Fall 2016

The ABSTRACT

American College of Mortgage Attorneys

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President's Column

By Donald A. Shindler

This letter provides a summary of some of ACMA's activities since the Spring Regents Meeting in Naples, Florida, and the publication of the last issue of *The Abstract*. It also serves as a reminder for the upcoming registration deadline for the ACMA Annual Meeting at The Resort at Pelican Bay in Newport Beach, California, September 22–24, 2016. This year, the meeting's programming will examine the theme "Ride the Boom & Rock the Bust!!!" and promises to be a continuation of ACMA's excellent CLE presentations and materials. Our room block is filling fast, so make your reservations and send in your registrations soon if you have not already done so.

As noted in my last letter, the Spring Regents Meeting was well attended, enjoyable, and successful, and your committees, the Board of Regents, and the Executive Committee dealt with full agendas for ACMA activities and improvements.

Our new executive director, Leslie Edsall, supported by her colleagues at Management Solutions Plus, has been busy undertaking projects for ACMA—both short and long term—as well as supporting committee functions, meetings, and activities and planning for the 2016 Annual Meeting and other future meetings. Thank you Leslie, Grace, Linda, Beth, and the rest of MSP.

Following the Regents Meeting, a number of ACMA activities are underway:

- The revitalized Strategic Planning Committee, under the leadership of Catherine Bray and John Murphy, commenced work to develop and help provide long-term strategic approaches for ACMA, including investigations and evaluations of what is important to our fellows and how to accomplish those goals.

- Following the Board of Requests' approval of the Technology Committee's recommendation to upgrade ACMA's website and database, the Technology Committee and MSP have been working with Your Membership to implement and install a new website and technology platform for ACMA. We look forward to a first look at our Annual Meeting in September.

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- The new Communications and Marketing Committee, led by Norm Roos and Lydia Stefanowicz, has provided downloadable examples of the ACMA logo to attach to your emails and biographies on your firm or company website. These will be transferred from our existing website to our new improved website for use by our fellows. *The Abstract* has been bolstered by new columns and information and has new life as a digital product.

- The Membership Development Committee, co-chaired by Norma Williams and Beverly Quail, continues its work with several important projects and working groups to help identify qualified and diverse candidates and approaches for the benefit of ACMA and its fellows.

- The Membership Committee, chaired by President-Elect Nancy Little, has considered, reviewed, and voted on excellent candidates nominated by our fellows. A list of new fellows will be announced this fall. If any fellow knows of a qualified attorney they think would be a good candidate, or any fellow has questions about criteria, nomination forms and guidelines can be found on ACMA's website.

- The Corporate Counsel Group revealed plans for its fall programs, which shape up to be excellent additions to the Annual Meeting. This year, there will be a special luncheon program open to all fellows during the Corporate Counsel Group's programming on Thursday, September 22. Please check our Annual Meeting schedule and give it some consideration (there is an additional fee for this lunch program).

- Sales of the Mortgage Law Summary continue. Consider buying copies (at the fellow's discount) for colleagues and clients, and contact the MLS Committee chairs, Andy Keeney and Laura McClellan, with any questions or comments or suggestions for potential sponsors/advertisers.

- We welcome interest in our committees. If you would like more information or wish to join a committee, please let me, Leslie Edsall, or any other member of the Executive Committee (Lou Pettey, Nancy Little, Alec Nedelman, and Jake Reby) know.

As I approach the end of my term as ACMA's president, I am heartened by the efforts and continuing willingness of our fellows to volunteer their time and talents for ACMA's benefit. Thank you everyone, as your cooperation contributes to the quality and collegiality of ACMA.

Be sure to look for and welcome our new fellows and first-time attendee fellows at the Annual Meeting this fall. If any fellows have suggestions for ACMA's improvement, please let me, Leslie Edsall, or any other officer know.

Laura and I look forward to seeing you and your guests at the Annual Meeting in California this fall. ◆

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Editor's Notes

by Norman H. Roos

As summer quickly turns to fall, memories for a number of ACMA fellows will include recollections of tapping their literary talents for the benefit of *The Abstract*. As a result, this edition of *The Abstract* contains a record number of articles as well as a number of informative reports.

In his article, "New Ontario Rules on the Property of Dissolved Corporations—Looking for New Solutions," Bram Costin discusses the new Forfeited Corporate Property Act that becomes effective in December and what real estate practitioners need to consider to protect lenders from the "somewhat draconian provisions of this Act."

Jacob Reby and Mark Winings ask whether "…the Equal Credit Opportunity Act…prohibits lenders from requiring a borrower's spouse to guaranty a loan." Their article, "Circuits Remain Split on Application of ECOA to Spousal Guarantors," provides an informative analysis and some practice tips.

In "Special Warranty Deeds: An Update," Jack Murray provides a detailed discussion of case law and statutory prohibitions and restrictions construing and limiting the use of special warranty deeds, and underscores the need for attorneys to "proceed with caution" when choosing the form of deed used by a grantor in a real estate transaction.

"Best Practices When Working in Indian Country" contains a guide to pursuing real estate development opportunities in "Indian Country." In her article, Nancy Appleby offers answers to 10 questions that developers and their lawyers should be asking themselves before pursuing such opportunities.

How did an article on drones find its way into this edition of *The Abstract*? Read Janel Yoshimoto and Imran Naeemullah's article "Recent Developments in the Law of Small Unmanned Aircraft Systems (Drones) and Applications for Mortgage Lenders" and find out.

In "The Meaning of Equal Priority," Michael Buckley discusses *Southern Highlands Community Association v San Florentine Avenue Trust et al*, a recent Nevada case involving "the not uncommon situation of a home subject to two associations" and the wider application of this "equal priority" case to mortgage law in general.

"Legal Privilege for In-House and Outside Counsel," by Don Shindler, addresses the "legal concept of privilege" and steps that inside and outside counsel should take to preserve that privilege.

In her article "Long-Awaited Guidance on Local Counsel Opinions in Real Estate Finance Transactions," Lydia Stefanowwicz previews the upcoming Local Counsel Supplement to the Real Estate Finance Opinion Report of 2012 and alerts local counsel to the value of the Supplement to those of us called upon to render local counsel opinions.

In addition to these articles, this issue of *The Abstract* contains Don Shindler's farewell president's message which provides an impressive summary of some of ACMA's significant activities since the Spring Regents Meeting and a warm welcome to the Annual Meeting in Newport Beach.

In her second executive director's report, Leslie Edsall recaps some details of the highly successful Regents Meeting in Naples and provides some details on the attractions that await the College at The Resort at Pelican Hill.

Thanks to Bram, Jake, Jack, Nancy, Janel, Michael, Don, and Lydia for the articles they contributed to this issue of *The Abstract*. As always, I invite those who have not submitted an article for publication in *The Abstract* to do so. Meanwhile, I look forward to seeing you in Newport Beach. ◆

Executive Director's Report

By Leslie Edsall

Although it was a bit of hard work, I had a lot of fun attending my first ACMA Board of Regents Meeting in Naples this past April. It was very nice to finally meet over 60 fellows in person, and I look forward to meeting even more of you at ACMA's 43rd Annual Meeting in Newport Beach, September 22–24, 2016.

The Board of Regents Meeting was one of ACMA's most well attended board meetings, with 96 people. This number surpassed the 2012 Phoenix meeting and is the highest attended board meeting recorded since 2008, when ACMA began to track the statistics! It was a wonderful meeting filled with lots of energy, opportunities for networking, and productive committee meetings.

I've had the pleasure of working with the Executive Committee, the Board of Regents, and all the hard-working committees that Don noted in his President's Report. I am enjoying the opportunity to help ACMA be successful on many levels, including the launch of the newly designed website through YourMembership. The new website is intended to be more user-friendly, includes many more advanced features on the member login pages, and offers better search capabilities and improved communications for all committees and work groups. I look forward to demonstrating the new website at the Board of Regents Meeting on Thursday, September 22, at 10 am.

Other minor improvements have been made to the ACMA website this year, including some changes to the "Refer a Fellow" and branding sections. Under the Communications & Publications Committee, the Branding Subcommittee has been reassessing the value of the AMCA brand.

As a reminder, the Business Referral Program is an incentive award program that encourages using the AMCA Roster to refer business to other fellows. You can refer fellows on the website at http://www.acmaatty.org/fellow/youracma/refer.cfm. Because of the quality of the fellows and their firms, referrals of business can be carried out with utmost confidence. The program also creates personal relationships among fellows, which promotes confidence in referring one another. Fellows state that the program is one of the primary benefits of membership in the College. Look for FAQs on the site. There is also a separate referral program available for in-house counsel at the same site link.

I look forward to ACMA's 43rd Annual Meeting at The Resort at Pelican Hill in September. It is a wonderful property with a world-class golf course and beautiful scenery. Fun tours have been set up for fellows and their guests. Tours include a back bay eco kayak tour, a sea hike, a "lifestyles of the rich and famous" tour, wine tasting tours, electric or manual bike tours, and more. Be sure to sign up before they sell out. Also, check out the Dine Arounds and register online before they fill up. This happens quickly with ACMA because everyone enjoys the networking that makes this organization shine. Both the resort complex and the Newport Coast area provide an enticing mixture of outdoor activities, attractions, dining and shopping choices, and scenic locations. The resort is known for its accommodations and facilities and offers an array of activities and amenities to enhance your stay.

If I can be of service to you in any way, please don't hesitate to contact me. Thank you for another great year. I look forward to seeing you in Newport Beach and to a productive annual conference ahead! ◆

New Ontario Rules on the Property of Dissolved Corporations — Looking for New Solutions

By Abraham Costin*

When an Ontario corporation dissolves, what happens to its real estate? If the dissolution is voluntary, the articles of dissolution must state that it has distributed its remaining property to its shareholders (s.238(1)(d) Business Corporations Act, [Ontario] RSO 1990 c. B.16, as amended [the BCA]). In the future (probably after the changes discussed in the article came into force), the articles of dissolution will also have to state that if the corporation was at any time the registered owner of land in Ontario, it no longer is (BCA s.238(1)(d.1)). Inevitably on a voluntary dissolution there is a general conveyance to cover any missed property.

However, not all dissolutions are voluntary. Under Section 241(1) of the BCA, where a corporation is in default in complying with any of the tax or other enumerated statutes, the corporation may be dissolved unless it remedies the default within 90 days of notice given either by registered mail to the corporation or by publication once in The Ontario Gazette. Once the notice period has expired without the default being remedied, the director under the BCA may issue an order dissolving the corporation, subject to rights of revival in certain circumstances (section 241(5)-(9), BCA).

From a real estate practitioner's point of view the importance of an involuntary dissolution is that any property of a corporation that is not disposed of on the date of dissolution is immediately forfeited to and vests in the Crown (s.244(1) BCA). It is for this reason that, when examining a title, it is necessary to ensure that all prior corporate owners were in existence while they owned the land.

After dissolution and forfeiture, a pre-existing mortgagee can continue its realization proceedings, notwithstanding the vesting of ownership in the Crown.

Effective December 10, 2016, the Forfeited Corporate Property Act, 2015 (the Act) will come into force. It provides a mechanism for the Crown to "clear" title to allow a maximum return to the Crown on the sale of the forfeited real property and to ensure the Crown does not become liable for the performance of outstanding encumbrances. Under Section 18(5) of the Act, no sooner than three years after the corporation's dissolution, the Minister, on 90 days' notice to the holder of an encumbrance, may make an order deleting the encumbrance from title.

In the case of the holder of a mortgage, the three-year delay and 90-day notice ought to be enough time to allow the mortgagee to realize on its security. We expect, however, the lenders will begin requiring borrowers to furnish annual evidence of their corporate existence. In addition, lenders may want to consider giving themselves the right to revive a dissolved corporate borrower and add the cost of doing so to the debt. Generally, however, even the most laid back lender will know something is wrong with a borrower before this right of involuntary dissolution under the Act becomes a problem.

However, the provisions in the Act (s.18(4)) dealing with restrictive covenants are more problematic. While still subject to the three-year waiting period and 90-day notice period, the Minster is entitled to cancel a restrictive covenant on title to forfeited property that may, in the Minister's opinion, "reduce the value or marketability of the property or limit the use of the property." By definition, any restrictive covenant will have that effect on a property.

Consider the case of a power centre where each pad is user owned. Such a centre is usually subject to a web of restrictive covenants ensuring a good mix in the centre. If one of the properties is forfeited under this Act, the Minister could cancel restrictive covenants on that property leading to unexpected competition in the centre decreasing the value of other parcels—a problem for both owners and lenders of the other pads.

Section 18(12) of the Act sets out a number of encumbrances not subject to cancellation by the Minister. One of those is an easement. In my power centre example, it is unclear whether the Minister could cancel a restrictive

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Circuits Remain Split on Application of ECOA to Spousal Guarantors

By Jacob W. Reby and Mark C. Winings*

Does the Equal Credit Opportunity Act ("ECOA"), which prohibits discrimination on the basis of marital status, prevent lenders from requiring a borrower's spouse to guaranty a loan? The answer depends on whether the guarantor-spouse is an "applicant," as defined in the ECOA, and, because of a split among the Federal Circuit Courts that was left unresolved by a recent U.S. Supreme Court decision, that answer may depend on the venue. In the Eighth Circuit states of Arkansas, Iowa, Minnesota, Missouri, Nebraska, South Dakota, and North Dakota, lenders are currently not prevented from requiring a borrower's spouse to guaranty a loan, but in other states, the answer is unclear.

Background

The ECOA (15 U.S.C. §1691 et. seq.) makes it "unlawful for any creditor to discriminate against any applicant, with respect to any aspect of a credit transaction…on the basis of…marital status." Thus, the determination of whether the anti-discrimination provisions of the ECOA apply to a guarantor-spouse depend on whether the guarantor-spouse is an "applicant" under the ECOA. The statute defines "applicant" as "any person who applies to a creditor directly for an extension, renewal, or continuation of credit, or applies to a creditor indirectly by use of an existing credit plan for an amount exceeding a previously established credit limit." In administering the ECOA, the Federal Reserve Board issued Regulation B, which defines "applicant" to include guarantors. However, in *Hawkins v. Community Bank of Raymore*, 761 F.3d 937 (8th Cir. 2014), the U.S. Court of Appeals for the Eighth Circuit held that two wives who guarantied commercial real estate loans to a limited liability company owned by their husbands were not "applicants" and were not entitled to the marital status protections of the ECOA.

The Circuit Split

On March 22, 2016, the U.S. Supreme Court affirmed, in a one-line decision with no written opinion, the Eighth Circuit's decision in *Hawkins*. However, because the vote was 4-4 (with a vacant seat resulting from the death of Justice Antonin Scalia), the ruling applies only to the Eighth Circuit states (Arkansas, Iowa, Minnesota, Missouri, Nebraska, South Dakota, and North Dakota). The U.S. Court of Appeals for the Sixth Circuit had previously reached a contrary conclusion, and the circuit split remains, resulting in uncertainty for lenders located outside of the Eighth Circuit states or with locations in both the Eighth Circuit states and other states.

The Eighth Circuit Case

Valerie Hawkins and Janice Patterson and their husbands guarantied four loans totaling over $2 million by Community Bank of Raymore to a limited liability company owned by their husbands to finance the development of a residential subdivision. Following a payment default, the bank accelerated the loans and demanded payment from the borrower and the guarantors, including the wives. The wives filed an action against the bank, alleging that the bank had required them to execute their guaranties solely because they were married to their husbands, constituting discrimination on the basis of marital status in violation of the ECOA. Their suit sought damages and a declaration that their guaranties were void and unenforceable. The wives argued that, consistent with the definition of Regulation B, they were "applicants" because they were guarantors and were entitled to the protection of the ECOA.

The Eighth Circuit disagreed and concluded that "the text of the ECOA clearly provides that a person does not qualify as an applicant under the statute solely by virtue of executing a guaranty to secure the debt of another." The court went on to write that "the plain language of the ECOA unmistakably provides that a person is an applicant only if she requests

credit…but a person does not, by executing a guaranty, request credit." The court stated that "[a] guarantor engages in different conduct, receives different benefits, and exposes herself to different legal consequences than does a credit applicant" and that the act of "…assuming a secondary contingent liability does not amount to a request for credit." The court noted that even if a guarantor desired for a lender to extend credit to a particular borrower, that was not tantamount to requesting or applying for credit herself. Finding the text of the ECOA to be unambiguous, the court did not defer to the Federal Reserve Board's interpretation of the definition of applicant pursuant to Regulation B and instead concluded that "a guarantor is not protected from marital-status discrimination by the ECOA."

The court also noted that its holding was consistent with the policies underlying the ECOA, which was intended, at least in part, to ensure fair access to credit and prevent people from being excluded from the credit process on the basis of their marital status. The wives in the Hawkins case who were required to execute guaranties were not denied access to credit; in fact, their complaint was that they were improperly included in the credit process.

In its decision, the Eighth Circuit addressed the contrary view of the Sixth Circuit. In *RL BB Acquisition, LLC v. Bridgemill Commons Dev. Grp.*, 754 F.3d 380 (6th Cir. 2014), the Sixth Circuit acknowledged that "[a] guarantor does not traditionally approach a creditor herself for credit" but went on to assert that she "does formally approach a creditor in the sense that the guarantor offers up her own personal liability to the creditor if the borrower defaults." The Sixth Circuit concluded that the language of the ECOA was ambiguous and thus deferred to the Federal Reserve's interpretation that a guarantor was an applicant for purposes of the ECOA. However, the Eighth Circuit rejected this reasoning, finding it to be "unambiguous that assuming a secondary, contingent liability does not amount to a request for credit."

Practice Tips

Lenders should proceed with caution when it comes to spousal guaranties. Courts outside the Eighth Circuit may still apply ECOA to prohibit a commercial lender from requesting a guaranty solely because the potential guarantor is married to the borrower or the owner of the borrower entity, and given the Supreme Court's tie vote in *Hawkins*, which left the circuit split unresolved, it is possible the Supreme Court will revisit this issue, possibly after Scalia's replacement is seated. This could result in a resolution of the circuit split in either direction—meaning that the law could even change in the Eighth Circuit.

The law in the Eighth Circuit is currently more favorable to lenders, so lenders with locations in the Eighth Circuit states should consider incorporating into their loan documents venue provisions in which the parties agree that disputes will be litigated in district courts within the Eighth Circuit. However, wherever located, lenders should carefully document the process by which spousal guaranties are offered or solicited. As part of its loan application process, a lender should ask for additional collateral or guarantors in a situation where the lender reviews an applicant's loan request and the financial statements are insufficient to support the requested loan because the applicant's assets are held in joint names, or because assets that are held solely in the name of the applicant are insufficient to support the requested loan. Documenting this process could help avoid costly litigation. ◆

**Jacob W. Reby is a member of Lewis Rice LLC in St. Louis, Missouri, and is secretary of the American College of Mortgage Attorneys. Mark C. Winings is a member of Lewis Rice LLC.*

New Ontario Rules

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covenant contained in a reciprocal easement and operating agreement that also contained easements between the parcels. Does the right to cancel an encumbrance include the right to cancel parts of an encumbrance while leaving others intact?

We have until December to figure all this out and determine what protection lenders and adjacent owners require from the somewhat draconian provisions of the Act. ◆

**Bram Costin is a partner with McCarthy Tetrault, Toronto, Canada, and is a member of the Board of Regents of the American College of Mortgage Attorneys.*

Special Warranty Deeds: An Update*

By John C. Murray* © 2016

Special and limited warranty deeds (the terms are virtually the same; the term "special warranty deed" will be used in this article to refer to both) afford greater protection to the grantee than a quitclaim deed but less protection than a full or general warranty deed. They are often given in connection with conveyances by trusts (including land trusts) and estates, land contract vendors, and financial institutions that have taken back property by foreclosure or deed in lieu of foreclosure in satisfaction of a defaulted mortgage loan. These types of grantors (as well as others who are able to negotiate delivery of a special warranty deed in connection with a property sale) will usually argue that they have only limited, incomplete, or indirect knowledge of the status of title to the property and/or have not been in actual possession of the property, but that they are willing to give the grantee greater protection than would be available by delivery of a quitclaim deed. This article will discuss and analyze special warranty deeds and examine court decisions that have ruled on the effect of special warranty deeds, including the encumbrances of title warranted against by the grantor under such deeds.

Definition and Scope of Special Warranty Deed

A special warranty deed provides that the grantor warrants only that it has not created or suffered any defect in title to occur during the period that it was in title to the property being transferred, i.e., the grantor warrants against its own acts or omissions and agrees to defend the grantee against any action by another party claiming by, through, or under the grantor that it has a superior title to the property conveyed to the grantee. A special warranty deed may contain any of the covenants for title, but they should be appropriately modified to warrant against only those claims arising by or through the grantor.

There is surprisingly little case law (and commentary) regarding the interpretation, scope, and enforceability of a special warranty deed (sometimes also referred to as a "limited warranty deed" [as noted above], "deed with a covenant against grantor's own acts," "bargain and sale deed", or "C deed"). There is a certain form of special warranty deed that is required by the U.S. Department of Housing and Urban Development ("HUD") for Buyer Select Closing Agent ("BSCA") transactions. (HUD adopted the BSCA program in 2013 to enable buyers to choose their own escrow/settlement officer.) The HUD form can be edited to assist the customer in preparing it.

Black's Law Dictionary defines "Special Warranty Deed," at 477 (9th ed. 2009), as follows: "A deed in which the grantor covenants to defend the title only against those claims and demands of the grantor and those claiming by, through and under the grantor."

See also 20 Am.Jur.2d *Covenants, Conditions, & Restrictions* § 62 (2005), which states as follows:

A special warranty is a limited form of warranty and recovery is only available if the defect in title occurs because of an act of the grantor. This limited warranty "does not render the grantor liable for defects in the title based on events that transpired when the property was in the hands of a prior titleholder."

Cases Construing Special Warranty Deeds

The following is a sampling of existing case law with respect to special warranty deeds:

1. In *Greenberg v. Sutter*, 661 N.Y.S.2d 933 (S.Ct. 1997), the court held that a covenant in the deed stating that the grantor warranted that it did not do or "suffer" anything whereby the property had been encumbered in any way whatever, should be construed broadly so that actual knowledge of an encumbrance is not necessary to cause a breach of the deed covenant.

2. In a 2013 Illinois decision, *Chicago Title Ins. Co. v. Aurora Loan Services, LLC*, 2013 Ill. App. (1st Dist.) 123510, 996 N.E.2d 44 (2013), the Illinois appellate court—in a matter of first impression—ruled that the special warranty deed given by the grantor of the property to the grantee did not protect the grantee against a delinquent special-assessment tax encumbrance.

   The special warranty deed in this case stated that [the grantor] "does covenant, promise and agree, to and with [the grantee], their heirs and assigns, that it has not done or suffered to be done anything whereby the said premises hereby granted are, or may be, in any manner encumbered or charged." The court ruled that the grantor had not done anything to cause the encumbrance, i.e., the tax sale was caused by a prior owner who did not pay the special-assessment tax. The court also reasoned that the *lis pendens* notice that had been filed against the property was not an "encumbrance" and that the tax lien, not the tax sale, was the actual encumbrance. The court also concluded that the grantor had not "suffered" the tax-lien encumbrance because it had not caused (as opposed to "tolerated") the occurrence of the tax sale, which was caused because the prior owner did not pay the special-assessment tax.

   The Aurora Loan Services case contains an excellent discussion and analysis of special warranty deeds (as opposed to general warranty deeds) and the existing case law from various jurisdictions regarding such deeds, as well an explanation of terms such as "encumbrance," "suffered," "lis pendens," and "covenant against encumbrances."

3. In another recent Illinois case, *Nair v. Bank of New York Mellon*, 2014 WL 1814000 (Ill. Cir. Ct., March 16, 2014) (Trial Order), the Illinois Circuit Court held that the use of a special warranty deed did not bar the grantee's claims to quiet title or for breach of the covenant of seisin (which "assure[s] the grantee that the grantor is, at the time of the conveyance, lawfully seized and has the power to convey an estate of the quality and quantity which he professes to convey (citation omitted)." Id. at p. 4), But the court further held that, as the Illinois appellate court ruled in *Aurora Loan Services*, supra, the grantee's count for breach of the covenant against encumbrances was barred by the language in the special warranty deed because the grantee did not allege any encumbrances created by the grantor's conduct.

4. In *Woolf v.1417* Spruce Associates, 68 F.Supp.2d 569 (E.D. Pa. 1999), the court, noting that "[t]here is a paucity of case law concerning obligations created by the conveyance of property through a special warranty deed," held that a mortgage lien on the property that pre-dated the acquisition of the property by Freddie Mac through a mortgage foreclosure proceeding (Freddie Mac subsequently conveyed the property to the defendant-purchaser by special warranty deed), was created "without Freddie Mac's knowledge, fault, consent, or acquiescence," and therefore "did not constitute a claim arising by, through, or under the grantor." *Id.* at 571. The court held that Freddie Mac never had a duty to extinguish the pre-existing lien in the first place because it did not arise as the result of any action (or inaction) by Freddie Mac.

5. But in *Egli v. Troy*, 602 N.W.2d 329 (Iowa 1999), the Iowa Supreme Court held that, as a matter of apparent first impression, where the grantor allegedly knowingly allowed a third party to establish a fence boundary for more than 10 years without any dispute, and the terms of the grantor's special warranty deed warranted for any claim "by, through or under" the grantor, the warranty covered claims permitted by the grantor as well as those affirmatively created by or acquiesced in by her. The court held that there was a genuine issue of fact as to whether the grantor was responsible for any part of the acquiescence during the 10-year period.

6. With respect to title issues concerning special warranty deeds, see, e.g., *Chicago Title Ins. Co. v. 100 Investments Ltd. Partnership.*, 355 F.3d 759 (4th Cir. 2004). In this case, the court stated that:

   > [D]efendant gave a special warranty [deed], promising only that [defendant] had not itself created any defect in title—a warranty whose breach would be specifically

> excluded from coverage. At the point of conveyance… any preexisting defect in title became [the grantee's] problem and [the grantee] would have to obtain its own title insurance to protect itself from any problem that might be caused by that defect.

Id. at 763-64.

Statutory Prohibition or Restriction of Special Warranty Deeds

Some states have statutes that govern the interpretation of different types of deeds. For example, Michigan has an unusual statute (the original version of which was enacted in 1885), which states as follows:

> Any person who shall print, sell, or keep for sale any blank forms of deeds containing the words "warranty deed," or "warranty deed-covenant-own-acts," or any similar words printed or written thereon, unless such deed is in fact an absolute warranty deed, and any person who shall knowingly use any such deed for the purpose of conveying title unless the same is an absolute warranty deed, shall be guilty of a misdemeanor.

MCL § 750.275.

This statute appears to make the use of special warranty deeds in Michigan a criminal misdemeanor, at least where pre-printed blank forms of these types of deeds are utilized. However, the author understands that this statute appears to be ignored or disregarded by most practicing attorneys in Michigan, and enforcement appears to be nonexistent. It is unclear whether computer-generated forms (certainly not contemplated by the statute) would fall within the language of the statute. As stated by Byron D. Cooper and Margaret A. Meyers in *Traps for the Unwary: Ambiguities and Anomalies in Michigan Conveyancing Law*, 27 Mich. Real Prop. Rev. 29, 29-30 (Spring 2000):

> Clearly, this statute is outmoded. Its limited application, due to the emphasis given to precise language, undermines the statute's purpose of preventing fraud on unsophisticated grantees. Is this form of protection still needed? This provision should be given legislative attention.

These commentators then discuss methods that may be utilized by Michigan attorneys to obtain the protection offered by special warranty deeds while avoiding the applicability of the aforementioned statute. According to the authors:

> To avoid this problem, John Cameron (in MICHIGAN REAL PROPERTY LAW (2d ed. 1993) recommends the use of a covenant deed or "Deed C" in which the grantor covenants that he or she "will Warrant and Defend the said granted premises . . . Forever, against the lawful claims and demands of all persons claiming by, from, or under" the grantor, "but against no other claims or persons" (footnote omitted). It is questionable whether the use of the word "warrant" in the Deed C successfully avoids the prohibition of the statute any better than the language of the traditional special warranty deed, especially given the similarity of the language in the statutory form for a warranty deed ("conveys and warrants") (footnote omitted). Another means of avoiding this problem might be to use a deed limiting the covenant of the grantor to an agreement "to defend title to the premises forever, against the lawful claims and demands of all persons claiming by, from or under the grantor, but against no other claims or persons."

Id. at 30.

The statute still remains effective in Michigan as of the date of this article and has not been amended or abrogated.

An Illinois statute, 765 ILCS 5/8, provides that any deed with the language "grant, bargain and sell" amounts to a covenant that the grantor has done no act, nor created any encumbrance, whereby the estate granted can be defeated, and creates a covenant against the acts of the grantor, except "the rents and services that may be reserved, and also for quiet enjoyment against the grantor, his heirs and assigns unless limited by express words contained in such deed." Covenants are implied only when all the words of the statute are used; and are not created by the use of the word "grant" alone.

In an 1890 case, *Wheeler v. Wayne Count*, 132 Ill. 599, 24 N.E. 625, 627 (1890), the Illinois Supreme Court stated that "if such a covenant exist at all, it must be by statute: the words "grant, bargain, sell" implying no such warranty at common law . . . [C]

ovenants will only be implied when all the words of the statute have been used." See also *Gittings v. Hilton*, (Illinois appellate court stated that if words "grant", "bargain" and "sell" are used in an instrument, without the subsequent words of limitation, then a fee simple interest arises in the grantee; but if words of limitation are used, then they are to be given effect and a lesser estate, consistent therewith, is all that is conveyed).

Alabama has a similar statute, Ala. Code § 35-4-271, which states that the words "'grant,' 'bargain,' 'sell,' or either of them," in all conveyances of real estate must be construed, unless stated otherwise in the conveyance, as limiting the grantor's warranty to be free from encumbrances "done or suffered by the grantor". See *Steele v. McRaney*, 855 So.2d 1114, 1118 (Ala. Civ. App. 2003), in which the Alabama appellate court ruled that the use of an Alabama statutory warranty deed, with the words "grant, bargain and sell," warranted only that grantors "had not conveyed title to anyone else; that they had not allowed the property to become encumbered while they held purported title; and that they had not caused or suffered anyone to do anything that would interfere with the property's quiet enjoyment by the grantee, the grantee's heirs or assigns"; *St. Paul Title Ins. Corp. v. Owen*, 452 So.2d 482, 486 (Ala. Sup. Ct. 1984) (Alabama Supreme Court held that "the words 'grant, bargain, sell' do not import an absolute general covenant of seizing against incumbrances and for quiet enjoyment, but…they amount to a covenant *only against acts done or suffered by the grantor and his heirs*".

New Jersey statutorily defines a "Covenant of special warranty" as follows, at N.J.S.A. 46:48:

A covenant by the grantor in a deed "that he will warrant specially the property hereby conveyed", shall have the same effect as if the grantor had covenanted that he, his heirs and personal representatives, will forever warrant and defend the said property unto the grantee, his heirs, personal representatives and assigns, against the claims and demands of the grantor and all persons claiming or to claim by, through, or under him.

Many states provide sample forms of special warranty deeds. See e.g., O.R.S. § 93-855 (Special warranty deed form); 2 Texas Forms Legal & Bus. § 2:43 (Special Warranty Deed–Sample Form); 2 Ill. Forms Legal & Bus. § 2:51 (Special Warranty Deed–By individual).

Conclusion

As evidenced by the cases and statutes discussed in this article, attorneys and title companies—and the parties to the transaction—must pay close attention to the form of deed used by the grantor in a real-estate transaction. If the grantor intends to limit its liability to defects occurring only during its period of ownership of the property, while giving the grantee more comfort than a simple quitclaim deed, then the deed must contain the proper limiting warranties and covenants to ensure that it qualifies as a special warranty deed under applicable law. In recognition of the increasing use of special warranty deeds, the Multi-Board Real Estate Contract version 6.0, which was adopted in July 2014 and is one of the most widely used basic forms of residential real-estate purchase-and-sale contracts, expressly modified the section regarding deeds contained in the former version 5.0 by deleting the word "general" before "Warranty Deed." Because there are still relatively few cases (or statutes) regarding special warranty deeds (or their equivalent), real-estate practitioners should proceed with caution in this area and monitor future case and statutory law closely. ◆

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* *Nothing in this Article is to be considered as the rendering of legal advice for specific cases, or creating an attorney-client relationship, and readers are responsible for obtaining such advice from their own legal counsel. This article is intended for educational and informational purposes only, and no warranty or representation is made as to the accuracy or completeness of the information contained herein. The views and opinions expressed in this Article are solely those of the Author, and do not necessarily reflect the views, opinions, or policies of the Author's employer, First American Title Insurance Company.*

Best Practices When Working in Indian Country

By Nancy Appleby*

Almost all American companies have experience working under federal, state, and local laws in the areas where they do business. Working in Indian country, however, involves a number of additional issues and challenges.

Indian country offers many opportunities for development in concert with tribes that are committed to creating jobs on reservations, generating revenue and creating sound economies for their people. Bringing such projects to fruition and maintaining positive relationships with tribes and their members requires learning about the respective tribes' government, history, and traditions.

What is Indian Country?

Broadly speaking, Indian country is all land under the supervision of the United States government that has been set aside permanently for the use of Indians. It includes all Indian reservations and other areas under federal jurisdiction designated for Indian use. Additionally, it includes (i) lands held by the United States in trust for tribes and tribal members and (ii) lands owned by tribes and tribal members that are subject to federal restrictions on alienation.

Where to Start?

The first step in creating a positive relationship with a tribe is to develop a strategic process. Ask yourself:

- What does your company want to achieve?
- How is the prospective tribal government or business entity organized?
- Who are the stakeholders I need to include or of whom I should be aware?
- What is my company's past history, if any, with the tribe or other tribes with whom the company has worked? What went right? What went wrong?
- What is the best strategy for achieving my company's goals?

Setting your strategy and understanding ***What Companies Need To Know About Indian Country*** can help you ensure that an otherwise promising transaction is not delayed or even canceled because communication and positive relationships went awry.

What Companies Need to Know About Indian Country

One: What is a tribe, band, pueblo, tribal nation?

There are 566 federally recognized Native American tribes in the United States. Each is a sovereign entity with its own form of governance and laws. How a tribe is organized will affect who can obligate the tribe and what tribal and federal approvals may be necessary to enter into a binding and enforceable contract with the tribe.

Tribal sovereignty includes the inherent right of tribes to exercise self-determination and self-governance. Federal law recognizes these powers and encourages self-governance. Tribal sovereignty also is the basis of a tribe's jurisdiction over people and activities on tribal land.

As part of their sovereign status, tribes generally have the authority to:

- Determine their form of government.
- Define conditions for membership in the tribe.
- Establish civil, criminal and regulatory legislation.
- Establish court systems.
- Assert jurisdiction over tribal members and Indian lands.
- Exclude persons from Indian lands.
- Assert limited jurisdiction over non-members.
- Tax non-tribal members engaged in economic activity on Indian land.

Two: How can I learn about how the tribe's governance works as a government and as a business?

Federal law recognizes that tribes may adopt whatever form of government best suits their practical, cultural, and/or religious needs. For example, most tribal governmental structures combine traditional features with Western-style, three-branch

governments. Some tribes elect their officials. Leaders of some traditional tribal governments are chosen by clans or families, or according to religious law or tradition. Often the choice is by consensus. Some tribes operate under a written constitution; others do not. Some tribes have codified their law; others have not. Each aspect of governance is a matter of tribal choice.

Federal law also allows tribes to incorporate under a charter issued by the Secretary of the Interior. The federal charter typically describes governance and authority and, like a tribal constitution or common law, may impose limits on authority and require specific protocols for certain actions, such as waiving the tribe's and/or the corporation's immunity from suit.

Tribes also frequently create business organizations under tribal law. These businesses may be governed by Articles of Incorporation, an Operating Agreement, or other organizational documents. In other cases, a tribal council resolution describes the business's organizational structure, powers, and authority.

In any transaction, it is essential to understand the tribe's governance and to confirm the actual authority of any individuals negotiating and executing documents on behalf of the tribe. As a practical matter, you will need to do your own due diligence and then ask your initial point of contact to explain lines of communication and authority within the tribe or tribal business. You may learn that your initial point of contact does not have the requisite authority to obligate the tribe or business. Do not assume authority or rely on apparent authority. And, in all cases, it is critical to know the tribe's law, as it relates to your business with the tribe.

Tips:

- Find out if the tribe's decision-making body is a council, business committee, corporation, or other governing body.
- Find out the correct titles for leadership (e.g., governor, chair, president).
- Find out the timeframes within which the decision-making body operates (e.g., the frequency of council meetings).
- Identify the tribe's protocol, including whether the tribe has a committee system or other means through which projects and relationships are vetted.

Three: Are there tribal cultural issues about which I should be aware?

Indian nations have unique cultures and traditions. Do not assume that tribal governance and/or culture is the same among the 566 federally recognized tribes. The better approach is to take time to learn about a tribe's history and culture, tribal customs and preferences, and political environment.

Tips:

- Always remember that you are a guest of the tribe.
- Respect the tribe's customs and laws.
- Understand that the tribe may be sensitive to controlling information and confidentiality. Be honest with the tribe if business demands make it impossible for you to provide the level of nondisclosure the tribe desires.
- When possible, build flexibility into your trips to participate in tribal social or cultural events to which you may be invited. Some events may be open only to tribal members. However, if you are invited, participating will help build your cultural understanding and foster positive relationships.
- If you are invited to participate in a ceremony or event, watch respectfully. Your demeanor is important.

Four: Are there stumbling blocks about which I should be aware?

Mistrust: Often, tribes and tribal members hold a deep-rooted mistrust of the United States government, state government, and outsiders. Mistrust of the United States and state governments is a result of historic federal policies and state attempts to encroach on tribal sovereignty. Mistrust of outsiders is the result of outsiders demanding substantial resources from Indian country for, at least in hindsight, what may be seen as inadequate compensation to Indian landowners.

Lack of capacity: Quite often, tribes lack the technical expertise, experience, and/or trained workforce to participate fully in revenue-generating activities on Indian land. While the lack of capacity can be frustrating to the tribe and to your company, it offers opportunities for collaboration that can create positive relationships.

Value of resources: The tribe and your company may place different values on tribal resources. Those differences will need to be reconciled to successfully develop the resource while

affording to the tribe the financial and ecosystem protections that it demands. Non-Indian development and environmental management relies on rules and judicial enforcement. Comparatively, traditional tribal society looks to cultural norms and spiritual mandates. Generally, Indians view their land as sacred and culturally important. That does not mean that it never should be used. However, balance is required. Certain lines cannot be crossed. It is up to the tribe and your company to determine what the lines are and what activities will cross them.

Five: Does tribal law apply to my company and its employees?

Jurisdictional issues on Indian land are complex. However, particularly when a company has a contract with a tribe to operate on tribal land, it is prudent to assume (and then to verify) that you are subject to tribal law when you are on tribal land.

Being knowledgeable about tribal law also is a big step toward ensuring that:

- Your company's agreements with the tribe have been duly and properly authorized and executed.
- Your company and its employees understand their obligations to the tribal government (e.g., obtaining a business license, paying tribal taxes, hiring tribal members, complying with tribal laws regarding sacred property and archaeological sites, obeying tribal traffic laws).
- Your company's initial, and continuing, relationship with the tribe is positive and lawful.

Six: How can I improve my cross-cultural communications skills?

In many cases, when you work with tribal representatives, you will be communicating with people from a different cultural background. Cross-cultural communication can be more challenging than conversations between people from similar cultures.

It is important to remember that people communicate both verbally and through body language, as well as through prevailing etiquette. Problems arise when people assume that elements of their own culture are natural, appropriate, and acceptable to others, ignoring the distinctions between cultures. Other factors that can lead to misunderstanding are (i) not having important knowledge; (ii) having inaccurate knowledge; (iii) fear of the unknown or unfamiliar; (iv) making unconscious assumptions; (v) applying stereotypes; (vi) negative non-verbal communication and (vii) being biased or prejudiced.

Tips:

- Better understand the tribe.
  - » Learn about a tribe's history and culture, tribal customs and preferences, and political environment.
  - » Understand the tribe's goals.
  - » Understand your company's goals and how your company can be a positive partner with the tribe.
  - » Understand that your priorities may not be the same as the tribe's priorities.
  - » Be aware that tribes, like other governments and business entities, may change priorities when administrations change.
  - » Demonstrate sensitivity and respect for different cultures.
  - » Be open-minded. Keep your opinions flexible, and be receptive to new ways of thinking and seeing the world.
- Embrace the process.
  - » Understand protocol.
  - » Learn, and work through, the appropriate process.
  - » Understand that breaking bread with your tribal counterparts and taking time to learn about them and their families may be crucial to building relationships.
  - » Listen and observe.
  - » Establish a face-to-face relationship.
  - » Identify and understand the interaction of the stakeholders.
  - » Educate and be patient.
  - » Be respectful and predictable.
  - » Establish a positive, credible presence.
- Appreciate a different sense of time.
  - » Appreciate that the urgency of time is not likely to be as important to your tribal counterparts as it is to you.
  - » Recognize that tribes may have a different process to reach decisions. Tribal meetings tend to allow everyone to express their views. Therefore, meetings or decisions may take longer than anticipated. Also, meetings often do not start "on time." The beginning of a meeting may be given over to polite conversation and socializing before substantive discussion of the agenda items begins. You may need flexibility and patience in your scheduling.

- Appreciate that business in Indian country is grounded in positive relationships that are developed over time.
- Acknowledge that you need to bridge two worlds. On one side, companies tend to be driven by business agendas and the pressure to increase productivity and efficiency and demonstrate results and profit. On the other side, tribes tend to put the tribe and community first. Theirs is a more holistic approach that requires discussion and consensus-building. They are committed to protecting their sovereignty, particularly in the face of their history and prior relations with governments and third parties.

Seven: Where can I go wrong?

Sometimes, even your company's best intentions will go awry. An unintentional slight may derail your relationship with a tribe. Your company can avoid many missteps by appreciating differences between tribal and Western cultures, language, communication styles, and values.

Unlike in Western culture, it is common for tribes to consider land, water, and land formations sacred. In the tribe's culture, violating sacred ground or draining sacred lakes may be the cause for great harm to come to the tribe and its people. The tribe's objections to a project that it believes will violate sacred land or water may be contrary to your company's financial considerations. Nonetheless, pressing the tribe for agreement, or appearing not to respect the sacred nature of the land, may irreparably undermine your relationship.

Differences in perception also may undermine your company's relationship with a tribe. For example, Western notions of "success" and "economic prosperity" typically are measured in dollars. Tribes may focus instead on preservation of community, culture, and resources; provision of services for tribal members; and the impact of today's actions on future generations. Therefore, merely offering a share of the economic return from a mining project may not satisfy the tribe's needs or goals. Failing to provide for other meaningful measures of success and prosperity may doom your company's relationship with the tribe and its project.

It is critical that tribes be fully engaged in negotiations, as an equal party at the table. Any implication—regardless of intention—that, though invited to the table, the tribe cannot effectively influence the outcome of negotiations, will undermine negotiations and make it unlikely your company will have a successful business relationship with the tribe.

Ignoring the differences between life on and off a reservation also is likely to alienate a tribe. While attending meetings may be a normal part of your day, attending meetings may be extremely difficult for tribal members, particularly on rural reservations or for members who are responsible for caring for their elders or their children. Additionally, failing to appreciate that tribal members may speak English as a second language signals disrespect and is likely to undermine meaningful communication.

Tips:

- Appreciate tribal beliefs, particularly as they impact the land and environment.
- Understand that traditional tribal beliefs are woven into everyday life and impact the tribe's decisions.
- Determine how the tribe measures and implements strategies for ensuring tribal success and economic prosperity.
- Be wary of creating a perceived power imbalance.

Eight: What is the relationship between federally recognized tribes and the United States government?

The federal government has a trust responsibility to tribes and tribal members.

The trust responsibility requires the United States to protect land held by the U.S. government "in trust" for the benefit of a tribe or a tribal member and Indians' right to use trust lands. The U.S. government is also obligated to protect tribal sovereignty and rights of self-governance and to provide basic social, medical, and educational services. It requires the federal government to act in the best interest of the trust beneficiary and to consider the wishes of the beneficiary.

The federal government must ensure that its actions are consistent with its obligation to protect trust land and Indian rights. As a practical matter, this means that harm to an Indian trust asset cannot be outweighed by "general public welfare." It means also

that, while the United States must balance its trust responsibility against competing statutory obligations, protection of trust assets and Indian rights generally are given great weight.

The federal government also has a government-to-government relationship with tribes. Typically, this relationship manifests itself in required federal–tribal consultation and collaboration when regulations, legislation, policies, and action proposed by the federal government will have substantial, direct impact on tribes.

Nine: Is federal approval required?

Indian nations are not only sovereign entities that have their own governing bodies; they also continually interact with the federal government and its primary tribal administrative agency, the Bureau of Indian Affairs (BIA). Pursuing commercial activity on Indian land often requires negotiating with the BIA to obtain its approval of contracts with tribes as well as structuring business contractual agreements and, sometimes, intergovernmental compacts with the state(s) in which tribal land is located.

Ten: What else can I do?

If you anticipate being in a relationship with a tribe for an extended period of time (e.g., if you are a lessee of, or grantee of a right of way over, Indian land), think both in the present and in the future.

Tips:

- Stay in touch with the tribe.
- Understand the extended stakeholders and establish a positive working relationship with them.
- Collaborate on non-project related matters.
- Offer expertise, funding, and partnerships for the benefit of the community, elders, and youth.
- Consider establishing a workforce training program.
- View your relationship with the tribe as an investment rather than with an "us/them" mentality.

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Appendix 1

Land and Minerals

The Non-Intercourse Act, 25 U.S.C. 177, requires federal approval for conveyances of Indian land. This restriction applies to leases, but not to permits, per 2012 revisions to federal Indian surface leasing regulations, 25 CFR Part 162.

25 U.S.C. 81(b) requires federal approval for contracts whose terms are more than seven (7) years. See also 25 CFR Part 84.003.

The Indian Long Term Leasing Act of 1955, 25 U.S.C. 415, permits surface leasing of Indian land, subject to restrictions in the statute and regulations at 25 CFR Part 162.

Indian Right of Way Act of 1948, 25 U.S.C. 323 et seq., vests in the United States the authority to grant rights of way over Indian lands. See also 25 CFR Part 169.

The Indian Mineral Leasing Act of 1938, 25 U.S.C. 396 et seq., and the Indian Mineral Development Agreement Act of 1982, 25 U.S.C. 2101 et seq., regulate subsurface mineral extraction. See also 25 CFR Part 212, 213 and 225.

The Indian Energy Policy Act of 2005, 25 U.S.C. §2101 et seq., streamline the planning and authorization for development of energy and mineral resources held in trust for the benefit of Indian owners. See also 25 CFR Part 224.

Cultural Heritage and Preservation

The National Historic Preservation Act of 1966, 16 U.S.C. §407, requires that federal agency, carrying out their Section 106 responsibilities, consult with any Indian tribe that attaches religious and cultural significance to historic properties that may be affected by an undertaking.

The American Indian Religious Freedom Act of 1978, 42 U.S.C. §1996, establishes the policy of the federal government to protect and preserve Indians' access to sites and the use and possession of sacred objects.

The Native American Graves Protection and Repatriation Act of 1990, 25 U.S.C. §3001 et seq., requires the consent of the tribe to the intentional removal or excavation of Native American remains and cultural items.

The Archaeological Resources Protection Act of 1979, 16 U.S.C. §470aa-mm, requires consultation with affected tribe before a permit is issued to impact cultural sites.

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Recent Developments in the Law of Small Unmanned Aircraft Systems (Drones) and Applications for Mortgage Lenders

By Imran Naeemullah and Janel M. Yoshimoto*

One of the most significant technological developments in recent years is the use of small unmanned aircraft systems ("small UAS"), also known as "unmanned aerial vehicles" or, more colloquially, "drones." Most readers probably know from popular media what a drone looks like; less widely known is the statutory definition of a drone as an "unmanned aircraft weighing less than 55 pounds."[1] The use of drones has become widespread in just a few years, in part due to their small size, relatively low cost, and rapid improvements in their technological capabilities. Drone "use is becoming so pervasive that the lines are becoming increasingly blurred between the application of these aerial vehicles as toys, models, and professional aerial instruments," so that what might "be thought of as a model or hobby aircraft taking pictures for the personal photo album of its operator, for example, can suddenly be classified as a commercial aerial application if one of the photographs is sold for a profit."[2]

Although media coverage of commercial drone use focuses on applications such as the delivery of products from retail giants like Amazon, this only paints a narrow portrait. From agricultural operations to bridge inspections to real estate marketing, "[t]he sky is truly the limit with the myriad uses" of drones.[3] Because of the potential benefits of drones to the closing and administration of mortgage loans, mortgage lenders (and their attorneys) would be well-advised to consider the integration of drone use into the mortgage lending process and to understand the legal framework for such use.

Legal Framework

Until recently, the Federal Aviation Administration (FAA) has "accommodated non-recreational small UAS use through various mechanisms, such as special airworthiness certificates, exemptions, and certificates of waiver or authorization."[4] This patchwork approach did not easily address the proliferation of drone usage, in response to which Congress passed the FAA Modernization and Reform Act of 2012 (the Act).[5] The Act required the Secretary of the Department of Transportation to, among other things, determine whether "certain unmanned aircraft systems may operate safely in the national airspace system" and, if so, to "establish requirements for the safe operation of such aircraft systems in the national airspace system."[6] In other words, the Act required promulgating regulations on drone usage, an effort led by the FAA.

On June 28, 2016, a few months behind the schedule called for in the Act, the FAA published its final notice of proposed rulemaking. Those rules took effect very recently, on August 29, 2016. The bulk of the FAA's rulemaking was to add Part 107 (Small Unmanned Aircraft Systems) to Chapter I of Title 14 of the Code of Federal Regulations ("Part 107"). Part 107 authorizes the routine civil operation of drones in the national airspace system and implements safety rules for such operations, providing a regulatory framework for drone usage.[7]

The effect of Part 107 is an incremental advance over the previous regime, summarized as follows: (1) it limits the use of small UAS to operating during daylight and restricted twilight hours with appropriate collision lighting, in confined areas of operation, and maintaining visual-line-of-sight operations; and (2) it covers airspace restrictions, remote pilot certifications, visual observer requirements, and operational limits for safety and national security purposes.[8] Note that because drone technology is evolving so rapidly, Part 107 provides a waiver mechanism by which individual operations can deviate from certain requirements of Part 107 if the FAA determines that "the proposed operation can safely be conducted under the terms of a certificate of waiver."[9]

Notably, 14 C.F.R. § 107.1 provides that, subject to certain exceptions, Part 107 primarily governs drone operations going forward. This is significant because it appears that, for example, drone operations under the previously created FAA exemption system will now be the exception rather than the rule. A drone operator that currently holds an FAA exemption for drone operation can continue to operate under the terms of that exemption until its expiration, although the operator can elect to operate in accordance with Part 107 if so eligible.[10] Consequently, mortgage lenders should focus on how Part 107 governs drone operations, select provisions of which are the focus of the remainder of this section.

14 C.F.R. § 107.7 discusses the required inspection, testing, and demonstration of compliance. This means, for example, that the remote pilot in command, the owner, or the person manipulating the controls of a small UAS must make available to the FAA Administrator the remote pilot certificate with a small UAS rating.[11] It also means that the FAA Administrator can test or inspect the small UAS, the remote pilot in command, the person manipulating the flight controls of the small UAS, and, if applicable, the designated visual observer.[12] Other safety-related rules include, for instance, the requirement that the remote pilot in command inspect the small UAS prior to each flight.[13]

14 C.F.R. §§ 107.11 through 107.51 set forth provisions that detail the limitations imposed on drone operations. These provisions, along with those discussed in the above paragraph, are important to mortgage lenders because they provide a framework for evaluating the suitability of a proposed drone operator for a given mission. Among the listed provisions are prohibitions on hazardous operation, such as operating a small UAS "in a careless or reckless manner so as to endanger the life or property of another,"[14] and operating a small UAS in violation of restrictions on the use of alcohol and drugs.[15] Among other things, the limitations also restrict flying hours,[16] operating a small UAS out of the visual line of sight,[17] the carrying hazardous material (as defined in 49 C.F.R. § 171.8),[18] operating a drone in the vicinity of airports and prohibited or restricted areas,[19] and the maximum speed and altitude at which the small UAS may be operated.[20] The visual-line-of-sight restriction is particularly relevant, for instance, to land surveyors, some groups of whom unsuccessfully urged the FAA to loosen this restriction to allow small UAS operations for surveying purposes out of the visual line of sight of the remote pilot in command as long as sufficient visual observers were stationed at appropriate locations (although a waiver may be possible as discussed below).[21]

Another provision, found at 14 C.F.R. § 107.9, mandates the reporting of an accident involving a small UAS. An accident report must be submitted to the FAA within 10 days of a small UAS operation that causes "[s]erious injury to any person or any loss of consciousness" or "[d]amage to any property, other than the small unmanned aircraft" (unless the cost of repair is $500 or less or the fair market value of the property, if totally destroyed, is $500 or less).[22] Similar to how lenders often require borrowers to report prohibited discharges of hazardous materials to the appropriate federal and/or state authorities, as discussed in the following section, lenders should require that their contracted drone operators adhere to all applicable requirements, including the accident-reporting provision.

Finally, 14 C.F.R. §§ 107.200 and 107.205 address waivers from Part 107. The FAA Administrator can issue a certificate of waiver authorizing deviation from certain regulations, including those pertaining to operating a small UAS beyond the visual line of sight and outside of daylight hours.[23] These waivers are particularly important because, for example, the visual-line-of-sight restriction could otherwise impede the ability of drone operators to effectively use small UAS to conduct land surveys or similar operations. The FAA will evaluate such waivers on a case-by-case basis, taking into consideration mitigating factors of the operating environment.[24] At the time this article was submitted for publication, the FAA had not yet finalized the website on which waiver applications may be submitted, but the FAA did indicate that it would attempt to process waiver requests within 90 days from the date of application.[25] It appears that such waiver requests must be submitted for each proposed operation rather than, for example, seeking a blanket waiver for a given type of operation (e.g., land inspections). Accordingly, the waiver system may not be a practical solution

if up to 90 days is needed to obtain the right to use a drone for the kinds of mortgage lending applications discussed below.

Practical Applications for Mortgage Lenders

To be clear, the FAA's incremental approach does not allow the unchecked use of drones in applications relevant to mortgage lenders. Nevertheless, particularly as to drone operators that may be able to obtain certain Part 107 waivers for specific operations (the ease of obtaining those waivers remains to be seen), lenders will have substantially greater leeway to use drones in connection with the closing and administration of mortgage loans. These uses potentially offer substantial benefits to mortgage lenders when executed properly. Here are some examples:

Lender's counsel in Hawaii will typically require in the normal course of closing a construction mortgage loan a mechanic's lien endorsement to the lender's title policy, insuring no loss of priority for the mortgage by mechanic's liens. To issue that endorsement in Hawaii, title insurers will need to assure themselves that no "visible commencement of operations" [26] exists at the mortgaged property as of the recording date of the mortgage. A title insurer will often have its representative inspect the construction site to confirm there is no physical evidence of construction commencement. It is not uncommon for loan closings to be held up because a title representative is unable to travel to the site in a timely manner, especially if the site is located in a remote part of the state. A digital aerial inspection of the construction site provided in real time by a small UAS would likely provide the verification needed for the title insurer to close on a timelier basis.

Similarly, in the preparation of land surveys, particularly for large tracts of undeveloped land, using aerial examination by a small UAS could accelerate finalizing the land survey by weeks and at significantly reduced cost, if a qualified operator for the surveyor can obtain a waiver for that purpose.

The same concepts apply to loan administration. Typical mortgage covenants require the mortgagor to keep the mortgaged property and its improvements in good condition and free from hazardous substances. Periodic verification of compliance with these covenants—or any other promise related to the use or condition of the property—could be more easily accomplished by a drone inspection. Draw requests for construction loan disbursements could also be facilitated by the use of drones to monitor progress of construction. From a competitive standpoint, the relative ease of inspecting mortgaged properties by drone could enable lenders to enter distant markets that might previously have been too remote to comfortably administer.

Implementation Concerns

The potential use of small UAS for mortgage lenders under the new rules remains hopeful but is of an unknown quantity at this time. Should mortgage lenders reach the point where drone use is possible through the waiver process, actual use should be implemented only after adequate policies and documentation are in place.

Particularly given the public's sensitivity to the infringing of drones on their privacy, privacy policies in connection with the use of small UAS and provisions relating to the mortgage lender's use of drones for land inspection purposes in loan documentation should be established to mitigate against potential claims by borrowers and others. Notably, the FAA deemed privacy issues to be outside the scope of Part 107[27] and also declined to include a preemption provision in Part 107.[28] Accordingly, lenders should consider other privacy-related restrictions, such as those imposed by state law, which may affect their drone usage. Subject to jurisdiction-specific considerations, mortgage lenders should consider incorporating a blanket provision into their loan documents that permits the mortgaged property to be inspected by drone. This provision might specify that the drone inspection can be conducted in any manner permitted by law.

Mortgage lenders will also want to develop careful policies for the selection of and contracting with drone operators. In selecting a drone operator, lenders should ensure that the operator is appropriately licensed and certified for the assignment at hand. From a contract perspective, a drone operator should represent and warrant that he or she is appropriately licensed and certified, and should be contractually obligated (similar to any third-party consultant engaged by the lender) to comply with all applicable laws and regulations (including accident

reporting requirements) in performing his or her services, to maintain meaningful liability insurance, and to indemnify the lender against any claims asserted by others relating to the drone operator's performance under the contract.

Conclusion

By promulgating Part 107, the FAA has clarified the regulatory landscape governing the commercial use of drones. Although the FAA's incremental approach contains certain key restrictions, such as those relating to the visual line of sight, there is now a better regulatory framework in place to facilitate commercial drone usage, such as in the closing and administration of mortgage loans. The doors to commercial drone usage therefore appear to be opening wider, and soon the skies may no longer be the limit! ◆

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Endnotes

1 Pub. L. No. 112-95, § 331(6), 126 Stat. 11.
2 Donna A. Dulo, Introduction to Unmanned Aircraft Law, in Unmanned Aircraft in the National Airspace 4 (Donna A. Dulo ed., 2015).
3 Id. at 3-4.
4 Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42065 (June 28, 2016).
5 Pub. L. No. 112-95, 126 Stat. 11.
6 Pub. L. No. 112-95, § 333(c), 126 Stat. 11. The "national airspace system" is a complex framework that encompasses "[t]he common network of U.S. airspace; air navigation facilities, equipment services, airports or landing areas; aeronautical charts, information and services; rules, regulations and procedures, technical information, and manpower and material," and includes components shared with the U.S. military. Cameron R. Cloar, Unmanned Aircraft in the National Airspace, in Unmanned Aircraft in the National Airspace 90 (Donna A. Dula ed., 2015) (internal quotation marks and citation omitted) (alteration in original).
7 Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42066 (June 28, 2016).
8 Id.
9 Id.
10 Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42084 (June 28, 2016).
11 The "remote pilot in command" is directly responsible for operating the small UAS and has the final authority as to operation of the small UAS. This person must be designated before or during the operation and must hold a remote pilot certificate with a small UAS rating and may, but does not have to be, the person manipulating the controls and/or the owner of the small UAS. The remote pilot certificate with a small UAS rating is the FAA equivalent to a driver's license for a drone pilot; anyone who manipulates the flight controls of a small UAS must hold this certificate or be under the direct supervision of a remote pilot in command who is immediately able to take control of the small UAS if necessary. 14 C.F.R. § 107.12(a).
12 4 C.F.R. § 107.12(b). The "visual observer" is someone designated by the remote pilot in command to assist in operating the small UAS by identifying other air traffic and objects in the air and on the ground, a role that helps to implement the "see and avoid" principle that is central to safely operating a drone. 14 C.F.R. § 107.3.
13 14 C.F.R. § 107.15.
14 14 C.F.R. § 107.23(a).
15 14 C.F.R. § 107.27.
16 14 C.F.R. § 107.29.
17 14 C.F.R. § 107.31.
18 14 C.F.R. § 107.36.
19 14 C.F.R. § 107.43; 14 C.F.R. § 107.45.
20 14 C.F.R. § 107.51.
21 Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42097 (June 28, 2016).
22 14 C.F.R. § 107.9.
23 14 C.F.R. § 107.205.
24 Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42097 (June 28, 2016).
25 https://www.faa.gov/uas/getting_started/fly_for_work_business/beyond_the_basics/ (accessed on August 1, 2016). Note that the FAA estimates that processing time is likely to vary depending on the complexity of the request, such that a waiver request for a drone operation in a low-density area with minimal air traffic would probably take considerably less time than a waiver request for a drone operation in congested airspace. Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42072 (June 28, 2016).
26 Haw. Rev. Stat. § 507-41.
27 Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42190 (June 28, 2016).
28 Operation and Certification of Small Unmanned Aircraft Systems, 81 Fed. Reg. 42064, 42194 (June 28, 2016).

Best Practices When Working in Indian Country

[continued from page 16]

Natural Resources and Environmental Protection

The National Environmental Policy Act of 1969, 42 U.S.C. §4321 et seq., requires preparation of an environmental assessment or environmental impact study for any proposed major federal action. CEQ regulations require agencies to contact tribes and provide them to participate at various stages during preparation of an EA or EIS. Additionally, approval by the United States of a conveyance of Indian lands is a major federal action that triggers NEPA compliance.

The Clean Water Act, 33 U.S.C. §1377(e); the Safe Drinking Water Act, 42 U.S.C. §300j-11; and the Clean Air Act, 42 U.S.C. §7601(d), authorize the EPA to treat tribes as states for purposes of becoming eligible to receive grants and to manage programs for which states also may be eligible. ◆

Endnotes

1 The federal government's trust responsibility to tribes is evidenced in a number of federal statutes that regulate the use of Indian lands by non-Indians. See Appendix 1 for a summary of key federal laws that address development of Indian land and minerals, cultural heritage and preservation, and natural resources and environmental protection.
2 For an example of a consultation policy, see EPA Region 5 Implementation Procedures for EPA Policy on Consultation and Coordination with Indian Tribes dated July 26, 2011 (http://www.epa.gov/Region5/tribes/pdfs/r5-consultation-procedures-20110726.pdf).

The Meaning of Equal Priority

By Michael E. Buckley*

With more than 518,000 units in 3,100 associations,[1] Nevada continues to deal with the aftermath of the Great Recession in common interest communities. Association and bank foreclosures remain fertile territory for the Nevada Supreme Court as it navigates its way through the Nevada Uniform Common Interest Ownership Act (the Act).[2] Past decisions have recognized the association "super priority" lien as a true priority[3] and whether costs are included in that priority (no, at least prior to legislative changes in 2015).[4] Because it concerns the meaning of "equal priority," the recent case of *Southern Highlands Community Association v. San Florentine Avenue Trust et al.*, 365 P.3d 503, 132 Nev. Adv. Op. 3 (Nev, 2016) may have wider application to mortgage law in general. On the other hand, while explaining the effect of "equal priority," the decision leaves open a number of practical questions and dismisses consideration of an otherwise confusing provision in the Act.

Southern Highlands involved the not uncommon situation of a home subject to two associations, Southern Highlands Community Association (Southern Highlands) and The Foothills at Southern Highlands Homeowners Association (Foothills). Foothills successfully foreclosed its assessment lien, resulting in San Florentine Avenue Trust (San Florentine) purchasing the property and providing $35,000 in excess proceeds.[5] Following Foothills' foreclosure, Southern Highlands sought to conduct its own sale. San Florentine sought a preliminary injunction prohibiting Southern Highlands from foreclosing, arguing that because the two associations were entitled to equal priority, the Foothills foreclosure had extinguished the Southern Highlands lien. The trial court enjoined the Southern Highlands foreclosure without deciding the merits of the case, and Southern Highlands appealed.

Southern Highlands contended on appeal that because Nevada law provides the associations with equal priority liens, its lien survived the Foothills foreclosure. The Court acknowledged the applicable language of the Act to be that "[u]nless the declaration otherwise provides, if two or more [homeowners'] associations have liens for assessments created at any time on the same property, those liens have equal priority."[6] The Supreme Court found the statute unambiguous, but recognized that equal priority is not explained. Thus, according to the Court, the issue was "what effect, if any, Foothills' foreclosure sale had on Southern Highlands' equal priority lien," quoting a superb analysis of the problem: "if two liens are equal in priority, the foreclosure of one lien cannot eliminate the other, else the foreclosed lien would be superior. However, neither can the non-foreclosed lien remain, else it would be superior."[7]

Relying on the general principles of law and equity provision of the Act,[8] the Court elected to follow the approach of California courts in dealing with mechanic's liens, finding the approach not prohibited by the Act and having the benefit of permitting only one foreclosure sale. As a result, the Court held the Foothills' foreclosure sale extinguished Southern Highlands' lien, but that Southern Highlands was entitled to proceeds from the foreclosure sale in the amount of its lien. The Court concluded, "If the sale proceeds are insufficient to satisfy Southern Highlands' lien, Foothills and Southern Highlands must share that loss pro-rata."

[1] Nevada Real Estate Division, Ombudsman's Report, February 2016. http://red.nv.gov/Content/Meetings/CIC_Calendar/

[2] NRS Chapter 116.

[3] *SFR Invs. Pool 1, LLC v. U.S. Bank, N.A.*, 334 P.3d 408, 130 Nev. Adv. Op. 75 (Nev., 2014

[4] *Horizons at Seven Hills Homeowners Ass'n v. Ikon Holdings, LLC*, ___ P.3d ___, 132 Nev. Advance Opinion 35 (Nev, 2016)

[5] The case makes no mention of a mortgage lien.

[6] NRS 116.3116(4) (2013). NRS 116.3116 was amended in 2015 and the identical language now appears as NRS 116.3116(8).

[7] Guy Lamoyne Black, Comment, *Tax Titles in Utah: caveats for Potential Purchasers and Proposals for Change*, 1991 BYU L. Rev. 1573, 1605 (1991).

[8] NRS 116.1108.

The Court resolved the parties' specific dispute; but of course the decision does not address how foreclosures involving equal priority association liens actually will work. Unlike equal priority mortgage liens or junior and senior mortgage liens, which are often governed by an agreement between the two lenders, association liens arise as a matter of law and are unlikely to have the benefit of an agreement between the lienholders addressing the foreclosure process. Associations are therefore free to use the process to their own advantage. While it is likely that each association will be bound by an obligation of good faith in enforcing its lien, it is unlikely that the good faith obligation extends to mandating mutual decisions on timing of foreclosure, bidding, cure rights, etc. Thus, while the ground rules are now in place, in the absence of clarifying legislation, it is not unlikely that the Court may have to address future disputes concerning equal priority.[9]

Each party had argued that the provision in the Act addressing application of foreclosure sale proceeds supported its position. That provision requires proceeds to be applied "in the following order: (1) the reasonable expenses of sale; (2) the reasonable expenses of securing possession before sale . . .; (3) *satisfaction of the association's lien*; (4) *satisfaction in the order of priority of any subordinate claim of record*….[Emphasis in original]"[10] San Florentine argued that clause (4) supports the notion that the Southern Highlands' lien was extinguished but that Southern Highlands was entitled to sale proceeds in an equal priority position. Southern Highlands argued that clause (3) shows that equal priority lienholders are never entitled to proceeds, so their liens must survive a foreclosure sale. The Court made short shrift of both arguments, determining that the provision does "not discuss or contemplate equal priority liens."

The foreclosure sale proceeds provision, found in the Act and in other uniform laws, remains curious. If, as the Court decided in *SFR Investments*,[11] an association lien has a statutorily defined, and thus limited, super priority, what is the meaning and effect of the language requiring foreclosure sale proceeds to be applied to "satisfaction of the association's lien" (without regard to super priority) before other "subordinate" claims? One is tempted to interpret the reference to "the association's lien" to mean the association's super priority lien, but that is not what the plain language says. Perhaps this language needs to be addressed in future reviews of UCIOA and similar laws. ◆

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[9] For example, NRS 645B.340 does not cover separate liens, but it does address the practical management of a deed of trust with multiple beneficiaries, providing that, in the absence of an agreement, the holders of 51 percent of the loan "may act on behalf of all the holders" including decisions relating to servicing, loan modifications, foreclosure and disposition of property acquired through foreclosure.

[10] NRS 116.31164(3) (2005), now found in NRS 116.31164(7).

[11] See Footnote 3.

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Legal Privilege for In-House and Outside Counsel

By Donald A. Shindler*

The legal concept of privilege generally refers to the assumed confidentiality of communications between attorneys and clients. Privilege is broadly respected throughout modern legal systems. Its purpose is to encourage and allow for complete discussions between attorneys and clients. Privilege is used to protect all communications (e.g., oral, written, electronic) between attorneys and clients, However, it is not absolute, and to be safe, it must be declared and asserted, maintained, and protected.

To assert and benefit from and by privilege, the communication sought to be protected must fit within certain rules and categories as use of privilege may not be absolute nor automatic. To utilize it, privilege must fit within a broad but definitive general rule as enunciated by the U.S. Supreme Court. In essence, privilege applies and protects communications between an attorney and client made in confidence for the purpose of seeking legal advice. *Upjohn Co. v. United States, 449 US 383 (1981).*

The assertion of privilege with respect to communications strictly between outside counsel and their clients, addressing the matters for which the client sought legal assistance, traditionally carries a strong presumption of applicability. There is usually no material question as to whether the outside counsel is providing legal advice. If privilege in such circumstances is challenged, it must be defended, but outside counsel generally has a relatively easy standard to meet the burden of proof as to provision of legal advice. For in-house counsel, however, a similar strong presumption of the application of privilege is not always operative due to the differing roles filled by in-house counsel.

There is no question that in-house counsel provide similar legal services and advice as that furnished by outside counsel to whose communications with the client privilege is more readily assumed to apply. Further, in substantially the same circumstances as present with privileged communications from and with outside counsel, privilege often will apply to communications with in-house counsel. For outside counsel, serving only as counsel and providing legal consultation and advice (broadly defined) almost exclusively, privilege more easily attaches. But, an essential difference for in-house counsel is that, to maintain the claim of attorney-client privilege successfully, in-house counsel must be sure that the elements for successful claims of privilege are present and the interpretations of the presence of those elements differs for in-house counsel. To that end, besides establishing that confidential communications for legal guidance and advice are needed and sought, which are the same for outside and in-house counsel, such communications must be made by the attorney to his or her client in the capacity as counsel and **not** as an officer conducting business affairs or providing business judgment and advice of, to, and for the client entity. To accomplish that, the identity of and roles being filled by the attorney and the officers and parties consulting the attorney are relevant. The entity's officers, directors, and other employees being provided the legal advice must control the course of action for the entity with respect to the pending issue. Further, the subject matter and communication of legal advice as opposed to general business strategy and guidance must be clearly identified. Additionally, an express indication that the communication for which privilege is desired is confidential in nature is recommended.

If in-house counsel is acting as a dual role in a legal and a business advisor, clear identification of the legal advice markers need to present, distinguishing the privileged advice as solely legal in scope from business consultation and advice, to which privilege does not apply and the mixture may jeopardize the protection of the privilege for the legal advice. *In re Old Group*

Securities Litigation, 226 F.R.D. 579 (N.D. 2005). Also, any such communication for which privilege is claimed should not be disclosed or circulated to non-attorneys, parties not in position to affect the course of action of the entity as to the particular subject involved (unless working directly for such a party on the matter and only after obtaining an acknowledgement of the need for confidentiality and the existence of privilege.)

While in-house counsel's communications face greater scrutiny than those of outside counsel, it is important for outside counsel to keep these strictures in mind for their own actions as well as when dealing with and advising corporate entities and their in-house counsel. This is especially true in situations where outside counsel may be an investor with the client in a business venture or serving in a separate business capacity (consider, for example, where outside counsel is an officer or an outside director or an investor in a client entity.)

With the prevalence of informal electronic communication, all counsel must take care to tag emails, letters, electronic depositories (e.g., Dropbox or other business document services electronic accounts) and text messages (if used) with appropriate identifiers of the intended application of attorney–client privilege. Prominent headings or notices such as "CONFIDENTIAL—SUBJECT TO ATTORNEY—CLIENT PRIVILEGE—DO NOT DISSEMINATE" would be useful and add support and probative value to assertions of privilege, especially with respect to any inadvertent, nondeliberate disclosure, if prompt remedying steps are taken.

Even if privilege exists and has been maintained and successfully asserted, it can be lost via subsequent waiver. Besides accidental release for which no prompt remediative action is undertaken, privilege can be waived by consent, subsequent express disclosure, or publication; in unsealed court filings and governmental applications; and by virtue of malpractice claims and assertions against counsel.

Another area in which privilege may be problematic is that of differentiation among related entities to whom advice is given and by or for whom legal advice may be sought. Both in-house and outside counsel must be careful to identify the recipient client entity entitled to seek and rely on legal advice provided by counsel. If a joint representation of related entities by the same attorneys in the same matter is involved, besides a potential conflict problem for the attorneys or law firm in question, a court may determine that no privilege exists, especially if the interests of the different entities are not aligned. *U.S. v. AT&T, 86 F.R.D. 603 (D. DC, 1979).*

Privilege also may be destroyed or waived by knowing disclosure by a party empowered to do so. For entities, only current officers or management are empowered to waive privilege via disclosure. *Milroy v. Hansen, 875 F. Supp. 646 (D. Neb. 1995).* Former officers or management generally cannot waive privilege for the entity. *Commodity Futures v. Waintraub, 471 U.S. 349 (1985).* Further, disclosure of information and materials within a corporate structure or related group of entities does not waive privilege, provided the information is communicated within a control group of employees who are working under the direction of such officers and management on the matter and on a "need to know" basis. *Andritz v. Beazer, 174 F.R.D. 609 (M.D. Pa. 1997).* In the event of an inadvertent disclosure of information and documents, F.R.E. 502 provides that privilege can be maintained if the party took prompt reasonable steps to prevent and rectify the error. Finally, as every law student learns, an exception to privilege which otherwise may be deemed to exist arises in the context of future commission of crimes or fraudulent acts. *U.S. v. Zolin, 491 U.S. 554 (1989)*

Utilization of the claim of attorney–client privilege to protect disclosure of communications between a client and its counsel is a strong element deployed to maintain secrecy for client activities. However, as noted above, it is subject to attack, which can be costly to defend and more costly if unsuccessful. Thus, counsel, both in-house and outside, would be wise to undertake requisite steps to ensure the application of privilege in their dealings with and on behalf of their clients. ◆

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Long-Awaited Guidance on Local Counsel Opinions in Real Estate Finance Transactions

By Lydia C. Stefanowicz*

In 2012, the respective opinions committees of the American Bar Association Section of Real Property, Trust and Estate Law, the American College of Mortgage Attorneys and the American College of Real Estate Lawyers jointly published The Real Estate Finance Opinion Report of 2012[1] (the "2012 Report"). The 2012 Report discusses a variety of opinion topics that are commonly the subject of third-party closing opinion letter requests, as well as appropriate assumptions and limitations, in the context of a "lead counsel" opinion in real estate finance transactions.

The 2012 Report expressly does not address issues unique to local counsel opinions, which has left a void for counsel seeking guidance in those circumstances. This year, after three and a half years of additional work, the same committees have produced an additional report titled "Local Counsel Opinion Letters in Real Estate Finance Transactions–A Supplement to the Real Estate Finance Opinion Report of 2012" (the "Local Counsel Supplement"). The Local Counsel Supplement will be published officially in the Fall 2016 issue of the ABA *Real Property, Trust & Estates Law Journal* and will also be posted on the ACMA website after it is published.

As its name suggests, the Local Counsel Supplement is a supplement to, and must be read in conjunction with, the 2012 Report. It includes discussion of the opinions that are the subject of the 2012 Report from the perspective of local counsel, and it addresses certain other opinions that are frequently requested of local counsel in a real estate finance transaction. Like the 2012 Report, the Local Counsel Supplement contains a form of illustrative opinion letter, which provides suggested language that may be used in rendering opinions about entity formation, existence, power, authority, and authorization as well as enforceability and other opinions covering some or all of the transaction documents. There is, however, no single form of local counsel opinion that fits all local counsel opinion situations or requests.

At the beginning of the project, the drafters of the Local Counsel Supplement thought that distinguishing between opinions typically given by lead counsel vs. local counsel would be self-evident. However, it soon became apparent that no such bright line of distinction exists. Opinions of local counsel vary across the board. They can range from opinions given by a local counsel who is retained in the very late stages of a transaction with respect to a client with whom the local counsel has never had any prior dealings, to opinions rendered by a local counsel who has for years represented the client. The local counsel opinion may be limited to one or a few very specific issues or it may cover most of the key opinions requested in the transaction. As noted in the Local Counsel Supplement,

> In themselves, the labels "lead" and "local" have insufficient inherent meaning to determine without more information what opinions each counsel is to provide. The labels more appropriately describe a hierarchy of relationship in the transaction than determine the scope of each such counsel's opinion letter. The legal matters to be addressed in an opinion letter of local counsel often are not as comprehensive as those matters on which lead counsel opines. The menu of opinions is substantially the same, however; and which opinions will be given by lead or by local counsel will depend on the facts and circumstances of each transaction.

The need for a local counsel opinion typically arises in three factual scenarios. First, the borrower or other loan party is located or organized under the laws of the local counsel's jurisdiction. Second, the real estate or other

significant collateral involved in the loan transaction is located in the local counsel's jurisdiction. These are the two most common examples, but any number of combinations of these facts are possible in local counsel situations, especially when several entities may be involved as borrower, guarantor, member, manager, or general partner, and the various entities are formed under the laws of different jurisdictions. The third factual scenario, which is less commonly encountered, is when some or all of the transaction documents are governed by the laws of the local counsel's jurisdiction, although none of the loan parties are organized, and no collateral is located, in the jurisdiction of the local counsel.

The Local Counsel Supplement acknowledges that there is no single form of local counsel opinion or set of opinion requests appropriate in all circumstances. The Local Counsel Supplement contains suggested language to address the most common requests, together with guidance as to when certain language should be used. Opinion practice in a local counsel setting, just as in the case of lead counsel, is subject to customary practice. Sometimes opinion requests involve matters that are better verified by sources other than a local counsel opinion. As noted in the Local Counsel Supplement:

> Local counsel should prepare an opinion letter that addresses the matters that are appropriate in the circumstances under customary practice. If this response is considered inadequate by the recipient, further content should be discussed and agreed upon, again within the bounds of customary practice, respecting the legitimate interests of the parties, including cost effectiveness and the necessity of the opinions and assumptions and limitations under consideration. Some subjects of the request may be answered more appropriately and customarily by service providers other than local counsel or by reliance on commonly accepted alternatives. Examples of such subjects are ownership of collateral (provided by title insurance), litigation (provided by search services, unless the request is limited to matters in which the opinion giver is representing the client), and U.C.C., tax, or similar searches (provided by search services).

The degree of familiarity that local counsel may have with the client can be extremely limited or it may be significant, and it may be anywhere in between. Certain practitioners believe that local counsel with limited knowledge of the client may have somewhat lesser ethical and professional responsibilities than opinion givers who regularly represent the client or have greater knowledge of the client. While this may seem intuitive, there is no basis for this distinction under ethical rules, and no case law has been found that states that ethical rules are applied differently to local counsel than to lead counsel. Therefore, the Local Counsel Supplement takes the position that local counsel has the same professional responsibilities and duties that must be discharged in rendering local counsel opinions that it has in any other legal matter. Accordingly, the Local Counsel Supplement notes that "[t]he formalities of establishing [the lawyer–client] relationship cannot be overlooked even in the face of a request for an opinion to be delivered in a very short time." Ethical obligations to the client are imposed by that relationship even though the local counsel may have no direct contact with the borrower.

In addition, the Local Counsel Supplement recognizes that situations exist in which local counsel are asked to opine on documents that, without modification, may be defective under the law of the local counsel jurisdiction, or to provide changes to documents that will improve them or provide for the best available remedies. Certain of these changes may be contrary to the interests of the borrower but necessary in order for local counsel to render the opinions requested. This can create an ethical dilemma for the local counsel. Some view this dilemma as inherent in the role of local counsel and that client consent is deemed waived or implied in the situation. However, local counsel should be mindful of this. As noted in the Local Counsel Supplement, it may be better in these situations for local counsel to represent the lender, not the borrower, in order to avoid these problems.

A local counsel opinion letter needs to identify clearly at the outset what issues and documents are covered by the opinion. The Local Counsel Supplement offers guidance on how to address the documents that are reviewed or not reviewed by local counsel in connection with the

opinion letter. Often, the transaction documents include documents that are not governed by the law of the local counsel's jurisdiction. Nevertheless, certain of these documents need to be reviewed in order to identify terms that are cross-referenced in documents covered by the local counsel opinion letter. Caution must be exercised in this situation because defined terms in a transaction document may have substantive meanings that are different than the general meanings of the same terms under the law of the local counsel's jurisdiction. In this situation, counsel may need to make appropriate assumptions or qualifications.

The 2012 Report and the accompanying illustrative opinion letter contain a number of customary assumptions. Which assumptions need to be made in a local counsel opinion depends on the nature of the requested opinion. For example, if local counsel is opining about the enforceability of transaction documents in the local jurisdiction with respect to a borrower formed under the laws of another jurisdiction, local counsel needs to include appropriate assumptions regarding the organization and authority of the borrower. Alternatively, if the borrower is formed in the local counsel's jurisdiction, local counsel would not normally take assumptions with respect to entity matters and would be expected to render opinions with respect to the status, power, authority, and authorization of the borrower. The Local Counsel Supplement further provides suggested assumptions with respect to matters involving the execution and delivery of documents and the form of acknowledgments to documents, and includes an assumption about acknowledgements that are taken outside of the local counsel's jurisdiction. Finally, the Local Counsel Supplement includes assumptions with respect to certain Uniform Commercial Code matters as they relate to fixtures.

The 2012 Report discusses and includes illustrative language with respect to 10 core opinions, namely: (1) entity status; (2) power; (3) authorization; (4) execution and delivery; (5) enforceability; (6) form of documents; (7) no breach or violation of organizational documents or other agreements; (8) no violation of law; (9) choice of law; and (10) usury and interest. The Local Counsel Supplement examines each of these opinions and suggests, where appropriate, how the substantive opinion topics may need to be modified or what considerations, assumptions, or limitations may need to be taken when dealing with specific local counsel opinion topics.

In addition to the 10 core opinion topics, the Local Counsel Supplement also discusses other substantive opinion requests that are frequently requested of local counsel in real estate finance transactions, namely: recording and its effect; governmental approvals required; the effect of the exercise of remedies; all customary remedies or specific remedies; recipient party matters such as doing business and taxation; zoning and land use; compliance with laws; and negative assurances. The Local Counsel Supplement analyzes the appropriateness of covering each of these issues in a local counsel opinion and where appropriate, offers suggested language and limitations.

Finally, the Local Counsel Supplement discusses how normal limitations in an opinion may need to be modified in local counsel opinion letters, including matters with respect to the effect of assignment of rents, the scope of the generic enforceability qualifications, and other matters.

The Local Counsel Supplement offers detailed practical guidance and thoughtful analysis to local counsel with respect to third-party closing opinions in real estate finance transactions. This fills a long-standing gap in opinion practice literature. If your practice involves issuing or receiving local counsel opinions in real estate finance transactions, the Local Counsel Supplement will be a useful tool and reference source. ◆

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Endnotes

1 47 Real Prop. Tr. & Est. J. 213 (2012). The 2012 Report can also be found on the ACMA website and on the ABA Legal Opinion Resource Center website, www.http://apps.americanbar.org/buslaw/tribar/.

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American Express reminds its cardholders that "membership has its privileges." Even more than carrying a tiny credit card, election to the American College of Mortgage Attorneys has numerous benefits and privileges that fellows may not remember or recognize immediately. For example:

1. ACMA provides a fellow the satisfaction that stems from peer recognition and election to the premier organization of real estate finance lawyers in North America.
2. ACMA membership is a professional credential that identifies fellows to their clients and colleagues as highly skilled and experienced practitioners in the practice of real estate finance law and includes the right to utilize the ACMA logo on, among other things, business stationery, business cards, resumes, and website biographies.
3. At each Annual Meeting, ACMA offers high-quality, advanced, accredited continuing legal education (CLE) programs on timely topics directly relevant to fellows' law practices, taught by experienced practitioners, including some of the pre-eminent thought leaders in mortgage law; ACMA CLE provides fellows with sufficient approved hours to satisfy most of the fellows' CLE requirements in many, if not all, jurisdictions.
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8. ACMA publishes the Mortgage Law Summary, a useful and handy reference volume summarizing mortgage and other laws related to real estate finance in every state, Canadian province, and Puerto Rico, which is updated biannually and distributed to fellows without charge.
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10. The ACMA Abstract, published twice a year, offers fellows informative articles on timely legal topics as well as updates on ACMA news and industry developments.
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12. The Consultative Resource related to third-party closing opinions, available on the ACMA website, allows any fellow to seek the advice of the entire ACMA Opinions Committee in real time on opinion issues arising in practice.
13. Other opinion letter resources are available to fellows on the ACMA website, including the Real Estate Finance Opinion Report of 2012, the 2016 Local Counsel Supplement, the Real Estate Opinion Guidelines, and a link to an online library of national, state, regional, and specialty reports and publications on opinion letter topics.
14. The ACMA Annual Meeting each fall and the spring Board of Regents Meeting give fellows an opportunity to meet in person with their peers to discuss professional topics and to socialize in a collegial setting that fosters camaraderie and results in life-long professional and personal relationships.
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18. ACMA Annual Meetings also offer fellows and their guests opportunities to enjoy local cultural, historic, sporting, sightseeing, and other attractions through organized tours and activities.
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