Administrative Law - Farmers Home Administration Is Not Required to Comply with Pennsylvania's Mortgage Foreclosure Statutes Prior to Foreclosing on a Loan Obtained through Its Federal Lending Program

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I. INTRODUCTION

The Farmers Home Administration (FmHA) administers a federal loan program, lending funds to individuals for the purpose of purchasing property and securing the loans with mortgages on the property.¹

¹ See United States v. Spears, 859 F.2d 284, 288-89 (3d Cir. 1988). The Farmers Home Administration (FmHA) is the result of long-standing government interest in promoting the agricultural industry in America. Note, Agricultural Law: FmHA Farm Foreclosures, An Analysis of Deferral Relief and the Appeals System, 23 WASHBURN L.J. 287, 288 (1984). It is the descendant of the Resettlement Administration, which was created during the Depression to help rural families become financially self-sufficient. Id. The Resettlement Administration was renamed the Farm Security Administration in 1938, when it was placed under the aegis of the Department of Agriculture and proceeded to supply "credit so farmers could be farm owners, counseling to borrowers, resettlement projects to establish new farms, and other social and economic programs." Id. at 289 n.15 (citing 11 N. HARL, AGRICULTURAL LAW 966 (1982)). In 1946, the Farm Security Administration became the FmHA, a similar agency with similar objectives created "to simplify and improve credit services to promote farm ownership." Id. at n.16 (quoting 1946 U.S. CODE & CONC. SERV. 1028).

The Housing Act of 1949 (the "Act") had as its objective "a suitable living environment for every American family." Pub. L. No. 171, 63 Stat. 413 (1949) (codified as amended at 42 U.S.C. § 1441 (1982)); Centner, Are FmHA Loan Entitlements Protected by the Due Process Clause?, 34 DRAKE L. REV. 389, 392-93 (1985). To this end, the government, through the FmHA, makes funds available for the purpose of purchasing real estate, for restoring homes to a "safe and habitable" condition, and for weatherization. Id. at 394 (citing Pub. L. No. 171, § 504, 63 Stat. 413, 414 (1949) (codified as amended at 42 U.S.C. § 1474 (1982))). The lending program is geared towards those homeowners, particularly farmers, who meet the eligibility and loan approval requirements set out in the Act. Some of the eligibility criteria include "creditworthiness, citizenship, . . . character as it relates to repayment, management ability [and] no credit elsewhere." Note, supra, at 290 (citations omitted). The prospective borrower must also meet loan approval criteria including "repayment ability and adequate security," Id. at 290-91 (citations omitted). If the prospective borrower meets both the eligibility requirements and the loan approval criteria, he will receive the loan and, in return, must sign "a Farm and Home Plan, a promissory note, and a security agreement." Id. (citations omitted).

Originally, virtually all of the loans granted were for farmers, but the Housing Act of 1961 "expanded the eligibility requirements of [the Act] to include owners of other real estate in rural areas." Centner, supra, at 394 (citing Pub. L. No. 87-70, § 803, 75 Stat. 149, 186 (1961) (codified as amended at 42 U.S.C. § 1471(a)(i) (1982))). Further expansion of the qualified pool resulted from the increased population limit of rural communities in which the agency was permitted to make loans, as delineated in the Housing and Urban Development Act of (535)
FmHA procedures, including foreclosure procedures, are generally defined in the agency's regulations. In some circumstances, however, the regulations do not control. For example, the agency regulations may not address a particular issue or the parties may contract to comply with state law. Also, the terms of the mortgage agreement or the procedure followed may differ from the agency's regulations. Additionally, in some cases there may be compelling reasons to incorporate state law. In such cases, the provisions of the mortgage agreements are governed by federal common law, which may derive its content from state law.


3. See Centner, supra note 1, at 415. The contractual nature of the arrangement is an important aspect of the relationship between the parties. It is important to note that the relationship is voluntary, and that "FmHA borrowers want [] to be homeowners and [are] willing to enter into agreements with the government to facilitate the acquisition of their own homes." Id. (emphasis added). Taking into consideration the voluntary nature of the obligations that the borrowers accept and the notice they receive regarding the consequences of default, it seems equitable to allow the FmHA to foreclose in accordance with the provisions set forth in the mortgage agreements—i.e., to allow the regulations to give content to federal law when the foreclosure proceedings take place in federal court. Id. For a discussion of the Third Circuit's consideration of the mortgage contract's provisions regulating foreclosure proceedings in Spears, see infra notes 33-35 and accompanying text.

4. Regulations of the Department of Agriculture, 7 C.F.R. § 1955.15(d)(2) (1988). The FmHA regulations provide: "A State Supplement may be issued if [the Office of the General Counsel] advises different or additional language or format is required to comply with State laws or if notice and mailing instructions are different than that outlined in this paragraph." Id. For further discussion of this provision, see infra note 34.

5. See United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979). For a discussion of Kimbell, see infra note 37 and accompanying text. See also United States v. Yazell, 382 U.S. 341 (1966). The Yazell Court found significant the fact that a Small Business Administration (SBA) loan to the Yazells was a "custom-made, hand-tailored, specifically negotiated transaction." Id. at 348. The Court also implied that the local SBA agents who had set up the loan knew about the state law in question and should have covered the possibility of coverture blocking collection of their loan in the loan documents. Id. at 346-48. The Court also held that

[b]oth theory and the precedents of this Court teach us solicitude for state interests, particularly in the field of family and family-property arrangements. They should be overridden by the federal courts only where clear and substantial interests of the National Government, which cannot be served consistently with respect for such state interests, will suffer major damage if the state law is applied.

Id. at 352.

6. See United States v. Spears, 859 F.2d 284, 289 (3d Cir. 1988). The Supreme Court has held that contractual arrangements arising out of federal lending programs are governed by federal law. See Kimbell, 440 U.S. at 726; see also Clearfield Trust Co. v. United States, 318 U.S. 363, 366-67 (1943). In Clearfield Trust, the Supreme Court held that federal law governed actions of the
Recently, in *United States v. Spears,* the United States Court of Appeals for the Third Circuit was confronted with the issue of whether federal common law required the FmHA to comply with Pennsylvania's preforeclosure statutes. The Third Circuit concluded that the parties did not contract to comply with state law and that there was no compelling reason to choose state law as the rule of decision. In so doing, the court provided practitioners in the Third Circuit with a clear formula as to when federal agencies must comply with state foreclosure laws before foreclosing on a mortgage obtained through a federal loan program.

II. Facts

In 1981, Marcus and Doris Spears purchased property in Pennsylvania, aided by a loan from the FmHA which was secured by a mortgage on the property. The Spears made payments on the property until June 1982, after which the couple separated and departed the property. In October 1982 and January 1983, the FmHA wrote to Doris Rivera (formerly Doris Spears), informing her that she had violated the mortgage agreement and that her interest credit had been cancelled. She was further advised to either sell the property or refinance.

Federal government which are based on constitutionally delineated powers. *Id.* at 366. In reaching its decision, the *Clearfield Trust* court stated:

> When the United States disburses its funds or pays its debts, it is exercising a constitutional function or power. . . . [Such disbursements and payments have their] origin in the Constitution and the statutes of the United States and [are] in no way dependent on the laws . . . of any other state. . . . In absence of an applicable act of Congress it is for the federal courts to fashion the governing rule of law according to their own standards.

*Id.* at 366-67.

7. 859 F.2d 284 (3d Cir. 1988).
8. *Id.* at 285. For a discussion of the facts of *Spears,* see *infra* notes 11-28 and accompanying text.
9. *Spears,* 859 F.2d at 285. For a discussion of the Third Circuit's holding and reasoning in *Spears,* see *infra* notes 29-61 and accompanying text.
10. For a discussion of this formula, see *infra* notes 89-91 and accompanying text.
11. *Spears,* 859 F.2d at 285. Along with the loan, the Spears received an "interest credit" from the FmHA because of their low family income. *Id.* The credit served to greatly reduce the monthly mortgage payments. *Id.*
12. *Id.* The *Spears* court referred to the defendant, Doris Spears, as Ms. Rivera (her maiden name, which she resumed after her divorce) throughout the opinion. *Id.* Marcus Spears, the defendant's former husband, was deceased at the time of the present action. *Id.* Prior to Mr. Spears' death, the couple had separated and Rivera moved to Puerto Rico, where she had planned to stay for "three to four months." *Id.* While in Puerto Rico, Mrs. Spears obtained a divorce and resumed use of her maiden name. *Id.* She remained in Puerto Rico until she moved to her daughter's house in Allentown, Pennsylvania, in July 1983. *Id.* at 285-86.
13. *Id.* The letters noted that abandonment of the mortgaged property and failure to make payments under the mortgage agreement were violations of the
the mortgage and discharge her debt to the government.\textsuperscript{14} In March 1984, the FmHA again wrote to Rivera, informing her that in response to her default on her loan, the agency planned to accelerate the loan and foreclose on her property.\textsuperscript{15} In addition, she was given notice of her right to a hearing before such foreclosure took place.\textsuperscript{16} Without ever having responded to any of the FmHA's letters, Rivera moved back onto the property in November 1985.\textsuperscript{17}

In mid-1985, the government began foreclosure proceedings in the United States District Court for the Eastern District of Pennsylvania.\textsuperscript{18} On remand from the district court the FmHA determined that the property in question had been abandoned and that foreclosure proceedings should continue in the district court.\textsuperscript{19} The district court agreed with the agency's determinations and refused to stop foreclosure proceedings.\textsuperscript{20} However, relying on United States v. Kimbell Foods, Inc.,\textsuperscript{21} the district court held that the FmHA was required to comply with the Pennsylvania statutes governing pre-foreclosure proceedings known as Acts 6 and 91.\textsuperscript{22} These statutes require a mortgagee to give thirty days written notice of its intention to begin foreclosure proceedings.\textsuperscript{23} In

mortgage agreement. \textit{Id.} The FmHA sent identical letters to both Rivera and Spears, until his death. \textit{Id.}

\textsuperscript{14} \textit{Id.}

\textsuperscript{15} \textit{Id.} at 286. Each letter that Rivera received listed procedures that she could follow in order to cure the default on her loan. \textit{Id.} These included "making specified payments, transferring the property to another person in accordance with agency regulations, or refinancing the mortgage." \textit{Id.}

\textsuperscript{16} \textit{Id.} Rivera was informed that by submitting a written request within 30 days, she would be entitled to an administrative hearing. \textit{Id.}

\textsuperscript{17} \textit{Id.} The Third Circuit noted that Rivera "has lived [on the property] since [then] without paying any installment on the mortgage." \textit{Id.} This fact did not significantly enter into the court's decision; the Spears court referred to Rivera's continued use of the property without payment only in the factual portion of its opinion.

\textsuperscript{18} \textit{Id.} The district court disposed of some preliminary matters and, with the parties' consent, "remanded the case to the FmHA for administrative determinations." \textit{Id.}

\textsuperscript{19} \textit{Id.} The agency determined that the property had been abandoned from July 1982 until December 1985. \textit{Id.} This determination was made following "a hearing and an appeal to the state director." \textit{Id.}

\textsuperscript{20} \textit{Id.} Rivera appealed the agency's determination based on her assertion that she had not, in fact, abandoned the property. \textit{Id.} The district court affirmed this portion of the agency's determination, however, finding that the agency's determination regarding the abandonment of the property had been supported with substantial evidence and, consequently, that Rivera's appeal had been properly denied. \textit{Id.}

\textsuperscript{21} 440 U.S. 715 (1979). For a discussion of Kimbell, see infra note 37 and accompanying text.

\textsuperscript{22} Spears, 859 F.2d at 286 (citing PA. STAT. ANN. tit. 41, §§ 401-408 (Purdon Supp. 1988) and PA. STAT. ANN. tit. 35, § 1680.401c (Purdon Supp. 1988)).

\textsuperscript{23} PA. STAT. ANN. tit. 41, § 403(a) (Purdon Supp. 1988). In pertinent part, Act 6 provides:

(a) Before any residential mortgage lender may . . . commence any
addition, the mortgagor must be provided with a list of consumer credit counseling agencies and informed of the right to apply for financial assistance from a state program. Because the FmHA failed to comply with the Pennsylvania statutes, the district court remanded the case to the agency.

legal action including mortgage foreclosure . . . or take possession of any security of the residential mortgage debtor for such residential mortgage obligation, such person shall give the residential mortgage debtor notice of such intention at least thirty days in advance as provided in this section.

(b) Notice of intention to take action as specified in subsection (a) of this section shall be in writing . . .

(c) The written notice shall clearly and conspicuously state:

(1) The particular obligation or real estate security interest;
(2) The nature of the default claimed;
(3) The right of the debtor to cure the default as provided in section 404 of this act and exactly what performance including what sum of money, if any, must be tendered to cure the default;
(4) The time within which the debtor must cure the default;
(5) The method or methods by which the debtor's ownership or possession of the real estate may be terminated; and
(6) The right of the debtor, if any, to transfer the real estate to another person subject to the security interest or to refinance the obligation and of the transferee's right, if any, to cure the default.

Id. § 403(a)-(c).


(a) Any mortgagee who desires to foreclose upon a mortgage shall send to such mortgagor at this [sic] or her last known address the notice provided in subsection (b): Provided, [sic] however, That such mortgagor shall be at least sixty (60) days contractually delinquent in his mortgage payments or be in violation of any other provision of such mortgage.

(b) The agency [Pennsylvania Housing Finance Agency] shall prepare a uniform notice for purposes of this section as follows: The notice shall list consumer credit counseling agencies and shall advise the mortgagor of his delinquency or other default under the mortgage and that such mortgagor has thirty (30) days to have a face-to-face meeting with the mortgagee who sent the notice or a consumer credit counseling agency to attempt to resolve the delinquency or default by restructuring the loan payment schedule or otherwise. . . . The notice shall include a statement that, if the mortgagor is unable to resolve the delinquency or default within thirty (30) calendar days of the mortgagor's first contact with either the mortgagee or a consumer credit counseling agency, the mortgagor may apply to the agency or its duly authorized agent at the address and phone number listed in the notice in order to obtain an application and information regarding the Homeowner's Emergency Mortgage Assistance Program. . . . During the time that the application [to the Assistance Program] is pending, no mortgagee may commence legal action to foreclose upon its mortgage with the mortgagor.

Id.

25. Spears, 859 F.2d at 286. The district court found that compliance with the statutes would not impose a "substantial administrative burden on the government." Id. Further, the court noted that FmHA mortgagors would not re-
Rivera appealed the agency’s determination and the district court’s affirmation that she had in fact abandoned the property and thus was not entitled to relief in the form of a stay of the foreclosure proceedings. The government cross-appealed the district court’s holding that it was required to comply with the state’s pre-foreclosure statutes. The FmHA asserted that compliance with the agency’s regulations, which provided for adequate notice and an opportunity for a hearing, was sufficient.

III. Discussion

The Third Circuit began its analysis by determining that jurisdiction was proper. It then turned its attention to the main issue—whether, receive “additional substantive benefits” by application of the state laws (presumably to the detriment of the FmHA). Id. Finally, the district court found that national uniformity in administration of the lending program was unnecessary and that application of the Pennsylvania statutes instead of the federal regulations would not “frustrate the objectives” of the program. Id.

In light of these findings, the district court found that the Supreme Court’s holding in Kimbell was controlling and held that the FmHA was required to comply with the state statutes. Id. Thus, the court dismissed both parties’ motions for summary judgment. Id. The district court noted, however, that once the agency complied with the Pennsylvania statutes, it could renew its motion for summary judgment. Id. For a discussion of the facts and holding in Kimbell, see infra note 37 and accompanying text.

26. Spears, 859 F.2d at 286. Rivera argued on appeal that the district court had erred in finding that the agency’s evidence regarding her abandonment of the property was sufficient. Id.

27. Id. The FmHA argued that it was not required to comply with state statutes which effectively restricted its rights as mortgagee against its mortgagor. Id. The FmHA regulations, however, provide that, in some circumstances, the FmHA must comply with state law. See Regulations of the Department of Agriculture, 7 C.F.R. § 1955.15(d)(2) (1988). For the text of this provision, see supra note 4, and for a further discussion of the provision, see infra note 34.

28. Spears, 859 F.2d at 290 (citing 42 U.S.C. § 1475, 1480(g), (k) (1982 & Supp. IV 1986); Regulations of the Department of Agriculture, 7 C.F.R. § 1955.15 (1986)). The regulations provided that to effectuate foreclosure, the borrower’s account must be accelerated. See Regulations of the Department of Agriculture, 7 C.F.R. § 1955.15 (1988). The FmHA was required to send notice of acceleration by certified mail, return receipt requested, to the last known address. Id. § 1955.15(d)(2). If a signed receipt was returned, no further notice was necessary, and a copy of the notice was sent to a hearing officer. Id.

In 1987, the FmHA promulgated more detailed foreclosure notice regulations. See id. § 1951.312. However, the FmHA regulations still do not require the agency to provide a list of consumer credit agencies, as mandated by Pennsylvania’s Act 91. Compare id. with Pa. Stat. Ann. tit. 35, § 1608.401c(b) (Purdon Supp. 1988). In addition, FmHA regulations continue to provide that in some circumstances the agency must comply with state law. See Regulations of the Department of Agriculture, 7 C.F.R. § 1955.15(d)(2) (1988).

29. Spears, 859 F.2d at 286. The case was heard by Circuit Judges Scirica, Sloviter and Weis. Id. at 285. Judge Weis delivered the opinion of the court. Id. It is interesting to note that Judge Weis also wrote the court’s opinion in United States v. Walter Dunlap & Sons, Inc., 800 F.2d 1232 (3d Cir. 1986), a case in which the Third Circuit held that state law, not a federal agency’s regulations,
prior to foreclosing on Rivera's property, the FmHA was required to
gave content to federal law. For a discussion of Walter Dunlap, see infra note 48
and accompanying text.

Addressing the jurisdictional issues, the Third Circuit first noted that the
district court's denial of summary judgment to both parties and remand of the
case to the agency level were interlocutory steps, not final orders, hence "gener-
ally not appealable." Spears, 859 F.2d at 286-87 (citing United Steel Workers of Am.
Local 1913 v. Union R.R., 648 F.2d 905, 909 (3d Cir. 1981); Boeing Co. v.
International Union, 370 F.2d 969, 970 (3d Cir. 1967); Marshall v. Celebrezze,
351 F.2d 467, 468 (3d Cir. 1965)).

The Third Circuit found, however, that given the procedural posture of
Spears, if the FmHA were to comply with the Pennsylvania statutes as the district
court had ordered, the issue of whether or not they were required to do so
would become moot, hence unappealable. Id. at 287. If the FmHA refused to
comply, and no appeal were allowed, the issue would, in the court's words, "re-
main in limbo." Id. Thus the Spears court applied an exception to the general
rule of nonappealability because "denial of appellate review before remand to
the agency would foreclose appellate review as a practical matter." Id. (quoting
AJA Assoc. v. Army Corps of Eng'rs, 817 F.2d 1070, 1073 (3d Cir. 1987)). See also
Consolidated Coal Co. v. Local 1702, UMW, 683 F.2d 827, 831 (4th Cir.
1982) (in case involving appeal of contempt convictions, union officials
were allowed to appeal "[b]ecause the union officials [were] no longer parties to the
main claim, [and therefore] they [had] no other opportunity for review of their
contempt convictions").

The Third Circuit also found that it could, under the doctrine of pen-
dant appellate jurisdiction, properly exercise its discretion and decide any collateral
issues in the case, such as the sufficiency of the FmHA's evidence supporting its
discontinuance of its financial relationship with Rivera. Spears, 859 F.2d at 287
("[O]nce we have taken jurisdiction over one issue in a case, we may, in our
discretion, consider otherwise nonappealable issues in the case as well, where
[the] issue is sufficient overlap in the factors relevant to [the appealable and nonapp-
pealable] issues to warrant our exercising plenary authority over [the appeal].")
(quotating San Filippo v. United States Trust Co., 737 F.2d 246, 255 (2d Cir.
1984), cert. denied, 470 U.S. 1035 (1985)). See also Intermedics Infusaid, Inc. v.
Regents of Univ. of Minn., 804 F.2d 129, 134 (Fed. Cir. 1986) ("[I]n connection
with review of [an] appealable interlocutory order, other interlocutory orders,
which ordinarily would be nonappealable standing alone, may be reviewed.");
Barrett v. United States, 798 F.2d 565, 571 (2d Cir. 1986) ("Although dismissal
of plaintiff's claim against Marcus was not a final judgment, and Rule 54(b)
certification was not entered as to that dismissal, since all of the issues involved in plain-
tiff's cross-appeal of that order are involved in the federal defendant's appeal, we accept
pendent jurisdiction of the cross-appeal.") (emphasis added); Sanders v. Levy,

The court noted that the doctrine of pendant appellate jurisdiction could
easily become the subject of abuse, allowing litigants with nonappealable claims
to get those issues before the court by bringing them in conjunction with an
appealable, but unimportant claim which normally would not be appealed.
Spears, 859 F.2d at 287. Judge Sloviter based her dissent on this issue, stating
that the majority's "adoption of a discretionary standard of appellate jurisdiction
over collateral matters will be improvident in the long run, consigning this court
to a plethora of dispositions over where the line should be drawn in future
appeals." Id. at 292 (Sloviter, J., concurring and dissenting).

Judge Sloviter also disagreed with the majority's interpretation of Kershner
v. Mazurkiewicz, 670 F.2d 440 (3d Cir. 1982). Id. (Sloviter, J., concurring
and dissenting). In Kershner, the Third Circuit had "limited the scope of an appeal
under 28 U.S.C. § 1292(a) to issues intertwined with the preliminary injunction
itself." Spears, 859 F.2d at 288. Judge Sloviter felt that Spears and Kershner were
comply with the Pennsylvania statutes. As a preliminary matter, the court noted that the mortgage was "a contractual obligation subject to federal law," and that federal law could derive its content from state law.

The court first examined the mortgage contract to determine whether the FmHA had contracted to comply with state law in the area of foreclosure proceedings. The court found that while the provisions

_not_ distinguishable and stated in her dissent that "[t]he issues in the government's appeal and Ms. Rivera's appeal are not 'inextricably intertwined,' as required under *Kershner*." *Id.* at 295 (Sloviter, J., concurring and dissenting). Thus, according to Judge Sloviter, while the government's appeal was properly before the court, Rivera's was not. *Id.* at 292 (Sloviter, J., concurring and dissenting).

The court also allowed the appeal because the issue of whether the federal agency must comply with a state law "is significant in the day-to-day operation of the agency and has spawned conflicting district court decisions within [the Third] Circuit." *Spears*, 859 F.2d at 287. See, e.g., United States v. Royer, 683 F. Supp. 484, 486 (M.D. Pa. 1986) (case involving foreclosure proceedings initiated by FmHA held that mortgage contract "authorized the government to foreclose solely in compliance with federal law"), aff'd, 815 F.2d 696 (3d Cir. 1987); United States v. Black, 622 F. Supp. 669, 672 (W.D. Pa. 1985) ("This court holds that these federal statutes and regulations regarding a mortgage foreclosure by a federal agency [FmHA] preempt the field with respect to a federal agency's remedies and procedures on default and may not be superseded [sic] by conflicting state legislation."). Further, the court determined that the issue was "purely one of law," and no further factual evidence was being sought in *Spears*. 859 F.2d at 287. Finally, the court stated that in *Spears*, "considerations of judicial economy, the litigant's interests, and practicality demand that we exercise jurisdiction over the Rivera appeal." *Id.* at 288.

30. *Spears*, 859 F.2d at 288. Interestingly, the Third Circuit noted that the notice given by the FmHA here appears to cover substantially the items listed in the state statute. Furthermore, Act 6 provides that the notice "shall not be required where the residential mortgage debtor [] has abandoned . . . the property." As a consequence, it is questionable whether notice was mandated by this Act in any event. Act 91 demands notification to the mortgagor and grants time to apply to a state agency for financial assistance before foreclosure may proceed.

*Id.* (citations and footnote omitted).

For a discussion of the notice given by the FmHA, see *supra* notes 13-16 and accompanying text. For the text of Acts 6 and 91, see *supra* notes 23 & 24, respectively.


32. 859 F.2d at 289 (citing United States v. Kimbell Foods, Inc., 440 U.S. 715, 718 (1979); United States v. Walter Dunlap & Sons, Inc., 800 F.2d 1232, 1235 (3d Cir. 1986)). For a discussion of *Kimbell*, see *infra* note 37 and accompanying text. For a discussion of *Walter Dunlap*, see *infra* note 48 and accompanying text. For a discussion of when the FmHA may be governed by federal common law which is defined by state law, see *supra* notes 3-6 and accompanying text.

33. *Spears*, 859 F.2d at 289. The *Spears* court quoted passages from the mortgage contract which it felt were relevant to the question. *Id.* Paragraph 17 of the contract stated that in the event of a borrower's default, "the Government, at its option, with or without notice, may: . . . declare the entire amount
of the mortgage contract indicated that the government could use state law in foreclosure proceedings, it was not obligated to do so.\textsuperscript{34} The court based its interpretation on the consistent use of the word "may" in the contractual provisions relating to use of state law in foreclosure proceedings, rather than "shall" or "must," words which, in the Spears court's opinion, would obligate the government to utilize state foreclosure procedures instead of those set forth in the agency regulations.\textsuperscript{35}

Having determined that the mortgage contract did not specify which law was to be used, the Third Circuit determined the proper rule of decision. The Third Circuit stated that the determination of "whether to adopt state law or to fashion a uniform federal rule rests on judicial policy drawn from the nature of the specific governmental interest at stake and the effect of applying state law."\textsuperscript{36} In determining whether there was a compelling reason to incorporate state law in Spears, the Third Circuit first examined \textit{United States v. Kimbell, Inc.}\textsuperscript{37} where the unpaid under the note . . . due and payable . . . [or] foreclose this instrument as provided herein or by law." \textit{Id.} (emphasis added).

Paragraph 21 stated, "[t]his instrument shall be subject to the present regulations of the Farmers Home Administration, and to its future regulations not inconsistent with express provisions hereof." \textit{Id.}

Paragraph 23 stated that the borrower agreed that in the event of his own default, "the Government may foreclose this instrument as authorized or permitted by the laws then existing of the jurisdiction where the property is situated and of the United States of America, on terms and conditions satisfactory to the Government . . . ." \textit{Id.} (emphasis added). For a discussion of the importance of the contractual nature of the arrangement, see \textit{supra} note 3.

34. \textit{Spears}, 859 F.2d at 289. The court stated that "[a] fair reading of the mortgage documents reveals that the FmHA 'may' utilize state foreclosure procedures." \textit{Id.} The court also noted that "no contractual clause binds the government to utilize state law in foreclosure." \textit{Id.}

The Spears court also cited an FmHA regulation which dealt with forms to be used in cases of acceleration of accounts. \textit{Id.} "The regulation stated that '[a] State Supplement may be issued if the [Office of the General Counsel] advises different or additional language or format is required to comply with State laws or if notice and mailing instructions are different from that outlined in this paragraph.'" \textit{Id.} (citing 7 C.F.R. § 1955.15(d)(2) (1986)). In a footnote, the court noted that the language of this regulation could require the FmHA to comply with state pre-foreclosure procedures like Pennsylvania's when state law is used to foreclose on mortgages in default, but noted that because the FmHA in Spears was using the federal court and federal procedures to foreclose on the mortgage, this language imposed no obligation on the FmHA. \textit{Id.} at 289 n.3.

35. \textit{Id.} at 289. The court cited no particular authority for its interpretation of the force of the words "may," "shall" and "must." The court merely stated that its interpretation was "a fair reading." \textit{Id.}

36. \textit{Id.}

37. 440 U.S. 715 (1979). \textit{Kimbell} involved a small supermarket corporation, O.K. Super Markets, Inc. (O.K.), which borrowed funds from Kimbell, which secured its loan with a lien on O.K.'s merchandise and equipment. \textit{Id.} at 719. Subsequently, O.K. obtained a loan from a Texas bank, which also secured its loan with a lien on O.K.'s merchandise and equipment. \textit{Id.} The Small Business Administration (SBA) guaranteed the bank's loan. \textit{Id.} O.K. defaulted on both of the loans. \textit{Id.} Kimbell filed suit and subsequently obtained a favorable judgment in the state court. \textit{Id.} at 719-20. The SBA paid off the bank's loan and
Supreme Court held that the priority of liens stemming from federal programs was to be determined with reference to federal common law, which was to derive its content from the applicable state law unless Congress had previously indicated that its own directives would govern the situation.\(^8\) The Spears court articulated the Kimbell analysis, setting out the factors which the Kimbell court stated were to be taken into consider-

accepted assignment of the bank's security lien on O.K.'s property. \(Id.\) Subsequently, O.K. sold its equipment and inventory and placed the proceeds in escrow. \(Id.\) at 720. Kimbell, pursuant to its favorable judgment, sought to foreclose its lien, and filed suit in district court, claiming that its interest in the escrow account was greater than the SBA's. \(Id.\)

In a companion case to Kimbell, United States v. Crittenden, debtor Ralph Bridges obtained a loan from the FmHA, securing it with an interest in his crops and farm equipment. \(Id.\) at 723. Bridges, in the course of running his farm, had his tractor repaired by Crittenden and was unable to pay the repair bills. \(Id.\) Crittenden retained the tractor. \(Id.\) Subsequently, Bridges filed for bankruptcy, and the United States filed suit to obtain Bridges' tractor, claiming that its security interest was superior to Crittenden's repairman's lien. \(Id.\) at 724. In both cases, the United States Court of Appeals for the Fifth Circuit had addressed the issue of priority by fashioning a federal rule to give content to the federal law which governed the situation. \(Id.\) at 722-24. For the prior history of these cases, see Kimbell Foods, Inc. v. Republic Nat'l Bank, 401 F. Supp. 316 (N.D. Tex. 1975), rev'd, 557 F.2d 491 (5th Cir. 1977); United States v. Crittenden, Civ. Action No. 75-37-COL (M.D. Ga. Sept. 25, 1975), rev'd in part, 563 F.2d 678 (5th Cir. 1977).

The issue to be decided in Kimbell was whether liens arising from federal loan programs take precedence over private liens in the absence of a federal statute setting priorities. Kimbell, 440 U.S. at 718. The Supreme Court held that determination of this issue required the application of federal law, which, until Congress directed otherwise, was to be given content with state law pertaining to the issue. \(Id.\) at 726, 729. The Court found that application of state law was appropriate in Kimbell because: (1) no national rule was needed to protect the interests of the federal lenders, \(id.\) at 729; (2) application of state law did not interfere with proper administration of the federal lending programs, \(id.\) at 733; (3) Congress, which had the power to displace state law if it felt that federal programs required the protection of priority setting legislation, had not done so, \(id.\) at 735; and (4) rejection of established commercial laws in each state could undermine the stability of the commercial communities which based their transactions on state commercial law, \(id.\) at 739-40.

The Kimbell Court placed special emphasis on the last criterion, stating that in cases involving commercial creditors whose lien status was based on state law, "the prudent course is to adopt the readymade body of state law as the federal rule of decision until Congress strikes a different accommodation." \(Id.\) at 740. The Court noted its desire to, as far as possible, avoid changing the status quo in the area of commerce. \(Id.\) Specifically, the Court stated, "[b]ecause the ultimate consequences of altering settled commercial practices are so difficult to foresee, we hesitate to create new uncertainties, in the absence of careful legislative deliberation." \(Id.\) at 739-40.


ation in evaluating the government's interest in having a uniform rule fashioned to serve its needs. These factors include the possibility that the federal program in question might need a single national standard to transact its business with certainty, the possibility that applying state law to situations involving the federal lender would "frustrate specific objectives of the federal program" and the possibility that application of a federal rule would "disrupt commercial relationships predicated on state law." The Third Circuit applied the Kimbell analysis to the facts in Spears, examining whether efficient administration of the FmHA loan program required a single national standard. The mortgage contracts used by the FmHA provided for discretionary use of state law. The court stated that these provisions clearly indicated that fashioning a uniform rule was unnecessary.

The court next turned its attention to whether the application of state law would frustrate the aims of the FmHA program. The court again noted that the FmHA had the "contractual alternative to employ state procedures." The court stated that this discretionary use of state law suggests that, at times, state law is compatible with the FmHA program. Further, the court stated that "efficient operation of the federal program conceivably could be improved through the FmHA's decision to utilize state law." Thus, the Third Circuit concluded that a uniform federal rule was unnecessary and that the application of state law would not frustrate the purposes of the FmHA loan program.

The Third Circuit next evaluated the impact that application of the FmHA regulations would have on concerned commercial interests. The court stated that the "critical factor" which would determine whether state law or uniform federal law would apply was the threat that application of a federal rule would impose on commercial expectations founded

39. Spears, 859 F.2d at 289. For a brief discussion of Kimbell and the factors examined by the Kimbell court, see supra note 37.
40. Spears, 859 F.2d at 289 (citing Kimbell, 440 U.S. at 728-29). For a discussion of the objectives of the FmHA lending program, see supra note 1.
41. Spears, 859 F.2d at 290.
42. Id. This provision seems to indicate that even the FmHA did not contemplate that use of state law would frustrate the efficient administration of the program. For a discussion of relevant provisions of the mortgage contract, see supra notes 33-35 and accompanying text.
43. Spears, 859 F.2d at 290. The court stated that "the contractual arrangements giving the FmHA an option to utilize state procedures conclusively demonstrate that no need for national uniformity is present." Id.
44. Id.
45. Id.
46. Id. In support of this position, the court pointed out that several state statutes allow mortgagees to sell properties in the event of default "without the delay and expense of foreclosure." Id. Presumably, the court was implying that adoption of such statutes would permit the FmHA to more easily collect on loans in default than would the agency's own procedures.
on state law. The Spears court noted that in Kimbell and United States v. Walter Dunlap & Sons, Inc., the parties seeking relief from application of a federal rule were not debtors involved in the federal loan program in question, but were instead third parties with commercial interests in the property which the government was seeking to seize pursuant to foreclosure proceedings. As such, the Spears court noted, the interested third

47. Id. In Spears, the only interested parties were the FmHA, which sought to foreclose and take possession of the property in which it held a security interest, and Rivera, the debtor. Since no third party interests were involved, there were no collateral commercial considerations.

48. 800 F.2d 1232 (3d Cir. 1986). In Walter Dunlap, the Third Circuit held that state law, not a federal agency’s regulations, gave content to federal law in a determination of the status of the agency’s lien on collateral sold by the debtor. Id. at 1239. Walter Dunlap involved an action for conversion brought by the government against a broker who sold a debtor’s livestock which had served as collateral for the debtor’s loan from the FmHA. Id. at 1234. The price realized at auction was insufficient to cover the debtor’s total debts and, following the debtor’s filing a petition in bankruptcy, the FmHA filed suit against the broker seeking to recover the gross proceeds, including the broker’s commission, realized at the sale. Id. at 1234-35.

Most significantly, the Third Circuit held that the FmHA’s regulations regarding proper application of the sale proceeds did not control over established state law, which permitted alternate allocation of the funds. Id. at 1239. Secondly, the court held that even if the regulations did apply, proper classification of the livestock as a “normal,” rather than a “basic” security, rendered the government’s argument ineffectual, because a normal security could be sold and the proceeds applied in the manner exercised by the debtor in Walter Dunlap. Id. Essentially, as the court noted, the importance of the distinction between normal and basic securities “lies in the fact that payment of routine living and farm operating expenses is permissible when normal income security is involved, but not when the collateral is basic security.” Id. The court noted that basic securities included “all equipment (including fixtures in U.C.C. states) and foundation herds . . . securing FmHA loans which serve as a basis for the farming or the operation outlined in . . . the Farm and Home Plan . . . and replacement of such property.” Id. The court found that normal securities included “all security not considered basic security including crops, livestock . . . and other property . . . which are sold in operating the farm.” Id. (quoting 7 C.F.R. § 1962.17 (1986)).

The Third Circuit held that the government’s interest in having its loan repaid was not paramount and that its security interest in the debtor’s property could not be collected in accordance with federal agency regulations to the detriment of the third party broker, whose interest in the property—his commission on the sale—was based on state law. See id. For a discussion of the Spears court’s application of Walter Dunlap, see infra notes 49-52 and accompanying text.

49. Spears, 859 F.2d at 290. In Kimbell, the relative rights of two interested parties other than the debtor were at issue. Kimbell, 440 U.S. at 718. The Small Business Administration, guarantor of the debtor’s loan, sought to collect the escrowed proceeds from the sale of equipment which had secured the loan to the debtor. Id. at 719-20. Kimbell, a grocery wholesaler that had made credit sales to the debtor, also sought to collect the proceeds based on its own security interest in the debtor’s equipment. Id. When Kimbell moved to foreclose on its lien, the present action between the two secured parties ensued. Id. at 720.

Walter Dunlap also involved two parties, neither of which was the debtor. Walter Dunlap, 800 F.2d at 1234-35. The FmHA sought to collect the gross proceeds, including the broker’s commission, from the sale of livestock in which the government held a security interest. Id. at 1234. The proceeds from the sale
parties had relied on the "intricate network of state laws regulating commercial activities" to perfect their security interests.\textsuperscript{50} Further, the court stated that the federal programs were interfering in commercial areas in which the priority of the private liens had already been established in accordance with state laws.\textsuperscript{51} The court implied that this interference would not necessarily further any federal interest, while private interests stood to be harmed to a great extent.\textsuperscript{52} Thus, the court concluded that application of state law was appropriate in both \textit{Kimbell} and \textit{Walter Dunlap}.\textsuperscript{53}

The Third Circuit found that the considerations in \textit{Kimbell} and \textit{Walter Dunlap} did not require application of state law in \textit{Spears} because no third parties were involved in the action.\textsuperscript{54} Contrasting the cases involving third party creditors with those involving only the government and the debtor, the court cited \textit{West Virginia v. United States}.\textsuperscript{55} The Third Cir-

\begin{enumerate}
  \item The statutes upon which the injured parties in \textit{Walter Dunlap} and \textit{Kimbell} had based their security interests were ones "on which private creditors base their daily commercial transactions." \textit{Id.} at 289 (quoting \textit{Kimbell}, 440 U.S. at 729). The court emphasized the drastic effect that giving all federal security interests priority over private security interests would have on the justifiable expectations of private creditors. \textit{Id.} at 289-90. For a discussion of \textit{Kimbell}, see supra note 37 and accompanying text. For a discussion of \textit{Walter Dunlap}, see supra note 48 and accompanying text.

  \item The Spears court further noted that the third party creditors in both \textit{Kimbell} and \textit{Walter Dunlap} "would have been prejudiced by a federal rule preempting the state system of lien priorities of general applicability" because they would have depended on the state system in perfecting their security interests. \textit{Id.} at 289. For a further discussion of the preemption issue, see infra note 72 and accompanying text.

  \item The court actually stated that "[f]ederal interests would not suffer and private businesses would benefit, by accommodating state law." \textit{Id.}

  \item The court also noted that no state interest was involved because the only possible area of interest—clear title to real estate—was not threatened by possible application of federal regulations. \textit{Id.} The FmHA notice regulations, stated the court, did not affect recording of deeds following foreclosure proceedings. \textit{Id.} Further, purchase of property at a federal foreclosure sale did not "create a cloud on the title." \textit{Id.}

  \item 479 U.S. 305 (1987). \textit{West Virginia} involved a suit brought by the government against West Virginia for payment of a past due debt plus prejudgment interest. \textit{Id.} at 307. The district court agreed with West Virginia's assertion that it was not liable for the interest because it had not consented to be, as required
cuit noted that "when the controversy does not affect third parties but embroils only the United States and a debtor, the factors that favor applying state law are considerably weakened if not removed entirely from consideration." 56

Further, the court found that Pennsylvania debtors would derive no particular benefit from application of the state laws instead of the federal regulations. 57 In the instant case in particular, the court found that provisions of the state law would not help Rivera because she was probably ineligible for the refinancing possibility offered by the program under the Pennsylvania statutes. 58 Thus, the court found that "[a]dherence to non-productive procedures that only result in additional expense and delay fails to support grafting state procedures on to a federal program." 59

The Third Circuit concluded that the absence of an outside commercial interest or third party in Spears rendered the Kimbell-Walter Dunlap analysis inapplicable. 60 Rather, the Spears court felt that West Virginia

by state law, but the Fourth Circuit reversed. Id. at 307-08. The Supreme Court affirmed the Fourth Circuit and held that West Virginia, under federal law, was obliged to pay the interest. Id.

Applying the first two prongs of the Kimbell test, the Supreme Court in West Virginia found that "[a] single nationwide rule would be preferable to one turning on state law, and the incorporation of state law would not give due regard to the federal interest in maintaining the apportionment of responsibility Congress devised in the DRA [Diaster Relief Act]." Id. at 509. Thus, the Court found that the federal government's interest in subjecting its contractual relations with states to "a single nationwide rule" was compelling, and that subjecting such relations to a federal rule would not "disrupt commercial relations predicated on state law." Id. (quoting Kimbell, 440 U.S. at 729). The Court thus applied a federal rule, rather than state law, and forced West Virginia to pay prejudgment interest to the United States. Id. at 311. The Court felt that the United States' interest in "complete compensation" for services rendered to states outweighed any interest the state might have had in being relieved of its obligation to the federal government. Id.

56. Spears, 859 F.2d at 290.

57. Id. The Third Circuit noted that the "FmHA regulations prescribe notification substantially equivalent to that mandated by state law. Indeed, in operation, the FmHA administrative regulations and procedures appear to offer mortgagors greater protection than the state statutes." Id. For a discussion of the significance of the pertinent state and federal regulations governing the respective procedures, see supra notes 25, 28, 34 and accompanying text.

58. Spears, 859 F.2d at 291. Rivera had never applied for participation in the program, though her legal counsel, Neighborhood Legal Services, clearly was familiar with the program. Id. The court felt that this supported the assumption that Rivera was probably ineligible for that program. Id. Thus, "notification of that which is already known—and which would be of no utility in any event—is not a circumstance which would justify an exception to general provisions of law." Id. For a discussion of the protections afforded by state law, including the possibility of refinancing, see supra notes 23-25.

59. Spears, 859 F.2d at 291.

60. Id. This statement by the court is inconsistent with the court's clear reliance on the reasoning of both the Kimbell and Walter Dunlap decisions throughout its opinion. For example, the Spears court applied the Kimbell three-
was the controlling decision. Thus, the Third Circuit concluded that adoption of state law as the proper rule of decision was not necessary and that "the FmHA should be permitted to carry out its task of servicing mortgages under the procedures it selects." The Third Circuit

prong test to the facts in Spears to find that uniformity was not required in administration of the FmHA programs, and to find that use of state law would not interfere with the efficient implementation of the agency's programs. Id. at 290. Further, the Spears court's holding, while admittedly different from the Kimbell and Walter Dunlap holdings, was reached by applying the crucial factor of the Kimbell test—whether commercial interests would be harmed by application of a federal regulation, rather than a state law. Id. at 290-91. For a further discussion of the relationships among the holdings in these three cases, see infra notes 87-89 and accompanying text.

61. Spears, 859 F.2d at 291. For a discussion of the similarity between the reasoning that resulted in the Kimbell and Walter Dunlap holdings and the reasoning that produced the West Virginia and Spears decisions, see infra notes 87-89 and accompanying text.

62. Spears, 859 F.2d at 291. The Third Circuit also briefly examined two minor issues—whether the foreclosure proceedings satisfied due process requirements and whether the agency's finding that Rivera had abandoned the property was supported by the facts of the case.

Concerning the due process issue, the Third Circuit found that the FmHA regulations concerning foreclosure satisfied due process requirements on their face. Id. at 290 (citing 42 U.S.C. §§ 1475, 1480(g), (k) (1982 & Supp. IV 1986); 7 C.F.R. § 1955.15 (1986)).

Next, the court found that the facts of Spears indicated that the regulations as applied to Rivera satisfied due process requirements. Id. The court found that the defendant had more than enough notice of the FmHA's impending action and more than enough time to present her case in a hearing. Id. The Third Circuit noted that the first letter from the FmHA to Rivera indicating the FmHA's intention to foreclose was sent on January 18, 1983. Id. Although that letter indicated that foreclosure proceedings would begin within 20 days if no action was taken by the debtor, the FmHA did not begin foreclosure proceedings within the 20-day period. Id. Rivera received further notice of impending foreclosure in the form of another letter dated March 16, 1984. Id. That letter, too, indicated that because of Rivera's default on her loan, the FmHA planned to "accelerate the loan and foreclose on the mortgage" beginning 60 days after the date on the letter. Id. The letter also outlined a procedure that Rivera could follow in order to schedule a hearing on the matter. Id. Again, the FmHA failed to take action within the period set out in the letter. Id. In fact, foreclosure proceedings did not begin until 1985, at which time Rivera requested a hearing. Id. Thus, the Third Circuit found that it was reasonable to conclude that Rivera had adequate notice of the impending foreclosure proceedings and that, consequently, "due process considerations do not dictate the choice of state or federal law." Id. For a further discussion of the significance of the fact that the FmHA regulations substantially fulfilled the Pennsylvania notice requirements, see infra note 91 and accompanying text.

Concerning the agency's finding that Rivera had abandoned her property, thereby triggering the foreclosure proceedings, the Third Circuit first examined the facts supporting that finding. Spears, 859 F.2d at 291-92. The Third Circuit found significant the facts that Rivera had not responded to any of the FmHA's letters regarding the impending foreclosure on the mortgage, that she had not made any payments towards discharging her debt, that she had not in any way maintained the property and that she had lived in another house to which she and her husband had title while in Puerto Rico. Id. The court also noted the fact that Rivera contacted the FmHA once during the period, and at that time
declared that the district court’s order requiring the FmHA to comply with Pennsylvania’s statutes should be vacated and the case remanded to that court for entry of summary judgment in favor of the government.63

IV. Analysis

On its face, the holding in Spears seems to contradict both the controlling Supreme Court and Third Circuit decisions on the issue of whether a federal agency must comply with a state’s laws when it utilizes federal courts to collect its security interests. In the Kimbell and Walter Dunlap cases, the government was forced to comply with state laws which determined the status of its security interests.64 Distinguishing Spears on its facts, the Third Circuit declared that it would not follow the holdings in Kimbell and Walter Dunlap and, consequently, did not use state law to give content to the applicable federal law.65 Instead, it found that the government could proceed to collect its security interest in accordance with the applicable FmHA regulations.66 While this may seem inconsistent with the earlier decisions, it is submitted that the reasoning in Spears is in accord with the rationale of the previous cases.

In Kimbell and Walter Dunlap, suits arose because of competing government and private security interests in the collateral in question.67 It is submitted that the Supreme Court and the Third Circuit concluded that application of state law was appropriate, perhaps even mandated in those cases, primarily to protect the private third parties who had relied on state law to perfect their security interests and assure that their investments were safe.68 In those cases, the courts found that protecting agreed to turn the property over to the government. Id. at 292. Noting that “[o]ur standard of review, as well as that of the district court, is limited,” the Third Circuit found that, taking into consideration the deference it was obliged to afford the agency’s findings, “[i]n light of Ms. Rivera’s expressed willingness on two occasions to convey the property to the government, her failure to arrange for any payments, and her absence for more than a year before making inquiry about returning, we cannot say that the agency’s determination of abandonment lacks substantial evidence.” Id.

63. Spears, 859 F.2d at 292.
64. For a discussion of Walter Dunlap, see supra note 48 and accompanying text. For a discussion of Kimbell, see supra note 37 and accompanying text. For a discussion of Spears, see supra notes 11-63 and accompanying text.
65. Spears, 859 F.2d at 291.
66. Id. The Third Circuit stated, “the FmHA should be permitted to carry out its task of servicing mortgages under the procedures it selects. . . . [T]he FmHA need not comply with [Pennsylvania’s pre-foreclosure statutes] whenever it chooses to utilize the federal court to foreclose on a mortgage in Pennsylvania.” Id. For a discussion of the Third Circuit’s reasoning behind this conclusion, see supra notes 29-63 and accompanying text.
67. Kimbell, 440 U.S. at 718-20, 723-25; Walter Dunlap, 800 F.2d at 1234-35. For a discussion of the factual setting in Kimbell, see supra note 37 and accompanying text. For a discussion of the dispute in Walter Dunlap, see supra note 48 and accompanying text.
68. See Kimbell, 440 U.S. at 739-41; Walter Dunlap, 800 F.2d at 1239. The
the government's security interests was less important than protecting
the stability of the commercial communities of the several states.\(^69\)
Those cases advanced the governmental policy of encouraging com-
merce, a policy which the *Kimbell* court seemed to feel was evidenced by
Congress' failure to statutorily grant priority to all government liens.\(^70\)

In *Spears*, there was no third party competing with the government

*Kimbell* Court, in evaluating the harm that applying a federal rule would have on
the interested commercial parties, noted that those parties had relied "on state
commercial law to provide the stability essential for reliable evaluation of
the risks involved." *Kimbell*, 440 U.S. at 739 (citations omitted). The Court felt
that failing to protect these interests by applying state law would subject interests,
previously regarded as secure, to unforeseeable consequences. *Id.* Taking an
even broader view, the Court implied that promulgation of a rule which would
allow any "federal contractual security interest [to] suddenly appear [] and
[take] precedence" over properly perfected private liens could alter the entire
fabric of commercial relations. *Id.* Because the Court was unwilling to subject
private interests to such uncertain fates, it found that it could not do other than
to adopt the "readymade body of state law." *Id.* at 740.

In *Walter Dunlap*, the Third Circuit, relying on *Kimbell*, found that the federal
regulations in question, which would allow the FmHA to collect the broker's
commission on a sale of property which secured the agency's loan, were not
"explicit 'congressional directive[s]' that [would] displace the application of
state law as the federal rule of decision." *Walter Dunlap*, 800 F.2d at 1239. As a
result, the federal regulations were not sufficiently definite for the court to apply
when, as a result of doing so, "the conduct of third parties having no relation-
ship with the agency is affected." *Id.* at 1238. The *Walter Dunlap* court found
"that giving the effect of law to a variety of regulations by a number of agencies
would be particularly disruptive to the stability of commercial law." *Id.* at 1239.
In order to avoid such a disruptive effect on commercial law in the state, the
court "decline[d] to accept the government's position that the regulations con-
trol." *Id.* (citations omitted).

69. See *Kimbell*, 440 U.S. at 739-40; *Walter Dunlap*, 800 F.2d at 1239. It is
important to note that the *Kimbell* Court recognized that some circumstances
could arise in which the government's interest was so strong that a federal rule
would be applied in spite of its effect on commercial relationships based on state
law. *Kimbell*, 440 U.S. at 740. Specifically, the Court stated that "formulating
special rules to govern the priority of the federal consensual liens in issue here
would be justified if necessary to vindicate important national interests." *Id.*

In this regard, it is important to recall the *Kimbell* Court's earlier assertion
that, according to its own decision in *Clearfield Trust* Co. v. United States, 318
U.S. 363 (1943), federal courts could formulate federal rules to give content to
federal law in areas in which Congress had not spoken "according to their own
standards." *Kimbell*, 440 U.S. at 727 (citing *Clearfield Trust*, 318 U.S. at 367). The
*Kimbell* Court also found that the decision to adopt a judicially fashioned federal
rule or a state law in cases such as *Kimbell* was a matter of "judicial policy." *Id.* at
728. In light of these comments, it is difficult to determine with any degree of
accuracy the future actions of courts which have to determine a choice of law
question based on their own discretionary determination of the relative impor-
tance of federal and private liens.

70. *Kimbell*, 440 U.S. at 735. The Court stated, "[w]e believe that had Con-
gress intended the private commercial sector, rather than taxpayers in general,
to bear the risks of default entailed by these public welfare programs, it would
have established a priority scheme displacing state law." *Id.*

The Third Circuit agreed with this reasoning in *Walter Dunlap*. The court in
that case stated, "there is no indication that Congress intended an agency regu-

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for possession of the property.\textsuperscript{71} In addition, Congress specifically empowered the FmHA to promulgate foreclosure notice procedures.\textsuperscript{72} Had there been third party competing interests involved in \textit{Spears}, the Third Circuit may have applied Pennsylvania state law in the name of protecting the third party’s reliance on that state law in his business transactions; however, in a case involving a notice statute substantially similar in its provisions to the agency regulations at issue, very little would be gained in terms of protecting third parties by requiring compliance with the state, rather than the federal procedure.\textsuperscript{73} The Third Circuit’s opinion does suggest that in a case in which a third party creditor would be \textit{harmed} by application of the appropriate federal regulations, the FmHA would be forced to comply with the Pennsylvania

\textsuperscript{71} \textit{Spears}, 859 F.2d at 291.

\textsuperscript{72} 42 U.S.C. § 1480 (1982). Section 1480(g) provides that the FmHA Secretary is empowered to

\textit{issue rules and regulations which assure that applicants denied assistance under this subchapter or persons or organizations whose assistance under this subchapter is being substantially reduced or terminated are given written notice of the reasons for denial, reduction or termination and are provided at least an opportunity to appeal an adverse decision and to present additional information relevant to that decision to a person, other than the person making the original determination, who has authority to reverse the decision.}

\textit{Id.} § 1480(g).

Under this directive, the FmHA promulgated the notice provisions which were followed in \textit{Spears}. \textit{See Spears}, 859 F.2d at 285-86; Regulations of the Department of Agriculture, 7 C.F.R. § 1955.15 (1988).

Thus, Congress provided express statutory guidance for the FmHA to follow when it promulgated foreclosure notice procedures. Yet, when determining whether to apply a uniform federal rule or state law, the \textit{Spears} court failed to mention this congressional guidance. In addition, the court failed to address the issue of preemption.

\textsuperscript{73} \textit{Spears}, 859 F.2d at 291. As the \textit{Spears} court noted, “[f]rom the standpoint of mortgagors in general, no overriding benefit flows from insistence on state procedures.” \textit{Id.} The Third Circuit noted the fact that the federal provisions governing moratoria on loans in default were as protective of the debtor as the state refinancing provisions. \textit{Id.} For further discussion of the court’s reasoning, see \textit{supra} note 30. The court was correct in this regard, as examination of the provisions in question reveals. Both federal regulations and state laws provide for the cessation of foreclosure procedures upon a showing by the debtor that the circumstances of the case require such action. For the text of the Pennsylvania statutes, see \textit{supra} notes 23-24. For a discussion of the federal provisions, see \textit{supra} note 28.

Regarding the protection offered to third parties, it seems clear that when federal provisions allow the federal government to foreclose on its lien pursuant to a certain set of procedures, and state provisions allow foreclosure by any mortgagee or mortgage lender pursuant to substantially the same procedures, a third party would not benefit by application of one set of procedures over the other. The property would be “available” for seizure by the lienholder(s) at the same time without regard to which procedures were implemented. Consequently, the value of adopting state law in such a case would be limited at best.
statutes upon which the non-governmental lenders had relied in granting the loans in question.\textsuperscript{74} However, the court does not suggest what the result might be in a case in which application of one set of regulations over the other produces no substantial detriment to either party. It is difficult to ascertain what the resolution of this issue might be in the Third Circuit, but an appropriate analysis might include a determination of whether the federal government was aware of the commercial lien when it accepted the property in question as security for its loan, or conversely, whether the commercial lienholder had notice of a previous federal lien.\textsuperscript{75} A party who takes a security interest with knowledge of a previously perfected interest could reasonably expect that his lien is preceeded by another and that, consequently, he might not have priority.

Despite the Third Circuit’s declaration that due to the factual setting in Spears the Kimbell-Walter Dunlap analysis did not apply, close examination of the Third Circuit’s reasoning in Spears reveals that it is in fact consistent with the reasoning in Kimbell and Walter Dunlap.\textsuperscript{76} The Kimbell-Walter Dunlap analysis involves an evaluation of three criteria: (1) the probable effect that preemption of the state lien system would have on third parties with commercial interests in the property; (2) the extent of the federal lending agencies’ need for a uniform federal system; and (3) an evaluation of the possibility that application of state law could frustrate the objectives of the federal lending program.\textsuperscript{77}

Applying this three-part analysis to the facts of Kimbell and Walter Dunlap reveals that in both cases significant harm to third parties with commercial interests would have resulted from the preemption of state law. Additionally, the administration of the federal programs themselves indicated that a uniform standard was not necessary to the smooth functioning of the federal program, and the application of state law would not frustrate the objectives of the programs.\textsuperscript{78} Thus, in those

\textsuperscript{74} Spears, 859 F.2d at 291. The Third Circuit stated, “[b]ecause no commercial interests or third parties are affected by the utilization of federal procedures, the rationale of the Kimbell-Walter Dunlap analysis is not controlling.” Id. (emphasis added). The implication in this statement is that had there been a competing interest, the Kimbell-Walter Dunlap analysis would have controlled and the government would have been forced to comply with the state laws upon which the competing parties had structured their security interests.

\textsuperscript{75} See United States v. Elverud, 640 F. Supp. 692, 696 (D.N.D. 1986) (“Although the redemption period [adopted by the court] affects the rights of junior lienholders, these junior lienholders, for the most part, should be aware of the FmHA’s lien.”). For a discussion of the facts and holding in Elverud, see infra note 85.

\textsuperscript{76} Spears, 859 F.2d at 291. For a discussion of the Spears court’s use of the Kimbell-Walter Dunlap analysis, see supra notes 37-46 & 48-53 and accompanying text.

\textsuperscript{77} See Kimbell, 440 U.S. at 728-29.

\textsuperscript{78} See id. at 729. The Kimbell court stated “[w]e are unpersuaded that, in the circumstances presented here, nationwide standards favoring claims of
cases the courts found that application of state law to the situation would protect commercial interests to a great extent, while at the same time it would not harm the government's interests.\textsuperscript{79}

In Spears, the Third Circuit found that, as in Kimbell and Walter Dunlap, no uniform standard was necessary to the smooth functioning of the FmHA.\textsuperscript{80} This was evidenced by the language in the mortgage contracts which indicated a willingness, if not an obligation, to abide by state law.\textsuperscript{81} Using the same evidence, the court found that application of state law would not frustrate the objectives of the FmHA's program.\textsuperscript{82} However, the Spears court found that no third parties were at risk in that case, distinguishing it from Kimbell and Walter Dunlap, and that in such a situation, delaying the government's satisfaction was unnecessary.\textsuperscript{83} Thus, the Third Circuit found that it was appropriate to allow the FmHA

the United States are necessary to ease program administration or to safeguard the Federal Treasury from defaulting debtors. Because the state commercial codes furnish convenient solutions in no way inconsistent with adequate protection of the federal interest[s], we decline to override intricate state laws of general applicability on which private creditors base their daily commercial transactions." \textit{Id.} (quoting United States v. Standard Oil Co., 332 U.S. 301, 309 (1947)). In Kimbell, if as the district court held, federal rules premised on the tax lien priority system were the proper rules to apply, Kimbell's lien would have fallen because it was not sufficiently "choate" at the time the government's lien was perfected. \textit{Id.} at 720-21. Clearly this would have caused Kimbell significant harm. Balanced against this harm was the questionable harm that the government would suffer if Kimbell was allowed to enforce his lien according to his judgment. The Court found, based on its own precedent, that application of state law would work "no hardship on the agency." \textit{Id.} at 730. Therefore, the court found that state law was the proper rule of decision in Kimbell.

In Walter Dunlap, the government claimed that the debtor had not correctly applied the proceeds from the sale of the property securing the government's loan. Walter Dunlap, 800 F.2d at 1237. Further, the government claimed that, pursuant to federal regulations, the entire proceeds from the sale were subject to the federal lien and all monies were to be paid to the government or to the government and the debtor jointly. \textit{Id.} at 1237-38. Walter Dunlap claimed that under state law the proceeds were not subject to the federal lien because the mortgage instrument contemplated sale of the property and completion of such a contemplated sale acted as a waiver of the lien by the government. \textit{Id.} at 1237. The Walter Dunlap court relied on Kimbell in finding that in such a case, state law was the proper rule of decision. \textit{Id.} at 1239.

79. See Kimbell, 440 U.S. at 739-40; Walter Dunlap, 800 F.2d at 1239.
80. Spears, 859 F.2d at 290. The Spears court stated that "no need for national uniformity is present." \textit{Id.} For a discussion of this portion of the Spears court's decision, see supra note 60 and accompanying text.
81. Spears, 859 F.2d at 290. For a discussion of the portion of the Spears court's decision dealing with interpretation of the mortgage contract, see supra notes 33-35 and accompanying text.
82. Spears, 859 F.2d at 290. The court found that applying state law would not "always frustrate the aims of the federal program." \textit{Id.} If a court finds that, in fact, application of state law would impact negatively on effective advancement of the agency's objectives, it is quite likely that a federal rule will be applied. For a discussion of such cases, see infra note 96 and accompanying text.
83. Spears, 859 F.2d at 291.
to foreclose according to its own rules and not delay any longer.  

84. Id.

85. Cases from other jurisdictions, however, indicate that this may not be the case. See, e.g., United States v. Elverud, 640 F. Supp. 692 (D.N.D. 1986). In Elverud, as in Spears, the debtors were the aggrieved parties seeking relief from foreclosure by the FmHA. Id. at 693. The debtors in Elverud were seeking application of North Dakota's one-year redemption period, rather than application of the 60-day redemption period sought by the government. Id. at 694-95. The Elverud court applied the Kimbell three-part test to determine that a specially formulated federal rule, rather than the state law, would give content to the federal law in that case. Id. at 695.

The Elverud court cited Kimbell and an Eighth Circuit case, United States v. Chappell Livestock Auction, Inc., 523 F.2d 840 (8th Cir. 1975), in support of the proposition that the FmHA did not require uniformity in administration of its programs. Elverud, 640 F. Supp. at 695. In Elverud, however, the court found that application of the state law in these circumstances could interfere with the efficient implementation of the purposes of the agency. Id. at 696. With regard to the third prong of the Kimbell test, the district court in Elverud found that "[t]he loan transaction between Elverud and the FmHA does not interfere with commercial relationships of third parties." Id. Based on these determinations, the court found that application of state law was improper. Id.

Following its specific holding, the Elverud court seemed to suggest that it might reach the same result in a case in which third parties were involved. Id. The court stated, "[a]lthough the redemption period [adopted by the court] affects the rights of junior lien holders, these junior lien holders, for the most part, should be aware of the FmHA's lien." Id.

This statement seems to indicate that the court felt that mere notice of an FmHA lien was enough to justify applying a federal rule that favored the government, even if such an action disadvantaged junior lien holders. But see United States v. Yazell, 382 U.S. 341 (1966) (where notice of state law preventing enforcement of judgments given to federal agency seeking to enforce its judgment led to application of state law in question to disadvantage of government). For further discussion of Yazell, see supra note 5.


87. Spears and West Virginia involved only the United States and the debtor as parties. In contrast, Kimbell and Walter Dunlap involved the United States and private creditors of the debtor as parties. For a discussion of this aspect of these cases, see supra notes 49-51 and accompanying text.
public policy goals—encouraging stability in the business community by protecting transactions based on state law by not giving the government preferential treatment.\textsuperscript{88}

It is submitted that because the result in Spears is so fact sensitive, it will have, in and of itself, little value in cases involving any creditor other than the government. However, it seems likely that the importance of Spears lies in its value as a gap-filler. That is to say, the Spears decision articulates what seems to be only implied in Walter Dunlap—that in a case in which no third party would be adversely affected by the application of federal rules rather than state law, the former course of action could properly be taken by the courts.\textsuperscript{89} The two lines of reasoning articulated by the Supreme Court and the Third Circuit in Kimbell-Walter Dunlap and West Virginia-Spears will provide practitioners in the Third Circuit with a very workable formula. When a third party will be harmed if a government lien is given priority under federal regulations, state law, which presumably will protect the private lien holder, will be applied.\textsuperscript{90} When no third party is in danger of economic harm, federal law may appropriately be applied.\textsuperscript{91}

It is further submitted that the facts in Spears require the result reached by the Third Circuit. In this respect, it seems particularly important to note that the regulations which the court allowed the FmHA to use in Spears substantially fulfilled the purpose of the state statutes

\textsuperscript{88} See West Virginia, 479 U.S. at 309; Kimbell, 440 U.S. at 739-40; Walter Dunlap, 800 F.2d at 1239.

\textsuperscript{89} See Walter Dunlap, 800 F.2d at 1238. The Third Circuit stated, ""[a] regulation which is to be treated as having the force of law, at a minimum, should have the definitiveness associated with statutory language when, as here, the conduct of third parties having no relationship with the agency is affected."" Id. (emphasis added). Though this statement by the court comes at a section of the opinion in which the clarity of the language of the federal regulations is under examination, rather than in an examination of the choice between the federal regulation and the state law, the importance of the presence of a third party is clear. It is likely that, had there been no third party requiring protection in Walter Dunlap, the Third Circuit would have granted the regulation in question ""the force of law"" by allowing it to give content to the applicable federal law, in spite of its lack of ""definitiveness.""

\textsuperscript{90} See Chicago Title Ins. Co. v. Sherred Village Assoc., 708 F.2d 804, 813 (1st Cir. 1989) (court applied Maine law to find that lien held by subcontractor was superior to mortgage assigned to HUD when developer defaulted on loan and held that ""the formulation of rules to ensure predictability and stability in relationships among the parties to construction projects is primarily a matter of local concern. Absent compelling reasons to displace state law, the relationships are best governed by those local rules."").

\textsuperscript{91} See United States v. Landmark Park & Assoc., 795 F.2d 683, 686 (8th Cir. 1986) (in suit between HUD and debtor, ""[p]rotection of the federal treasury and the purposes and integrity of nationwide federal lending programs"" is important federal interest to be protected by application of federal rules). But see In Re Bubert, 61 Bankr. 362, 366 (W.D. Tex. 1986) (in suit between SBA and debtor over applicability of Texas homestead exception to judgment collection procedures, state homestead law applied to provide commercial concerns with ""stability in allocating risk in their commercial transactions").
that Rivera sought to impose on the agency.⁹² It seems clear that in a case involving a government creditor who wishes to foreclose under an agency regulation which subverts the purpose of an existing state law, harming the debtor (the only other party with an interest in the matter) in the process, a court may reach a result quite different from the result in Spears, and would be justified in doing so.

It is clear that the reasoning espoused in Spears, derived from the United States Supreme Court’s reasoning in Kimbell, is applicable in cases involving the Small Business Administration⁹³ and the FmHA.⁹⁴ The Kimbell analysis has also proved useful in cases involving other federal agencies that occasionally find themselves to be holders of security interests with uncertain priority,⁹⁵ such as the Federal Deposit Insurance Company (FDIC)⁹⁶ and the Department of Housing and Urban Development (HUD).⁹⁷ Additionally, in similar actions not involving federal lending programs, cases have tended to favor the application of state law for essentially the same reason articulated in Kimbell—applying state law tends to perpetuate security and predictability in the state courts.⁹⁸

⁹² The Third Circuit stated, “FmHA regulations prescribe notification substantially equivalent to that mandated by state law.” Spears, 859 F.2d at 291. For the text of the relevant Pennsylvania statutes, see supra notes 23-24 and accompanying text.
⁹³ See Kimbell, 440 U.S. at 715. For a discussion of Kimbell, see supra note 37 and accompanying text.
⁹⁴ See Spears, 859 F.2d at 284. For a discussion of Spears, see supra notes 11-63 and accompanying text.
⁹⁶ Case law seems to suggest that in cases involving the FDIC, a uniform federal rule will be applied. See, e.g., D’oench, Duhme & Co. v. FDIC, 315 U.S. 447, 459 (1942) (protection of FDIC programs found to be of paramount interest requiring application of uniform federal rule). Accord Trigo v. FDIC, 847 F.2d 1499, 1502 n.4 (11th Cir. 1988); FDIC v. Bank of San Francisco, 817 F.2d 1395 (9th Cir. 1987). But see FDIC v. Palermo, 815 F.2d 1329, 1334-35 (10th Cir. 1987) (“We are aware of no federal policy or need for uniformity that would be frustrated by incorporating the law of Oklahoma as the federal rule of decision in this case.”). For a discussion of the treatment of liens held by the FDIC, see generally Note, Formulating a Federal Rule of Decision in Commercial Transactions After Kimbell, 66 Iowa L. Rev. 391 (1981).
⁹⁷ See United States v. Landmark Park & Assoc., 795 F.2d 683 (8th Cir. 1986); Chicago Title Ins. Co. v. Sherred Village Assoc., 708 F.2d 804 (1st Cir. 1983). For a discussion of Landmark Park, see supra note 91. For a discussion of Chicago Title, see supra note 90.
⁹⁸ See, e.g., Northern Group Servs. v. Auto Owners Ins. Co., 833 F.2d 85, 94 (6th Cir. 1987) (Michigan law governing coordination of benefits by no-fault auto insurers was not preempted by Employee Retirement Income Security Act provisions covering benefits because application of federal regulations “would undermine the general authority and autonomy the states now enjoy in their
V. Conclusion

In conclusion, it is submitted that Spears was properly decided. In holding for the government, the Third Circuit has established a rule that protects the federal government’s interest in collecting its debts in cases in which the only competing interest—that of the debtor—clearly should not take precedence over the government’s interest. At the same time, the Spears decision protects commercial interests by leaving viable the holding in Walter Dunlap, which courts in the Third Circuit can apply in cases in which commercial interests based on state law would be harmed by application of a federal rule which made federal agency liens superior to pre-existing private liens. In view of the combined effect of the Walter Dunlap and Spears decisions, it seems likely that attorneys representing debtors and their private creditors in the Third Circuit will be able to more accurately assess the possibility that a federal rule will be applied to the detriment of their clients.

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regulation of insurance.”), cert. denied, 108 S. Ct. 1754 (1988); Morgan v. South Bend Community School Corp., 797 F.2d 471, 477 (7th Cir. 1986) (In civil rights action brought by demoted black school principal, Indiana state law governed power of school superintendent and school board attorney to settle claim because “[r]ules should be as simple and predictable as possible; the ‘borrowing’ of state law will achieve this.”).

99. The weight of authority seems clearly to be on the side of the government in cases involving only the government and a debtor. See D’oench, Duhme & Co. v. FDIC, 315 U.S. 447 (1942) (case involving FDIC and debtor); Spears, 859 F.2d 284 (5th Cir. 1988) (case involving FmHA and debtor); United States v. Landmark Park & Assoc., 795 F.2d 683 (8th Cir. 1986) (case involving HUD and debtor); United States v. Elverud, 640 F. Supp. 692 (D.N.D. 1986) (case involving FmHA and debtor).

For a discussion of the holding in Spears, see supra notes 29-62 and accompanying text. For a general discussion of the importance of the contractual nature of FmHA mortgage arrangements, see Centner, supra note 1, at 415.

100. It seems clear that in cases involving interested third parties, the balance tips in favor of the private lien holder. See, e.g., Chicago Title Ins. Co. v. Sherred Village Assoc., 708 F.2d 804 (1st Cir. 1983). For a discussion of Chicago Title, see supra note 90. For a discussion of the Spears court’s use of the Walter Dunlap analysis in its opinion, see supra notes 49-53 and accompanying text.