STATE OF NORTH Dakota

ATTORNEY GENERAL'S OPINION 88-21

Date issued: September 6, 1988

Requested by: Wayne P. Jones, Ransom County State's Attorney

- QUESTION PRESENTED -

Whether a United States Marshal's Deed, which appears to be the final step of a foreclosure action by the Small Business Administration in federal district court, can be recorded by the register of deeds without regard to the payment of past due real estate taxes.

- ATTORNEY GENERAL'S OPINION -

It is my opinion that a United States Marshal's Deed, which appears to be the final step of a foreclosure action by the Small Business Administration in federal district, may not be recorded by the register of deeds without regard to the payment of past due real estate taxes.

- ANALYSIS -

Your question addresses the obligation of the Small Business Administration (SBA) under N.D.C.C. " 11-18-02 and 11-18-03 to pay past due real estate taxes before being allowed to record its marshal's deed issued, apparently, as the final step in a federal foreclosure action.

N.D.C.C. ' 11-18-02 directs the register of deeds to refuse to record any deed "unless there is entered thereon a certificate of the county auditor showing that a transfer of the lands described therein has been entered and that the delinquent taxes and special assessments or installments of special assessments against the land described in such instrument have been paid." Under North Dakota law, "a deed to real estate cannot be recorded until all the taxes on the property have been paid." Collins v. Federal Land Bank of St. Paul, 119 F.2d 228, 229 (8th Cir. 1941). This is consistent with the general rule of law that "a purchaser at judicial sale takes title subject to any liens and encumbrances, including taxes accruing prior to the consummation of the sale." Patron v. American National Bank of Jacksonville, 382 So.2d 156, 158 (Fla. Dist. Ct. App. 1980); see also In re UnitedAmerican Financial Corp., 53 Bankr. 43 (E.D. Tenn. 1985); 55 Am. Jur. 2d Mortgages ' 817 (1971).

However, section 11-18-02 provides an exception to these requirements if the instrument is "entitled to record without regard to taxes" as provided in section 11-18-03. Section 11-18-03 reads, in part, as follows:

11-18-03. Instruments entitled to record without regard to taxes. The following instruments may be recorded by the register of deeds without the auditor's certificate referred to in section 11-18-02:

1. A sheriff's or referee's certificate of sale on execution or on foreclosure of a mortgage.

An illustrative case regarding the recording requirements of sections 11-18-02 and 11-18-03 is found in Century Park Condo. v. Norwest Bank, 420 N.W.2d 349 (N.D. 1988). The foreclosure process in that case is explained by the court as follows:

The Kinnischtzkes defaulted and the Bank brought a foreclosure action. A foreclosure judgment was entered and a sheriff's sale was held. The Bank was the only bidder and a sheriff's certificate of sale was issued and recorded. After the redemption period expired, a sheriff's deed was issued to the Bank on February 8, 1984. The Bank did not record the sheriff's deed because of unpaid real estate taxes. The Bank was unable to find a buyer for the property. The land reverted to the county on October 1, 1985, upon expiration of the redemption period for nonpayment of the 1980 real estate taxes, and was subsequently deeded to the City of Bismarck.

420 N.W.2d at 350.

As the North Dakota Supreme Court explained, a sheriff's certificate of sale evidences an ownership interest which is not as complete as that of a sheriff's deed, which "vest[s] in the grantee all the right, title, and interest of the mortgagor in and to the property sold, at the time the mortgage was executed, or subsequently acquired by him." 420 N.W.2d at 352 (quoting N.D.C.C. ' 32-19-09). As a marshal's certificate of sale and a marshal's deed are essentially equivalent to a sheriff's certificate of sale and a sheriff's deed under state law, the SBA would be allowed to record its marshal's certificate of sale, but it would not be able to record its marshal's deed without having paid the past due real estate taxes. See generally 28 U.S.C.A. ' 570 West. 1968) ("A United States marshal and his deputies, in executing the laws of the United States within a State, may exercise the same powers which a sheriff of the State may exercise in executing the laws thereof."); IV American Law of Property ' 18.65 (A. Castner ed. 1952).

Because the present inquiry involves "rights of the United States arising under nationwide federal programs," we must first determine whether N.D.C.C. " 11-18-02 and 11-18-03 are preempted by any federal law which would negate the recording requirement of these sections. United States v. Kimbell Foods, Inc., 440 U.S. 715 (1979); see also Clearfield Trust Co. v. United States, 318 U.S. 363 (1943).

There does not appear to be a direct or implied conflict between any federal law or regulations and sections 11-18-02 and 11-18-03. If such a conflict were to exist, then under the federal preemption doctrine federal law would govern. See Fidelity Fed. Sav. and Loan Ass'n v. de la Cuesta, 458 U.S. 141 (1982). In de la Cuesta, the Court considered the preemptive effect of a regulation issued by the Federal Home Loan Bank permitting federal savings and loan associations to use "due-on-sale" clauses in their mortgage contracts. The court held that the regulation preempted conflicting limitations imposed by the state. The Court explained that "state law is nullified to the extent where it actually conflicts with federal law" and that "a conflict arises when 'compliance with both federal and state regulations is a physical impossibility,' . . . or when state law 'stands as an obstacle to the accomplishment and execution of the full purposes and objectives of Congress.'" 458 U.S. at 153 (quoting Florida Lime & Avocado Growers, Inc. v. Paul, 373 U.S. 132 (1963) and

Hines v. Davidowitz, 312 U.S. 52, 67 (1941)). See also United States v. Victory Highway Village, Inc., 662 F.2d 488, 498 (8th Cir. 1981) (concluding that "state redemption laws are not applicable to foreclosure of federally held or insured loans under the National Housing Act").

The lack of a conflict between federal and state law in this case is evident in 15 U.S.C.A. ' 646 (West. 1976) which provides that state-imposed property tax liens are given priority over SBA security interests. That section reads as follows:

Any interest held by the [Small Business] Administration in property, as security for a loan, shall be subordinate to any lien on such property for taxes due on the property to a State, or a political subdivision thereof, in any case where such lien would, under applicable State law, be superior to such interest if such interest were held by any party other than the United States.

See United States v. California-Oregon Plywood, Inc., 527 F.2d 687, 689 (9th Cir. 1975) (concluding that Congress expressly made SBA liens subordinate to certain state created property tax liens under section 646); United States v. Clover Spinning Mills Co., 373 F.2d 274, 278 (4th Cir. 1966) ("We think it obvious that it was the purpose of the Congress to place the Small Business Administration's security claim against property in the several states upon the same level as those held by private parties."); United States v. Ravalli County Creamery, Inc., 657 F.Supp. 481 (D. Mont. 1987); United States v. Christensen, 218 F.Supp. 722 (D. Mont. 1963) (holding that section 646 by its own terms, made state law determinative).

The federal statutes and these cases, therefore, demonstrate that there is no federal law which would preempt the application of N.D.C.C. " 11-18-02 and 11-18-03 in this case.

The more difficult question is to determine the appropriate rule of decision; that is, whether federal common law or state law governs the recording requirements in question here. As the Supreme Court explained in Kimbell Foods, 440 U.S. at 729, "[c]ontroversies directly affecting the operation of federal programs, although governed by federal law, do not inevitably require resort to uniform federal rules."

In Kimbell Foods the Court was asked to consider whether a lien held by the SBA or a mechanic's lien acquired after the SBA lien was entitled to priority. 440 U.S. at 723. The Court concluded that "the priority of liens stemming from federal lending programs must be determined with reference to federal law." Id. at 726. However, rather than adopting a general federal rule, the Court held that a lien held by the SBA should be given the same priority that a similar lien held by a private commercial party would have under the law of the state where the competing liens were acquired. Id. at 740.

In reaching this conclusion that state law should be applied, the Court elaborated a three-part test for determining whether state law should be adopted as the federal rule. The court considered: (1) the need for a uniform federal rule; (2) the degree to which "application of state law would frustrate specific objectives of the federal program;" and (3) "the extent to which application of a federal rule would disrupt commercial relationships

predicated on state law." Id. at 728-9.

In Kimbell Foods the Court determined that a nationwide standard favoring claims of the United States was unnecessary to ease SBA program administration or to safeguard the Federal Treasury from defaulting debtors. The Court also found that state commercial codes furnished convenient solutions, which were not inconsistent with adequate protection of the federal interests, and, therefore, "decline[d] to override intricate state laws of general applicability on which private creditors base their daily commercial transactions." Id. at 729. The Court further reasoned that the need for a uniform federal rule was diminished because SBA operations were specifically designed to comport with state law. Id. The Court noted "the SBA's practice of 'individually negotiat[ing] in painfully particularized detail' each loan transaction." Id. at 730 (quoting United States v. Yazell, 382 U.S. 341, 357 (1966)). The Court then distinguished the SBA and FmHA lending programs "from 'other nationwide act[s] of the Federal Government, emanating in a single form from a single source." Id. at 733 (quoting Yazell, 382 U.S. at 348). After noting that these lending agencies entered into commercial dealings voluntarily, the Court found that "[t]he Government therefore is in substantially the same position as private lenders, and the special status it seeks is unnecessary to safeguard the public fisc." Id. at 737. The Court then concluded that state law governed the priority of the SBA's lien.

Accordingly, the three factors to consider in whether the SBA must follow state law and is only entitled to record its marshal's deed if it pays past due real estate taxes include: (1) the SBA's need for a nationally uniform body of law, (2) whether application of N.D.C.C. " 11-18-02 and 11-18-03 to the SBA would frustrate specific objectives of the SBA's federal lending program, and (3) the extent to which application of a federal rule allowing the SBA to record its deed would disrupt commercial relationships predicated on the recording statutes.

The first criterion to consider is the SBA's need for a nationally uniform body of law in administering its federal lending program.

If Congress or the SBA believed in the need for a nationally uniform standard for recording SBA deeds, there is no reason why Congress or the federal agency would not have provided for such a rule. The need for a federal standard, thus, appears insignificant. As Justice O'Connor wrote in her concurring opinion in de la Cuesta:

Nothing in the language of '5(a) of HOLA [Home Owner's Loan Act of 1933], which empowers the Board to "provide for the organization, incorporation, examination, operation, and regulation" of federally chartered savings and loans, remotely suggests that Congress intended to permit the Board to displace local laws, such as tax statutes and zoning ordinances, not directly related to savings and loan practices.

458 U.S. at 172. Similarly, nothing in the federal law empowering the SBA to act suggests that Congress intended to displace local laws not directly related to savings and loan practices.

Additionally, as noted by the Supreme Court in Kimbell Foods, the SBA negotiates in "painfully particularized detail" each loan transaction. 440

U.S. at 729. This localized practice diminishes significantly the need for federal uniformity as to state recording requirements.

The second consideration is whether "application of state law would frustrate the objectives of the federal programs." Kimbell Foods, 440 U.S. at 728. It does not appear that not having its marshal's deed recorded would seriously frustrate the SBA's lending program. First, the federal law recognizes that state law tax priorities apply to the SBA. See 15 U.S.C.A. ' 646 West. 1976). Because a county's tax lien would be superior to the SBA's interest in its mortgage, the recording requirements of sections 11-18-02 and 11-18-03 would not conflict with the SBA mortgage foreclosure process or the SBA's objectives. Furthermore, a distinction is drawn between state recording requirements which are peripheral to the operation of SBA's lending program and enforcement of the agency's interest in protecting itself from defaulting debtors via remedies that are available by federal law and directly related to savings and loan practices. This situation is unlike de la Cuesta where the conflict in the state law and the federal agency's objectives was direct and integral to the federal lending board's ability to collect on its "due-on-sale" clause, an express term of the mortgage contract. Any frustration or impact that sections 11-18-02 and 11-18-03 would have on the SBA is the same as that faced by any other financial institution doing business in North Dakota. The SBA would be, in the words of Kimbell Foods, "in substantially the same position as private lenders," and, as the Court concluded in that case, the federal agency is not in need of a special status to protect itself from defaulting debtors in a manner that is different from other financial institutions. Placing the SBA on an equal footing with other financial institutions is not inconsistent with its stated policy that "the Government should aid, counsel, assist and protect insofar as possible, the interests of small-business concerns in order to preserve free competitive enterprise." 15 U.S.C.A. ' 631(a) West (1976).

The third consideration is the extent to which the application of a federal rule allowing the SBA to record its deed without regard to the payment of taxes would disrupt commercial relationships predicated upon sections 11-18-02 and 11-18-03. Historically, recording acts are of local significance and application. The purpose of recording is to give notice to subsequent parties of interest. Farm Bureau Fin. Co., Inc. v. Carney, 100 Idaho 745, 605 P.2d 509 (1980); see also American Law of Property, supra, at ' 17.31 ("Accordingly it is important in any given state to know what is essential, by the terms of its recording act, to the making of a record; and not merely one good for a single purpose but for the two purposes for which these records serve, as an evidentiary muniment of the interest purposed to be created and as record notice of that interest or claim."). As explained in United State v. Larson, 632 F.Supp. 1565, 1568 (D.N.D. 1986), "the state has a strong interest in its laws affecting real estate liens." It has long been recognized in North Dakota that the enforcement by foreclosure of an assigned mortgage is a matter that is governed by the law of the forum where the land is located. Cosgrave v. McAvay, 139 N.W. 693 (N.D. 1913).

Further, the county's interest in collecting anticipated property tax revenues is seriously impeded when property owners become delinquent. Requiring the payment of past due real estate taxes on property before a financial institution is allowed to record deeds obtained after foreclosure is one mechanism which facilitates more prompt payment of such taxes. Allowing the

SBA to record its deed without regard to the payment of taxes would tend to disrupt state commercial relationships predicated upon the assurance that a deed is recorded after past due real estate taxes are paid.

On balance, applying the Kimbell Foods three-part test leads me to the conclusion that the appropriate rule of decision is state law. A similar conclusion was reached in 1988 N.D. Att'y Gen. 8, where I concluded that the FmHA would be required to follow state procedures in obtaining deficiency judgments.

This result is also consistent with the modern trend to treat federal lending agencies, such as the SBA, on an equal footing with private commercial lenders except in limited circumstances. See United States v. Pastos, 781 F.2d 747 (9th Cir. 1986) (holding that state redemption laws apply to SBA loans even where the loan contains an express waiver of redemption rights); United States v. Dismuke, 616 F.2d 755 (5th Cir. 1980) (concluding that the Georgia deficiency statute was to be adopted as part of federal law); United States v. S.K.A. Associates, Inc., 600 F.2d 513 (5th Cir. 1979) (applying Florida law to allow a landlord's lien to prevail over SBA's article 9 security interest); United States v. Cambria County, 532 F.Supp. 634 (W.D. Pa. 1982) (applying Pennsylvania law which subordinated the SBA security interest to state imposed property tax liens encompassing interest, penalty, fee and cost assessment).

Accordingly, absent a court order, the register of deeds would not be required to record the SBA's marshal's deed without the payment of past due real estate taxes.

- EFFECT -

This opinion is issued pursuant to N.D.C.C. ' 54-12-01. It governs the actions of public officials until such time as the question presented is decided by the courts.

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