains to what extent a foreclosing mortgagee may remedy the problem of a constitutionally defective notice provision by providing more extensive notice to interested parties than the statute requires. Logically, if such notice was provided to all interested parties, no person would have standing to challenge the foreclosure and the statute because no one would have suffered injury.²⁰ In one recent federal district court decision, the court specifically held that a power of sale foreclosure complied with *Mullane* where the mortgagee supplied greater notice to the mortgagor than the power of sale statute required.²¹ Moreover, the court in *Ricker v. United States*²² emphasized the fact that the mortgagee did not attempt to notify the mortgagor other than by complying with the statutory requirement. The court implied that had the mortgagee made an effort to give actual notice, the foreclosure would not have been constitutionally defective on notice grounds.

Notwithstanding those cases, because of the United States Supreme Court's decision in *Wuchter v. Pizzutti*,²³ there is still doubt that a foreclosing mortgagee has the ability to conduct a constitutional power of sale foreclosure by supplying necessary notice not required by the applicable statute. In *Wuchter* the Supreme Court held that a nonresident motorist service of process statute that required only service on the secretary of state violated the fourteenth amendment due process clause even though the secretary of state in that case actually mailed notice to the nonresident defendant. While this case seems unsound because no one was injured as a result of the statutory notice provision, its existence

20. See *Warth v. Seldin*, 422 U.S. 490 (1975); C. WRIGHT, A. MILLER & E. COOPER, *FEDERAL PRACTICE AND PROCEDURE* § 3531 (1975 & Supp. 1976).

21. *United States v. White*, 429 F. Supp. 1245, 1250 (N.D. Miss. 1977).

22. 417 F. Supp. 133 (D. Me. 1976).

23. 276 U.S. 13 (1928).

should make mortgagees cautious as to their ability to resurrect invalid foreclosure statutes through their own resources.

CONSTITUTIONALITY OF POWER OF SALE—
HEARING PROBLEMS

Independently of the constitutionality of notice provisions, power of sale statutes frequently have been attacked on the ground that the due process clause of the fourteenth amendment requires the opportunity for a hearing before a person may be deprived of a significant property interest. This attack is centered on *Sniadach v. Family Finance Corp.*²⁴ and *Fuentes v. Shevin*.²⁵ In *Sniadach* the Supreme Court held that, except in exceptional circumstances, prejudgment garnishment without provision for a judicial hearing prior to the garnishment violated the due process clause of the fourteenth amendment. In *Fuentes*, a 4-3 decision, the Court struck down certain state replevin statutes because they did not provide for an opportunity to be heard before chattels were taken from the possessor, even on a temporary basis, pending a trial on the merits. At least three principles were established in *Fuentes*:

1. Procedural due process requires notice and an opportunity for a hearing before the state authorizes its agents, on the application of another, to seize property in the possession of a third person. A bond requirement is not a sufficient substitute for a hearing.
2. The debtors, who had already made substantial payments under installment contracts, had a sufficient property interest to invoke fourteenth amendment protection even though they lacked full title to the goods.
3. The hearing requirement is applicable whether or not the items to be seized are "necessities."

Based on *Fuentes*, a strong argument may be made that power of sale foreclosure statutes which do not provide the opportunity for a hearing prior to the foreclosure sale violate the due process hearing requirement of the fourteenth amendment. If *Fuentes* requires some type of hearing before chattel security may be seized even temporarily, surely it may be argued that the due process clause does not permit the *permanent* taking of real estate security by passage of title with no opportunity for a hearing *at all*. Several courts that have reached the hearing issue directly have utilized *Fuentes* to invalidate power of sale provisions.²⁶ In *Turner v. Blackburn*,²⁷ which invalidated the North Carolina power of sale

24. 395 U.S. 337 (1969).

25. 407 U.S. 67 (1972).

26. See *Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975); *Garner v. Tri-State Dev. Co.*, 382 F. Supp. 377 (E.D. Mich. 1974); *Northrip v. Federal Nat'l Mtg. Ass'n*, 372 F. Supp. 594 (E.D. Mich. 1974), *rev'd on other grounds*, 527 F.2d 23 (6th Cir. 1975). *Contra*, *Guidarelli v. Lazaretti*, 233 N.W.2d 890 (Minn. 1975).

27. 389 F. Supp. 1250 (W.D.N.C. 1975).

statute, the three-judge federal court held, based on *Fuentes*, that a hearing prior to foreclosure and sale is essential. At a minimum, due process "requires the trustee to make an initial showing before the clerk or similar neutral official that the mortgagor is in default under the obligation; the mortgagor must of course be afforded the opportunity to rebut and defend the charges."²⁸ In *Ricker v. United States*²⁹ the government argued that in the context of a Maine nonjudicial mortgage foreclosure the opportunity to be heard would be "mere surplusage" because the issues were "open and shut": the existence of an overdue debt and a valid mortgage. The federal district court rejected this argument on two grounds. First, the simplicity of issues does not necessarily obviate the constitutional necessity for a hearing. Second, in the case at hand the mortgagors had also challenged the validity of the government's decision to foreclose on the theory that the mortgage notes lacked consideration. The court concluded that, at a minimum, fifth amendment due process requires "a hearing at which [mortgagors] could challenge both the legal right of the [mortgagee] to foreclose and the propriety of the decision to do so."³⁰

Some temporary concern existed that a subsequent Supreme Court decision had deprived *Fuentes* of its strength. In *Mitchell v. W.T. Grant Co.*³¹ the Supreme Court upheld the constitutionality of a Louisiana sequestration statute which required the secured creditor to come before a judge who, based on a verified complaint delineating the specific facts supporting the claim, could then issue a writ of sequestration. There was no right to a hearing prior to the seizure of the chattel, but the procedure did provide for an immediate right to a hearing thereafter and dissolution of the writ if the plaintiff failed to establish adequate grounds for its issuance. In a dissenting opinion, Justice Stewart concluded that *Mitchell*, in effect, had overruled the *Fuentes* decision.³² However, the subsequent decision in *North Georgia Finishing, Inc. v. Di-Chem, Inc.*³³ made it clear that Justice Stewart's prediction of *Fuentes*' demise was premature. The Court struck down a Georgia prejudgment garnishment statute that did not provide for a hearing prior to the imposition of the garnishment remedy. The Court distinguished *Mitchell* by noting that, unlike the Louisiana procedure, the garnishment writ was issued by a clerk, not a judge, upon an affidavit stating only conclusory and non-specific supporting grounds for the garnishment.³⁴ Moreover, the Court noted that, unlike *Mitchell*, there was no opportunity under

28. *Id.* at 1259.

29. 417 F. Supp. 133 (D. Me. 1976).

30. *Id.* at 139.

31. 416 U.S. 600 (1974).

32. *Id.* at 629-36.

33. 419 U.S. 601 (1975).

34. *Id.* at 606-07.

the Georgia statute for an early post-seizure hearing to demonstrate at least probable cause for the garnishment.³⁵

The significance of the foregoing for the power of sale foreclosure hearing problem is two-fold. First, the *North Georgia* decision sets to rest the argument that *Fuentes* has been overruled and therefore has no effect on power of sale real estate foreclosure. Second, in view of the fact that *Fuentes* is still good law, the impact of the *Mitchell* case really does not weaken the lower federal court cases considered earlier that invalidate the power of sale statutes on *Fuentes* hearing grounds.³⁶ The Louisiana statute was upheld in *Mitchell* in large measure because the statute guaranteed the right to an early post-seizure hearing. Power of sale foreclosure statutes, on the other hand, usually make no provision for a hearing at *any* time, *before or after* the *final* deprivation of the mortgagor's real estate. Thus some type of hearing prior to the foreclosure sale is probably required. Indeed, in *Garner v. Tri-State Development Co.*,³⁷ a post-*Mitchell* but pre-*North Georgia* case, the federal trial court held that the Michigan power of sale statute violated the fourteenth amendment due process clause because no opportunity for a hearing was provided *at all*. The *Garner* court focused on the fact that in *Mitchell* a judge issued the writ of sequestration and, more importantly, that there was a right to a hearing immediately after the seizure. Thus, the court concluded: "Evaluated by these criteria the foreclosure by advertisement method now before the court fails to meet due process requirements. The procedure used has no provision for a hearing before or immediately after the seizure."³⁸

It has been argued that there is in fact an opportunity for a hearing under most power of sale statutes because a mortgagor has the right, based on either common law or statute, to bring suit to enjoin the foreclosure sale. In some jurisdictions this is a common practice and is a primary vehicle for developing the law of mortgages in the power of sale context.³⁹ While at least one court has found this argument persuasive,⁴⁰ others have rejected it.⁴¹ To equate the foregoing procedure with the constitutional right to a hearing required by *Fuentes* seems questionable for several reasons. First, what *Fuentes* seems to be saying is that the opportunity for a hearing must be an integral part of any statutory procedure that can be used to deprive a person of a property interest.

35. *Id.*

36. See text accompanying notes 24-28 *supra*.

37. 382 F. Supp. 377 (E.D. Mich. 1974).

38. *Id.* at 380. *Accord*, *Roberts v. Cameron-Brown Co.*, 410 F. Supp. 988 (S.D. Ga. 1975).

39. See *Nelson*, *supra* note 3, at 432.

40. See *Young v. Ridley*, 309 F. Supp. 1308 (D.D.C. 1970).

41. See, e.g., *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975); *Northrip v. Federal Nat'l Mtg. Ass'n*, 372 F. Supp. 594 (E.D. Mich. 1974), *rev'd on other grounds*, 527 F.2d 23 (6th Cir. 1975).

The mortgagor's ability to bring a separate injunction suit normally exists independently of any power of sale statute. To maintain that the ability to bring such an injunction suit satisfies the constitutional hearing requirement would be analogous to contending that a 42 U.S.C. section 1983 injunction suit filed by a tenured college professor to prevent his termination would be a constitutionally permissible substitute for a hearing requirement as an integral part of the college's termination procedure.⁴² One court has aptly characterized the injunction suit as a form of "self-help" that does not meet the requirements of either *Fuentes* or *Mitchell*.⁴³ Second, where the remedy sought is a temporary injunction, the mortgagor must post an injunction bond.⁴⁴ Such a requirement seems to condition unfairly the mortgagor's right to a hearing on his ability to pay. It is true, of course, that a mortgagor could avoid the bond requirement in many jurisdictions by simply bringing an action for a permanent injunction. However, although such an action deters many mortgagors from proceeding with the sale, it does not guarantee such a result. Third, for the mortgagor to bring a separate injunction suit inevitably will require the services of a lawyer. On the other hand, even an impecunious mortgagor at least would be able to answer a summons and appear to state his case without counsel at a hearing required as part of a statutory procedure.

WAIVER PROBLEMS

Even if a power of sale foreclosure statute is constitutionally deficient as to notice and hearing, such rights, in theory at least, are capable of being waived. In this connection, several cases are important. A few weeks prior to *Fuentes*, the United States Supreme Court in *D.H. Overmyer v. Frick Co.*⁴⁵ and *Swarb v. Lennox*⁴⁶ rejected a fourteenth amendment due process argument and sustained the constitutionality of certain state statutes authorizing summary entry of judgment based on confession of judgment clauses contained in promissory notes. These cases stand for the proposition that "under [the] appropriate circumstances, a cognovit debtor may be held effectively and legally to have waived those rights he would possess if the document he signed had contained no cognovit provision."⁴⁷ In *Fuentes* itself, the Court recognized that waiver was possible, but rejected it in that case. The *Fuentes* contract provided that "in the event of default of any payment or payments, Seller at its option may take back the merchandise."⁴⁸ Other contracts

42. See *Perry v. Sindermann*, 408 U.S. 593 (1972).

43. *Garner v. Tri-State Dev. Co.*, 382 F. Supp. 377, 380 (E.D. Mich. 1974).

44. D. DOBBS, REMEDIES § 2.10 (1973); Dobbs, *Should Security Be Required As A Pre-Condition To Provisional Injunctive Relief?*, 52 N.C.L. REV. 1091 (1974).

45. 405 U.S. 174 (1972).

46. 405 U.S. 191 (1972).

47. *Id.* at 200.

48. 407 U.S. at 94.

provided that the seller "may retake" or "repossess" the merchandise in the event of a "default in any payment."⁴⁹ These "waivers" were ineffectual for several reasons: the contracts did not provide specifically for a waiver of constitutional rights nor did they specify how or through what process "the seller could take back the goods"; there was a lack of awareness by the parties of the significance of the waiver; and there was no bargaining over contractual terms between parties who were equal in bargaining position.⁵⁰

Two pre-*Fuentes* cases determined that the presence of a power of sale in the mortgage or deed of trust constituted the mortgagor's waiver of notice and hearing rights,⁵¹ but subsequent decisions have rejected such an approach.⁵² In *Turner v. Blackburn*,⁵³ for example, the court emphasized that there was a presumption against waiver. In rejecting waiver, the *Turner* court pointed out that there was no waiver of specific constitutional rights, that the purported waiver language was in fine print, and that there was no evidence that the mortgagor was made aware of the significance of that language. Other courts have stressed that merely consenting to foreclosure pursuant to state law is not a sufficient substitute for a delineation of the specific constitutional rights waived.⁵⁴ Moreover, in *Ricker v. United States*⁵⁵ the court noted that even if the waiver of specific rights had been spelled out, the government-mortgagee did not show that the mortgagors "were actually aware or made aware of the fine print now relied on as a waiver of constitutional rights."⁵⁶ The court also emphasized that when the mortgage was executed the mortgagors were elderly, ill-educated, and without the services of an attorney.⁵⁷

The foregoing illustrates that the waiver concept will not be a practical solution to the constitutional problems of power of sale foreclosure. If a valid waiver depended only upon ensuring that the waived rights are specified and the mortgagor is aware that he is waiving those rights, a carefully drafted document probably would suffice. For exam-

49. *Id.*

50. *Id.* at 95-96.

51. See *Young v. Ridley*, 309 F. Supp. 1308 (D.D.C. 1970); *Huggins v. Dement*, 13 N.C. App. 673, 187 S.E.2d 412, *appeal dismissed*, 281 N.C. 314, 188 S.E.2d 898, *cert. denied*, 409 U.S. 1071 (1972).

52. *United States v. White*, 429 F. Supp. 1245 (N.D. Miss. 1977); *Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975); *Garner v. Tri-State Dev. Co.*, 382 F. Supp. 377 (E.D. Mich. 1974); *Law v. United States*, 366 F. Supp. 1233 (N.D. Ga. 1973).

53. 389 F. Supp. 1250 (W.D.N.C. 1975).

54. *Ricker v. United States*, 417 F. Supp. 133 (D. Me. 1976); *Northrip v. Federal Nat'l Mtg. Ass'n*, 372 F. Supp. 594 (E.D. Mich. 1974), *rev'd on other grounds*, 527 F.2d 23 (6th Cir. 1975).

55. 417 F. Supp. 133 (D. Me. 1976).

56. *Id.* at 139.

57. *Id.* at 139-40. See *United States v. White*, 429 F. Supp. 1245 (N.D. Miss. 1977).

ple, the mortgagee could have a mortgagor execute a separate recordable document in bold type that clearly specifies a waiver of constitutional rights to notice and hearing and that further contains a statement by the mortgagor that the waiver has been fully explained to him. Although even this type of document could engender later disputes as to whether the mortgagor *actually* understood the significance of the waiver, most title examiners probably would be willing to rely on such a document in approving a title derived from a power of sale foreclosure. If, on the other hand, as *Fuentes* and other cases suggest, a valid waiver depends on such factors as equality of bargaining position and similar considerations, an impossible burden is placed on the title examiner.⁵⁸ How can an examiner, evaluating a five-year-old mortgage foreclosure, determine from the record that there was equality of bargaining position? Is there ever equality of bargaining position? Would a recorded statement contemporaneous with the original mortgage certifying that such equality existed suffice? For title examiners who by nature rely primarily on the record, the waiver concept becomes an almost impossible burden and, to the extent that titles thereby become unmarketable, waiver must be considered an impractical concept.

Even assuming that title examiners could be convinced that a fool-proof waiver could be developed to bind a mortgagor, it is doubtful that such a waiver would also be effective against holders of subordinate interests in the mortgaged real estate. If, in fact, there is a presumption against waiver and if a party must be made aware of what rights are being waived, how can waiver be accomplished with respect to subsequent grantees of the real estate or junior mortgagees? They, after all, are not parties to the original mortgage transaction, yet they often have a significant financial stake in the mortgaged real estate. It could be argued that such parties take their interests on notice of the record and that they therefore implicitly consent to the terms of previously recorded documents.⁵⁹ However, it is doubtful that constitutional rights can be waived in such a manner. Moreover, whatever the likelihood that subsequent grantees and junior mortgagees will search the record prior to taking their interest in the mortgaged real estate, it is less likely that either judgment creditors or mechanics lienors will make such a search. It would, indeed, be stretching the waiver concept to conclude that these latter parties could have waived notice and hearing rights. Accordingly, since the waiver concept may well prove unworkable as a practical matter with respect to *some* parties, it probably cannot be relied upon at all.

THE STATE ACTION PROBLEM

The fourteenth amendment requires sufficient notice and an opportunity for a hearing; it is, however, fundamental that state action must

58. See Nelson, *supra* note 3, at 433-34.

59. *Id.* at 431.

be found before the amendment is applicable. Unless sufficient state action is found in connection with power of sale foreclosure, a court will not reach the notice or hearing issues, no matter how deficient a statute may be in those respects. Interestingly, some of the early power of sale fourteenth amendment cases resolved the constitutional issues without a consideration of state action.⁶⁰ However, the issue has become increasingly important, and the trend of the case law is clearly against finding state action.⁶¹ This trend is significant because, as a practical matter, it means that power of sale statutes continue to provide an effective foreclosure method for nongovernmental mortgagees even where the statutes are noticeably deficient in the notice and hearing area.

At least five theories have been advanced to find state action in the power of sale foreclosure area.⁶² These are the "direct" state action theory, the "encouragement" theory, the governmental function theory, the judicial enforcement theory, and the "pervasiveness" theory.

Under the first theory, state action exists when state officials act directly to enforce rights arising from a state statute. *Fuentes* illustrates this theory. State action was found, albeit without analysis, because the replevin statute provided for the writ to be issued by a clerk of court and the service of the writ and seizure of the property to be carried out by the sheriff. This theory was used in the mortgage context in *Turner v. Blackburn*.⁶³ Under the North Carolina power of sale statute, certain relatively unusual powers were conferred on the clerk of court. For example, within thirty days after the receipt of the sale proceeds, the person holding the power of sale had to file a final report with the clerk. The clerk then audited and approved the final report and filed it. The filing of the report and the lapse of a ten-day period was a precondition to the trustee's power to convey to the highest bidder at the foreclosure sale. During the ten-day period the clerk had the authority to reject or accept an upset bid. This was held to constitute direct participation by a state official and thus state action for purposes of the fourteenth

60. See *Young v. Ridley*, 309 F. Supp. 1308 (D.D.C. 1970); *Huggins v. De-ment*, 13 N.C. App. 673, 187 S.E.2d 412, *appeal dismissed*, 281 N.C. 314, 188 S.E.2d 898, *cert. denied*, 409 U.S. 1071 (1972).

61. See *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23 (6th Cir. 1975); *Barrera v. Security Bldg. & Inv. Corp.*, 519 F.2d 1166 (5th Cir. 1975); *Bryant v. Jefferson Fed. Sav. & Loan Ass'n*, 509 F.2d 511 (D.C. Cir. 1974); *Kenly v. Miracle Properties*, 412 F. Supp. 1072 (D. Ariz. 1976); *Lawson v. Smith*, 402 F. Supp. 851 (N.D. Cal. 1975); *Y Aleman Corp. v. Chase Manhattan Bank*, 414 F. Supp. 93 (D. Guam 1975); *Global Indus., Inc. v. Harris*, 376 F. Supp. 1379 (N.D. Ga. 1974); *Federal Nat'l Mtg. Ass'n v. Howlett*, 521 S.W.2d 428 (Mo. En Banc), *appeal dismissed*, 423 U.S. 909 (1975). *Contra*, *Turner v. Blackburn*, 389 F. Supp. 1250 (W.D.N.C. 1975).

62. See *Barklage, Constitutional Law—Mortgages—Extra-Judicial Mortgage Foreclosure Not State Action*, 41 MO. L. REV. 278 (1976).

63. 389 F. Supp. 1250 (W.D.N.C. 1975).

amendment. On the other hand, the Missouri Supreme Court rejected this argument in *Federal National Mortgage Association v. Howlett*⁶⁴ because the intervention of public officials was limited primarily to ministerial functions performed by the recorder of deeds.⁶⁵ While the direct state action theory was useful in *Blackburn*, its impact in the power of sale area is limited because most power of sale statutes do not inject state officials into the process to the same extent as did North Carolina. In many jurisdictions a power of sale foreclosure will normally be consummated without the knowledge, much less the participation, of any public official other than perhaps the recorder of deeds.⁶⁶

The "encouragement" theory asserts that state action may be found when state statutes tend to "encourage" objectionable, but otherwise private, activity.⁶⁷ The case most representative of this concept is *Reitman v. Mulkey*,⁶⁸ where state action was premised on the adoption of a constitutional amendment that protected a person's right to refuse to sell or rent his property to anyone for any reason. The United States Supreme Court, in a 5-4 vote, concurred in the finding of the California Supreme Court that the sole purpose of the amendment was to invalidate state anti-discrimination statutes, to prohibit their future enactment and to create a constitutional right to discriminate.⁶⁹ Thus the state became at least a "partner" in racial discrimination in violation of the fourteenth amendment.

It can be argued that the existence of state power of sale foreclosure statutes encourages this method of foreclosure and therefore is state action for purposes of the fourteenth amendment. However, most courts have rejected this argument,⁷⁰ advancing at least three reasons for doing so. First, *Reitman* involved racial discrimination and there is some indication that such cases will receive "special scrutiny" for state action purposes.⁷¹ Second, power of sale statutes do not encourage nonjudicial foreclosure because the method existed prior to its authorization by the

64. 521 S.W.2d 428 (Mo. En Banc 1975).

65. See *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23 (6th Cir. 1975); *Barrera v. Security Bldg. & Inv. Corp.*, 519 F.2d 1166 (5th Cir. 1975). But see *Garner v. Tri-State Dev. Co.*, 382 F. Supp. 377 (E.D. Mich. 1974).

66. See, e.g., § 443.320-.330, RSMo (Supp. 1975), TEX. REV. CIV. STAT. ANN. art. 3810 (Vernon 1966).

67. See Comment, *Power of Sale Foreclosure After Fuentes*, 40 U. CHI. L. REV. 206, 217-18 (1972).

68. 387 U.S. 369 (1967).

69. *Mulkey v. Reitman*, 64 Cal. 2d 529, 413 P.2d 825, 50 Cal. Rptr. 881 (1966).

70. See *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23 (6th Cir. 1975); *Barrera v. Security Bldg. & Inv. Corp.*, 519 F.2d 1166 (5th Cir. 1975); *Bryant v. Jefferson Fed. Sav. & Loan Ass'n*, 509 F.2d 511 (D.C. Cir. 1974); *Federal Nat'l Mtg. Ass'n v. Howlett*, 521 S.W.2d 428 (Mo. En Banc 1975).

71. See *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23 (6th Cir. 1975). See also Comment, *supra* note 67, at 217-18.

legislature.⁷² Third, the extension of the "encouragement" theory to power of sale foreclosure would subject a vast range of private conduct to fourteenth amendment coverage, since statutes regulate so many forms of private activity and to some extent encourage such activity.⁷³

The governmental function theory would find state action when a private person performs a function that is essentially governmental in nature.⁷⁴ Perhaps the classic example of this theory is found in *Marsh v. Alabama*,⁷⁵ where a "company town" was held to the same first amendment standards as a municipal corporation.⁷⁶ On the other hand, the Supreme Court recently has refused to expand this concept to such arguably quasi-municipal functions as covered mall shopping centers.⁷⁷ It could be argued that power of sale statutes have delegated the traditional governmental function of judicial foreclosure to private parties.⁷⁸ The Court of Appeals for the Fifth Circuit rejected this argument in confronting the Texas deed of trust power of sale statute in *Barrera v. Security Building and Investment Corp.*⁷⁹ The court found that there was no state action based on a governmental function theory because foreclosure of the mortgagor's equity of redemption had never been the exclusive prerogative of the state. The court noted that extrajudicial foreclosure dated back to 1774. Thus, the trustee exercising a power of sale was not deemed to be performing a governmental function.⁸⁰

72. See *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23 (6th Cir. 1975); *Barrera v. Security Bldg. & Inv. Corp.*, 519 F.2d 1166 (5th Cir. 1975); *Federal Nat'l Mtg. Ass'n v. Howlett*, 521 S.W.2d 428 (Mo. En Banc 1975).

73. See *Federal Nat'l Mtg. Ass'n v. Howlett*, 521 S.W.2d 428 (Mo. En Banc 1975); Comment, *supra* note 67, at 217-18. Many power of sale cases have utilized decisions under section 9-503 of the Uniform Commercial Code, which permits "self-help" repossession of secured chattels. These cases have found no state action under UCC § 9-503 and, *inter alia*, have rejected the "encouragement" theory. See *Gibbs v. Titelman*, 502 F.2d 1107 (3d Cir. 1974); *Turner v. Impala Motors*, 502 F.2d 607 (6th Cir. 1974); *Shirley v. State Nat'l Bank*, 493 F.2d 739 (2d Cir. 1974); *Adams v. Southern California First Nat'l Bank*, 492 F.2d 324 (9th Cir. 1973); *Bitchell Optical Labs. Inc. v. Marquette Nat'l Bank*, 487 F.2d 906 (8th Cir. 1973).

74. See *Barklage*, *supra* note 62, at 280.

75. 326 U.S. 501 (1946).

76. See *Evans v. Newton*, 382 U.S. 296 (1966) (private trustees' management of park on segregated basis was determined to be a governmental function); *Terry v. Adams*, 345 U.S. 461 (1953) (pre-primary elections with no apparent state involvement held subject to the fifteenth amendment).

77. See *Lloyd Corp. v. Tanner*, 407 U.S. 551 (1972).

78. See *Muller, Deed of Trust Foreclosure: The Need for Reform . . . Fair Play and the Constitution Revisited*, 29 J. Mo. B. 222, 229 (1973).

79. 519 F.2d 1166 (5th Cir. 1975).

80. See *Roberts v. Cameron-Brown Co.*, 556 F.2d 356 (5th Cir. 1977); *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23 (6th Cir. 1975); *Federal Nat'l Mtg. Ass'n v. Howlett*, 521 S.W.2d 428 (Mo. En Banc 1975).

Under the judicial enforcement theory state action exists when state courts enforce the rights of private parties. The origin of this theory is *Shelley v. Kraemer*,⁸¹ in which the Supreme Court held that specific judicial enforcement of a racially restrictive covenant constituted state action and was violative of the fourteenth amendment equal protection clause. If *Shelley* were extended to power of sale foreclosure, it could be argued that judicial enforcement of power of sale mortgages would constitute state action. Where such foreclosures ultimately entail intervention by a court, either in the form of a sheriff ejecting a holdover mortgagor or in a subsequent quiet title suit based on the foreclosure, judicial recognition of the mortgage agreement arguably could be considered state action. However, most power of sale foreclosures are accomplished with no subsequent judicial second-guessing, making the *Shelley* concept inapplicable. The Supreme Court has refused to apply the *Shelley* concept outside of the racial covenant area and to some extent has restricted its scope.⁸² The Missouri Supreme Court in *Howlett* refused to apply the *Shelley* theory to power of sale deed of trust foreclosure. It noted that title passed by virtue of the trustee's deed and without judicial intervention; courts were used only when mortgagors do not surrender possession. In such a situation, the court noted, possession is obtained by an unlawful detainer action in which the Missouri courts are not permitted to inquire into the merits of title. Thus, courts are not involved in the process by which title passes.⁸³ This reasoning is problematic. If a mortgagor brings a subsequent suit in equity to set aside a power of sale foreclosure, a court would be called upon to enforce the private agreement, and the logic of *Shelley* would be inescapable. Perhaps the better approach is simply to say that the *Shelley* concept should not be extended beyond the racial covenant area; otherwise judicial enforcement of every private agreement could be brought within the state action ambit.⁸⁴

Finally, state action is sometimes found under a "pervasiveness" theory. Under this concept state action exists when statutory regulation pervasively governs otherwise private conduct. This theory, however, was

81. 334 U.S. 1 (1948).

82. The other Supreme Court decision to apply *Shelley* was *Barrows v. Jackson*, 346 U.S. 249 (1953), a case involving a suit for damages for breach of a racial covenant. The Court avoided *Shelley* in *Lombard v. Louisiana*, 373 U.S. 267 (1963), a sit-in case involving racial segregation in public accommodations. More recently the Court rejected the application of the *Shelley* concept in *Evans v. Abney*, 396 U.S. 435 (1970), where a state court ruled that a trustor's intention to provide a park for whites only could not be carried out and that therefore the property reverted to his heirs. The Supreme Court held that the state court ruling did not constitute state action under the fourteenth amendment.

83. See *Federal Nat'l Mtg. Ass'n v. Howlett*, 521 S.W.2d 428, 437 (Mo. En Banc 1975).

84. See *Global Indus., Inc. v. Harris*, 376 F. Supp. 1379, 1383 (N.D. Ga. 1974).

rejected by the Supreme Court in *Jackson v. Metropolitan Edison Co.*,⁸⁵ where an attempt was made to find state action in a public utility termination of services. According to the Court,

[the] mere fact that a business is subject to State regulation does not by itself convert its action into that of the State for purposes of the Fourteenth Amendment. Nor does the fact that the regulation is extensive and detailed, as in the case of most public utilities, do so [T]he inquiry must be whether there is a sufficiently close nexus between the state and the challenged action of the regulated entity so that the action of the latter may be fairly treated as that of the State itself.⁸⁶

The *Barrera* court rejected the application of this theory to the Texas power of sale statutes. It found the nexus between state and private activity required by *Jackson* to be absent and determined that in its absence state regulation alone is not sufficient to establish state action.⁸⁷

The foregoing illustrates that, absent a rather unusual power of sale situation such as existed in North Carolina⁸⁸ (where public officials are significantly involved), it will be difficult to establish the state action required by the fourteenth amendment. By finding no state action, many courts avoid the myriad of complex constitutional issues considered earlier. These include: the form of notice which is required; whether all parties, including junior lienors, should be entitled to notice; and the type of hearing which is required, judicial or otherwise. By avoiding these difficult issues such courts apparently defer to legislatures which are perhaps better equipped to deal with them.⁸⁹

THE GOVERNMENT AS MORTGAGEE: "FEDERAL ACTION" PROBLEMS

Where power of sale constitutional litigation involves a direct instrumentality of the state or federal government as the mortgagee, courts cannot avoid the constitutional issues of notice and hearing. Even though a court would find that a particular state power of sale statute lacks the requisite state action when a private party is the mortgagee, the presence of the government as a mortgagee provides the "governmental action" necessary to reach the constitutional issues. If the foreclosing mortgagee is a direct instrumentality of the state, the fourteenth amendment state action requirement is readily satisfied. If the foreclosing mortgagee is a direct federal instrumentality, then the requisite "fed-

85. 419 U.S. 345 (1974). See also *Moose Lodge No. 107 v. Irvis*, 407 U.S. 163 (1972) (state licensing and regulation of a private club not sufficient to find state action).

86. 419 U.S. at 350-51.

87. *Barrera v. Security Bldg. & Inv. Corp.*, 519 F.2d 1166, 1171-72 (5th Cir. 1975).

88. See text accompanying notes 61-64 *supra*.

89. See *Barrera v. Security Bldg. & Inv. Corp.*, 519 F.2d 1166, 1174 (5th Cir. 1975).

eral action" exists, and a court will apply fifth amendment due process standards to test the constitutionality of the foreclosure.

It is a relatively common practice for a direct instrumentality of the federal government to be a foreclosing mortgagee in state court under local power of sale statutes. This situation will arise, for example, where direct loans made by the Veterans Administration (VA) or the Farmers Home Administration (FmHA) under various government programs are foreclosed.⁹⁰ It also could occur where the Federal Housing Administration (FHA) opts to take an assignment of an FHA insured mortgage that is in default and then forecloses.⁹¹ For example, in *Ricker v. United States*⁹² the FmHA foreclosed a mortgage under a Maine nonjudicial foreclosure statute. The mortgagors brought suit to invalidate the foreclosure in federal court. Because the government was the mortgagee, the federal district court went directly to the fifth amendment notice and hearing issue and invalidated the foreclosure. Had this foreclosure involved a private mortgagee, the challenge would have been under the fourteenth amendment. Given the trend of the case law, state action probably would not have been found, and the merits would not have been reached.

Difficult federal action issues arise when the mortgagee is either the Federal National Mortgage Association (FNMA) or the Federal Home Loan Mortgage Corporation (FHLMC). Both entities are quasi-federal and purchase large quantities of mortgage loans on the secondary market.⁹³ They commonly foreclose mortgages under power of sale statutes with respect to those mortgage loans they have purchased and which subsequently go into default. Are these entities the "federal government" for purposes of the fifth amendment due process clause? Courts thus far have concluded that FNMA is not.⁹⁴ Until 1968, FNMA was wholly owned and administered by the federal government. In 1968 Congress changed its status to a federally-sponsored private corporation whose purpose was to provide a secondary market for residential mortgages.⁹⁵ The stock is completely privately owned, but the President of the United States appoints five of the fifteen members of the Board of Directors.⁹⁶ The federal government regulates FNMA in many respects, such as establishing debt limits, approving the sale of stock, and requiring that a certain portion of its mortgage purchases be related to furthering the

90. See G. NELSON & D. WHITMAN, *supra* note 1, at 511-12; *United States v. White*, 429 F. Supp. 1245 (N.D. Miss. 1977).

91. See G. NELSON & D. WHITMAN, *supra* note 1, at 511.

92. 417 F. Supp. 133 (D. Me. 1976). See *United States v. White*, 429 F. Supp. 1245 (N.D. Miss. 1977).

93. See G. NELSON & D. WHITMAN, *supra* note 1, at 483-84, 486-87.

94. See *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23 (6th Cir. 1975); *Federal Nat'l Mtg. Ass'n v. Scott*, 548 S.W.2d 545 (Mo. En Banc 1977).

95. 12 U.S.C. § 1716 (1970).

96. 12 U.S.C. § 1723a(b) (1970).

development of low and middle income housing.⁹⁷ In *Northrip v. Federal National Mortgage Association*,⁹⁸ the Court of Appeals for the Sixth Circuit found that FNMA, while evidencing "significant" federal involvement, should not be treated as the federal government for fifth amendment purposes when it forecloses mortgages. The court thought that *Jackson v. Metropolitan Edison Co.*,⁹⁹ which found no state action involved in a public utility's termination of customer service, represented an analogous case. According to the court in *Northrip*, "here as in *Jackson* there is not a 'sufficiently close nexus' between the state and the challenged act of foreclosure."¹⁰⁰

The FHLMC poses a somewhat more difficult federal action problem. It was created in 1970 by Congress to strengthen the secondary market in federally insured and conventional mortgages. Its stock is wholly owned by the twelve Federal Home Loan Banks.¹⁰¹ The Board of Directors is composed of the three members of the Federal Home Loan Bank Board, the members of which are appointed by the President of the United States.¹⁰² Although there is no case law in point, FHLMC probably should be treated as the federal government for purposes of the fifth amendment. While Congress clearly intended to make FNMA a private corporation,¹⁰³ FHLMC is more substantially tied to the federal government. There is, for example, no private market for FHLMC shares as is the case with respect to FNMA. Moreover, because the directors are Presidentially appointed, FHLMC's day-to-day operations are inevitably more significantly intertwined with the federal government than those of FNMA.

Even where the federal government is not the mortgagee, it has been argued that federal action may exist where the mortgage being foreclosed was initiated pursuant to a federally subsidized and regulated program. *Roberts v. Cameron-Brown Co.*¹⁰⁴ illustrates this type of situation. The mortgage being foreclosed under a Georgia power of sale statute was initiated under section 235 of the National Housing Act and subsequently sold to FNMA, the foreclosing mortgagee.¹⁰⁵ The section 235 program was designed to encourage homeownership by low income groups; to accomplish this goal, the federal government makes mortgage assistance payments to the mortgagee on the mortgagor's behalf.¹⁰⁶ The economic effect of the program is to reduce the cost of the mortgage to

97. 12 U.S.C. § 1723a(h) (1970).

98. 527 F.2d 23 (6th Cir. 1975).

99. 419 U.S. 345 (1974).

100. 527 F.2d 23, 32 (6th Cir. 1975).

101. 12 U.S.C. § 1453(a) (1970).

102. 12 U.S.C. § 1452(a) (1970).

103. See *Northrip v. Federal Nat'l Mtg. Ass'n*, 527 F.2d 23, 32 (6th Cir. 1975).

104. 410 F. Supp. 988 (S.D. Ga. 1975).

105. 12 U.S.C. § 1715z(a) (1970).

106. See G. NELSON & D. WHITMAN, *supra* note 1, at 542.

the equivalent of a mortgage with a one percent per annum interest rate.¹⁰⁷ Private mortgagees who take part in the section 235 program are extensively controlled by federal statutes and regulations.¹⁰⁸ In *Roberts* the federal district court concluded that even though no state action existed for purposes of the fourteenth amendment, the combination of federal subsidy to the mortgagor and substantial federal regulation of the mortgage transaction resulted in federal action for purposes of the due process clause of the fifth amendment. In an ambiguous opinion, the Fifth Circuit reversed and determined that the federal government's involvement was insufficient to sustain a finding of federal action.¹⁰⁹ Even though the presence of FNMA as the foreclosing party was not emphasized in the district court's reasoning, the court of appeals stressed the fact that FNMA is not a federal instrumentality. Although the Fifth Circuit rejected the pervasive federal regulation and participation argument, its opinion failed to confront the significance of the financial subsidy provided by the section 235 program.

As more courts invalidate power of sale foreclosures by federal or quasi-federal agencies or if courts become more willing to find federal action in connection with federally subsidized and regulated mortgage programs, an interesting two-tier foreclosure system may develop. Where federal action is found, foreclosures under such state statutes probably will be held to violate the notice and hearing requirements of the fifth amendment. However, continued use of power of sale foreclosures by other mortgagees, at least in non-federally subsidized situations, will be permitted because the statutes themselves probably do not represent state action for purposes of the fourteenth amendment. The result could be that "federal" foreclosures may have to be judicial while "private" power of sale foreclosures may continue.

The "federal" role as mortgagee, either as a result of direct loans or because of activity in the secondary market, is substantial. Moreover, federal subsidy programs for privately held mortgages are also significant and, under those programs, even where a private mortgagee forecloses, the costs of foreclosure are usually borne by the federal government.¹¹⁰ Therefore, federal pressure for constitutional and workable state foreclosure procedures without the full formality of judicial foreclosure may become significant. Local institutional lenders who sell loans on the "federal" market or who participate in federal subsidy programs could also become a force for legislative change of state power of sale statutes.

107. *Id.*

108. *See, e.g.*, 12 U.S.C. § 1715z(b) (1970); 24 C.F.R. § 235 (1977); U.S. DEPT OF HOUS. & URBAN DEV., HANDBOOK No. 4155.1, MORTGAGE CREDIT ANALYSIS (July 25, 1972).

109. 556 F.2d 356 (5th Cir. 1977).

110. *See generally* 24 C.F.R. §§ 203.355-.417 (1977).

SOME FURTHER PROBLEMS

In the event a court surmounts the state action problem and determines that a particular power of sale statute is unconstitutional, the question arises whether a sale held under such a statute will be classified as void or merely voidable. If the sale is rendered void, no title passes in law or equity. Thus the sale purchaser, whether the mortgagee or a third party, cannot obtain title of any kind and no title would pass to subsequent purchasers.¹¹¹ On the other hand, if the constitutional sale is only voidable, the right to set aside the foreclosure and regain *the land* will be cut off as against any purchaser for value without notice.¹¹² Few cases have considered this problem. *Ricker v. United States*,¹¹³ in holding that a nonjudicial foreclosure under a Maine statute violated the notice and hearing requirements of the fifth amendment due process clause, avoided classifying the foreclosure as either void or voidable; instead, the court determined that the subsequent purchasers from the federal government were not bona fide, since the original mortgagors stayed in possession and since recorded documents established that the foreclosure was nonjudicial. "Under Maine law a purchaser at a foreclosure sale cannot claim protection as a bona fide purchaser where, as here, it appears from documents and facts known at the time of purchase that there may be a substantial defect in the seller's claim of title."¹¹⁴ The court may be correct in its assertion that the mortgagors' continued possession gave subsequent purchasers notice of their claim, thus depriving them of bona fide purchaser status. However, the mere presence in the public records of a document indicating that nonjudicial foreclosure had been employed is hardly tantamount to notice of a defect in the title. At present the law is far from clear on the constitutional issues; if the United States Supreme Court, or a majority of lower federal decisions, firmly establish that foreclosures without notice and hearing are unconstitutional, then it will be fair to say that purchasers who trace their titles through foreclosures conducted thereafter lack bona fides. That time is not here yet. The *Ricker* court's holding would make it virtually impossible for any person to claim BFP status and hence would in effect make all such foreclosures void; that view is simply unreasonable at this stage of the law's development.

For the countless thousands of people in the United States who may "own" land whose title was derived from a foreclosure sale under an arguably unconstitutional power of sale statute, the above problems are hardly theoretical. Unless they have been in possession for the applicable

111. See G. NELSON & D. WHITMAN, *supra* note 1, at 280.

112. *Id.* at 281. See also Dingus, *Mortgages—Redemption After Foreclosure Sale in Missouri*, 25 MO. L. REV. 261 (1960).

113. 417 F. Supp. 133 (D. Me. 1976).

114. *Id.* at 140.

period to establish adverse possession, they may not own their land. The few cases invalidating power of sale foreclosure have not dealt with this problem. However, as a practical matter, if a court is to invalidate a state power of sale statute, it virtually will be compelled to make the decision prospective only. Although it has been the traditional rule that newly announced constitutional doctrines are given retroactive effect, the Supreme Court has been loath to do so when there are important overriding societal considerations.¹¹⁵ Given the substantial reliance on the power of sale foreclosure method in this country, a retroactive application of unconstitutionality could cloud countless titles and result in enormous volumes of costly litigation.¹¹⁶ This is especially true in inflationary periods when rising land values will encourage potential claimants to upset past foreclosure sales. In fact, the spectre of retroactivity doubtless encourages courts to find other methods, such as the lack of state action, to avoid reaching the constitutional questions involved in power of sale foreclosure. Whatever standards the United States Supreme Court has applied to the retroactivity question in the past in the criminal and other areas, the practical necessities would seem to dictate prospective application of unconstitutionality in the power of sale situation.

CONCLUSION AND RECOMMENDATIONS

Assuming fourteenth amendment state action exists, many state power of sale statutes are deficient on notice grounds, and nearly all fail to satisfy the constitutional hearing requirement. As we have seen, waiver of the rights to notice and hearing, as a practical matter, simply will not work.¹¹⁷ While many courts have avoided the constitutional problems by utilizing the "no state action" approach, this cannot be the long-range solution to the problem.

The reason the "no state action" approach can at best be only a temporary expedient is because of the two-tier situation discussed earlier.¹¹⁸ It is true that if courts continue to follow the "no state action" approach, private mortgagees can in theory continue to utilize current power of sale foreclosure. Whatever standards the United States Supreme Court has applied to the retroactivity question in the past in the amendment state action. However, as *Ricker* so graphically illustrates, mortgagees that are federal agencies for purposes of the fifth amendment due process clause will not be able to utilize such foreclosure stat-

115. See G. GUNTHER, *CONSTITUTIONAL LAW* 546 (1976); Mishkin, *The High Court, the Great Writ, and the Due Process of Time and Law*, 79 HARV. L. REV. 56 (1965); Schwartz, *Retroactivity, Reliability, and Due Process: A Reply to Professor Mishkin*, 33 U. CHI. L. REV. 719 (1966); Wellington, *Common Law Rules and Constitutional Double Standards*, 83 YALE L.J. 221 (1973).

116. See Barklage, *supra* note 62, at 284.

117. See text accompanying notes 45-59 *supra*.

118. See text accompanying notes 90-103 *supra*.

utes because such foreclosures will be unconstitutional. These federal mortgagees, as noted earlier, may include such quasi-federal agencies as the Federal Home Loan Mortgage Corporation (FHLMC) as well as direct federal instrumentalities. In addition, federal action may be present where federal subsidy programs are involved. State agencies which hold mortgages, such as state housing finance agencies, will also be subject to analogous fourteenth amendment standards.

In theory, of course, the federal government may be satisfied with judicial foreclosure in foreclosures by federal agencies or under federally subsidized programs, even though private mortgagees continue to use power of sale statutes. However, this is not the likely result, if for no other reason than judicial foreclosure is both more time-consuming and costly than its power of sale counterpart.¹¹⁹ The more probable result is that there will be federal pressure on large private institutional lenders to encourage the enactment of new foreclosure legislation that meets constitutional standards yet retains the power of sale feature.

It is quite possible to enact workable legislation that meets such standards. First, as has been noted earlier, if a statute requires notice by mail to all parties of record subordinate to the mortgage being foreclosed, the constitutional notice requirement can be satisfied. Such notice could be mailed to each subordinate party at the address provided in the recorded document that evidences such party's interest in the real estate. Moreover, it is possible for the legislation to provide for a hearing and still retain a power of sale feature. For example, the statute could require that a two-part postcard be mailed to all the subordinate parties described above. The postcard would apprise them, in simple non-technical language, of the foreclosure proceeding, and inform them that if a hearing is desired the second half of the postcard should be returned by mail to the court. If any cards are returned, a judicial hearing would be scheduled. However, if no cards are returned the mortgagee or trustee would be free to exercise the power of sale contained in the mortgage instrument without any judicial intervention. The latter result would, in fact, be likely; even judicial foreclosure actions culminate with a high percentage of default judgments. Such legislation thus may retain the cost saving advantage of the power of sale foreclosure and yet meet constitutional requirements. Such legislation should be seriously considered.

Finally, a decision by the United States Supreme Court is badly needed to clarify the merits of the constitutional issues. Such a decision probably should involve a federal, quasi-federal, or state agency in order to obviate the state action argument. In this context the Court would be in a position to detail appropriate standards for both the notice element (which can be inferred fairly readily from the Court's prior decisions)

119. See McElhone & Cramer, *supra* note 1.

and the hearing requirement (which, in the foreclosure situation, is given only meager guidance from prior cases). A new decision of this type would give strong impetus to the movement for reform of state statutes as legislatures brought them into line with the Court's holding. In this context the state action argument would be irrelevant, foreclosure would become much fairer to those whose interests it cuts off, and further costly and wasteful constitutional litigation would be unnecessary.

