ABA SECTION OF REAL PROPERTY, TRUST & ESTATE LAW
ANNUAL SPRING SYMPOSIUM

RECENT REAL PROPERTY DEVELOPMENTS: LAW PROFESSORS' REPORT

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JOHN V. ORTH – CASES

(1) Hofstad v. Christie, 240 P.3d 816 (Wyo. 2010) (tenancy in common of unmarried partners – unequal contributions – "family relationship" raised presumption of gift of excess contribution). JVO

In this partition action brought by one of two tenants in common, a cohabiting unmarried couple, plaintiff sought an unequal distribution of the sale proceeds of the home based on the unequal contribution plaintiff had made to the purchase price. The trial court ordered an equal division, ruling that plaintiff had failed to prove that the couple did not have a "family relationship" or that plaintiff had not intended a gift of the excess contribution. On appeal the Wyoming Supreme Court, finding the question of a family relationship between unmarried tenants in common one of first impression, relied on precedent from other states to affirm the trial court's finding on both grounds.

Where property is titled in tenancy in common, there is a presumption that the shares of each co-tenant are equal. This presumption may be rebutted by evidence of intention to hold the property in unequal shares. The evidence may be express, as in a written agreement, or implied from unequal contributions. However, in case the attempted rebuttal of equal shares is based on unequal contributions, there is a counter-presumption of equal shares if the co-tenants are in a "family relationship."

This case required the court to venture into the troubled area of defining a "family relationship." Because the couple had raised two children of their own during their cohabitation, the court found that they formed a family for purposes of the partition action. It also found that the plaintiff intended to make a gift of the excess contribution. Although treated as a distinct question, whether a gift was intended was also largely resolved by reference to the couple's relationship.

Comment. Although the finding of a family relationship in this case is heavily dependent on the fact that they cohabited and had children together, it seems to indicate that the same result would be reached in a case of extended cohabitation whether children were begotten or not.

(2) Hoit v. Rankin, 320 S.W.3d 761 (Mo. App. W.D. 2010) (joint tenancy among two couples, mother & stepfather and son & daughter-in-law – mother & stepfather contributed entire purchase price – "family relationship" did not raise irrebuttable presumption of gift). JVO

Two couples, a mother and stepfather and a son and daughter-in-law, took title to a house intended for both couples to occupy. The mother and stepfather paid the entire purchase price, while the son and daughter-in-law later paid only a comparatively small amount for taxes and insurance. The joint living arrangement swiftly deteriorated, and the mother and stepfather moved out and brought this action to partition the property. The trial court awarded the house outright to the plaintiffs and entered a small "owelty judgment" in favor of the son and daughter-in-law in the amount of the taxes and insurance.

Where property is titled in joint tenancy, as where it is titled in tenancy in common, there is a presumption that the shares of each co-tenant are equal. As with tenancy in common, this presumption may be rebutted by evidence of express or implied agreement or by a counter-presumption of equal shares if the co-tenants are in a "family relationship." In this case a family relationship obviously did exist, so the question became whether the presumption of equal shares had been rebutted. The resolution of this question was complicated by a prior Missouri case, Montgomery v. Roberts, 714 S.W.2d 234 (Mo. App. E.D. 1986), which had quoted a popular property hornbook that the presumption of unequal shares based on unequal contributions may be rebutted by proof that "there is neither a family relationship among the co-tenants nor any evidence of donative intent on the part of those who contributed more than their pro rata amounts" (Cunningham et al., *The Law of Property* § 5.2 (1984); same in successor edition, Stoebuck & Whitman, *The Law of Property* § 5.2 (2000)). Subsequent Missouri Court of Appeals cases have apparently treated the presumption of equal shares as irrebuttable when there is "any evidence of a family relationship and/or donative intent." The court in the present case rejects that view of the law. It also rejects the position in Corpus Juris Secundum that the rebuttal must be by clear and convincing evidence, 86 C.J.S. Tenancy in Common, § 13, at 257-58 (2006), and applies only a "substantial evidence" standard. The court upbraids the law professor authors of the hornbook for "elevating a common sense principle of evidence into a principle which reads like an irrebuttable presumption." And it takes the federal bankruptcy court for the Western District of Missouri to task for treating the presumption as irrebuttable in a recent case, In re Kilman, 2010 WL 743685 (Bankr. W.D. Mo. 2010) (not reported in B.R.): "Though we are unable to overrule *Kilman*, we can instruct that its analysis is not accurate and should not be followed."

While affirming the trial court, the Court of Appeals points out that for purposes of determining shares on partition the relevant contributions to be considered are to the purchase price not subsequent contributions, as here to taxes and insurance. Also owelty was technically not involved in this case as owelty is a sum of money owed when property is partitioned in-kind but the division does not result in shares of exactly equal value. In this case there was neither a partition in-kind nor a partition by sale and division of the proceeds; the house was awarded outright to the plaintiffs. In addition, the court clarifies that the so-called owelty judgment was not an in personam against the son and daughter-in-law but rather in rem, a lien against the house.

Comment 1. The fact that the title in *Hoit* was joint tenancy with right of survivorship rather than tenancy in common as in *Hofstad* was not significant, although the defendant son and daughter-in-law tried to argue that it implied an intention that they would take all if they survived. The court rejected this, pointing out that a beneficiary deed could have been used, or a will executed. In no case – joint tenancy, beneficiary deed, or will – would the intention have been irrevocable while the mother and stepfather lived.

Comment 2. Although it's not mentioned in this case, at common law a grant to two married couples as joint tenants would have resulted in the couples holding their respective shares as tenancies by the entirety, while the two couples would hold together as joint tenants with the right of survivorship. This remains the rule by statute in a few states. E.g., NCGS § 39-13.6.

(3) Rice v. Coholan, 695 S.E.2d 484 (N.C. App. 2010) (residential restrictive covenants – majority vote to remove restrictions – effective although not at automatic renewal date – "one vote per lot"). JVO

Covenants in deeds granted between 1946 and 1951 established restrictive covenants on eighteen lots in a residential neighborhood, providing among other things that the deeded lots "shall not be subdivided." The covenants were made effective until 1975; thereafter, they automatically renewed for successive periods of ten years unless terminated by a "majority of the owners." In 2006, one year after the covenants had automatically renewed, defendants purchased one of the lots. In the same year owners of ten of the eighteen lots, apparently including some who owned more than one lot, executed a Termination of Restrictions Agreement. Plaintiffs, lot owners who had not signed the agreement, sued to enjoin defendants from subdividing their lot. The trial court granted the injunction, ruling that a "majority of owners" had not voted to terminate the restrictions because owners were entitled to only one vote per person, not one vote per lot: "The Restrictive Covenants do not contemplate a cumulation of votes." The trial court went on to rule that even if a majority had voted to terminate, termination would be effective only on the next anniversary, in this case 2015.

The North Carolina Court of Appeals found that questions of what constituted a majority of owners and when termination is permitted were questions of first impression in North Carolina. Considering precedents in other states, it reversed the trial court and held that (1) a majority of owners would be determined by "one vote per lot" and (2) a majority of owners could terminate the covenants at any time during the renewal periods.

Comment 1. The Michigan Court of Appeals in a similar case also decided this year, Brown v. Martin, __ N.W.2d __, 2010 WL 2390210 (Mich. App. 2010), held to the contrary concerning the date of termination: a majority of owners could terminate the covenants only on the anniversary of the renewal periods.

Comment 2. The North Carolina Marketable Title Act terminates covenants that do not appear of record within the prior 30 years but exempts covenants that create a uniform plan of residential development.

(4) Snyder v. Heidelberger, 933 N.E.2d 1235 (Ill. App. Ct. 2010) (joint tenancy – attorney liability for failure to create joint tenancy – statute of repose). JVO

Prior to his marriage to plaintiff, legal title to husband's residence was held in a land trust with himself as life tenant and his son by a prior marriage as remainderman. In 1997 husband married plaintiff and shortly afterwards instructed defendant attorney to retitle the property in joint tenancy with his new wife. Defendant prepared a quitclaim conveying legal title to the property from husband as sole owner to husband and plaintiff as joint tenants, which was duly signed and recorded. In 2007 husband died and two months later plaintiff's stepson demanded possession of the property. When she refused to vacate, he brought a forcible entry and detainer (FED) action against her. In 2008 Plaintiff, as third party beneficiary of the professional relationship between husband and defendant, sued defendant for malpractice. In a second count she sought to impose a constructive trust on the stepson, contending that he had been unjustly enriched by defendant's negligence. The stepson's action for possession was consolidated with the plaintiff's action.

Defendant attorney pleaded that the Illinois statute of repose for professional malpractice actions barred plaintiff's action against him. The statute in separate sections bars actions without regard to knowledge of an injury brought "more than 6 years after the date on which the act or omission occurred" or "when the injury caused by the act or omission does not occur until the death of the person for whom the professional services were rendered…, within 2 years after the date of the person's death." The trial court awarded the stepson possession based on the terms of the land trust and dismissed plaintiff's malpractice action, holding that the injury had occurred more than 6 years before the action was commenced. Plaintiff appealed, and a bitterly divided Illinois Court of Appeals (2d Dist.) reversed in a decision in which the three judges adopted three different positions about when the injury occurred, although two concurred in the result that the plaintiff's malpractice action was not barred.

Justice # 1 (McLaren, J.), who authored the "opinion of the court," would have held that a recent Illinois Supreme Court precedent, Wackrow v. Niemi, 899 N.E.2d 273 (Ill. 2008), governed the result in this case. In *Wackrow*, another professional malpractice action, an attorney who also failed to notice that legal title to certain realty was held in a land trust, drafted an amendment to a client's revocable inter vivos (or living) trust that would have directed the property at client's death to his brother. The state Supreme Court held that the brother's injury did not occur until the client's death and that the malpractice action in that case was timely: "Because [decedent] could have revoked that amendment or changed the beneficiary prior to his death, the injury did not occur until [decedent's] death." Although Justice # 1 thought *Wackrow* was essentially similar to the present case, he also believed that a second injury occurred at husband's death because defendant "failed to effectuate a transfer of the property to plaintiff upon [her husband's] death."

Justice # 2 (Jorgensen, J.), reasoned that the injury caused by defendant was "the failure of [husband's] undivided one-half interest to pass to plaintiff upon his death," so to that extent found common ground with Justice # 1 that the action was not barred.

Justice # 3 (O'Malley, J.), in dissent, would have ruled that the injury occurred only at the execution of the quitclaim. He described the so-called opinion of the court as "a bewildering incongruity" and expressed the hope that readers of the opinion "will be more careful than my colleagues in ascertaining what holding has garnered two votes from this panel." In his opinion Justice # 2 authored the true opinion of the court, although it reached the same result as the opinion labeled as such.

Comment 1. Using trusts to avoid probate sometimes results in settlors forgetting that they had transferred legal title to the trustee (often themselves) while retaining only a beneficial interest. It is not clear from the opinion in this case whether the defendant lawyer handled the creation of the husband's land trust, in which case it should have been in his client file. If he did not, was it malpractice not to inquire about the state of the title? It does not appear from this opinion what information defendant was given by the husband.

Comment 2. The root of the problem in this case seems to lie in the recent tendency to subject will substitutes to the same rules as wills proper. From this perspective *Wackrow,* the Illinois Supreme Court precedent relied on by Justice # 1, can be understood as based on the principle that a revocable inter vivos trust is a will substitute that gives a beneficiary no greater right than a devisee's expectancy. The two year limitation on actions when the injury does not occur until the death of a person seems designed for actions by disappointed devisees.

Comment 3. Joint tenancy is a will substitute but an "imperfect" one because it creates a present vested interest. Had a valid joint tenancy been created in this case, plaintiff would have received an undivided one-half interest that was alienable and partitionable but not devisable or inheritable, plus the so-called right of survivorship, i.e. sole ownership if she outlived her husband. Her husband could not have undone the transfer during his life; he could only have severed his interest from hers by alienation or partition. Under traditional property law, nothing "passes" to the surviving joint tenant at the time of the death of the other joint tenant. The survivor's title dates back to the creation of the estate; the decedent's interest "vanishes" at death. Obviously, had plaintiff predeceased her husband, her interest would have been the one that vanished.

Comment 4. At common law a grant from a sole owner to himself and another as joint tenants resulted in a tenancy in common because of the absence of the necessary Four Unities of time, title, interest, and possession. Most states have changed this rule by statute, as has Illinois.

Comment 5. At common law the plaintiff would have had to overcome the privity requirement in her action against her husband's lawyer. She was not the lawyer's client. Many states now permit such actions.

Comment 6. It is lucky for plaintiff that she overcame the statute of repose for malpractice actions because her action to impose a constructive trust on her stepson would likely run into the defense that he had not participated in causing her injury.

FAITH RIVERS JAMES – CASES

(1) Withers v. Jepsen, 246 P.3d 1215 (Utah App. 2011) (Partition sale rather than partition in kind was appropriate given minimum lot size zoning restriction; the concept of owelty is inapplicable to division of the proceeds of a partition by sale.). FRJ

Plaintiff filed action for partition of joint tenancy property. Plaintiff and defendant were married in 1994, divorced in 1998, and reconciled in 1999. The couple was still divorced but cohabiting in 2001, when the defendant received a six-acre tract of land as a gift from his parents. Upon receipt, defendant reconveyed the property to himself and the plaintiff as joint tenants in 2001. The property was encumbered by a mortgage, which the defendant indicated was obtained to finance home improvements. The property was subject to zoning density restrictions that require residential lots to be at least five acres in size.

The trial court granted plaintiff's motion for summary judgment and ordered the property to be sold and the net proceeds divided equally after retirement of the mortgage. The court determined that the property could not be equitably divided into parcels. Defendant argued that the trial court abused its discretion when it failed to make equitable adjustments in the nature of owelty, rather than selling the property.

The Utah Court of Appeals affirmed the trial court, noting that equitable issues arising in a partition action rest in the sound discretion of the district court and would be subject to reversal only if the trial court is shown to have abused its discretion.

Guided by the Utah statutory proscription that sale of real property in lieu of partition (in kind) is permissible when physical division of the property cannot be accomplished "without great prejudice to the owners," the Utah Court of Appeals relied upon the zoning restriction to conclude that the property "could not have been physically divided without losing its residential status or leaving one party with a one-acre, nonresidential lot." Accordingly, the net proceeds of the sale, after retirement of the mortgage, were properly divided equally between the co-tenants.

Defendant further argued that the trial court should have made an equitable adjustment in the distribution of the net proceeds because the plaintiff breached an oral contract between the parties to live together on the property and jointly retire the mortgage debt (by allegedly having an affair). The Court of Appeals denied defendant's attempt to apply the concept of owelty to the distribution of sale proceeds, and affirmed that the trial court had the discretionary power to decline to make equitable adjustment of the distribution of the sale proceeds on the basis of defendant's alleged breach of contract.

Comment 1. In circumstances when sale of property is undesirable, but equitable partition is impossible, the Court of Appeals affirmed that courts may proceed with the partition (in kind) and use owelty as a tool to compensate the prejudiced party. While acknowledging Utah precedent permitting the remedy of owelty to be used in conjunction with partition,[1] the Court of

[1] *United Park City Mines Co. v. Stichting Mayflower Mountain Fonds*, 2006 UT 35, ¶140 P.3d 1200.

Appeals in this case limited the application of owelty to partition *in kind*. The Court refused to extend the concept of owelty to division of the proceeds from partition *by sale*, despite defendant's plea for an unequal distribution of the sale proceeds.

Comment 2. The Court of Appeals affirmed the trial court's refusal to partition the six-acre tract into two parcels on the basis of existing land use regulations. The trial court's conclusion that the six-acre tract could not be divided overlooks the possibility that landowners could request a variance from the density restrictions or seek to rezone the property to a non-residential use. Despite the preference for partition in kind, the Court permitted partition by sale because the property divided in a manner that would maintain its current residential use. This limited remedy also ignores the possibility that the property could have maintained conformity with the five-acre lot size, with a compensatory cash owelty award to accompany the non-conforming one-acre lot. Parties seeking partition in kind should consider the implications of land use regulations on the proposed property division.[2]

(2) Dyer v. Cotton, 2010 WL 4676982 (Tex. App.-Hous. (1 Dist.)) (Deed purporting to convey an entire fee simple estate, rather than the grantor's limited interest, does not constitute a repudiation of co-tenancy and claimant must prove ouster to establish adverse possession.). FRJ

Plaintiff filed an action to quiet title to a tract of property that passed from a mother to her seven children via intestate succession. Plaintiff and one heir shared cattle grazing and care responsibilities for more than twenty years. Plaintiff acquired another heir's $1/7^{th}$ interest pursuant to a deed that purported to convey the full interest in the entire tract in 1994. The remaining heirs sold their $6/7^{th}$ interest to defendant, and notified him that plaintiff owned the outstanding $1/7^{th}$ interest. Throughout the period, the heirs occasionally used the property to hunt or fish, and would walk over the property once or twice a year. Plaintiff raised cattle, repaired or built fences, built a road through the property to his house, and paid some proportion of taxes over the years.

Plaintiff claimed that the deed purporting to convey the entire fee simple estate to him, rather than his grantor's limited $1/7^{th}$ interest in the property, constituted a repudiation of the co-tenancy relationship as a matter of law, relieving Plaintiff of the requirement to prove ouster as one element of establishing adverse possession between co-tenants. Whereas co-tenants have an equal right to possession of entire common estate, the long-standing rule provides that in addition to proving the elements of adverse possession, cotenants seeking to establish title must prove ouster of the cotenant not in possession, or prove ouster or repudiation of the co-tenancy relationship.

[2] See also, *Chaney et al. v. Upchurch*, 603 S.E.2d 255 (Georgia 2004) (Expert opinion that property could not be divided in kind in a manner allowing each cotenant to comply with zoning requirements regarding lot size and public road frontage (in part) satisfied test "(1) that partition in kind cannot be conveniently made, and (2) that the interest of the parties owning the land will be promoted by a sale.").

In this case, the Texas Court of Appeals clarified a precedent[3] asserting that an exception to this rule would apply if a claimant entered into possession as a trespasser before obtaining deeds from his co-owners, or procured conveyances purporting to convey the entire title to the land. The Texas Court of Appeals explained that the exception does not provide that a deed purporting to convey an *interest greater* than that held by the co-tenant is sufficient, standing alone, to prove adverse possession.

Mere recording of an after-acquired deed is insufficient to alleviate the requirement to prove ouster as an additional element to adverse possession between cotenants. In order for a deed to provide constructive notice of an adverse claim, the Texas Court of Appeals stated that the adverse instrument must be recorded *prior* to the co-tenant's acquisition of title.

Aside from the presumptive constructive notice via a prior recorded deed, the Court of Appeals cites precedent that a co-tenant may demonstrate notice of the repudiation of co-tenancy by circumstances, which a jury may infer "from long continued possession of the land under claim of ownership" along with either "non-assertion of claim by the owners,"[4] or a "change in use or character of possession."[5]

Comment. The fact-intensive inquiry required to prove the elements of adverse possession between cotenants is fraught with jurisdictional variations. Offering an argument akin to color of title, the plaintiff attempted to acquire title to cotenant property through recordation of an erroneous deed, rather than a deed that bore a simpler defect due to recording or description errors. Here, the court affirmed that co-tenant occupancy is usually occurs with the acquiescence of the other cotenants, maintained the requirement of proof of ouster, and refused to convert recordation of an over-reaching deed into an adverse occupation hostile to the interests of other cotenants.

(3) Bank of America, N.A. v. 414 Midland Avenue Associates, LLC, 78 A.D.3d 746 (2010 N.Y. Slip Op. 08053, 2010) (Mere recording of deed, without any changes in possession or notice to allegedly ousted cotenants does not constitute ouster.). FRJ

Plaintiff Bank administered a trust for the benefit of Ms. Quirk, who enjoyed a 1/3rd interest in the subject property. Defendant's predecessors in title acquired the property by bequest from Mr. Quirk. While serving as executor of Mr. Quirk's estate, Kenneth Kupersmith conveyed "all" of the property to himself and his brother Corey. The brothers conveyed their interests to the defendant LLC in 1996 and 2007, respectively, and encumbered the property.

Plaintiff bank filed action to quiet title to its 1/3rd interest in the property. Defendant asserted several affirmative defenses, including ouster. Defendant counterclaimed that Plaintiff bank trustee was effectively ousted from co-tenancy in the subject property by the deed from Mrs.

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[3] See *Evans v. Covington*, 795 S.W.2d 806 at 808 (Tex.App.-Texarkana 1990) (Court noted that an exception (to proving ouster) would apply if the claimant had entered into possession as a trespasser before obtaining deeds from the co-owners, or had procured conveyances purporting to convey the entire title to the land.) .
[4] *Todd v. Bruner*, 365 S.W.2d 155, 156 (Tex. 1963).
[5] *Glover v. Union Pac. R.R.*, 187 S.W.3d 201, 213 (Tex.App.-Texarkana 2006, pet. denied).

Quirk's estate to Kupersmith, and was on constructive notice of the ouster when the deed was filed in 1996, inquiry notice in 1997 when the property passed to the Trust, and actual notice in 2001 when the bank's counsel became aware of the Kupersmith deed in the chain of title.

The New York Court of Appeals held that ouster of non-possessing cotenants requires possessing cotenants to expressly communicate the intention to exclude or deny the rights of cotenants. The Court affirmed the trial court finding that the executor's Kupersmith deed did not constitute ouster because there was no change in possession after the deed was recorded in 1996. Moreover, the Court did not apply the common law doctrine of "implied ouster" that would enable co-tenants to establish ouster when the acts of the possessing co-tenant are so openly hostile that the non-possessing cotenant can be presumed to know that the other party is adversely possessing against them. The bank trustee properly commenced the action to quiet title with within ten years of receiving actual notice in 2001, and the trial court properly dismissed the affirmative defenses.

Comment. The Court requires a change in possession or other express notice as a prerequisite to proving ouster via deed recordation as an element of adverse possession. New York's statutory presumption that a cotenant holds property for the benefit of the cotenant ceases only after ten years or upon ouster via express communication of an intention to exclude or deny the cotenant's rights. Interim recording of an after-acquired deed was not held to provide constructive or inquiry notice to the other co-tenants. Although this case dealt with corporate entities, the required change in possession or proof of express notice provides an additional layer of protection, above and beyond the statutory presumption, to individual co-tenants facing adverse possession claims from other co-tenants.

(4) Matter of Kaur v. New York State Urban Dev. Corp., 15 N.Y.3d 245933, 907 N.Y.S.2d 122 (N.Y. 2010) (Eminent domain proceeding taking private land to expand private, nonprofit campus was supported by a sufficient public use, benefit or purpose.). FRJ

Petitioners are the owners of various commercial establishments in the West Harlem neighborhood of Manhattan, including the Tuck-It-Away, Inc. storage facilities, and a number of gasoline service stations. In December of 2008, respondent Empire State Development Corporation (ESDC) issued a determination pursuant to New York's Eminent Domain Procedure Law (EDPL) § 204 that the corporation should use its power of condemnation to purchase 17 acres of privately owned property, including petitioners' property, in connection with the Columbia University Educational Mixed Use Development Land Use Improvement Project.

The Project proposed new academic research centers, graduate and faculty housing for Columbia University, a private, not-for-profit educational corporation. In addition to promoting education and academic research through Columbia University, the Project offered other "civic benefits" to the public, including infrastructure upgrades; gateless, publically accessible open space; an open-air market; and a financial commitment to the West Harlem Piers Park. Economic development forecasts projected 14,000 construction jobs, and Columbia University indicated that the new space would accommodate 6,000 of the institution's permanent employees. Columbia declared that the institution would underwrite the cost of the project and not seek financial assistance from the government.

In February 2009, petitioners challenged the ESDC's findings in the Appellate Division. Petitioners contended that the blight findings were made in bad faith, and successfully argued that the condemnation was not for the purpose of putting the acquired properties to "public use" within the meaning of article I, § 7(a) of the New York State Constitution. ESDC countered that the project qualified as a "land use improvement project" within the meaning of the New York State Urban Development Corporation Act (L. 1968, ch. 174, § 1, as amended [UDC Act]), both on the grounds that the Project serves as a mechanism to eliminate blight, as well as on the alternative ground that the project qualified as a "civic project." The Appellate Division of the Supreme Court annulled the EDSC's determination that the project site was blighted. On appeal, respondent ESDC charged that the Appellate Division erred as a matter of law when the court conducted a de novo review of the administrative record and concluded that the Project site was not blighted.

Citing *Matter of Goldstein v. New York State Urban Development Corp.*, 13 N.Y.3d 511 (2009), the New York Court of Appeals reversed. The court held that ESDC's condemnation of petitioners' property qualified as a land use improvement, both on the ground of blight, as well as on the ESDC's alternative ground of "civic purpose." The court concluded that these determinations were rationally based and entitled to legislative deference. The Court of Appeals affirmed that the ESDC is statutorily empowered to exercise eminent domain in furtherance of a "civic project," regardless of a finding of blight. The statute defines a "civic project" as one "designed and intended for the purpose of providing facilities for educational, cultural, recreational, community, municipal, public service or other civic purposes."[6] The Court of Appeals embraced the statute's provision that imbues ESDC with power to undertake acquisition of property if a project consists of suitable buildings or facilities to meet an ESDC-determined "need for the educational, cultural, recreational, community, municipal, public service, or other civic facility"[7] to be included in the project.

In a separate concurrence, Judge Smith objected to the majority's active engagement of the "civic purpose" alternative justification for a land use improvement project. Having accepted that the ESDC's finding of blight justified the taking, Judge Smith considered the majority's discussion of "civic purpose" unnecessary and its definition of the term "civic project" overly broad. Judge Smith opined that constitutional constraints would require a narrower reading of "civic project" because the broad definition could embrace "any public or private activity that can be fairly be called educational or, by implication, cultural or recreational…." The majority denied that Judge Smith's hypothetical private tennis camps, karate schools, private casinos, or recreational adult video stores could qualify as a "civic project' within the meaning of the UDC Act. The U.S. Supreme Court denied certiorari.[8]

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[6] Uncons. Laws § 6253[6][d] [UDC Act § 3(6)(d)].
[7] Uncons Laws § 6260[6] [UDC Act § 10(c)].
[8] Tuck-It-Away, Inc. v. New York State Urban Development Corp., *131* S.Ct. 822, 178 L.Ed.2d 556, 79 USLW 3210, 79 USLW 3356, 79 USLW 3359 (U.S. Dec. 13, 2010).

Comment 1: In this case, the Court of Appeals maintained a deferential posture for eminent domain, allowing legislative bodies to define and support government takings on a minimal, rational basis standard. Takings jurisprudence firmly continues to embrace *Kelo v. New London*'s holding that a public purpose can be served through a private entity. The Court of Appeals affirmed and extended that principle. As noted in the concurrence, New York's "civic purpose" rationale extends beyond public purposes that benefit private entities. Rather, the UDC Act's fairly permissive "civic purpose" ground for eminent domain empowers local legislative and administrative bodies to justify a broad array of non-deleterious uses for condemned property.

FAITH RIVERS JAMES – UPHPA

Uniform Partition of Heirs Property Act (NCCUSL and ABA recommend Uniform Act to institute standard partition sale procedures.) FRJ

The National Conference of Commissioners on Uniform State Laws and the American Bar Association have approved and recommended the Uniform Partition of Heirs Property Act. The act is designed to address the challenge of partitioning land between cotenants that acquire undivided interests in tenancy-in-common property through intestacy or devise. In the absence of a right of survivorship or estate planning strategies to consolidate interests, family ownership becomes further fractionated at each generation, resulting in an ever-increasing pool of owners who lack the corporate capacity to manage land. From ranches in the West, family compounds in the Northeast, to coastal heritage lands in the Southeast, family cotenants encounter emotional and practical conflicts in the quest to manage and maintain family property. The problem is exacerbated in farm dissolutions, and in areas encountering suburban and resort real estate development.

Cotenants have the right to demand separation of their interest through partition. While the stated preference of courts and legislatures is to partition land in kind, courts often resort to partition by sale to divide cotenant interests. These partition sales often dispossess cotenants who object to selling the property, and tend to result in lower prices due to fire-sale conditions. For decades, courts and legislators have grappled to resolve the conflicting interests of cotenants who may have occupied the land or taken on disproportionate responsibilities with respect to the land, and cotenants who may be less involved with the land and prefer that it be sold.

The Uniform Partition of Heirs Property Act is designed to incorporate the basic tenants of real estate transactions into the partition process. The act defines heirs property as tenant in common real property that is acquired from a relative and at least 20 percent of the interests are held by or acquired from related cotenants. The act does not apply to tenancy-in-common property governed by a binding agreement in a record. Thus the act specifically *excludes* Section 1031 like-kind exchange property. The act also excludes joint tenant property where the tenancy has not been severed.

The goal of the statute is to provide guidance for courts considering partition of family tenant in common property, and to establish a commercially-reasonable structure for the conduct of partition sales. It does so by instituting notice, value determination, and sale procedures. Similar to standard TIC agreements, the act incorporates a buyout provision that enables cotenants to purchase the interests of cotenants seeking to sell their interests. Providing substance to the statutory preference for partition in kind, the act provides courts with a comprehensive list of factors to consider, along with additional compensation tools to achieve equitable division of property in kind. The act enhances the ability of judges to balance divergent cotenant interests and improves the cotenant capacity to maintain ownership of family property.

Section-by-Section Analysis of the Uniform Partition of Heirs Property Act

SECTION 1. SHORT TITLE: "Uniform Partition of Heirs Property Act"

SECTION 2: DEFINITIONS

- **Heirs Property** is defined as real property held in tenancy in common that satisfies the following requirements:
  - There is no binding agreement that governs the partition of the property;
  - One or more of the cotenants acquired title from an ascendant, descendant, or a collateral relative; and
  - One or more of the following is true:
    - 20 percent or more of the interests are held by cotenants that are related,
    - 20 percent or more owned by someone who acquired title from ascendant, descendant, collateral; or
    - 20 percent or more of the cotenants are related.

- **Other Key Definitions**
  - **Determination of Value** pertains to a court order determining the fair market value of heirs property (under Section 6 or 10), or adopting the valuation agreed upon by all cotenants.

  - **Partition by Sale** refers to a court-ordered sale of the entire tract of property, whether by the preferred open-market sale, or alternatively, by sealed bids or auction (under Section 10).

  - **Partition in Kind** provides for the division of property into physically distinct and separately titled parcels.

  - **Relative** means an ascendant, descendant, or collateral, or an individual related by blood, marriage, adoption, or law.

SECTION 3: APPLICABILITY – DETERMINATION OF HEIRS PROPERTY STATUS

- In an action to partition real property, the court shall determine if the property constitutes heirs property (as defined in Section 2). If determined to be heirs property, the partition shall proceed under provisions of the Act.

SECTION 4: NOTICE BY POSTING

- **Method of service** of a complaint is not affected or limited by the act.
- **Notice by Publication & Signage:** In an action to partition heirs property, if the plaintiff provides notice of the action by publication, the plaintiff shall also post and maintain a conspicuous sign on the property. The sign shall be posted within 10 days of the court determination of heirs property status. Signage shall provide information on the parties, the court hearing the action, and the common designation by which the property is known.

SECTION 5: COMMISSIONERS

- **Qualifications:** If the court appoints commissioners (referees, or partitioners) pursuant to the partition statute, the commissioners must be:
  - Disinterested,
  - Impartial, and
  - Neither a party to nor a participant in the action.

SECTION 6: DETERMINATION OF VALUE

- **Court Determination:** In an action to partition heirs property, the court shall determine the fair market value of the property by one of the following methods:
  - **Appraisal**
    - **Appraiser:** The appraisal shall be conducted by a licensed, disinterested real estate appraiser. The appraiser will determine the value of the property as a consolidated, fee simple estate.
    - **Notice:** Within 10 days of the appraisal filing, the court shall notify all parties of the appraised value, the availability of the appraisal in the clerk's office, and the opportunity for parties to file an objection (stating grounds) within 30 days.
    - **Hearing:** No sooner than 30 subsequent to the appraisal filing, the court shall conduct a hearing to determine the fair market value of the property, where the court shall consider any appraisals, objections, or other evidence of value offered by a party. After the hearing, but before considering the merits of the partition action, the court shall determine the fair market value and send notice of the value to the parties.

  - **No Appraisal Options:**
    - **Agreement:** The court may adopt the valuation agreed to by all of the cotenants, or
    - **Evidentiary hearing**: If the evidentiary value of the appraisal is outweighed by the cost, the court shall hold an evidentiary hearing to determine the fair market value of the property and send notice to the parties stating the value determined.

SECTION 7: COTENANT BUYOUT

- **Interests Eligible for Buyout:** In an action for partition by sale, after court determination of value, the court will distribute notice advising the parties that non-petitioning cotenants may buyout the interests of any petitioning cotenant(s) seeking partition by sale. Within 45 days of the notice, any non-petitioning cotenants may submit notice electing to buyout the interests of the petitioner or any non-appearing cotenant(s) at the appropriate pro-rata share of the court-determined value of the property. Should multiple cotenants seek to exercise the buyout, the court shall allocate the buyout right in proportion to the cotenant's fractional ownership interest in the property.

- **Buyout Procedures:** Cotenants shall pay the apportioned price into the court within 60 days of the notice. If any cotenant fails to pay the apportioned buyout price to the court, the remaining cotenants will have 20 days to buyout that interest. After this buyout opportunity period has expired, the court shall simultaneously issue an order reallocating all of the cotenants' interests, disburse amounts as entitled, and refund any excess payments. The court will then proceed to resolve the partition action (under Section 8).

SECTION 8: PARTITION ALTERNATIVES

- **Preference for Partition In Kind:** If all petitioning cotenant interests are not purchased, or if a request to partition in kind remains after conclusion of the cotenant buyout, the court shall order partition in kind, unless the court finds that it will result in great or manifest prejudice to the cotenants as a group, pursuant to the factors established in Section 9.

    - **Aggregation:** The court shall approve requests by two or more cotenants to aggregate their fractional interests.

    - **Allotment | Owelty:** When partitioning property in kind, the court may require cotenants to pay amounts to other cotenants in order to make the property division just and proportionate.

    - **Residual Interest Parcel:** When partitioning in kind, the court shall allocate a portion of the property to represent any interests of cotenants determined by the court to be unknown, unlocatable, or subject to a default judgment if the interests remain unpurchased after the cotenant buyout (pursuant to Section 7).

- **Partition Alternatives**

    - **Partition Sale:** If the court does not order partition in kind (pursuant to the standards in Section 8, above, and the factors in Section 9, below), then the court shall order partition by sale under Section 10, or

    - **Dismiss:** If no cotenant requested partition sale, the court shall dismiss the action.

SECTION 9: CONSIDERATIONS FOR PARTITION IN KIND

- **Factors: W**hen determining whether partition in kind would result in great or manifest injustice to the cotenants as a group, the court will consider the totality of the circumstances regarding the following factors:

  - **Practicability:** whether the property can be practically divided,
  - **Aggregate Value:** whether partitioning in kind would apportion the property such that the aggregate fair market value is materially less than if the property were sold as a whole, taking into account the condition under which a court-ordered sale likely would occur,
  - **Duration:** evidence of the collective duration of ownership or possession of the property by related cotenants and their predecessors,
  - **Attachment:** sentimental attachment to the property, including ancestral, unique, or other special value to cotenant(s),
  - **Use:** current, lawful cotenant use and the degree of harm to the possessing cotenant if such use discontinues,
  - **Responsibility:** degree to which cotenants have contributed their pro rata share to expenses, or physical improvements, maintenance, or upkeep of the property, or
  - **Other:** any other relevant factor.

Section 10: Open-Market Sale, Sealed Bid or Auction

- **Open Market Sale Preferred:** The court must select an open-market sale rather than an auction sale, unless the court finds that a closed-bid or auction sale would be more economically advantageous and in the best interests of the cotenants as a group.

- **Real Estate Broker:** Once a sale is ordered, the parties shall select a licensed real estate broker. If the parties cannot agree, the court will appoint a disinterested broker and establish a reasonable commission.

- **Commercially Reasonable Sale Procedures:** The broker selected shall offer the property for sale in a commercially reasonable manner at a price no lower than the court determined value, and on the terms and conditions established by the court.

- **Offers**
  - **Sale at or above Minimum Price:** If the broker obtains an offer at or above the court determined value, the broker will make a report of the open-market sale (*see* Section 11).

  - **No Minimum Offers:** If the broker cannot obtain an offer at the court determined value within a reasonable time, the court may:
    - Approve the highest outstanding offer,
    - Re-determine the value and extend the sale period, or
    - Order the property sold by sealed bids or auction, according to the terms and conditions established by the court. Auctions shall be conducted pursuant to statutory provisions for partition sale or, in the absence there of, foreclosure sale.

- **Cotenant Purchaser Credit:** If a cotenant is entitled to a share of the proceeds of a sale, the cotenant is entitled to a credit against the purchase price commensurate to the purchasing cotenant's share.

SECTION 11: REPORT OF OPEN-MARKET SALE

- **Offer Report:** Within seven days of receipt of an offer, the real estate broker must file a report with the court that details:
  - Property description,
  - Name of each buyer,
  - Proposed purchase price,
  - Terms and conditions of sale, including any owner financing,
  - Amounts to be paid to lienholders,
  - Statement of contractual, other arrangements, or conditions of the broker's commission,
  - Other material facts relevant to the sale.

PROCEDURAL PROVISIONS

- The Act includes standard provisions regarding construction, electronic signatures, transition, and the effective date.
  - Section 12: Uniformity of Application and Construction
  - Section 13: Relation to Electronic Signatures in Global and National Commerce Act
  - Section 14: Transitional Provisions
  - Section 15: Effective Date

EILEEN M. ROBERTS -- CASES

(1) Fifth Third Mortgage Co. v. Chicago Title Insurance Co., __ F.Supp.2d __, 2010 WL 5287532 (S.D. Ohio) (title insurance—insurer's defenses to claim by an insured). EMR

Fifth Third Mortgage Co. (Lender) made a mortgage loan to an individual named Buford. Chicago Title Insurance Company issued a short-form residential loan policy that insured that Lender's mortgage was the first lien against Buford's property. Buford was part of a mortgage-fraud scheme, and Lender's lien was in fact the fourth lien against Buford's property. A principal of Direct Title, the entity that issued the loan policy on behalf of Chicago Title, also was a party to the mortgage-fraud scheme. When the actual first mortgagee foreclosed by action on Buford's property, Lender demanded that Chicago Title defend it in that litigation and indemnify it from any loss that it sustained as a result.

Chicago Title rejected Lender's claim on the ground that Lender failed to follow standard underwriting guidelines in approving Buford's loan. Lender then sued Chicago Title for (1) breach of contract, (2) declaratory relief, and (3) bad faith, and moved for summary judgment. In response, Chicago Title raised a number of defenses that the trial court rejected in granting summary judgment for Lender on all counts.

Among its defenses, Chicago Title contended that it was not liable to Lender because Direct Title exceeded its actual authority, and therefore was not acting as an agent for Chicago Title. The court rejected that defense on the ground that Direct Title had apparent authority to bind Chicago Title and, under Ohio law, the power of an insurance agent to bind the insurer is coextensive with the agent's apparent authority. Chicago Title also argued that it was not liable to Lender because Lender was negligent in making the loan to Buford. The court rejected that defense on the ground that Lender's underwriting guidelines were irrelevant in determining Chicago Title's liability under the loan policy. Under Ohio law, lenders owe no general duty of care, and particularly no duty of care that would create tort liability based on internal lending guidelines. Had Chicago Title performed its duties under the policy, Chicago Title would have discovered the defects in Buford's title and Lender would not have made the loan.

The court also held that as a matter of law, Chicago Title had acted in bad faith in denying Lender's claim because there were no circumstances that furnished reasonable justification for Chicago Title's denial of coverage. In response to Chicago Title's invocation of the rule that every contract contains an implied duty to act in good faith and deal fairly, the court noted that that rule does not supplant express contract terms. In this case, the court would not read that implied duty into the loan policy because Lender and Chicago Title were sophisticated parties who engaged in extensive negotiations with respect to the loan policy and the contested provisions were not central to the existence of the loan policy or to performance of its purposes.

Comment. This decision is interesting because it contains a catalogue of title insurer defenses and responds to them succinctly and appropriately. It is hard to imagine why Chicago Title refused to defend or cover this claim, because its liability under the loan policy was clear. That said, this and similar decisions could encourage lax loan underwriting, which in turn might result in an increase in title insurance claims and an attendant and universal increase in premiums.

(2) First National Bank of Jeanerette v. Lawyers Title Insurance Corp., 2010 WL 3734956 (W.D. La) (title insurance—insurer has no liability on loan policy if insured sustained no actual loss or had actual knowledge of a prior lien). EMR

First National Bank of Jeanerette (Lender) made a $300,000 purchase-money residential mortgage loan to the Burtons in September 2007. Lawyers Title Insurance Corp. issued a short-form residential loan policy that insured that Lender's mortgage was the first lien against the Burton property. The Burtons' July 2007 loan application indicated that there were no liens against them, but in fact the IRS had recorded a $166,000 federal tax lien in the local land records in 2003. Lender received a credit report in July 2007 that revealed the federal tax lien, but Lender did not disclose the lien to Lawyers Title or confirm that the lien had been satisfied before Lender funded the Burton loan. The tax lien did not appear in Lawyers Title's loan-policy commitment or the final policy.

After closing, Lender tried to sell the Burton loan to an investor, but the investor refused to buy it because of the federal tax lien. Lender then sued Lawyers Title for breach of contract and detrimental reliance based on Lender's inability to sell the loan. This court granted Lawyers Title summary judgment on both counts.

The court denied Lender's breach of title claim because a title insurance policy is a policy of indemnity, which means that it insures only against actual monetary loss. Lender argued that it had sustained a loss when it failed to collect a service fee from selling the Burton loan, and that it was suffering an ongoing loss because it had to service the Burton loan itself. The court rejected that argument because neither of those "costs" constituted an actual monetary loss that would trigger Lawyers Title's duty to indemnify. In fact, Lender was profiting from the Burtons' mortgage because the Burtons were current on their monthly payments and had paid an origination fee to Lender when the loan closed. As further evidence that Lender had sustained no actual loss, the court pointed out that Lender's mortgage remained in first-lien position as insured, because a federal tax lien is subordinate to a purchase-money lender's lien even if the purchase-money lien arises after the lender had notice of the tax lien.

The court also denied Lender's detrimental reliance claim. To succeed on such a claim, a party's reliance must be reasonable. In this case, it was unreasonable for Lender to rely on the absence of the tax lien from the title insurance commitment when Lender had actual knowledge that the tax lien had recently existed and had means readily available to check on the status of the lien before funding the Burton loan. Finally, standard language in the title insurance commitment expressly relieved Lawyers Title from liability for Lender's reliance if Lender had actual knowledge of a defect, lien, or encumbrance and failed to disclose that knowledge to Lawyers Title.

Comment. This well-reasoned decision clarifies the meaning of "actual monetary loss" in the title-insurance context and provides an example of the relative priorities between a purchase-money mortgage and a federal tax lien.

(3) Londen Land Co., LLC v. Title Resources Guaranty Co., 2010 WL 3034871 (D. Ariz.) (title insurance—no liability on owner's policy to transferees of the insured owner's interest). EMR

Londen Land Company bought 142 acres of unimproved property (the Property) in 2002. Title Resources Guaranty Company issued an owner's policy of title insurance to Londen at that time. In 2005 Londen conveyed the property by special warranty deed to Florence Ventures, LLC, for nominal consideration. Londen owned, controlled, and was the sole member of Florence Ventures. In 2007 Londen learned that the Property was subject to a utility easement that encumbered 2.64 acres of the Property. The easement restricted building heights within 30 feet of the easement and granted the utility company a right of ingress and egress to maintain its transmission lines.

Londen filed a claim with Title Resources for the diminution in value of the Property attributable to the easement. Title Resources acknowledged that it had missed the easement and failed to except it from Londen's owner's policy, but it denied coverage because Florence Ventures, not Londen, owned the Property. Londen then sued Title Resources for breach of contract. This court granted Title Resources's motion for summary judgment.

The owner's policy provided that coverage would continue in favor of the *insured* so long as the insured retained an estate or interest in the land or was liable on the covenants of title in any conveyance of the Property. The owner's policy defined the insured as the insured named in the policy and anyone who succeeded to the insured's interest in the Property "by operation of law as distinguished from purchase." Londen acknowledged that Florence Ventures had acquired the Property by purchase rather than by operation of law, but contended that Londen retained an insured estate or interest in the Property by virtue of Londen's ownership and control of Florence Ventures. Citing a provision of the Arizona Limited Liability Company Act that characterized an interest in an LLC as personal property, the court held that once Londen delivered the special warranty deed to Florence Ventures, Londen had no further estate or interest in the Property.

Londen also argued that Florence Ventures was a "disregarded entity" because, as a single-member LLC, Florence Ventures had elected that characterization for federal tax purposes. The court held that Florence Ventures's income-tax election was irrelevant because it had nothing to do with the issue before the court, namely, whether Londen had retained an insurable estate or interest in the Property.

Finally, Londen contended that its owner's policy remained in effect because the utility company's easement was a defect in title to the Property for which Londen remained liable on the special warranty deed that it had delivered to Florence Ventures. Because Londen had delivered a special – rather than a general – warranty deed, however, and there was no evidence that the easement arose while Londen was in title to the Property, the court rejected this argument as well.

Comment. This decision is correct. Although a *lender's* policy of title insurance covers assignees of the originating mortgage lender's interest, an *owner's* policy does not extend coverage to the original insured's transferees. Furthermore, Londen's interest in Florence Ventures was a personal – rather than a real – property interest, so it did not fall within the coverage of an owner's policy of title insurance.

(4) Nationwide Life Insurance Co. v. Commonwealth Land Title Insurance Co., 579 F.3d 304 (3d Cir. 2009) (applying Pennsylvania law) (title insurance—insurer's obligation to identify in specific rather than general terms certain rights and interests that affect the insured property). EMR

When Company A sold commercial property (the Property) to Company B in 1988, the companies executed and recorded a declaration of restrictions (the Declaration) that gave Company A the right to refuse approval of future purchasers of the Property (the Rights of Refusal). Company B financed its purchase of the Property with a $3.5 million mortgage loan from Nationwide Life Insurance Company. Commonwealth Land Title Insurance Company issued a lender's policy to Nationwide on the 1992 ALTA Loan Policy form with an ALTA 9 Endorsement. Commonwealth excepted the Declaration from coverage in Schedule B, Part I, of the loan policy but did not call out the Rights of Refusal as a separate exception.

Company B defaulted on the Nationwide mortgage loan in 2003, and conveyed the Property to Nationwide. Nationwide tried to sell the Property but Company A's successor in interest refused to approve the sale. Nationwide submitted a claim to Commonwealth, contending that the loan policy covered Nationwide for loss arising from the Rights of Refusal. Commonwealth denied Nationwide's claim on the ground that the Rights of Refusal was in the Declaration, and the Declaration was expressly excepted from coverage under Nationwide's loan policy.

In its suit against Commonwealth to enforce the policy and recover damages, Nationwide acknowledged that the loan policy itself excepted the Declaration from coverage, but contended that the coverage was reintroduced through the ALTA 9 Endorsement. Paragraph 1(b) of the ALTA 9 stated that "[u]nless expressly excepted in Schedule B," the loan policy insured Nationwide against loss or damage sustained by reason of "[a]ny instrument referred to in Schedule B as containing covenants, conditions or restrictions on the land which… provides for an option to purchase, a right of first refusal or the prior approval of a future purchaser or occupant." Nationwide argued that because Commonwealth did not *expressly* except the Rights of Refusal in Schedule B, the loan policy covered Nationwide's loss stemming from the Rights of Refusal.

The federal district court granted Commonwealth's motion to dismiss. The trial court held that Commonwealth's reference to the Declaration in Schedule B of the loan policy unambiguously eliminated coverage for loss stemming from the Rights of Refusal. The trial court also held that it was up to Nationwide, not Commonwealth, to exercise due diligence to ensure that the

Declaration did not contain restrictions that were adverse to Nationwide's interest in the Property.

On appeal, the Third Circuit reversed. The appellate court held that the ALTA 9 Endorsement covers loss stemming from rights of refusal unless those rights are *explicitly* noted in a schedule of exceptions to the policy. It was Commonwealth's obligation, not Nationwide's, to find any rights of refusal or similar interests that were "embedded" in the Declaration. The appellate court based its decision on the text and purpose of the loan policy as well as custom and practice in the title insurance industry. To hold otherwise, the appellate court wrote, "would make title insurance a Barmecide feast."

Comment. The Third Circuit based its opinion on a detailed interpretation of the text of the loan policy and the ALTA 9 Endorsement, as well as custom and practice in the title insurance industry and the purpose of title insurance generally. As the court observed, it would flout the purpose of title insurance and violate custom and practice in the title insurance industry to allow title insurers to list exceptions only in general terms and thereby shift to their customers the duty to examine thoroughly the underlying documents. The appellate court pointed out that the language of the ALTA 9 Endorsement that was at issue in this case is "essentially identical" to that in the ALTA 9.1 Endorsement, which covers an owner's policy, so this decision should apply to owner's as well as loan policies.

(5) Chicago Title Insurance Company v. Mary B., 190 Md. App. 305, 988 A.2d 1044 (2010) (recording acts—relative priority of judgment lien and deed of trust). EMR

Charles Petr once owned the real property in Baltimore County, Maryland, that was at issue in this suit (the Property). Mary B., Petr's niece, sued Petr for battery and recovered a $2 million civil judgment against him on May 11, 2007. Under Maryland law, a money judgment that is recorded and indexed in a particular county is a lien against any real property of the judgment debtor located in that county. Mary B. obtained a writ of execution on her judgment and the sheriff levied on the Property by posting a notice of sale. The sale was scheduled for October 25, 2007.

On October 18, 2007, Chicago Title Insurance Company, for itself and for Aegis Funding Corporation, Chicago Title's insured, filed suit against Mary B. in Baltimore County seeking an injunction against the execution sale and a declaratory judgment that the lien of Aegis's deed of trust had priority over the lien of Mary B.'s judgment. Aegis's deed of trust secured a $150,000 loan that Aegis made to Petr on July 15, 2005. Through inadvertence, the deed of trust was not recorded until October 9, 2007, after the sheriff's sale to satisfy Mary B.'s judgment had been advertised.

The trial court entered a temporary restraining order halting the sheriff's sale until the priority suit between Aegis and Mary B. was resolved. Chicago Title and Mary B. each moved for summary judgment. Chicago Title claimed that under Maryland law, the deed of trust had priority over the lien of Mary B.'s judgment. Mary B. countered that her judgment lien had statutory priority over the deed of trust. The trial court granted Mary B.'s cross-motion for summary judgment.

On appeal, this court reversed, holding that Aegis's deed of trust had priority over Mary B.'s judgment lien. The court explained that one Maryland statute defined "deed" to include a deed of trust, and another (the Statute) provided as follows:

> The effective date of a deed is the date of delivery, and the date of delivery is presumed to be the date of the last acknowledgment, if any, or the date stated on the deed, whichever is later. Every deed, when recorded, takes effect from its effective date as against the grantor, his personal representatives, every purchaser with notice of the deed, and every creditor of the grantor with or without notice.

Chicago Title argued that the plain language of the Statute meant that the deed of trust, although recorded on October 9, 2007, was effective as to Mary B., Petr's creditor, on July 15, 2005, the date that Petr delivered the deed of trust to Aegis. In response, Mary B. contended that a *judgment* creditor was not a mere "creditor" for purposes of the Statute, but instead should stand on an equal footing with the holder of a deed of trust or any other lien against real estate, whether that lien was obtained voluntarily or involuntarily.

The court found no support for Mary B.'s position under Maryland law. The court cited Maryland common law that held that a judgment creditor was not a bona fide purchaser for value under Maryland law. Because Mary B. was only a "creditor" of Petr, the deed of trust was effective against Mary B. as of July 15, 2005, almost 22 months before her judgment against Petr was entered and her judgment lien arose. If the General Assembly had intended to avoid that result by distinguishing between general creditors and lien creditors in the Statute, the court observed, the General Assembly could have done so.

Comment. Not all jurisdictions would reach this result. This case turns on the particular language of the Statute, which reflects the view that judgment creditors are not bona fide purchasers for value because they do not rely on public real estate records in their decision to extend credit to their customers. The result in this case was harsh as applied to Mary B., a victim of protracted sexual abuse at the hands of Petr, because she was a tort creditor rather than a contract creditor. The Court's decision honored the plain meaning of the Statute, however, by affording recording act protection to Aegis and Chicago Title, both of whom relied on the public land records in deciding to loan money to Petr and to insure Aegis's deed of trust as the first lien against the Property, respectively.

(6) Citizens State Bank v. Raven trading Partners, Inc., 786 N.W.2d 274 (Minn. 2010) (recording acts—availability of doctrine of equitable subrogation to reverse recording-act priorities). EMR

On February 16, 2005, Citizens Bank made a loan to Feyereisen Enterprises, Inc., that was secured by a mortgage on land in Hennepin County (the Feyereisen parcel). Feyereisen used the loan proceeds to pay off two prior mortgages that had encumbered the Feyereisen parcel (the old mortgages). Five days later, the title insurance company submitted the Citizens Bank mortgage to Hennepin County for recording. In March 2005 the county recorder returned the unrecorded Citizens Bank mortgage to the title insurance company because the check for the mortgage registry tax was for an incorrect amount.

On April 7, Feyereisen executed a mortgage on the Feyereisen parcel in favor of Raven Trading Partners. The Raven Trading mortgage referred to the old mortgages but not the Citizens Bank mortgage. On April 20, the Citizens Bank mortgage was resubmitted to Hennepin County for recording. On April 29, the Raven Trading mortgage was recorded. On May 9, the Citizens Bank mortgage was recorded.

In 2007, Citizens Bank sued Raven Trading for a declaratory judgment that because the proceeds of the Citizens Bank loan had been used to pay off the old mortgages, Citizens Bank should be equitably subrogated to the positions of the old mortgagees so that the Citizens Bank mortgage would have priority over the Raven Trading mortgage.

The district court granted Citizens Bank's motion and denied Raven Trading's cross-motion for summary judgment. Although the Raven Trading mortgage would have priority over the Citizens Bank mortgage under Minnesota's race-notice recording act, that result would be inequitable, the district court held, because (i) Raven Trading knew that its mortgage would be subordinate to another mortgage, (ii) Raven Trading had a security interest in another Feyereisen property, (iii) Raven Trading would receive a windfall if the recording act were strictly applied, and (iv) Citizen Bank's delay in recording was excusable. The district court therefore applied equitable subrogation to reverse the recording act result and give the Citizens Bank mortgage priority over the Raven Trading mortgage.

Raven Trading appealed to the court of appeals, which reversed and remanded the district court decision. The court of appeals held that the district court had abused its discretion in granting summary judgment to Citizens Bank. Citizens Bank appealed to the supreme court, which affirmed the decision of the court of appeals and remanded the case to the district court.

According to the supreme court, it was undisputed that Raven Trading was a good-faith purchaser who had priority over Citizens Bank under the recording act, so the only question was whether the court should apply equitable subrogation to reverse that priority.

The supreme court observed that the purpose of the Minnesota recording act, which has existed in some form since Minnesota's territorial days, is to protect recorded titles against the gross negligence of those who fail to record their interests in real property. The doctrine of equitable subrogation also has a long history in Minnesota. Although Minnesota courts have refrained from applying equitable subrogation if it would cause harm to an innocent third party, they have considered applying the doctrine when (i) a party satisfies a lien in order to protect its own interest, (ii) a party has a legal duty to satisfy a lien, or (iii) there is a misrepresentation, a mistake that is justifiable or excusable, duress, undue influence, or deceit.

Citizens State Bank was a case of mistake. The initial mistake was that the title company, acting on behalf of Citizens Bank, did not include the correct amount of mortgage registry tax when it first submitted the Citizens Bank mortgage for recording. The second mistake was the unexplained 38-day delay in resubmitting the Citizens Bank mortgage for recording with the correct amount of mortgage registry tax.

Traditionally, the mistakes that triggered application of the doctrine of equitable subrogation were mistakes of fact that misled a person to perform an action that, but for the error, the person would not have done. In those cases, the supreme court has applied equitable subrogation in the interest of substantial justice if (i) the party seeking subrogation has acted under a justifiable or excusable mistake of fact, and (ii) injury to innocent parties will otherwise result.

Comment. Commercial lenders are well aware that loss of recording-act priority is a predictable consequence of failing to record promptly. Citizens' mistake in failing to act for 38 days was not a justifiable or excusable mistake of fact that supported the application of equitable subrogation. As the supreme court observed, to apply equitable subrogation to protect Citizens Bank in this case would turn the "race" requirement of the Minnesota recording act into a mere suggestion.

(7) Hauck Holdings Columbia SC, LLC v. Target Corporation, No. C-1-08-682, 2010 WL 1258103 (S.D. Ohio March 25, 2010) (title insurance—scope of title insurer's obligation to indemnify and defend). EMR

In April 2006 Hauck Holdings Columbia SC, LLC, bought a shopping mall (the Property) that was part of a larger development known as Northtowne Common Shopping Plaza (Northtowne). Northtowne was subject to a recorded Operation and Easement Agreement (the OEA). The OEA stated that it could be amended only by a writing signed by all parties, and that any amendment was effective only when recorded.

Target Corporation also owned a retail parcel at Northtowne. Hauck claimed that the OEA required Target to pay Hauck a fee for Target's share of Northtowne's common area maintenance expenses (CAM expenses). Target refused to pay, claiming that its obligation to pay CAM expenses was governed by a Supplemental Restriction Agreement (the SRA) that amended Target's obligations under the OEA.

First American Title Insurance Company insured Hauck's purchase of the Property. Hauck's owner's policy excepted the OEA from coverage. The owner's policy made no mention of the SRA, however, because it was unrecorded and Target did not disclose it until June 2007. When Target refused to pay Hauck as required by the OEA, Hauck tendered a claim to First American. First American denied the claim.

Hauck sued Target to recover the CAM expenses that were due under the OEA. Hauck alleged that the OEA, not the SRA, governed Target's obligations because the SRA was unenforceable by its terms for lack of recording. Hauck also sued First American on three counts. First, Hauck sought a declaratory judgment that First American was obligated to reimburse Hauck for any damages, attorney fees, and costs that Hauck incurred in enforcing the SRA. Second, Hauck claimed that its owner's policy covered the SRA, and therefore that First American had breached its obligations under the owner's policy by denying coverage. Third, Hauck claimed that First American had breached its duty of good faith by denying coverage under the owner's policy.

Hauck ultimately settled with Target, but continued to seek attorney fees and damages from First American in connection with that settlement. First American moved for summary judgment, alleging that (i) Hauck's suit against Target was to enforce the OEA, which First American had specifically excepted from coverage in Hauck's policy, and (ii) First American had no obligation to indemnify or defend Hauck in connection with the SRA because Hauck's claims for coverage were "logically precluded." This court agreed with First American and dismissed the case.

In support of its dismissal, the court explained that different events trigger an insurer's duty to defend and its duty to indemnify. While the duty to indemnify arises when there is *actual* liability under the policy terms, the duty to defend arises when there is *alleged* liability under the policy terms. That alleged liability must potentially or *arguably* fall within the liability coverage of the policy. The insurer need not provide a defense to an alleged claim of liability "if there is no set of facts alleged in the complaint which, if proven true, would invoke coverage."

In this case, the OEA stated that it could be amended only by a written instrument signed by the parties and recorded in the county where Northtowne was located. Hauck conceded that the SRA was neither effective nor enforceable because it was not recorded, and therefore that the SRA did not constitute a defect or encumbrance on title to the Property that would make First American liable to Hauck under the owner's policy. Hauck claimed that First American nevertheless had a duty to defend so that a court could make the no-liability determination. The court disagreed, stating that First American had a duty to defend only if there were *some* set of facts alleged by Hauck that, if proven true, would invoke coverage.

There was no such set of facts. If the unrecorded SRA *was* enforceable against Hauck, it could only be because Hauck had actual knowledge of it. If Hauck had actual knowledge of the SRA, then the owner's policy excluded it from coverage. If Hauck did *not* have notice of the SRA, then the SRA was not enforceable against Hauck and Hauck would suffer no loss.

Comment. This decision was correct but the court's supporting analysis did not emphasize an important point. First American had no duty to indemnify or defend Hauck because under Ohio law—which follows the majority rule—the facts could lead to just two results, namely, that (i) the SRA was *not* enforceable against Hauck because it was unrecorded, or (ii) the SRA *was* enforceable because Hauck had actual knowledge of it. If Hauck had actual knowledge of the SRA, then First American had no duty to indemnify Hauck because Paragraph 3(b) of the Exclusions to Coverage in the owner's policy of title insurance specifically excludes matters known to the insured, unknown to the insurer, and not recorded in the public records at date of policy. This exclusion was essential to the outcome of this case. While the court alluded to the exclusion in general terms in its recitation of the facts, the court did not mention it in its analysis and decision.

(8) **MidCountry Bank v. Krueger, 782 N.W.2d 238 (Minn. 2010) (recording acts—when an instrument is "properly recorded" for recording-act purposes). EMR**

The Kruegers owned three parcels that were subject to a single mortgage in favor of MidCountry Bank. When the MidCountry mortgage was presented for recording, the county recorder indexed it correctly in the grantor-grantee index but inadvertently posted it against only two of the three parcels in the tract index.

When the Kruegers agreed to sell the third parcel to Hinshaw, the abstractor examined only the tract index and concluded that the parcel was unencumbered. At closing, the Kruegers delivered a warranty deed to Hinshaw and Hinshaw executed a mortgage in favor of PHH Home Mortgage Loans LLC, and thereafter both instruments were properly recorded. The MidCountry mortgage remained unsatisfied.

When the Kruegers later defaulted on the MidCountry mortgage, MidCountry brought a judicial foreclosure action naming the Kruegers, Hinshaw, and PHH as defendants. MidCountry contended that Hinshaw could not be a good-faith purchaser for recording act purposes because the MidCountry mortgage was recorded prior to the Kruegers' conveyance to Hinshaw.

Rejecting MidCountry's argument, the district court found that the MidCountry mortgage was *not* properly recorded for recording act purposes because it was not entered in the tract index at the time of the Krueger-Hinshaw closing. Hinshaw and PHH therefore could not be charged with actual, implied, or constructive notice of the MidCountry mortgage, so they were entitled to judgment as a matter of law.

The court of appeals reversed the district court's decision, holding that the MidCountry mortgage, though indexed only in the grantor-grantee index, created a recording priority against Hinshaw's deed and PHH's mortgage. The court referred to the grantor-grantee index as the "primary" index and observed that although some Minnesota counties maintained tract indexes prior to 2005, tract indexes were not mandatory until that year. Because the MidCountry mortgage appeared in the grantor-grantee index, Hinshaw was charged with knowledge of the contents of the documents recorded in that index as well as the newer tract index.

After characterizing the issue before it as whether Hinshaw and PHH had constructive notice of the MidCountry mortgage as a matter of law, the supreme court affirmed the court of appeals's decision in favor of MidCountry but on different grounds.

The supreme court observed that an index is intended to be a springboard in helping the record searcher find the word-for-word record of the document that is on file with the county recorder's office. Since the MidCountry mortgage was not listed in the tract index as encumbering the Hinshaw mortgage, the mortgage did not satisfy all of the statutory indexing requirements as to the tract index.

The MidCountry mortgage *was* correctly indexed in the "historically primary" grantor-grantee index, however, and an electronic image of the mortgage, which contained the legal description of the Hinshaw property, was available on the county recorder's website as well as on its official in-house system. Thus, although the MidCountry mortgage was *imperfectly indexed* it nevertheless was *properly recorded*, because under the recording act, parties are charged with notice of the entries in the indexes as well as the contents of the documents themselves. Proper recording does not require perfect indexing, or even perfect recording. Instead, for an instrument to be "properly recorded," there must be (i) a reference in the indexes sufficient to locate the document, (ii) a record of the document itself, and (iii) between the indexes and the record, sufficient evidence that the document pertains to the property. Because the MidCountry mortgage satisfied that test, Hinshaw and PHH had constructive notice of its existence and therefore were not good-faith purchasers under the recording act.

Comment. Hinshaw and PHH argued that if the court were to hold that the MidCountry mortgage was properly recorded, then subsequent purchasers could no longer rely on county recorders' recording and indexing, but instead would have to read the full text of any document referenced in any index. The supreme court correctly characterized that argument as "overstated," because for over 90 years, it has been the rule in Minnesota that purchasers of abstract property are presumed to have read and are charged with constructive notice of the entire record, including information contained in the indexes and the contents of the recorded document itself if it appears in the grantor-grantee index under the correct name.

R. WILSON FREYERMUTH – CASES

(1)
In re Buttermilk Towne Center, LLC
Bankruptcy Court Decision: 428 B.R. 700 (Bankr. E.D. Ky. 2010)
6th Cir. Bankruptcy Appellate Panel Decision: 2010 WL 5185870 (Dec. 23, 2010)

Assignment of Rents: Absolute Assignment or Security Interest?

Facts and Holding. Buttermilk Towne Center (Buttermilk) built a shopping center (the Center) on land ground leased from the City of Crescent Springs, KY, using the proceeds of industrial revenue bonds issued by the City. LaSalle Bank (now BOA and hereafter referred to as BOA) purchased the bonds, repayment of which was secured by a mortgage (dated December 1, 2007 and recorded December 28, 2007) on both the City's fee interest in the Center and Buttermilk's interest as ground lessee. Buttermilk leased space within the Center to numerous retail tenants, and repayment of the bonds was also secured by a recorded assignment of rents, which purported to absolutely assign ownership of the rents from the retail leases to BOA, with Buttermilk holding a license to collect and use rents as long as it was not in default.

After Buttermilk defaulted, BOA gave written notice to Buttermilk and the Center's retail tenants, on April 6, 2010, of Buttermilk's default and the termination of Buttermilk's license to collect rents. The next day, BOA filed an action to foreclose the mortgage and obtain a receiver for the Center. On April 28, 2010, Buttermilk filed a Chapter 11 petition and sought to use the Center's rents during the Chapter 11 case. BOA objected, arguing that the rents were not the property of the bankruptcy estate due to the "absolute" nature of the assignment. Further, BOA argued that even if the rents were property of the estate, Buttermilk could not use them because BOA's lien lacked adequate protected given that Buttermilk had no equity in the Center. The bankruptcy court held that the rents were part of the estate. Further, the bankruptcy court allowed Buttermilk to use the rents to pay operating expenses (and eventually even professional fees), concluding that giving BOA a "replacement lien" on future rents provided BOA with adequate protection for Buttermilk's use of rents during bankruptcy.

The Sixth Circuit Bankruptcy Appellate Panel affirmed in part and reversed in part. The BAP agreed that the rents were property of the estate, notwithstanding the purported "absolute" nature of the assignment, because the context demonstrated that the assignment was intended as security. The BAP noted that: (1) Buttermilk retained the right to collect the rents so long as it was not in default; (2) even after default, rents could only be applied to reduce the debt to BOA, and (3) the assignment of rents terminated upon satisfaction of the mortgage debt. The BAP further held that even if BOA had properly sent notice to tenants to pay rent to BOA, this did not give BOA absolute ownership of post-petition rents.

The BAP reversed the bankruptcy court's holding that a "replacement lien" on future rents would adequately protect BOA's lien. The BAP relied upon an unpublished prior Sixth Circuit opinion, *Stearns Bldg. v. WHBCF Real Estate*, 165 F.3d 28 (1998), in which the court held that a mortgage lender with an assignment of rents has two distinct security interests — a lien on the land and a lien on rents — and that each must be adequately protected. In *Stearns*, the debtor argued that as long as the debtor maintained the mortgaged premises and the lender retained its lien on future rents, this provided adequate protection of the lender's lien. The court in *Stearns* rejected this argument, noting that the assignee of rents has a lien on the full amount of future rents and the "diversion of the net rents … would diminish the [lender's] interest in the assignment of rents portion of its perfected security interest."

Comment. The BAP went 3 for 4 with three home runs and a swinging strikeout. First, the BAP was correct in its "substance over form" analysis that the purportedly "absolute" assignment of rents merely creates a lien on the rents, does not pass "title" to future rents, and thus does not remove post-petition rents from the bankruptcy estate. Second, the BAP was correct to hold that BOA's prepetition notification to tenants did not extinguish Buttermilk's interest in post-petition rents. While this notification would have entitled BOA to take any rents remitted by Center tenants and apply them in reduction of Buttermilk's indebtedness — which would have thus extinguished Buttermilk's interest in those particular rent payments collected and applied to the debt — this did not extinguish the debtor's residual ownership interest in as-yet unaccrued rents (including rents that accrued post-petition). Third, setting aside whether the BAP should have relied upon a prior unpublished opinion, its analysis on the adequate protection point is also correct. A lender holding a mortgage and an assignment of rents has a lien on the land, on the rents that accrue during the pendency of a Chapter 11 case, and the rents that accrue post-confirmation. If the debtor has equity in the land, the lender's equity cushion can provide adequate protection for the debtor's use of rents during the bankruptcy. But where the lender is undersecured and faces a potential deficiency — and where rents accrued during the pendency of the case could reduce that loss — the debtor must provide adequate protection for the use of those rents. This means giving the undersecured lender something it doesn't already have. Because the lender already has a lien on future rents, the future rents can't be a "replacement" of the already-accrued rents for adequate protection purposes.

In the end, however, the BAP's analysis is incomplete. Undersecured lenders are likely to cite the opinion for the position that unless the debtor can provide the lender with a replacement lien on unencumbered assets, it cannot use post-petition rents. However, Bankruptcy Code § 552(b) provides that while a lender's pre-petition assignment of rents interest generally extends to post-petition rents, this is not true "to [the] extent that the court, after notice and a hearing and based on the equities of the case, orders otherwise." In other words, if the court concludes after notice and a hearing that the equities of the case so permit, the court may order that the lender's lien does not extend to some or all of the rents accruing during the bankruptcy. If the court so concluded, those rents should not be "cash collateral" and thus could be used by the debtor in its bankruptcy within any constraints the court deems appropriate based on the "equities of the case." In this regard, it would be appropriate for a bankruptcy court to permit the debtor to apply gross rents toward the reasonable expenses of operating the mortgaged premises; if the debtor simply turned over the keys, the lender would have bear these expenses to maintain the property as a going concern pending a foreclosure sale. However, while a court should allow the debtor to apply gross rents to reasonable operating expenses under the "equities of the case" exception, this should not extend to allowing the debtor to use post-petition rents to pay attorney fees, as Buttermilk was trying to do in this case.

(2)

In re Lingham Rawlings, LLC

2010 WL 3490204 (Bankr. E.D. Tenn. 2010)

Assignment of Rents: Absolute Assignment or Security Interest?

Facts and Holding. The debtor, Lingham Rawlings, LLC (Debtor) borrowed $2MM secured by a mortgage and assignment of rents on a shopping center in Knoxville, TN. The note, mortgage and assignment of rents were later assigned to Square Mile Capital Management, LLC (Square Mile). In September 2009, Square Mile notified Debtor of Debtor's default under the note, the acceleration of the remaining balance (approximately $1.9MM), and the termination of Debtor's "license" to collect rents pursuant to the terms of the assignment of rents. Debtor subsequently filed a Chapter 11 petition and filed a motion seeking court approval to use post-petition rents.

Square Mile argued that the assignment of rents, by its terms, constituted an "absolute assignment" of the rents from the property, noting that the assignment stated "This is a present and absolute assignment, not an assignment for security purposes only …." As a result, Square Mile argued, Debtor's interest in the rents was limited to a revocable license, which was terminated prior to bankruptcy. Therefore, according to Square Mile, the rents did not constitute property of the bankruptcy estate and thus could not be used by Debtor in its reorganization effort. The bankruptcy court agreed with Square Mile.

Comment. The court's opinion lacks any actual reasoning. It merely quotes the language of the assignment of rents (at unnecessary length) and then states that the assignment does not create a security interest because its language states that it is absolute and not for security purposes. The closest the opinion comes to reasoning is the following:

> [The assignment of rents] divests the Debtor of any legal right in the rents to be paid to [Square Mile] and any equitable rights the Debtor may have in the rents is subordinate to the rights of [Square Mile]. Accordingly, the [Debtor] cannot assert those rights against [Square Mile] and cannot reclaim the subject property based on any such equitable right as long as the related debt is outstanding.

This entirely misses the point. If a debtor has any equitable interest in property at the time of the bankruptcy petition, that property is property of the estate. Whether the debtor is entitled to "reclaim" that property despite a creditor's pre-bankruptcy repossession and/or enforcement actions is irrelevant. Nothing in the assignment of rents absolutely assigned legal and equitable ownership of the rents to Square Mile; any rents it collected had to be applied to reduce the debt, and after satisfaction of the debt, subsequent rents belonged to the Debtor. In context, there is no question that the rents were serving as security for the loan.

After *In re Senior Housing Alternatives* (page F4) and *Buttermilk Towne Center* (page F1), each of which interpreted an essentially identical assignment and held that the assignment created only a lien on the rents, it is doubtful that this decision retains continuing validity.

(3)
In re Senior Housing Alternatives, Inc.
2011 WL 165991 (Bankr. E.D. Tenn.)

Assignment of Rents: Absolute Assignment or Security Interest?

Facts and Holding. Debtor borrowed funds from the predecessor-in-interest of Bernard Global Investors, Inc., which held a deed of trust and an assignment of rents. The assignment of rents contained language to the effect that it was an "absolute" assignment of the rents "for partial payment of any of the debtor's outstanding obligations." The assignment gave the debtor a revocable license to collect and use rents in payment of its obligations, and further stated that Debtor could reacquire the property assigned to the lender if Debtor repaid the full amount of the debt.

Following Debtor's default, the lender notified Debtor that its license to collect rents had been revoked, and instituted foreclosure proceedings. Debtor obtained a temporary injunction, but in August 2010, the court dissolved the injunction. Debtor filed a motion for a stay pending appeal, which was granted on the condition that Debtor post a $1.27MM bond. This prompted Debtor to file a Chapter 11 petition and seek an order authorizing its use of post-petition rents. The lender moved to prohibit Debtor from using the rents, arguing that the rents had been absolutely assigned to lender and thus did not constitute property of the bankruptcy estate.

The court held that whether the rents constituted property of the estate depended upon whether the parties had intended the pre-bankruptcy assignment to be an absolute transfer or a transfer only for security purposes. Looking at the assignment of rents, the court looked past the "absolute" label and concluded that the assignment was merely for security purposes. The court held that Tennessee mortgage law has clearly established the principle that a deed of conveyance that is absolute on its face and is given in connection with a loan to the grantor will nevertheless be treated as a mortgage if the property is to be reconveyed upon satisfaction of the debt. Extending this principle to the context of rent assignments, the court held that the assignment of rents was intended for security because it was given in connection with a mortgage loan, collected rents were to be applied against the debt, and Debtor would reacquire ownership of the rents upon satisfaction of the debt. As a result, Debtor retained an equitable interest in future rents and thus post-petition rents did constitute property of the bankruptcy estate.

Comment. As discussed in conjunction with the discussion of *Buttermilk Towne Center*, the court here was plainly correct to reject the argument that the assignment of rents had "absolutely" transferred ownership of the rents to the lender. Because the decision focused solely upon whether the rents were property of the estate, the court did not address whether Debtor could provide adequate protection for the lender's lien on post-petition rents.

(4)
In re Village Green I, GP
435 B.R. 525 (Bankr. W.D. Tenn. 2010)

Assignment of Rents: Absolute Assignment or Security Interest?

Facts and Holding. Debtor owned the Village Green Apartments in Memphis, TN, subject to a deed of trust in the original principal amount of $9.2MM, currently held by Fannie Mae. The deed of trust was executed on the Fannie/Freddie multifamily form, which contains an assignment of rents and leases. In April 2010, Debtor filed a Chapter 11 petition and sought approval to use post-petition rents in its reorganization efforts. Fannie Mae objected, arguing that the assignment of rents was an absolute assignment such that the post-petition rents did not constitute property of the Debtor's bankruptcy estate.

The Fannie/Freddie multifamily deed of trust contains the following provision:

> Borrower and Lender intend this assignment of Rents to be immediately effective and to constitute an absolute present assignment and not an assignment for additional security only. For purposes of giving effect to this absolute assignment of Rents, and for no other purpose, Rents shall not be deemed to be a part of the Mortgaged Property ….

The court held that this language, and the context of the transaction, demonstrated that the assignment is "in reality a pledge of security, not an absolute assignment." The court noted that under the deed of trust, the Debtor retained an interest in the surplus rents generated after the payment of the monthly installment due, as well as the rents generated after the indebtedness was satisfied. Comparing the situation to prevailing law under the UCC, the court noted that it is the practical effect of the agreement that determines whether it creates a security interest, not merely the formal language of the loan documents.

Comment. As discussed in conjunction with the discussion of *Buttermilk Towne Center*, the court here was plainly correct to reject the argument that the assignment of rents had "absolutely" transferred ownership of the rents to the lender.

However, the court here went somewhat further and held concluded that the Debtor had also established a prima facie case that Fannie Mae was adequately protected against Debtor's use of the rents. The court noted that the Debtor now had a positive cash flow, the property was maintained and insured, and Debtor could now make the ongoing note payments (and that Fannie Mae had presented no evidence to the contrary). The court's conclusion that Fannie Mae would be adequately protected is not self-evident, however, given that the parties stipulated that Fannie Mae was undersecured by approximately $2MM and it was not clear whether surplus rents (over and above reasonable maintenance expenses) were being sequestered for Fannie Mae's benefit. Nevertheless, taking the court's recitation of the facts as correct, it would appear that the Debtor would have had a compelling argument for being able to use post-petition rents under the "equities of the case" exception in Bankruptcy Code § 552(b).

(5)

Albice v. Premier Mortgage Services of Washington, Inc.

239 P.3d 1148 (Wash. Ct. App. 2010)

Power of Sale Foreclosure: Presumption of Finality in Favor of Foreclosure Purchaser

Facts and Holding. Christa Albice and Karen and Bart Tecca owned a 10-acre parcel (worth > $750,000) subject to a deed of trust in favor of Option One Mortgage Corp. (Option One) securing a $115,500 loan to the Teccas. In April 2006, the Teccas defaulted and Premier Mortgage Services (Premier), the trustee under the deed of trust, scheduled a foreclosure sale for September 8, 2006. The Teccas and Option One later entered a forbearance agreement under which the Teccas would pay off the delinquency in installments, and the sale was postponed. The Teccas made the payments specified in the forbearance agreement (although late). Option One refused to accept the Teccas final payment under the forbearance agreement, which was due January 16, 2007 (the payment was made on February 2, 2007 and rejected by notice on February 10, 2007). On February 16, 2007, Premier proceeded with the foreclosure sale (which had been postponed 6 times), and the property was sold to Ron Dickinson for $130,000.

Albice and the Teccas then sued Premier, Option One, and Dickinson to set aside the foreclosure sale and quiet title, arguing that Option One breached the forbearance agreement and Premier breached its duty as trustee by continuing the sale for > 120 days in violation of Washington's power of sale foreclosure statute. Dickinson moved for summary judgment arguing that he was a BFP entitled to the benefit of the recitals in Premier's trustee's deed that it had complied with the statute. The trial court quieted title in Dickinson. In a striking opinion, the Washington Court of Appeals reversed and remanded to the trial court for entry of an order declaring the sale void.

Washington's power of sale foreclosure statute provides, in pertinent part:

> [The trustee's] deed shall recite the facts showing that the sale was conducted in compliance with all of the requirements of this chapter and of the deed of trust, which recital shall be prima facie evidence of such compliance and conclusive evidence thereof in favor of bona fide purchasers and encumbrancers for value …. [Rev. Code Wash. Ann. § 61.24.040(7)]

Premier's deed to Dickinson recited that "[a]ll legal requirements and all provisions of [the] Deed of Trust have been complied with, as to acts to be performed and notices to be given, as provided in Chapter 61.24 RCW." However, the deed did not mention the forbearance agreement, any of the six continuances, or the fact that tender of the final installment (although late) would have cured the original default if accepted. The court held that the "conclusional" recitals in the deed "make it impossible to determine, as a matter of fact, whether the sale took place within the statutorily required time or whether the borrowers were actually in default at the time of the sale." 239 P.3d at 1154. As a result, the court held that Dickinson was not entitled to rely upon trustee's recitals as conclusive evidence of the sale's compliance with the statutory requirements. The court's reasoning bears an extended quotation:

> We are unwilling to accept a trustee's legal conclusions contrary to the actual facts of the foreclosure process as conclusive evidence where an accurate reporting of the facts would have shown the legal conclusions to be incorrect.

> Moreover, a trustee's bald statements that he or she has complied with the law, as distinguished from recitals of fact demonstrating such compliance, tend to dilute the statutory protections afforded borrowers by the Act. While the purpose of RCW 61.24.040(7) is to enhance the reliability of land titles, conclusional recitals do so at the borrower's expense. A conclusional recital in a trustee's deed requires little effort or oversight by the trustee yet it severely limits a borrower's ability to obtain post-sale relief. In contrast, requiring the trustee to recite the statutorily mandated facts of the loan-default procedure strikes the appropriate balance between the competing interests of all the parties. Where, as here, the deed contains legal conclusions but not factual recitals that establish compliance with RCW 61.24.040(7), we decline to extend protection to a purchaser beyond what the legislature clearly intended. We emphasize that the problem here is not that the recitals are wrong or misleading; rather, it is the trustee's failure to recite any facts triggering the protections afforded by chapter 61.24 RCW. [*Id.* at 1154-55.]

After concluding that Dickinson could not claim the protection of the statute, the court then proceeded to evaluate the validity of the sale. The court held that while the statute gives the trustee broad discretion to continue a sale one or more times "for any cause the trustee deems advantageous," the statute explicitly limits such continuances to "a period or periods not exceeding a total of one hundred twenty days." The court concluded (consistent with prior Washington authority) that the statute "divests a trustee of authority to conduct a sale more than 120 days from the date in the Notice of Sale," and that the sale was thus void. The court further held that Dickinson was not a bona fide purchaser based upon (a) evidence of his familiarity with Washington's foreclosure process (including having purchased numerous properties in foreclosure sales) and (b) the low sale price relative to the property's fair market value. As a result, the court concluded, Dickinson should have investigated the sale further, which investigation would have revealed the excessive delays, the forbearance agreement, and the attempted cures by the Teccas. Finally, the court held that the substantial inadequate sale price, in conjunction with "the circumstances surrounding the default and the Teccas' attempts to save their substantial equity in the property," warranted setting aside the sale on equitable grounds.

Comment. The decision is a blow to the ability of the statute to provide an assurance of finality to foreclosure sale buyers. However, the court's interpretation of the statute is plausible, as the statute requires recital of "facts showing that the sale was conducted in compliance" with the requirements of the statute and the deed of trust. Further, one might argue that this is a good result as a policy matter; if power of sale foreclosure provides lenders with an expedient means of foreclosure without pre-sale judicial process, it is appropriate to require the trustee to provide evidence demonstrating the trustee's compliance with the statute and the loan documents.

One point of note about the decision is its divergence from customary practices. According to Dickinson, the recitals in the trustee's deed were essentially identical to the form ***recommended by the Washington State Bar Association in its practice deskbook***. Nevertheless, the court held that the deskbook "is not authority we are bound to follow" and that the statute clearly requires the recital of facts demonstrating compliance, not a conclusory recital of compliance.

(6)

American Home Mortgage Servicing v. Panko, 2010 WL 785951 (Mich.App.)

Foreclosure Sale: Statutory Redemption and Bid Mistake

Facts and Holding. The Holleys owned a home subject to a mortgage held by Bank of America (BOA) securing repayment of nearly $500,000. When the Holleys defaulted, they entered into an agreement with Panko under which Panko would redeem the home from the mortgage and enter into an installment land contract with the Holleys while they attempted to secure new financing. Panko redeemed the land from the BOA mortgage using the proceeds of a $650,000 mortgage loan from American Home Mortgage Servicing (AHMS).

When the Holleys failed to make payments on the land contract, Panko could no longer make payments on the mortgage, resulting in foreclosure by AHMS. Although the property was worth at least $550,000 and potentially as much as $700,000, AHMS was the high bidder at the sale for a bid of $69,113.13 for the home at the foreclosure sale. AHMS recorded the deed along with an affidavit specifying the post-sale redemption price (approximately $70,000). The Holleys obtained a quitclaim deed from Panko and, having obtained a $100,000 mortgage from another bank, tendered the redemption amount to AHMS. At this point, AHMS realized it had made a mistake in the amount of its bid at the foreclosure sale. When the Holleys refused to agree to set aside the sale and allow AHMS to conduct a new sale, AHMS filed suit seeking to set aside the sale. The trial court held that the Holleys acted in bad faith because they knew the value of the land was much lower than AHMS had bid and thus the Holleys had taken advantage of AHMS's mistake by redeeming the property. The Holleys appealed.

The Michigan Court of Appeals reversed, concluding that because the Holleys acted in strict compliance with the redemption statute, the low sale price did not justify setting aside the sale. The court held that the trial court had overstepped its bounds by invoking equitable principles to save AHMS from its own mistake, concluding that there was no authority for the proposition that "equity may disturb an otherwise valid sheriff's sale based solely on the lender's unilateral mistake" or for the proposition that the Holleys had any duty to inform AHMS of its mistake.

Comment. The court noted that AHMS offered "no authority suggesting that equity may disturb an otherwise valid sheriff's sale based solely on the lender's unilateral mistake." It is worth noting, however, that courts in other states have allowed a foreclosing lender to set aside a sale based upon the lender's unilateral mistake, particularly where the allowing the sale to stand would have created an unjustified windfall (either for a third party or a redeeming borrower). *See, e.g.,* Long Beach Mtge. Corp. v. Bebble, 985 So.2d 611 (Fla. Dist. Ct. App. 2008) (setting aside foreclosure sale of property worth $500,000 for third party bid of $1,000 where bid was a product of mistake by lender's agents); Peterson v. First Nat'l Bank, 203 N.W. 53 (Minn. 1925) (setting aside sale of property worth $21,000 where lender mistakenly bid $835 rather than making $15,000 full credit bid and refusing to allow borrower to redeem for $835 bid price).

(7)
Bastache v. Hansen
246 P.3d 10 (Ore. Ct. App. 2010)

Equitable Mortgage; Foreclosure Rescue; Usury.

Facts and Holding. The Hansens inherited land from their father. In 2005, the county foreclosed a tax lien on the land. The day before the redemption period was to expire, the Hansens executed a "Loan Agreement and Option to Purchase Real Property" with Bastasch, under which Bastasch loaned the Hansens $9,251.73 (the amount needed to pay the back taxes), with the Hansens to repay the loan 8 months later with 12% interest "plus 5 points." The agreement further provided that if the Hansens "fail to repay the loan (including interest and points) within 8 months," Bastasch would have the option to purchase the property for the sum of $60,000 less the loan amount and any costs of collection (including attorney fees).

After the Hansens failed to repay the loan within 8 months as agreed, Bastasch notified the Hansens of his intention to exercise the purchase option. The Hansens refused to vacate possession, so Bastasch filed an action for specific performance, to which the Hansens asserted defenses of usury and unconscionability. The Hansens argued that the loan was usurious in violation of Or. Rev. Stat. § 82.010, which establishes a 12% interest rate limit on loans of $50,000 or less. Bastasch sought summary judgment, arguing that the usury statute did not apply because Or. Rev. Stat. § 82.025 excludes from the usury law "[a]ny loan secured by a first lien on real property or made to finance the acquisition of real property and secured by a lien on that property." The trial court granted summary judgment for Bastasch, ruling that the usury law did not apply because the loan was given to enable the Hansens to finance the acquisition of land (to redeem the land from the tax sale) and it was secured by an equitable lien on the land (as the parties were using title to the land to secure repayment of the Hansen's obligation). The Hansens appealed, arguing that because they remained the owners of the land until the end of the redemption period, the loan did not finance acquisition of the land and therefore the usury exclusion did not apply.

The Oregon Court of Appeals held that the loan was usurious and that the exclusion did not apply because nothing in the agreement created a lien on the land: "[T]he text of the agreement does not in any way pledge a conveyance of an interest in the land as security for the debt." The court rejected the argument that the agreement gave rise to an equitable lien, stating that "nothing about the option agreement indicates an intention to convey to plaintiff a present interest in the property as security for a debt."

Bastasch also argued that he was still entitled to specific performance of the option to purchase the land, despite the usury violation, because the statutory sanction for usury in Oregon is only forfeiture of the right to collect interest, and the Hansens had still failed to repay the principal amount. The court agreed that the Hansens remained liable for the principal amount of the loan. The court concluded, however, that because "the option becomes operational only upon defendants' default in repaying the loan (including interest and points)," and because the obligation to pay interest and points could not be enforced, the condition necessary to trigger the option could not be satisfied and thus the option had not been triggered. The court thus reversed the grant of summary judgment, presumably leaving Bastasch with the ability to obtain a judgment for the unpaid principal and to enforce that against the land in an execution sale.

Comment. The court's reasoning worked in favor of the Hansens (the borrowers) in this case, on facts upon which one might conclude that the Hansens entered a potentially exploitative lending arrangement in an effort to avoid losing their land by tax foreclosure. Still, the court's reasoning that the option agreement did not create an equitable mortgage lacks depth and is potentially quite unfortunate.

There is little doubt that Bastasch was using title to the land (the rights granted by the option) to secure the obligation of the Hansens to repay the loan. Where it is proven that parties are using title to land to secure payment of an obligation, courts have traditionally treated such devices (whether absolute deeds or sale-repurchase agreements) as equitable mortgages. Certainly, several of the factors typically relied upon by courts and/or identified in the *Restatement of Mortgages* are present here: (1) the Hansens were in financial distress at the time of the agreement and in imminent risk of losing their land; (2) the Hansens remained in possession of the land during the loan term (presumably retaining the obligation to pay taxes and other carrying costs of ownership during that time); and (3) it does not appear that the Hansens were counseled in the context of entering this agreement.

Further, there was no evidence cited by the court regarding the value of the land in question. If the value of the land in question was $100,000, for example, then the failure to repay the loan meant that Bastasch would have been able to acquire the land at a bargain price ($60,000), thus depriving the Hansens of their equity in the property (by contrast to the foreclosure process, under which such equity would inure to the benefit of the Hansens if the land sold for $100,000 in foreclosure). If the value of the land was really only $60,000, of course, then characterizing the agreement as a bona fide option would not result in serious practical harm to the Hansens. But by not focusing on the value of the underlying land, the court appears to invite a "lender of last resort" like Bastasch to use an option device to potentially strip away the borrower's equity, when that would not be permissible under mortgage law.

(8)
Capital Assets Financial Services v. Jordanelle Development, LLC, 2010 WL 5186634 (Utah App.)

Foreclosure; Deficiency Judgments

Facts and Holding. Jordanelle Development, LLC (Jordanelle) and Bruce Riches (Riches) owned property on which Capital Assets Financial Services (Capital) held a third-priority deed of trust. After Jordanelle's default, Capital conducted an apparently proper foreclosure sale at which Capital bought the property for a $1MM credit bid against the outstanding debt of $1.5MM. Capital then sought a $500K deficiency judgment from Jordanelle and Riches, who moved to dismiss arguing that they owed no deficiency under Utah's "fair value" statute because the unencumbered FMV of the property was $2MM, which exceeded the amount owed to Capital. The trial court agreed and granted the motion. The Utah Court of Appeals reversed, holding that the trial court erred by not including the amount of the senior encumbrances when determining the property's FMV for purposes of Capital's deficiency judgment. The court held that the term "fair market value" in Utah's deficiency statute refers to the value of the property subject to all encumbrances.

The Utah statute provides that a "court may not render judgment for more than an amount by which the amount of indebtedness … exceeds the fair market value of the property as of the date of the sale." Utah Code Ann. § 57-1-32. In interpreting this statute, the court noted that the purpose of the statute is to protect the debtor from the creditor who may "be tempted to inflate their deficiency judgment by bidding less at the trustee's sale" than the amount a willing buyer might pay if she had knowledge of relevant facts. As the court noted, this type of buyer would be aware of all encumbrances that would accompany the property and would "calculate his bid based on the value of the property as encumbered." Thus, the court concluded, because a willing and knowledgeable buyer would factor in the balance due on the senior encumbrances in establishing her bid, the "fair market value" in the deficiency statute could only realistically mean the value as subject to any senior liens that would not be extinguished by the foreclosure.

Comment. Although Utah's anti-deficiency statute is ambiguous, the court's interpretation is certainly correct. Because the buyer at a subordinate mortgage foreclosure sale will take title subject to the lien of any senior mortgage(s), the balance due on any senior mortgage(s) is properly considered in calculating the "fair market value" of property being sold subject to senior liens. The opinion may thus prove useful in other states having a "fair value" anti-deficiency statute that is similarly drafted. *See, e.g.,* Idaho Code § 6-108.

A better-drafted "fair value" statute might avoid this problem. Nevada's statute provides a useful example; under that statute, a deficiency may not exceed the lesser of: "(1) the amount by which the amount of the indebtedness which was secured exceeds the fair market value of the property sold at the time of the sale … or (2) the amount which is the difference between the amount for which the property was actually sold and the amount of the indebtedness which was secured …." Nev. Rev. Stat. § 40.459. *See also* S. Dak. Codif. Laws § 21-47-16 ("fair and reasonable value, less the sum of the balances due as of the date of judgment on any prior liens or encumbrances ….").

(9)
Federal National Mortgage Association v. Mapletree Investors Limited Partnership
2010 WL 1753112 (E.D. Michigan)

Mortgages; Receivership and Mortgages Held by GSEs

Facts and Holding. In July 1999, Mapletree Investors Limited Partnership (Mapletree) borrowed approximately $7.7MM, secured by a mortgage on the Mapletree Apartments in Southfield, MI. The mortgage was executed on the Michigan Fannie/Freddie multifamily mortgage form, which includes an assignment of leases and rents, and later assigned to Fannie. Mapletree defaulted in August 2009, at which point Fannie gave notice of the default and terminated Mapletree's "license" to collect rents. Fannie began a power of sale foreclosure and filed suit in federal court seeking the appointment of a receiver during the foreclosure proceeding and the six-month redemption period thereafter, relying upon the mortgage under which Mapletree consented to the appointment of a receiver after an uncured default.

The court first held that appointment of a receiver in a diversity case is controlled by federal law, not state law. The court then addressed Fannie's argument that the receivership clause was dispositive of its right to the appointment of a receiver. Noting a split of authority, the court decided to "err on the side of caution and consider the parties' consent as a strong factor weighing in [Fannie's] favor, but not dispositive." The court noted that other decisions specified the following factors as relevant: (1) the adequacy of the lender's security; (2) the financial position of the borrower; (3) any fraudulent conduct by the borrower; (4) imminent danger of the property being lost, concealed, injured, diminished in value, or squandered; (5) inadequacy of legal remedies; (6) probability that harm to lender by denial of a receiver would outweigh harm to the borrower from appointment of a receiver; and (7) whether lender's interests will in fact be well-served by a receivership. The court appointed a receiver based upon the evidence, including (1) waste due to the malfeasance and mismanagement of the existing property managers, (2) the fact that the apartments were 41% occupied as compared to occupancy rates of 90-98% in the surrounding area, (3) the fact that the property managers were referring prospective tenants to other properties owned by Mapletree, and (4) Mapletree's failure to pay monthly installments on the mortgage as well as utility payments.

Comment. The court's ruling is certainly correct on the merits, based upon Fannie's factual showings. It would nevertheless be useful to have a definitive determination whether Fannie and Freddie are entitled to appointment of a receiver based purely upon the consent provision. An interesting side note regarding this case is that Fannie sought a receiver not only pending the foreclosure sale, but also pending the six-month statutory redemption period in Michigan. There is existing authority for the proposition that HUD and FHA are not subject to state statutory redemption laws as a matter of federal law. *See, e.g.*, United States v. Stadium Apartments, Inc., 425 F.2d 358 (9th Cir. 1970); United States v. Highway Victory Village, 662 F.2d 488 (8th Cir. 1981); United States v. Scholnick, 606 F.2d 160 (6th Cir. 1979). With Fannie and Freddie now in the conservatorship of FHFA, one might rightly wonder whether pre-emption of state statutory redemption laws might also be applicable to mortgages foreclosed by Fannie and Freddie.

(10)

Collector of Revenue v. Bhatti (In re Foreclosures of Liens for Delinquent Land Taxes by Action in Rem)

Supreme Court of Missouri, En Banc (March 1, 2011)

Tax Foreclosure Sales; Notice/Due Process.

Facts and Holding. Bhatti failed to pay real estate taxes for 2005-2007 on a home in St. Louis. According to Bhatti, during this period he invested substantial monetary resources in renovating the home, which was unoccupied (but which Bhatti alleged had a value of approximately $170,000). The Collector of Revenue for the City of St. Louis filed a tax lien foreclosure action. Bhatti did not respond and the circuit court entered a default judgment and order the parcel to be sold. In accordance with the Missouri statute, the Sheriff sent Bhatti notice of the tax sale via first class mail to the address of the parcel being foreclosed (the address provided by Bhatti when he acquired title to the home). At the sale, the home was sold to Lewis Mitchell Company for $7,600, who then filed a motion with the circuit court to confirm the sale. Again, this motion was sent to Bhatti using the address of the property. The circuit court confirmed the sale.

Five months later, Bhatti filed a motion to set aside the tax sale and the confirmatory judgment. Bhatti claimed that he did not receive notice of the tax sale and the confirmation hearing, such that the sale deprived him of due process and was thus invalid. Bhatti's argument focused upon the appropriate understanding of the U.S. Supreme Court's holding in *Jones v. Flowers*, which requires that a government entity must take reasonable additional steps to notify a property owner if it knows or has reason to know that the notice was ineffective. 547 U.S. 220, 234 (2006). Bhatti presented evidence that the house was listed for a sale with a broker (with a "for sale" sign in the front yard) and testified that he never received a tax bill for the home or notice of the tax sale. He also testified that he never notified the assessor of any change of address and stated that because he was renovating the house, "he was there frequently." The circuit court overruled the motion, holding that Bhatti had not presented evidence to indicate that the Sheriff knew or had reason to know that the notice of the tax sale was ineffective. Bhatti then moved for a new trial, citing as new evidence an affidavit from a mail carrier for the Postal Service that no mail was delivered to the home because the home was vacant. The circuit court overruled this motion, stating that Bhatti failed to demonstrate that this evidence was not available previously.

Bhatti appealed to the Missouri Supreme Court, arguing that there were reasonable additional methods that the Sheriff could have used to notify him of the tax sale, including (1) using the address provided in his City-granted building permits, (2) through the real estate agent, whose name and contact information was visible on a for-sale sign in the front yard of the home, and (3) by posting the notice of sale on the property itself. In a 4-3 decision, the Court affirmed the judgment of the Circuit Court. The majority held that under Jones v. Flowers, the Sheriff did not have to take these steps because there was no reason to know that the original notice was ineffective. The Court noted that the deed to Bhatti had listed the property address as the address for tax notices, and Bhatti had never changed the address with the tax officials. While Bhatti argued in his brief that the case file contained a document reflecting that the Sheriff's notice was "returned to sender," the majority noted that this was never offered into evidence before the circuit court. The majority noted that it "regrets the result in this case," but concluded that it was the result of multiple acts of negligence by Bhatti.

The dissent argued that under *Mullane*, the Sheriff was required to use the "best practicable" method of notice and that the Sheriff's use of regular mail to the vacant property did not meet this requirement. The dissent noted that "[a]fter title passed to Lewis Mitchell Company following the foreclosure sale, Lewis Mitchell provided notice to Bhatti at his residence — which obviously was not difficult to find because his address is in various city records — that he had lost title to his property." The dissent argued that "merely sending notice to the [vacant] residence, without attempting to determine whether — as was the case here — the city's own records provided an alternative address" was not reasonably calculated to provide notice and thus did not satisfy due process. The dissent argued that the presumption that mail sent is mail received should not apply to properties in foreclosure, because the high vacancy rate for properties in foreclosure undermines the presumption in that context. The dissent also argued that the city had notice that the property was vacant because Bhatti had applied for a building permit (although this assertion seems dubious — building permits are issued for renovations of occupied properties). The dissent also argued that because the Postal Service does not deliver mail to vacant homes, it was unreasonable for the city to assume that mail sent to a vacant home would be received by the intended recipient.

The dissent also argued that as an institutional matter, if the city was going to rely upon regular first-class mail and not maintain any record of whether notices were delivered or returned (as would be the case with certified mail), then the city should not be able to claim a presumption of delivery. In the dissent's view, "[i]t is only by documenting what notices are returned that the city can have the benefit of cases that approve first-class mail as an adequate means of notice."

Comment. In the midst of the current real estate market, perhaps it is not surprising that this scenario produced a 4-3 decision. On the one hand, Bhatti's negligence (not paying taxes for three years and having his tax bills sent to a house he was not going to occupy) is pretty staggering. On the other hand, many foreclosure properties are vacant, it is well-known that the Postal Service doesn't deliver mail to vacant addresses, and the Postal Service does provide a service that allows mailers to identify vacant properties.

Furthermore, if the city had used certified mail, it would have learned that the notice was not delivered and therefore would have had to have provided traditional service of process (or found another address at which notice sent by first-class mail would have been delivered). The majority argued that the city did not have any obligation to go to this additional burden/expense, but as the dissent correctly notes, the city should be indifferent, because the costs of sale are paid by the buyer and the city is thus reimbursed for the additional cost.

Even if one does not accept that the Constitution obligates the city to thus send notices in a fashion that creates a record of their receipt/return, there is substantial reason for states and municipalities to do so anyway. First, more taxpayers should receive notice (and potentially pay off their taxes). Second, purchasers at tax foreclosure sales should have greater comfort that they have received good title by the sale, which finality theoretically should produce higher prices at tax sales.

(11)

Bank of America, NA v. Alvarado

Superior Court of New Jersey, Chancery Division (Jan. 7, 2011)

Foreclosure; Reliance Upon Lost Note Affidavit

Facts and Holding. Alvarado executed a note to Washington Mutual Bank (WaMu), secured by a mortgage on her home. In 2006, the note was sold (along with a pool of other mortgage loans) by WaMu to WaMu Asset Acceptance Corp., which in turn transferred ownership of the note to LaSalle Bank, NA, as Trustee for the securitized trust holding the mortgage pool.

Alvarado defaulted on the note in 2008. Bank of America (BOA), as successor to LaSalle Bank, subsequently brought an action to enforce the note and foreclose the mortgage on Alvarado's home. BOA was unable to produce the promissory note, but provided an Affidavit of Lost Note, dated July 14, 2006, in which WaMu certified that the Alvarado note had been lost. Alvarado did not dispute her default, but argued that (1) BOA could not enforce the note because it never possessed the note and (2) BOA could not rely upon the lost note affidavit because it was not "in possession of the note and entitled to enforce it when the loss of possession occurred" within the meaning of UCC § 3-309 as adopted in New Jersey. BOA sought summary judgment, arguing that there was no issue of material fact regarding Alvarado's default or its right to foreclose.

Alvarado argued that a number of courts interpreting UCC § 3-309 held that it precluded enforcement of a lost note by a successor or assignee of the person who had lost the note. *See, e.g., Dennis Joslin Co., LLC v. Robinson Broadcasting Corp*., 977 F. Supp. 491 (D.D.C. 1997). Revised Article 3 (2002) rejected the holding in *Dennis Joslin* and amended § 3-309 to provide that a person may enforce a lost instrument if that person "has directly or indirectly acquired ownership of the instrument from a person who was entitled to enforce the instrument when the loss of possession occurred." Because New Jersey has not adopted Revised Article 3, however, Alvarado argued that the court should hold under *Dennis Joslin* that BOA could not rely upon the lost note affidavit to enforce the note.

The court rejected Alvarado's argument and granted summary judgment to BOA, holding that under Alvarado's argument, no entity would now exist that could enforce Alvarado's defaulted obligation. The court held that such a ruling would unjustly enrich Alvarado, and thus allowed BOA to enforce the note based upon the lost note affidavit.

The court noted that § 3-309(b) required a finding that Alvarado was adequately protected against the risk that another person might seek to enforce the note in the future. The court held that the passage of four years since the lost note affidavit and the absence of a competing demand within that time made it unlikely that Alvarado would face a conflicting demand for payment. Nevertheless, the court did hold that BOA would be obligated to intervene and participate in Alvarado's defense if a subsequent action to enforce the note was filed.

Comment. The *Alvarado* result is plainly the correct result, and (as to negotiable mortgage notes) ought to be applied by courts facing similar disputes in other states that have not enacted Revised Article 3.

(12)
Wells Fargo Bank, N.A. v. Ford
Superior Court of New Jersey, Appellate Division (Jan. 28, 2011)

Foreclosure; Standing to Foreclose

Facts and Holding. In March 2005, Ford borrowed $403,750 from Argent Mortgage Co. (Argent), executing a negotiable note to Argent secured by a mortgage on her home. Five days later, Argent purportedly assigned the note and mortgage to Wells Fargo. Ford stopped making payments on the note in the spring of 2006, and Wells Fargo filed an action to enforce the note and foreclose the mortgage in July 2006. Appearing pro se, Ford filed an answer and counterclaim alleging that Argent had engaged in fraud and predatory lending practices in connection with the loan. Ford demanded production of the loan documents and the purported assignment to Wells Fargo. Wells Fargo then moved for summary judgment, supported by an affidavit from Baxley, an employee of its servicer, who certified that Wells Fargo was the holder and owner of the note and further certified that the note and mortgage attached to the affidavit were "true copies." Ford sought to dismiss Wells Fargo's complaint and asked for judgment on her counterclaim, supported by additional evidence of Argent's allegedly fraudulent conduct. The trial court granted summary judgment for Wells Fargo, holding that even if Ford's allegations of fraudulent conduct by Argent were true, Wells Fargo was a "holder in due course" entitled to enforce the note free of such claims and defenses.

The Appellate Division reversed, concluding that Wells Fargo had failed to establish that it was either the holder of the note or a nonholder entitled to enforce the note under UCC § 3-301 as adopted in New Jersey. The court held that Wells Fargo had not demonstrated it was a holder of the note because it had failed to provide evidence that Argent had indorsed the note. The court also held that Wells Fargo had not demonstrated that it was "a nonholder in possession of the [note] who has the rights of a holder." According to the court, Baxley's affidavit merely stated in a conclusory fashion that Wells Fargo was the holder and owner of the note and mortgage, without giving any indication of how Baxley obtained knowledge of these alleged facts.

The court thus held that Wells Fargo had failed to establish its standing to foreclose, and remanded the case to the trial court for further proceedings.

Comment. The result here looks like a product of an overwhelmed servicer and some questionable pleading. Once Ford filed an answer raising personal defenses to payment of the note and counterclaims based upon fraud and predatory lending practices, Wells Fargo's ability to enforce the note as a would-be holder in due course depended on its ability to demonstrate the proper negotiation of the note by Argent. Instead, Wells Fargo submitted only a copy of the front page(s) of the note, which would not have indicated the note's indorsement. [Perhaps the note was never indorsed, but in that case, the Baxley affidavit would have been factually incorrect and misleading, as it identified Wells Fargo as the "holder" of the note.] Once Ford had pled her defenses, Wells Fargo took an imprudent risk in proceeding without better evidence of the note's indorsement by Argent.

(13)

Martinez v. MERS, Inc.

United States Bankruptcy Court, District of Kansas (February 11, 2011)

Foreclosure; MERS and Standing to Foreclose

Facts and Holding. In August 2002, Martinez (now Graham) borrowed $140,000 from Countrywide, executing a note and a mortgage on her home. The mortgage was to "MERS, as the nominee for Countrywide and its successors and assigns." By its terms, the mortgage noted:

> MERS holds only legal title to the interests granted by Borrower in this Security Instrument, but, if necessary to comply with law or custom, MERS (as nominee for Lender and Lender's successors and assigns) has the right: to exercise any or all of those interests, including, but not limited to, the right to foreclose and sell the Property; and to take any action required of Lender.

Graham defaulted in May 2004. After Graham's first two bankruptcy filings were dismissed, in January 2006 MERS filed a foreclosure action on behalf of Countrywide (which held Graham's note). Graham joined Countrywide as a party alleging fraud and violations of Kansas consumer laws. In February 2008, the trial court granted summary judgment to MERS and Countrywide, and in January 2009 entered a judgment allowing foreclosure. Following Graham's appeal, the Kansas Court of Appeals reversed the judgment and dismissed the foreclosure action, holding that MERS lacked standing to foreclose because it did not hold Graham's note.

In June 2009, Graham filed bankruptcy yet again, and then filed an adversary proceeding arguing that (1) MERS could not enforce the mortgage because it did not hold the note, and (2) by having MERS hold the mortgage while retaining the note, Countrywide had "split" the note and the mortgage, rendering Countrywide's claim unsecured. Graham sought summary judgment; MERS and Countrywide filed cross-motions for summary judgment, arguing that MERS did have authority to enforce the mortgage on behalf of Countrywide. The bankruptcy court granted summary judgment for MERS and Countrywide, holding that the MERS mortgage did not "split" the note and the mortgage. Citing the *Restatement (Third) of Property — Mortgages*, the Court held that MERS was an agent of Countrywide and thus had the authority to enforce the mortgage on Countrywide's behalf. The court specifically noted that "[t]he fact that MERS and Countrywide chose to use the word "nominee," rather than "agent," does not alter the underlying [agency] relationship between the two parties."

Comment. As a matter of commercial law and mortgage law, the bankruptcy court's analysis is plainly correct. The argument that a MERS mortgage splits the note and the mortgage is patently absurd, and is belied by both the language of a MERS mortgage and the very structure of the MERS system. The more difficult question is whether the April 2010 judgment of the Kansas Court of Appeals should have been dispositive based upon *res judicata* principles. The bankruptcy court held that it was not, because MERS and Countrywide did not have a "full and fair opportunity to litigate" the question of MERS's agency (Graham's pleadings had characterized MERS as Countrywide's agent). Ultimately, this is a defensible conclusion because the Kansas Court of Appeals was clearly wrong to dismiss the foreclosure action altogether, rather than remand for further findings regarding MERS's agency.

(14)
U.S. Bank National Ass'n v. Ibanez
Supreme Judicial Court of Massachusetts, 2011 WL 38071 (Jan. 7, 2011)

Foreclosure; Standing to Foreclose.

Facts and Holding. This consolidated proceeding involved two cases. In the first, U.S. Bank had conducted a nonjudicial foreclosure sale pursuant to a mortgage executed by Ibanez; in the second, Wells Fargo had conducted a nonjudicial foreclosure sale pursuant to a mortgage executed by the LaRaces. In each case, the lender purchased the property at the sale, and subsequently brought an action in the Land Court seeking a declaration that it had acquired clear title to the respective parcels. Both loans were transferred several times in the process of securitization, and in each case, the original mortgagee executed an assignment of the mortgage "in blank" (i.e., with no assignee specified). While there was no apparent dispute that U.S. Bank and Wells Fargo held the right to enforce the underlying notes, the facts indicated that U.S. Bank and Wells Fargo never received or recorded a written assignment of the respective mortgages until after the respective foreclosure sales had taken place (although the belated Wells Fargo assignment did purport to have an effective date prior to that foreclosure sale).

The trial judge entered a judgment against the mortgagees, ruling that the foreclosure sales were invalid because the mortgagees "acquired the mortgages by assignment only after the foreclosure sales and thus had no interest in the mortgages being foreclosed" at the time of the foreclosures. The Supreme Judicial Court affirmed this judgment. The court noted that while Masschusetts permits power of sale foreclosure, a lender relying upon power of sale foreclosure must "strictly" follow the terms of the power of sale and the authorizing statute, or the underlying sale is void. The court noted that Mass. Gen. Laws ch. 183, § 21 provides that the power of sale may be exercised only by "the mortgagee or his executors, administrators, successors or assigns," and thus held that U.S. Bank and Wells Fargo only had the authority to conduct the foreclosure sales if they were "assignees" of the mortgages at the time notices of sale were given and at the time of the sales. Because the evidence showed that the express written assignments of the occurred AFTER the foreclosure sales in question, the court held that U.S. Bank and Wells Fargo had failed to establish that they held the respective mortgages at the time of the foreclosures. The court noted:

> We do not suggest that an assignment must be in recordable form at the time of the notice of sale or the subsequent foreclosure sale, although recording is likely the better practice. Where a pool of mortgages is assigned to a securitized trust, the executed agreement that assigns the pool of mortgages … may suffice to establish the trustee as the mortgage holder. However, there must be proof that the assignment was made by a party that itself held the mortgage. A foreclosing entity may provide a complete chain of assignments linking it to the record holder of the mortgage, or a single assignment from the record holder of the mortgage.

U.S. Bank and Wells Fargo also argued that because they held the respective mortgage notes, they held a sufficient financial interest in the respective mortgages to allow them to foreclose, despite the lack of a written assignment of the mortgages, on the theory that "the mortgage follows the note." The court rejected this argument, holding that under established Massachusetts precedent, "where a note has been assigned but there is no written assignment of the mortgage underlying the note, the assignment of the note does not carry with it the assignment of the mortgage" (quoting *Barnes v. Boardman*, 149 Mass. 106, 21 N.E. 308 (1889)). The court further held that this principle was later incorporated into the state's power of sale foreclosure statute, which permits enforcement to the mortgagee and his "successors or assigns" but (according to the court's interpretation) "not to a party that is the equitable beneficiary of a mortgage held by another."

Finally, U.S. Bank and Wells Fargo argued the court should have accepted the post-foreclosure sale assignments as sufficient based upon the fact that the use of post-sale assignments was both customary in the industry and consistent with the state bar's title standards (which suggest that "[a] title is not defective by reason of [an assignment executed after the foreclosure sale] where said Mortgage has been foreclosed, of record, by the Assignee." The court rejected this argument as inconsistent with the language of the power of sale foreclosure statute.

Comment. In a formalistic sense, the *Ibanez* decision ought to have few repercussions outside of Massachusetts, as the court's opinion relies upon legal principles peculiar to Massachusetts. In particular, it is well-established under the law in most states that "the mortgage follows the note." Thus, the holder of the mortgage note would have the right to enforce the mortgage, even if there had been no specific written assignment of the mortgage, unless the state's foreclosure statute specifically required a separate written assignment of the mortgage.

Nevertheless, the *Ibanez* decision may informally reflect the increased willingness of some courts to permit collateral attack to nonjudicial foreclosure sales, which potentially undermines the utility of nonjudicial foreclosure. In this regard, the *Ibanez* decision is of a kindred spirit with the recent *Albice* decision in Washington (discussed on pages F6-F7), in which concerns over the lack of transparency in the nonjudicial foreclosure process appear to have motivated the court's willingness to allow collateral attack of nonjudicial foreclosure.

(15)
In re Agard
United States Bankruptcy Court, Eastern District of New York (February 10, 2011)

Foreclosure; MERS and Standing to Foreclose.

Facts and Holding. In June 2006, Agard obtained a mortgage loan on his residence from First Franklin, executing a note to First Franklin and granting a mortgage to MERS as nominee for First Franklin and its successors and assigns. In February 2008, the mortgage was subsequently assigned to U.S. Bank (as Trustee for a securitization pool) and was serviced by Select Portfolio Services (Select). After Agard defaulted, Select instituted a foreclosure proceeding and obtained a judgment of foreclosure in November 2008.

In September 2010, Agard filed bankruptcy. Select moved for relief from stay to foreclose on the home on behalf of U.S. Bank as the holder of the note. Agard objected that Select lacked standing to seek relief from stay because the purported February 2008 assignment to U.S. Bank was invalid as MERS lacked authority to assign the mortgage. Select argued that because the state court had entered a final order of foreclosure, the issue of MERS's authority to assign the mortgage was *res judicata* and not subject to review by the bankruptcy court under the *Rooker-Feldman* doctrine (by which lower federal courts lack subject matter jurisdiction to sit in direct review of state court judgments). Select further argued that the February 2008 assignment was valid because the mortgage granted MERS the right to assign the mortgage as nominee/agent for the lender and its assignees. Finally, Select argued that (in any event) it was entitled to enforce the lien on U.S. Bank's behalf because U.S. Bank was the holder of the note. The court held that *Rooker-Feldman* precluded a judgment that Select lacked standing to foreclose because the effect of such a judgment would have been "to deny U.S. Bank rights that were lawfully granted to U.S. Bank by the state court." The court further ruled that Agard had a full and fair opportunity to litigate U.S. Bank's right to foreclose in the state court proceeding and thus could not relitigate that question in bankruptcy court consistent with principles of res judicata. As a result, because Select had demonstrated sufficient grounds for relief, the court granted relief from the stay.

While the decision to grant relief from the stay fully resolved the motions in the *Agard* case, the court noted that it had numerous other pending cases in which comparable arguments had been raised regarding MERS mortgages, and thus the court proceeded to "give a reasoned opinion" on whether the recipients of MERS assignments would have standing to seek relief from stay. In this regard, the court made the following observations/statements:

- (1) Select had not produced evidence that U.S. Bank was the rightful owner of the note. All that Select offered was the written assignment of the mortgage by MERS to U.S. Bank, which contained a reference to the note. The court noted that this could not constitute an assignment of the note, because MERS had no interest in the note and no authority to assign the note.

- (2) The court noted that while Select could enforce the note and mortgage on behalf of U.S. Bank if U.S. Bank was in possession of the note, properly endorsed, there was nothing in the record to prove this was true other than MERS's representation that its database reflected a transfer of the note to U.S. Bank. The court deemed this insufficient proof to establish U.S. Bank's possession of a properly endorsed note.

- (3) The court concluded that "MERS's 'nominee' status and the rights bestowed upon MERS within the Mortgage itself, are insufficient to empower MERS to effectuate a valid assignment of the mortgage.

- (4) The court concluded that the MERS membership rules do not explicitly create an agency relationship between MERS and its members and thus do not grant authority to MERS to execute mortgage assignments, either by themselves or as supplemented by the language of the MERS mortgage document. The court noted that "none of the documents … even mentions the word 'agency.'"

- (5) The court concluded that MERS's purported status as "mortgagee of record" does not give it the right to assign the mortgage, noting that it was "absurd" for MERS to argue that it was both the mortgagee and an agent of the mortgagee.

Comment. There are one or two (but ***only*** one or two) positive things to say about *Agard*. First, the court was correct in its jurisdictional conclusions; Agard had a full and fair opportunity to litigate U.S. Bank's right to foreclose in the state court foreclosure, and should not have gotten a second bite at the apple in bankruptcy. Second, while the rest of the opinion was a gratuitous advisory opinion that no responsible federal judge ought to deliver, the court's statements highlighted in the first two bullet points noted above are not objectionable as far as they go.

The rest of the "opinion," however, is pretty embarrassing. For example, as noted above, the court points out that "none of the documents … even mentions the word 'agency'" in its argument that MERS had failed to prove an agency relationship. To quote Seth Meyers, "Really?" A deed into which a court implied an easement of necessity wouldn't explicitly create an easement, either. But a responsible court would be expected to look at the entire context in which that deed was executed to ascertain whether the parties intended an easement to arise. No one can look at a MERS mortgage and the MERS system dispassionately and reach any plausible conclusion other than that MERS was structured to serve as an agent of the MERS members. [One can dislike the idea of MERS, but one cannot seriously argue that the system is not intended to create an agency relationship.] Even worse, after refusing to acknowledge MERS's obvious agency, the court dismisses MERS's claim to be "mortgagee of record" by stating that "MERS's position that it can be both the mortgagee and an agent of the mortgagee is absurd, at best." But it is equally if not more absurd to suggest that MERS can be ***neither*** the mortgagee ***nor*** an agent, which is effectively how the court treats MERS.

Agard is an irresponsible decision, and creates an inappropriate encouragement (if its "reasoning" is embraced by judges in other states) for collateral attack of nonjudicial foreclosure sales. This concern was alluded to previously, in conjunction with the *Ibanez* decision (pages F18-F19). If one accepts *Agard*'s conclusion that a MERS mortgage and the MERS member rules are insufficient to demonstrate MERS's authority to assign a MERS mortgage, any completed nonjudicial foreclosure sale of a MERS mortgage would be subject to being invalidated by collateral attack.